

## THE ECONOMIC TOOLKIT REVEALED

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

Reading the Reserve Bank of India (RBI) 's annual report for 2020-21, the economist is driven to rethink why India today needs its central bank more than ever before. So, what would be the direction from which these thoughts are likely to flow? Most likely it will be the one suggesting that perhaps the RBI is to be desired more for its role as a source of unbiased and reliable information on the economy than its potency in driving it. The former is not a trivial presence at all, especially at a time when citizens are sceptical of the independence of government agencies originally intended to be free from its influence, leave alone stranglehold. The annual report is a splendid document. The information presented in it enables us to understand which economic policy can move the economy even as it shows that the RBI's own capacity in this task may currently be limited. This by itself is vital guidance at this moment, though the RBI may not read the situation in the same way as others do.

In the annual report we find data on the movement of three variables over the past year, namely, interest rates, inflation and credit flow. Helpfully, in some cases the data are exactly for one year commencing March 27, 2020, a few days after the nationwide lockdown was announced. So, we are able to track the path of the variables of our interest since. Together they tell a coherent story.

And, what is that story? First, it is one of the very active use of monetary policy to stave off the negative impact of the lockdown. The RBI immediately lowered the interest rate in its command, the repo rate, in fact more than once, and has held it since. Then it attempted to influence the long-term rate of interest through targeted long-term repo operations (TLTROs) in order to encourage investment. It enhanced liquidity by lowering the cash reserve ratio. Finally, in sync with the credit guarantee available under the Emergency Credit Line Guarantee Scheme of the Government of India, the on-tap TLTRO scheme was expanded to cover 26 stressed sectors. These amounted to a combination of incentives, enabling measures and safety nets revolving around credit. India's monetary authority cannot be faulted for the speed with which it acted, which was markedly different from what was seen on the fiscal front.

The second part of the story is that these thoughtful monetary policy actions were not successful in spurring the growth of credit, and thus economic activity. In the following year, credit growth slowed further, remaining barely positive for industry, a sector highly dependent on bank credit. To get the picture, non-food credit to this sector grew by a mere 0.4% in 2020-21.

To understand this outcome we do not have to seek very far. It is not as if the reduction in the central bank's interest rate actions did not have an impact on commercial bank lending rates, which too declined for all the sectors of the economy. Thus, the so-called 'transmission mechanism' worked. That it did not spur credit growth though is to be seen in the light of experience gained from episodes when aggregate demand collapsed. The lockdown did set off such a movement. We see replicated in India the global history of the Great Depression of the 1930s and the Great Recession of the 2000s when monetary policy was ineffective, as animal spirits, at least among investors outside the stock market, were bearish. However, in the case of inflation, again meticulously documented by the RBI, India's experience stands out. Here, after the lockdown and contrary to the global pattern, the inflation rate has risen well beyond the target, leaving in doubt the ability of monetary policy to control it.

The contribution of the RBI, through its admirably transparent annual report, is to have laid bare the economic toolkit at our disposal. It is plain that monetary policy has run its course. Fiscal

policy alone can spur the economy now.

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To reassure Indian Muslims, the PM needs to state that the govt. will not conduct an exercise like NRC

**END**

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