

## All eyes on February: RBI set for another cut?

*The RBI is expected to deliver a further 25bp rate cut in February as inflation remains well below target, driven by soft food prices, stable commodity prices, and strong kharif and rabi crop output. Core inflation is also subdued, signaling limited demand-side pressures. MPC members in the December policy minutes highlighted that very low inflation compresses pricing power, may weigh on margins, and could dent investment, reinforcing the need for supportive monetary policy. Meanwhile, high-frequency indicators point to moderation in growth, particularly for MSMEs exposed to trade and tariff uncertainties. The December cut has already eased real rates, and with inflation projected to remain below ~4% in H1FY27, the February easing would provide additional support to consumption and investment without pushing real rates into overly accommodative territory.*

- **Rate cut with a neutral stance:** The RBI delivered a 25bp repo rate cut to 5.25% in Dec'25 while retaining a neutral stance, reflecting confidence in the inflation outlook but caution amid external and trade-related uncertainties.
- **Dissent on stance:** The rate decision was unanimous, but Prof. Ram Singh voted to shift the stance to accommodative, citing high real rates, a negative output gap, and risks from prolonged low inflation.
- **Rationale behind the cut:**
  - **Inflation at record lows:** Headline CPI fell below 1% for the second consecutive month in Nov'25, led by a sharp food price correction. Core CPI (ex-precious metals) at ~2.6%, signaling muted demand pressures.
  - **Growth peaking:** HFIs (PMI, IIP, and exports) suggest momentum peaked in H1FY26, with H2 moderation amid tariff and trade uncertainty affecting MSMEs.
  - **Supply-side comfort:** Strong kharif output, healthy rabi sowing, adequate reservoirs, and soft commodity prices anchor inflation expectations.
- **Outlook:**
  - **One more cut likely:** With inflation well below target and growth moderating, we expect a 25bp cut in February, supporting MSMEs amid trade and tariff pressures. We believe that inflation is likely to remain benign through 1HFY27, providing the MPC adequate space to prioritise growth support.
  - **Pause thereafter:** After February, the MPC may enter an extended pause, as real rates approach the neutral range and FY27 inflation nears ~4%, making further easing data-dependent.
  - **February policy key:** The MPC will review the new GDP and CPI series, which could influence growth, inflation, and terminal rate guidance.

- **Growth strong but past its peak:** While Q2FY26 growth surprised on the upside at 8.2%, members acknowledged that growth momentum has likely peaked in H1. The MPC expects moderation ahead, with GDP growth projected at 7.3% in FY26 and 6.7–6.8% in H1FY27. High-frequency indicators—PMI, IIP, exports, and business surveys—point to moderation since Oct'25. External headwinds, including trade and tariff-related uncertainty, were flagged as risks, particularly for MSMEs, which account for a large share of employment.
- **Inflation outlook dominates policy thinking:** The minutes repeatedly emphasize that benign inflation was the primary driver of policy action. CPI inflation is projected to average 2% in FY26 before mounting towards ~4% in FY27. Excluding precious metals, inflation is even lower, suggesting slack and a negative output gap. Some members flagged that very low inflation could hurt margins and investment, but the balance of risks favored growth support.

- **Transmission supportive:** MPC members observed that the cumulative 100bp of rate cuts over the past year have been transmitted effectively across the financial system. Lending rates have eased noticeably, leading to improved credit offtake, particularly for MSMEs and other growth-sensitive sectors. This has helped bridge the gap between policy intentions and real economy impact, supporting investment and working capital needs. Members highlighted that the smoother transmission underpins the effectiveness of monetary easing, ensuring that the benefits of lower policy rates are reflected in borrowing costs, consumption, and capex decisions across key sectors.

### One look Macro Snapshot: February policy in focus



## ■ Key statements by MPC members

**Dr. Nagesh Kumar:** “The economic activity appears to have peaked in 2Q... high-frequency indicators suggest a loss of momentum since October.”

