

RBI MPC Minutes: A foreseeable Feb cut

January 2, 2025

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Key takeaways: Minutes of RBI MPC meeting, December 2024

In the latest meeting of the RBI MPC, the committee unanimously maintained the policy stance at 'neutral' and held the key policy repo rate at 6.50%, with a 4:2 vote, a change from 5:1 majority in the previous meeting. Of the three external MPC members, Dr. Nagesh Kumar continued to favor a 25bp rate cut but an additional member, Prof. Ram Singh, who had supported status quo in policy rate in October, voted for a rate cut.

In December, the RBI also cut the cash reserve ratio (CRR) by 50 basis points to 4% of NDTL (net demand and time liabilities) that was implemented in two equal tranches of 25 bps each with effect from the fortnight beginning December 14, 2024 and December 28, 2024. This step towards liquidity infusion followed the change in stance to 'neutral' from 'withdrawal of accommodation' at the MPC meeting in October.

Most MPC members noted that the balance between growth-inflation dynamics had turned adverse since the meeting in October, with inflation surprising on the upside and growth disappointing. Despite raising the inflation forecast for FY25, most members remained comfortable about its trajectory. However, the recent weakness in domestic growth was met with divergent views, causing the main difference between the doves and hawks within the MPC. The members favoring a rate cut viewed policy easing as necessary to support growth, with Prof. Ram Singh putting forth the arguments for a policy pivot needed to a counter-cyclical mode. But the ones preferring to preserve gains from disinflation viewed durable reduction in inflation as key to rekindling growth on a sustainable basis by raising households' disposable incomes and purchasing power.

The need to infuse liquidity was duly noted by majority of MPC members that led to the CRR cut. Perhaps, an important cue was the statement by Dr. Rajiv Ranjan who advocated the importance of sequencing and timing of policy measures, suggesting that the start of easing with a 25bp cut to the policy repo rate is plausible at the upcoming meeting in February. However, as also suggested by Dr. Ranjan, the expected easing of food inflation could open policy space to 'normalize' rates, indicating a shallow easing cycle.

It is important to note that Shri Sanjay Malhotra took over as RBI Governor, as Shri Shaktikanta Das' term concluded in December. Also, DG Dr. Patra's extended term is set to end in mid-January, so the upcoming policy meeting from 5-7 February will have two new committee members.

Food prices expected to ease; divergent views on spill over effects

Imbalance between growth-inflation trajectory: The minutes of the latest RBI MPC meeting held in December indicate a largely consensus view that the growth-inflation dynamics in the economy had turned adverse, with inflation surprising on the upside and growth disappointing. In October, CPI headline inflation breached the RBI's upper tolerance band of 6% after a gap of more than a year, while the year-on-year real GDP growth in Q2-FY25 printed sub-6% at a seven-quarter low. However, most MPC members expect this imbalance to correct in H2-FY25, with growth expected to average 7% and inflation to moderate to 4.5% in Q4-FY25 from 5.7% in Q3.

Vegetable prices, a supply-side phenomenon: External MPC members Prof. Ram Singh and Dr. Nagesh Kumar, who voted for a 25bp rate cut, emphasized that the ongoing volatility in food inflation was induced by vegetable prices due to supply-side issues, over which monetary policy had limited control. While vegetable prices are expected to ease in coming months due to seasonal correction, some members noted the recent rise in other components of the food basket, but their views on spill over effects of high food inflation were mixed.

Concerns over other pockets of the food basket: Most MPC members noted the recent rise in edible oil prices, attributable to increase in global food prices and import duty hike. Particularly, Shri Saugata Bhattacharya noted the increase in prices of agriculture-related inputs such as non-edible oils that could feed into consumer goods prices, and the risk that the forecast of above-normal minimum temperatures in winter could impact Rabi crop. However, as noted by ED Dr. Rajiv Ranjan, waning of food prices pressures on expected lines could open the policy space to normalize policy rates.

Divergent views on second order effects of food inflation: The MPC members favoring a rate cut opined that the spill overs from food to core inflation had reduced in recent years, as ascertained by the ongoing persistent gap between core and food inflation and also noted that the persistence of core inflation had declined over time. However, DG Dr. Patra noted that the early signs of second order effects of high primary food prices had started to emerge, warranting vigilance over higher input costs that could trickle down to selling prices.

