

IMPACT OF MONETARY POLICY ON ECONOMIC STABILITY

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By

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CERTIFICATION OF AUTHORSHIP

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled “**Impact of Monetary Policy on Economic Stability**”. The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor it has been proposed and presented as part of requirements for any other academic purposes. The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declare that all information sources and literature used are cited in the reference section of this dissertation.

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REPORT OF RESEARCH COMMITTEE

Mr. Sajjan Shrestha has defended research proposal entitled “**Impact of Monetary Policy on Economic Stability**” successfully. The research committee has registered the dissertation for further progress. It is recommended to carry out the work as per suggestions and guidance of supervisor Dr. Pitri Raj Adhikari submit the dissertation for evaluation and viva-voce examination.

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APPROVAL SHEET

We, the undersigned, have examined the dissertation entitled “**Impact of Monetary Policy on Economic Stability**” presented by Sajjan Shrestha candidate for the degree of Master of Business Studies (MBS Semester) and conducted the viva voce examination of the candidate. We hereby certify that the dissertation is worthy of acceptance.

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ABBREVIATIONS

CBs-		Commercial Banks
FMDB L	-	First microfinance Development bank Ltd.
GDP	-	Gross Domestic Product
MFDBs	-	Microfinance Development Banks
MFI s	-	Microfinance Institutions
NRB	-	Nepal Rastra Bank
SACCOs	-	Savings and Credit Cooperatives
SPSS	-	Statistical Package for Social Sciences
WDR	-	World Development Report

ABSTRACT

This research study investigates the impact of monetary policy on economic stability in Nepal sample commercial banks by developing a model that is able to investigate how monetary policy of the government has affected economic stability through the use of multi-variable regression analysis. We understudied the variables of monetary policy instruments to include: broad money supply (MS), average exchange rate (EXC), repo rate (REPO), and consumer price index (CPI). Economic stability was represented by Gross Domestic Product (GDP) at constant prices. Descriptive research design was employed and all our estimating variables were stationary at first difference except the component of interest rate which shows that our model interpretation would be spurious and a true representation of the relationships that exists between the explained and explanatory variables. To accomplish the purpose of the study, various analysis models were employed.

From our result, all four variables (money supply, average exchange rate, repo rate and consumer price index) had a positive but fairly significant impact on economic stability. Measures of all this variables ratio on the other hand, had a positive but highly significant impact on economic stability which supports the assertion by Busari et al. (2022) that monetary policies are better suited when they are used in targeting inflation rather than in stimulating growth. In addition, regression analysis was done and showed the existence of a long run relationship between monetary policy and economic stability. Finally, our variables and the results showed the existence of auni-directional causality between money supply and economic stability. We recommend that partial autonomy should be replaced with full autonomy for the central banks, which is invariably subjected to government interference and its politics. Finally, monetary policies should be used to create a favourable investment climate by facilitating the emergency of market.

The result supports the impact of monetary policy on economic stability of the country. It can reduce unemployment, promote investments and stabilize the economy so monetary authorities and policy makers should focus on healthy monetary policy for economic stability of the country.

Keywords: Broad money supply (MS), Average exchange rate (EXC), Repo rate (REPO), and Consumer price index (CPI) and Gross domestic production (GDP)

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

By regulating the amount of money in circulation, the central bank seeks to preserve price stability. Therefore, through a variety of mechanisms, monetary policy influences economic development in a stabilizing manner. The type of the mechanism used to transmit monetary policy, the pursuit of other major goals of the policy at the same time, and other elements, such as the uncertainty that faces decision-makers and the direction of economic policies, may, nonetheless, restrict the extent of this function. Furthermore, pursuing intermediate aims concurrently with the ultimate goal of attaining sustainable growth may have consequences (Nkoro, 2005).

Price stability is preserved by monetary policy, which contributes to sustained growth. Monetary policy employs its instruments to efficiently control the money supply in order to preserve medium- to long-term price stability, as prolonged increases in price levels are seen to be primarily a monetary phenomena. It is suggested by theory and empirical data in the literature that lower price levels are linked to sustainable long-term growth. To put it another way, excessive inflation is detrimental to the welfare and long-term economic performance (Folawewo & Osinubi, 2006). The financing circumstances in the economy are greatly impacted by monetary policy; these factors include costs as well as credit availability and banks' willingness to take on particular risks. It also affects expectations of how inflation and economic activity will develop in the future, which has an impact on currency rates, asset prices, product pricing, investment, and consumption (Ahrend et al., 2008).

For instance, a monetary policy move that decreases interest rates also lowers borrowing costs, which encourages investment and the purchase of consumer durables. Banks may loosen lending policies in response to expectations that the economy would grow, allowing individuals and businesses to increase spending. A low interest rate environment makes equities more appealing to purchase, increasing family financial assets.

Additionally, this may increase consumer spending and increase the appeal of businesses' investment initiatives (Banadoi et al., 2009). Low interest rates also contribute to currency depreciation since rising costs for imported items increase demand for homegrown goods. These elements work together to increase investment, consumer spending, production, and employment (Ahrend et al., 2008).

The main goals of monetary policy are to maintain a sustainable balance of payments and manage inflation; in order to do this, monetary and fiscal policy must work closely together. Monetary policy's ability to stabilize the economy is constrained in the absence of fiscal restraint (Mankiw, 2002). Similar to fiscal policy, monetary policy promotes growth in its stabilizing capacity. Additionally, monetary impulses directly impact output. Because of this, the credit limitation that defines fund-supported programs is frequently linked to a short-term slowdown in production growth, but it can be challenging to separate the effect of credit restraint from the accompanying fiscal contraction. Furthermore, the structural features of the financial system, such as the way in which taxes, spending, and the public enterprise sector are organized, have strong oligopolistic banking sector and widespread interest rate and credit regulations that are intended to encourage investment, advance priority industries, and supply the public sector with low-cost financing are features of the financial systems seen in many developing nations. Investment and growth have been hampered by these limitations since they have frequently led to poor savings and an inefficient use of financial resources. Furthermore, when uncontrolled financial markets expand, these regulations often erode, which makes it harder for monetary policy to accomplish its stabilizing goals. Long-term structural adjustment and growth can be facilitated by financial reform, which encourages the expansion of financial markets and increases dependence on credit allocation and interest rate mechanisms set by the market. This may also improve the monetary policy's efficacy (Dhal et al., 2011).

Since the supply and demand of a wide range of products and services determines prices, the central bank does not directly regulate them. Nevertheless, the central bank may affect how prices are determined and therefore meet its inflation objective by

implementing monetary policy. The latter emphasizes how crucial it is that the monetary authority determine how its actions affect the whole economy and, in particular, the process of setting prices. The monetary policy transmission mechanism is the study of the pathways by which these impacts occur (Dhal et al., 2011). Generally speaking, the way that central banks meet the demands of the economy for liquidity is how they carry out monetary policy. This phase might be characterized as the transmission mechanism's first stage. Money market players get liquidity from the monetary authority through adjustments to certain items of the central bank balance or through other actions that have a direct impact on interest rates. According to Dhal et al. (2011), there are four channels in the second stage of the transmission mechanism that allow short-term interest rates to affect overall supply and demand as well as pricing.

1.2 Problem Statement

The acts of a central bank or other regulatory body that control the amount and pace of expansion of the money supply, which in turn influences interest rates, are known as monetary policy. Adjusting interest rates, purchasing or disposing of government bonds, and adjusting the amount of cash banks must retain in the vault are ways to sustain monetary policy (Acharya, 2013).

The term "monetary policy" refers to any measure taken to alter the amount of money in circulation. It can take two forms: contractionary policy, which lowers the overall amount of money in the economy, and expansionary policy, which raises it. Conventionally, expansionary policy has been employed to address unemployment. In this view, the only choices and actions of the monetary authority and the state that have an impact on the amount of money in circulation and interest rates are referred to as monetary policy. Therefore, the definition of monetary policy is defined as include actions that affect the price, amount, and accessibility of credit in order to accomplish predetermined goals.

