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TODAY'S ANALYSIS

(02 April 2024)

TOPICS TO BE COVERED

- **90 YEARS OF RBI.**
- **CENTRAL BANK DIGITAL CURRENCY**

90 YEARS OF RESERVE BANK OF INDIA (RBI)

The **Reserve Bank of India (RBI)**, which was established on **April 1, 1935,** is responsible for **monetary stability, currency management, inflation targeting, regulating the banking system, and setting interest rates.**

The central bank's story of the last 90 years includes ups and downs, but has generally been one of stellar achievement.

THE EARLY YEARS OF RBI

Legislation to set up the **Reserve Bank of India** was enacted in **March 1934,** and the provisions relating to the constitution of the bank, issue of share capital, and establishment of central and local boards became operative from **January 1, 1935.**

The **first Governor of the RBI** was the **Australian Sir Osborne Arkell Smith**, one of the two managing governors of the Imperial Bank of India. **Sir C D Deshmukh** was the **first Indian to become Governor.**

Following Partition, it was agreed that the **RBI would cease to be the currency authority for Pakistan,** and Indian notes would cease to be legal tender in Pakistan.

THE 1991 REFORMS

A **sharp increase in oil prices in August 1990** led to an acute economic crisis, making the **balance of payments** situation unmanageable, depleting foreign exchange reserves along with massive capital outflows, and pushing India close to default.

The **RBI transferred more than 46 tonnes of gold from its reserves to the Bank of England**, **Bank of Japan** & **Union Bank of Switzerland** (20 Tonnes) to borrow forex to manage immediate liquidity problems.

The rupee was devalued twice, by 9% and 10%, in three days.

THE OUTCOMES OF THE REFORMS

- **Full convertibility of the rupee** on trade account was allowed, giving more flexibility to trade.
- Banking reforms were announced, the setting of interest rates by lenders was deregulated, and
- New private bank licences issued between 1991 and 1995.

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WHAT IS FULL CONVERTIBILITY?

Full convertibility would mean the rupee exchange rate would be left to market factors without any regulatory intervention. Indian currency is fully convertible in the Current Account & partially convertible in Capital Account.

2008 CRISIS AND THEREAFTER

- **2008 FINANCIAL CRISIS:** India escaped the 2008-09 global financial crisis through a **combination of management, structure, and luck.**
  - Pre-crisis, the policies of Governor Y V Reddy against capital inflows, especially to the real estate sector, and against rapid foreign bank expansion, were timely.
  - Post-crisis, management was excellent, and appropriately measured.
- **RBI UNDER D SUBBARAO:** Under Subbarao, the RBI **opted for a liberal accommodative policy** to salvage economic growth.
- **RBI UNDER RAGHURAM RAJAN:** Raghuram Rajan **announced plans to internationalise the rupee, float inflation bonds linked to the consumer price index, steps to boost exports and increase inflows, and plans to review the monetary policy process**, and **gave banks freedom to open branches** without having to approach the RBI for licences.

DEMONETISATION OF 2016

- On **November 8, 2016,** the government announced the demonetisation of **Rs 500 and Rs 1000 notes** of the Mahatma Gandhi Series. It also announced the **issuance of new Rs 500 and Rs 2000 notes** in exchange for the demonetised notes.
- The sudden withdrawal of notes **created a liquidity shortage** in the country. There were **long queues outside banks, and people faced immense hardships** across the country.
- It also **roiled the economy — demand fell, businesses faced a crisis, and GDP growth declined close to 1.5 per cent.**
- Many small units reported huge losses even after nine months. The pace of remonetisation was slow.

Managing the situation was one of the biggest challenges faced by RBI. At stake was the credibility of the bank and Governor Patel.

MONETARY POLICY COMMITTEE

- The Monetary Policy Committee (MPC) is a committee **constituted by the Central Government and led by the Governor of RBI.**

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- Monetary Policy Committee (MPC) was constituted as per **Section 45ZB under the RBI Act of 1934** by the Central Government. The **first meeting** of MPC was conducted on **3rd October 2016** in Mumbai.
- Monetary Policy Committee was formed with the **mission of fixing the benchmark policy interest rate (repo rate)** to **restrain inflation** within the particular target level.
- The committee determines the policy interest rate required to achieve the inflation target.
- The **MPC is required to meet at least four times in a year.**
- The **quorum** for the meeting of the MPC is **four members.**
- Each member of the MPC has **one vote,** and in the event of an equality of votes, the **Governor has a second or casting vote.**
- Once every six months, the Reserve Bank is required to publish a document called the **Monetary Policy Report** to explain the sources of inflation and the forecasts of inflation for 6-18 months ahead.

