Credit Control Methods of RBI-Explained

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The Central Bank (RBI) controls the quantity of credit given by commercial banks by using the following methods.

Quantitative Methods

BANK RATE:-

It is the rate at which bills are discounted & rediscounted by the banks with the RBI. During inflation, the bank rate is increased & during deflation, bank rate will be decreased.

OPEN MARKET OPERATION:-

The buying & selling of government securities by the RBI directly in the open market is known as 'Open Market Operations'. During inflation, the securities are sold in the market by the central bank. While in the deflation period, the RBI buys the bills from the market & pays cash to the commercial banks.

VARIABLE RESERVE RATIO:-

All commercial banks have to keep a minimum cash reserve with the RBI depending on the deposits of the commercial banks. During inflation, this variable reserve ratio is increased & at the time of deflation, the ratio is decreased.

QUALITATIVE METHODS:-

This approach is also known as 'Selective Credit Control Methods'.

FIXATION OF MARGIN:

The Banker will be lending money against the price of securities. The amount of loan will be depending upon the margin requirements of the banker. The word 'margin' in the above statement means the difference b/w the loan value & market value of securities.
The RBI will be having the power to change the margins, which limits the loan amount to be sanctioned by the commercial banks. During inflation, the margin would be higher & it will be lower at the time of deflation.

REGULATION OF CONSUMER CREDIT:

The buyer gets this kind of foreign exchange reserves & exchange value of the Rupee in relation to other country's currencies. Currencies should only be exchanged with RBI or its authorised banks.

DIRECT ACTION:

To control the volume of bank loans the RBI may issue instructions to the commercial banks from time to time. The instructions may be in the form of oral or written statements or appeals or warnings. By means of these instructions, the central bank may increase or decrease the volume of credit.

RATIONING OF CREDIT:

It is a system of regulating & controlling purpose for which credit is guaranteed by the commercial bank. It is of two types.

Variable Portfolio Ceilings:

In this, the RBI fixes a maximum amount of loans & advances for every commercial bank.

Variable Capital Assets Ratio:

In this technique, the RBI fixes a ratio, which the capital of the commercial bank must bear to the total assets of the bank. By varying this ratio the credit can be controlled.

MORAL SUASION:-

This is a tactful technique followed by RBI. In this technique, the RBI will give advice & suggestions to the bankers to follow the directives given by it, by sending letters & conducting the meeting of the Board of Directors.