Indian Express editorial

RBI's focus on CPI suggests more rate hikes, which will hit consumption, investment.

While the RBI governor, Raghuram Rajan, has done well to bring in interest rate futures and other policies like credit enhancement for corporate bonds, it is unfortunate that he has chosen to lay more emphasis on the CPI than on the traditional WPI while gauging inflation. The excessive reliance on the CPI suggests that one or more rate hikes will take place over the next six months. The new CPI has several problems in its construction, as a result of which it throws up results that look astounding, given how demand has collapsed in the economy. Indeed, the WPI, the RBI's traditional policy barometer, has been consistently lower than it was for years — it averaged 9.6 per cent in 2011, 7.6 per cent in 2012, and is around 6 per cent now, and that's after the rupee plummeted to record lows. Once you take away food inflation, which monetary policy cannot tackle since it is more of a supply-side issue, manufacturing inflation is very muted, at 2 per cent. Fruit and vegetable inflation has been high because, while demand rose as a result of per capita income increasing by 33 per cent between 2009-10 and 2011-12, supply rose just 5.3 per cent and 12.6 per cent respectively.

If inflation was really in danger of spiralling out of control, the rate hikes would make sense. But unlike in 2009-10, when inflation started to increase, growth rates are now on a declining trend. There is little question of producers being able to pass on costs to consumers. GDP growth averaged 9.3 per cent in 2010-11. In contrast, GDP growth fell from 4.8 per cent in March 2013 to 4.4 per cent in June 2013. Indeed, the RBI has lowered its 2013-14 forecast from 5.7 per cent to 4.8 per cent, and from 6.5 per cent to 5.8 per cent for 2014-15. Even in nominal terms, private consumption has been falling for the past three quarters and investment has been falling for the last two quarters. The magnitude of the fall in nominal values indicates just how serious the growth problem is. Since around 45 per cent of the total investment in the country in 2011-12 came from the household sector, which doesn't have the same access to funds that the private corporate sector has, the impact of interest rate hikes is even more severe.