

The Feb'25 monetary policy decision will be announced amid an uncertain global backdrop, under Trump 2.0. The rupee has seen a threshold to 87-level closing at 87.46 per dollar on 5th Feb'25 versus 84.74 levels at the time of Dec'24 MPC. Meanwhile, in a flexible inflation targeting framework, FX is likely to be the shock absorber as the MPC focuses on weak growth and inflation trends. While headline inflation is expected to trend back towards the 4% target in Q4-FY25, GDP growth, on the other hand, is estimated at ~6% for Q3-FY25 versus MPC's forecast of 6.8%. Apart from this, the RBI is staying focused on liquidity measures to counter impact of FX related outflows. With several conflicting dynamics playing out and the upcoming MPC meet being the first policy decision under the new RBI Governor Shri Sanjay Malhotra, all eyes would be on the outcome on 7th February. We expect a 25bps repo rate cut to 6.25% in a unanimous decision, with neutral stance maintained. However, more than the rate cut, we will watch for the RBI Governor's guidance on various aspects, his actions with respect to Rupee and liquidity have been loud and clear.

- **Unanimous decision with a balanced guidance likely**

We always maintained the view that for the new RBI Governor, the three policy focus areas in the order of priority are *rupee, liquidity and rates*. With timely forex market interventions by the RBI to help reduce volatility, the rupee has been trending towards its fair value. With the liquidity deficit in the banking system hitting close to Rs 3 lakh crore in end-January (highest levels in more than a decade), the RBI has announced a number of liquidity measures worth Rs 1.5 lakh crore on 27th Jan'25. With liquidity measures having been initiated, the focus now turns to rates.

On a positive note, the Budget, on 1st February, beautifully balanced the goal of fiscal prudence with the much-needed demand stimulus. While the consolidation of fiscal deficit in FY26 implies a negative fiscal impulse, however, income tax cuts, are likely to have a multiplier effect and help de-clog the channel of public capex push crowding in broad-based private capex recovery. With capex budget for key ministries like roads and railways kept unchanged YoY, the government has clearly passed on the baton to boost capex recovery to the private sector. That said, the impact of the demand stimulus along with other measures in the Budget (especially Deregulation) is likely to play out gradually over the coming quarters. Hence, the RBI led MPC as it meets during 5-7th February, is likely to treat the current macro backdrop as weak in a volatile world, with sustained uncertainty regarding which way will Trump finally tilt given the flip-flop seen since the last weekend. Consequently, we see start of a shallow 50bps rate cut cycle in the 5-7th February MPC meeting. *While in an inflation targeting framework, FX is allowed to become the shock absorber on global developments, we still see the space being limited amid global volatility and paring of Fed rate cut expectations.*

By:

Kanika Pasricha
kanika.pasricha@unionbankofindia.bank

Nidhi Arora
nidhiarora@unionbankofindia.bank

Jovana Luke George
jovana.george@unionbankofindia.bank

Dhiraj Kumar
dhirajkumar@unionbankofindia.bank

- **Macro projections may be revised lower**

There is a fair chance that the MPC revises lower both growth and inflation projections for the current financial year, FY25. For instance, for the quarter ended Dec'24 (Q3-FY25), the growth numbers are looking close to 6% while the MPC's forecast is 6.8%. This implies a relatively sharp downward revision for FY25 GDP growth estimate of 6.6% (versus 6.4% advance estimate). On the inflation front, with veggie prices finally cooling in January, we see a convergence between headline inflation and inflation ex veggies (-3.8% for last 6 months). Hence, the inflation numbers for Jan-Mar'25 ending quarter are tracking ~4% (inflation target) versus MPC's estimate of 4.5%. On balance, macro backdrop is ripe for rate easing.

- **Liquidity support initiated hence do not see need for CRR cut as of now**

Liquidity deficit in the banking system hit close to Rs 3 lakh crore in end-January (highest levels in more than a decade), on the back of liquidity impact of FX related outflows of ~Rs 5.2 lakh crore (*ref. fig.3*). This led the RBI to announce a number of liquidity measures worth Rs 1.5 lakh crore on 27th Jan'25. Accordingly, to ease the situation, the central bank decided to hold open market operations (OMOs) of Rs 60,000 crore in three tranches (*one tranche already done*), dollar-rupee buy/sell swap auction of USD 5 billion for a tenor of six months (*already conducted*) and a 56-day variable rate repo auction of Rs 50,000 crore (*due on 7th Feb'25*). (Please see "[RBI's liquidity steps to provide significant relief; all eyes now on Budget & MPC](#)")

These steps are likely to support core liquidity deficit (excluding government balances) becoming neutral by year-end unless FX related liquidity outflows again play spoilsport. Hence, we do not see the need for a repeat of a CRR cut in this policy meeting even as any other liquidity announcements will remain on close watch. That said, we will seek clarity on two counts: (i) implementation of revised Liquidity Coverage Ratio (LCR) guidelines due from 1st April, as banks still provisioning for the same thereby keeping short-end funding rates elevated, and (ii) liquidity management framework in terms of levels, if any, on watch as per the policy cycle and any revisions in the current framework to align policy rate with weighted average call rate.

