

RBI MPC likely to ease policy repo rate by 25bps to 6.25% at February meet

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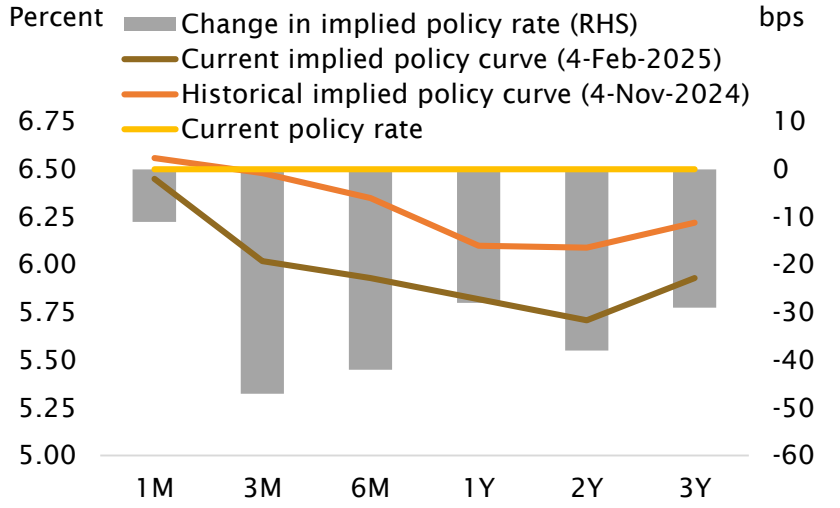
- The market polls are pricing 25bp repo rate cut by the RBI MPC on 7-Feb-25. The policy rate has been held stable since Feb-2023, when the RBI was in a tightening mode, and will mark the first cut since May-2020, when the policy was in an easing cycle to deal with COVID-19 related disruptions. The markets are currently pricing easing to the tune of 50bps in three months time, indicating another 25bp cut likely in April.
- There has been a change of guard, with the new Governor Shri Sanjay Malhotra taking over after the previous Governor Shri Shaktikanta Das' term concluded in December. Prior to this assignment, Shri Malhotra was Secretary, Department of Revenue in the Ministry of Finance, Government of India. Deputy Governor Dr. Michael Debabrata Patra's extended term ended in mid-January and in his place, Deputy Governor Shri M. Rajeshwar Rao will take charge of the Monetary Policy Department. In the previous meeting held in Dec-2024, two of the three external members of the MPC, Professor Ram Singh and Dr. Nagesh Kumar had voted in favor of a 25bp rate cut, and in the meeting prior to that in Oct-2024, the MPC had changed the policy stance to 'neutral' from 'withdrawal of accommodation' by a unanimous vote.
- A lot has transpired since the last MPC meeting that concluded on 6-Dec-24. In the domestic economy, real GDP growth is slated to ease to four year low of 6.4%YY in FY25, as per the first advance estimate by the national statistical office. However, the anticipated rebound in growth in H2-FY25 has been rather sluggish, as per the high frequency indicators of economic activity. On the bright side, inflation was sub-6% in Nov-Dec and is expected to ease further in coming months. The RBI introduced a slew of measures ranging from daily VRR auctions to OMO purchases to address the liquidity deficit in the system. The Indian rupee has depreciated by almost 3% and is breaching fresh lows, while the 10Y has rallied, backed by multiple favorable factors, including a prudent fiscal policy that delivered a consumption stimulus.
- Globally, central banks are confronted with the risk of trade wars and remain cautious while easing, as inflation remains sticky and growth falters in some economies. Commodity prices, including Brent, remain range-bound, though US policy uncertainty continues to bite global financial markets.

