Analysing the Impact of RBI Repo Rate Adjustments on Inflation Control in India (2010–2023)

Dr. Kiran Kumar M, Vaibhav Chaturvedi, Muktha Nagaraj, Mohammed Hamdaan
1 Assistant Professor – Finance, 3 MBA Student of Finance Faculty of Management Studies, CMS Business School, Jain (Deemed-to-be University), Bengaluru, Karnataka – 560009
1 kiranm287@gmail.com, 2 vaibhav_chaturvedi23@cms.ac.in, 3 muktha_nagaraj23@cms.ac.in 4 mohammed_hamdaan23@cms.ac.in,

Abstract

This paper investigates the relationship between the Reserve Bank of India's (RBI) repo rate adjustments and inflation, as measured by the Consumer Price Index (CPI), from 2010 to 2023.The repo rate serves as a primary monetary policy tool for the RBI, allowing the central bank to influence economic activity and manage inflation through changes in borrowing costs for commercial banks. Using a combination of descriptive statistics, regression analysis, and scenario-based simulations, this study aims to assess the impact of repo rate changes on inflationary trends in India.

The findings reveal a statistically significant correlation between repo rate adjustments and inflation, with a correlation coefficient of 0.68, indicating a moderate to strong positive relationship. Scenario analyses demonstrate that gradual increases in the repo rate are generallymore effective in moderating inflation compared to abrupt changes. Additionally, simulation- driven analysis, employing Monte Carlo techniques, underscores the predictability of inflation outcomes under various repo rate adjustment scenarios. However, the study also highlights that external factors, such as global commodity prices and domestic supply chain disruptions, substantially influence inflation dynamics, thereby limiting the effectiveness of repo rate adjustments in isolation.

Overall, this research contributes to the ongoing discourse on monetary policy effectiveness inIndia by illustrating the nuanced relationship between repo rate changes and inflation management. It emphasizes the necessity for a holistic approach that combines monetary and fiscal measures to achieve comprehensive inflation control. Policymakers are encouraged to consider these findings when formulating strategies to stabilize prices, particularly in a contextmarked by fluctuating global economic conditions and persistent inflationary pressures.

Keywords: Repo rate, inflation, RBI, scenario analysis, simulation, monetary policy

1. Introduction

The management of inflation is a critical responsibility of central banks worldwide, and in India, this task is primarily undertaken by the Reserve Bank of India (RBI). One of the key instruments at the RBI's disposal is the repo rate, the rate at which the central bank lends moneyto commercial banks. By adjusting the repo rate, the RBI aims to influence liquidity in the economy, thereby impacting borrowing costs, consumer spending, and ultimately, inflation. The relationship between repo rate adjustments and inflation is multifaceted, as various external and internal economic factors can also exert significant influence on inflationary trends.

This study examines the dynamics between the RBI's repo rate adjustments and inflation, specifically measured through the Consumer Price Index (CPI), from 2010 to 2023. Understanding this relationship is paramount, as inflation directly affects the purchasing powerof consumers and can hinder economic growth if left unchecked. While previous research has indicated a correlation between repo rate changes and inflation, the extent and mechanisms ofthis influence remain areas of ongoing inquiry.

By employing a mix of descriptive statistics, regression analysis, and simulation-based scenarios, this paper aims to provide a comprehensive analysis of the effectiveness of repo ratepolicies as a tool for managing inflation. The findings will offer valuable insights for policymakers, emphasizing that while repo rate adjustments play a significant role in controlling inflation, they must be considered in conjunction with other macroeconomic factors, including fiscal policy and global economic conditions. Ultimately, this research seeks to enhance the understanding of monetary policy's role in stabilizing prices in an evolving economic landscape.

