Press Release

Dilemma before RBI MPC

Will it wait more for the pivot?

February 5, 2024

The RBI MPC meeting of Feb'2025 is significant in several ways. This is the first meeting of the MPC under the leadership of the new RBI Governor. Secondly, it comes at a time when there are several headwinds in both the external and the domestic environment. The change in the US Government has dramatically altered the expectations regarding Fed's monetary policy and the interest rate trajectory, translating to a stronger USD and capital outflows as well as a sharp currency depreciation in developing economies like India. On the other hand, the Indian economy has witnessed a slowdown in the current fiscal with consensus estimates of 6.4% GDP growth from 8.2% in FY24. While headline inflation has moderated to 5.2% in Dec'2024 and is expected to subside further to 4.5% over the next few months, there are concerns on its sustainability amidst the INR touching 87 to the USD.

The benchmark repo rate of RBI has been "higher for longer" at 6.50% since Feb'2023 and there are increasing demands on the central bank to go for the pivot. Given the conflicting needs of maintaining low inflation, stabilizing the INR and also reviving the growth momentum in the economy, the Feb'2025 meeting will be a tough call for the RBI. Union Budget 2025-26 has just provided an impetus to consumption by reducing taxes and increasing disposable incomes of the middle class. With the fiscal policy prioritized towards demand and growth revival, the burden on the monetary policy has lessened to some extent. We believe there is a case for RBI MPC to support the fiscal initiative on growth by providing an easier liquidity environment through various tools like OMO and even a further CRR cut at the current juncture while postponing the rate cut decision to April'2025.

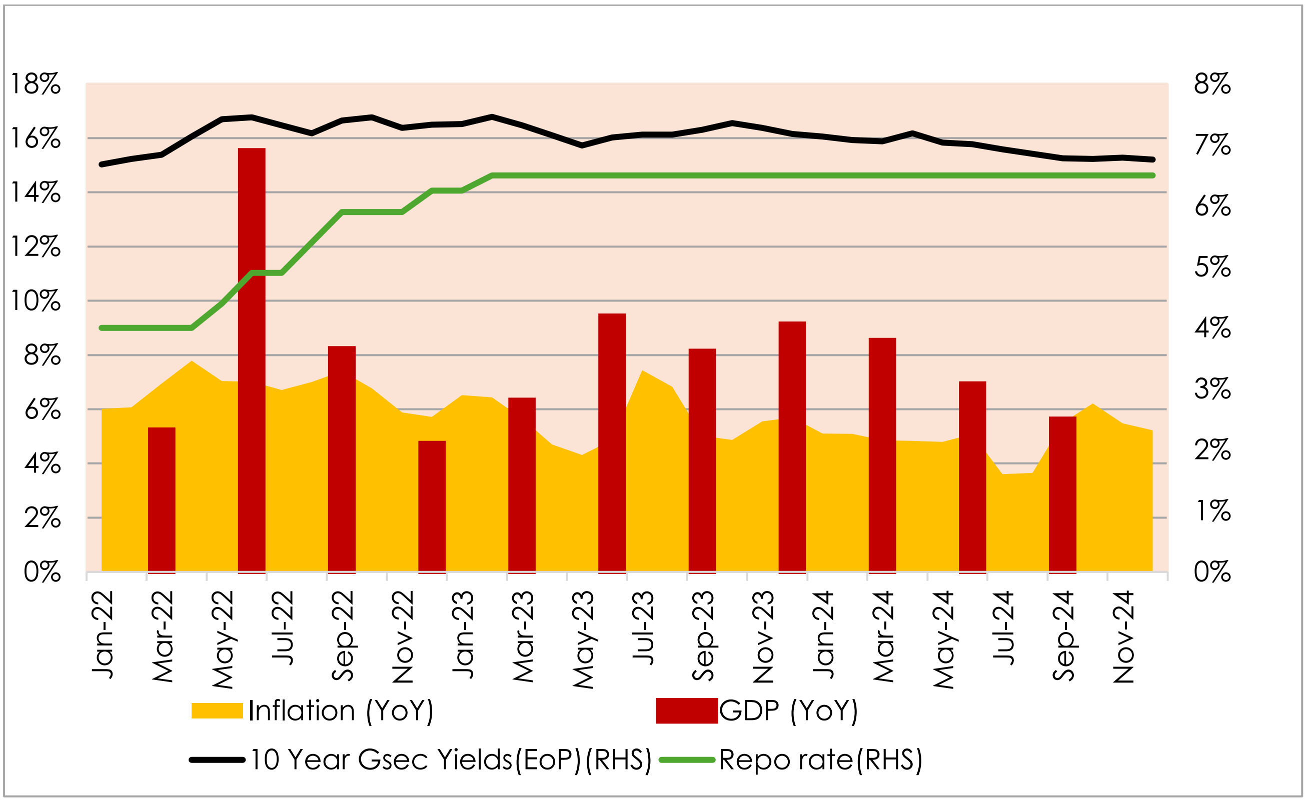
Recently, several high-frequency indicators present a mixed economic outlook. The economic survey has projected GDP growth for FY25 at 6.4%, reflecting expectations of a better performance in Q3 FY25 and Q4 FY25 following a slowdown to 5.4% in Q2 FY25. On the agricultural front, the rabi season is progressing well, with wheat, rice, and maize continuing to show solid growth. While the Industrial activity grew by 5.2 per cent in Nov'2024, we are still seeing softness in the core sector activity (latest Dec'2024 data). While there was some pro-investment measures announced in the latest budget, especially for the MSME sector, the sentiment in the market is still slightly muted as corporate earnings growth has been subdued (so far) in Q3FY25.

That weakness is mostly due to pressures from weak urban demand; however, the recent budget has given a tax break to the middle class to help boost the economy. The inflation outlook is benign in the near term; however, the recent depreciation of the rupee has introduced some incipient inflationary risks.

There is now increased pressure on the RBI to cut rates and improve the growth sentiments. While food inflation levels have moderated on the back of winter seasonality, headline inflation is still 120 bps higher than the target figure of 4.0%. Further, the rupee has faced substantial external pressures, hitting an all-time low of 87.29 per US dollar in early Feb'2025; this depreciation has mainly been due to external headwinds, such as uncertainty on new trade tariffs by the US under President Donald Trump affecting the market. We also continue to witness a sell off by FII's which is increasing the volatility in the markets.

To address the liquidity deficit in the system brought about partly by the volatile external scenario, RBI has announced measures to infuse Rs 1.5 lakh Cr into the system. These measures include purchase of ₹60,000 Cr of government securities and conducting a Rs 50,000 Cr variable rate repo auction. Further, another CRR cut of 50 bps can be on the agenda for this meeting, bringing the CRR to 3.5%. This will signal the onset of an accommodative phase in monetary policy with a likely rate cut in the April'2025 and subsequent meetings contingent on incoming data.

Chart 1: Growth, Inflation, Repo Rate, G-sec Yields



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