An Analysis of RBI Monetary Policy during the Narendra Modi Regime

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Abstract

This paper provides a comprehensive analysis of the Reserve Bank of India's monetary policy framework and implementation during the tenure of Prime Minister Narendra Modi from May 2014 to January 2026. The study examines key policy shifts including the adoption of flexible inflation targeting, responses to major economic disruptions such as demonetization and the COVID-19 pandemic, and the evolution of interest rate policies. Through empirical analysis and graphical representation, we assess the effectiveness of monetary policy interventions in achieving macroeconomic stability, controlling inflation, and supporting economic growth. The findings reveal a period marked by significant institutional reforms, heightened policy activism during crisis periods, and a general trend toward greater transparency and forward guidance in monetary policy communication.

The paper ends with "The End"

1 Introduction

The period since May 2014 has witnessed substantial transformations in India's monetary policy framework under the leadership of Prime Minister Narendra Modi. The Reserve Bank of India (RBI), under three successive governors—Raghuram Rajan, Urjit Patel, and Shaktikanta Das—has navigated through unprecedented challenges including structural economic reforms, the shock of demonetization, implementation of the Goods and Services Tax (GST), and the COVID-19 pandemic.

This analysis examines the RBI's monetary policy stance across multiple dimensions: the institutional shift toward inflation targeting, interest rate policy evolution, liquidity management strategies, and crisis response mechanisms. The study period encompasses significant milestones in India's economic policy landscape and provides insights into the interplay between fiscal and monetary authorities in achieving macroeconomic objectives.

2 Inflation Targeting Framework

One of the most significant institutional reforms during this period was the formalization of the Flexible Inflation Targeting (FIT) framework in 2016. The Reserve Bank of India Act was amended to provide a statutory basis for monetary policy, establishing a six-member Monetary Policy Committee (MPC) with the mandate to maintain price stability while keeping in mind the objective of growth.

The inflation target was set at 4% Consumer Price Index (CPI) inflation with a tolerance band of $\pm 2\%$. This represented a paradigm shift from the previous multiple-indicator approach to a more focused and accountable monetary policy framework. The move enhanced transparency, predictability, and credibility of monetary policy actions.

2.1 Implementation and Outcomes

The FIT framework has generally succeeded in anchoring inflation expectations. Average CPI inflation during 2016-2019 remained close to the 4% target, demonstrating the effectiveness of the new framework. However, challenges emerged during periods of supply shocks, particularly food price volatility, and during the pandemic-induced disruptions.

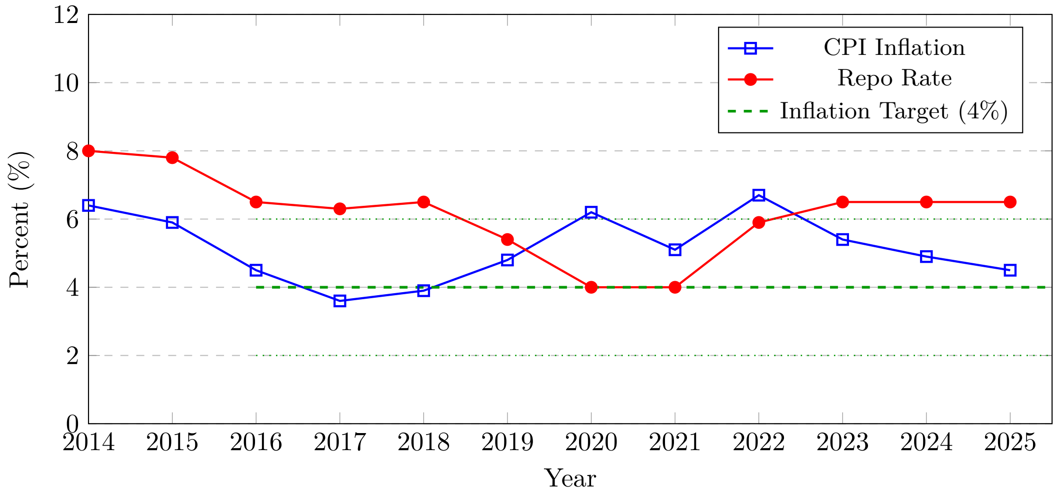

Figure 1: CPI Inflation and Repo Rate Trends (2014-2025)

3 Demonetization and Monetary Policy Response

The demonetization initiative announced on November 8, 2016, presented unique challenges for monetary policy management. The sudden withdrawal of 86% of currency in circulation created severe liquidity disruptions in the economy. The RBI responded with extraordinary measures to manage the transition.