“Very low inflation reflects a demand deficit and warrants policy support, especially to protect MSME employment.”

**Shri Saugata Bhattacharya:** “Inflation has persistently undershot forecasts, while growth projections point to a gradual deceleration.”

“Lower seller pricing power may not be conducive to investment decisions.”

**Prof. Ram Singh:** “Real interest rates remain excessively high even after the cumulative rate cuts.”

“Delaying easing will prolong the low-inflation phase and weigh on nominal GDP growth, profits, and investment.”

**Dr. Poonam Gupta:** “When inflation and its forecast are as low as they are currently, they ought to get a larger weight in monetary policy deliberations.”

**Shri Sanjay Malhotra:** “Low core inflation excluding precious metals indicates minimal demand pressures.”

“Retaining a neutral stance preserves flexibility in an uncertain and evolving global environment.”

## ■ Real rates and policy space:

- Despite the RBI’s Dec’25 cut, real interest rates remain slightly restrictive, particularly when measured against the RBI’s estimated neutral range of 1.4–1.9%. With headline CPI expected to remain below 4% in H1FY27, the implied real policy rate is projected to move closer to the neutral range, creating a narrow window for further easing.
- This provides a rationale for a possible 25bp rate cut in Feb’26, aimed at supporting growth, especially for MSMEs and sectors affected by trade and tariff-related uncertainties. Beyond that, additional cuts will depend on whether inflation continues to print below expectations and whether growth momentum weakens further.

**Exhibit 1: Implied real rate table**

Period	Repo rate (%)	CPI inflation (%)	Implied real rate (%)	Policy signal
<b>FY26 (avg)</b>	5.25	2	~3.2	❖ Real rates are clearly restrictive; the December cut is justified
<b>3QFY26</b>	5.25	0.6	~4.6	❖ Peak real tightness amid food deflation
<b>4QFY26</b>	5.25	2.9	~2.4	❖ Restrictiveness is easing gradually
<b>1QFY27</b>	5.25	3.9	~1.3	❖ Real rates fall below the RBI neutral range; room for potential easing
<b>2QFY27</b>	5.25	4	~1.25	❖ Policy is near neutral; further cuts are conditional on growth & inflation
<b>RBI neutral range</b>	—	—	1.4–1.9	❖ Reference band for neutral real policy rate

## Inflation Compass: What it means for rates?

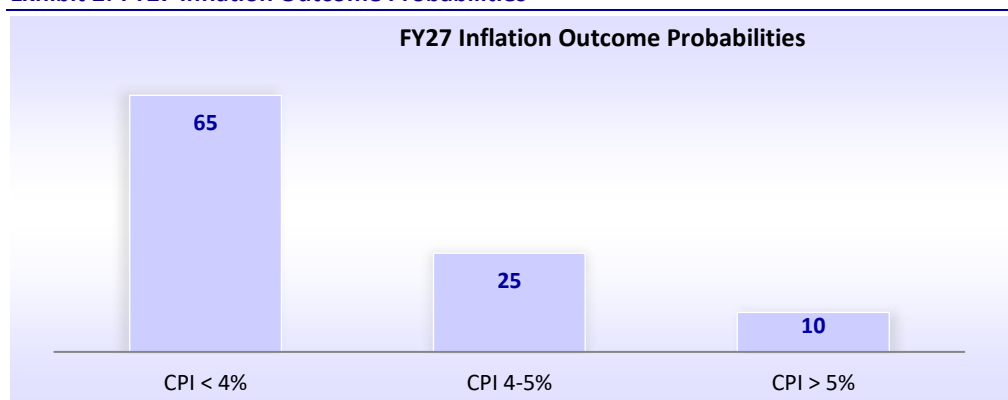
**Base case:** With a high likelihood (60–65%) that inflation stays below 4% through H1FY27, the balance of risks supports one additional rate cut in February, followed by a prolonged pause. This scenario is underpinned by soft food prices, comfortable supply conditions and subdued core inflation, allowing the RBI to support growth without compromising price stability.

