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## RBI Monetary Policy: First rate cut in nearly five years

**In line with expectations, the RBI's MPC, under the new Governor and a new internal member, unanimously decided to reduce the policy rates by 25bps to 6.25% and retain the policy stance at *'neutral'*, marking the first unanimous resolution in the last 12 months. Notably, this is the first-rate action since February 2023, and the first cut in nearly five years (Last cut in May 2020). The MPC's policy announcements have been calibrated and gradual, beginning with a shift in stance to a *'neutral'* in October, followed by liquidity infusion through a 50bps CRR cut in December, additional support via OMO purchases, forex buy/sell swaps, and longer-duration VRRs in late January and a rate cut today. Notwithstanding an expected growth recovery in the second half, emerging signs of growth moderation in high-frequency indicators, along with sustained softening of headline inflation toward the 4% target, created room for the current rate cut. Growth forecast for FY26 is pegged at 6.7%, an improvement from the 6.4% growth in FY24 as per the First Advance Estimate. Inflation, on the other hand, is projected to decline from an estimated 4.8% in FY25 to 4.2% in FY26, aided by softening food inflation.**

**While the rate cut today signals a shift towards a less restrictive monetary policy, the continuation of a rate-cutting cycle will hinge on the extent of growth moderation and inflation dynamics. With headline inflation softening and fiscal consolidation reinforcing macroeconomic stability, the moderation in economic growth will be a sin-qua-non determinant for the MPC's policy decision going ahead. However, the RBI will remain vigilant against risks emanating from the trilemma of banking system liquidity deficit, exchange rate depreciation, and underlying global policy uncertainties. A calibrated liquidity management approach, leveraging both durable and transient tools, will be essential. As the rate cut cycle has commenced, ensuring effective policy transmission will be critical to supporting growth without exacerbating inflationary pressures or financial stability risks.**

- **Rate cut of 25bps, first since May 2020:** The RBI's MPC expectedly and unanimously decided to reduce the policy repo rate by 25bps to 6.25% and retain the stance as '*neutral*'. With this, the Standing Deposit Facility (SDF) and the Marginal Standing Facility (MSF) rates—the upper and lower bounds of the Liquidity Adjustment Facility (LAF) corridor—stand adjusted at 6%, and 6.5% respectively. A favorable inflation outlook, steadily converging toward the 4% target, along with signs of economic growth moderation has provided room for the MPC to support growth while remaining focussed on aligning inflation with the target.

*The RBI's MPC expectedly and unanimously reduced the policy repo rate by 25 bps to 6.25% while retaining the stance as "neutral".*

- **Inflation projected at 4.2% in FY26:** Headline inflation is projected to decline to 4.2% in FY26 from 4.8% in the current fiscal year. The Q1 FY26 forecast has been revised lower by 10bps to 4.5%, with an expected sub-4% reading (3.8%) in Q2, followed by stable estimates of 4.2% for the subsequent two quarters. Despite a modest uptick in core inflation, the headline trajectory will be shaped by easing food inflation, supported by a strong Kharif harvest, seasonal declines in vegetable prices, and favorable Rabi prospects. However, risks remain from global financial market uncertainties, energy price volatility, and adverse weather conditions, which could exert upward pressure on inflation.

*Inflation estimate for FY26 is pegged at 4.2%, while GDP growth is estimated at 6.7% for FY26.*

- **GDP growth forecast pegged at 6.7% in FY26:** The GDP growth forecast for FY26 is pegged at 6.7%, up from the First Advance Estimate of 6.4% growth for FY25. This is on the higher side of the growth range of 6.3% to 6.8% projected by the Economic Survey for FY26. The growth projection for Q1 and Q2FY26 have been revised downwards by 20bps and 30bps to 6.7% and 7% respectively. Growth momentum is expected to be supported by 1) improved household consumption, driven by tax reliefs, easing inflation and strong agriculture prospects, and 2) a stable recovery in investment demand, underpinned by higher capacity utilisation, positive business sentiment, healthier balance sheets of corporates and banks and sustained Government thrust on capex. However, risks persist from geopolitical tensions, trade policy uncertainties, and volatility in global commodity prices and financial markets.

