

IMPACT OF MONETARY POLICY ON INDIAN ECONOMY FOR PAST FOUR QUARTERS (2018 - 2019)

1. MONETARY POLICY

Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.

The key aim of monetary policy for most central banks is to keep inflation low and steady.

1.1 Objectives of Monetary Policy:

- Rapid Economic Growth
- Price Stability
- Exchange Rate Stability
- Balance of Payments (BOP) Equilibrium
- Full Employment
- Neutrality of Money
- Equal Income Distribution.

1.2 Instruments of Monetary Policy - Quantitative & Qualitative Tools:

- Bank Rate Policy (BRP)
- Open Market Operation (OMO)
- Variation in the Reserve Ratios (VRR)
- Fixing Margin Requirements
- Consumer Credit Regulation
- Publicity
- Credit Rationing

- Moral Suasion

2. BANK DEPOSITS

Bank deposits consist of money placed into banking institutions for safekeeping. These deposits are made to deposit accounts such as savings accounts, checking accounts and money market accounts. The account holder has the right to withdraw deposited funds, as set forth in the terms and conditions governing the account agreement.

2.1 Impact on Deposit and Lending Rates:

- Higher repo rates have already translated into higher deposit rates. Many banks, such as State Bank of India and Axis Bank, have hiked deposit rates. However, since this move was anticipated by lenders long ago, the lending rates have already gone up many fold. This would effectively mean higher EMIs on [Home Loans](#), [Car Loans](#) as well as [Personal Loans](#).
- The Home Loan segment is likely to face the brunt of this increase in repo rate. This is because Home Loan rates are usually floating-rate loans that change along with the interest rates in the country. Also, the amount of loan taken by a borrower is usually much higher than that of a Car Loan or Personal Loan. So, any increase in Home Loan interest rates will mean a higher interest payout for the Home Loan borrower.

2.2 Impact on FDs

With an increase in policy rates, bank deposit rates are expected to rise as well, SBI hiked its deposit rates by 5 to 10 BPS. This means marginally higher interest earnings for customers opening Fixed Deposits with banks.

2.3 Impact on Loans

Loans will get marginally costlier. In June, several leading banks, including SBI, had increased their MCLR. With the rate hike today, we'll see loans get costlier. On a loan of Rs. 1 lakh for 20 years at an interest rate of 8.5%, the EMI is Rs. 868. If the rate rises to 8.75%, the EMI increases to 884. If the interest rate reaches 9%, the EMI becomes Rs. 900. In a rising rate scenario, it makes immense sense for customers repaying loans to make periodic principal pre-payments. This is especially helpful while you're in the first half of your loan tenure. Pre-payments made in the first half have an immense impact in reducing your long-term interest outgo and thus ensuring savings.

2.4 Impact on Equity and Equity Mutual Funds

In recent years, we had seen heavy inflows into the equity markets corresponding with a steady drop in interest rates. The intrepid investor seeking higher returns chose equity in this period. As a result, Mutual Fund AUMs grew at a tremendous pace. The investor with a risk appetite can continue to invest in equity with the expectation of above-average returns in the long-term.

2.5 Impact on Debt Funds

Rising rates are bad news for Debt Mutual Funds investors. This is because the prices of bonds fall, and bring down the NAV of debt funds. It would be advisable for investors to steer clear of long-term debt funds and go for funds with shorter maturity periods. Short-term debt funds are expected to deliver lower volatility and low risk in this scenario.

2.6 Impact on Small Savings Scheme

With two consecutive hikes in the repo rate, taking it to 6.50%, there is now heavy expectation of increase in small savings returns. For the April to June quarter, the

rates remained unchanged. Investors looking for risk-free, guaranteed returns may continue to invest in PPF, NSC, Sukanya Samridhi, and Post Office Savings etc.”

3. BANK CREDIT

Bank credit is the aggregate amount of credit available to a person or business from banking institutions. It is the total amount of funds financial institutions provide to an individual or business. A business or individual's bank credit depends on the borrower's ability to repay the total amount of credit available in the banking institution.

Bank credit is the total borrowing capacity banks provide to borrowers. It allows borrowers to buy goods or services. However, it requires a fixed minimum monthly payment for a specified period. For example - the most common form of a bank credit is a bank credit card. Borrower starts with a zero balance and use the card to make transactions. The borrower pays off the balance and borrows again until the credit limit reached

3.1 Impact of Bank Credit

- **Strict Requirements:** Because many bank loans require some form of collateral, start-ups and existing businesses without any assets can find it difficult to get their loan applications approved. If these borrowers choose to go for unsecured loans, they are hit with higher interest rates.
- **Irregular Payment Amounts:** If you get a bank loan with variable interest rates, the rate changes with market conditions. This makes it difficult to determine the exact amount of future payments. Consequently, it becomes challenging **to make sound financial plans.**

