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FIRST IN NEARLY FIVE YEARS

Under New Captain, RBI may Finally Unleash its Cut Shot

ET POLL

Nine of 12 financial institutions see 25bps reduction in repo rate this Friday

Rozebud Gonsalves

Mumbai: The Reserve Bank of India (RBI) is expected to cut interest rates for the first time in nearly five years this Friday on waning concerns about stubborn inflation, economists and investors polled by ET said, as Mint Road's priority changes to helping a visibly slowing economy accelerate.

Nine of the 12 financial institutions polled believe the new-look Monetary Policy Committee

Rate Cut Expectations

SBI Mutual Fund	Status quo
Anand Rathi	Status quo
IDFC First Bank	25 bps
Tata Mutual Fund	25 bps
DBS Bank	25 bps
HDFC Bank	25 bps
Standard Chartered Bank	25 bps
ICICI Securities Primary Dealership	25 bps
Bank of Baroda	25 bps
Jana Small Finance Bank	Status quo
Barclays	25 bps
Union Bank of India	25 bps

(MPC), which will meet for the first time after new Governor Sanjay Malhotra took over in December, will vote to reduce the repo rate, or the rate at which the RBI lends to banks, by 25 basis points to 6.25%. Additionally, Saturday's budget will also increase the MPC's

comfort with the government proposing a fiscal deficit of 4.4% of GDP in FY26 compared with a better-than-budgeted 4.8% in FY25.

One basis point is a hundredth of a percentage point. This would be the first reduction since May 2020, when rates were slashed to cushion the impact of Covid-19.

"Revenue expenditure in proportion to GDP was reduced to 11% from 11.4% and this is fiscally prudent," said Gaura Sengupta, chief economist at IDFC First Bank. "So from an MPC perspective, the deficit numbers won't have a bearing," she said.

"This would be a good time to cut rates as inflation has eased and is expected to ease," said Abhishek Upadhyay, senior economist, fixed income strategy, ICICI Securities Primary Dealership. "Cutting rates would also allow the RBI to focus on managing growth."

Easing Inflation >> 4

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Easing Inflation

» From Page 1

To be sure, three of the participants in the poll believe the RBI will not reduce rates.

The RBI has been among the few central banks that hasn't reduced interest rates despite peers, including the US Federal Reserve, initiating an easing cycle much earlier as domestic inflation, dominated by food prices, remained stubbornly high. The MPC believed that prematurely reducing rates would keep the inflation genie out of the bottle for long.

Inflation in December eased to 5.2%, from 5.5% in November, while GDP growth in the September 2024 quarter retreated to 5.4%, and is expected to be sluggish due to weak consumption and a decline in profits for corporates.

The overnight index swap (OIS) rates are also pricing in a cut, with the 1-year OIS trading at 6.33% on January 31, CCIL data showed. The OIS market typically prices in a spread of around 25 basis points over where traders expect the repo rate to be at a certain time. The RBI's actions on liquidity measures also point to the beginning of an easing cycle as it conducted numerous variable rate repo auctions and direct bond purchases to reduce the liquidity gap that had become as wide as ₹2.2 lakh crore.

Global factors are also at play comp-

licating policy responses by the central bank. The rupee has weakened over 3% since November to 86.6 per dollar. Selling US dollars to prevent sharp slide has led to the liquidity drain, which the RBI is addressing through various measures.

This, some believe, is an indication that the central bank may even postpone its first rate reduction to April as it would have a better handle on liquidity and the currency movements as well.

"I believe we would get a cut in April, and not in the February policy," said Rajeev Radhakrishnan, chief investment officer-fixed income, SBI Mutual Fund. "The RBI needs to ensure that there is adequate liquidity and that it is not stressed. A rate cut now will not have the desired impact as rates would not be transmitted. We would need easy, neutral to surplus liquidity conditions for rates to be transmitted."

Some investors expect the RBI to reduce the Cash Reserve Ratio (CRR) yet again, like it did in December, releasing Rs 1.16 lakh crore into the system. But questions on that arise given that it has announced other liquidity boosting measures. "It would be suitable for the RBI to first use other measures to infuse liquidity and then assess if a CRR cut is needed," Upadhyay said.

