



भारतीय रिज़र्व बैंक

RESERVE BANK OF INDIA

वेबसाइट : www.rbi.org.in/hindi

Website : www.rbi.org.in

इ-मेल email: helpdoc@rbi.org.in

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001

DEPARTMENT OF COMMUNICATION, Central Office, S.B.S.Marg, Mumbai-400001

फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 22660358

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RBI Working Paper Series for August 2011

The Reserve Bank of India today placed two working papers on its website.

- i) [Effects of Recent Financial Crisis on Optimal Asset Allocation of Foreign Exchange Reserves](#) by A. K. Srimany, Sneharthi Gayen and Ranjeev

Post financial crisis, yield in the developed sovereign markets is prevailing at very low level and consequently return generated by deployment of foreign exchange reserves have been very low together with increased risk of getting negative return more frequently. In this working papers the authors, discuss some strategies for the central banks to create optimum portfolio depending on their level of reserves under the present low yield scenario. The optimal asset allocation during post-crisis period suggests a concentrated portfolio as against the barbell structure for pre-crisis period. The authors observe that central banks can get higher pick in return in the post-crisis scenario than in the pre-crisis scenario for the same amount of increase in duration. However, in the post-crisis period the probability of negative return will increase substantially. The authors have also tried to find out an alternative strategy to increase the portfolio yield and reduce the probability of negative return under this low yield scenario. The authors conclude that central banks with medium/ long target duration can get substantial yield and return pick-up and also reduce the probability of negative return by including emerging Asia within the investment universe even without extending the duration.

- ii) [Monetary Policy and Food Prices in India](#) by Jeevan Kumar Khundrakpam and Dipika Das

Using a vector error correction model (VECM), the paper examines the relative response of food and manufactured prices to change in interest rate and money supply in India during the period 2001:Q1 to 2010:Q2. It finds that, in the long-run, while money supply leads to rise in the prices of both, food and manufactured prices, hike in call rate has a negative effect only on manufactured prices. The impact of money supply is, however, more on food prices than on manufactured prices. There is no evidence of long-run neutrality of money, as increase in money supply leads to less than proportionate change in price. In the short-run, there is overshooting in the prices of both food and manufactured products from their respective long-run equilibrium following monetary shocks. The overshooting, however, is more in food prices than in manufactured prices. Further,

in the short-run, call rate has a significant impact only on manufactured prices, while the impact of money supply is significant only on food prices. Both food and manufactured prices increase induces call rate hike. But money supply increases with rise in food prices and decreases with the rise in manufactured prices.

The Reserve Bank of India introduced in April this year, a 'RBI Working Paper Series' (RBI - WP) to provide a platform to the Reserve Bank Staff for presenting their research studies as well as to receive feedback from informed researchers.

The views expressed in all the research publications of the Reserve Bank, including the RBI Working Papers Series, do not necessarily reflect the views of the Reserve Bank and as such should not be reported as representing the views of the Reserve Bank of India.

Feedback, if any, on the papers could be addressed to the respective authors of the research studies.

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Alpana Killawala
Chief General Manager