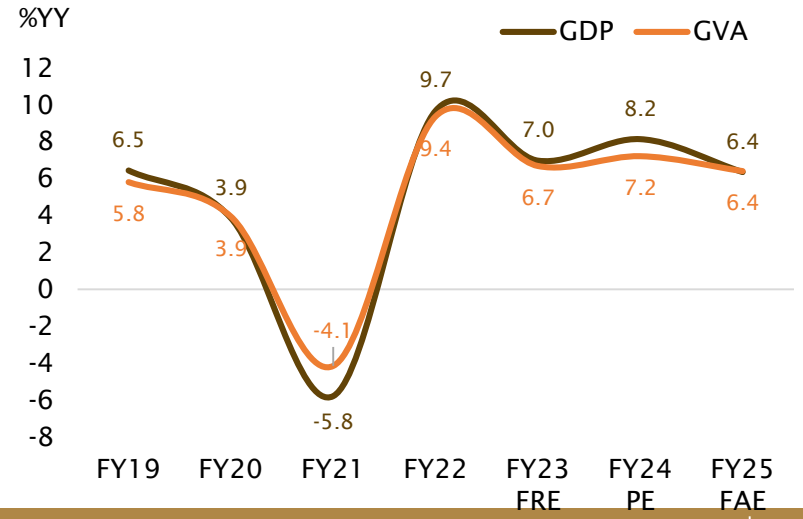
Market pricing of policy rate path



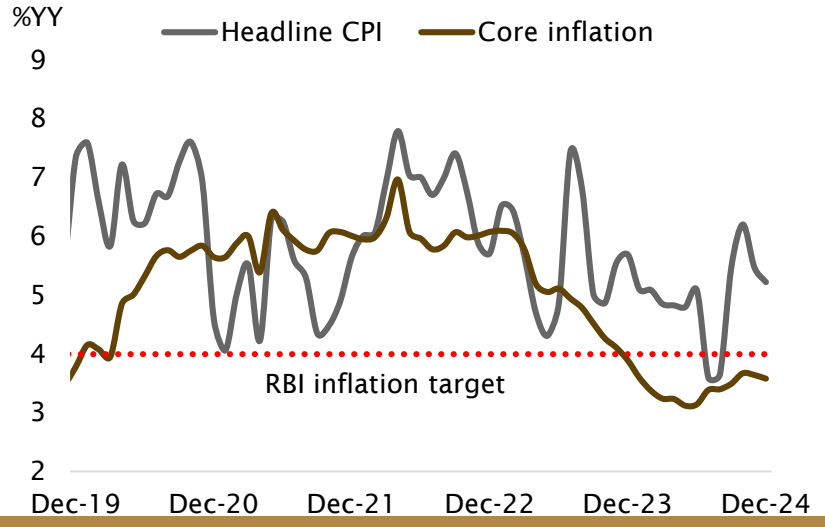
Growth expected at 6.4% in FY25; CPI inflation sub-6% in Nov-Dec

- In Q2-FY25, both real GDP and GVA growth slipped below 6% to seven-quarter low. Real GDP growth eased to 5.4%YY from 6.7% in Q1, while real GVA growth moderated to 5.6% from 6.8%. The drag on GVA growth was mainly from industry, while GDP growth; excluding discrepancies, valuables, and changes in stocks; was relatively resilient. As per national statistical office's first advance estimates, GDP growth is slated to ease to four year low of 6.4%YY in FY25, following 8.2% increase in FY24. Real GVA growth is expected to moderate to 6.4%YY from 7.2% in FY24. The estimates for the entire fiscal year FY25 imply improvement in real GDP growth to 6.7%YY in H2-FY25 from 6.0% in H1, and real GVA growth to 6.6% from 6.2% in H1. However, signals from high frequency indicators of economic activity remain mixed and indicate a sluggish recovery.
- After reaching 14-month high of over 6% in October, CPI inflation eased in November and December due to seasonal softening in prices of certain horticulture items such as vegetables. However, shifting pockets of concern within the food basket continue to impinge on the disinflationary process, with spillovers from persistently high inflation in primary food articles starting to reflect in certain components of the CPI index. On the bright side, the fuel index has been in deflation for more than a year now, and despite bottoming out in mid-2024, core inflation remains benign and sub-4%. However, global commodity prices remain a wildcard and vulnerable to external shocks. Since the last MPC meet, the weakening of the Indian rupee has raised concerns over potential rise in imported inflation, though the impact is likely to be felt with a lag.

GDP and GVA growth expected to ease to 6.4% in FY25



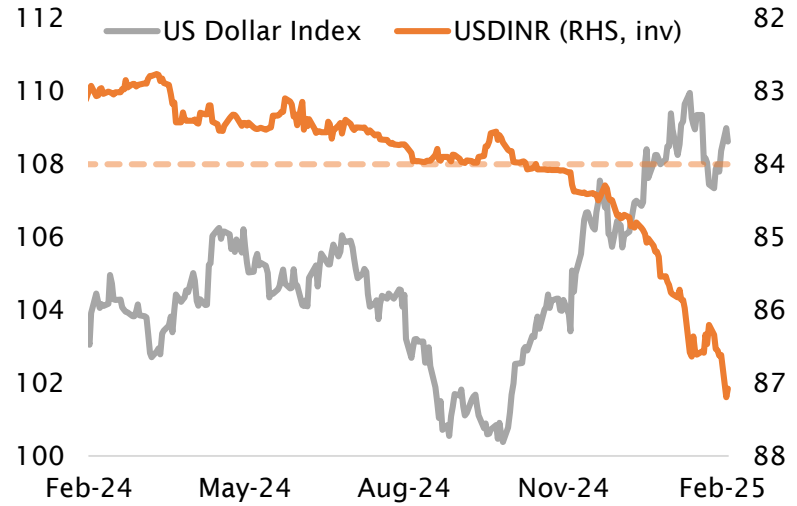
CPI inflation remained sub-6% in Nov and Dec



