

## **20120208 Reserve Bank of India: Evidence on Interest Rate Channel of Monetary Policy Transmission in India (Research Paper)**

**Source: Reserve Bank of India**

With the development of domestic financial markets and gradual deregulation of interest rates, monetary policy operating procedure in India in the recent years has evolved towards greater reliance on interest rates to signal the stance of monetary policy. This process is buttressed by significant evidence that policy rate changes transmit through the term structure of interest rates, though the intensity of transmission varies across financial markets. But how does policy rate change affect output and inflation remains an open question? Following a quarterly structural vector auto-regression (SVAR) model, we find evidence that policy rate increases have a negative effect on output growth with a lag of two quarters and a moderating impact on inflation with a lag of three quarters. The overall impact persists through 8-10 quarters. These results are found to be robust across alternative specifications with different measures of output, inflation and liquidity. Moreover, significant unidirectional causality was found from policy interest rate to output, inflation and various measures of liquidity except broad money (M3), underlining the importance of interest rate as a potent monetary policy tool.

**To view the paper click [here](#).**

**NovaRes Team**