REBALANCING GROWTH INFLATION TRADE OFF:CRR CUT MILDLY OFFSETS WIDE FLUCTUATION IN GOVERNMENT CASH BALANCES THAT IS THE NEW NORM…CRR SHOULD BE BROUGHT DOWN TO 3% (MARCH 2020)…FIRST REPO RATE CUT IN FEBRUARY 2025…

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As widely expected, the MPC decided to keep repo rate at 6.50% (eleventh time in a row), with a 4-2 voting. MPC however unanimously decided to continue with the neutral monetary policy stance and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.

RBI has sharply downgraded its real GDP growth forecast for FY25 from 7.2% to 6.6% (Q3: 6.8%, and Q4: 7.2%) with risks evenly balanced. Such a downward revision in growth forecast is nothing new as in FY22 and FY23 the growth forecasts were downgraded on an average by 90 basis points. In current fiscal, growth forecast was indeed revised, but upwards from 7 to 7.2%. This is the first time in the last 5 years that the RBI has first revised the growth estimates upwards and then downwards to 6.6%. This is indeed an implicit recognition by RBI of missing the growth estimates by a wide margin. **We believe that GDP growth for FY25 will be lower than the RBI's estimate and we are pegging the GDP growth at 6.3% for FY25.**

RBI has revised upwards its inflation projection for FY25 by 30 bps to 4.8% with Q3 at 5.7% (earlier: 4.8%), and Q4 at 4.5% (earlier: 4.2%). At the same time, although the policy is mute on rates, it is considerably loaded on regulatory and development front.

RBI reduced CRR by 50 bps in two equal tranches of 25 bps each to 4.0% of NDTL with effect from the fortnight beginning 14 Dec'24 and 28 Dec'24, respectively. ₹1.16 lakh crore will be released due to CRR cut will may ease the liquidity situation in the coming months. **However, the reduction in CRR may not mathematically translate to any change in deposits and lending rate, however, it may have positive impact on margins** (3-4 bps on NIM) of the banks.

To be fair to RBI, liquidity in the system has been significantly impacted by the wide volatility in Government cash balances a counter cyclical measure to address systemic liquidity. This has entered a new phase with the launch of SNA Sparsh, replacing the earlier CSS-SNA and absorbing huge float funds from the banking system. **27 Major CSS schemes having a Budget outlay of ~Rs 3.70 lakh crore have migrated to SNA SPARSH in FY 2024-25.** SNA SPARSH eliminates the role of commercial banks, as central ministries and state treasuries are integrated on RBI's eKuber platform using IFMIS (Integrated Financial Management and Information System). **The next couple of years will thus be the biggest challenge for the RBI liquidity management to take care of an estimated Rs 7.5 trillion fund flow through IFMIS. Thus we strongly recommend that CRR may be brought down to 3% , that was prevailing in March 2020. This could release an additional Rs 2.32 trillion in the banking system. The decision to raise the upper limit of FCNR rates will not bring any new capital inflows. Instead, a CRR cut on such products would have been very helpful.**

RBI has allowed SFBs to extend pre-sanctioned credit lines through the UPI. This may have potential to make available low-ticket, low-tenor products to 'new-to-credit' customers. In a significant move, **RBI has announced Introduction of the Secured Overnight Rupee Rate (SORR)** – a Benchmark based on the Secured Money Markets. The measure is a continuation of the ongoing reform measure in financial benchmarks. The SORR is expected to give further boost to derivate markets, provide an additional input for banks to price loan if necessary. The decision to hike loan limit to Rs 2 lakhs is also helpful.

On the digital banking side, RBI has constituted a committee to develop a Framework for Responsible and Ethical Enablement of AI. The objective is to provide firms providing financial products and services with a set of foundational principles to consider when using AI in decision-making and promote public confidence and trust in the use of AI. In a similar vein, **the use of technology to detect mule accounts is is significant for banks as mule accounts is a sophisticated mechanism to misuse banking channel for money laundering**.

On the communications side, RBI expanded the policy consultation process of the RBI through *Connect 2 Regulate*. The measure will be open to all including scholars for directly sharing suggestions and ideas with the RBI. The measure makes financial regulation process more democratic and participatory. **RBI will also use podcast for wider information dissemination. We expect RBI to cut rates in February 2025 cumulative 75 bps and such a decision is unlikely to be impacted by what is happening to $, as was the case in 2018 when the RBI did not hike rates even as rupee was under enormous pressure.**

