



LEKHA CHAKRABORTY

# GROWTH FIRST

*RBI is grappling with multiple challenges. For now, it has made its priority clear*

IN THE recent Jackson Hole economic symposium and the FOMC (Federal Open Market Committee) meeting, US Fed Chair Jay Powell specified the likelihood of tightening US monetary policy by reducing the balance sheet of the Fed, and also a possible hike in the policy rate by early 2022. This has repercussions for the rest of the world, especially emerging economies like India. However, the recent meetings of the Monetary Policy Committee have revealed that the RBI has chosen not to be hawkish, given domestic growth concerns.

Pressure was mounting on the RBI to move away from its accommodative stance, not only due to the impending taper tantrum but also because commodity prices and energy prices are soaring globally. Central banks have treated inflationary pressures as “transitory”, attributing them to supply chain disruptions. The RBI is also concerned about inflationary pressures, though it did not join other central banks in raising interest rates. Any attempt to do so — to tackle a possible capital flight and spiralling inflation — can hurt the economic recovery. Therefore, the MPC unanimously decided to maintain the status quo.

But the RBI’s challenges go beyond the repo rate decision. As part of the economic stimulus, it had engaged in an emergency bond purchase programme to infuse liquidity into the economy. However, it has not announced anything specific about the liquidity normalisation procedure, except abstaining from announcing a further G-sec Acquisition Programme (G-Sec). Another decision to absorb excess liquidity was to tweak the monetary policy corridor — the space between the

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reverse repo rate and the upper bound of the overnight marginal lending facility. Tightening the corridor can reverse the “nudging” RBI engaged in by tweaking the reverse repo to help the pandemic-hit economy. However, there was no upwards revision in the reverse repo rate. The limited calibration was with regard to the cut-off yield of the variable rate reverse repo (VRRR), at 3.99 per cent now. The RBI has chosen to remain “accommodative” rather than moving towards a “neutral” stance.

Mounting foreign exchange reserves have increased the liquidity in the economy, and in turn, can increase high-powered money in the system. Operation Twist — the simultaneous buying (long term) and selling (short term) of bonds to postpone the refinancing risks — was another method to infuse liquidity, as a part of the monetary stimulus package to tackle the pandemic. However, there are now concerns about a delay in policy normalisation in financial markets. This is primarily because of the repercussions on the call money market with the overnight call money rates now being below the policy rate. Another concern is the impact of this liquidity on the possibility of fuelling bad credit.

The RBI is grappling with multiple challenges — global macroeconomic challenges, which can trigger a capital flight, inflationary pressures and an uneven economic recovery. In this policy dilemma, it has chosen to give priority to economic growth by keeping the rates status quo.

Pressure is also mounting to keep control on the fiscal deficit, which flared up to 9.5 per cent of GDP in the revised estimates for

2020-21. This is a tricky situation because any normalisation on the fiscal stimulus front is equally detrimental to the economy during a pandemic. When the efficacy of monetary policy, despite its heavy lifting, has been inconclusive, fiscal dominance is crucial. Steps towards controlling the fiscal deficit through expenditure compression can have negative repercussions on growth. North Block’s articulation that a high deficit during the pandemic can be substantiated through enhanced capital infrastructure spending is thus welcome.

To add to these policy uncertainties, the recent debates on “greening” the RBI have created controversies over the efficacy of the monetary policy reaction function to integrate climate change variables. The green bonds strategy can open up a political economy question that may limit the degree of freedom the RBI needs to maintain price and financial stability. Economists also suggest letting the greening of macro policy be “fiscal” in nature.

However, the assumption that climate change cannot affect financial stability has also been questioned by policymakers. Christine Lagarde of the European Central Bank, for instance, is vocal about greening the monetary policy. If these assertions are to be provided space, the operational independence of our central banks may need a relook beyond the narrow mandates of the monetary policy committee decisions.

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