IJCRT.ORG ISSN : 2320-2882

INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

THE IMPACT OF MONETARY POLICY ON INDIAN ECONOMY

L.Madhu[1], M Archana[2], Manoj Kumar K[3] ,Meghana Varma C[4] ,Mariam Fathima Ali[5], Dr. Mansi Kukreja[6]

1,2,3,4,5 MBA Student, 6 Professor, CMS Business School, JAIN (Deemed-to-be University), Bengaluru, India.

ABSTRACT

Long-term and short-term growth are equally impacted by monetary policy. In this study, the examination of monetary policy and its effects on the Indian economy are the main topics. The central bank monitors the amount of money supply in an effort to maintain price stability. As a dependent variable, the study uses the gross domestic product (GDP), whereas the independent variables are the repo rate, reverse repo rate, unemployment, foreign direct investment, and inflation.

These variables were used to demonstrate how completely dependent they are on a country's economy. The GDP calculation used different inputs. The study's goals are to evaluate the efficiency of Indian monetary policy and the effects of particular financial instruments on the domestic economy.

Keywords: monetary policy, gross domestic product **(**GDP), repo rate, reverse repo rate, unemployment, foreign direct investment, and inflation.

INTRODUCTION

It is critical to comprehend how the Reserve Bank of India (RBI) manages monetary policy. The central bank must implement monetary policy in order to manage the supply and demand for money in the economy in order to achieve particular macroeconomic goals including price stability, economic growth, and employment.

The impact of monetary policy on the Indian economy can be seen in the following ways:

- In order to control the amount of money in the economy, the RBI employs a variety of monetary policy tools, including open market operations, the bank rate, the repo rate, and reverse repo rate, the cash reserve ratio (CRR), and the statutory liquidity ratio (SLR). For instance, if the CRR or SLR were lowered, more money could be released into the banking system, increasing the money supply. These rates can be raised, though, if it intends to decrease the money supply.
- Price stability: The main objective of the RBI's monetary policy is to maintain price stability or control. By controlling the money supply, which can lead to inflationary pressure, the RBI can lower excessive demand. The RBI recently established a 4% inflation target with a +/- 2% tolerance zone.
- Exchange rate: The value of the Indian rupee can also be influenced by monetary policy. A higher interest rate in India may attract foreign investment, which could strengthen the rupee, but a stronger rupee could be bad for Indian exporters because their goods would cost more outside.
- Economic expansion: Another crucial element in supporting economic growth is monetary policy. By cutting borrowing costs and providing affordable credit, the RBI may promote investment and

consumption, which would in turn boost economic activity. However, inflation and other macroeconomic imbalances can also result from an overly expansionary monetary policy.

The RBI's monetary policy also has a substantial impact on interest rates, currency exchange rates, economic stability, and price stability, all of which have an impact on the Indian economy. Although the RBI has accomplished these objectives, there are still a number of challenges it must overcome, such as balancing growth and inflation, managing external shocks, and maintaining financial stability.

LITERATURE REVIEW

For many years, the effect of monetary policy on the Indian economy has been discussed in economics literature. The role and efficacy of monetary policy in accomplishing macroeconomic goals including price stability, economic growth, and employment have been the subject of countless research by academics. Some of the major discoveries and arguments on this subject are highlighted in this literature review.

Chand and Pramanik (2014) came to the conclusion that India's economic development was not much impacted by monetary policy over the long run. Furthermore, the authors contend that a number of additional elements, including fiscal policy, outside shocks, and political stability, had a more profound impact on the nation's economic growth.

Other academics, however, have demonstrated the importance of monetary policy in containing inflation. For instance, a study by Anand and Mishra (2010) revealed that the Reserve Bank of India's tightening of its monetary policy had reduced inflation in India.

Additionally, Shallu and Abhishek (2020) recently conducted a study to assess the efficacy of India's monetary policy. While monetary policy had a part to play in macroeconomic management, the study found that it was insufficient to address the problems the Indian economy was facing, particularly those relating to the financial system and the struggles of the regulated financial institutions.

