JM FINANCIAL

# RBI MPC Preview

## Wade through uncertainty with a pause

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The delay in finalising the trade deal with US has heightened uncertainty further. The MPC's larger than expected rate cut in June makes sense in hindsight, as reflected in the uptick in credit growth in July, however there is limited scope for further policy easing. We expect downward revision in inflation expectation for Q2 as well as FY26 atleast by 20bps. The downside risk to RBI's inflation expectation would allow the RBI to ease, as indicated by the governor, however we believe that the MPC would have to effectively time the incremental rate cuts. The "neutral" policy stance would even restrict RBI's ability to deliver policy easing in stealth mode. Hence we expect the MPC to wade through the uncertainties with caution and maintain status quo on policy rates in August.

- Limited room for policy easing: The MPC will meet in the backdrop of a not so favorable tariff rate with the US despite multiple rounds of negotiations. In hindsight, the larger than expected 50bps rate cut in June makes sense now. But is there space for further policy easing? If RBI delivers a rate cut now, how would it respond if the tariff uncertainty intensifies going forward? The policy statement for June MPC had indicated that there is limited space for further policy easing. However RBI governor in his recent speeches has hinted that moderation in inflation below the central bank's projection would open up space for further policy easing. The bond markets on the other hand are building an end to the rate cut cycle, as is evident in the uptick in benchmark yields ~10bps to 6.37% post the MPC meet in June.

- Surplus liquidity in the system: Liquidity in the system continues to remain in surplus (INR 4.1Tn) as on 3rd Aug. This is significantly higher than the 1% of NDTL which the RBI is comfortable maintaining. The RBI has been actively fine tuning liquidity in the system with the announcement of VRRRs and VRRs in July, collectively to the tune of INR 10.25Tn (Ex 3). Although the main aim of the liquidity fine tuning was to align the call rates with the Repo rate, the call rates (5.05%) have moderated below the lower end of the policy corridor (Ex 2). The "neutral" policy stance would mean that the liquidity fine tuning will continue. Announcement of higher tariff led to steep depreciation in INR last week. The depreciating bias in USD also reverted in last week, exerting pressure on EM currencies. INR depreciated 2.4% in the month of July, and the latest penalty threat propelled INR to 87.9/ USD levels.

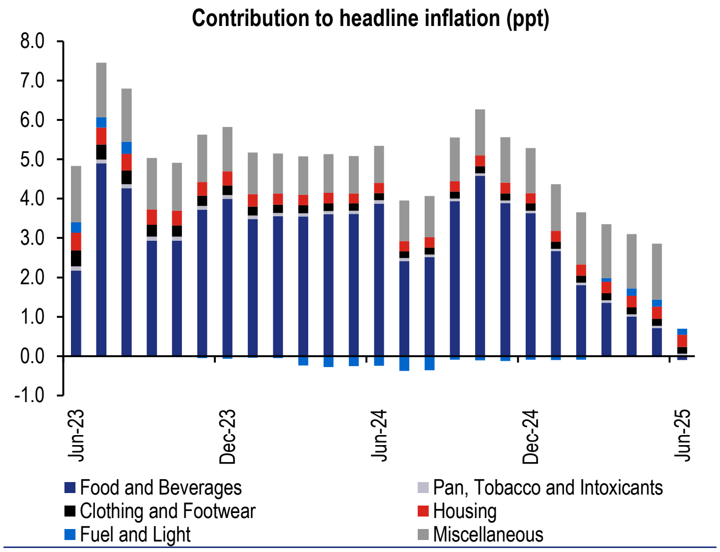
- Downside risk to Inflation expectation: Inflationary pressures continue to ease, on the back of deflationary forces in the food category. July month's CPI inflation is expected to moderate further lower to ~1.4% due to base effect as well as the deflationary forces in food category. CPI inflation averaged 20bps lower (2.7%) than MPC's expectation in Q1FY26. We see downside risk to MPC's Q2 FY26 inflation expectation of 3.4%, hence MPC is likely to revise down its inflation expectation for FY26 to atleast 3.5%. Credit growth seems to have bottomed out in July and the improvement was broad based across segments except agriculture. Pickup in credit growth hints at the transmission in the system.

