

EconWorld2025@Prague

Fiscal-Monetary Nexus- Insights from a Nonlinear Framework

Mathew Koshy Odasseril¹, K R Shanmugam¹, Magulsha George¹¹Madras School of Economics, India

ABSTRACT

The interaction between fiscal and monetary policy plays a crucial role in macroeconomic stability, particularly in emerging economies like India. This study examines the fiscalmonetary nexus using quarterly data from 2000 to 2022, with a focus on the fiscal theory of the price level (FTPL) framework. Specifically, it investigates how public debt affects the interest rates, under varying economic conditions. The findings provide robust evidence that the monetary-fiscal nexus in India exhibits nonlinear characteristics. Nonlinear modelling approaches of Markov regime switching and penalised spline regression are employed to analyse the impact of public debt while incorporating various control variables to account for broader macroeconomic dynamics. The results reveal a significant negative relationship between the lagged public debt-to-GDP ratio and the call money rate, consistent with the FTPL framework. This finding underscores the interconnect-edness of fiscal and monetary policies and suggests that fiscal dominance constrains the central bank's ability to manage interest rates independently. Policymakers must address the sustainability of public debt to allow the central bank to retain its autonomy and effectiveness in stabilizing the economy.

KEYWORDS Fiscal Theory of the Price Level (FTPL); Monetary-Fiscal Nexus; Non-Linear Model

JEL E62, E52, C32