Quantitative Easing in Indian Scenario

Monetary or fiscal policy is the backbone of the country's economy. A sound monetary policy acts as an osmosis regulating the balance of the domestic viz viz the international currency. Fiscal policy affects macroeconomic stability, growth, and income distribution. Citizens expect their governments to ensure value-for-money for public spending, a fair and efficient tax system, and transparent and accountable management of public sector resources.

Monetary dynamics in India are a very unique one. A trend has been noted that in spite of the subprime crisis, India remained nearly unaffected. If Indian fiscal status did get affected it was only due to the recent heightened prices of the crude oil purchases and gold to a certain extent. Another contributing reason being the low exports and large inflation leading to the widening of the CAD. Though today we see that the inflationary tendencies are under control and the CAD is in a better position, however only due to decreasing crude oil prices . India's export combativeness shows a very feeble growth and at the same time weak contribution to the fiscal deficit. Recently , there are also reports predicting a higher sovereign rating to India which can be a valued precursor to the inflow of foreign investments into India. However, keeping in tune with all these positive foot prints at the country level economics , we see that the activity on the ground level is hardly in pace with the national marathon on growth. Primarily because of the weak capital available to businesses to pump in the necessary infrastructure and at the same time poor public investment in transport and communication infrastructure, cost of importing a certain item of certain weight from UAE is 10 times lower in transporting the same from a port in Mumbai to Nagpur. In conditions such as these promotion of manufacturing in India and export of the same seems illogical. Along with these, administrative reforms and judicial reforms, are the two fundamental challenges that need to be changed.

There are debates on improvising the fiscal policy to be in tune with the International standards and adopting fiscal procedures upon the suggestions of the IMF. The IMF being the leading source of fiscal policy and management expertise worldwide which also monitors and analyzes global fiscal trends and advises IMF member countries on fiscal issues directly.

Fiscal measures such as Quantitative easing have been prescribed to be adopted in the Indian context. QE is a relatively simple process in developed economies as they have a very strong bond market. But the problem with QE is that the Central Bank doesn't know when to apply brakes to it. The fact of just stopping the QE creates panic in the markets, which is evident nowadays when all the economies are anticipating a rate hike by Federal Reserve.

So inflation is only a monetary phenomenon (Milton Freidman) for the developed economies and it can be controlled by having a strict monetary policy. While the Indian side of the story is that inflation is not purely a monetary phenomena but majorly linked to supply constraints. Another problem is that the policy rates in India are not the transmission rates unlike in the US.. So changes in policy rates come with a major lag and may not in most of the cases affect the base rates of banks. As base rates by the Indian banks are calculated on average principle rather than marginal principle .This makes QE tough to have an effect on the economy because only interest rates can't affect the investors sentiments, there are several other factors that determine their level of investment. If it does have an effect then in case of India the inflation, if not controlled, will be far tougher to deal with. Thus, it is difficult for easing out capital to Indian business at a competitive rate even when the RBI brings about a cut in the interest rate.

It has been the IMF's prerogative to stabilize economies of the countries and stop the negative effect of downfall of one on the other. This is done by IMF by easing out capital requirements to the weakened economy on low interest rates. One benefit is that governments are able to borrow money cheap and the addition to their debt is limited to mainly the principle amount and addition to the debt in the form of interest is limited.

However, it becomes very important for IMF and the weakened economy that the low interest loaned capital reaches the sector where the same invested will trigger growth. Sixty percent of the Indian population resides in villages and unfortunately no attempt is being made to enhance transport and communication infrastructure and make it a most important agenda of rural development. It is unfortunate that either the IMF suggested or the

Indian government thought it imperative to make Smart Rural India as the slogan campaign instead of 100 smart cities. Digital India efforts which are being done since 25 years now require restructuring because it is based on old silos. Today we need cloud computing, open source software through low cost models and all of that requires total revamping of the system, and nobody is prepared to do it.

Another issue with fiscal policy is that most of the currencies are pegged with the dollar. Dollar represents strength of the US economy thus acting as a conduit to spread distress if in one, to the connected economies. Though there are increasing practices to have country to country currency link up such as the Iran India pact on crude oil sale on rupee value. The growth in such political decisions have not been an encouraging one. The probable issue being the strong importance of dollar in the economy. Last time, when Fed announced in 2013 that they were planning to withdraw stimulus in phases, it created a knee-jerk reaction in the global financial markets. The countries which had twin deficit, saw their currencies depreciating very sharply within a few weeks. Only when Fed communicated to the world its intention, did the markets stabilize. Similar trend was observed, when analysts expected Fed to raise interest rates from Sep 2015. But Fed communicated saying that despite conditions were ripe for US to raise interest rates, in the interest of the global economy and financial markets, the decision was being postponed. Every economic expert says that if US raises the interest rate, it will affect the world. There was also monetary easing in Europe, Japan and now in China. Despite all, these, every one gives more importance to the policy action from US.
This has raised volatility in markets again, this year expecting, US to raise interest rates.

The crisis witnessed from 2008, was unique and for the first time, there was a synchronized slow down across the world. Of course, countries like India and China were able to weather the storm. The developed countries used all the conventional Monetary and Economic Policies and since there was no end in sight for the trouble, they had to resort to Unconventional Monetary policies. The governments have played a major role in bringing some stability to the economies. IMF also acted in concert and trying to find a feasible solution to end the troubles. But so far, the efforts taken by all the authorities did not meet the expectations when these policies were introduced. There are views that IMF should advise countries to shun the Unconventional Monetary policies.