THE WEEK

How do experts see interest rates panning out post RBI status quo

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Borrowers can heave a sigh of relief as the Reserve Bank of India left key interest rates on hold, while also maintaining an accommodative monetary policy stance, signalling that it is not going to be in a hurry to reverse its easy money policy unleashed when the COVID19 pandemic hit.

RBI's status quo was also a relief to bond markets; bond yields which had hardened to over 6.9 per cent post the Union Budget announcement cooled to around 6.72 per cent on Thursday.

RBI's continued dovish stance is in stark contrast to major global central banks, which are increasingly tightening their policies amid surging inflation. RBI's decision to hold rates is based on two factors – 1. it believes after peaking in the current quarter, inflation will moderate and 2. domestic consumer demand remains lacklustre and below pre-pandemic levels.

The central bank had widely been expected to keep the repo rate on hold, but several economists had felt that it would raise the reverse repo rate and thus start normalisation of the liquidity corridor. But, that too didn't happen. The repo rate stayed at 4 per cent and the reverse repo rate also remained unchanged at 3.35 per cent.

A key reason to keep the policy interest rate at historic lows longer is to spur a more durable rebound in private consumption, said Prasenjit Basu, chief economist at ICICI Securities.

"India did not massively boost monetary growth during the worst phase of the pandemic (as the US Federal Reserve, European Central Bank and Bank of England did), so there is less need for the RBI to roll back monetary accommodation," said Basu.

Brent crude oil price is trending over $90 a barrel, which will have an impact on India's current account deficit and also inflation. In the US, the Federal Reserve is expected to raise its benchmark rate by at least 4 times this year amid surging inflation.

In the past, the RBI has raised policy rates during periods of rising crude oil prices. For instance, there was a cumulative repo rate hike of 150 basis points in 2010, 225 bps in 2011 and 50 bps in 2018, noted DK Joshi, the chief economist at CRISIL. He believes that RBI will have to begin normalising its monetary policy from April.

"Through today's policy, the RBI showed domestic factors remain its primary concern, and that it can chart a different policy trajectory relative to other advanced economies such as the US. However, we believe domestic inflation, too, could face upside risks from surging crude oil prices. In addition, firms can increase pass-through of cost pressures to consumers as demand strengthens over the coming year," said Joshi.

He expects the RBI to raise the repo rate by 25 bps each three times, bringing it to 4.75 per cent by the end of March 2023, which will still be lower than the 5.15 per cent seen just before the pandemic.

On the other hand, the expectation of inflation moving within the monetary policy committee's upper range provides scope for the continuation of the accommodative policy stance, feels M Govinda Rao, chief economic advisor, Brickwork Ratings.

"However, the forecast on inflation is highly dependent on normal monsoon and stability in international commodity prices, including other domestic factors like demand and supply situation," said Rao, who was a member of the 14th finance commission.

RBI's accommodative stance indicates it is willing to wait longer to see growth becoming durable and sustainable, said Indranil Pan, the chief economist at Yes Bank.

"RBI may be able to hold back repo rate increases for longer and may not have any compulsion to follow global central banks unless their actions have any severe implication on the US Dollar/Rupee rates," said Pan.

Still, he expects the central bank to raise the repo rate twice in 2022-23.

Niraj Kumar, chief investment officer at Future Generali India Life Insurance feels upside risks to inflation may have been downplayed by the MPC.

"Belying the market expectations of a reverse repo rate hike, MPC has continued with its effective stealth tightening by way of variable rate reverse repo (VRRR) and has chosen to preserve its ammunition for later, and play the waiting game for now," said Kumar.