THE IMPACTS OF MONETARY POLICY IN THE 21ST CENTURY

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THE IMPACTS OF MONETARY POLICY IN THE 21ST CENTURY: PERSPECTIVES FROM EMERGING ECONOMIES

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INVESTOR IN PEOPLE

The book is dedicated to my

Mother who left all of us in the Holy Rashapurnima this year

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Foreword

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In the era of globalization, the world economy has faced numerous challenges in terms of risks to the global growth, stability as well as to the employment. This is more so in the context of emerging market economies such as India, where the economies are opened up for the factors of production, especially the foreign capital as they were scarce. While globalization has had positive outcomes in terms of enhancing the growth potential in the capital scarce nations, it has also resulted in increasing risks being transmitted through the foreign capital. Globalization has also posed challenges to fiscal, monetary, and the external sector policies. In some countries it has resulted in high inflation while in many it has enhanced the potential growth while also leading to structural change. However, as it happened, it has also accompanied by various global shocks. Since early 1990s, the emerging market economies have witnessed shocks periodically in terms of Asian crisis, Dotcom bust, sub-prime crisis, European crisis, commodity shocks, and the recent crisis in the foreign exchange markets following US Quantitative Easing of monetary policy, Brexit, etc. This has also posed challenges in terms of the overall understanding of the relationship between various macroeconomic variables, real-financial linkages, fiscal–monetary nexus as well as domestic and international transmission mechanism of monetary policies.

While some of the above challenges are theoretical in nature, most of them are empirical and it needs to be evaluated on a continuous basis by using contemporary information as well as quantitative models. Indeed, the global shocks and its prediction also suggest that most of the empirical relationships are time varying in nature and depends on the country under question. In some countries, as the interest rates came into negative territory, it has posed challenge to theoretical understanding of the open-economy macroeconomic relationships. Toward this direction, the present book edited by Dr Ramesh Chandra Das is very timely and covers most of the issues that are relevant for the stability of emerging market economies such as India. The book especially focuses on the challenges that the economies face in formulating monetary policies in the context of global shocks.

The issues that the book covers are wide-ranging and are a combination of both theoretical as well as empirical papers. Some of the conclusion of the papers are very interesting and also in some cases challenging, especially when the conclusions are counter-intuitive. One such conclusion is about the absence of

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long-run relationship between the United States and China growth while the presence of long-run relationship of both the countries with Indian growth. But most importantly, the book helps the policymakers at least to relook at the empirical issues the way that were traditional understood. It is also worth to emphasis that some of the chapters adopt advanced quantitative methods to re-look at some of the empirical relationships. There are many chapters that look at the issue of monetary policy transmission and conclude that they largely depend on the country specific as some countries found to have credit channel while some find the presence of interest rate channel.

In the context of India, some of the chapters focus on standard monetarists propositions while couple of chapters focus on the issue of demonetization. However, the conclusions about demonetization and its impact needs to be carefully understood especially due to limited information available since the demonetization. At least when it comes to its impact on the behavior of monetary variables, one needs some more statistical information. But the scrutiny of demonetization would be much more rigorous in the coming years.

To sum it up, as Dr Das pointed out in the Introduction, the challenges to monetary policy in the twenty-first century is enormous, especially in the context of maintaining macroeconomic stability in the emerging market economies. While some of the chapters in this volume help in understanding those challenges and help in overcoming them, needless to say that there is a need for evidence-based policy making and that needs more studies that are time and country specific. In that direction, this volume is a very good addition to the literature.

