ABSTRACT

The monetary policy transmission is an importance process, which conveys the central bank's assessment of the economy and its future outlook. This study empirically investigates the monetary policy transmission mechanism in India, using the Structural VAR model and monthly data for call money rate, industrial output, exchange rate, money supply and inflation for the period June 2000 to July 2010. The call money rate is taken as the policy instrument. A non recursive restriction is applied in the contemporaneous matrix in SVAR framework to identify the monetary policy shock. The impulse response functions and variance decomposition are generated to analyze the movements of the shock and percentage influence of each variable on study variables. Results imply that (i) interest rate channel has a significant impact on the other variables, especially money supply, and (ii) inflation deviations and money supply explain the highest variation in short-term interest rate. Thus, the interest rate adjustment has become an effective transmission channel.