SPECIAL LECTURE

A Monetary Business Cycle Model for India

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Abstract

This paper builds a New Keynesian monetary business cycle model with specific features of the Indian economy to understand why the aggregate demand channel of monetary transmission is weak. Our model allows us to identify the propagation mechanism and quantify the variance decomposition of a variety of real shocks (TFP, investment specific technological change, and fiscal policy) and nominal shocks (base money shocks, interest rate shocks) on the economy. Our main finding is that base money shocks have a larger and more persistent effect on output than an interest rate shock, as in the data. We show that financial repression (in the form of a statutory liquidity ratio and administered interest rates) does not weaken monetary transmission. This is contrary to the consensus view in policy discussions in Indian monetary policy. We also show that the presence of an informal sector hinders monetary transmission.

Venue: Economics Seminar Room, Economics Department, Presidency University.
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