

A VALID PAUSE: ON RBI HOLDING RATES

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

The [Reserve Bank of India's decision to leave interest rates unchanged](#), given easing inflation and the slowdown in economic momentum, was both expected and reasonable. In fact, the RBI was prompted to sharply lower its projection for price gains after an unexpected softening in food inflation and a collapse in oil prices in a surprisingly short span of time — the price of India's crude basket tumbled almost 30% to below \$60 by end-November from \$85 in early October. The monetary policy committee (MPC) now estimates retail inflation in the second half of the fiscal year to slow to 2.7%-3.2%, at least 120 basis points lower than its October forecast of 3.9%-4.5%. And it foresees the softness in prices enduring through the April-September half of next year, when headline inflation is projected to hover around its medium-term target of 4% and register in a 3.8%-4.2% range. The MPC's decision to stand pat on rates must also have been bolstered by the findings in the RBI's November survey of households' inflation expectations: the outlook for price gains, three months ahead, softened by 40 basis points from September. On growth, the monetary authority has largely stuck with its prognosis from October, while flagging both external and domestic risks to momentum as well as the likely sources of tailwinds. Among the positives cited, beyond a likely boost to consumption demand and corporate earnings from softer fuel costs, are two key data points from the RBI's own surveys. Capacity utilisation rose to 76.1% in Q2, higher than the long-term average of 74.9%. Also, industrial firms reported an improvement in the demand outlook for Q4. Still, the forecast for full-year GDP growth has been retained at 7.4%, on the back of an expected 7.2%-7.3% second-half expansion, with the risks weighted to the downside.

Interestingly, and justifiably so, the RBI has opted to keep the powder dry by sticking to its policy stance of 'calibrated tightening'. Given that its primary remit is to achieve and preserve price stability, the central bank is wary of the uncertainties that cloud the inflation horizon. For one, with the prices of several food items at "unusually low levels", the RBI reckons there is the clear and present danger of a sudden reversal, especially in prices of volatile perishable items. Also, the medium-term outlook for crude oil is still quite hazy, with the possibility of a flare-up in geopolitical tensions and any decision by OPEC both likely to impact supplies. Buttressing this reasoning, households' one-year-ahead inflation expectations remain elevated and unchanged from September. Most significantly, the central bank has once again raised a cautionary signal to governments, both at the Centre and in the States. Fiscal slippages risk impacting the inflation outlook, heightening market volatility and crowding out private investment. Instead, this may be an opportune time to bolster macroeconomic fundamentals through fiscal prudence.

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