MPC minutes: Inflation below lower-bound triggers cut

The minutes of December meeting highlight RBI's commitment to maintaining the growth momentum. While the growth surprised on the upside in the first half, it is expected to soften in the second half. MPC members noted that inflation remains below the lower bound of FIT and thus necessitates counter-cyclical action from the central bank. While most MPC members remained of the view that the stance should be held at "neutral" owing to global uncertainties, Prof. Ram Singh opined for a change in stance to "accommodative" signaling room for further easing. The next meeting of the MPC is scheduled post Budget alongside a new CPI series with a change in base and restructuring in the weight diagrams. The new CPI will likely lead to lower food weightage and thus the comfort derived from low food prices could be limited. While we expect MPC to maintain the "neutral" stance, we do not expect RBI to cut rates further unless growth falters significantly.

Confidence in inflation a key for rate cut: As in the previous meeting, December meeting minutes also indicated a continued confidence in muted inflation trajectory. MPC members note that both headline and core (excluding gold and silver impact) inflation appears favourable to deliver a quarter point rate reduction. The comfort derived from lower food prices will likely continue as the kharif production and rabi sowing both remain healthy. While headline inflation has already bottomed out, the chances of sudden surprises on the upside seems slim. Dr. Nagesh Kumar highlighted that inflation for 2025-26 which is revised lower at 2% does not appear healthy and suggest a "demand deficit". Prof. Ram Singh opined that the current lower inflation makes it especially necessary for the central bank to act "counter-cyclical" to ensure that prices do not breach the lower bound of the target. Shri. Indranil Bhattacharya emphasized that FIT system should focus on bringing inflation closer to the 4% target and thereby lower inflation prints provided room for the RBI to bring down rates.

Strong commitment to maintain growth: Growth in the first half of the current fiscal year has remained robust at 8% backed by manufacturing and services sector. Rural consumption has remained robust led by a rise in real incomes while the urban demand has seen recovery. However, in H2, the growth is expected to soften. The minutes of the December meeting clearly highlight the intent of MPC to maintain growth by stimulating demand. MPC members have also noted that there are no signs that the economy might be overheating. Dr. Poonam Gupta in her statement noted that most nominal indicators do not indicate overheating alongside support from lower inflation. Prof. Ram Singh highlighted that the 2025 HCES survey indicates a strong demand for durable goods. Governor Malhotra noted that various domestic developments such as income tax rationalization alongside easing monetary policy and a GST-led rationalization push from the fiscal side will enable sustained growth in the second half. Further he added that demand pressures appear on the lower side and thereby real interest rates need to be lower. Owing to these factors, RBI also revised its growth forecast for FY26 higher to 7.3%.

MPC members unanimous on lower inflation providing the scope to cut rates: Broadly, the minutes bring about a clarity as to why the MPC members were unanimous on a cut in the December policy. Going forward, the bar for rate cuts have moved higher. As of the latest reading on both CPI and WPI, inflation appears to have turned the corner and is likely to continue to gently head higher in the months to come, due to an unfavourable base effect and a turn in the vegetable prices. The RBI sees headline as also core retail inflation in the first half of FY27 to be anchored the 4% mark. This indicates a 1.25% interest rate, lower than the RBI's own study that had put the ideal spread at 1.4-1.9%. With RBI preferring to be more open to currency depreciation, thereby maintaining its preference on independence of monetary policy, the likely impact of the depreciation on the WPI and its pass-through to CPI needs to be factored. Further, the next policy announcement will come close to the Ministry's publication of the new base year CPI along with its change in the weighting diagram. Household Expenditure Survey of 2022-23 indicates a lowering of the food weight in CPI and a higher weight for non-food items. Further, changes in methodology of capturing housing sector inflation could provide some upward bias to the inflation prints. If this is true, it will further reduce the real interest rate gap.
Consequent to the above, unless there is any serious crumbling of the growth dynamics, we think the current interest rate cut cycle of the RBI is over and the RBI will likely maintain a long pause along with stance being kept at "neutral". Actions to keep liquidity comfortable and anchor the operative rate to the repo rate is expected to continue.

Highlights

- MPC members note that lower inflation remains a key factor in bringing rates down
- MPC members unanimously voted for a 25-bps cut: However, Prof. Ram Singh opined for a stance change to "accommodative" from "neutral"
- While inflation has bottomed out, it is expected to move upwards hereon. We do not expect RBI to bring rates down while maintaining the neutral stance

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