Challenges for Monetary policy committee

What is the issue?

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Rising current account deficit and the depreciating rupee poses a daunting challenge before the Monetary policy committee scheduled to meet in October.

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What are the present uncertainties?

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- India being a net importer of goods, ends up paying more for its consumption when the rupee slips, leading to imported inflation.
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- Global crude price has already touched $78 a barrel and has a huge spill over, fuelling inflationary trends.
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- The **Economic Survey** estimates that a $10 per barrel increase in the price of crude would reduce growth by 0.2-0.3 percentage points.
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- This anomaly in trade gets reflected in the rising CAD which might go beyond 2.5 per cent in FY 19 from 1.9 per cent in FY 18.
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- This would also significantly impact the targeted GDP growth of 7.4 per cent for FY19.
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- Also, in the last eight months Rupee has depreciated by more than 12 per cent, the highest in Asia.
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- The increasing possibility of a Fed rate hike will put further pressure on the rupee.
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- **RBI estimates** that a 10% depreciation in the rupee could add up to 50 basis points to inflation.
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How should RBI respond?

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- **Market Intervention** - RBI should intervene,with the objective of managing volatility, in the forex market to arrest the rupee's fall by using the tools at its disposal.
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- Typically, when the rupee weakens, the central bank sells dollars from its reserves to shore up its value.
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- Forex reserves have already declined to just around $400 billion from a peak of $426 billion in mid-April this year.
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- **Dollar Inflow**– Special NRI bonds with maturity period of at least 3 years could be allowed.
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- Opening a foreign-exchange swap window to meet the daily dollar requirements of the oil marketing companies, which have the highest dollar demand, could be made.
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- Indian borrowers could be encouraged to issue rupee-denominated 'masala bonds'.
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How should government respond?

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- Duties on gold bullion and jewellery were raised in 2013 to bridge the current- account gap.
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- As the **electronics imports have outpaced gold** the focus must move towards the former.
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- It can also look into reducing the excise on crude, which was earlier raised on account of lowering crude prices in the global market.
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What lies ahead?

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- The global uncertainties are bound to continue with the embattled Venezuelan economy which halved its crude output.
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- Also, the US threat of sanctions on Iran has upset the demand-supply equilibrium for oil.
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- The RBI will have to fulfil its objective of curbing the inflation whilst satiating dollar demand.
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- Emerging markets like Indonesia and Philippines have already tightened policy rates to support their currencies.
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- Given that the policy rates have swung in tandem with inflation movement, a third increase on policy rate seems quite inevitable.
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