- **Liquidity conditions ease:** The banking system liquidity has moved from an average surplus of Rs 1.4 lakh crore in November 2024 to a deficit of Rs 68,469 crore in December 2024 and further widening to ~Rs 2 lakh crore in January, primarily due to capital outflows, advance tax payments and a significant pick-up in currency in circulation. To ameliorate the challenges from widening banking system liquidity deficit, the RBI conducted a slew of measures ranging from daily variable rate repo operations and OMO purchase operations worth Rs 58,835 crore in January 2025 alongside additional package of liquidity measures announced on January 27th, 2025, which is likely to infuse liquidity worth ~Rs 1.5 lakh crore. This resulted in the deficit falling to an average of Rs 1 lakh crore in the first five days of this month. The RBI has urged banks to actively trade in the weighted call money market instead of passively parking funds with RBI. The weighted average call money rate has been closer to the upper bank of the policy rate corridor at 6.71% in December 2024 and January 2025, reflecting the pressure on the banking system liquidity.
- **Regulatory measures:** Key regulatory measures announced include: (1) introduction of forward contracts in government securities, (2) allowing SEBI-registered non-bank brokers direct access to the NDS-OM platform to deepen secondary market transactions in G-Secs, (3) formation of a working group to review trading and settlement timings across RBI-regulated financial markets, (4) introduction of dedicated internet domains ("bank.in" for banks and "fin.in" for non-bank financial entities) to enhance trust, and (5) implementation of an additional factor of authentication for international card-not-present (online) transactions to strengthen security.
- **Is this the beginning of a shallow or longer rate cut cycle?** While the rate cut today signals a shift towards a less restrictive monetary policy, the continuation of a rate-cutting cycle will hinge on the extent of growth moderation and inflation dynamics. With headline inflation softening and fiscal consolidation reinforcing macroeconomic stability, the moderation in economic growth will be a sin-qua-non determinant for the MPC's policy decision going ahead. However, the RBI will remain vigilant against risks emanating from the trilemma of banking system liquidity deficit, exchange rate depreciation, and underlying global policy uncertainties. A calibrated liquidity management approach, leveraging both durable and transient tools, will be essential. As the rate cut cycle has commenced, ensuring effective policy transmission will be critical to supporting growth without exacerbating inflationary pressures or financial stability risks.

**Table 1: Current policy rates**

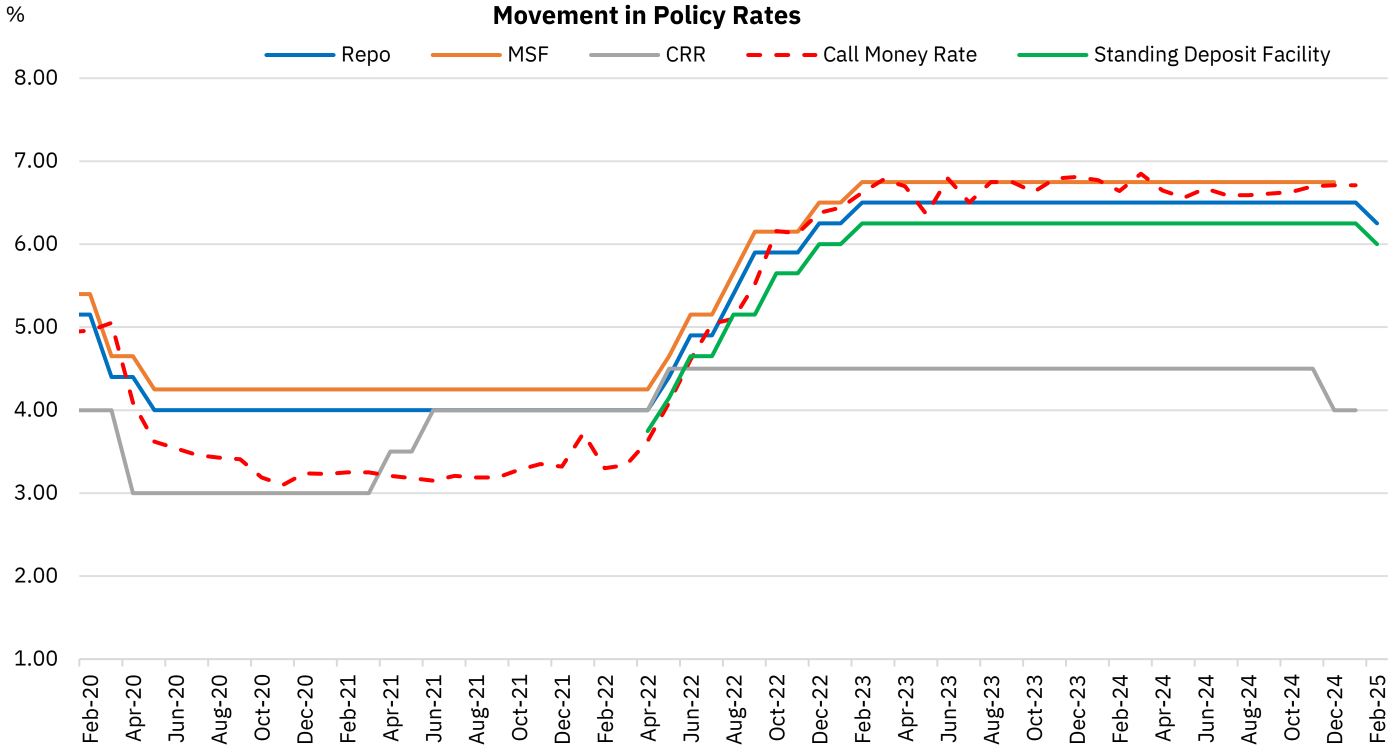
The policy repo rate was unanimously reduced by 25bps to 6.25% alongside retaining the policy stance at *'neutral'*. This has been the first policy rate cut since May 2020 and after maintaining status quo in policy rates for 11 consecutive meetings since February 2023.

