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RBI MONETARY POLICY: FOCUSING GROWTH, VIGILANT ON INFLATION

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The RBI Monetary Policy Committee (MPC) reduced the policy repo rate by 25 bps from 6.50% to 6.25% in the Feb'25 monetary policy. Subsequently, the standing deposit facility (SDF) rate remains at 6.00% from 6.25% and the marginal standing facility (MSF) rate and the Bank Rate become 6.50% from the previous 6.75%. Further, the MPC decided to maintain the stance to 'neutral' in line with their focused approach towards a durable alignment of inflation with the target, while supporting growth.

RBI Monetary Policy 7 Feb 2025: Snapshot of various policy rates (%)

Rates/Parameters	Dec 2024	Feb 2025	Change (reduced/increased)
Repo rate	6.50	6.25	Reduced by 25 bps
Standing Deposit Facility (SDF)	6.25	6.00	Automatic/instantaneous 25 bps downward adjustment.
Marginal Standing Facility (MSF)	6.75	6.50	Automatic/instantaneous 25 bps downward adjustment.
Bank rate	6.75	6.50	Automatic/instantaneous 25 bps downward adjustment.
Reverse Repo (Fixed Reverse Repo rate)	3.35	3.35	No change
Cash Reserve Ratio (CRR)	4.00	4.00	No change
Statutory Liquidity Ratio (SLR)	18.00	18.00	No change

Source: RBI.

The major decisions and related aspects are illustrated as follows:

Rationale for keeping repo rate at 6.25%: The MPC noted that inflation has shown softening trends, which is expected to moderate further due to a favorable outlook on food inflationary trends. The MPC also noted that ***growth remains much weaker*** compared to last year, which opens policy space for the MPC to support growth, while remaining focused on aligning inflation with the target. Therefore, the MPC decided to reduce the policy repo rate by 25 basis points to 6.25 per cent.

The MPC also explained the rationale of the neutral stance as too much volatility in global financial markets and persistent uncertainties about global trade policies coupled with adverse weather events pose risks to the growth and inflation outlook. Hence, continuing with a neutral stance is essential which will provide MPC with the flexibility to respond to the evolving macroeconomic environment.

Real GDP Growth Projections: According to the first advance estimate (AE), real GDP growth for the current year is estimated at 6.4 per cent, a moderate expansion after a robust 8.2 per cent growth last year. Growth in real GDP in Q2 at 5.4 per cent remains much lower than expected, primarily driven by poor performance of the manufacturing companies. Operating profit of 1679 listed private manufacturing companies contracted by 0.3 per cent (y-o-y) during Q2:2024-25.

On the other hand, the real GDP increased by 6.7 per cent in the first quarter of FY25. In the previous monetary policy, the real GDP growth for the first quarter (Q1) in 2025-26 was projected at 7.3 per cent, moderately increased from the 7.2 per cent from the previous policy, whereas the real GDP growth projection for 2024-25 remained at 7.2 per cent.

Going forward, the prospect for the agricultural sector remains bright, supported by a healthy rabi sowing and robust reservoir levels. The manufacturing sector has seen a mild recovery, as the operating profit of 393 listed private manufacturing companies expanded modestly by 0.9 per cent against a contraction of 5.4 per cent observed in

Q2:2024-25. On the demand side, rural demand continues to be on an uptrend, while urban consumption remains subdued with high frequency indicators providing mixed signals.

Going forward, tax relief in budget, robust agricultural growth and somewhat moderating inflation would likely to support household consumption. Global developments are, however, hostile and put a downside risk. Taking all such factors into consideration, the real GDP is projected as follows:

- **Real GDP growth for FY26 is projected at 6.7%.**
- **Q1 at 6.7%.**
- **Q2 at 7.0%.**
- **Q3 at 6.5%.**
- **Q4 at 6.5%.**

Inflation Projections: The Headline inflation has reduced in Nov~Dec'25. Earlier, inflation increased in Sept~Oct'2024 led by an unanticipated increase in food prices. The vegetable inflation remained particularly elevated among different sub-groups. However, the vegetable inflation softened considerably in Dec'24 at 26.56% from 42.23% in Oct'24 (YOY% change).

