Inflation eases, but RBI may not go for aggressive cuts

Policy easing hinges on liquidity, Fed decisions: Experts

SUBRATA PANDA
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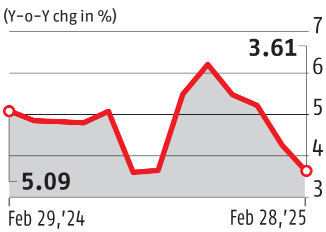
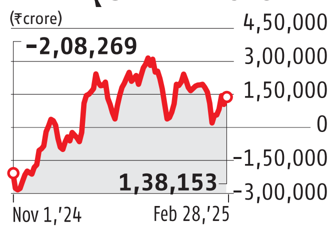
CPI INFLATION



Sources: Mospi, Bloomberg

NET LIQUIDITY INJECTED



Note: + indicates liquidity injection, while a - shows absorption

RATE CUT FORECAST: DIVERGING VIEWS

- **GAURA SEN GUPTA (IDFC Bank):** 25 basis-point (bp) cut in April, followed by another 25 bp in June
- **MADAN SABNAVIS (Bank of Baroda):** 25 bp cut in April, then a pause in June
- **RAHUL BAJORIA (BofA):** RBI to cut policy rates by 100 bp cumulatively
- **TANVEE GUPTA JAIN (UBS Securities):** 50 bp cut in this cycle, with the next move in April

A softer inflation print in February is unlikely to prompt the Reserve Bank of India's (RBI's) rate-setting body to opt for deeper cuts, especially when system liquidity remains in deficit and the full transmission of the 25-basis-point (bp) rate cut in February is yet to take place, economists said.

India's headline CPI inflation eased to 3.61 per cent in February — the lowest since July 2024 — on the back of a sharp decline in food inflation, mostly due to lower vegetable prices. In January, headline inflation stood at 4.3 per cent. According to UBS Securities, headline CPI inflation is expected to average 4.2 per cent in 2025-26.

"Despite February's inflation print coming in below 4 per cent, we anticipate a shallow rate cut trajectory by the RBI, with a 25-bp cut in April followed by another 25 bp in June. While softer inflation presents an opportunity for a deeper rate cut, the RBI's decision will depend on the US Fed's rate actions, domestic growth dynamics, and inflation-related uncertainties," said Gaura Sen Gupta, chief economist, IDFC Bank.

In its February meeting, the six-member monetary policy committee reduced the policy repo rate by 25 bp to 6.25 per cent, against the backdrop of expected easing of inflation and slowing economic growth, marking the first interest rate reduction by the central bank in almost five years.

However, with banking system liquidity remaining in deficit, the transmission of the 25-bp rate cut into new lending rates has not happened fully, especially for loans linked to the marginal cost of funds-based lending rate and deposit rates. The RBI has taken several measures to infuse durable liquidity into the system through open market operations, daily variable rate repo auctions, and foreign exchange swaps to ensure better transmission of policy rates into lending and deposit rates. As of March 12, the liquidity deficit in the system was ₹1.38 trillion.

Experts said that despite the rate cut, corporate bond spreads and state government securities spreads over government securities are hampering the transmission of rates. Similarly, certificate of deposit rates have climbed due to tight liquidity concerns and upward pressure on bulk deposit rates.

According to Madan Sabnavis, chief economist, Bank of Baroda, the RBI is unlikely to go for deeper rate cuts despite a softer inflation print. "The RBI will not be in a hurry to go for sharper cuts, especially when liquidity is in deficit territory, so they will be cautious," he said, adding that while the RBI will likely cut by 25 bp in April, it may pause in June to take stock of the monsoon.

Bank of America, however, continues to expect a 100-bp rate cut by the RBI.

"Our baseline call for some time has been that the RBI could cut policy rates by 100 bp, and we are sticking to it. One or two inflation prints showing low headline inflation may not lead to the RBI going for deeper cuts. It will be a function of growth dynamics and the Fed's rate cut trajectory," said Rahul Bajoria, head of India and Asean economic research at Bank of America.

India reported a GDP growth of 6.2 per cent in the Q3FY25, compared to 5.6 per cent in the second quarter of FY25, driven by an improvement in consumer demand, higher export growth, and increased government expenditure.

"With cyclical recovery already underway, we believe monetary policy support in terms of rate cuts, liquidity support, and regulatory easing will help strengthen India's domestic growth amid rising global uncertainty (especially US trade policies and the risk of reciprocal tariffs on India)," said Tanvee Gupta Jain, chief India economist at UBS Securities.