Introduction

The new millennium has started with its bitter experiences on the East Asian Crisis and Dot Com bubble during the final lap of the last century. The new century has witnessed first the monetary mismanagements of the EURO Zone countries especially of the GIIPS (Greece, Ireland, Italy, Portugal, and Spain) who struggled for sovereign debt problems, the emergence of global financial crisis of the 2007–2009 preceded by housing market collapse, then the Quantitative Easing Policies taken by the US Central Bank, and the recessionary phase in the aftermath. The mismanagement in the monetary policy and its aftermath crisis effects have compelled the world leaders and the governments of the countries in the world to apply for interest rates cuts to attract new demanders in the credit market to boost up aggregate demand as well as national income. In addition to that, the newly developed group, BRICS, has started their own banking system to fight against any sort of financial crisis as well as to promote intercountry development of the group. There is again the democratic decision of the British to leave the European Community that made several policy decisions by the UK as well as the other countries in the European Zone and the countries of the rest of the world. Besides, there are the policies like demonetization by the world's second largest country in terms of population and third largest in terms of GDP, who is none other than India. The stock markets have traveled trembling after all the above monetary mismanagements.

The prime managers of monetary systems of all the country are their central banks who make adjustments of rate of interest and inflation levels by active monetary policies. But, the roles of these central banks are not independent to each other as some decisions taken by the international financial bodies like IMF and the World Bank compel them to tune their own policy decisions. The Basel norms in banking supervision make the countries' central banks to control their own banking systems at par the international standards, in terms of credit delivery and minimizing nonperforming assets. An optimum monetary policy is always accepted as income increasing and price stabilizing. Any deviation from it makes the related macroeconomic indicators to move not in their expected trajectories. Hence, any mismanagement may be crucial not only to the concerned country, but the other countries as well.

Under the milieu, the present book endeavors to establish empirically the effect of monetary policies upon economic indicators during the twenty-first century at the global, regional, group, or country levels. Motivated by the positive moves by the stake holder publisher, Emerald Publishing Limited, upon my submitted proposal, I proceeded further for its fruition. After a series of scrutiny and suggestions by the review teams of the publisher, the title is finalized as *The Impacts of Monetary Policy in the 21st Century's World-special reference to emerging economies*.

Keeping in mind its broad coverage, the book has been structured in two sections to present 27 finalized chapters. Section I envelops the monetary policy effects in the global perspectives with nine chapters and Section II covers various aspects of monetary policies at different emerging economies with special emphasis on the Indian economy with 18 chapters. The basic features of the covered chapters are outlined below.

Section I: Monetary Policy Effects at the Global Perspectives

Chapter 1 aims to determine the effects of monetary policies on capital markets of the emerging E7 economies for 1997–2016 and the results show that there is a long-run relationship between interest rate and bond market, but this is not a causality relationship. On the other side, cointegration and causality relationship does not exist between stock market and interest rates.

Chapter 2 develops a baseline theoretical framework to examine the inflation–output dynamics under the regime of monetary policy anchored to inflation rate. It reveals that the persistence of inflation is significantly explained by the credibility of monetary authority in the regime of inflation targeting monetary policy. Further, the nature of inflation–output dynamics in the aftermath of any adverse supply shock in a closed economy with inflation targeting monetary policy depends crucially on the degree of central bank's credibility and the extent of monetary transmission.

Chapter 3 analyzes the effects of the Official Development Assistance on GDP per capita of 92 developing countries for the period 2009–2013. The result of this study indicates that foreign aid through monetary policy managements has a negative influence on GDP per capita and the coefficient is always statistically significant.

Chapter 4 aims to estimate the link between asset prices and monetary policy, and also to estimate the responses of monetary policy and the asset price shocks for Nigeria. The results show that changes in asset prices lead to a marginal increase in monetary policy rate in the short run and the impact stabilizes a bit in the medium term and becomes negative in the long run.

Chapter 5 discusses the impact of negative rate on economic growth and bank customers besides discussing the future trends of negative interest rates under a conceptual framework and opined that low interest rates in the developed countries can also appear in the countries like India in the near future.

Chapter 6 reexamined the traditional research topic in finance – the efficient market hypothesis within the context of nonlinearity unit root test on the Nigerian economy. The results indicate rejections of the null hypothesis for all the series, an indication that stock market indices in Nigeria are nonlinear and asymmetric in nature.

