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The RBI keeps policy rate unchanged but revises stance to “neutral”; a rate cut in December comes into play

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- The RBI's Monetary Policy Committee (MPC) decided to keep the repo rate unchanged at 6.5% for the tenth consecutive meeting, with a 5:1 majority. Dr. Nagesh Kumar, a newly appointed member, voted to cut the repo rate by 25 basis points (bps).
- Considering a well-balanced inflation-growth dynamic, the MPC changed the monetary policy stance from “withdrawal of accommodation” to “neutral.” It remains unambiguously focused on achieving a durable alignment of inflation with the target (of 4% within a band of +/- 2%) while supporting growth.
- The RBI left its FY25 projections for economic growth and inflation unchanged at 7.2% YoY and 4.5% YoY, respectively, while tweaking quarterly numbers.
- Compared to the August meeting, the October policy statement is relatively balanced, noting progress made on disinflation and a favourable outlook for inflation despite an expected temporary jump in September.
- The RBI stated that it now has greater confidence in navigating the last mile of disinflation, accounting for better prospects for both kharif and rabi crops, as well as ample buffer stocks of foodgrains.
- Still, it remains non-committal on the future course of action regarding the policy rate outlook. However, it noted that the change in policy stance gives the MPC greater flexibility and optionality to act in line with evolving conditions and the outlook, indicating a data-dependent approach.
- The RBI remains vigilant about significant risks to the inflation outlook, stemming from uncertainties related to ongoing geopolitical tensions, financial market volatility, adverse weather events, and the recent uptick in global commodity prices.
- Assuming no major surprise on geopolitical and domestic food inflation fronts, we continue to anticipate the first rate cut by the RBI at the December policy meeting.
- Regarding liquidity, the system liquidity has been in surplus during August-September and in early October, thanks to the pick-up in government spending and a decline in currency in circulation.
- With the change in the policy stance and the expected pick-up in government spending, we anticipate liquidity to remain in surplus, though a brief period of the deficit is likely around tax payments and festival-related cash demand.

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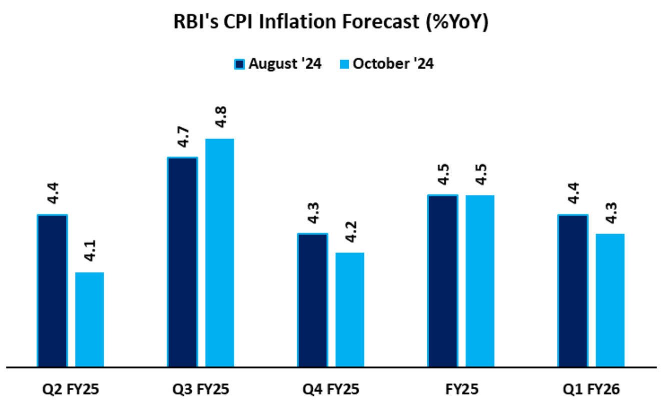
The RBI keeps the key policy rate unchanged but revises the stance to “neutral” from “withdrawal of accommodation”

In today’s RBI monetary policy meeting, the MPC decided, with a 5:1 majority, to keep the repo rate unchanged at 6.5% for the tenth consecutive meeting. Newly appointed external member Dr. Nagesh Kumar voted to cut the repo rate by 25bps. The standing deposit facility (SDF) rate remains unchanged at 6.25%, and the marginal standing facility (MSF) rate and the Bank Rate at 6.75%. Importantly, the MPC decided to change the monetary policy stance from “withdrawal of accommodation” to “neutral” and to remain unambiguously focused on a durable alignment of inflation with the target (of 4% within a band of +/- 2%), while supporting growth. This is a prudent move, as we believe that a change in stance should precede a policy rate change to ensure a smooth transition from the hawkish status quo of the last meeting.

Policy statement is balanced; notes flexibility and optionality to act in sync with the evolving conditions

Compared to the August meeting, the October policy statement is relatively balanced. The MPC remains upbeat on the growth outlook, notwithstanding soft readings for several high-frequency indicators in recent weeks. According to the RBI, this provides headroom for monetary policy to focus on the goal of attaining a durable alignment of inflation with the target. On inflation, the RBI now has greater confidence in navigating the last mile of disinflation. Considering well-balanced inflation-growth dynamics, the MPC decided to change the monetary policy stance from “withdrawal of accommodation” to “neutral”.

