AIR Spotlight: RBI’s Monetary Policy Decisions

AIR Spotlight is an insightful program featured daily on the All India Radio Newsonair. In this program, many eminent panellists discuss issues of importance which can be quite helpful in IAS exam preparation.

This article is about the discussion on the **RBI’s Monetary Policy Decisions.**

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Context: Recently, in its bimonthly policy meeting, the 6-member Monetary Policy Committee of the Reserve Bank of India (RBI) announced a 35 basis point increase in the repo rate to 6.25% in an attempt to keep retail inflation under control.

Introduction:

- Since the start of the tightening cycle in April 2022, the RBI has raised the policy rates by 225 basis points (bps) in an effort to reduce inflation from its current level.
- In October, headline inflation in India fell to a three-month low of 6.77%, down from 7.41% in September. However, inflation has remained well above the RBI's medium-target range of 2-6% for the past ten months.
- The RBI is now more concerned about the rise in core inflation, the non-food, non-oil component of inflation, which has accelerated after a summer slowdown.
- Also, the Rupee's weakness against the US Dollar is adding to the RBI's inflationary concerns, given that imports account for one-third of the Consumer Price Index (CPI) basket. Household inflation is also expected to remain high on account of inflation in food prices.

Effects of Inflation on the Economy:

- The recent 35 basis point hike is much smaller than the previous three 50 basis point hikes, indicating that inflation is slowing, but it remains outside the RBI's flexible inflation targeting framework of 4% (+/-2%).
- The Consumer Price Index (CPI), which RBI targets for inflation control, has been above 6% for 10 consecutive months.
- The majority of the inflation has resulted from supply-side disruptions caused by geopolitical tensions such as the Russia-Ukraine conflict, Chinese aggression in the South China Sea, etc.

- RBI in its capacity to control inflation is doing a fine balancing act between making liquidity available in the economy and addressing inflationary tendencies. This is critical for India to maintain its growth rate in such difficult circumstances.
- As a globally integrated economy, the US Federal Reserve's tightening policy has caused a flight of foreign investors from India, and every emerging market is feeling the impacts. With oil accounting for 90% of imports and edible oils accounting for 60%, global economic shocks will have an impact on the Indian domestic economy.
- More importantly, rate increases typically take some time to reflect in the banking system. There is a growing divergence between saving rates and loan rates.
- The impact of repo rate hikes is expected to be evident by the first quarter of 2023. From an investment standpoint, one must invest for a shorter period of time until the market provides a clear picture of which direction the economy will be moving.
- On the plus side, the World Bank revised India's GDP growth forecast upward to 6.9% from 6.5% previously, Standard and Poor's, the world's leading rating agency, set India's growth rate at 7%, while the RBI reduced the growth rate for the Indian economy from 7% to 6.8%.
    - A consensus has emerged around India's growth rate of around 6.827%, which is significantly higher than the global economy's growth rate.

Way Forward

While inflationary pressures persist, the silver lining is that India is growing faster at a time when developed economies are on the verge of recession. In India, GDP growth remained largely resilient, and the economy gained strength in October. "India is seen as a bright spot in an otherwise gloomy world," according to the RBI Governor. However, in an interconnected world, India cannot be completely isolated from the negative consequences of the global slowdown and geopolitical adversaries.