IJCSE International Journal of Computer Sciences and Engineering Open Access
Review Paper Vol.6, Special Issue.9, Nov 2018 E-ISSN: 2347-2693

How Effective Monetry Policy Signals Inflation in Indian Economy?

P. Ganguly[1*], R. Gunwani[2]

[1]Dept. of Management, Aryabhatta College of Management, Rajasthan Technical University, Ajmer, India
[2]Masters of Business Administration, Aryabhatta College of Management, Rajasthan Technical University, Ajmer, India

[*]*Corresponding Author* pallaviganguly9123@gmail.com, *Mob.: 8209945559*

Available online at: www.ijcseonline.org

***Abstract*—**The regulating mechanism of monetary policy plays an important role in the Indian economy as it conveys the central bank's valuation and its future outlook to the general public. Inflation measurement is fundamental to the conduct of monetary policy. In every country government takes some actions in Economic field that cover the systems for setting Interest Rates & Government Budget as well as labor market, National ownership & many other areas of government interventions into the Economy. Such policies are often influenced by International Institutions like IMF or World Bank as well as political beliefs & consequent policies of parties. This paper concludes all about how monetary policy help to regulate inflation in Indian economy and it also shows how changes are made to hook the instability occurred in recent development of the country due to inflation. In this paper we will also study whether the monetary policy really a helpful technique in signaling Inflation in country like India or not?

***Keywords*—** RBI (Reserve Bank of India), CRR (Cash Reserve Ratio), SLR (Statutory Reserve Ratio), Inflation, Money Supply

I. INTRODUCTION

India, monetary policy of the Reserve Bank of India is aimed at managing the quantity of money in economy in order to meet the financial requirements of different sectors of the economy and to increase the pace of economic growth. Monetary Policy is the series of operations by which the monetary authority of India the Reserve bank of India (Central Bank) manage money supply in our economy. Monetary policy is how central bank manage liquidity to create economic growth where liquidity means availability of money in economy.

There are various monetary policy tools that are used by RBI to control inflation such as open market operations, bank rate policy, reserve system, credit control policy, moral persuasion and through many other instruments. Using any of above instruments will lead impact on the money supply in the economy.

Classification of Monetary Policy

Monetary policy can be expansionary and contractionary in nature-

Contractionary Monetary Policy-The Monetary Policy which aims at contracting or bringing down the money supply in the economy. The RBI increases the interest rates in the economy which ultimately reduces the purchasing power of people in the economy.

Expansionary Monetary Policy-The Monetary policy aims at expanding the money supply in the economy that is the money supply in the economy is increased. The RBI decrease the interest rate which ultimately increases the purchasing power of people in the economy.

Tools of Monetary Policy

There are some tools of monetary policy which can be used to measure the level of inflation in the economy-

Open Market Operations:-Open Market Operations refers to buying and selling of government securities and bonds by central bank to general public and bank.In case of inflation the RBI sale the securities to general public and banks.In case of deflation the RBI buys the securities from general public and banks.

CRR :- It is the ratio of bank deposit that commercial bank has to keep with the central bank .In case of inflation the RBI increases the CRR.In case of deflation the RBI decreases the CRR which results in increase the bank's excess and thus increases the ability to give credit.

SLR :- Every bank is required to maintain a fixed percentage of its assets in the form of cash or other liquid assets called SLR.In case of inflation the RBI increases the SLR , which results in reducing the bank excess reserve which leads to restrict the ability of bank to give credit .In case of deflation the RBI decrease the SLR which results in increasing the bank's excess reserve and thus results in increase the ability of bank to give credit.

Repo Rate :- Repo Rate is the rate which the central bank of our country give money to commercial bank in case of shortfall of funds. Repo rate is basically used to control the inflation in the economy.

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Reverse Repo Rate :- Reverse Repo Rate is the rate at which central bank of our country borrow money from the commercial bank. It is basically used to control the money supply from the economy.

Bank Rate:-Bank Rate is the rate charged by RBI for lending funds to the commercial banks.In case of inflation the RBI increases the bank rate in order to control the inflation. In case of deflation the RBI decreases the bank rate in order to overcome the problem of deflation from the economy.

II. OBJECTIVE OF THE STUDY

- To show how monetary policy effectively signals inflation in Indian economy.
- To determine the relationship between monetary policy and inflation.
- To understand the present economic scenario of monetary policy which help us to understand the problem of inflation faced by the Indian economy
- To show that how RBI signals the problem of inflation in Indian economy.

III. LITERATURE REVIEW

Ben S. Bernanke and Frederic S. Mishkin ('Spring 1997') His conclusion is based on the discussion on his given article which emphasis that the new strategy for monetary policy which is literally known as"Inflating Targeting", is highly flamed up in recent years. This article emphasis that inflating targeting is a policy that features an increased communication with the people about plans and policies of monetary policy maker like Central Bank in any country.

