SBI Research

Epilogue to June-25 MPC Meeting

Reading between the lines behind a 50-basis point rate cut in June’25 policy with a stance change… Separately SBI estimates of poverty reveal a continued fall in 2024 to 4.6% from 5.3% in 2023 by World Bank…

Issue # 8, FY26   10-June-2025

Executive Summary….1/2

- As select cohorts of markets try to understand RBI's larger than anticipated (by quite a few!) rate decision, we feel it imperative to glance back while look forward to decipher the motives closer to the truth beyond cacophony

- Jumbo rate cuts have been more common than their counterparts since 2001… volatility has been a harbinger for larger rate hikes as vouched during GFC to PIIGS crisis / Taper Tantrums.. the recent 50 bps cut is the first such instance post 2020

- The change in policy stance from accommodative to neutral is a shift from "time based" forward guidance in April policy to "state based" forward guidance in June policy. Since pandemic RBI has introduced "state based" and "time based" forward guidance and the change in stance in the June policy is merely reflective of the changing priorities

    - The "time based" forward guidance was explicitly used in the April policy signalling the commitment to keep the accommodative stance in force indicating rate cuts or pause as the only option. The June policy has effectively shifted from "time based" guidance to "state based" guidance
    - The "state based" guidance is explicitly used to revive growth on a durable basis: i.e., guidance contingent on the state of the economy
    - The time based" guidance is more explicit, while "state based" is more implicit. For example, growth on a durable basis is not quantifiable but merely an implicit guidance on the state of the economy

- Thus the MPC decision to go for a relatively mammoth cut, while changing the stance to neutral, should not be confused with a pause on future rate cuts trajectory in the medium term but rather a semblance of adopting flexible maneuverability on part of a conscious regulator to diligently perform a new troika- manage the yield curve and ensure adequate liquidity in the ecosystem, while renewing the pledge to keep growth sacrosanct… mindful of inflationary concerns and checkmating any bubbles formation

Executive Summary….2/2

- The RBI has also made it clear that CRR has evolved more as a regulatory intervention tool / countercyclical liquidity buffer rather than as a liquidity tool even as the transition towards a SORR based regime looks imminent
  - There is possibly a justification to cutting CRR apart from it enhancing liquidity in the busy season. There is no denying of the fact that Reserve Money growth has slowed down since the pandemic. From 18.8% in pandemic year FY21, it decelerated to 4.3% in FY25 (currently at 6.1%), of which ~ 70% is because of the decline in currency in circulation apart from the cut in CRR
  - The cut in CRR along with the increasing digitization augments the money multiplier. In fact, the money multiplier tends to increase when the reserve ratio is cut/ and lower currency leakage indicating higher multiple expansion in broad money on account of bank deposits. With deposit rates being cut, such an increase in money multiplier will clearly act as a buffer… We estimate the money multiplier may cross ~6% in FY26 because of the CRR cut
  - Thus, a lower expansion in RM can co-exist with a stable M3 growth with a jump in money multiplier making the relation of base money and money supply agnostic. This is important in an inflation targeting regime where money supply growth is endogenous

- As a relief to households through transmission of reduced rates by FIs, If we consider that ~ 80% of the retail & MSME loans portfolio linked to EBLR, then around Rs 50,000 to Rs 60,000 could be saved by the households… On an average, the easing cycle continues for ~2-years, thereby the interest cost of households will continue to decline

- RBI's proposed LCR guidelines may improve the LCR of banks by 6% points at the aggregate level… these guidelines will free-up lendable resources by Rs 2.5-2.7 lakh crore, which will get headroom equivalent to 1.4-1.5% of additional credit growth

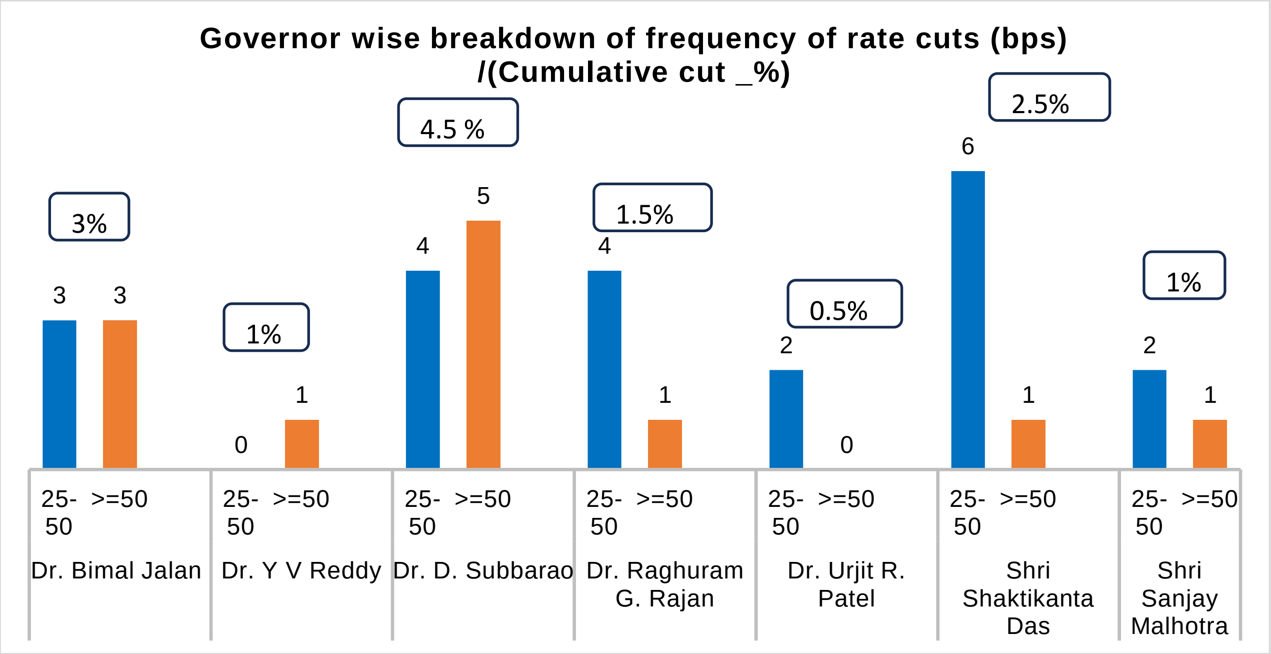
- **The current focus of RBI is to support the momentum in capital formation for more durable growth**

