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Another pause from the MPC

Aditi Nayar, Chief Economist, Head- Research & Outreach, ICRA

After the October 2024 policy review, the Monetary Policy Committee (MPC) was faced with a barrage of increasingly unpleasant data. The CPI inflation catapulted to 5.5% in September 2024, and further to 6.2% in October 2024. Soon after that, the GDP growth print for Q2 FY2025 revealed a discomfiting dip to 5.4%.

As expected, the optics of the CPI inflation exceeding the upper threshold of the MPC's medium term target range of 2-6%, did not deem it prudent for the Committee to cut the repo rate in its December 2024 policy review, despite the slowdown in India's GDP growth. At the same time, in a practical decision to support economic activity, the Reserve Bank of India (RBI) announced that the cash reserve ratio (CRR) is being reduced by 50 bps in two tranches in December 2024 itself, to infuse durable liquidity of Rs. 1.16 lakh crore.

Two largely anticipated changes were the revisions in the MPC's quarterly and annual CPI and GDP forecasts. In line with our own projection, the Committee raised its CPI forecast for FY2025 to 4.8% in the December 2024 policy meeting, from the extant 4.5%. More importantly, it envisions the CPI inflation to print at 4.0% in Q2 FY2026, the elusive midpoint of its medium-term target.

Further, the MPC reduced its FY2025 growth forecast to 6.6% from 7.2% following the large miss in Q2 (5.4% vs. the MPC's October 2024 forecast of 7.0%). We believe that India's GDP is likely to expand by around 6.5% each in FY2025 and FY2026, in the current global context, and that its potential growth is closer to 6.5-7.0%, not the aspirational 7.0-8.0% suggested by some.

With transient issues easing, especially the above-normal monsoons affecting sectors like mining and electricity, we expect back-ended Government capex and a sustained improvement in rural sentiment to boost GDP growth in H2 FY2025. Additionally, we forecast the headline CPI inflation at 5.5% in November 2024 and around 5.1% in December 2024. If no new risks emerge that derail the moderation in inflation to the projected 4.0% by Q2 FY2026, a repo cut in February 2025 could be on the table.

Interestingly, the MPC's decision to pause in December 2024 was not unanimous, with two external members voting for a 25-bps rate cut. The Minutes that shall be published in a fortnight, are usually carefully parsed to glean insights into the members' likely future voting patterns, although the composition of the MPC may well change in the immediate term.

The December 2024 MPC meeting was the last scheduled review for this calendar year. We do not yet know if it will prove to be the last in other aspects, including the ultimate one before the timing becomes appropriate to embark on rate cut(s). Notwithstanding the arguably heightened global uncertainties, we maintain our baseline view that domestic inflation and growth dynamics support a shallow rate cut cycle of 50 bps, that could be spread over the February 2025 and April 2025 policy meetings.

For further information, please contact:

Media Contacts:	
Naznin Prodhani Head – Group Corporate Communications & Media Relations ICRA Ltd Tel: + (91 124) 4545300, Dir - 4545860 Email: naznin.prodhani@icraindia.com	**Shreya Bothra** Senior Manager - Corporate Communications & Media Relations ICRA Ltd Tel: + (91 022) 61693300, Dir - 61693367 Email: shreya.bothra@icraindia.com

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