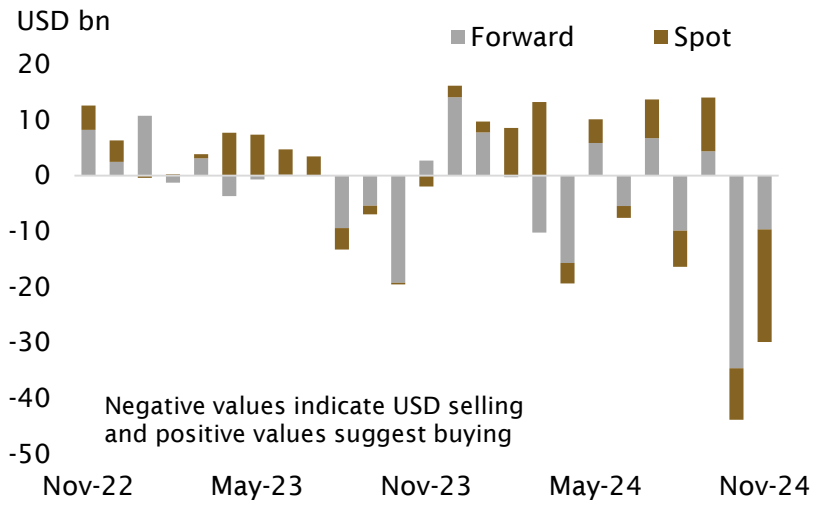
INR depreciated since last MPC meet amid USD strength, FPI selloff

- Since the last RBI MPC meet in Dec-2024, the INR has depreciated vis-à-vis the USD, in part due to a strong USD and a global risk-off sentiment that triggered sell-off in EM equities, including India. The USD rally was briefly interrupted by uncertainties around US Trump administration's trade policies, only to resume again, aided by recalibration of expectations towards high interest rates in the US due to strong economic data.
- Meanwhile, the USDINR slipped to 87.1/USD (as on 4-Feb-25) from 84.7 on the day of last MPC meeting (6-Dec-24), amounting to depreciation of close to 3%. The central bank sold USD in both spot and forward markets, as per data for Oct-2024 and Nov-2024. Foreign exchange reserves dwindled to the lowest level since Mar-2024 to USD624bn (17-Jan-2024), though there was mild accretion the following week. Between the last MPC meet on 6-Dec-24 and till 24-Jan-25, FX reserves eroded by around USD25bn. However, this was lower than the decline of USD36bn of reserves in the previous inter-meeting period.
- In January, foreigners sold Indian equities worth USD8.4bn but bought USD1.6bn in debt. Cumulative foreign portfolio flows in debt instruments since the announcement of bond index inclusion in Sep-2023 and till Jan-2025 has been USD22.3bn, while equities have posted outflows due to selloff in recent months.
- In January, the RBI announced changes to FEMA regulations to promote cross border transactions in INR. These include allowing persons resident outside India to use their balances in repatriable INR accounts for foreign investment, including FDI, in non-debt instruments, among other changes.

USDINR continues to breach fresh lows



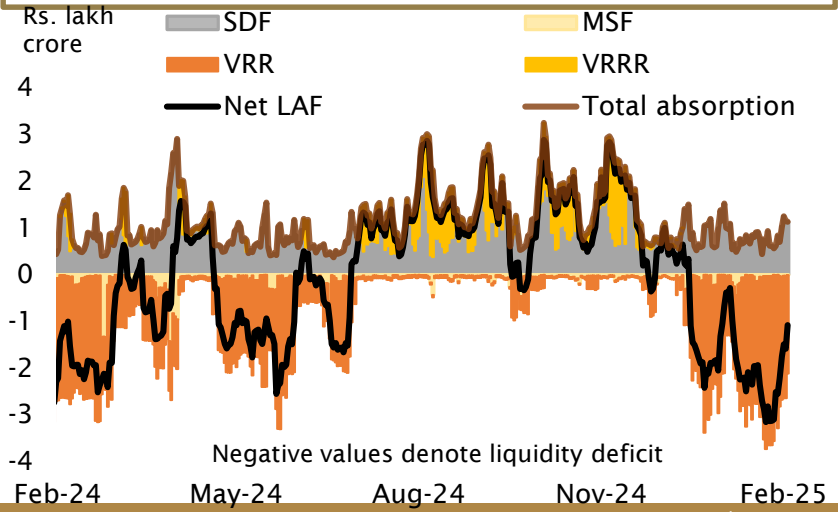
RBI sold USD in spot and forward markets in Oct-Nov



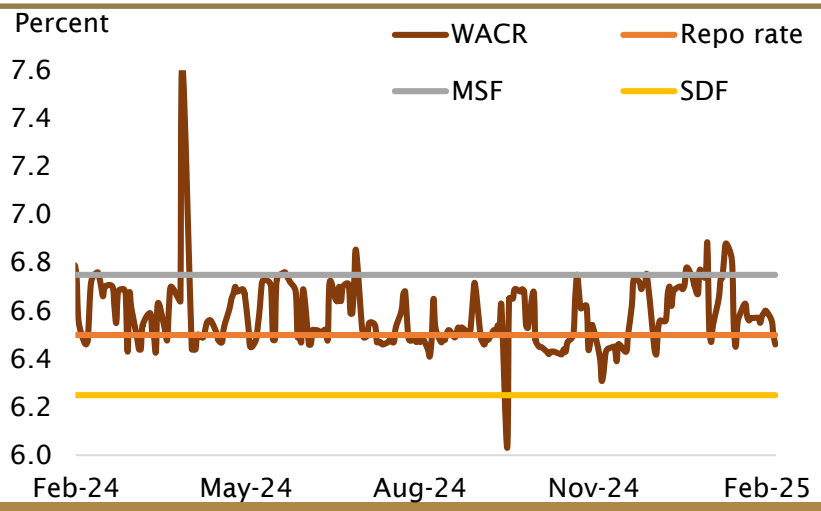
Liquidity deficit prompted easing measures by the RBI

