

Fiscal-Monetary Initiatives Should Moderate Inflation

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WE

welcome the Centre's decision to rein in runaway inflation through a series of fiscal initiatives unveiled by Finance Minister Nirmala Sitharaman on 21 st May. These, coupled with Reserve Bank of India (RBI's) double action to fight inflation, should moderate, if not arrest, increase in price indices.

RBI's twin initiatives are: 1) changes in monetary policy to suck excess liquidity in economy announced on 4 th May and 2) periodic release of US dollars from its reserves to slow down depreciation of rupee.

The fiscal initiatives include cut in excise duty on petrol and diesel and proposed changes in taxation of inputs in certain sectors such as steel and petrochemicals. On the expenditure side, additional allocation for fertilizer subsidy and special LPG subsidy for poor have been announced.

We wish all such steps should have been taken at least a couple of months back to soften all-round rise in prices across all spheres of economic activity and depreciation of rupee. It is easy to control fire in the initial stages and difficult to manage when it becomes menacing.

Delay in fiscal and monetary interventions emboldened inflation and falling rupee to get locked in tango. Synchronized play of inflation and Rupee depreciation is nightmarish as both sustain each other. Their snowballing effect creates both short-term and long-term pains for the economy.

As put by RBI Governor Shaktikanta Das at Monetary Policy Committee (MPC) meeting on 4th May 2022,

"Sustained high inflation inevitably hurts savings, investment, competitiveness and output growth. It has pronounced adverse effects on the poorer segments of the population by eroding their purchasing power".

Inflation-led depreciation of Rupee also increases the country's debt burden. This is because we have to generate more rupee resources to repay foreign loans. Factor in here additional requirement for depreciating rupees to buy US dollar-denominated crude oil, liquefied natural gas, coal, edible oils, etc., whose prices have hardened in global markets.

We don't know whether unfolding price rise is as per the inflation forecast by Finance Ministry and Reserve Bank of India (RBI). If so, then it reflects duo's belated concern for the direction towards which prices and rupee are heading.

We urge the Government to launch a holistic action plan, comprising the right mix of monetary, fiscal and political initiatives.

It is high time to protect framework for statutory, flexible inflation targeting. It provides for consumer price index (CPI)-based annual inflation rate of 4% with cap of 6% and lower ceiling of 2%.

Consider the macro-economic fundamentals now. The Wholesale Price Index (WPI) has been in double digits for more than a year. As put by official release issued on 17th May,

"The annual rate of inflation reported 15.08% (Provisional) for the month of April, 2022 (over April, 2021) as compared to 10.74% in April, 2021". According to rating major ICRA, this is highest level since September 1991.

Similarly, inflation rate based on Consumer Price Index increased to 7.79% in April 2022 as compared to 4.23% rise in April 2021. The latest CPI is highest mark recorded since May 2014.

Latest Finance Ministry data shows that Current account deficit (CAD) increased to USD 23.0 billion (2.7 per cent of GDP) in Q3 of 2021-22 from USD 9.9 billion (1.3 per cent of GDP) in Q2 of 2021-22. As put by Ministry's Monthly Economic Review for April 2022, ***"Widening of CAD led to depreciation of Nominal exchange rate, yet the Real Effective Exchange Rate continued to appreciate to more than offset any price competitiveness that a depreciation of nominal exchange rate may have imparted to India's exports"***.

In a report captioned 'Outlook on Current Account Deficit (CAD) and INR' issued a few days back, ICRA says: ***"we expect the trade deficit to widen to an all-time high of US\$ 250-255 billion in FY 2023"***.

The provisional, official data on merchandise export-import shows increase in annual trade deficit to \$192.41 billion for March 2021-April 2022 from \$ 102.63 Billion in preceding year. With this, ICRA has projected India's CAD to widen to 2.7% of gross domestic product (GDP) in 2022-23.

The fiscal deficit (FD) for 2022-23 was at 6.4% of GDP in the Budget presented on 1 February 2022. Fiscal scenario has undergone significant change since then. It is likely to alter more if geo-political uncertainty gets more complicated and enhanced. In all probability, FD would be higher than the target at the close of the financial year. It goes without saying that high level of fiscal deficit is inflationary.

Factor in rise in poverty and unemployment during the last two years. There is thus little to celebrate about economic recovery after easing of pandemic and related curbs on economic activities. As put by RBI's Monetary Policy Report released last month, ***"real gross domestic product (GDP) rose by 8.9 per cent in 2021-22, above its pre-pandemic (2019-20) level by just 1.8 per cent"***.

Rupee, which touched an all-time low at 77.80 to a US\$, has been projected by certain experts to decline further to 78-80 per one US\$ in the coming months.

All this data shows that there is no room for complacency. The State Governments should take a cue from Centre's tax changes and accordingly whittle down their respective value-added tax (VAT) on petrol and diesel.

We urge Prime Minister Narendra Modi to turn battle against inflation into a national mission. For this, PM should consider convening a conference of Chief Ministers to formulate a combined strategy against inflation. The conference should also discuss all supply-side constraints, whose removal can moderate prices of commodities and services. It should also agree to speed up approvals for exploration and production of crude oil, natural gas, coal and coal-bed methane.

Several fossil fuel projects have been delayed for long. This has contributed to increased dependence on energy imports. These turn into import of inflation when global energy prices shoot up and rupee gets into depreciation mode.

Team India also needs to take a political call on centre-state competition to dole out freebies. These increase consumptive expenditure instead of capital expenditure through the Central and State budgets, apart from increasing fiscal deficit.

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