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Impact of Monetary Policy on Bank Credit since Reforms Period

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ABSTRACT

Does Bank Rate, Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) affect the bank credit? This question always comes in the mind of researchers, economist, academicians, and policymakers and to get the answer to it, many research activities and projects are carried out by them. This study is also on the same line. The study intends to examine the impact of monetary policy on bank credit since reforms period. The study uses multiple regression models to test the selected banking variables by using the time series data collected from RBI. The study found that there is an inverse relationship between CRR and bank credit, SLR and bank credit but there is no association between bank rate by RBI and bank credit by the scheduled commercial banks in India since reforms period.

Keywords: Bank credit, bank rate, cash reserve ratio, statutory liquidity ratio

The Scheduled Commercial Banks in India are very important for economic growth and development. The nexus between financial development and economic growth was first put forward by Joseph Schumpeter (1911) in his work on 'Financial Development and Economic Growth'. According to him, the kind of services which are provided by financial institutions such as mobilizing savings, evaluating projects, managing risk, monitoring managers and facilitating transactions etc. are important for any economy. It encourages technological innovation and thereby overall economic growth and development.

The Indian banking sector has undergone significant transformation since early 1990s. The major reforms were initiated by the economy during the same period. The banking sector reforms were one of the parts of financial sector reforms initiated by the Government of India during early 1990's. The major banking sector reforms have initiated by the Reserve Bank of India and Government of India in 1991 and 1998 with the help of two reports, and both the committee chaired by the M. Narasimham. The major aim of the banking sector reforms was to increase operational flexibility measures, strengthening measures, competitive measures and developing technological and institutional infrastructure etc. There is a remarkable and rapid transformation has taken place in Indian banking sector in the post-reform period (RBI 1991) and the second committee recommendation was to modernizing the banking sector, better regulation and supervision, and introduction of prudential norms (RBI 1998). The financial and banking sector reforms have to produce essential transformation in the operation of commercial banks in India. The reforms have shifted the organization system, ownership pattern and operational activities of scheduled commercial banks and infused the system into the competitive environment. The reforms have forced all banking sector to restructure their banking activities to meet these challenges.

Bank Rate, CRR and SLR

According to the Committee on Financial System (CFS, 1991), the level and structure of interest