International Journal of Social Science and Economic Research

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

RBI'S ANTI-INFLATIONARY MEASURES DURING ELEVENTH FIVE YEAR PLAN

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ABSTRACT

The people of India have been greatly troubled by the rise in prices of the commodities in the recent past. The inflation has been a source of concern over the past few years due to the increase in the prices of essential commodities affecting the lives of common man. The rise in the prices of commodities, especially of food and fuel, are adding to the economic woes of low income families. Besides, the fall in the value of money is increasing the level of poverty in the country.

This paper provides insights into the inflationary situation witnessed in India during the eleventh five year plan period i.e. 2007-12. It examines the reasons behind the phenomenon of inflation and describes the various measures taken by RBI to control the rising inflationary trend in the country.

Keywords: Inflation, Eleventh plan, inflationary measures, Wholesale Price Index

Introduction

During the immediately past three years Indian economy has witnessed adverse situations like negative growth in the agriculture and allied sector in 2008-09, erratic monsoons resulted in severe drought during 2009-10, unseasonal late rains affecting the winter seasons crops during 2010-11. This period of economic stress has severely tested the people of India and its policy makers. Due to the adverse situations, the economy of india witnessed a phase of continuous rise in the prices of various commodities.

Inflation-meaning

Inflation is defined as the rate (%) at which the general price level of goods and services is rising, causing purchasing power to fall. It basically indicates the rise in the level of prices of goods or services in an economy over a certain period of time. When the price level rises, each unit of currency will buy fewer goods and services; consequently, leading to erosion in the purchasing power of money. It is a loss of real value in internal medium of exchange and a unit

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

of account in the economy. Therefore it indicates an increase in the cost of living over a period of time. Inflation is mainly of two types: cost push inflation and demand pull inflation.

Cost-push inflation occurs when the price of inputs increases. Cost-push inflation basically means that prices have been "pushed up" by increases in costs of any of the four factors of production (labour, capital, land or entrepreneurship).

Demand Pull inflation occurs when total demand for goods and services exceeds total supply. This type of inflation happens when there has been excessive growth in aggregate demand and there is an inflationary gap.

How inflation is measured

Inflation is taken as the rise in the prises of a basket of commodities on a point to point basis. Inflation is measured by monitoring changes in the price indices. Two major measures for inflation, which are widely used, are Wholesale Price Index (WPI) and Consumer Price Index (CPI). In india however whole sale price index is used as an indicator of inflation.

Whole sale price index: WPI tends to take into account a combined increase in the fixed basket of goods in the wholesale market. This basket constitutes as many as 435 commodities, the prices of which are determined through wholesale price Index. This Index is available on weekly basis

Consumer price index measures the change in the cost of a fixed basket of products and services, including housing, electricity, food, and transportation. Consumer price Index is measured and reported monthly and is also called cost-of-living index.

Inflation in India during 11th five year plan (2007-12)

The eleventh five year plan approved on 19th Dec 2007 was addressed to the challenge of making growth in the country faster and inclusive. The target of 9% rate of growth was set for the plan period from 2007-08 to 2011-12.

However the very first year of the Eleventh Plan witnessed a steep increase in inflation especially in the last quarter mainly due to the rise in international prices of oil and food grains. The rate of inflation as measured by the Wholesale Price Index (WPI) showed a declining trend through the first three quarters of 2007/08 as inflationary tendencies tended to stabilise. But the surging international prices of commodities – from oil to steel to chemicals to food – erupted into the domestic economy towards the end of 2007, and disrupted the process of stabilisation.

The following table indicate the rates of inflation during 2007-11.

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

Y-O-Y Inflation rates during 11th five year plan (2007-12)

	India's Growth rate in GDP	WPI inflation rates	CPI inflation rates
1st year of eleventh five year plan (2007-08)	9.3	4.8	6.2
2nd year of eleventh five year plan (2008-09)	6.8	8.1	9.1
3rd year of eleventh five year plan (2009-10)	8.0	3.9	12.4
4th year of eleventh five year plan (2010-11)	8.5	9.6	10

Source: central statistical organization

Inflation rate in India in the early 2007 (starting of the 11th five year plan) as measured by the whole sale price index was around 4.8%. On February 15, 2007, the inflation rate reached a two-year high of 8.1%.

