Indian Economy · GS - III

“The Reserve Bank of India’s monetary policy plays an important role in influencing economic growth and controlling inflation.” Explain how monetary policy affects India’s GDP.

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 19/10/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
10	~150 words

Answer Hint

Repo rate, interest rates, money supply, bank credit, consumption, investment, aggregate demand, inflation control, monetary policy transmission, limitations.

Model Answer

Introduction

Monetary policy refers to measures taken by the Reserve Bank of India (RBI) to regulate liquidity, credit and interest rates to maintain price stability while supporting economic growth.

Main Body

1. Expansionary Monetary Policy

When the RBI reduces the repo rate or injects liquidity, borrowing may become cheaper. This can encourage businesses to invest and households to spend, increasing aggregate demand and GDP.

2. Contractionary Monetary Policy

When inflation is high, the RBI may increase the repo rate or absorb liquidity. Higher borrowing costs can reduce excessive consumption and investment, helping control inflation but potentially slowing short-term economic growth.

3. Credit and Investment

Monetary policy influences bank lending rates, credit availability and business confidence. Easier credit can support production, employment and investment, while tighter credit may moderate economic activity.

Limitations:

Monetary policy alone cannot address structural problems such as inadequate infrastructure, low productivity or unemployment. Its effectiveness also depends on banks' lending behaviour and demand for credit.

Conclusion

The RBI influences GDP mainly through interest rates, credit, consumption and investment. Price stability, combined with suitable fiscal and structural policies, is essential for achieving sustainable economic growth.

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