

The Importance of RBI in the Indian Economy

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ABSTRACT

The present economic conditions in many countries worldwide are greatly affected by setbacks. Examples include conflicts, worldwide economic downturn, decrease in economic expansion, and unpredictability resulting from the pandemic. Both growth and inflation face threats from ongoing conflict and sanctions, as well as high oil and commodity prices, prolonged supply chain disruptions, increased global financial market volatility due to changes in monetary policy in major economies, and new outbreaks in India.

Most industries experienced a rise in the interest rates of their current loans. With the help of both traditional and non-traditional liquidity tools, the RBI has assisted banks in upholding orderly market conditions and improving sentiment in the financial markets. Given the current situation, the study thoroughly analyzes the patterns of tools utilized by RBI for regulating deposit flow and money circulation within banks, aiming to mitigate adverse impacts of economic downturn. This paper aims to assess the influence of RBI's financial instruments on the Indian economy. The article delves deeper into the impact of specific tools (Repo Rate, Reverse Repo Rate, Cash Reserve Ratio) on Inflation rate, GDP, and Unemployment rate. The research is focused on descriptive study. The research paper heavily relies on World Bank data as the primary secondary source gathered from RBI.

Keywords-- GDP, Repo Rate, Growth, Financial Market, RBI, Major Economies

India's economy is currently one of the most vibrant in the world due to its successful banking sector. India's extensive financial sector is experiencing rapid growth, driven by the expansion of existing companies and the emergence of new players. The sector consists of commercial banks, insurance firms, non-banking financial institutions, cooperatives, pension funds, mutual funds, and other smaller financial organizations. The banking regulator has recently approved the establishment of new entities, such as Payment Banks, broadening the range of organizations active in the market. The RBI's statistics show that over 64% of the total assets within the Financial System are held by Commercial banks, indicating that the Indian financial sector is predominantly characterized by banking activities. India's economy is currently one of the most dynamic globally due to the growth of its banking and insurance sectors. Many companies in the Financial Services Industry welcomed the relaxation of foreign investment rules by announcing intentions to increase their stakes in partnerships with Indian businesses. The Reserve Bank of India (RBI) asserts that the Banking Industry in India has sufficient capital and is properly regulated. The country possesses much more favorable financial and economic conditions than any other country globally. Research on credit, market, and liquidity risk shows that Indian banks are typically strong and have performed successfully throughout the global economic downturn.

Anticipated growth in the banking sector is expected to receive additional support from higher infrastructure spending, improved project implementation, and continued reforms. All these signs suggest that the banking industry in India is in a good position for growth, as fast-growing companies turn to banks for loans. Moreover, the rise of technology has increased the visibility of online and mobile banking services. The banking sector is giving more importance to providing improved services to customers and updating their technology to enhance the overall customer experience and maintain a competitive advantage.

Alongside cooperative credit institutions, the Indian banking system comprises 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks, and 96,000 rural banks.

Listed below are the key factors that have a major impact on the performance of Indian Banks: The

I. INTRODUCTION

India's extensive financial sector is experiencing rapid growth, driven by the expansion of existing companies and the influx of new players. The sector is comprised of commercial banks, insurance companies, non-banking financial institutions, co-operatives, pension funds, mutual funds, and other smaller financial organizations. The banking regulator recently approved the establishment of new entities, such as Payment Banks, diversifying the range of organizations in the market. The data from RBI shows that Commercial banks account for over 64% of the total assets in the Financial System, establishing the Indian financial sector as predominantly banking oriented.

Repurchase Option / Agreement (REPO) rate is the interest rate at which the RBI provides short-term funds to commercial banks when they borrow from the RBI. Repo Rate involves selling securities with a promise to buy them back later. If inflation goes beyond acceptable levels, the RBI will increase the Repo Rate, leading to an increase in home loans, other EMIs, and lending rates, thereby decreasing demand and liquidity in the financial system. Raising interest rates lowers inflation and has a varying effect on GDP and unemployment.

