BANKING

Inflation Tolerance: Why RBI's Interest Rate Move Is Sparking Debate

The Reserve Bank of India's decision to keep the repo rate and reverse repo rate unchanged has divided economists and financial experts into two camps.

A man checks his phone outside the Reserve Bank of India (RBI) headquarters in Mumbai, India, April 5, 2018. Photo: Reuters/Francis Mascarenhas/Files

99acres
Yug Heights
Escalate Your Living
2 BHK Apartments
at SHILPHATA
₹ 49.99 Lakh onwards*
RERA: P51700014553

Kaushal Shroff

Listen to this article: 00:00 07:46

BANKING ECONOMY 11/FEB/2022

Mumbai: At a time when inflation is fast becoming a threat in the global macroeconomic theatre, the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) opted to keep the repo rate and the reverse repo rate unchanged.

The RBI kept the repo rate as it is for the 10th time in a row at 4%, signalling that it will "continue with an accommodative stance as long as necessary to revive and sustain growth on a durable basis" in order to mitigate the damage caused by the pandemic.

The MPC's decision has divided economists and financial experts into two camps. While one is ardently supporting the decision given that India's consumption levels are still to take off meaningfully, the other is criticising it on grounds that the central bank will be forced to revisit its inflation projection considering the rapidly spiralling out-of-control commodity prices.

Also read: What Does the Future of RBI's Inflation Targeting Look Like?

Five members of the MPC voted to continue with the accommodative stance as long as neces rate at 4%, the reverse repo rate at 3.35 standing facility and bank rate at 4.25% Varma of IIM Ahmedabad expressed reservations on continuing with the accommodative policy stance.

99acres
HEIGHTS
Escalate Your Living
2 BHK Apartments
at SHILPHATA
₹ 49.99 Lakh onwards*
RERA: P51700014553

Pro-growth

ICICI Securities welcomed the MPC's decision of maintaining the status quo saying that the "RBI policy was better than market expectation in terms of no rate hike and maintain (sic) accommodative liquidity stance. The focus of RBI continues on reviving growth and not dampening market sentiment by continuing its overall dovish stance".

RBI's dovish stand is underscored by its assessment that inflation is likely to moderate in the first half of FY23 and proceed along the projected trajectory giving the MPC "room to remain accommodative".

The central bank is projecting inflation at 5.3% for FY22 and at 5.7% for Q4FY22. The banking regulator is estimating CPI inflation for FY23 at 4.5% provided that the monsoon doesn't play spoilsport. Inflation for the four quarters of FY23 has been projected to be 4.9%, 5%, 4% and 4.2%, indicating that the RBI is more optimistic than central banks around the globe – especially the Federal

Reserve – which has come to terms with the reality that the inflation is far from transitory.

Edelweiss Wealth Research termed the growth" while cautioning that inflation will remain a key monitorable.

"Contrary to consensus, the MPC continued to maintain the status quo on rates as it indicated that normalisation in monetary policy is growth-dependent and recovery is still nascent. High inflation is expected to be transitory, with CPI expected to fall to 4% by H1FY23. RBI also acknowledges that monetary tightening by global central banks and higher crude/commodity prices could be challenges in formulating the domestic policy… Overall, a pro-growth policy announcement, unlike other global central banks, with domestic recovery the key focus," Edelweiss Wealth Research said.

Lakshmi Iyer, CIO (Debt) & Head – Products, Kotak Mahindra Asset Management Company, heartily greeted the MPC's announcement saying that the decision will boost positive sentiments in the bond markets.

"The perfect V-day gift to bond markets was delivered on P-day. No change in rates or stance is a big boost to sagging bond prices and a much-needed respite. No major worries on the inflation front as well. FY 23 inflation forecasts at 4.5% also seem absolutely fine for yield. This coupled with the current liquidity situation calls for anchoring of bond yields and expect positive sentiment to revive in bond markets in the near term," Iyer said.

Taking a nuanced stand, Crisil Research contended that it expects RBI to start raising repo rate from the next fiscal and that it sees the central bank pushing up the repo rate by 25 bps each three times this year with the first one kicking off in April.

“Monetary policy remains inclined towards supporting
growth. The RBI believes it has space t
accommodative based on the expectatic
inflation will stay within its target rang
growth recovering from the brief impact of the third Covid-19 wave and becoming more broad-based next fiscal, the RBI could soon turn towards managing rising risks from external factors. Surging crude oil prices pose a risk to major macros in the Indian economy, including inflation. The US Federal Reserve is expected to raise rates six times in 2022 – the fastest pace since the 2008 Global Financial Crisis. Given this, we expect the RBI to start raising the repo rate next fiscal. We foresee three rate hikes of 25 bps each, with the first move in April,” Crisil said in its note.

Care Ratings on the other hand does not expect any policy rate hike till the first half of FY23. In its note, Care Ratings flagged the risk of higher crude prices as a roadblock to continuing with the accommodative policy.

“This policy was being closely watched for signals of a shift in policy stance and the potential timelines for change in policy rates given the global inflationary upswing and financial tightening that is underway in the advanced economies. The RBI has indicated that it is likely to continue with its accommodative policy stance well into FY23. In doing so it is taking comfort from the expected downward inflation trajectory for the coming fiscal. The risk here, however, is of global crude oil prices rising,” Care Ratings said.

Inflation focused?

Others, including Samiran Chakraborty and other economists of Citigroup, pointed out in a note that the RBI’s MPC dovish stance will likely cause the monetary policy to fall behind the curve.

In its note, the economists said that "short tenor rates will likely struggle to recover from overwhelming dovishness", whereas long tenor rates will "fear of larger quantum of cumulative hikes due to the delay to get on with it (interest rate hike)".

Suyash Choudhary, head of fixed income at IDFC Asset Management Ltd, also noted that "RBI's defense that it is not behind the curve comes from their own rigorous analysis and forecast on the likely inflation trajectory ahead.

"This assessment is markedly different from most of the private sector forecasts. It is then a matter really about who turns out to be right on the assessment eventually."

Anubhuti Sahay of Standard Chartered Plc and other economists said that they expect RBI to revise its benign inflation projections at subsequent meetings "as input price pressures are yet to be passed on to the economy", adding that sans a correction in commodity prices "achieving the FY23 inflation target of 4.5% will be challenging".

1 Support The Wire ₹2400 once

The founding premise of The Wire is this: **if good journalism is to survive and thrive, it can only do so by being both editorially and financially independent.**This means relying principally on contributions from readers and

concerned citizens who have no interest other than to sustain a space for quality journalism. For any query or help

I would like to contribute

Once | Monthly | Yearly

Select amount

₹200 | ₹1000 | ₹2400 | Type an amount

Continue

2 Add contact details

3 Review & Pay