| Key rates | August 2024 | October 2024 | December 2024 | February 2025 |
|---|---|---|---|---|
| Repo Rate | 6.50% | 6.50% | 6.50% | 6.25% |
| Standing Deposit Facility (SDF)* | 6.25% | 6.25% | 6.25% | 6.00% |
| Marginal Standing Facility (MSF) | 6.75% | 6.75% | 6.75% | 6.50% |
| Bank Rate | 6.75% | 6.75% | 6.75% | 6.75% |
| Cash Reserve Ratio (CRR) | 4.50% | 4.50% | 4.00% | 4.00% |

Source: RBI, NSE EPR. * Introduced in April 2022 policy as the new floor of the LAF corridor. + after implementation of the phased reduction of CRR

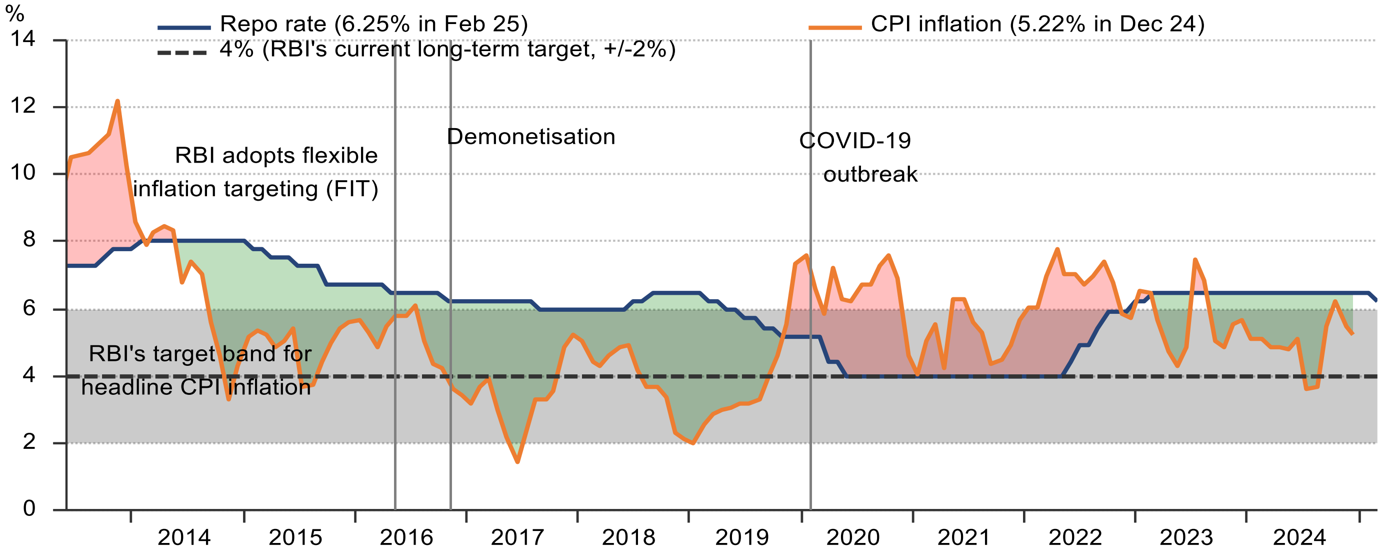
**Figure 1: Movement in key policy rates**

The average Weighted Average Call Money Rate (WACR) has remained closer to the upper band of the policy rate corridor at 6.71% in December and January 2025.



