Business Standard

RBI keeps rates unchanged: Don't expect miracles till March 2018

Unless inflation falls very sharply or growth slumps, will there be a reversal till March 2018

Madan Sabnavis December 06, 2017 Last Updated at 15:51 IST

RBI

The MPC quite expectedly has maintained a status quo on rates this time and the indication is that there would be no rate cut this year till March. This conclusion can be drawn from the fact that the forecast for the rest of the year for inflation has been put at 4.3-4.7per cent. The view on liquidity also appears to be fairly straightforward given the surpluses that are there in the reverse repo window. Hence, an unchanged stance is what one can expect unless there is a serious reversal of the fundamentals.

The Report rightly highlights the latent inflation potential in the economy which has also started resurfacing. Starting with food prices which have shown an upward movement, the crude oil price uncertainty adds to the pressure on the index. The kharif crop has been low for pulses and oilseeds which though not prodigious can push up prices at the margin. Onions and tomatoes continue to play truant with the index and hence would have to be monitored closely. While they do not influence or get influenced by interest rates, they affect the singular target that the MPC is to look at.

Curiously, the RBI also continues to highlight the demand pull forces which are emerging which go beyond higher input costs. First is the issue of fiscal slippage, which could result due to the GST reductions as well as loan waivers. Second, the HRA component of CPI would continue to show an increase in the coming months. This additional power should in effect actually be good for demand, but would be inflationary.

However, the call on GDP growth remains unchanged and hence the 6.7 per cent GVA number has been retained. The inference here is that the extra demand emanating here will be more inflationary rather than a demand booster.

What does this mean for the markets? The GSec yields will continue to be elevated in the region of 7-7.10 per cent unless inflation moves in a contrary direction, which seems unlikely. The rates had firmed up after the earlier policy when a similar hawkish tone was assumed in the communication.

Second, maintenance of interest rates at the current level is also good for FPI inflows which is useful from the point of view of forex reserves and will help to keep the rupee strong. With US rates likely to be increased, there was the fear of FPI flows slowing down to EMEs including India. In fact, with the current account likely to widen such flows will help to firm up the rupee. This may not be a good sign for exports as a stronger rupee could come in the way of a significant improvement.

Third, the investment cycle will still continue to be contingent on the demand conditions which have shown some signs of recovery in the last two months. However, unless the capacity utilization rates improve and the NPA issue of banks gets in the mood of resolution, the demand and supply for credit would still be moderate.

The policy hence clearly takes a stance on both inflation and growth and believes that the right way to go is for a neutral stance. Unless inflation falls very sharply or growth slumps, will there be a reversal till March 2018. This can be the main takeaway.

Madan Sabnavis is a Chief Economist, CARE Ratings. Views expressed are personal.

Chief Economist, CARE Ratings