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Opinions & Editorial

Staying the course

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The outlook on inflation, says the Reserve Bank of India (RBI), will be shaped in the near term by three factors: the monsoon at home, trends in global energy and commodity prices, and domestic demand-side pressures owing to higher-than-anticipated growth. The monsoon still looks a bit iffy — good but not good enough. But any concern on this score is more than compensated by the slowing down of global growth, including that of China, and the consequent easing of commodity prices, especially energy. While global demand is unlikely to exert inflationary pressures — in fact, the concern in Europe is that deflationary pressures may be at work — the major source of inflation at home would remain domestic demand. This, RBI thinks, should be managed in such a way that inflationary expectations are kept firmly under check. With this objective in mind, the central bank has, predictably, raised key benchmark rates while releasing its first quarter review of monetary policy for fiscal 2010-11. It has increased the repo rate, the rate at which banks borrow from RBI, by 25 basis points, from 5.5 per cent to 5.75 per cent, and the reverse repo rate, the rate at which the central bank borrows money from banks, by 50 basis points, from 4 per cent to 4.5 per cent. In doing so, it has narrowed the policy interest rate corridor by 25 basis points, enunciating the two principles that define its policy in this regard. Keeping in mind the demand for liquidity, the central bank has left the cash reserve ratio (CRR) unchanged at 6 per cent of the net demand and time liabilities of scheduled banks. All these measures are along expected lines. RBI has done well to keep its eye firmly on inflation and repeat its views once again that it will adhere to “a monetary policy committed to keeping inflation low and stable”. The central bank has good reasons to claim that its record in this regard constitutes “an important foundation for the credibility of monetary policy and, more generally, the broader inflation management framework”. RBI has perfected the art of managing market expectations, retaining the ability to shock the markets every now and then. Clearly, RBI has been able to limit the hike in policy rates because of its reading of the impact of global growth and demand on energy and commodity prices. Slower global recovery is helping India manage inflation without hurting its own growth prospects by too much. One consequence of the revised growth and inflation numbers, with expected growth hiked from 8 per cent to 8.5 per cent and expected inflation rate revised upwards from 5.5 per cent to 6 per cent, is that the expected nominal gross domestic product (GDP) growth rate for 2010-11 will be 14.5 per cent rather than 13.5 per cent. This one percentage point increase in expected nominal GDP growth will help the Union finance minister show better performance in fiscal and budget deficit management. North Block should be grateful for Mint Road’s accommodative stance!