Preserving gains from disinflation: DG Dr. Patra noted that the recent softness in domestic growth was the result of repeated price shocks, making it imperative to preserve gains from disinflation. Governor Shri Shaktikanta Das reiterated that the biggest support for higher growth would come from price stability, as durable alignment of inflation with target would help to rekindle growth on a sustainable basis by raising households' disposable income and purchasing power.

The pathway to growth – lower inflation or policy rate cut?

Interpreting Q2 GDP print: MPC members noted the weakness in latest domestic growth data for Q2-FY25, particularly the slowdown in manufacturing GVA and moderation in growth of consumption and investment within GDP. Most members expect growth to improve in H2-FY25 due to improved farm prospects and further pick-up in government spending. However, the external members favoring a policy rate cut (Prof. Ram Singh and Dr. Nagesh Kumar), and also the third external member Shri Saugata Bhattacharya noted that reducing the cost of doing business by lowering interest costs could help support growth, particularly in the manufacturing sector and in case of small enterprises. However, as noted earlier, Governor Shri Shaktikanta Das and DG Dr. Patra, who voted for status quo policy, attributed the ongoing sluggishness in economic activity to price pressures, and therefore, viewed lower inflation as a pathway to higher, sustainable growth.

Policy pivot to counter-cyclical mode: Some of the key arguments by Prof. Ram Singh, one of the three external MPC members, who tilted in favor of a policy rate cut at the December meeting, are noted below:

- Though inflation estimate for FY25 was raised by the MPC, the trajectory was unchanged, with alignment to target expected in FY26. However, the recent slowdown in growth and its impact on full-year forecast was sharper than anticipated, perhaps warranting policy pivot to a counter-cyclical mode.
- The decline in core inflation amid the recent growth slowdown indicated that the divergence between the actual and potential growth of the economy was widening. Additionally, a not-so-tight labor market implied that the economy could grow faster without stoking inflation.
- The difference between core inflation (also, expected four-quarter ahead CPI inflation) and the current policy rate continued to point to a restrictive policy vis-à-vis the natural rate for the economy.
- A rate cut could reduce the cost of doing business and perhaps, also spur investment by raising the opportunity cost for firms to hold on to cash.
- The economy has a limited window to capitalize on the demographic dividend, making it imperative to focus on growth, while avoiding extreme scenarios on the inflation front. In that context as well, price stability within a range was perhaps more plausible, instead of focusing on alignment with the target.

Enhancing liquidity as a step towards easing policy repo rate

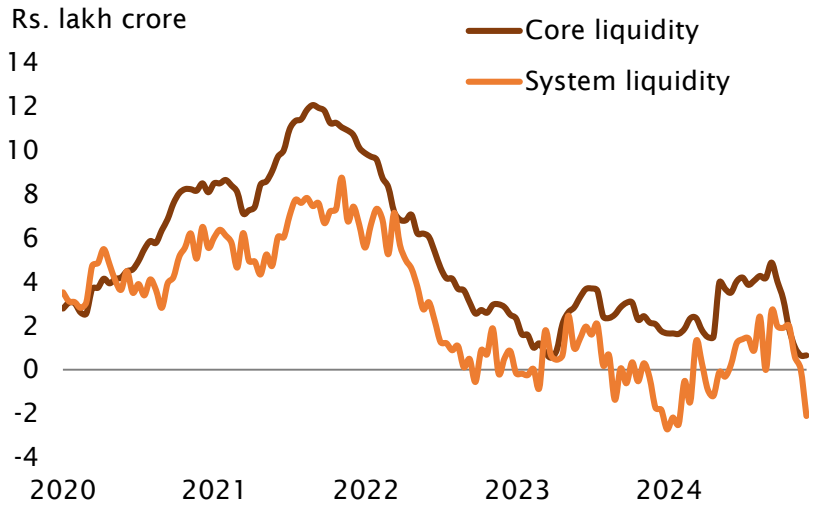
The case for liquidity infusion: Majority of the MPC members expressed the importance of enhancing system liquidity, be it to improve the flow of credit to micro and small firms, as noted by Shri Saugata Bhattacharya, or to facilitate improvement in policy transmission once rate easing cycle starts, as enunciated by Dr. Rajiv Ranjan. In fact, Dr. Ranjan advocated the significance of sequential steps, which was eventually implemented by way of 50bp CRR cut in two equal tranches of 25 bps each with effect from the fortnight beginning December 14, 2024 and December 28, 2024, taking the CRR rate to the pre-COVID level of 4% of NDTL.

