Our Views

Monetary Policy in Sync with Budget to Support Economic Growth

The new Governor in his debut monetary policy meeting adopted a measured approach to inflation targeting and focused on economic growth. The Monetary Policy Committee unanimously decided to cut the repo rate by 25 bps, lowering it from 6.5% to 6.25%, in line with the market expectation. I believe that the government's fiscal prudence with its commitment to a steady glide path for the fiscal deficit and reducing total debt relative to GDP has provided RBI with the necessary headroom to implement a repo rate cut for the first time in five years. For FY 2024-25, the revised fiscal deficit estimate stands at 4.8%, slightly better than the projected 4.9%, and for FY 2025-26, it is expected to decrease to 4.4%, surpassing market expectations of 4.5%.

Maintaining a neutral stance, the RBI reaffirmed its priority of controlling inflation and ensuring price stability while considering economic growth. Assuming normal rainfall, the CPI Inflation rate for FY 2025-26 is projected at 4.2%. The Real GDP growth is projected at 6.7%, closer to the upper end of the Economic Survey's forecast range of 6.3% to 6.8%. This is based on strong reservoir levels, anticipated improvements in manufacturing activity in the second half of FY26, and an expected boost in household consumption driven by better employment conditions, tax relief in the Union Budget, moderating inflation, and robust agricultural performance. With inflation aligned with its target, the RBI stated during its press conference that the time has come to adopt a more supportive stance on growth.

Despite inflation aligning with target and optimism regarding GDP growth, the RBI maintained its stance on liquidity, largely attributing it to the rising uncertainty in the global markets which could pose as a threat to the inflation trajectory. Further, it alluded to global uncertainties being a greater concern for RBI over rupee depreciation, as the former directly impacts investment, consumption, and growth. The bond market's reaction was mixed, with yields initially rising due to the RBI's decision to maintain a neutral policy stance and the absence of new liquidity measures.

The central bank has also showcased its commitment to providing adequate system liquidity by taking appropriate measures to ensure orderly conditions while remaining watchful and nimble. System liquidity has recently turned into a deficit during December 2024 and January 2025, which can be attributed to the advance tax payments, capital outflows, foreign operations amongst others.

We also observed an increased focus by the Central Bank on the cost of regulation for banks. It announced a deferment in implementation of the proposed LCR norms and project financing by over a year. The changes will now be implemented in a phased manner post March 31, 2026, vis-à-vis the original timeline of April'25, coming in as a big relief for banks. Additionally, the RBI has expanded its suite of interest rate derivative products by introducing forward contracts in government securities, enabling insurance funds to better manage interest rate cycles. To combat cybersecurity threats and the rise in digital fraud, RBI will launch a dedicated Internet domain for banks and NBFCs starting April 2025. All banks and NBFCs will be required to use websites ending in '.bank.in' and '.fin.in,' replacing existing domains. This initiative aims to help customers identify genuine bank websites and avoid suspicious ones.

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A rate cut amidst global uncertainty and depreciating pressure on INR, suggests that RBI is prioritising growth as inflation is aligning towards its target. I believe that, so far in FY2025, the RBI has done a commendable job in keeping inflation anchored near its long-term target despite prevailing geopolitical uncertainties. Further, the fiscal prudence demonstrated by the government, has offered a valuable buffer. That being said, RBI has taken cautious approach with its neutral stance leaving room for it to take further actions in its next meeting.

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