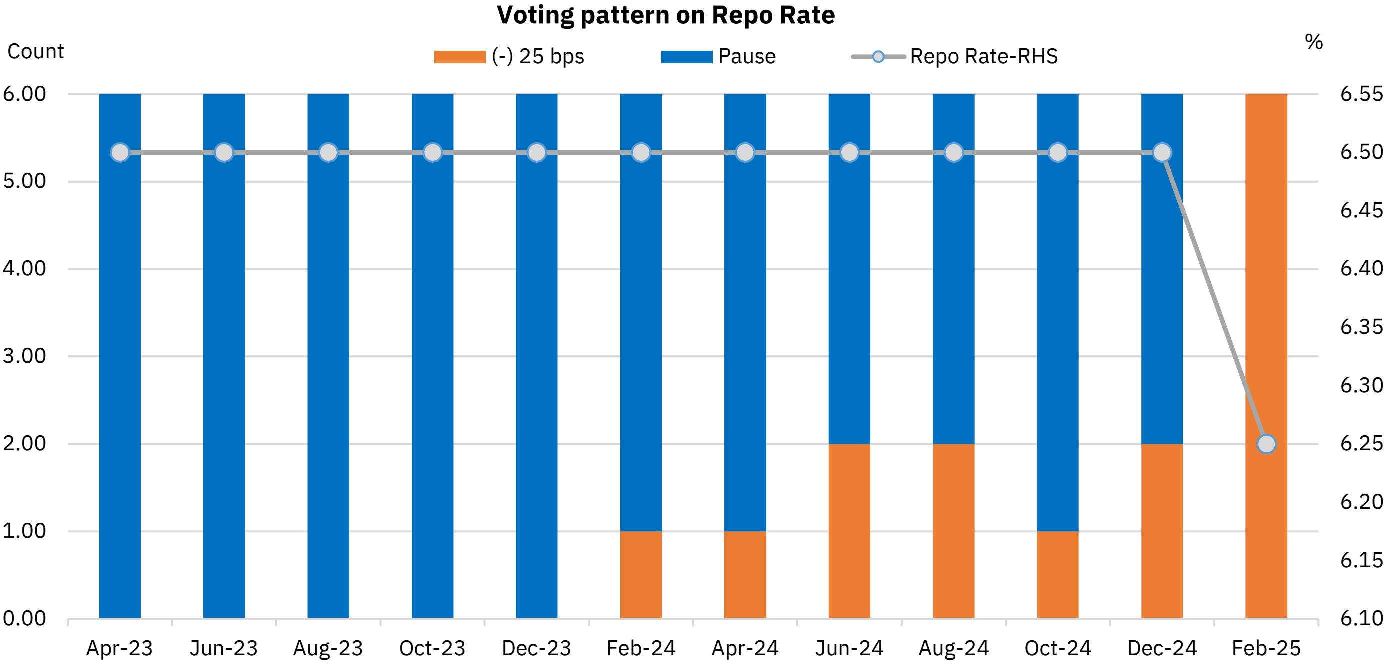

Source: LSEG Datastream, NSE EPR.

**Figure 2: Real interest rates**




Source: Refinitiv Datastream, NSE EPR.

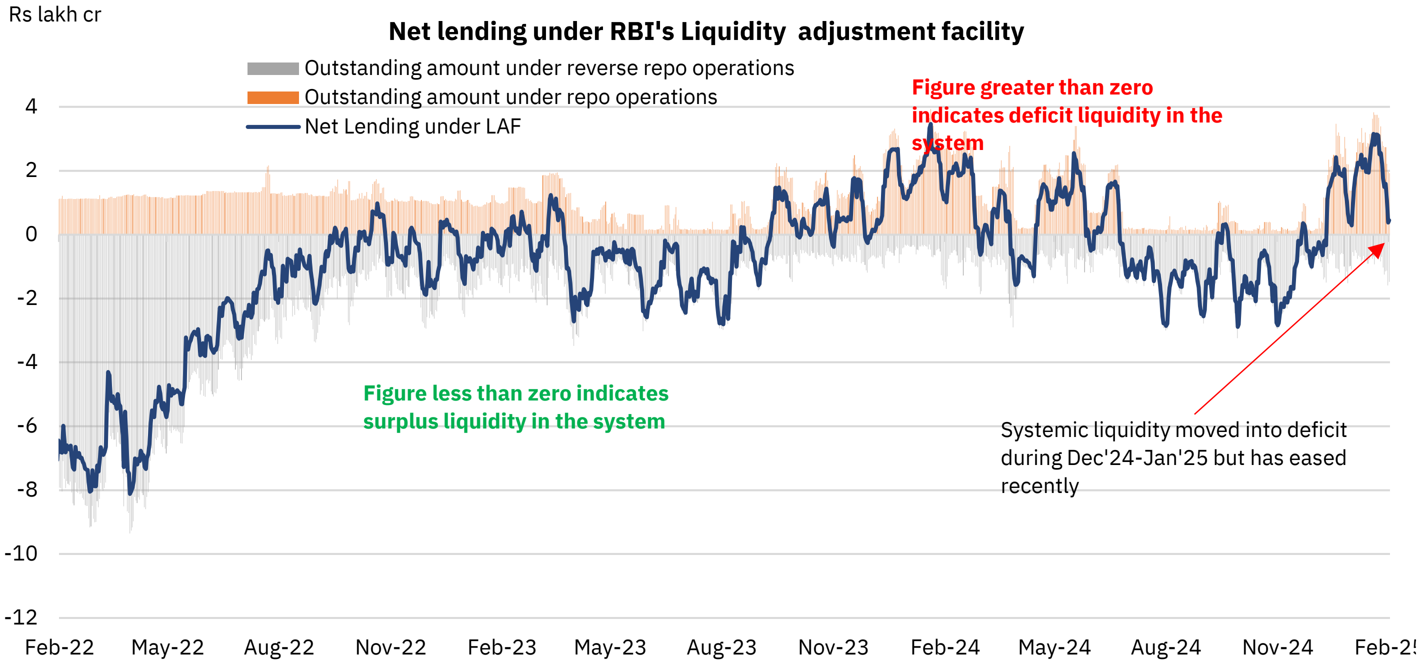
**Figure 3: MPC members' voting pattern**