- In mid-December, system liquidity slipped into deficit, as government cash balances accrued due to quarter-end advance tax outflows and monthly GST payments. The last tranche of long-term repo operations held in 2021 to tackle COVID-19 related disruptions matured in end-Dec, withdrawing liquidity of Rs.2,530 crore. As a result, liquidity deficit worsened to the steepest level in a year at Rs.3.16lakh crore on 23-Jan-25. As on 10-Jan-25, core liquidity, which excludes government cash balances, turned to deficit of Rs.40,000 crore.
- To remedy the situation, the RBI announced daily VRR auctions in mid-January. Since the last MPC meet that concluded on 6-Dec-24, the RBI has conducted four main and 34 VRR auctions and injected liquidity to the tune of Rs.30.4 lakh crore. The central bank also conducted OMO purchases amounting to Rs.31,045 crore.
- On 27-Jan-25, the RBI announced more steps to infuse liquidity in the system. These included: 1) OMO purchase auctions for an aggregate amount of Rs.60,000 crore in three tranches of Rs.20,000 crore each to be held on 30-Jan-25, 13-Feb-25, and 20-Feb-25. 2) 56-day VRR auction for notified amount of Rs.50,000 crore to be held on 7-Feb-25. 3) USD/INR buy/sell swap auction of USD5bn for a tenor of six months to be held on 31-Jan-25. As a result, liquidity deficit eased to Rs.0.45lakh crore as on 5-Feb-25.
- The weighted average call rate (WACR), which is the operating target of monetary policy, slipped below the repo rate on 5-Feb-25 after breaching the upper band or MSF rate towards end-December and mid-January. The one-year OIS, which tends to reflect market expectations about the repo rate, is currently more than 20bps below the repo rate, signaling an easing bias being priced in by market participants.

Liquidity deficit has eased due to RBI actions



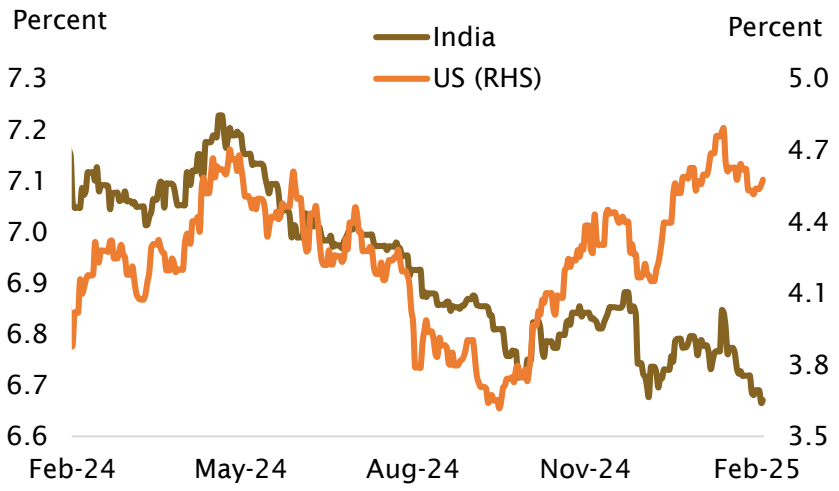
WACR has moved in tandem with liquidity conditions



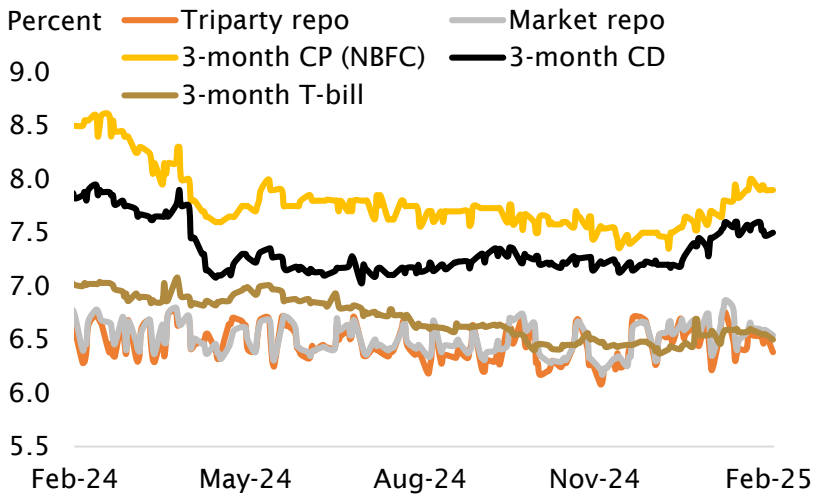
Except at the short-end, yields have softened across the curve

