

Rationalising Monetary Policy

What is the issue?

 $n\n$

\n

• Almost 30% of the core inflation is relatively ineffective (unresponsive) to RBI's monetary policy.

\n

• This calls for the RBI to pay attention to the real impact of its inflation targeting and monetary policy-making.

 $n\$

What is RBI's recent stance?

 $n\n$

\n

• In October 2018, the Reserve Bank of India (RBI) changed its policy stance to calibrated tightening.

۱n

- \bullet This effectively ruled out any possibility of a rate cut in the near future. $\ensuremath{\backslash} n$
- Back then, the central bank cited risks to inflation from higher MSPs, high oil prices and rising input costs.
- Then followed the talks of a rate hike, to support the weak rupee, before the December 2018 policy.

\n

- Since then, the rupee has strengthened, oil prices have fallen and inflation prints have been the lowest in over a year. $\$
- The broad expectation now is for the RBI to hold rates steady in its upcoming February (2019) policy.

\n

 $n\n$

How is the inflation scenario?

 $n\n$

\n

- **Headline** RBI's upper bound of acceptable headline inflation is 6%.
- The latest CPI (Consumer Price Index) inflation for December, 2018 came in at 2.2% and the following month was driven by fall in food inflation.
- Food inflation has made almost a complete about-turn from 2.9% in the first quarter of the fiscal to -2.0% in the third quarter, to average 0.5% in the fiscal so far.

\n

- \bullet Vegetables, pulses and sugars have witnessed a deflation in this year so far.
- **Core** Core inflation (excludes food and fuel) has not followed the headline inflation trend and has remained consistent around 6%.
- Within core, housing, health and education have witnessed the fastest rates of inflation.

۱n

- \bullet Housing inflation is still bearing the impact of the increased HRA (House Rent Allowance) under the Seventh Pay Commission recommendations. $\$
- **Components** The miscellaneous category has a weight of 28.32% in the CPI basket, 60% weight in the core CPI basket.
- Inflation in this category has averaged 5.8%, during the first three quarters of the fiscal.

۱n

- Within this, items like metal utensils, cookware, electrical appliances and electrical fittings and fixtures have experienced high rates of inflation.
- Also, charges for domestic help and cleanliness workers have seen high inflation.

\n

• Besides, items like hospital charges, doctors' fees and medicines have seen quite high inflation.

۱n

- This is largely driven by the shortfalls in India's healthcare sector, but consumers continue to prefer paying high for quality services.
- \bullet School and college fees also take a substantial share of households' income. $\ensuremath{^{\text{h}}}$
- Private tuitions and coaching institutes have become too common, formal and commercialised.

\n

- The movement in crude oil price impacts inflation directly via the weight of fuel components in the CPI basket and indirectly via second round impact on other items of the CPI basket.

\n

Government taxation, too, has some bearing on retail fuel price inflation.

 $n\n$

What is the challenge here?

 $n\n$

\n

- Food and fuel fall outside the purview of target of the central bank's policy.
- So core inflation (demand-side inflation) is what the monetary policy aims to tackle.

\n

• But as seen above, certain categories within core inflation seem to have dominance of supply-side factors.

\n

• Consumers are left with no choice but to pay the higher price, as is the case with health and education.

۱'n

• So this makes around 30% of the core inflation relatively ineffective to monetary policy.

\n

- High inflation in these categories could also be one of the reasons for household inflation expectations remaining high.
- The RBI should take these limitations into account, in its monetary policy decisions.

\n

 $n\n$

 $n\n$

Source: Financial Express

\n

