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AN ANALYTICAL REVIEW OF THE MONETARY POLICY OF INDIA FROM 2008 TO 2013

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ABSTRACT

This paper tries to analyse the policy frameworks of RBI in the past five years (2008-2013). These years have been very crucial for the RBI because the ongoing financial crisis in the world which initiated from the September of 2007 due to the imprudent lending of banks in the U.S. had the spill over effects in all the emerging economies of the world and India was in no way to be spared. Thus, the RBI had a very important role to play for the Indian economy to be back on its track. High prices of essential goods and services which were purchased by the common man had a negative effect upon the fiscal policy framed by the government when in order to reduce the burden upon the common man, there were subsides being showered very lavishly leading high fiscal deficits which had been targeted at 4.8% but still remains at 5.1%. In addition to it the CAD (current account deficit) was also burgeoning to heights. Thus, the apex bank of India had to play like a rescue ranger with some tough decisions at times which are briefly studied in the content of this paper.

KEYWORDS: RBI, Monetary Policy, Repo Rate, Reverse Repo Rate, Interest Rates.

INTRODUCTION

Money has been a hot topic of discussion since times immemorial. Nobody has been left untouched by the thin paper and the metallic circular commodity. Its importance is not limited to the lenders, "lalas" and "seths" as we say in layman's language. The dealers of the moolah are now in great need of forecasting of the moolah's state because of the recent changes in different economies as money can be useful only when the state of the economy is known precisely. Investing today may be good for tomorrow is hard to realize without the proper policy framework and with such a volatile global economic scenario, one cannot just put in his/her money without any prior knowledge of future expected financially engineered framework in mind. Inflation and deflation occurring time and again in India has given a tough time to the RBI governor. The past five years have been challenging and it would not be an imaginary to say that in future also, the same booms and busts would force the central bank to amend its very own policies and rates mentioned under those policies.

The global financial crisis was a big shock to the emerging economies as well as the developed economies of the world. The spill over effects of this crisis were so massive that they would be mentioned in the history books as a separate chapter no matter the topic may belong to economics and finance. Indian investors were in state of limbo with the foreign capital moving out abruptly specially in 2012 because of the volatile nature of the financial conditions .Indian economy was so much hurt by the global scenario that the common man had started to lose trust in the ruling government with government resorting to short term measures like subsidies, price cuts, freebies being unscrupulously being distributed, thus adding to the already inflating fiscal deficit. To curb the economy from collapsing due to unwanted inflationary conditions, burdens of unnecessary subsidies and outflowing capital, the RBI took healthy drastic measures to stop any further negative outcomes from taking tangible forms. Thus, the years 2008 to 2012 were very important with respect to monetary policy frameworks in India as these years had given a very tough time to the policy frame workers in the apex bank of the country. The lessons learnt from these five years will help the future governors of the RBI to make their policies in order to come to terms with the booms and busts which affect the country. Dr. Subbarao had a very tough tenure. He handed over the baton tor to the future governor Dr. Raghuram Rajan who continues to take up the agenda of controlling inflation by keeping an eye upon the economic outcomes of the past mistakes. The layman may not understand the repo rates reverse repo rates but a brief knowledge of these concepts which massively affect his/her life concepts and how RBIs works is a must now a day.

LITERATURE REVIEW

Before starting to discuss about the monetary policy functions in the years 2008-2013, I would like to give a brief review of the books and research papers. I went through relating to the topic of my paper. “MONETARY POLICY” written by “PARTHA RAY” proved to be very useful to me as it described about the roots of monetary, its evolution, the beginning of central banks in India with different schools of thought giving a new form to monetary policy. It also helped me to understand certain concepts which were presenting a hazy picture to me previously. The macro-economic concepts of hyperinflation, reserve requirements have been described in a very insightful manner. The book ends with 240 pages in total. It has tables, boxes and useful figures. My analysis of the book made me go further into the details of recent monetary policy amendments which took place in India after the global economic crisis and write briefly about the years 2008-2013 with reference to Indian financial scenario, the sudden changes taking place in Indian economy and some future speculations.