The reverse repo rate is the rate at which banks can place their funds with the RBI, meaning that it involves the RBI borrowing funds from banks for a short period. The reverse repo market helps regulate cash flow and maintain the country's financial reserves. Cash is transferred between accounts at the opposite repo rate. When all other variables remain unchanged, an increase in the reverse repo rate results in a reduction in the money supply, and the opposite is also true. The decline in market supply will occur because commercial banks will be more likely to deposit their cash with the RBI when the reverse repo rate increases. Increasing the reverse repo rate reduces inflation while leaving GDP and unemployment unchanged.

The RBI utilizes the Cash Reserve Ratio (CRR) as a traditional monetary tool to control domestic inflation and regulate credit to the commercial sector. The CRR refers to the proportion of a bank's overall deposits that needs to be maintained in liquid cash. A bank is not able to utilize the cash it holds with the RBI for lending or investing purposes, and it also does not earn any interest on it. CRR helps with the advancement and upkeep of the financial stability of commercial banks. The CRR rate helps to ensure a consistent circulation of money and credit in the economy. An increase in the CRR rate influences inflation, while GDP and the unemployment rate remain unaffected.

GDP is a measure that calculates the value of final goods and services bought by consumers and produced within a country in a given time frame (quarter/year). GDP is comprised of investment spending, net exports, government spending, and consumption.

Inflation is the term used to describe the speed at which prices increase or the reduction in the value of money over a set period of time. Four types of inflation exist: hyperinflation, galloping, walking, and creeping. Demand-pull, cost-push, inherent factors, increased money supply, devaluation, rising wages, and more are the primary factors that drive inflation. The Consumer Price Index (CPI) is utilized to gauge inflation. Inflation greatly benefits individuals with higher incomes, but adversely affects those with lower incomes. Rising inflation poses a serious threat to achieving maximum employment.

II. REVIEW LITERATURE

Akiko (2005) discussed a range of problems stemming from the volatile foreign exchange rates in Asian nations. The author concentrated particularly on capital inflows in China and India. The author discovers links between credit growth in two economies, but their effects do not last long. Some changes in exchange rate policy are being recommended in order to increase policy flexibility, even though there are limited incentives, and also to tighten liquidity management of currencies more than before. Ultimately, the author contends that in order to keep the exchange rate stable, it is necessary to implement domestic reforms for capital account convertibility and gradually increase exchange rate flexibility over time.

Sastry and colleagues (2010) have observed that there is a noticeable shift in lending stickiness within an economy as financial reforms continue to progress. In the period of reforms from 1990 to 2000, there was a shift in the role of various policy rates, leading to a decrease in lending rates. As a result, most Indian policymakers utilized discount rates for signaling policy. The Authors suggest that the repo rate did not respond as expected despite changes in discount rates. A 100 basis point change in all policy rates near the conclusion of the reference period could impact lending rates in India. Authors emphasize the significance of inelastic credit demand in India. Writers suggested that there will be a rise in the demand for personal and housing loans in India in the future because of demographic reasons, leading to an increase in loan rates.

Nath (2013) noted that Repo plays a crucial role in India for implementing the daily Liquidity Adjustment Facility (LAF) that enables primary dealers to handle their liquidity requirements. As a result of this liquidity strain, short-term interest rates are affected. People without sufficient securities balances may seek funds from the inter-bank uncollateralized call market, where call rates are susceptible to liquidity shocks within the system. The author utilized certain techniques to analyze the effects and responses of the system to an abundance of liquidity. The tests showed that the stability of monetary policy remains consistent in both regimes and there is no significant difference in the effectiveness of monetary policy between the two regimes.

Shayanewako (2018) believed that the banking sector is the driving force behind the economic activities of contemporary financial systems. Banks are crucial for promoting economic growth by distributing resources, diversifying risk, and maintaining optimal interest rates. The author examines how interest rate spread affected South Africa's banking system between 2000 and 2017 using non-linear frameworks and discovered a detrimental

correlation between the two. The findings of this research indicate that economic growth and the real exchange rate have a positive impact on the efficiency of the Banking system, while non-performing loans hinder Banking system efficiency in South Africa.

