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The first MPC meeting under the new Governor delivered a unanimous rate cut of 25 basis points after almost five years, in line with market expectations. The commentary on inflation is benign, particularly regarding food prices, with FY26 headline inflation projected to moderate to 4.2%. The outlook for FY26 growth remains upbeat at 6.7%. The stance has been retained as “Neutral,” citing global uncertainty. While there were no major announcements on further liquidity measures, which may disappoint the market slightly, the readiness to proactively provide liquidity is reassuring. There is also more flexibility on currency movement due to market conditions. Overall, this is a well-balanced policy that meets market expectations for the third consecutive time. The new MPC’s more flexible approach to the inflation trajectory under the inflation targeting framework provides room for further rate cuts, even as the MPC remains data dependent. A fiscally prudent budget and the onset of the rate cut cycle set the stage for domestic market yields to come down.

Key decisions/Highlights



Rate cut by 25 bps

- Policy repo rate at 6.25%
- Standing deposit facility (SDF) rate at 6.00%
- Marginal standing facility (MSF) rate and the Bank Rate changes at 6.50%.



Policy stance retained as Neutral

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



FY26 Real GDP projected at 6.7%

- Q1FY26 at 6.7% (down from 6.9%)
- Q2FY26 at 7.0% (down from 7.3%)
- Q3FY26 at 6.5%
- Q4FY26 at 6.5%



CPI projected at 4.2% for FY26

- FY25 at 4.8% (retained) and Q4FY25 at 4.4% (down from 4.5%).
- FY26 projection at 4.2%
- Q1FY26 at 4.5% (down from 4.6%)
- Q2FY26 at 4.0% (retained)
- Q3FY26 at 3.8%
- Q4FY26 at 4.2%

MPC delivers a rate cut of 25 bps after almost 5 years; meets the expectations

This MPC was a complex one in many ways.

First - The global backdrop has been mixed as the US Federal Open Market Committee (FOMC) paused its rate cut cycle after delivering 100 bps in previous three policies, owing to sticky inflation, a healthy jobs market, and now added political uncertainty under new US’s President. Bank of Japan hiked the policy rates by 25 bps, in line of market expectations. Many other Central banks like Bank of England (BoE) and European Central Bank (ECB) have cut rates by 25 bps while Indonesia delivered a surprise rate cut of 25 bps to support domestic growth, even as currencies remain under pressure.

Second – The INR has been under pressure as the USD continues to gain strength with US policy uncertainty and also as RBI reduced its intervention in Forex (Fx) market. A minority section of market even expected MPC to maintain status quo on policy rates to support currency.

Third - It was a first MPC under the new Governor and also for many other new MPC members, so the approach towards global uncertainty, domestic growth – inflation dynamics and tight banking liquidity was to be seen.

Against this backdrop, MPC has delivered a 25 bps rate cut with a unanimous vote, almost after 5 years and is in line with market expectations. MPC delivered a well-balanced policy by shifting focus to support economic growth while maintaining inflation closer to the long term target. MPC has maintained a “Neutral” stance so as to maintain flexibility on either side, considering the global uncertainty. Nonetheless, new MPC’s more flexible approach to the inflation trajectory under the inflation targeting framework, as against the specific 4% target provides room for further rate cuts, even as the MPC remains data dependent.

February 7, 2025

Growth projections for FY26 remains upbeat at 6.7%

RBI sounded more upbeat on FY26 growth projections at 6.7% - towards the higher end of recent economic survey which pegged the growth at 6.3% - 6.8%. FY25 growth is expected at 6.4%, sharply down from the RBI's first estimate at 7.2%, on account of lower fiscal impulse, weaker exports and declining bank lending growth. Even as the growth is expected to improve in coming year with pick up in economic activity, improving rural consumption, recovery in manufacturing activity, better employment conditions and recent tax relief, we believe it may still be a tall task to achieve 6.7% especially when the global uncertainty overhang remains high.

Benign inflation commentary with FY26 headline inflation projected to moderate to 4.2%

The CPI inflation eased sequentially in November'24 and December'24 to 5.58% and 5.22% respectively primarily on back of moderating food prices. Going ahead inflation is expected to moderate further owing to healthy water reservoir levels supporting crop production. Base effect is also expected to be conducive. Core inflation is expected to rise but is likely to be moderate. The Governor indicated in the statement that MPC would adopt a more flexible approach towards inflation trajectory under the inflation targeting framework rather than be specific about achieving 4% inflation target. This marks a big shift as earlier Governor – Mr. Das was quite committed towards 4% number. Global headwinds coupled with volatile energy prices and unexpected erratic weather conditions can derail the inflation moderation.

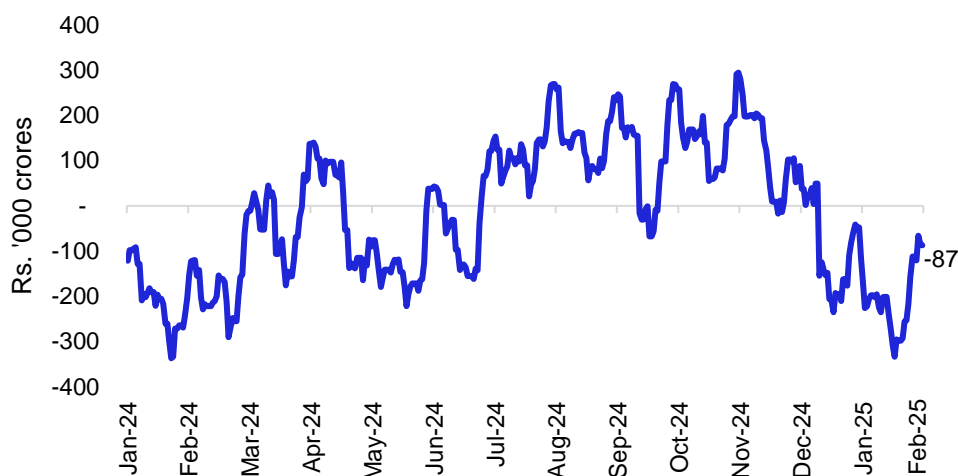
No major announcements around liquidity measures however assurance to proactively manage liquidity is positive

