Reserve Bank of India Surprises By Keeping Interest Rates On Hold

- **The Reserve Bank of India left its benchmark interest rate unchanged at 5.15% on the back of inflationary concerns.**
- **Accommodative monetary policy stance was maintained; we expect further monetary easing in early 2020.**

The Reserve Bank of India (RBI) surprised market participants today by leaving the benchmark repo and reverse repo rates unchanged at 5.15% and 4.90%, respectively. The decision follows five consecutive interest rate reductions between February and October, totalling 135 basis points (chart 1). There was an unanimous agreement within the six-member Monetary Policy Committee (MPC) to leave interest rates on hold while maintaining an "accommodative" monetary policy stance.

Despite India's current weak economic growth momentum that highlights the need for continued stimulus efforts, the MPC decided to pay more attention to the country's recent inflation dynamics. Higher risks related to the economy's inflation trajectory were the key reason for taking a break from monetary easing. India's headline inflation accelerated to a 16-month high of 4.6% y/y in October, surpassing the midpoint of the RBI's annual inflation target of 4% ±2%. The pickup was largely due to a surge in food prices that reflects an erratic monsoon rainfall. Meanwhile, core inflation remains contained (the core CPI eased to 3.4% y/y in October) on the back of weak demand-driven price pressures. RBI Governor Shaktikanta Das pointed out that while the pickup in headline inflation is expected to be transitory, the MPC would like to have greater clarity on inflationary developments before stimulating the economy further. Indeed, Governor Das emphasized that the RBI's primary objective is inflation-targeting. The MPC identified various factors that will influence India's inflation outlook: 1) prices of vegetables and other food items; 2) rising inflation expectations by households; 3) volatile domestic financial markets; 4) weakness in domestic demand and its impact on core inflation; and 5) international oil prices. Moreover, Governor Das also pointed out that the Union Budget for FY2020–21 (April-March), to be unveiled in early February, will provide greater insights regarding the Indian government's future fiscal initiatives, which will impact the economy's inflation and growth prospects.

The MPC noted the current weakness of the Indian economy. Indeed, the country's real GDP grew by only 4.5% y/y in Q3—the slowest pace since early-2013—reflecting muted consumer spending and fixed investment growth. While policymakers expect the economy to recover over the coming months, the RBI lowered the FY2019–20 real GDP growth forecast sharply, from 6.1% y/y to 5.0%. Recognizing the need for accommodative monetary conditions, the MPC assesses that there is monetary policy space left for further interest rate reductions. Governor Das also pointed out that the prior cuts will continue to be transmitted into lower lending rates, which will help stimulate growth. Given India's contained core inflation and soft economic growth momentum, we expect monetary policy to be eased further. The benchmark repo rate will likely be lowered by 25 bps to 4.90% following the next MPC meeting, scheduled for February 4–6, 2020.

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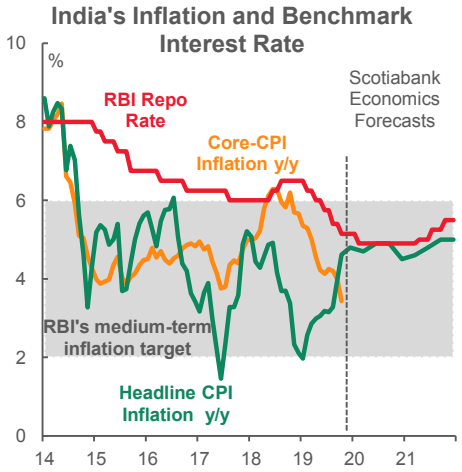
Chart 1



Sources: Scotiabank Economics, Bloomberg.