Kostikov et al. (2019) conducted a research to examine the impact of market interest rates on commercial banks and the resulting effects. The author expressed the view that the global economy has led to exceptionally low interest rates in the loan and mortgage market in the Czech Republic. Low interest rates lead to the generation of more affordable money, causing interest rates to fall below 2.5% and impacting GDP, unemployment, and the real effective exchange rate. The writer discovered that the return on equity of banks was influenced by both profit margin and liquidity.

III. METHODS AND DATA COLLECTION

The study merges a cause-and-effect research design with a descriptive research design. The study utilizes secondary sources such as RBI reports, annual reports of Indian Banks, websites, newspapers, magazines, journals, and online media. The theoretical literature is derived from books. The research report gathers data from over 19 years.

IV. RBI NORMS FOR INDIAN BANKS

The Reserve Bank of India is known as the nation's central bank. Most central banks, as we recognize them today, are still a fairly recent development, originating in the early 1900s. The suggestions from the Hilton Young Commission were the basis for establishing the Reserve Bank of India. The legal basis for the operations of the Bank was set by the Reserve Bank of India Act in 1934, and it officially began functioning on April 1, 1935. The primary purpose of founding the Bank was to:

1. The man was very tall and had a distinctive scar on his cheek, making him easy to recognize. Regulate the printing of paper money.
2. Before departing on their journey, the group gathered together to discuss the itinerary. Keep reserves to guarantee stability in the economy.

3. The company decided to reduce its workforce in order to cut costs and improve efficiency. Administer the country's credit and currency systems in a manner that is advantageous to it.

When the Bank began operating, the responsibility for managing Government accounts and public debt was moved from the Controller of Currency and the Imperial Bank of India to the Bank. Even though Burma (Myanmar) gained independence from the Indian Union in 1937, the Reserve Bank continued to serve as the nation's central bank until the Japanese occupation and then until April 1947. Following the split of India, the Reserve Bank served as Pakistan's central bank until June 1948, when the State Bank of Pakistan began functioning. The Bank, established as a shareholder's bank, was taken over by the government in 1949.

From the start, people perceived the Reserve Bank of India as having a distinct role to fulfill in the realm of development, particularly in agriculture. In the 1960s, as India started its planning efforts, the Reserve Bank played a leading role in introducing the concept of using funds to stimulate development, highlighting the Bank's role in development.

The Bank was instrumental in setting up organizations that contributed to the development of the country's financial framework.

The Bank has been instrumental in founding organizations that have contributed to developing the country's financial infrastructure, such as the Unit Trust of India, the Industrial Development Bank of India, the National Bank of Agriculture and Rural Development, and the Discount and Finance House of India.

As a result of liberalization, the Bank is now refocusing on important central banking tasks such as monetary policy, bank supervision, regulation, and monitoring the payments system, and is currently focused on developing the financial markets.

Repo Rate, Reverse Repo Rate and Cash Reserve Ratio are aggregated annually

Table 1: The rate of growth is assessed and displayed in the table below, labeled as

Year	Repo Rate (%)	Growth Rate (%)	Reverse Repo Rate (%)	Growth Rate (%)	Cash Reserve Ratio (%)	Growth Rate (%)
2000	11.638		11.923		8.534	
2001	8.750	-24.812	9.005	-24.476	7.729	-9.433
2002	7.750	-11.429	8.135	-9.661	5.260	-31.946
2003	7.050	-9.032	7.136	-12.282	4.635	-11882
2004	6.000	-14.894	6.221	-12823	4.591	-0.953
2005	6.250	4.168	4.922	-20.884	5.000	8.9313
2006	6.917	10.667	5.673	15.256	5.000	0.000
2007	7.625	10.241	6.000	5.773	6.333	26.667
2008	7.917	3.825	6.000	0.000	7.746	22.303
2009	5.083	-35.789	3.582	-40.306	5.064	-34.621
2010	5.625	10.656	3.983	11.191	5.734	13.230
2011	7.536	33.968	6.298	58.150	6.000	4.636
2012	8.000	6.161	7.188	14.117	4.971	-17153
2013	7.583	-5.208	6.542	-8.986	4.048	-18.558
2014	8.000	5.495	6.313	-9.225	4.000	0.000
2015	7.313	-8.594	6.313	-9.225	4.000	0.000
2016	6.375	-12.821	5.875	-6.931	4.000	0.000
2017	6.000	-5.882	5.833	-0.709	4.000	0.000
2018	6.250	4.167	6.042	3.571	4.000	0.000
2019	5.617	-10.133	5.367	-11.172	4.000	0.000

Source: RBI Database (Annual reports)

Information provided in Table 1 details the annual performance of financial instruments acquired from the RBI's reports covering the years from 2000 to 2019.

