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Impact of Monetary Policy on Inflation

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Abstract:
This paper investigates to find out the relationship between inflation and monetary policy. The paper support the assertion that inflation in Pakistan is a monetary phenomenon, but changes in money supply does not impact inflation rapidly. The study states that the system does not congregate to equilibrium in reaction to fluctuations in any of the variable.
Inflation is one of the key problem confronted by fewer established countries. In addition to the distortion of income distribution, inflation unpleasantly disturbs the poverty level and prospects of business enterprises. All Central monetary authorities in fewer advanced countries, expresses a monetary policy to control inflation in Pakistan.
There is a lot of empirical studies on monetary policy and inflation are presented which explain their relationship deeply and all of them mostly evaluated the productiveness of monetary policy in controlling inflation in Pakistan. This study fills the breach in the literature by exploring the interconnection of monetary policy and inflation.

1. Introduction

Monetary policy can be well-defined by the procedure in which the government or central bank country focus on money supply, money availability, & interest rate, so as to accomplish an arrangement of goals situated towards the development and solidness of the economy. On the other side, inflation refer to a constant increase in the basic worth level of goods or services in an economy over a time period, when the level of price increases every unit of a currency buys some goods and services. Inflation adversely can disturbs the total growth of the country, effect of inflation on the economy among the central bank can be the constant value is the prime goal of monetary policy and the central banks have agreed inflation as the focal of monetary policy, and aiming on the inflation explicitly or verifiably as and when needed.
This study aimed to focus on the relationship between monetary policy and inflation as these are the two significant factors that plays their role in the economic prosperity of the country as well as gives insights in predicting and regulating the economic pitfalls.

1.1. Research Questions

- What is the impact of monetary policy on inflation?
- What is the relationship between interest rate on inflation?
- How monetary policy effect the price of FMCG's in Karachi?

1.2. Purpose of Study

The purpose of this study is to determine the relationship between the monetary policy and the inflation, how the increment and decrement in inflation impacts the country and how policy makers can monitor and control inflation through changes in monitory policy making.

1.3. Significant of the Study

This study is an important step to understand the relationship of inflation with monetary policy. This study is a useful tool for the policy makers in making different monetary policies for monitoring and regulating inflation, through this we going to find out that how we can control inflation through making different monetary strategies because increment in inflation is bad for every country. Karachi is being targeted in the study as it comprises of most about huge population.

1.4. Objectives of the Study

- To find the impact of monetary policy on inflation.
- To find the relationship between interest rate on inflation.
- To find the effect of monetary policy on the price of FMCG's in Karachi.

1.5. Limitations

In this study we have done our full efforts to fulfill the objectives , the research has successfully achieved the above mentioned objectives. Some of the limitations were:

- There were very few recent researches found on the topic, most of the researches were outdated and the trends were old.
- It's difficult to find secondary data on the internet about monetary policy because of confidentiality.
- The time spam of the research was limited.

1.6. Scope of the Study

This research will provide guidelines for the future researches about the concern variable and their relationships. The world is changing and this is changing the trends of the economies , this research provides an updated knowledge of the present trends and implications for the future .

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2. Literature Review

(Takáts, 2015)A few nations need aid simultaneously encountering truly low expansion rates and ages populaces. May be there is a connection, as of late proposed toward percentage senior national bankers. We attempt a thorough test from claiming this theory previously, a board from claiming 22 nations again those 1955–2010 periods. They Figure a stable and noteworthy relationship to the middle of the demography. Furthermore, low-frequency expansion to particular bigger offer for dependents (i.e. youthful Furthermore old) will be associated with higher inflation, same time a bigger. They find a significant, though unstable, association with the middle of demography and also monetary policy.

(Sims, 2009) BIS working papers would composed by parts of the monetary and financial section for those bank to global Settlements, who wants more from duration of the time should time eventually Tom's perusing different economists. Furthermore, they need aid distributed toward those banks. The papers need aid for subjects from claiming topical anesthesia premium and are specialized foul clinched alongside character.

This paper has three parts. Part 1 constructs an established budgetary model from claiming inflation, increased toward a complete situated from claiming financial markets. Part 2 develops an arrangement for adjusted cases to delineate how the center monetary model demonstrates those historical backdrops from claiming expansion. Part 3 gives proof should indicate that those unpredictable monetary policies, taken after in those get of the 2008 budgetary crisis, might have been successful on settling expansion desires those center fiscal model gives an bound together schema on clarify how a premium lead could make used to control expansion to typical times, and to illustrate the reason for the unpredictable monetary approach the point when strategy attains the zero level bound. (Farmer, 2012)

In the direct of monetary policy, there exists a risk-return trade-off to the middle of financial states and financial stability, which complements monetary policy's conventional trade-off the middle of expansion and true action. Those trade-offs exist regardless of the monetary approach doesn't focus budgetary soundness considerations freely from claiming its expansion and genuine movement goals, in light of dangers on future monetary dependability need aid expanded toward the development of monetary vulnerabilities starting with persistency. Accommodative monetary approach at that economy is near possibility. (Tobias Adrian, 2014)they survey monetary Arrangement transmission channels and budgetary frictions that provide for climb on this trade-off between Money related states Furthermore budgetary stability, inside the following project crosswise over stake markets saving money firms, shadow banking, and the nonfinancial division.