Any monetary policy's main goal has always been to promote economic development and stability. However, as financial inclusion has gained more attention, the financial market and institutional framework have developed both globally and in Nepal. Therefore, as the

financial system has evolved, the likelihood of experiencing financial difficulty has also increased, especially in the wake of the 2008 global financial crisis. As a result, challenges with financial stability are linked to the expansion of the financial industry. Different economists have different opinions on it. For example, Gokarn (2010) and Woodland (2012) said that the monetary authority's mandate should be expanded to include financial stability as a secondary goal in addition to the principal goal of preserving price stability. On the other hand, Svensson (2010) contended that in order to prevent misunderstanding between the two policies, the purpose of financial stability should be separated from that of price stability. Thus, the question of whether financial stability should be fully or partially under the purview of the central authority together with price stability or if financial stability should be handled by a different body emerges. The question of whether the tools available to the central bank (credit, interest rates) to address price stability are adequate to guarantee both the dual objectives of price stability and financial stability is another crucial one. Lastly, is there a connection of any kind between financial and price stability? If so, what is the duration—long term or short term? This study proposal is an attempt to address all of these unresolved issues. Researchers, policy makers, and academics will all benefit from the study project. The following problems with the study's data are:

- i. What part does monetary policy play in preserving Nepal's economic stability?
- ii. Is there a connection between Nepal's gross domestic output and the country's broad money supply, exchange rate, repo rate, and consumer price index?
- iii. How well do the various instruments of monetary policy work together to keep Nepal's economy stable?

1.3 Objectives of the Study

This study aims to examine how monetary policy affects Nepal's economic stability. In particular, it looks at economic stability by analyzing internal and external default risk indicators. The primary aim of this research is outlined below.

- To evaluate how monetary policy contributes to Nepal's continued economic stability.

- To investigate the connection between Nepal's gross domestic output, the broad money supply, the exchange rate, the repo rate, and the consumer price index.
- To evaluate the efficiency of various monetary policy instruments in preserving Nepal's economic stability.

1.4 Rationale of the Study

The historical context of inflation and the key decisions made by various governments in various nations have an impact on this research. Because of various economic swings from 2017 to 2019, the function of monetary policy key rates has been increasingly important in Nepal in the modern period. The study will support the researcher's work on sustainable development and policy formulation. The research could offer guidance to many organizations, decision-makers, and individuals or groups interested in the same or similar fields. It was discovered that the inflation was under control during the research period. Maintaining price stability, which is closely related to fluctuations in price levels, or inflation, is the major goal of monetary policy. As a result, the study has critically assessed how monetary policy affects economic stability.

1.5 Limitations of the Study

- i. The study's foundation is the use of macroprudential and monetary policy tools to influence the economy and determine economic stability.
- ii. The NRB's data and the results of using the right computer software are what determine how accurate the conclusions are.
- iii. Secondary data from several NRB and concerned official publications served as the foundation for this investigation.
- iv. The study covers the data of 10 years from 2013/14 to 2022/23.
- v. Only macroeconomic variables are examined in this study; other variables are disregarded.

CHAPTER-II

REVIEW OF LITERATURE

It is very commendable that so many academics and professionals in the field of monetary policy have contributed. Despite the fact that many papers have been analyzed, only those that are closely associated with this study have been included in order to identify certain research gaps.

2.1 Conceptual Review

The relationship between monetary policy and the economy is a topic of intense debate and extensive study. The role of monetary policy is growing, and its instruments are becoming more deeply ingrained in the economy, despite shifts in economic theory and basic ideas. It thus creates opportunities for more study and policy development. The influence of monetary policy on economic regulation through inflation and output channels is one of the basic ideas pertaining to economic regulation. Mathai (2017) looked at how monetary policy controls the money supply, which in turn controls inflation and economic activity to stabilize the economy. Mathai agreed with the Fed and ECB's strategy of controlling inflation and economic growth through monetary policy.

a) Definition of Monetary Policy

One might define monetary policy broadly or narrowly. In a larger sense, monetary policy encompasses not just monetary actions that affect the cost and availability of money, but also non-monetary actions that affect the monetary situation, such as physical control, wage or price control, budgetary measures, and income policy actions. However, when interpreted narrowly, policy refers to any monetary choices and actions intended to have an impact on the monetary system.

The "Quantity theory of money," which views nominal national income, best captures the early perspective on monetary policy. Up until the early 1930s, when money had very little effect in increasing output or aggregate income, this strategy was quite common. On the other hand, as components of the actual sector of the economy, it was primarily

defined by capital, labor, or technology. As a result, classists contend that money has no influence on the actual economy and instead plays a passive function in it. Back then, the sole goal of monetary policy was to contain inflation. This does not imply that the goal of monetary policy was to achieve a zero rate of inflation, but rather that a low and positive rate of inflation (let's say 1 or 2 percent), which was a crucial component of economic policy, and that raising the money supply under normal conditions will raise aggregate output while also lowering interest rates.

b) Definition of Economic Stability

Every central bank has made achieving economic stability its top priority. Low and steady inflation is a sign of economic stability. Economic stability, in general, refers to the overall level of prices in the economy that does not significantly fluctuate over time. Stated otherwise, there ought to be minimal oscillations in the overall level of prices within the economy, or alternatively, there shouldn't be a notable degree of either deflation or inflation. Monetary equilibrium and economic stability are synonymous. The level of prices is established when the money supply and demand are equal. When customers need the same amount of money to make the purchases they wish to make, neither more nor less, this pricing (at equilibrium level) tends to stay steady. The steady level of prices in the economy that prevents protracted periods of inflation or deflation and maintains the value of money throughout time is known as economic stability.

Economic stability means that consumer spending is unaffected by inflation, so that consumers don't have to worry about their money's worth fluctuating over time. Note that price increases for specific items and services are not the same as price increases for the overall level of commerce. The general level of prices does not necessarily alter in response to shifts in the supply and demand for specific items. When a product's price rises by 5% but the overall price level stays constant, consumers are aware that the product's relative price has increased and may choose to purchase it in smaller quantities. However, consumers won't be able to discern the relative pricing if the general price level is unstable owing to excessive inflation since there will be rapid variations in prices.

Hence, economic stability aids in the decision-making process for enterprises and consumers as it relates to investment and consumption.

c) Inter-Linkages between Economic Stability and Monetary Policy

The previous 25 years have seen changes to the monetary policy framework. According to the central banking system's history, the primary goals of central banking's establishment in the early 17th century were to issue currency and provide funding for the government. For instance, the first central bank was the Swedish Riksbank, which was founded in 1668 as a joint stock bank to lend money to the government and serve as a clearinghouse for the private sector.

The 19th century saw a shift in central banks' goals. The obligation to ensure financial stability started to become apparent, even if it wasn't explicitly acknowledged as a central bank duty. Nonetheless, Walter Bagehot's "responsibility doctrine," which emphasizes the central bank's duty as the lender of last resort, continues to be the cornerstone of the financial stability function.

As we turn our attention to the 20th century, the Great Depression forced central banks to concentrate on creating jobs and growth in order to protect against the crises that arose in the late 1930s and early 1970s. However, price stability became one of the central banks' main goals in the 1980s as a result of the stagflation situation (high unemployment and inflation). It was found that when resources were allocated efficiently, price stability would always result in financial stability. Research grounded on the experience of developed nations such as the US, UK, Canada, and Japan imply that price volatility fueled financial instability (Bordo and Whelock, 1998).

But the goals of central banks have drastically changed in the twenty-first century, especially in wealthy nations, especially in the wake of the 2008 financial crisis. As a result, the express goal of monetary policy should be to ensure economic stability; that is, monetary policy and financial stability policy should be distinguished from one another. However, opinions on who should have central power to deal with economic stability continue to diverge.

d) Objectives of Monetary Policy

The various objectives of Monetary Policy of Nepal are as follows:

Growth in the economy is the primary goal of monetary policy. Through regulating interest rates and their effect on economic investment, monetary policy affects economic growth. The economy accelerates investment and fosters economic growth when the NRB chooses an easy credit policy, i.e., by maintaining low interest rates.

Price stability is seen as the main goal of monetary policy. Price instability is a result of both deflation and inflation, both of which are bad for the economy. The primary goals of monetary policy are to prevent such a scenario and maintain prices at a level that reduces income and wealth disparities.

Exchange Rate Stability: The goal of monetary policy is to keep the exchange rate relatively stable and to prevent frequent fluctuations. By adjusting foreign currency reserves, the NRB seeks to influence foreign exchange demand and preserve exchange rate stability.

