HOW FAR MONETARY POLICY IS EFFECTIVE TO CONTROL PRICES.

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ABSTRACT

Monetary policy refers to measures, designed to ensure a more efficient operation of the economic system through their influence upon the supply, cost and availability of money. One of the policy objectives of monetary policy is to stabilize the price level. The success of monetary policy actions depends on the magnitude with which they achieve the final objectives. Inflationary trends have assumed an alarming rate in the country .Inflation has been responsible for causing considerable disruption not only in the developmental efforts but also in social and economic life of the country. Inflation is not only a demand side issue, It has been a supply side constraint also. So there is a need of making joint monetary and fiscal policy to control inflation.

INTRODUCTION

Monetary policy in India is an adjunct of economic policy. As such, the objectives of monetary policy are not different from the objectives of the economic policy .The government of India tries to manipulate its monetary policy through the Reserve Bank of India which is the monetary authority in the country. Monetary policy refers to measures, designed to ensure a more efficient operation of the economic system through their influence upon the supply, cost and availability of money .It involves the deliberate manipulation of monetary instruments like the bank rate, open market operations, changes in reserve requirements and qualitative credit control for the realization of the objectives of economic policy. The effectiveness of monetary policy depends upon the degree to which it can succeed in achieving these objectives .In brief, the objectives of monetary policy are:-

1. To stabilize the internal price level or price stability.
2. To stabilize the rate of foreign exchange or exchange stability.
3. To protect out flow of gold.
4. To control business cycles or economic stability.
5. Economic growth.
6. Maximization of employment. Of these objectives, price stability is the dominant one as price stability provides the appropriate environment in which growth can take place.

The success of monetary policy actions depends on the magnitude with which they achieve the final objectives. Now a days most monetary authority are increasingly using indirect instruments (such as interest rates and open market operation) rather than direct measures due to increasingly deep financial system.

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Since 1970's wholesale price index (WPI) have been averaged between eight to ten percent a year. Also CPI has been high, averaged around nine percent a year. We can also say that prices have been continuously raised in India since the beginning of mid 1950s. In Indian economy money supply growth has been higher than output growth resulting in higher inflation level. The change in money supply causes change in aggregate demand, prices, interest rates and other economic variables. Any change in money supply causes disequilibrium between the public's actual and desired real cash balance of assets .If money supply increases , it increases the cash balances with public .People will increase their spending on financial and non-financial assets .It leads to increase output, employment and income. It also leads to increase prices .There may be reverse relationship between money, prices and output.

Inflationary trends have assumed an alarming rate in the country .Inflation has been responsible for causing considerable disruption not only in the developmental efforts but also in social and economic life of the country. Price instability brings uncertainty and instability to the economy .Therefore one of the policy objectives of monetary policy is to stabilize the price level. Causes of higher inflation in India are increase in the prices of oil, petrol, depreciation of rupee etc. In recent times ,the inflation has mostly affected real output ,relative prices ,taxes, interest rates and specially manufacturing sector which showed very slow growth rate in the year 2012-13 .Other factors which are affecting the inflation are increasing public expenditure for non productive purposes ,deficit financing ,erratic agricultural growth, hoarding of essential articles ,inadequate rise in industrial production etc. Inflation can be control by tight monetary policy . But even if we talk about food inflation, we have negative output gap .We have to sacrifice large growth even for a small reduction in inflation on account of monetary tightening . The variable to control inflation can be the rate of interest, but this largely affects the output gap, which is already negative. Other variables which affect inflation and formation of inflation expectations are high prices of oil and food, the exchange rate, fiscal deficit and infrastructure bottlenecks .All these variables are present in are economy for last few years. We should have long term strategy to tackle inflation because higher price have decreased financial savings. We need a policy which should have balance between controlling inflation and revival of growth, particularly in the industrial sector. In April 2009 repo was 4.75%, which was 9% in July 2008. It has been believed that inflation is a demand side issue and policy measures has been started by RBI to control inflation and with 13 hikes, repo rate again brought up to 8.5%. As a part of July 2013 measures, marginal standing facility (MSF) was increased to 3.0 % points above the repo rate. With the easing of exchange rate pressures, the MSF rate was gradually decreased. October ,2013 onward , the repo rate has been raised by 0.25 percentage points to 7.75 percent .And MSF rate has been reduced from 9.0 percent to 8.75 percent .Thus the margin between the repo rate and the MSF rate has been brought back to 1.0 percent , as prevailing prior to July 2013 .

CONCLUSION

But inflation is not only a demand side issue , It has been a supply side constraint also .With the hike in repo rate ,the growth started getting retarded as the cost of capital increased. It was believed by RBI that with the increase in rate of interest, inflation will decrease, but global factors continued to increase inflation. Monetary policy may be affected by fiscal policy. So there is a need of making joint monetary and fiscal policy to control inflation and to reduce

unemployment and to increase growth rate of economy. Otherwise responsibility for dealing with the monetary and fiscal problems should be allocated between RBI and the government respectively.

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