The 'impossible trinity'

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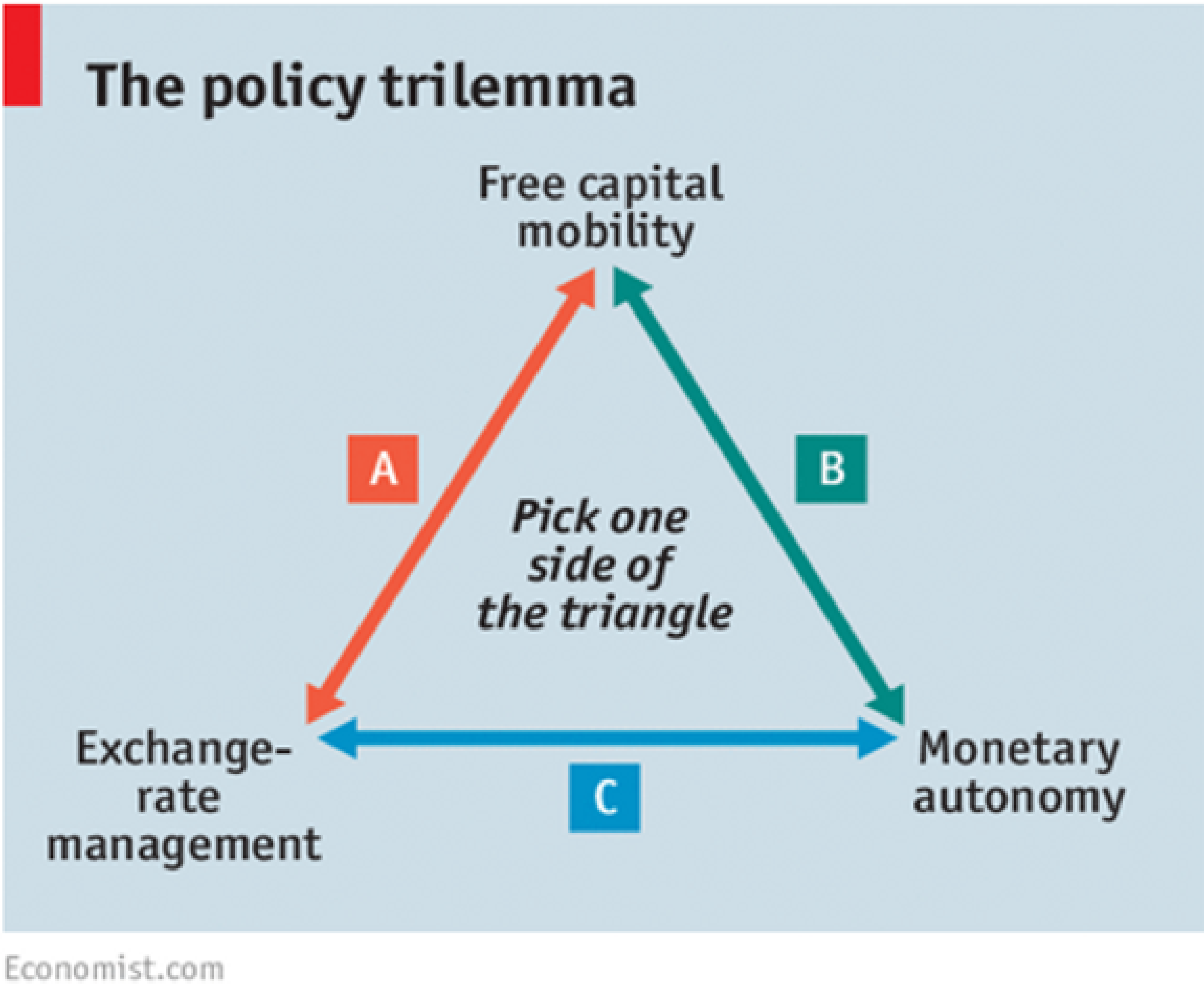
The Reserve Bank of India (RBI) currently faces the **problem** of the “**impossible trinity**”.



[ref-quantum advisors]

About the 'impossible trinity':

- It is a theory that states that a country **cannot** have 1. **Free capital flow** (no capital controls), 2. **Fixed or stable exchange rate**, and 3. **Independent monetary** policy, **all at the same time**.
- An able **policymaker** can, at best, achieve **two** of these **three** objectives at any given time.
- **Concept given by**: John Marcus Fleming and Robert Alexander Mundell
- It is also known as the "**trilemma**".
- It describes the **inherent challenges** countries face when trying to simultaneously achieve **three specific policy** objectives related to their **exchange rate** and **capital flows**.

India's monetary policy:

- India is reluctant to **increase** the **Repo rates** due to the fear of causing a **recession**.
    - **Repo rate** is the rate at which **commercial banks** borrow money from the central bank of a country.
- A **lower interest rate** signifies a flight of **capital** (shares) back to the **US**, leading to **depreciation** of the Indian rupee.

Other key facts:

- The **increase** in **imports** in **India** from **China** due to a stronger rupee against **Chinese Yuan** will place enormous **downward pressure** on the rupee.
- **Capital controls** can seldom withstand **pressure** on the rupee from different macroeconomic factors for long period.
- **Cheaper yuan** as compared to an **expensive rupee** will make China’s **exports more competitive** in the global markets and will threaten **India’s domestic market** as Indian products will be replaced by **more affordable Chinese** export goods.

