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RBI MONETARY POLICY

DECEMBER 2024

HIGHLIGHTS

The RBI acknowledges growth concerns, cuts CRR

- **MPC's fifth bi-monthly Monetary Policy Review: 2024-25**
  The Monetary Policy Committee (MPC) held rates unchanged at 6.5% by a 4-2 majority and unanimously maintained its stance to neutral, with emphasis on durable alignment of inflation with the target, while supporting growth.

  The RBI cut CRR by 50 bps effective in two equal tranches over the next two fortnights, which will cumulatively add Rs.1.16 lakh crore to the banking system.

- **Policy Actions**
  Repo rate maintained at 6.50%.
  Consequently, SDF is at 6.25% and MSF is at 6.75%.
  RBI cut CRR by 50 bps to 4.00%.

GROWTH-INFLATION DYNAMICS

- The RBI raised its inflation forecast for FY25 to 4.8% due to persistent high food prices. The central bank now sees inflation for Q3 and Q4 of this fiscal year at 5.7% and 4.5%, respectively. For FY26, the RBI projects inflation at 4.6% in Q1, up from 4.3%, and 4.0% in Q2, with risks evenly balanced.

  The evolving trajectory of domestic edible oil prices, following the hike in import duties and rise in their global prices, need to be closely monitored. The near-term inflation and growth outcomes in India have turned somewhat adverse since the October policy. The medium-term prognosis on inflation suggests further alignment with the target, while growth is expected to pick up its momentum.

- The GDP growth forecast revised downwards to 6.6% for FY25 vs 7.2.% previously, which is in line with the expectation of our Axis Bank Economic Research team. India's 1H GDP growth was weak at 6.0% YoY, with weak trends in line with a negative fiscal impulse and with tightening financial conditions. The fiscal impulse is likely to recover in 2H with momentum likely running into 1HFY26 where the base is weak.

  The reason mentioned behind the downward revision are the geo-political uncertainties, volatility in international commodity prices, and geo-economic fragmentation which continue to pose risks to the economic growth outlook. However, the MPC has noted the high-frequency indicators available so far suggest that the slowdown in domestic economic activity bottomed out in Q2FY25 and has since shown signs of recovery supported by strong festive demand and a pick-up in rural activities.

LIQUIDITY AND EXTERNAL SECTOR

- The current liquidity tightness is basis fall in core liquidity. This is unlike previous recent instances when core liquidity was heavily in surplus and headline liquidity tightness was owing to fluctuations in government cash balances. The RBI will continue to be nimble and proactive in its liquidity management operations to ensure that money market interest rates evolve in an orderly manner and the productive requirements of the economy are met.

- The depreciation of the INR and its volatility was less as compared to its EME peers, reflecting India's strong macroeconomic fundamentals and improvement in external sector outlook. Foreign exchange reserves are deployed judiciously to mitigate undue volatility, maintain market confidence, anchor expectations and preserve overall financial stability. These interventions focus on smoothening excessive and disruptive volatility rather than targeting any specific exchange rate level or band.

POLICY STANCE AND GUIDANCE

- **The MPC decided unanimously to continue with the 'neutral' stance and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.**

  Given that the inflation projections have been pushed higher, Axis Bank Economic Research team maintain their expectation of the first rate cut only by Apr-25.

  Today's CRR cut was fundamentally to restore the "easier" durable liquidity stance of the RBI. However, this measure will boost not just liquidity but improve credit growth and thus economic growth.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
December 8, 2023	• There will now be a unified regulatory framework on connected lending for all regulated entities of the RBI to strengthen the pricing and management of credit. • Introduction of a regulatory framework for web-aggregation of loan products to enhance customer centricity and transparency in digital lending. • Proposal to set up a Fintech Repository which will be operationalized by the Reserve Bank Innovation Hub in April 2024 or earlier. This will help in the increasing partnerships between Banks and NBFCs and FinTechs. • Proposal to increase UPI transaction limit from ₹1 lakh to ₹5 lakh for payments to hospitals and educational institutions. • E-Mandate limit increased to ₹1 lakh per transaction for mutual fund subscriptions, insurance premiums, and credit card repayments. • Establishment of a cloud facility in India for the financial sector to enhance data security, integrity, privacy, scalability, and business continuity. It is intended to be rolled out in a calibrated fashion over the medium term.
February 8, 2024	• Review of the Regulatory Framework for Electronic Trading Platforms (ETPs) • Allowed resident entities to hedge their price of gold in the OTC segment in the International Financial Services Centre (IFSC). • Introduction of Programmability and Offline Functionality in Central Bank Digital Currency (CBDC) Pilot. • RBI will put in place a system of principal-based authentication to promote alternative authentication mechanisms. • Banks to provide Key fact statement for all retail and MSME borrowers.
April 5,2024	• Trading of Sovereign Green Bonds in IFSC. • RBI Retail Direct Scheme - Introduction of Mobile App. • Small Finance Banks (SFBs) are permitted to use only Interest Rate Futures (IRFs) for proprietary hedging. It has now been decided to allow SFBs to use permissible rupee interest derivative products. • Enabling UPI for Cash Deposit Facility. • UPI Access for Prepaid Payment Instruments (PPIs) through Third Party Apps. • Distribution of Central Bank Digital Currency (CBDC) through Non-bank Payment System Operators. • Review of Liquidity Coverage Ratio (LCR) Framework.
June 7, 2024	• Proposed to revise the definition of bulk deposits as 'Single Rupee term deposit of Rs.3 crore and above' for SCBs (excluding RRBs) and SFBs. • Proposed to rationalise the extant FEMA guidelines on export and import of goods and services. • Proposed to establish a Digital Payments Intelligence Platform for network level intelligence and real-time data sharing across the digital payments' ecosystem.

