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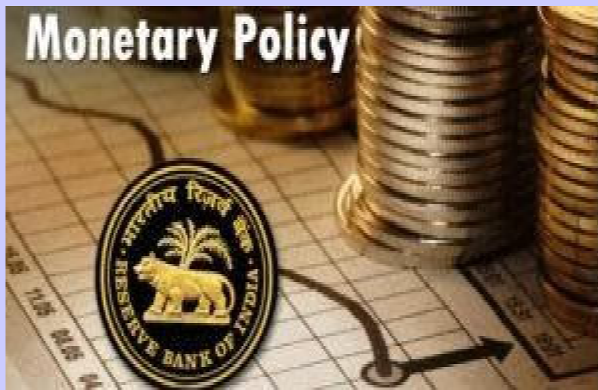
IMPACT OF MONETARY POLICY ON THE INDIAN ECONOMY

ABSTRACT:

The purpose of this study is to analyze and understand the Monetary Policies given by Reserve Bank of India (RBI). Monetary policy is a policy made by Central Bank to control money supply in the economy and thereby fight both inflation and deflation. Monetary policy helps to maintain price stability and achieve high economic growth. To combat Inflation, RBI reduces Money Supply (Tight/Dear money policy). The transmission of monetary policy refers to how changes to the cash rate affect economic activity and inflation. A lower cash rate tends to result in a depreciation of the exchange rate, leading to higher net exports and imported inflation.

INTRODUCTION:

Monetary policy is the policy adopted by the monetary authority of a nation to control either the interest rate payable for very short-term borrowing (borrowing by banks from each other to meet their short-term needs) or the money supply, often as an attempt to reduce inflation or the interest rate, to ensure price stability and general trust of the value and stability of the nation's currency.

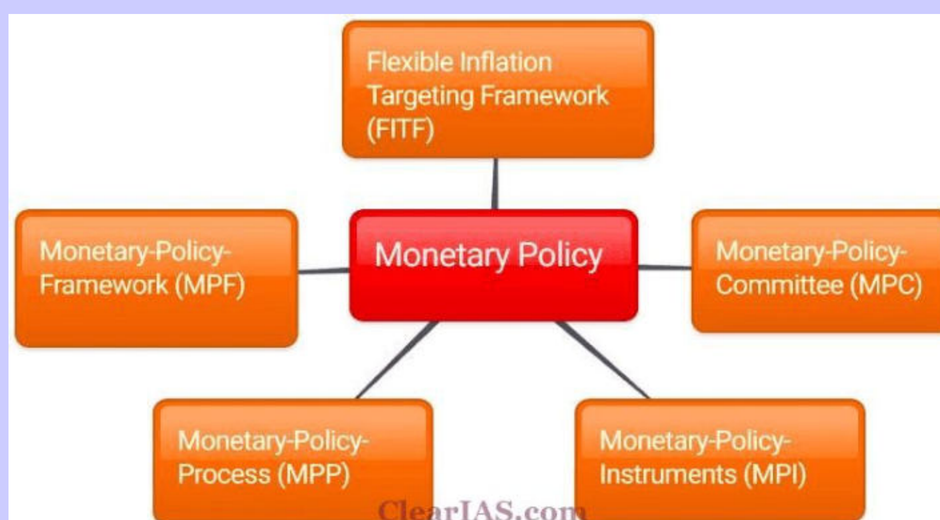


The Monetary Policy Committee (MPC) constituted by the Central Government under Section 45ZB determines the policy interest rate required to achieve the inflation target.

The Reserve Bank's Monetary Policy Department (MPD) assists the MPC in formulating the monetary policy. The Financial Market Committee (FMC) meets daily to review the liquidity conditions so as to ensure that the operating target of monetary policy (weighted average lending rate) is kept close to the policy repo rate.

