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Bank of India

NEW DELHI, Jan 21: The decision of the Reserve Bank of India (RBI) to increase the bank rate and cash reserve ratio (CRR) to further tighten the dear money policy heralded by the new governor Bimal Jalan, evoked diametrically opposite response from economists. While one has approved of the RBI steps stating that the containment of the value of rupee should be the most immediate task of the central bank, the other opined that the set of measures would push back the industrial recovery process and fuel inflationary pressure.

According to J D Agarwal, director of the Indian Institute of Finance, industry was "trying to make a mountain out of a molehill" by harping on the high interest rates. The most important task before the finance ministry and the RBI was to check the falling value of rupee which was the root cause of many an economic evil, he added. Agarwal suggested more steps in this regard pleading for restrictions on forward trading by foreign exchange dealers to arrest speculation. Arguing that the rupee should be pegged around Rs 35-36 per dollar, he said RBI should do everything within its means to keep the value of rupee below Rs 40 per dollar.

For S P Gupta, director-general of ICRIER, the measures announced by the RBI "have distorted the priorities of the country". The foremost task before the finance ministry and the Reserve bank should be to facilitate industrial recovery. The RBI, he added, "has moved in the wrong direction." According to Gupta, the "internal value rupee was more significant than the external value of rupee." He held the view that by increasing the bank rate and the CRR, the RBI would not be able to stop depreciation of the value of rupee. At most, these measures would only provide temporary relief to the sliding rupee.

Agarwal, on the other hand, opined that the banks, which were flushed with funds, had started speculating in the foreign exchange to earn quick profits. "They are doing it to show results", he added. The dear money policy, according to him, would dissuade them from speculation in the foreign exchange market. This would be the direct result of imposing higher CRR. Secondly, he said, it was also

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necessary for the RBI to simultaneously increase the bank rate. He argued that higher interest rates would prompt the banks to maintain profits as larger funds would be locked in the CRR. Apart from positive fallout on the forex market, Agarwal said that CRR increase would help the government to contain inflationary pressure. He argued that about Rs 2,000 to Rs 2,500 crore would be pumped into the system on account of forthcoming general elections. Hence the CRR increase would mop up equivalent amount of liquidity from the system arresting the inflationary spiral, he added.

However, for Gupta higher interest rates would fuel inflationary expectations. He argued that inventories were piling up and there was sluggish demand for manufactured goods. Hence the inflation was not demand-pull. On the other side, high interest rates would add to the cost of finished goods and the inflation would be cost-push.

He added inflationary expectations have started strengthening with likelihood of a poor agriculture performance and now high cost of capital would further added to the worsening price situation.

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