‘6.5% is below our potential or desirable rate of growth’

High real interest rates for a longer period can hurt economic growth as it happened during 2015, says **ASHIMA GOYAL,** external member, MPC, in an email interview with **Manojit Saha**. Edited excerpts:

> “THE NEXT FEW MONTHS ARE CRITICAL. IF THEY SHOW A SUSTAINED REDUCTION IN CORE INFLATION, THEN THERE WOULD BE NO NEED TO RAISE REPO RATES. MONSOON RELATED SPIKES, IF ANY, SHOULD BE TRANSIENT”
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> ASHIMA GOYAL
> EXTERNAL MEMBER, MPC

In the minutes, you have stressed on the point that the real repo rate does not rise too high as inflation expectation falls. What should be the real repo rate, given that January-March inflation is projected at 5.1 per cent?
The real repo rate is still in an acceptable band around one. If we get a sequence of inflation forecasts below 5 per cent, the real repo rate would approach 2 per cent. This is too high with the global slowdown and other vulnerabilities. A real repo rate of around 1 per cent is adequate to bring inflation down to target, as supply shocks unwind.

Can higher real rates, for a longer period, hurt growth?
Yes. This happened after 2015 when inflation fell with oil prices but the nominal repo rate was not reduced adequately. As investment cycle is reviving in India after many years, it is to be protected.

You said consumption and exports are areas of softness, pent-up demand for services may moderate, and unemployment remains high. Do you think the FY24 growth projection of 6.5 per cent is optimistic?
No, but 6.5 per cent is below our potential or desirable rate of growth needed to raise employment.

Q&A

ASHIMA GOYAL
External member, MPC

Even if there are monsoon-related uncertainties, do you believe the interest rate cycle has peaked?
The next few months are critical. If they show a sustained reduction in core inflation, there would be no need to raise repo rates. Monsoon-related spikes, if any, should be transient.

You have also said, citing research that the inflation targeting regime has contributed to reducing inflation expectations while adding “it does not require the nominal repo to be kept higher for longer.” Does this mean you would like to see the repo rate start to come down sooner than later? Is it possible that the repo rate will start declining in the current fiscal as some analysts have suggested?
Monetary policy affects inflation in two ways. First, it anchors inflation expectations. For this to work, the inflation targeting regime has to be credible. For credibility, the nominal repo rate has to rise or fall with the expected inflation rate, so that the real rate is at an appropriate level. Second, the real repo rate affects aggregate demand. For this also, the real rate has to be at the correct level. So, statements about the nominal repo alone are inadequate. Since the aggregate demand channel works with a lag, nominal rates have to be seen in the context of expected inflation. If the latter falls sustainably below 5 per cent, the nominal repo rate also needs to come down.