GOALS OF MONETARY POLICY:

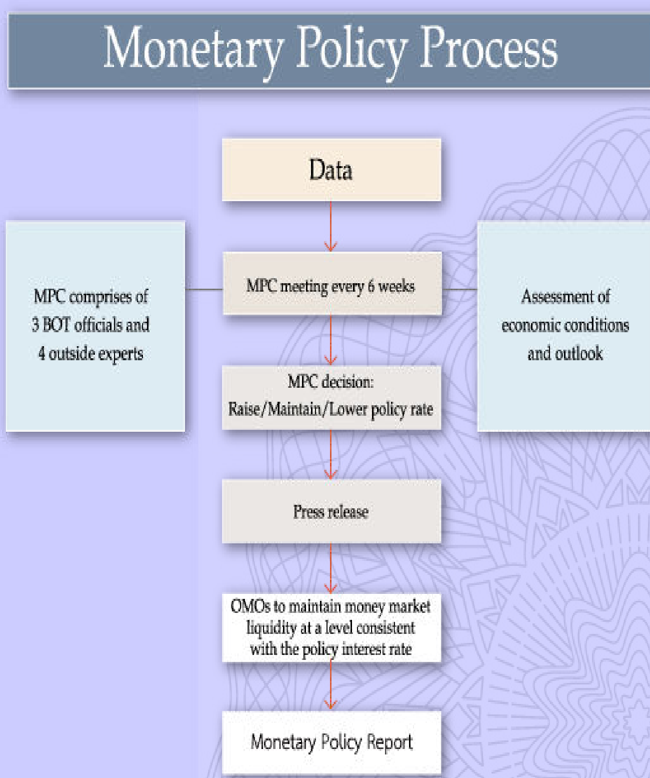
- The primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth. Price stability is a necessary precondition to sustainable growth.
- In May 2016, the Reserve Bank of India (RBI) Act, 1934 was amended to provide a statutory basis for the implementation of the flexible inflation targeting framework.
- The amended RBI Act also provides for the inflation target to be set by the Government of India, in consultation with the Reserve Bank, once in every five years. Accordingly, the Central Government has notified in the Official Gazette 4 per cent Consumer Price Index (CPI) inflation as the target for the period from August 5, 2016 to March 31, 2021 with the upper tolerance limit of 6 per cent and the lower tolerance limit of 2 per cent.
- The Central Government notified the following as factors that constitute failure to achieve the inflation target:(a) the average inflation is more than the upper tolerance level of the inflation target for any three consecutive quarters; or (b) the average inflation is less than the lower tolerance level for any three consecutive quarters.
- Prior to the amendment in the RBI Act in May 2016, the flexible inflation targeting framework was governed by an Agreement on Monetary Policy Framework between the Government and the Reserve Bank of India of February 20, 2015.



MONETARY POLICY FRAMEWORK:

- The amended RBI Act explicitly provides the legislative mandate to the Reserve Bank to operate the monetary policy framework of the country.
- The framework aims at setting the policy (repo) rate based on an assessment of the current and evolving macroeconomic situation; and modulation of liquidity conditions to anchor money market rates at or around the repo rate. Repo rate changes transmit through the money market to the entire financial system, which in turn influences aggregate demand – a key determinant of inflation and growth.
- Once the repo rate is announced, the operating framework designed by the Reserve Bank envisages liquidity management on a day-to-day basis through appropriate actions, which aim at anchoring the operating target – the Weighted Average Call Rate (WACR) around the repo rate.
- The operating framework is fine-tuned and revised depending on the evolving financial market and monetary conditions, while ensuring consistency with the monetary policy stance. The liquidity management framework was last revised significantly in April 2016.

MONETARY POLICY PROCESS:



- Section 45ZB of the amended RBI Act, 1934 also provides for an empowered six-member Monetary Policy Committee (MPC) to be constituted by the Central Government by notification in the Official Gazette. The first such MPC was constituted on September 29, 2016.
- The MPC determines the policy interest rate required to achieve the

inflation target. The first meeting of the MPC was held on October 3 and 4, 2016 in the run up to the Fourth Bi-monthly Monetary Policy Statement, 2016-17.

