# Economics

India | Economics

Global Markets Research

## RBI makes first move towards easing cycle

6 December 2024

**Key takeaways:** The RBI Monetary Policy Committee (MPC) held the policy rates steady at 6.5% and maintained the stance at Neutral. It however cut cash reserve ratio (CRR) by 50bps to 4%, which was in line with our and consensus expectations. The CRR cut in today's policy allows the RBI to address growth concerns as also risks to the Indian Rupee amid the strength in the USD and continuous FII outflows. With food inflation pressures likely to ease starting January 2025, headline inflation may come closer to 5%, allowing the RBI's MPC space to address growth concerns after the recent dismal GDP growth of 5.4% vs market expectation of 6.5%. **We expect MPC to cut policy repo rate by 25bps in Feb 2025E and expect a total of 75bps rate cut this easing cycle.**

**CRR normalization to ease liquidity conditions, going forward:** The RBI's pre-emptive move to cut the CRR by 50bps to 4% matched our expectations, as potential challenges to durable system liquidity have increased incrementally, in our view. **On the external front**, the INR is overvalued on real effective exchange rate and remains under continuous downward pressure especially on the back of USD strength. In support of the INR, the RBI holds ~USD 60-65bn in forwards, (likely half of them in the 1m-3m period) and should RBI take their deliveries, it would further drain systemic liquidity at a time when Q4FY25 is likely to see durable liquidity turning into deficit. As such, a CRR cut was a prudent move as it allowed room for RBI to address INR weakness while also signaled its readiness to act.

**Domestically**, a repo cut may not have brought effective rate cut transmission in the system amid anticipated tighter liquidity conditions in the upcoming months due to tax outflows, advance tax payments, higher demand from agriculture sector post harvest. Hence, the move to ease liquidity in the banking system (expected to release primary liquidity of ~INR 1.16tn in the banking system, as per RBI) was a more prudent move in our view before policy rate cuts. Durable and system liquidity peaked at INR 4.9tn and INR 2.7tn respectively because of FX outflows.

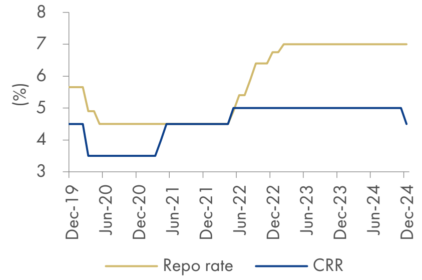
**Growth and inflation risks up:** Given the downside surprise in Q2FY25 growth, **the RBI lowered its FY25 GDP growth projections to 6.6% (Elara estimates at 6.5%)** versus 7.2% previously. The RBI remains positive on growth impulses in H2FY25E, led by positive trends in rural demand, improving spending by the government and external demand buoyed by services exports.

On the inflation side, while the RBI held its confidence as regards inflation subsiding in Q4FY25E, a ~90bps bump in Q3 projection versus last meet's projection led the RBI to **raise FY25 projections by 30bps to 4.8% (Elara estimate at 4.8%).** Better sowing outlook for the *Rabi* crop, adequate reservoir levels, record *Kharif* production and seasonal price corrections in vegetables may inject downside pressure in food prices and hence, on headline inflation, per the RBI. We however expect this to playout not before Jan 2025.

**Measures supporting INR welcome:** Indirect measures to support the INR via liquidity measures and raising interest ceilings on FCNR (B) deposits (1-3m tenure) have the potential to ease some depreciation pressure on the INR in the near term. Adding to this, the introduction of Secured Overnight Rupee Rate (SORR) based on ONREPO and TREPS can lend incremental support to the INR due to positive carry potential over major market rates such as SOFR (191bps) and SONIA (180bps). Not to forget, the USDINR still remains the least volatile unpegged EMFX, even as iVols have increased by ~30% Q3FY25TD in three-month and six-month forward tenors.

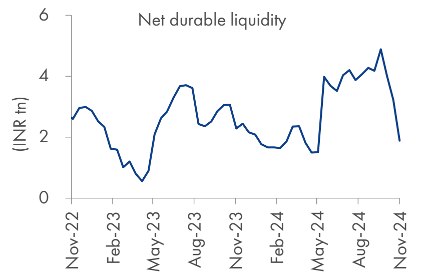
However, in our view, moves in the USDINR and overall, Asia EMFX remain mainly a function of the USD for now and BoJ policy, over domestic idiosyncratic factors.

CRR rate normalized; repo held




Source: CEIC, Elara Securities Research.