- **Repayment Burden:** Loan borrowers must make periodic payments to their banks. Those who fall behind on payments face the prospect of having their assets seized. Even if you manage to make late payments, your bank could still report you to credit bureaus – a move that negatively affects your credit score. With a lower score, obtaining loans in the future becomes more difficult. The repayment burden is a disadvantage compared to raising money through shareholders, because shareholders don't require regular repayments. Instead, they are typically paid dividends only on profits.
- **Higher Rate of Interest:** Interest as compared to other forms of loans as the lending is based on the collateral security which carries uncertainty over its value. For example, take the collateral as inventory, it might be worth millions today but a policy change or emergence of new competitive product in the future may lead to a permanent decline in its value.
- **Minimum Commitment Charges:** The lender would always be willing to extract a minimum charge from the lent amount regardless of the fact that the borrower has utilized that much limit or not. For example, when a bank sanctions a cash credit of up to \$100 million, the lender would stipulate a clause that the borrower would pay a minimum interest on \$20 million or the amount withdrawn, whichever is higher.
- **More Compliance and Checks:** One of the cons of cash credit system of finance is that the borrower is under an obligation of quarterly/semi-annually (depending on the terms and conditions) filings of reports with the banker which would state the present conditions of his collateral e.g. filing of the monthly stock statement with the bank. These obligations hamper the usual operations of the business and create an extra administrative burden on the borrower

4. SURPLUS LIQUIDITY

Surplus liquidity occurs where cash flows into the banking system persistently exceed withdrawals of liquidity from the market by the central bank. This is reflected in holdings of reserves in excess of the central bank's required reserves. The occurrence of surplus liquidity is widespread, covering many countries around the world. Historically, it has been observed most often in soviet, wartime and transitional countries. Transitional economies, for example, often attract large capital inflows as the economy opens and undergoes privatisation. The effect of these inflows on liquidity is often magnified by central bank intervention in the

foreign exchange market when there is upward pressure on the domestic currency. In the wartime economy, consumption is restricted and large amounts of involuntary savings accumulate until goods and services eventually become more widely available. Soviet-style economies have displayed widespread shortages administered prices. This creates a situation of repressed inflation, whereby prices are too low relative to the money stock, leaving individuals with excess real balances. The importance of surplus liquidity for central banks is threefold and lies in its potential to influence:

- 1) The transmission mechanism of monetary policy
- 2) The conduct of central bank intervention in the money market
- 3) The central bank's balance sheet and income.

4.1 Impact of the liquidity surplus in the economy

- The RBI faces a policy dilemma, requiring a balancing act between managing liquidity keeping the currency stable and sticking with its inflation- targeting mandate.
- Holding the rupee down – would fuel already flush liquidity conditions, putting the central bank's inflation mandate at risk.
- Measures seem to be under consideration and more durable liquidity tool the Standing Deposit Facility (SDF) was proposed in May 2017.
- An increase in the CRR is another alternative, but this has not gained traction as a small 25-50 basis point hike might not be sufficient, instead adding to the costs of the already stressed banking sector.
- Incremental approach is more likely involving a mix of regular tools, bond sale and market stabilisation bills.
- Liquidity on inflation, a monetary policy response via rate cuts is not warranted.
- Instead of monetary policy response the dilemma is likely to be dealt by a combination of forex market intervention, liquidity- absorption measures and modest rupee gains, despite the associated costs.

5. CONSUMER PRICE INDEX

A Consumer Price Index (CPI) is designed to measure the changes over time in general level of retail prices of selected goods and services that households purchase for the purpose of consumption. Such changes affect the real purchasing power of consumers' income and their welfare. The CPI measures price changes by comparing, through time, the cost of affixed basket of commodities.

The basket is based on the expenditures of a target population in a certain reference period. Since the basket contains commodities of unchanging or equivalent quantity and quality, the index reflects only pure price. The annual percentage change in a CPI is used as a measure of inflation.

5.1 Consumer Price Index in India

In India, the consumer price index is calculated on a monthly basis and is released every month at 5.30 p.m. on 12th day of the following month. If it is a holiday, then it is released on the next working day. All-India CPIs (Rural, urban, combined) along with inflation rates for sub-group, group, CFPI and General Index (all groups) are released through a Press Note and are also uploaded on the website of the Ministry of Statistics and Programme Implementation. **The Consumer Price Index (CPI) in December 2018 rose by 2.19% (YoY)** from a year ago. According to data released by the Central Statistics Office the country's CPI in December 2018 was pegged at 140.2, compared to 137.2 reported in the corresponding period last year. The CPI in December 2018 for urban areas was 138.0 and for the rural areas were 138.0.

This months CPI figure represents a decline of 0.43% (MoM) since last month, as CPI (combined) for November 2018 stood at 140.8.

6. GOVERNMENT SECURITIES AND EXCHANGE COMMISSION

The commission adopted in the rules of financial reporting and auditing standards and to ensure consistency in the implementation of the rules and to attain fair presentation and transparency of financial statements. The bulletins are issued by the office of the general accountant to Asset Corporation and their accountants /auditors in coming with their financial reporting obligations, and to ensure consistency of implementation.

