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The Reserve Bank of India today released the [Winter 2011 issue of its Occasional Papers](#). RBI Occasional Papers is a research journal of the Reserve Bank and contains contributions of its staff and reflects the views of the authors. This issue contains following articles, special notes and book reviews.

Financial Stability, Economic Growth, Inflation and Monetary Policy Linkages in India: An Empirical Reflection

The paper on “*Financial Stability, Economic Growth, Inflation and Monetary Policy Linkages in India: An Empirical Reflection*” by Sarat Dhal, Purnendu Kumar and Jugnu Ansari provides an empirical assessment of crucial issues relating to the linkages of financial stability with economic growth and inflation in the Indian context. For this purpose, the study uses vector auto-regression (VAR) model comprising output, inflation, interest rates and a banking sector stability index for a period 1995:Q2 to 2012:Q3. The banking stability index is constructed with capital adequacy, asset quality, management efficiency, earnings and liquidity (CAMEL) indicators. The paper finds that financial stability on the one hand and macroeconomic indicators comprising output, inflation and interest rates on the other hand can share a statistically significant bi-directional Granger block causal relationship. The impulse response function of the VAR model provides some interesting perspectives. First, financial stability, growth and inflation could share a medium-longer-term relationship. Second, enhanced financial stability could be associated with higher growth accompanied by softer interest rates without much threat to price stability in the medium to long term. Third, greater economic stability or higher output growth can enhance financial stability. Fourth, higher inflation or price instability could adversely affect financial stability. Fifth, financial stability can contribute to the effectiveness of monetary transmission mechanisms. Finally, the paper finds that with financial stability, output growth could become more persistent and inflation less persistent.

Measures of Core Inflation in India - An Empirical Evaluation

The paper on “*Measures of Core Inflation in India – An Empirical Evaluation*” by Janak Raj and Sangita Misra attempts to analyse seven exclusion-based measures of core inflation in India based on WPI (2004-05=100) for the period 2004-11. The measures were tested for volatility, unbiasedness and tracking the trend and predictive power. The paper finds that while two measures - WPI excluding food and WPI excluding food and fuel - did not perform well in terms of volatility, the remaining five measures - WPI excluding fuel, WPI non-food manufacturing; WPI excluding fuel and basic metals and metal products; WPI excluding fuel, metal group and non-food primary articles; and WPI non-metal manufacturing- broadly satisfied the conditions relating to volatility, unbiasedness and tracking the trend and predictability of future inflation. Of these five measures, it was tested based on the conventional gap

approach model, that all except non-food manufacturing revert to headline inflation violating a key property of core measure. This finding was further corroborated by granger causality and inflation persistence tests. Thus, the paper concludes that non-food manufacturing is the only exclusion based measure which broadly satisfies all the properties of a core measure. However, given the loss of information content in the construction of core inflation and the relatively greater public acceptability of the headline inflation, the core measures are useful only as indicators of the underlying inflationary process rather than as policy targets. Thus, containing headline inflation, and not core inflation, should be the focus of monetary policy, particularly in countries like India, where food and fuel are a major part of the consumption basket.

Corporate Bond Market in India: Issues and Challenges

The paper titled "*Corporate Bond Market in India: Issues and Challenges*" by Amarendra Acharya attempts to plug the gap in literature on corporate debt market in India. The approaches to deal with issues are both analytical and empirical. The progress made on the recommendations of R. H. Patil Committee on corporate bond and securitisation has been delineated exclusively as a sequel to the analysis of issues on this segment of the financial market. Empirical verification of monetary policy transmission through SVAR, and volatility spillover through VECM (1,1) confirms that this segment responds to monetary policy in deficit liquidity conditions, and is insulated from overseas influences.

Special Note

In a note titled "*After a Decade- What do the Trends and Progress of Fiscal Management of Uttarakhand Suggest?*", P.S. Rawat provides an overview of the fiscal situation of Uttarakhand after a decade since its inception in November 2000. The author examines finances of Uttarakhand with the aim of understanding structural aspects of budgetary transactions. It is found that although Uttarakhand inherited the legacy of fiscal problems of undivided Uttar Pradesh, the enactment of FRBM Act and implementation of VAT has been instrumental in improving the fiscal health of the State. The gross fiscal deficit declined from 5.1 percent in pre FRBM period to 3.2 percent in the post FRBM period. Since 2009-10, however, there has been some fiscal stress on account of implementation of the Sixth Pay Commission and slackness in tax collections caused by slowdown in the domestic economy. The paper suggests that in order to further accelerate the economy of Uttarakhand, high priority should be given to public policies that improve productive efficiency while ensuring the protection of the enriched biosphere keeping in view the potential of forest driven growth.

Book Reviews

Dipak Chaudhari reviews a book titled "*China after Sub Prime Crisis: Opportunities in the New Economic Landscape*" authored by Chi Lo and published by Palgrave Macmillan (UK).

The author examines implications of sub-prime crisis for the emergence of China as global super-power. It covers a wide range of issues from growth dynamics to financial sector rigidities that are important for any economy to grow and make a niche in global arena. The author is of view that China's domestic consumption so far has been suppressed by the skewed supply-side expansion growth model. However, with massive household savings, an under-leveraged consumer sector, improving social welfare and a critical consumption mass being formed, it is expected that China's growth will become more sustainable and less dependent on external demand.

Soumasree Tewari reviews a book titled "*India after the Global Crisis*" by Shankar Acharya and published by Orient Blackswan (Hyderabad). The book, a collection of essays by the author, focuses on India's performance right from the emergence of the US crisis in 2008 and till the period when the world economy is facing the brunt of the EU Sovereign debt crisis. In this book, the author draws a vivid picture of India's resilience in the face of global economic and financial crisis in 2008 following a robust growth, a gradual approach of Reserve Bank of India (RBI) towards capital account convertibility and domestic regulation of banks and other financial intermediaries. According to the author, with the resurgence of the sovereign debt crisis and the dismal performance of the advanced countries, there is a remote chance of the crisis being over in the near future, which will have implications for India's growth performance in the coming years.

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