

RBI monetary policy committee's first real inflation challenge is here



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RBI buys net \$6.93 billion in currency market in November

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India's central bank has seen nasty double-digit inflation in the past, but its monetary policy committee (MPC) hasn't.

Formed just a little over three years ago, MPC will have its first real challenge in keeping retail inflation within the lawfully-agreed flexible target of 2-6%, considering that inflation has breached this target to reach 7.35% in December.

The latest number has surpassed everyone's expectations, even though a large swath of economists had anticipated a nasty number above the policy target.

Indeed, even the Reserve Bank of India (RBI) had indicated in its December policy that it expects inflation to briefly exceed the 4% target it wants to guard at all costs. The central

bank's forecast is that inflation will be 4.7-5.1% during October-March.

Following the December inflation data, economists are beginning to worry that inflation may stay above the target for a long period. There are multiple reasons for this.

The main culprit for an inflation surge was food. Within food, vegetables drove up prices sharply, and

Aditi Nayar, chief economist at Icria Ltd, in an emailed note.

While onions and garlic prices may cool off, prices of pulses depend not just on the rabi output, but also on how deftly the government manages its food stocks.

The fact that the government took time to import onions shows it has been slipping on its food management off late.

"We could have easily avoided the 14% food inflation if the government had been as proactive as it had been in the past on onion prices," said an economist, requesting

BREACH AHEAD

HEADLINE inflation surged in December, topping flexible target of 2-6% given to RBI's monetary panel

VEGETABLES and pulses drove surge in headline inflation as the govt faltered on food management

RBI may pause on rate cuts until second half of 2020 due to more-than-expected rise in retail inflation

pulses too hardened considerably. "In particular, prices of pulses may remain elevated in the coming months, despite the favourable outlook for the rabi crop. Stickiness in prices of protein items may provide a floor to food inflation, going forward, even after vegetable prices correct to seasonally-appropriate levels," said

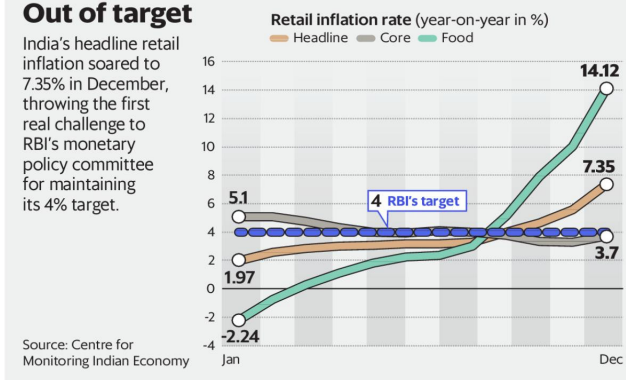
anonymity.

Even as food plays spoilsport, telecom tariff hikes, cement price increases and, of course, the fired-up global crude oil prices will keep up the pressure.

Meanwhile, even as New Delhi faltered in managing food inflation, RBI has been left with fighting a slowing

Out of target

India's headline retail inflation soared to 7.35% in December, throwing the first real challenge to RBI's monetary policy committee for maintaining its 4% target.



SATISH KUMAR/MINT

economy with rising inflation.

MPC will have to protect its 4% inflation target, but the cost of doing so could be high. A breach of inflation target necessitates a policy rate hike, but in the current context—of the slowest economic growth in six years—this will be dangerous. Instead, economists expect a long-

drawn pause. "We are not looking at a rate cut until the second half of 2020," said Shubhada Rao, chief economist, Yes Bank Ltd.

MPC will have to watch onions, garlic and potato prices, besides hoping that past policy rate cuts will somehow reignite the dying embers of investment.