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Monetary policy | First cut

A cautious turn

February 2025

RBI cuts repo rate by 25 bps, maintains neutral stance

The Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) cut policy rates by 25 basis points (bps), a first since May 2020. Easing inflation and a slowing economy prompted the central bank to cut rates. However, the MPC maintained its neutral stance, which gives it flexibility to remain data-dependent and respond to any global shock. The MPC is wary of risks emanating from the US tariff policy, global market volatility and unexpected weather events.

Highlights of the February monetary policy

- The MPC voted unanimously to cut policy rates by 25 bps – the repo rate is now 6.25%, standing deposit facility rate is 6.00% and marginal standing facility (MSF) rate is 6.50%
- The MPC decided unanimously not to change its 'neutral' stance
- The MPC expects Consumer Price Index (CPI) inflation to ease to 4.2% in fiscal 2026 from an expected 4.8% in current year
- The MPC projects India's gross domestic product (GDP) growth to rise 6.7% in fiscal 2026 from 6.4%[1] in fiscal 2025

What prompted RBI to cut rates?

- **Easing inflation:** Since the last policy meeting, CPI inflation cooled steadily to 5.2% in December 2024 from 6.2% in October 2024, owing to food inflation moderating to 8.4% from 10.9% over the period. Non-food inflation remained stable at a much lower 3.1% between October and December.

  Food has been the main risk for India's CPI inflation this fiscal. However, the MPC believes food inflation will ease, given a favourable agricultural production outlook for this fiscal. Kharif sowing is estimated to be 5.8% higher on-year, and rabi sowing has been higher on-year as well. However, the impact of adverse weather shocks on output remains a monitorable.

[1] *National Statistics Office's first advance estimate*

Also, while the MPC believes core inflation (CPI excluding food and fuel) would rise next fiscal, it expects the print to remain moderate. It remains watchful of global financial market uncertainty and any energy price volatility.

With food inflation easing, the MPC expects overall CPI inflation to move closer to its mid-point target range (2-6%) next fiscal – CPI inflation is forecast to ease to 4.2% next fiscal from 4.8% in the current fiscal, with risks evenly balanced.

Growth slowdown: The MPC noted that GDP growth is likely to slow to 6.4% in the current fiscal from 8.2% in the previous year. Moderating government capital expenditure and weak manufacturing growth are the primary factors behind the slowdown in growth in the current year.

But the expectation of easing inflation gives the MPC space to support growth by cutting rates.

The MPC expects investments to recover next fiscal with higher capacity utilisation and healthy balance sheets aiding private investment, along with continuing government's capex. Also, household consumption, which recovered in the current year, is expected to be supported further by tax relief provided in Union Budget 2025-26. Healthy agricultural outlook bodes well for rural demand.

Still, the MPC is wary of risks to growth from protectionist trade policies and global market volatility.

Overall, though, it sees GDP growth rising slightly to 6.7% next fiscal year, with risks evenly balanced.

Why was the policy stance not changed?

- The MPC kept its policy stance at neutral, as this provides it flexibility to keep rate cuts dependant on incoming data. An accommodative stance would have given certainty on rate cuts in upcoming policy meetings
- While the base outlook for inflation looks supportive for rate cuts, the MPC aims to monitor risks emanating from the US tariff hikes. There is considerable uncertainty on US tariff policy at present, with its implementation having the potential to disrupt global trade flows. The initial tariff announcements have already led to a sharp strengthening of the US dollar, heightened global market volatility and accelerated rupee depreciation – the rupee weakened 1.5% on-month on average in January vs 0.7% in the previous month
- Unexpected weather events remain a risk to inflation outlook as well. The frequency of extreme weather events, such as heatwaves, has been increasing with climate change

Our view

We expect the MPC to cut rates by 75-100 bps next fiscal. This rate cut cycle will be lesser than the previous rate cut of 225 bps during the pandemic. US tariff hikes, moderating US Federal Reserve rate cuts and weather-related risks will have bearing on the rate cutting cycle.

Today's rate cut was as per our expection. CPI inflation, the MPC's main target, has been easing towards the committee's stated target. The impact of the RBI's past rate hikes has also played out, with elevated borrowing costs having contributed to a slowdown in GDP in the current year.

That said, agricultural output looks favourable in the base case, furthering easing food inflation next fiscal. Benign global commodity prices, such as crude oil and other industrial inputs, augur well for non-food inflation as well, even as there is a statistical uptick from the low base of the current fiscal.

However, unexpected weather shocks cannot be discounted. Despite a normal monsoon in 2024, food inflation has been higher than last year. Climate change has played a role, with the National Aeronautics and Space Administration (NASA) recording 2024 as the hottest year on record.

The faster rupee depreciation has added the risk of imported inflation. Import of crude and edible oils impacts India's inflation outlook. The impact of stronger US dollar and foreign capital inflows, hence, need to be monitored.

And the tariff war set off by the US will have a bearing on policy rate cuts worldwide. While President Trump has made some tariff moves on China, Canada and Mexico so far, the future course of actions remain highly uncertain. The retaliatory moves by the affected economies further risk disrupting global trade, growth and inflation dynamics.

To be sure, tariff hikes are likely to put pressure on inflation in the US as well, which will affect rate cuts by the US Federal Reserve (Fed). The Fed had already paused on its rate cutting cycle in January, after cutting rates by 100 bps between September and December 2024. S&P Global expects only one rate cut in the first half of 2025 (calendar year), followed by a pause until the second half of 2026.

In the case of the RBI, which is beginning its rate cut cycle much later than advanced economy central banks, domestic inflation-growth dynamics will be the main driver of rate actions.

In this milieu, we expect India's GDP to rise slightly to 6.5% next fiscal. While the budget's tax cuts augur well for households, the overall fiscal impulse to economic growth is coming down with continued reduction in the fiscal deficit. Easing inflation, along with the RBI's rate cuts, is expected to lift consumption. But any substantial pick-up in investment depends on private investment. And exports face headwinds from rising global tariffs.

Given easing inflation and mild rise in growth, though, we expect further rate cuts in our base case. However, the quantum of rate cuts is expected to be 75-100 bps in the current cycle vs 225 bps cuts around the pandemic. A shallower Fed rate cut cycle and weather risks will have a bearing on the extent of rate cuts in India as well. Additionally, we expect the RBI to use other instruments, such as liquidity and foreign exchange interventions, to support financial conditions.

Analytical contacts

Dharmakirti Joshi
Chief Economist, Crisil Ltd
dharmakirti.joshi@crisil.com

Pankhuri Tandon
Senior Economist
pankhuri.tandon@crisil.com

Media contacts

Ramkumar Uppara
Media Relations
Crisil Limited
M: +91 98201 77907
ramkumar.uppara@crisil.com

Roma Gurnani
Media Relations
Crisil Limited
M: +91 70662 92142
roma.gurnani@ext-crisil.com

Sanjay Lawrence
Media Relations
Crisil Limited
M: +91 89833 21061
sanjay.lawrence@crisil.com

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