REPO RATE KEPT AT 6.5%; STANCE AT NEUTRAL

- As expected, MPC decided to keep repo rate at 6.50% (eleventh-time in a row), however, this time also not unanimously. Two of the newly inducted members voted to reduce the policy repo rate by 25 bps. MPC unanimously decided to continue with the neutral monetary policy stance and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.
- RBI has revised upwards its inflation projection for FY25 by 30 bps to 4.8% with Q3 at 5.7% (earlier: 4.8%), and Q4 at 4.5% (earlier: 4.2%). The outlook for inflation will be largely shaped by food inflation trajectory (on positive side softening in vegetable prices while on negative side adverse weather events and rise in international agricultural prices).
- RBI has sharply downgraded its real GDP growth forecast for FY25 from 7.2% to 6.6% (Q3: 6.8%, and Q4: 7.2%) with risks evenly balanced. Such a downward revision in growth forecast is nothing new as in FY22 and FY23 the growth forecasts were downgraded on an average by 90 basis points. In current fiscal, growth forecast was indeed revised, but upwards from 7 to 7.2%. This is the first time in the last 5 years that the RBI has first revised the growth estimates upwards and then downwards to 6.6%. This is indeed an implicit recognition by RBI of missing the growth estimates by a wide margin. **We believe that GDP growth for FY25 will be lower than the RBI's estimate and we are pegging the GDP growth at 6.3% for FY25.**
- Given that RBI increased CPI projection and at the same time reduced growth forecast, the question remains that when is RBI going to cut rates.

DEVELOPMENT AND REGULATORY MEASURES

- **CRR slashed by 50 bps:** RBI has reduced CRR by 50 bps in two equal tranches of 25 bps each to 4.0% of NDTL with effect from the fortnight beginning 14 Dec'24 and 28 Dec'24, respectively. This will restore the CRR to 4% of NDTL, which was prevailing before the commencement of the policy tightening cycle in April 2022. This reduction in the CRR would release primary liquidity of about ₹1.16 lakh crore to the banking system.
- The system liquidity remains tight, with Rs 0.69 lakh crore in December (till now), compared to Nov number of Rs 1.35 lakh crore. So, this Rs 1.16 lakh crore release due to CRR cut will not ease the liquidity situation in the coming months due to tax outflows, increase in currency in circulation, forex market intervention and volatility in capital flows. Further with the implementation of Just in Time (JIT), the system liquidity has already taken a hit of Rs 55,000 crore.
- Further, the reduction in CRR may not mathematically translate to any change in deposits and lending rates, however, it may have positive impact on margins (3-4 bps on NIM) of the banks. **The CRR cut will reduce the M0, so, the money multiplier will increase by 15-20 bps.**

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q3 FY25	Q4 FY25	FY25	Q1 FY26	Q2 FY26
Dec'24	5.7	4.5	4.8	4.6	4.0
Oct'24	4.8	4.2	4.5	4.3	-
Aug'24	4.7	4.3	4.5	4.4	-
Real GDP Growth (%)	**Q3 FY25**	**Q4 FY25**	**FY25**	**Q1 FY26**	**Q2 FY26**
Dec'24	6.8	7.2	6.6	6.9	7.3
Oct'24	7.4	7.4	7.2	7.3	-
Aug'24	7.3	7.2	7.2	7.2	-

Source: RBI, SBI Research

GDP Estimates: RBI Vs NSO (%)

Year	RBI (Feb policy/ First projection)	RBI (Oct policy projection	RBI (Final projection/ Dec policy)	NSO 1st AE	NSOs final estimate	Difference in NSO's and RBI's final estimate
FY25	7.0	7.2	6.6	-	-	-
FY24	6.4	6.5	7.0	7.3	8.2	1.2
FY23	7.8	7.0	6.8	7	7	0.2
FY22	10.5	9.5	9.5	9.2	9.7	0.2
FY21	6.0	-9.5	-7.5	-7.7	-5.8	1.7
FY20	7.4	6.1	5.0	5.0	3.9	-1.1
FY19	7.4	7.4	7.4	7.2	6.5	-0.9

Source: SBI Research

Average Liquidity Position (Rs lakh crore)

Indicator	FY25 Average	Post policy (09 th Oct - till date) average	05-Dec-24
Repo Outstanding	0.54	0.13	0.02
Reverse Repo Total	0.44	0.62	0.02
SDF	0.88	0.89	0.55
MSF	0.06	0.05	0.05
Net LAF (-absorption)	-0.61	-1.25	-0.42
Government Cash Balance (net LAF-core liquidity)	2.72	2.02	1.23
Core Liquidity (-Surplus) system liquidity adjusted with GOI Balances	-3.32	-3.28	-1.88

