

RBI's Monetary Policy and its Influence on Commercial Banks in India

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Abstract

The financial system is essential in the overall development of an economy because it promotes efficient resource allocation, thus supporting growth. The Reserve Bank of India (RBI), which was founded in 1935, is the Central Bank of India and serves as the primary monetary and financial authority in the country to preserve monetary and financial stability. In its capacity as the central bank, the RBI develops and executes the country's monetary policy as a means of managing the money supply and credit available within the economy. In pursuing these objectives, the RBI utilises a variety of instruments, including the repo rate, reverse repo rate, CRR, SLR, and open market operations, to achieve price stability, control inflation rate, and promote sustainable economic growth in the country.

Introduction

The financial system is essential for economic development, with the Reserve Bank of India (RBI) acting as its central authority. Established in 1935, the RBI formulates and implements monetary policy to maintain price stability, promote growth, and ensure financial stability. It regulates currency supply, manages foreign exchange, and supervises the banking system. Monetary policy involves managing money supply and credit using tools such as the repo rate, reverse repo rate, CRR, SLR, and open market operations to control inflation and influence economic activity.

Statement of Problem

The Reserve Bank of India (RBI) uses monetary policy tools such as the repo rate, reverse repo rate, CRR, and SLR to control inflation, manage liquidity, and ensure financial stability. However, the impact of these policies on commercial banks is often uneven and delayed, as changes in policy rates do not always fully translate into lending and deposit rates. In recent years, challenges like inflation, liquidity constraints, and global uncertainties have highlighted the need to assess how effectively RBI's monetary policy influences bank operations. This study examines how commercial banks in India respond to monetary policy changes and identifies factors affecting the efficiency of policy transmission.

Need for Study

Monetary policy is a key tool used by the Reserve Bank of India (RBI) to maintain economic stability, control inflation, and manage liquidity. Policy instruments such as the repo rate, reverse repo rate, CRR, and SLR directly influence commercial banks, which act as the primary channel for transmitting monetary policy to the economy. Changes in these tools affect banks' interest rates, lending behaviour, and credit flow. In recent years, challenges like inflation, liquidity constraints, and global uncertainties have increased the importance of effective monetary policy transmission. However, delays and inefficiencies in banks' responses often weaken policy outcomes. This study examines the impact of RBI's monetary policy on commercial banks' performance, including lending, profitability, credit creation, and financial stability, to assess the effectiveness of India's monetary transmission mechanism and support a more resilient financial system.

Scope of Study

This study examines the impact of the Reserve Bank of India's (RBI) monetary policy on the performance of commercial banks in India. It analyses how policy tools such as the repo rate, reverse repo rate, CRR, SLR, and open market operations affect lending

behaviour, credit creation, profitability, liquidity management, and financial stability. The study focuses on scheduled commercial banks, including public and private sector banks, over recent years of major policy interventions.

Objectives

- To analyse how changes in monetary policy affect the lending behaviour and credit creation capacity of commercial banks.
- To evaluate the impact of policy rate changes on the profitability, liquidity, and overall financial stability of commercial banks.

Research Methodology

Research methodology is the systematic approach used to plan and conduct a study. It defines the methods, techniques, and procedures for collecting, analysing, and interpreting data to achieve research objectives. A well-designed methodology ensures clarity, reliability, validity, and rigor in research findings.

Research Design

Research design is the overall plan that guides how a study is conducted, including data collection, sampling, and analysis methods. This study uses a descriptive and comparative research design to examine and compare employees' perceptions of remote work and on-site work. It focuses on understanding differences and similarities in comfort, productivity, challenges, and preferences across both work environments.

Methods of Data Collection

Secondary Data: For secondary data, the related journals, articles, websites, and past thesis were referred for this project

Limitations

- The study focuses solely on India and does not compare monetary policy impacts with other countries.
- Limited availability of uniform data across banks may restrict in-depth quantitative or econometric analysis.