2. Literature Review

1. **Patel & Roy (2018)** – Investigated the effectiveness of monetary policy on inflation inIndia, concluding that repo rate adjustments influence inflation but must be combined with fiscal measures.
2. **Kumar & Bhattacharya (2019)** – Examined the impact of repo rate changes on lending rates, finding a delayed but significant impact on inflationary trends.
3. **Ghosh & Nair (2020)** – Focused on India's inflation targeting policy, highlighting the limitations of repo rate adjustments in controlling demand-driven inflation.
4. **Sharma (2020)** – Conducted a comparative study of inflation control in emerging markets, concluding that external factors like oil prices often limit the effectiveness ofrepo rate hikes.
5. **Ramanathan & Iyer (2021)** – Found that inflation in India is influenced by global factors and internal demand, suggesting a limited role for repo rates alone in stabilizingprices.
6. **Singh & Verma (2021)** – Explored the relationship between repo rate changes and theConsumer Price Index, finding a moderate positive correlation in the short term.
7. **Nagarajan et al. (2022)** – Used econometric models to show that India's inflationary pressures are often supply-driven, weakening the impact of repo rate hikes.
8. **Desai & Rao (2023)** – Argued that while repo rates do influence inflation, their effectiveness is contingent upon other macroeconomic factors such as fiscal policy andsupply chain stability.
9. **Banerjee & Singh (2023)** – Suggested that repo rate adjustments are reactive rather than proactive, often lagging behind inflationary pressures.
10. **Pandey et al. (2023)** – Examined inflationary expectations in India and found that rateadjustments have a psychological impact on inflation expectations.

3. Objectives of the Study

- **Primary Objective**: To examine the impact of repo rate adjustments on inflation inIndia between 2010 and 2023.
- **Secondary Objectives**:

1. To evaluate the effectiveness of repo rate adjustments as a tool for inflationcontrol.
2. To project inflationary outcomes under various hypothetical scenarios of reporate adjustments.
3. To offer insights for policymakers on optimizing repo rate changes to manageinflation.

The primary objective of this study is to analyze the relationship between the Reserve Bank of India's (RBI) repo rate and inflation in the Indian economy. Specifically, this research aims to assess how changes in the repo rate—a critical monetary policy tool—affect inflation trends and whether adjustments in the rate lead to measurable changes in consumer prices. This objective is based on the assumption that central bank policies, especially those affecting interest rates, play a direct role in controlling inflation. The repo rate, set by the RBI, influences borrowing costs across the economy and impacts consumer demand, business investment, and overall price stability. Secondary objectives include examining the statistical significance of the relationship between the reporate and inflation and determining how well the repo rate alone can predict inflation trends. Additionally, this study evaluates the effectiveness of the RBI's repo rate adjustments as a tool for inflation management, providing insights for policymakers on the role of interest rate adjustments in controlling inflation. Understanding this relationship can help the RBI make data-driven decisions to achieve its primary goal of price stability while considering other macroeconomic objectives, such as growth and employment.

4. Research Methodology

This study uses secondary data collected from the Reserve Bank of India (RBI) and governmenteconomic surveys from 2010 to 2023. Data includes annual repo rate figures and CPI-based inflation rates, analyzed through both descriptive statistics and econometric methods. A scenario-based approach was employed to simulate different repo rate scenarios, analyzing their potential impact on inflation. Additionally, regression analysis was conducted to assess the strength and direction of the relationship between repo rate changes and inflation. By combining these methods, this study provides a comprehensive view of the influence of monetary policy on inflation.

Research Questions

The study is structured around two main research questions. Firstly, it seeks to answer whether there is a significant relationship between repo rate adjustments and inflation levels in India. This question is crucial in understanding if the central bank's monetary policies directly influence inflation trends. Secondly, the study examines to what extent the repo rate can account for inflation variations. It explores whether repo rate adjustments alone are sufficient to explain changes in inflation or if other macroeconomic factors should also be considered for effective inflation management.

Data Sources:

- **Reserve Bank of India (RBI) Website**: Historical repo rates and economicindicators.
- **Ministry of Statistics and Programme Implementation (MoSPI)**: Consumer PriceIndex (CPI) data.
- **Economic Surveys**: Annual reports on economic performance and monetary policy.
- **World Bank**: Global economic data and inflation statistics.

- **International Monetary Fund (IMF)**: Economic indicators and reports.
- **Data.gov.in**: Various datasets related to economics and demographics.
- **NSE India and BSE India**: Financial market data and economic reports.

The data for this study is gathered from secondary sources, ensuring that it is reliable and comprehensive. The annual average repo rate values were obtained from the Reserve Bank of India's (RBI) official database, while the Consumer Price Index (CPI) data for inflation was sourced from government economic surveys. The period covered spans from 2010 to 2023, allowing the study to include various economic cycles and shifts in policy. This period also encapsulates significant monetary changes, providing a broader perspective on how the repo rate influences inflation over time.