The SEC has four major divisions

- The Division of Corporation Finance ensures corporate disclosure of important information to the investing public.
- The Division of Trading and Markets ensures fairness, order and efficiency in market activities.
- The Division of Investment Management helps to protect investors and encourages capital formation through oversight and regulation of the investment management industry.
- The Division of Enforcement investigates securities law violations and initiates civil and criminal actions.
- Maintain fair, orderly and efficient markets
- Facilitate capital formation
- The SEC consists of five divisions and 23 offices. Their goals are to interpret and take enforcement actions on securities.

7. EXCHANGE RATE

An exchange rate is the price of a nation's currency in terms of another currency. Thus, an exchange rate has two components, the domestic currency and a foreign currency, and can be quoted either directly or indirectly. Exchange rates can be either fixed or floating. Fixed exchange rates are decided by central banks of a country whereas floating exchange rates are decided by the mechanism of market demand and supply

In a **Direct quotation**, the price of a unit of foreign currency is expressed in terms of the domestic currency. In an **Indirect quotation**, the price of a unit of domestic currency is expressed in terms of the foreign currency.

Exchange rates are quoted in values against the US dollar. However, exchange rates can also be quoted against another nation's currency which is known as **cross currency** or cross rate.

Present currency rate 71.26 INR against USD (January 2019).

7.1 Impact

The Indian rupee has had a terrible year so far—but it is only likely to get worse. The 2019 general elections may drag down the currency even further, warns global financial services firm Nomura.

- A strengthening U.S dollar is causing the rupee to depreciate as the cost of India's hefty, dollar denominated oil imports are raising.
- The falling rupee suggests that Indian monetary policy will enter a tightening phase to stem debt outflows, manage inflation and ease the currency's fall in the world's fastest-growing economy.
- With one eye on re-election in 2019, Prime Minister Narendra Modi will continue to indulge in populist spending, which will expand the country's deficit and slow the government fiscal consolidation drive.
- While economic trends in India will weaken Modi as a candidate, the absence of a unified opposition indicates that he will remain the favourite in the 2019 general elections.
- The rupee has now depreciated by about 7 percent from June 2018, when the Reserve Bank of India (RBI) started hiking rates, and close to 13 percent in 2018. Thus, by any stretch of the imagination, the depreciation in the rupee has now outpaced other Asian currencies like Indonesia rupiah. We believe, beyond a certain level of depreciation, the costs could outweigh benefits.
- There are many components of such cost. India's short-term debt obligations as on December '17 were to the tune of \$217.6 billion. Assuming half of this amount has either been paid in H1 2018 or is rolled over to 2019, the remaining repayment amount in rupee terms would be Rs 7.1 trillion at average 2017 exchange rate of Rs 65.1/ US dollar.
- For H2, assuming that rupee depreciates to an average value of the 71.4/US dollar, the debt repayment amount would be Rs 7.8 trillion, thereby implying an extra cost of Rs 670 billion. This is a model estimate of the cost that depreciation can put on the country as the repayment is done throughout the year.

7.2 Oil Import Bill

The next is the impact on oil import bill. We assume that the volume of our crude oil imports would increase by a modest 3.6 percent (average of past 5 years) in 2018. If we reduce the volume of oil imported in the first half of the current FY, the remaining volume of crude to be imported comes to 0.76 bin bbl.

At an average oil price of \$74.24/bbl for the remaining half, crude import bill of India in 2018 should amount to \$57 billion. If the average exchange rate remained at Rs 65.1/ US dollar, the crude oil import bill would have been Rs 3,643 billion.