Liquidity in the system has moderated sharply




Note: Data as on 15 November 2024; Source: CEIC, Elara Securities Research

RBI downgrades FY25 growth projections...

| Period (%) | MPC Oct-24 | MPC Dec-24 |
|---|---|---|
| Q1FY25* | 6.65 | 6.65 |
| Q2FY25* | 5.4 | 5.4 |
| Q3FY25E | 7.4 | 6.8 |
| Q4FY25E | 7.4 | 7.2 |
| **FY25E** | **7.2** | **6.6** |
| Q1FY26E | 7.3 | 6.9 |
| Q2FY26E | | 7.3 |

Note: *Actuals; Source: RBI, Elara Securities Research

...and upgrades FY25 inflation projections

| Period (%) | MPC Oct-24 | MPC Dec-24 |
|---|---|---|
| Q3FY25E | 4.8 | 5.7 |
| Q4FY25E | 4.2 | 4.5 |
| **FY25E** | **4.5** | **4.8** |

Source: RBI, Elara Securities Research.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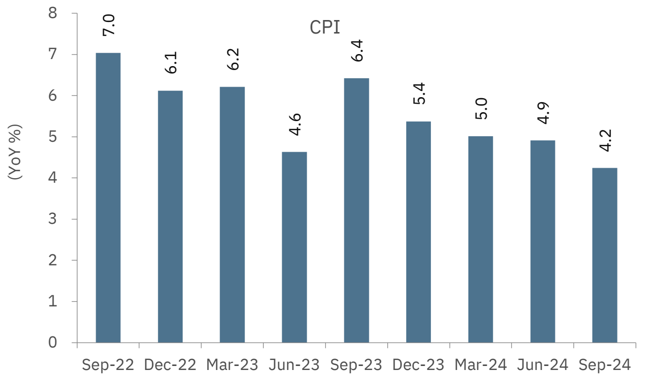
**Outlook – Expect 25bps cut in Feb '25E:** We expect the MPC to cut policy repo rate by 25bps in Feb 2025E and expect a total of 75bps rate cut this easing cycle. The CRR cut following the change in stance in previous meeting paves the way for further policy easing in the form of rate cuts. While Q3FY25 GDP growth is likely to be higher than Q2FY25 level, the impact of RBI's macro-prudential policies (to check the excesses in credit growth) and of sluggish government spending may take time to wear off.

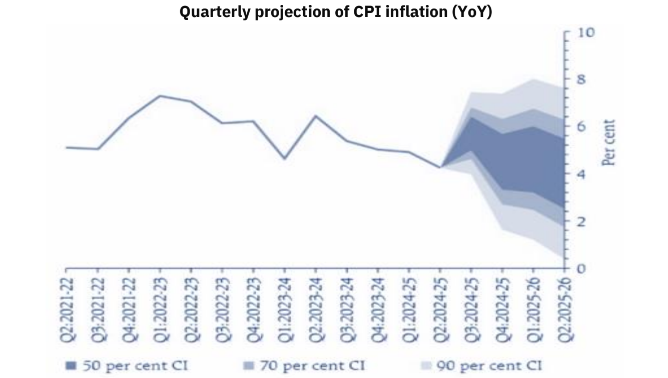
We expect FY25E GDP growth at 6.5% versus RBI's estimate of 6.6%. The CRR cut in today's policy leaves scope for the RBI to address growth concerns as well as external risks amid firming USD and FII outflows. As food inflation pressures begin to ease starting Jan 2025, headline inflation shall likely come closer to 4.5-5%, allowing the MPC space to address growth concerns. By then, there will also be clarity on Trump's policy decisions when he assumes power and on the Fed's policy outcome in December and Jan end.

