RBI Cuts Repo Rate by 25 Bps to 6.25%

Projects FY26 GDP Growth at 6.7%

- Aims for Neutral Monetary Policy
- Retained the CPI Inflation Forecast for FY25 at 4.8%
- Aims To Stimulate Economic Growth
- Makes Borrowing More Affordable
- Encourages Spending And Investment

BRICKWORK RESEARCH February 2025

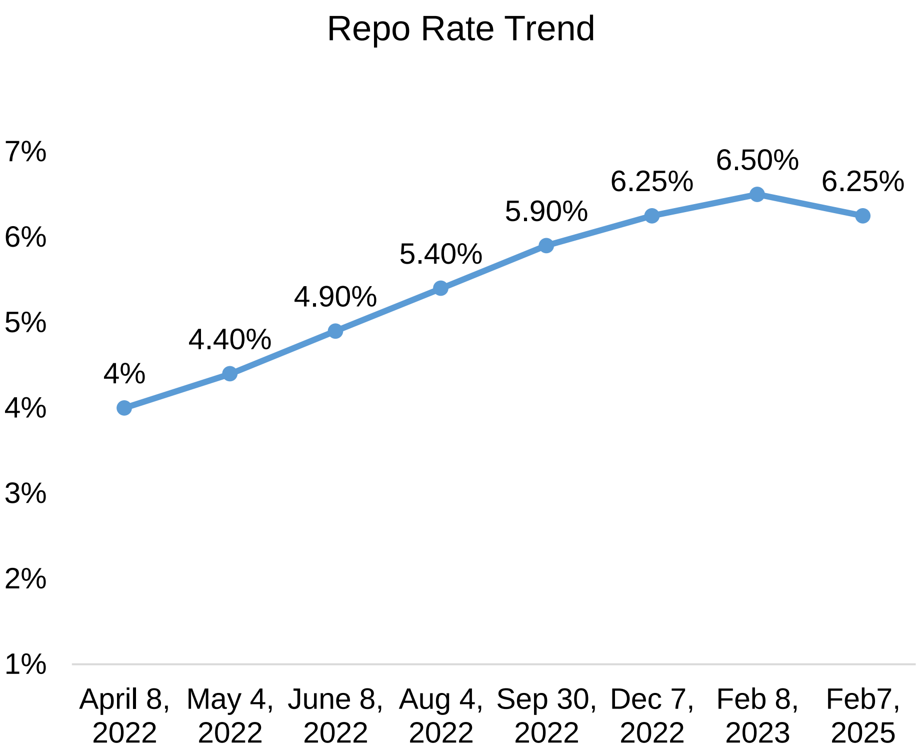
RBI Cuts Repo Rate; First Rate Cut in Five Years

The RBI reduced the repo rate by 25 basis points to 6.25% on February 7, 2025, marking the first policy decision under the chairmanship of the newly appointed RBI Governor, Sanjay Malhotra. This decision marked the sixth and final bi-monthly monetary policy review of FY25

Key Highlights of the Meeting:

- **Repo Rate Cut:** The Monetary Policy Committee (MPC) of the RBI, unanimously voted to reduce the repo rate by 25 basis points, bringing it down to 6.25% from 6.50%. This is the first repo rate cut in nearly five years, with the last cut happening in May 2020
    - The RBI's decision to reduce the repo rate aims to boost economic activity by making borrowing more affordable for individuals and businesses, thereby encouraging spending and investment
    - It is a sign that RBI is adopting an accommodative stance to support the economy.
    - The central bank expects the move to foster growth while managing inflation
- **SDF and MSF Rates:** Consequently, the standing deposit facility (SDF) rate adjusted to 6.00%, and the marginal standing facility (MSF) rate and the Bank Rate to 6.50%
- **First Rate Cut in Nearly Five Years**
- This rate cut marks the first rate cut by RBI since May 2020. The last rate reduction occurred in May 2020, when the RBI cut rates by 40 basis point to aid economic recovery during the Covid pandemic
- However, the central bank initiated a rate hike cycle from May 2022 due to global economic pressures from the Russia-Ukraine conflict and paused this cycle in May 2023 after six consecutive rate hikes aggregating to 250 basis points. The pause in interest rates lasted until the MPC meeting on February 7, 2025, when the repo rate was reduced

Interest Rate Trend



KEY HIGHLIGHTS OF THE RBI POLICY MEET OUTCOME

Unanimous Decision

- The decision to cut the repo rate was unanimous among the MPC members, assessing the current and evolving macroeconomic situation

Aims for Neutral Monetary Policy

- Despite the rate cut, the MPC decided to maintain a 'neutral' policy stance. RBI Governor Sanjay Malhotra announced the MPC's neutral monetary policy stance, aiming to align inflation with the target and support economic growth. This indicates that future rate actions will not be pre-determined to either easing or tightening, allowing flexibility to adapt to changing economic conditions

