

Date
13/Aug/2020

Indian Economy - Class-10

Topics → Monetary System

Investment Multiplier

$$Y = C + S$$

$$\frac{\Delta Y}{\Delta Y} = \frac{\Delta C}{\Delta Y} + \frac{\Delta S}{\Delta Y}$$

$$1 = \frac{\Delta C}{\Delta Y} + \frac{\Delta S}{\Delta Y}$$

$$1 = \left(\frac{\Delta C}{\Delta Y} \right) + \left(\frac{\Delta S}{\Delta Y} \right)$$

$$1 = MPC + MPS$$

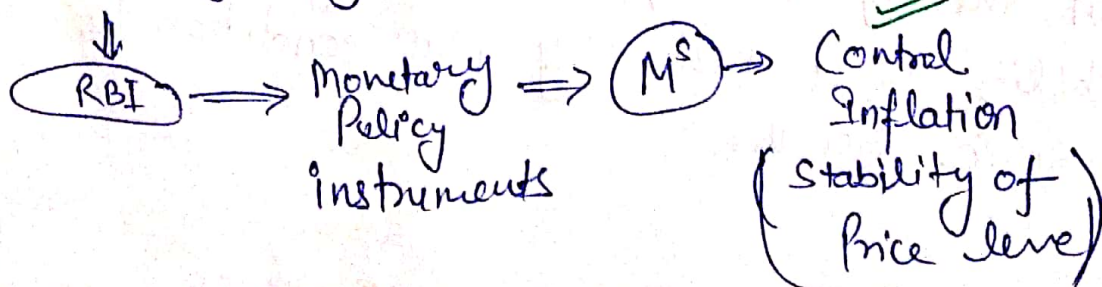
MACRO ECONOMIC POLICIES

1) Monetary Policy

↓
monitored/implemented by RBI

Primary object - is to control inflation ✓

Monetary Policy



②

2. Fiscal Policy \Rightarrow G & T \rightarrow instrument of fiscal policy
G - Govt Expenditure
T - Taxes
 \Downarrow
implemented by GOI
 \Downarrow
target - Higher Economic Growth

3. Trade Policy (FTP) / foreign Trade Policy
Exports \uparrow & Imports \downarrow

$$\underset{\uparrow}{AD} = C + I + G + \underset{\uparrow}{X} - \underset{\downarrow}{M}$$

Monetary Policy

Monetary Policy refers to the policy of the central bank which is related to use of monetary policy instruments to achieve the objective which is specified in the RBI act 1934. RBI has responsibility of conducting monetary policy and this responsibility mandated under the RBI act 1934. The primary objective of monetary policy to maintain price stability or controlling inflation, while keeping in mind the objective of economic growth. Price stability is a necessary pre condition to sustainable economic growth.

In May 2016, RBI act 1934 was amended to provide the basis for the implementation of the flexible inflation targeting framework. The amended

RBI act also provide for the inflation target to set by the GOI in consultation with the RBI. Once in five year. Accordingly the centre govt has notified the official gadget that 4% CPI (Consumer Price Index) as the target for the period from Aug 5, 2016 to 31 March, 2021. with the upper tolerance limit of 6% and the lower tolerance limit of 2%.

The Central Govt. notified the following as factors that constitute failure to achieve inflation target.

1. The average inflation is more than the upper tolerance limit of the inflation target for any three consecutive quarters.
2. The average inflation is less than the lower tolerance limit for any consecutive quarters.

Prior to the amended in the RBI act in May 2016, the flexible Inflation Targeting framework was implemented on the basis of agreement between RBI and GOI on 23 Feb 2015.

Monetary Policy

1. Expansionary Monetary Policy

→ When RBI changes the monetary policy instruments
 $M^S \uparrow \Rightarrow i \downarrow \Rightarrow AD \uparrow \Rightarrow Y \uparrow \Rightarrow \text{emp} \uparrow$

2. Contractionary Monetary Policy

Changes M P instrument $\Rightarrow M^S \downarrow = AD \downarrow = Y \downarrow \Rightarrow \text{emp} \downarrow$

Higher Inflation
 \uparrow
 \downarrow Excess demand
 \uparrow
 $\downarrow AD > AS(Y)$

Expansionary Monetary Policy

When RBI decreasing the policy rates or monetary policy instruments and increasing the liquidity in the economy, it is known as expansionary monetary policy. RBI takes these steps when the economy facing low aggregate demand or low inflation or recessionary effect.

Expansionary Monetary Policy helps to increase aggregate demand and economy may recover from recessionary effect.

Contractionary Monetary Policy

When RBI increasing the policy rate and decreasing the liquidity in the economy, it is known as contractionary monetary policy. RBI takes this step when economy is facing higher inflation. Contractionary monetary policy controlling the inflation by decreasing the aggregate demand.

Section 45 ZB of the amended RBI Act 1934, provides empowered six members monetary policy committee to be constituted by the Govt. of India. By the notification in the official gazette. Accordingly the

by the GOI in Sep '2016, constituted the MPC. The Monetary Policy Committee constitute by the Central Govt. besides the help in formulation of the MPC. ~~policy required the achievement rate~~ meets everyday

The financial market committee to review the liquidity conditions in the market.

Composition of MPC (Monetary Policy Committee)

- 1) The Governor of RBI → as a chairperson (ex-officio)
 - 2) Deputy Governor of the RBI → In-charge of Monetary Policy department.
 - 3) Officers of RBI → Nominated by the Central Board of the RBI
- Other three members from the Government.

⑥

The three members from the government side will hold the office for a period of 4 years or until further orders.

The first meeting of MPC was held on October 3rd & 4th, 2016. Under the amended RBI act the monetary policy committee is required to meet atleast four times in a year. The Quorum for the meeting four members. Each member of the MPC has one voting right and in the event of an equality or tie then governor has a second voting right.

The resolution adopted by the MPC is published after conclusion of every meeting of the MPC on the 14th day, the minutes of the proceeding of the MPC are published which includes

1. The resolution adopted by the MPC.
2. The vote of each member on the resolutions.
3. The ~~the~~ statement of each member on the resolution adopted.