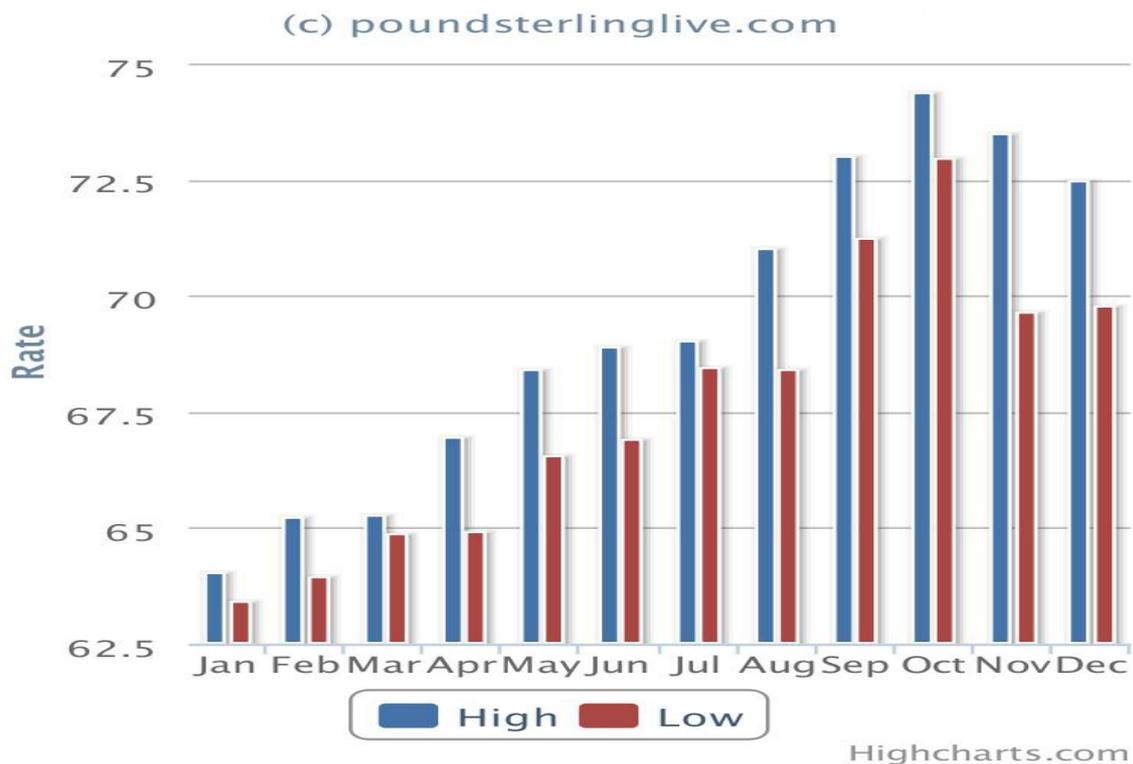
However, with rupee depreciating to an average of Rs 71.4/US dollar in H2 2018 end, the import bill would increase to Rs 4036 billion, implying an extra cost of around Rs 0.353 trillion.

With crude oil averaging to \$76/bbl for the remaining half and average exchange rate at Rs 73/ US dollar, the extra cost could go up to Rs 457 billion

7.3 Inflation

As per RBI, a depreciation of the Indian rupee by around 5 percent relative to the baseline, inflation could edge higher by around 20 bps. With rupee expected to depreciate by say around 14 percent this year, keeping everything else constant inflation could edge by 56 bps going by the RBI numbers.

DOLLAR TO INDIAN RUPEE SPOT EXCHANGE RATE IN 2018



8. IMPACT OF MONETARY POLICY ON GDP

Monetary policy refers to the process in which the government, central bank or monetary authority of a country controls the supply of money, availability of money, the cost of money or the rates of interest in order to obtain a set of objectives oriented towards the growth and stability of the economy. Monetary policy rests on the relationship between the rates of interest on the economy that is the price at which money can be borrowed and the total supply of money. It uses a variety of tools to control one or both of this, to influence outcome like economic growth, inflation, exchange rate with other currencies and unemployment. The impact of monetary policy on GDP is done by increasing the money supply available in the economy. Expansionary policy attempts to promote aggregates demand growth. Aggregate demand is the sum private consumption, investment, government spending and imports. Monetary policy focuses on the first two elements.

8.1 Gross Domestic Product (GDP)

In economics, GDP is defined as the value of all goods and services produced within the geographic territory of an economy in a given interval, such as a year. A well-known formula

for GDP has been stated as the total market value of all final goods and services produced in a country in a given year, equal to total consumer, investment and government spending, plus the value of export, minus the value of imports. The four major components used for calculation of GDP are:

- **Consumption (C)**
- **Investment (I)**
- **Net exports (X)**
- **Government expenditure (G)**
- **Imports (M)**

GDP (Y) is the sum total of C+I+G (X-M)

- **Consumption** is normally the largest GDP components in the economy, consisting of private expenditures in the economy (household final consumption expenditure). This personal expenditure fall under one of the following categories: durable goods, nondurable goods and services. Examples include food, rent, jewellers, gasoline and medical expenses, but not the purchase of new housing.
- **Investment** includes, for instance, business investment in equipment but does not include exchanges of existing assets. Example includes construction of mines, purchase of software, machinery or equipment for factory etc. Spending by households (not government) on new houses is also included in investment. In contrast to its colloquial meaning, “investment” in GDP does not mean purchases of financial products. Buying financial product is classes as “savings”, as opposed to investment. This avoids double counting: if one buys shares in a company and the company uses the money received to buy plant, equipment, etc., the amount will be counted towards GDP when the company spends the money on those things; to also count it when one gives it to the company would be to count two times an amount that only corresponds to one group of products. Buying bonds or stocks is a swapping of deeds, a transfer of claims on future production, not directly an expenditure on products.
- **Government spending** is the sum of government expenditures on final goods and services. It includes salaries of public servants, purchase of weapons for the military

and any investment expenditure by a government. It does not include any transfer payments, such as social security or unemployment benefits.

