Indian Economy · GS - III

Analyse the role of monetary policy tightening in controlling inflation. How can an increase in the repo rate influence household consumption, investment and economic growth in India?

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 18/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
15	~250 words

Answer Hint

Inflation targeting, monetary transmission, repo rate, borrowing costs, household EMIs, consumption demand, private investment, savings, liquidity management, growth-inflation trade-off.

Model Answer

Introduction

The Reserve Bank of India's monetary policy aims to maintain price stability while keeping growth objectives in mind. Increasing the repo rate is a conventional monetary tightening instrument used to moderate inflationary pressures.

Mechanism of Inflation Control

- **Cost of credit:** Higher repo rates increase banks' borrowing costs, which may translate into higher lending rates.
- **Demand moderation:** Costlier loans can reduce consumption and investment demand, easing demand-side inflation.
- **Savings incentive:** Higher deposit rates may encourage households to save rather than consume.

- **Inflation expectations:** A credible tightening policy can prevent inflation expectations from becoming entrenched.

Impact on the Economy

1. **Households:** Higher interest rates on housing, vehicle and personal loans can increase EMIs and reduce disposable income.
2. **Businesses:** Increased borrowing costs may delay expansion and capital expenditure.
3. **Financial markets:** Higher interest rates can influence bond yields, equity valuations and capital flows.
4. **Economic growth:** Reduced consumption and investment may moderate short-term economic activity.

Limitations and Challenges

- Monetary tightening may be less effective against supply-side inflation caused by food, fuel or global commodity disruptions.
- Higher interest rates can disproportionately affect highly indebted households and small businesses.
- Excessive tightening may weaken employment and investment.

Way Forward

RBI should follow a data-driven and calibrated approach, supported by supply-side interventions, fiscal coordination and effective inflation monitoring.

Conclusion

Repo rate increases can moderate inflation by influencing credit and aggregate demand. However, sustainable price stability requires a balanced policy that protects growth and addresses structural supply constraints.