Chapter 7 attempts to determine the optimal monetary policy instrument for Nigeria with data from 1970 to 2016 and suggest that, although money supply is superior in meeting Nigeria's monetary policy goals, a combination of both money supply and interest rate instruments is optimal rather than employing each instrument independently.

Chapter 8 explores the strategic importance of the International Monetary System, tracking its evolution, and how it is managed before leading to an examination of the emergence of the global financial capitalism. It concludes the global crisis has underlined the vulnerability of the millions of workers who lost their job and, with it, access to any source of income or health coverage.

Finally, Chapter 9, in this section, attempts to explore the dynamic impact of globalization on inflation empirically in developing countries in Asian region. Empirical findings imply that globalization significantly influences inflation in selected Asian developing economies.

Section II: Aspects of Monetary Policy in Emerging Economies with Special Focus on Indian Economy

Chapter 10 examines the impact of economic and political decisions such as demonetization, change of Clinical Establishment (CE) Act, and media news on medical tourism and also examine how demonetization and CE Act of West Bengal affect the emerging market of medical tourism in West Bengal, India upon a primary survey basis and showed that the Act played important role for discrimination where accreditation did not have significant impact for discriminating between the two groups.

Chapter 11 investigates whether three major economic indicators of the modern world economy, namely financial integration, growth rate, and trade openness, have long-run associations for the three leading economies, USA, China, and India. The results that the indicators are not cointegrated or have long-run equilibrium relations for USA and China, but they are for India. This indicates that financial integration, trade openness, and growth of income for India are interrelated.

Chapter 12 integrates the issues of fragmented credit market, vertical interaction between formal and informal financial sectors, rationing of formal credit, and monetary policy in a theoretical framework. Theoretical proposition suggests that an expansion of formal credit results in shrinking the size of contested segment of the informal credit market and thereby reduction of interest rate in the market.

Chapter 13 identifies the causes or genesis of global crisis; to examine the impact of the crisis on world economy with special emphasis on India; to make an analysis of the impact on the share price movement of select S&P BSE Sensex companies in India, and concluded that India is not an exception and the equity market performance of the select BSE companies were comparatively better in the pre-period (2005–2007) than in the crisis period.

Chapter 14 judges the efficiency of Indian commercial banks for the study period 2006–2017 using financial intermediation and service-oriented production approach, and concludes that Indian Banking industry suffered in terms of both financial intermediation as well as production during banking crisis in managerial pure efficiency but performed quite well with respect to other aspects of efficiencies.

Chapter 15 highlights historical evolution of monetary policy across the countries as well as trends in India's monetary policy over time and challenges thereof, provides some tentative solutions, and pointed out the challenge for monetary policy have been changing over time, even though some basic issues have remained of perennial concern.

Chapter 16 tries to add to the debate by focusing on an empirical analysis of sudden demonetization announced by the India Government and observed that sudden and almost complete demonetization is an unanticipated monetary shock in a very specific sense. Moreover, though the much-hyped objectives of recovering black money, curbing terrorist activities, confiscating fake currencies, and motivating a cashless economy was stated ceremoniously, no clarity was there regarding the growth objective or the possible job-loss scenario of the economy.

Chapter 17 aims to show whether there is a possible trade-off between the rate of inflation, growth, and money supply by considering annual data ranging from 1981 to 2016 for the Indian economy and the results show that India uses no predetermined strategy to change money supply, at the most the policymakers keep in mind that excessive inflation is unacceptable and money supply is moderated when expected inflation is seen to be going out of the specified bounds.

Chapter 18 examines the contribution of Indian banks' financial aspects to their operating efficiency and results show that variables positively and significantly affecting operating efficiency are past operating efficiency, provision by total advances, provision by investment, advances by deposit plus borrowing, etc.