Balance of Payments Equilibrium- India and other developing nations are plagued by the imbalance of payments. The balance of payments is made up of two parts: the balance of payments deficit and the balance of payments surplus. The former illustrates an overabundance of money in the economy, whilst the latter indicates a deficiency. By means of its Monetary Policy, the Reserve Bank of India endeavors to preserve balance in the Balance of Payments.

e) Benefits of economy stability

In order to achieve high levels of employment and financial growth, economic stability helps by:

1. Increasing price mechanism transparency to prevent price fluctuations in relation to changes in the general level of prices from being misinterpreted. This facilitates more effective resource allocation and well-informed investment and consumption decisions.
2. It lowers the danger of inflation in interest rates. As a result, real interest rates drop and investment incentives rise.
3. It assists in mitigating the adverse effects of inflation or deflation by avoiding pointless endeavors.

4. Diminishes inflationary or deflationary distortions, which may worsen the distorting influence of tax and social security systems on economic behavior.
5. Avoiding a random transfer of income and wealth due to unanticipated inflation or deflation.
6. Finally, price stability is influenced by financial stability.

Monetary policy in developed nations has a short-term impact on actual economic activity and a long-term impact solely on pricing. It is debatable if monetary policy has a short-term impact on output for emerging economies (Starr, 2005). The main causes of this are that in mature economies, there is imperfect competition, sticky wages, and sticky prices, all of which encourage monetary policy to counteract aggregate shocks. While wages and prices are flexible in developing countries, monetary policy also confronts difficulties due to the concerns of currency substitution and fiscal dominance. Asongu (2013) claims that the impact of monetary policy changes on real variables is less evident in nations with high rates of inflation, a flexible labor market, and salaries because these changes may be swiftly reflected in prices with minimal actual impact.

f) Instruments of monetary policy

The Bank Rate, Cash Reserve Ratio (CRR), Repo Rate, Reverse Repo Rate, Statutory Liquidity Ratio (SLR), and other measures are examples of monetary policy tools.

Bank Rate: The rate at which NRB lends money to commercial banks is known as the bank rate. The interest rate that the NRB charges for supplying money or loans to the banking sector is called the bank rate, often referred to as the discount rate. Money is supplied in one of three ways: directly through loan, through discounting, or through the purchase of money market instruments like Treasury and commercial bills. In an inflationary environment, the central bank raises the bank rate, which raises the cost of borrowing for commercial banks. This lowers the volume of credit extended by the banks, which in turn reduces the amount of money in circulation, and vice versa.

Repo Rate: Repurchase rate is abbreviated as "Repo Rate." These loans are often made for brief periods of time. To put it simply, repo rate refers to the interest rate at which the NRB loans money to commercial banks in exchange for the commitment of government securities. The interest rate at which commercial banks borrow money from NRB during financial crises through the sale of their assets and bonds is known as the repo rate. It

works well in temporary financial crises. It is one of the most effective instruments the central bank has at its disposal to manage the nation's money supply, inflation rate, and liquidity.

The NRB raises the repo rate when the economy requires less money supply, which makes it harder for banks to borrow money. Conversely, the central bank lowers the repo rate when the economy needs more money, which encourages banks to borrow money.

Reverse Repo Rate: The rate at which a nation's central bank borrows money from its domestic commercial banks is known as the reverse repo rate. It is the interest rate at which NRB short-term borrows money from other banks. NRB does this by offering to purchase back government bonds and assets from banks at a later time. The NRB raises the reverse repo rate, which lowers liquidity with commercial banks and raises interest rates, in an effort to limit the amount of money in the economy.

Cash Reserve Ratio (CRR): Ratio of Cash Reserves The Reserve Bank has established a CRR for Scheduled commercial banks, with no floor or ceiling rate, in accordance with section 42 (1) of the NRB Act, 1934. A specific portion of all deposits was required under the cash reserve ratio to be maintained in a current account with the NRB; commercial banks were not permitted to use this money for any kind of business or economic activity. One element of the NRB's monetary policy that controls the nation's money supply, degree of inflation, and liquidity is the cash reserve ratio (CRR). Bank liquidity is inversely correlated with CRR, and vice versa. When efforts are taken to lower the amount of money in the economy during periods of high inflation, the NRB rises and the CRR drains the bank's loanable funds, which in turn slows down investment and lowers the amount of money in the economy, all of which contribute to lowering inflation.

Statutory Liquidity Ratio (SLR): Statutory Liquidity Ratio (SLR) Under Section 24, of the Banking regulation act, 1949 through the banking regulation (Amendment) act, 2007 replacing the regulation (Amendment) ordinance, 2007 effective January 23, 2007, the reserve bank can prescribe the SLR for Scheduled commercial banks in specified assets. The value of such assets shall not be less than such percentage not exceeding 40 % of its total DTL in Nepal as on the last Friday of the second preceding fortnight as the Reserve Bank may, by notification in the official gazette, specify from time to time.

g) Indicators of Monetary Policy

The goals of monetary policy are threefold. These are the interest rate, the money supply, and the accessibility of credit.

Money Supply: Since the central bank cannot directly regulate prices or production, it chooses to use the money supply growth rate as a middle-ground goal. For the economy to function smoothly and to prevent inflation and recession, Friedman believes that the money supply should be maintained at a constant rate of three to four percent annually. Another reliable measure of monetary policy is the money supply. It is the primary factor influencing production level, price level in the near term, and nominal aggregate demand in the long term. The money supply has an impact on aggregate demand. Keynes predicted that when money supply grows, it would be spent on bonds, which will drive down interest rates and spur investment. However, monetarists contend that a rise in the money supply will result in expenditure on a wide range of assets, not only bonds.

Credit availability and Interest rates: These two factors pertain to monetary policy. By restricting lending, for example, or by implementing an expansionary monetary policy with low short-term interest rates or a contractionary policy with tight short-term interest rates, monetary authorities can influence economic activity.

h) Theory regarding monetary policy in influencing economic stability

When it comes to the notion of how monetary policy might affect economic stability, there are two extreme scenarios. The Keynesians argue that since "money does not matter," it cannot affect economic expansion. They claim that there may be an indirect correlation since they contend that there is very little connection between the monetary sector and the actual sector of the economy (Khabo, 2002). The Monetarists, on the other hand, support the use of monetary policy to affect economic development because they hold that "money matters." They contend that the monetary and real sectors of the economy are directly related.

The transmission mechanism establishes a connection between the monetary and real economic sectors. The transmission mechanism consists of two phases. First, according to Dornbusch et al. (1998), a rise in real balances causes an imbalance in the portfolio. The money market will experience disequilibrium due to an excess money supply if it rises. Consumers will buy bonds and other financial assets to remedy this imbalance,

driving up the price of these assets. Interest rates and bond prices are inversely correlated, meaning that rising bond prices will result in falling interest rates. As a result, the transmission mechanism's second stage will become active. Reduced interest rates will boost output by having a beneficial impact on aggregate demand. Thus, by altering the money supply, monetary policy influences aggregate demand's interest-responsive elements, particularly investment expenditure.

For changes in the real money stock to have an impact on changes in production or income, there are two essential linkages that need to be present. Interest rates must, first and foremost, react to changes in the money supply and, second, cause changes in aggregate demand. Changes in the money supply can be used to communicate adjustments in an economy's production levels as long as these two connections are present.

The description of the transmission mechanism given above sets up competing theories amongst Keynesians and Monetarist economists regarding how monetary policy affects economic development. The scenario put out by the Keynesians prevents the interest rate from falling as a result of the portfolio imbalance. The liquidity trap will occur if increases in the money supply do not result in a decline in interest rates (Khabo, 2002). When the current interest rates are near or equal to zero and the monetary authority is powerless to boost the economy through monetary policy, a liquidity trap occurs. If interest rates are very low, the money supply may become less responsive to changes in the rate of return on investments, making subsequent reductions less attractive to investors. Because investors would prefer to hoard money, changes in interest rates have little effect on money demand. Therefore, the Keynesians contend that monetary policy will have no influence on economic development and instead support the use of fiscal policy to alter economic growth.