Key policy responses included enhanced liquidity provisions through various channels, relaxation of withdrawal limits in phases, and careful management of the currency replacement process. While the immediate impact on economic activity was significant, with GDP growth slowing in subsequent quarters, the monetary policy framework remained focused on medium-term inflation control.

3.1 Liquidity Management During Demonetization

The RBI's balance sheet expanded significantly as demonetized currency returned to the banking system. Banks experienced a surge in deposits, leading to excess liquidity in the system. The RBI conducted Open Market Operations (OMOs) to absorb excess liquidity and prevent undue downward pressure on interest rates.

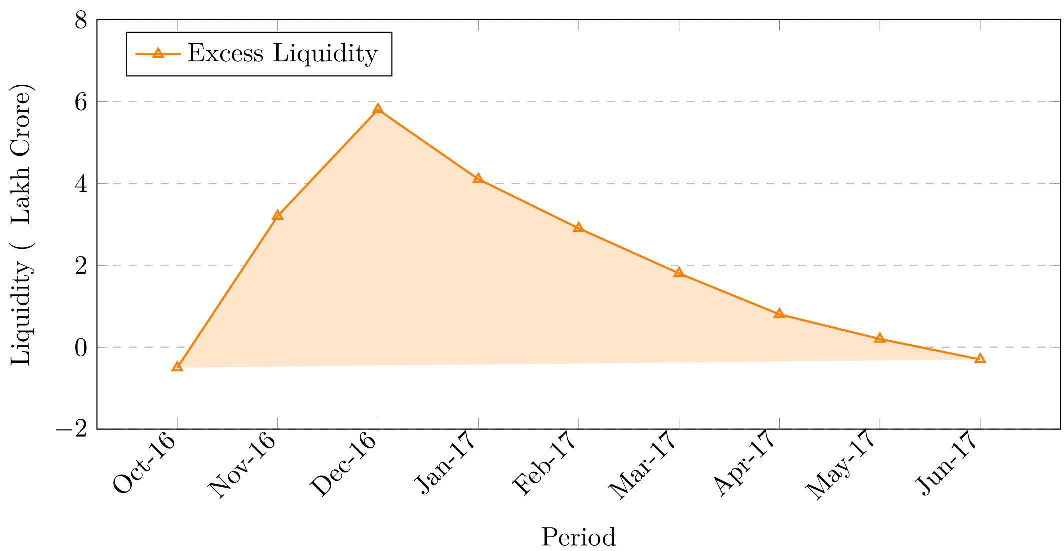

Figure 2: Banking System Liquidity Post-Demonetization

4 COVID-19 Pandemic Response

The COVID-19 pandemic and associated lockdowns in 2020 necessitated unprecedented monetary policy intervention. The RBI adopted an accommodative stance, reducing the repo rate by 115 basis points between March and May 2020, from 5.15% to 4.0%, the lowest level in two decades. This was accompanied by unconventional measures including targeted long-term repo operations (TLTROs), moratorium on loan repayments, and enhancement of liquidity support.

4.1 Unconventional Monetary Policy Tools

The RBI employed several unconventional tools during the pandemic:

Long-Term Repo Operations (LTRO): Introduced to inject durable liquidity at the policy repo rate for one- and three-year tenors, facilitating credit flow to productive sectors.

Targeted LTRO (TLTRO): Designed to channel liquidity toward specific sectors such as investment-grade corporate bonds, commercial paper, and non-convertible debentures.

Government Securities Acquisition Programme (G-SAP): Announced in 2021 as a secondary market operation to provide comfort to the market on the availability of ample liquidity.

These measures ensured financial market stability, supported credit growth, and prevented a credit crunch despite severe economic contraction.

