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Sectoral Effects of Monetary Policy Shock: Evidence from India

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ABSTRACT

This paper analyzes the effect of monetary policy shock on the aggregate as well as on the sectoral output of Indian economy using reduced form vector auto regression (VAR) model. We find that the impact of a monetary policy shock at the sectoral level is heterogeneous. Sectors such as, mining and quarrying, manufacturing, construction and trade, hotel, transport and communications seems to decline more sharply than aggregate output in response to a monetary tightening. We also augment the basic VAR by including three channels- credit channel, exchange rate channel and asset price channel of the monetary policy, and analyze the sector specific importance of each of the channel. The channels through which monetary policy is transmitted to the real economy are found to be different for every sector. In most of the cases, multiple channels are responsible for the changes in the aggregate and sectoral output to the monetary policy shock. These results clearly indicate the need for a sector specific monetary policy in India.

KEYWORDS Monetary transmission mechanism; Sectoral output and VAR

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