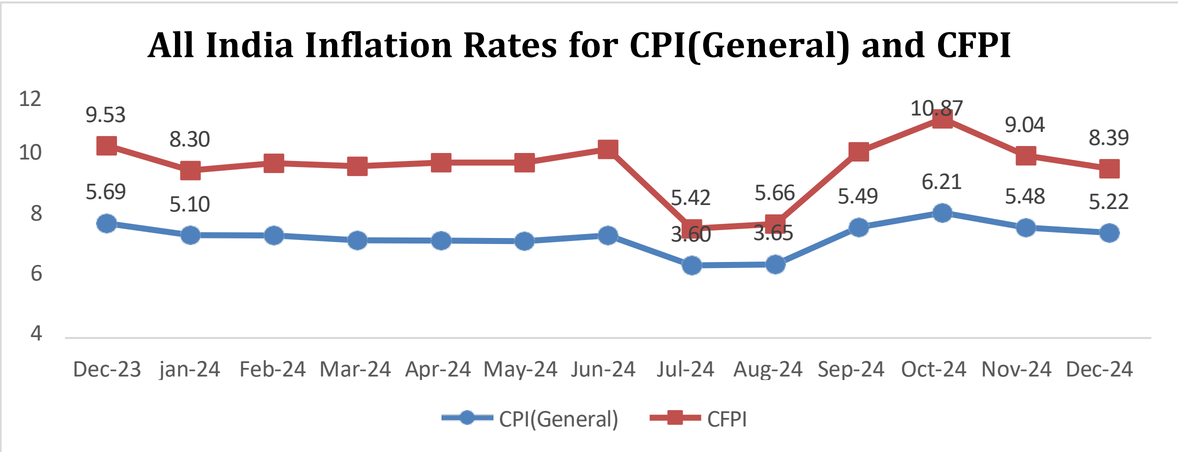
Going ahead, a good rabi season would be crucial for softening food inflation pressures. The following factors, in the absence of any supply-side shock, are expected to soften food inflation:

- Good kharif production (*As per the first advance estimates of kharif production for 2024-25 released on November 5, 2024, rice production is expected to increase by 5.9 per cent, while tur and moong dal production is expected to be higher by 2.5 per cent and 19.8 per cent, respectively in 2024-25, compared to 2023-24*).
- Winter-easing in vegetable prices (*High frequency food price data from Department of Consumer Affairs (DCA) points to a significant month-on-month correction in prices of tomatoes, onions, and potatoes in January 2025*).
- Favorable rabi crop prospects.

Emerging uncertainty in global financial markets coupled with enduring volatility in energy prices and adverse weather events presents upside risks to the inflation trajectory.

Considering these factors, **CPI inflation for the current financial year (FY25) is projected at 4.8% with Q4 at 4.4%.**

Assuming a normal monsoon,
CPI inflation for the financial year 2025-26 (FY26) is projected at 4.2%.
with Q1 at 4.5%.
Q2 at 4.0%.
Q3 at 3.8%.
Q4 at 4.2%.



Source: MOSPI.

External Sector Developments: India's current account deficit (CAD) moderated from 1.3 per cent of GDP in Q2 of last year to 1.2 per cent in Q2 of this year. According to the World Bank, India, with an estimated inflow of 129.1 billion US dollars, continues to remain the largest recipient of remittances globally in 2024.

As on 31st January this year, India's foreign exchange reserves (forex reserves) stood at USD 630.6 billion, providing an import cover of over 10 months. Overall, India's external sector remains resilient as key indicators stay robust.

On the other hand, there are some caveats, so if we consider the pessimistic factors, there is a fear of imported inflation due to Trump's tariffs. However, such pessimistic fears are somewhat overvalued since, India is not immediately in the hit list of Trump, who is more concerned with China, Mexico, and Canada. Moreover, Indian exporters are eyeing more markets in US due to US-China trade war, where electrical machinery, auto components, mobile, pharma, chemicals, apparel, and fabrics are the top beneficiaries according to exporters feedback survey.

China has already reduced their soyabean and aircraft imports from US, where countries like Vietnam is increasing their share in exportable to US. India could also enhance their share in US exportable.

