Indian Economy · GS - III

“Monetary easing can stimulate short-term economic growth, but cannot independently guarantee sustained high growth.” Examine this statement in the context of the debate over interest-rate cuts and economic growth.

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

MARKS	WORD LIMIT
15	~250 words

Answer Hint

Monetary transmission, aggregate demand, consumption and investment, inflation, productive capacity, productivity, central bank autonomy, structural reforms.

Model Answer

Introduction

Monetary policy influences economic activity through interest rates, liquidity and credit availability. However, lower borrowing costs alone cannot ensure exceptionally high and sustained economic growth.

How Lower Interest Rates Stimulate Growth

- **Consumption:** Cheaper loans encourage household spending on housing, automobiles and other durable goods.
- **Investment:** Reduced financing costs can encourage businesses to expand production and undertake new projects.
- **Aggregate demand:** Higher consumption and investment can increase output and employment in the short run.
- **Credit transmission:** Effective transmission of policy-rate reductions to bank lending rates strengthens this process.

Why Monetary Easing Has Limitations

- **Inflationary pressures:** Excessive demand stimulus can increase inflation, particularly when supply is constrained.
- **Liquidity trap:** When confidence and investment demand remain weak, lower interest rates may have limited impact.
- **External pressures:** Interest-rate reductions can influence capital flows and exchange-rate stability.
- **Supply-side constraints:** Infrastructure bottlenecks, skill shortages and low productivity cannot be resolved through monetary easing alone.

Sustaining Long-Term Growth

Sustained growth requires capital formation, technological innovation, skilled labour, infrastructure development, competitive markets and institutional stability. Fiscal policy and structural reforms must complement monetary policy.

Central bank independence is also important because interest-rate decisions should be guided by macroeconomic conditions and the inflation-growth balance rather than short-term political demands.

Conclusion

Monetary easing is an important instrument for stabilising demand and supporting growth, but it is not a substitute for productivity-enhancing reforms. Sustainable economic expansion requires coordinated monetary, fiscal and structural policies.

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