Source: RBI, NSE EPR.

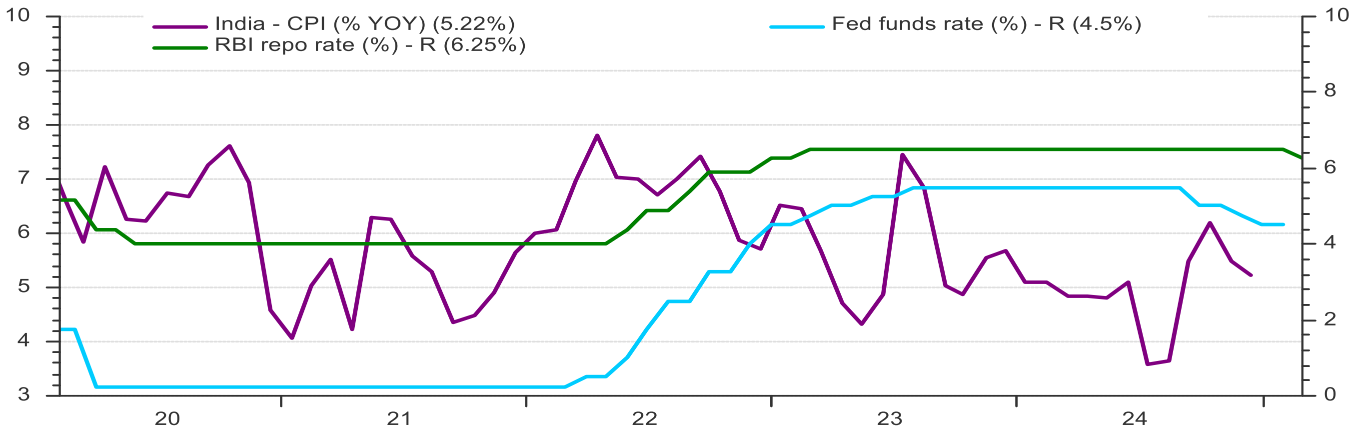
**Figure 4: Net lending under RBI's Liquidity Adjustment Facility**

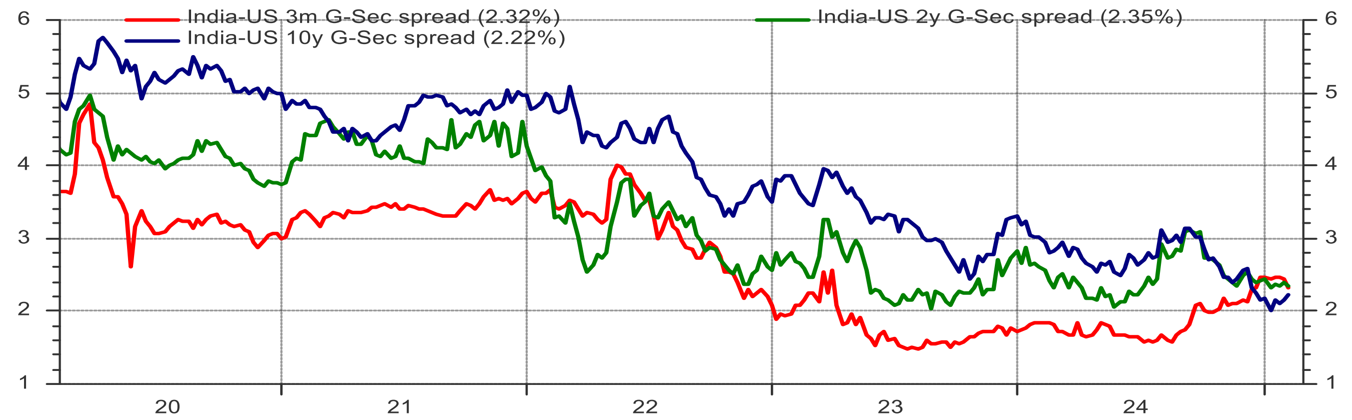
The banking system liquidity has moved from an average surplus of Rs 1.4 lakh crore in November 2024 to a deficit of Rs 68,469 crore in December 2024 and further widening to ~Rs 2 lakh crore in January 2025, primarily due to capital outflows, advance tax payments and a significant pick-up in currency in circulation.




