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MPC stance of 'calibrated tightening' is more like 'calibrated loosening'; here's why

The MPC retained its 'calibrated tightening' stance, but, by reducing SLR by 0.25% now, and 0.25% every quarter from now till it reaches 18%, RBI is going to inject liquidity into the system

RBI must do its bit to support growth

By VP Singh

RBI's recent standoff with government is ample indication of the stress and complexity building into the economy. The monetary policy in such an environment would quite naturally be a complex one, like the one rolled out last week. The Monetary Policy Committee (MPC) has retained 'calibrated tightening' stance, but, reduced SLR by 0.25%, to 19%. Further, it says that it would reduce SLR every quarter by 0.25% to reach a level of 18% equivalent to

Liquidity Coverage Ratio (LCR). This implies that despite a tightening stance, RBI is going to flush liquidity into the system by an amount of Rs 30,000 cr every quarter. In fact, it looks more of ‘calibrated loosening’. The October policy had seen the stance changing from ‘neutral’ to ‘calibrated tightening’, yet RBI kept on increasing liquidity through open market operations throughout. The persistent gap between credit growth and bank deposits needed increasing liquidity. Benign food prices had enabled CPI to decline, but the WPI had increased in October to 5.28% from 5.13% due to rising commodity prices, especially crude oil. The recent decline in crude oil price will have an easing impact on WPI inflation, too. RBI expects the CPI-based inflation in the second half of 2018 to range between 2.7% and 3.2%. Its expectation from the first half of 2019 is of 3.8-4.2%. Hence, overall the inflation is expected to remain benign. Then, why not reduce the repo rate too? It has been retained at 6.5% considering the possibility of crude oil price rise, a sound measure considering OPEC announced production cuts. Basing our policy decisions on the ability of OPEC to influence global crude oil supply could be risky. Past experience shows that targets have either not been met or have fallen short. In 2016, OPEC decided to cut production by 1.8mbpd but, by April 2018, the world saw 2.7 mbpd being taken off. Prices rose more than expected. The world also over-reacted to the oil supply-cut due to the economic sanctions on Iran. Now, though, crude oil price has crashed. The capital outflow experienced over the last few months due to strengthening of the US economy is also under control. The US Fed isn’t expected to increase the interest rate; hence, there is little pressure on India from that dimension to keep interest rates high. A reduction in repo rate by 25 basis point would have lifted the investment mood in the country. RBI’s mandate also includes growth, and not just targeting inflation. The current stance of ‘calibrated tightening’ seems to indicate that we may not see rates being decreased even in the February 2019 policy. In case private consumption and private investment do not pick up, then, the government, being in the election mode, will have to increase spending leading to increased fiscal deficit. Such kind of fiscal indiscipline has the potential to undo the last four years’ record of sound fiscal management. The ill-effects of slippage on fiscal targets may be harsher than any damages expected from a rate cut in this environment. It is to be noted that S&P has not upgraded India’s sovereign rating from the lowest investment grade of “BBB-” since January 2007. It has cited the sizeable fiscal deficit apart from low per capita income and high government debt levels as the primary reasons. The Indian government has been trying to impress upon S&P executives that the Centre would stick to the path of fiscal consolidation. The Centre aims to reduce the fiscal deficit to 3.3% this fiscal, to 3.1% in 2019-20 and 3% by 2020-21. In 2017-18, it had contained fiscal deficit at 3.5% despite the fact that GST revenue was collected for only 11 months that year.

Moody's, which upgraded India's sovereign rating to 'Baa2' after a long gap of 14 years, has said that there were risks of the fiscal deficit breaching the 3.3% target. Fitch, too, has maintained a 'BBB-'rating for India for over 11 years now. Any slippage on the fiscal front can lead to downgrade by these rating agencies. India can't afford to risk this. This may lead to flight of capital from the economy and certainly an increase in cost of funds for corporates targeting external commercial borrowings. In September and November, RBI took steps to liberalise norms pertaining to external commercial borrowings in an attempt to stabilise the then falling Rupee. An increased fiscal deficit threatens to undo all these efforts. The masses are already seeing a conflict of interest between government and RBI. At this stage, the two need to be seen to be on the same page and complement each other to give a strong growth push. A neutral stance of the MPC would have given some hope of repo rate cut in the future and may have arrested the rising MCLR. RBI must do its bit to spur growth and shun caution for the time being.

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