Inflation, based on variations in the wholesale price index (WPI) on a year-on-year basis, eased to 3.8 per cent as on January 12, 2008 from its peak of 6.4 per cent at the beginning of the financial year and from 6.2 per cent a year ago.

In December 2009, the WPI inflation climbed to 7.15%,. In new series of WPI, inflation had remained in the negative zone in June 2009 and July 2009 and turned positive in August 2009 and thereafter it reached to double digits in March, 2010. The average WPI inflation rate for last 12 months (February 2010 to January 2011) was 9.4 per cent as compared to 2.4 per cent during corresponding period in 2009-10.

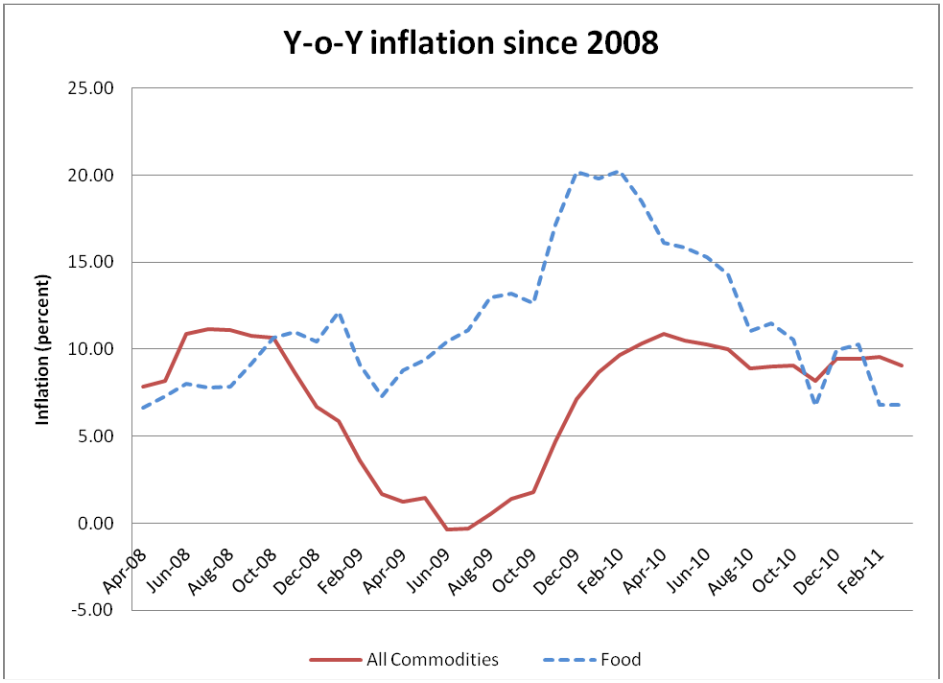
It however continued to rise, and was at peak in April 2010, at 11%. In august 2010 the headline inflation came down to single digit i.e. 8.8%. In November 2010 it was recorded at 8.1%. Inflation in food articles jumped to 13.6% in December 2010.

Based upon the financial indicators, the year 2010-11 can be broadly divided into three periods. According to the Annual Statement on Monetary Policy for the Year 2009- 10, a careful assessment of the manner in which inflation is evolving in India reveals that primary food

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

articles have contributed significantly to inflation during 2008-09 and in 2009-10. At the same time, prices of manufactured products account for well above 50 per cent of headline inflation.



Thus, the inflationary pressures, which emanated from food, clearly became generalised as the year progressed. Year-on-year inflation measured in terms of WPI for January 2011 was at 8.23 per cent. This reflects deceleration of 20 basis points compared to WPI inflation in December 2010. (Inflation was 5.88 per cent in January 2009).

