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# Types of Monetary Policy

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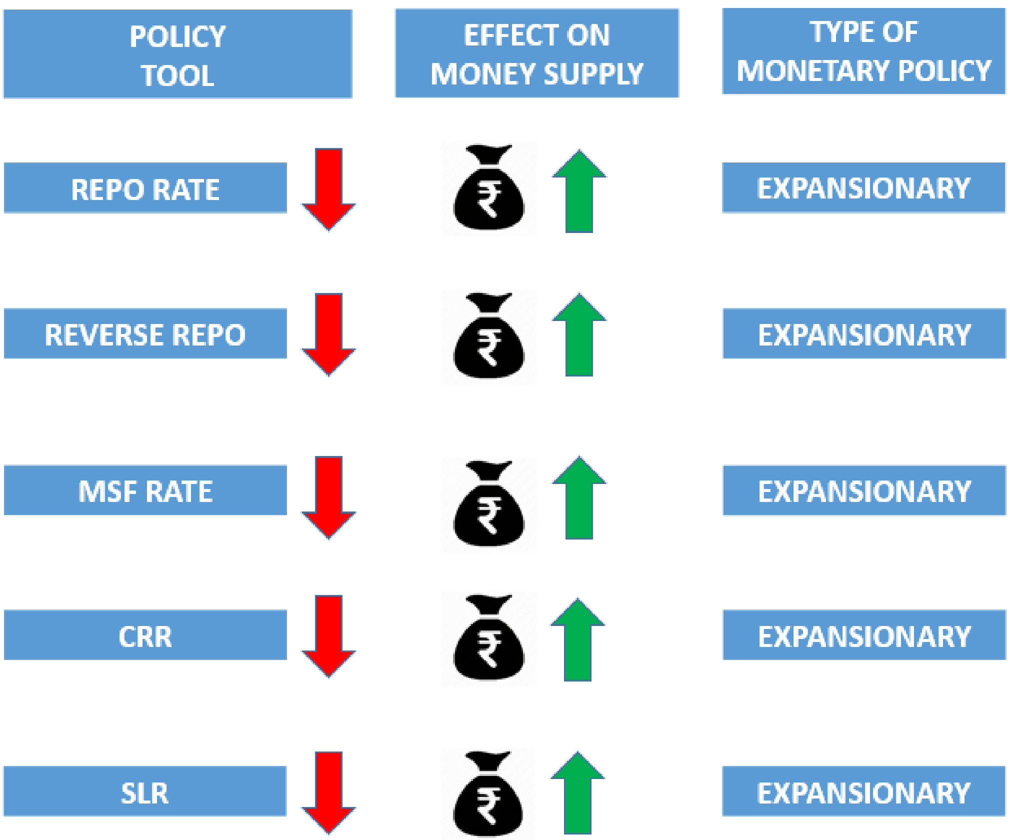
## Types of Monetary Policy

Monetary policy can be broadly divided into two types – expansionary and contractionary. Expansionary monetary policy, as the name suggests, helps in increasing the supply of money in the economy, whereas contractionary monetary policy help in reducing the supply of money. Central banks usually reduce supply of money in a bid to control inflation, whereas they increase the supply of money to boost demand thereby the GDP growth rate.

