

Reserve Bank of India keeps rates on hold

Slow growth and upward inflation trajectory provides little leeway for the RBI policy in either direction



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6% RBI repurchase rate

As expected

No surprises here

As widely expected, the Reserve Bank of India's Monetary Policy Committee (MPC) voted 5-1 for a stable monetary policy at their meeting today. One MPC member remained in favour of a policy rate cut.

Upward inflation trajectory

Inflation remains in the driving seat for the RBI's rate policy.

But today's statement reflected concerns about private consumption recovery. And highlighted risks of continued upward inflation trajectory in the near-term as a result of higher food and fuel prices, administrative measures such as the hike in housing allowance for central government staff and waivers of farm loans in some states, rising inflation expectations, and above all, the possible widening of the fiscal deficit due to reforms.

The MPC revised its forecast range for CPI inflation in the second half of fiscal year 2017/18 to 4.3-4.7% from 4.2-4.6%.

Weak policy transmission mechanism

Hopes remained pinned on the recapitalisation of public sector banks in boosting credit and GDP growth.

However, as the RBI's Deputy Governor Dr Viral Acharya noted in a speech recently, weak balance sheets hinder the transmission of rate cuts to the real sectors of the economy via the credit channel. There was no change to the central bank's 6.7% growth forecast for the current financial year ending in March 2018.

Expect on-hold RBI in 2018

While equities sold off in a knee-jerk reaction, there was little impact on the currency and the government bond markets. We remain of the view that slow growth and upward inflation trajectory provide little leeway for the RBI policy in either direction. We forecast an on-hold policy throughout 2018.