WPI Inflation rates (monthly) during 11th five year plan (2007-12)

Year	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
2007	6.36	6.36	6.6	6.28	5.46	4.53	4.71	4.14	3.51	3.11	3.25	3.83
2008	5.51	5.47	7.87	7.81	7.75	7.69	8.33	9.02	9.77	10.45	10.45	9.70
2009	10.45	9.63	8.03	8.70	8.63	9.29	11.89	11.72	11.64	11.49	13.51	14.97
2010	16.22	14.86	14.86	13.33	13.91	13.73	11.25	9.88	9.82	9.70	8.33	9.47
2011	9.30	9.35	8.82	9.41	9.41	8.72	8.62	8.43	8.99	10.06	9.39	9.34

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

Reasons for inflation in india during eleventh five year plan

The WPI rate of inflation showed a declining trend in the first quarter of 2007-08, but the increase in the international prices of oil and steel adversely affected the domestic prices. The price of crude oil jumped from $90 to $140 per barrel, steel soared to over $1,200 per tonne, gold to nearly $1,000 per ounce and rice to $1,000 per tonne. The domestic prices of commodities also followed the trend

The rate of WPI inflation soared from 3.8 per cent at the end of December 2007 to 7.8 per cent by the end of March 2008. The increase of 3.0 percentage points came mainly from steel and iron ore (42 per cent), primary food (19 per cent), petroleum products (12 per cent) and edible oil & oilseeds (12 per cent). Most of this increase occurred in the month of March 2008.

The prices of primary articles (weight: 22.0 per cent in the WPI basket) registered a year-on-year increase of 3.9 per cent as on January 12, 2008 as compared with 9.5 per cent a year ago. The relatively lower increase in prices of primary articles during 2007-08 was mainly due to food articles; however, prices of non-food primary articles like cotton and oilseeds went up sharply.

On June 4, 2008, prices of motor spirit, diesel and domestic LPG cooking gas were raised to partly neutralise the cost impact of more expensive crude oil. The prices of other industrial fuels and feedstock were also raised. As a result, the WPI inflation rate rose to 11.1 per cent, and climbed towards 12 per cent over the next one and a half months.

Due to the damage to the onion crops in 2010, the supply of onion was badly affected, thereby increasing the prices of onions. The supply bottlenecks in vegetables, milk, eggs, tomatoes, onion, fruits and fish was the main reason behind increased prices of food articles in December 2010. Food price inflation during 2010-11 was mainly because of increase in the prices of pulses, cereals and sugar due to bad monsoons.

What RBI has done to control inflation during eleventh five year plan?

With the introduction of the Five year plans, the need for appropriate adjustment in monetary and fiscal policies to suit the pace and pattern of planned development became imperative. The monitory policy of the country on one hand ensures the speedy economic development in the country and on the other hand aims at controlling and reducing the inflationary pressure in the economy**.** It refers to the steps taken by the central bank of the country to control the money supply in the economy and thus check the inflationary trends.

A number of measures were taken by the RBI to tackle rising inflation rate in India which included increase in repo rates and increase in Cash Reserve Ratio**.**

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

Inflation measured in terms of the wholesale price index (WPI) peaked at 12.9 per cent in early August 2008 and remained high for some time. From mid- September till end-October 2008, the economy was in the grip of a serious liquidity crisis and credit crunch as detailed earlier. The Reserve Bank of India (RBI) acted aggressively from mid-October to ease the situation by a series of rate cutting and liquidity injecting measures that went on till April 2009.Considering the increasing trend of inflation RBI raised the policy rates a number of times in 2010-11. In march 2010 itself the repo rate and the reverse repo rate had been increase by 175 basis points and 225 basis points respectively. The following have been discussed in detail the steps taken by RBI to control inflation:

Cash Reserve Ratio

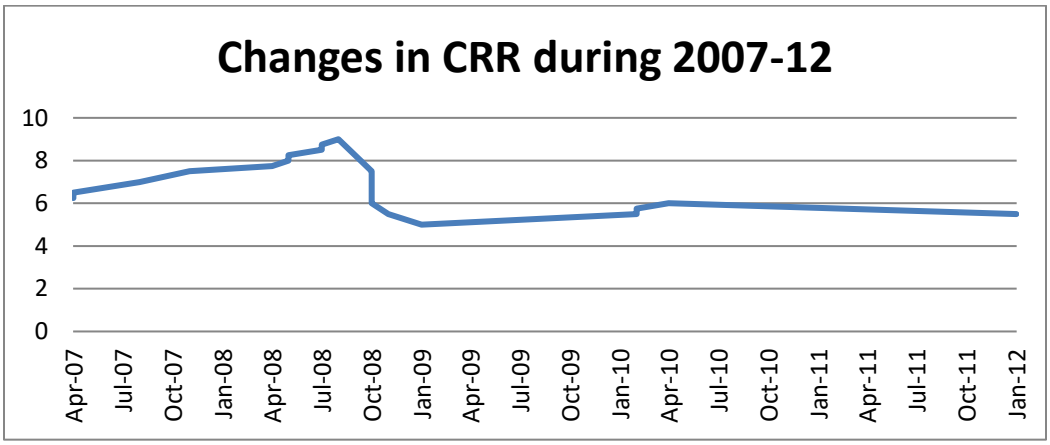
Cash reserve Ratio (CRR) is the amount of Cash (liquid cash like gold) that the banks have to keep with RBI. This Ratio is basically to secure solvency of the bank and to drain out the excessive money from the banks. If RBI decides to increase the percent of this, the available amount with the banks comes down and if RBI reduces the CRR then available amount with Banks increased and they are able to lend more. Due to this increase in CRR, the ability of banks to lend money goes down. Now banks also want to show profit for their business. So to keep their profit up, they increase the lending rate which essentially decreases the availability of cheap loans. As the cost of loans goes up, people tend to spend less on frivolous purchases or at the least try to keep them at the minimum. Thus demand of goods goes down in general. Consequently inflation goes down.

During the first six months of the financial year 2008-09, RBI consciously endeavoured to control monetary expansion through increases in CRR and RR. While CRR was increased by 150 basis points in six tranches from 7.50 (before April 26, 2008) to 9.0 per cent w.e.f. August 30, 2008, RR was also increased by 125 basis points in three tranches from the level of 7.75 (as it prevailed on April 1, 2008) to 9.0 per cent w.e.f. August 30, 2008. These changes were made in the context of monetary expansion and double-digit inflation in the economy.

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

Effective date	Rate of CRR	Effective date	Rate of CRR
14-Apr-2007	6.25	30-Aug-2008	9.00
28-Apr-2007	6.50	11-Oct-2008	7.50
4-Aug-2007	7.00	11-Oct-2008	6.50
10-Nov-2007	7.50	25-Oct-2008	6.00
26-Apr-2008	7.75	8-Nov-2008	5.50
10-May-2008	8.00	17-Jan-2009	5.00
24-May-2008	8.25	13-Feb-2010	5.50
5-Jul-2008	8.50	27-Feb-2010	5.75
19-Jul-2008	8.75	24-Apr-2010	6.00
		28-Jan-2012	5.50