In addition, Kalyanaraman and Manjunatha's (2018) research looked at the connection between monetary policy and the value of the Indian rupee. According to the authors, changes in monetary policy caused volatility in the value of the Indian rupee, which had an impact on trade competitiveness and foreign exchange holdings.

Sahoo and Sahoo (2016) also investigated the monetary policy and macroeconomic performance of the Reserve Bank of India. According to the study, monetary policy was crucial in preserving price stability, supporting economic growth, and successfully addressing various macroeconomic imbalances including inflation.

In last, these studies demonstrate that the influence of monetary policy on the Indian economy has multiple dimensions and is the subject of various degrees of analysis by various academics. While it appears that monetary policy plays a significant role in India's efforts to control inflation and maintain price stability, various discussions tend to centre on the usefulness and effectiveness of monetary policy as a macroeconomic tool, particularly when it comes to achieving more comprehensive, long-term goals.

OBJECTIVE TO STUDY

1. The primary objective of monetary policy is full employment.

2. Price stability: Stabilising the price level is the other goal of the strategy. The economy becomes uncertain and unstable as a result of price swings.

3. Economic growth: This is the process by which a nation's actual per capita income rises steadily over time.

4. Balance of Payments: To keep the balance of payments in balance.

Research Methodology

The central bank implements monetary policy to maintain economic stability, keep unemployment low, safeguard the value of the currency, and promote economic growth. A central bank can change the rates of borrowing, spending, and saving through adjusting interest rates, reserve requirements, or through open market operations.

By changing the amount of money availability, central banks modify their monetary policy. Typically, they do this by buying or selling securities through the open market. Short-term interest rates are impacted by open market operations, which in turn affect longer-term rates and the economy.

Credit rationing, consumer credit regulation, guidelines, margin requirements, and moral persuasion are some of the qualitative weapons of monetary policy.

Open Market Operations, Bank Rate, Repo Rate, Reverse Repo Rate, Cash Reserve Ratio, Statutory Liquidity Ratio, Marginal Standing Facility, and Liquidity Adjustment Facility (LAF) are all included in the list of quantitative instruments.

Studying the effects of monetary policy requires the use of secondary data. For the study, a variety of resources from the RBI website and other journals were used to pursue a major.

The factors that determine how well monetary policy achieves price stability were identified. The country's GDP growth comes first, and other factors that affect it include the inflation rate, unemployment rate, foreign direct investment (FDI), and changes in the money supply.

Using a flow-of-funds methodology, Manohar Rao (1999) examined both the real and monetary aspects of short-run structural adjustment. It then lays forth an empirical framework based on such a structure.

Framework that may integrate the Bank's strategy for meeting financial requirements with the Fund's financial programming model in a way that does away with the current divisions between the real and financial sectors of the economy. The realistic stabilisation policy choices for the Indian economy for the current fiscal year are then suggested using the integrated model, which establishes the balance of the monetary, external, real, and financial sectors.

Manohar Rao (2000) assessed two key problems. First, an assessment of the two-way interactions between business cycles and exchange rates is made: first by looking at some of the primary determinants of exchange rates, followed by consideration of the contribution of currency rates to the stabilisation of business cycles. Second, by formalising the fundamental linkages between the primary macroeconomic variables, the study provides an analytical framework that, among other things, aids in forecasting the exchange rate in the Indian context.

In his 2002 book, George Macesich described how money functions in a country's economy and what monetary regimes produce. When it comes to money, the central bank and the ministry of finance share power and authority. The author also provides fascinating historical histories of the rules versus discretion dispute.

According to Reddy (2002), in order to increase the effectiveness of the Reserve Bank's money market operations through the Liquidity Adjustment Facility, the automatic availability of the RBI refinancing facility to banks must also be reviewed. Therefore, refinancing facilities may be scaled back or completely eliminated, and access to the non-collateral call money market may be restricted as the CRR is decreased and the repo market grows in order to increase the effectiveness of monetary policy behaviour.

