Monetary Policy Springs No Surprises

By Dr M. Govinda Rao, Chief Economic Adviser, Brickwork Ratings *

The monetary policy announced on October 6 by the RBI Governor springs no surprises. In a unanimous decision, the Monetary Policy Committee (MPC) has kept the policy rate unchanged at 6.5% and standing deposit facility and marginal standing facility rates remain at 6.25% and 6.75% respectively. The MPC has decided to focus on the withdrawal of the accommodative stance by a 5-1 majority to align inflation to the target. Although considerable progress has been achieved in controlling and stabilizing inflation, the status quo has been prompted by the prevailing economic conditions, and growth-inflation dynamics, and to enable the full transmission of the 250 points increase in the repo rate since May, 2022.

The MPC has maintained both GDP and inflation forecasts for FY 24 at 6.5% and 5.4% respectively. While there are no changes in the quarterly projections of GDP, the inflation projection for the second quarter has been increased from 6.2% to 6.4% mainly due to a sharp increase in the prices of vegetables. Considering the fact that in the first two months of the quarter, the CPI rose by 7.4% and 6.8% respectively, projecting inflation at 6.4% for the quarter looks very optimistic. On the other hand, the good news is that the core inflation has softened to 4.9% in July-August, 2023, from 6.39% in January 2023.

The MPC considers that the risks to both growth and inflation are evenly balanced which may not be entirely correct. On the growth side, growth in the agricultural sector will hold the key. Although the acreage under cultivation might have shown a marginal increase, there may be adverse effects on productivity due to the shortage of water for standing crops due to the erratic monsoon and lower reservoir levels. With a sharp decline in the household sector's net financial savings to 5.1% and the aggregate fiscal deficit for FY 24 estimated at 8.7%, elevated levels of interest rates will continue to pose difficulties to private investment activity. On inflation, food inflation will need a continuous watch as the acreage under pulses has shown a sharp decline and there are risks of increasing prices of onion and spices as well as in the expectations of poor Kariff yield. The international oil price movements too can pose risks.

Over the last few weeks, there has been a liquidity deficit in the economy, and with the phasing out of the incremental CRR from October 7. An additional liquidity of Rs. 1.1 lakh crore will be released to restore the balance and that should ensure adequate liquidity during the festival season. However, the warning of siphoning off excess liquidity through open market operations may increase the yield of government securities in the short term. The assurance that the focus of the RBI is to tame the inflation rate to 4% and not confine itself to 6% which is the upper limit of the flexible target is reassuring but will require the continued focus on keeping tight conditions.

* Views are personal.

CONTACTS

Dr M Govinda Rao, Chief Economic Adviser

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