The liquidity trap is shown by a downward-sloping IS curve and a horizontal LM curve. The link between the interest rate and the amount of revenue that emerges in the market for goods and services is represented by the IS curve, whereas the relationship in the money market is represented by the LM curve (Mankiw, 2002). As a result, modifications to the IS curve are the sole way to alter the output level. The Keynesians therefore

contend that fiscal policy should be used to alter economic growth rather than monetary policy, as the latter will be ineffectual in influencing it.

The great unlikelihood of a liquidity trap and the paucity of evidence that one has ever happened were highlighted by opponents of the Keynesian model (Ajisafe and Folorunso, 2002). One group of people that disagree with Keynesians is the Monetarists, who deny the existence of liquidity traps. They contend that, in contrast to the Keynesians' horizontal LM curve, the LM curve slopes downward. As a result, modifications to the LM curve are the only way to alter the output level. This makes the monetary policy effective in bringing about changes in economic growth.

Once more, monetarists cite Irvin Fisher's equation of exchange to bolster their claim that monetary policy has a positive influence on economic growth. They do translate this equation of trade into the theory of amount of money, which reads like this:

$$MV = PY \dots\dots (1)$$

Where P stands for price level, Y for output level, V for velocity of circulation, and M for the money supply, which the South African Reserve Bank (SARB) has some influence over. Equation (1) shows a one-to-one link between changes in the money stock and changes in the value of national income when V is constant, which is the assumption made by monetarists. Equation (1) will therefore become equation (2) below, where k stands for a constant.

$$M = kPY \dots\dots (2)$$

Equation (2) states that adjustments to the money supply are the only way to affect production. Thus, the idea of a constant velocity provides the direct connection between the monetary and real sectors of the economy. This clarifies the underlying theory behind the monetarist claim that adjustments to monetary policy would affect economic expansion.

Monetarists do, however, concede that the economy could not always be producing jobs at a rate equal to real GDP. Thus, expansionary monetary policies are thought by monetarists to have the potential to raise real GDP in the near term by boosting aggregate demand. Nonetheless, they agree that the classical quantity theory is still a fair approximation of the relationship between the money supply, the level of prices, and the real GDP over the long term, when the economy is running at full employment.

On the other hand, Keynesians maintain that there is little correlation between the money supply and the amount of national income. Keynes finds a significant flaw in the theory when he assumes that shifts in the money supply directly impact the level of prices without influencing other factors (Cittadino et al, 2007). While Keynesians concede that this may hold true in the long term, they assert that in practice, changes in the amount of money do have an impact on how individuals use money and banks, as well as how banks handle reserves. Keynes disproves the idea that the economy is constantly at or close to real GDP's natural level, allowing Y (output) in the equation of exchange to be fixed. They also reject the classical theory's premise that velocity is constant. Therefore, adjustments to the money supply cannot cause adjustments to the output. Thus, the money supply and actual GDP are indirectly related, according to the Keynesians.

2.2 Empirical review

This section examines many literature examples attentively in order to determine how monetary policy affects economic stability in Nepal. The following literature review table describes the essential parameters. The study differs from previous studies in that it focuses on the influence of monetary policy on GDP growth, using various variables.

In light of current tensions in the global banking industry, Whelan (2023) looked at the relationship between monetary policy and financial stability and addressed it. The yield curve has steepened significantly as a result of the main central banks' synchronized tightening of monetary policy, which has hurt financial institutions that were ill-prepared to withstand the shock. After all, the prominent bank failures of Credit Suisse and many US institutions do not appear likely to be replicated throughout the euro area, and the ECB can concentrate on bringing inflation back to target levels without having to deal with a financial crisis in the process. This is not to suggest that in the upcoming years there won't be conflicts or bank collapses. Because banking is an inherently unstable industry, individual institution failures are unavoidable. Although it is hoped that increased oversight and the capital levels amassed in recent years will restrict the scope of bank failures in the euro area in the future, it is crucial that prompt action be taken to address any issues that arise in a way that maintains financial stability while minimizing public costs.

Joshi (2022) conducted study on how monetary policy affects Nepal's economic expansion. The goal of this study is to determine how Nepal's economic growth is impacted by monetary policy and how these two factors are related. For this reason, information was obtained from World Bank national account sources for the years 1965 through 2020. To prevent spurious regression, an augmented Dickey-Fuller unit root test was carried out. After confirming that all variables had been integrated in order I, the Johansen co-integration test was utilized. The Vector Error Correction model was then employed to determine the rate of adjustment towards long-run equilibrium. The VECM coefficient, which demonstrates the long-term correlation between monetary policy and GDP growth, was negative and substantial. Results of Granger Causality indicate a two-way relationship between GDP growth and the money supply. The outcome demonstrates how monetary policy affects the nation's economic expansion. Monetary authorities and policy makers should concentrate on sound monetary policy in order to support the nation's economic growth, since it may lower unemployment, encourage investments, and stabilize the economy.

A research on monitoring policy and financial stability in emerging market economies was carried out by Tobal and Menna in 2020. Everyone agreed that interest rate changes by central banks should only be made in reaction to production and (potentially) inflation. Both during the current epidemic and in the wake of the Global Financial Crisis, this consensus was called into doubt. Some commentators contended that financial crises are endogenous phenomena, contending that central banks also needed to lean against the wind in order to slow the growth of financial imbalances, in contrary to the majority of the conventional literature. Nevertheless, a significant aspect of emerging market economies (EMEs) has been overlooked in favor of the advanced economies (AEs) in this discussion. In this study, we define the parameters of the discussion for EMEs based on more current studies. We contend that because the financial circumstances in these nations are heavily reliant on capital flows, as opposed to AEs, the link between monetary policy and financial stability is different. The central banks of EMEs must make more complicated trade-offs as a result of this trait.

Ayodeji and Oluwole (2019) investigated the effect of monetary policy on economic growth in Nigeria by creating a model that can utilize multi-variable regression analysis to look at how the government's monetary policy has effected economic growth. The variables of monetary policy tools that we proxy include the exchange rate (ER), money supply (MS), interest rate (IR), and liquidity ratio (LR). The Gross Domestic Product (income) at constant prices served as a proxy for economic growth. The findings indicate that the money supply and exchange rate had a marginally significant but favorable effect on economic growth. On the other hand, measures of the interest rate and liquidity ratio had a highly substantial negative influence on economic development, supporting the claim that monetary policies are more appropriate when they are employed to target inflation rather than to stimulate growth. Lastly, a granger causality test was performed on our variables. The findings indicated that there is a bi-directional causal relationship between interest and economic growth, but a union-directional causal relationship between money supply and economic growth, as well as a granger causal relationship between economic growth and liquidity ratios and exchange rates.

A research on the use of monetary policy to stabilize economic activity was carried out by Walsh (2019). Examining how monetary policy affects actual economic activity stabilization is the primary goal. Studying a range of theoretical models first teaches us that the problem of economic stabilization is, even in theory, very complex, and that more in-depth research into theoretical underpinnings and empirical relationships would be required before specific policy recommendations could be supported. The crisis has taught us a few things about how monetary policy may support stability in the real economy. Central banks need to respond aggressively to negative aggregate demand shocks that might push interest rates to zero, especial as the ZLB is a constraint on the ability of monetary policy to stabilize real economic activity when policymakers have limited ability to steer future expectations. Monetary policy should not respond directly to financial market variables presumes that there is no fundamental role for financial distortions. Yet real distortions that interact with nominal rigidities are the rationale for having monetary policy be concerned with real economic stability and not just inflation stability. The presence of financial distortions calls for central banks to trade off some stability of inflation and real economic activity to ensure financial market stability. ..

When negative aggregate demand shocks threaten to drive interest rates to zero, central banks must act swiftly. This is especially true since the ZLB limits the power of monetary policy to stabilize actual economic activity at a time when policymakers have little control over future expectations. Assuming that financial distortions have no fundamental function, monetary policy shouldn't react directly to financial market factors. However, actual distortions interacting with nominal rigidities are the reason why genuine economic stability, not simply inflation stability, should be the focus of monetary policy. In order to maintain the stability of the financial markets, central banks must compromise on some inflation stability in exchange for genuine economic activity. This is because financial distortions exist.

