‘Current repo rate balances inflation, avoids sacrifice of economic activity’

FIRM STAND. RBI Governor Shaktikanta Das rebuffs calls for rate cut, bats for continued caution on policy easing

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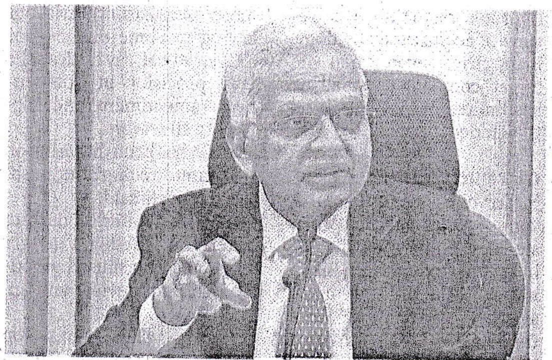

HOLDING STEADY. Shaktikanta Das, RBI Governor

Reserve Bank of India Governor Shaktikanta Das countered calls for a 25 basis points policy repo rate cut from two rate-setting panel members — Ashima Goyal and Jayanth R Varma — stating that with a forecast of 4.5 per cent headline inflation for FY25, the present rate is broadly in balance and avoids costly sacrifice of domestic economic activity.

At the monetary policy committee's latest bimonthly meeting, Das emphasised that, at this stage, when durable disinflation to the target is still a work in progress, the issue of equilibrium natural interest rate (NIR) is premature.

NIR is the short-term real interest rate that would prevail in the absence of business cycle shocks, with output at potential, saving equating investment and stable inflation.

"Policy making in the real world cannot be based on an abstract, theoretical and model specific construct which is unobservable and time varying. Hence, any justification for policy easing based on so called high real rates can be misleading," the Governor said.

RATES UNCHANGED

RBI on Thursday released minutes of the MPC meeting held during August 6 to 8, 2024. The committee decided by a 4 to 2 majority to keep the policy repo rate unchanged at 6.50 per cent.

The resolution "to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth too was decided by a similar majority.

Goyal, Emeritus Professor, IGIDR, Mumbai, observed that the Fed in indicating a cut in its September meeting, pointed out that since monetary policy acts with a lag they can't afford to wait until they reach their inflation target before cutting.

Goyal said that many analysts expect a 4 per cent headline inflation by summer next year as base effect and good monsoon sharply reduces food inflation, implying the expected real policy rate is 2.5 per cent. Since Indian inflation is not well measured and could be over or under-estimated, too much precision with regard to a target is unproductive, she added.

"Even if growth is high, it has to rise to its full potential. A falling (headline inflation) trend and low core inflation indicates growth is below potential, implying real rates are above the NIR and there is scope to reduce the repo rate and raise growth.

MIXED RESPONSE

Varma, Professor, IIM (Ahmedabad), underscored that for the last several meetings, he has been expressing concerns about the unacceptable growth sacrifice induced by a monetary policy that is excessively restrictive.

"The majority of the MPC however, do not share this concern, perhaps because they think that the Indian economy is already growing at close to its potential growth rate. Such a view reflects — (a) an unwarranted pessimism about the growth potential of the economy and (b) an overly sanguine expectation about growth in ensuing quarters. I disagree with both prongs of this assessment," he said.

Varma noted that on a forward looking basis, the current repo rate of 6.5 per cent translates into a real rate of 2.1 per cent. This is well above what is needed to drive inflation to the target of 4 per cent. "It is true that disinflation has been protracted and therefore restrictive monetary policy has to be maintained for a few more quarters. But a real interest rate of 1.5 per cent is sufficiently restrictive in this environment.