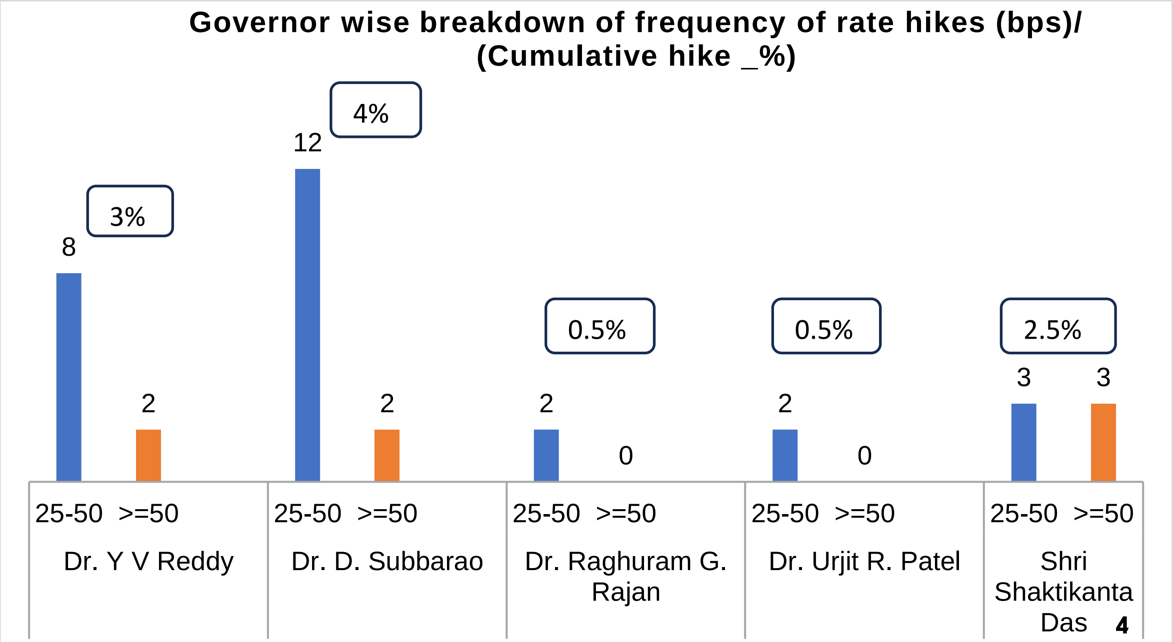
A History of Jumbo Rate Actions

- We have analyzed the frequency of rate cuts and hikes of 25-50 bps and 50 bps or more by RBI governors to understand their monetary policy approach, the pace and intensity of easing during their tenure in response to evolving macroeconomic situations

- Highest cumulative rate cut in magnitude (4.5%) took place between Oct'08 – Jul'13 followed by Apr'01- Aug'03. Most of the jumbo rate cuts (>=50 bps) were also undertaken between Oct'08 – Jul'13. However, 25 bps rate cuts were more pronounced in recent years during Feb'09- Dec'24

- Highest number of rate hikes took place between Oct'08 – Jul'13. Furthermore, jumbo rate hikes have been uncommon with only 7 taking place since 2001





A History of Jumbo Rate Actions

- The recent 50 bps cut in repo rate is the first such instance post 2020
- We have analyzed the history of almost 25-year period of jumbo rate actions (>=50 bps) and found that jumbo reductions are more often than the jumbo rise
- A jumbo action is mostly a reaction to a major key event and aftermath (like GFC, Covid-19, Russia-Ukraine conflict, etc.)
- While analyzing the jumbo rate actions we found that: *Whenever the liquidity situation is in deficit mode at the time of rate action (increase/decrease), it moved into surplus mode after 6 months*

A History of Jumbo Rate Actions

Governor	Period	Cumulative rate hike	Cumulative rate cut	Count of 50 bps rate action (Max 100 bps)	
				hike	cut
Dr. Y.V. Reddy	Sept 6, 2003 to Sept 5, 2008	300	100	2	1
Dr. D. Subbarao	Sept 5, 2008 to Sept 4, 2013	400	450	2	5
Dr. Raghuram G. Rajan	Sept 4, 2013 to Sept 4, 2016	50	150	-	1
Dr. Urjit R. Patel	Sept 4, 2016 to Dec 11, 2018	50	50	-	-
Shri Shaktikanta Das	Dec 12, 2018 to Dec 10, 2024	250	250	3	1
Shri Sanjay Malhotra	Dec 11, 2024 onwards	-	100	-	1
Average		210	183	-	