Inflation Target

- The RBI MPC projected an inflation rate of 4.2% for FY 2025-26, aiming to maintain CPI aligned with the target and improve macro outcomes using flexible targeting for the economy's best interest
- The quarterly projections for FY26 are Q1 at 4.5%, Q2 at 4%, Q3 at 3.8% and Q4 at 4.2%, with risks evenly balanced

Context

- The MPC's decision to cut rates comes shortly after the Union Budget 2025-26 was presented
- The rate cut is expected to support economic growth while keeping inflation in check
- The RBI had kept the repo rate unchanged at 6.5% since February 2023
- The meeting was met with high expectations for a rate cut to boost market liquidity and GDP growth
- In December 2024, the RBI made a Rs 1.16 trillion liquidity boost after announcing a 50 basis point cut in the cash reserve ratio (CRR) to 4%, aiming to enhance liquidity and boost credit growth
- The current decision to cut repo rate is influenced by the expected easing of CPI inflation and the need to boost GDP growth
- Lower interest rates can boost sectors like real estate, automobiles, and infrastructure, which rely on credit availability, as businesses and consumers take cheaper loans.

RBI Retained CPI Inflation Forecast for FY25 at 4.8% and Project 4.2% for FY26

- The RBI expects CPI inflation to ease to 4.8% in FY25, with Q4 FY25 inflation projected at 4.4%
- The MPC anticipates moderate inflation rates in 2025-26, moving towards the target, with positive food price projections and previous measures' effects. RBI projects CPI inflation at 4.2% for fiscal year 2025-26, which is marginally higher than the target rate of 4%
- The inflation targeting framework has led to a decrease in average inflation, and the CPI has largely remained consistent.
- The committee remains steadfast in its commitment to maintaining inflation alignment with the target, while also promoting growth.
- The committee is focusing on a durable alignment of inflation with the target, while supporting growth, despite a decrease in average inflation and CPI alignment with the target

Projects FY26 GDP Growth at 6.7%

GDP Growth Projections

- The RBI projects a real GDP growth of 6.7% for FY2025-26

GDP Growth for FY25

- The RBI predicts a 6.4% real GDP growth for FY25, with economic activity expected to surge in the latter half due to improvements in agriculture and manufacturing
- Key growth drivers include strong household consumption, fixed investment recovery, and resilient services exports, with downside risks including geopolitical tensions, trade protectionism, commodity price volatility, and financial market uncertainties

Inflation Estimates

Period	Current Forecast	Previous Forecast
FY 2024-25	4.8%	4.8%
Q4	4.4%	4.5%
FY 2025-26	4.2%	-
Q1 FY26	4.5%	4.6%
Q2 FY26	4.0%	4.0%
Q3 FY26	3.8%	-
Q4 FY26	4.2%	-

Real GDP Growth Estimates

Period	Current Forecast	Previous Forecast
FY 2024-25	6.4%	6.6%
Q4 FY25	-	7.2%
FY 2025-26	6.7%	-
Q1 FY26	6.7%	6.9%
Q2 FY26	7.0%	7.3%
Q3 FY26	6.5%	-
Q4 FY26	6.5%	-

Key Factors that Influenced the RBI's Decision to Cut the Repo Rate

1. **Moderating Inflation**
   - The RBI observed a moderation in inflation due to reduced vegetable prices and improved supply conditions, with expectations of further moderation in 2025-26 to 4.2% for fiscal year 2025-26, due to positive food price projections and previous monetary measures, thus allowing RBI flexibility for rate reduction
2. **Economic Growth Concerns**
   - Concerns about a slowing domestic economy might have forced RBI to cut rates. India, despite being one of the fastest-growing major economies, experienced a slowdown in GDP growth, dropping to 5.4% in the July-September 2025 quarter and projected to reach 6.4% in the current fiscal year, the weakest pace in four years, attributed to weakened manufacturing and slower corporate investments and others factors like high price pressures, stagnant wages, and weak consumption patterns
3. **Fiscal Policy Support**
   - The government's recent fiscal measures, including tax cuts for the middle class, aim to boost domestic consumption and support the economy, thereby encouraging spending and investment
4. **Government Fiscal Prudence**
   - The government is aiming for a fiscal deficit of 4.8% of GDP for the current year and targeting 4.4% in 2025-26, demonstrating fiscal prudence and a downward trend in interest rates
5. **Liquidity Boost:**
   - In December 2024, the RBI made a Rs 1.16 trillion liquidity boost by announcing a 50 basis point cut in the cash reserve ratio (CRR), making it 4% to enhance liquidity and boost credit growth
6. **Global Economic Environment**
   - India's export-driven sectors are being impacted by global economic uncertainties, including trade tensions and geopolitical risks, which the RBI is aiming to mitigate by reducing the repo rate

RBI's Inflation Management Strategy

The RBI plans to manage inflation while cutting rates through a combination of strategies:

- The MPC aims to use flexible inflation targeting to optimize macroeconomic decisions and enhance macro outcomes in the best interest of the economy
- **Maintaining a Neutral Stance:** The MPC decided to maintain a 'neutral' policy stance
- **Data-Driven Decisions:** Any rate reduction is expected to be gradual and dependent on incoming data
- **Monitoring Inflation:** RBI Governor Sanjay Malhotra predicts continued inflation decrease in 2025 and 2026, based on the policy panel's observation of a decline in inflation
- **Monetary Policy Tools:** The RBI controls inflation through monetary policy tools, influencing interest rates and managing the money supply during economic crises to balance growth and inflation
- **Considering Growth-Inflation Dynamics:** The Reserve Bank of India (RBI) is focusing on boosting growth by adopting a less restrictive monetary policy due to current growth-inflation dynamics.

Impact of Repo Rate Cut on The Housing Market and Economy

- **Reduced borrowing Costs:** The rate cut is anticipated to result in lower borrowing costs, thereby making home loans more affordable for homebuyers
- **Stimulus for Key Sectors:** The rate cut is expected to increase affordability of home and vehicle loans, boosting demand in the housing and automotive sectors, and potentially supporting economic growth by encouraging consumer spending.
- **Boost to Housing Demand:** The RBI's decision is expected to boost housing demand by lowering borrowing costs, making home loans more affordable and stimulating sector growth, according to real estate developers and experts
- **Increased Sales and New Project Launches:** The rate cut is expected to boost sales and new project launches, benefiting both homebuyers and developers
- **Boost to affordable and mid-income segments:** The residential market is expected to experience increased demand, particularly in the affordable and mid-income segments, driven by end-users, individual and institutional investors
- **Benefits for Developers:** Housing Developers can benefit from lower financing costs, accelerating new construction projects, and improved credit access, which ensures steady supply and timely deliveries for project execution
  - **However,** CREDAI, the Realtors' apex body, suggests the 25 bps rate cut may have limited direct impact and is seeking further reduction in the next monetary policy meeting to boost housing demand
- **Stimulating Economic Growth:** The repo rate cut aims to stimulate economic growth by making borrowing more affordable for individuals and businesses, thereby boosting spending and investment.
- **Enhanced Liquidity:** The RBI's cautious approach aims to balance interest rate cuts with inflation control, emphasizing durable liquidity for credit growth and adequate credit flow to support economic activities
- **Boost to Credit Growth and Consumption:** The rate cut is anticipated to enhance liquidity, reduce borrowing costs, and promote economic growth in fiscal year 2026, while reducing inflation expectations

Additional Measures Announced by the RBI

Introduction of forward contracts in Government Securities

- The RBI announced to introduce forward contracts in government securities as part of its efforts to expand the suite of interest rate derivative products available to market participants. This is expected to help long-term investors like insurance funds manage their interest rate risk across interest rate cycles and enable efficient pricing of derivatives using Government securities as underlying instruments
- Bond forwards involve the actual delivery of bonds, unlike forward rate agreements (FRAs). Insurance companies can use bond forwards for hedging and direct bond delivery. Experts predict this regulatory announcement will enhance price discovery and market participation

NDS-OM Access

- The RBI will allow SEBI-registered non-bank brokers to access the Negotiated Dealing System-Order Matching (NDS-OM) platform, which facilitates secondary market transactions in government. Non-bank brokers registered with SEBI will be permitted to directly access NDS-OM. This expands access to the platform, which was previously limited to regulated entities, banks, and primary dealers
- The objective is to expand government securities market participation and boost retail investor engagement
- The NDS-OM is an RBI-owned electronic system for trading government securities in the secondary market, allowing Gilt Account Holders (GAHs) direct access to trade in G-Sec, subject to Primary Members controls

Digital Security

- The RBI has introduced new digital security measures, including exclusive domains and improved authentication protocols, to combat financial fraud and enhance cybersecurity in the Indian banking and financial sector
- The RBI will introduce a '.bank.in' domain exclusively for Indian banks in April 2025 to differentiate legitimate banking websites from fraudulent ones, with the Institute for Development and Research in Banking Technology (IDRBT) as the exclusive registrar for these domains
- The RBI has also introduced an additional layer of security by enabling AFA for cross-border 'Card Not Present' transactions, extending the security already in place for domestic digital payments to international online transactions

BWR VIEW

- The RBI has cut the repo rate by 25 basis points as a strategic move to boost economic growth amidst easing inflation and slowing activity, aiming to stimulate demand and investment while monitoring global economic developments

- This rate cut by RBI is a strategic move to stimulate economic growth, reduce borrowing costs, increase consumer spending, and improve financial system liquidity amid inflation and global uncertainties

- The rate cut aims to boost economic activity by making loans cheaper, encouraging spending and investment, following the Central government's recent cut in personal income tax

- Despite the reduction, concerns about retail inflation, rupee-USD exchange rate, and global trade-related uncertainties persist and future repo rate cuts will depend on addressing these issues

** Views are personal*

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