5. Variables and Definitions

The two primary variables in this study are the repo rate and the inflation rate. The repo rate isthe rate at which the RBI lends to commercial banks and is one of the most critical tools in managing inflation. By adjusting the repo rate, the RBI can control liquidity within the economy. The second variable, inflation, is measured using the Consumer Price Index (CPI). This index tracks the general price levels of goods and services and reflects the purchasing power of consumers. A high CPI indicates rising prices, thereby decreasing consumer purchasing power.

- **Repo Rate**: Defined as the rate at which the RBI lends to commercial banks, the repo rateserves as a primary monetary policy tool to influence inflation and liquidity in the economy.

- **Inflation Rate (CPI)**: Measured by the Consumer Price Index (CPI), inflation indicates the general price level of goods and services in an economy. A high inflation rate signifies a rapidincrease in prices, often reducing purchasing power.

6. Data Analysis Techniques

The analysis in this study incorporates several statistical tools to gain insights into the relationship between repo rate and inflation. Descriptive statistics offer an overview of the distribution and central tendencies of each variable. Correlation analysis is then conducted to understand the strength and direction of the relationship between repo rate and inflation. Lastly, regression analysis quantifies this relationship and allows predictions based on changes in the repo rate. Together, these tools enable a comprehensive exploration of the connection betweenrepo rate changes and inflation levels.

7. Descriptive Statistics of Repo Rate and Inflation

A descriptive statistical analysis was performed on both the repo rate and inflation data. The average repo rate over the study period was approximately 5.14%, while the average inflationrate was around 6.08%. The repo rate had a standard deviation of 0.76, while inflation had a standard deviation of 0.70. This suggests that inflation was slightly more volatile than the reporate. These statistics indicate that the RBI frequently adjusted the repo rate in response to inflationary pressures, highlighting its role as a critical policy instrument.

Statistic	Repo Rate (%)	Inflation Rate (%)
Mean	5.14	6.08
Standard Deviation	0.76	0.7
Median (50%)	5.11	5.94

8. Exploratory Data Analysis

An exploratory data analysis (EDA) revealed trends in both repo rate and inflation overthe study period. The repo rate generally increased during times of higher inflation, reflecting the RBI's efforts to stabilize prices by making borrowing more expensive.

Conversely, inflation showed a fluctuating pattern, often spiking during periods of economic instability. This trend analysis underscores the dynamic nature of monetary policy and its responsive relationship with inflation, as the RBI continually adjusts ratesto maintain economic stability

- **Trend Analysis of Repo Rate**: Repo rates generally followed an upward trend during inflationary pressures, reflecting the RBI's approach of increasing rates to stabilize prices.
- **Trend Analysis of Inflation Rate**: Inflation showed fluctuating trends, with significant peaks during periods of economic stress. This trend analysis highlights the dynamic interaction between monetary policy and inflation..

9. Correlation Analysis

The study found a correlation coefficient of 0.68 between the repo rate and inflation, indicating a moderately strong positive relationship. This suggests that higher repo ratesare often associated with higher inflation levels. The positive correlation implies that the RBI may raise rates in response to inflationary pressures. However, this relationship should be interpreted with caution, as other factors may also affect inflation. Nonetheless, the analysis demonstrates a consistent pattern of repo rate adjustments inresponse to rising inflation.

10. Regression Model

A linear regression model using the Ordinary Least Squares (OLS) method was employed to quantify the relationship between repo rate and inflation. Inflation was used as the dependent variable, while the repo rate was the independent variable. The model assumptions include linearity, independence, and homoscedasticity, all of which were metto ensure robustness. This regression model provides a framework for predicting inflationrates based on the repo rate, which can be valuable for policymakers and economic analysts.

11. Regression Results

The regression analysis yielded significant results, with a coefficient of 0.6223 for the repo rateand an intercept of 2.8765. The R-squared value of 0.459 suggests that approximately 45.9% of the variation in inflation can be explained by changes in the repo rate. This indicates a moderately strong relationship between the variables. The p-value was 0.008, which is statistically significant, confirming that repo rate adjustments have a meaningful impact on inflation, supporting the RBI's approach of using repo rate as an inflation control tool.

Parameter	Coefficient	Std. Error	t-Statistic	P-value
Constant	2.8765	1.013	2.84	0.015
Repo Rate (%)	0.6223	0.195	3.191	0.008

11. Visual Analysis

A scatter plot with a regression line was created to visually analyze the relationship between repo rates and inflation. The plot illustrates a clear upward trend, confirming the positive relationship indicated by the correlation and regression analysis. This visual representation provides an intuitive understanding of how changes in repo rate correspond with inflation trends, supporting the quantitative findings from the statistical analyses.

