A challenge for the RBI: Rate-setting Committee Dec 4-6

Dr. T. K. Jayaraman

The Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) will hold its scheduled bimonthly meeting from December 4-6 for setting the policy interest rate (REPO) for the next two months. The MPC faces a significant challenge. There were critical comments in the second week of last month on RBI's performance from two central key ministers and the Chief Economic Advisor (CEA). That is just three weeks before the term of RBI Governor Shaktikanta Das ends on December 10.

The economic health card came on November 29, reporting that the economy has been slowing down over the past three months. It reported the GDP growth rate in the July-September quarter (Q2 FY25) was only 5.4%, a big drop from 8.1% in Q2 FY2. It was also a decline from 6.7% in Q1 FY25. Inflation has been rising from 3.60% in July to 5.49% in September. The October inflation is 6.21% which will pose a big challenge to MPC, decreasing growth and rising price level.

Besides these developments, there has been growing pressure from the private sector, with calls for RBI to follow the trend of advanced and some emerging economies, including China, in easing monetary policies by cutting interest rates. They argue that India's current high interest rate of 6.50%, set in February 2023, is negatively impacting consumption and investment, and that the country should emulate global trends to stimulate growth.

Background

By end of 2021, the world was recovering from COVID-19 pandemic, which devastated global economy. Most countries were on the road to toward recovery, driven by pent-up demand and expansionary fiscal and monetary policies. However, the outbreak of the Ukraine-Russia war in February 2022 halted growth by disrupting global fuel and food supply chains, triggering widespread price hikes. These inflationary pressures continued into 2023 and early 2024, forcing countries to tighten monetary policies.

India steadily raised its repo rate from 4.0%in 2022 to 6.5% in February 2023, maintaining this rate to date. America also raised its federal funds rate steadily from 0.25% in 2022 to a peak of 5.50% by July 2023, as did many other economies, adopting restrictive monetary policies to combat inflation. These measures showed results, with inflation gradually decreasing over the period in 2024, prompting the Federal Reserve to consider early rate cuts to prevent a potential recession.

India, with a target inflation rate of 4% (set in 2016 and extended through 2026), allows a margin of 2%, providing a comfort zone up to 6%, taking into account the country's vulnerability to natural disasters that reduce availability of food supplies. Food inflation is particularly significant, as it comprises 46% of the consumer basket, directly influencing public sentiment. The highest recorded inflation in India was 7.44% in July 2023, before it fell steadily over the period to 4.75% in May 2024.

RBI response

The scheduling dates of MPC meetings are often fixed in the first week of the month, Given the data lag (official inflation data of a given month is typically released only in the second week of the following month, as the daily data, 30 or 31 days, processing and procedural requirements of vetting the data at different levels of authority, which take a fortnight), it would be more appropriate to schedule MPC meetings in the third week, rather than in the first week. The October MPC meeting was held in the first week, 7-9, without September inflation, as it was available only by middle of October. The MPC decided on the basis of August inflation of 3.65% (**Table 1**), instead of September inflation of 5.49%, which was available only by October 14.

As 2024 August inflation was 3.65%, below the target rate of 4%, keeping up the downward trend beginning from May 2024, MPC announced its shift in its stance from "withdrawal of accommodation" to a neutral position. However, it, opting to "wait and watch" for further developments by maintaining the repo rate at 6.50% .

Differences between Government and RBI

On November 14, Commerce Minister Piyush Goyal sparked a debate by stating that high interest rates were contributing to the economic slowdown. He urged the RBI to lower rates, arguing that taking food inflation into account for calculating inflation" is a flawed procedure".

