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CREDIT RATING AGENCY

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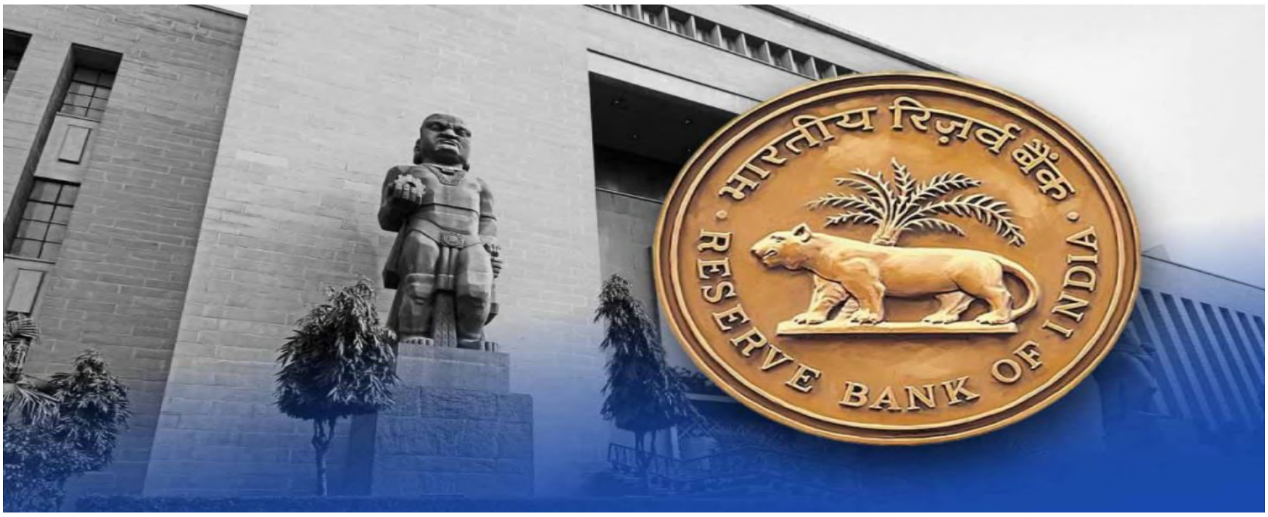
THE RBI OPTED FOR A JUMBO RATE CUT

06 June 2025

I. Introduction:

In line with our previous policy expectation, RBI has reduced the repo rate by 50 bps point in its June'25 monetary policy. We have written in our pre-policy expectation "In a nutshell, to sustain the growth momentum amid global headwinds and subdued inflationary scenario, we expect RBI to reduce the repo rate by at least 25 bps (the ideal reduction could be in the range of 25~50 bps)."[1]



However, interestingly while in April'25 policy, the RBI altered its previous stance from 'neutral' to 'accommodative', in today's (6 June'25) policy, the stance has been reversed again towards 'neutral'. RBI has explained this change of stance as "After having reduced the policy repo rate by 100 bps in quick succession since February 2025, under the current circumstances, monetary policy is left with very limited space to support growth. Hence, the MPC also decided to change the stance from accommodative to neutral."

Earlier, the RBI has reduced its policy rate by 25 bps at 6.00% in its 9th April 2025 monetary policy. In the previous Feb'25 RBI policy, RBI Monetary Policy Committee (MPC) reduced the policy repo rate by 25 bps from 6.50% to 6.25% With this 50-bps reduction in June'25 policy, the repo rate stands at 5.50%.

[1] https://www.infomerics.com/publication-detail/rbi-monetary-policy-further-softening-is-likely

The standing deposit facility (SDF) rate under the liquidity adjustment facility (LAF) shall stand adjusted to 5.25 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 5.75 per cent.

The global growth and trade projections outlook remains uncertain, which have been revised downwards by multilateral agencies. Equity markets have started regaining, whereas the US dollar index and crude oil remain subdued. However, gold prices continue its upsurge.

II. The Growth-Inflation dynamics: Frontloading the rate cuts in line with policy easing

The inflation outlook for the year is being revised downwards from the earlier forecast of 4.0 per cent to 3.7 per cent. The economic growth remains lower amidst challenging global situation and heightened uncertainty. According to the provisional estimates released by the National Statistical Office (NSO) on 30th May 2025, real GDP growth in Q4:2024-25 has been positioned at 7.4 per cent as against 6.4 per cent in Q3. On the supply side, real gross value added (GVA) increased by 6.8 per cent in Q4:2024-25. For 2024-25, real GDP growth was placed at 6.5 per cent, while real GVA recorded a growth of 6.4 per cent.

Agriculture prospects remain bright on the back of an above normal southwest monsoon forecast and resilient allied activities. Services sector is expected to maintain its momentum. However, spillovers emanating from protracted geopolitical tensions, and global trade and weather-related uncertainties pose downside risks to growth.

Considering the above-mentioned factors, real GDP growth for 2025-26 is projected at 6.5 per cent with the following quarterly projections:

- Q1 at 6.5 per cent.
- Q2 at 6.7 per cent.
- Q3 at 6.6 per cent.
- Q4 at 6.3 per cent.

