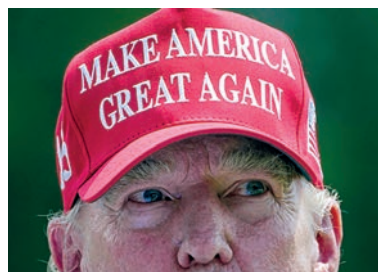


# What will be RBI's response in the midst of growth vs inflation?

■ Dr. T. K. Jayaraman

The Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) is set to meet from February 5-7 to decide whether to change or continue the current Repo rate at 6.50%. This rate, which was introduced in April 2023 as part of anti-inflationary measures, has been a topic of debate. In November of last year, both the Minister for Industries and the Finance Minister attributed the economic slowdown — marked by a 5.4% GDP growth in the July-September quarter of FY 2025, down from 6.7% in the April-June quarter — to the high Repo rate. The Industries Minister suggested that food inflation be excluded from the retail inflation calculation, while the Finance Minister emphasized that the interest rate should be more “affordable”.

The GDP growth rate for the October-December quarter will be released on February 28, after the MPC meeting. However, the first MPC meeting under the new Governor, Sanjay Malhotra, who assumed office on December 10, will rely on the GDP growth data from July-September. Similarly, the MPC meeting will also have to base its decisions on December inflation data, as the January inflation report will only be available on February 12. The January inflation figures are particularly significant, given the appreciation of the US dollar since mid-2024, with its likely impact on domestic price level, through rise in import prices



## The rising power of the US Dollar

Since October, the US dollar has experienced a steady increase in value against nearly all global currencies. This rise

is largely attributed to Donald Trump's campaign for a second presidential term, where he revived his “Make America Great Again” (MAGA) platform. As part of his campaign, he proposed reducing corporate taxes from 25% to 15% and bringing US-based production back from China, backed by tariffs and other protectionist policies. These promises have made the dollar stronger even before the elections.

As the elections neared, foreign portfolio investors began pulling out funds from emerging markets and developing economies (EMDEs) starting in September, shifting their investments to the US. This resulted in the dollar index rising against six major global currencies, reaching an unprecedented level of 110. While currencies in Africa, Asia, and Latin America saw significant declines, even advanced economies like the Eurozone and Japan saw their currencies depreciate by 7% and 11%, respectively, in 2024. The Indian rupee depreciated by a comparatively modest 3.6%.

## The impact of Tariffs and Inflation potential

The depreciation of the rupee, starting in October, has led to an increase in import costs for essential goods, such as crude oil, natural gas, and other refined petroleum products — all priced in US dollars. Following his inauguration, President Trump announced a 25% tariff on goods from Mexico and Canada, which will take effect on February 1. Additional tariffs on imports from India are expected, given his description of India as the “King of Tariffs.” Furthermore, Trump's policy to deport illegal migrants has begun, with plans to send deported workers to Ecuador, which has agreed to receive them if other countries of their origin do not accept them.

The appreciation of the dollar, combined with rising tariffs and labor shortages due to deportations, will likely increase production costs in the US. As a result, US goods imported by EMDEs, including India, will become more expensive, contributing to imported inflation. India, in particular, will be adversely affected as it imports 88% of its energy requirements — from crude oil, natural gas, and refined petroleum products — all priced in US dollars. This translates to higher prices for these commodities in rupees, adding to inflationary pressures.

Although the impact of the dollar's appreciation on inflation in the October-December period may be partially reflected in December data, the full effect will only be measurable over a year. The MPC will need to assess whether there is a clear upward trend in price levels before deciding on any change in monetary policy at its February meeting. The current schedule for MPC meetings in the first half of the month seems less than ideal, as it does not allow time for the latest inflation data to be considered in full. Holding meetings in the third week of the month would provide a more comprehensive view of inflation trends.

## A Prudent Approach: Awaiting clear inflation trends

In the absence of complete December inflation data, the MPC's options remain limited. The most prudent course of action may be to postpone any decision until the next meeting. Inflation data has shown significant variability: 3.54% in July, 3.65% in August, 5.49% in September, 6.21% in October, and 5.48% in November. This uncertainty suggests that the MPC should adopt a cautious stance.