Source: SBI research

Impact of Jumbo Rate Actions

Governor	Period of Action	Action	Net LAF position	
			At the time of action	Post 6 months
Dr. Y.V. Reddy	Jun'08 to Jul'08	Hike 100 bps in 2 tranche	Deficit	Surplus
	Aug'08	Cut 100 bps	Deficit	Surplus
Dr. D. Subbarao	May'11 to Jul'11	Hike 100 bps in 2 tranche	Deficit	-
	Oct'08 to Jan'09	Cut 300 bps in 4 tranche	Surplus	Surplus
Dr. Raghuram G. Rajan	Sep'15	Cut 50 bps	Neutral	Deficit
Shri Shaktikanta Das	Mar'20	Cut 75 bps	Surplus	Surplus
	Jun'22 to Sep'22	Hike 150 bps in 3 tranche	Surplus	Surplus
Shri Sanjay Malhotra	Jun'25	Cut 50 bps	Surplus	-

Source: SBI research

A colossal cut, and a quick change in stance…Behind the finesse of curating anti-fragile regulation

- Taking a cue from the RBI statement in 2021, wherein it had provided a succinct rationale behind the distinction between "time-based" guidance and "state-based" guidance (and the interwoven plot of the same with the forward guidance; explicit as well as implicit), the RBI's present shift from "time-based" guidance to "state-based" guidance is a firm commitment to support growth in an implicit manner in the highly uncertain environment of today where it has to navigate through much troubled waters

- MPC decision to go for a relatively mammoth cut, while changing the stance to neutral should not be confused with a pause on future rate cuts trajectory in the medium term but rather a semblance of adopting flexible maneuverability on part of a conscious regulator to diligently perform a new troika- manage the yield curve and ensure adequate liquidity in the ecosystem, while renewing the pledge to keep growth sacrosanct

- The vagaries of inflation management too must be weighing on the collective conscience of the MPC as changing dynamics of trade and tariffs can be a perfect vehicle for the pass-through of unanticipated volatilities, while uncertainties on climate front can squeeze supply side visibility despite a promising crop output, both together accentuating the inflationary prints sans any warning

- Interestingly, MPC has perhaps explicitly signaled to broader markets that the quick shift to neutral stance should prohibit a Bull whip effect in the making where markets, poetically hooked to an accommodation-in-perpetuality stance, could be front running the regulator, creating myriad bubbles in no time through prisms of lower policy rates… this could well be the other side of the coin of the regulatory action in late 2023 that took the winds out of the sails of a masquerading market fueling a false rally, chiefly on retail side through an avalanche of unsecured loans

CRR Cut

- We quote from the SBI Research pre policy report dt Feb 04’ 2025 (Prelude to MPC Meeting: February 5-7, 2025)

  "*The RBI could look into using CRR more as a regulatory intervention tool / countercyclical liquidity buffer rather than as a liquidity tool in future. There is an urgent need to revisit the existing liquidity management framework (LMF) by RBI by replacing the WACR as a policy rate as it does not serve the intended purpose….* “

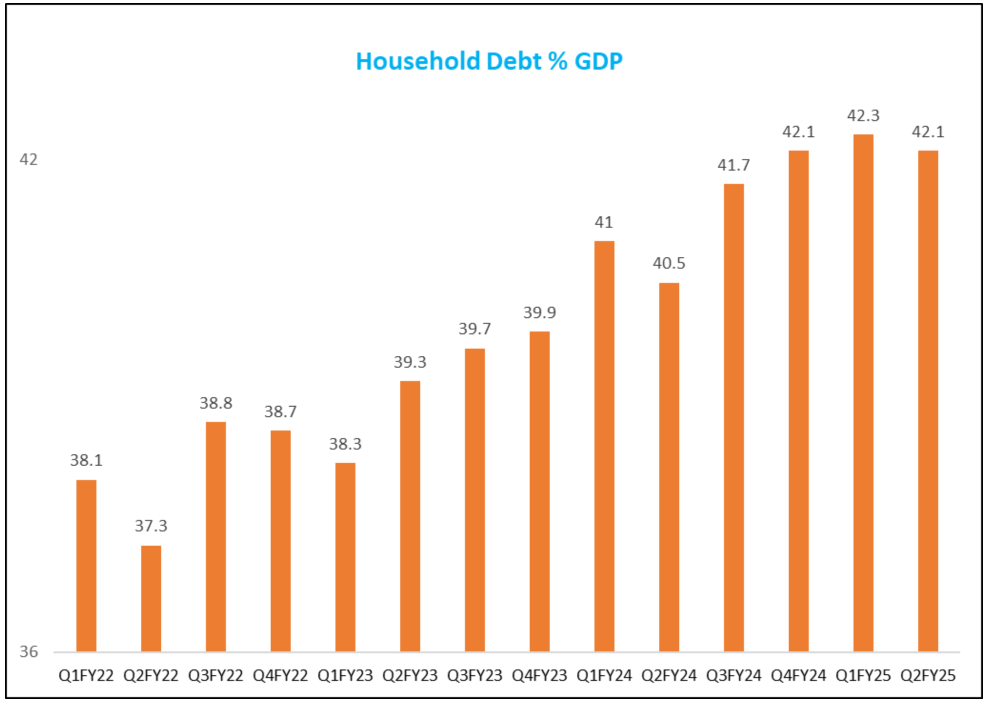
- **Reading in sync with SBI Research report dt January 20’ 2025 wherein sweeping changes in LMF were suggested** (*In principle, liquidity management per se still has some operational challenges like improving the market microstructure, a proper indicator of liquidity tightness in the system and most importantly maintaining a delicate balance between effective mix of durable and transient liquidity injection / withdrawal….Amend Liquidity Management Framework to replace Weighted Average Call Rate /WACR with Secured Overnight Rupee Rate/SORR… Considering inclusion of a certain portion of CRR /countercyclical Liquidity Buffer towards HQLA as a countercyclical measure to help improve liquidity… and, need to continuously develop the term money market to provide sufficient liquidity beyond the overnight time slot*)