India has already reduced customs duties on motorcycles and automobiles from US, whereas such policies would help improving trade relations with US.

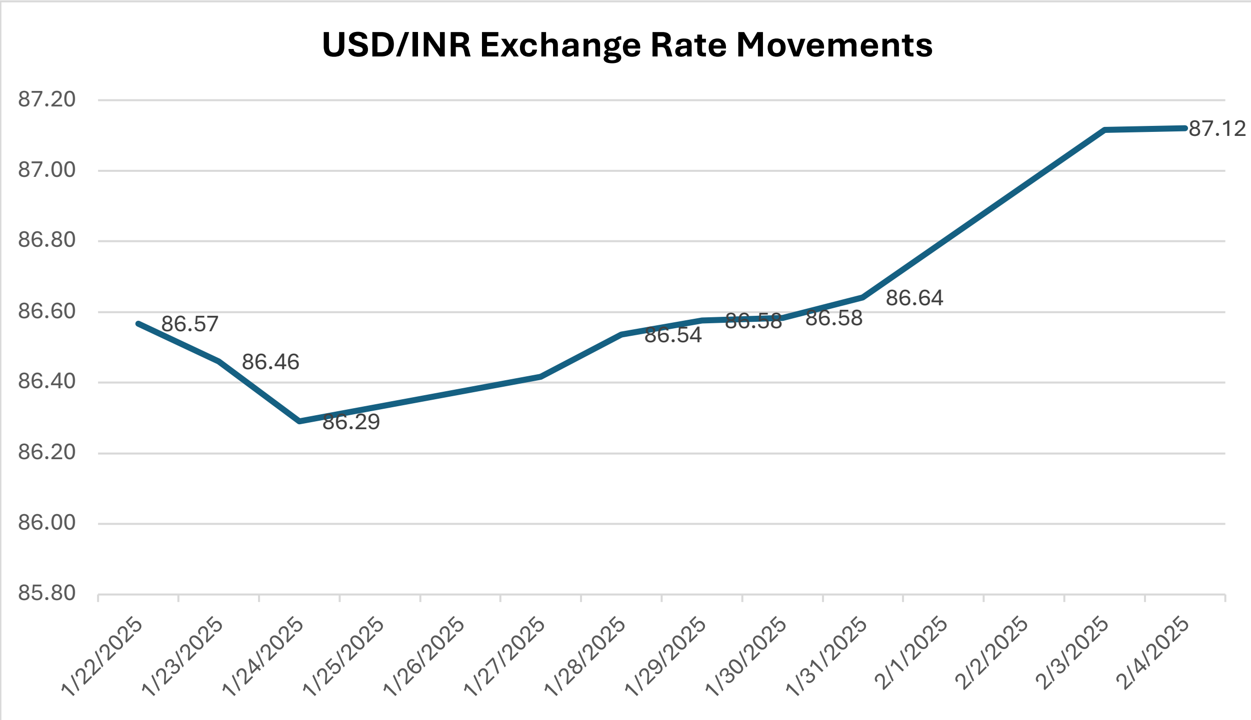
One concern in this regard is the continuous decline of the Indian rupee (INR) that crosses the 87 (USD/INR) mark. However, there are two aspects regarding this, all emerging market currencies are declining due to strong US Dollar index after the post US election results. Second, the rupee remains overvalued for reasonably longer time, where the real effective exchange rate (REER) has shown upward trends after Apr'2023, which needs to be corrected by showing its fundamental value. Hence the decline in the nominal value of the rupee was inevitable at certain point in time. In this regard, the RBI Governor has highlighted the following:

"*I would like to mention here that the Reserve Bank's exchange rate policy has remained consistent over the years. Our stated objective is to maintain orderliness and stability, without compromising market efficiency. Accordingly, our interventions in the forex market focus on smoothening excessive and disruptive volatility rather than targeting any specific exchange rate level or band. The exchange rate of the Indian Rupee is determined by market forces*."[1]