Stein (2018) conducted research and created a model that describes the purpose and approach of financial stability policy. There are three primary aspects. Firstly, the model identifies the core market failure that has to be fixed from a normative standpoint. Second, it demonstrates how traditional monetary policy instruments like open market operations may be used to control this externality in a basic economy where commercial banks are the sole lenders. Thirdly, the model offers a constructive viewpoint by explaining how monetary policy might impact bond lending and actual activity.

Smets (2018) looked at the financial crisis of 2007–2008 and the need to reevaluate the framework for monetary policy, with a primary focus on preserving price stability. This is because price stability has not been shown to be a necessary condition for financial stability, and a lack of financial stability can have a detrimental effect on price stability.

In order to generate future inflation, Debabarta and Roy (2015) used a computationally intensive approach. They then explored the factors that influence inflation expectations by estimating a new type of Philip curve, similar to the one used by Keynes, that takes into account factors such as country-specific characteristics, the stance of monetary and fiscal policy, marginal costs, and exogenous supply shocks. The paper's empirical outcome suggests that people's expectations of future inflation may be influenced and prolonged by high and rising inflation.

According to Taylor et al. (2014), reserve holdings in the contemporary period of globalized capital markets may be accurately explained by a model based on financial stability and financial openness. Important determinants of reserve stock include the

amount of domestic financial obligations that may be converted into foreign currency (M2), the availability of foreign currency through the loan market, and exchange rate policy. Based on external short-term debt, the empirical financial stability model appears to perform better than the classic model and current expectations.

The Reserve Bank of India's policy reaction functions were studied by Kalirajan and Singh (2006) to determine how the choice about the policy stance reacts to variations in the aim variables. Using the Granger causality test, they have examined the transmission impacts of RBI's policy positions on goal variables. The findings indicate that the RBI should focus more on price factors when implementing monetary policy, shelve the cash reserve ratio (CRR), and avoid using quantity and price control tools at the same time.

Jalan (2002) looked into the financial industry as a whole and the increasing intensity of financial sector reform. Achieving internal strength and good management, as well as the general worries about financial stability, have become more important than they were in the past. At the same time, our financial system's flaws are more visible than ever due to increased transparency and stricter prudential standards. The financial system's structure is evolving, and regulators and supervisors are fundamentally under the most pressure to adapt and shoulder a significant portion of the burden for the future. Price increase with financial stability is a constant source of vigilance for both regulators and the regulated.

Table 1

Meta table

Author/ Year	Article	Objectives	Methodology	Findings
Whelan (2023)	Monetary policy and financial stability discussed the interaction between monetary policy and financial stability in light	monetary policy tightening from major central banks around the world has led to a sharp steepening of	that data was taken from the sources of national account of World Bank	is to be hoped that improved supervision and the higher capital levels built up in recent years will limit the extent of future bank failures

	of recent tensions in the global banking sector	the yield curve and this had a negative impact on financial institutions that were not well-positioned to cope with this shock		
Joshi (2022)	the impact of monetary policy on economic growth in Nepal.	This study tends to find the impact of monetary policy on economic growth of Nepal as well as the relationship between them	For that data was taken from the sources of national account of World Bank from the year 1965 to 2022 for this purpose	The result supports the impact of monetary policy on economic growth of the country.
Tobal Menna, (2020)	and monetary policy and financial stability in emerging market economies.	The consensus was that central banks had to adjust interest rates only in response to inflation and (possibly)	Such consensus was questioned in the aftermath of the Global Financial Crisis, as well	the relationship between monetary policy and financial stability is different in these economies because, unlike in AEs, the financial conditions are strongly dependent

		output	during the	on capital flows
			present	
			pandemic	
Ayodeji and Oluwole (2019)	the impact of monetary policy on economic growth in Nigeria	monetary policy of the government has affected economic growth through the use of multi-variable regression analysis	For that data was taken from the sources of national account of World Bank	Finally, granger causality test was done on our variables and the results showed the existence of a union-directional causality between money supply and economic growth, economic growth granger causing liquidity ratio and exchange rates while a bi-directional causality exists between interest and economic growth
Walsh (2019)	Evidence of interest rate channel of monetary policy			The presence of financial distortions calls for central banks to trade off some stability of inflation and real economic activity to ensure financial

				market stability.
Tarullo (2019)		the relationship between financial stability and monetary policy and suggest that the development		the number of occasions on which a difficult trade-off between financial stability consideration and near term growth or price stability aims will need to be made
Stein (2018)	An index of financial stress for Canada, bank of Canada working.		the goal and method of financial stability policies	Third, from a positive perspective, the model provides an account of how monetary policy can influence bond lending and real activity
Smets (2018)				
Jalan (2002)	progressive intensification of financial sector reform, and the financial sector	It has become more sensitive than before to achieve internal strength and effective management as well as to the	methods and procedures for acquiring the information needed	For both the regulators and the regulated eternal vigilance is the price growth with financial stability

overall
concerns for a
financial
stability

2.3 Research Gap

Research that have been done thus far highlight the ways in which monetary policy may be used to directly affect the money supply and the economy in order to reduce inflation. Research also demonstrates the extent to which price stability has contributed to economic expansion and if price stability by itself is sufficient to maintain the financial market's smooth operation and prevent disruptions. There aren't many research on economic stability.

The current study examines how monetary policy affects economic stability and evaluates the extent to which monetary policy succeeds in bringing about economic stability. The efficiency of monetary policy tools in preserving price stability was the major focus of the study. In addition, the research project compares and evaluates how well monetary tools and macroprudential policies support Nepal's economic stability. The study also evaluated the relationships that exist between economic and pricing stability. Researchers, academics, and policy makers all benefited from the study.

CHAPTER-III

RESEARCH METHODOLOGY

The study concept and the technique that methodically addresses the research topic are presented in this chapter. It serves as the general study's blueprint and fundamental structure. This chapter's goal is to give a summary of the findings. Prior to evaluating and interpreting the data, the study technique must be established and described. The methodology used by the researchers to analyze the data for the study challenge and the reasoning behind the topics discussed in this chapter. It aims to describe the steps involved in doing research, including the target population, sampling technique, study design, data collecting, and statistical tools used for analysis. It is also described as a section of the report's body that provides an explanation of the sampling strategy, study design, and other technical steps involved in data collection.

3.1 Research Design

A particular descriptive and informal comparative research design was used for this study. The term "research" refers to the general approach a researcher takes in order to logically and rationally integrate the many study components. The plan, structure, and approach of a study that are taken into consideration in order to manage variations and find answers to research questions is known as research design. The methodical, scientific approach to problem-solving and analysis is known as research methodology. It is a collection of guidelines and practices for carrying out the research.

The investigation of the relationships between the elements that affect finances is the main goal of the study. The goal of research design is to gain answers to research questions and manage variation through the planning, organization, and conduct of the inquiry. A research paper outlines the procedures and strategies for gathering the necessary data. The project's general operational pattern or framework specifies which sources of information must be gathered from and how that information should be processed.

3.2 Population and Sample

The research is a representation of the two key components of the NRB data warehouse's database on the Nepalese economy. The sample of these key rates, which are the monetary policy measures' key rates, has been chosen from 2013–14 through 2022–23. The samples were chosen by the application of basic random sampling methods. It is therefore predicated on convenience sampling.

3.3 Sources of Data

The CPI-based inflation rate and all other important monetary policy rates that have been deemed appropriate for the research study are among the secondary data that form the basis of the study and were gathered from NRB Publications.

3.4 Data Collection and Procedures

The NRB bulletin, NRB occasional papers, NRB annual reports, the handbook of statistics on the Nepalese economy, NRB, and CSO publications, the economic survey, finance and development, the economic diary, the economic times, the Nepalese economic journal, the financial express, the Nepalese Economic Service publications, the CPI published by the Ministry of Programmed Implementation (MOSPI), and relevant websites were the sources of the secondary data.

3.5 Descriptive Statistic

A descriptive analysis uses metrics, such as the mean (central tendency) and the standard deviation, minimum, and maximum variables (dispersion or variability), to summarize data in a useful manner. These metrics may reveal patterns that meet specific criteria for the data. either reflects the population or sample that was utilized in the study. The goal of descriptive research is to pinpoint or characterize events. For instance, if the inquiry in descriptive research is, "What is the present or past state of the events?"

3.6 Data Analysis Tools

During the data analysis process, a number of statistical methods will be used to help this research project achieve its intended goals.

