RBI may remain hawkish to tame inflationary expectations.

For a change, the market isn't clamouring for a rate cut. On the contrary, a 25-basis point rate hike is not only being factored in by the market but also welcomed, as such a move would help anchor inflationary expectations and nudge the government to address supply-side issues affecting prices. For a change, the market will welcome any action taken by either the government or the Reserve Bank of India (RBI) to counter runaway prices. With both the consumer price index (up 10.09 per cent year-on-year) and wholesale price index (up seven per cent y-o-y) for October climbing higher, the market has factored in the possibility of a rate action by RBI in December.

The current spike in inflation has been driven largely by primary articles, although core inflation is beginning to rise. Headline inflation (WPI) has averaged at 5.8 per cent through the financial year so far and if one excludes primary articles, then inflation has averaged at 4.4 per cent this year. The increase in headline inflation was led by primary articles. Prices of fruit and vegetables have driven a large part of the spike in primary articles. Between April and October, food prices increased 13 per cent compared to 9.5 per cent in the previous year. Compared to September, food prices have seen some easing but with core inflation picking up, the headline print has remained under stress.

With the government choosing to cut its subsidy bill through increase in prices of petroleum products, the spike in inflation is almost a given but is not something that economists are agonising over. Also, the jump in core inflation has a lot to do with the rupee's fall and that is something that needs structural re-adjustment. However, RBI can do little through policy action to tame runaway food prices. CRISIL Research says with inflation rising, and RBI now expecting WPI inflation to be higher than its earlier forecast of 5.5 per cent in 2013-14, a 25-basis point hike in the repo rate is likely during the remaining months of the financial year. Economists believe a hike would help curb the inflationary expectations.

However, this will do little to tame the monster. There is a bigger structural issue at hand, which needs to be addressed if price rise has to be tamed. It is apparent now that inflation is not necessarily due to supply-demand mismatches alone. There are broader supply-side constraints that are driving prices up, which the government needs to address by easing infrastructure bottlenecks. Leif Eskesen of HSBC Global Research, says: "Structural reform implementation, including efforts to reduce infrastructure bottlenecks remains an essential weapon in the fight against inflation."

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