- a) Findings on Repo Rate show that the RBI's recommended repo rate falls between 6.250 and 11.638. The highest Repo rate was seen in the 2000-01 period, while the lowest Repo rate was observed in the year 2018-2019. The analysis of growth rates shows that the most significant decrease was seen in 2001-2002 at -24.812 percent, while the highest increase occurred in 2011-2012 at 33.968 percent.
- b) Findings on Reverse Repo Rate show that the RBI's recommended Reverse Repo Rate falls between 6.042 and 11.923. The Reverse Repo rate reached its peak in the 2000-01 period, while it hit its lowest point in the 2018-2019 fiscal year. The analysis of growth rate

shows that the most significant decrease occurred between 2008 and 2009, dropping by -40.306 percent, while the highest increase was seen between 2010 and 2011, with a growth rate of 58.150 percent.

- c) Findings regarding the Cash Reserve Ratio show that the RBI-mandated range is from 4.000 to 8.534. The period of 2000-01 recorded the highest Cash Reserve Ratio, while the year 2018-2019 saw the lowest Cash Reserve Ratio. The analysis of growth rates shows that the most significant decrease occurred in 2008-2009 at -34.621 percent, while the highest increase was observed in 2006-2007 at 26.667 percent.

The compilation of GDP, Inflation, and Unemployment rates by year is presented in Table 2 for measuring and showcasing growth rates.

Table 2: Financial Instruments Results was the outcome.

Year	GDP (%)	Growth Rate (%)	Inflation (%)	Growth Rate (%)	Unemployment Rate (%)	Growth Rate (%)
2000	3.840		4.010		5.750	
2001	4.820	25.521	3.780	-5.736	5.730	-0.348
2002	3.800	-21.162	4.300	13.757	5.770	0.698
2003	7.860	106.842	3.810	-11.395	5.770	0.000
2004	7.920	0.763	3.770	-1.050	5.720	-0.867
2005	7.920	0.000	4.250	12.732	5.650	-1.224
2006	8.060	1.768	5.800	36.471	5.520	-2.301
2007	7.660	-4.963	6.370	9.828	5.410	-1.993
2008	3.090	-59.661	8.350	31.083	5.360	-0.924
2009	7.860	154.369	10.880	30.299	5.610	4.664
2010	8.500	8.142	11.990	10.202	5.650	0.713
2011	5.240	-38.353	8.860	-26.105	5.650	0.000
2012	5.460	4.198	9.310	5.079	5.660	0.177
2013	6.390	17.033	11.060	18.797	5.670	0.177
2014	7.410	15.962	6.650	-39.873	5.600	-1.235
2015	8.000	7.962	4.910	-26.165	5.560	-0.714
2016	8.260	3.250	4.950	0.815	5.510	-0.899
2017	6.800	-17.676	3.330	-32.727	5.410	-1.815
2018	6.530	-3.971	3.950	18.619	5.330	-1.479
2019	4.040	-38.132	3.720	-5.823	5.270	-1.126

Source: RBI Database financial assets (Annual Report)

Information provided in Table 2 details the annual performance of financial assets as reported by the RBI from 2000 to 2019. The study's main findings are as follows.

