HSBC Mutual Fund

RBI Monetary Policy Update

6 December 2024

MPC Announcement

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The Monetary Policy Committee (MPC) came out with their bi-monthly policy statement on December 06, 2024. Some of the key announcements are as follows:

- The MPC decided by a majority of 4 out of 6 members to keep the policy Repo Rate unchanged at 6.50%. Two members of the committee voted to reduce the policy repo rate by 25 basis points
- Consequently, the standing deposit facility (SDF) rate remains unchanged at 6.25% and the marginal standing facility (MSF) rate and Bank Rate at 6.75%
- The MPC also decided unanimously to continue with the neutral stance of monetary policy and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth. The growth and inflation estimates have been revised as per the below mentioned table:

	Growth		Inflation	
Period	Oct 2024 forecast	Dec 2024 forecast	Oct 2024 forecast	Dec 2024 forecast
Q3 FY2025	7.40%	6.80%	4.80%	5.70%
Q4 FY2025	7.40%	7.20%	4.20%	4.50%
FY2025	7.20%	6.60%	4.50%	4.80%
Q1 FY2026	7.30%	6.90%	4.30%	4.60%
Q2 FY2026	NA	7.30%	NA	4.00%

As expected by markets, the growth and inflation estimates have been revised from the October forecasts. GDP growth for Q3 FY2025 has been revised lower by 60 bps to 6.80% and the full year estimate has also been lowered by 60 bps to 6.60%. Inflation forecast for Q3 FY2025 has been increased by 90 bps to 5.70% and the full year estimate has been increased by 30 bps to 4.80%. RBI estimates the inflation to fall to the target level of 4.00% in Q2 FY2026.

The biggest takeaway (which was widely anticipated by markets) was the reduction in CRR by 50 bps to 4.00% of NDTL in two tranches. The reduction in the CRR is consistent with the neutral policy stance and would release primary liquidity of about INR 1.16 trn to the banking system.

Our Take:

The policy was broadly in line with market expectations, with the RBI delivering a 50 bps CRR cut, to address the current liquidity situation. Liquidity has unexpectedly fallen sharply due to persistent FPI outflows resulting in net dollar sales by RBI, thereby tightening liquidity. While a section of the market was expecting an easing in policy rates as well, the MPC has decided to look through the current aberrations in growth and inflation prints and would want to monitor incoming data before taking any action on that front. This will also give RBI the time to examine how global markets evolve over the next couple of months. The RBI will remain cognizant of any further volatility in currency. The increase in interest rate ceiling on FCNR(B) deposits is a step to try and gather dollar deposits to alleviate pressure on the external sector.

One key point to note is that the RBI expects Q2 FY2026 inflation to reach 4.00%, which will allow them to act on policy rates if inflation falls in line with their estimates. Any further fall in growth prints or high frequency indicators would also push the MPC to act. We assign a higher probability to a first rate cut in Feb 2025. While the base case might still remain of 50 bps of easing, but if growth continues to lag and food inflation retraces majority of its up move over the next few months, RBI might be pushed to ease rates by 75 bps. On liquidity front, RBI will remain nimble in its approach. Given, that even with a CRR cut, system will remain tight over the next few months, we can't rule out possibility of an OMO purchase as well as a durable form of liquidity injection.

Given this backdrop, we continue to maintain a positive duration bias across the funds with duration at the higher end of the prescribed band for most of the funds. We recommend investors to stay invested and add duration to their portfolios wherever possible subject to their risk return frameworks.

Abbreviations:
MPC: Monetary Policy Committee
NDTL: Net Demand and Time Liability
CRR: Cash Reserve Ratio
FCNR: Foreign Currency Non Resident
IGB: Indian Government Bond

Source: RBI, HSBC MF Research, Data as on Dec 6, 2024.

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

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