**Cash Reserve Ratio (CRR)**

- Cash reserve Ratio (CRR) is the amount of funds that the banks are required to park with the RBI. If the central bank decides to increase the CRR, the available amount with the banks comes down. The RBI resorts to CRR tool to drain out excess money out of the system.
- Commercial banks are required to maintain with the RBI an average cash balance, the amount of which shall not be less than 3% of the total of the Net Demand and Time Liabilities (NDTL), on a fortnightly basis and the RBI is empowered to increase the rate of CRR to such higher rate not exceeding 20% of the NDTL.

**Repo Rate**

- The rate at which the RBI lends money to commercial banks is called repo rate. It is an instrument of monetary policy. Whenever banks have any shortage of funds they can borrow from the RBI.
- A reduction in the repo rate helps banks get money at a cheaper rate and vice versa. The repo rate in India is similar to the discount rate in the US
- Discount rate is at which a central bank repurchases government securities from the commercial banks, depending on the level of money supply it decides to maintain in the country's monetary system. To temporarily expand the money supply, the central bank decreases repo rates (so that banks can swap their holdings of government securities for cash), to contract the money supply it increases the repo rates. Alternatively, the central bank decides on a desired level of money supply and lets the market determine the appropriate repo rate.

**Reverse Repo rate**

- Reverse Repo rate is the rate at which the RBI borrows money from commercial banks. Banks are always happy to lend money to the RBI since their money are in safe hands with a good interest.
• An increase in reverse repo rate can prompt banks to park more funds with the RBI to earn higher returns on idle cash. It is also a tool which can be used by the RBI to drain excess liquidity (money) out of the banking system.

Statutory Liquidity Ratio (SLR)

• SLR (Statutory Liquidity Ratio) is the amount a commercial bank needs to maintain in the form of cash, or gold or government approved securities (Bonds) before providing credit to its customers. SLR rate is determined and maintained by the RBI (Reserve Bank of India) in order to control the expansion of bank credit.

• How is SLR determined? - SLR is determined as the percentage of total demand and percentage of time liabilities. Time Liabilities are the liabilities a commercial bank liable to pay to the customers on their anytime demand.

• What is the Need of SLR? - With the SLR (Statutory Liquidity Ratio), the RBI can ensure the solvency a commercial bank. It is also helpful to control the expansion of Bank Credits. By changing the SLR rates, RBI can increase or decrease bank credit expansion. Also through SLR, RBI compels the commercial banks to invest in government securities like government bonds.

• SLR to Control Inflation and propel growth - SLR is used to control inflation and propel growth. Through SLR rate tuning the money supply in the system can be controlled efficiently.

Inflation in India

Inflation is as an increase in the price of bunch of Goods and services that projects the Indian economy. An increase in inflation figures occurs when there is an increase in the average level of prices in Goods and services. Inflation happens when there are less Goods and more buyers, this will result in increase in the price of Goods, since there is more demand and less supply of the goods.
How government manages inflation?

- At present, India manages inflation through effective monetary policy which monitored by Reserve Bank of India and fiscal policy regulated by Union Finance Ministry.
- The monetary policy formulated by Reserve Bank encompasses studies of the causes of inflation and other economic and financial indicators that help it identify the underlying inflationary pressures and formulate an effective policy.
- Inflation is caused by an increase in the money supply in the economy and can be controlled by lowering the money supply in the economy as people would have lesser money to spend, leading to reduced demand. Reserve Bank of India manages the monetary measures through reserve requirements and lending rates comprising of Bank rate, Repo rate, Reverse repo rate, Cash reserve rate – by imposing restrictions and requirements on lending institutions to reduce the amount of credit available in the market, thereby reducing the amount of free flowing capital in the economy, i.e., the amount of excess liquidity in the financial market.
- This action increases the cost associated with borrowing currency, thereby reducing the demand of goods and services, which in turn reduces or stabilizes the prices of these goods and services.

What is Deflation - Deflation is the continuous decrease in prices of goods and services. Deflation occurs when the inflation rate becomes negative (below zero) and stays there for a longer period.

What are the effects of Deflation? - During deflation the price of goods and services continue to fall and during that consumers will tend to delay their purchases hoping that prices may fall further. This is dangerous as this will lead to lower production, lower wages, and decline in demand and thus, consequently lead to further decrease in prices. This is known as deflationary spiral.

What is Deflationary Spiral? - It is a situation when decrease in the prices leads to lower production, lower wages and demand, which can lead to further decrease in
the prices. A deflationary spiral is when decrease in prices lead to a vicious circle (a trouble leads to another that aggravates the first).

**How inflation is calculated in India?**

India uses the Wholesale Price Index (WPI) to calculate and then decide the rate of inflation in the economy. Most developed countries use the Consumer Price Index (CPI) to calculate inflation.

- WPI was first published in 1902, and was one of the major economic indicators available to policy makers until it was replaced by the Consumer Price Index in most developed countries by in the 1970s.
- WPI is the index that is used to measure the change in the average price level of goods traded in wholesale market. In India, price data for 675 commodities is tracked through WPI which is an indicator of movement in prices of commodities in all trades and transactions. It is also the price index which is available on a weekly basis with the shortest possible time lag -- two weeks. The Indian government has taken WPI as an indicator of the rate of inflation in the economy.
- CPI is a statistical time-series measure of a weighted average of prices of a specified set of goods and services purchased by consumers. It is a price index that tracks the prices of a specified basket of consumer goods and services, providing a measure of inflation.
- CPI is a fixed quantity price index and considered by some a cost of living index. Under CPI, an index is scaled so that it is equal to 100 at a chosen point in time, so that all other values of the index are a percentage relative to this one.
- Some economists argue that it is high time that India abandoned WPI and adopted CPI to calculate inflation.
- India is the only major country that uses a wholesale index to measure inflation. Most countries use the CPI as a measure of inflation, as this actually measures the increase in price that a consumer will ultimately have to pay for.
- CPI is the official barometer of inflation in many countries such as the United States, the United Kingdom, Japan, France, Canada, Singapore and China.
The governments there review the commodity basket of CPI every 4-5 years to factor in changes in consumption pattern.

- WPI does not properly measure the exact price rise an end-consumer will experience because, as the same suggests, it is at the wholesale level.