- 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.
- The Financial Markets Operations Department (FMOD) operationalizes the monetary policy, mainly through day-to-day liquidity management operations. The Financial Markets Committee (FMC) meets daily to review the liquidity conditions so as to ensure that the operating target of the Weighted Average Call Money Rate (WACR) is aligned with the repo rate.
- Before the constitution of the MPC, a Technical Advisory Committee (TAC) on monetary policy with experts from monetary economics, central banking, financial markets and public finance advised the Reserve Bank on the stance of monetary policy. However, its role was only advisory in nature. With the formation of MPC, the TAC on Monetary Policy ceased to exist.

INSTRUMENTS OF MONETARY POLICY:

There are several direct and indirect instruments that are used for implementing monetary policy.

- Repo Rate: The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities under the Liquidity Adjustment Facility (LAF).
- Reverse Repo Rate: The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight

basis, from banks against the collateral of eligible government securities under the LAF.

- Liquidity Adjustment Facility (LAF): The LAF consists of overnight as well as term repo auctions. Progressively, the Reserve Bank has increased the proportion of liquidity injected under fine-tuning variable rate repo auctions of range of tenors. The aim of term repo is to help, develop the inter-bank term money market, which in turn can set market based benchmarks for pricing of loans and deposits, and hence improve transmission of monetary policy. The Reserve Bank also conducts variable interest rate reverse repo auctions, as necessitated under the market conditions.

- Marginal Standing Facility (MSF): A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest. This provides a safety valve against unanticipated liquidity shocks to the banking system.

- Corridor: The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.

- Bank Rate: It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. The Bank Rate is published under Section 49 of the Reserve Bank of India Act, 1934. This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes alongside policy repo rate changes.

- Cash Reserve Ratio (CRR): The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such per cent of its Net Demand & Time Liabilities (NDTL) that the Reserve Bank may notify from time to time in the Gazette of India.

- Statutory Liquidity Ratio (SLR): The share of NDTL that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.

- Open Market Operations (OMOs): These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.

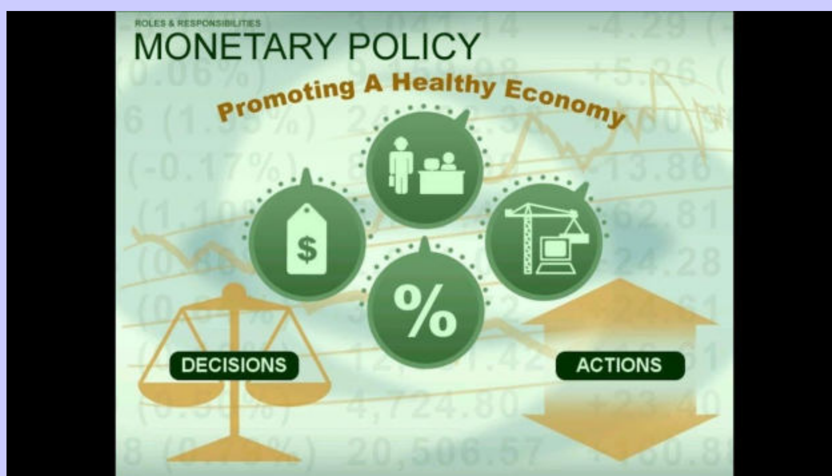
- Market Stabilization Scheme (MSS): This instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury bills. The cash so mobilized is held in a separate government account with the Reserve Bank.

MONETARY POLICY STATEMENT OF DECEMBER 2020:

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting decided to:

- Keep the policy repo rate under the Liquidity Adjustment Facility (LAF) unchanged at 4.0 per cent. Consequently, the reverse repo rate under the LAF remains unchanged at 3.35 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 4.25 per cent.
- The MPC also decided to continue with the accommodative stance as long as necessary – at least during the current financial year and into the next financial year – to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

These decisions are in consonance with the objective of achieving the medium-term target for Consumer Price Index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth. The main considerations underlying the decision are set out in statement below:



GLOBAL ECONOMY: The outlook for Q4 (October-December) of 2020 is overcast with a surge in COVID-19 infections in a second wave across Europe, the US and major Emerging Market Economies (EMEs), with accompanying lockdowns. Progress on vaccine candidates has, however, generated some offsetting optimism. World trade recorded a rebound in Q3 as lockdowns were

eased, but it is likely to slow in Q4 as pent-up demand is exhausted, inventory restocking is completed, and trade-related uncertainty is rising with the second wave. CPI inflation has remained muted across Major Advanced Economies (AEs) while it picked up in some EMEs on firming food prices and supply disruptions. Global financial markets remain buoyant, supported by highly accommodative monetary policies and positive news on the vaccine.

