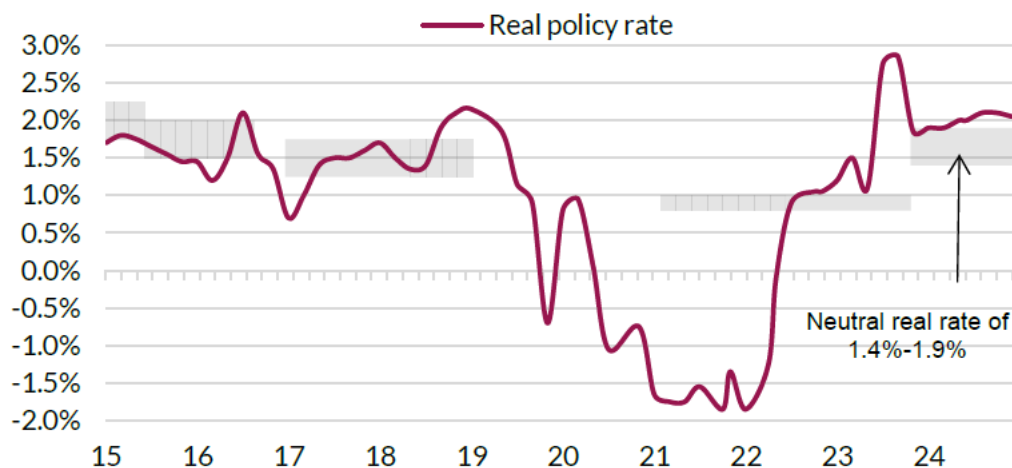


Beyond the rate cut: MPC sees need to support growth

The MPC, in a unanimous move, and as expected by consensus, cut rates by 25 bps (the first in five years) and kept stance at neutral. They noted the growth slowdown, and the need to support it. The rate cut by itself may not help growth, but the promise to provide as much liquidity as necessary, including durable liquidity, should help revive credit growth. An equally important shift, in our view, while qualitative, was that RBI would balance “benefits and costs of ... regulation.” MPC’s forecast of growth and inflation in FY26 are both 30bps lower than ours: our growth forecast may have some downside, due to slow credit growth, we fear inflation may be stickier than MPC’s assumptions.

Exhibit 1 - Assuming RBI's FY26 inflation est. 4.2%, two more rate cuts possible



Source: Axis Bank Economic Research.

The RBI cuts policy rates, signals space opening for supporting growth

The MPC cut policy rates for the first time in five years, reflecting the cut in growth projections (FY26 growth projected at 6.7%, with 2H at 6.5%). The governor and the MPC noted growth is “much below last year”, and that “growth-inflation dynamics open up policy space for the MPC to support growth...”. While the 4.2% inflation projection for FY26 is lower than the FY25 average of 4.8%, we note that inflation forecasts that overlap with earlier projections remained broadly unchanged, and above Oct estimates.

Emphasis on durable liquidity/macprudential regulations growth supportive

The governor acknowledged the “trade-offs between stability and efficiency” and the need to balance the “benefits and costs of each and every regulation”. In our view this shift, while qualitative, can contribute meaningfully towards reviving system credit growth: concerns on LCR norms and instructions on LDR had contributed to some large banks being forced to slow credit growth. Similarly, given that weak money creation by the RBI has been a contributor to the growth slowdown, the “endeavor to provide as much liquidity as required”, including durable liquidity, should give banks confidence to revive loan growth.

MPC's FY26 growth and inflation projection below our expectations

The MPC growth and inflation forecasts for FY26 are both 30bps below ours. On inflation, we expect more states to announce income transfer schemes that drive up the demand for food items like vegetables where the supply is relatively inflexible. We also worry about deteriorating diffusion measures (a third of food items in Dec-2024 had inflation above 6%), which signal high inflation in vegetables may be affecting inflation in other goods. If credit growth does not revive quickly, there may be moderate downside to our FY26 projections, but we continue to believe trend-growth currently is near 7%. Late-year spending by the union government in FY25 should provide tailwinds to growth.

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