Monetary policy should react to changes in asset prices and/or financial imbalances beyond their impact on the forecast for inflation, according to a 2003 study by the Bank for International Settlements. The study comes to the conclusion that, even if monetary officials are probably aware of these tendencies, the macroeconomic effects can be properly addressed within an accommodating and prospective formulation of inflation targets. In 2003, Robert Nobay and David Peel examined the best monetary policy, which they defined as a central bank using an asymmetric objective function. Numerous conclusions on the time consistency issue need not hold under asymmetric preferences, according to the findings. They investigated

the effects of the central bank having an asymmetric loss function for the best discretionary strategy in this research.

When evaluating the stance of monetary policy and shifting monetary conditions, Kannan et al. (2006) attempted to create a Monetary Condition Index (MCI) for India that simultaneously takes into account interest rate and exchange rate networks.

According to their research, interest rates have a greater influence on India's monetary conditions than exchange rates.

(2010) Deepak Mohanty highlighted the world financial crisis and how India's monetary policy responded. The current emphasis is shifting from crisis management to recovery management both globally and in India. By lowering the liquidity overhang without endangering the growth process, RBI measures can now, in his opinion, help anchor inflationary expectations. Market liquidity is still at a comfortable level.

Research Design:

The study examined five variables—one of which was a dependent variable, and the other four were independent—to examine the effect of monetary policy on the Indian economy.

Dependent variables -GDP (gross domestic product)

Independent variables- Inflation, Foreign Direct Investment, Unemployment Rate, Policy Rates.

Type of Research- Empirical research is used for analysing the data.

Methods of Data Collection- Secondary-based research, RBI Bulletin, RBI Occasional Articles, RBI Annual Reports, Currency and Finance Report, Economic Survey, Economic and Political Weekly (EPW), Finance and Growth, Economic Diary, The Hindu, ICSSR, Economic Times, IMF Report, Indian Economic Journal, Financial Express, World Bank Reports and Internet, etc. used to collect data.

Data analysis

Gross domestic product:

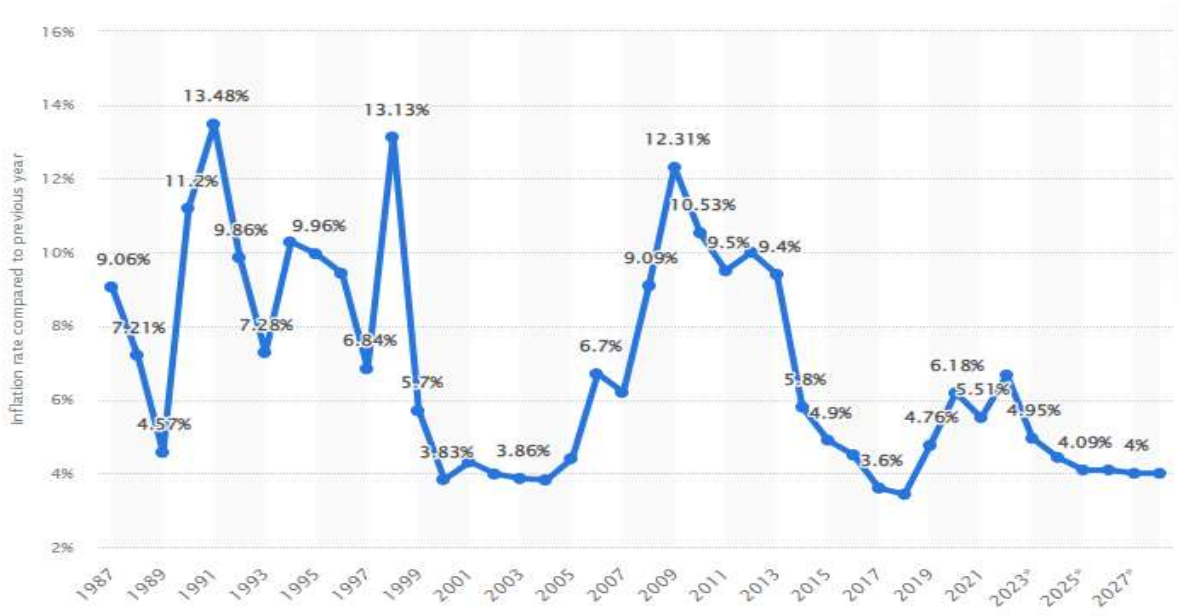
Due to significant capital inflows, the GDP growth rate increased to 8.59% in 2009–10 and 8.91% in 2010–11 after falling to 6.72% in 2008–09 as a result of the global financial crisis. However, because of a domestic policy impasse and tax disagreements, it fell to 6.69% in 2011–12, 4.47% in 2012–13, and 4.74% in 2013–14.