Source: SBI Research, RBI

- To be fair to RBI, liquidity in the system has been significantly impacted by the wide volatility in Government cash balances a counter cyclical measure to address systemic liquidity. This has entered a new phase with the launch of SNA Sparsh, replacing the earlier CSS-SNA and absorbing huge float funds from the banking system. **27 Major CSS schemes having a Budget outlay of ~Rs 3.70 lakh crore have migrated to SNA SPARSH in FY 2024-25.** SNA SPARSH eliminates the role of commercial banks, as central ministries and state treasuries are integrated on RBI's eKuber platform using IFMIS (Integrated Financial Management and Information System). **The next couple of years will thus be the biggest challenge for the RBI liquidity management to take care of an estimated Rs 7.5 trillion fund flow through IFMIS. Thus we strongly recommend that CRR may be brought down to 3% , that was prevailing in March 2020. This could release an additional Rs 2.32 trillion in the banking system.**
- **Interest Rates on FCNR(B) Deposits:** RBI has permitted banks to raise fresh FCNR(B) deposits of 1-3 year at Alternative Reference Rate (ARR) plus 400 bps and deposits with maturity 3- 5 years to ARR plus 500 bps. This relaxation will be available till March 31, 2025.
- **The aim is to attract capital amid pressures on the rupee. However, we don't expect that banks will increase the rates, as the rates are already quite high. With SOFR at 4.59%, FCNR (B) deposits in USD could be 7.09% for 1-3 year tenors and 8.09% for 3-5 year tenors.**
- **Expanding the reach of FX-Retail Platform through linkages with Bharat Connect:** To expand the reach of FX-Retail platform and enhance user experience, it is proposed to facilitate the linking of the FX-Retail platform with Bharat Connect. The linkage will enable users to register and transact on the FX-Retail platform through the apps of banks (mobile applications, internet banking etc.) and non-bank payment system providers.
- Though, this will expand reach of FX-Retail platform, enhance user experience and promote fairness and transparency in pricing with adequate safeguards, but it may impact banks margins, as business move to FX-retail.
- **Introduction of the Secured Overnight Rupee Rate (SORR) – a benchmark based on the secured money markets:** RBI has announced Introduction of the Secured Overnight Rupee Rate (SORR) – a Benchmark based on the Secured Money Markets.
- In accordance with the committee report, we expect sufficient time will be provided for transition. Further, legacy trades will continue to be linked to MIBOR till maturity. The proposal was extensively discussed with the market participants before announcement. **Hence, no adverse impact is expected. Going forward, the new benchmark is expected to be a better reflective of market dynamics owing to large sample size (Basket repo and TREPS vs only call market earlier).**
- **Collateral-free Agriculture Loan — Enhancement of Limit:** RBI has raised the limit for collateral-free agriculture loans from Rs 1.6 lakh to Rs 2 lakh. This is long-standing demand which has been fulfilled partially. The limit should ideally increase to Rs 3.0 lakh, starting with accounts having a good track record for 5 years-plus.
- **'Connect 2 Regulate' – An Initiative for Open Regulation:** To foster an inclusive and multifaceted consultative framework with various stakeholders, the RBI has instituted a program titled "Connect 2 Regulate". This initiative will provide stakeholders with an opportunity to proffer their conceptualizations on the issues articulated by the central bank.
- **Introduction of Podcast facility as an additional medium of communication:** Over the past two decades, central banks have become more alive to the reality that economic shocks affect different groups of society differently. A key to enhancing trust during periods of uncertainty is listening – engaging the public in conversations. This is particularly key when monetary policies are directly affecting people's lives, such as when inflation is above target and interest rates are rising. Central banks have been moving toward more direct, two-way public engagement. In this regard and furtherance of its commitment to transparency and elucidation of the impact of its decisions and in line with the ECB, Fed and RBA podcasts, the RBI intends to inaugurate a podcast for the expansive dissemination of pertinent information to the public.
- **Pre-sanctioned Credit Lines through UPI :** The pre-sanctioned credit lines through UPI was already available to SCBs in Sep'2023. Today, RBI has allowed SFBs to extend pre-sanctioned credit lines through the UPI. This may have potential to make available low-ticket, low-tenor products to 'new-to-credit' customers. RBI could have allowed this facility to payment banks and RRBs too.

- **Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE-AI) in the Financial Sector**: The issue of ethical AI has been gaining traction worldwide. The issue at hand is the unintended bias in AI algorithms which can harm some sections of the customers through denial of services or unfair pricing. Similar standards on ethical AI have been adopted in jurisdictions such as in Singapore. The objective is to provide firms providing financial products and services with a set of foundational principles to consider when using AI in decision-making and promote public confidence and trust in the use of AI.

- **AI solutions to identify mule bank accounts - Mule-Hunter.AI** : Money mule accounts is a common method adopted by fraudsters to channel proceeds of frauds. The proposed measure is significant for banks as mule accounts is a sophisticated mechanism to misuse banking channel for money laundering. While high valued transactions are routinely screened as per PMLA, mule accounts are very difficult to track.

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