

RBI–The Culprit

RESERVE BANK OF INDIA (RBI) and Finance Ministry are happy with the rate of inflation 'declining' to less than five percent. RBI has raised interest rates repeatedly in the last two years. This has made it more expensive for industrialists to borrow for making investment in factories or in building up stocks.

Prices rise when demand is high and supply is less. The upward pressure on prices implies that people have more money in their hands and are demanding more goods. The question is this: Wherefrom people are getting more money in their hands? Increased inflows of foreign investment appear to be the reason. Foreign investors are bringing money into India and buying shares of Indian companies. Indian sellers are getting high prices for their shares. They are using the sale proceeds to build new houses or other expenditures. This is leading to more demand for cement, steel and labour. On the other hand, RBI is raising interest rates to reduce demand by industries. The increase in demand from sellers of shares is being offset by a reduction in demand from industries. Thus inflation has officially and theoretically come under control.

However, it is not necessary that such an increase in demand should arise from sellers of shares. Increase in demand occurs only if RBI buys the dollars and prints new notes to pay for them.

RBI simply prints notes and buys the dollars. These newly-printed notes lead to an increase in money supply in the economy and to price rise. The reason for inflation, therefore, is not foreign investment. Rather it is the policy of RBI to buy dollars.

The American economy is in trouble. Cost of production of American goods is high and they are not able to export their goods. But it is politically necessary for Mr Bush to provide goods for consumption to the American people. He has, therefore, appealed to RBI to buy Treasury Bonds issued by the US Government. The RBI has meekly obliged and is increasing its forex reserves by doing George Bush's bidding. This leads the RBI to print notes for purchase of dollars in the Indian forex market instead of letting the importers buy the same. So Indians won't have any respite from being troubled by uncontrolled inflation and price

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