

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 repo rate 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.

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- Continuing with its neutral stance, the MPC reiterated its commitment to keeping CPI inflation at a target of 4% while supporting growth.

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- On development and regulatory policies, the RBI announced rationalisation of the merchant discount rate.

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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.

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- 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 reversal of declining growth trend 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.

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- 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
- ii. food prices are expected to stay elevated owing to lower rabi acreage than last year.
- iii. oil prices going up
- iv. the impact of increase in house rent allowance (HRA) by the Centre
- v. bond market trends seem to suggest rising inflationary expectations
- vi. risk of fiscal slippage
- 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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- The status quo in interest rate makes sense to resolve the NPA issue before expecting monetary transmission.

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

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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.

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- 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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- Trends in savings, investment and debt need to be placed in the public domain, as well as the MPC’s take on them.

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Source: Business Line

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