Inflation projection for FY25 retained with tweaks in the quarterly profile

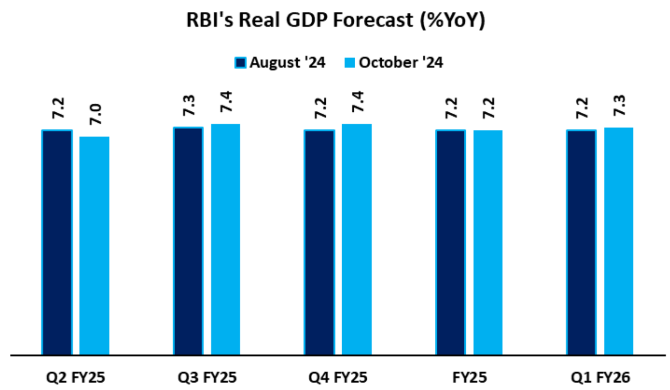


Source: RBI; Note: August ‘24 and October ‘24 refer to projections given by the RBI in its August 2024 and October 2024 MPC updates respectively.

The RBI retained its inflation forecast for FY25 at 4.5% but adjusted its quarterly profile as shown in the chart. It noted that headline inflation is on a downward trajectory, though its pace has been slow and uneven. After inflation came in below 4% in July and August, it is expected to see a temporary jump in September due to unfavourable base effects and a pick-up in select food items prices momentum. However, it should ease after that as base effects fade and considering better prospects for both kharif and rabi crops and ample buffer stocks of foodgrains. Core inflation is likely to remain broadly contained though global commodity prices could pose risks.

The RBI remains vigilant about significant risks to the inflation outlook from uncertainties relating to ongoing geopolitical tensions, financial market volatility, adverse weather events and the recent uptick in a few global commodity prices. It remains non-committal on the future course of action on the policy rate outlook, with the governor noting that it is "not appropriate to talk about timing of a rate cut." In his statement, the governor emphasised that “the inflation horse has been brought to the stable” with a lot of effort and it must “keep the horse under tight leash, so that we do not lose control”. The change in the policy stance gives the RBI greater flexibility and optionality to act in sync with the evolving conditions for further confirmation of the disinflationary impulses and the outlook, indicating a data-dependent approach. Assuming no major surprise on geopolitical and domestic food inflation fronts, we continue to anticipate the first rate cut by the RBI at the December policy meeting.

Growth forecast remained unchanged at 7.2% with adjustments in quarterly forecasts

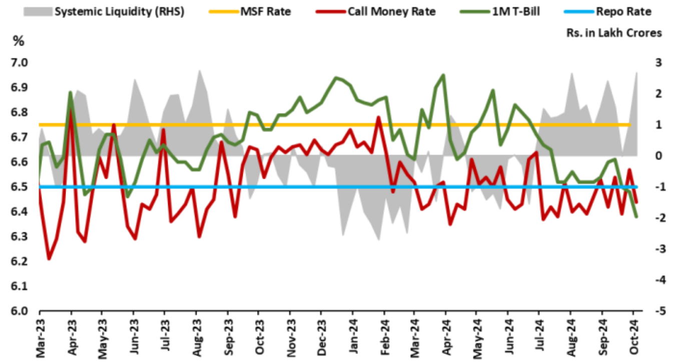


Source: RBI; Note: August ‘24 and October ‘24 refer to projections given by the RBI in its August 2024 and October 2024 MPC updates respectively.

The RBI remains upbeat on economic growth in FY25. It retained its projection of 7.2% growth in FY25 while tweaking quarterly numbers. It forecasts economic growth in Q1 FY26 at 7.3%, compared to the previous projection of 7.2%. It continued to view prospects for private consumption as bright supported by the agricultural outlook, rural demand

and buoyancy in services. It expects government spending to pick up, which together with consumer and business optimism should support investment activity. However, we note that there are emerging risks to economic growth, as reflected in recent softer high-frequency economic data including PMI manufacturing and services, auto sales, GST, and exports, etc. We expect economic growth to be sub-7% in FY25.

The RBI remains flexible in managing evolving liquidity dynamics to align overnight rates to the policy rate



Source: CMIE Note: Data till 4th October.