Systemic liquidity has turned deficit since December'24 as RBI intervened heavily in Fx market which sucked out INR liquidity, in addition to other regular outflows like advance tax payments, capital outflows and increase in currency in circulation. Even before the MPC meeting, RBI under new Governor had taken various measures to address liquidity concerns like reduced intervention in Fx market, Open Market Operation (OMO) calendar for purchase of ~Rs 60,000 crore, longer term Variable Repo Rate (VRR) of ~Rs. 50,000 crore, daily VRRs and Fx sell/buy swap of USD 5 bn. In addition, RBI has also conducted several secondary market OMO purchase of ~Rs 38,000 crore.

Despite the various liquidity measures, banking liquidity remains deficit and is expected to further worsen to a deficit of Rs 1 – 1.5 lakh crore towards March'25 end. Against this backdrop, many market participants were expecting additional measures like an outright Cash Reserve Ratio (CRR) cut, OMO purchase calendar or Fx swap. Even though RBI has not announced any concrete measures in this policy meeting, which came as a disappointment, the Governor has re-assured the market for proactively providing adequate liquidity including durable liquidity. We believe RBI will announce measures like OMO purchases and Fx swap in February'25. As such, we don't envisage an outright CRR cut for now.

February 7, 2025

Banking Liquidity (Rs.'000 crores)



Source: Bloomberg. Data as on February 6, 2025

Market reacted negatively as Neutral stance was retained and no liquidity measures were announced

Even though the wider market consensus was for a 25 bps rate cut, we saw excessive buying over last few days, which drove the yields down in anticipation of a more dovish MPC in terms of stance change to “Accommodative”, signaling future rate cuts and concrete measures on the liquidity front. As the MPC maintained a well-balanced and data dependent approach for future rate actions, market reacted negatively with yields hardening by 3-5 bps across the yield curve. It is, however, to be noted that on a week on week basis, G-Sec yields have ended flat, reflecting that the post MPC market correction is only the reversal of earlier tactical rally.

Segment	Broad movement of yields in bps (as on February 7, 2025)	
	G-Sec	AAA Corporates
3 months	+1 bps	+5 bps
6 months	+2 bps	+5 bps
1 year	+2 bps	+5 bps
2 -3 years	+3 bps	+5 bps
4 - 5 years	+5 bps	+5 bps
10 years	+6 bps	+5 bps
15 years	+5 bps	NA
30 years	+4 bps	NA

Source: Bloomberg

External factors continue to provide resilience

India's external sector indicators have remained resilient with manageable current account deficit (CAD), healthy import cover of more than 10 months, moderating inflation, fiscal consolidation and relatively stable credit environment. Even as the global headwinds are putting pressure on Emerging Countries, India is expected to remain strong. INR has become relatively more volatile but that seems to be more in line of general USD strength and as RBI has reduced its intervention in Fx market. Despite the recent depreciation, INR continues to remain relatively stable as compared to other Emerging Market (EM) peers. On forex market intervention, RBI clarified that intervention in the forex market will be measured based on excessive and disruptive moves in the currency and the exchange rate would be determined by market forces, a departure from earlier tight policy on INR management.

February 7, 2025

Well-balanced policy that meets market expectations, flexibility in inflation targeting framework provides room for further rate cuts

Amidst easing inflation, slowing economic growth and government's fiscally prudent approach, MPC has provided much needed support by starting the rate easing cycle with a 25 bps rate cut. Even as MPC has retained the stance as "Neutral," citing global uncertainty and maintains a data dependent approach, we believe new MPC's more flexible approach to the inflation trajectory under the inflation targeting framework provides room for further rate cuts. In our view, inflation projection of 4.2% in FY26 and current policy rate of 6.25% provide space for incremental 25-50 bps rate cut, however the last 25 bps rate cut may still depend upon the global factors.

Risk-reward remains favourable for debt markets

Overall, risk-reward remains favorable at current juncture as healthy domestic demand-supply dynamics & further rate cuts and expectations of RBI's OMOs will help in bringing the market yields down and produce capital gains. Central Government has maintained its fiscal prudence by budgeting the FY26 fiscal deficit at 4.4% which is 40 bps consolidation over FY25, and has outlined a gliding path thereafter to reach debt / GDP at ~50% by 2031. This is a structural driver as G-Sec supply will remain muted over next few years. Against this, demand from domestic investors as well as global investors is expected to remain robust as sovereign bonds get included in another two global EM debt indices – Bloomberg & FT Russell.

It will be critical to position appropriately on G-Sec & Corporate bonds yield curve. G-Sec yield curve is steep and is expected to flatten with long end yields coming lower on robust demand from investors like Insurance companies, National Pension System (NPS), Employee Provident Fund Organization (EPFO) in last quarter of a financial year. Corporate bond yield curve on the other hand, is inverted and is also expected to flatten but with short end i.e 1- 5 yr yields coming lower more rapidly. Any uptick in yields due to still evolving global factors should be seen as an opportunity to build further exposure as the rate cut cycle commensurate over next few months. Active fund management is critical as uncertainties may emanate from domestic inflation and global backdrop which may influence various yield curve segments differently.

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