Few papers which helped me to write this paper included the paper “REVIEW OF IMF RESEARCH ON MONETARY POLICY FRAMEWORKS” BY “Kenneth Kuttner”, “Petra Geraats”, “Refet Gurkaynak”. This paper released a brief review of the framing of monetary policy in some economies of the world after taking into consideration around 60 IMF working papers on monetary policy frameworks .Another paper which I referred to was “Global Financial Crisis, Its Impact on India and the Policy Response” by “Nirupam Bajpai”. This paper gives an insight into the impact which the global financial turmoil had on India during the past 3 years of period ranging between 2007-2009 and some policy measures which were adopted by the policy frameworkers of India during that time of crisis. The paper “SUB-PRIME CRISIS IN U.S.: EMERGENCE, IMPACT AND LESSONS” by K.V. Bhanumurthy and Ashish Taru Deb gives a view of the fact that a financial sector of any country can fall off into doldrums if left unregulated and how the same financial crisis of 2007 had a negative impact upon Indian financial sector through the spill over effects in 2008 and 2009. Another paper “CONDUCTING MONETARY POLICY AT VERY LOW

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SHORT TERM INTEREST RATES" by "Ben Bernanke" and "Vincent, R. Reinhart" which describes the impact of low interest rate policies in the short term on monetary policies of Japan, U.S. and some changing compositions of the Central bank's balance sheets with proper consideration of their balance sheets. Monetary policy is the set of rules and regulations framed by the apex bank of any country in order to regulate the financial ups and downs of that particular economy. To be more precise the cost and quantity of money in any nation is controlled through this supreme authority. Bank of England in the U.K., U.S. Federal Reserve System in the United States and Bank of Japan in Japan are a few examples of central banks.

RESERVE BANK OF INDIA (RBI) AND INTERNATIONAL MONETARY SYSTEM

In India this job is performed by the RESERVE BANK OF INDIA (RBI). The RBI performs the following functions:

1. Issuance of currency.
2. Debt management. (Government debt).
3. Banking of banks. Therefore referred to as "banker of banks".
4. Maintenance of foreign exchange.
5. Maintenance of financial stability.
6. Maintenance of growth.

The preamble of India says "The basic functions of the Reserve Bank of India are to regulate the issuance of bank notes and keeping of reserves with a view to keep securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

The RBI born in 1935 had a tough time initially due to the Second World War but recent years have too put in a war like situation due to burgeoning fiscal deficit, Plunging growth rate, plummeting of rupee, tapering winding by U.S. Federal Reserve, bearish approach of FIIs and many more underlying causes. Efforts by the RBI have been commendable but still more needs to be done to tackle the skyrocketing inflation. If we analyse the recent conventional trends of monetary policy in India we may see that the RBI adopts the "MULTIPLE INDICATOR APPROACH" mainly. This approach is a multi-pronged attack on financial instability of the country because it emphasizes upon employment generation, GDP enhancement, inflation control and exchange rate stabilization.

Employment generation and GDP enhancement come under the fiscal monetary co-ordination. Although the emerging market economies are hailed in honour with great expectations in the recent years but still they are engulfed by poverty and unemployment resulting in a low per capita income. The confusion comes at that point when the RBI is stuck in the dilemma of whether to adopt a contractionary monetary policy for tackling inflation or to adopt an expansionary one for generation of growth and employment. If RBI adopts the expansionary monetary policy then it generates growth through the following procedure.

Cutting of Interest Rates → Increase in Investment → Increase in Business Opportunities → Increase in Requirement of Workers → Increase in Employment.

If RBI adopts the contractionary monetary policy then it goes through the following phases:

Increase of Interest Rates → Decrease in Investment → Decrease in Investment Opportunities → Decrease in Requirement of Workers → Decrease in Employment.