- While the fresh cut in CRR augurs well on liquidity front, and gives a quick respite to banking sector through additional deployable resources, we reiterate that CRR no longer remains a liquidity management tool primarily, but is truly evolving into a regulatory intervention tool / countercyclical liquidity buffer tool that increasingly acts as the enabling guardrail of banks’ optimizing returns on resources, as also assets as they endeavor to protect the NIM…also, RBI’s series of Fx swaps to stabilize the rupee amidst global upheavals in off late could meet the maturity profile smoothly without disturbing the liquidity conditions

- **The move thus signals a pivot to the better synchronization of overnight as also term money market rates with policy rates given WACR has increasingly been detached from the realities of broader markets (TREPS, CBLO), paving the immediate need to move towards the SORR based regime**

India’s Household debt is manageable: Stress on Easing Cycle will Reduce Significantly

- India’s household debt is relatively low (42%) compared to other EMEs (49.1%) , however, it has increased over the past three years
- Interestingly, the increase is driven by a growing number of borrowers rather than an increase in average indebtedness
- Disaggregated analysis of the nature of individuals’ borrowings shows that loans are primarily used for consumption like personal loans, credit cards, consumer durable loans and other personal loans(45% share), asset creation like home loans and vehicle loans (25%) and for productive purposes like agriculture loans, business loans and education loans (30%)
- So, the rise in HH debt is not worrisome at all as two-thirds of the portfolio is of prime and above credit quality
- In the current rate easing cycle, RBI has already reduced repo rate by 100 bps and the external linked benchmarked interest rates reduced automatically
- **If we consider that ~ 80% of the retail & MSME loans portfolio linked to EBLR, then around Rs 50,000 to Rs 60,000 will be saved by the households**



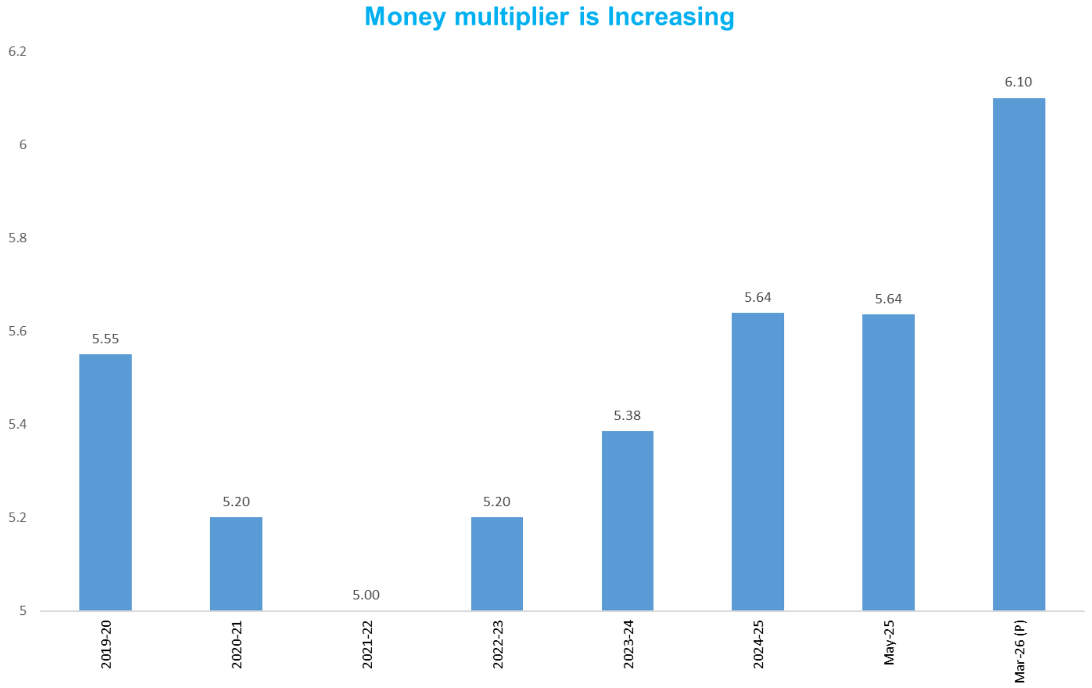
Transmission to Banks’ Deposit and Lending Rates (Variation in basis points)

Period		Easing Phase	Tightening Phase	Easing Phase		
		Jan'19 to Apr'22	May'22 to Jan'25	Feb'25	Apr'25	Jun'25
Repo Rate		-250	250	-25	-25	-50
Term Deposit Rates	WADTDR_Fresh Deposits	-	253	-27		
	WADTDR_Outstanding Deposits	-188	199	-1		
Lending Rates	EBLR	-	250	-50		
	1-Yr. MCLR (Median)	-155	175	0		
	WALR_Fresh Rupee Loans	-244	181	-6		
	WALR_Outstanding Rupee Loans	-152	113	-17		