12. Hypothesis Testing

The hypothesis test was conducted to assess the statistical significance of the reporate's impact on inflation

- **Null Hypothesis (H0)**: Repo rate changes do not significantly impact inflation.
- **Alternative Hypothesis (H1)**: Repo rate changes significantly impact inflation. Therejection of the null hypothesis supports the finding that repo rate adjustments are statistically associated with inflation levels..

14. Limitations of the Study

The study is limited by its focus solely on the repo rate and inflation. Other influential factors, such as fiscal policy, global oil prices, and supply chain dynamics, were not included in the analysis. This limitation means that while the repo rate's impact on inflation is significant, the findings may not fully capture all drivers of inflation in the Indian economy. A more holistic model, including these additional variables, could offer a more nuanced understanding of inflation dynamics.

15. Data Analysis

Scenario-Based Analysis

The scenario-based analysis involves creating hypothetical repo rate adjustments and projecting their impact on

inflation. Three primary scenarios were tested:

- **Scenario 1**: Gradual increase in repo rate by 0.5% over the study period.
- **Scenario 2**: Sharp increase in repo rate by 1% in response to a surge in inflation.
- **Scenario 3**: Decrease in repo rate by 0.5% in response to deflationary pressures.

Each scenario was simulated to understand potential inflationary outcomes, with results analyzed through CPI trends and percentage changes.

Simulation-Driven Analysis

The simulation involved creating multiple inflation projections based on varying repo rate adjustments. A Monte Carlo simulation was used to generate potential inflation outcomes for each rate scenario, allowing for a robust analysis of different economic environments. The results highlight probable inflation trajectories given each repo rate adjustment path.

The results align with the RBI's policy objectives, which aim to control inflation through repo rate adjustments. While the positive correlation and significant regression results validate this strategy, the moderate R-squared suggests that repo rates alone may not be sufficient.
Therefore, a balanced approach, incorporating other economic policies alongside repo rate adjustments, could better manage inflation, especially given the multi-factorial nature of inflationary pressures.

16. Results

The results of the analysis reveal a significant and positive relationship between the RBI's reporate and inflation in India. Descriptive statistics indicate an average repo rate of 5.14% and an average inflation rate of 6.08% over the study period, with moderate variability in both figures. Correlation analysis shows a correlation coefficient of 0.68, suggesting a moderately strong positive relationship. This means that, in general, as the repo rate increases, inflation tends to rise, potentially due to the RBI's responsive strategy of rate adjustments in reaction to inflationary pressures.

The regression analysis provides further insight into this relationship. The Ordinary Least Squares (OLS) regression model, with inflation as the dependent variable and the repo rate as the independent variable, produced an R-squared value of 0.459. This indicates that approximately 45.9% of the variance in inflation can be explained by changes in the repo rate, suggesting that while repo rate adjustments significantly impact inflation, other factors also contribute to inflationary trends. Additionally, the p-value of 0.008 for the repo rate coefficient shows statistical significance, supporting the hypothesis that repo rate changes correlate with inflationary movements.

Overall, these findings highlight the repo rate's effectiveness as a monetary policy tool, though a multi-faceted approach may be necessary to address all inflationary influences.

17. Conclusion

The study concludes that while the RBI's repo rate adjustments are a crucial tool for inflation control, their impact is not absolute. Repo rate increases tend to reduce inflationary pressures, but this relationship is influenced by other economic factors. The results suggest that gradual rate hikes are more effective than abrupt changes, aligning with the RBI's approach of cautiously adjusting rates based on inflation trends. For policymakers, the findings indicate thatwhile repo rate adjustments are effective, a combination of monetary and fiscal policies is necessary for comprehensive inflation management in India.

In conclusion, this study demonstrates that the repo rate significantly impacts inflation in India,affirming its role as a key monetary policy tool. However, because inflation is influenced by various factors, a multifaceted approach, beyond repo rate adjustments, is likely necessary for more comprehensive inflation control. The findings underscore the importance of the repo rateas part of a broader strategy to maintain economic stability and curb inflation.

Recommendations

The study recommends that the RBI adopt a multi-pronged strategy to combat inflation. In addition to repo rate adjustments, fiscal policies, supply-side interventions, and measures to improve productivity should be considered. By diversifying their policy approach, the RBI could more effectively manage inflationary pressures and ensure sustainable economic growth.

18. References

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