



**भारतीय रिज़र्व बैंक**  
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## RBI releases Winter 2010 Issue of its Occasional Papers

The Reserve Bank of India, today released the [winter 2010](#) issue of its Occasional Papers. Occasional Papers, a research journal of the Reserve Bank, contains contributions of its staff and reflects the views of the authors. This issue is woven around some important themes which have been at the forefront of policy discussions. The issue contains articles, special notes and a book review.

### Should Monetary Policy in India Respond to Movements in Asset Prices?

The paper '*Should Monetary Policy in India Respond to Movements in Asset Prices?*' by Bhupal Singh and Sitikantha Pattanaik examines whether monetary policy should become more sensitive to asset price movements and respond proactively to prevent any build up of bubbles. The assessment is done in the backdrop of the debate stimulated by the recent sub-prime crisis. The empirical analysis in the study indicates that while interest rate changes cause movements in stock prices, the reverse causality does not hold. This suggests that monetary policy in India does not respond to asset prices, but the asset price channel of monetary policy transmission exists. However, shocks to credit conditions explain a significant part of asset price variations over medium to long-run, which could be part of a broader co-movement of variables over the business cycle, particularly real activity, credit flows and asset prices.

The authors are of the opinion that since higher interest rates seem to cause contraction in output, credit demand as well as asset prices, the impact on asset prices alone should not be viewed as a good enough reason to use monetary policy for stabilising asset price cycles. Further, any policy that aims at limiting the overall pace of credit growth may have to be driven by developments, such as, either economic overheating or persistent high inflation, but not the perception of an asset price bubble. In their evaluation, asset price dynamics could be difficult to decipher for a meaningful use in the conduct of monetary policy. The authors are of the view that financial stability concerns from asset price bubbles could be better addressed through micro and macro-prudential measures, and the effectiveness of such measures could be enhanced when implemented in a sound macroeconomic policy environment.

### Exports and Economic Growth: An Examination of ELG Hypothesis for India

In the paper titled '*Exports and Economic Growth: An Examination of ELG Hypothesis for India*', Dr. Narayan Chandra Pradhan examines the nexus between export growth and economic growth and tests the export-led growth (ELG) hypothesis for Indian economy. The paper has gone beyond the traditional neo-classical theory of production function by estimating an augmented Cobb-Douglas production function covering exports including services exports, and has empirically examined both, short and long-run relationships between exports and growth. The study finds that about 14 per cent disequilibrium is corrected every year in case of 'goods and services' and GDP. This empirical finding reinforces the nexus between export and GDP growth in both, short and long run. The test of Granger causality suggests that the direction of causality runs from export growth to GDP growth. On the other hand, there is no reverse causation from GDP growth to export growth. The result of Granger causality/Block Exogeneity in VAR framework can be interpreted to

say that in the case of Indian economy, movements in the exports appear to lead those of GDP. This implies that one can use exports as an additional variable to better predict the GDP growth thus substantiating the importance of exports in the growth process of Indian economy.

### **Special Notes**

#### *Determinants of Private Corporate Sector Investment in India*

Under the Special Notes section, the paper on '*Determinants of Private Corporate Sector Investment in India*' by Ramesh Jangili and Sharad Kumar has explored the determinants of corporate investment in a sample of non-Government non-financial public limited companies operating in India. The paper spans the period 2000-01 to 2008-09. The paper has used the panel regression model for empirically identifying the factors which influence corporate investment decisions. Specific factors, such as, firm size, dividend payouts, leverage, cost of funds, production as well as cash flows along with the macro-economic variables like real effective exchange rate, inflation, non-food credit growth and capital market developments are considered as endogenous variables in the model. The results show that firm size, cash flow ratio and growth in value of production are positively associated, whereas, dividend payout ratio and effective cost of borrowing are negatively associated and are statistically significant to investment of the firm. The authors also find that real effective exchange rate and inflation at the macro level are negatively related with the corporate investment and non-food credit growth and capital market developments are positively related.

#### *Inclusive Growth and its Regional Dimension*

The study, '*Inclusive Growth and its Regional Dimension*' by P. K. Nayak, Sadhan Kumar Chattopadhyay, Arun Vishnu Kumar and V. Dhanya analyses the inter-linkages between different development indicators and various regions and sections to understand the nuances of India's growth process. The authors examine the causal relationship between bank finance and economic growth in a time-series framework with co-integration and error correction model. The study finds that bank finance plays a major role in the growth process with bi-directional causality between GDP growth and financial development. The impulse response function analysis indicated that the impact of credit on GDP is stronger than the reverse. In conclusion the authors emphasise the role of financial institutions in the overall scheme of inclusive growth. The study concludes that furtherance of macroeconomic reforms, harnessing synergistic links among the sectors, opportunities provided by the forces of globalisation and intensive use of technology could lead to achieving higher level of inclusive growth.

### **Book Review**

P.S. Rawat reviews the book titled '*Asia and the Global Economic Crisis: Challenges in a Financially Integrated World*' by John Malcolm Dowling and Pradumna Bickram Rana, Palgrave-Macmillan, 2010.

The book, with twelve chapters, elaborately covers the origin of global economic crisis and deals with the responses of the US and Europe and quickly moves on to focussing on its spread to Asia, especially Asia's reaction/policy responses to it. The book analyses the impact of the policy responses and the persisting challenges in rebalancing the global economy, the next steps in regional economic integration in Asia, and issues related to reform of the international financial architecture. As the world is emerging from the crisis, the book assesses what has been achieved so far, where Asia stands at the beginning of the new decade and what more needs to be done to successfully manage financial globalisation in the future.