Source: SBI Research, RBI

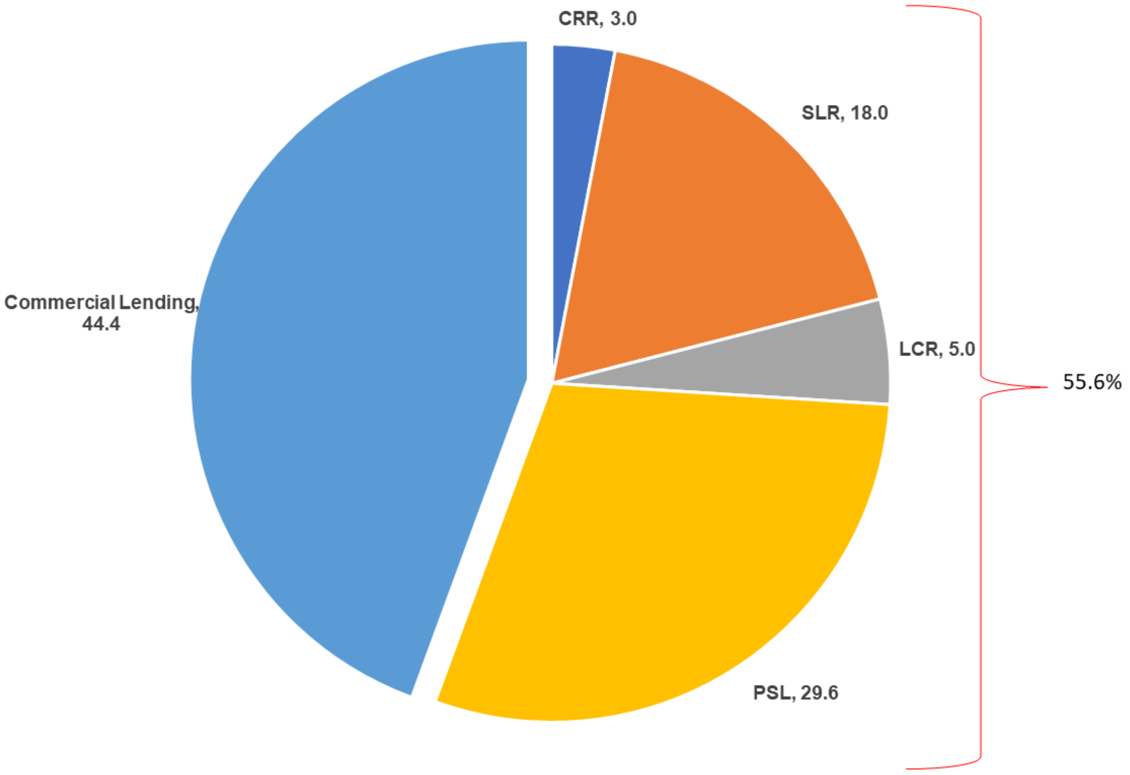
Impact of CRR

- The cut in CRR would release primary liquidity of about ₹2.5 lakh crore to the banking system by December 2025. Besides providing durable liquidity, it will reduce the cost of funding of the banks, thereby helping in monetary policy transmission to the credit market.
- The reduction in CRR may not mathematically translate to any change in deposits and lending rates, however, it may have positive impact on margins (3-5 bps on NIM) of the banks
- The CRR cut will reduce the M0, so, the money multiplier may cross ~6% by March 2026

