Monetary Policy Communication and Financial Markets in India

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Forward-looking monetary policy communication has become a key element of flexible inflation-targeting regimes across advanced and emerging market economies. The Reserve Bank of India’s implementation of a flexible inflation targeting framework since 2016 has been supported by a broad set of communication tools, more recently aided by policy innovations such as forward guidance on policy rates and, asset purchases, increasing the predictability of monetary policy. A review of the recent innovations of monetary policy communications during the initial waves of the pandemic suggests forward guidance likely played a key role in moderating uncertainty and supporting some asset prices. We also find that the relationship between monetary policy surprises and yields for government and corporate securities across all maturities are positive and statistically significant. The results support an important role for monetary policy communication in guiding market expectations about the monetary policy stance, including the likely path of policy interest rates.

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