प्रेस प्रकाशनी PRESS RELEASE

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001

DEPARTMENT OF COMMUNICATION, Central Office, S.B.S.Marg, Mumbai-400001
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 22660358

वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
इ-मेल email: helpdoc@rbi.org.in

August 25, 2015

Summary of the Electronic Consultation with the Technical Advisory Committee on Monetary Policy: July 2015

Consultation with external Members of the Technical Advisory Committee (TAC) on Monetary Policy was held electronically between July 22 and 28, 2015 in the run up to the Third Bi-monthly Monetary Policy Review, 2015-16 on August 4, 2015. The main points suggested by Members are set out below.

1. Members' assessment of the global economic activity was that though the overall level of activity was low, the US Fed sees policy risks shifting. Recent data point to moderate growth in the June quarter in the US following a weak growth in March quarter. While there have also been some increase in wage growth, core measures of inflation remained below the US Fed's inflation target. There are clear indications that initiation of normalisation of the policy stance would be sooner and gradual, rather than later and more rapid, suggesting a Fed fund rate hike in September or December. On Greece, while the prospects of a Greek exit from the Euro have diminished for now, it cannot be ruled out in the future.

2. On the domestic front, Members noted that the real economy continues to be weak. With the IIP growth as subdued, the departure of the May slowdown (2.7 per cent) from the consensus estimates of 4 per cent is worrying. Comparatively speaking, the source of concern is on the consumer goods side, which continues to be weak with both consumer durable and consumer non-durable output contracting in May. The input sectors (mining and electricity) may continue to drive the expansion of the IIP, but whether these are a source of sustained growth will depend on how the policy framework evolves. The purchasing managers' index for both manufacturing and services has declined in June 2015 and new investment initiatives have not gathered steam, which is worrying. Exports dipping seven months in a row is also a major concern for growth, especially since a possible secular stagnation may constrain an export led revival.

3. Regarding inflation, some Members were of the view that with the revival of monsoon in late July and reduction in rainfall deficit to 5 per cent, food prices may remain soft, keeping prospects of a sustained uptick in CPI inflation low. The current rise in food prices may be an aberration because of difficulties in transportation during heavy rains, although the rise in prices of pulses from 16 per cent in May to 22 per cent in June is significant. The Iran agreement will help keep oil prices soft. Food inflation is presently ruling well below 6 per cent. Core inflation, even after a steady climb since January 2015, is still ruling at 4.98 per cent. Other Members were not so comfortable with the increase in CPI

inflation to 5.4 per cent in June from 5 per cent in May as this was an across the board increase. Food inflation increased to 5.7 per cent in June from 5.1 per cent in May. Protein items also saw strong sequential increases, although there may be some moderation forthcoming in certain items like pulses where higher imports have been allowed. High pulses inflation as well as of egg, meat and fish that may translate into inflation expectations may be kept in view while formulating the policy response. There was also an increase in core inflation driven in part by an increase in the service tax and higher petrol prices. Because a slowing down of rural wage growth should put downward pressure on various items of core inflation such as clothing and footwear, core inflation is likely to stay around the 5.5 per cent range this year, and may further dip in the near term because of lower petrol prices. Some increase in services inflation (miscellaneous category) however may arise because of the increase in service taxes effective June.

4. Members found growing weakness on trade account as a serious medium-term risk to financial stability and economic performance. The fall in India's export growth is the largest among emerging markets and India is the fourth worst affected after Russia, Columbia and Peru. Therefore, fall in global demand may not be the only reason explaining the fall in exports. Since current account deficit is under control, oil prices have fallen further and commodity prices continue to be soft, some Members were of the view that downward adjustment of the nominal rupee exchange rate could encourage exports, without adding to inflation or upsetting foreign investors.

5. Four of the seven Members recommended a reduction in the policy repo rate. Three of them suggested a reduction of 25 basis points. According to these Members, firstly, headline inflation target for January 2016 will be comfortably met. Secondly, domestic demand condition is weak and growth in bank credit, industrial production and exports are low. Thirdly, the fiscal situation is showing signs of improvement, with deficits coming down and the composition of government expenditure shifting towards capex. Fourthly, the US Fed may raise rates later this year. Therefore, the Members felt that the time is opportune to use the space that is available for a reduction in the policy repo rate. The fourth Member advocated a reduction in policy repo rate by 50 basis points as the real economy continues to be very weak, inflation risks are receding and both the fiscal and current account deficits are under control.

6. Three Members recommended a status quo in the policy repo rate. According to them, firstly, with deceleration in credit growth, there is surplus liquidity in the markets as witnessed by the fact that the reverse repo operations are in excess of the repo operations and banks are holding significant excess investment in statutory liquidity ratio (SLR) securities. The rates for collateralised borrowing and lending obligations have generally been lower than the policy repo rate and banks are sourcing funds largely from this window. The excess liquidity should, therefore, result in further reduction in deposit rates and consequently the cost of funds would decline followed by reduction in lending rates. A reduction in repo rate at this stage may at best have a signaling effect but no real effect. Secondly, while both the inflation and IIP releases in July are unfavourable, progress of the monsoon over the July-August period will be crucial for the inflation outcome. Since this data will not be available for the August review, the Reserve Bank should "wait-and-see" as the data evolve, and this would suggest a pause. Thirdly, external conditions are such that the US economic activity is

picking up, in the Euro area there are signs of growth improving in France and Germany, and even Japan is showing signs of a gradual recovery. Given the chance of the US Fed reversing its monetary policy stance early, it would be appropriate to keep the Indian stance on monetary policy unchanged. One of these members recommended that the Reserve Bank should continue the policy of open market operations to mop up excess liquidity even at the risk of further increase in yields. Another Member advocated a reduction in the SLR by 50 basis points.

7. All the seven external Members – Shri Y.H. Malegam, Dr. Shankar Acharya, Dr. Arvind Virmani, Prof. Indira Rajaraman, Prof. Errol D'Souza, Prof. Ashima Goyal, and Prof. Chetan Ghate – sent their feedback through e-mail.

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.

Alpana Killawala
Principal Chief General Manager

Press Release : 2015-2016/491