Some Policy Inferences

- **(1) Government is going to run a consolidated fiscal deficit of at least 7 per cent in the medium term**
- **(2) the size of the G/GDP ratio is not going to change downward (ill say why I think so).**
- **(3)Monetary policy management can/should take these as parametric.**

- **RBI should, therefore, focus on liquidity management policy and credit policy to enable and facilitate access to domestic savings by the private sector subject to the prior claim of government on public savings to bond finance it's fiscal deficit**
- **interest rate targeted solely and exclusively at securing a stable rate of inflation, consistent with the lower bound constraints on the inflation rate that arise from the (known) G/GDP ratio and the (my assumed minimum) 7 per cent level of bond financed fiscal deficits.**

- **Improvements in the productivity of public spending (including eliminating the revenue deficit), as and when they occur, would positively impact the maximum level of growth that can be achieved consistent with these levels of deficit financing.**

- **The growth rate, and the growth-inflation trade-off, therefore, should not concern RBI in the delivery of its inflation control and liquidity and credit management mandates.**

- **It follows, from this, that interest rates should not (because, given my propositions regarding the parametric nature of the fiscal deficit and theG/GDP ratio, they cannot) be set with private sector needs for loanable funds in mind.**

- **On this score the RBI can do much better by delivering sound and private sector friendly liquidity management and credit policies.**

- **Likewise increases or decreases in savings rates should be viewed as impacting liquidity and private credit, and not growth.**

- **Even if the fiscal deficit reduces, as long as the size of the G/GDP ratio is constant, the only change will be in the proportion of G that is tax financed.**

- **This is unlikely to impact RBI policy, in any major way, as the impact of such on the savings rate is the only relevant consideration for the Central Bank, and this has already been factored in.**

- **Finally, the above policy assignment will only work if and when the RBI is not distracted by trying to impact the exchange rate, a distraction which is undesirable and, more importantly, one which the RBI cannot effectively address with the macro instruments at its disposal, given the current policy on sovereign external borrowing and foreign portfolio investment , and the contemporary state of global financial markets**