

## CHALLENGES AND OUTLOOK

4.65 Overall Inflation is likely to remain moderate in the coming months, as the policy measures taken during the course of the year work their way through the system. The behaviour of agricultural prices, including essential consumption items, will be critical, given falling poverty and rapidly rising per capita income. Global prices are having a more pronounced impact on domestic prices as the ability to meet shortfalls at affordable prices is being eroded by global shortages and rising prices. Thus we will continue to depend on enhancement of supplies through higher productivity and efficient supply management to eliminate wastage. Domestic supply management is therefore critical to stabilizing inflation expectations, moderating pressures for upward revision of wages and prices, and containing pressures for cost push inflation through monetary and fiscal accommodation.

4.66 The parts of the economy characterized by market competition, such as manufacturing, have responded to the increase in demand through higher investment and capacity creation. The supply side pressures are likely only in sectors like agriculture that suffer from structural problems, infrastructure sectors still characterized by a monopoly core, heavily dependent on Government investment and relatively slow decision making sectors such as urban land. Monetary policy needs to address the inflationary expectations triggered by sub-sectoral price flare-ups arising from mismatches in demand and supply. Monetary policy also has to manage the stress arising from continued increase in capital flows and the consequential changes in the exchange rate, exchange reserves and liquidity. This is particularly challenging in a period of stagnancy or decline in production of durable consumer goods and deceleration in global demand for our exports.

