ISBN: 978-93-90847-43-3

11. An Analysis of Effectiveness of Monetary Policy of Reserve Bank of India

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Abstract:

The liquidity or the money supply in the economy is controlled by the **RBI**. The **RBI** decides on this **policy** after taking into consideration the current economic scenario and the future economic scenario of the country. **Monetary policy** in **India** is an adjunct of economic **policy.** It aims at controlling inflation by restraining the secondary expansion of credit and regulating the supply of money in order to meet the requirements of different sectors of the economy to accelerate the pace of economic growth.

The Monetary Policy Committee (MPC) constituted by the Central Government under Section 45ZB determines the policy interest rate required to achieve the inflation target.

The Reserve Bank's Monetary Policy Department (MPD) assists the MPC in formulating the monetary policy. Views of key stakeholders in the economy, and analytical work of the Reserve Bank contribute to the process for arriving at the decision on the policy repo rate.

Keywords:

RBI Monetary Policy, Price Stability, Growing Economy

11.1 Introduction:

The Reserve Bank of India Act, 1934 (RBI Act) was amended by the Finance Act, 2016, to provide a statutory and institutionalized framework for a, monetary policy committee for maintaining price stability, while keeping in mind the objective of growth. The Monetary Policy Committee is entrusted with the task of fixing the benchmark policy rate (repo rate) required to maintain inflation within the specified target level. As per the provisions of the RBI Act, three of the six Members of the Monetary Policy Committee will be from the RBI and the other three Members will be appointed by the Central Government.

The Government of India, in consultation with RBI, notified the 'Inflation Target' in the Gazette of India Extraordinary dated 5 August 2016 for the period beginning from the date of publication of the notification and ending on the March 31, 2021 as 4%. At the same time, lower and upper tolerance levels were notified to be 2% and 6% respectively. Inflation rate in 2020 is 6.2. The speaker started by talking about the RBI's perspective on the prevalent economic landscape in the country and highlighted some of the supervisory concerns it has on infrastructure funding by banks.

Amid slow growth and high inflation, the Indian economy had to contend with serious challenges to external stability emanating from an unsustainable high current account deficit (CAD), capital outflows and consequent exchange rate pressures over the last year.

Measures initiated by Reserve Bank and the Government of India have since helped stabilize the economy. Improved political stability, a firmer commitment to fiscal consolidation, stronger monetary policy framework and better policy implementation are expected to improve the GDP growth rate. RBI's macroeconomic outlook is one of steady disinflation with growth gaining momentum and improvement in macro-balances, particularly lower CAD on the back of commitment to fiscal consolidation. Growth-inflation trade-off in India is complex, particularly when inflation is above the threshold level. Hence, the belief in RBI is that monetary policy possibly cannot spur growth by tolerating higher inflation. It is important for India to ensure price stability as a necessary means to promote sustainable growth. RBI's developmental measures during the past year have revolved around five major themes: strengthening of the monetary policy framework; strengthening the existing banking structure through entry of new banks and licensing new banks with niche focus; broadening and deepening financial markets; promoting financial inclusion and improving the financial system's ability to deal with corporate distress and financial institution distress. RBI's resources are directed at fostering a competitive, vibrant and sound financial system for meeting the financing needs of a growing economy. There is a limitation on how much infrastructural capacity can a benevolent 'State' create without stretching its own financial or without burdening its citizens with high user charges. Hence, the pricing for using infrastructure services, which may be exclusively built by the private sector, in a public private partnership or exclusively by the public sector, assumes utmost importance for the viability of the projects service provider/operator are remunerative and based on commercial considerations.

Key Indicators	
Indicator	**Current Rate**
CRR	3%
SLR	18.00%
Repo Rate	4.40%
Reverse Repo Rate	3.75%
Marginal Standing Facility Rate	4.65%
Bank Rate	4.65%

11.2 Literature Review:

This article presents an analysis of the literature on monetary policy and equity volatility. The study analyzed and classified 67 articles that were published from between 2010 to end of 2017 in the databases Web of Science, Science Direct and Springer. The articles were identified using the keywords: ‘monetary policy’ and ‘equity market volatility’.

The prominence of reviewed literature is premised on: publication year, geographical/country location, methodology/data, unit of analysis, and statistical technique. Surprise or policy uncertainty was the most researched aspect whereas transparency of relevant monetary institutions and emerging economies received the least attention.