- GDP findings show that RBI's recommended GDP falls within the range of 6.530 to 4.040 the peak GDP was recorded in the period from 2000 to 2019, while the lowest GDP was seen in the year 2018 to 2019. The analysis of growth rates shows that the most significant decrease was seen in 2018-2019 at -38.132%, while the highest increase occurred in the period of 2008-2009 at 154.369%.
- Findings on Inflation indicate that the inflation rate set by the RBI falls between 3.330 and 11.990. The peak

of inflation occurred from 2009 to 2010, while the lowest inflation rate was seen in 2016-2017. The analysis of growth rates indicates that the most significant decrease occurred in 2013-2014 at -39.873 percent, while the largest increase was observed in the 2018-2019 period at -5.823 percent.

- Findings regarding Unemployment indicate that the RBI's prescribed rate falls between 5.330 and 5.270. The highest rate of unemployment was seen in the period from 2018 to 2019, while the lowest rate was observed in 2018-2019. The analysis of growth rates shows that the most significant decline occurred in 2018-2019 at -1.126%.

4.1 Results Gathered through Statistical Analysis

Table 3: Displayed below statistical data findings

SN	Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
1	MEAN	6.777	6.062	5.028	6.017	6.220	6.040
2	MEDIAN	6.917	6.000	4.635	7.410	5.700	5.650
3	STANDARD DEVIATION	1.687	1.948	1.412	3.508	2.644	1.527
4	COEFFICIENT OF VARIATION	24.895	32.136	28.091	58.304	42.510	25.282

Source: Compiled from R-studio results

4.2 Findings of the Correlation Analysis

instruments and financial indicators.

Below in Table 4, you can find the outcomes of the inter correlation analysis conducted on the chosen

Table 4: Correlation Findings

SN	Correlation	Repo Rate	Reverse Repo Rate	Cash Reserve Ratio	GDP	Inflation	Unemployment
1	REPO RATE	1.000					
2	REVERSE REPO RATE	0.937	1.000				
3	CASH RESERVE RATIO	0.720	0.607	1.000			
4	GDP	0.000	-0.067	-0.249	1.000		
5	INFLATION	-0.118	-0.353	0.059	0.019	1.000	
6	UNEMPLOYMENT	-0.472	-0.395	-0.278	0.019	-0.014	1.000

Source: Derived from the output of R-studio

Interpretations

Correlation analysis is used to assess the connection between the variables. The variables undergo Significance analysis, revealing that the calculated p-values for the chosen variables are below the 5 percent significance threshold.

- a) The correlation between Repo Rate and other variables reveals a strong positive association with Reverse repo rate ($r=0.937$), a strong positive correlation with Cash Reserve Ratio ($r=0.720$), no correlation with GDP ($r=0.000$), a negative correlation with inflation ($r=-0.118$), and a negative correlation with unemployment rate ($r=-0.472$).
- b) The correlation between Reverse Repo Rate and other factors suggests that Reverse Repo Rate displays a strong positive correlation with Cash Reserve Ratio ($r=0.607$), a weak negative correlation with GDP ($r=-0.067$), and negative correlations with inflation ($r=-0.353$) and unemployment rate ($r=-0.395$).
- c) The correlation between Cash Reserve Ratio and other variables suggests that Cash Reserve Ratio has demonstrated a minimal positive correlation with

Inflation ($r=0.059$), a negative correlation with GDP ($r=-0.249$), and a negative correlation with unemployment rate ($r=-0.278$).

- d) The correlation between GDP and other variables suggests that GDP has a weak positive correlation with Inflation (0.019), a weak positive correlation with Unemployment (0.019), and no effect on Repo Rate, Reverse Repo Rate, Cash Reserve Ratio.
- e) Inflation shows a slight negative correlation with Unemployment (-0.014) while other variables are not affected.
- f) The Unemployment Rate does not have any influence or connection with other Variables.

4.3 Findings from Linear Regression

In order to analyze the influence of RBI tools on financial metrics, we utilized linear regression and have shared the collected findings.

