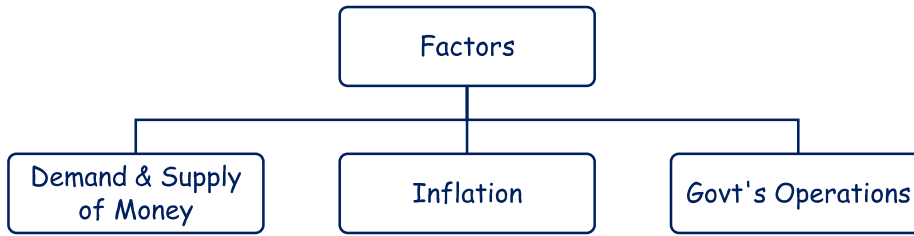




INTEREST RATE RISK MANAGEMENT 17Q|5PE

Q1. What are the Factors Affecting Interest Rates? (Important)

A.



Demand & Supply of Money - The central bank of the country, RBI controls the money supply in the economy through its monetary policy. RBI loosens its monetary policy to reduce the interest rates and when required it strengthens its monetary policy which leads to increase in interest rate.



When economic growth is high, demand for money increases and money available in the market is low, which pushes the interest rates up. And when demand for money is low and money is available in the markets, interest rates are low.

Inflation

Inflation and interest rates are closely linked to each other. Inflation is the increase in the price level of goods and services in an economy over a period of time. RBI attempts to influence the rate of inflation by setting and adjusting the target for the interest rate. This enables RBI to expand or contract the money supply as needed, which influences target employment rates, stable prices, and stable economic growth.

So, when interest rates are low, the economy grows, and inflation increases as interest rates are reduced, more people are able to borrow more money, consumers have more money to spend. This causes the economy to grow and inflation to increase. On the other hand, when interest rates are high, the economy slows and inflation decreases.

Govt.'s Operations

Government is the biggest borrower. It's borrowing levels determine the interest rates. RBI, by either printing more notes or through its Open Market Operations (OMO) of