The Index of Industrial Production (IIP) for India has decreased, going from 5.6% YoY in June 2014 to 2.95% in the June 2019 quarter. Since the demonetization, IIP has decreased by 1.54%. Due to low revenue, India's budget deficit is expected to increase to 3.6% of GDP this fiscal year from 3.4% previously.

Inflation:

Between 2005 and 2010, wholesale prices of all goods increased by around 38%, but the cost of food increased by more than 77%. Vegetable prices have increased by 101%, while milk, eggs, meat, and fish prices have increased by 80%. The country saw the worst food inflation in 2009–2010, which was a substantial contributor to overall inflation.

As the price of onions, potatoes, and wheat dropped, the increase in the price of other items slowed on the back of a good monsoon, resulting in a sharp drop in food inflation in India from 8% to 4.3% for the week ended December 2015. Over the past four weeks, inflation has dramatically decreased. For the week ending November 2012, it had decreased to just one digit from 12.21%.



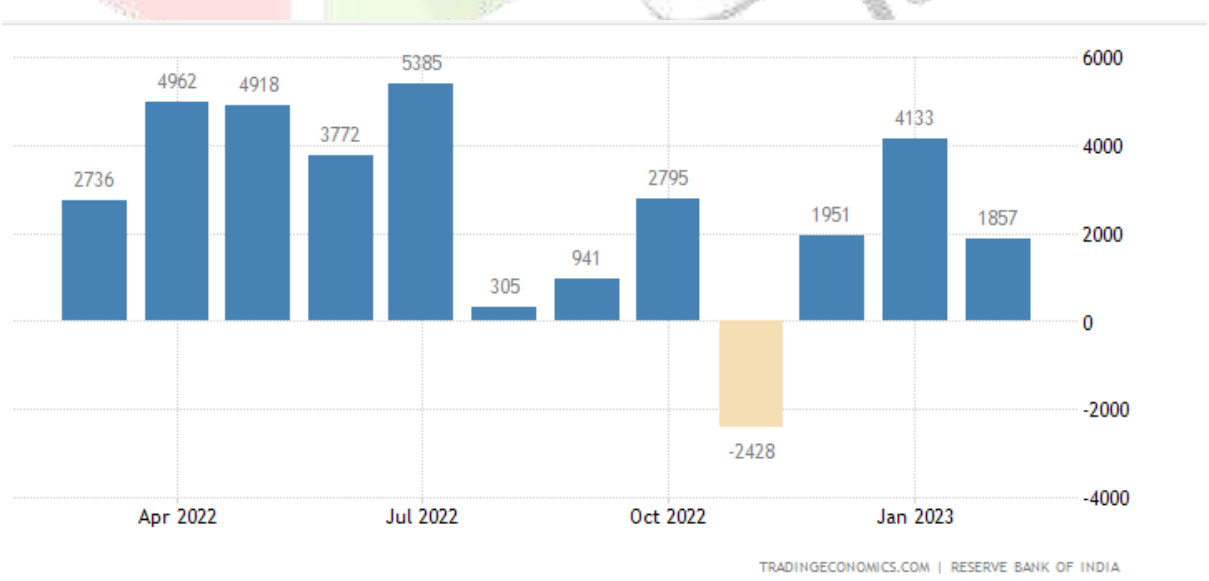
(SOURCE: STATISTA 2023) India: Inflation rate from 1987 to 2028