An essential certainty to rise up out of the VAR (value at risk) assessments is that exogenous monetary policy shocks (additionally named unsystematic monetary policy) have a postponed, persevering, hump formed impact on inflation. According to(Mojon, 2005)The argue that this experimental design is fragile, specifically, it vanishes when one adjustment for the impacts of expansive movements (breaks) in normal inflation or analyzes periods without such moves. A vital result is that the hump molded VAR evaluated reaction of inflation is not fitting to fit adapted models of the reaction of inflation around a stable steady state of inflation level.

Numerous business cycle models use an even short-run Phillips curve, because of time-dependent estimating a vital complementarities to illustrate variances on genuine yield. But, done finishing so these models anticipate unrealistically high persistence to hold on and also Dependability about us expansion for late decades. We ascertain "reset value inflation" based on new costs decided toward those subsample of cost changers to dismember this error. They Figure that the models produce a lot of hold on in Also soundness both previously, reset value expansion in the route reset value expansion is changed over under real expansion our discoveries exhibit a test with existing demonstrations for benefits of the business cycles.(Mark Bils, 2012)

(Ume, 2011)This article concentrates on the effect about monetary arrangement onGDP. The paper Look into about different creators has been mulled over in this respect to demonstrate those theories then afterward in profundity investigation by applying relapse investigation procedure that association between those two exists. The information of previous 30 years' time ofPakistan need been utilized for driving the conclusion. The study demonstrated that the investment rate need minor relationship with GDP yet the Growth over cash supply extraordinarily influences. Further be utilized to developmental undertakings to the Growth of Economy, nature, improvements, family unit production, underground economy, expectancy, environment, Political resistance and ethnic Equity.

Inflation will be a standout amongst those primary issue confronted toward the nation. Pakistan (SBP) formulates monetary strategy to control expansion for Pakistan. A considerable measure about investigations have been utilized should inspect immediate.

Contemporaneous impacts of cash supply development ahead swelling rate in Pakistan. Nonetheless those impacts from claiming variability previously, cash supply need in this way not been analyzed. This investigation will be endeavor with inspect the effect About monetary variability around swelling rate to Pakistan. We have assessed monetary variability form utilizing basic moving difference of the long haul arrangement for its continuously vast majority resorted should act in connected facts. Basic graphical systems would use to inspect reaction of inflation. Pakistan over light of the key discoveries of the study, it may be recommended that SBP necessity with control fiscal variability alongside cash supply growth should control inflation clinched alongside Pakistan. (asmat Ullah, 2013)
This paper endeavors should figure out long run association between inflationand cash supply. This paper backing those declarations that inflation in Pakistan will be monetary wonder in the long run yet all the progressions in cash supply doesn't affect inflation right away. (Anwar, 2012)those examine proclaims that those framework doesn't meet will harmony because of the opposition to progressions previously any of the variable.
(QAYYUM, 2006)This research paper link the between the abundance cash supply growth and inflation in Pakistan. It should test that legitimacy of the monetarist stance that inflation will be monetary phenomenon. Effects from the relationship investigation show that there may be a sure companionship the middle of cash development and inflation. The cash supply growth in first round influences genuine GDP development during those moment round it influences inflation over Pakistan. Those significant finding starting with that investigation is that the abundance cash supply growth need a paramount donor of the climb in inflation over Pakistan, throughout the contemplate period, hence supporting those monetarist proposition that expansion for Pakistan will be An monetary policy.
(Rabanal, 2004)this paper evaluate the essential of the cost channel from declaring monetary policy to another. Keynesian model of the business cycle insignificant and open to rigidities will be augmented by obtaining that a segment about firms have on attain money to pay their expenses. Subsequently, monetary policy fixing extends capable unit work costs for manufacturing and may propose an increase in inflation. This paper examines the states under which those model could Produce a positive response of inflation with a monetary compression, and appraisals the model's parameters using Bayesian strategies. Those paper demonstrates that the surveyed interest side effects for monetary strategy overpower the assessed supply symptom, paying little heed to restrictions would drive. That settle on occasion of a certain extension light of a monetary compression less averse.

3. Methodology

The method that is used for this research is based on secondary based data collected by using an historical data of consumer price index (CPI) and interest rates.

3.1. Hypothesis

In this study we strive the impact of monetary policy that how it will increase or decrease the inflation in Pakistan by analysis the following hypotheses:

- H_0: There is no impact of monetary policy on inflation.
- H_1: There is an impact of monetary policy on inflation.