- The yields at short end of the curve remain elevated compared to the levels at the time of last MPC meet, reflecting the tight liquidity conditions, though there has been some easing in recent weeks due to a slew of measures by the RBI to infuse liquidity. The yields at the belly and long end of the curve have shifted lower.
- In the money market, yields on 3-month T-bills, certificates of deposit (CDs) and 3-month commercial papers (CPs) issued by NBFCs averaged 6.53 percent, 7.43 percent, and 7.72 percent, respectively between the last MPC meeting outcome on 6-Dec-24 and till 4-Feb-25. These were higher than average yields in the previous inter-meeting period at 6.46 percent, 7.21 percent, and 7.53 percent, respectively. The average risk premia (3-month CP minus 91-day T-bill) stayed high at 119 bps versus 107 bps in the prior inter-meeting period.
- The yield on 10Y G-sec benchmark increased around 10bps to 6.85 on 13-Jan-25 (Source: Bloomberg) from 6.75 at the time of last MPC meet on 6-Dec-25. This was in line with the surge in US treasury yields and rise in crude oil prices. However, since then, the 10Y yield has softened (6.67 as on 4-Feb-25) due to multiple factors: 1) the government's fiscal deficit target and market borrowing in the Union Budget FY26 was in line with market expectations 2) anticipation of a 25bp rate cut at the RBI MPC meet in February 3) US treasury yields have rallied on hopes that Trump administration policies will uplift the US economy, though there is volatility due to uncertainties about government's stance on trade tariffs 4) Despite geopolitical woes, Brent remains range-bound and currently below USD75/bbl. Futures pricing till June shows this trend to persist.

India 10Y has rallied in recent weeks



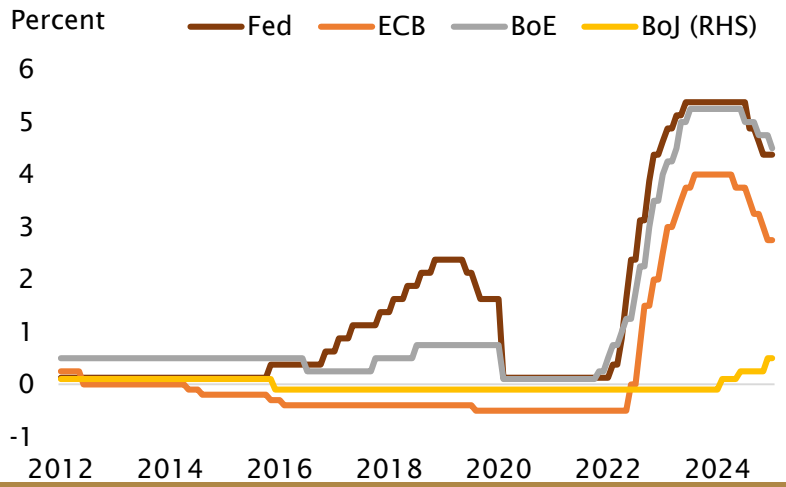
Money market rates stay elevated despite recent easing



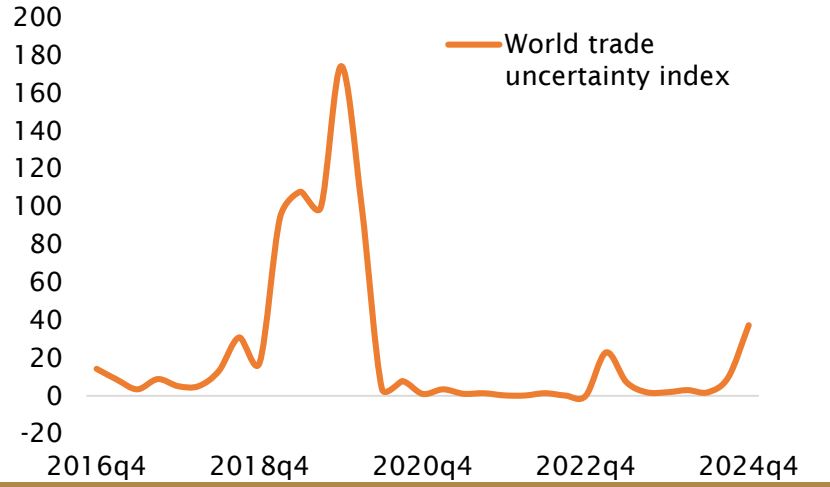
Global policy deviations amid changing external, domestic backdrop

- Many central banks embarked on policy easing in later half of 2024, as disinflation progressed, even as exceptions remain due to country-specific idiosyncrasies. In some cases, inflation is taking longer to align with the target and growth is faltering, complicating the central banks' task. Globally, the ongoing risk of trade wars is adding another layer of uncertainty amid the already fragile geopolitical backdrop.
- The US Federal Reserve started with a sharp 50bp easing in Sep-2024, followed by two more cuts of 25bp each in Nov-2024 and Dec-2024, before pausing in Jan-2025. In Dec-2024, the dot-plot indicated total 50bp cut as the baseline scenario for 2025, compared to 100bp easing that was projected in Sep-2024, mainly due to higher core inflation forecasts for 2025 and alignment to target in 2027, instead of 2026.
- The Bank of England has cut thrice so far by 25bp each time, starting in Aug-2024, and followed by two more in Nov-2024 and Feb-2025. The central bank remains cautious and gradual in its approach to easing amid near-term bump expected in inflation and growth likely to be weaker in 2025 than earlier projected.
- The ECB started to ease in Jun-2024 and since then, has cut the deposit facility rate 5 times by 25bp each time, totaling 125bp. The ECB is currently grappling with weak growth and pickup in inflation in recent months but has been more dovish in easing so far, compared to its counterparts in advanced economies.
- The Bank of Japan ended an eight-year long negative interest rate regime in Mar-2024 by hiking policy rate for the first time in 17 years amid expectations that inflation will remain above target and growth above potential. The BoJ hiked twice again in Jul-2024 and Jan-2025, amounting to total hike of 60bp.