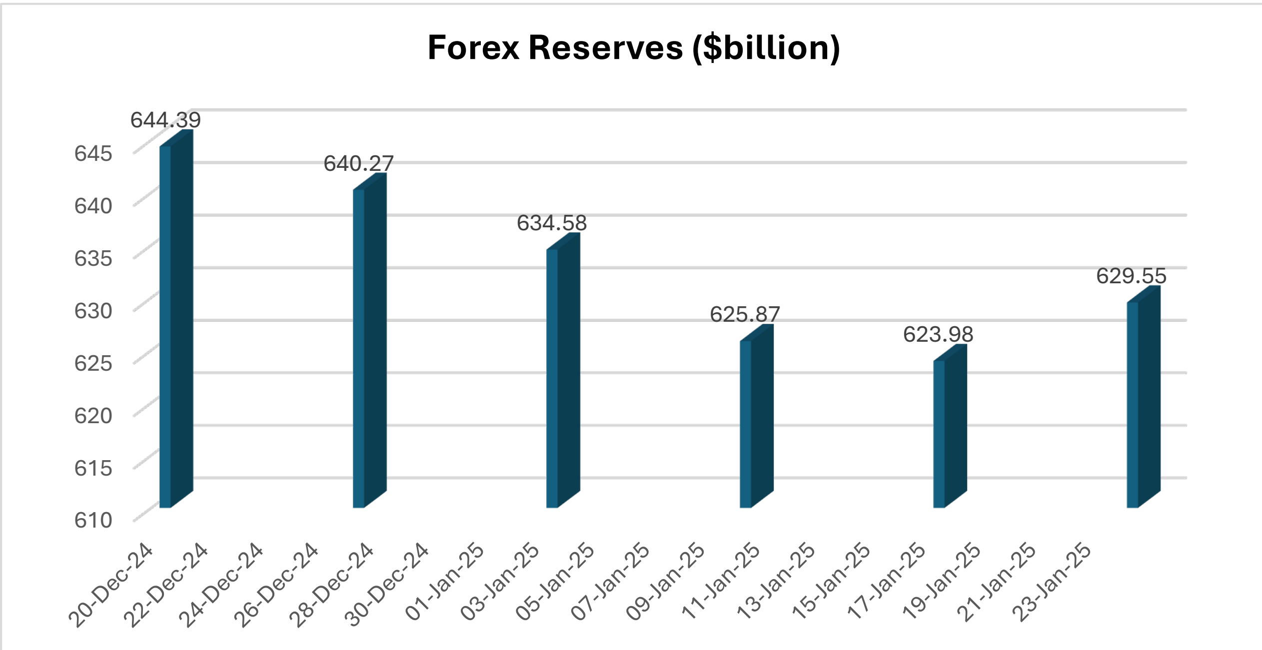
The Outlook of the Indian Rupee (INR): During the current calendar year (CY) 2024, the INR depreciated by 1.4% till November 19, 2024, against the US dollar (USD) mostly due to strong US Dollar Index and outward FII flows. The Dollar Index increased by about 4.8% till November 19, 2024. Further, the Dollar Index touched 108.07 on November 22, 2024, its highest in more than a year, exerting pressure on emerging market currencies. A declining INR would enhance export competitiveness, but on the other hand, the import costs would rise. However, the overall impact would depend on many factors like pass through of commodity prices, the degree of export-import elasticities or the so-called Marshall-Learner Conditions etc.[2] While corporates are well-hedged, especially after experiencing continuing decline in the rupee, many might avoid due to either higher hedging costs, and considering the rupee decline might have a halt going forward due to multiple factors including RBI's market intervention. Going forward, the rupee might be under stress for some time due to continued dollar strengthening and Trump's policy uncertainty regarding tariff before starting stabilizing.

[1] RBI Monetary Policy 7 Feb 2025.

[2] The condition states that a country's currency depreciation can improve its trade balance if the sum of the absolute values of its export and import price elasticities is greater than one.



Source: RBI.



Source: RBI.

Stance on Liquidity: After remaining in surplus from July to November 2024, system liquidity [as measured by the average net position under the liquidity adjustment facility (LAF)] turned into deficit during December 2024 and January 2025. The drainage of liquidity is mainly attributed to advance tax payments in December 2024, capital outflows, forex operations and a significant pickup in currency in circulation in January 2025.