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RBI has had to time and again increase its interest rates, more precisely the key policy rates in the recent years due to the spill over effects of the global economic crisis. The global economic crisis brought down the growth of India to a mere 6.1% as it was put forward by the annual policy statement of RBI even though the PMEAC (Prime Minister`s Economic Advisory Council) had put it as 7.1%. Inflation in India during that time was not much; around 4.8% therefore keeping in view the state of the economy the RBI lowered the key policy rates to attract investment for grappling with the slowdown. It was feared by many that this was a clear invitation to inflation and the fears of the warners came true when suddenly after 2009 end that is between 2009 and 2010 India was shackled by inflationary chains and this inflation was coupled with oil and fuel shock. Thus, it was a battle with the devil on one side and the witch on the other side. RBI had to definitely control inflation because it was, is and will remain its priority to maintain price stability because being the issuer of the currency RBI has keep a check upon its circulation. Over circulation of the currency leads to inflation and the opposite to deflation. Therefore, the RBI opted for a slash in interest rates because there was a big demand for rejuvenating the Indian economy as the industrial activity particularly the infrastructure sector had seen a slump in growth. The services sectors too had a reduced rate of growth. Thus, the fiscal stimulus given by the government on slashing of interest rates by the RBI brought about some recovery in the economy. There was a need to arrest moderation in growth for a better shape of the Indian financial scenario. A big cut in the repo rate from 9% in September 2008 to 4.25% in April 2009 led to spike in investments. Again the cash reserve ratio (CRR) was also reduced from 9%in September 2008 to 5% in January 2009. During the second half of the year 2009, the RBI increased the Statutory Liquidity Ratio (SLR) from 24% to 25% because the RBI needed to increase the securities in the form of gold and some assets to be on a safer side in case the Indian economy too was engulfed by NPAs like the U.S. and another may take place. The banks were under severe pressure to maintain the credit. The RBI also strengthened its provisioning norms to 0.1% from 0.4%. Banks were to increase their provision coverage to 70% by September 2010. Collateralized Borrowing and Lending Obligations (CBLO) were also subject to the maintenance of Cash Reserve Ratio (CRR) from November 21, 2009. CBLO are those securities and instruments which are used for borrowing money. They create an obligation on the borrowers to repay the money back at a predetermined date along with the charges on the securities pledged. The RBI also restored the export credit refinance facility to 15% which was the same as during the pre-crisis level. This was because the 2008 crisis had led to a an abysmal fall in exports when the RBI had tightened the norms for the foreign trade sector too in view of being on the safer side lest the economy may fall into the hands of another disaster which could have been an uncoverable Current Account Deficit (CAD). As mentioned above exports were restricted by restraining of the export credit refinance facility and imports were restrained indirectly by the RBI through time and again directing the government to take measures to restrict the import of gold and some unnecessary items. Thus RBI had opted for a relaxed policy with few restrictions. This paved a way for the domestic economy to recover to a certain level in terms of investment rising leading to increase in employment. The risen employment levels led to higher growth rate in the year 2009 of about 7.4%. When the fourth quarter of the Indian economy grew by 8.6%. This was because in the fourth quarter of 2009-

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2010, the Indian economy grew by 8.6%. The Indian economy had suddenly risen from a sluggish growth of 6.5% in the previous quarter. There was a two digit growth in the industrial sector also of around 11% and it jumped to14%in the April of 2010. Thus the year 2009 was a very tough year for the RBI to come to terms with the spill over effects of the global scenario. The sectors which contributed to the Indian economy constituted of mainly the demand side components. Private consumption contributed upto 36%, government consumption contributed nearly 14%, fixed investments added upto 26% and net exports added upto 20%. Achallenge was awaiting the RBI in 2010 for the RBI when the WPI (wholesale price index) jumped from 0.5% in September 2009 to 9.9% in March 2010. This showed an increase of 1.4% in the limit set by RBI for March 2010. Thus RBI had to come to the rescue of the Indian economy by taking measures through the tools available to it. Hiking prices was a concern for the common man. RBI as well could not hang its boots in such a case. Management of liquidity circulating in the economy was a worrisome point to be dealt with. Thus as was expected the RBI raised the two key rates namely the Repo rate and the Reverse Repo rate by 0.25% and 0.25% respectively on July 03, 2010. Before this rate hike the RBI had raised the key rates two times. This gives us a scene of the economy in India going through periods of hyperinflation, thus forcing the apex bank of the country to hike the key rates repeatedly. After this hike on July 03, 2010, RBI raised the interest rates ten times more. Thus, the year 2010 was in great news for RBI`s rate changes.