Through analysis and classification of the reviewed articles, it was possible to identify the existing gaps in the current literature on monetary policy and equity market volatility; thus, contributing to a future research agenda on the topic.

Furthermore, the study could add value to researchers or those working in monetary regulatory institutions and or capital markets; by providing a structured and quantitative.

The conduct of monetary policy has been engaging considerable attention in the context of the current slowdown in the Indian economy. From financial markets and industry, the case for easy monetary policy has been expressed in terms of lower interest rates.

With the upturn remaining elusive, an intellectual advocacy for monetary activism *via* monetization of the fiscal deficit has been gaining ground. It is argued that neither credit nor commodity markets in India are supply-constrained nor monetization of the fiscal deficit does not cause inflationary pressures when the economy is demand-constrained (Patnaik, 2001).

It is also pointed out that maximizing seignior-age revenues may, in fact, be optimal in a situation where the budget constraint is hard (Rakshit, 2000).

The revival of the call for monetary activism in India *via* the fiscal deficit is not new; indeed, it characterized the debate in the mid-1990s on some unpleasant monetarist arithmetic (Venkitaramanan, 1995) and why gentlemen prefer blonds (Moorthy, 1995).

Against the welling tide of arguments for monetary easing, it is important to take note of a near solitary view that interest rate reductions in India have gone too far and it is necessary to recognize the country's specific vulnerabilities while formulating monetary policy response (Tara-pore, 2001).

The debate remains unsettled, and it is plausible that as the economy continues to be bound by the inertial dynamics of the downturn, more heat would be generated. Monetary Policy is the policy which looks after the supply of money into the economy, keeps record of inflation and takes into account the economy’s growth. Central bank of a country conducts the monetary policy of that country.

Reserve Bank of India (RBI) is the central bank of India hence regulates the monetary policy of the country. RBI formulates implements and supervises all the functions of monetary policy. Indian Monetary Policy has seen many structural changes since independences. During early 1990s, the major monetary policy measures were

Cash Reserve Ratio (CRR) and Statutory Liquid Ratio (SLR).In case of India, it has been seen that the increase in inflationary pressure is mainly due to the money demanded by the central government to meet the budgetary deficit of the country.

If we talk about the recent development in monetary policy of India, we see that Monetary Policy Committee (MPC) has been constituted after the recommendation of Urjit Patel Committee in the year 2016.

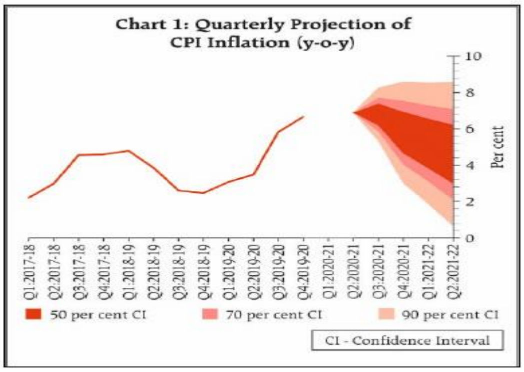
Objectives:

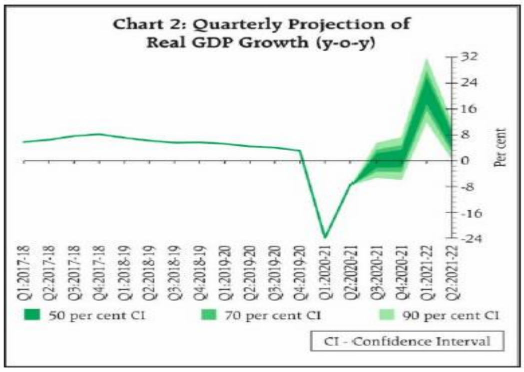
- To understand the effectiveness of monetary policy of RBI.
- To analyze economic growth through ensuring adequate availability of credit and lower cost of credit.
- To understand Easy availability of credit at low interest rate stimulates investment and thereby quickens economic growth.

11.3 Data Collection & Analysis: (Primary Data & Secondary):

The goals of monetary policy are to promote maximum employment, stable prices and moderate long-term interest rates.

By implementing effective monetary policy, the Fed can maintain stable prices, thereby supporting conditions for long-term **economic growth** and maximum employment.





The present system of data and information management in the Reserve Bank evolved over several years in response to the emerging needs of the Reserve Bank and to disseminate information as a 'public good'.

