

Impact of Monetary Policy On the Profitability of Commercial Banks in India

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The study is conducted with a view to quantify the impact of various instruments of monetary policy on the profitability of commercial banks during the period 1960-84. The task has been accomplished with the help of step-wise multiple regression analysis. Further Beta co-efficients have been calculated to compare the relative impact of various policy measures. The reserve requirement ratio (cash reserve ratio and statutory liquidity ratio) has been found to be the most significant instrument of credit control having a negative impact on the banks' profitability. Although priority sector financing also had a negative impact but its magnitude was much less as compared to reserve ratio. The study makes a case for reducing the reserve requirement ratio to increase the diversion of funds towards industries which had a significantly positive impact on banks' profitability.

Monetary Policy refers to the use of certain instruments by the central bank to regulate the availability, cost and use of money and credit in the economy with a view to achieve a high rate of economic growth with price stability. The monetary policy operates mainly through the banking system to control and regulate the money supply in the economy. The Reserve Bank of India has been following an anti-inflationary credit policy ever since 1973. In the process, it has been putting severe restraints on the credit expansion of the commercial banks. As a result there has been a continuous rise in the statutorily pre-empted funds from about 28 per cent in 1970 to about 50 per cent in 1985. This affects the overall interest income of the banks negatively. Thus it has been hypothesised in the present study that monetary policy has been contributing negatively to the much talked about declining profitability of the commercial banks in India. An attempt has been made in the present study to measure quantitatively the impact of the various instruments of monetary policy on the profitability of commercial banks.