

SHORT-TERM MONETARY POLICY IN A DEVELOPING ECONOMY*

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IN India, so far no attempt has been made to provide estimates of total money supply and its components on monthly basis so that seasonal fluctuations in national income (particularly in agricultural production) are taken care of. Here we shall try to find out the seasonal fluctuations in national income and money-multiplier (potential increase in total money supply for unit increase in currency) so that the total increase in money supply and the increase in its components are determined in consonance with the objective of price-stability. We shall also try to determine the genuine need of small coins.

I. *For a Quantity Theory Approach*

An effective monetary policy requires regulation of both money supply and rate of interest. In developing economies the money and capital markets are either undeveloped or under-developed. Most of the increases in money supply, therefore, are likely to be channelised towards the commodity market and bidding the prices of commodities up. In other words, it is likely that money supply affects expenditure directly and not via rate of interest. In terms of Prof. Modigliani's³ equations $Y = L^{-1}(M)$ (the inverse of demand for money equation $M = L(Y)$ and $Y = v(r)M$ where Y stands for income, M for money supply, v for income velocity of circulation and r for rate of interest, it means that for quantity theory to hold the demand function for money should be stable in income and there should be no correlation between money supply (M) and rate of interest (r), between income (Y) and r , and between velocity of circulation (v) and r .

For examining the stability of the demand function for money, i.e. whether the regression coefficient of money supply with the

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