

RBI on interest rate cuts

What is the issue?

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The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) is planning for a cut in the interest rates.

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What is Monetary policy committee?

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- The Finance Act 2016, provide a statutory and institutionalised Monetary Policy Committee for maintaining price stability.

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- The MPC has the task of fixing the benchmark policy rate (repo rate) required to contain inflation within the specified target level.

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- There are six Members of Monetary Policy Committee, three Members will be from the RBI.

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- The other three Members of MPC will be appointed by the Central Government.

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What are importance of interest rates?

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- A change in the interest rate has consequences for the exchange rate, which has effects on inflation, investment and growth.

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- India's "import-oriented" growth strategy is based on availability of foreign finance.

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- The interest rate has a greater importance in sustaining inflows of foreign finance.

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What is the present need for rate cut?

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- The core inflation and inflationary expectations are high.
- A lower interest rate is expected to revive investment or increase capacity utilisation.
- Companies are debt-laden and banks are burdened with non-performing assets.

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What will be consequences of reduced interest rates?

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- The inflow of foreign finance is most likely to decline, this may result in a serious depreciation of the rupee.
- This would threaten to increase inflation, bring insolvency to companies that have borrowed in foreign currency.
- There will be negative impact on manufacturing.
- There are chances of economic slowdown.

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How the issues can be addressed?

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- A transition from foreign finance-led growth to growth driven by both exports and domestic demand is required.
- The policy focus on achieving current account surplus is needed.
- Import-dependence of manufacturing sectors need to be curbed.

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- Growth of domestic demand can be fetched from income growth in agriculture.

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Source: Business Standard

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