Navigating policy amidst uncertainties: When the MPC changed its monetary policy stance to 'neutral' from 'withdrawal of accommodation' at its meeting in October, the main rationale cited was the flexibility it would impart to policy making to counter both domestic and external uncertainties. The minutes of the latest meeting show that uncertainty remained a concern among some of the MPC members but the underlying context and their approach navigate it varied. Dr. Rajiv Ranjan noted that globally, uncertainties in the path of disinflation were keeping central banks cautious in their policy easing cycle. Dr. Ranjan emphasized the past success of cautious and calibrated approach amid difficult policy trade-offs domestically, and advocated the importance of sequencing and timing in policy making to address challenging situations. On the other hand, Prof. Ram Singh suggested that the current backdrop of heightened uncertainty warranted policy objective as price stability within a range rather than to a point target.

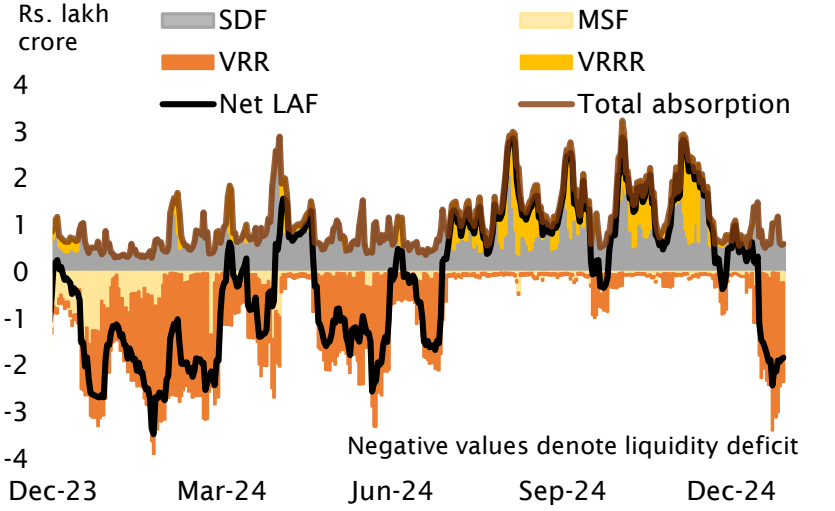
Implications for monetary policy: Though central banks that have started monetary easing remain cautious due to the prolonged last mile of disinflation, interest rate cuts by systemic central banks have opened space for their counterparts in emerging markets to embark on their easing cycle. In addition to this, domestically, the expected moderation in food inflation could provide an opportunity for the MPC to adjust the policy repo rate. However, as noted by Dr. Rajiv Ranjan, this would amount to normalization of the policy rate, indicating a move towards a neutral rate and a shallow easing cycle. With the change in policy stance to 'neutral' at the meeting in October, followed by 50bp CRR cut in December, perhaps a 25bp cut in February would be apt in terms of sequencing and timing of monetary policy calibration.

Appendix I

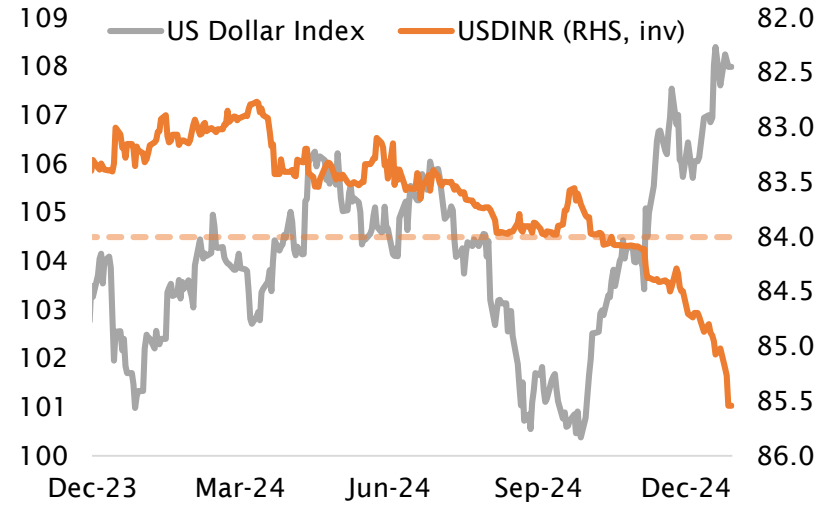
Core liquidity has narrowed sharply despite CRR easing



