FICCI Comments on Monetary Policy

RBI Finally Recognizes Importance of Sustaining Growth

New Delhi, Oct 25, 2011: As widely expected, RBI increased the repo rate by 25 basis points. Importantly, there was a definite statement of intent from RBI on ruling out further rate increases in December. However, as per FICCI research, WPI based purely on imported inflation items is still higher than the WPI and any further rupee depreciation may result in added inflationary pressures. Therefore, according to Dr Rajiv Kumar, Secretary General, FICCI, “a clearer statement on preventing a rapid depreciation of the Rupee by the Governor would have been specially welcome”. It is heartening to see that RBI finally giving some importance to supply side measures and talking about the need for raising the potential rate of growth through the implementation of structural reforms.

The RBI estimate of inflation rate of 7% at the end of March 2012 could possibly be an underestimation. This is based almost entirely on the expectation that the higher base effect will bring down the inflation rate in the coming months. This may, help to bring down inflationary expectations. “RBI’s strong emphasis on greater fiscal discipline and policy initiatives for removing supply side bottlenecks is very welcome”, said Dr Rajiv Kumar. The Governor has done well to point out that any further increase in government borrowing will neither augur well for inflation nor it will help to encourage growth in private investments.

The deregulation of saving bank deposit rate is a welcome move and it is likely to lead to increased product innovations across banks through more competition. Such a move will also result in more effective transmission of monetary policy impulses. On the flip side, however, it remains to be seen whether the smaller banks are able to effectively compete in the market with larger banks after this move.

The announcement of a 1% subsidy on home loan by the government which came almost at the same time at the Credit Policy announcement will surely help in arresting the further decline in demand for new housing. Overall, FICCI is relieved to see a halt in the cycle of interest rate increases and urges the Government to take further steps that will restore investors’ confidence in coming months.

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