Moody’s cautions against curbing RBI autonomy on policy rates

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Moody’s Analytics, an economic research unit of Moody’s Corp, also raised a red flag over the Parliament logjam and said it is denting business confidence as key reform bills like land and GST are stuck.

A revised draft of the Indian Financial Code calls for creation of an interest rate-setting panel, where majority of the seven members will be nominated by the government.

While the earlier version of the code gave RBI Governor veto power over panel’s decision, the revised draft does not confer any such powers on him.

“We believe that a government-elected panel undermines the RBI’s independence. Moving to the new model would severely dent the RBI’s competency: Credibility would be lower, politics would drive decisions, and transparency would be reduced.

“Overall, we believe that tampering with the central bank’s independence would make it difficult to anchor inflation expectations. This would weigh on India’s economic prospects, particularly financial market stability,” Moody’s Analytics said in a report.

It said India’s monetary policy, with Governor Raghuram Rajan at the helm, has been effective.

The report titled– India’s Outlook: Waiting for Reforms to Fuel Growth– said inflation has fallen, external accounts have improved, and the economy is poised for further rate cuts.

Terming the measure as a “dangerous road ahead”, it said “a recent draft bill could undo the RBI’s good work.”

It, however, hoped that given the criticism of the draft Indian Financial Code bill, it is unlikely to pass Parliament.

Talking about reform measures of the Government, Moody’s Analytics said: “India’s political infighting is denting business confidence. Without a majority in the Upper House, the ruling Bharatiya Janata Party’s power has been nullified and the opposition has blocked proposed reforms”.

Key reforms such as the land acquisition bill, flexible labour laws, and the goods and services tax have failed to pass Parliament. “Given the political seesaw, these are unlikely to be delivered until later this year or even 2016,” the report said.

The land acquisition bill is a catalyst to investment, it said, adding passing the bill will improve Indias business environment by speeding up the conversion of land for infrastructure use. Foreign firms are wary of investing in India, as lengthy delays in acquiring land tend to stall projects.

Moody's Analytics is the economic research analysis unit of Moody's Corporation and is independent of Moody's Investor Service, the credit rating agency of the US-based firm.

It also also projected India to grow 7.5 per cent in 2015, although lack of private investment and could derail medium to long-term growth prospects of the country.

"India's negative output gap is showing little signs of closing in 2015. Though the economy has been in a cyclical upswing since late 2014, it has failed to gain broader momentum. Green shoots are slowly emerging, but the government's failure to deliver promised reforms is the major impediment," Moody's Analytics said.

"We expect at least one more benchmark rate reduction in 2015 to complement the 75 basis points already delivered this year. Accommodative monetary policy will lift GDP to 7.6 per cent in 2015, increasing to 8 per cent in 2016..," it said, adding India's true potential GDP growth rate lies somewhere near 10 per cent".

It cautioned that there are "signs that not all is well for manufacturing, the key industry touted by the BJP to drive India's growth engine." It said Purchasing Managers' Indexes have dropped for both manufacturing and services in the past several months.

"The reform vacuum is largely to blame," it said.

It said despite a lack of reform, credit growth is likely to accelerate in the coming quarters due to lower interest rates and commercial banks are starting to pass on the RBI's rate cuts. The RBI has cut rates by 0.75 per cent since January.

"We believe the RBI will cut interest rates again this year. There could be two more 25-basis point rate cuts in 2015. Subpar economic growth justifies interest rate cuts on the demand side. A number of supply-side developments also favour lower interest rates," Moody's Analytics said.

(Financial Express)