DOMESTIC ECONOMY:

I. In India, the data released by National Statistical Office (NSO) on November 27 showed a contraction of 7.5 per cent in real GDP in Q2:2020-21 (July-September). In Q3:2020-21, high frequency indicators point to a recovery gaining traction, with double digit growth in passenger vehicles and motorcycle sales, railway freight traffic, and electricity consumption in October, although there was moderation in some of these indicators in November. Riding on the favorable monsoon, the outlook for agriculture remains bright, with rabi sowing up 4.0 per cent from the acreage covered at this time last year under supportive soil moisture and reservoir conditions.

II. CPI inflation rose sharply to 7.3 per cent in September and further to 7.6 per cent in October 2020, with some evidence that price pressures are spreading. Food inflation surged to double digits in October across protein-rich items including pulses, edible oils, vegetables and spices on multiple supply shocks. Core inflation, i.e., CPI excluding food and fuel, also picked up from 5.4 per cent in September to 5.8 per cent in October. Both three months and one year ahead inflation expectations of households have eased modestly in anticipation of the seasonal moderation of food prices in the winter and easing of supply chain disruptions.

III. Domestic financial conditions remained easy in October-November and systemic liquidity continued to be in large surplus. Reserve money increased by 15.3 per cent (as on November 27, 2020), driven by a surge in currency demand. Money supply (M3), on the other hand, grew by only 12.5 per cent as on November 20, 2020. A noteworthy development is that non-food credit growth accelerated and

moved into positive territory for the first time in November 2020 on a financial year basis – hitherto, the large inflow of deposits into the banking system was being predominantly deployed in SLR investment. Corporate bond issuances stood at ₹4.4 lakh crore during April-October 2020 as against ₹3.5 lakh crore during the same period last year. India's foreign exchange reserves were US$ 574.8 billion (as on November 27), up from US$ 545.6 billion on October 2 at the time of the MPC's last resolution.

The outlook for inflation has turned adverse relative to expectations in the last two months. The substantial wedge between wholesale and retail inflation points to the supply-side bottlenecks and large margins being charged to the consumer. While cereal prices may continue to soften with the bumper kharif harvest arrivals and vegetable prices may ease with the winter crop, other food prices are likely to persist at elevated levels. Crude oil prices have picked up on optimism of demand recovery, continuation of OPEC plus production cuts and are expected to remain volatile in the near-term. Cost-push pressures continue to impinge on core inflation, which has remained sticky and could firm up as economic activity normalizes and demand picks up.

Turning to the growth outlook, the recovery in rural demand is expected to strengthen further, while urban demand is also gaining momentum as unlocking spurs activity and employment, especially of labor displaced by COVID-19. These positive impulses are, however, clouded by a possible rise in infections in some parts of the country, prompting some local containment measures. At the same time, the recovery rate has crossed 94 per cent and there is considerable optimism on successes in vaccine trials. Consumers remain optimistic about the outlook, and business sentiment of manufacturing firms is gradually improving. Fiscal stimulus is increasingly moving beyond being supportive of consumption and liquidity to supporting growth-generating investment. On the other hand, private investment is still slack and capacity utilization has not fully recovered. While exports are on an uneven recovery, the prospects have brightened with the progress on the vaccines. Demand for contact-intensive services is likely to remain subdued for some time due to social distancing norms and risk aversion.

