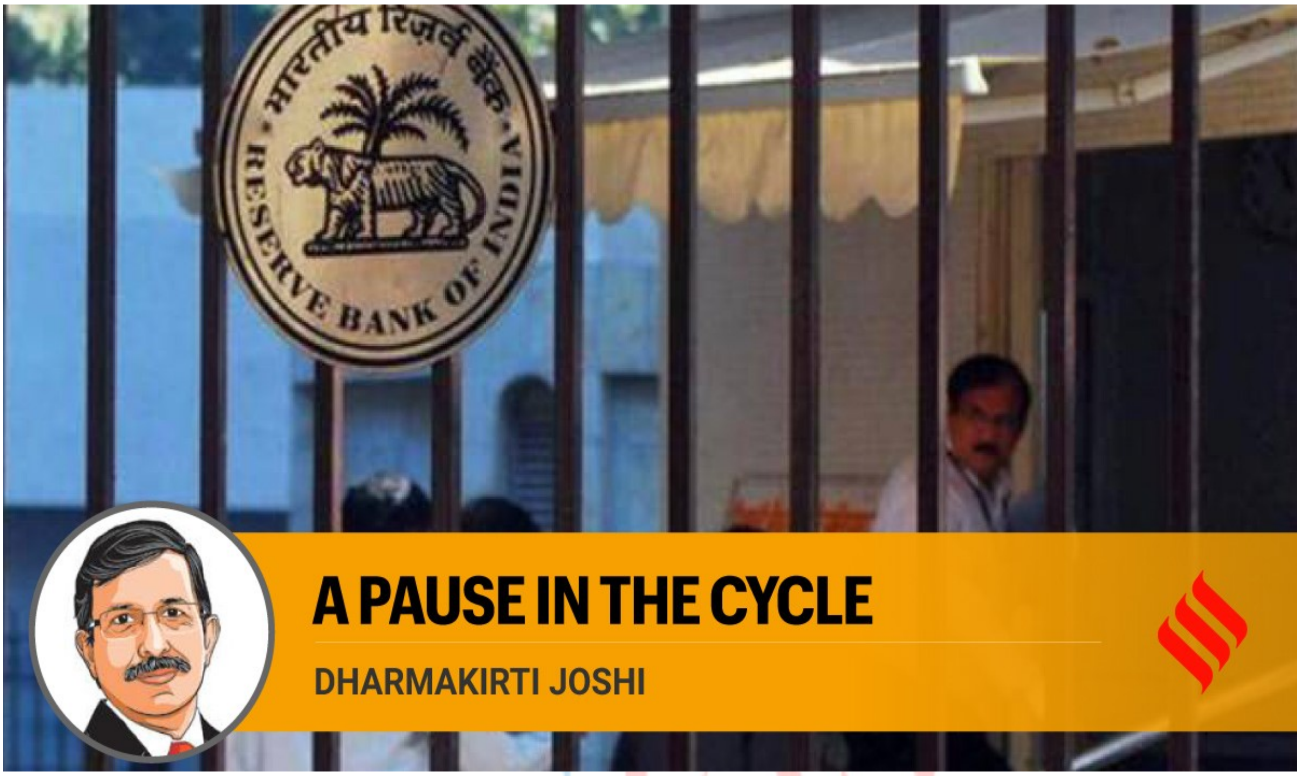
4. RBI's Pause On Repo Rate Hike: Concerns Over Inflation And Global Pressures Remain

Prelims Syllabus: Economy

Mains Syllabus: GS-III Economics - Issues relating growth and development, employment



Why in News?

- The RBI has decided to not increase the repo rate amid continuing hikes by important central banks such as the US Federal Reserve (Fed) and European Central Bank (ECB), and domestic inflation concerns. However, if incoming data point to rising inflation risks, this decision could prove to be only a pause in the rate hiking cycle.

The RBI's decision to pause on rate hikes

- The RBI feels that money market rates have effectively risen more than the 250-basis-point yank in the repo rate since May 2022, and hence it decided to pause and assess the impact of rate hikes.
- The key reason behind the MPC decision is the expectation of a decline in inflation to 5.2% in the current fiscal, driven by a healthy rabi crop, normal monsoon, moderating international commodity prices, and the impact of rate hikes. The RBI acknowledges the upside risks and stated its readiness to fight any unexpected rise in inflation.

Impact on GDP growth:

- The RBI expects GDP growth to slow to 6% from 7% this fiscal as slowing global growth, domestic interest rates, and messy geopolitics bite.
- Slowing global growth will be net negative for India's exports, and the growing dependence on commodity exports makes India more vulnerable to global growth volatility.
- Fiscal 2024 will, therefore, test the resilience of India's domestic demand amid rising interest rates.

Reasons for the expected cooling of consumer inflation:

- **Fuel inflation expected to reduce:** Fuel inflation is expected to reduce to 3% from a high of over 10% in the current fiscal because some easing of crude oil prices is likely as global growth slows down.
- **Decline in core inflation:** Slowing domestic growth will ease core inflation from very sticky levels of over 6% last fiscal to 5.5% in the current one. However, the decline in core inflation will be limited as input cost pressures have not dissipated. To protect their margins, firms will continue to pass on input costs to end-consumer. Services inflation will also continue to exert pressure as the rotation of consumption demand from goods to services continues.
- **Moderate food inflation:** Food inflation, which has a high weightage in the Consumer Price Index and has driven headline inflation in the past, is projected to moderate to slightly below 5%, assuming a normal monsoon. However, food inflation has always been volatile and carries upside risks largely because of climate-related factors affecting agriculture output and prices.

How slowing global growth will have a negative impact on India's exports?

- **The impact of the growth slowdown in the US and Europe is deeper than the recovery in China:** The US and Europe have a combined GDP that is twice that of China. Therefore, the impact of the growth slowdown in the US and Europe will be deeper than the recovery in China. This will have a negative impact on India's exports to the US and Europe.
- **India's exports to the US and Europe are more than to China by a factor of six:** India exports more to the US and Europe than to China by a factor of six. Therefore, the negative impact of the growth slowdown in the US and Europe will be felt more by India than by China.

- **India's growing dependence on commodity exports makes it more vulnerable to global growth volatility:** India's exports of petroleum products and steel are growing, and this makes India more vulnerable to global growth volatility. As global growth slows down, demand for commodities is likely to decline, which will have a negative impact on India's exports.

External vulnerabilities

- India's external vulnerability is expected to decline with a narrower current account deficit (CAD) and modest short-term external debt.
- The CAD is expected to narrow to 2% of GDP this fiscal from an estimated 2.5% last fiscal.

Conclusion:

- The RBI's decision to pause on rate hikes is driven by expectations of a decline in inflation. However, inflation risks remain, and the impact of rate hikes on GDP growth is expected to be significant. India's external vulnerabilities are expected to decline, but the banking turmoil playing out amid interest rate hikes by important central banks and elevated debt levels remains a risk. The RBI's decision to pause on rate hikes will be closely watched, and further rate hikes may be necessary if inflation risks persist.