Chapter 19 investigates the long-run and short-run linkages between "broad money supply and GDP," "GDP and inflation rate," and "money supply and inflation rate" for Indian economy and reveals that there are no long-run cointegrating relations among them. Further, causality results show that the change of growth rate of GDP has influence upon the change of growth rate of inflation in a three years period lag.

Chapter 20 reviews the concept of global liquidity and studies the effects of QE, and surplus liquidity generated there from, on emerging economy stock markets like India's to gauge the possibilities of financial market vulnerabilities and results indicate that the Indian stock market movements may not be totally independent of changes in global liquidity.

Chapter 21 aims to examine the major monetary policy changes that have taken place since independence and attempts to compare the post-crisis era to the pre-crisis one. It reveals that changes in cash reserve ratio and nonperforming asset have a positive impact on liability–asset ratio, whereas credit-deposit ratio of scheduled commercial banks has a negative influence.

Chapter 22 aims to study the significant difference between marginal cost based lending rate (MCLR) charged by different banks by using mean comparison paired *t*-test and observes that the variation of HDFC bank's MCLR has a significantly positive impact on SBI's MCLR. Axis bank's MCLR significantly and positively impacted by UBI. In case of PNB, Canara, UBI, and OBC have positive impact whereas Axis has a significantly negative impact.

Chapter 23 tries to explore the basic determinants of financial inclusion in rural India; estimate the impact of policy variables of the RBI on the flow of credit to the priority sectors in rural areas and to estimate the structural shift, if any, in this flow and identify interregional variations in the flow of credit to the priority sector particularly the self-help groups, and, hence, to identify regional variations in the process of financial inclusion. It revealed that although there has been spread of banking networks through microfinancial activities but there are growing inequalities among the groups.

Chapter 24 investigates the impact of monetary policy on the corporate financial structure, using a sample of 422 manufacturing firms in India for the period 2011–2017and the findings suggest that a contractionary monetary policy cuts down overall corporate debt, and that there is an increase in long-term borrowings of listed firms after monetary tightening.

Chapter 25 draws attention to the term "globalization of monetary policy" and some of the forces at work that indicate the pace of such globalization after giving in detail at the beginning of some common features that exist across globe in the conduct of monetary policies and found a long-run cointegration among the variables, besides that the inflation adjusts to its equilibrium rapidly at a rate of 35% in short run.

Chapter 26 analyzes the impact of monetary policy on Indian economy in the recent past to understand the effectiveness of the policy in India context in the twenty-first century world where different kinds of external financial shocks and observed that different monetary policy instruments have been adjusted by the central bank of the country to counter the shock.

Finally Chapter 27 argues that a combination of regulatory landscape in credit financing domain and insurance domain plays a crucial role in causing credit crisis in India. For making the current discussion more comprehensive, the study has also incorporated contextual discussions on monetary and fiscal aspects of policy where it finds necessary. The study finds that during crisis, credit insurance has created a demo effect and increased the risk in the free market system.

The extracts of the chapters covered by the book reveal that the global financial crisis has been the toughest crisis the world economy has witnessed in the new millennium. Not only the economies of the developed zones are affected, the economies of the emerging countries have also hit hard. The central banks of the countries have been busy in framing and adjusting different monetary policy tools to protect their economies. India is not an exception to this scenario. Besides, the demonetization policy in India has invited new unprecedented economic impacts that hindered its growth of income and employment. The policy suggestions provided by the authors in the book will inevitably help the monetary authorities of the countries to safe guard their economies from any such crises that may happen in the future.

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Editor

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After giving over a long time on the stages from proposal writing to final submission of the proposed book titled, *The Impacts of Monetary Policy in the 21st Century's World-special reference to emerging economies*, it is now an unimaginable pleasure to proclaim from my part as editor that the proposed book on the said title has been in due course unearthed. The ultimate achievement in mounting to such a huge volume could not be articulated if the contributions of plethora of academicians all around the world were not united. Hence, it would be blameworthy if I do not recognize the contributions of the concerned academicians and the other members of the society directly or indirectly attached to the project.

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Editor