RBI’s monetary policy prioritises global economic headwinds

MPC has given relative significance to global headwinds and uncertainties. Therefore, a sudden reduction in rates is not feasible when inflation expectations are elevated. The catch, however, is high rates complicate public debt management

The potential conflict of RBI’s mandate for price stability with the public debt management is the formidable challenge before the new MPC, given the fiscal consolidation path ahead

Against the backdrop of geopolitical uncertainties and poly-crisis, the 51st RBI Monetary Policy Committee (MPC) has kept the rates “status quo” at 6.5 percent. The poly- crisis includes the tensions in West Asia, energy price volatility, supply chain disruptions, fluctuating oil prices and mounting global inflation. The US Fed Reserve has reduced the rate by 50 bps in September 2024, however, RBI has given relative significance to the global economic headwinds and geopolitical uncertainties while taking the decisions.

This meeting is the first in the series under the new MPC, constituted recently with three new external members for a four-year term. All the six members of the new MPC voted to change the monetary policy stance from “withdrawal of accommodative stance” to “neutral” stance.

'Neutral stance' brings growth back into policy matrix

A “neutral stance” refers to a policy stance by the central bank to increase or decrease the interest rates, with dual policy priorities of inflation containment and growth recovery process. This transition in the policy stance to “neutral” is welcome.

It is interesting to recall that since May 2020, the RBI has kept the policy stance “accommodative”, with an articulation of “withdrawal of accommodation” in the recent years.

In the period between May 2020 to May 2022, RBI had kept the repo rate constant at 4 per cent. Since May 2022, the RBI has started increasing the repo rate and has been increased the rate by 250 basis points (bps) to 6.5 per cent by February 2023. Since February 2023, the MPC kept the repo rate unchanged at 6.5 per cent in all the policy review meetings. It is a bold decision by the RBI to transit to “neutral stance”, giving equal importance to growth and inflation

Potential conflict between inflation mandate and public debt management

Fiscal policy has remained accommodative over the years to support the growth recovery process, as the monetary policy, by mandate, was focusing on price stability. However, with high interest rates, the public debt management has become costlier. High deficits and high debt are substantiated in times of low interest rate regime, if it is linked to enhancing capital infrastructure and also to reduce output gaps.

However, this potential conflict of RBI’s mandate for price stability with the public debt management is the formidable challenge before the new MPC, given the fiscal consolidation path ahead.

Elevated inflationary expectations matter

The RBI Governor has emphasised on the success of “new monetary framework” envisioned for India in February 2016, based on Urjit Patel Committee recommendations. The new monetary policy framework envisages “price stability” as the single mandate of RBI, through the flexible inflation targeting framework. As per the flexible inflation target (FIT) framework in India, a nominal anchor of 4 percent CPI inflation was decided, within a band of + or – 2 percent.

The MPC is mindful of “negative interest rates”, if the inflationary expectations are higher than the nominal interest rate. So their decision reflects the reality that a sudden reduction in the policy rates at this moment is not feasible, given the geo-political uncertainties.

The RBI Governor has emphasised on “central bank independence” – in terms of “operational independence” - recalling the decision in 2016 to constitute the Monetary Policy Committee (MPC) with internal and external members, instead of RBI Governor unanimously taking decisions on the policy rates. The “operational independence” allow the MPC members to take an independent stance regarding the policy rates based on their voting powers. In the latest MPC meeting, a unanimous decision towards “neutral” policy stance was taken. A majority of 5 out of 6 members voted to keep the policy repo rate unchanged at 6.50 per cent.

The monetary policy corridor is kept “symmetrical”, with lower and upper bounds of the corridor equi-distant from the repo rate.

The term structure of interest rates is fascinating to look at. The long term 10-year G-Sec yield rate softened to an average of 6.79 percent in October (up to October 7) as compared to 6.98 percent during June – July 2024. The weighted average call rate (WACR) is slightly below the repo rate, averaged at 6.44 percent during October (up to October 7) as against 6.55 percent during June – July 2024.

Given the volatility in the global financial markets and the downward risks from the geo-political uncertainties, the real GDP growth for Q1:2025-26 is projected at 7.3 percent. The RBI's growth and inflation outlook highlights global resilience, despite geopolitical risks, noted RBI Governor Shaktikanta Das, in his statement. Given the “Viksit Bharat” commitments announced in the recent Union **Budget 2024**-25, fiscal and monetary policy co-ordination is crucial for sustained economic growth towards a high income country status by 2047.

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