Planning an exit out of the easy money regime

The Reserve Bank of India (RBI) embarked on an extraordinary expansionary policy to manage the financial pressures unleashed by COVID-19. It slashed policy interest rates aggressively, flooded the market with an unprecedented amount of liquidity and instituted a slew of measures for targeted assistance to especially distressed sectors.

Must be a deliberative process

As we see spring shoots in the economy, the RBI must be planning for a non-disruptive exit out of the easy money regime.

The challenges that the RBI will confront on the way out

1. By far the biggest challenge will be to manage the tension between restraining inflation and supporting the recovery. This is a policy dilemma even when the macroeconomic situation is benign; the pandemic, shrouded in unusual uncertainty, has made the dilemma much sharper.
2. Inflation remained above the RBI's target band for the past several months, and according to the RBI's own estimates, is expected to remain above the band for the next several months.
3. Yet, the MPC decided against any rate action out of concerns for growth and financial stability. The MPC expects inflation to soften on its own in the weeks ahead as supply chains, disrupted by the lockdown, normalise, and the bumper winter crop comes into the market.

Inflation, Revival and Employment

1. That outcome is not inevitable. Inflation could be pressured upwards by several factors. There is the risk that persistently high inflation expectations would result in food inflation getting more generalised.
2. Equally, there are concerns that the recovery, for all the positive signals, is still fragile. It has also been uneven and unequal, with large industries finding their foothold while small and medium enterprises and the entire informal sector continue to be in distress.
3. And there is heightened concern about an aggravated unemployment problem caused by big firms retrenching labour to cut costs.

Plight of savers

Quite apart from the upside risks to inflation and downside risks to growth, the RBI should also be concerned about the plight of savers who are being shortchanged by low-interest rates at a time of high inflation. All these concerns taken together make a complex cocktail of dilemmas for the RBI as it seeks to normalise the policy rates.

The Trinity

Another big challenge for the RBI going forward which will be to restrain the rupee from appreciating out of line with fundamentals. Here, the RBI is confronted with a classic case of 'the impossible trinity' — of keeping doors open for capital flows while simultaneously maintaining a stable exchange rate and restraining inflation. Maintaining a policy balance across all three conflicting objectives can be tricky.

Conclusion:

It is better to be rough right, as Keynes said than be precisely wrong. That should be the guiding principle for RBI as it navigates its way out of the crisis-driven easy money policy.

The front seat in electric mobility

The progression to electric vehicles is important for India because such vehicles are sustainable and profitable in the long term. Reducing dependence on crude oil will save the government money, reduce carbon emissions, and build domestic energy independence. Besides being an economically and environmentally viable option, India's transition to electric vehicles will allow us to fine-tune our infrastructure. This will also influence India's foreign policy as our energy security dependence will shift from West Asia(Oil) to Latin America(Lithium Reserves).

Shift to electric vehicles

1. Under the 'Faster Adoption and Manufacturing of Hybrid and Electric Vehicles' and its updated (Fame 2) version, the government has allocated $1.3 billion in incentives for electric buses, three-wheelers and four-wheelers to be used for commercial purposes till 2022, and earmarked another $135 million for charging stations.

2. Besides these incentives, a proposal for a $4.6 billion subsidy for battery makers has also been proposed by the NITI Aayog. These policies are embedded with the vision to have 30% of electric vehicles plying the roads by 2030.

E-vehicles and Foreign Policy

1. Developing domestic battery manufacturing capacity may fundamentally change India's relationship with resource-rich Latin America as the government plans to buy overseas lithium reserves.
2. Latin America's famous lithium triangle that encompasses lithium deposits under the salt flats of northwest Argentina, northern Chile, and southwest Bolivia hold about 80% of the explored lithium of the world. In Latin America, most of the production comes from Argentina, Chile, and Bolivia.

Scouting for mineral assets

1. Khanij Bidesh India Limited (KABIL) will scout for strategic mineral assets like lithium and cobalt abroad for commercial use and for supplying to meet the domestic requirement for battery manufacturers.
2. At present, India's lithium-ion battery demand is fulfilled by imports from China, Vietnam, and Hong Kong.
3. In the last two years, India has had a growing appetite for lithium-ion batteries, and so, lithium imports have tripled from $384 mn to $1.2 bn.
4. Notably, the government has intercepted this growing demand from its incipience. With its policy intervention to support battery manufacturers by supplying lithium and cobalt, this industry is more likely to grow domestically to support India's goal to switch to electric mobility.
5. The Indian government's initiation to take the front seat in electric mobility and preemptive action to send a high-level delegation to have a precise understanding of the availability of lithium and possibilities of joint ventures will supply domestic markets and drive international markets.
6. Most importantly, this will be a long-term solution to clean our cities, build new markets, and skill people for new jobs towards an 'Atma Nirbhar Bharat'.

Additional Facts for Prelims:

Interestingly, lithium is also used as a drug to treat bipolar disorder and is soon becoming the metal to treat a world polluted by excessive carbon emissions.