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# 'Time not ripe to signal monetary policy reversal'

COMMENT

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Both the global and domestic economic backdrops suggest that a pivot to domestic monetary policy easing will not come soon.

Globally, measures of consumer and business confidence are rising. Global economy, especially the United States, has shown greater resilience than expected, which means there is less possibility of a further rapid reduction in inflation. The annual American inflation at 3.4 per cent is miles away from the Federal Reserve (Fed)'s 2.0 per cent target and there is no guarantee the target will be achieved soon. Market participants now expect the Fed to lead major central banks (except Bank of Japan), to keep their policies on hold till the end of 2024, as inflation remains persistent. Also, newer risks to global inflation are coming from soaring shipping costs due to a prolonged Red Sea crisis and low water levels in the Panama Canal.

Domestically, growth, especially in non-agricultural segments, is holding firm amid improved macro-financial stability. Headline CPI inflation moderated from 6.4 per cent in Q2FY24 to 5.4 per cent in Q3FY24 and the core CPI inflation from 4.8 per cent to 4.0 per cent. The Reserve Bank of India (RBI)'s continued thrust on 'withdrawal of accommodation' not just improved the policy transmission but also strengthened the 'asset-liability' profiles of lenders, as short-term rates have hardened at a faster pace, prompting lenders to raise funds of relatively longer maturity, and thus improving the average duration of their liabilities.

Of late, there is pressure on the RBI to change the policy stance in its upcoming monetary review, as banking liquidity has been under pressure for over a quarter now. According to some voices, this may slow down the credit growth if RBI does not infuse durable liquidity immediately. However, one needs to look at the real reasons behind the persistent liquidity deficit. These are increased cash withdrawals induced by festival demand, a deceleration in government spending due to fiscal prudence, and a continued mismatch between the growth rates of credit and deposits. As on January 12, non-food credit and deposit growth stood at 19.9 per cent and 12.4 per cent year-on-year (Y-o-Y), respectively, showing a gap of 7.05 percentage points.

RUN-UP TO MPC MEETING

In our opinion, the time is not yet ripe to signal a monetary policy reversal due to the following reasons. While inflation has significantly moderated, it is still way above the RBI's target of 4.0 per cent. Domestic food inflation, especially originating from cereals and pulses, unpredictable global crude prices due to geopolitical stresses, and increased cash in circulation ahead of elections pose significant risks to India's inflation outlook. On the positive side, a fiscally prudent Interim Budget and lower-than-expected net market borrowings for FY25 have brought some respite to interest rates, even without monetary easing.

Many cross-country empirical studies show that 'premature easing' has great potential to reaccelerate the inflationary process. As India's inflation has not yet dropped to its targeted level on a sustainable basis, it will be prudent for the MPC to maintain status quo on the policy stance and rates on February 8.

It is important to highlight that not just the 'growth' but a credible policy mix — that is 'prudent fiscal policy' and 'inflation targeting monetary framework' — have made India an attractive investment destination for global investors.

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