

Bi-Monthly Monetary Policy Review

Why in news?

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The fifth bi-monthly monetary policy review of the ongoing fiscal year was released by the RBI.

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What are the highlights?

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• The six-member monetary policy committee (MPC) has kept the policy <u>reportate</u> unchanged at 6%.

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- Repo rate is the interest rate at which banks borrow funds from the central bank to overcome short-term liquidity mismatches.
- Continuing with its neutral stance, the MPC reiterated its commitment to keeping <u>CPI inflation</u> at a target of 4% while supporting growth.

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• On development and regulatory policies, the RBI announced rationalisation of the <u>merchant discount rate</u>.

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• This is to give a further fillip to the acceptance of debit card payments across a wider network of merchants.

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- RBI also permitted the overseas branches/subsidiaries of Indian banks to refinance external commercial borrowings (ECBs) by raising fresh ECBs.
- This applies to top-rated corporates as well as 'Navaratna' and 'Maharatna' public sector undertakings.

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What is the rationale?

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• The recent <u>reversal of declining growth trend</u> with an economic revival in the recent quarter hints at no pressing crisis on the growth front.

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• Thus, the cautious stance of MPC is certain to be primarily driven by the inflation concerns.

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• Having committed itself to keeping inflation within 4%, the MPC was expected to take a serious view of 3.6% retail inflation.

• Inflation forecast for the second half of 2017-18 has been slightly raised to 4.3-4.7% from the earlier forecast range of 4.2-4.6%.

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• The MPC cited various reasons -

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i. Fuel and food prices have indeed increased in recent months \n

ii. food prices are expected to stay elevated owing to lower rabi acreage than last year.

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iii. oil prices going up

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iv. the impact of increase in house rent allowance (HRA) by the Centre $\ensuremath{^{\backslash n}}$

v. bond market trends seem to suggest rising inflationary expectations

vi. risk of fiscal slippage

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vii. status of rupee in the event of a rising interest rate differential possibly due to the imminent reversal of the rate easing cycle the world over

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 \bullet The status quo in interest rate makes sense to resolve the NPA issue before expecting monetary transmission.

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 \bullet Also, banks need to keep deposit rates attractive so that long-term savings are not depleted, impeding their ability to make long-term loans. \n

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What are the drawbacks?

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• The MPC has not addressed growth issues, while maintaining its growth forecast for 2017-18 at 6.7%.

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• The economy remains demand-constrained, and needs a push either from fiscal or monetary policy.

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• The MPC has emphasized predictable concerns over "fiscal slippage" and its inflationary effects.

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• But it needs to go beyond being a plain inflation forecaster.

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MPC should certainly do a dynamic analysis of the economy.

• Notably, central banks the world over monitor job trends, but this does not figure in the MPC's scheme of things.

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 \bullet Trends in savings, investment and debt need to be placed in the public domain, as well as the MPC's take on them. \n

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Source: Business Line

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