

After a long time, we have in Sanjay Malhotra—current RBI Governor—an intellectual with a flair for data, and one who comes with a firm pro-growth ideology. And this is what sets him apart. Leaders with conviction in their ideology will lead their team, while the others will instead be led by their team. Indeed, in the one-hour press conference, there were only about two questions that Malhotra passed to the Deputy Governor to answer, while fielding all queries with clarity and ease. Below mentioned is the summarized content of our monetary policy. In our view, the monetary policy through its actions and communication marks a seismic shift – aimed at nudging the potential growth rate of the economy higher. The actions taken last Friday should be viewed in the context of the current economic landscape.

- i. 50bps cut in repo to 5.5% – Historically, policy rate moves in increment of 50bps reflect economic duress. The recent surprise cut in our opinion is a catch up on an unusually restrictive policy in the last fiscal and resets the trajectory of economic growth higher. This action also reflects confidence in conducting the monetary policy to align with the domestic economic reality – a decoupling of monetary policy is a pre-cursor to a decoupled economic growth.
- ii. 1% cut in CRR (which will create durable liquidity of Rs2.7trn): We have had a 4% CRR benchmark since FY13, barring a 1% cut during the pandemic which then reverted with recovery taking hold. CRRs during the late nineties and early 2000s were the preferred monetary tool used to influence liquidity and rates. Over the last decade – especially since FY12, the RBI's ownership of government bonds has consistently exceeded the CRR deposits. As of FY25, the RBI owned nearly Rs15trn of government bonds against CRR deposits of only ~Rs10trn. This reflects the RBI's use of OMO as a primary liquidity lever, apart from important but indeterminate forex flows. Meanwhile, the cost of idle CRR reserves – assuming opportunity cost of yield at 8% – is a staggering Rs800bn. Again, we applaud the Governor's resolve to question the basics and purge the antiquated policies. We believe that over the next several years, the RBI will progressively lower the reserve requirements – keeping a very low threshold, and only for savings/low duration time deposits.
- iii. We believe that the next stage of reforms demands gradual withdrawal of lending restrictions to corporates for land, against shares and such. Real estate in aggregate accounts for one third of investment activity in the country without access to low cost funds for most developers. After RERA implementation, builders consolidation, and timely and transparent data availability, etc, the underwriting risk is no longer systemic or disproportionately higher than that for any other industrial project finance. Likewise, lending against shares is a critical need – especially as new-age companies have more intangible assets than hard physical collaterals. It is about time that we start respecting market assessment of equity value as much as the due consideration we give to replacement cost of physical assets.

WHY WE NEED LOWER RATES

1. Pre policy, the 10-year yields were about 6.2-6.25%, indicating a near-flat yield curve – clearly implying that policy rates were restrictive even as the stance was accommodative.
2. Most importantly, the past 12-month core inflation average stands at about 3.7%, with the forecast print likely to remain sub-4%. Notably, core inflation captures a near 30% rise in gold prices too. Headline inflation has averaged at about 4.3%, with few spikes in print due to volatile fruit/vegetable prices. Given the structural rout in oil prices (which has a large indirect impact) and commodities, India remains on the right side of this trade; and barring unforeseen geo-political risks, the inflation environment will remain benign.

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3. India's credit-to-GDP has moved up by only about 300bps to ~55% over the last 15 years – a point that needs much wider debate. If we strip out the higher growth rates in retail loans, the under-penetration within the corporate and MSME sector is glaring. Policy rates need to be outcome-focused. There is absolutely no threshold of real rates (no theoretical literature either) as long as inflation remains contained and financial stability is not compromised. Indeed, the effectiveness of monetary policy should finally reflect in the slope of the credit growth – up or down. Credit growth is the surest leading indicator of growth. ***Investment finally is the interplay between cost of capital and expected IRR on the project. There is absolutely no doubt that lower rates will reignite the investment cycle – the uncertainty is how low do the rates need to go.*** The RBI has sufficient direct and indirect levers, such as risk weights, to guide rates lower for investments.
4. In his closing statement, the Governor alluded to the fact that “while price stability is a necessary condition, it is not sufficient for growth”. He further aptly simplified it by stating that controlling inflation boosts real income, which itself supports or accelerates growth, but supportive policy levers are required to lift growth rates to aspirational levels.

WHY THE CHANGE IN STANCE

The aggressive moves on the policy front have been calibrated with a change in stance, back to 'neutral' mode. The earlier switch to an accommodative stance was done only in the prior policy meet. While the official version is that under the present circumstances, there is limited space to lower rates further, a more practical reasoning is simply to wait out the usual 6-9 months of the transmission impact to play out, remain data-dependent, as well as firmly communicate the RBI's inflation fighting credentials – dovish actions completed with a mildly hawkish signaling. In our view that the hallmark of this government has been several small, albeit relevant, incremental policy changes (against big-bang reforms), and remaining data dependent which allows course correction. ***We believe as inflation remains anchored at lower levels, the RBI will continue to gradually lower rates, although at longer intervals. We are probably in a long-term bond bull market as well.***

MARKET IMPACT: NBFCs set to outshine BANKS

Any pro-growth policy measure usually augurs well for the markets as well, unless valuations are out of sync. Sen, Emkay's Head of Research and Strategist, who correctly timed the explosive rally sees Nifty at about 26000 this fiscal. Anand Dama, our banking analyst, expects net impact (drag from lower rates on EBR-linked loans offset by release of idle CRR funds) of about 15-20bps on banks' NIMs – limiting earnings growth to a high single digit. Also, the pain will be more front loaded as deposits reprice with a lag. A few banks—with high-yield fixed rate products like credit cards, personal loans and MFI—will benefit significantly, also helped by tapering credit costs and an expected reversal in the business cycle. Meanwhile, the construct for NBFCs looks promising – they were growing fast to begin with, and the policy surprise is an added booster. We like Shriram Finance and AB Capital; the latter could see its price double in about 18-24 months. We will explore this investment hypothesis in more detail shortly.

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