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A tightrope walk for RBI

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A great deal of literature in economics is devoted to determining the relative importance of fiscal policy vis-a-vis monetary policy. John Maynard Keynes, whose path-breaking Keynesian economics propounded the use of fiscal measures, once believed that monetary policy or stability of prices was sufficient for the stability of the economy until he saw the prolonged periods of unemployment or the Great Depression, which led him to advocate strongly for fiscal measures.

On the face of it and rightfully so, the Covid-19 pandemic has led us to believe that fiscal policy has a far greater role as compared to monetary policy, in mitigating the after-shocks. For more than a year now, we are witnessing that RBI doesn't have the bandwidth to intervene beyond a point. It can't reach the informal sector directly which is worst affected by lockdown restrictions. It is also incapable of targeting assistance to especially hard-hit sectors of the economy or specific geographic regions. For the past 13 months, the RBI has kept the repo rate at 4%, so as to sustain and revive the GDP growth on a durable basis. World over, the central bankers have kept the stance accommodative in addition to undertaking large scale asset purchases and supporting the small-scale business through discounted lending facilities. India has been no outlier.

The onus for ameliorating Covid-19-induced losses lies largely on the fiscal policy, partly because the intervention if designed effectively, can reach without any lag and is more targeted. We have seen how fiscal measures being implemented in India since March 2020 are coming to the rescue of millions. Examples abound, In-Kind transfers in terms of distribution of food grains free of cost or at subsidised rates, disbursal of urea-based fertiliser at statutorily fixed MRP and non-urea based fertilisers at subsidised rates are already operational. Recently, the finance minister announced a slew of measures that aim to push credit off-take in priority areas such as Health, Tourism, MSMEs etc. by providing interest rate concessions. Further, to provide relief to the MSME sector, an additional Rs 1.5 lakh crore for the Emergency Credit Line Guarantee scheme was announced. All these direct and indirect measures are aimed, not only at ending the miseries of the affected people but also to spur the economy back into action before it can start healing on its own.

However, it would be incorrect and untimely to conclude that monetary policy or the RBI's role has hit the ceiling. The inflation figures are already seeing a worrying trend with fuel prices leading the pack. India's CPI inflation rate, for May 2021, though provisional, points to a figure over 6%, up from 4.3% in April 2021. If the status quo is not altered, it won't be feasible for the RBI to retain the accommodative stance and keep the repo rate unchanged. Post Covid-19, the ball is once again entering the court of RBI. The debt of the households has aggravated over time. Many small businesses are already facing a liquidity crunch and are operating on the brink. Banks or in general financial institutions are in no good position either. Being saddled with the NPAs, banks' balance sheets are even more stressed. An innovative design of deferred payments, moratoriums, easing of interest rates and liquidity support might be required to lighten the burden of the individuals, businesses and financial institutions alike. There is certainly an uphill task for the RBI ahead.

In effect, Covid-19 has made the task for RBI, even more onerous. On one hand, it has to ensure that banks provide the necessary credit to the affected parties and at the same time, ensure that bad loans do not balloon up. Similarly, there is no scope to loosen the measures which have been taken earlier to strengthen the governance of banks or else we stand to repeat the history. Additionally, the RBI has to lift up thousands of medium and small scale businesses in the country through discounted lending facilities, some of which have closed operations. If this was not enough, the RBI has to honour the monetary policy mandate of keeping the retail inflation at 4% with a margin of 2% on either side irrespective of the growth rate pressures. As the new deadly mutants of Sars-CoV-II are emerging on the horizon, the task of bringing the economy back on track might take a hit if another wave strikes India. Indeed, a tightrope walk for RBI ahead.

(The writers are with Indian Economic Service)