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RBI surprises with rate hike

OUR SPECIAL CORRESPONDENT

Mumbai: The cost of home, car and personal loans is expected to rise after the Reserve Bank of India (RBI) surprised the Street by raising its policy interest rate — the repo — by 25 basis points to 6.25 per cent to combat inflationary pressures that have started to bubble because of higher global crude oil prices.

This is the first rate increase since January 28, 2014. Since then, the central bank had cut the rate six times.

A majority of the economists in a Reuters poll conducted ahead of the second monetary policy review this fiscal and market mavens had expected the RBI to hold off on a rate increase until August.

The six policymakers were unanimous in their decision to raise the repo rate at the end of a three-day meeting of the monetary policy committee (MPC).

The RBI's decision to raise the rate comes in the wake of similar moves made by central bankers in Indonesia and Turkey.

But the big surprise was that the RBI continued to maintain a neutral stand on the rate cycle — indicating that future increases would be dependent on the trajectory of retail inflation which is currently ruling at 4.58 per cent.

This means that RBI governor Urjit Patel is keeping all his options open. Patel saw no contradiction between today's rate hike and its neutral stand.

Urjit Patel at the news conference in Mumbai on Wednesday. (PTI)

"Actually, it is not conflicting at all. A neutral stance leaves all options open. Other central banks do the same. So, there is tension between the two. The committee felt that there was enough uncertainty for us to stick to a neutral stance and yet respond to the risks to inflation target that have emerged in recent months," he told reporters after the monetary policy announcement.

Markets welcomed the RBI's neutral stance with the 30-share BSE Sensex surging almost 276 points at the close of trading.

The repo rate increase is likely to raise the cost of funds for industry as well as banks mull lending rate hikes. This could weaken the private sector's resolve to crank up investment.

But the RBI is betting that the surge in economic growth — exemplified by the 7.7 per cent growth in the fourth quarter of 2017-18 (January-March) — and the rise in capacity utilisation levels captured in the central bank's latest order book, inventories and capacity utilisation (Obicus) survey will eventually bolster the private sector's investment propensity.

The RBI is sticking to its April forecast of 7.4 per cent real GDP growth this year, substantially higher than the 6.7 per cent in 2017-18. GDP growth is projected in the range of 7.5-7.6 per cent in the first half (April-September) which could temper slightly to 7.3-7.4 per cent in the second half (October-March).

But the big worry is over retail inflation with the forecast raised to 4.8-4.9 per cent in the first half and 4.7 per cent in the second half.

The big upside risk to inflation is crude oil prices which have risen 12 per cent since the April policy review. The price of the Indian crude import basket has surged to $74 a barrel from $66 in April.

The RBI governor said one of the reasons why the central bank had put the policy rate on hold for such a long time was the nascent recovery in the economy. Since then the signs have been encouraging with investment activity picking up.