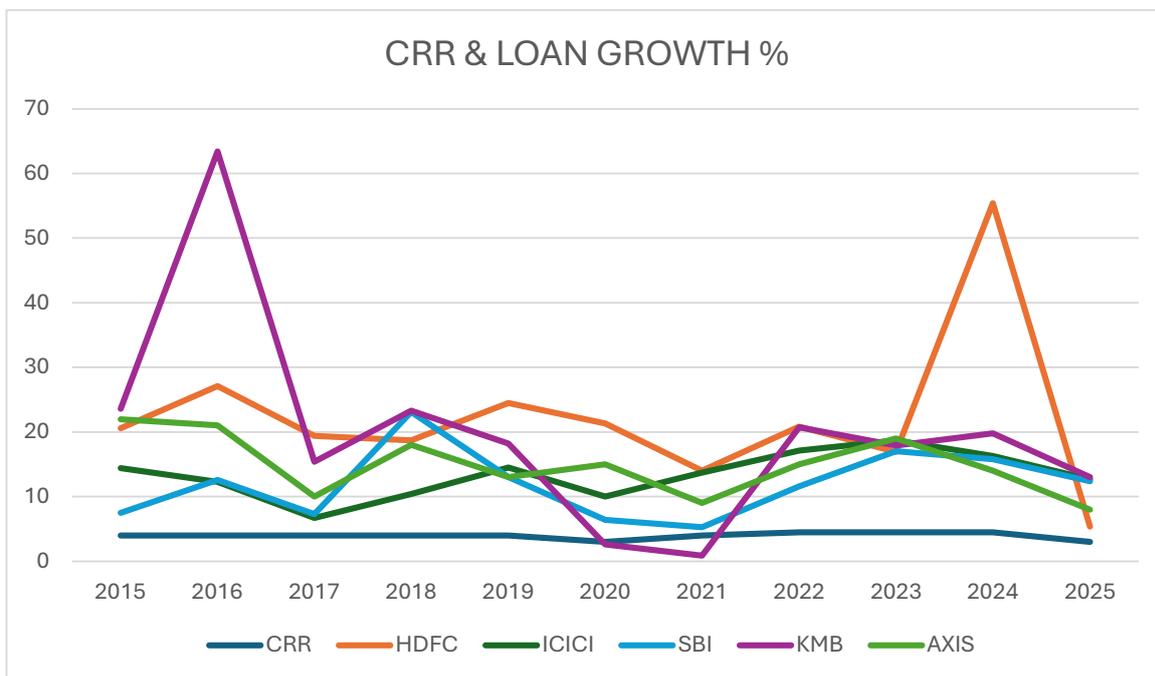
Review of Literature

Belavadi Nikhil and Shivakumar Deene (2021) studied the impact of abrupt and overlapping monetary policy changes on the performance of India's banking sector. Their research shows that RBI's policy tools significantly affect bank performance indicators such as credit growth, asset expansion, deposits, and profitability. Sudden or overlapping policy shifts disrupt monetary transmission and strain banks' ability to adjust, negatively affecting performance. The study recommends smoother and more transparent policy actions and greater operational flexibility within banks to manage policy-related shocks effectively.

Background of The Study

The Reserve Bank of India (RBI) plays a central role in maintaining economic stability through monetary policy tools such as the repo rate, reverse repo rate, CRR, SLR, and open market operations. These tools influence liquidity, credit flow, and interest rates, directly affecting commercial banks' lending behaviour and profitability. With the shift to a flexible, market-driven framework—especially after the adoption of inflation targeting in 2016—understanding how RBI's policies impact commercial banks has become increasingly important. This study examines how monetary policy decisions affect banks' liquidity, lending, and performance in India.

