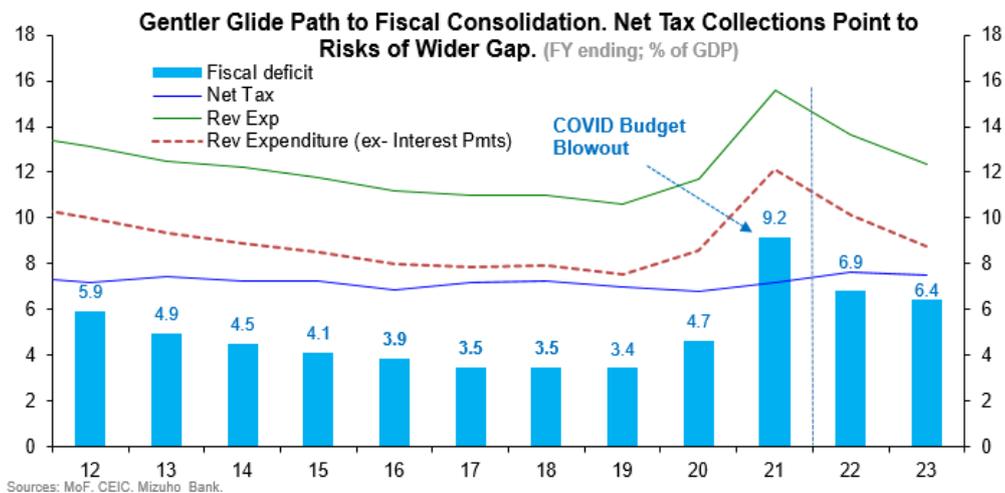
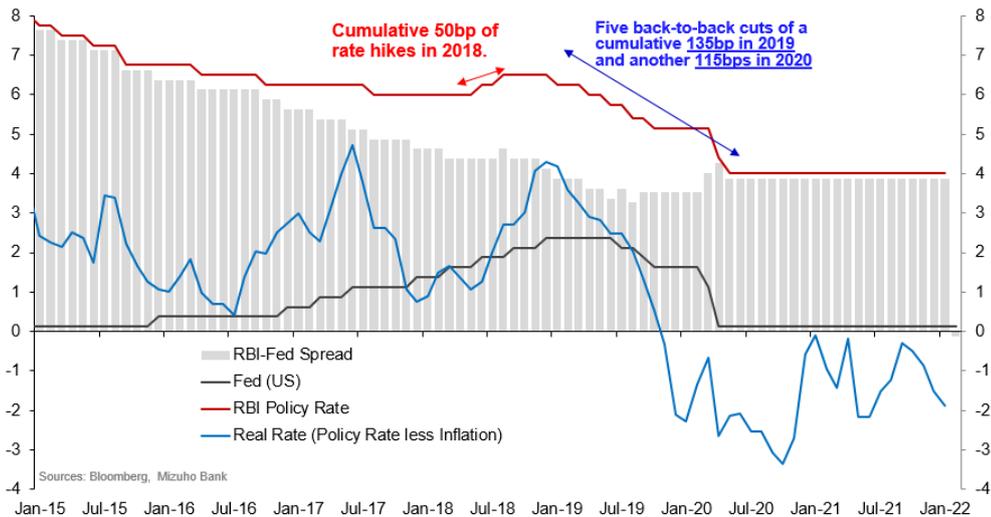


## The RBI's Risky, Leveraged Bet

RBI Real Rates remain exceptionally low, suggesting a calibrated "lift-off" need not be ruled out due to downside risks to growth. Instead, as real rate spreads vs. US diminishes in coming months macro-stability risks will mount.



*"The curious incident of the dog in the night-time" – Sherlock Holmes*

- The **RBI's dovish insistence**, citing **lingering downside risks to growth** (amid COVID "variant" risks) alongside **expectations of peaking inflation** (in Q1 2022) is a **high-stakes, leveraged policy bet**; *with a narrow window for course correction*.
- Especially given that the RBI notably abstained from even a token narrowing of the repo window (with a calibrated shift higher in the reverse repo rate towards the policy repo rate)
- To be sure, the RBI is **not wrong in its assessment of an incomplete and uneven recovery that has probably been interrupted**, albeit slightly dampened rather than seriously derailed, by Omicron.
- **But** trouble is, the **RBI appears too sanguine, if not recklessly overconfident about inflation risks**. **Especially given elevated and escalating oil prices** amid worrying geo-political risks.

- Point being, **inflation** expected to be **close to the 6% upper limit of the RBI's 4%+/-2%-pts target band in Q1 2022, may not only fail to subside as quickly** towards 4% by Q4 2022/Q1 2023, **but could instead accelerate** in coming months due to a conspiracy of hard-to-predict energy market volatility, commodity cost-push and global supply-chain kinks.
- What's more, the RBI **endangers macro-/rupee-stability as policy inaction** amid inconveniently high inflation, *particularly at a time when the Fed is turning increasingly hawkish*, threatens to **squander, price-stability credentials**; which is notoriously more costly to restore than exploit.
- Admittedly, while real (India-US) rate spreads are buffered for the time being by record high US inflation. But this *exceptional inflation differential inversion* (with US inflation higher than India's) *and resultant policy buffer are on borrowed time*. Hence, the **RBI has merely delayed the inevitable** (policy calibration). And in the process **upped the risks of being thrown further behind the curve**.
- Crucially, this **policy feet dragging risks** being rendered as an unwitting **high-stakes game of brinkmanship given a far looser, and more highly leveraged fiscal position**.
- Specifically, **a far more gradual glide-path to fiscal consolidation**, and the resultant jump in public debt alongside its attendant debt financing obligations, **amplifies macro- and rupee stability risks** (particularly as it resonates via credit and exchange rate channels).
- All said, the **RBI's intentional inaction**, *subordinating inflation risks to growth recovery*, **comes at the cost of much sharper macro-stability trade-offs**. Crucially, **significantly higher public debt servicing burden imposed by a pro-growth budget** (stretching out fiscal consolidation plans) **amplifies these macro-/rupee-stability risks**.
- Particularly if the **myopic desire to anchor debt financing costs** (by holding down policy rates) **backfires rudely in the event of capital outflows** amid surging global inflation rates; which more than wipes out policy anchor effects on yields as risk premium jump brutally.
- While worst case outcomes may be avoided, the path to **regaining a grip on macro-stability risks may entail the RBI changing course fairly abruptly** (as early as April) to put through a quick succession of rate hikes. Risk is, the *slower the initiation of "lift off", the greater the amplitude of hikes the RBI will be forced to undertake to compensate*.
- On balance, the **RBI slipping behind the curve further at this meeting** has **tipped out rate outlook from 75bps to 100bps of cumulative hikes for 2022**. The *"curious incident"* of the RBI doing nothing (akin to the dogs not barking in the Sherlock Holmes mystery) in response to inflation risks, is in fact the "smoking gun" that warns of a knife's edge between heightened pipeline macro- and rupee-stability risks and the RBI having to scramble to compensate with more tightening later.

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