5. Monetary Policy Committee- Economy

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) has decided to keep the repo rate unchanged at 5.25%

Recent Monetary Policy Developments

The Monetary Policy Committee (MPC) has-

1. Revised GDP growth projection for FY26 upward to 7.4% (from 7.3%).
2. Revised retail inflation projection to 2.1% (from 2%).
3. Projected CPI inflation at 4–4.2% in Q1–Q2 FY27, slightly higher due to precious metal prices.
4. Noted continued food price deflation, helping keep headline inflation benign.

These revisions indicate macroeconomic stability alongside sustained growth momentum.

What is the Repo Rate?

The repo rate (repurchase rate) is the interest rate at which the Reserve Bank of India lends short-term funds to commercial banks against government securities.

It is the primary instrument of monetary policy.

Mechanism of Operation

When the repo rate is reduced-

1. Banks borrow funds at lower cost.
2. Lending rates decline.
3. Credit becomes cheaper.
4. Investment and consumption increase.
5. Liquidity in the system rises.
6. Aggregate demand strengthens.

When the repo rate is increased-

1. Borrowing costs rise.
2. Credit demand moderates.
3. Inflationary pressures ease.
4. Liquidity tightens.

Thus, repo rate adjustments serve as a counter-cyclical stabilisation tool.

Monetary Policy Committee (MPC)

The MPC is a statutory body constituted under the amended Reserve Bank of India Act, 1934 (amended in 2016).

Composition

6 Members-

1. 3 from RBI (including Governor as Chairperson)
2. 3 external members appointed by the Government of India

Decision-Making

1. Decisions by majority vote.
2. Each member has one vote.
3. RBI Governor has casting vote in case of tie.

Mandate

1. Maintain price stability.

2. Support growth while keeping inflation under control.

The MPC meets at least four times a year (in practice, bi-monthly).

Flexible Inflation Targeting Framework (FITF)

India adopted the FIT framework in 2016.

Key Features

Inflation target set every five years by Government in consultation with RBI.

Current mandate (until March 31, 2026)-

1. Target CPI inflation- 4%
2. Tolerance band- ±2%
3. Acceptable range- 2%–6%

Rationale

1. Anchors inflation expectations.
2. Enhances credibility of monetary policy.
3. Reduces discretionary decision-making.
4. Improves transparency and accountability.

Failure to maintain inflation within the band for three consecutive quarters requires RBI to explain corrective measures.

Reasons Behind the Recent Policy Decision

Resilient Growth Momentum

1. Strong domestic consumption.
2. Income tax relief measures.
3. GST rationalisation.
4. Capital expenditure push under Union Budget.
5. Stable rural demand and services growth.

India's growth remains among the highest globally.

External Sector Uncertainties

1. Geopolitical tensions.
2. Volatile crude oil prices.
3. Divergence in global interest rate cycles.
4. Potential capital flow volatility.

A cautious stance safeguards exchange rate stability and capital inflows.

Inflation Within Target Band

1. Headline CPI within 2–6% band.
2. Core inflation remains contained.
3. Food deflation offsets global commodity pressures.

This reduces urgency for immediate rate changes.

Impact of Trade Agreements

India has signed trade agreements with-

1. United States
2. European Union
3. Oman
4. New Zealand

These agreements may-

1. Boost exports.
2. Attract FDI.
3. Reduce trade barriers.
4. Strengthen supply chains.
5. Support medium-term GDP growth.

Impact on the Indian Economy

Impact on Borrowers and Households

1. Stable EMIs for home and auto loans.
2. Predictable interest cost environment.
3. Reduced financial stress for middle-class households.

Impact on Investment and Credit Growth

1. Policy stability encourages private investment.
2. Corporate borrowing decisions become predictable.
3. Banking sector credit growth remains healthy.

Macroeconomic Stability

1. Reinforces credibility of inflation targeting.
2. Signals institutional maturity.
3. Enhances investor confidence.
4. Supports sovereign ratings stability.

Risks and Structural Concerns

Despite positive outlook, risks remain-

1. Imported inflation through oil shocks.
2. Global financial tightening spillovers.
3. Currency volatility.
4. Supply chain disruptions.
5. Climate-related food inflation risks.

Way Ahead

Strengthening Monetary Transmission

1. Ensure banks pass on previous rate cuts to borrowers.
2. Improve transmission through MCLR and external benchmark-linked loans.
3. Enhance competition in banking sector.

External Sector Management

1. Active liquidity management.
2. Adequate forex reserve buffer.
3. Calibrated exchange rate flexibility.
4. Monitoring global monetary cycles.

Fiscal-Monetary Coordination

1. Continued fiscal consolidation.
2. Targeted capital expenditure.
3. Avoid excessive deficit financing.
4. Maintain debt sustainability.

Structural Reforms

1. Improve supply-side capacity.
2. Strengthen agricultural logistics to reduce food inflation volatility.
3. Boost manufacturing under PLI schemes.
4. Deepen bond markets.

Strategic Assessment

The current policy stance reflects a calibrated approach-

1. Growth remains strong.
2. Inflation is within target.
3. External risks persist.
4. Institutional credibility is preserved.

India's monetary policy currently prioritises-

1. Stability over aggressive easing.
2. Anchored inflation expectations.
3. Gradual support to growth.

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