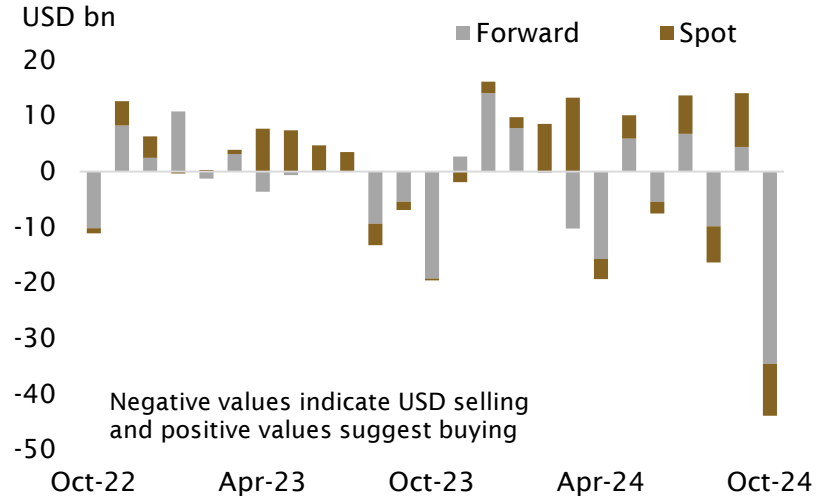
System liquidity in deficit despite VRR operations



INR depreciation partly a result of USD strength



Sharp build-up of USD short positions in October



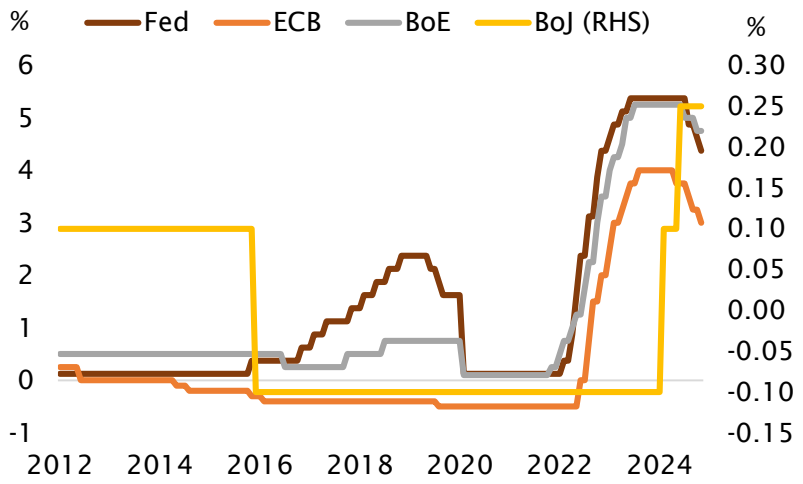
Appendix II:
Select high frequency indicators

Colour codes based on minimum and maximum Z-score values since April 2023 for respective variables; green shows improvement, red indicates weakening. (Reversed for MGNREGA data where a fall implies improved farm activity)