- **Exports** represent gross exports. GDP captures the amount of a country produces, including goods and services produced for other nation's consumption, therefore exports are added.
- **Imports** represent gross imports, it is subtracted since imported goods will be added in the terms **C**, **G**, or **I** and must be deducted to avoid counting foreign supply as domestic.

GDP can be determined in three ways, all of which should in principle give the same result. They are the production (or output or value added) approach, the income approach and the expenditure approach.

The most direct of the three is production approach, which sums the outputs of every class of enterprise to arrive at the total. The expenditure approach works on the principle that the entire product must be bought by somebody, therefore the value of the total product must be equal to people's expenditure in buying things. The income approach works on the principle that the incomes of the productive factors (producer, colloquially) must be equal to the value of their product and determine GDP by finding the sums of all producers incomes.

A. Production approach: This approach emphasizes on the following points

1. Estimates the gross value of domestic output out of the many various activities.
2. Determine the intermediate consumption i.e. the cost of material, supplies and services used to produce final goods and services
3. Deduct intermediate consumption from gross value to obtain the gross value added.

Gross value added = gross value of output - value of intermediate consumption.

Value of output = value of total sales of goods and services plus value of changes in inventory

The sum of the gross value added in the various economic activities is also known as "GDP at factor cost".

GDP at factor cost plus indirect taxes less subsidies on products = "GDP at producers price".

B. Income approach: The second way of estimating GDP is to use “the sum of primary incomes distributed by resident producers units”.

The US “National Income and Expenditure Accounts’ divide incomes into five categories.

1. Wages, salaries and supplementary labor income
2. Corporate profits
3. Interest and miscellaneous investment income
4. Farmer’s income
5. Income from non-farm unincorporated businesses

These five income components sum to net domestic income factor at cost. Two adjustments must be made to get GDP.

1. Indirect taxes minus subsidies are added to get from factor cost to market prices.
2. Depreciation or capital consumption allowance is added to get from net domestic product to gross domestic product.

Total income can be subdivided according to various schemes, leading to various formulae for GDP measured by the income approach, the common one is as follows

GDP = compensation of employee + gross operating surplus + gross mixed income + taxes less subsidies on production and import

$$\text{GDP} = \text{COE} + \text{GOS} + \text{GMI} + \text{T (P\&M)} + \text{S (P\&M)}$$

Compensation of Employee (COE) measures the total remuneration to employees for work done. It includes wages as well as employer contributions to social security and other such programs.

Gross Operating Surplus (GOS) is the surplus due to owners of incorporated businesses. Often called profits, although only a subset of total costs is subtracted from gross output to calculate GOS.

Gross Mixed Income (GMI) is the same measure as GOS, but for unincorporated businesses this often includes most small businesses.

The sum of **COE, GOS and GMI** are called **factor production**, total factor is also sometimes expressed as:

Total factor income = employee compensation + corporate profits + proprietor's income + rental income + net interest.

C. Expenditure approach: The third way to estimate GDP is to calculate the sum of the final uses of goods and services all uses except intermediate consumption measured in purchases prices.

Market goods which are produced are purchased by someone. In the case where a good is produced and unsold, the standard accounting convention is that the producer has bought the good from themselves. Therefore, measuring the total expenditure used to buy things is a way of measuring production. This is also known as expenditure method of calculating GDP.

9. IMPACT & BENEFITS of IFMIS (Integrated Financial Management Information System) in PRODUCTION SECTOR

9.1 Reforms

Government institutions are restructuring to:

- Improve services to citizens
- Improve strategic and day-to-day decision making
- Reduces bureaucracy and improve efficiency
- Reduce cost of operations
- Increase public accountability
- Ensure adequate controls to minimize fraud and corruptions
- Provide citizens with better access to information.

9.2 Improve Efficiency and Controls

- Better control over budget through full integration of budget and budget execution data.
- Enhanced efficiency.
- Ability to decentralize functions and processes yet maintain overall control by Ministry of Finance.
- Forces financial discipline.

- Reduction of operating costs by reducing administrative tasks.
- More available resources to facilitate management control and the development of new activities that add value.
- Strengthen the monitoring and evaluation capacity.
- Improve service delivery.
- Facilitates improvement of customer service.
- Control over fraud and corruption.

9.3 Improve Confidence through Transparency

- Credibility of the budget.
- Transparency of information.
- Comprehensiveness and transparency.
- Predictability and control in budget execution.
- External Scrutiny and Audit.
- Foundation of performance-based budgeting (PBB) and Monitoring & Evaluation and broader reform on corruption, transparency and e-government.
- These include problems in the lack of credible budgets and transparency. Growing globalization has drawn governments to modernize in order to support economic growth. This helps to converge economic development with public finances.
- IFMIS is no longer a luxury.

9.4 Increase Government Revenue

- This is a frequent theme for sub-national governments.
- Improved revenue collection.

