RBI's Repo Rate Cut

What is the issue?

- The Reserve Bank of India has cut the repo rate by 25-basis points to 6.25%, in its last bi-monthly meeting for 2018-19.
- The move signals both the RBI and the Centre getting in line with each other, after the recent tussle (Click here to know more).

What is the significance?

- The RBI had raised the policy rates twice last year, but has maintained a 'neutral' stance in the last two bi-monthly meetings when the MPC did not change the rate.
- But it did change the stance from ‘neutral’ to ‘calibrated tightening’ in the fourth meeting in early October 2018.
- With a new Governor at RBI now, the Monetary Policy Committee’s view on the state of the Indian economy seems to have changed.
- It has now switched its policy stance from ‘calibrated tightening’ to ‘neutral’.

What is RBI's rationale?

- The MPC had been over-estimating inflation risks and had stuck to a tighter monetary policy.
- But the inflation scenario has been favourable in the last few months.
- Consumer Price Index-based inflation have continued to slow and is projected to stay well below the medium-term target of 4%
- The MPC has particularly taken note of deflating food prices to adopt a liberal stance with the rates.

- The overall demand conditions are moderate, in the backdrop of a slowdown in private and public consumption expenditure.
- In the MPC’s view, there is an output gap, and the public spending on infrastructure alone cannot support investment activity.
- The RBI also sees the actual GDP growth for 2018-19 to be a bit less than the projected 7.4%.
- Production and import of capital goods (a key factor for investment demand)

and credit flows to industry remain dull.
- There is also a slowdown in farm output growth.
- So there is a need for strengthening private investment activity and boosting private consumption which a rate cut is expected to facilitate.

How does the future look?

- A policy rate cut facilitating an investment boost is expected to complement the recently released 'expansionary' interim budget.
- The developmental and regulatory policy initiatives announced alongside the policy is timely and progressive.
- Notably, there is a proposal to study the offshore Rupee markets and to rationalise the regulations on the interest rate derivatives which would be of special significance to the financial markets.
- However, the Interim Budget has shown some slippage from the fiscal roadmap and projected a budget deficit of 3.4% for both the current financial year and the next.
- So the risk of government borrowing, crowding out private investment demand, remains, which the RBI has to be cautious of.

Source: Business Line, The Hindu