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Govt should act to improve quality of capital inflows

IN ITS LATEST MONETARY policy review, the Reserve Bank of India (RBI) has reiterated the focus of its policy on containing inflationary pressures. At the same time, it has acknowledged that its role in containing inflation is limited to preventing a generalised spread of inflationary pressures. The remedy for high inflation is no longer solely in the central bank's purview. A larger concerted effort needs to be made by fiscal authorities to ensure permanent solutions to structural supply-side bottleneck issues.

The upcoming Budget should, hopefully, contain more measures on this front. In my view, a sustained high level of structural inflation could jeopardise the economy's medium-term growth prospects. RBI has highlighted that the composition of capital inflows into the country needs to shift towards long-term commitments such as foreign direct investment (FDI). We expect the government to act towards improving the quality of capital inflows by speeding reforms on the FDI front.

While the prolonged liquidity deficit situation and the consequent spike in short-term borrowing costs will result in margin pressures, the steady pace of monetary tightening is not likely to significantly impact capex and investment demand, at least at this juncture.

The corporate sector's increased demand for growth capital is reflected in healthy annual growth in flow of resources to the sector and strong credit offtake. However, we need higher government spending in productive, capital-intensive projects to solve the dual problems of systemic liquidity deficit, as well as to ensure momentum in the infrastructure development. The quality of government expenditure will be under greater scrutiny in the time to come.