**Upside inflation risk:** If inflation gradually moves into the 4–5% range in H2FY27 (25–30% probability), the MPC is likely to stay on hold as policy approaches neutrality.

**Tail risk:** A sharp inflation spike above 5% remains a low-probability, event-driven risk (5–10%), which could reintroduce a tightening bias, though this is not the base case.

**Bottom line:** February represents the most likely—and potentially final—easing opportunity in the current cycle.

**Exhibit 2: FY27 Inflation Outcome Probabilities**



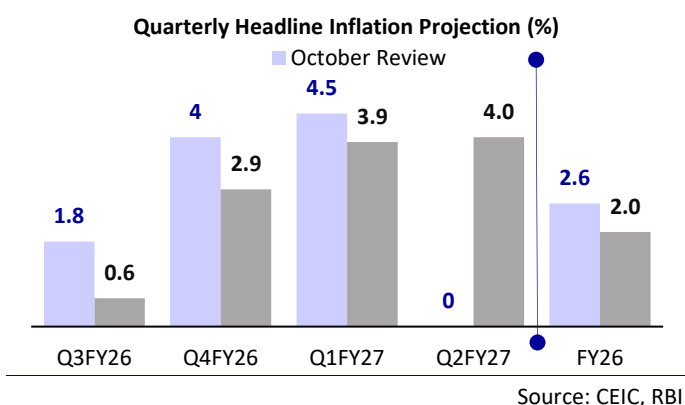
**Exhibit 3: Inflation risk probability matrix**

Scenario	Probability	Likely Period	Policy Response
CPI <4%	60–65	H1FY27	Feb cut + pause
CPI 4–5%	25–30	H2FY27	Extended pause
CPI >5%	5–10	Event-driven	Tightening bias

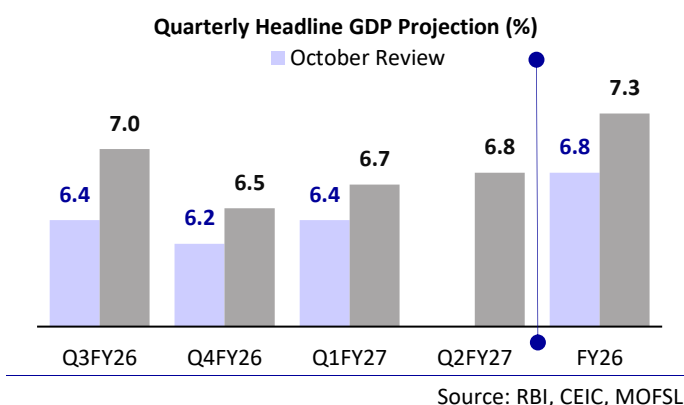
## ■ Outlook:

- **One more rate cut likely:** With inflation projected to remain well below target through FY26 and growth momentum moderating, the MPC has clearly pivoted toward growth support, albeit without committing to a pre-defined rate path. We expect one additional 25bp rate cut in the February policy, as inflation prints are likely to remain benign and growth risks tilted to the downside, particularly for MSMEs amid trade and tariff-related uncertainties.
- **Pause thereafter:** After the expected February rate cut, the MPC is likely to move into an extended pause, as the real policy rate would fall close to or below the RBI's estimated neutral range. With inflation expected to rise towards ~4% in FY27, further easing would risk pushing real rates into accommodative territory, making future policy actions increasingly data-dependent.
- **Feb'26 policy crucial:** The upcoming meeting will be important as the MPC assesses the impact of the new GDP and CPI series on headline growth and inflation, which could influence the assessment of slack and the terminal policy rate.

**Exhibit 4: RBI inflation projections – Oct vs. Dec policy**



**Exhibit 5: RBI GDP projections – Oct vs. Dec policy**



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