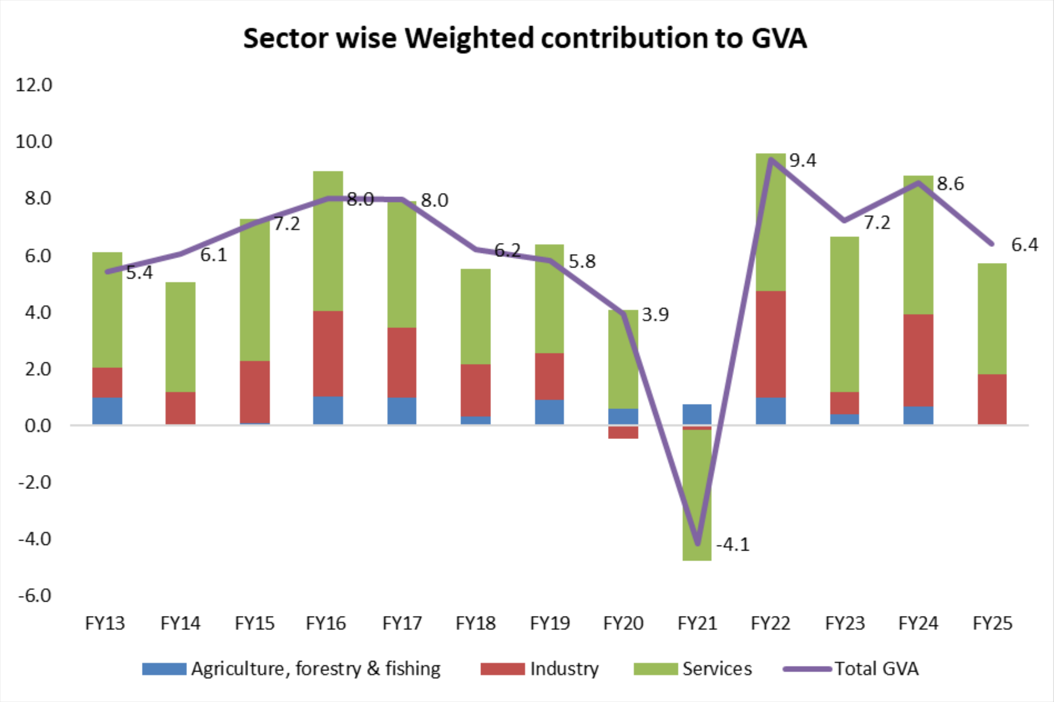


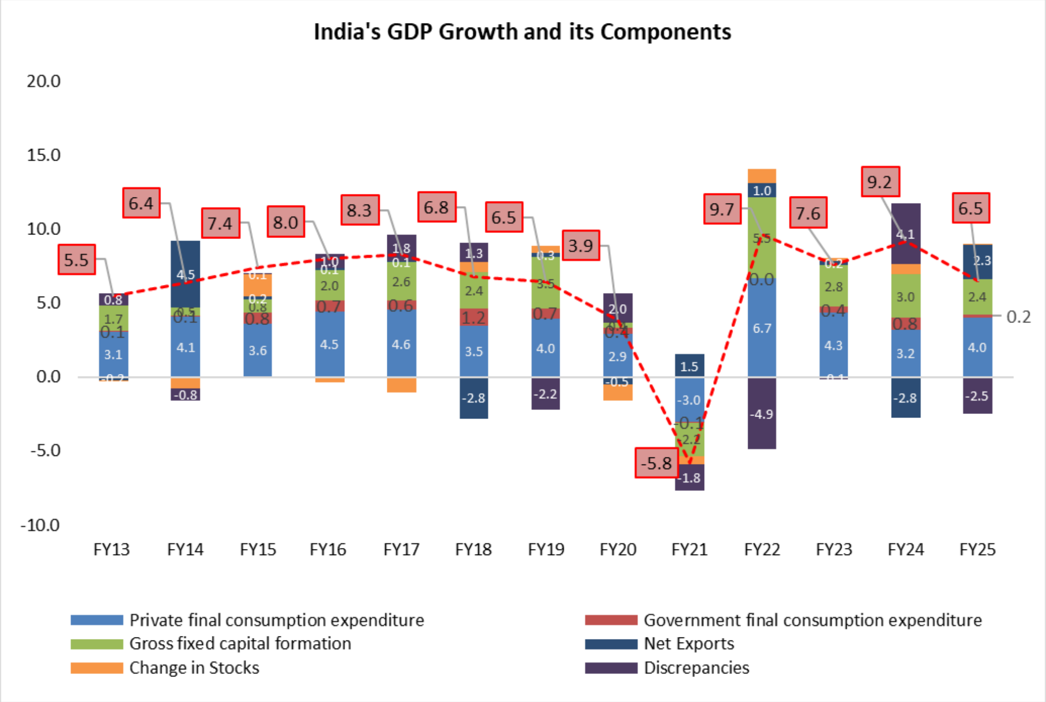
Lendable resources increases for commercial lending post CRR and LCR adjustment

- **After deducting all the pre-emptive regulations like CRR, SLR, LCR etc, banks left with only Rs 44.4 for commercial lending with every deposit of Rs 100**
- In the last 2-years, RBI has tightened many guidelines to ensure banks maintain sufficient liquidity to handle sudden cash outflows. So, the systemic LCR has declined to 130% in Dec'24 from 147% in Mar'22
- RBI has issued new LCR guidelines, which will be implemented from 01 April 2026, which may improve the LCR of banks by 6% points, at the aggregate level
- **This guidelines will free-up lendable resources by Rs 2.5-2.7 lakh crore, which will get headroom equivalent to 1.4-1.5% of additional credit growth**