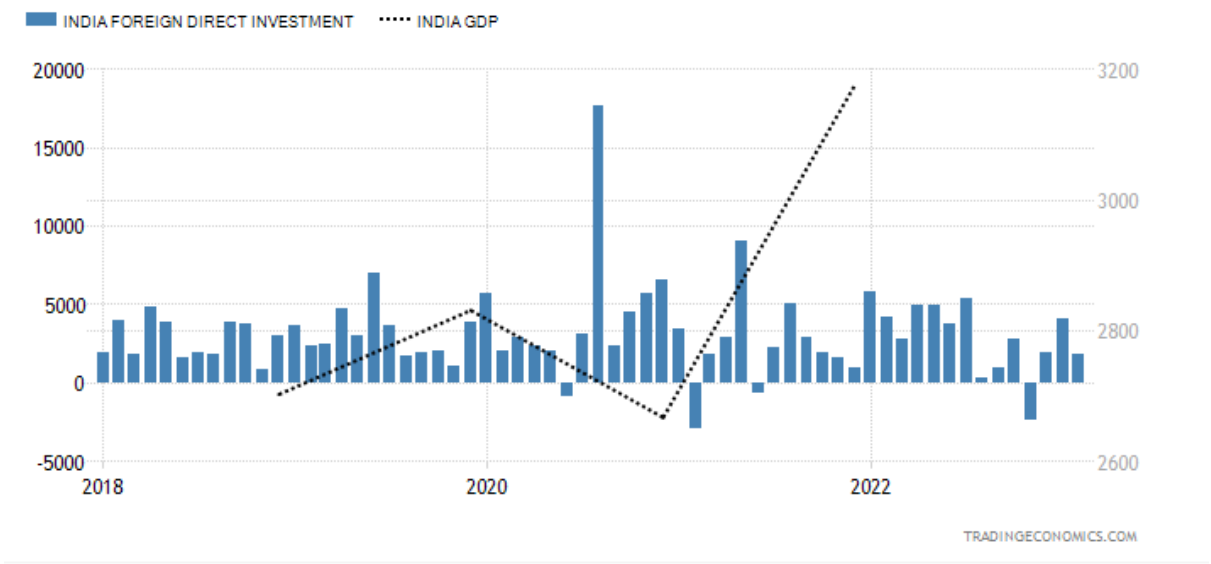
The graph clearly shows how the inflation rate has changed over time. The inflation rate was rather high in several years, such as 1995 and 2007, hitting 13.48% and 12.31%, respectively. Other years, including 2015 and 2025, had comparatively low inflation rates, at about 3.86% and 4.4%, respectively. Additionally, the graph illustrates by horizontal lines that there have been years where the inflation rate was the same as the year before. For instance, the horizontal line indicates that the inflation rate in 2008 was 9.09%, which was the same as the rate in the prior year.

FDI:

In 2009, FDI decreased by 35.6%, while in 2010, it decreased by 6.75%.The Indian economy experienced its slowest growth (GDP fell to 5.5) and struggled with risks related to high inflation as a result. As a result, investor confidence was impacted, and FDI inflows to India significantly decreased. In 2011, FDI increased by 31.56%, and it did so again in 2012.

But after 2013, it continued to rise until 2016, and the MAKE IN INDIA campaign was what caused it. From 2013 to 2016, FDI surged in India by 91%.



