RBI ends rate cut wait; Malhotra stresses 'less restrictive' policy

First repo cut in 5 yrs, of 25 bps to 6.25%, set to ease home loan rates; MPC keeps 'neutral' stance

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Mumbai, 7 February

Interest rates are set to fall after the six-member Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) decided to reduce the policy repo rate by 25 basis points to 6.25 per cent, against the backdrop of easing inflation and slowing economic growth. This marks the first interest rate reduction by the central bank in almost five years and will lead to lower loan rates and deposit rates, though with a lag.

All six members voted unanimously for the rate cut while maintaining a neutral stance.

The rate cut comes even as the past four headline inflation prints were above 5 per cent. RBI Governor Sanjay Malhotra noted that inflation is expected to decline.

This was the first MPC meeting since Malhotra took over as RBI governor in December last year.

In a major relief for banks, the RBI governor also deferred the implementation of certain regulations related to liquidity coverage ratio and project financing norms, and the expected credit loss framework for loan loss provisioning.

Malhotra said inflation has declined and is expected to moderate further, while growth is likely to recover from the low of 5.4 per cent in Q2FY25. However, he noted that growth remains significantly below last year's levels (FY24). "These growth-inflation dynamics open up policy space for the MPC to support growth while remaining focused on aligning inflation with the target," he said.

He further said: "The MPC, while continuing with the neutral stance, felt that a less restrictive monetary policy is more appropriate at the current juncture."

Turn to Page 6

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> **SANJAY MALHOTRA,** RBI governor

RBI'S PROJECTIONS

Inflation forecast (%)

	Policy	
	Dec	Feb
Q4FY25	4.5	4.4
FY25	4.8	4.8
FY26	–	4.2
Q1FY26	4.6	4.5
Q2FY26	4	4
Q3FY26	–	3.8
Q4FY26	–	4.2

Growth forecast (%)

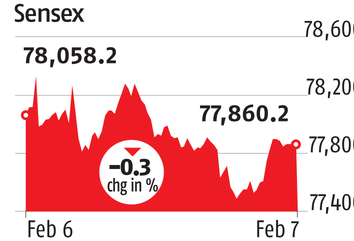
	Policy	
	Dec	Feb
FY25	6.6	6.4*
FY26	–	6.7
Q1FY26	6.9	6.7
Q2FY26	7.3	7
Q3FY26	–	6.5
Q4FY26	–	6.5

*First Advance Estimates
Source: RBI

THE TAKEAWAYS

- Proposed LCR norms, originally set to be introduced on April 1, have been deferred to at least March 31, 2026
- Implementation of project finance norms has also been pushed back to March 31, 2026
- RBI will allow banks sufficient time for ECL implementation
- Rate cut will result in 40% of loans linked to external benchmark getting repriced immediately
- Transmission to deposit rates and MCLR-linked loans will take at least two quarters
- RBI is satisfied with moderation in growth rate of unsecured retail loans
- Central bank will use "cease and desist" order only in rarest of rare cases
- India is capable of achieving a 7%+ growth rate, according to Malhotra
- Government's tax incentives will not be inflationary, says RBI governor

MPC move fails to cheer markets



Equity benchmark indices Sensex and Nifty ended in the red on Friday as the Reserve Bank of India's (RBI's) rate cut failed to enthuse investors. The Sensex ended the session at 77,860, down 198 points or 0.3 per cent. The Nifty closed at 23,560, down 43 points or 0.2 per cent. Both the Sensex and the Nifty indices logged gains to the tune of 0.46 per cent and 0.33 per cent, respectively, for the week.

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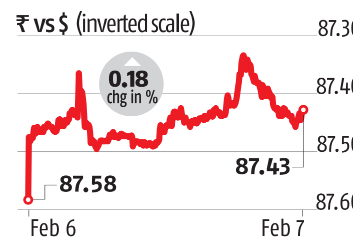
RBI intervenes to stabilise ₹



Source: Bloomberg

On Friday, the RBI intervened in the foreign exchange market by selling dollars to stabilise the rupee ahead of the policy decision. The rupee opened stronger at 87.46 following the intervention, said dealers. During the day, the rupee appreciated to a high of 87.32 per dollar but later gave up some gains, to settle at 87.43 per dollar, compared to the previous close of 87.59 per dollar.