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Measures announced in chronological order in last 1 year.

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June 7, 2024	• Inclusion of Recurring Payments with Auto-Replenishment Facility under the e-mandate Framework • Introduction of Auto-Replenishment of UPI Lite Wallet – Inclusion under the e-mandate Framework.
August 8, 2024	• Proposes to create a public repository of digital lending apps (DLAs) deployed by its regulated entities. The regulated entities will report and update information about their DLAs in this repository. • Proposed to increase the frequency of reporting of credit information to credit information companies (CICs) on a fortnightly basis or at shorter intervals. • Enhance the limit for tax payments through UPI from ₹1 lakh to ₹5 lakh per transaction. • Proposed to reduce the clearing cycle by introducing continuous clearing with 'on-realisation-settlement' in CTS.
October 9, 2024	• Banks and NBFCs are not permitted to levy foreclosure charges/ pre-payment penalties on any floating rate term loan sanctioned to individual borrowers for purposes, other than business and now proposed to include loans availed by micro and small enterprises or MSEs as well. • To increase the per-transaction limit in UPI123Pay from Rs 5,000 to Rs 10,000; and raise the UPI Lite wallet limit from Rs 2,000 to Rs 5,000 and per-transaction limit from Rs 500 to Rs 1,000. • RBI will issue a discussion paper on capital raising avenues for Urban Co-operative Banking (UCB) Sector. • Proposes to create a data repository for climate risk assessment, namely, the Reserve Bank – Climate Risk Information System (RB-CRIS) • Proposes to introduce Beneficiary Account Name Look-up Facility for RTGS and NEFT system. This facility will enable the remitter to verify the name of the account holder before effecting funds transfer to him/her through RTGS / NEFT.
December 6, 2024	• Expanding the reach of FX-Retail Platform through Linkages with Bharat Connect platform of NPCI. • Proposes to introduce a new benchmark - the Secured Overnight Rupee Rate (SORR) - based on all secured money market transactions – overnight market repo as well as TREPS. • To increase the limit for collateral-free agriculture loans from ₹1.6 lakh to ₹2 lakh per borrower. • to permit Small Finance Banks also to extend pre-sanctioned credit lines through the UPI. • Experts committee to set up a Framework for Responsible and Ethical Enablement of AI (FREE-AI) in the financial sector.

IMPACT ON THE MUTUAL FUND INDUSTRY:

- **Liquid Funds**:

  These schemes will continue to generate returns around the operating rate due to their portfolio composition i.e. being invested at the shorter end of the money market segment. Liquid funds have low average maturity as they concentrate more on high quality papers including CPs, CDs and other debt securities with residual maturity of up to 3 months.

- **Ultra Short Term / Low Duration / Money Market Funds (Maturity Up to 1 Year):**

  These schemes predominantly invest in below 1 year maturity paper. The strategy adopted by these schemes is to hold the paper till maturity and capitalize on the running yield. Hence, returns in this category will continue to remain relatively attractive depending on the positioning of the fund.

- **Short Duration Funds**:

  Schemes in this category are predominantly invested in Corporate Bonds, CPs and CDs while a few of them also have some exposure to G-Secs. We continue to remain bullish at the shorter end of the curve. Investors may consider these funds (with an investment horizon commensurate with the maturity profile of such funds) and gain from current accruals and capital appreciation in the event of a fall in yields.

- **Medium Duration:**

  Given the flattened yield curve there are sufficient buffers in the intermediate duration (3-6 years) segment. Till the time RBI is anchoring the long end of the yield curve, the current yield curve may provide some cushion even if there are mark-to-market losses. Investors may consider those funds with high quality portfolios and where the investment horizon is commensurate with the maturity profile of the funds and also gain from current accruals and capital appreciation in the event of a fall in yields.

