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Central Bank Intervention and Monetary Approach of Exchange Rates : An Evidence from India

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Abstract

The aim of the study is to understand the effectiveness of the Purchasing Power Parity(PPP) theory of exchange rate determination theory in Indian context. In addition to investigate the relationship between the exchange rate and the currency intervention in forex market using the ARDL method. The sample data is from 2000 to 2017 monthly data of USD/INR, interest rate, IPI, money supply of India and US and the RBI intervention data. The volatility of the exchange rate is found using the ARMA, GARCH (1,1) model. The result indicates that there is a clear evidence of asymmetric relationship of the intervention even though intervention is having a short-term relationship impact in the volatility of the exchange rates. In addition, the Purchasing Power Parity theory is found ineffective in Indian economy. In this study, we find that the monetary theory of exchange rate determination is not effective in India.

I. Introduction

IN RECENT YEARS, the researcher has conducted a few studies to understand the relationship of the intervention. The asymmetric relationship of the exchange rate intervention is found by (Keefe and Shadmani, 2018)[3] and (Ramachandran and Srinivasan, 2007). The central banks have a variety of approaches to determine the exchange rate behavior via. Uncovered Interest Parity (UIP), Purchasing Power Parity (PPP) theory to examine the international competitiveness of an economy, and traditional portfolio model (Amato, Filardo, Galati and Peter, 2005). This study is an effort to explore the effectiveness of the monetary theory of Purchasing Power Parity (PPP) theory and to understand the relationship between the exchange rate volatility and central bank intervention in India.

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