Divergent views of Credit policy

Why in news?

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- The fifth meeting of the Monetary Policy Committee (MPC) held on June 6 and 7.
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- For the first time, it broke with unanimity and also went against widespread industry aspirations of a policy repo rate cut.
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What is the background of the issue?

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- The unanimous approach towards the rate cuts has been replaced by an exchange, if not a clash of contrary views.
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- The concern is of members now doing their own leap, coming as they do from different backgrounds, so that divergent.
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- The members placed on record that the readings on “a clear declining trend” in inflation.
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- Contrary to that of the RBI, as actual inflation had turned out to be lower than the latter’s projections.
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- There is a wait and watch scenario in the decisions made.
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What are the concern with the decisions taken?

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- The question on how the meeting is likely to influence market perspectives, particularly since there isn’t any clear forward guidance provided as a holistic view of the Committee as a whole.
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- There remains a larger risk of a policy decision arising out of a melange of views that prosecute individually held or ideologically driven opinion.
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- The “output gap”, which is the actual output minus potential output, and is an important measure to help a central bank assess short-run inflationary pressures.
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- A negative gap calls for an expansionary monetary policy, which in this case means a policy repo rate cut.
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- An output gap calculated on data for 2016-17 that profile a slowdown will, by definition, be negative and wider than otherwise.
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- For an economy that is projected to grow at 7.3 per cent in 2017-18, however, it must be the case that the output gap would narrow and close.
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- These are very divergent views, and they might indicate a reiteration of held positions, rather than a discussion in which the two convince each other.
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What is the way forward?

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- The quiescent investment cycle remains a key macroeconomic concern and there are most critical aspects of the monetary policy.
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- Even if a rate cut is offered, a likely scenario is that banks will not reduce the lending rate, or make very minor changes and will take up the “wait and watch” approach.
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- But they will be tempted to cut the deposit rate further, this brings some unintended and undesirable results for a policy that is meant to boost the dormant investment cycle.

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- The members are in hurry for a policy repo rate reduction, mirroring what possibly is a view that is usually said to be held by the government wanting a booster for the economy.
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- Hence there is a good clash of ideas building up, bringing a new kind of dynamic to the RBI.
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Source: Business Line

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