Source: CMIE Economic Outlook, NSE EPR.

**Figure 5: India vs. US policy rates and yield differential**

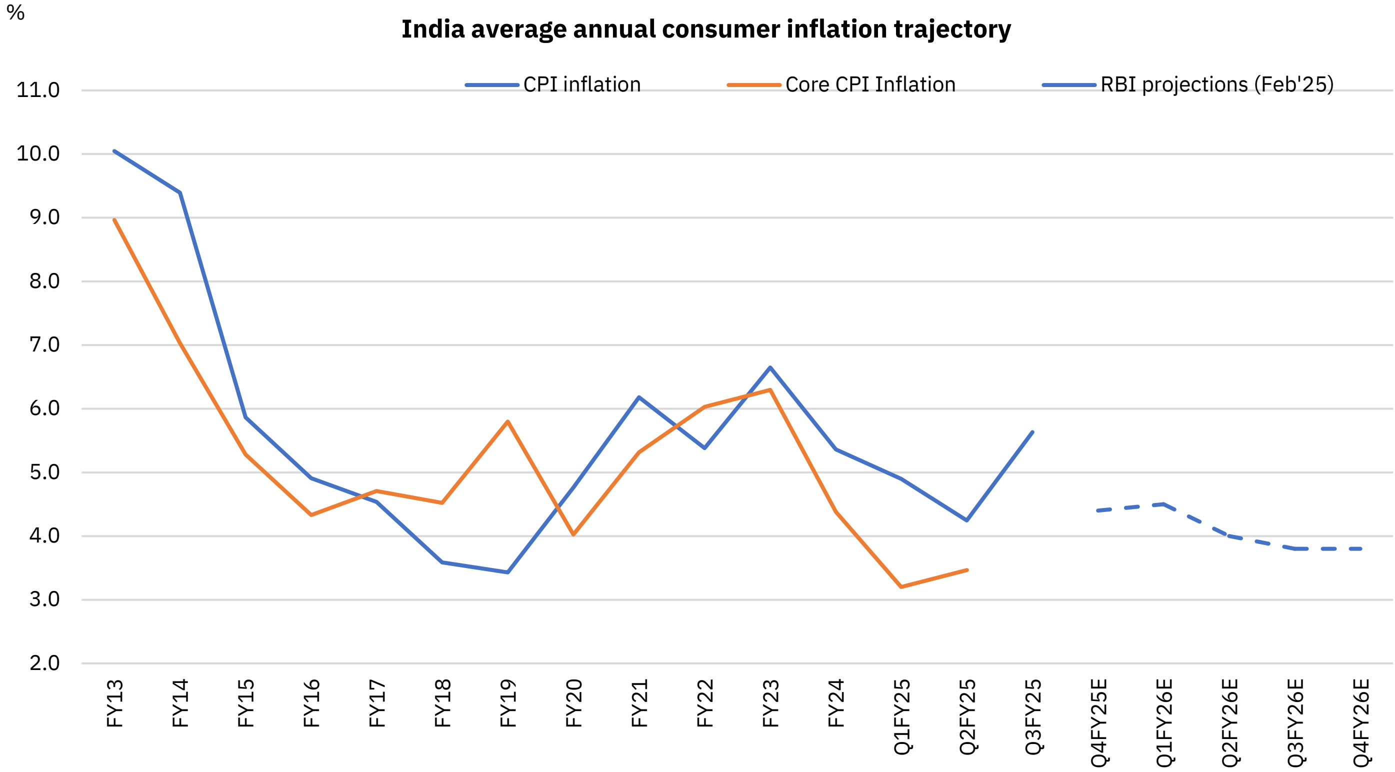



Source: LSEG Datastream, NSE EPR.

