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RBI Must Drain Out Excess Liquidity

Why in news?

The RBI panel has forecasted the retail inflation to 5.7% in the financial year 2021-22.

What is India's current inflation trend?

Inflation is the rate of increase in prices over a given period of time

- CPI inflation remained elevated around 5.6% in July 2021.
- The WPI inflation at double digit level has been alarming since April 2021.
- The current forecast of 5.7% is close to RBI's upper tolerance limit in the 2-6% band.

What policy measures had led to inflation?

- These accommodative policy of RBI during COVID time had led to the built-up of inflationary pressures
- The Monetary Policy Committee (MPC) has cut the repo rate by 115 basis points (since March 2020).
- RBI has been buying both domestic and foreign assets that correspond to quantitative easing.
- RBI has refinanced to all-India financial institutions and granted

additional SLR exemption to accommodate banks under Marginal Standing Facility.

- RBI has announced asset purchases (2.2 trillion) under the Government Securities Acquisition Programmes

What are the major effects of inflation?

- **Creditors and debtors -** The effect of inflation on debtors is positive because they can pay their debts with money that is less valuable. With the conditions reversed it negatively affects creditors
- **Producers and workers -** Producers gain because they get higher prices and more profits from the sale while workers lose as their money wages do not usually raise proportionately with the increase in prices.
- **Fixed income-earners -** Salaried people, landlords, pensioners, etc., suffer because inflation reduces the value of their earnings
- **Investors and bondholders -** The investors in equity shares gain as they get dividends at higher rates. But the bondholders lose as they get a fixed interest with reduced value.
- **Effects on Production -** Inflation stimulates the production of goods as producers get more profit.
- **Effect on growth -** A mild inflation promotes economic growth, but high inflation hampers the economic growth as it raises cost of development projects.
- Inflation affects the poor more than the rich widening the **income inequality**

What should be done?

- RBI has to normalise its monetary policy in a non-disruptive manner by draining at least 75% of the excess liquidity

- 14-day variable rate reverse repo auction conducted by RBI to absorb surplus liquidity has to be continued
- The RBI has to sell dollar opportunistically to reduce excess liquidity

Source: The Hindu, BussinessLine

Quick Facts

Monetary Policy Committee

- RBI's MPC determines the policy interest rate required to achieve the inflation target (with the upper tolerance limit of 6 per cent and the lower tolerance limit of 2 per cent)
- The primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth
- It is composed of 6 members - three members from RBI (including RBI governor) and three members nominated by central government
- The decisions by the MPC are decided by a majority of votes by the members present and voting.
- In the event of an equality of votes, the Governor has a second or casting vote.
- Currently, the MPC meets six times in a financial year, i.e., every two months.