

# Should MPC have hiked rates?

**MISSED OUT.** High inflation expectations, leveraged asset demand and a depreciating rupee are good reasons to hike rates



**ABHIMAN DAS**  
**SMITA ROY TRIVEDI**

The Monetary Policy Committee (MPC) has decided to hold the policy rates unchanged in the April monetary policy, which remains largely in consonance with market expectations. In the last few months, as conflict in West Asia intensified and fuel pangs were brought home, two differing views emerged on the likely impact on India: first, our economy is resilient and domestic demand-driven which will keep it afloat and on track of growth trajectory even with rupee declines; and second, the current account deficit and rupee woes will jeopardise the growth dynamics.

Both the views can be tempered and calibrated with an integrated view of domestic forward-looking indicators and external sector dynamics. First, firm level forward looking indicators clearly suggest a build-up of inflation expectations. With rupee depreciation and consequent rising fuel costs would impact firms first, making them the primary transmission channel of external shocks.

The latest data from Business Inflation Expectations Survey (BIES), conducted monthly by IIMA, that polls a panel of business leaders about their inflation expectations in the short and medium term, shows a marked increase in inflation expectations.

## INFLATION EXPECTATIONS

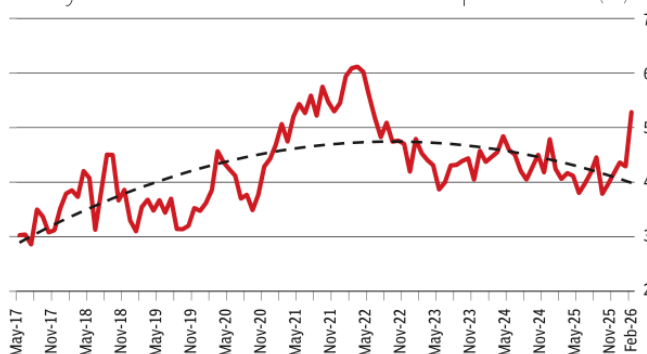
The one year ahead business inflation expectation recorded in March 2026 has shot up sharply by 100 basis points (bps) to 5.29 per cent, from 4.29 per cent recorded in February 2026. This is the highest ever monthly increase during the past nine years of the BIES. The trajectory of one year ahead business inflation expectations is presented in Chart 1.

The uncertainty of business inflation expectations has remained elevated by over 2 per cent during February-March 2026. The RBI in its monetary policy statement has also projected one year ahead CPI inflation to be in the range of 4-5 per cent with an upward risk.

The latest data shows Consumer

CHART 1

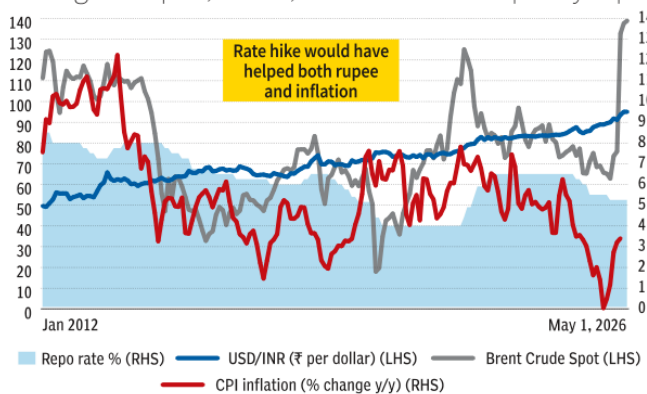
One year ahead business inflation expectations (%)



Source: BIES, IIMA

CHART 2

Linkages: Rupee, crude, CPI inflation and policy repo



Source: LSEG, Authors' annotations

Price Index (CPI) inflation climbed to a 13-month high of 3.4 per cent in March an increase from the 3.2 per cent

**The only way to prevent inflation from thwarting the limited growth prospects in the medium term is targeting inflation first. Immediate growth sacrifice is a better option before inflation becomes deeply entrenched**

recorded in February (*businessline*, April 13, 2026).

Second, the crude prices remain the primary cause of concern, with Chart 2 showing how closely crude is tied to India's inflation figures and rupee depreciation. The supply shock feeds into both domestic growth and exports given the import dependence of export industries. There is no immediate supply side solution to this. With linkages to disposable incomes, firm performance and agricultural sector through fertilizer prices, crude shock directly feeds into consumption expenditure and hence growth. While the situation tends to be stagflationary, doing nothing and

waiting for prices and wages to adjust in the labour market may not be the best option at this point in time. The historical experience suggests a rate cut or rate pause at this stage may not have desired impact. The 1970s experience clearly indicates the only way to prevent inflation from thwarting the limited growth prospects in the medium term is targeting the inflation first. Immediate growth sacrifice is a better option before inflation becomes deeply entrenched.

Globally we are seeing a move towards a hawkish tilt, with both Federal reserve and ECB holding rates steady yet cautioning against inflation driven risks. Markets are repricing this possibility of tightening, and Bank of Japan continues with a tightening phase.

## WHY INTEREST RATE HIKE

There are two reasons at least why an interest rate hike would have been the right approach: First, as iterated by the RBI Governor, while credit growth has improved consistently, higher credit offtake might suggest either overoptimistic exuberance or leverage building. This would therefore be the right time for countercyclical policies. With sectors like real estate, gold and personal loans continuing to lead credit growth, a possibility of over-exuberance in face of inching inflation and muted growth suggests tightening would be prudent.

Secondly, a rate hike would have helped to stall rupee depreciation. Interventions with regard to the rupee generally need to be kept to a minimum. First, not only would spot market interventions reduce liquidity, it could push up inflation if followed up with liquidity infusion measures. Second, forward market interventions would build up dollar liabilities in the future, which given the geopolitical situation can be avoided.

Indirect intervention measures to regulate actions of market participants can lead to greater speculation. However, a rate increase would not only encourage foreign capital inflows, but help banks to make policies like FCNR (B) more attractive to attract capital flows.

Thus, a tilt on the hawkish side would have been more consistent with the flexible inflation targeting framework.

Das is IICI Bank Chair Professor, IIM Ahmedabad, and Trivedi is Associate Professor, National Institute of Bank Management (NIBM). Views are personal