**Exhibit 1: Headline inflation is easing...**



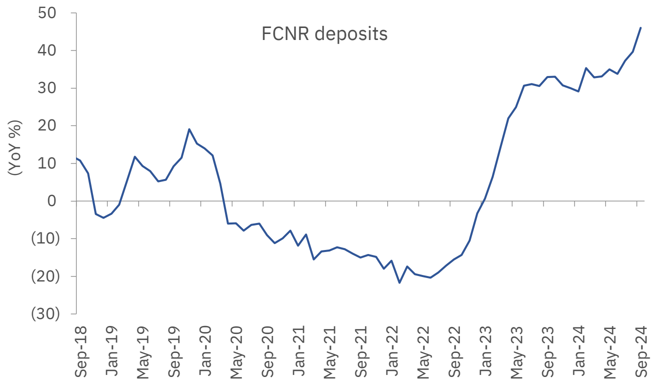

Source: CMIE, Elara Securities Research

**Exhibit 2: ...and is expected ease going forward**



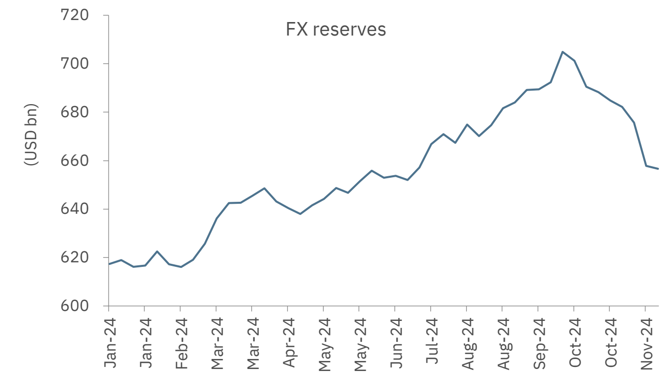

Source: RBI

**Exhibit 3: FCNR deposits growing at record pace**




Source: CEIC, Elara Securities Research

**Exhibit 4: RBI using the FX reserves to rein the USDINR volatility**




Note: Data till 22 November 2024; Source: CEIC, Elara Securities Research

### Exhibit 5: Additional measures related to developmental and regulatory policies

| | |
|---|---|
| Reduction in cash reserve ratio | Reduce the cash reserve ratio (CRR) of all banks by 50bps in two equal tranches of 25bps each to 4.0% of net demand and time liabilities (NDTL) with effect from the fortnight beginning 14 December 2024 and 28 December 2024, respectively. This will restore the CRR to 4%of NDTL, which was prevailing before the commencement of the policy tightening cycle in April 2022. This reduction in the CRR would release primary liquidity of ~INR 1.16tn to the banking system. |
| Interest rates on FCNR(B) deposits | In order to attract more capital inflows, it has been decided to increase the interest rate ceilings on FCNR(B) deposits. Accordingly, with effect from today (6 December 2024), banks are permitted to raise fresh FCNR(B) deposits of one year to less than three years maturity at rates not exceeding ARR plus 400bps and deposits with maturity between 3 and 5 years at rates not exceeding ARR plus 500bps. This relaxation will be available till 31 March 2025. |
| Expanding reach of FX-Retail Platform through linkages with Bharat Connect | To expand the reach of FX-Retail platform and enhance user experience, it is proposed to facilitate the linking of the FX-Retail platform with Bharat 2 Connect (earlier known as Bharat Bill Payment System) operated by the NPCI Bharat Connect. The linkage will enable users to register and transact on the FX-Retail platform through the apps of banks (mobile applications, internet banking etc.) and non-bank payment system providers, which are integrated with Bharat Connect. In the first phase, it is proposed to implement a pilot facilitating purchase of US Dollar against the Rupee by individuals and sole proprietors. Going forward, the scope will be expanded to cover other FX transactions, including sale of US Dollar against the Rupee and other categories of users. Users will continue to have the option to directly access the FX-Retail platform, as hitherto, and transact under the existing mechanism. |
| Introduction of the Secured Overnight Rupee Rate (SORR) – a benchmark based on the secured money markets. | It is proposed to develop a benchmark based on the secured money markets (both basket repo and TREP) – the Secured Overnight Rupee Rate (SORR). Financial Benchmarks India (FBIL) is being requested to take the proposal forward. |
| 'Connect 2 Regulate' – An initiative for open regulation | This shall provide an opportunity to the stakeholders to share their ideas and inputs in the form of case studies/ concept notes, etc. on the topics announced by the RBI from time to time. |
| Introduction of podcast facility as an additional medium of communication | It proposes to launch podcasts for wider dissemination of information that is of interest to the general public. |
| Collateral-free agriculture loan –– Enhancement of limit | At present, banks are required to extend collateral-free agriculture loans up to INR 0.16mn per borrower. This limit was enhanced from INR 0.1mn, set in the year 2010 to INR 0.16mn in the year 2019. Keeping in view the overall inflation and rise in agricultural input costs since then, it has been decided to raise the limit for collateral-free agriculture loans from INR 0.16mn to INR 0.2mn. This will enhance the coverage of small and marginal farmers in the formal credit system. |
| Pre-sanctioned credit lines through UPI – Extending the scope to SFBs | It is proposed to permit SFBs to extend pre-sanctioned credit lines through UPI. |
| Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE-AI) in the financial sector – Setting up of a committee | It is proposed to constitute a committee to develop a Framework for Responsible and Ethical Enablement of AI (FREE-AI) in the financial sector. |
| AI solutions to identify mule bank accounts - MuleHunter.AI | This model enables detection of mule bank accounts in an efficient manner. A pilot with two large public sector banks has yielded encouraging results. Banks are encouraged to collaborate with RBIH to further develop the MuleHunter.AITM initiative to deal with the issue of mule bank accounts being used for committing financial frauds. |

Source: RBI, Elara Securities Research

## Appendix

ONREPO = Overnight Repo Rate

TREPS = Tri Party Repo Rate

SOFR = Secured overnight financing rate, USA

SONIA = Sterling Overnight Index Average, UK

FCNR = Foreign Currency Non-Resident (Banks) Account

Ivol = Implied volatility

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