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RBI'S FEBRUARY POLICY: REPO RATE CUT ON

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Global Perspective

The International Monetary Fund's (IMF's) latest World Economic Outlook (WEO) released on January 17, 2025 makes sober reading. While the IMF maintained its global growth forecast unchanged at 3.3 per cent both in 2025 and 2026, global headline inflation is likely to decline to 4.2 per cent in 2025 and to 3.5 per cent in 2026. In this tumultuous time, adroit risk management "requires a keen policy focus on balancing trade-offs between inflation and real activity, rebuilding buffers, and lifting medium-term growth prospects through stepped-up structural reforms as well as stronger multilateral rules and cooperation".

This is quite a tall order in view of President Donald Trump's accent on tariffs, a throwback to protectionism, currency volatility, checking inflationary impulses while raising growth. The WEO's assessment "growth in India also slowed more than expected, led by a sharper-than-expected deceleration in industrial activity" causes a gnawing feeling. But given the global setting of "divergent and uncertain" growth and India's consistent outperformance, there is no case for alarm.

The Union Budget on February 1, 2025 provided an impetus to the transformative growth process of the Indian economy and revive the "animal spirits".

Domestic Backdrop

India's GDP is expected to decline to 6.4 per cent in FY 25 over 7.2 per cent growth in FY 24 because of a fall in manufacturing and investment growth. The Ministry of Statistics and Programme Implementation (MoSPI) said in its official release "Real GDP has been estimated to grow by 6.4 per cent in FY 2024-25 as compared to the growth rate of 8.2 per cent in Provisional Estimate (PE) of GDP for FY 2023-24. Nominal GDP has witnessed a growth rate of 9.7 per cent in FY 2024-25 over the growth rate of 9.6 per cent in FY 2023-24".

This slowest growth rate since the pandemic manifests moderation across key sectors and occurred in the wake of higher interest rates amid elevated inflation, particularly of food commodities, slack urban consumption and capital expenditure. This deceleration marked a significant decline from 8.2 per cent growth in FY24. Incidentally, the RBI had lowered its growth projection for the current financial year to 6.6 per cent from 7.2 per cent in its December 2024 Policy.

The RBI has kept the Repo rate steady since April 2023 (i.e., the last 11 consecutive meetings) after raising it by 250 basis points to 6.5 per cent between May 2022 and February 2023 to check inflation and bring inflation to the medium-term target of 4 per cent.

While agriculture is set to perceptibly rise by 3.8 per cent (1.4 per cent last year), most sectors face lower growth. Mining is projected to slow to 2.9 per cent from 7.1 per cent, while manufacturing growth is forecast at 5.3 per cent, down from 9.9 per cent. Electricity growth is estimated at 6.8 per cent, lower than last year's 7.5 per cent, and construction is expected to grow at 8.6 per cent, down from 9.9 per cent.

The top three contributors to GDP—manufacturing, trade & hotels, and financial services & real estate—are also estimated to slow in FY25, while public administration is expected to rise. Urban consumption has been hit because of the ravages of sticky inflation eroding the purchasing power of the urban poor.

There were also factors, such as, rising economic uncertainties, the base effect, and heightened geopolitical risks driving down the growth rate.

Nominal GDP is expected to grow by 9.7 per cent in 2024-25 over 9.6 per cent growth in 2023-24.

Inflation

Inflation seems to be softening with sharp reduction in food prices led by vegetables likely to reduce retail inflation to 4.5 per cent in January 2025. CPI inflation for FY 26 is expected to average 4 per cent.

Inflation fell steadily to a four-month low of 5.22 per cent in December, down from 5.48 per cent in November and 6.21 per cent in October. While this decline is welcome, December marked the fourth consecutive month of inflation exceeding 5 per cent. Viewed thereof, "sticky inflation" causes concern.

Why Rate Action?

Against this macroeconomic backdrop, the repo rate is likely to be reduced by 25 basis points (bps) from 6.5 per cent to 6.25 per cent in the upcoming MPC. Decelerating GDP growth together with persistently stubborn inflation make the RBI's task of adroitly managing the growth-inflation trade-off odious.

Flagging growth and extensive measures to infuse liquidity of Rs 1.5 lakh crore to change the liquidity deficit banking ecosystem on top of Rs 1.16 lakh crore of liquidity infusion in December 2024 because of 50 bps reduction in cash reserve ratio (CRR) bolster the case for a growth-supportive monetary policy. This rate cut in juxtaposition with income tax relief given to tax payers earning Rs 12 lakhs or lower will enhance consumption-led demand but the falling rupee is a concern. This measure will help to shore up consumption and discretionary spend with multiplier effects across the consumer goods industry.

In sum, lower fiscal deficit and buoyant direct taxes provide space to the RBI to effect a policy rate cut in February 2025. This space, which becomes more pronounced in view of the evolving growth-inflation trade-off, needs to be effectively used in the decision-making matrix to distinctly alter the ground-realities in the pursuit of the avowed objectives of development. As William Shakespeare wrote eloquently in Julius Caesar,

"There is a tide in the affairs of men

Which, taken at the flood, leads on to fortune;

Omitted, all the voyage of their life

Is bound in shallows and in miseries.

On such a full sea are we now afloat;

And we must take the current when it serves,

Or lose our ventures."