Editorial

Rajan's Exit and End of Monopoly Regime over the Monetary Policy

With the exit of Raghuram Govind Rajan, from the post of Governor of the Reserve Bank of India (RBI), the power of periodic review of monetary policy would also devolve upon a six member "Monetary Policy Committee" (MPC). The Narendra Modi government has amended the Reserve Bank of India Act in June-2016, to transfer the governor's sole and discretionary authority of periodical review of country's monetary policy to this yet to be constituted 6 member committee. This timely change to take care of country's monetary policy, in tune with the global trend, at a time, when many countries have slashed their interest rates, to near zero or negative to boost their growth rates, exports and investments, would certainly enable the nation to attain requisite economic resilience. The way Rajan has stuck to a very tight monetary policy and high repo rates, culminating into a 12% or even higher interest rate for borrowers has caused worst ever industrial sickness, decline in exports and a financial logjam in the economy, even when the wholesale price index (WPI) has turned negative in India since end 2014 preparing sufficient ground for a major rate cut. As a consequence of hawkish and inflation-bashing monetary policy, characterised with high interest rates, the investments, employment generation, corporate growth and credit off-take in the economy have come to a near halt. A strong negative trend in exports, growing industrial sickness, burgeoning non-performing assets (NPA's) of banks, declining credit off-take and unprecedented abandonment of new projects in the pipeline has emerged as a consequence of such high interest rates in disregard of the global trend.

Almost 12 precious years appear to have been lost by the country, since March 2004, when the repo rate was raised from 6 to 6.25% at a time when all major economic powers were moving in the opposite direction and are now having near zero or even negative interest rates. Repo rate was even raised to 9% in July 2009. In his last review also, Rajan has held the rate at 6.5% ignoring contemporary competitive global scenario. In today's open and globalised economy, when goods and capital have free mobility from across the borders, pursuing such a tight monetary policy with high interest rates in complete disregard of the near zero or even negative interest rates of several countries, has led India's economy to a state of such mess. Exports have fallen continuously through the last 20 months, except in June 2016, inter alia, due to high cost of borrowings. Companies are turning non-competitive and sick, one after the other, due to the higher interest burden,offering themselves as easy prey for takeover by foreign MNCs. Non-performing assets (NPA's) of banks have peaked, to turn growth in the credit off-take from banks to negative. New projects and fresh investments have badly dampened to the worst ever state of the post-independence period, and projects worth Rs 8, 80,000 crores has been abandoned by most of the promoters. The loss of output and exports suffered by the country, deprivation of youth from getting jobs in their precious working age and the nation's falling behind the other countries; not only like China, Korea and Malaysia but, even behind Bangladesh, Philippines and Vietnam in matters of certain exports and industry performance, is a serious cause of concern.

Indeed, growth mostly accompanies, a bit of inflation. Monetary expansion is often seen as a good means to enhance investments, employment, output, raise per capita availability of goods and services, generate demand, raise consumption-creating further impetus for investments, employment and demand etc., which may perpetuate to ultimate self-sustained growth. Without mild inflation in the economy, how will the investments come? S. Korea had on an average 7.6 inflation throughout the preceding 5 decades, yet they posted more robust growth, by a very low interest rate regime. The inflation had even touched 28% but, they achieved a more robust development than China, by pursing a liberal monetary policy and low interest rate regime. S. Korea has an equivalent of just 5% of our area and population. But, it has 24% share in world's total ship building, while India has less than 0.1% contribution in world ship-building, inspite of being world's 4th largest steel producer. One should not forget that, in the globalised economy, the prices in

India are less influenced by money supply and more by scarcities and external variables. The high CPI in June 2016 is due to higher food prices, wherein the prices of pulses have shot up due to shortage in production. Otherwise also, the inflation in India, in all these years had been high due to external variables viz-

(i) Huge inflow of FII investments leading to higher commodity prices.

(ii) Decline of Re exchange rate from Rs 50 per USD in 2011 to Rs 66.6 per USD in 2016, due to higher trade account, current account, and investment income deficits, leading to higher prices of all imports in Rupee terms.

(iii) Poor availability of essential items like pulses, oilseeds etc. due to shortfalls in output. To improve the supply side, a liberal monetary policy is the need of hour. Even a farmer would dare to borrow money for farm implants and inputs for raising output, if interest rates are low.

If the interest rates are lowered, the size of installment comes down for both households and corporate borrowers, facilitating them to undertake new expenditure and investments respectively, to fuel growth. Monetary expansion and growth in money supply is necessary to provide funds for investment, employment generation, consumption growth and creation of demand leading to further investment, employment etc to perpetuate a phase of self-sustained growth and development.

The tight monetary policy of Rajan and his two predecessors had little influence over price rise due to lack of any geo-political barriers in the post globalised economy. Due to quantitative easing (QE) by the US to the extent of USD 2 trillion after the global melt down along with the similar QE in Japan and EU the FII investment into India has nearly trebled. Between 2001 to 2007 India received USD 60 billion as portfolio investment, which shooted to USD 162 billion in the six year period between 2009-15, fueling commodity prices to shoot up inflation, which the RBI tried to control by strangulating domestic economy through higher interest rates. Likewise, when the US Fed Reserve (Central Bank of USA) raised interest rate by just 25 basis points in end 2015, this led to an outflow of USD 735 billion from emerging market economies (EMEs). India also experienced a net outflow of USD 3 billion in portfolio investment in 2015-16, posing threat to the Rupee value as we had a current account deficit (CAD) of $22 billion and it would be safe as we could receive USD 44 billion as FDI. But, the country had to open FDI into 15 sectors in November 2015 and 9 sectors in June 2016 to sustain FDI inflows. But, when we already have trade and current account deficits, then continuous inflow of FDI without matching outbound Direct Investments would worsen the balance of payments (BOP) due to growing deficit in investment income, which is already above USD 25 billion.

Therefore, the new RBI governor and the MPC to be put in place, has to evolve an integrated approach, keeping in view the global changes while shaping the new monetary policy. In any case, the interest rates need to be reduced with monetary easing for economic resilience, investments, employment generation and revival of exports. However, reduction in interest rates may prove vulnerable for the senior citizens dependent on interest income. They may be safeguarded by retaining higher interest rates for senior citizens in post office savings or through some other special purpose vehicle (SPV) for their savings. But, India would not be able to restore double digit growth with creation of jobs in the economy and revive the sagging exports unless the interest rates are eased. People may hope the new governor and the monetary policy committee (to be constituted) would take care.

(Prof. Bhagwati Prakash Sharma)
Editor in chief