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RBI Monetary Policy Review

The MPC with a 4-2 majority kept repo rate unchanged at 6.5%. The dissenting votes were cast by 2 of the 3 new members of the MPC. Stance was kept at neutral to allow the MPC flexibility on future path of policy action. This is important as the Governor's statement underlined the need for maintaining a favourable growth-inflation balance, as the two are highly interlinked. RBI now forecasts GDP growth lower at 6.6% in FY25, while inflation is projected higher at 4.8%. However, with growth expected to recover in H2 and inflation abating, we see a scope of 25bps rate cut in Feb'25. We expect a cumulative easing of 50-75bps in the current cycle.

Key rates: In line with our expectations the monetary policy committee decided to keep repo rate unchanged at 6.5%. However, the voting pattern suggested that calls for a rate cut increased, with 2 members, Dr. Nagesh Kumar and Dr. Ram Singh, now voted for a 25bps rate cut. Stance of the monetary policy was retained at neutral by a unanimous vote.

Growth projections: While noting the slowdown in growth in Q2FY25, RBI expects growth to remain resilient in H2 FY25 and FY26, while advocating the need for caution. Growth projections were lowered to account for the slowdown in growth in Q2. For FY25, RBI expects growth at 6.6%, a downward revision of 60bps. Even quarterly projections were lowered, with the maximum downward revision in Q3 FY25 of 60bps. IIn Q4 FY25, RBI expects GDP growth of 7.2% versus 7.4% estimated earlier, while GDP growth in Q1FY26 is also estimated lower at 6.9% (lower by 40bps). Our GDP estimate stands at 6.6-6.8%, with likely impetus coming from the agriculture sector and government capex.

Figure 1: Growth projections

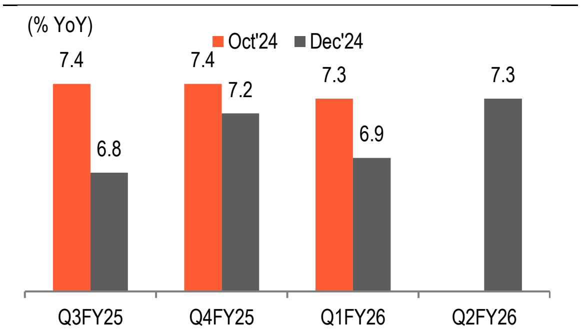
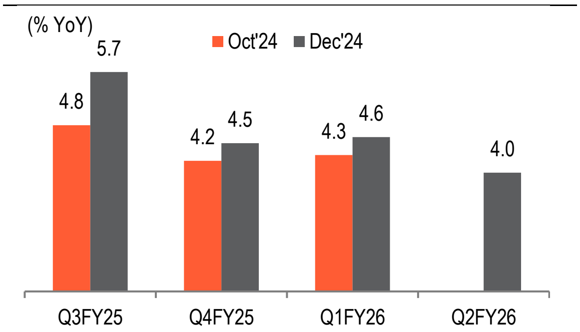


Figure 2: Inflation projections



Source: RBI, Bank of Baroda Research

Inflation projections: RBI revised its inflation projections for FY25 upward to 4.8% versus 4.5% anticipated earlier, with inflation in Q3 estimated sharply higher at 5.7% compared with 4.8% projected in Oct'24 policy. For Q4 FY25 and Q1 FY26, inflation projections were revised up by 30bps to 4.5% and 4.6% respectively. Inflation is projected to moderate to 4% only in Q2 FY26. A good rabi season along with arrival of kharif harvest is likely to help in easing prices pressure in the near term. Global prices of edible oils and Vegetable prices have started softening as the seasonal impact wanes which is also positive for the inflation outlook. We expect inflation to average between 4.7-4.8% in FY25, in the absence of any fresh shocks, both global as well as domestic.

CRR cut: To ease anticipated shortfall in system liquidity in the coming months, the CRR was cut to 4% of the NDTL from 4.5%. This will be implemented in two equal fortnightly tranches of 25bps each, beginning from 14 Dec 2024. It must be noted that RBI had increased CRR to 4.5% in May'22. The decision is likely to infuse liquidity of ~Rs. 1.16 lakh crores in the banking system which will help ease pressures on banks due to advance tax payments.

Other regulatory developments: RBI also increased the interest rate ceiling on FCNR (B) deposits with maturities of 1 to 3 years and 3 years to 5 years. Accordingly, banks can now garner fresh deposits under these categories by offering a higher rate of interest. This will not only help banks in attracting for investible funds for funding credit growth but will also help in attracting more foreign inflows into India, thus supporting the rupee. Further, it was decided to link the FX-retail platform with the Bharat Connect platform which will enhance access of foreign exchange for MSMEs and ensure greater transparency. On a pilot basis, this will be available only for sole proprietors and individuals for purchase of USD. Other important announcement related to increase in limit of collateral free agriculture loan to Rs. 2 lakhs from Rs. 1.6 lakh previously. This step is likely to enhance credit access to small and marginal farmers.

Concluding remarks

The latest policy marks a difference from previous policies as the RBI laid greater emphasis on preserving the growth inflation balance. Particularly, durable price stability was recognised as a necessary pre-condition for sustainable growth. Stress was also placed the 'timing' of appropriate policy action while being cognizant of the future trajectory and avoiding knee-jerk reactions. We expect a rebound in GDP growth in H2 FY25. Inflation too has started moderating with prices of essential commodities, particularly vegetables, normalising. Hence, we expect a rate cut in Feb'25 as the most likely scenario with a total reduction of 50-75bps in the current cycle.

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