Regarding the liquidity management approach, there were no changes in the governor's statement, as it stated that the central bank will continue to remain flexible and nimble in managing evolving liquidity conditions to ensure that money market interest rates evolve in an orderly manner. Except for a deficit during a brief period in the latter half of September due to tax payments, the system liquidity has been in surplus during August-September (averaging Rs 1.3 lakh crore) and in October (averaging Rs 2.3 lakh crore, up to October 7), thanks to a pick-up in government spending and decline in currency in circulation. The RBI conducted two-way operations to ensure alignment of the inter-bank overnight rate with the policy repo rate, in line with evolving liquidity conditions. The weighted average call rate (WACR) averaged 6.53% during August – September as against 6.55% during June – July. The WACR averaged 6.44 % in October (up to October 7). With a change in the policy stance and an expected pick-up in government spending, we expect the liquidity to remain in surplus, though a brief period of the deficit is likely around tax payments and festival-related cash demand.

Related to RBI's assessment of financial stability, the governor noted the likelihood of stress buildup in a few unsecured loan segments, like loans for consumption purposes, microfinance loans and credit card outstandings. He advised banks and NBFCs to assess their exposures carefully, focusing on size and quality, and to maintain robust underwriting and monitoring standards, while also continuing to pay attention to potential risks from inoperative deposit accounts, cybersecurity landscape, mule accounts, etc. The RBI is closely monitoring these developments and may take necessary actions.

With a focus on NBFCs, the governor noted that the sector remains healthy and supports credit flow to the underserved segments, bolstering financial inclusion. However, he noted three messages for "outliers". Firstly, he noted that some NBFCs are aggressively pursuing growth without building up sustainable business practices and risk management frameworks, commensurate with the scale and complexity of their portfolio. The governor indicated that an imprudent 'growth at any cost' approach would be counterproductive for the health of such entities. Second, the governor noted that some NBFCs, including microfinance institutions (MFIs) and housing finance companies (HFCs), are pursuing excessive returns on equity due to significant capital inflows and investor pressure, raising concerns when they charge usurious interest rates combined with high processing fees and frivolous penalties. He observed that this behaviour is often driven by business targets rather than actual demand, leading to high costs and indebtedness, which could pose financial stability risks if not addressed. Third, he advised that the NBFCs should review their prevailing compensation practices some of which appear to be purely target-driven in certain NBFCs, which in turn may result in adverse work culture and poor customer service. Overall, he advocated that NBFCs, including MFIs and HFCs, should follow sustainable business goals; a 'compliance first' culture; a strong risk management framework; a strict adherence to the fair practices code; and a sincere approach to customer grievances. While self-correction by NBFCs would be a desired outcome as per the governor, he noted that the RBI is closely monitoring and will take appropriate action, if necessary.

The RBI also announced the developmental and regulatory policy measures listed below:

Regulations

- **Responsible Lending Conduct – Foreclosure Charges/Pre-payment Penalties on Loans:** The RBI has announced a broadening of the scope of the guidelines that prevent banks and NBFCs from charging levy foreclosure charges/pre-payment penalties on any floating rate term loan sanctioned to individual borrowers for purposes, other than business. These guidelines will now include loans to Micro and Small Enterprises. A draft circular for public consultation will follow.

- **Discussion Paper on Capital Raising Avenues for Primary (Urban) Co-operative Banks:** The RBI will issue a Discussion Paper on Capital Raising Avenues for Primary (Urban) Co-operative Banks (UCBs), following the Expert Committee on Primary

(Urban) Co-operative Banks's recommendations on the newly enabled capital related provisions such as issuance of special shares, issuance of shares at a premium, etc.

- **Creation of Reserve Bank Climate Risk Information System (RB-CRIS):** With a view to enabling climate risk assessments by regulated entities, the RBI announced measures to bridge the gaps in climate-related data. It will create a data repository namely, the Reserve Bank – Climate Risk Information System (RB-CRIS) comprising two parts viz (1) A web-based directory, listing various data sources, (meteorological, geospatial, etc.) which will be publicly accessible on the RBI website and (2) a data portal comprising of datasets (processed data in standardised formats).

Payment Systems

- **UPI - Enhancement of limits:** The RBI raised transaction limits for UPI products to encourage wider adoption. The per-transaction limit for UPI123Pay will be raised from Rs 5,000 to Rs 10,000. For UPI Lite, the wallet limit will be increased to Rs 5,000 from Rs 2000 presently and a per-transaction cap will be raised to Rs 1,000 up from existing Rs 500.

- **Introduction of beneficiary account name look-up facility:** The RBI proposed introducing a 'beneficiary account name look-up' facility for RTGS and NEFT systems. This will allow remitters to verify the beneficiary's name using the account number and IFSC code before transferring funds, reducing the risk of wrong credits and fraud.

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