### 1. Types

### 1.1 Expansionary Monetary Policy



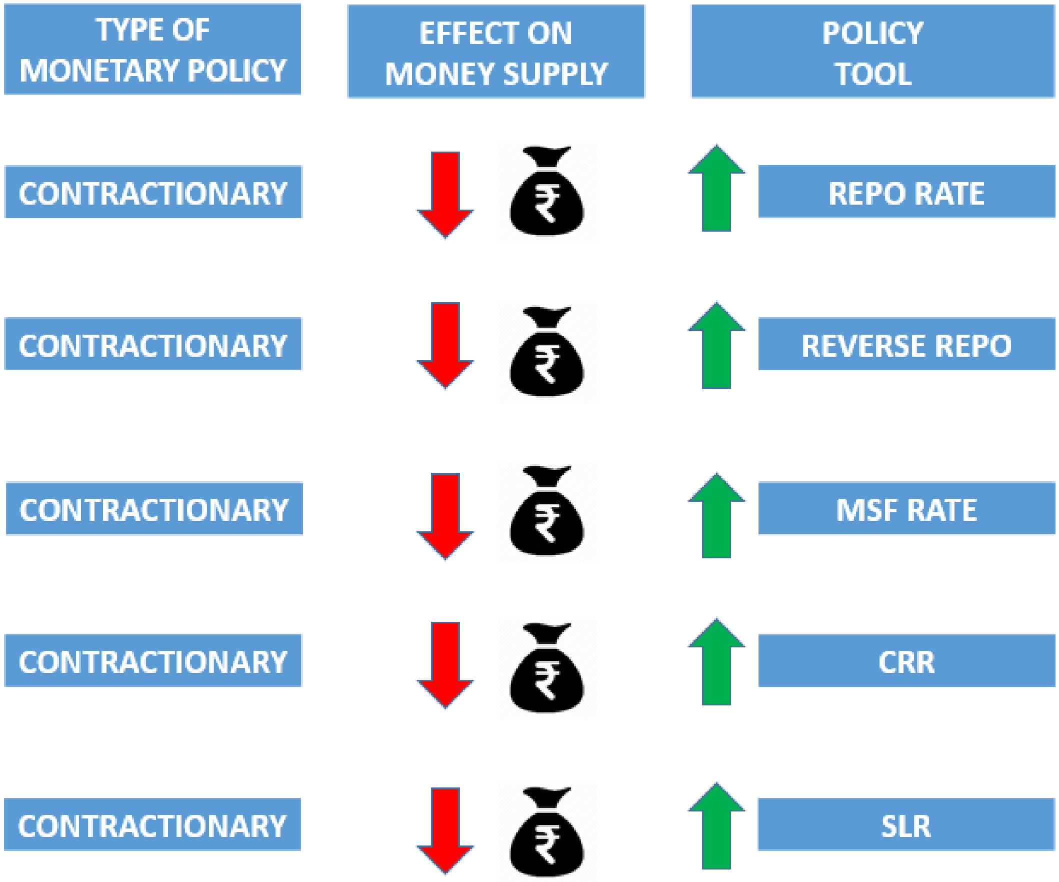
**Expansionary** monetary policy or **easy money** results if the **RBI increases the money supply** and **lowers interest rates** and is the recommended policy to **counter a slowdown in GDP growth.** Expansionary moves include:

- **The decreases in the repo rate/Bank rate/MSF rate:** As these rate falls, corporations and consumers can borrow more cheaply.
- **Purchases of government securities:** As RBI purchases government securities from financial institutions, it increases money supply in the market.
- **Reductions in the reserve ratio (CRR/SLR):** The central bank seeks to encourage increased lending by banks by decreasing the reserve ratio, which is essentially the amount of capital a commercial bank needs to hold onto when making loans.

**Expanding the money supply** results in **lower interest rates** and borrowing costs, with the goal to **boost consumption and investment.**

**This type of policy is also called as Easy / Loose / Accommodative / Dovish Monetary Policy.**

## 1.2 Contractionary Monetary Policy




**Contractionary** monetary policy or **tight money** occurs if the **RBI decreases the money supply** and **raises interest rates** and is the recommended policy to **reduce inflation.** Contractionary moves include:

- **The increases in the repo rate/Bank rate/MSF rate:** As these rate rises, corporations and consumers borrowings become more expensive.
- **Sales of government securities:** As RBI sells government securities to financial institutions, it decreases money supply in the market.
- **Increase in the reserve ratio (CRR/SLR):** The central bank seeks to discourage increased lending by banks by increasing the reserve ratio.

Contracting the money supply results in higher interest rates and borrowing costs, with the goal to control inflation.

Calibrated tightening is a version of contractionary monetary policy – it means interest rates can only move upward.

This type of policy is also called as **Tight / Hawkish / Restrictive Monetary Policy**.

**Note: Neutral stance means interest rates may move either way—upward or downward.**

## 2 Concept Check

**Q. If the Reserve Bank of India is following an expansionary monetary policy, it can**

(a) Lower the Statutory Liquidity Ratio

(b) Lower the Cash Reserve Ratio

(c) Lower the Repo Rate

(d) Lower the Reverse Repo Rate

(e) All of the above

**Answer: E**

**Q. An increase in the Bank Rate generally indicates that the**

(a) Market rate of interest is likely to fall

(b) Central Bank is no longer making loans to commercial banks

(c) Central Bank is following an easy money policy

(d) Central Bank is following a tight money policy

(e) None of the above

**Answer: D**

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