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Literature on central banking tells us that monetary policy will be more effective if it is transparent and credible. By holding the rates as well as the policy stance in today's policy announcement, the Reserve Bank of India (RBI) has achieved both these goals in effect. In his statement, the RBI Governor re-emphasised, "Headline inflation still remains above the target and being within the tolerance band is not enough. Our goal is to achieve the target of 4.0 percent, going forward." Thus, transparency is achieved through the central bank's revealed commitment to a point target of inflation. Credibility is attained when the central bank's actions are consistent with reaching this goal.

According to the Governor, while risks to near-term inflation have moderated somewhat, pressure remains during the second half of the year which needs to be watched and addressed at the appropriate time. The Monetary Policy Committee (MPC) has **lowered its inflation projections for the first two quarters** of FY24 but has not touched the projections for the second half of the year. It sees upside risks to inflation coming from uncertainties around the monsoon, geopolitical tensions, volatility in global commodity prices and also in global financial markets (rupee depreciation). While a likely moderation of inflation in the first half of FY24 has allowed the MPC to keep **the policy rate unchanged in today's meeting,** the likely upside risks to inflation in the second half of FY24 has prompted majority of the MPC members to retain the stance at 'withdrawal of accommodation'.

Avoiding Policy Flip-flop

This reflects the RBI's calibrated approach to monetary policy normalisation. In all probability, this approach will help the RBI avoid the **"policy flip-flop" recently observed in a couple of central banks' actions.** On June 7, the Bank of Canada un-paused and raised its policy rates again by 25 basis points, after having "paused" following the January hike. At that time the pause was widely considered as the end of the rate hikes and a pivot towards rate cuts. The Bank of Canada is now the second central bank after the Reserve Bank of Australia, which had paused in April and un-paused in May and hiked for the second time on June 6.
What is a bit surprising in today's policy is the MPC's relatively higher optimism about growth despite the weak manufacturing activity and the continued skewness in the private sector's investment and consumption spending. Even the Government of India data shows continuation

of a lower pace of project implementation than intentions during FY23 and a declining capacity utilisation rate in many industries barring a few exceptions like electrical equipment, transport equipment, food processing, etc. A narrowing of the trade deficit for India due to faster contraction in merchandise imports than that of merchandise exports is a sign that its manufacturing sector is settling at a lower level of equilibrium. Having said that, the monetary policy's role in the revival of manufacturing investment is limited and its dedicated focus on "price stability" will create conducive conditions for manufacturing investment, going ahead.

Responding To Future Needs

Besides the monetary measures, the RBI today announced several regulatory and developmental measures. For instance, (1) it has decided to allow banks to issue RuPay prepaid forex cards to expand the payment options for Indians travelling abroad. (2) It has decided to streamline the Bharat Bill Payment System processes and membership criteria to enhance efficiency and encourage greater participation. (3) It has decided to expand the scope and reach of e-RUPI vouchers by permitting non-bank pre-paid instrument issuers to issue e-RUPI vouchers. (4) It has decided to widen the scope of the framework for the resolution of stressed assets. Given the increased frequency of extreme weather events and natural calamities, it has decided to rationalise the existing prudential norms on a restructuring of borrower accounts that are affected by natural calamities. (5) It has decided to issue guidelines on default loss guarantee arrangements in digital lending to facilitate the orderly development of the digital lending ecosystem and enhance credit penetration in the economy. (6) It has decided to rationalise and simplify the licensing framework for authorised persons to improve the efficiency in the delivery of foreign exchange facilities to various segments of users, including common persons, tourists, and businesses.

All these measures will not just help in expanding the business and strengthening the balance sheets of lenders but will also help in meeting the emerging requirements of the Indian economy based on digitalisation.

Given the current growth-inflation mix and the uncertain economic outlook, we expect the RBI to remain in the "pause" mode at least until the third quarter of FY24. Also, the monetary policy moves of the major global central banks like the US Federal Reserve and the European Central Bank will weigh on its future policy moves. By keeping everything on hold today, the RBI, in fact, has kept all its options open to deal with the upcoming challenges.

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