Q&A: Gita Gopinath, Professor of Economics, Harvard University

'10 per cent inflation means the economy is overheating`

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Gita Gopinath, Professor of Economics at Harvard University, says the monetary policy in India is not transparent and it would be nice to know very clearly from the central bank what steps it has to control inflation and what impact the rate hikes had on controlling inflation. Excerpts from an interview with *Vrishti Beniwal*:

Why do you think that the monetary policy in India is not very transparent?
India, like the US, does not want to have a very strict inflation target because it wants to respond to both inflation and growth. Then it becomes quite unclear what the central bank is doing. The US economy has a long history of sound monetary policy to a great extent, barring a few exceptions. The world thinks that the US Federal Reserve will not tolerate inflation of more than 2 per cent. So there is communication happening constantly and that tells markets what to expect. So a clear communication is needed from the Reserve Bank of India (RBI) also that 10 per cent inflation is not good and it doesn't want that. It should also make a clear statement on where it is going to be and what tools it has to bring it down.

We have seen six hikes in last six months. Was the monetary action inadequate?
First the RBI needs to figure out that if there were six hikes how did that show up in the inflation? We have not communicated well how these rate hikes have translated into controlling inflation, because it is still very high. If this has not worked, then you need other kinds of intervention such as controlling credit expansion in the economy. I think it is fair to be skeptical about another rate hike.

The RBI needs to communicate whether there is a need for a 25 basis-point hike or even more. It seems like there is more information on fiscal policy than on monetary policy in India.

While inflation is high, industrial output has not been very high. So how will RBI set its priorities?
The question is whether the RBI can do much about industrial production at this point. When you see inflation at 10 per cent, you see an overheating economy. Some part of it is food inflation, but it is showing up in the wholesale price index and the consumer price index. So at this stage, to go out and do more expansionary monetary policy so that you can stimulate industrial production is not required.

How do you see capital flows in India panning out? Is it time to put curbs on some flows?
Now is the time to act, because things can change very quickly for the reason that we are growing now and in the rest of the world interest rates are low. This means that people want to send money to India. This is what comes alongside with the boom in emerging markets. Secondly, India has to keep an eye on the kind of capital flows that are coming in. To the extent possible, make it more long-term. Make sure that it does not fuel a real estate boom, which is usually a sign that there are not many good investment opportunities in the economy.

Do you think this is the time for the Indian government to withdraw the stimulus?

All temporary stimuli that were put in place during the global recession should be withdrawn. Certainly, it is not sustainable. It is not good to have a high deficit in a growing economy. There are many areas where it can cut the deficit, like fuel subsidies — and especially diesel and kerosene — because global oil prices are going to go up again. The other thing I find hard to understand is the proposed Food Security Bill, which is expanding food subsidies to a larger chunk of the population. It makes sense for the Unique ID to become operational before you expand something like this.