Unit-I

Lecture-17

Objectives of Monetary Policy:

According to RBI Governor Dr. D. SubbaRao, "The objectives of monetary policy in Indiaare price stability and growth. These are pursued through ensuring credit availability withstability in the external value of rupee and overall financial stability."

Following are the main objectives of monetary policy:

- **To Regulate Money Supply in the Economy:**

Money supply includes both money in circulation and credit creation by banks. Monetarypolicy is farmed to regulate the money supply in the economy by credit expansion or creditcontraction. By credit expansion (giving more loans), the money supply can be expanded.By credit contraction (giving less loans) money supply can be decreased.The main aim of the monetary policy of the Reserve Bank was to control the money supplyin such a manner as to expand it to meet the needs of economic growth and at the sametime contract it to curb inflation. In other words monetary policy aimed at expanding andcontracting money supply according to the needs of the economy.

- **To Attain Price Stability:**

Another major objective of monetary policy in India is to maintain price stability in the country. It implies Control over inflation. Price level, is affected by money supply. Monetarypolicy regulates money supply to maintain price stability.

- **To promote Economic Growth:**

An important objective of monetary policy is to make available necessary supply of moneyand credit for the economic growth of the country. Those sectors which are quitesignificant for the economic growth are provided with adequate availability of credit.

- **To Promote saving and Investment:**

By regulating the rate of interest and checking inflation, monetary policy promotes savingand investment. Higher rates of interest promote saving and investment.

- **To Control Business Cycles:**

Boom and depression are the main phases of business cycle. Monetary policy puts a checkon boom and depression. In period of boom, credit is contracted, so as to reduce moneysupply and thus check inflation. In period of depression, credit is expanded, so as toincrease money supply and thus promote aggregate demand in the economy.

❖ **To Promote Exports and Substitute Imports**:

By providing concessional loans to export oriented and import substitution units, monetarypolicy encourages such industries and thus help to improve the position of balance ofpayments.

❖ **To Manage Aggregate Demand:**

Monetary authority tries to keep the aggregate demand in balance with aggregate supply ofgoods and services. If aggregate demand is to be increased than credit is expanded and theinterest rate is lowered down. Because of low interest rate, more people take loan to buygoods and services and hence aggregate demand increases and vice-verse

❖ **To Ensure more Credit for Priority Sector:**

Monetary policy aims at providing more funds to priority sector by lowering interest ratesfor these sectors. Priority sector includes agriculture, small- scale industry, weaker sectionsof society, etc.

❖ **To Promote Employment:**

By providing concessional loans to productive sectors, small and medium entrepreneurs,special loan schemes for unemployed youth, monetary policy promotes employment.

❖ **To Develop Infrastructure:**

Monetary policy aims at developing infrastructure. It provides concessional funds for

developing infrastructure.

❖ **To Regulate and Expand Banking:**

RBI regulates the banking system of the economy. RBI has expanded banking to all parts ofthe country. Through monetary policy, RBI issues directives to different banks for settingup rural branches for promoting agricultural credit. Besides it, government has also set upcooperative banks and regional rural banks. All this has expanded banking in all parts of the country.

Contribution of Monetary Policy towards Economic Growth

Monetary policy can contribute to the achievement of economic growth in two ways: 1. Management of Aggregate Demand, 2. Encouragement to Saving and Investment

Economic growth is unquestionably a primary goal of any economy. Hence, it is an avowed objective of monetary policy.

Till recently however, a majority of economists considered monetary policy as a short-run policy primarily aimed at full employment and mitigating cyclical fluctuations and not concerned with economic growth as such. Recently, however, it has been realised by many that it is not enough to achieve full employment but that the economy should develop at an ever-growing pace if people have to be provided with a high standard of living.

Monetary policy can contribute to the achievement of economic growth in two ways:

1. Management of Aggregate Demand:

The monetary authority should keep the aggregate monetary demand in balance with the aggregate supply of goods and services. For this a flexible monetary policy is called for. A restrictive money policy will have to be applied when there is excess demand in the economy threatening to raise prices and create conditions of unsustainable boom. An expansionist credit policy is to be followed when there is a deficiency of aggregate demand and supply is in excess causing a fall in prices, production, employment and income.

It is sometimes argued that a tight or restrictive money policy impedes while an expansionist or easy money policy promotes economic growth. But as a matter of fact, neither view is true, since the truth lies somewhere midway. A tight money policy is not conducive to growth when it is applied at a wrong time, say when there is a deficient demand.

In a situation of the deficient demand and unemployed resources, an easy money policy is most suitable, but if it is carried far beyond the stage of full employment, it will generate an inflationary impact, and to control a speculative boom in such a situation, a tight money policy will be appropriate.

Thus, the important thing is that they should be applied at the appropriate time; otherwise, they do more harm than good to economic growth. Therefore, a flexible monetary policy has been advocated to achieve economic growth with price stability. Briefly, thus, the monetary policy can assist in promoting economic growth by maintaining reasonable price stability and optimum use of economic resources in an economy.

2. Encouragement to Saving and Investment:

The monetary authority can help economic development by creating a favourable environment for saving and investment which greatly influence economic growth. For this, the monetary policy's aim of price stabilisation is very important. Reasonable price stability encourages both saving and investment. As saving is the main source of capital formation, when saving increases under favourable circumstances, capital formation can also be accelerated which in turn accelerates economic growth.

In short, a monetary policy is necessarily concerned with all the major objectives of economic policy, namely, exchange stability, price and economic stability, full employment, and economic growth. These objectives are, to some extent, in conflict with one another.

However, few people are willing to admit that any one of these objectives is undesirable and should be abandoned. Also, there is no common denominator of stability in terms of ends towards which a monetary policy can be directed. Thus, monetary authorities are always confronted with the problem of priorities. They have to resolve the conflicts between various objectives by assigning different degrees of importance to the different objectives in different economic situations.