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GLOBAL ECONOMICS
| FLASH REPORT

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Reserve Bank of India Refrains From Tightening Monetary Policy, For Now

- **The Reserve Bank of India (RBI) left the benchmark repo rate unchanged at 6.50% following its bi-monthly monetary policy meeting that concluded on October 5.**
- **The RBI changed its policy stance from "neutral" to "calibrated tightening", implying that the pause will prove temporary.**

The RBI is taking a break from monetary tightening. Following the scheduled three-day policy meeting that concluded today, the benchmark repo and reverse repo rates were left unchanged at 6.50% and 6.25%. The decision was against the consensus—and our—expectation of a 25 basis point (bps) hike. Five out of six members of the Monetary Policy Committee (MPC) voted in favour of status quo, while one member voted for a 25 bps rate increase. The RBI had raised the policy rates at the two previous meetings in June and August. The change in the MPC's policy stance from "neutral" to "calibrated tightening" indicates that further hikes are in store. We assess that the RBI will likely raise the policy rate by 25 bps following the next monetary policy meeting on December 5.

Today's decision not to tighten monetary conditions implies that the RBI is not overly concerned about the recent depreciation of the Indian rupee; instead, the RBI is prioritising financial sector stability in the midst of elevated shadow banking sector stress. Indeed, India's headline inflation has eased in recent months, giving the RBI some breathing room to focus on maintaining adequate levels of liquidity in the system in order to stabilize the financial sector. Moreover, the pause in monetary tightening supports the economy, which is still at the early stages of economic recovery following disruptive reform implementations over the past two years. Nevertheless, given that the RBI is signalling a hiking bias with its hawkish policy stance implies that the MPC continues to give high priority to preserving policy credibility vis-à-vis the central bank's inflation targeting mandate.

Indian headline inflation weakened to 3.7% y/y in August from 4.9% two months earlier, thereby dropping below the midpoint of the RBI's target range of 4% ±2%; weaker price pressures allowed the RBI to tweak its inflation forecasts slightly lower, yet the central bank continues to expect a gradual rebound in inflation over the coming months. Meanwhile, Indian core inflation remains elevated at close to 6% y/y. In line with the MPC's hawkish "calibrated tightening" stance, we continue to observe carefully the development of the following upside risks to inflation: 1) ongoing financial market volatility and the associated depreciation of the Indian rupee; 2) households' rising inflation expectations; 3) elevated crude oil prices; 4) higher input price pressures in the manufacturing sector; 5) below-average rainfall during the monsoon season (June–September) and its potential impact on food prices; 6) the central government's decision to implement minimum support prices for certain crops; 7) potential fiscal slippage ahead of the 2019 general election; and 8) higher housing rent allowances given to government employees. Against the backdrop of substantial upside risks to inflation, the recent easing in price pressures will likely prove a temporary phenomenon. Accordingly, we expect the headline rate to close 2018 at 4.0% y/y and to pick up over the course of 2019.

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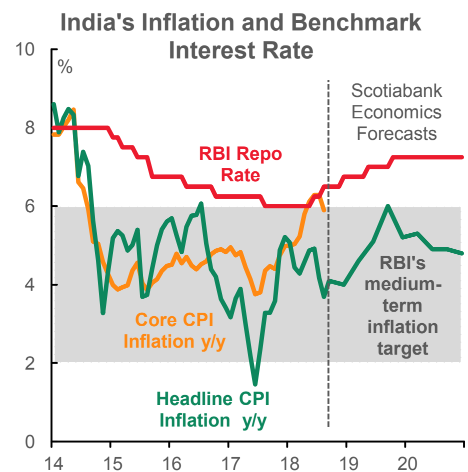
Chart 1



Sources: Scotiabank Economics, Bloomberg.

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