‘Current global uncertainty unparalleled in recent times’

A repo rate of 6 per cent is “pretty normal” if retail price inflation is expected to come down to 4 per cent in two years, said **RAKESH MOHAN**, president of the Centre for Social and Economic Progress and member (part time) of the Economic Advisory Council to the Prime Minister. The policy rate currently stands at 5.90 per cent. The former deputy governor of the Reserve Bank of India spoke to **Indivjal Dhasmana** about the global slowdown, its impact on India and other issues. Edited excerpts:

Many analysts, including economist Nouriel Roubini, have predicted that the US and the rest of the world are about to face an ugly and long recession. Do you see any severe impact of such a recession on India?

The current period is characterised by a kind of uncertainty that the world has not seen for a very long time, including the period of the North Atlantic financial crisis of 2008-09. We don’t know what is ahead of us because of both Covid and the Russia-Ukraine war. We have also had a continuous, almost unprecedented, regime of very low interest rates and low inflation across the world for about a decade and half. The experience of low inflation seems to be changing, but we don’t know how and when it is going to end. Given these disruptions, there is no question that global demand will slow down. Besides, there are demographic changes with population growth going down everywhere, which would affect global growth in the medium term. In that context, we can’t expect to be untouched. Even though we are among the better-performing economies in the world, we have to be aware that we are part of the global economy and there can be no decoupling.

Retail inflation has not come down despite continuous rate hikes by the MPC since May. Could it be that the committee is tightening monetary policy even as the problem is coming from the supply side?

I have never been a votary of the inflation targeting framework. Leaving that aside, the impact of monetary policy actions has a very long lag (time). The impact of actions taken today would be seen after four to six quarters. To expect results now, when monetary tightening just started in May, is a mistake. One of the negative impacts of the inflation targeting framework is that it has led people to have excess faith in the power of central banks and monetary policy to curtail inflation immediately. Second, we can’t really say the monetary policy is tight yet. With a repo rate of 5.9 per cent and inflation rate of 7.4 per cent in September, real policy rates are still negative. If you say that expected inflation two years from now is about 4 per cent, one could conclude that a 6 per cent policy rate, i.e. a real policy rate of 2 per cent, is about right and pretty normal.

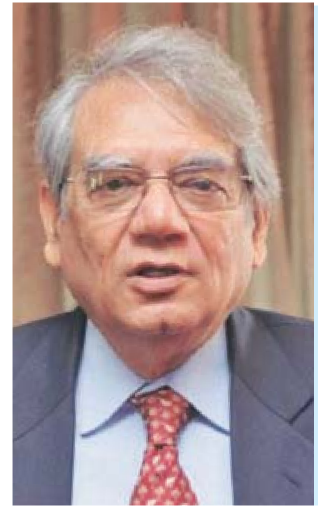
While inflation is not coming down, the Index of Industrial Production shrank 0.8 per cent in August. Going ahead, do you think the MPC will be in a dilemma whether to boost growth or contain inflation?

This is the most difficult question faced by most central banks today. But the important question to ask is how much interest rates are responsible for a slowdown in the economy. If we are expecting a nominal economic growth rate of 12-15 per cent in India this year and beyond on the basis of real economic growth rate of 6-7 per cent, and inflation at 4-7 per cent, then nominal lending rates of 8-10 per cent are not particularly high.

Q&A

RAKESH MOHAN

President, Centre for Social and Economic Progress



> ONE OF THE NEGATIVE IMPACTS OF THE INFLATION–TARGETING FRAMEWORK IS THAT IT HAS LED PEOPLE TO HAVE EXCESS FAITH IN THE POWER OF CENTRAL BANKS AND MONETARY POLICY TO CURTAIL INFLATION IMMEDIATELY

Finance Minister Nirmala Sitharaman recently said the 2023-24 Budget would target both high inflation and slowing economic growth. What broader points do you think should come up in the Budget to do that?

Let me take a non-traditional and non-conventional view. Let us think of the Budget from a medium-term view and not immediate macroeconomic management. Areas where India has failed miserably are health, education, and nutrition. All NFHS (National Family Health Surveys) have shown that around 30 per cent of kids are stunted in rural areas. Thus, there appears to be a major nutrition problem despite efforts by governments to provide free or cheap foodgrain to the poor. The same thing goes for rural health. There is improvement but not adequate. In education too, ASER (The Annual Status of Education Report) is showing that outcomes are not good despite an increase in numbers. These issues are not tackled in one year, but it is very important for the country if this Budget really indicates a major focus towards these areas with a three-year or a five-year framework.

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