- **Regulatory announcements in focus**

We expect the RBI Governor to also provide clarity on implementation of the regulatory steps like revised Liquidity Coverage Ratio (LCR) guidelines, Expected Credit Loss (ECL) and project finance.

Fig 1: We see downside risk to the MPC's growth and inflation projections in FY25

UBI vs MPC projection comparison					
	GDP		CPI		Risk
	RBI MPC	UBI	RBI MPC	UBI	
Q1 FY25	6.7 (actual)		4.9 (actual)		
Q2 FY25	5.4 (actual)		4.2 (actual)		
Q3 FY25	6.8	6.0	5.6 (actual)		
Q4 FY25	7.2	6.7	4.5	4.0	
FY25	6.6	6.2	4.8	4.7	
Q1 FY26	6.9	-	4.6	4.1	
Q2 FY26	7.3	-	4.0	4.0	

	2023	2024	2025 (MPC)	2025 (UBI)	2026 (UBI)	Risk
GDP (% YoY)	7.00	8.20	6.60	6.20	6.50	↓
CPI (% YoY)	6.70	5.40	4.80	4.70	4.00	↔
Repo rate (%)	6.50	6.50	6.25	6.25	6.00	↔

Fig 2: CPI seen slipping to 4% threshold in the coming months as headline CPI and CPI ex veggies converge; % YoY

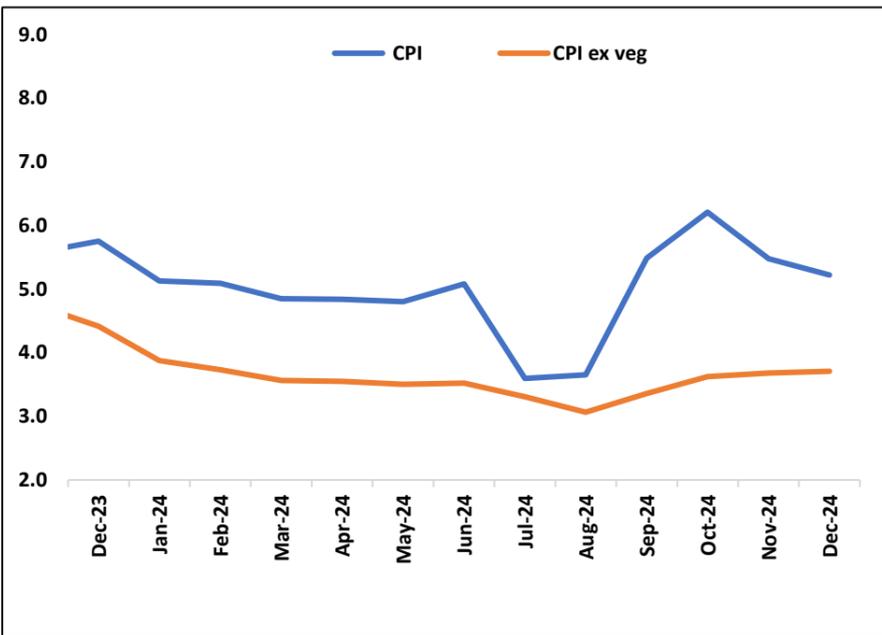


Fig 3: FX related liquidity outflow seen at -Rs 5.2 lakh crore in last 4 months; RBI measures likely to support; Rs lakh crore

