RBI’s Wait and Watch Approach

What is the issue?

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Monetary policy of Reserve Bank of India is not clear in regard to the present economic scenario.

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What was RBI’s monetary policy approach?

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- Early in June six-member Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) discussed the bi-monthly review of the monetary stance.
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- There was a certain clarity among all observers, That’s because, since the April review, crude oil prices had registered a sharp jump.
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- But the MPC raised the repo rate by 25 basis points while keeping the policy stance as “neutral”.
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- Essentially, the RBI wanted to keep all its options open for August 1, when the next monetary policy is due.
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What is the status of economy since then?

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- Domestically, the composition of the factors driving inflation was changing in a worrisome manner as the consumer price index-based inflation (excluding food and fuel) rate had risen sharply.
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- Internationally the United States Federal Reserve was signalling a dearer money policy.

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- Between April and June, the CPI-based retail inflation rate has gone up by 42 basis points and the core-CPI rate, which excludes food and fuel prices, has moved up 56 basis points.
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- Geopolitical instability as well as the weakening of the rupee, which has lost 3 per cent against the dollar since the last review.
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- Most growth indicators suggested that the output gap in India was narrowing and, as the MPC noted, domestic economic activity had exhibited sustained revival in recent quarters.
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- So there were both cost-push and demand-pull factors for inflation.
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What are the uncertainties with monetary policy?

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- The inflation rates have continued to move up and there are some growth hiccups, retail inflation in June was at a five-month high of 5 per cent.
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- The wholesale inflation rate, even though not a factor that the MPC considers, is at a four-year high.
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- These movements have happened despite no significant surge in the Indian basket of crude oil over the past two months.
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- Though the MSPs are roughly 30 to 40 per cent more than market prices and can potentially bump up food inflation, its exact impact is still unclear due to uncertainties over procurement.
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- Another unknown factor is how the monsoon will play out, given that some deviation from the earlier projection has already been reported in some parts of the country.
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- All this has made the markets bet on a rate hike on the grounds that the RBI may not like to fall too far behind the curve on inflation, as it did almost five years ago.
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What are the concerns with Indian economy?

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- Fund flows into emerging markets have slowed in recent months, with both equity and bond funds experiencing outflows.
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- The solution, however, is not that easy, as the recent economic growth data is worrying.
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- Industrial growth, as measured by the Index of Industrial Production, fell to a seven-month low in May, on the back of a slowdown in infrastructure and construction goods and negative growth in consumer non-durables.
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- As a balancing act, the RBI would perhaps do well to opt for the status quo on the repo rate for the time being, and signal a shift in stance from neutral to “tighten”.
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Source: Business Standard

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