

Interview request for Al-Jazeera on monetary policy

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15 March 2022 at 21:43

To: Somesh Jha

On Tue, Mar 15 2022 at 06:39:13 PM, Somesh Jha

1. The preamble of the RBI Act mentions that the "primary objective of the monetary policy is to maintain price stability while keeping in mind the objective of growth." There is a clear emphasis on price stability having a predominant objective. However, a reading of the MPC statements ever since the COVID-19 pandemic has hit India gives us a different sense in terms of its approach. The MPC in its statements has time and again stressed upon focussing on economic growth as the predominant objective of setting the monetary policy. What are your views on this – do you think growth has taken precedence over price stability for far too long unlike the actual reading of the RBI Act of 1934?

6. Do you think that the monetary policy's independence is at stake with the RBI stressing on economic growth far more than on price control, which is the primary domain of the monetary policy?

I do not think so. We were hit by a once-in-a-century pandemic, and suffered a growth shock that is unprecedented in the history of modern India. Had inflation been benign, this growth shock would have necessitated a monetary policy far looser than what we had in 2020-21. It is the uncomfortable level of inflation that prevented such a reduction in the policy rate. I have stated in all my dissents that I agree with the current level of the policy rates. The argument in my dissent has been that this growth shock has abated, and the calculus of monetary policy making should change accordingly. The majority believes that the recovery from the pandemic is uneven and not firmly established. The disagreement in the MPC, as I see it, is not about the objective of monetary policy. The MPC has in my view always been acutely conscious of its inflation mandate. The difference of opinion is about the best way to achieve that objective.

2. The RBI has not changed its monetary policy stance, nor has it changed the policy rates even once since the COVID-19 pandemic hit India, especially in the present circumstances when most of the central banks have embarked on a direction of policy rate hikes or have announced a plan to do so in the near future. Do you think that the RBI's role of sovereign debt management is one major factor why the central bank is hesitant to hike the policy rates, or change its monetary policy stance from being accommodative, given the huge borrowing requirements of the government? Do you suggest the responsibility debt management to move away from the RBI for effective monetary policy?

Speaking for myself, the borrowing cost of the government has never been a factor influencing my thought processes in the MPC. Nor do I see debt management concerns being adduced as a reason for the positions of other members of the MPC in their statements. I would like to assume that senior functionaries of the RBI who sit on the MPC have the intellectual integrity and epistemological dexterity to keep their MPC role separate from their RBI roles, and that they would vote in the MPC solely on the basis of the statutory mandate entrusted to the MPC. Moreover half of the MPC consists of independent external members who are not conflicted in this manner.

3. In the August 2021 meeting of the MPC, you said, "While there is some comfort that inflation is forecast to be below the upper end of the tolerance band, it is important to emphasise that the inflation target for the MPC is 4% and not 6% or even 5%. Treating 5% as the target would significantly increase the risk of inflation targeting failures. CPI inflation stayed in or around 4% about 3 years ago. Do you think that this has posed a serious risk for inflationary expectations to be dis-anchored or has it already been dis-anchored? Do you feel that the RBI is no longer targeting 4% CPI inflation and is comfortable with inflation remaining within the band?"

My worry (as articulated in that statement) was about creating an erroneous perception about the MPC's concerns. MPC members have not in their statements abandoned the 4% target, and have instead argued that their position is consistent with that target. However, I believe that clear communication is part of the task of the MPC, and I still believe that a neutral stance would communicate the MPC's commitment more effectively.

4. Experts said that the RBI has been tightening the supply of money through tools other than the repo or the reverse repo rate of late. Do you think this renders the new monetary policy framework in place since 2016 redundant?

I have objected to the schizophrenic behaviour of (a) mentioning the reverse repo rate in the MPC minutes thereby suggesting that the MPC decides on this rate, and (b) claiming that the reverse repo rate is a liquidity management tool that lies outside the remit of the MPC. But excluding the reverse repo rate from the MPC's remit is not a serious constraint on the functioning of the MPC. It would add one more friction in the process of monetary transmission, but the MPC could compensate for this friction as it compensates for other transmission frictions. For example, if the RBI believes that (a) the width of the corridor should be x%, and (b) for liquidity management reasons, money market rates should be close to the lower end of the corridor, the MPC can simply set the repo rate to be x% above what it would like money market rates to be.

5. Do you think that the RBI has been downplaying inflationary concerns by projecting lower levels of inflation, as some experts suspect, and what do you think are the consequences of it, as a result, on the monetary policy framework?

I have repeatedly argued that in the current situation of heightened uncertainty, point estimates of inflation (and growth) are quite unreliable and meaningless. What matter is the range of uncertainty around the point estimate as depicted in the fan chart. These fan charts do indicate high probability of inflation rising to the upper end of the corridor or beyond. Monetary policy acts with long and unpredictable lags, and I tend to approach it from a risk management rather than an optimization perspective. As such the RBI's point estimates have not been an important factor for my decision making.

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