Monetary policy view

A repo hike by fiscal-end

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Monetary policy across major central banks remains more yoked to growth than inflation at this juncture. Friday's move by the Monetary Policy Committee (MPC) of the Reserve Bank of India to stand pat and accommodative shows it sees inflation as transitory.

Indeed, that's the case on the supply side. But unlike advanced countries such as the US, inflation in India is over a high base and in spite of weak demand.

Companies have already begun passing on rising input costs to consumers to protect margins. The MPC will have to keep its eyes peeled on prices in the coming quarters.

But with the clamour around prices getting louder, the MPC has also, like many others, raised its inflation forecast to 5.7% for the current fiscal from 5.1% in June.

As expected, the RBI has kept India's growth outlook unchanged at 9.5% for this fiscal. Together with external demand, it sees domestic drivers of consumption and investment gaining traction.

While CRISIL also projects the same number, the upside and downside from here hinge on how the vaccinations and a third wave of the Covid-19 afflictions pan out.

In the recent past, the RBI's focus has been more on making its extant policy more effective by facilitating flow of credit to the worst-impacted segments where easing financial conditions do not percolate sans a nudge from it, or through guarantees by the government. Friday's move is a continuation of that stance, through Targeted Long-Term Repo Operations and extension of forbearance.

The transition from low interest rates and easy financial conditions to post-pandemic normalcy can be a bumpy one. The RBI is trying to smoothen the process by gradually draining excess liquidity through variable reverse repo rate operations.

Another read-through is that the RBI feels economic recovery must continue to be supported by low interest rates and conducive financial conditions.

But with recovery expected to gain momentum in the second half of this fiscal, and inflation remaining elevated, we expect tightening down the road.

The US Federal Reserve is expected to begin tapering by the end of calendar 2021, further reducing scope for the RBI to continue its present policy stance.

We expect a 25 basis points repo rate hike (to 4.25%) by the end of this fiscal.

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