Rate cut on the cards

That's all very well, but it should translate into broad-based recovery

It is expected that the Monetary Policy Committee under the chairmanship of Urjit Patel will cut repo rates tomorrow. The reasons are not far to seek. The *Economic Survey* has hinted that the impact of demonetisation cannot be brushed aside. The Budget, while trying to balance fiscal consolidation and stimulating selective sectors, may just have an underwhelming effect. Therefore, the onus will be on the MPC to pick up the tab. It was expected to lower rates two months ago, when the immediate effects of demonetisation were being acutely felt. However, the MPC opted for a status quo on the repo rate, which now stands at 6.25 per cent, citing inflation concerns arising out of commodity prices. Still, it was perhaps just as perturbed by the possible impact of a rate cut on FII investors in debt, and hence the exchange rate, particularly in the context of the Fed likely to change course through 2017. Now it is perhaps clearer that the economy needs a push, with gross credit outstanding as on December 23 down to 5.1 per cent year-on-year, the lowest growth rate in many years. Credit growth was in the region of 9 per cent prior to the demonetisation exercise. External uncertainties may only increase in later months, reducing the scope to cut rates.

The RBI's Industrial Outlook Surveyfor Q4 of 2016-17 "indicated a decline in business sentiments", both in terms of "demand condition" and "pressure from rise in cost of raw material". With capacity utilisation in industry at 73 per cent for over two years, it would seem that the demand constraint in the economy is considerable. That perhaps explains why a 175-basis point reduction in repo rate since January 2015 has not helped spur credit growth and investment. The immediate effort now should be to at least restore credit growth to pre-November 8 levels. While banks have slashed rates on fresh loans in 2016, and more so in the wake of demonetisation after being awash with funds, the benefit has gone to the well rated corporates, home loan takers and at best a few MSMEs. A rate cut may signal banks to lend at lower marginal rates and correct the prevailing skew.

Sectoral trends in bank credit tell a story. Gross credit outstanding to industry as a whole was down by 4.3 per cent as on December 23, over the figure in the same period last year. Within this segment, credit to micro and small industries had fallen 8.2 per cent, while in the case of medium and large industries the decline was 7.9 per cent and 3.5 per cent. However, the services and personal loans sectors (both accounting for about 20 per cent apiece of total bank credit, with industry accounting for 40 per cent) posted a growth of 8.3 per cent and 13.5 per cent, respectively. The bias in favour of personal loans does not seem to have set off an economic revival. The MPC should look into these aspects.