Hamletian dilemma of monetary policy

Why in news?

The recent Monetary Policy Commitee (MPC) meeting indicated that there was some divergence of opinion among the MPC members with respect to balancing growth and inflation

What is the dilemma about?

- MPC decided to keep the policy repo rate, reverse repo rate and marginal standing facility (MSF) rate unchanged.
- It also decided to continue with the accommodative monetary policy stance till the economy recovers and CPI inflation rate is contained within the mandated 2-6% band.
- The dissenting view argued that the projected inflation is beyond the target inflation rate set.
- It led to speculations whether RBI has deviated from its mandate of flexible inflation targeting (FIT) and started emphasising growth over inflation.

What are the reasons for the current inflation?

- **Supply-side problem -** The supply chain of the country have got negatively affected due to lockdowns.
- International prices soar up due to global shortages.
- All these led to rise in prices of products including food prices.
- Industrial production has shown a remarkable growth rate but it was still 13.9% below its May 2019 level.
- The latest quarterly GDP statistics shows that in real terms many industrial and services sub-sectors have not yet reached the pre-Covid production levels.

What are the counter arguments against the dissenting view?

- If interest rate is raised to control inflation, there can be additional cost pressure on the firms which may lead to further price rise.
- Because of uncertainties associated with pandemic, projections based on past data with the assumption of business-as-usual can go wrong.

- Increase in reverse-repo rate allows the banks to park their additional funds with the RBI leading to lazy banking.
- So, it is perfectly sensible if RBI chooses to focus more on sustaining the nascent but uncertain growth process.

Source: The Hindu Business Line

SHANKAR IAS PARLIAMENT
Information is Empowering