IMPACT ON THE MUTUAL FUND INDUSTRY:

- **Credit Risk Funds:**

  We remain cautious on Credit Risk Funds as they have failed to prove their mettle in the last 2-3 years with the overhang of defaults and erosions of NAV on the back of mark-to-market impacts due to the aforementioned. The uncertainty around credit funds which are in an open ended avatar continues to pose risks to investors. Much also depends on the liquidity conditions in the market and redemption pressure on these funds. Thus, we think there is a systemic risk in the market within the credit space. Hence, it makes sense for one to stay away from these funds.

- **Long Term Income Funds / Gilt Funds / Dynamic Bond Funds**:

  The MPC held rates 4-2 with a majority and voted unanimously to continue a neutral monetary policy stance, with an aim to remain unambiguously focused on a durable alignment of inflation, while supporting growth. The durable liquidity in the system had tightened due to forex operations of the RBI and therefore to ease liquidity in the banking system the RBI cut CRR by 50 bps. Moreover, given the recent uptick in inflation and the sluggish GDP growth in Q2, the RBI Governor emphasized the need for a flexible approach to managing inflation while balancing growth.

  The high-frequency indicators available so far suggest that the slowdown in domestic economic activity bottomed out in Q2FY25 and has since shown signs of recovery supported by strong festive demand and a pick-up in rural activities. With likely recovery in growth, and concurrent recovery in inflation momentum, the February 2025 rate cut is still not certain and will be data dependent, while we expect the RBI to enter the easing cycle from April 2025, where more clarity on these trends can be had. Instead, macroprudential and quantitative measures can help ease conditions in the financial system to allow the credit impulse to respond to a positive fiscal impulse. Quantitative measures, however, might intensify pressures on the INR, while macroprudential measures can bring up longer term risks.

  Looking ahead, we expect that supporting growth will become a key priority, provided inflation doesn't experience significant negative shocks. The revised inflation and growth outlook, along with the RBI's cautious stance of "prudence, patience, practicality," suggests that the central bank will take calibrated policy actions in the near term. The CRR cut is expected to inject liquidity into the banking system and support credit growth. However, the governor in its commentary today

IMPACT ON THE MUTUAL FUND INDUSTRY:

have opened the door to act to support growth if required. We expect shallow rate cuts based on the developments in inflation and INR that can push these eventual cuts back – with possibility that liquidity might actually be held at tighter levels to offset both these risks for a time. However, current market pricing indicates the potential for 75 bps rate cuts in a years' time, largely looking at the impact of weaker growth prints. While our Axis Bank Economic Research team view is that around 50 bps of rate cuts are likelier, with timing pushed back to the April policy meeting at the earliest.

Indian bond yields, which are currently trading at around 6.69% levels, are expected to remain volatile with emphasis on upside risks to inflation from food and global prices. On the global front, we foresee the US Fed to continue the easing trend, while the quantum will be data dependant. On domestic front, FPI sell-offs continue to weigh on yields. In absence of firm domestic cues, the yields should continue to move in sync with the US yields. The growth trajectory along with the evolving global conditions from here is important to determine the trajectory of interest rate direction. CPI print will also be keenly watched to understand the dynamics after a more than expected rise. Given that, we believe the 10-year benchmark yields to remain volatile and likely to trade in the range of 6.70%-6.90% in the near-term and eventually see gradual rate cuts starting from early FY26, assuming no shocks from exogenous factors like the expectation of rate cuts, inflation print, geopolitical escalation and rise in crude prices.

The benchmark yields are trading at 6.74%, down by 2 bps from last policy and up by 6 bps from previous day (at the time of writing). We believe the 3 to 6 years segment appears to be in a favorable position from a risk-reward perspective. Being cognizant of the environment, we continue being Neutral and remain constructive on the short to medium end of the yield curve, with a quality approach on bonds.

- **Conservative Hybrid Funds *(Erstwhile: Monthly Income Plans (MIPs)***:

  With a 10% to 25% allocation to equity, returns of CHFs are largely determined by the vagaries of the equity markets as against the debt markets. These funds are therefore suitable for investors who have a reasonably long-time horizon & are comfortable with taking exposure to equities.

OUTLOOK

- The India MPC held rates unchanged and kept its stance to neutral as expected. The emphasis on durable alignment of inflation with the target, while supporting growth suggests that rate cuts are unlikely in Feb as inflation projections were raised higher. The surprise cut in CRR was to keep durable liquidity in surplus and improve credit growth and thus economic growth.

- We remain constructive on the short to medium end of the yield curve. **Short Duration funds, Banking & PSU Debt funds, Corporate Bond funds, Debt Index funds (Target Maturities), Medium Duration funds, Floating Rate funds, Money Market funds, Low Duration funds and Ultra Short Duration funds** can be considered by investors with an investment horizon commensurate with the maturity profile of the schemes. Investors can consider investing in **Medium/Long Duration** funds as per their risk appetite with an investment horizon of at least 2-3 years to avoid any intermittent volatility.

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