The following Table shows the important rate changes in key policy rates of RBI in 2010 (repo rate and reverse repo rate).

S.NO.	DATE	REPO RATE	REVERSE R. R.	CRR	SLR
1.	13-02-2010	4.75%	3.25%	5.5%	25%
2.	27-02-2010	4.75%	3.25%	5.75%	-
3.	19-03-2010	5.00%	3.5%	5.75%	-
4.	20-04-2010	5.25%	3.75%	5.75%	-
5.	24-04-2010	5.25%	3.75%	6.00%	-
6.	02-07-2010	5.5%	4.0%	6.0%	-
7.	27-07-2010	5.75%	4.5%	6.0%	-
8.	16-09-2010	6.00%	5.00%	6.0%	-
9.	02-11-2010	6.25%	5.25%	6.0%	-
10.	27-10-2010	6.25%	5.25%	6.0%	24%

MONETARY POLICY ISSUES

September 2009 Policy	January 2010 Policy	April 2010 Policy
Watch inflation trend and be prepared to respond swiftly and effectively. Monitor liquidity to meet credit demands of productive sectors while securing price and	Anchor inflation expectations, while being prepared to respond appropriately, swiftly and effectively to further build-up of inflationary pressures. Actively manage liquidity to	Anchor inflation expectations, while being prepared to respond appropriately, swiftly and effectively to further build-up of inflationary pressures. Actively manage liquidity to

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financial stability. Maintain monetary and interest rate regime consistent with price and financial stability, and supportive of the growth process.	ensure that the growth in demand for credit by both the private and public sectors is satisfied in a non-disruptive way. Maintain an interest rate regime consistent with price, output and financial stability.	ensure that the growth in demand for credit by both the private and public sectors is satisfied in a non-disruptive way. Maintain an interest rate regime consistent with price, output and financial stability.
Source: RBI		

The above table shows a very brief summary of central bank policies in October 2009, January 2010 and April 2010. Thus, the end of October 2009 showed an urgent need to monitor inflation and the from beginning of year 2010 RBI was determined to catch hold of inflation by its neck. The impact of inflation was so strong that the increase in key rates in the beginning brought about very little change in inflation (WPI). Thus, as mentioned above; in 2010 the RBI amended the key policy rates thirteen times. Even after these repeated efforts of arresting inflation, still there was resurgence in inflation in the last quarter of the year. International commodity prices went up by the end of this year. Therefore, basically the raw material components of manufactured goods which had to be essentially imported from overseas were raising the cost of the final products in India. Rising demand of those goods added even more to inflation because there was a scarcity in the supply as compared to the wants. Growth had been moderating in capital goods production and investment spending. Thus, there was an indication that still there was need for the RBI to take steps for arresting the rising price levels.

Three factors which shaped the strategy of was adopted by the RBI then which were

A. Global commodity prices which were touching the heights and were expected to peak further in future at that time.

B. Increasing levels of headline inflation which was measured by WPI (wholesale price index) and core inflation. While the headline inflation depicts a picture mainly of increasing food and energy costs, the core inflation measures the rising costs of non-food items. Thus, very less room was left in the Indian economy which was left untouched by inflation.

C. Moderation in demand was the third challenge for the RBI to take into consideration for a reduction in pricing power and subsequent passing of prices to the commodities.

Thus, a tough positioned RBI had to see towards the fluid situation of the economy .To solve the multiple problems which had erupted from inflation, RBI constituted a working group committee on the operation of monetary policy procedure which was headed by the chairmanship of Shri Deepak Mohanty. The committee gave the following recommendations:

1. The weighted average overnight call money rate to be taken as operating target of monetary policy of the Reserve bank.
2. This was in consideration with only one independently varying rate being the main rate, that is, the repo rate and as such the framing of policy by the RBI was to become an easier task with greater accuracy in hand.