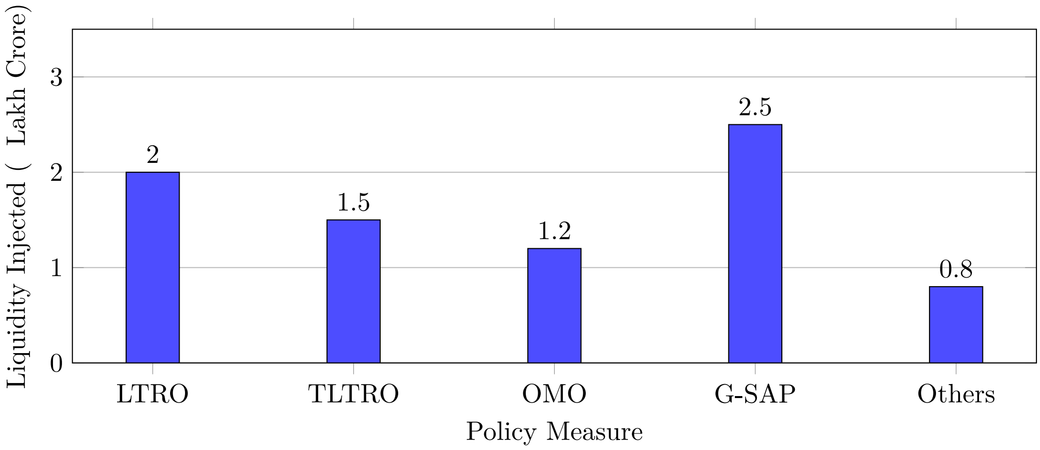

Figure 3: Liquidity Injection Through Various Measures (2020-2021)

5 Interest Rate Policy Evolution

Interest rate policy during the Modi regime has been characterized by cycles of accommodation and normalization, responding to inflation dynamics, growth imperatives, and global economic conditions.

The period 2014-2015 saw a continuation of the easing cycle initiated earlier, bringing rates down from elevated levels. After the adoption of inflation targeting in 2016, rate decisions became more systematic and data-driven. The period 2017-2018 witnessed rate stability as inflation remained benign. However, rising inflation and global monetary tightening led to rate hikes in 2018-2019.

The pandemic period (2020-2021) marked aggressive easing, followed by a normalization cycle beginning in 2022 as inflation surged post-pandemic. The MPC raised rates by 250 basis points between May 2022 and February 2023 to combat inflation driven by supply disruptions and commodity price shocks.

6 Coordination with Fiscal Policy

The relationship between monetary and fiscal authorities has been a defining feature of this period. While the adoption of inflation targeting provided operational independence to the RBI, coordination with fiscal policy remained crucial for macroeconomic stability.

Key areas of coordination included managing government borrowing programs, particularly the significant expansion during COVID-19, and aligning fiscal stimulus with monetary accommodation during crisis periods. The RBI's participation in government securities markets, while supporting fiscal needs, raised questions about the boundaries of monetary financing and central bank independence.

7 Banking Sector Reforms and Financial Stability

Monetary policy during this period operated in the context of significant banking sector challenges, particularly the non-performing asset (NPA) crisis. The RBI implemented several measures:

- Asset Quality Review (AQR) initiated in 2015 to recognize the true extent of stressed assets
- Insolvency and Bankruptcy Code (IBC) implementation from 2016
- Prompt Corrective Action (PCA) framework for weak banks
- Bank recapitalization programs
- Merger of public sector banks to create stronger entities

These structural measures complemented monetary policy in strengthening the transmission mechanism and ensuring financial stability.

8 Monetary Policy Transmission

Effective transmission of policy rate changes to lending and deposit rates remained a challenge. The transmission improved after the shift to an external benchmark-based lending rate system in 2019, which linked retail loan rates more directly to policy rates.

