Indian Economy · GS - III

Raising the policy repo rate to control inflation involves a trade-off between price stability and economic growth. Examine this statement in the context of the Indian economy.

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 16/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
10	~150 words

Answer Hint

Monetary Policy Committee, inflation targeting, repo rate, cost of credit, consumption, investment, aggregate demand, exchange rate, food inflation, growth-inflation trade-off, monetary transmission.

Model Answer

Introduction

The Reserve Bank of India uses the repo rate as a key monetary policy instrument to maintain price stability while supporting economic growth. An increase in the rate represents a contractionary monetary policy stance.

Impact of a Repo Rate Increase

- **Inflation control:** Higher borrowing costs moderate credit demand and aggregate consumption, helping contain demand-driven inflation.
- **Investment:** Costlier loans may discourage private investment and expansion by businesses.
- **Households:** Increased home and vehicle loan EMIs can reduce disposable income and consumption.
- **Currency stability:** Higher interest rates may support capital inflows and reduce depreciation pressures, depending on global conditions.

Challenges in the Indian Context

Food and fuel inflation often arise from supply-side disruptions, which monetary tightening cannot directly resolve. Excessive tightening may also weaken employment and economic activity.

Way Forward

RBI should adopt data-driven and calibrated monetary decisions, while the government addresses supply bottlenecks through agricultural reforms, logistics and strategic food management.

Conclusion

Monetary policy must balance inflation control with growth considerations. Effective coordination between monetary and fiscal policies is essential for macroeconomic stability.

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