In inflation's shadow: on RBI holding repo rates at 6%

The Reserve Bank of India's decision to keep the **repo rate unchanged** was no surprise given the focus with which the Monetary Policy Committee has approached its mandate: of keeping inflation in check. With the relevant measure of price gains, the Consumer Price Index, reflecting an acceleration in inflation for a sixth straight month in December, and that at the fastest pace in 17 months, the bank's rate-setting panel must have had little difficulty in choosing to remain on hold. This was probably best exemplified by the reversal in stance of the six-member panel's hitherto most dovish member, Ravindra H. Dholakia, to vote to stand pat on interest rates. This the MPC did while retaining a 'neutral stance', which gives it the flexibility to change gears in either direction. The RBI's nominee, Michael Debabrata Patra, in fact voted to head off incipient price pressures by raising the policy rate by 25 basis points. Laying out the factors informing its decision, the RBI once again spotlighted the less than reassuring outlook for price stability. For starters, "an unusual pick-up in food prices in November", combined with a "less than usual" softening in the winter seasonal food price moderation, meant headline inflation averaged 4.6% in the third quarter. The RBI had in December made a projection for inflation in the range of 4.3-4.7% in the six months through March 2018. With pump prices of petrol and diesel having risen sharply in January, the RBI has now been forced to raise its estimate for retail price gains in the fourth quarter to 5.1%.

Extending the time horizon beyond the current fiscal, the **inflation scenario** gets even more worrying. Clouding the outlook are multiple uncertainties. These include the staggered impact of HRA increases by various State governments that may induce second order effects on prices; the pick-up in global growth, a factor the RBI also cites as a positive for the economy, that may push up crude oil and commodity prices worldwide; the Budget's proposed changes to the minimum support price norms for crops as well as the proposals to increase customs duty on a range of goods; and the fiscal slippage, which could not only fan inflation but also risks increasing borrowing costs. The normalisation of monetary policy by advanced economies could spell a decisive end to global 'easy money' conditions and may trigger some flight of capital from emerging markets including India. The upshot is that the RBI sees CPI inflation hovering in the 5.1-5.6% range in the first six months of the new fiscal before moderating to 4.5-4.6% in the second half, subject to a big assumption: a normal monsoon in 2018. Under the looming shadow of inflationary risks, the RBI has again reasserted the need for unwavering vigilance on the price stability front.

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