Source : www.thehindu.com Date : 2020-03-17

RBI’S FOCUS ON LIQUIDITY IS CORRECT

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

Shaktikanta Das

The messaging from the press conference of RBI Governor Shaktikanta Das is loud and clear: the central bank has an armoury of weapons and it will not hesitate to deploy them to mitigate the impact of COVID-19 on the economy. The two steps that Mr. Das has outlined now — forex swap and a second long-term repo operation (LTRO) of Rs. 1 lakh crore — are aimed at supporting liquidity in the market. Market rates may incidentally fall as the LTRO is at the repo rate of 5.15%.

The focus on liquidity is the right thing to do at this point in time. A rate cut, while being a short-term sentiment booster, is not going to help in alleviating the situation as seen by the experience in the U.S., where the Federal Reserve has taken the funds rate to zero, but the markets remain unimpressed.

The situation is clearly an evolving one and prudent action requires that the central bank keep its powder dry simply because we may not have seen the worst yet in terms of the virus impact, both in human and economic terms. In fact, in economic terms, this is just the start of what’s likely to be a long period of instability and falling growth in the global economy. The falling indices and currencies are only a manifestation of the first order impact. The second, and more severe one, will come when major economies either slow down sharply or tip into recession. The disruption caused to commerce, trade and travel already is so immense that the effects on the world economy will be felt for the rest of this calendar year. The effect will multiply if the virus infection curve does not flatten over the next 2-3 weeks.

India cannot remain insulated from global economic turbulence and economic growth is sure to slow down in the coming quarters. In such a situation, it is sensible to hold on to the rate cut option for use at a more challenging time, which is bound to follow. With headline inflation and core inflation — both CPI and WPI — trending south, food prices reducing and fuel prices falling (despite the government appropriating some of the benefit in the form of higher excise duty), the environment is indeed favourable for a rate cut, if the monetary policy committee were to decide on one.

The question is one of timing. The RBI Governor would surely want elbow room in the monetary policy space and not find himself in the position of the Fed or the central banks of other developed countries, where rates have been beaten down to zero or close to zero, leaving no space for action. The focus will be on the next meeting of the monetary policy committee in the first week of April, unless if the situation deteriorates so badly that the RBI is forced to act urgently.

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