Impact of Repo Rate Changes by RBI on Bond Prices and Yields: An Empirical Analysis of Monetary Policy Transmission

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Abstract

This study investigates how monetary policy and fiscal decisions made by the Reserve Bank of India (RBI)—specifically, variations in the benchmark repo rate, systemic liquidity adjustments, and forward guidance—affect sovereign bond pricing and yield curve dynamics. Employing both conventional monetary policy (CMP) and unconventional monetary policy (UMP) frameworks, the paper integrates high-frequency OIS data, sovereign yield spreads, and vector error correction models (VECM) to capture transmission effects across maturities. The findings reveal that short-term treasury yields are tightly linked to repo rate changes ("target factor"), while long-term yields, such as the 10-year government security (G-Sec), respond more significantly to RBI's forward guidance ("path factor"), inflation expectations, and term premium adjustments. Robustness tests including the Breusch–Godfrey LM test, White's heteroscedasticity test, and the Jarque–Bera normality test confirm model validity. The study concludes that the RBI's communication policy has become a critical instrument in shaping yield curve outcomes, especially during periods of unconventional interventions such as Operation Twist and G-SAP.

Index Terms

RBI, Repo Rate, Bond Yields, Monetary Policy Transmission, Liquidity Adjustment, Yield Curve, India