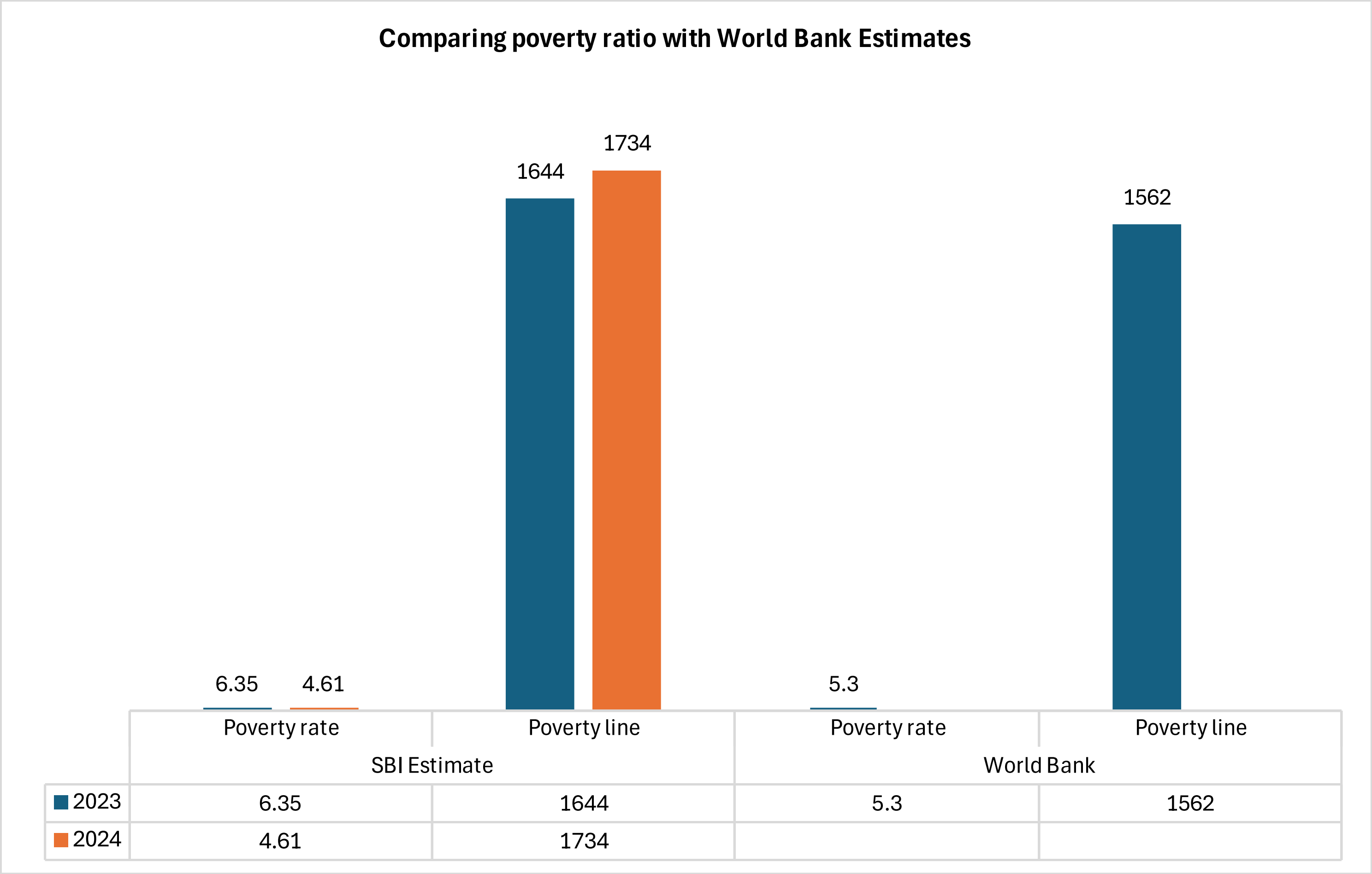
Indian economy outlook remains positive amidst uncertainty





- India's economy grew by 7.4% in Q4 FY25 with a overall growth of 6.4% in FY25
- Capital formation was the key drivers of growth along with private consumption
- Inflation is firmly with RBI limit of 4% +/- 2%
- The current focus of RBI is to support the momentum in capital formation for more durable growth

Poverty estimates by SBI and World Bank are remarkably similar…. SBI estimates it at 4.6% in 2024….down from 5.3% in 2023 as estimated by World Bank



	SBI Estimate: Poverty rate	SBI Estimate: Poverty line	World Bank: Poverty rate	World Bank: Poverty line
2023	6.35	1644	5.3	1562
2024	4.61	1734		

Recent estimates for poverty ratio for India are comparable with consumption-based estimates by SBI, making allowance for different in methods and definitions

US Non-Farm Payroll: Truth behind the numbers

- US Nonfarm Payrolls (NFP) came in at 139k (126k expected, 147k revised last) in May'25. The unemployment rate was unchanged at 4.2%. The labour force participation rate fell to 62.4% from 62.6% last month

- Revisions in the payroll numbers are something that need some analysis. In the last two months the net revision was -138,000. On average, the NFP report has been revised down by an average of 14% since Jan'24

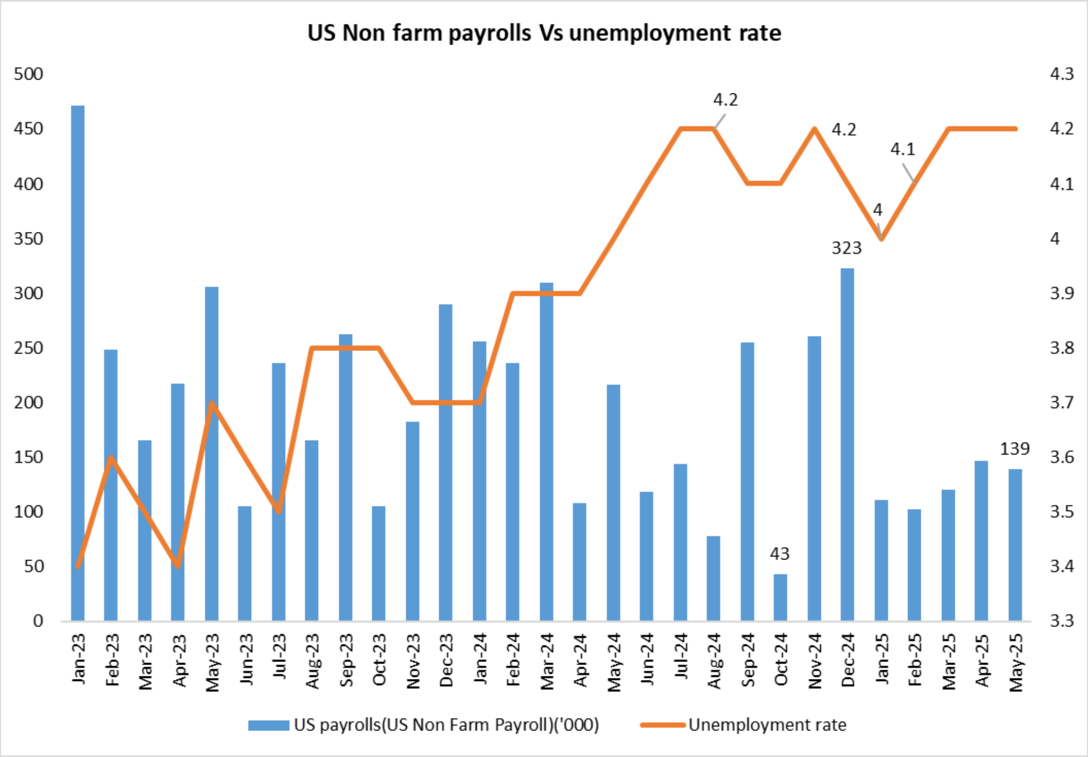
- The other slightly troubling data point is the Household survey showed a decline in people working by close to 700k. The Nonfarm Payrolls count how many jobs were added whereas the Household survey asks if someone is working. The fact that the number of people working fell, is another sign that the labour market is softening