9.5 Reduce Costs

- Expenditure control – mentioned by many speakers.
- Debt cancellation.
- Sourcing of goods and services from pre-qualified suppliers eliminates “brief-case” suppliers [not real companies].
- Use of the Treasury Single Account to reduce borrowing.
- Reduces costs to report to donors.

9.6 Improve Budgets, Planning and Decision-Making

- Credibility of the budget.
- Policy-based budgeting.
- More realistic and standardized budget formulation.
- Close monitoring of outstanding bills, cash in bank accounts and improved cash planning.
- Provision of timely and accurate data for management and budget decision making.
- Access to reliable and timely information to support decision making.
- Accounting, Recording and Reporting.
- Critical for decision-making.
- Forces financial discipline.

10. IMPACT OF WHOLESALE PRICE INDEX BY MONTHLY POLICY FOR FOUR QUARTERS

10.1 Quarter I

The Wholesale Price Index for the first quarter stood at 5.28% in April and 4.02% in May last year (2018). Food article witnessed deflation at 3.31% in May against 1.39% in April.

Vegetables deflated at 26.98% in May to 18.65% in previous month

Impact on fuel and power – high inflation from 16.28% to 18.44%

Petrol and diesel inflation was 12.06% and increased to 20.165

It is said that WPI inflation was led by a deeper disinflation in prices of primary food, articles.

Easing of inflation related to crude and petroleum and mineral oils because of the correction in retail price and some impact of appreciation of the rupee on the landed prices of the imports.

Few experts say that the WPI inflation rate will remain from 4.5% to 5% for the rest of the year.

The Central bank lowered the retail inflation projection to 2.7 to 3.2% for the second half.

10.2 Quarter II

While domestic activity had continued to exhibit resilience and stability after April 2018 Monetary Policy Report, the external environment has remained challenging and imparted downside risk to India's growth prospects.

In the period following the Monetary Policy Report (MPR) of April 2018, several risks it had flagged have been materializing on an ongoing basis. The global macro economic and financial environment has been roiled by bouts of financial market volatility, retaliatory trade protectionism among major economies of the world, elevated and volatility crude oil prices, and recurring jitters around the efficacy of managing monetary policy normalization in the US amidst a late in the cycle US fiscal Stimulus, occurring all at once, lashing Emerging Market Economies (EMEs) as an asset class with asset price shocks and capital outflows. More recently, vulnerability surfacing amongst specific EMEs have produced powerful contagion effects. Taken together, this global factors appear to be increasing risks around India's growth prospects.

- Meanwhile, domestic economic activity has continued to exhibit resilience and stability in these high unsettled global conditions. On the agricultural front, the spatial distribution of South West monsoon was somewhat skewed, all though most of the kharif crop growing States received normal rainfall. Industrial activity has gathered pace and the outlook for the service sector is gradually improving. Inward foreign direct investment remains buoyant. The slow farming up of private consumption were expected to be sustained. However, volatility in global financial markets and surging oil price remain upside risk to inflation over the 12 months ahead horizon. These developments pose challenges for the setting of monetary policy in India.

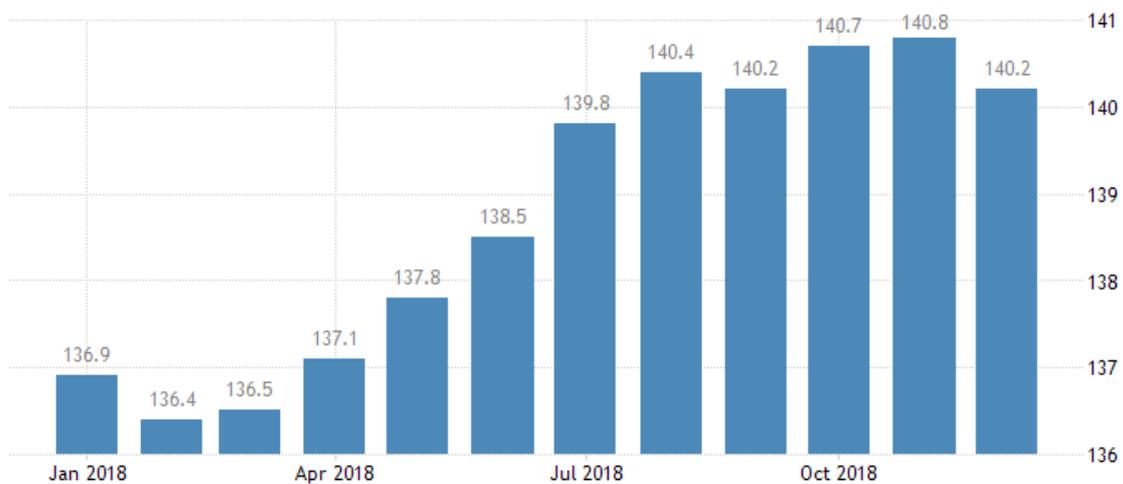
Monetary Policy Committee: April 2018

During April 2018, MPC met thrice in accordance with its bi-monthly schedule. Maintaining status quo in its April 2018 meeting, the MPC increased the policy repo rate 25 basis points (Bps) successively.

