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MONETARY POLICY: IMPACT ON ECONOMY

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ABSTRACT

Monetary policy consists of the actions of a financial institution or other regulatory committee that determine the scale and rate of growth of cash supply, which successively affects interest rates. Monetary policy is maintained by modifying the interest rates, buying or selling government bonds, and changing the quantity of cash which banks are required to stay in the vault (Bank reserve). By monetary policy, we mean the policy concerned with changes in the supply of cash. Monetary policy can either be expansionary policy or a contractionary policy, where an expansionary policy increases the full supply of cash in the economy, contractionary policy decreases the full monetary resource. Expansionary policy is traditionally wont to combat unemployment. During this sense, monetary policy comprises only those decisions and measures of the state and of the monetary authority which affect the degree of cash and level of interest rates. Thus, monetary Policy is defined as comprising of such measures which result in influencing the value, volume and availability of cash & credit so on achieve certain set objectives. Historically, economic process and inflation has been the first objective of any monetary policy. But the rising specialize in financial inclusion has subsequently led to the event of monetary market and financial institutional structure not only in India but also at global level. Thus, together with the event of monetary system, the probability of economic distress has also increase particularly, after the world financial crisis. Thus, because of the financial sector development issues associated with financial stability grapple. Different economist has different views regarding it. Few economists argued that monetary authority needs broader mandate to incorporate the financial stability as another objective together with the first objective of maintaining the worth stability. Few other economists argued that financial stability objective should be distinguished from price stability to avoid confusion between both policies. Thus, the question arises is whether or not the central authority lean the responsibility either fully or shared of maintaining financial stability together with price stability or there should be a separate authority to house the matter of monetary stability. Another important issue is whether or not the central bank's instruments (interest rate, credit) for addressing the worth stability is sufficient to make sure multiple objective of price stability and financial stability both. Finally, is there any inter-linkage between the worth stability and financial stability. If there, then whether it's long term or short run. Present article could be a contribution towards of these unsettled issues.

Keywords: *Economies, Stability, Price Impact, Development, Monetary, Capital Flow, Trade*.

Introduction

Indian monetary policy framework has undergone a major change over the time. During the 1980s and early 1990s, India followed a monetary targeting frame under which broad money (M3) was used because the target for monetary policy. Monetary policy like other branches in Economics has always been growing with the changes in macroeconomic situations. The broad consensus amongst academicians and central bankers at the international level in the area was emerging that single goal of inflation targeting and single tool of charge per unit is most fitted for framing and implementing best monetary policy. Among these, the commercial rate is usually considered because the main channel of transmission. During this channel, change in policy rate of interest affects the deposits and lending rates of economic institutions, and alters the spending and investment decisions of households and businesses, and consequently inflation and growth. in the present study rate of interest is employed as a

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policy variable rather than finances because the main focus in Indian economy after 1991 has increasingly shifted towards interest rates because the procedure for monetary policy transmission. Monetary policy is assumed to exert an analogous effect on real economic activity. In developing nations like India, monetary policy plays a major role in the proper functioning of an economy. Therefore, it's to be designed in such a fashion so it can help to fulfill the necessity of various sectors of the economy and to extend the pace of economic process. Housing and massive business units make spending and investment choices based upon current and expected future actions of monetary policy.

Significance of Monetary Policy

In developed countries as well as in developing countries like India, the role of monetary policy is of immense importance. There has always been much talk on the revival, development and improvement in Monetary Policy in both developed and developing countries and due to changing economic environment it's become more relevant. In developed countries, monetary policy plays a vital role. Inflation occupies the prime position among the objectives of Monetary Policy. In developed economics there has been a shift from achievement of financial condition to manage inflation but this is often not so relevant just in case of developing countries where unemployment may be a major problem affecting future growth. However, as far because the trade-off between growth and inflation is worried, there's a typical ground in both developing and developed countries that there's no trade-off but a vicious circle where growth and control of inflation mutually reinforce one another. In developed countries a good deal of homage is paid to monetary policy management in context of inflation or charge per unit and not in context of growth. The national economy of developed countries is additionally more sophisticated and over- developed than the developing countries where as in developing countries the financial institution but promoting growth also has to have attention on development of the financial structure. In developing countries, the entrepreneurship is weak and therefore the capacity to assume and assess risk is extremely limited. This demands for a greater degree of stability in the charge per unit structure while rate on a mean should be positive to stimulate savings, it also has got to be recognized that too high real rate of interest may reduce the profitability of obtainable investment opportunities briefly run & might just chock-off capital but also investment and will cause losses on large scale. Thus, short term monetary policy in developing countries can't be pursed without due respect to these longer- term consideration. To regulate inflation has been the important objective of Monetary Policy but in developed countries but this, preferences have also been given to the free operation of economic process, resistance to government intervention, abolition of exchange controls, improvement in information technology etc. these developments have had a significant impact on monetary policy in developed countries. The bank of England as an example has given up the employment of reserve requirement and not tries to influence the quantum of credit directly through rationing its own refinance. For all these purposes it relies only on rate of interest at short run. This shows that Monetary Policy is changing and discarding several of its traditional instruments. With current development like globalization of capital market and other financial innovations, the role of monetary policy limited to only charge per unit management is being questioned apart of limited impact of changes in interest rates on demand, the impact of monetary policy on interest rates generally is additionally diluted by the range of economic markets and instruments. Although these considerations are of less relevant for developing countries, where financial innovation haven't reached in the same proportions as in developed economies. In developing countries, the first goal of monetary policy is to facilitate economic process with an inexpensive stability in prices, maintained balance of payments, keeping inflation in restraint are its main functions. But achieving a coffee and a stable rate of inflation is that the most difficult task for developing countries, after all truly and in practice many few countries manage to try so but over again and more countries achieve low rate of inflation it should be feasible to aim at even lower rates of inflation and is considered a significant achievement of recent years that it's now not considered as unthinkable to aim at a zero rate of inflation. For achieving stability, it's necessary to stay the expansion of cash supply in step with the demand for it. This line of reasoning has led in practice to some version of monetary targeting in developed additionally as developing countries and this has been encouraged by the stabilization programs initiated under IMF.

