Pre-emptive strike: on RBI's repo rate hike

At the end of an unusually long three-day meeting, the Monetary Policy Committee of the Reserve Bank of India opted for a **hike in key interest rates by 25 basis points** — the first such increase in four and a half years. This hike, the first during this NDA government's tenure, was approved unanimously by the six-member committee, citing worries about hardening inflation trends and a firming up of growth recovery at home. Global uncertainties affecting emerging markets in particular have played a role as well — be it rising tensions over trade wars initiated by the Donald Trump administration or the strengthening dollar or further rate hikes by the Federal Reserve that could strengthen the exodus of global capital from **emerging markets such as India**. Already, between January and May, outflows from foreign portfolio investors have reached their highest level in 10 years, and by June 4, $6.7 billion was pulled out on a net basis from the domestic capital market. The rupee, along with other emerging market currencies, is hurting too, but RBI Governor Urjit Patel dismissed suggestions that the rate hike was a bid to stem outflows. The MPC, he asserted, is driven purely by its inflation management mandate, and there is no contradiction between the rate hike and the committee sticking to its neutral policy stance.

To be sure, while retaining its **growth projections for 2018-19 at 7.4%**, the MPC has revised upwards its inflation projections for the year since its April meeting — from 4.7-5.1% in the first half and 4.4% in the second half to 4.8-4.9% and a significantly higher 4.7%, respectively. This should worry a government gearing for parliamentary elections next year. Though seasonal food inflation spikes are delayed, input cost pressures have hardened owing to a spurt in global commodity prices, led by fuel. Moreover, inflationary expectations among producers as well as consumers have gathered steam. Crude oil prices have been the biggest factor at play, rising 12% from $66 a barrel when the MPC met in April to $74 a barrel. The committee said this rise is "sharper, earlier than expected and seems to be durable", and termed it a major upside risk to its earlier inflation projections. Industry has expressed concern, but effective borrowing rates and bond yields had been firming up even before this rate hike. The government has, surprisingly, welcomed the RBI's stance as one that could help steady the markets and dampen uncertainties. The RBI's neutral stance, as Mr. Patel pointed out, allows it to keep all options open. But a reversal in rates is unlikely till global headwinds clear up and the mandarins in New Delhi work out a viable strategy to minimise the inflation transmission from global oil prices that is exacerbated by their taxation policy for fuels.

The new biofuels policy is high on ambition, but success will depend on the details

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