10.3 Quarter III

Annual consumer inflation in India declined to 2.19 percent in December of 2018 from 2.33 percent in November, matching market expectations of 2.2 percent. It is the lowest inflation rate since June of 2017 as food prices continued to decline and inflation eased for clothing, housing and fuel. Inflation Rate in India averaged 6.32 percent from 2012 until 2018, reaching an all-time high of 12.17 percent in November of 2013 and a record low of 1.54 percent in June of 2017.

Consumer Price Index CPI in India decreased to 140.20 Index Points in December from 140.80 Index Points in November of 2018.



CPI inflation expected to be at 4.3% in Q4 of FY19

Mumbai: Professional forecasters surveyed by the Reserve Bank of India in March 2018 expect Consumer Price Index (CPI) inflation to firm up to 5.1 per cent in the first quarter (Q1) of 2018-19, and moderate thereafter to 4.3 per cent in the fourth quarter (Q4) of 2018-19.

Their medium-term inflation expectations remained unchanged at 4.5 per cent, while longer-term inflation expectations increased by 40 basis points to 4.5 per cent.

Taking into account the initial conditions, signals from the forward-looking surveys, and estimates from structural and other models, CPI inflation is projected to pick up from 4.4 per cent in February 2018 to 5.1 per cent in Q1 of 2018-19 due to unfavorable base effects and then moderate to 4.7 per cent in second quarter, and 4.4 per cent in third quarter and Q4, with risks tilted to the upside,” the monetary policy report said.

The direct impact of the increase in the house rent allowance announced by the government fades away by December 2018.

10.4 Quarter VI

WPI inflation reached a peak of 5.2 per cent in December 2017 (4.9 per cent, excluding the estimated impact of HRA for central government employees), reflecting an unseasonal spike in the prices of vegetables and the full impact of the central government implementing the 7th Central Pay Commission's (CPC's) HRA award. The delayed setting in of the seasonal food prices moderation took down headline inflation to 4.4 per cent in February (4.1 per cent, excluding the estimated impact of HRA for central government employees). It is likely that this softening will keep the reading for March begins before it reverses in April. The incidence and strength of this reversal will condition monetary policy responses in 2018-19.

Turning to the outlook, inflation expectations of urban households remain elevated, according to the March 2018 round of the Reserve Bank's survey. Inflation expectations three months ahead and a year ahead increased by 30 bps and 10 bps respectively, from the previous round (December) to 7.8 per cent and 8.6 per cent, respectively. The proportion of respondents expecting the general price level to increase by more than the current rate declined for both three months and one year horizons.

Manufacturing firms polled in the Reserve Bank's industrial outlook survey (March 2018) expected higher input price pressures in 2018-19 due to rising cost of raw materials (higher negative values for cost of raw materials indicate higher input price pressures). Sale prices are also expected to increase, but not sufficient to protect profit margins. The Nikkei's purchasing managers' survey also indicates input and output price pressures for manufacturing (March 2018) as well as services (February 2018) sectors.

For 2019-20, assuming a normal monsoon and no major exogenous/policy shocks, structural model estimates indicate that inflation will move in a range of 4.5-4.6 per cent. The 50 per cent and the 70 per cent confidence intervals for 2019-20 are 3.0-6.1% and 2.2-7.0% respectively.

11. Index Of Industrial Revolution

The Index of Industrial Production (IIP) is an index for India which details out the growth of various sectors in an economy such as mineral mining, electricity and manufacturing. The all

India IIP is a composite indicator that measures the short-term changes in the volume of production of a basket of industrial products during a given period with respect to that in a chosen base period. It is compiled and published monthly by the central statistical organisation (CSO), Ministry of Statistics and Programme Implementation six weeks after the reference month ends.

The level of the Index of Industrial Production (IIP) is an abstract number, the magnitude of which represents the status of production in the Industrial sector for a given period of time as compared to a reference period of time. The base year was at one time fixed at 1993–94 so that year was assigned an index level of 100. The current base year is 2011-2012.

The Eight Core Industries comprise nearly 40.27% of the weight of items included in the Index of Industrial Production (IIP). These are Electricity, steel, refinery products, crude oil, coal, cement, natural gas and fertilisers.

11.1 The Beginning

The first official attempt to compute the IIP was made much earlier than even the recommendations on the subject at the international level. The Office of the Economic Advisor, Ministry of Commerce and Industry made the first attempt of compilation and release of IIP with base year 1937, covering 15 important industries, accounting for more than 90 percent of the total production of the selected industries. The all-India IIP is being released as a monthly series since 1950. With the inception of the Central Statistical Organization in 1951, the responsibility for compilation and publication of IIP was vested with this office.