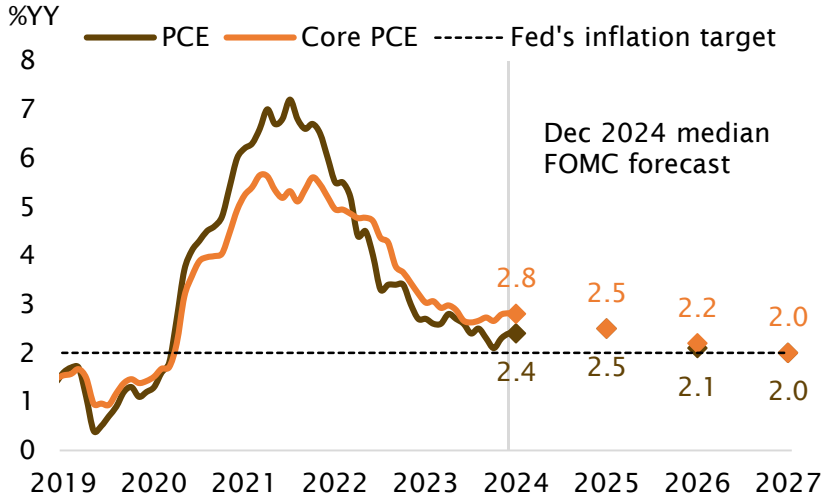
(%YY, unless mentioned otherwise)		May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24
Agriculture and rural sector	Fertiliser sales	10.5	7.3	-1.4	-9.4	-7.7	-7.8	4.6	
	Tractor sales	0.5	3.5	1.4	-5.5	2.4	21.0	-0.9	
	Tractor registrations	-1.0	-28.4	-11.9	-11.4	14.7	3.1	29.9	
	Two wheeler sales	10.1	21.3	12.5	9.3	15.8	14.2	-1.1	
	Two-wheeler registrations	2.8	4.7	17.2	6.3	-8.5	36.3	15.8	
	Three-wheeler registrations	23.7	5.1	12.9	1.6	0.7	11.5	4.2	
	Household work demand under MGNREGA	-14.3	-21.7	-19.5	-16.0	-13.4	-7.6	3.9	
Industry, construction and urban sector	Industrial production	5.9	4.2	4.8	-0.1	3.1	3.5		
	Core sector output	6.3	4.0	6.1	-1.8	2.0	3.1	4.3	
	Cement production	-0.6	1.8	5.1	-2.5	7.2	3.1	13.0	
	Natural gas production	6.7	2.9	-1.4	-3.7	-1.6	-1.6	-5.5	
	Electricity requirement	17.3	8.0	4.0	-5.4	1.2	0.5	4.0	
	Steel consumption	13.0	21.1	13.8	10.3	11.8	8.9	10.0	
	Fuel consumption	1.9	2.3	10.6	-2.3	-1.6	2.9	9.3	
	Passenger vehicle sales	12.9	5.0	-1.9	-1.6	-0.4	1.1	4.3	
	Passenger vehicle registrations	1.5	-6.8	10.2	-4.5	-18.8	32.4	-13.7	
Services	Commercial vehicle sales		3.3			-4.2			
	Commercial vehicle registrations	7.7	-4.7	5.9	-6.0	-10.4	6.4	-6.1	
	Railway freight traffic	4.4	11.2	4.9	-5.0	-0.1	0.8	1.4	
	Port cargo traffic	3.8	6.8	5.9	6.7	5.8	-3.4	-4.9	
	Toll collection (volume)	3.6	5.8	9.4	6.8	6.5	11.3	11.9	
	Domestic air cargo traffic	10.4	10.3	8.8	0.6	14.0	8.9	0.3	
	International air cargo traffic	19.2	19.6	24.4	20.7	20.5	18.4	16.2	
	Domestic air passenger traffic	5.9	6.9	7.5	6.7	7.4	9.6	13.8	
	International air passenger traffic	14.6	11.4	8.9	10.9	11.2	10.3	10.8	
	Tourist arrivals	0.3	9.0	-1.3	-4.2				
	GST e-way bills (total)	17.0	16.3	19.2	12.9	18.5	16.9	16.3	
	GST revenue collection	10.1	7.6	10.3	10.0	6.5	8.9	8.5	
PMI (Index)	PMI Manufacturing	57.5	58.3	58.1	57.5	56.5	57.5	56.5	57.4
	PMI Services	60.2	60.5	60.3	60.9	57.7	58.5	58.4	60.8

Appendix III

Major systemic banks have started easing cautiously



US core PCE inflation expected to reach target by 2027



Less amount of easing penciled in for 2025 and the long run in latest US Fed dot plot

Longer run	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
4.00										
										•
3.75					••	•	•	•	•	•
			•	•				•	•	••
3.50					•	••	••	••	••	••
									••	•
3.25		•	•	•	•				•	
							•	•		•
3.00	••	•	•	•	•	•	•••	••••	••	•••
						•			••	••••
2.75				••		•	•	•••	•••	•
	•	•	•	••	••	•	•	•	•	•
2.50	••••••••	••••••••	••••••••	•••••••	••••••••	••••••••	••••••••	•••••	•••	•
	•	••	••	•••	•••	•••	•	•	•	•
2.25	••••••	••••	•••							

Though systemic central banks have embarked on monetary easing by cutting interest rates, they remain cautious, as the policy path remains interrupted by the prolonged last mile of disinflation.

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