Comments on: "Monetary policy approaches in India" by Kaushik Bhattacharya

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This interesting and well written paper duly gives credit to the Reserve Bank of India for successfully shepherding the Indian economy through major financial and economic liberalisation while avoiding damaging financial volatility, and for presiding over disinflation and growth acceleration since the mid-1990s. However, the Indian economy is becoming more globalised and its financial markets are deepening. As India is considering further liberalisation of its capital account, it might find it beneficial to move the mechanics of its monetary policy implementation closer to global practices. Irrespective of its formal framework, implementation of monetary policy would, in our view, be greatly facilitated by the development of an effective communication strategy, that would, in effect, make the private sector a partner in the policymaking process.[1] We believe this would entail a better statistical basis, more structured and predictable policymaking, clearer policy objectives, and more market-friendly reporting.

Data

As the paper points out, India does not have a comprehensive measure of inflation, it publishes very little available data on formal labour market conditions and there are no reliable indicators of wages and employment in the informal sector. Other data not currently available that would support policymaking, and stabilise market expectations, include: quarterly data on GDP by demand component; some index of real estate and land prices; more detailed data on the sectoral distribution of domestic credit; and monthly data on consolidated state-level fiscal performance. In addition, India's balance of payments data do not follow the IMF Balance of Payments Manual 5 standard, and there are issues with the coverage of the international trade data.[2]

More structured and predictable policymaking

The RBI has recently moved to four monetary policy statements a year, from two previously. But, as stressed by Governor Reddy, rates can be hiked at any time.[3] For instance, after surprising the market by not hiking rates in April 2006, the RBI surprised again by raising rates between meetings on 8 June 2006. Policy implementation could gain in efficiency if rate decisions took place at preannounced meetings, perhaps held on a monthly basis to reflect India's complex and fast-changing economy. In addition, India does not have a formal monetary policy committee. The establishment of such a committee could increase policy transparency and predictability, which would be further enhanced if the policy setting committee published the minutes of its meetings.

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1 See Ben S Bernanke, "A perspective on inflation targeting", Federal Reserve Board, 25 March 2003.

2 See IMF, "Staff report for the Article IV consultation", Washington DC, December 2005.

3 See "RBI, markets take global clue", *Business Standard*, 12 June 2006.

Clearer policy objectives

The RBI routinely adds to its policy statements the objective of “provision of adequate credit to the productive sectors of the economy”. This is a bit confusing since it could be interpreted as suggesting that monetary policy also targets the credit relationship between banks and their borrowers. Yet financial sector efficiency is more likely to improve through structural policies than through changes in aggregate monetary conditions. Although improving the efficiency of the financial sector is part of the RBI’s mandate as regulator and supervisor, it belongs more to structural than to cyclical policy. As stressed by the paper, the credit objective could be restated as one of supporting medium-term GDP growth.

Stronger demarcation of macroeconomic and policy updates and of structural studies

As highlighted by the paper, the RBI quarterly policy statements are “lengthy and often consist of about 60 pages”.[4] They tend to include a long list of developmental and regulatory measures. Since these are not intended to support the cyclical management of the economy, they could be communicated to the markets in a separate document. This would allow the pace of release of cyclical policy statements to be consistent with the pace of cyclical developments, which tends to be faster than the pace of structural developments. At the same time, as stressed by the paper, macroeconomic projections and modelling that many central banks use as channels of communication with the market are not readily available in the quarterly policy statements. A quarterly macroeconomic report could play a useful role in helping the market better understand the RBI views on the economy and on the monetary transmission mechanism. Finally, the paper also states that the RBI has a long publication list, and that “RBI reports and reviews are often too long”. While the quality of these reports attests to the strength of the RBI research department, they may be more than most market participants can absorb. Communications with the market could be facilitated by a clearer demarcation between in-depth analysis and broader research on the one hand, and shorter, macroeconomic and policy updates on the other.

[4] At the same time, the RBI can also be surprisingly concise. For instance, the 8 June 2006 surprise hike in the policy rate was explained only by “a review of current macroeconomic and overall monetary conditions”.