Repo rate

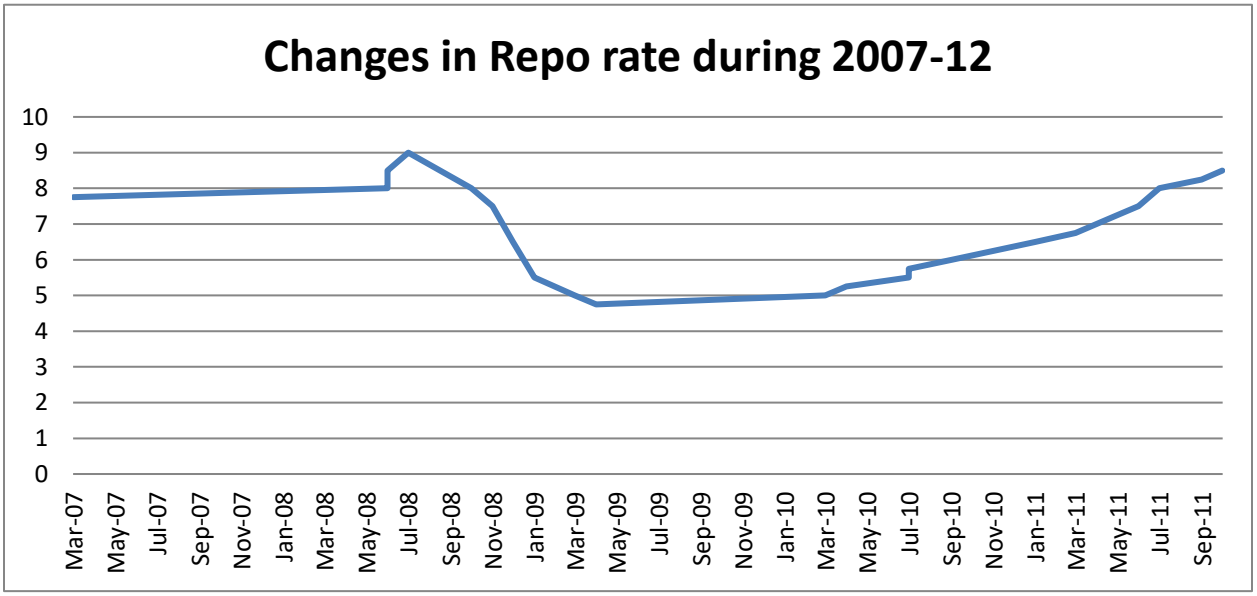
Repo rate is the rate at which the banks borrow from RBI. This facility is for short term measure and to fill gaps between demand and supply of money in a bank. When a bank is short of funds they borrow from bank at repo rate and if bank has a surplus fund then they deposit the funds with RBI and earn at Reverse repo rate. A reduction in the repo rate will help banks to get money at a cheaper rate. When the repo rate increases borrowing from RBI becomes more expensive. RBI changed the repo rate a number of times to adjust according to the situation and to reduce the impact of inflationary trends.

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

Effective date	Repo rate	Effective date	Repo rate
30-Mar-2007	7.75	02-July-2010	5.50
12-Jun-2008	8.00	27-July-2010	5.75
25-Jun-2008	8.50	16-Sept-2010	6.00
30-Jul-2008	9.00	02-Nov-2010	6.25
20-Oct-2008	8.00	25-January-2011	6.50
3-Nov-2008	7.50	17-March-2011	6.75
8-Dec-2008	6.50	03-May-2011	7.25
5-Jan-2009	5.50	16-June-2011	7.50
5-March-2009	5.00	26-July-2011	8.00
21-April-2009	4.75	16-September-2011	8.25
19-March-2010	5.00	25 October-2011	8.50

In order to tighten the liquidity position of commercial banks the repo rate was increased from 7.75 in march 2007 to 8% in Jun 2008 and then to 9% in July 2008. This made the availability of credit facility expensive from RBI to the banks, thereby reducing the available funds with the banks.