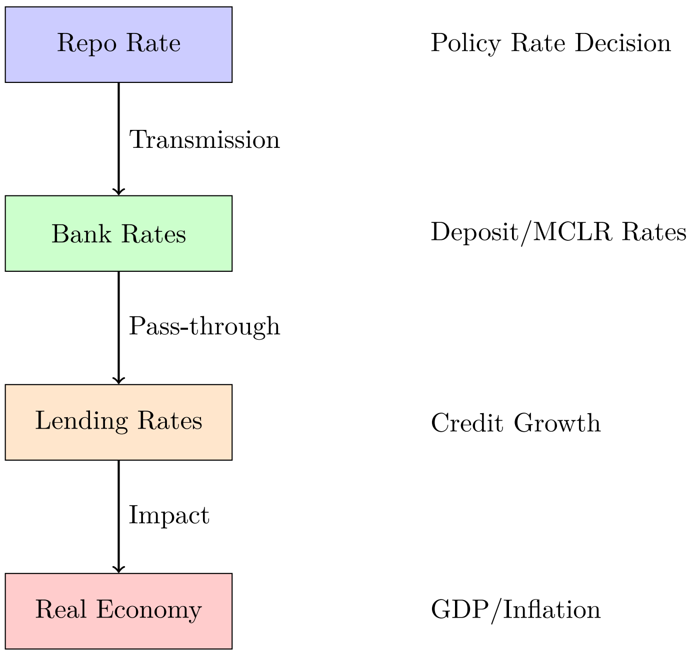

Figure 4: Monetary Policy Transmission Mechanism

9 Challenges and Criticisms

The monetary policy framework faced several challenges:

Supply-side inflation: Food price volatility, particularly in perishable commodities, limited the effectiveness of demand-side policy interventions.

Growth-inflation trade-off: Balancing growth support with inflation control proved challenging, especially during periods of economic slowdown with elevated inflation.

Central bank independence: Debates emerged regarding the autonomy of the RBI, particularly around differences with the government on issues such as dividend transfers and regulatory forbearance.

Financial market volatility: Managing capital flows and exchange rate pressures while pursuing domestic objectives presented recurring challenges.

10 Conclusion

The RBI's monetary policy during the Modi regime has been characterized by significant institutional evolution, enhanced transparency, and active crisis management. The adoption of inflation targeting provided a clear nominal anchor, improving policy credibility. Response to major shocks—demonetization and COVID-19—demonstrated policy flexibility and innovation.

The period achieved reasonable success in inflation control, with average inflation remaining close to target in non-crisis periods. However, challenges in monetary transmission, managing growth-inflation trade-offs, and navigating fiscal-monetary coordination persist. Looking ahead, the framework's resilience will continue to be tested by global uncertainties, domestic structural challenges, and the evolving nature of inflation dynamics.

The experience offers valuable lessons on the importance of institutional credibility, the need for complementary structural reforms to enhance policy effectiveness, and the critical role of communication and forward guidance in shaping expectations.

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Glossary

CPI (Consumer Price Index) A measure of average change in prices paid by consumers for a basket of goods and services, used as the primary inflation measure under the FIT framework.

Repo Rate The rate at which the central bank lends short-term funds to commercial banks, serving as the key policy rate in India's monetary policy framework.

Reverse Repo Rate The rate at which the RBI borrows money from commercial banks, effectively setting a floor for short-term interest rates.

Monetary Policy Committee (MPC) A six-member committee constituted under the RBI Act to determine the policy interest rate required to achieve the inflation target.

MCLR (Marginal Cost of Funds Based Lending Rate) An internal benchmark system used by banks for determining lending rates based on their marginal cost of funds.

Open Market Operations (OMO) Purchase or sale of government securities by the central bank to adjust liquidity conditions in the banking system.

Cash Reserve Ratio (CRR) The percentage of deposits that banks must maintain with the RBI as reserves, used as a tool for liquidity management.

Statutory Liquidity Ratio (SLR) The percentage of deposits that banks must invest in specified securities, primarily government bonds.

LTRO (Long-Term Repo Operations) A liquidity management tool providing banks with longer-term funding at the repo rate to support credit flow.

G-SAP (Government Securities Acquisition Programme) A framework for outright purchase of government securities by the RBI to provide liquidity and support orderly market functioning.

Forward Guidance Communication by the central bank about likely future policy actions to influence expectations and financial conditions.

Inflation Targeting A monetary policy framework where the central bank sets an explicit inflation target and adjusts policy instruments to achieve it.

LAF (Liquidity Adjustment Facility) The primary instrument for day-to-day liquidity management, encompassing repo and reverse repo operations.

NPA (Non-Performing Asset) A loan or advance for which principal or interest payment has remained overdue for a specified period.

Monetary Transmission The process through which monetary policy decisions affect interest rates, asset prices, exchange rates, and ultimately economic activity and inflation.

The End