Government’s turn

That the RBI left its key policy rates unchanged on Wednesday while maintaining a neutral monetary policy stance was in line with market expectations. The Monetary Policy Committee wisely chose not to rock the boat for now though it does seem that there is a compelling case to raise interest rates considering the growing upside risks to inflation such as higher oil prices, a pick-up in global growth reflected already in higher bond yields, and uncertainties like the staggered impact of HRA increases by state governments and a possible increase in the Minimum Support Price for kharif crops, higher customs duties on several items announced in the budget besides fiscal slippages. In such a scenario, the MPC has projected Consumer Price Inflation to rise to 5.1 per cent at the end of FY 18 and in the range of 5.1 to 5.6 per cent in the first half of 2018-19 while underlining the need to be vigilant around the evolving inflation scenario. It is not the inflation trajectory and rising bond yields in India that will lead to higher cost of borrowings which is a worry. Though the growth forecast for this fiscal has been upgraded to 6.6 per cent, it is the MPC’s view that “the nascent recovery needs to be carefully nurtured and growth put on a sustainably higher path through conducive and stable macro-financial management”, which should stoke concern.

Over the past year, the yield on the benchmark 10-year bond has gone up by over 100 basis points, while global central banks are clearly signalling the end of a long phase of easy money. The US Fed is expected to raise rates with the 10-year bond yields rising close to 50 basis points over the last six weeks. So is the Bank of Japan while the European Central Bank has started cutting back on its $30 billion monthly bond purchase programme. Weighed against these is the downside risk of a deterioration in public finances which could crowd out private investment. Clearly, the central bank has reasons to be concerned with fiscal slippages as RBI Governor Urjit Patel pointed out — in a higher fiscal deficit in 2017-18 and 2018-19 and the postponment of the medium-term fiscal adjustment programme. Yet, the RBI has been more mindful of these challenges to growth, preferring to hold back on raising rates seeing a rebound in sight on the back of a synchronised global recovery. It is this flexibility, a better recognition of market realities, which appeared missing in government as reflected in the timing of a long-term capital gains tax.

Governor Patel referred to the five levies on capital in India — corporate tax, Dividend Distribution Tax, the marginal rate on dividends, STT, and capital gains tax — and the impact it can have on investment when the economy is on a recovery path. Last time, too, the central bank’s extraordinary concern over growth was visible. Globally, central banks are slowly taking away the punch bowl. And with the window for a monetary stimulus having been closed in India, too, it is now the government’s turn to counter the headwinds.

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