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**Monetary Policy Of RBI And Its Impact On Inflation****Dr. Babasaheb Gore****Principal,**Smt. Sushiladevi Deshmukh Womens college,Latur**Abstract**

*The global slowdown in the year 2008 raised serious problems in front of all the developed and developing countries. India is no exception to this severe economic blow but its strong regulators like the Reserve Bank of India and others have tried hard to reduce the impact of this economic hold back. The monetary policy of any country's central bank helps that economy to manage the economic resources within the country. The same policy has been adopted by the Reserve Bank of India in the past few years to overcome the problems of recession. Inflation is another serious phenomenon which destroys the backbone of a country's economy. The demand and supply ratio of commodities determine its prices. When there is a fluctuation in this ratio due to many internal & external factors, inflation starts booming. This phenomenon makes us think about the relationship between monetary policy and its impact on inflation.*

**Key words:** RBI (Reserve Bank of India), monetary policy, inflation.**Introduction:-**

Central banks are the national authorities responsible for providing currency & implementing monetary policy. Monetary policy is a set of actions through which the monetary authority determines the conditions under which it supplies the money that circulates in the economy. Monetary policy therefore has an effect on short-term interest rates. It is now widely agreed that monetary policy can contribute to sustainable growth by maintaining price stability, in turn, may be defined as a rate of inflation that is sufficiently low that households and businesses do not have to take it into account in making everyday decisions. High inflation has an adverse effect on growth due to a number of factors: distortion of relative price which lowers economic efficiency; redistribution of wealth between debtors & creditors; aversion to long-term contracts & excessive resources are devoted to hedging inflation risks. In developing economic, in particular, an additional cost of high inflation emanates from its adverse effects in the poor population. Maintenance of low & stable inflation has thus emerged as a key objective of monetary policy & a noteworthy development during the 1980s and the 1990s was the reduction in inflation across a number of countries, irrespective of their stages of development. This reduction in inflation is

believed to be on account of improvements in the conduct of monetary policy, although there is an ongoing debate on this in view of other factors such as globalization, deregulation, competition & prudent fiscal policies that might have also played a role. In advanced economies, inflation rates in the recent decade have averaged around 2-3 percent annum-consistent with the establishment of reasonable price stability. In developing & emerging economies too, inflation rates have declined significantly.

The current phase of low global inflation is comparable with the pre-world war II phenomenon when inflation rates across regions were quite low. In the post-world war-II period, however, price levels showed a clear upward trend, with inflation rates rather than price levels clustering around a stationary level following price shocks. In particular, the collapse of Bretton woods arrangement was associated with a surge in inflation during the 1970s. Commodity price shocks, especially oil prices, coupled with expansionary demand management policies including Vietnam war related fiscal expansion in the US provided a significant impetus to inflation. The belief that there existed a stable long-run trade-off between inflation and output as well as overestimation of potential output also contributed to the accommodative stance of monetary policies during this period. With inflation in double digits, deliberate disinflation strategies were put in place in a number of advanced economies during the 1980s and these were successful in reducing inflation. In particular, co-oriented fiscal and monetary policies were deployed to curtail demand pressures in the economy.

### **Objectives of paper and Data:**

The research paper is aimed at focusing on the issues related to the monetary policy of the RBI and its impact on the inflation.

- 1) To focus on the monetary policy of the RBI.
- 2) To study the various tools adopted by RBI for credit control.
- 3) To study the impact of monetary policy on inflation.

The present study is very important from the point of view that it speaks about the various methods adopted by RBI to control the flow of credit. Therefore, the reports and occasional papers of RBI are used as the data for the paper. The books, journals and periodicals are also considered for the exhaustive study of the problem.

**Credit control policy of RBI**

There are two major tools used for monetary policy viz, qualitative and quantitative measures, The RBI frequently uses the quantitative measures to control the credit supply of the economy, The Indian economy is suffering from the global recession, The prices of the commodities which have a global demand e.g.crude oil etc,affect on the currency of any developing country,The purchasing power of a relatively weaker currency tends to be lesser than the currencies like US dollar and British pounds.With the application of monetary policy,a central bank can assure the capacity building of the domestic currency,After the adoption of new economic policy in 1991,the RBI reduced the rate of CRR and SLR,which was accepted as a booming factor for the growth of the economy,Currently the CRR is 4.75%and SLR is kept at 24%,The Reserve Bank,through its quarterly reviews makes necessary changes in these short term interest rates.Time and time again, these quantitative measures have been adopted by the RBI to control the money flow in the economy.

**The Phenomenon of Inflation:**

In economics, inflation is a rise in the general level of prices of goods and services in an economy over a period of time .When the general price level rises,each unit of currency buys fewer goods and services.Consequently,inflation also reflects erosion in the purchasing power of money-a loss of real value in the international medium of exchange and unit of account in the economy.A chief measure of price inflation is the inflation rate, the annualized percentage change in a general price index which is generally known as Consumers Price Index over time.

**Table 1.1.Inflation:A Historical Perspective (Consumer price inflation in percent)**

Country Group	1900-13	1930-39	1950-60	1961-70	1971-80	1981-90	1991-95	1996-2000	2000
1	2	3	4	5	6	7	8	9	10
Advanced Economies	1.5	0.2	4.3	4.0	10.8	8.1	3.9	2.0	2.5
Selected Emerging Market Economies	1.2	1.6	15.2	18.3	29.8	139.7	94.4	23.4	7.8

Sources:World Economic Outlook,May 2002.IMF.