The MPC is of the view that inflation is likely to remain elevated, barring transient relief in the winter months from prices of perishables. This constrains monetary policy at the current juncture from using the space available to act in support of growth. At the same time, the signs of

recovery are far from being broad-based and are dependent on sustained policy support. A small window is available for proactive supply management strategies to break the inflation spiral being fueled by supply chain disruptions, excessive margins and indirect taxes. Further efforts are necessary to mitigate supply-side driven inflation pressures. Monetary policy will monitor closely all threats to price stability to anchor broader macroeconomic and financial stability. Accordingly, the MPC in its meeting today decided to maintain status quo on the policy rate and continue with the accommodative stance as long as necessary – at least during the current financial year and into the next financial year – to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

How Monetary policy has impacted the Economy?

Monetary policy is the process of drafting, announcing, and implementing the plan of actions taken by the central bank, currency board, or other competent monetary authority of a country that controls the quantity of money in an economy and the channels by which new money is supplied. Monetary policy consists of the management of money supply and interest rates, aimed at meeting macroeconomic objectives such as controlling inflation, consumption, growth, and liquidity. This is achieved by actions such as modifying the interest rate, buying or selling government bonds, regulating foreign exchange (forex) rates, and changing the amount of money banks are required to maintain as reserves.

The monetary policy in developing countries is mainly aimed at fostering economic growth while stabilizing prices. For achieving stability, it is generally considered necessary to keep the growth of money supply in step with its demand, which is assumed to be uniquely related to the national income, at any rate over the medium-term.

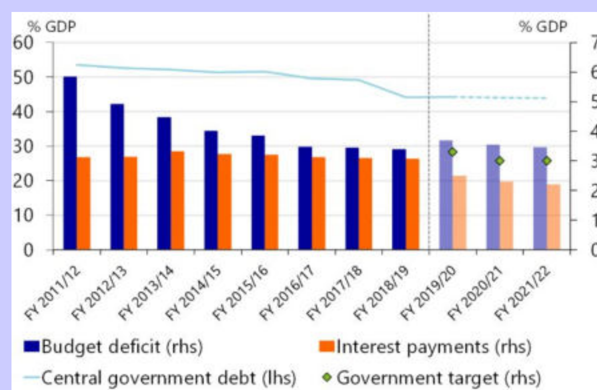
The post-reform period

India saw an economic policy reform in 1991. The reforms of the liberalization, which changed the economic face of the country, put an end to 'red tapeism' and several public monopolies. Foreign Direct Investments in a number of sectors started pouring in. Various types of Indian economic (monetary) indicators are used for different periods of time. These indicators are essential as they give us an accurate status of the Indian economy at different periods. Thus, these indicators help us analyses the Indian economy. An important economic indicator is the rate of inflation. The real Gross Domestic Product (GDP), money supply, credit availability, interest rates, foreign trade & balance of payment (BOP) are some other key macroeconomic indicators.

Direct and indirect instruments of the RBI

The Reserve Bank of India has adopted various monetary policy instruments over time. Bank rate policy is an indirect method of influencing the volume of credit in the economy. It first influences the cost and availability of credit to the commercial banks and thereby, influences the willingness of the businesspersons to borrow and invest. Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) are the most direct methods because they control the volume of credit by directly influencing the cash reserves of the commercial banks.

Open market operations are another instrument which controls the volume of credit by influencing the cash reserves of the commercial banks through the purchase and sale of securities. Therefore, the success of this policy depends on the existence of a well-developed securities market in the economy. Repo and reverse repo rates under the Liquidity Adjustment Facility (LAF) allow the Reserve Bank to manage market liquidity on a daily basis and transmit interest rate signals to the market.



A shift to indirect methods

During the 1990s, a shift from direct to indirect instruments of the monetary policy took place in consonance with the consistent preference for market-based instruments of the monetary policy. The process was reinforced by a switch, within the group of indirect instruments, from

relatively less market-oriented instruments such as reserve requirements to relatively more market-oriented instruments such as open market operations.

With the initiation of financial sector reforms, monetary management in India has been increasingly relying on the use of indirect instruments like open market operations and fine-tuning of liquidity conditions through the Liquidity Adjustment Facility (LAF). The modulations in policy interest rates have emerged as a principal instrument of signaling monetary policy stance. Key monetary policy rates, such as the bank rate and the repo rate have been reduced substantially since 1998 reflecting the countercyclical monetary policy stance. The bank rate was reduced from 11 percent in January 1998 to 6 percent by April 2003. The repo rate also witnessed a cut from 6 percent in January 1999 to 4.5 percent in August 2003.