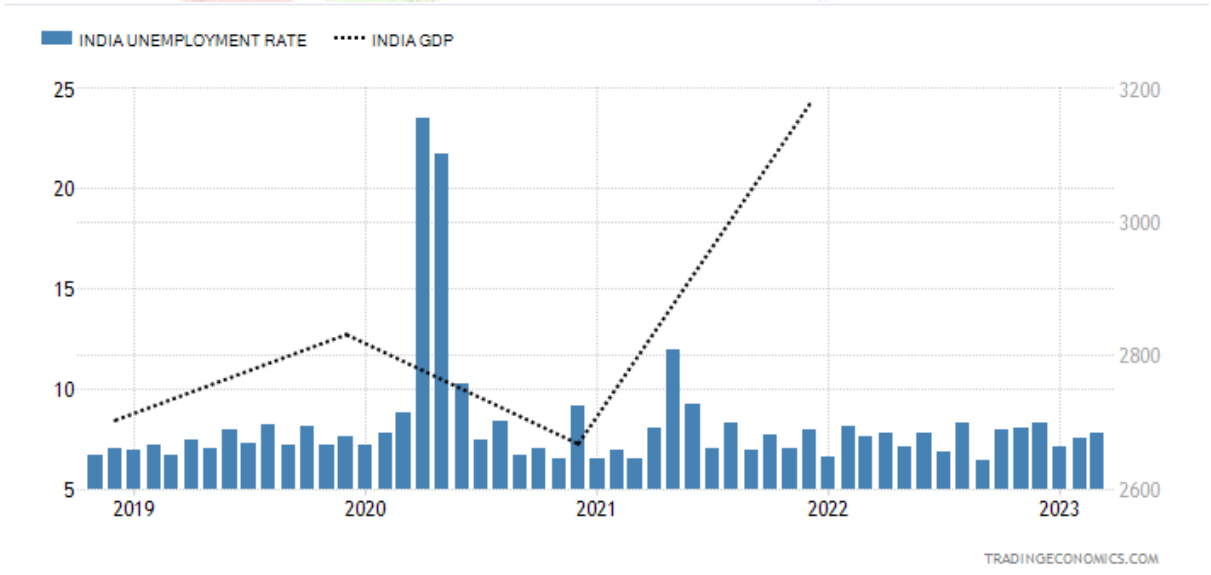


The graph shows that, with a few changes throughout the years, FDI inflows into India have been rising gradually. The amount of FDI inflows, which ranged from $2 billion to $5 billion from 1995 to 2003, remained very modest. Even Nevertheless, there have been sporadic decreases in FDI inflows into India since 2004, with a peak of almost $81 billion in 2021. The graph also demonstrates that there have been some years, like 2008 and 2020, where FDI inflows have decreased relative to the prior year. This may be because of a number of factors, including the state of the global economy, modifications to governmental regulations, or difficulties unique to a given sector of the economy.

Overall, the graph shows that India has grown to be a more alluring location for FDI over time, with higher FDI inflows, which may have favourable effects on economic expansion, job creation, and technology transfer.

Unemployment Rate:

The financial crisis began in 2008, and when the economy stabilises in 2009, employment rates also start to rise. Later, a poor monsoon season caused a decline in employment, with the employment rate falling to 3.54 in 2010 and 2011. The year when there is sporadic employment is 2012. Then, FDI is started in India, which increases employment opportunities and raises the employment rate to 6.1 in 2018.



The unemployment rate in India in 2021 was 5.98%, down 2.02% from the previous year. The unemployment rate in India for 2020 was 8.00%, up 2.73% from the previous year. The unemployment rate in India for 2019 was 5.27%, down 0.06% from 2018.In 2018, India's unemployment rate dropped by 0.03% from the previous year to 5.33%.

Policy Rate:

Reverse and Repo Rate When the economy enters a recession in 2008, the repo rate is 8 and 14, respectively, and the Indian government decides to control the economy by lowering the rates to 5.8 and 9.8 in 2009. Following that, it changed to 6 and 10.2, and this pattern persisted through 2012. In 2012, the rates were 8.2 and 16, and in 2013, they were 7.1 and 13.8. Then, in 2017, it was 6 and 11, and since the economy was already struggling due to Demonetization and the implementation of GST, the government decided to raise the rates once more. As a result, rates didn't change.

