6 Chapter

Major Findings, Conclusion, Policy Implications and Limitations of the study

6.1 Major Findings

Major findings of the study are as follows

It has observed through analysis that the overall growth rate of real GVA, velocity of reserve money and real effective exchange rate has been upward sloping while on other hand downward sloping or decreasing trend has found in inflation rate, inflation gap, output gap, call money rate, nominal output gap and reserve money with respect to time.

In Taylor rule the case of closed economy, output gap has statistical significant impact on interest rate at 10% level interest rate not impact by inflation rate. Weather in case of open economy, both output gap and exchange rate have impact on interest rate and but interest rate not impact by inflation rate.

In McCallum Rule the case of closed economy, reserve money has influenced by growth rate of target GVA, nominal output gap and money velocity. But reserve money is more influenced by money velocity as compare to others. Weather in case open economy reserve money has influenced by growth rate of target nominal GVA, nominal output gap and but reserve money not influenced by exchange rate.

In hybrid McCallum-Taylor rule the case of closed economy, growth rate of target nominal GVA, velocity of reserve money and nominal output gap has not influence on interest rate. Whether in open economy interest rate has influenced by nominal output gap and exchange rate but growth rate of target nominal GVA and velocity of have not impact on it.

In hybrid McCallum-Taylor rule the case of closed economy, reserve money has influenced by inflation gap but not impact by real output gap on reserve money. Whether in open economy reserve money has impact by inflation gap but not influence by real output gap and exchange rate on reserve money.

6.2 Conclusion

Output gap is more responsive rather than inflation rate to change in short-run interest rate. Growth real GVA targeting (Output targeting) should be allow rather than inflation targeting in Indian economy. RBI is more response about negative output gap than positive output gap and also response disinflation than inflation rate, persistent with the indication of greater influence of policy decisions on the output gap. And exchange rate (REER) are more responsive rather than inflation rate to change in short-run interest rate. i.e. RBI should emphasis output targeting with concerned exchange rate than inflation rate and also concerned depreciation of currency of domestic rather than appreciation.

Apart from the debate on IT, especially for emerging economies, some of the major factors that need to be studied for India have been identified. It is found that India has been performing well with its Multiple Indicator Approach till date. However, given the performance of India for the last 5 years, at least in terms of inflation, the decision to stick to a multi-indicator approach amidst the entire debate about inflation targeting has been vindicated. Since the turn of events after the crisis, a dual policy of price stability coupled with growth is a sensible approach for an emerging economy. EMEs are, in general, subject to economic shocks of higher magnitude during financial crises, and financial stability becomes the sole objective under such circumstances. Therefore, RBI should continue its Multiple Indicator Approach where price stability, financial stability and economic growth are considered for decision-making. However, deducing the positives that can come out of focusing on inflation, a greater weightage should be given to inflation in the Multiple Indicator Approach. This would ensure that inflation does not go out of bounds, but at the same time, growth would not be sacrificed for the sake of inflation.

Since parameter estimates are based on data which includes period before the introduction of WMA and the launch of LAF, as more data becomes available, going by the results in the study, McCallum rule should become a choice of monetary policy reaction function, given that RBI has declared monetary base as its official operating target.

To conclude, performance of McCallum rule augurs well for the conduct of monetary policy in the Indian context. This study was exploratory in nature, attempting to operationalize the rules, rather than a statement in favour of a particular rule. It would be worth looking at the performance of McCallum rule in detail. If indeed velocity of monetary base has a stable relation with short term interest rate (as should be the case in the light of RBI s new found favour for reserve money, else meeting the reserve money target would entail potentially infinite variance of the short term rate).

McCallum rule was worked and appropriate rather than Taylor rule in context of Indian economy. Both policy instrument variables has required in Indian economy to modulate appropriate monetary policy.

6.3 Policy implications

- The RBI should manage regularly reserve money over the time to accelerate growth rate of real GVA and reduce the inflation gap.
- As per findings of Taylor rule, output gap and exchange rate (REER) are more responsive rather than inflation rate to change in short-run interest rate. So Policy makers need to implement the policies with the consideration of growth rate of real GVA and exchange rate.
- As per findings of McCallum rule, money velocity is more responsive to change in reserve money. The policy makers have consider the money velocity as factor to analysis the inflation and it will be reach the economic and price stability.

6.4 Limitations of the study

- The study has concerned with annual data rather than quarterly or monthly.
- The study has attempted to reexamine the McCallum rule, Taylor rule and Hybrid McCallum-Taylor rule on the basis of backward-looking behavior rather than the forward-looking bahaviour.