Table 2

Selected Dependent and Independent Variables

S.N	Notations	Variables	Unit of measurement
-----	-----------	-----------	---------------------

1	GDP	Gross Domestic Production	Natural Logarithm
2	MS	Broad Money Supply	Natural Logarithm
3	EXC	Exchange Rate	Natural Logarithm
4	REPO	Repo Rate	Natural Logarithm
5	CPI	Consumer Price Index	Natural Logarithm

(Source: Joshi, 2022)

Descriptive statistics

Arithmetic Mean: The result of dividing the total of all the values in a distribution by the total number of values in the distribution is the mean. Therefore, the mean is a variable's arithmetic average. Thus, the term "average" also refers to the arithmetic mean. It is computed as

$$\text{Mean } (\bar{X}) = \frac{\sum X}{n}$$

Where,

(\bar{X}) = Arithmetic mean

$\sum X$ = Sum of all value of variable

n = No. of Observation

Standard Deviation: The ranges and magnitude of deviations from the mean or center are shown by the standard deviation. It is frequently employed to calculate how much values deviate from the mean. It displays the difference between a single number and the average value. It quantifies the overall risk of the data that is changing over the course of the time period in analytical terms. More danger is indicated by more value, and vice versa.

$$\text{Standard deviation } (\sigma) = \sqrt{\frac{\sum(X-\bar{X})^2}{n-1}}$$

Inferential Statistics

Correlation of coefficient (r): We can determine the strength and direction of the association between two sets of scores using the correlation coefficient. By dividing the covariance of two variables by the sum of their standard deviations, one may find this coefficient. The degree of the linear link between two variables is indicated by the correlation coefficient's magnitude. When the correlation is 0, it means there is no link.

The value of the correlation rises towards +1 with increasing relationship strength, and increases to -1 with decreasing relationship strength between the variables. Given that a connection between two variables is absolutely positive when the value is +1 and perfectly negative when the value is -1

The following formula may be used to determine the simple correlation coefficient, which has been utilized as a tool in this study:

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}}$$

Multiple Regression Analysis: Because several independent variables might predict the response variable in real-world scenarios, straightforward linear regression is rarely used. Therefore, to determine the combined effect of the independent variable in this situation, multiple regression analysis must be taken into consideration. Regression models that were employed in this study include:

$$GDP = \beta_0 + \beta_1 MS + \beta_2 EXC + \beta_3 REPO + \beta_4 CPI + e$$

Where,

GDP = GDP growth rate

MS = Broad money supply

EXC = Average exchange rate

REPO = Repo rate

CPI = Consumer price index

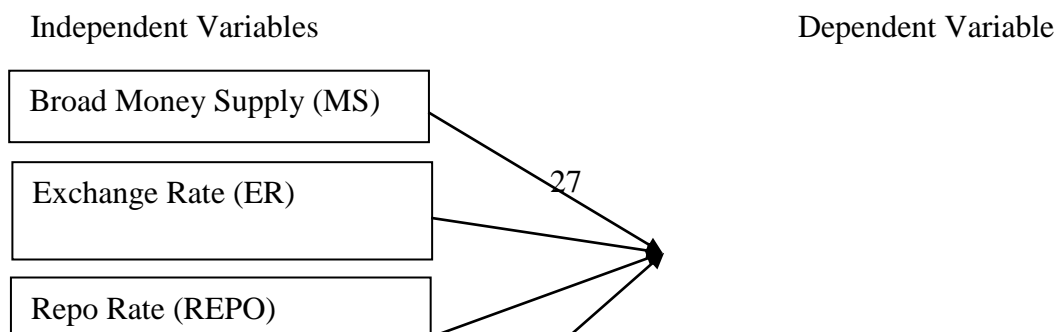
β_0 = Intercept (Constant),

$\beta_1, \beta_2, \beta_3, \beta_4$ = The slope represents the degree with which bank's performance changes as the independent variable changes by one unit of variable, and $e_{i,t}$ = error component. The model is transformed into log form to reduce the problem of heteroskedasticity.

3.7 Conceptual framework

Figure 1

Schematic Diagram between Dependent and Independent Variables



Gross Domestic Production (GDP)

(Source: Joshi, 2022)

Definition of independent variables

a) Broad money supply (MS)

Cash, checks and other deposits that are easily converted to cash, including certificates of deposit, are all included in the broad money supply. Calculating an economy's money supply is a difficult task. There are several methods for determining the money supply because of the intricacy of the notion of "money" and the magnitude and degree of specificity of an economy. These measurements, which range from narrow to wide monetary aggregates, are commonly categorized as "M" s.

b) Average exchange rate (EXC)

Average Exchange Rate means the daily average currency exchange rate for the most recently ended fiscal quarter of the Borrower for which financial statements have been delivered (or, prior to the first such delivery, such financial statements), as reasonably determined in good faith by the Borrower based on the Bloomberg Key Cross Currency Rates Page at such time or, if the Borrower is unable to determine the Average Exchange Rate based on the Bloomberg Key Cross Currency Rates Page for any reason, publicly reported currency exchange rate information in consultation with the First Lien Administrative Agent; Furthermore, it is provided that the currency exchange rate used for that amount will be as specified in the Swap Agreement if the amount that was supposed to be converted using the aforementioned methodology has been hedged, swapped, or otherwise effectively converted into another currency in accordance with a Swap Agreement to which any Loan Party is a party.

c) Repo rate (REPO)

The repo rate, which is sometimes referred to as a repurchase agreement or repurchasing option, is the interest rate that commercial banks pay the central bank when they borrow

funds, using government assets as security. The word "repo" comes from the word "repurchase agreement," which emphasizes the transaction's contractual basis. The procedure entails a short-term loan in which the lender, the central bank, purchases assets from the borrower, often a commercial bank, with the understanding that the securities would be bought back at a later date, generally the following day, at a somewhat higher price. The interest rate at which the Reserve Bank of India lends money to India's commercial banks is referred to in this instance as the repo rate.

d) Consumer price index (CPI)

The consumer price index (CPI) is the instrument to measure inflation. It is used to estimate the average variation between two given periods in the prices of products consumed by households. It is a composite measurement of trends in the prices of products, at constant quality. The CPI is one of the most popular measures of inflation and deflation. The CPI report uses a different survey methodology, price samples, and index weights than the producer price index (PPI), which measures changes in the prices received by Nepalese producers of goods and services.

Definition of dependent variable

a) Gross domestic production (GDP)

The monetary value of final products and services—those purchased by the end user—produced in a nation over a specific time frame, such as a quarter or a year, is measured by gross domestic output. It includes all product produced inside a nation's boundaries. GDP is made up of both market-driven products and services as well as certain non-market output, like government-supplied goods and services for military and education. A different idea known as gross national product, or GNP, totals the productivity of a nation's citizens.

CHAPTER-IV

RESULTS AND DISCUSSION

This chapter also covers testing the hypotheses that were developed in the first chapter. The study is predicated on the examination of secondary data. With the aid of SPSS, the data are examined, and the results are shown in tables and diagrams for easy interpretation.

4.1 Presentation of Results

4.1.1 Descriptive Statistics

Brief informative coefficients known as descriptive statistics are used to provide an overview of a specific data collection, which may be a sample or a representative of the full population. where mean, determined by adding up the series and dividing by the number of observations, is the average value of the series. When the values are arranged from smallest to greatest, the middle value of the series—or the average of the two middle values—is called the median. Compared to the mean, the median is a more reliable indicator of the distribution's center and is less susceptible to outliers. The highest and lowest values of the series in the current sample are denoted by the terms Max and Min. Standard deviation, or Std. Dev., is a measurement of dispersion or spread the series.