Interpretation:

We can see the policy rate for each month's end in the graph above. The repo rate is 4000 in April 2022 and 4400 in May 2022. In contrast, the repo rate stays the same in June and July 2022 at 4900 and then rises to 5400 in August 2022. Later, the repo rate is 5900 in September, October, and November 2022 before rising to 6250 in December 2022 and January 2023. It rises to 6500 once more in February and March of 2023. Through this analysis we can see a growth in repo rate in the economy. To combat inflation, a nation's central bank—in India, the RBI—raises the repo rate.In Mar 2023, the India cash rate (Policy Rate: Month End: Repo Rate) was set at 6.50% pa, up from 6.50% pa in Feb 2023.From April 2001 to March 2023, the India Policy Rate, which is revised monthly, had an average annual rate of 6.50%.The statistics peaked in Sep 2008 at 9.00% pa and fell to a record low in Apr 2022 at 4.00% pa.Recent reports on India's short-term interest rate indicate that: India's MIBOR over the last three months was 7.44% per annum in March 2023.Government Securities Yield: 10 Years declared its Long Term Interest Rate as 7.44% pa in October 2022.In March 2023, the USD/INR exchange rate for India was 82.27 on average. In February 2023, the Real Effective Exchange Rate was 109.28.

Results

To give a sneak peek at the findings, it was discovered that there is solid evidence that monetary policy consistently has negative effects on a nation's competitiveness, which is represented in a fall in the unemployment rate. The study comes to the conclusion that both short- and long-term monetary policy affects growth. The appraisal of monetary policy and its effects on the Indian economy are the main topics of this study.As a dependent variable, the study uses the gross domestic product (GDP), whereas the independent variables are the repo rate, reverse repo rate, unemployment, foreign direct investment, and inflation. Using these variables, we discovered that a country's economy completely depends on these elements. In 2008, the global financial crisis shook the Indian economy. The policy rates of the central banks were cut to historic lows. Despite a fiscal deficit, the economy expanded in 2010–11 and subsequent years. The two political giants, the BJP and the Congress, have a significant impact on the economic as well as political turmoil. We

saw the economy change while both political parties were in power. The GDP calculation used different inputs. Demonetization, which took place in the nation in 2016, has had an effect on the Indian economy. After 2014, India's fiscal deficit increased each subsequent year.

CONCLUSION

All the many elements that affect the health of the Indian economy are combined to form India's GDP. The GDP of India gives us a comprehensive assessment on the performance of the Indian economy. The "Cost Factor" or "Real Price" techniques are the two methods for calculating the Indian GDP. The main cause of India's GDP development following and up until the 1990s was the economy's opening up. Markets were opened up, and the government used private capital as leverage. More money has since flooded the markets. Monetary policy laws can be either active or passive. The passive rule, which maintains a constant flow of capital, is similar to Milton Friedman's money growth rule. The second, referred to as the rule of price stability, is that in reaction to increases in overall supply or demand, the money supply should be adjusted to keep prices steady. The idea of active regulation is to keep inflation and the price level under control. Our monetary policy is dominated by this Indian law. Healthy advancement is a development that is stable.

REFERENCES

1. Chand, S. K., & Pramanik, A. (2014). Monetary Policy and Macroeconomic Performance in India: An Empirical Assessment. International Journal of Economics and Finance, 6(4), 210-222.

2. Anand, R., & Mishra, P. (2010). Inflation Targeting, Monetary Policy, and Inflation Expectations: Evidence from Indian Household-level Data. Journal of Asian Economics, 21(3), 237-254.

3. Shallu & Abhishek (2020). Effectiveness of Monetary Policy in India: An Exploratory Study. The international Journal of Applied Business and Economic Research, 18(5), 525-534.

4. Kalyanaraman, A., & Manjunatha, T. A. (2018). Monetary Policy and the Exchange Rate of Indian Rupee: An Empirical Investigation. International Journal of Economics, Commerce and Management, 6(12), 1-10.

5. Sahoo, S. K., & Sahoo, B. K. (2016). Monetary Policy and Macroeconomic Performance in India: An Empirical Analysis. Eurasian Journal of Business Economics, 9(17), 125-145.