On November 18, addressing the State Bank of India Conclave of Bankers and Economists, Finance Minister Nirmala Sitharaman expressed concerns about high lending rates as they were causing "stress to borrowers." She did not make

TABLE : 1 — India: Food Inflation, Retail Inflation Rates and RBI Policy Interest (REPO) Rates (%)

YEAR/ Month	Food Inflation	Retail Inflation	Policy Rate Repo
2023			
Jan	5.94	6.52	6.25
Feb	5.95	6.44	6.50
Mar	4.79	5.66	6.50
Apr	3.84	4.70	6.50
May	2.96	4.25	6.50
June	4.49	4.80	6.50
July	11.51	7.44	6.50
Aug	9.94	6.83	6.50
Sept	6.62	5.02	6.50
Oct	6.61	4.87	6.50
Nov	8.70	5.55	6.50
Dec	9.53	5.69	6.50
2024			
Jan	8.34	5.10	6.50
Feb	8.66	5.09	6.50
Mar	8.52	4.85	6.50
Apr	8.74	4.83	6.50
May	8.70	4.75	6.50
June	9.36	5.08	6.50
July	5.42	3.60	6.50
Aug	5.66	3.65	6.50
Sept	9.04	5.49	6.50
Oct	10.90	6.21	6.50

Source : Reserve Bank of India

any reference to Goyal's remarks. She wanted interest rates "should be made affordable" .

On November 18, speaking to the same State Bank of India Conclave next date, CEA Anantha Nageswaran suggested that if volatile items like tomatoes, onions, and potatoes (TOP) were excluded but even gold and silver were included, inflation rate would be much lower.

Food Inflation in Low-Income Countries

RBI Governor Shaktikanta Das has repeatedly emphasized that food inflation cannot be ignored, as it significantly impacts the public's perception of inflation. Food inflation holds particular significance in India due to its large low-income population. It is more sensitive to price changes in essential goods Moreover, second-round effects, such as rising costs for processed foods, domestic help, and food delivery services, further contribute to core inflation too, which is not necessarily low all the time. The core inflation is calculated by leaving food and fuel goods, whose prices are volatile. This is the worldwide procedure adopted by central banks,

The selective approach to inflation calculations, as suggested by the CEA is based on expediency, rather than on rationality. One cannot take out inconvenient items and add "convenient" items for the sake of getting favourable result. It is like changing the goal posts in the course of an ongoing football game. It risks undermining the credibility of the inflation target which was discussed and decided by Finance Ministry and RBI.

It was wisely left to bureaucrat to put the lid on the debate. On November 20, Ajay Seth, Secretary of the Department of Economic Affairs told the FICSS's curtain raiser ahead of AGM and 97th Annual Convention in New Delhi that, "despite sectoral slowdowns, there were no significant risks to the 2024-25 growth projection of 6.5%-7%". He acknowledged the role of weather-related factors in food inflation and stressed that monetary policy falls under the RBI's domain. Apparently, it was a needless debate, causing an embarrassment to government and RBI, as it amounts to making suggestions to MPC and even to attempt to interfere in a critical decision procedure.

RBI Governor Das, in his address to the Conference of Central Bankers of the Global South on November 21, emphasized that macroeconomic growth with price stability is a shared responsibility between the government and the central bank. The global economic landscape is changing. The return of Donlad Trump with protectionist policies, and forced deportation of illegal immigrants could lead to rise in inflation through tariffs and shortage of labour in US. Critical imports from US would be up in price and hurt India's exports eventually. In such an environment, the RBI's role is crucial in maintaining both domestic and external stability of Indian rupee. By keeping the repo rate unchanged, the RBI would continue to assure global financial markets of India's commitment to stability, which is vital for sustaining investor confidence.

The RBI has done well under Governor Das's leadership. Governor Das and two other Governors (of Denmark and Switzerland Central Banks) were given A+ grade by Global Finance Magazine for successfully managing inflation, currency stability, and interest rate policy. They figure in the 2024 list of first ten top Central Bank Governors, selected from 100 world central bankers. ■

— Dr. Jayaraman is an Adjunct Professor at the University of Tunku Abdul Rahman, Kampar Campus, Perak State. He previously served as a Senior Economist at the Asian Development Bank in Manila and as a Professor of Economics at Fiji National University.