Table 3

Descriptive Statistics of Data After Required Transformations

N	Minimum	Maximum	Mean	Std. Dev.
---	---------	---------	------	-----------

LogGDP	10	5.38	6.81	5.91	0.43
LogMS	10	2.67	9.54	5.93	2.29
LogEXC	10	0.29	4.73	3.61	1.40
LogREPO	10	1.79	3.26	2.51	0.33
LogCPI	10	1.79	3.26	2.51	0.34

Source: *SPSS Analysis, 2024*

Table 3 presents descriptive data over a ten-year period, with variables adjusted using the logarithm. The logGDP mean ranges from 5.38 percent at the least to 6.81 percent at the maximum, with a 0.43 deviation. The LogMS varies from 2.67 percent at least to 9.54 percent at maximum. Its standard deviation from the mean is 2.29 percent, with a mean value of 5.93. LogEXC ranges from 0.29 percent at least to 4.73 percent at maximum. Its standard deviation from the mean is 1.40 percent, with a mean of 3.61. Additionally, the LogCPI mean is 2.51, with a range of 1.79 to 3.26, and a standard deviation of 0.34 percent from the mean. High maximum values for the money supply, GDP, repo rate, exchange rate, and consumer price index were observed during the financial sector reform era, which was marked by the employment of indirect monetary policy tools. On the other hand, times when the government prioritized fiscal over monetary policy account for the low minimum value for all of our estimating parameters. We consequently draw the conclusion that, from 2013–14 to 2022–23, all of our variables have a normal distribution.

4.1.2 Correlation Analyses

A statistical technique for determining the degree of link between two quantitative variables is correlation analysis. This section establishes the link between the Consumer Price Index (CPI), Repo Rate (REPO), Average Exchange Rate (EXC), and Broad Money Supply (MS). It is therefore logical to anticipate a link of some type between these variable pairs. A weak correlation indicates that there is little to no association between the variables, whereas a high correlation indicates that two or more variables have a significant relationship. The correlation matrix displays the Pearson correlation coefficients for each pair of variables.

Table 4

Structure of Correlation Matrix of variables

		GDP	MS	EXC	REPO	CPI
GDP	Pearson Correlation	1.00				
	Sig. (2-tailed)	-				
MS	Pearson Correlation	.959**	1.00			
	Sig. (2-tailed)	0.00				
EXC	Pearson Correlation	.747*	.725*	1.00		
	Sig. (2-tailed)	0.013	.018			
REPO	Pearson Correlation	.702*	.786**	.307	1.00	
	Sig. (2-tailed)	.024	.007	.307		
CPI	Pearson Correlation	.972**	.959**	.757*	.651*	1.00
	Sig. (2-tailed)	.000	.000	.011	.042	

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

Source: *SPSS Analysis, 2024*

Three items are displayed in Table 4; First, the values of the Pearson's correlation coefficients between each pair of variables are displayed in the table. Second, each correlation's one-tailed significance is shown. Lastly, each correlation's total number of contributing cases is displayed. We can see that in this correlation matrix, all of the correlation coefficient values are 1.00 along the diagonal, indicating a perfect positive correlation. The correlation between each variable and itself is represented by these numbers, which explains why. The values that arise are, of course, 1.00.

The degree of link between two variables is displayed in the matrix. The findings indicate a favorable correlation between GDP and CPI (0.972), EXC (0.747), REPO (0.702), and MS (0.959). It implies that the dependent variable will rise as the independent variables

do. According to the correlation matrix, the variable having the highest correlation with the outcome ($P < 0.001$) among all the predictors indicates that it is most likely to best predict or influence the monetary policy's impact on economic stability.

4.1.3 Regression Analysis of Variables

The general analysis and regression analysis findings about the factors influencing economic stability are shown in this section. GDP served as the primary performance metric in this investigation. These monetary variables represent an economy's entire capacity to achieve stability, which is why they were chosen as the metrics for measuring economic stability. Thus, in this study, they serve as the dependent variable. The MS, EXC, REPO, and CPI are the independent variables. The regression models are shown in the table below. They are as follows:

$$\text{GDP} = \beta_0 + \beta_1\text{MS} + \beta_2\text{EXC} + \beta_3\text{REPO} + \beta_4\text{CPI} + e$$

Table 5

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.978 ^a	.956	.921	1.88107

a. Predictors: (Constant), CPI, REPO, EXC, MS

Source: *SPSS Analysis, 2024*

Table 5 illustrates the phase whereby the GDP alone is employed as a predictor. The model summary table is used to provide the values of R, R Square, and Adjusted R Square. The dependent variable (Outcome) and the predictors included in the model are described in this model summary table. The R Square number indicates how much of the variation in the result can be explained by the predictor, in this case, GDP. With a R Square value of 0.978 in this model, GDP accounts for 97.8% of the total. The remaining 2.2% was explained by other variables not taken into account by the model.

Table 6

ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	386.807	4	96.702	27.329	.001 ^b
	Residual	17.692	5	3.538		
	Total	404.499	9			

a. Dependent Variable: GDP

b. Predictors: (Constant), CPI, REPO, EXC, MS

Source: *SPSS Analysis, 2024*

Table 6 displays if using the model as a best estimate is considerably more accurate than using the mean to forecast the result. More specifically, the F-ratio is a measure of how much the model's remaining inaccuracy is outweighed by the gain in prediction that comes from fitting the model. The F ratio is 27.329, and the accompanying p-value is 0.001, indicating a considerable likelihood of occurrence.

Table 7

Regression Table for Dependent Variable GDP

Model	Unstandardized		Standardized		t	Sig.
	Coefficients		Coefficients			
	B	Std. Error	Beta			
1 (Constant)	-32.561	33.301			-.978	.000
MS	.272	1.468	.103		.185	.001
EXC	.082	.182	.078		.452	.000
REPO	.630	1.211	.117		.521	.005
CPI	.382	.210	.738		1.815	.000

a. Dependent Variable: GDP

Source: *SPSS Analysis, 2024*

Table 7 demonstrates that the b-value provides information regarding the correlation between the predictor, such as MS, EXC, REPO, and CPI, and the economy's stability based on monetary policy. There is a positive correlation between the predictor and the result, as indicated by the positive b-values of the MS, EXC, REPO, and CPI.

The GDP falls by 0.272 percent for every 1% increase in MS, according to the coefficient of regression MS, which is 0.272. The coefficient's p-value of 0.001 and t-statistic of

0.185 indicate that the outcome is regarded as statistically significant. In a similar vein, the coefficient of EXC is 0.082, meaning that for every 1% increase in EXC, the banks' GDP will also grow by 0.082 percent. It is possible to conclude that the coefficient significantly increases GDP because its p-value of 0.000 is less than 5%. Conversely, the GDP grows by 0.630 percent if REPO increases by one percent, according to the coefficient of REPO, which is 0.630. Given that the coefficient's p-value of 0.000 is less than 5%, it may be concluded that bank REPO significantly boosts GDP. Similarly, the GDP grows by 0.382 percent if the CPI increases by one percent (the coefficient of CPI is 0.382). Given that the coefficient's p-value of 0.000 is less than 5 percent, it may be concluded that the CPI significantly affects GDP.

4.2 Discussion

The goal of the study was to analyze and investigate the link between the effects of monetary policy and economic stability using a model. The research drew upon a decade's worth of data released by the Nepalese News Bureau. Few scholarly studies have been conducted by various researchers, but the prior research primarily focused on price and financial stability; there was a gap or void in the literature regarding the study and examination of economic stability and its parameters, which include MS, REPO, EXC, and CPI, among others.

The studies attempt to evaluate how Nepal's monetary policy affects the country's economic stability. The various results discussed below relate to the above findings:

On the diagonal of the correlation matrix, every value of the correlation coefficient exhibits complete positive correlation. These results indicate the correlation between each variable and itself, which clarifies why. One can naturally expect to find values of 1.00.

The findings of Joshi (2022), Tobal and Menna (2020), Ayodeji and Oluwole (2019), Tarullo (2019), Stein (2018), and Smets (2018) are corroborated by this study.

Although, the result contrary with finding of Jalan (2002), Whekan (2023), Dong (2016), Debabarta and Roy (2015), Taylor et. al (2014), and Kalirajan and Singh (2006).

Finally, it provides proof of the long-term connection between the nation's economic stability and monetary policy. The study's main conclusions allow us to draw the conclusion that monetary policy instruments were crucial in controlling the economy to promote growth. The direction of causation between the variables is demonstrated by the

study's results. There is four-way causation between GDP growth and MS, EXC, REPO, and CPI. The results of several experiments demonstrate the connection between monetary policy and economic stability and indicate that these factors should be the primary focus of monetary authorities and policy makers in order to maintain the nation's solid economic stability. For economic stability, the central bank should prioritize both short- and long-term monetary policy (Mahara, 2020). Policymakers should prioritize monetary policy mechanisms and programs that promote economic stability in order to achieve a healthier level of broad money supply expansion.