'Rate cut decision in future to be based on fresh assessment'

At the same time, he warned that excessive volatility in global financial markets, continued uncertainties about global trade policies, and adverse weather events pose risks to the growth and inflation outlook. "This calls for the MPC to remain watchful. Accordingly, it decided to continue with a neutral stance," he said.

The market expects further rate cuts, even though the central bank has indicated that future action will be data-dependent. "The MPC will take a decision in each of its future meetings based on a fresh assessment of the macroeconomic outlook," Malhotra said.

While retaining the inflation forecast for FY25 at 4.8 per cent, the RBI projected headline inflation to average 4.2 per cent in FY26. In the third quarter of FY26, headline inflation is projected to fall below 4 per cent.

Malhotra said food inflation pressures should ease significantly, barring any supply-side shocks, and noted that core inflation is expected to rise but remain moderate.

On growth, the RBI said rural demand continues to trend upward, while urban consumption remains subdued, with high-frequency indicators providing mixed signals. The central bank has projected a 6.7 per cent GDP growth rate for FY26.

"By highlighting a 'less restrictive' policy given the current growth-inflation dynamics, he contained market expectations of a series of future rate cuts that could have been triggered by a more dovish statement," said economists at Standard Chartered Bank.

Analysts are divided on how deep the interest rate cut cycle will be, but they agree on another rate cut in the April policy review. "The RBI's MPC sees FY25-26 real GDP growth and CPI inflation at 6.7 per cent Y-o-Y and 4.2 per cent Y-o-Y. We see a 25 basis point cut on April 9," said Aastha Gudwani, India chief economist at Barclays.

The reduction in the policy repo rate will immediately impact retail loans and loans to small enterprises extended by commercial banks, as these are linked to the repo rate. RBI Deputy Governor Swaminathan J said 40 per cent of loans are linked to an external benchmark, which will see an immediate impact.

"The EBLR (external benchmark lending rate)-linked loan book is about 40 per cent, on which we will see a more immediate impact. With respect to MCLR (marginal cost of the fund-based lending rate)-linked loans, which are almost equivalent to the EBLR book, it typically takes about two quarters for the rate cut impact to play out based on our past assessment. The reset periods are mostly six months," Swaminathan said. "The existing deposits must be carried forward for the contracted period, and only new deposits will reflect the rate change. For monetary policy transmission to deposit rates, it again takes about two quarters."

The policy pivot was not only in terms of rates but also in foreign exchange reserve intervention and banking regulation, central bank watchers said. On the issue of intervention in the foreign exchange market, Malhotra reiterated the central bank's stated strategy of maintaining orderliness and stability, adding that the objective is also to ensure market efficiency.

"The new RBI governor confirmed a regime shift on rates, liquidity, FX, and regulation. We expect 75 basis points of further rate cuts and more liquidity easing," Nomura said in a note.

Though no new liquidity measures were announced, Malhotra assured that the RBI remains committed to providing sufficient system liquidity. "We have taken several steps in this regard and will continue to monitor evolving liquidity and financial market conditions, proactively taking appropriate measures to ensure orderly liquidity conditions," he said.

Observing that some banks are reluctant to on-lend in the uncollateratised call money market and instead passively parking funds with the RBI, the governor said: "We urge the banks to actively trade among themselves in the uncollateratised call money market to make it deeper and vibrant for better signal extraction from the weighted average call money rate (WACR)."

As the RBI deferred the implementation of some regulations in the pipeline, Malhotra said the banking regulator would attempt to strike the right balance, keeping in mind the benefits and costs of each regulation.

"The liquidity coverage ratio (LCR) implementation has been postponed to 'at least March 2026' from the scheduled 1 April 2025. The proposed tightening around expected credit loss (ECL) and project finance (PF) has also been pushed to the back burner," Nomura said.

The next policy review is scheduled for April 7-9, 2025.