MONETARY POLICY

MONETARY POLICY

Definition:

Monetary Policy refers to the credit control measures adopted by the central bank of a country.

Monetary policy "as policy employing central bank's control of the supply of money as an instrument for achieving achieves of general economic policy."

OBJECTIVES OF MONETARY POLICY

- The following are the principal objectives of monetary policy:
- Full Employment
- Price Stability
- Economic Growth
- Balance of Payments
- Exchange Rate Stability
- Neutrality of Money
- Equal Income Distribution

Full Employment:

Full Employment has been ranked among the foremost objectives of monetary policy.

It is an important goal not only because unemployment leads to wastage of potential output, but also because of the loss of social standing and self-respect.

Price Stability

- One of the policy objectives of monetary policy is to stabilize the price level.
- Both economics and favour this policy because fluctuations in price bring uncertainty and instability to the economy.

Economic Growth

- One of the most important objectives of monetary policy in in recent years has been the rapid economic growth of an economy.
- Economic growth is defined as “the process where by the real per capita income of a country increases over a long period of time.”

Balance of Payments

Another objectives of monetary policy since the 1950s has been to maintain equilibrium in the balance of payments.

Exchange Rate Stability:

- Exchange rate is the price of a home currency expressed in terms of any foreign currency.
- If the exchange rate is very volatile leading to frequent ups and downs in the exchange rate, the international community might lose confidence in our economy.
- The monetary policy aims at maintaining the relative stability in the exchange rate.

Neutrality of Money:

Economist such as Wicksted, Robertson has always considered money as a passive factor.

According to them, money should play only a role of medium of exchange and not more than that.

Therefore, the monetary policy should regulate the supply of money.

Equal Income Distribution:

Many economists used to justify the role of the fiscal policy is maintaining economic equality. However in recent years economists have given the opinion that the monetary policy can help and play a supplementary role in attaining an economic equality.

TYPES OF MONETARY POLICY

Monetary policy design changes as per the goals set for the monetary policy and the emerging economic scenario.

The monetary policy is characterized as expansionary policy, contradictory policy.

- Expansionary Monetary Policy
- Contractionary Monetary Policy

Expansionary Monetary Policy

Expansionary or easy monetary policy aims at encouraging spending on goods and services by expanding the supply of credit and money by lowering the policy rates (bank rate or repo rate), lowering the reserve requirements and purchasing the government securities from the market.

Contractionary Monetary Policy

- Contractionary or tight monetary policy aims at preventing inflation by contracting the money supply.
- Contraction in money supply is achieved by increasing the policy rates, increasing the reserve requirements and purchasing the government securities from the market.

INSTRUMENTS OF MONETARY POLICY

- Credit control is a major weapon of the monetary policy used to control the demand and supply of money in the economy.

Quantitative	Qualitative
1. Bank rate	1. Rationing of credit
2. Open market operation	