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THE EFFECTIVENESS OF MONETARY POLICY TRANSFORMATION IN PAKISTAN: EXPLORING MONETARY NEUTRALITY PROPOSITION

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Abstract

This study analyses the effectiveness of monetary policy innovations in Pakistan by price and quantity based monetary anchors. We hypothesize that state bank of Pakistan (SBP) cannot evaluate the unanticipated variations in inflation and output in the same year by applying a recursive limitation on structural vector autoregressive disturbances. The monetary policy is found partial in the short-term and rejects the impartiality condition. Whereas the monetary policy execution on price based tools has a robust effect on inflation and output level by rapid improvement. While transformation by quantity based policy, anchors has a mixed impact on economic activity. The effectiveness of policy innovations inclines more towards price anchors rather than quantity. The restricted SVAR suggest that the choice of policy and non-policy variables are essential for monetary policy operations. SBP policy transformation still has the potential to control economic fluctuations. Hence, we put forward the policy that SBP needs to concentrate on price based instruments for effective implementation and assessment of monetary policy.

Keywords: Monetary Policy Effectiveness South Asia Economic Activity SVAR Pakistan

JEL classification: E51; E52; E62; E44

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