Source : www.thehindu.com Date : 2020-08-08

ALERT AMID UNCERTAINTY: THE HINDU EDITORIAL ON RBI HOLDING INTEREST RATES

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Inflation & Monetary Policy

The RBI has prudently decided to keep its powder dry for now, citing the “extreme uncertainty” that characterises the current outlook for inflation and economic activity. Observing that the “unprecedented shock” from the pandemic has left the economy stressed, the RBI said that while the monetary policy committee recognised the primacy of supporting a recovery, it was necessarily mindful of its inflation targeting mandate. The picture on prices is clouded by many uncertainties. While the provisional June CPI inflation reading of 6.1% had edged over the upper bound of the mandated medium-term goal of 4% plus/minus 2%, a spike in food prices as well as cost push pressures from higher transport fuel and raw material prices were combining to obscure the inflation outlook. Vowing to ensure that the policy stance remains ‘accommodative’ for as long as needed to revive growth, Governor Shaktikanta Das emphasised that the RBI was ready to act on rates once a durable reduction in inflation was sighted. For now, however, the projections remain less than encouraging. The latest round of households’ expectations of price gains in an RBI survey shows that consumers expect inflation to remain elevated in the near term — a finding that the RBI’s assessment broadly backs.

The prognosis on the economy is also worrisome. While the RBI expects the rural economy to turn in a robust recovery on the back of a strong showing by agriculture, a deterioration in consumer sentiment in the central bank’s July survey undermines the prospects for a more broadbased revival in domestic demand. Additionally, external demand faces headwinds from a world economy in recession and as global trade shrinks. Forecasting a contraction in real GDP in the current fiscal year, the RBI rather optimistically posits that an early containment of the pandemic may impart an upside surprise to its outlook. Interestingly, its analysis of the macro-economic environment skirts the potential challenges that heightened tensions with China, one of India’s largest trading partners and, in recent years, a source of inbound foreign capital, could pose to the economy. The central bank has therefore opted to focus its energies on trying to untangle the kinks hindering the flow of credit amid more than adequate liquidity, wary lenders and severely stressed borrowers. The restructuring, resolution and enhanced gold loan proposals mooted by the RBI acknowledge the sheer scale of the pandemic’s devastation on the finances of firms and households. The onus now is on Governor Das to ensure that the stability of the financial sector is safeguarded even as loan terms are reset to protect otherwise viable businesses. Any harm to financial stability risks undermining the economy as a whole.

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