In latest meets, the Fed paused; BoE, ECB cut; BoJ hiked

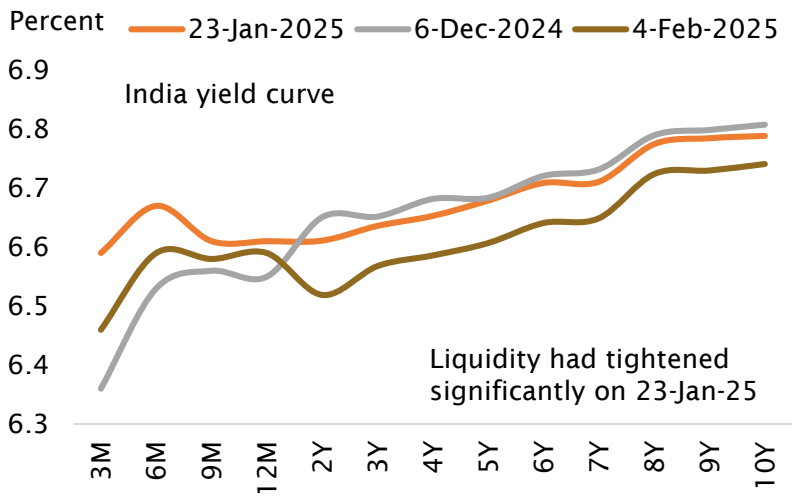


Trade uncertainty high under Trump administration

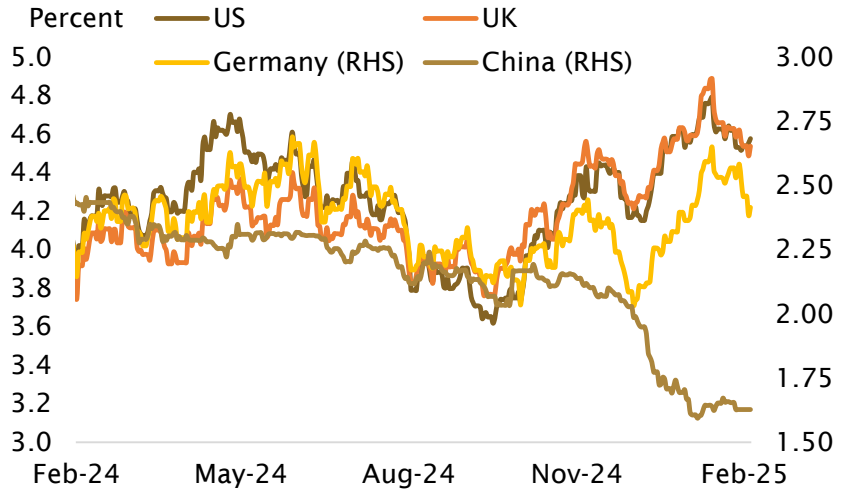


Appendix I

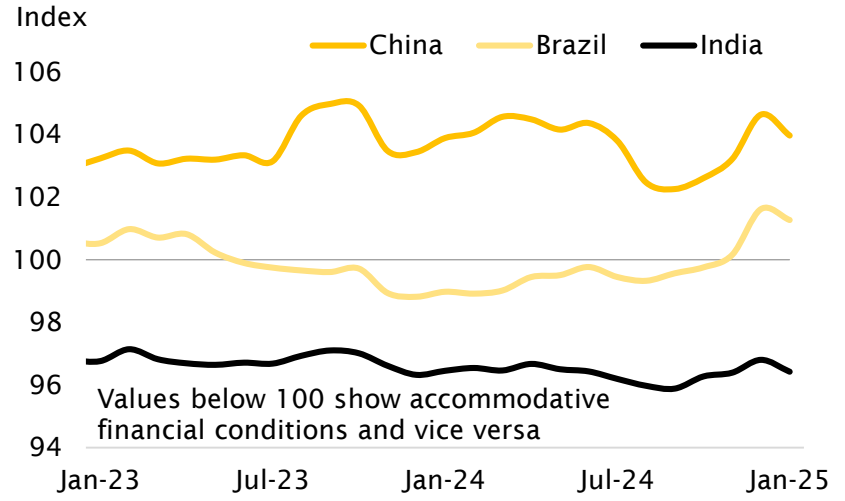
Despite recent easing, near-term yields stay elevated



