Q. The MPC framework has performed well in delivering on its mandate. Yet, there are some actions by RBI recently which could be perceived as inimical to the functions of the MPC. Discuss.

Ans: Government of India constituted MPC (monetary Policy Committee) by amending RBI act, 1934 by finance act, 2016 to bring more transparency and accountability in fixing India's Monetary Policy.

* It performed well in delivering its mandate since its is established.

* Objective Measures of MPC
  - Gave transparency and democratic accountability to the process of interest rate setting
  - Brought inflation closer to the target
  - Contributed for tempering house hold inflation expectations
  - Kept borrowing costs at reasonable levels, though economy had distortions.

* Even many rating agencies and institutions mentioned that MPC as a landmark structural reform for macro economic management

* However, Since last year different monetary actions of RBI left MPC decision on policy rate not useful, diluted its monetary decision making.

Reasons for why this happened:

1. Pumping huge levels of money
2. Contradiction in Policy rates between MPC and RBI → Enormous liquidity glut
3. RBIs policy rates not part of MPC resolution

With the intention to improve transmission of monetary policy to households & corporations, RBI pumped around 7 trillion Rs. into Banking system

* This is done by purchasing government bonds & dollars
* Due to impaired balance sheets and economic growth not met satisfactorily, pumping liquidity cannot be a long term measure to address financial sector stress.
* The implication of this measure is casualty of MPC framework

(2) Even when MPC kept policy rates unchanged, RBI injected more money to decrease medium-interest rates which led direct contradiction of each other.

(3) Enormous liquidity glut resulted Banks - excess money to be absorbed by RBI at reverse repo rate which is lower than Policy rate. Even RBI further lowered reverse repo outside MPC meeting cycle. So final net effect was market rates were increasingly controlled by RBI than MPC.

Impact

(1) Pose risks for India's macro economic stability in future.

(2) Supply-chain disruptions - due to measures taken to sustain in covid-19 impact, may raise cost-push inflatory pressures

(3) Can also rise econonomy wide borrowing rates, losses for banks and impact financial stability

(4) Impacts the inflation credibility built by MPC framework

(5) Disturbing MPC's mandated inflation rate of 4%, shifted to upper limit of 6%.

(6) Can Also lead to uncertainity in external sector i.e low bank deposit rates induce some non-resident deposits to exit countries

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* Hence, as it is very unpredictable time, RBI should preserve its inflation credibility.
* So, it should not bypass MPC at changing market rates instead make MPC more enduring.

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