

SPECIAL UPDATE

Monetary Policy

February 07, 2025

Monetary Measures

- Monetary Policy Committee (MPC) unanimously decided to reduce the policy repo rate under the Liquidity Adjustment Facility (LAF) by 25 basis points to 6.25 per cent with immediate effect;
- Consequently, the Standing Deposit Facility (SDF) rate shall stand adjusted to 6.00 per cent and the Marginal Standing Facility (MSF) rate and the Bank Rate to 6.50 per cent;
- The MPC decided to continue with the neutral monetary policy stance and remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.

Analysis & Outlook

- **Inflation:** Headline inflation softened sequentially in November-December 2024 from its recent peak of 6.2 per cent in October 2024. The moderation in food inflation, as vegetable price inflation came off from its October 2024 high, drove the decline in headline inflation. Core inflation remained subdued across goods and services components and the fuel group continued to be in deflation. Going ahead, food inflation pressures, absent any supply side shock, should see a significant softening due to good kharif production, winter-easing in vegetable prices and favourable rabi crop prospects. Core inflation is expected to rise but remain moderate. Continued uncertainty in global financial markets coupled with volatility in energy prices and adverse weather events presents upside risks to the inflation trajectory. Taking all these factors into consideration, Consumer Price Index (CPI) inflation for 2024-25 is projected at 4.8 per cent with Q4 at 4.4 per cent. Assuming a normal monsoon next year, CPI inflation for 2025-26 is projected at 4.2 per cent with Q1 at 4.5 per cent; Q2 at 4.0 per cent; Q3 at 3.8 per cent; and Q4 at 4.2 per cent.
- **Growth:** The global economy is growing below the historical average even though high frequency indicators suggest resilience amidst continued expansion in world trade. The strong dollar, inter alia, continues to strain emerging market currencies and enhance volatility in financial markets. On the domestic front, as per the First Advance Estimates (FAE), Real Gross Domestic Product (GDP) is estimated to grow at 6.4 per cent (y-o-y) in 2024-25 supported by a recovery in private consumption. On the supply side, growth is supported by the services sector and a recovery in agriculture sector, while tepid industrial growth is a drag. Among the key drivers on the demand side, household consumption is expected to remain robust aided by the tax relief in the Union Budget 2025-26. Fixed investment is expected to recover, supported by higher capacity utilisation levels, healthy balance sheets of financial institutions and corporates, and Government's continued emphasis on capital expenditure. Resilient services exports will continue to support growth. However, headwinds from geo-political tensions, protectionist trade policies, volatility in international commodity prices and financial market uncertainties, continue to pose downside risks to the outlook. Taking all these factors into consideration, real GDP growth for 2025-26 is projected at 6.7 per cent with Q1 at 6.7 per cent; Q2 at 7.0 per cent; and Q3 and Q4 at 6.5 per cent each.
- **Liquidity:** The Reserve Bank is committed to provide sufficient system liquidity. RBI will continue to monitor the evolving liquidity and financial market conditions and proactively take appropriate measures to ensure orderly liquidity conditions.
- Yields at the shorter end (3 month tenor) rose by upto 4-5 bps at the time of writing.
- Yields in the medium to longer end of the curve rose by around 3 bps from yesterday's close at the time of writing.

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Position of Funds

Duration funds:

- The absolute yield levels are attractive from a medium to long-term investment horizon. Therefore, it represents a good opportunity for investors to invest in fixed income duration funds with a medium to long-term horizon.
- However, geopolitical risks, extreme weather conditions, volatile food prices remain key risks. Markets may remain volatile in the near term.

Money market funds: The yields at the shorter end of the curve will move in tandem with the liquidity in the system. The short-end rates are expected to be anchored around the repo rate.

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.

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