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संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई 400001
DEPARTMENT OF COMMUNICATION, Central Office, S.B.S. Marg, Mumbai 400001
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 2270 3279

प्रेस प्रकाशनी **PRESS RELEASE**

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
इ-मेल email: helpdoc@rbi.org.in

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Reserve Bank of India releases Monsoon 2008 Issue of its Occasional Papers

The Reserve Bank of India today released the Monsoon 2008 issue of its Reserve Bank of India Occasional Papers, which is a research journal of the Reserve Bank and contains contributions of the Bank's staff and reflects the views of the authors. This issue is woven around some important themes which are at the forefront of policy discussion. It contains articles, special notes and book reviews.

The first paper titled 'The Microstructure Approach to Exchange Rate in India: Evidence from Technical Trading' by Rajiv Ranjan, Sarat Dhal and Bhupal Singh, explores the role of market microstructure in explaining the short run movement in exchange rate in India. The market microstructure pertaining to interdependence of intra-day high, low and closing exchange rates is examined within the framework of parametric technical trading strategy combined with vector error correction and cointegration model (VECM). The paper finds that linkages among these market micro structures of exchange rate are associated with demand and supply conditions in the foreign exchange market. Closing exchange rate shows more or less symmetric response to high and low exchange rates. Market participants seem to be bound by a long-run bid-ask spread. Macroeconomic factor such as relating to liquidity, foreign interest rate and stock return could have differential impact on the daily high, low and close exchange rates. From a policy perspective, these findings may contain useful information for the exchange rate management.

The second paper by Jeevan K. Khundrakpam titled 'How Persistent is Indian Inflationary Process, Has it Changed?' analyses the nature of inflation persistence in India in terms of autoregressive properties and lag response of inflation to systematic monetary policy for the period 1982:4 to 2008:3. The paper, based on the autoregressive properties of various alternative inflation measures, finds that inflation persistence is on the lower side, particularly when allowed for the break in the mean of inflation observed around the second half of the 1990s. Among the components of WPI, 'manufacturing' inflation is found to be the most persistent, while 'food' and 'fuel' exhibit a lower level of persistence. Inflation persistence in general also declined with the lowering of mean rate of inflation, though some increase was observed in the later part of the sample period. The paper observes that the impact of money supply on various measures of inflation is positive and had its maximum impact with a much longer lag during the higher inflationary period before the mid-1990s than during the succeeding lower inflationary environment. Interest rate, on the other hand, have a negative impact on all the inflation series and, in general, had its maximum impact on inflation with a much longer lag than that of change in money supply.

Under the section on Special Notes, the paper 'The Inflation Rate in India: Some Applied Issues' by Janak Raj and Sarat Dhal deals with empirical issues pertaining to month-over-month and year-on-year wholesale price inflation rate in the Indian context by observing their association of with monetary aggregates, output, interest rate, and equity prices. The paper finds that while sample means of the two inflation rates could not be statistically different from each other the volatility could be significantly different, and the persistent in annual inflation rate could be more than the monthly inflation rate. The papers also finds the annual inflation rate to fit better in models for gauging inflation expectation and persistence, and had stronger relationship with monetary aggregates and industrial production than was the case with monthly inflation rate. Thus, the paper suggests that the standard year-on-year inflation rate could be more useful than the monthly inflation rate for policy analysis.

The second paper in this section, titled 'Evolution of the Basel Framework on Bank Capital Regulation' by Anupam Prakash deals with the issue of regulating bank capital. The challenges in bank capital regulation posed by the recent global financial turmoil have been presented in the backdrop of the major initiatives in the area by the Basel Committee on Banking Supervision (BCBS) during the past two decades. Basel I, adopted in different countries with certain country-specific adaptations, established itself at the core of the assessment of soundness and stability of the banking system. However, in view of the deficiencies in the Basel I framework, the revised framework (Basel II) was developed by aligning the capital requirements with underlying risks through enhanced risk measurement techniques. Basel II evoked mixed response in the light of the complexities inherent in the framework. Notwithstanding the need to refine and streamline Basel II in the light of recent experiences during the global financial turmoil, many experts have emphasized the need for faster implementation of Basel II. The issues being re-examined currently include inter alia strengthening the risk capture on trading book and off-balance sheet exposures, dampening procyclicality, strengthening framework to assess liquidity at banks, and globally coordinated supervisory follow-up exercises. With financial stability gaining prominence in recent times, these measures need to be evaluated in terms of their ability to prevent future crises. The Basel framework on capital regulation, thus, continues to evolve in response to the financial innovations and other emerging challenges in banking regulation and supervision.

Alpana Killawala
Chief General Manager

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