Qualitative Tools of Monetary Policy

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These tools help in ensuring that prudent practices are followed in the financial sector, while also ensuring that credit is channelized in the right direction.

- **Qualitative tools are direct and specific in nature.**
- **Qualitative tools** include persuasion by the Central bank in order to make commercial banks discourage or encourage lending which is done through **moral suasion.**
- Qualitative also called **selective credit control instruments** work through regulation of **margin requirement, credit rationing, regulation of consumer credit and direct action.**

1. Types of Qualitative Tools

1.1 Credit Rationing

- Rationing of credit is another method of selective credit control. It is done by **regulating the purposes for which the loans are given** among the various member banks. To **ensure overall development** of a nation, **development of various sectors is a must**. Finance is to be distributed to various sectors as per these requirements.
- **Priority sector** should be given **preference in lending loans.**
- For others, minimum attention only will be given in this respect. It paves way for the optimum utilization of money.

1.2 Loan to Value Ratio

- It is the **amount of loan that is given against a fixed value of collateral**.
- Loan-to-Value is calculated as follows: **Financial institutions calculate LTV of a borrower using given method: (Amount borrowed / Value of property) x 100 = LTV ratio in percentage**
- For example: Suppose a person wants to get a loan by **mortgaging its gold worth Rs.1 lakh.**
- The **LTV is 60%**, then the amount of loan the **person will receive is Rs. 60,000.**
- By using this method, during the period of **inflation** with a view to **control credit**, the **RBI lowers the LTV Ratio** and during **deflation it raises the LTV to expand the credit.**

1.3 Moral Suasion

- Moral suasion aims at strengthening natural confidence and understanding between the monetary authority and the banks as well as financial institutions. It is not a statutory obligation.
- Moral Suasion is just as a **request by the RBI to the commercial banks** to take certain actions and measures as per the trend of the economy.
- RBI may **request commercial banks not to give loans for unproductive purpose** which does not add to economic growth but increases inflation.

1.4 Direct Action

- This step is **taken by the RBI against banks that don't fulfill conditions and requirements.**
- RBI may **refuse to rediscount their papers** or **give excess credits** or charge a **penal rate of interest** over and above the Bank rate, for credit demanded beyond a limit.

2. Concept Check

Q. Which one of the following is not an instrument of selective credit control in India?

(a) Regulation of consumer credit

(b) Rationing of credit

(c) Margin requirements

(d) Variable cash reserve ratios

(e) Direct Action

Answer: D