Indian Economy · GS - III

Examine the effectiveness and limitations of an accelerated monetary tightening cycle in controlling persistent inflation. How should central banks balance price stability with economic growth?

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 13/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
10	~150 words

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Answer Hint

Monetary tightening, policy rate transmission, inflation expectations, aggregate demand, real interest rates, investment slowdown, employment, monetary policy credibility, growth-inflation trade-off.

Model Answer

Introduction

Monetary tightening involves increasing policy interest rates to moderate borrowing, spending and aggregate demand. Central banks generally use it to contain persistent inflation and stabilise inflation expectations.

Effectiveness

Higher interest rates increase borrowing costs, discourage excessive consumption and investment, and moderate credit expansion. They can also strengthen monetary policy credibility by signalling commitment to price stability.

Limitations

Monetary tightening is less effective against inflation arising primarily from supply disruptions, geopolitical conflicts or rising commodity prices. Excessive rate increases may weaken private investment, employment and economic growth. Their impact also operates with variable time lags, making policy calibration difficult.

Balancing Growth and Inflation

Central banks should assess core and headline inflation, inflation expectations, output conditions and labour-market trends. Gradual, data-dependent decisions can prevent unnecessary economic contraction. Monetary policy should be complemented by appropriate fiscal and supply-side measures where inflation originates outside domestic demand.

Conclusion

Effective monetary policy requires balancing price stability with sustainable growth. The pace of tightening should reflect the persistence, source and broader economic consequences of inflation.

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