Monetary Policy Frameworks: Conjectural Scope and Empirical Evidences

Dr Firoz Alam*

The present paper seeks to analyze Monetary Policy Frameworks in India by constructing a descriptive narrative of each framework and accounting for evolution within the framework. It also analyzes the interest rate setting behavior of Reserve Bank of India over the monetary policy frameworks i.e. Monetary Targeting Framework, Multiple Indicator Approach (MIA), Flexible Inflation Targeting and analyze RBI's response to various macroeconomic variables: inflation, output gap and exchange rate from the perspective of modern monetary policy rules viz. Taylor Rules and Mc Callum Rules. The key difference between the two rules is choice of instrument in the central bank's reaction function. While the Taylor rule uses a short term nominal rate of interest, McCallum Rule uses growth rate of monetary base. Also, the study seeks to empirically characterize the systematic component of conduct of monetary policy of India over frameworks and demonstrate how the conduct of monetary policy differed over different frameworks. A Monetary Policy Framework defines the institutional and operational arranagement under which monetary policy is made and the constraints and context under which it operates. The choice and design of Monetary Policy Framework has been substantially conditioned and altered not only by changes in macroeconomic circumstances but also in macroeconomic theory and thought.

Keywords: Monetary Policy Framework, Multiple Indicator Approach, Managed Exchange Rate, Monetary Targeting, Emerging Market

1. Introduction

Monetary Policy Frameworks in India have evolved and restructured themselves over the last three decades in response to and conditioned by challenges of globalization, financial integration and increase in capital flows. Amended RBI Act explicitly provides

Assistant Professor, College of Business Administration & Financial Sciences, Saudi Electronic University KSA Riyadh