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RBI releases Minutes of the July 24, 2013 Meeting of the Technical Advisory Committee on Monetary Policy

The thirty third meeting of the Technical Advisory Committee (TAC) on Monetary Policy was held on July 24, 2013 in the run up to the First Quarter Review of Monetary Policy 2013-14 on July 30, 2013. The main points of discussion in the meeting are set out below.

1. Members were of the view that the global economy remains subdued. Most Members felt that while quantitative easing (QE) in the US cannot continue forever, its withdrawal could well be slow. In the euro area, the European Central Bank has stressed its commitment to keep interest rates low for an extended period of time. Only Germany has marginally managed to avert recession. In the UK, the new Governor of the Bank of England had confirmed keeping interest rates at a record low for longer than investors had expected. In China, banks are now allowed to set their own lending rates, subject to a ceiling. The recent surge in interbank rates and the money market cash squeeze in the financial markets will reduce credit growth and also growth of the Chinese economy. Brazil has raised the benchmark interest rate for the third consecutive time and is possibly behind the world’s biggest tightening cycle with its currency weakening by about 13.0 per cent in the past three months on capital outflows due to withdrawals from equity mutual funds.

2. On growth, Members’ assessment was that domestic activity has slowed down and industrial production is weak. The confidence level of investors has worsened and most investment plans have been kept on hold. Even though firms are cash rich and liquidity is adequate, they are not taking any investment decisions. Smaller entities are suffering, mostly on account of working capital and supply constraints. However, at present, the IT sector is doing well on account of the positive outlook from the US although exports to the euro area have been adversely affected. One Member was of the view that since IIP covers only large firms and does not include small and medium enterprises, it may be overestimating the slowdown. The actual picture will be revealed by the data of annual survey of industries.

3. Regarding inflation, Members’ were of the view that though the monsoon has been good, inflation facing consumers is still high. Food prices are still elevated and the food security bill will aggravate food price inflation as it will tilt supply towards cereals and away from other farm produce (proteins), which will raise food prices further. Fuel under-recoveries are also a consideration. On the other hand, rupee depreciation has not had much impact on inflation, reflecting the weak pricing power of corporates. With global commodity prices

low and the output gap negative, Members expected inflation to be lower than what it was over the past year. On risks to inflation, Members noted that the inflation expectations have not declined significantly and the fear of resurgence of inflation was still high. One Member wanted a transition by the Reserve Bank from the wholesale price index to the consumer price index as the indicator used for monetary policy communication.

4. On the fiscal front, Members hoped that the fiscal deficit is reduced in a manner that is not growth punishing, i.e., that capital expenditure should not be cut down. According to them, the real cure was in reducing the revenue deficit and undertaking serious economic reforms. Members desired that the Reserve Bank impress on the government the need to address supply side constraints which are causing inflationary pressure, especially on the food front.

5. The Members were of the view that developments in the external sector – large current account deficit (CAD) and pressure on the rupee – is the immediate concern that needs to be addressed. The CAD is high and unsustainable, and the net international investment position has worsened by 50.0 per cent in the last two years. Some Members suggested that in these circumstances, the Reserve Bank should let the real effective exchange rate depreciate to help regain competitiveness that Indian exports have lost. According to one Member, the CAD in India is uniquely segmented. While the non-gold component reflects structural infirmity of the real sector, the gold CAD mirrors structural infirmity of the financial sector. The measures taken on gold are proving to be effective and may help in containing CAD. On external risks, some Members were of the view that markets are forward-looking and have already factored in the impact of tapering of QE by the US.

6. On the recent measures taken by the Reserve Bank to contain the exchange market volatility, one Member was of the view that since April 2012, the Reserve Bank has reduced the policy repo rate by 125 basis points (bps), CRR by 75 bps and SLR by 100 bps and the impact of these measures is still unfolding. The recent actions of increasing the marginal standing facility rate and squeezing liquidity out of the system are not inconsistent with its long-term commitment on growth. Another Member was of the opinion that looking at implied volatility and forward positions, the measures could be gradually withdrawn. The CAD is high since domestic financial saving is falling - in this regard, the objective of market development should not be lost sight of for enhancing household saving. Another Member was of the view that if monetary conditions have to be tightened in defence of the rupee, it would have been better to simply raise the policy rate by, say, 100 basis points, widen the corridor by an equivalent amount and indicate that this is a temporary measure. Yet another Member felt that the Reserve Bank has tinkered with the operating framework of the monetary policy. Once the width of the interest rate corridor is raised, the market understands that the Reserve Bank is open to more interest rate volatility. Volatility in the money market distorts the monetary policy signal, affecting its credibility. In this Member's view, it would have been more appropriate to raise the cash reserve ratio to ensure that banks do not use their excess liquidity to make gains in the forex markets. However this Member was more sympathetic of the measures taken by the Reserve Bank on July 23, 2013.

7. On monetary policy measures, four of the seven Members recommended maintenance of status quo in the policy repo rate. In their view, though growth and inflation are projected to move down, we still have to guard against high inflation expectations that can destabilize the momentum of the economy. Moreover, the external front is fragile and warrants that we do not do anything that can send wrong signals about our discounting the possibility of capital outflows. Of these, one Member was not in favour of any change to the policy rate till the operational architecture, through which monetary policy is steered, goes back to a symmetric corridor within the standing facilities that provides a small window within which overnight rates move. In this Member's view, to act without that situation having been reached, would be destabilizing. Two Members recommended a reduction in the policy repo rate by 25 basis points to improve sentiment and show sensitivity to growth. One Member recommended a repo rate increase by 25 basis points given the expectation of higher volatility in the exchange rate in the second half of 2013. To ameliorate the fund constraints of small scale enterprises, one Member suggested the Reserve Bank to open a bill discounting window for this sector. Another Member recommended that the Reserve Bank should show its commitment to growth by reducing the procedural infirmities, specifically those that lead to delays in granting of loans.

8. The meeting was chaired by Dr. D. Subbarao, Governor. Other internal Members present were: Dr. Urjit R. Patel (Vice-Chairman), Dr. K.C. Chakrabarty, Shri Anand Sinha and Shri Harun R. Khan, Deputy Governors; and external Members present were: Shri Y.H. Malegam, Prof. Indira Rajaraman, Dr. Arvind Virmani, Prof. Ashima Goyal and Dr. Chetan Ghate. Dr. Shankar Acharya and Prof. Errol D'Souza who could not attend the meeting, submitted their written views. Officials of the Reserve Bank Shri Deepak Mohanty, Dr. Michael D. Patra, Shri B.M. Misra, Dr. B.K. Bhoi and Shri Pardeep Maria were in attendance.

9. Since February 2011, the Reserve Bank has been placing the main points of discussions of the meetings of TAC on Monetary Policy in the public domain with a lag of roughly four weeks after the meeting.

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