

**ANALYSTS' VIEW**

Business Standard

**Rate cut would have fuelled asset markets**

**R**BI governor Dr Reddy has rightly chosen to maintain a status quo on policy interest rates despite tremendous pressure from several corners to cut rates. Institutional credibility of RBI relative to other central banks has been on a rise and this policy will only improve its image. Expectations of a rate cut increased due to an inter-meeting cut of 75 bps by the US Fed, heightened uncertainty in the global markets and signs of moderation in economic growth particularly reflected in exports, rate sensitive sectors and bank credit. Closer look at growth drivers suggest economy likely to grow at or above 8 per cent in CY 08.

With money supply growing at over 22 per cent and commodity prices remaining elevated, inflation is likely to surprise on the upside over the next few months.. Structural reasons suggest that barring a scenario of deeper recession in US than feared by the market, global commodity prices are likely to remain steady. RBI has been on a mission to bring down long term inflationary expectations and it cannot afford to squander the gains

accumulated over the last few years. Asset markets might be disappointed in the short term, however, central bank's resolve in bringing down inflation expectations will ultimately be far more positive for every asset in the longer run.

Rising rate differential between US and India were also cited as justification for a rate cut by RBI. I think a rate cut would have fuelled a rally in asset markets leading to higher capital flows than the other way round. If capital flows pick up due to aggressive Fed easing and RBI were to do another CRR hike, it would be very inappropriate to decrease rates (price of money) now and then decrease quantity of money later.

We all know how difficult it is for monetary policy makers to carry or nurse a triplet (handling capital flows and managing inflation and exchange rate). RBI gets full credit for managing it deftly so far in an increasingly challenging environment.

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