

# MONETARY POLICY TRANSMISSION

- Central bank's policy action is transmitted in order to achieve the **ultimate goals of inflation and growth**.
- If the RBI reduces the policy rates then the benefits of reduced lending rates must be passed on to the customers.
- However, the monetary policy was not transmitted to the customers in the internal benchmark era.
- The below table summarizes the monetary policy transmission before and after the introduction of **External Benchmark Lending Rates**.

<b>ADVANTAGE BORROWERS</b>			
	Repo rate (bps)*	Bank lending rates (bps)*	
		Outstanding rupee loans^	Fresh rupee loans^
Feb 2019 - Sep 2019#	-110	2	-43
Oct 2019 - Sep 2021#	-140	-120	-147

\*Rate change in basis points; #Pre- and post- external benchmark, ^Weighted average lending rates (WALR)

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# MONETARY POLICY TRANSMISSION MECHANISM IN INDIA

- The repo rate has a significant impact on the monetary policy transmission.
- The repo rate serves as the anchor rate in determining the economy's interest rate (of the banking system).
- The **banking system** is central to India's monetary policy transmission.
- In general, there are two steps to the policy transmission mechanism:
  - *In the financial markets, there is a transmission from the policy rate to key rates.*
  - *Transmission through financial markets to final objectives such as inflation, employment, and output.*

# CHANNELS OF TRANSMISSION

**Interest Rate**

**Credit**

**Exchange Rate**

**Asset Price**

# MONETARY POLICY TRANSMISSION - SIGNIFICANCE

- **affects economic growth, prices** and other aspects of the economy.
- Due to central banks **raising** the official interest rate, **bank lending rates and bond yields will rise**.
- The **discount rates** used to compute the present value of cash flows, which are used to estimate the value of securities, are affected by changes in the official interest rate.
- Economic agents would expect lending to increase as a **consequence of lower borrowing costs** or asset prices to rise as a result of lower discount rates and expectations of stronger growth if official interest rates were cut.
- Changes in the official interest rate have an impact on exchange rates.
- When interest rates in a country **rise, investment in that country becomes more appealing**, all other factors being equal.

# CHALLENGES TO MONETARY POLICY TRANSMISSION

- Inflexible Funding Costs
- Policy rates are not linked to the market.
- Nearly three-fourths of the outstanding loans are not linked to external benchmarks.
- High levels of non-performing assets (NPAs)
- Four Balance Sheet Problems