

RBI needs to gradually tighten fiscal policy: IMF

PRESS TRUST OF INDIA

NEW DELHI, 12 AUGUST

The Reserve Bank of India needs to gradually tighten monetary policy in view of inflationary pressure due to higher oil prices, increase in kharif MSP and possible fiscal slippages, the International Monetary Fund (IMF) has said.

The report comes within days of the RBI raising benchmark short-term lending rate (repo) by 25 basis points to 6.5 per cent citing inflationary concerns. It was the second such hike in a row.

The IMF said the monetary policy tightening in early June was appropriate and further gradual tightening will be needed.

“The RBI will need to gradually tighten policy further, in response to inflation

pressures, which will help to build monetary policy credibility,” the report said. It noted that headline and core inflation are rising and forecast to be above the mid-point of the headline inflation target band in the near and medium term, raising the probability that adverse shocks could push headline inflation above the RBI’s target range (four per cent, +, - two per cent) and calling for a tighter stance.

“With demand recovering and rising oil prices, medium-term headline inflation has risen to 4.9 per cent in May 2018, above the mid-point of the RBI’s headline inflation target band,” said the Washington-headquartered multilateral lending agency.

As per the IMF, inflation risks are tilted to the upside,

including from higher oil prices, potential changes to minimum support prices (MSPs), exchange rate depreciation, possible fiscal slippages, second-round effects from state-level increases in HRAs, and recently-announced increased import duties.

“Tighter monetary policy will, however, make it more challenging to revive the credit cycle,” it said.

The IMF further said that to enable the RBI to achieve the medium-term inflation target on a sustained basis, continued action to improve the monetary transmission mechanism is needed.

Having established a robust institutional framework for monetary policy, key next steps include enhancing competition in the banking system.