Indian Economy · GS - III

Discuss the role of central bank independence in maintaining macroeconomic stability. How can political pressures on monetary policy create challenges for inflation management and sustainable economic growth?

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 21/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
15	~250 words

Answer Hint

Central bank autonomy, monetary policy independence, inflation targeting, policy rate, monetary transmission, fiscal dominance, inflation expectations, accountability, coordination between monetary and fiscal policy.

Model Answer

Introduction

Monetary policy plays a crucial role in maintaining price stability and supporting sustainable economic growth. In India, the Reserve Bank of India (RBI) exercises monetary policy functions within a statutory framework, including the flexible inflation-targeting regime.

Importance of Central Bank Independence

1. **Price stability:** Operational autonomy enables a central bank to take necessary measures against inflation, even when such decisions are politically unpopular.

2. **Credibility:** An independent central bank strengthens public and investor confidence in its commitment to controlling inflation.

3. **Macroeconomic stability:** Predictable monetary policy helps stabilise inflation expectations, interest rates and financial markets.

4. **Long-term growth:** Price stability creates a favourable environment for investment, savings and sustainable economic expansion.

Risks of Political Pressure

- **Inflationary pressures:** Excessive pressure to maintain low interest rates may stimulate demand beyond the economy's productive capacity.
- **Fiscal dominance:** Monetary policy may be influenced by government borrowing requirements rather than macroeconomic conditions.
- **Distorted expectations:** Frequent political interference can weaken confidence in the central bank's inflation-control commitment.
- **External vulnerability:** Inappropriate interest-rate decisions may affect capital flows, exchange-rate stability and investor confidence.

Way Forward

India's Monetary Policy Committee (MPC) framework provides institutional safeguards through collective decision-making, an inflation target and transparent communication. Constructive coordination between the government and RBI should continue without compromising operational independence.

Conclusion

Central bank independence does not mean absence of accountability. It requires a transparent institutional framework in which monetary policy decisions are guided by economic evidence, price stability and long-term growth rather than short-term political considerations.