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Amidst the dilemma of sharp growth slowdown and still-elevated inflation, the MPC maintains a balanced approach by keeping both policy rates and stance unchanged while addressing tight banking liquidity concerns through a 50 bps CRR cut. The revision of FY25 growth and inflation projections to 6.6% and 4.8% respectively, reflects an adverse balance, necessitating support for growth. Even though the MPC has maintained a data-dependent approach, a policy rate cut in February'25 is highly likely, as growth may surprise on the downside and headline inflation is expected to realign close to 4% in FY26, driven by receding food inflation. Overall, the MPC's actions were in line with expectations and are moving towards easing policy. The next quarter is expected to benefit from improved liquidity, anticipated rate cuts, and favourable demand-supply dynamics.

Key decisions/Highlights

Four out of six Monetary Policy Committee (MPC) members **voted to keep the policy rate unchanged at 6.50%** while 2 members voted to reduce the policy rate by 25 bps.

The **standing deposit facility (SDF)** rate remains **unchanged at 6.25%** and the **marginal standing facility (MSF)** rate and the **Bank Rate at 6.75%**.

MPC **unanimously voted to continue with the neutral monetary policy stance** and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.

Consumer Price Index (CPI) **inflation projections for FY25 at 4.8% (up from 4.5%)** with Q3FY25 at 5.7% (up from 4.8%) and Q4FY25 at 4.5% (up from 4.2%). **Q1FY26 inflation is projected at 4.6% (up from 4.3%)** and **Q2FY26 at 4.0%** with risks evenly balanced.

Real GDP growth projections for **2024-25 at 6.6% (down from 7.2%)** with Q3FY25 at 6.8% (down from 7.4%) and Q4FY25 at 7.2% (down from 7.4%). **Q1FY26 GDP is projected at 6.9% (down from 7.3%)** and **Q2FY26 is at 7.3%** with risks evenly balanced.

Cash reserve ratio (CRR) **has been reduced by 50 bps to 4%** of net demand and time liabilities (NDTL) in two equal tranches of 25 bps each with effect from the fortnight beginning December 14, 2024 and December 28, 2024.

In order to **attract more capital inflows, the interest rate ceilings on Foreign Currency Non-Resident Bank (FCNR(B)) deposits has been increased**. This relaxation will be available till March 31, 2025.

To further **develop the interest rate derivatives market** in India and **improve the credibility of interest rate benchmarks**, RBI proposes to **introduce a new benchmark - the Secured Overnight Rupee Rate (SORR)** - based on all secured money market transactions – overnight market repo as well as TREPS.

Amidst global uncertainty & adverse domestic inflation-growth dynamics, MPC maintains a balanced policy approach

Today's monetary policy announcement was quite significant given the recent global and domestic developments. Globally, the US presidential election outcome has raised concerns about policy continuity and any shift in economic, trade and geo-political policies may have an impact on fueling US's inflation and on global financial market over the course of 2025. The election results also led to a sharp hardening in UST yields (US treasury Bond yields), however UST yields have cooled off by 20-25 bps post the knee jerk market reaction. The dollar index (DXY) gained strength which resulted in major currencies including EM currencies (Emerging market) to come under pressure.

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Domestically, the growth momentum slowed down considerably in Q2FY25 as the GDP came at an abysmal 5.4%. At the same time, inflation jumped sharply in September'24 and October'24 owing to increase in food prices, while core inflation continued to remain below 4%. The banking system liquidity turned to a deficit in the last week of November'24 due to RBI's forex (Fx) intervention and GST related outflows. Although liquidity turned into surplus later due to government spending, it is anticipated to remain relatively tight or in deficit for the next few months. INR also came under pressure due to strengthening of US dollar and selling pressure by Foreign Portfolio Investors (FPI). This shift in growth-inflation dynamics required RBI to act in a way that would strike a balance between anchoring inflation expectations and addressing growth concerns.

Amidst the mixed indicators, as expected, MPC maintained a balanced approach of keeping both policy rates and stance unchanged while addressing tight banking liquidity concerns through a 50 bps CRR cut. The split in voting, with 2 members in favour of 25 bps rate cut, also sets the stage for rate cut in February'25.

Growth projections sharply reduced to 6.6% for FY25; still looks a challenging one

GDP growth for the September quarter came at a seven-quarter low of 5.4% Y-o-Y, down from 6.7% in previous quarter and well below market expectations. Given the sharp slowdown in growth, subdued government capex and global growth concerns; it was expected MPC to switch its focus to addressing growth concerns while being cognizant of reigning inflation towards 4% by FY26. The downward revision of GDP for FY25 to 6.6% is on expected lines. The MPC expects H2FY25 to be better due to improving rural consumption, healthy investment cycle, strong services exports etc. For FY25 GDP to be close to ~6.4% - 6.5%, the H2FY25 GDP needs to come at 7%, which seems to be a tall task. It is likely that growth numbers may surprise on a downside, necessitating MPC's focus on supporting growth.