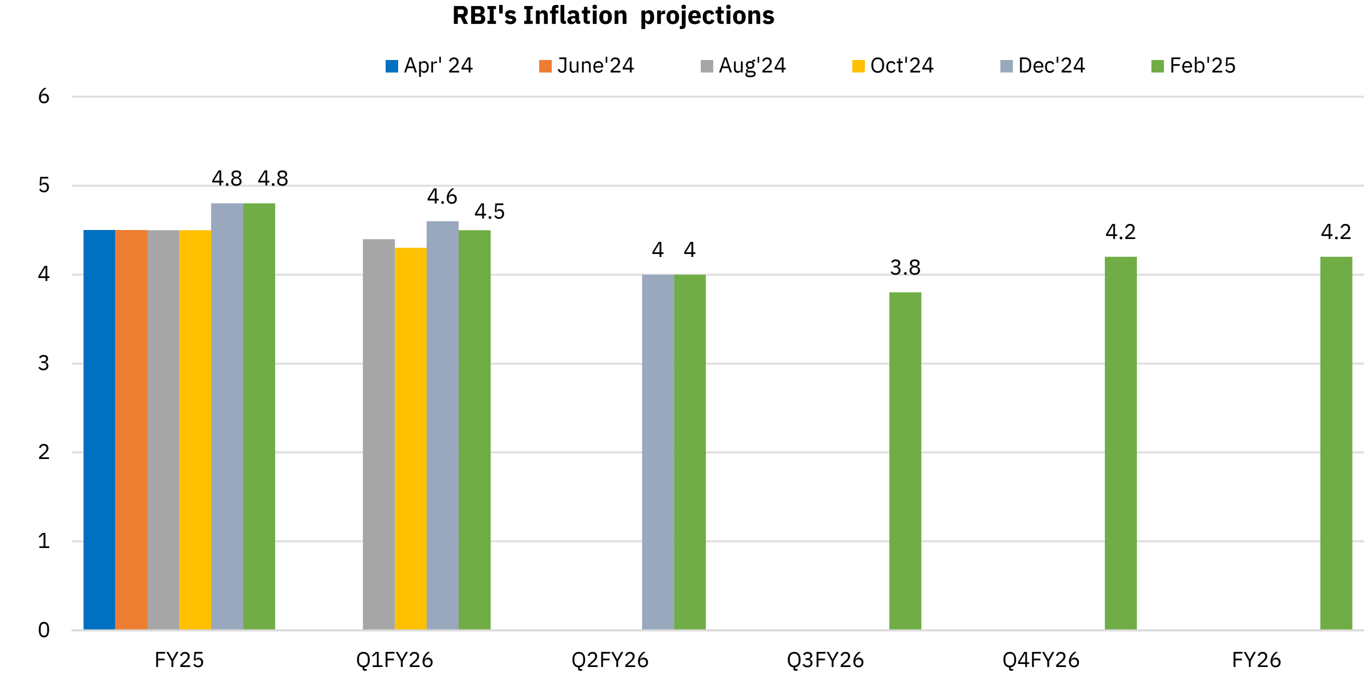
**Figure 6: India's consumer inflation trajectory and RBI's forecasts**

Headline inflation is projected to moderate at a gradual pace towards the median inflation target of 4%. RBI has forecasted headline inflation at 4.2% in FY26, lower than 4.8% in FY25.




Source: CMIE Economic Outlook, RBI EPR. Core inflation is calculated as CPI inflation excluding food, pan, tobacco & intoxicants and fuel & light.

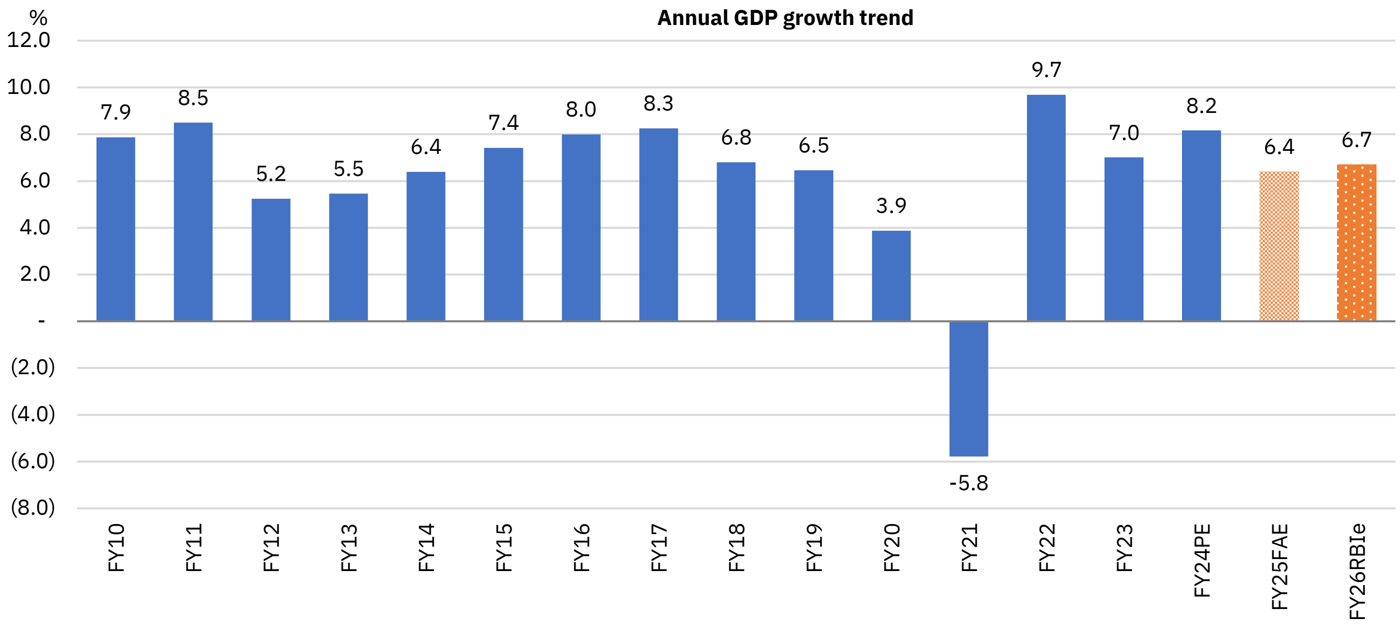
**Figure 7: Quarterly and annual inflation forecasts by RBI**