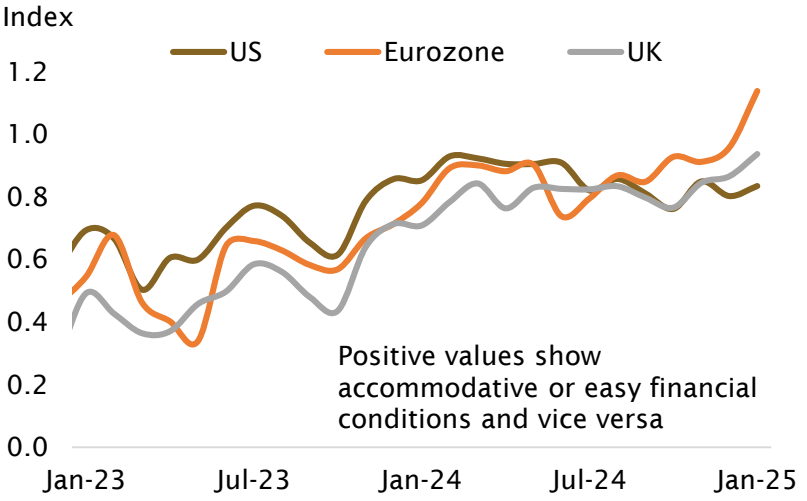
Falling China 10Y partly reflects deflationary concerns



Financial conditions remain accommodative in India

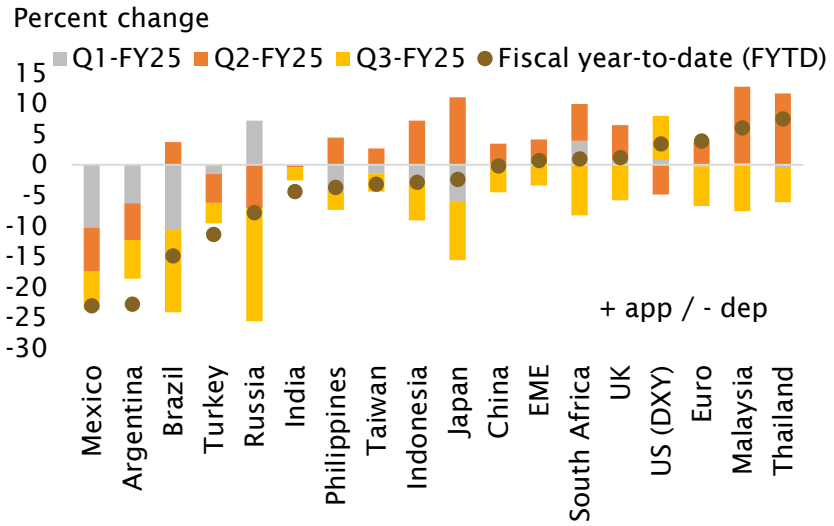


Financial conditions remain easy in major AEs

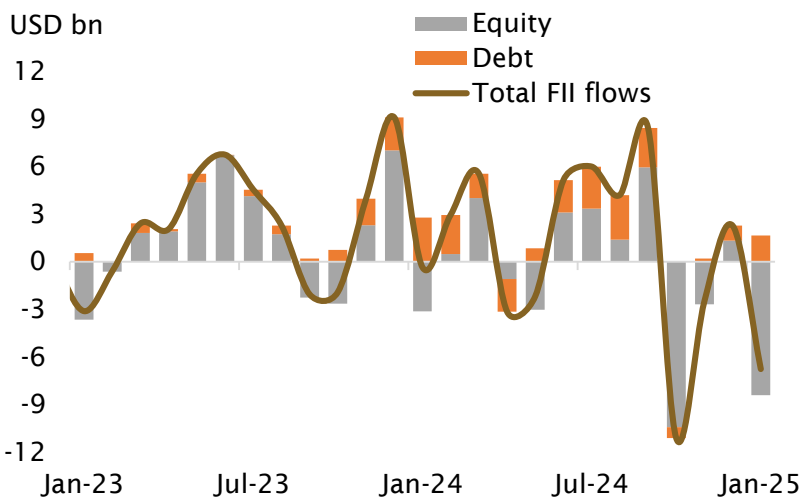


Appendix II

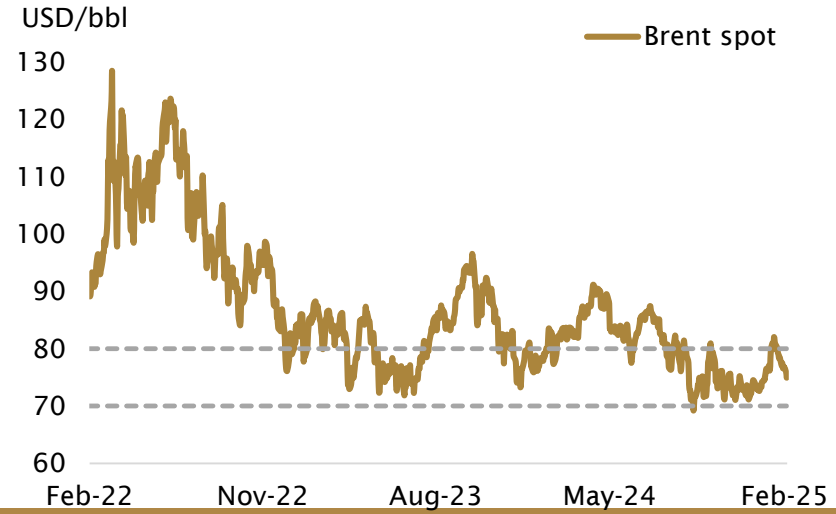
INR underperformed relative to peers on FYTD basis



