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RBI's move not unexpected but a late remedy as inflation will continue to stay high, say experts

"There is all the possibility that inflation could go up to 7 per cent and the cost of credit could go up," Madan Sabnavis, Chief Economist at Bank of Baroda said, reacting to RBI's repo rate hike

While the effects of the Reserve Bank of India (RBI) repo rate hike effected on Wednesday led to the markets showing their displeasure and rate-sensitive sectors like banking, automobiles, and real estate being upset at it for slowing their recovery, academicians and experts of the subject are far from surprised and believe it's actually a move that has been made a little too late.

Dr. M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, and a former member of the 14th Finance Commission, feels that we react too late to the situation and that in view of the elevated prices of crude oil and continued supply-side bottlenecks in addition to continuation of COVID curbs, the increase in inflation is imminent.

He said that such a delayed move by the RBI will only see India's inflation continue to trend above 6 percent for the rest of the year.

"All these are likely to have a secondary impact on inflation, which will remain elevated above the upper limit of the target at least in the first two quarters of FY23. Therefore, the action on policy rates and managing liquidity are imminent, and the increases in the repo rate and CRR in an unscheduled manner represent the urgency to anchor inflation expectations," he said.

"This heralds the increase in the rate cycle, and as the inflation is likely to remain elevated beyond the upper bound of the target, we expect a 1.5% to 2% hike in the policy rate in the current fiscal," he added.

Dr. Rao said that the RBI's decision to call for an unscheduled meeting of the MPC to address the inflationary concerns emanating from geo-political factors, secondary effects of supply disruptions, global commodity prices, and tightening monetary policy in advanced countries on inflationary expectations shows the sensitivity of the central bank towards maintaining macroeconomic stability.

"We are actually too late in taking steps. In April, the food inflation was 6.99 per cent and is now expected to be 7.4 per cent. The inflation rate has shot up and we are only trying to accommodate all the time," the Bengaluru-based economist said.

The overall view among experts is that the RBI's twin actions of both increasing the policy rate and withdrawing liquidity through the CRR are timely and a move that gives a clear signal.

"It also shows that the RBI is sensitive to anchoring inflationary expectations to ensure macroeconomic stability while ensuring adequate liquidity to revive economic growth in a calibrated manner," Brickworks Ratings said.

Academician and policy analyst Dr Manoj Kamat termed the RBI's move as a good one and something that should have happened earlier as its peers had already done it the world over. "The issue of EMI impact is not really huge. It has a 0.5 per cent effect and that too is temporary in nature. A loan horizon is of 10-15 years and interest rate corrections will be done further so that will provide relief as we go ahead," he said.

Dr. Kamat observed that this was done by other banks around a year back. "We are four quarters late. But the move will help us in removing excess liquidity from the markets. Lower inflation rates in the coming days will offset the pinch," he said.

Madan Sabnavis, Chief Economist at Bank of Baroda, however, warned that exogenous shocks will not be mitigated as the rate hike by RBI will control excess demand pressures. "There is all the possibility that inflation could go up to 7 per cent and the cost of credit could go up," he said.

Senior economists predicted that inflation was not set to ease despite anticipated further rate hikes. "The RBI could raise a further 100 basis points for the rest of the calendar year. Price pressures will persist above 6 per cent through most of the rest of the calendar year," they warned.