Despite considering monetary targeting as a necessary instrument from achieving and maintaining stability, there are some criticisms often heard during this respect i.e. the speed of circulation of cash or the income elasticity of demand for money isn't constant over short periods of time but there's some relationship which might be calculated as being reasonably stable over a period and may be assumed as what's likely to prevail in near future. Further, monetary targeting only is smart if the rise in funds is correctly distributed between the budget, private sectors & countries

interchange reserve. But it's tasking to apportion increase funds between the budget, private sector and external sector. As an economy grows and its external trade expands, it'll need exchange reserves and it'll need more priority in the allocation of the increased cash in hand than the general public and also the private sector. In most developing countries, there's an inclination to place the requirement of public sector before private sector. The bank can perform its developmental role properly given that it assumes chargeable for establishment of a diversified financial structure that supports the borrowing & lending needs of personal sector. A part of the responsibility that financial institution can discharge is by directly providing resource to credit institutions that support private sector. Another experience in developing countries is that after inflations are allowed to accelerate, it's difficult to bring it in restraint except by strict monetary measures. There's no magic solution to hyperinflation from now on than the matter of correctly guessing the changing needs for liquidity when high inflation rates are suddenly brought down. The demand for money often increases with stabilization and unless it's met a crisis may result causing much loss of output and employment. But it's difficult to guess the extent of change in demand for money correctly. Thus, the financial institutions themselves should avoid policies and procedures which give an excessive amount of discretionary powers to financial institution and government and a spirit of liberalisation should be engaged in the system which allows even public financial institutions, including central banks, to be free from routine governmental interventions.

Monetary Policy and Price Stability

Price Stability has been the foremost objective of each central banking authority. Price stability means low and stable inflation. In normal sense, price stability means general indicant in the economy doesn't change much over time. In other words, there shouldn't be much fluctuations in the general index in the economy or we will say there should be no significant degree of inflation on deflation. Price stability could be a synonym to monetary equilibrium. Index is decided at the purpose where supply of cash adequate to demand for money. This price (at equilibrium level) tends to be stable when money needed to people for the acquisition which they require to get isn't more and not but what they require. Price stability is the stable level of costs in the economy, which avoids long period of inflation or deflation and sustains the worth of cash over time. Index number stability denotes the patron spending isn't tormented by inflation i.e. consumer shouldn't worry about change in value of cash over a period of your time. It should be noted that increase in the prices of individual goods and services differs from the rise generally index. Change in demand and provide of individual goods doesn't mean that general indicator will change. If price of a product increases by 5%, but general indicant is stable then consumer knows that the relative price of this product has increased, So, they'll arrange to buy its less quantity. On the opposite hand, If, general indicator isn't stable because of high inflation, consumer won't be ready to determine the relative price as due to instability in prices there would be fast changes in prices. Thus, price index stability helps economic agents (firms, consumers) in taking decisions regarding consumption and investment.

Monetary Policy and Financial Stability

Over the last two and a half decade since the introduction of deregulation and globalization there has been a greater integration between financial and real market in the Indian economy in variety of inflow and outflow of money. This ends up in development of a financial set-up. financial set-up are going to be sound only if financial stability is maintained which may be possible when national economy can fulfil its three main functions which are Transforming savings i.e. .mobilize savings for productive purpose, Allowing risk management, and Sufficient resilience to disturbance arising from unanticipated shocks. Any imbalance in the national economy will pose great threat to the economic environment in variety of credit or liquidity expansion (asset price boom). It'll further spur unanticipated inflation and hence adversely affect price stability and economic process. Maintaining financial stability is fruitful not just for the efficient working of the economic system but also in maintaining price stability by making the mechanism process effective. The relevance of economic stability was first recognized during the international financial crisis at the tip of the 90's and further exacerbated during the economic and financial crises which emerged in 2007. This prompted a desire for a sound financial set-up and a reliable condition of the country's financial sector.

Conclusion

Monetary policy is the action of financial organization to see the dimensions and rate of growth of cash supply in the economy. By using various instruments like cash reserve Ratio, Repo rate, Reverse repo rate, statutory liquidity Ration etc. The financial institution achieves the varied objectives of monetary policy like controlling Inflation, encouraging economic process, maintain rate stability and

keeping balance of payments in equilibrium. Price stability contributes to a low and stable level of inflation in the economy which promotes economic process, raises investment opportunities and builds the confidence in the financial set-up of a country because when prices are stable it ends up in more accurate decisions regarding investment in the economy. There are less fluctuations and stability is maintained which creates less confusion with the general public regarding consumption and investment decisions and it helps in the smooth and stable running of the economy. All this can be maintained through monetary mechanism process. to keep up Price stability is the major goal of Monetary Policy for a developing country like India where maintaining a coffee level of Inflation may be a tough challenge Price stability contributes to economic process, improves transparency in the financial system, increases investments opportunities in the economy briefly, stable price levels contribute towards the graceful working of the economy of a country. However, there's still a tradeoff between growth and inflation, which becomes a puzzle and an issue of debate for the monetary authorities of developing country like India and this also, raises a matter on the role of Monetary Policy. The method through which monetary Policy works is an economy is thought as monetary mechanism. This Monetary mechanism takes place through various channels – charge per unit credit and rate etc.

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