Reverse repo rate

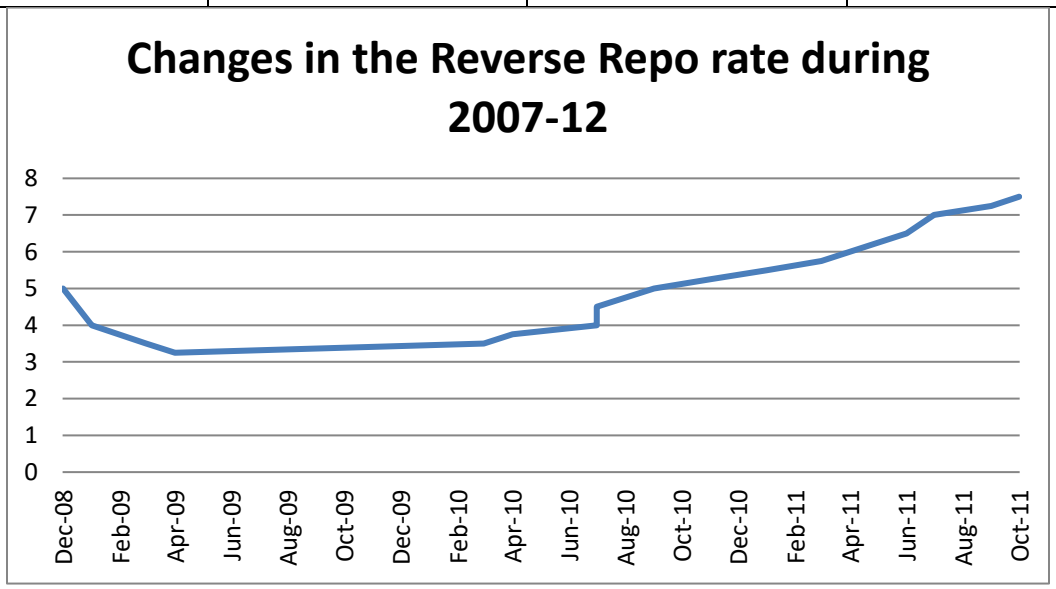
Reverse Repo rate is the rate at which Reserve Bank of India (RBI) borrows money from banks. The benchmark interest rate (reverse repo) was last reported at 7.5 percent on Oct 2011. From 2000 until 2010, India's average interest rate was 5.82 percent reaching an historical high of

ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

14.50 percent in August of 2000 and a record low of 3.25 percent in April of 2009. The rate had been changed a number of times to adjust to the situations. The following table shows the changes in the reverse repo rate in India.

Effective date	Repo rate	Effective date	Repo rate
8-Dec-2008	5.00	02-Nov-2010	5.25
5-Jan-2009	4.00	25-January-2011	5.50
5-March-2009	3.50	17-March-2011	5.75
21-Apr-2009	3.25	03-May-2011	6.25
19-March-2010	3.50	16-June-2011	6.50
20-Apr-2010	3.75	26-July-2011	7.00
02-July-2010	4.00	16-September-2011	7.25
27-July-2010	4.50	25 October-2011	7.50
16-Sept-2010	5.00		



ISSN: 2455-8834

Volume:03, Issue:05 "May 2018"

Review of RBI's anti-inflationary policy

Inflation has a negative effect on growth when the wholesale price index (WPI) based inflation goes beyond the 5.5 per cent threshold. A number of monetary and fiscal measures had been adopted by the government of india and RBI to control inflation during 2007-12.

The GDP growth forecast for 2011-12 has been revised to 7.0 per cent from 7.6 per cent. The agricultural prospects look buoyant, industrial production has decelerated. The slowdown in industrial production will also impact service sector growth. Further, weaker global growth will also have an adverse impact.

Liquidity conditions remained tight which made lending tough to fuel growth. The reduction in the policy rate will be conditioned by signs of sustainable moderation in inflation. However, the persistence of tight liquidity conditions could disrupt credit flow and further exacerbate growth risks. In this context, the CRR is the most effective instrument for permanent liquidity injections over a sustained period of time. The reduction can also be viewed as a reinforcement of the guidance that future rate actions will be towards lowering them.

Inflation still remains a key challenge. Although primary food inflation declined sharply reflecting seasonal fall in vegetable prices and high base, high protein inflation continues due to structural demand-supply imbalances. The decline in food inflation is expected to be short-lived as a result. Inflation in non-food manufactured products remains persistently high, reflecting input cost pressures, partly resulting from the rupee depreciation that has offset the impact of softer global prices of some commodities.

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Volume:03, Issue:05 "May 2018"

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