Near term inflation to remain elevated; however, expected to moderate closer to the target in FY26

Inflation pressures have surged significantly over the past couple of months. CPI inflation for October'24 came in at 6.2%, up from 5.5% in September'24, breaching the RBI's upper tolerance threshold. The increase was mainly led by unanticipated spike in food process. Core inflation inched up in October'24 largely led by gold prices and even then, continues to remain below 4%. Recent softening of energy prices is favourable but hike in global agriculture commodity prices pose an upside risk. We expect inflation to remain close to 5.5% - 5.7% for November'24 owing to persistent food price pressures, keeping the inflation elevated for Q3FY25. Food inflation is likely to soften in Q4 given the seasonal easing of vegetables prices, good kharif production and healthy reservoir levels. We expect headline inflation to realign close to 4% in FY26 on the back of receding food inflation.

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RBI proactively reduces CRR by 50 bps to address expected tightness in banking liquidity

Overall system liquidity for October- November'24 remained in surplus of about Rs. 1.5 lakh crore, however deteriorated sharply and turned deficit towards the end of November'24 as RBI intervened heavily in Fx market to protect INR, capital outflows and currency leakage through circulation. RBI had conducted fine-tuning variable rate repo (VRR) operations intermittently during October and November to manage liquidity. Even as the banking liquidity is marginally surplus now with government's month end spending, going ahead liquidity is expected to tighten due to tax outflows, increase in currency in circulation and volatility in capital flows. In order to ease liquidity, RBI reversed CRR to pre-covid 4% level which would infuse ~Rs. 1.16 lakh crore, this infusion augurs well for faster policy transmission. RBI is expected to continue to be nimble and proactive in its liquidity management operations to ensure that money market interest rates evolve in an orderly manner. If we were to see heightened capital outflows during Q4FY25, it may require RBI to take more concrete measures to inject durable liquidity.

Market reaction was on the expected lines

Market yields had come down sharply post the Q2FY25 GDP print and 10 yr G-Sec benchmark had cooled off by 15-17 bps in anticipation of easing of monetary policy in order to support growth. While the market was largely factoring in CRR cut for liquidity infusion and a rate cut only by February'25 or so, traders had built in additional positions over last 3-4 days to see if MPC can also deliver a surprise policy rate cut. As the MPC maintained a status quo on policy rates, we saw the unwinding of trading positions post policy announcement which led to a 4-7 bps correction in G-Sec yields with bear flattening bias. At the same time, as CRR cut came in line of market expectations, 3 months to 1 year money market rates saw the yields declining by 1-3 bps.

Segment	Broad movement of yields in bps (as on December 6, 2024)	
	G-Sec	AAA Corporates
3 months	-1 bps	-3 bps
6 months	-1 bps	0 bps to -1 bps
1 year	-1 bps	0 bps to -1 bps
2 -3 years	+3 bps	+3 bps to 5 bps
4 - 5 years	+7 bps	+3 bps to 5 bps
10 years	+6 bps	+3 bps to 5 bps
15 years	+6 bps	NA
30 years	+4 bps	NA

Source: Bloomberg

Growth-inflation dynamics may turn favourable for a policy rate cut in February'25 policy

Amidst the dilemma of sharp growth slowdown and still-elevated inflation, the MPC has maintained a balanced approach by keeping both policy rates and stance unchanged in this policy. The revision of FY25 growth and inflation projections to 6.6% and 4.8% respectively, reflects an adverse balance, necessitating support for growth. Even though the MPC has maintained a data-dependent approach, a policy rate cut in February'25 is highly likely, as growth may surprise on the downside and headline inflation is expected to realign close to 4% in FY26, driven by receding food inflation.

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While the growth is expected to recover in H2FY25, it would still be a challenge to grow at ~7% as RBI's projection (6.8% in Q3 and 7.2% in Q4) amidst weaker fiscal impulse, global growth overhang and tight monetary policies. Inflation, though may remain elevated in Q3 on still higher food prices, it is expected to moderate in Q4 and further in FY26. RBI has projected 4% inflation in Q2FY26 and we expect RBI in its February' 25 policy to project close to 4% inflation in FY26. As the targeted inflation comes in sight and as growth surprises on downside, we expect MPC will have a space opened up for a rate cut in forthcoming February'25 policy.

Risk to our view is largely coming from the global factors which could put pressure on INR thereby restricting MPC's ability to deliver a rate cut.

Risk-reward remains favourable for debt markets

Today's policy outcome has set the stage for beginning of easing cycle. We believe the current elevated yields provide an entry opportunity for investors across the yield curve. The shorter end of the curve is expected to reap the benefit of benign liquidity. While longer end of the curve is likely to benefit from expected rate cut in the February'25 policy and healthy demand supply dynamics. We believe investors can look at increasing allocation, depending on the risk appetite, toward funds like Gilt fund, Medium duration fund, Corporate bond fund, Banking & PSU fund etc. Active fund management is critical as uncertainties may emanate from domestic inflation, volatility in global crude oil prices and geo-political risks which may influence various yield curve segments differently.

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