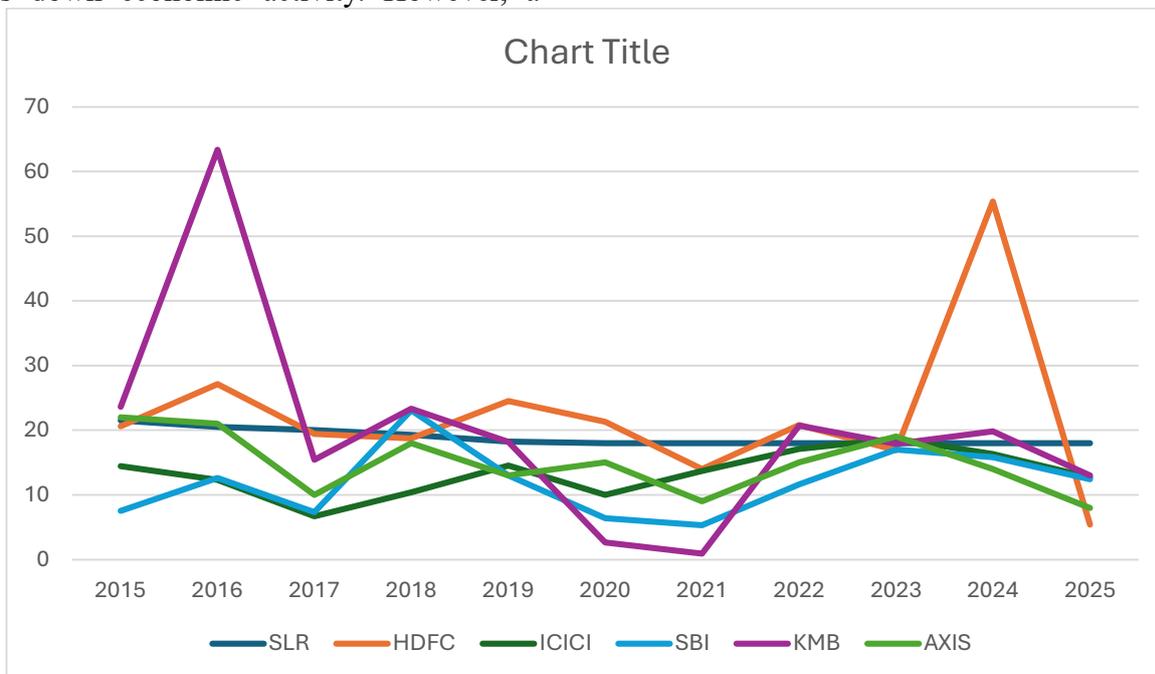
1.Loan growth
Table 4.1



Interpretation

Cash Reserve Ratio refers to the fraction of total deposits that banks need to keep as liquid cash with the central bank, without using it for giving loans. When the central bank increases the CRR, banks have less money to lend, which leads to tight credit and slows down economic activity. However, a

reduction in CRR increases the availability of funds for lending, thereby encouraging borrowing and investment. Thus, CRR directly influences banks' lending behaviour and is an important tool for controlling the supply of liquidity in the economy. Table 4.2