11.2 Successive Revision

As the structure of the industrial sector changes over time, it became necessary to revise the base year of the IIP periodically to capture the changing composition of industrial production and emergence of new products and services so as to measure the real growth of industrial sector (UNSO recommends quinquennial revision of the base year of IIP). After 1937, the successive revised base years were 1946, 1951, 1956, 1960, 1970, 1980–81 and 1993–94. Initially it was covering 15 industries comprising three broad categories: mining, manufacturing and electricity. The scope of the index was restricted to mining and manufacturing sectors consisting of 20 industries with 35 items, when the base year was shifted to 1946 by Economic Adviser, Ministry of Commerce & Industry and it was called

Interim Index of Industrial Production. This index was discontinued in April 1956 due to certain shortcomings and was replaced by the revised index with 1951 as the base year covering 88 items, broadly categorised as mining & quarrying (2), manufacturing (17) and electricity (1) compiled by CSO. The items in this index were classified according to the International Standard Industrial Classification (ISIC) 1948 of all economic activities.

The index was revised in July 1962 to the base year 1956 as per the recommendations of a working group constituted by the CSO for the purpose and it had covered 201 items, classified according to the Standard Industrial and Occupational Classification of All Economic Activities published by the CSO in 1962. The index with 1960 as the base year was based on regular monthly series for 312 items and annual series for 436 items. Hence, though the published index was based on regular monthly series for 312 items, weights had been assigned for 436 items with a view to using the same set of weights for the regular monthly index as well as the annual index covering the additional items. However, the mineral index prepared by the IBM excluded gold, salt, petroleum and natural gas.

The next revised series of index numbers with 1970 as the base year, had taken into account of the structural changes occurred in industrial activity of the country since 1960 and this index was released in March 1975 covering 352 items comprising mining (61), manufacturing (290) and electricity (1). The working group (set up in 1978) under the Chairmanship of the then Director General of CSO, decided to shift the base to 1980–81, to reflect the changes that had taken place in the industrial structure and to accommodate the items from small-scale sector.

A notable feature of the revised 1980 index number series was the inclusion of 18 items from the SSI sector, for which the office of the Development Commissioner of Small-Scale Industries (DCSSI) could ensure regular supply of data. The production data for the small-scale sector were included only from the month of July 1984 onwards; prior to this the production data from the Directorate General of Technical Development (DGTD) for large and medium industries alone had been utilised. For the period April 1981 to June 1984 in respect of these 18 items, average base year (1980–81) production as obtained from DGTD was utilized. From July 1984 onwards, combined average base year production both for DGTD and DCSSI products was utilised. The weights for these items were based on ASI 1980–1981 results and no separate weights for DGTD and DCSSI items were allocated in the 1980–81 series.

The next revision of IIP with 1993–94 as the base year containing 543 items (with the addition of 3 items for mining sector and 188 for the manufacturing sector) has come into existence on 27 May 1998 and ever since, the quick estimates of IIP are being released as per the norms set out for the IMF's SDDS2, with a time lag of six weeks from the reference month. These quick estimates for a given month are revised twice in the subsequent months. To retain the distinctive character and enable the collection of data, the source agencies proposed clubbing of 478 items of the manufacturing sector into 285 item groups and thus making a total of 287 item groups together with one each of electricity and mining & quarrying. The revised series has followed the National Industrial Classification NIC-1987. Another important feature of the latest series is the inclusion of unorganised manufacturing sector (That is, the same 18 SSI products) along with organised sector for the first time in the weighting diagram.

Recent revision of IIP released by CSO with 2004–05 as the base year comprises 682 items. As per chief statistician T C A Anant, this index shall give a better picture of growth in various sectors of the economy, because it is broader and includes technologically advanced goods such as cell phones and iPods. The previous base year (1993–94) was not usable as the list contained an array of outdated items such as typewriters and tape recorders.

11.3 Recent News: Dated - MARCH 2018

Inflation Relief, IIP Boost May Not Be Enough for Monetary Policy

The Indian economy got a twin boost as consumer inflation fell more than expected and industrial output growth remained strong. Yet, that may not be enough for the monetary policy committee to change its outlook in its review next month even as a nascent recovery looks visible.

CPI inflation in India stood at 4.4 percent in February slowing for the second straight month from a 17-month high, according to data released by the Central Statistics Office today. Economists polled by Bloomberg had forecast retail inflation at 4.7 percent. The Index of Industrial Production rose 7.5 percent in January, compared to the estimated 6.4 percent.

India's GDP growth picked up pace in the quarter ended December as manufacturing and agriculture growth improved after twin disruptions of the note ban and the Goods and Services Tax. Inflation worries, the MPC said, have not abated. The data released Monday is

the last set of inflation numbers that India's monetary policy committee will have to work with before it meets next month. For a while now, the MPC has maintained its neutral stance and kept rates on hold citing risk of heightened inflation. The February inflation is lower than the Reserve Bank of India's 5.1 percent estimate for the January-March period. But the committee expects inflation to rise again in the first quarter of next fiscal.
