Reserve Bank of India Maintains Status Quo

- **The Reserve Bank of India left the benchmark repo rate unchanged at 4.0% despite weaker inflation.**
- **Strengthening economic activity and the government's expansionary fiscal policy reduced the urgency for additional monetary stimulus.**

The Reserve Bank of India (RBI) opted to leave its benchmark repo and reverse repo rates unchanged at 4.0% and 3.35% (chart 1), respectively, following the February 3–5 Monetary Policy Committee (MPC) meeting. We had expected a 50 basis point cut on the back of significantly weaker inflationary pressures and a still-challenging economic environment. Nonetheless, the MPC maintained an accommodative policy stance and pointed out that it would be continued as long as necessary to revive growth on a durable basis. The RBI also pledged to continue providing ample liquidity to the banking system through various facilities, yet it opted not to provide additional bond market measures.

The MPC's policy decision was justified by an improving economic outlook. RBI Governor Shaktikanta Das noted that the Indian economy is recovering with stronger consumer confidence and energy demand indicating a broadening rebound. The RBI forecasts that India's real GDP will expand by 10.5% in fiscal year 2021–22 (April–March), a sharp reversal from the current fiscal year performance that the National Statistics Office estimates to be -7.7% y/y. While we assess that somewhat looser monetary conditions would be helpful in supporting the nascent recovery, the government's expansionary fiscal policy unveiled in the Union Budget 2021–22 on February 1 reduced the need for immediate monetary response. Indeed, the MPC pointed out that the budget announcements regarding capital outlays in various sectors will help accelerate India's economic growth momentum.

With the economic recovery gaining traction, we assess that the MPC turned its full attention to its primary goal of price stability. India's inflation outlook has improved recently following a significant drop in headline inflation. Prices increased by 4.6% y/y in December (chart 1 again) compared with the October peak of 7.6%; therefore, inflation is now comfortably within the RBI's 2–6% target range. Nevertheless, with food being a significant part of the Indian consumption basket and the Southwest monsoon (June–September) rainfall having a large impact on food prices, the inflation outlook is surrounded by significant uncertainty. Additionally, the MPC pointed to other inflation risks, such as higher industrial raw material prices and international crude oil prices, and highlighted that core inflation—CPI inflation excluding food and fuel—remains elevated at 5.5% y/y. The RBI forecasts headline inflation to hover around 5% y/y over the next year; we foresee price pressures to be somewhat more moderate, averaging 4.2% y/y in 2021 before accelerating to slightly above 5% y/y in 2022.

The RBI's next monetary policy meeting is scheduled for April 5–7. We now forecast that the central bank will stay on hold in 2021, paying close attention to the strength of the economic recovery and inflationary developments. Nevertheless, should the economy face renewed softness, the RBI would have sufficient policy space left to stimulate the economy further.

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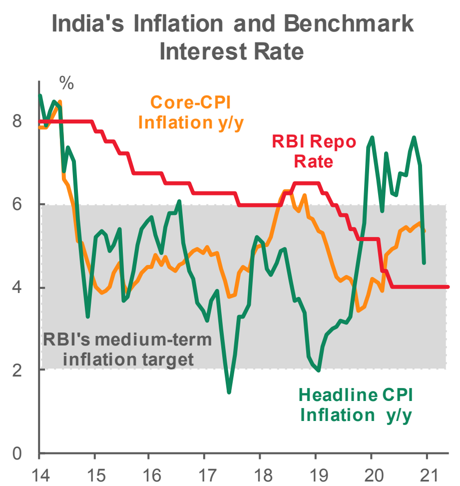
Chart 1



Sources: Scotiabank Economics, Bloomberg.