Prudent increase: on RBI's rate hike

The decision by the Reserve Bank of India’s Monetary Policy Committee **to raise benchmark interest rates again by 25 basis points** is a prudent one. This is the second successive rate increase in as many months, a response to mounting uncertainties on the inflation front. Continuing volatility in crude oil prices, the recent softening notwithstanding, and its vulnerability to geopolitical tensions and supply disruptions is one of the main risks to the inflation outlook. Among the RBI’s other concerns are volatile global financial markets, possibilities of fiscal slippage at the Central and State levels, the likely impact of the increase in the minimum support price for kharif crops, and the staggered impact of upward revisions to house rent allowance paid by State governments. Rainfall has so far been 6% below the long-period average and deficient over a wider area than last year — more than a fifth of the country’s 36 sub-divisions have reported shortfalls. This has resulted in a drop in the total sown area under kharif. The monetary authority has flagged the need to keep a close watch on rain over the remainder of the season, given the risks regional imbalances may pose to paddy output and CPI inflation. The June round of the RBI’s own survey of household inflation expectations reveals that families see prices hardening even further over both the three- and 12-month horizons. Domestic economic activity having strengthened to a point where the output gap has ‘virtually closed’, manufacturers polled by the central bank have reported higher input costs and selling prices over the April-June quarter.

The portents could not be clearer. With retail inflation having accelerated to 5% in June, the RBI has revised its projection for CPI inflation in the second half of the current fiscal year to 4.8%, from the June forecast of 4.7%, and now sees price gains accelerating to 5% in the April-June quarter of 2019. Policymakers on the MPC have understandably spotlighted the risks to the domestic economic rebound from global developments. While rising trade protectionism threatens to impact investment flows, disrupt global supply chains and hurt all-round productivity, depreciations in the value of most currencies against the strengthening dollar have rippled through many major advanced and emerging economies, spurring inflation across these markets. The MPC’s primary remit is to ensure that retail inflation stays firmly within a band of 2-6%, and preferably anchored at 4% over the medium term. So there is no room to quibble over the committee’s majority decision to raise borrowing costs while retaining a ‘neutral’ policy stance. With inflation widely accepted as a hidden tax on the poor, the containment of price gains justifiably ought to be the *raison d’etre* of monetary policy.