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3. The reverse repo rate was decided as not to be left independent with a fixed pegging of 1% below the repo rate.
4. MSF was instituted which is the Marginal Standing Facility. This was instituted to facilitate the scheduled commercial banks for borrowing call money overnight upto1% of their NDTL (net demand and time liabilities).The rate was decided to be kept over repo rate by 1%.
5. This indicated that the corridor width between repo rate, reverse repo rate and the MSF was fixed now. The repo rate was kept in the middle with reverse repo rate and MSF on the sides.
6. Repo rate: A, Reverse repo rate: A-1 MSF: A+1
7. Although the width of this corridor was fixed and the above changes were enforced from May 07, 2011, it was decided that the RBI had the flexibility to change the corridor width.

INFLATION AND CPI (CONSUMER PRICE INDEX)

The year on year inflation as measured by the CPI (consumer price index) for industrial workers had moderated from April to July, rose to about 9%in August which showed an increase in food prices. The year on year M3 money supply growth moderated from 17.2% in the beginning of the financial year 2011-2012 to 16.2% in October. During the first half of the year 2011 the modal deposit rate of banks increased by 80 basis points to 7.45%. Liquidity conditions also remained deficit consistently with the anti-inflationary stance of the monetary policy. The rupee also depreciated against the dollar by 8.7% between March and September and then by 2.3% between end September and October. Nevertheless, the continuous efforts made by the RBI were helping the economy even in that phase of turmoil of the spill over effects of the global economic crisis. There was a slight moderation in the prices by the cumulative efforts of RBI in commodity prices by the mid of next year, that is April 2012. Thus, it was a positive sign of the efforts done in 2011by the RBI which were disappointing the common people, the investors, the bankers and financial stakeholders in that particular year but boosted the morale of the very same people, the next year.

The year 2012 was again a very tough year for the RBI. The rupee was getting devalued again and again. On April 17, 2012 the RBI reduced the repo rate from8.5% to 8%. The reverse repo rate was brought to 7%.The bank rate and the MSF that is the Marginal Standing Facility was brought to 9%. Dr. Subbarao also warned the financial hubs, investors and market players that any further cuts in rates during that year were not meant to be expected at all. This rate cut was given by the RBI governor for giving a LIQUIDITY CUSHION TO THE ECONOMY in the light of the need for generation of a little investment. It was observed by the apex bank that the NPAs that are the nonperforming assets were not very alarming and in view of the economic scenario all over, the RBI raised the banks' provisioning requirements from 2% to 2.75%. The global outlook for India as assessed by the apex bank remained bleak in 2013. The emerging market economies like Argentina, Brazil, Russia, and South Korea suffered a plunge in growth due to the global slowdown continuing even after 2011. Although its effects were now slowly receding, the leftover impacts were still now being felt. China was the only country which was growing considerably at that time. Thus, the RBI was vigilant enough. The quantitative easing by the US Federal Reserve was

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perceived as a stoker of slight inflationary fires by the RBI. Thus, there was no ease in inflation tackling by the RBI. Few signs of recovery were not enough for the RBI to cut out on the key policy rates. However the RBI assured the keen investors and financial dealers about possible rate cuts in case of softening of inflation.

CONCLUSION

The Indian the Indian economy has been in much need of a good policy framework as it is essential in today's time when the Fleming Mundell model cannot be neglected totally which advocates the fact that an open economy cannot remain unaffected when the world economies are booming or busting. We saw a spectacular RBI policy framework from 2008-2013. This kind of aggressive stand taken by the RBI had never been in the picture before. The reason is simple the economy of India is an open economy once an economy is open it is prone to attacks of global activities' repercussions whether positive or negative. Thus, a hawk eyed view of inflation in other countries, the crisis, there cessionary phases all need to be kept in the mind by our policy frame workers and it indeed has been kept giving a shield to our economy.

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