With increasing integration with the global economy and the growing complexity of the economic structure, the information needs have increased considerably and data gaps are being experienced in various domains of central banking.

To address the concerns about data gaps and to place the information management on a more technologically mature footing, the Committee on Data and Information Management set up by the Reserve Bank reviewed the current system of data collection, dissemination and management processes and examined the feasibility of moving towards granular, multi-purpose data collection and more integrated and structured data production processes.

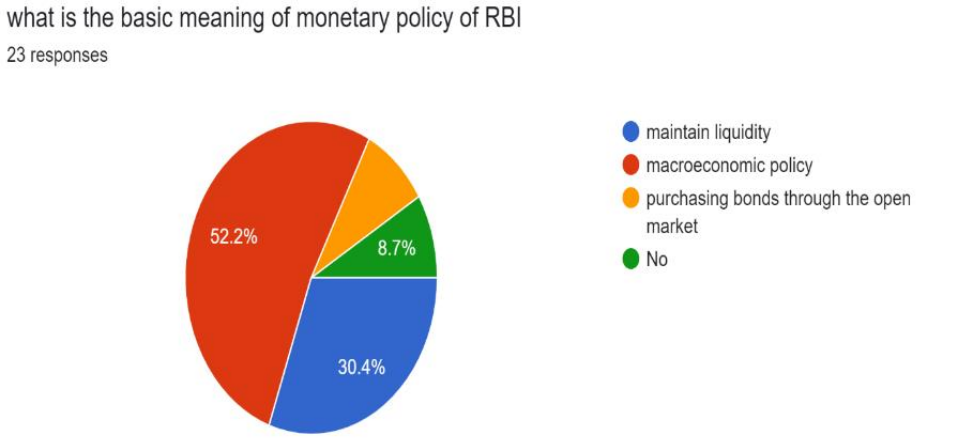
The Reserve Bank of India (RBI), which performs multiple functions ranging from monetary policy to regulation and supervision, requires a large variety of information to effectively discharge its responsibilities.

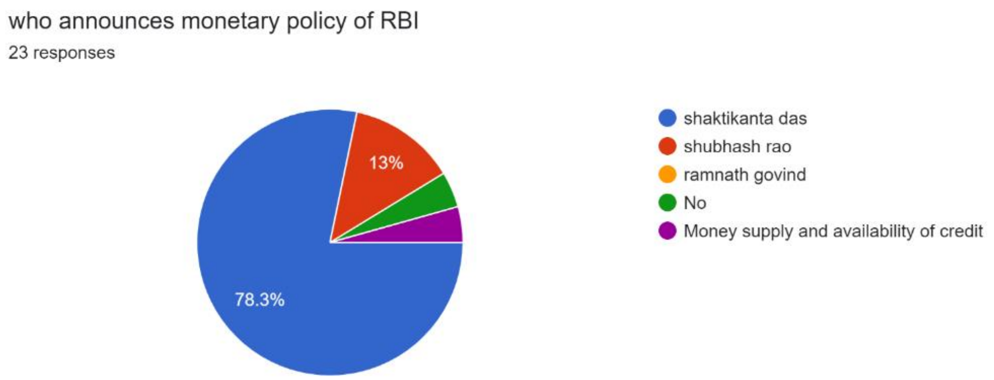
The present system of collecting, managing and utilizing information evolved over several years in response to the emerging needs of the Reserve Bank and with the objective of disseminating information as a 'public good'.

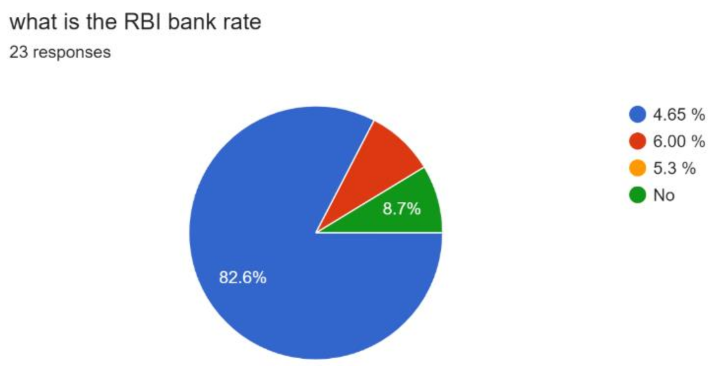
With increasing integration with the global economy and the growing complexity of the economic structure, the information needs have expanded considerably.

