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INEVITABLE INCREASE: THE HINDU EDITORIAL ON RBI'S INTEREST RATE HIKE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The penny has dropped. After stubbornly holding off from acting to tame inflation, which has steadily eroded consumers' purchasing power and derailed broader economic momentum, the RBI's rate setting panel on Wednesday announced an 'off-cycle' increase in benchmark interest rates. The Monetary Policy Committee voted to raise the policy repo rate by 40 basis points to 4.4% with immediate effect. RBI Governor Shaktikanta Das rationalised that letting inflation remain elevated at current levels for too long risked 'de-anchoring inflation expectations' and consequently hurting growth and financial stability. While Russia's invasion of Ukraine and the subsequent western sanctions on Moscow have roiled the outlook for prices on a range of commodities, including wheat, edible oil, crude oil and coal, Indian households' perception and expectations of inflation have been running well above the RBI's upper tolerance threshold of 6% for more than two years. That the RBI has been forced to act now, after insisting that price pressures were 'transitory', is a belated yet welcome acknowledgment that the economic costs of failing to anchor price stability can potentially be far more deleterious to growth than a relative decrease in the availability of low-cost credit. To cite Mr. Das: "Sustained high inflation... hurts savings, investment, competitiveness and output growth. It has pronounced adverse effects on the poorer segments ... by eroding their purchasing power."

In explaining its decision to raise borrowing costs for the first time in 45 months, the MPC has acknowledged that the overall outlook for inflation has darkened considerably since it met last month. Prices are on a tear globally and inflationary pressures are broadening worldwide. The IMF last month posited that the war in Ukraine was poised to not only slow global growth in 2022 but would also cause inflation to accelerate by 2.6 percentage points to 5.7% in advanced economies this year, and spur a more appreciable quickening of 2.8 percentage points in the case of emerging market and developing economies. With central banks in advanced economies led by the U.S. Federal Reserve pursuing a path of policy normalisation, the prospects of volatility in capital flows adding pressure on the exchange rate and consequently heightening the risks of imported inflation have also surely queered the pitch for the RBI. The fact that the novel coronavirus is still lurking and it could trigger a fresh wave of infections, as seen in China, adds considerably to the uncertainty. Monetary authorities have also rightly pointed to the impact that the increases in domestic pump prices of petroleum products have had on inflation. The onus is now squarely on the RBI and fiscal authorities to move in lockstep and take every possible measure including cutting fuel taxes to keep inflation from running away and landing the economy in stagflation.

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