250-bp rate hike lowered demand, inflation by 160 bps

Durable alignment with target in sight, says report

SUBRATA PANDA
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The 250 basis points (bps) hike in policy rate by the Monetary Policy Committee (MPC) since May 2022 has negatively contributed to aggregate demand and headline inflation by 160 bps each till Q2FY25, a report by Reserve Bank of India (RBI) staffers, including deputy governor Michael Debabrata Patra, said.

Since 2022, central banks across the world started raising policy rate aggressively in a synchronised fashion to counter an inflation surge. In India, MPC also undertook monetary policy tightening since May 2022.

"In the event, inflation has largely been restrained to its last lap of alignment with targets across geographies. In fact, early movers of monetary policy tightening in this episode have been successful enough to pivot to commencing easing cycles," Patra wrote in the report.

According to the report, the process of disinflation, in India, has been stubborn, slow, and uneven, stalled by the incidence of repetitive and often overlapping supply shocks. The trajectory of disinflation has, however, been downwards and a durable alignment with the target is in sight, it said.

In the current monetary tightening cycle, money market interest rates rose broadly in tandem with the policy repo rate hikes, the increase in CRR and the decline in surplus liquidity. These rates increased in the range of 236-325 bps during May 4, 2022 to September 30, 2024, the article mentioned.

Meanwhile, on the credit and deposit front, the 250 bps hike in policy rate has resulted in the weighted average lending rate (WALR) on fresh rupee loans rising by 190 bps, while that on outstanding loans rose by 119 bps during May 2022 to August 2024. In the case of deposits, the weighted average domestic term deposit rates on fresh and outstanding deposits rose by 243 bps and 190 bps, respectively, during the same period.

"Our findings on monetary policy transmission in India suggest that monetary policy changes affect short-term interest rates more than long-term rates. While anticipated policy changes do not have any instantaneous impact on long-term rates, policy 'surprises' significantly impact all market segments and across tenors," the report said.

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- Monetary policy changes affect short-term rates more than the long-term ones
- Anticipated policy changes don't have any instantaneous impact on long-term rates
- Policy surprises significantly impact all market segments and across tenors
- Policy rate tightening anchored inflation expectations and modulated aggregate demand