John H.Boyd, Ross Levine and Bruce D. Smith(P. February 2000) The evidence discussed in this paper specified that there is a negative relationship between inflation and both banking sector evolution and equity market activity. This paper focused on both positive and negative impact on inflation on financial sector performance of economy.

IV. DATA ANALYSIS, RESULTS AND DISCUSSIONS

The below table showing all the current policy rates of all the instruments of monetary policy by RBI for the year 2018-19.

Table 1: Policy Rates as per recent RBI statistics release

S.NO	RATES	PERCENTAGE
1.	CRR	4%
2.	SLR	19.5%
3.	REPO RATE	6.50%
4.	REVERSE REPO RATE	6.25%
5.	BANK RATE	6.75%

The RBI releases their monetary policy rates twice in a year. These rate technically impact on every aspect of our Indian economy.

For instance, liquidity is important for an economy to spur growth. To maintain liquidity, the RBI is dependent on the monetary policy. By purchasing bonds through open market operations, the RBI introduces money in the system and reduces the interest rate.

There are certain tools available which are used to control or regulate the monetary policy of our economy. The tools are basically used by RBI or central bank to regulate the cost of money supply in the economy.

Relationship between Monetary policy and Inflation

The research paper is conducted on the secondary data. The data shows that there is direct relationship between the monetary policy and inflation. The basic reasons behind this are as follows-

Retail Based Inflation is very high in the economy- The consumer goods and services has seen an increased in their price, due to increase in money supply in the market which leads to the problem of retail base inflation in the economy.

Reduce in the money supply by US government-As a result of dearer monetary policy in US. The money supply in the Indian economy is decreases due to appreciation of dollar in the US economy. The decrease in the money supply means there is more demand of rupees in Indian economy in the economy, but the supply of money is less due to depreciate the value of rupees which leads to reduction of credit availability of loans in the economy.

Cost push factors and Demand pull factors

Cost Push Factors- These factors leads to increase in the price of commodity due to increase in the cost of production. And which leads to decrease in the supply of commodity in the market.

Demand Pull Factors- This indicates that when the aggregate demand is more than the aggregate supply then the price of good tends to increase. The reasons for demand pull inflation is the increase in hike of MSP for farmers in rural areas which leads to high income and which results in increase in their purchasing power of farmers. So increased purchasing power leads to increase in demand and which leads to demand pull inflation.

How does RBI controls Inflation in India?

One popular method of controlling inflation is through a contractionary monetary policy. In India its carried out by Monetary Policy Committee headed by the RBI Governor. The goal of a contractionary monetary policy is to reduce the money supply within an economy by decreasing bond prices and increasing interest rates. This helps reduce spending because when there is less money to go around, those who have money want to keep it and save it, instead of spending it. It also means that there is less available credit, which can also reduce spending. Reducing spending is important during inflation, because it helps halt economic growth and, in turn,

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the rate of inflation. The repo rates, reverse repo rates etc are tools of monetary policy.
Thus, primary aim of central bank is to control inflation and secondary is to increase economic growth.

V. CONCLUSION

Economic Growth and inflation are directly proportional to each other. Increased in money supply thus resulted in increase the inflation. And decrease of money supply decrease the inflation. Monetary policies are the policies which are created and implemented by RBI to control or signals the problem of inflation in the economy. and this can be done by increasing the interest rates which ultimately brings down the purchasing power of people and reduce the problem of inflation. So if country seeing low inflation the RBI decreases the interest rates, to increase the economic growth. On the other part if the country face high inflation, then RBI increases the interest rates to reduce the money supply and inflation.

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Authors Profile

Ms. Pallavi Ganguly, HOD of Management Department is associated with Aryabhatta College of Management, Ajmer since 2013 as a Faculty of Management Studies. She is MBA in Finance from Rajasthan Technical University, Kota and pursuing her PhD in Finance. She looks after all departmental administrative works. She has guided around 50 minor projects of management students of BBA and MBA.

She has also attended various workshops and organized by different colleges of Ajmer. She has organized various departmental even ts like management quiz, seminars, expert lectures etc. Her research interest and teaching includes Finance, Banking, Accounting, Marketing, Statistics and other allied subjects.

Ms. Rajni Gunwani has pursued his Bachelors in computer Applications from Aryan International College, and Currently She is pursuing her Masters in Business Administration from Aryabhatta College of Management, Affiliated To Rajasthan Technical University. Recently she has completed his Internship from Anand Rathi Shares and Stock Broker Ltd, Ahmadabad in the area of Human Resources, The topic of Internship report was “Best HR Practices in Service Industry”. Where she get the knowledge of all key working area of an HR Manager i.e. Recruitment, selection, Payroll, Performance Management and many more.

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