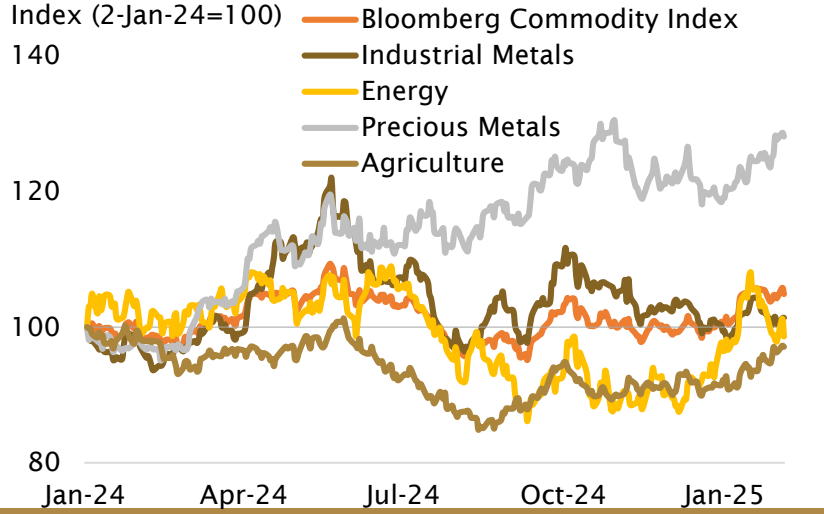
FIIs have sold Indian equities amid broad EM selloff



Crude oil prices stayed range-bound in recent months



Bloomberg commodity index up 5% since 1-Jan-2024



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)		Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24	Jan-25
Agriculture and rural sector	Fertiliser sales	7.3	-1.4	-9.4	-7.7	-7.8	4.6	12.2	
	Tractor sales	3.5	1.4	-5.5	2.4	21.0	-0.9	13.3	
	Tractor registrations	-28.4	-11.9	-11.4	14.7	3.1	29.9	25.8	
	Two wheeler sales	21.3	12.5	9.3	15.8	14.2	-1.1	-8.8	
	Two-wheeler registrations	4.7	17.2	6.3	-8.5	36.3	15.8	-17.6	
	Three-wheeler registrations	5.1	12.9	1.6	0.7	11.5	4.2	-4.6	
	Household work demand under MGNREGA	-21.7	-19.5	-16.0	-13.4	-7.6	3.9	8.2	
Industry, construction and urban sector	Industrial production	4.2	4.8	-0.1	3.1	3.5	5.2		
	Core sector output	4.0	6.1	-1.8	2.0	3.1	4.3	4.0	
	Cement production	1.8	5.1	-2.5	7.6	3.1	13.5	4.0	
	Natural gas production	2.9	-1.4	-3.7	-1.6	-1.6	-5.5		
	Electricity requirement	8.0	4.0	-5.4	1.2	0.5	4.0	5.2	
	Steel consumption	19.5	14.4	10.0	11.8	8.9	9.5	3.3	
	Fuel consumption	2.3	10.7	-3.1	-4.4	4.1	9.5	2.1	
	Passenger vehicle sales	12.9	-1.9	-1.6	-0.4	1.1	4.3	11.4	
	Passenger vehicle registrations	-6.8	10.2	-4.5	-18.8	32.4	-13.7	-2.0	
Services	Commercial vehicle sales	3.3			-10.7			1.2	
	Commercial vehicle registrations	-4.7	5.9	-6.0	-10.4	6.4	-6.1	-5.2	
	Railway freight traffic	11.2	4.9	-5.0	-0.1	0.8	1.4	1.6	
	Port cargo traffic	6.8	5.9	6.7	5.8	-3.4	-4.9	3.5	
	Toll collection (volume)	5.8	9.4	6.8	6.5	11.3	11.9	9.8	
	Domestic air cargo traffic	10.3	8.8	0.6	14.0	8.9	0.3	4.3	
	International air cargo traffic	19.6	24.4	20.7	20.5	18.4	16.2	10.5	
	Domestic air passenger traffic	6.9	7.5	6.7	7.4	9.6	13.8	10.8	
	International air passenger traffic	11.4	8.9	10.9	11.2	10.3	10.8	9.2	
	Tourist arrivals	9.0	-1.3	-4.2	0.4	-1.4			
	GST e-way bills (total)	16.3	19.2	12.9	18.5	16.9	16.3	17.6	
	GST revenue collection	7.6	10.3	10.0	6.5	8.9	8.5	7.3	
PMI (Index)	PMI Manufacturing	58.1	58.1	57.5	56.5	57.5	56.5	56.4	57.7
	PMI Services	60.3	60.3	60.9	57.7	58.5	58.4	59.3	56.8

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