

Monetary Policy in India is Opaque

By

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Monetary policy in India is opaque and stakeholders do not have a clear idea of the measures the central bank plans to use to rein in inflation or if earlier rates hikes have worked, said Gita Gopinath, economist at Harvard University.

“What’s needed is more clear communication from RBI (Reserve Bank of India),” Gopinath said on the sidelines of a panel discussion at the India Economic Summit on the country’s economic outlook. Gopinath was one of the panelists at the discussion.

RBI and the US Federal Reserve have multiple objectives such as spurring growth and reining in inflation. Multiplicity of objectives and the absence of a clear inflation target makes for an unclear policy, Gopinath said.

Though the Federal Reserve functions under similar conditions as RBI, the former’s long institutional history makes it easier for stakeholders to interpret its actions, Gopinath said.

Though RBI does not have an immediate inflation target, the central bank has announced its policies are designed to bring down inflation in the medium term to a range of 4-4.5%.

RBI governor, D.Subbarao, has stated inflation targetting in India does not make sense as there are multiple indices used to track inflation. Moreover, with food and fuel inflation making up a key part of inflation, the central bank is hamstrung in tackling inflation. Price of food and fuel in India are beyond the central bank’s control.

RBI has increased policy rates six times since the second quarter of 2009-10 to combat inflation. Gopinath felt RBI’s policy statements did not give enough information on the outcome of its actions on interest rates over the last year. Moreover, there is not enough information in public domain to indicate how RBI is going to go about bringing back inflation in line with its medium-term target, she said.

In this backdrop there is going to be some skepticism about India’s monetary policy, Gopinath said.

In order to enhance the quality of the central bank’s communication, Subbarao in his 2 November policy statement, gave an indication on interest rates for the next three months. Subbarao said the central bank would keep rate hikes in abeyance for the next three months unless there is an extraordinary situation.

Separately, Subbarao had last year said one of his aims was to enhance the quality of the central bank’s communication with stakeholders.

An expansionary fiscal policy blunts monetary tools which can be used by RBI. Gopinath was apprehensive about the Indian government’s approach to fiscal consolidation.

She pointed out the government should use the current juncture to reform its fuel subsidy program as in the absence of reforms a firm price trend in international crude would have an adverse impact on the size of the fiscal deficit.

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