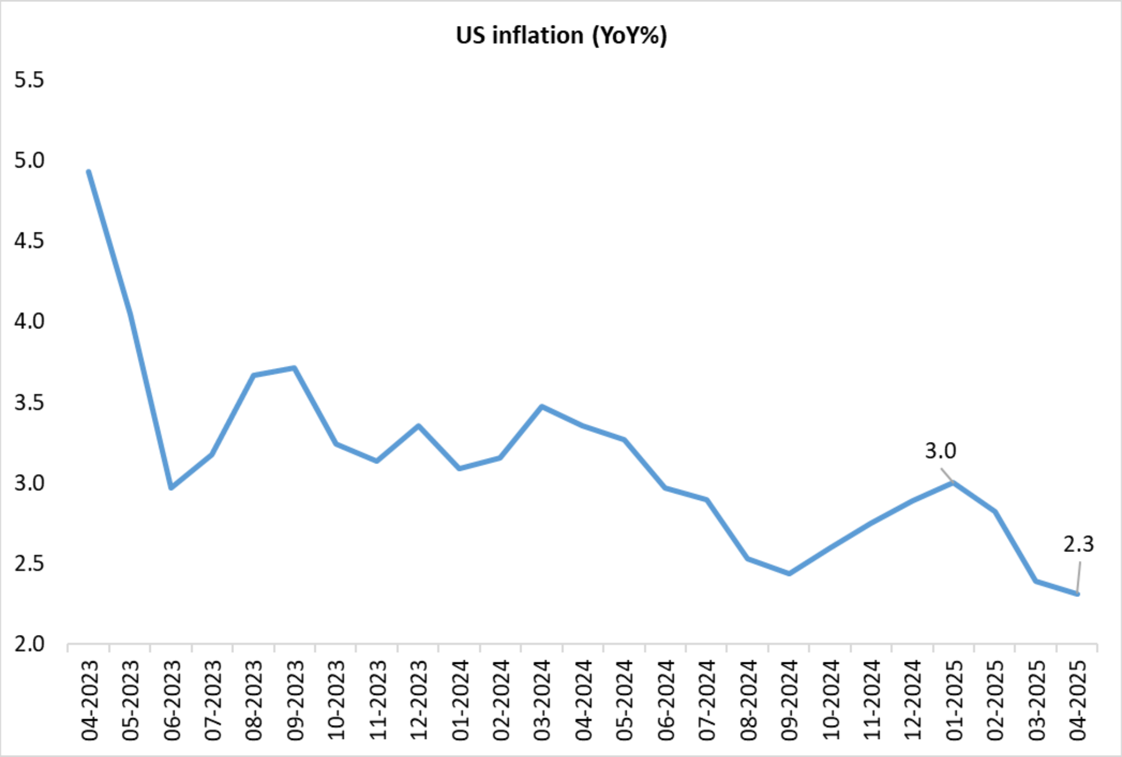
Nonfarm Payroll Employment:Revisions between over-the-month estimates (in '000)

Month	First Report	Revised Report	Change	Change %
Jan-24	353	256	-97	-27
Feb-24	275	236	-39	-14
Mar-24	303	310	7	2
Apr-24	175	108	-67	-38
May-24	272	216	-56	-21
Jun-24	206	118	-88	-43
Jul-24	114	144	30	26
Aug-24	142	78	-64	-45
Sep-24	254	255	1	0
Oct-24	12	43	31	258
Nov-24	227	261	34	15
Dec-24	256	323	67	26
Jan-25	143	111	-32	-22
Feb-25	151	102	-49	-32
Mar-25	228	120	-108	-47
Apr-25	177	147	-30	-17
May-25	139	-		

Source: SBI Research; Raymond James Fixed Income Research Ratings

Federal Reserve rate outlook, a pause in near term





- The US CPI inflation hovers close Federal reserve target of 2%
- The latest employment figures shows that the US labor market is cooling. However, the unemployment rates remains unchanged at 4.2% is below the median projection of 4.4% for 2025.
- Thus, while inflation is close to target there is risk of wage-price spiral on account of tight labor markets and higher wage growth
- Because of this the US Fed is expected to maintain a status quo in near future

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