Earlier, the RBI highlighted that systemic liquidity may tighten in the coming months due to tax outflows, increase in currency in circulation and volatility in capital flows. Hence, to ease the potential liquidity stress, the *RBI reduced the cash reserve ratio (CRR) of all banks to 4.0 per cent* in two equal tranches of 25 bps each from the fortnight beginning December 14, 2024, and December 28, 2024.[3] This reduction in the CRR was consistent with the neutral policy stance and *released primary liquidity of about ₹ 1.16 lakh crore to the banking system.*

The RBI has taken several measures to ease liquidity like Variable Rate Repo auctions (VRRR) from 16th January 2025 and purchase of government securities of 58,835 crore rupees through open market operations (OMOs) in January2025. Additionally, a package of measures was announced on 27th January 2025 to inject durable liquidity through OMOs, forex buy-sell swap and a 56-day variable rate repo to be conducted later.

The RBI has also urged banks to actively trade among themselves in the uncollateralized call money market to make it deeper and more vibrant for better signal extraction from the weighted average call money rate (WACR).

Financial Stability: The Credit Deposit Ratio (CD ratio) for the banking system at the end of January 2025 was at 80.8%, broadly similar to that on 30th September 2024. Though the net interest margin (NIM) moderated, return on assets (RoA) and return on equity (RoE) have improved.

The system-level parameters for NBFCs remain well balanced. Total capital to risk weighted assets (CRAR) of NBFCs is 26.5 per cent and Tier I CRAR is 24.4 per cent, as on 30th September 2024. GNPA ratio improved from 2.9 per cent in September 2023 to 2.6 per cent in September 2024.

The return on assets (RoA) improved from 2.9 per cent in September 2023 to 3.2 per cent in September 2024. YoY growth in advances was 16.4 per cent in September 2024 as compared to 22.5 per cent in September 2023.

[3] This will restore the CRR to 4.0 per cent of NDTL, which was prevailing before the commencement of the policy tightening cycle in April 2022.

Week Ended	Credit-Deposit Ratio	Credit-Deposit Ratio (Including merger impact)	*Incremental* Credit-Deposit Ratio	*Incremental* Credit-Deposit Ratio (Including merger impact)
Jan 10, 2025	78.64	80.36	85.30	81.66
Dec 27, 2024	78.67	80.42	86.13	82.58
Dec 13, 2024	77.91	79.69	75.91	72.49
Nov 29, 2024	77.70	79.52	72.82	69.82
Nov 15, 2024	77.60	79.44	70.73	67.41

Source: RBI, CMIE.

Cybersecurity Measures: Increased instances of fraud in digital payments are a significant concern. To combat the same, **the Reserve Bank of India (RBI) is introducing the 'bank.in' exclusive Internet Domain for Indian banks**. This initiative aims to reduce cyber security threats and malicious activities like phishing; and streamline secure financial services, thereby enhancing trust in digital banking and payment services. The Institute for Development and Research in Banking' Technology (IDRBT) will act as the exclusive registrar. The actual registrations will commence from April 2025. Detailed guidelines for banks will be issued separately. Going forward, it is planned to have an exclusive domain viz., "fin.in" for other non-bank entities in the financial sector.

Introduction of Forward Contracts in Government Securities: The RBI would introduce forward contracts in government securities to facilitate long-term investors such as insurance funds to manage their interest rate risk across interest rate cycles. It will also enable efficient pricing of derivatives that use Government securities as underlying instruments.

Negotiated Dealing System-Order Matching (NDS-OM) facility to be extended towards SEBI registered non-bank brokers: To enhance access of retail investors to government securities, the RBI shall expand the access of NDS-OM, the electronic trading platform for secondary market transactions in government securities, to non-bank brokers registered with SEBI.

Review of trading and settlement timings across various market segments: The RBI will set up a working group with representation from various stakeholders to undertake a comprehensive review of trading and settlement timing of markets regulated by the Reserve Bank.

Overall, the Feb'25 RBI policy remains prudent focusing on reviving growth while remaining vigilant in monitoring inflation.