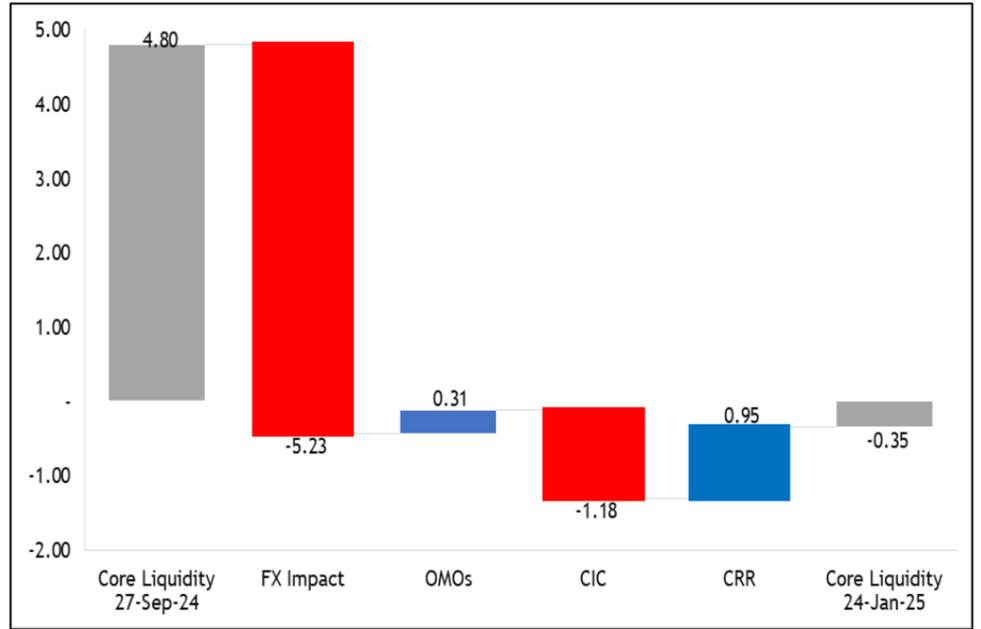
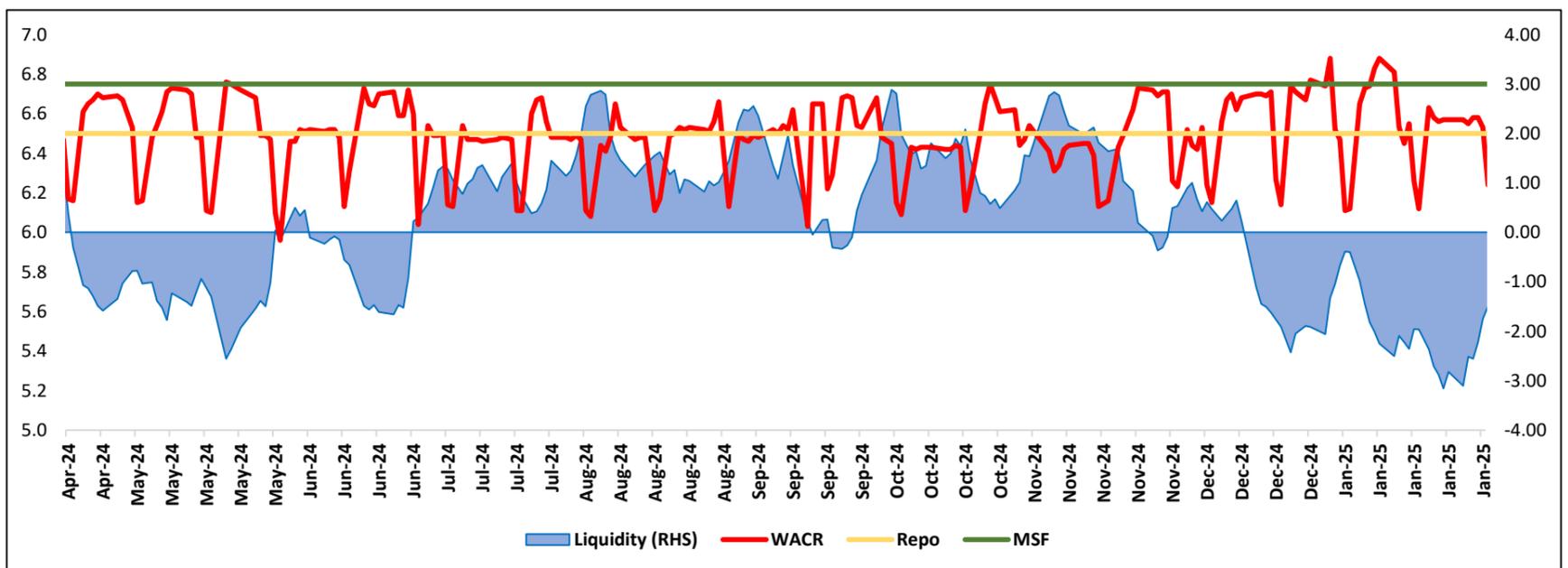


Fig 4: Weighted average call rate has eased back towards repo rate post announcement of liquidity steps by the RBI



Source: RBI, UBI research

Banking Research Team	
Kanika Pasricha Chief Economic Advisor	kanika.pasricha@unionbankofindia.bank
Suneesh K	suneeshk@unionbankofindia.bank
R Gunaseelan	gunaseelan@unionbankofindia.bank
Nidhi Arora	nidhiarora@unionbankofindia.bank
Rajesh Ranjan	rajeshranjan@unionbankofindia.bank
Jovana Luke George	jovana.george@unionbankofindia.bank
Amit Srivastava	asrivastava@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@unionbankofindia.bank
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Shreyas Bidarkar	shreyas.bidarkar@unionbankofindia.bank

Disclaimer:

The views expressed in this report are personal views of the author(s) and do not necessarily reflect the views of Union Bank of India. Nothing contained in this publication shall constitute or be deemed to constitute an offer to sell/ purchase or as an invitation or solicitation to do so for any securities of any entity. Union Bank of India and/ or its Affiliates and its subsidiaries make no representation as to the accuracy; completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability regarding the same.