Without RBI interventions, the depreciation of the rupee would likely have been more severe, with even greater fluctuations. To mitigate this, the RBI has intervened by selling US dollars in both the spot and forward markets to stabilize the rupee and meet the demand of importers. As a result, India's foreign exchange reserves, which peaked at \$705 billion on September 27, have declined to \$623 billion. Not all of this decrease can

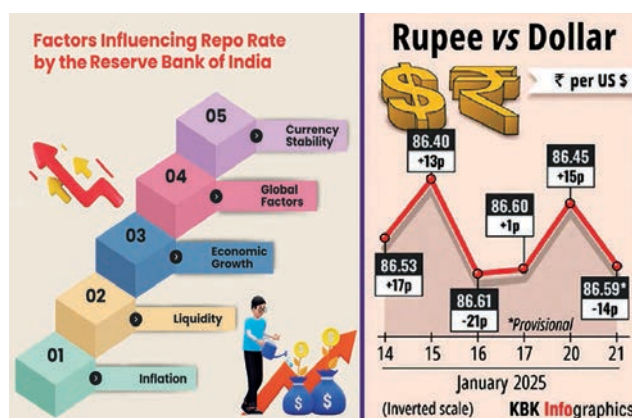
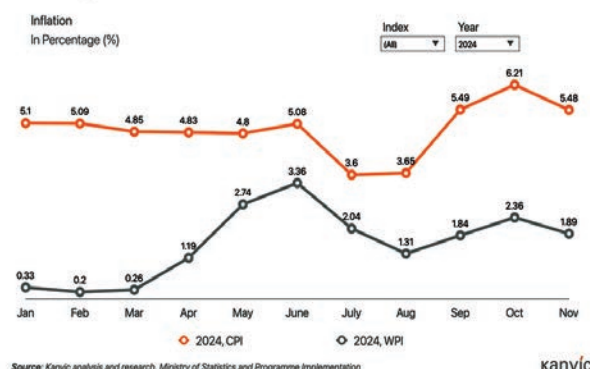
**TABLE**  
**India's Foreign Exchange Reserves and Exchange Rate in 2024**

YEAR 2024	Forex Reserves US\$ (billion) Billion	Exchange Rate Rs/ US\$ Rupees	NEER Index	REER Index
JANUARY	622	83.03	90.72	103.66
FEBRUARY	646	82.90	91.99	104.72
MARCH	638	83.39	92.15	104.68
APRIL	642	83.39	92.19	103.47
MAY	647	83.42	92.22	104.76
JUNE	652	83.37	92.22	107.33
JULY	675	83.69	92.02	107.45
AUGUST	684	83.68	90.84	104.45
SEPTEMBER*	705	83.79	90.4	105.32
OCTOBER				
Weekending 4	701	83.97	NA	NA
Week ending 11	690	84.06	NA	NA
Weekending 18	688	84.08	NA	NA
Weel ending 25	685	84.09	90.89	107.22
NOVEMBER				
Weekending 1	682	84.03	NA	NA
Weekending 8	676	84.34	NA	NA
Weekending 15	658	84.41	NA	NA
Weekending 22	657	84.44	NA	NA
Weekending 29	658	83.99	91.8	108.14
DECEMBER				
Weekending 6	655	84.69	NA	NA
Weekending 13	653	84.83	NA	NA
Weekending 20	644	85.09	NA	NA
Weekending 27	640	85.83	90.22	107.5
2025 JANUARY				
Weekending 3	635	85.80	NA	NA
Weekending 10	626	85.92	NA	NA
Weekending 17	634	85.60	NA	NA
Weeending 24	TBA	86.40	NA	NA
Weekending 31	TBA	TBA	TBA	TBA

\* On 27 September, the highest level of reserves, \$705 billion was reached  
No weekend report on NEER and REER

TBA: To be announced

### Inflation Soars in 2024: WPI and CPI Exceed 6%, Jolting the Economy



be attributed to interventions; some of it is due to payments for imports and revaluation of non-dollar assets that have lost value due to the dollar's appreciation.

### Maintaining the repo rate and providing liquidity

Recent signals suggest that the RBI is unlikely to intervene as aggressively as it did in the initial phases of the rupee's depreciation. The central bank may prefer a more gradual approach, expecting some self-correction in the value of the dollar. While campaign promises are easy to make, their implementation faces numerous challenges, particularly legal ones. Additionally, there is growing recognition that India's real effective exchange rate was overvalued by approximately 7-8% in November (Table), suggesting that a slight further depreciation of the rupee could enhance India's export competitiveness.

In light of these factors, it would not be surprising if the RBI opts to maintain the current Repo rate, while providing additional liquidity through open market operations and potentially reducing the Cash Reserve Ratio (CRR) by another 50 basis points. ■



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