CHAPTER-V

SUMMARY AND CONCLUSION

This chapter, which includes a summary, conclusion, and implication, is the last one in the research. This chapter provides an overview of the link between monetary policy, other factors, and gross domestic production in the context of economic stability, as stated in the study's objectives.

5.1 Summary

Because of its enormous influence on economic sustainability, monetary policy is a crucial component of every economy's plan for economic development. It has shown to be a useful instrument for controlling the economy in a number of ways. These days, managing economic growth processes through the use of monetary policy tools is standard procedure in all market economies. This includes monitoring trends in inflation rates, adjusting the money supply and demand in domestic markets, and maximizing the benefits of international trade through exchange rate management and overall financial flows. Through an analysis of the link between monetary policy instruments and economic stability, I looked at how monetary policy tools affected Nepal's economy.

This study attempts to examine the impact of monetary policy on economic stability of commercial banks in Nepal. I used the explanatory variables Consumer Price Index (CPI), Average Exchange Rate (EXC), Repo Rate (REPO), and Broad Money Supply (MS) in this study to examine the effects on GDP, or economic stability. The data analysis was conducted using SPSS version 25. The secondary data used in this study spans a ten-year period, from 2013–14 to 2022–23.

This study investigates the connection between monetary policy and economic stability using descriptive research methods. To further explore the historical foundations of the contemporary economic relationships between monetary policy instruments and economic development, a substantial body of research has been explored. the examination of the effectiveness of monetary policy in managing the domestic economy. Analysis showed that monetary policy instruments, such as MS, EXC, REPO, and CPI, had a favorable impact on economic growth over the chosen time, indicating that they were successful in controlling the economy.

5.2 Conclusion

The purpose of the study is to examine the factors related to monetary policy that affect Nepal's economic stability. The nation's primary priority during the epidemic and in the wake of the Global Financial Crisis is economic stability. Contrary to much of the classical literature, a number of authors asserted that financial crises are natural occurrences and that central banks must also restrict the growth of financial imbalances. But most people preferred developed economies to emerging market economies, ignoring important elements of the latter. Based on more recent studies, this study examines the relationship between monetary policy and financial stability.

Here, from 2012/13 to 2022/23, the study examined how monetary policy—that is, the broad money supply (MS), average exchange rate (EXC), repo rate (REPO), and consumer price index (CPI)—affects economic stability, or GDP. The study's primary objective is to analyze the relationship between monetary policy and economic stability using a model.

The purpose of the study was to determine the correlation and strength between the independent and dependent variables. One key performance indicator for gauging the stability of the economy was GDP. where MS, EXC, REPO, and CPI are the independent variables. The predictor and the result have a strongly positive relationship, according to the model.

GDP exhibits a positive link with MS, EXC, REPO, and CPI, as seen by the correlation coefficient between the two variables. It indicates that the dependent variable was impacted more by greater independent factors. Regression analysis reveals that the GDP accounts for 97.8% of the R Square, F-ratio is 27.329, and the corresponding p-value is 0.001, indicating a very likely positive significant relationship. The b-value provides information about the relationship between the predictors, such as MS, EXC, REPO, and CPI, and the economy's stability based on monetary policy. There is a positive correlation between the predictor and the result, as indicated by the positive b-values of the MS, EXC, REPO, and CPI.

5.3 Implications

The study highlighted the connection that exists between monetary policy and economic stability. Although the effect is modest, monetary policy has a favorable influence on changes in the economic stability index. These results provide credence to the theory that

monetary policy significantly affects economic stability. This is not to suggest that the upcoming years would be devoid of conflicts or setbacks. The economy is inherently unstable, and individual institution failures are unavoidable.

The study may have significant effects on the economy of Nepal. The money supply and consumer price index, which measure economic stability, cannot be negatively impacted by Nepalese monetary policy. Since monetary policy tools are failing to address the economy, the government's fiscal policies, which have proven more successful in maintaining economic stability thus far, have to be further examined in order to maintain stability in uncertain future situations. Thus, one of the primary goals of economic policies need to be financial stability.

This study is also beneficial to readers who are not experts because I did not employ complex models to assess the impact of monetary policy. Students pursuing comparable coursework may also find this research useful in understanding how monetary policy affects economic stability in light of Nepal's unpredictable economic environment.

Additionally, scholars, economists, and students may use the study as a guide to examine and assess how monetary policy and economic stability are related. Additionally, after developing monetary policy, academics may use this study to better understand how these variables affect Nepalese economic stability.

As other factors that make up overall economic stability and how those factors are affected by monetary policy are not presented in this study, future researchers can incorporate additional independent and dependent variables to examine the effects of monetary policy on economic stability.

Lastly, the study lays the groundwork for further investigations into how monetary policy affects economic stability in relation to GDP.

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APPENDIX-I

Major Monetary Policy rates and reserve requirements - GDP, MS, EXR, FER and GFCF

Date	GDP	MS	CPI	EXR	REPO
2012/13	22.73	2.67	108.8	112.78	5
2013/14	24.36	2.98	113.2	129.07	3
2014/15	24.52	3.56	119.8	125.6	3.6
2015/16	28.97	4.25	125.7	125.61	3.3
2016/17	33.11	4.95	132.1	126.15	3.9
2017/18	34.19	5.68	132.1	126.38	3.9
2018/19	33.43	7.45	135.7	124.49	5
2019/20	36.92	8.25	143.9	132.23	5.5
2020/21	40.83	9.26	144.2	136.05	5.5
2022/23	41.21	9.21	144.8	133.15	7

Source:- WWW.nrb.org.np handbook of statistics

APPENDIX-II

Correlations

		GDP	MS	EXC	REPO	CPI
GDP	Pearson Correlation	1				
	Sig. (2-tailed)					
MS	N	10				
	Pearson Correlation	.959**	1			
EXC	Sig. (2-tailed)	.000				
	N	10	10			
REPO	Pearson Correlation	.747*	.725*	1		
	Sig. (2-tailed)	.013	.018			
CPI	N	10	10	10		
	Pearson Correlation	.702*	.786**	.307	1	
	Sig. (2-tailed)	.024	.007	.388		
	N	10	10	10	10	
	Pearson Correlation	.972**	.959**	.757*	.651*	1
	Sig. (2-tailed)	.000	.000	.011	.042	
	N	10	10	10	10	10

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.978 ^a	.956	.921	1.88107

a. Predictors: (Constant), CPI, REPO, EXC, MS

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	386.807	4	96.702	27.329	.001 ^b
	Residual	17.692	5	3.538		
	Total	404.499	9			

a. Dependent Variable: GDP

b. Predictors: (Constant), CPI, REPO, EXC, MS

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-32.561	33.301		-.978	.000
	MS	.272	1.468	.103	.185	.001
	EXC	.082	.182	.078	.452	.000
	REPO	.630	1.211	.117	.521	.005
	CPI	.382	.210	.738	1.815	.000

a. Dependent Variable: GDP

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GDP	10	22.73	41.21	32.0270	6.70405
MS	10	2.67	9.26	5.8260	2.54349
EXC	10	112.78	136.05	127.1510	6.36520
REPO	10	3.00	7.00	4.5700	1.24370
CPI	10	108.80	144.80	130.0300	12.95034
Valid N (listwise)	10				

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CHAPTER-I INTRODUCTION 1.1 Background of the Study By regulating the amount of money in circulation, the central bank seeks to preserve price stability. Therefore, through a variety of mechanisms, monetary policy influences economic development in a stabilizing manner. The type of the mechanism used to transmit monetary policy, the pursuit of other major goals of the policy at the same time, and other elements, such as the uncertainty that faces decision-makers and the direction of economic policies, may, nonetheless, restrict the extent of this function. Furthermore, pursuing intermediate aims concurrently with the ultimate goal of attaining sustainable growth may have consequences (Nkoro, 2005). Price stability is preserved by monetary policy, which contributes to sustained growth. Monetary policy employs its instruments to efficiently control the money supply in order to preserve medium- to long-term price stability, as prolonged increases in price levels are seen to be primarily a monetary phenomena. It is suggested by theory and empirical data in the literature that lower price levels are linked to sustainable long-term growth. To put it