3.2. Model

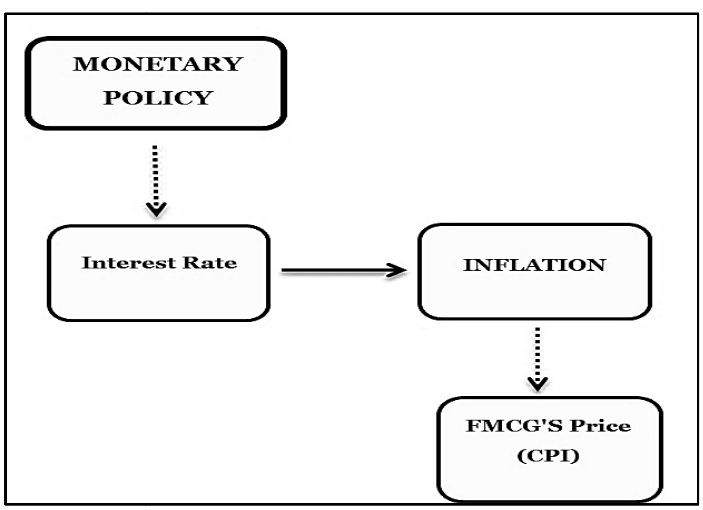

Figure 1

3.3. Data Source

- In this study wecollect the secondary based data (i.e. ratio & interest rate graphs).
- We will find different models to find out the result that how interest rate l affect the inflation.
- We will take a recent survey of the economy of Pakistan to find out the CPI.

3.4. Statistical Techniques

In this study we will useSPSS to collect all the data and find the effects on monetary policy and inflation in Pakistan.

4. Data Analysis

The analysis of the hypothesis is tested on SPSS to find the results of this study.

4.1. Descriptive Statistics

Descriptive Statistics							
	N	Minimum	Maximum	Mean	Std. Deviation	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
Interest Rates	47	4.50	13.50	9.7766	2.22586	.058	.347
Consumer Price Index	47	69.49	202.11	132.0394	44.77581	.135	.347
Valid N (list wise)	47						

Table 1

4.2. Correlations

Correlations			
		Interest Rates	Consumer Price Index
Interest Rates	Pearson Correlation	1	.187
	Sig. (2-tailed)		.209
	N	47	47
Consumer Price Index	Pearson Correlation	.187	1
	Sig. (2-tailed)	.209	
	N	47	47

Table 2

4.3. Regression

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3215.017	1	3215.017	1.625	.209[b]
	Residual	89009.154	45	1977.981		
	Total	92224.171	46			
a. Dependent Variable: Consumer Price Index						
b. Predictors: (Constant), Interest Rates						

Table 3

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	95.319	29.524		3.229	.002
	Interest Rates	3.756	2.946	.187	1.275	.209
a. Dependent Variable: Consumer Price Index						

Table 4

5. Conclusion

From the above stats, we can bring about that monetary policy is the most vital tool for economic growth in Pakistan. Monetary policy is termed as expansionary when regulators decide to increase the money supply and lower interest rates so as to encourage the expansion of businesses and thus reducing unemployment, however on the other hand inflation increases. Whereas, monetary policy is termed as Contractionary curbs the supply of money in the market, increases the interest rates and thus discouraging the expansion of businesses so as to cater inflation or sustain it to acceptable level. Regulators, select the type of monetary policy i.e. Expansionary monetary policy or Contradictory monetary policy as per the needs of economy. This research has attempted to explore the effects of components of monetary policy and related inflation on the economic growth of Country through analyzing the ten year data (2004 from 2015).

6. Acknowledgement

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In the end I hope and pray that this report meets the criteria.

Thank You

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APPENDIX I

1. Interest Rates

Years	January-March (%)	April-June (%)	July-September (%)	October-December (%)
2015	8	6.5	6.5	-
2014	9.5	9.5	9.5	9
2013	9	9	8.5	9.5
2012	11.5	11.5	10	9.5
2011	13.5	13.5	13	11.5
2010	12	12	12.5	13.5
2009	13.5	12.5	12.5	12
2008	9.5	11.5	12.5	4.5
2007	9	9	9.5	9.5
2006	8.5	8.5	9	9
2005	7	8.5	8.5	8.5
2004	7	7	7	7

Data Source: http://www.tradingeconomics.com/pakistan/interest-rate

2. Consumer Price Index

Years	January-March (%)	April-June (%)	July-September (%)	October-December (%)
2015	195.57	200.89	202.11	-
2014	190.82	194.74	199.4	196.79
2013	175.82	179.94	185.18	188.68
2012	164.98	169.99	172.44	172.82
2011	148.91	152.78	158.5	160.12
2010	131.75	134.83	143.49	145.9
2009	118.49	120.64	124.89	126.37
2008	100.64	108.72	115.23	116.18
2007	88.19	89.46	93.51	95.34
2006	81.91	83.61	86.28	87.63
2005	76.61	77.67	79.35	80.48
2004	69.49	71.43	73.11	74.17

Data Source: http://www.tradingeconomics.com/pakistan/consumer-price-index-cpi