III. Above-normal monsoon is favourable for food inflation, despite surging gold prices pose moderate risk for the core inflation

CPI headline inflation softened by a cumulative 45 basis points during March-April 2025, from 3.6 per cent in Feb’25 to a low of 3.2 per cent in April 2025; the lowest reading since July 2019. Due to piquant correction in vegetable prices, food inflation reduced to a 42-month low of 2.1 per cent in April from 3.8 per cent in Feb’25. Fuel group has increased to 2.9 per cent in April 2025. CPI excluding food and fuel inflation have increased to 4.2 per cent (YOY) in April 2025. Gold, which has a share of 2.3 per cent within CPI excluding food and fuel, contributed 21.4 per cent to the core inflation in April 2025.

Going forward, the likely above normal monsoon along with its early onset augurs well for Kharif crop prospects. Hence, inflation expectations are showing a moderating trend, especially for the rural households. According to RBI survey, the current perception of inflation reduced by 30 basis points (bps) to 6.3 per cent for rural households in May 2025 as compared with the previous round. Moreover, their year ahead inflation expectation also declined by 40 bps to 8.9 per cent in the latest survey.

- Despite such favourable trends, RBI has flagged the following risks:
- Weather-related uncertainties.
- Possible transmission of tariff related concerns towards global commodity prices. Potential upward thrusts on core inflation due to upward gold prices (this risk though not flagged directly by RBI; this must be considered due to increasing gold preferences amid global uncertainties).

Taking note of the abovementioned factors and assuming a normal monsoon, CPI inflation for the financial year 2025-26 is now projected at 3.7 per cent, with the following quarterly projections:

- Q1 at 2.9 per cent.
- Q2 at 3.4 per cent.
- Q3 at 3.9 per cent.
- Q4 at 4.4 per cent.

The inflation projections have been slightly enhanced for Q3 (3.9 per cent) compared to the previous policy projections for the third quarter at 3.8 per cent. However, overall projection for 2025-26 remains favourable at 3.7 per cent in June'25 policy compared to the 4 per cent projection at the previous Apr'25 policy. In the Apr'25 policy, CPI inflation for the financial year 2025-26 was projected at 4.0 per cent, with Q1 at 3.6 per cent; Q2 at 3.9 per cent; Q3 at 3.8 per cent; and Q4 at 4.4 per cent.

IV. The Liquidity Issue

The RBI decided to reduce the cash reserve ratio (CRR) by 100 basis points (bps) to 3.0 per cent of net demand and time liabilities (NDTL), which will be carried out in four equal tranches of 25 bps each with effect from the fortnights beginning September 6, October 4, November 1 and November 29, 2025. The cut in CRR would release primary liquidity of about ₹2.5 lakh crore to the banking system by December 2025. In addition to provide durable liquidity, it will also reduce the cost of funding of the banks.

Earlier, system liquidity was in deficit in January 2025 with net injection under the liquidity adjustment facility (LAF) scaling a peak of ₹ 3.1 lakh crore on 23rd January 2025. However, because of a slew of measures injecting liquidity of about ₹ 6.9 lakh crore, the system liquidity deficit situation has been improved during February-March 2025 and turned into surplus on 29th March 2025. As the government spending picking up pace during the latter half of Mar'25, system liquidity improved, and it stood at a surplus of ₹1.5 lakh crore as on 7th April 2025. The weighted average call rate (WACR) has also traded 16 bps below the policy repo rate during April-June (up to June 4)'25 as compared to 6 bps above the repo rate during February-March'25 thus reflecting favourable liquidity situations.

V. Concluding Remarks:

The RBI has opted for a frontloading of a jumbo 50 bps rate cut taking advantage of the most conducive situation for a growth booster, given the lowest CPI and food inflation scenario. The current CPI inflation remains at its lowest at 3.16 per cent after July 2019. There is a decline of 18 basis points in headline inflation of April 2025 in comparison to March 2025. A sharp decline of 91 basis point is observed in food inflation in April 2025 (1.78 per cent) in comparison to March 2025, which is also the lowest after October 2021.

The liquidity injection via CRR cut remains favourable for banks. However, scope for improvement of further policy rate transmission mechanism exists, given that transmission happened mostly in short-term rates,

e.g. the average commercial paper (CP) and certificate of deposit (CD) spread over T-bill moderated from 134 bps and 108 bps, respectively in March to 82 bps and 65 bps, respectively in May'25. The short-term G-Sec bonds have surged, while long-term bonds remain mostly muffled. The G-Sec 10 Yr and other bonds were mostly trading in the range of 6.22~6.28 per cent.

The RBI has also changed the policy stance towards neutral from accommodative clarifying that the space for growth has become limited after a cumulative 100 bps reduction in the policy repo rate. The jumbo rate cut may be justified at this policy in the sense that going forward, such conducive environment may not be available with potential risks like weather related uncertainties, possible transmission of tariff related concerns towards commodity prices, potential upward thrusts on core inflation due to upward gold prices, any further geopolitical challenges may push up global commodity prices and distort the supply chains. Hence, the policy decision can be explained largely from the point of view of taking maximum advantage of the opportune time.