COMPOSITION OF THE COMMITTEE

- The committee comprises of **six members** (including the Chairman) - three officials of the RBI and three external members nominated by the Government of India.
  - Governor of RBI acts as the Chairperson (ex-officio) of the committee.
  - Members nominated by the Government hold office for a period of four years from the date of appointment.
- None of the Central Government nominees are eligible to be re-appointed.
- The committee meets quarterly i.e. every three months.
- **Decisions are taken by majority vote** with each member having a vote.
  - In case of a tie, the Chairman has a casting vote.

WHAT IS SECTION 45 ZN?

This section says that **in case the RBI fails to meet the inflation target,** it has to **present a report to the government explaining the reasons for the failure.** In the report, the central bank will have to mention the **remedial actions it proposes to take,** and **an estimated time within which the inflation target will be achieved** following the timely implementation of the proposed remedial actions. The report is required to be sent to the government within one month from the date on which the RBI failed to meet the inflation target.

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ASSET QUALITY REVIEW

Despite calls from corporate India to go easy on the asset quality review kicked off by Rajan, Patel continued the exercise.

The RBI has utilised the **Insolvency and Bankruptcy Code (IBC)** to address the huge debt pile of some of the biggest defaulters; it has drawn up **two lists of 40 corporates with debt of around Rs 4 lakh crore** which are in various stages of resolution in **National Company Law Tribunals.**

COVID PANDEMIC: THE LATEST CHALLENGE

As **demand crashed**, there were **production cuts and job losses**, and **growth declined**.

Shaktikanta Das, the current Governor, and his team **opted for an accommodative monetary policy. Repo rate, the main policy rate, was brought down to 4%** to kickstart growth.

However, the liberal policy **led to a spike in inflation**, forcing the **RBI to raise rates by 250 basis points to 6.5% now.**

However, the pandemic aided the RBI in **boosting digitisation of payments.** The **launch of UPI** revolutionised payments in the banking system. The next step taken by RBI in this direction is **Central Bank Digital Currency. (CBDC)**

CENTRAL BANK DIGITAL CURRENCY

The Reserve Bank of India's (RBI) digital currency is called the **Central Bank Digital Currency (CBDC) or the Digital Rupee (e₹).**

It's a **tokenized digital version of the Indian Rupee** that can be exchanged **one-on-one with fiat currency.** The CBDC was proposed in January 2017 and launched on December 1, 2022.

ABOUT CBDC

- **CBDCs are legal tender** that can be used for **consumer-to-consumer**, consumer-to-business, and business-to-business transactions.
- They're affordable, eliminate financial barriers, and **operate on blockchain technology**, which uses encryption and decentralized ledgers to protect financial transactions.
- This security can protect individuals from fraud and cyber threats.

OBJECTIVES OF CBDC

- Mitigate the risks and trim costs in handling physical currency

- Phase out soiled notes
- Reduce transportation costs
- Reduce insurance costs
- Reduce logistics costs
- Wean people away from cryptocurrencies as a means for money transfer

The CBDC could also be used to send payments like **child benefits and food stamps**, and **tax refunds** to people **instantly,** rather than trying to figure out prepaid debit cards or mail them a cheque.

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MCQs

1. Consider the following statements wrt RBI & mark the correct one:

   1. RBI is a constitutional body.

   2. RBI was also functioning as a central bank for Pakistan post independence till 1954.

   (A) Only 1

   (B) Only 2

   (C) Both 1 & 2

   (D) Neither 1 nor 2

   Ans. (D)

2. Who among the following was the governor of RBI in 1947?

   (A) Sir Osborne Smith

   (B) Sir James Braid Taylor

   (C) Sir CD Deshmukh

   (D) Sir Benegal Rama Rau

   Ans. (C)

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3. Who among the following is **not** part of the Monetary Policy Commission?

(A) The Finance Minister

(B) RBI Governor.

(C) Any official of the RBI as mandated by the governor.

(D) Any member nominated by the GoI

Ans. (A)

4. Consider the following statements:

1. Lowering of Repo Rate can cause an increase in inflation.

2. Bond Yields are indexed with Repo Rate.

3. RBI has the dual responsibility of containing inflation & promoting growth.

How many of the above statements are correct?

(A) Only 1 are correct

(B) Only 2 are correct

(C) All three are correct

(D) None of them is correct

Ans. (B)

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5. Which of these could be the probable use of Central Bank Digital Currency?

1. Reduce Digital frauds.

2. Instant cash transfers.

3. Phase out soiled notes.

(A) Only 1 of the choices

(B) Only 2 of the choices

(C) All three of these choices

(D) None of these choices

Ans. (C)