With the changing framework of the monetary policy in India from monetary targeting to an augmented multiple indicators approach, the operating targets and processes have also undergone a change. There has been a shift from quantitative intermediate targets to interest rates, as the development of financial markets enabled the transmission of policy signals through the interest rate channel. At the same time, availability of multiple instruments such as CRR, OMO including LAF and MSS has provided the necessary flexibility to monetary operations.

Flexible inflation targeting network

In a historic monetary policy overhaul, the finance ministry and the Reserve Bank of India (RBI) have agreed to put in place a monetary policy framework to focus on flexible inflation targeting, something the central bank has been pressing for. The new framework makes RBI more accountable since now it will have to explain to the government if it fails to meet the inflation targets. Economists say the targets will restrain the RBI from taking any aggressive or accommodating monetary policy stance. This will put India at par with other nations in terms of flexible inflation targeting.

There is a definite and remarkable economic impact of the monetary policy on Indian economy in the post-reform period. The importance of the monetary policy has been increasing year after year. Its role is very relevant in attaining monetary objectives, especially in managing price stability and achieving economic growth. Along with that, the use and importance of monetary weapons like bank rate, CRR, SLR, repo rate and the reverse rate have increased over the years.

Repo and reverse repo rates are the most frequently used monetary techniques in recent years. The rates are varied mainly for curtailing inflation and absorbing excess liquidity thereby maintaining price stability in the economy. Thus, this short-time objective of price stability is more successful for the Indian economy rather than other long-term objectives of development.

Monetary policy rules can be active or passive. The passive rule is to keep the money supply constant, which is reminiscent of Milton Friedman‘s money growth rule. The second rule, called the price stabilization rule, is to change the money supply in response to changes in aggregate supply or demand to keep the price level constant. The idea of an active rule is to keep the price level and hence, inflation in check. In India, this rule has been dominant, as a stable growth is a healthy growth.

Monetary Policy is a macroeconomic policy by RBI, wherein through Repo, OMO etc. tools it tries to manage the money supply, interest rates, loan distribution, and thereby helping in the Economic Stability, Growth, and Development.

There are 3 prominent ways of making monetary policy:

- Targeting Exchange rate stability
- Targeting Multiple Indicators
- Targeting Inflation

Monetary policies can stabilize inflation only caused due to demand shocks and are ineffective against supply shocks. Inflation in emerging markets such as India is very sensitive to exogenous shocks like global oil prices, a weaker rupee and a poor monsoon. Food inflation, which impacts the common people the most, is prone to supply-side bottlenecks, which are out of the scope of any remedy under the aegis of monetary policy of RBI. In order to contain inflation, RBI often undertakes liquidity management through Open Market Operations. This sometimes leads to liquidity shocks in the market. Liquidity is also an important factor as these can reinforce or negate the changes in policy rates.

The Indian economy, severely hit by the coronavirus pandemic, would be well placed to start recovering from the "horrible crisis" with the government making efforts on both the fiscal and monetary side in addition to putting in place structural elements, a top IMF official has said. The

International Monetary Fund in its annual World Economic Outlook significantly downgrades India's growth for the fiscal year 2020 to minus 10.3 percent. At the same time, IMF said that India is likely to bounce back with an impressive 8.8 per cent growth rate in 2021, but for this New Delhi needs to ramp up its efforts in various fields. In terms of what can be done going forward, clearly on the fiscal side, the IMF believes there is more that can be done to provide support to households and firms that have been affected by the pandemic, Malhar Shyam Nabar, Division Chief, Research Department, IMF, told reporters on Tuesday at a news conference here on the eve of the annual meetings of the IMF and the World Bank.