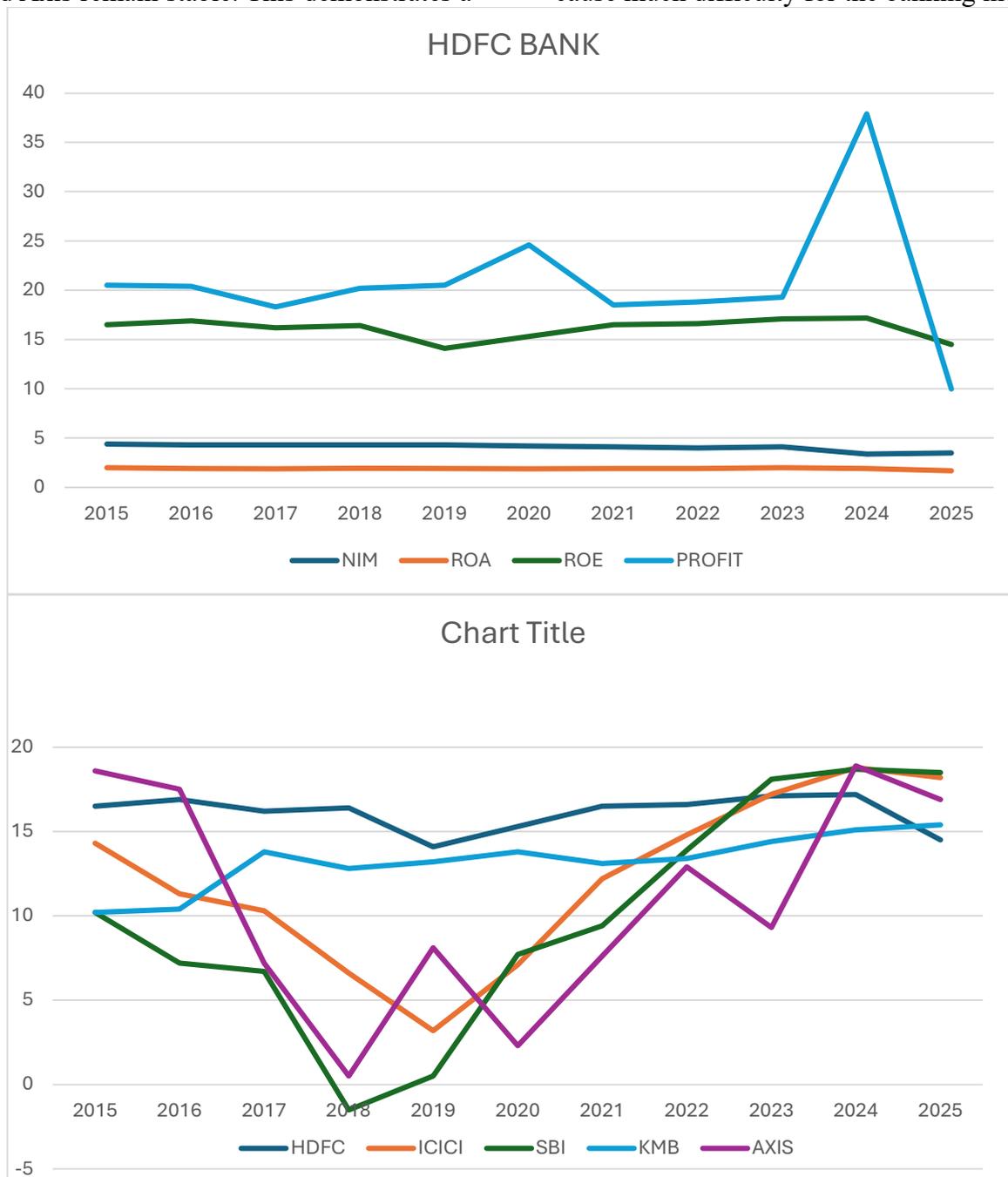
Interpretation

The above graph shows that the SLR line remains constant through the years, indicating stable

regulatory requirements for banking investment in safe assets. On the other hand, the loan growth of individual banks exhibits greater variability. This

demonstrates a clear difference between lending styles adopted by individual banks. Banks such as HDFC and KMB exhibit erratic behavior, indicating a more aggressive lending policy. In turn, SBI, ICICI, and Axis remain stable. This demonstrates a

stable SLR line where the loan growth of individual banks is dictated by the bank's lending policy in specific instances and not regulatory pressure. This also highlights the fact that a stable SLR does not cause much difficulty for the banking industry.



Interpretation- HDFC BANK:

The graph shows that HDFC Bank maintains stable **NIM and ROA** throughout the period, indicating consistent operational efficiency and asset quality. **ROE** remains steady with minor fluctuations, reflecting effective use of shareholders' funds. Profit growth shows moderate variation, with a sharp spike

in 2024 followed by a decline in 2025, suggesting one-time gains or exceptional performance in that year. Overall, HDFC demonstrates strong financial stability with controlled risk and consistent profitability.

Interpretation – ICICI Bank:

ICICI Bank's graph reflects high volatility in **profit levels**, with losses during 2016–2019 followed by a sharp recovery after 2020. This turnaround indicates improved asset quality and better risk management. **ROE and ROA** show a steady upward trend post-2020, highlighting improved profitability and efficiency. NIM also improves gradually, supporting sustainable earnings growth. Overall, ICICI shows a clear recovery phase transitioning from stress to strong financial performance.

Findings:

- Cash Reserve Ratio (CRR) is an important factor, which impacts banks' credit potential, as a higher CRR limits credit, while a lower CRR boosts credit expansion.
- A constant Statutory Liquidity Ratio (SLR) year after year implies a consistent regulatory policy which does not affect the banks' lending activities directly.
- Loan growth is not consistent among banks, which indicates that bank strategies play the major role in determining lending behavior rather than regulations.
- HDFC Bank shows good financial stability in terms of consistency in its NIM, ROA, and ROE figures.
- ICICI Bank displays a clear transformation over its financial year 2020, with rising profitability, improving asset quality, and better risk management practices.
- Overall, the results suggest that although the monetary instruments, such as CRR and SLR, are important for liquidity, bank-specific policies and management decisions play a crucial role in the bank's lending behaviour and financial performance.

Suggestion:

- The banks should maintain a balanced lending strategy by aligning the credit growth with changes in the CRR so that excessive risk during tight liquidity periods could be avoided.
- Since SLR remains relatively stable, it is more important for banks to implement better internal lending policies rather than seek growth through regulatory changes.

- The banks which have shown erratic loan growth should strengthen credit appraisal and risk assessment mechanisms to make sure that lending is on sound fundamentals.
- The bank, therefore, should continue with the same conservative and efficient approach while emphasizing stable profitability over time.
- The entity of ICICI Bank shall continue the improved risk management practices to prevent recurrence of earlier financial stress.

Conclusion

The study comes to the conclusion that banks' lending behavior is shaped both by regulatory actions as well as management actions. The study examines the role of the monetary policy instruments namely Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) in the control mechanism of liquidity in Indian banks. It is noted from the study that each bank has formulated its own lending strategies based on its risk-taking capacity, efficiency, and management actions as well. In the case of HDFC Bank, it is noted from the study that the bank delivers consistent and stable financial outcomes, whereas ICICI Bank illustrates the success story of its turnaround strategy through improved profitability and risk management practices.

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