Table 5: Linear Regression Findings

S.NO.	Impact Of Independent Variables	Impact Of Dependent Variables	Regression Equation
1	REPO RATE, REVERSE REPO RATE, CRR	GDP	$GDP=4.9019+1.4421(RR)-1.1373(RRR)-0.3505(CRR)$
2	REPO RATE, REVERSE REPO RATE, CRR	INFLATION	$INFLATION=4.01495+2.71192(RR)-2.69465(RRR)+0.03254(CRR)$
3	REPO RATE, REVERSE REPO RATE, CRR	UNEMPLOYMENT	$UNEMPLOYMENT=9.2288-0.9803(RR)+0.3919(RRR)+0.2145(CRR)$

Source:-Derived from the findings in R-studio

Explanations

a) Research on Financial Instruments (Repo Rate, Reverse Repo Rate, and CRR) and their impact on GDP shows that Repo rate boosts the GDP Growth rate, while Reverse Repo Rate and Cash Reserve Ratio (CRR) dampen the GDP Growth rate. Moreover, an increase in Repo rate has a positive impact on GDP growth by 1.44 times, while an increase in Reverse Repo Rate has a negative impact on GDP growth by -1.13 times, and an increase in Cash Reserve Ratio has a negative impact on GDP Growth rate by -0.35 times. The following equation represents the overall linear relationship between the independent variables Repo Rate, Reverse Repo Rate, and CRR, and the dependent variable GDP.

$$GDP=4.9019+1.4421(RR)-1.1373(RRR)-0.3505(CRR)$$

b) Research on the impact of Financial Instruments (Repo Rate, Reverse Repo Rate, and CRR) on Inflation shows that the Repo rate and Cash Reserve Ratio (CRR) have a positive effect on the Inflation rate, while the Reverse Repo Rate has a negative effect on the Inflation rate. Moreover, a one-unit increase in the Repo rate has a positive impact on inflation by 2.71 times, while a one-unit increase in the Cash Reserve Ratio has a positive impact on inflation by 0.03 times, and a one-unit increase in the Reverse Repo Rate has a negative impact on inflation by -2.69 times. The following is the general linear equation created using the independent variables Repo Rate, Reverse Repo Rate, and CRR and the dependent variable Inflation.

$$INFLATION=4.01495+2.71192(RR)-2.69465(RRR)+0.03254(CRR)$$

c) Research on Financial Instruments (Repo Rate, Reverse Repo Rate, and CRR) and Unemployment shows that the Reverse Repo rate and Cash Reserve Ratio (CRR) have a positive impact on the Unemployment rate, while the Repo Rate has a negative impact on the Unemployment rate.

Moreover, an increase in Reverse Repo rate positively impacts Unemployment by a factor of 0.39, while an increase in Cash Reserve Ratio positively impacts Unemployment by a factor of 0.21, and an increase in Repo Rate negatively impacts Unemployment by a factor of -0.98. The general linear equation involving independent variables Repo Rate, Reverse Repo Rate, and CRR and dependent variable Unemployment is presented below.

$$UNEMPLOYMENT=9.2288-0.9803(RR)+0.3919(RRR)+0.2145(CRR)$$

V. CONCLUSION

The decisions made by the RBI have had a small effect on the Indian economy. The economy of a nation is significantly influenced by the repo rate as it plays a crucial role in regulating the flow of cash in the market. The Indian monetary policy manages the repo rate based on market liquidity and inflation cash flow. Moreover, the repo rate has a direct impact on banks' access to borrowing funds. When the repo rate increases, banks can borrow less, leading to a decrease in industries' ability to produce and an increase in the cost of necessary goods and services, as well as higher unemployment rates. Repo rates play a crucial role in managing inflation within the country. If there is a significant increase in inflation, the RBI will likely increase the repo rate in order to decrease the circulation of currency in the market. A decrease in cash flow leads to a decrease in investment and manufacturing capacity, resulting in a decrease in the inflation rate. Commercial banks are advised to take loans from RBI because, on the flip side, RBI only lowers the repo rate when inflation decreases. The repo rates of RBI and the interest rates on loans from commercial banks are directly related. When the repo rates go up, loan interest rates also go up and vice versa. An increase in reverse repo rate leads to encouraging commercial banks to deposit more funds with the RBI, thus restricting the amount of

money available in the market. An increase in the reverse repo rate will lead to a decrease in the money supply, and the opposite is also true. India's growth rate has decreased due to an increase in Repo and Reverse Repo rates, leading to a rise in inflation and a drop in unemployment.

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