Economic Laws Don’t Always Hold

What is the issue?

Bond yields, food inflation, credit growth and rupee value don’t seem to be guided now by the forces of demand and supply.

What is the normal case of economic law?

- Higher demand leads to higher price.
- Higher supply brings down price.
- Lower price does not necessarily lead to higher demand.

What is the case of violations of economic laws that have taken place this year?

- **G-Sec rate-** The 10-year bond yield has now crossed the 6.50% mark and it has crept upwards notwithstanding the efforts of the RBI to keep liquidity in a surplus position all the time.
- The surplus is to the extent of Rs. 6-8 lakh crore on a daily basis which has been done by inducing funds through **G-Sec Acquisition Programme** (which has been stopped now), besides the surpluses generated within the system.
- The bond yields should ideally have come down. The law of supply did not work.
- **Reason**- The market expected a higher return on two counts.
    1. Inflation has been rising and there are expectations that it will continue to be in the 5-6% range this year till March. Therefore, the market has started looking at real interest rates.
    2. The size of the government borrowing programme or the expectation of government borrowing is exceeding the budgeted Rs. 12 lakh crore.
- Disinvestment is still flowing and the idea to mobilise Rs. 1.6 lakh crore in the next three months sounds difficult.
- Therefore, the market is demanding higher yields from the auctions.
- **Lending rates-** The RBI has maintained the repo rate at 4% on grounds of growth being the driving factor, banks have lowered their lending rates in general.
- The loans were cheaper yet increase in credit was just 3.3% over March and 7.3% on a year-on-year basis.
- There is less demand for credit and today there is a situation of some banks giving home loans at 6.40% which is even lower than the rate at which the government borrows.
- Growth in credit to manufacturing was negative, while that in services was just 0.8%.
- **Inflation**- Despite having the advantage of a good kharif harvest this time, food inflation remains a concern.
- Prices of edible oils and as well as horticulture products have rised upsetting the calculations of the RBI.
- Even core inflation has moved up amid stagnant demand.
- **Reasons**-

1. India imports 60%of its edible oil requirements which means that inflation gets imported when global prices increase.
2. The monsoon withdrawal was later than usual which in turn has increased the prices of vegetables in particular.
3. In the case of core products (non-food and non-fuel), higher raw material costs due to an increase in global commodity prices have pushed up retail inflation of consumer, personal care and pharma products.
4. Services like healthcare, education and entertainment have become more expensive.
5. Commodity and service price inflation has been more due to supply side factors than demand.

- **Currency-** Normally it is said that the exchange rate is the result of demand and supply of dollars.
- During the year, the forex reserves of the country increased by around 58 billion dollars.
- This should normally have led to rupee appreciation but the dollar rate has fallen from Rs. 72.5-73 in April to Rs. 74-75 by December.
- **Reason**- A stronger dollar versus the euro caused all currencies to slide which included the rupee.
- **Deposit rates-** The weighted average deposit rate on outstanding deposits has come down from 5.26% to 5.04%.
- Here it is a situation of banks lowering the deposit rate to ensure that deposits do not increase as they have a negative carry of 165 basis points when invested in the reverse repo window.
- Deposit growth has slowed down to 5% from 6.7% last year.
- Households have moved to alternative avenues like mutual funds, stock coins and cryptocurrency.
- This can be a worry going forward for the system as higher risk is taken by individuals.

Reference

1. https://www.thehindubusinessline.com/opinion/economic-laws-dont-always-hold/article38205860.ece

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