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GROWTH PROP: ON RBI REPO RATE CUT

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

Barely four months after the Reserve Bank of India switched its monetary policy stance to one of ‘calibrated tightening’, signalling interest rates were set to trend higher, it has reversed direction. Not only did the RBI’s monetary policy committee unanimously opt to revert to a ‘neutral’ posture, but the rate-setting panel unexpectedly decided, by a 4-2 majority, to cut the benchmark repo rate by 25 basis points, to 6.25%. The MPC’s reasoning has been fairly straightforward. With Consumer Price Index-based inflation having continued to slow and projected to stay well below the medium-term target of 4% till at least the October-December quarter, the MPC saw an opportune moment to pivot to a growth-supportive stance. That there is a need to bolster economic momentum is evident from the RBI’s downward revision of the forecast for growth in the first half of the next fiscal year. The projection has been lowered to a range of 7.2-7.4%, from 7.5% posited in the RBI’s December statement, as moderating global growth and slowing overseas demand add uncertainties to the prevailing domestic imbalances. Specifically, production and import of capital goods, which is a key gauge of investment demand, contracted in November/December and credit flows to industry remain muted. With an overall shortfall of 4% in rabi sowing across various crops, and storage in major reservoirs at just 44% of the full level, the slowdown in farm output growth may, worryingly, end up being more protracted.

The less-than-sanguine outlook for the rural economy is also reflected in the high-frequency indicators of the services sector. Data on sales of both motorcycles and tractors in December underscore weakening demand in the hinterland. This weakness in the farm sector is undergirding the unprecedented softness in food prices. The December CPI data showed continuing deflation in food items. While the RBI’s inflation calculus clearly benefits from the ongoing trend in price gains, the MPC is justifiably cognisant of the tenuousness of the assumptions it has made for its forward projections. Importantly, while it has assumed a normal monsoon this year, the central bank acknowledges that any variation in geographic spread or uneven distribution in terms of time could roil the inflation outlook. Inexplicably, however, the RBI’s policy statement fails to make any mention of its hitherto abiding concern about fiscal prudence. With the Interim Budget showing some slippage from the fiscal roadmap and projecting a budget deficit of 3.4% for both the current financial year and the next, the risk of government borrowing crowding out private investment demand remains tangibly real. One must assume that the central bank will resume normal service on providing salutary caution to the government after the coming general election.

The Meghalaya government must urgently ensure that all illegal mines are shut down

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