MPC Meeting: Amid too many risks, status quo in policy rates is welcome

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RBI MPC revised the growth projections upward, despite the downward risks from the global economy.

The RBI held its last Monetary Policy Committee deliberations of 2023 during December 6-8, 2023. As expected, RBI has not deviated from its primary mandate of bringing price stability, and to tame inflation back to the official nominal anchor of 4 percent. The RBI Governor has clearly articulated that his prime aim is inflation containment. Therefore, the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) has kept the repo rate unchanged at 6.5 percent. The monetary policy stance of "withdrawal of accommodation" is maintained rather than switching to a "neutral stance".

The **monetary policy corridor** is defined by the lower bound of SDF and upper bound of MSF. The December 8 announcement by RBI maintained a symmetrical monetary policy corridor with SDF rate at 6.25 percent and the MSF rate and the bank rate at 6.75 percent. The symmetrical corridor is translated as both SDF and MSF are equidistant from the policy rate at 6.5 percent.

MPC's Prudent Call

Given the global headwinds, he communicated effectively that RBI is maintaining a status quo in its policy rates at 6.5 percent. There is a growing recognition that the global economy is facing a "poly crisis" emanating from war, climate change crisis, energy crisis and debt crisis. These crises culminated into a prolonged period of "volatility". While the central bank left the policy rates untouched at high levels to stabilise prices and to tackle the poly crisis, we should not forget the tradeoffs. The tradeoffs include the slowdown in global growth and severe debt crisis.

Inflation targeting and public debt management never go hand in hand. The "party is over", of low interest rates regime. Now given the hawkish trend in interest rates, the public debt management is becoming costlier. Fiscal policy is continuing to remain accommodative to avert a global recession. Accommodative fiscal stance with high public debt and deficits in the post-Covid era needs an effective rollback as it should not culminate into severe fiscal risks. The combined fiscal-monetary risks and climate change related risks can trigger an irreversible threat to the global economy. Against this backdrop, the RBI Governor has judiciously conducted his policy rate manoeuvring, with majority votes for the decision of status quo in policy rates. This RBI decision is welcome.

The RBI announcement effects can be multifold. The monetary policy tightening has led to inflation containment though CPI is slightly above the nominal anchor. The Monetary Policy Committee deliberations have projected CPI inflation at 5.4 percent for 2023-24, with Q3 at 5.6 percent and Q4 at 5.2 percent. CPI inflation for Q1 2024 is projected at 5.2 percent, Q2 at 4 percent and Q3 at 4.3 percent. It is surprising to note that RBI MPC has slightly revised the growth projections upward, despite the downward risks from the global economy. The RBI Governor Dr Shaktikanta Das articulated that the inflation targeting "cannot be on autopilot," acknowledging that CPI inflation could be above the nominal anchor. This is all the more relevant because India cannot afford to be in a prolonged negative interest rate regime.

The RBI MPC announcement on December 8 revealed that the real GDP growth for 2023-24 is projected at 7 percent, up from the earlier 6.5 percent. The GDP growth for Q3 is projected at 6.5 percent and Q4 is projected at 6 percent. The RBI Governor said that GDP is likely to grow at 6.7 percent in Q1 2024, 6.5 percent in Q2 2024, and 6.4 percent in Q3 2024. **Does this optimism** about economic growth figures suggest a “decoupling” or a retreat from globalisation? There is an increasing trend towards reshoring, nearshoring and “friend-shoring” globally. The RBI Governor reinforced that India’s economy is resilient, despite the fragility of the world economy, and therefore RBI has revised the GDP growth figures upwards.

Regulatory Frameworks

The RBI Governor announced that a fintech repository will be operationalized in April 2024 to understand the fintech ecosystem, and for strengthening the partnership between banks and fintech firms. The RBI Governor also said that the UPI transaction limit for payments made to hospitals and educational institutions be enhanced to Rs 5 lakh from the previous Rs 1 lakh.

However, extreme caution is required when banks deal with fintech firms, and it is highly relevant for the banks to diversify its portfolio rather than disproportionately focusing on fintech firms, which can create a financial exuberance and in turn a fintech bubble.

The significance of scaling up Central Bank Digital Currency (CBDC) is also crucial, and clarity regarding CBDC is awaited from RBI. CBDC is indeed the digitized legal tender. However, immense ambiguity remains on how UPI and CBDC co-exist in India in the coming years.

The Pause And Its Consequences

The RBI Governor has articulated that his pause in the rates cannot be **misunderstood** as peak rate. The MPC Statement mentioned that the next MPC meeting will be conducted during February 6-8, 2024. If the inflation containment is successful by February 2024, will RBI think of decreasing the policy rates then?

This question can be answered only after we understand the mood of the US Federal Reserve in the upcoming Jackson Hole meetings. If the US Fed Reserve continues to be in hawkish mode, and if Jay Powell increases policy rates, it will have further adverse consequences on emerging market economies. RBI will continue to be in “interest rate defense” mode if such hawkish announcements persist, to avoid capital flight from the Indian economy.

To prevent Current Account Deficit (CAD) from widening, we are financing the CAD with capital inflows. In 2013, India tried capital controls to prevent volatility in currency markets, however it was partially effective. So RBI will continue to be on interest rate defence mode. It has three advantages and two disadvantages. The advantages of a high interest rate regime are inclusive of protecting financialisation of savings, per-empting a capital flight and also to tackle the mounting inflation. However the disadvantages are economic growth recovery will slow down as the credit will not be cheaper for investment upturn, and public debt management will also be costly.

In February, India will also confront an Interim Budget before the general elections. Given the hawkishness in interest rates, the debt servicing burden and fiscal risks are mounting. It is highly likely that there will be no major fiscal announcements in the Interim **Budget 202**4-25 before elections. Given the constrained fiscal space, India will remain firm on fiscal arithmetic, with the medium term fiscal glide path of fiscal deficit towards 4.5 percent by 2025-26.

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