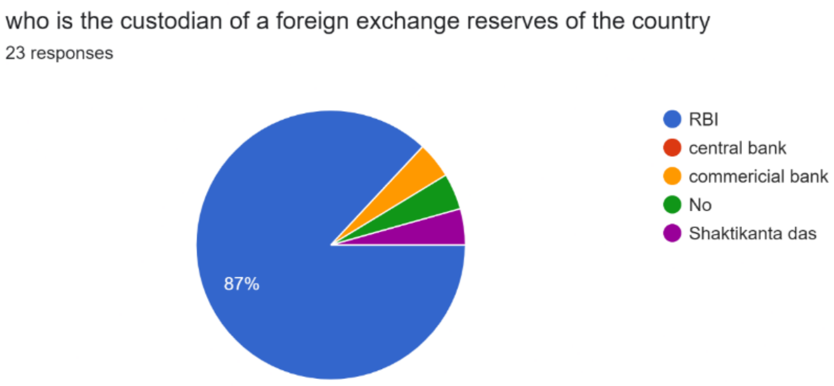
Therefore, gaps are being experienced in various domains of information required for policy formulation as also in efficient management of information.

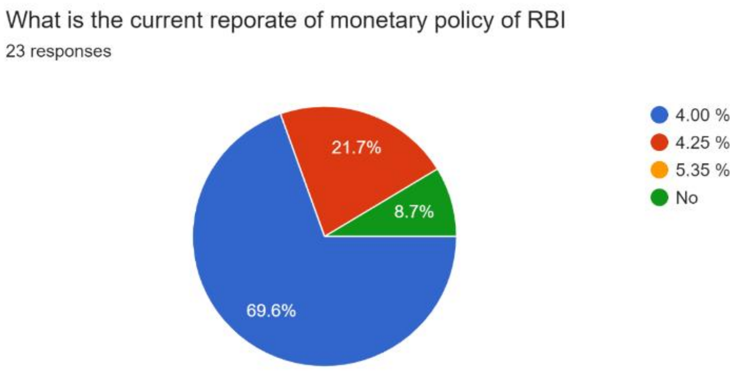
A Committee to comprehensively review the current system of data collection, dissemination and management and to examine the feasibility of moving towards granular, multi-purpose data collection and more integrated and structured data production processes. On the basis of Responses Collected from Society the analysis is shown below:











On the Bases of Primary data Collected from Society out of 23 people 52% are aware about the basic meaning of Monetary policy, 78% are aware about the Authority who announces RBI policy, 83% people are aware about the Current RBI Bank rate, 87% person know about the Custodian of a Foreign Exchange reserve of Country and 70% are aware about the Repo rate of RBI.

11.4 Conclusion:

You should by now have realized that in a small open economy with flexible exchange rates, monetary policy is extremely effective. Equilibrium is determined at the intersection of the LM curve and the line at the interest rate determined by world market conditions. If that intersection is at a level of output and income below full employment, the level of income and employment can be increased to the full-employment level by having the country's monetary authority simply expand the money supply.

As the LM shifts to the right towards a full-employment equilibrium, the IS curve will follow it automatically as a result of a devaluation of the real and nominal exchange rates as domestic residents create an incipient balance of payments surplus by attempting to rebalance their portfolios by purchasing non-monetary assets from foreigners. The devaluation expands output, shifting the IS curve to the right by shifting world demand onto domestic goods.

In the long run under full-employment conditions the authorities, by adjusting the rate of monetary growth, control the domestic inflation rate. If inflation is too high the solution, which is not without cost, is to reduce the rate of money growth.

This will shift the LM curve to the left, lead to an appreciation of the domestic real and nominal exchange rates and temporarily reduce the level of output and income below full-employment levels. Eventually the rate of growth of the price level will decline---its long-run rate of increase can be eventually reduced to a satisfactory level. At that point the LM and IS curves will both be shifting to the right in each period by an amount equal to the rightward shift of the levels of full-employment output and income. The nominal exchange rate will be rising or falling through time at a rate consistent with the new equilibrium domestic inflation rate together with any rate of change through time in the full-employment equilibrium real exchange rate as the economy grows through time. You should now understand the above analysis by simply drawing the appropriate graphs in your mind or perhaps on a sheet of paper. If you need help along this line, simply click on and print out and for your reference. If you cannot draw the appropriate graphs on your own to analyse the above issues, you need to return to the beginning of this lesson and work through it again!

11.5 References:

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