In India, customer deposit constitutes the majority of funds to be lent by the banks, whereas the market borrowings through the issuance of debentures/commercial papers is negligible. The cost of funds typically remains inflexible as most of these deposits are contracted at fixed rates. Further, Interest rates on small savings remained at elevated levels compared to that of banks. This has led to a decline in deposits with the banks. The shortfall in the funds has made it virtually impossible for banks to lend at lower deposit rates. The latest monetary policy announcement made on December 4 held no surprises. It held the status quo on the key interest rates, the repo and the reverse repo acts as the floor level for interest rates in the wider economy. Instead, the focus on the latest announcement before the next Union Budget and it's spinning a positive narrative for growth. The supposedly pro-growth "accommodative" monetary policy stance rests on making liquidity available in the system. Justifying this accommodation was the Reserve Bank of India's latest estimates of GDP growth in 2020-21. The RBI now expects GDP to contract by only 7.5% in the current fiscal year, not by as much as 9.5% it expected earlier. Significantly, it expects positive growth for the first time in the second half of the current financial year, by a 0.1% in the current quarter, followed by 0.7% in the last quarter of 2020-21. Further, it expects at least 6.5% growth in the first half of 2021-22.

NEGATIVE IMPACT OF MONETARY POLICIES:

The Government has implemented a judicious mix of fiscal and monetary policies to mitigate the negative impact of COVID-19 on the economy. On May 12 2020, Government announced the

Aatma Nirbhar Bharat Package (ANBP), a special economic and comprehensive package of Rs 20 lakh crores - equivalent to 10 per cent of India's GDP with an aim to encourage business, attract investments and strengthen the resolve for 'Make in India'. The Minister stated that on the monetary front, the Reserve Bank of India (RBI) responded with a mix of conventional and unconventional monetary and liquidity measures to mitigate the negative economic fallout of COVID19. The policy rates have been significantly reduced and around Rs. 9.57 lakh crore or 4.7 per cent of GDP have been injected since February 2020 to enhance the credit flow in the economy. Shri Thakur said that RBI has taken several developmental and regulatory policy measures to enhance liquidity support for financial markets and other stakeholders, ease financial stress caused by COVID-19 disruptions while strengthening credit discipline, improve the flow of credit, deepen digital payment systems and facilitate innovations across the financial sector by leveraging on technology. It has announced certain regulatory measures wherein, in respect of all term loans (including agricultural term loans, retail and crop loans) outstanding as on March 1, 2020, all regulated lending institutions were permitted to grant a moratorium of six months on payment of all instalments falling due between March 1, 2020 and August 31, 2020. Subsequently, it has provided a framework to enable the lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership and personal loans.

Advantages of Monetary Policy:

1. **They encourage higher levels of economic activity:**

Monetary policy tools encourage consumer activities based on the current status of the economy. When a stimulus is necessary to keep growth happening, then banks can lower their interest rates on lending products to encourage additional spending. Lower interest rates create price reductions, which help keep spending at a consistent level. People have more incentive to buy low, even if their wages are under the national median, which means their spending gives strength to the local community.

2. **They encourage a stable global economy:**

Most countries operate with currencies which are traded in value against others. There is no "gold standard" in use by the most influential financial nations in the world today. Thanks to monetary policy tools, there is greater consistency in the financial markets because there are known factors of scarcity. That's why a government which decides to print more money will devalue their currency. It also creates opportunities to purchase bonds, increase reserves, or invest in the debt of other nations to generate multiple revenue lines.

3. **They promote additional transparency:**

Monetary policy tools create predictable results when used as intended. Everyone involved in the financial sector understands what happens when movement occurs in either direction – or if the status quo is maintained instead. These design of the tools forces those who use them to do so in ways that are understood by the general public, allowing organizations and consumers to make decisions about their future now instead of waiting for the tools to create a measurable effect.

4. **They promote lower inflation rates:**

One of the most significant advantages that monetary policy tools offer is price stability. When consumers know how much their preferred goods or services cost, then they are more likely to initiate a transaction. That process keeps pricing structures stable because the value of the money used is also consistent. These tools make it possible to keep the value of money close to what it tends to be.