Effects of the inflation on any country may be various depending upon the country's economic condition, volume of international trade, value of the country's currency in the global market etc. These effects may also be positive or negative. Negative effects of inflation include a decrease in the real value of money and other monetary items over time, uncertainty over future inflation may lead to shortages of goods if consumers begin hoarding out of concern that prices will increase in the future. Positive effects include ensuring central banks can adjust nominal interest rates and encouraging investment in non-monetary capital projects.

**Table 1.2 Survey based measures of inflation expectations in India.**

<b>Survey based measures of inflation expectations in India.</b>			
<b>Name of the survey</b>	<b>Commenced in</b>	<b>Coverage</b>	<b>Period for which expectations assessed</b>
1	2	3	4
Industrial outlook survey	1998	2,000 manufacturing companies approached in each round (response rate is around 70 percent).	3- Month ahead
Inflation expectations survey of households	2005	4,000 urban household across 12 cities (recently increased to 5,000 households across 16 cities)	3- Month ahead and 1- year ahead
Survey of professional forecasters	2007	About 30 professional forecasters	Quarterly for next 4 quarters; next 5 years and next 10 years
Consumer confidence survey	2010	5,400 households across 6 metro cities	1 year ahead

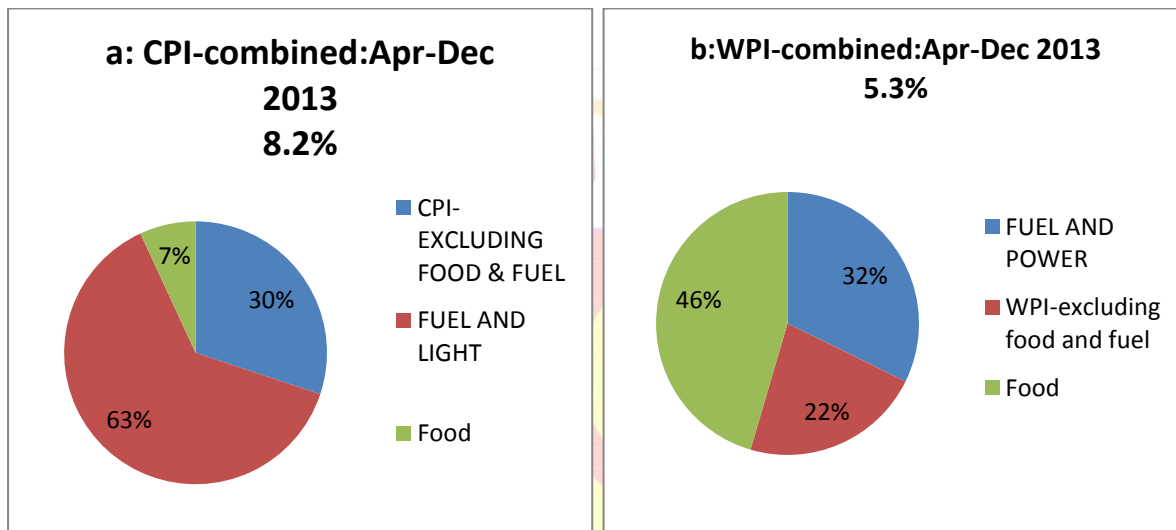
Source: <http://www.rbi.org.in>

**Inflation in the current period:**

Inflation declined significantly in dec, 2013, both in terms of the CPI and WPI, driven by falling food prices which had firmed up considerably during April-November. Despite the moderation, CPI inflation continued to remain high near 10 percent with inflation excluding food and fuel components also persistent at 8.0 percent. Going forward, inflation is expected to moderate gradually but stay above the RBI's comfort level. Upside risks to inflation in 2014-15 arise from likely upward revisions in domestic energy prices and growth acceleration. However, global commodity prices, especially for metals, are expected to remain soft and partially counter-balance these pressures.

**Chart 1.1 Inflation in 2013-14**

**Chart VI.3: Build-up of inflation during 2013-14 so far is dominated by the food and fuel segments**



**Relationship between inflation and international commodity prices:**

There is a close relationship between the inflation and the international prices of the globally demanded commodities. The crude oil, basic metals and gold influence the international trade. A slight rise in the prices of these commodities at international level can influence the demand as well as retail prices of commodities at domestic level. The volatility of international prices often tends to create a pressure on the purchasing power of any country's currency. Therefore, to deal with such external factors affecting on the domestic prices, RBI uses the credit control measures in a frequent manner. Though, this practice has not been as fruitful as it was expected, RBI has no choice but to increase the short term interest rates to control the inflation.

**Impact of monetary policy on inflation**

The use of monetary control measures affects on the inflation. It is a phenomenon existing for a period of few years in which the prices of the commodities can be controlled. When the prices of the global commodities are raised, inflation in any developing country hikes but when some of the monetary measures are used, the inflation rate gets down to some extent. Inflation affects GDP in an inverse manner. If there is a continuous decline in a country's GDP, it ensures the slow growth rate of the country. India however, has experienced

that the monetary policy adopted by the RBI has successfully handled the situation of global recession.

The short term interest rates affect on the purchasing power of the domestic currency. This leads to decrease in the demand of the commodities. The producer thinks of reducing the production which ultimately leads to cost cutting of the product. The commodities tend to get cheaper than earlier and it leads to reduction in prices of the commodities. In this way monetary policy, if implemented in a proper way can reduce the inflation in the economy.

The Reserve Bank of India, through the implementation of proper monetary policy can reduce the effects of inflation. The aim of sustainable growth for the twelfth plan cannot be achieved without erasing the problem of inflation. The RBI with its monetary policy tries to manage the inflation rate as well as the economic stability. The Central Bank with its various measures tries to control the inflation rate and raise the capital within the country by managing the international currency. This leads to steady the economy in a great manner, at last, it is observed that the monetary policy is a healthy tool for eliminating inflation.

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