Source: RBI, NSE EPR. PE: Provisional estimates, FAE: First Advanced Estimates; RBIe: RBI estimates.

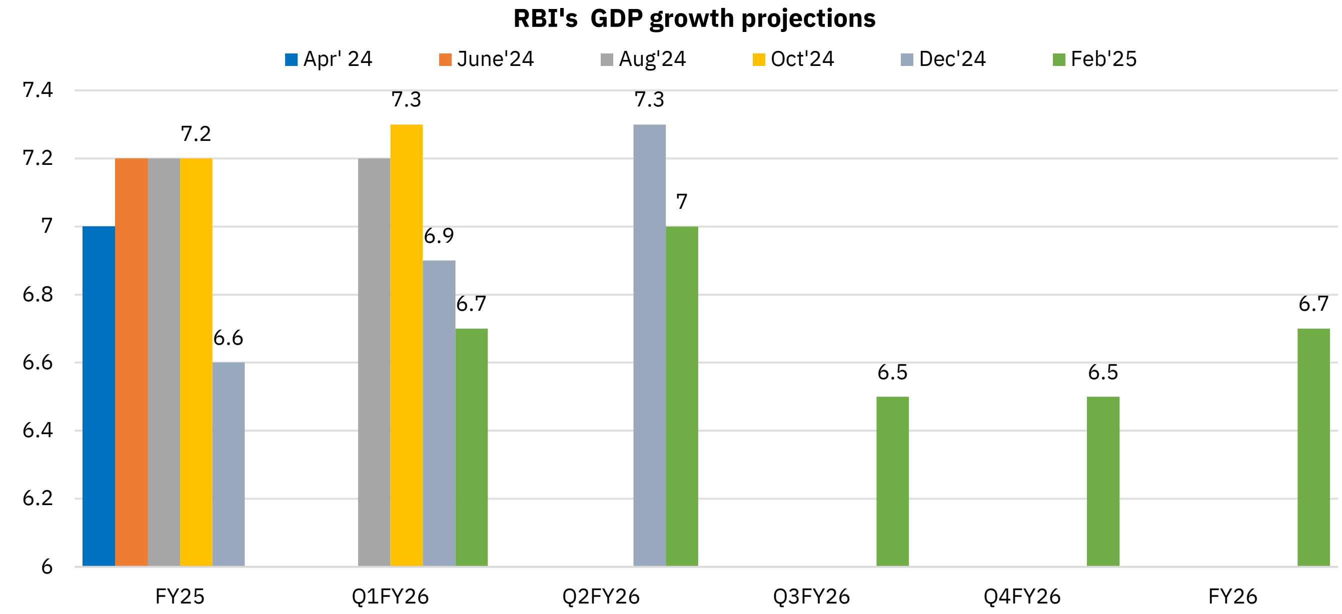
**Figure 8: GDP growth trend and RBI's estimates**

The GDP growth has been projected at 6.7% in FY26, higher than 6.4% in the previous year, but lower than the 8.2% growth in FY24, opening space for a rate cut in the current policy.




Source: CMIE Economic Outlook, RBI, NSE EPR. RBIe = RBI estimate, PE= Provisional Estimate.

**Figure 9: RBI's quarterly and annual GDP growth forecasts**




Source: RBI, NSE EPR.

**Economic Policy & Research**

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