5. **They create financial independence from Government Policies:**

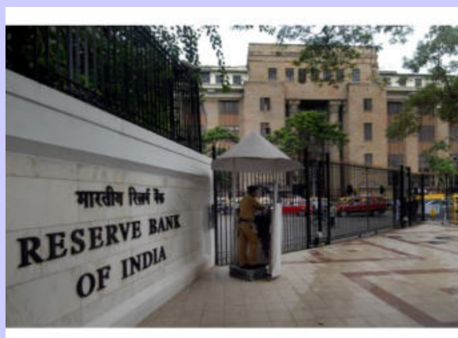
Monetary policy tools are kept separate from centralized governments, implemented by a central bank or similar institution instead. The government might try to influence these tools by passing targeted legislation against them, but it cannot control them outright. By keeping the economic decisions separate from the political decisions, there is a reduction of risk for the average person that the government will impact their vote, life, or choices by limiting the value of their overall income.

6. **They are implemented with relative ease:**

When a central agency indicates that it will use a monetary policy tool in specific ways, then the market shifts automatically to account for the announced changes. Results are often produced well before the effect of the tools begin to occur. That allows for rapid results in some sectors, allowing the government and agencies involved to find tangible evidence that the tool used will create meaningful outcomes.

7. **They can boost exports:**

When the money supply increases at a national level, or interest rates are lowered deeply compared to the global market, then the currency in question becomes devalued. Weaker currencies sometimes benefit from a worldwide perspective because exports receive a boost thanks to purchases from those in stronger economies. Foreigners find that the products are less expensive, so they buy more of them.



Disadvantages of Monetary Policy:

1. **They do not guarantee economic growth:**

The implementation of monetary policy tools does not guarantee results. People and businesses have free will. They can choose to initiate more spending when rates are lowered, or they might choose to hold onto their cash. Consumers don’t take out loans because the interest rates are down all the time. 100% of households don’t buy or refinance their home. There will always be outliers in every economy which respond in unpredictable ways. If enough entities do this, then the results of the monetary policy tools could be different than what was expected.

2. **They take time to begin working:**

The United States operates on budget estimates which account for 10 years of activity. Some countries can evaluate changes in half that time, while others use cycles that last for 20-40 years instead. Because currencies are not based on the scarcity of precious metals at this time, the tools must change the overall market to initiate economic shifts instead. Some changes take several years to start creating positive results. There can still be negative experiences in the initial days of a tool being implemented too.

3. **They always create winners and losers:**

Monetary policy tools try to give everyone the same chance at success. The reality of any financial market, however, is that any shift in policy will create economic winners and losers. These tools try to limit the damage to the people who struggle under the changes made while enhancing the benefits of those who see currency gains.

4. **They create a risk of hyperinflation:**

Small levels of inflation within an economy are not a bad thing. They encourage investments, allow workers to expect a higher wage, and stimulate growth at all levels of society. Having all items cost a little more over time can slow growth when necessary. If the interest rates are set too low, then artificially low rates happen. That creates speculative bubbles where prices increase too quickly, often to levels which create barriers to access for the average person.

5. **They create technical limitations:**

The lowest an interest rate can go under current economic structures is 0%. If the central agency sets rates at this level, then there are limits to what monetary policy tools can do to continue limiting inflation or stimulating economic growth. Prolonged low interest rates also create a liquidity trap, creating a high rate of savings which renders the policies and tools ineffective. They affect bondholder behaviors, consumer fear, and a lack of overall economic activity.

6. **They do not offer localized supports or value:**

Monetary policy tools are only useful from a general sense. They affect an entire country with the outcomes they promote. There is no way for them to generate a local stimulus effect. If a community struggles with unemployment, they might need more stimulus to counter the issue.

The current design of monetary policy tools doesn’t allow this to happen. The tools are unable to be directed at specific problems, boost individual industries, or apply to regions within the national footprint.

CONCLUSION:

Monetary policy is the process by which the monetary authority of a country, generally the central bank, controls the supply of money in the economy by its control over interest rates in order to maintain price stability and achieve high economic growth. In India, the central monetary authority is the Reserve Bank of India. It is designed to maintain the price stability in the economy.

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 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.