- Expect a pause in August: The 25% tariff imposed on India by US has been significantly higher than the peer countries (Ex 9). Moreover the risk of an unspecified penalty for trading in Russian crude oil would negatiely impact India's trade activity. This uncertainty would hamper RBI's ability to effectively deliver its policy decision, as a rate cut would leave limited to no room for further policy easing in later part 2025. US markets are also factoring in accelerated incremental rate cuts (75bps) after the weaker than expected payroll numbers in July. MPC delivered its policy decision in June with a vote of 5:1, however majority had indicated of limited room for policy easing going forward. Hence we expect the MPC to pause in August and wade through the uncertainty around tariffs with caution. However we would not be surprised if the MPC decides to deliver a rate cut (25bps), but the chances of that would be slim.

### Key Highlight

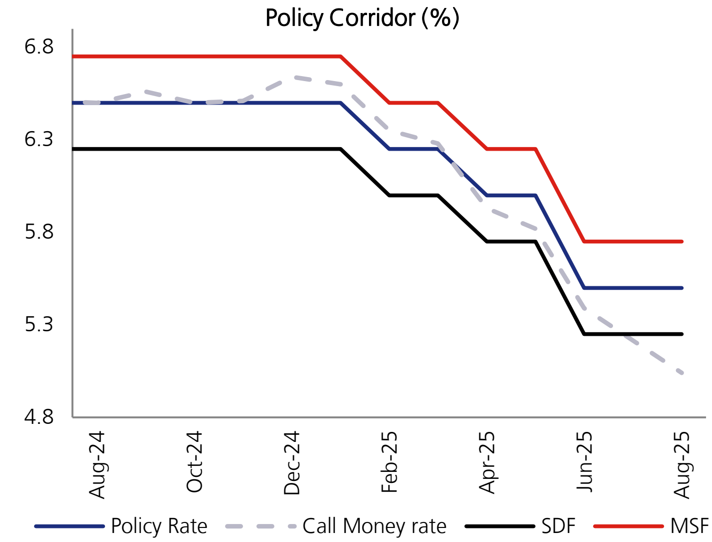
- Lower than expected inflation to open up room for policy easing.
- Expect downward revision in inflation expectation
- Neutral policy stance restricts RBI's ability to ease in stealth mode.
- RBI will have to effectively time the rate cut.
- We expect status quo on policy rates in August.

Exhibit 1. Deflationary forces in food aided CPI inflation




Source: MOSPI, JM Financial

Exhibit 2. Call rates eased below the policy corridor



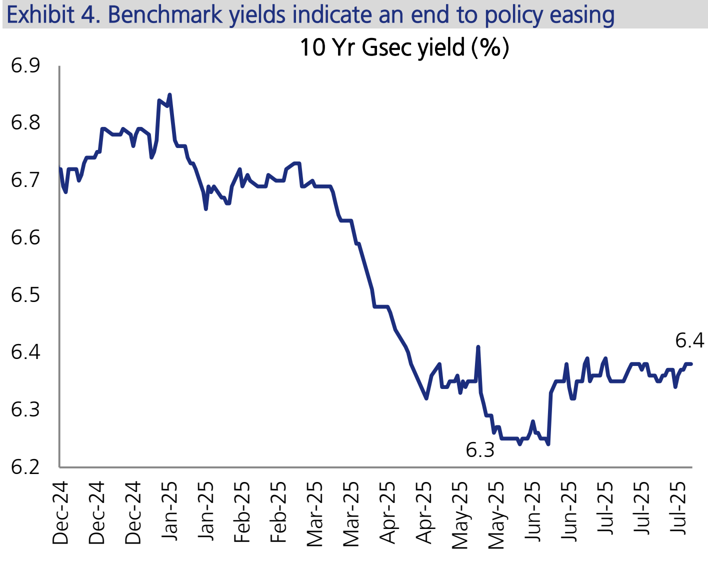

Source: CMIE, JM Financial

Exhibit 3. Liquidity fine tuning by RBI in July

| Date | 4-Jul | 9-Jul | 11-Jul | 14-Jul | 18-Jul | 23-Jul | 24-Jul | 25-Jul | 29-Jul | 1-Aug | Sub Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Announced | 1,00,000 | 1,00,000 | 2,50,000 | 1,00,000 | 2,00,000 | -50,000 | -50,000 | 1,25,000 | 50,000 | 2,00,000 | 10,25,000 |
| Offers accepted | 1,00,010 | 97,315 | 1,51,633 | 57,450 | 2,00,000 | -50,001 | -1,421 | 1,25,008 | 46,058 | 1,71,795 | 8,97,847 |
| Cut off Rate (%) | 5.47 | 5.49 | 5.49 | 5.49 | 5.49 | 5.53 | 5.51 | 5.49 | 5.49 | 5.49 | |

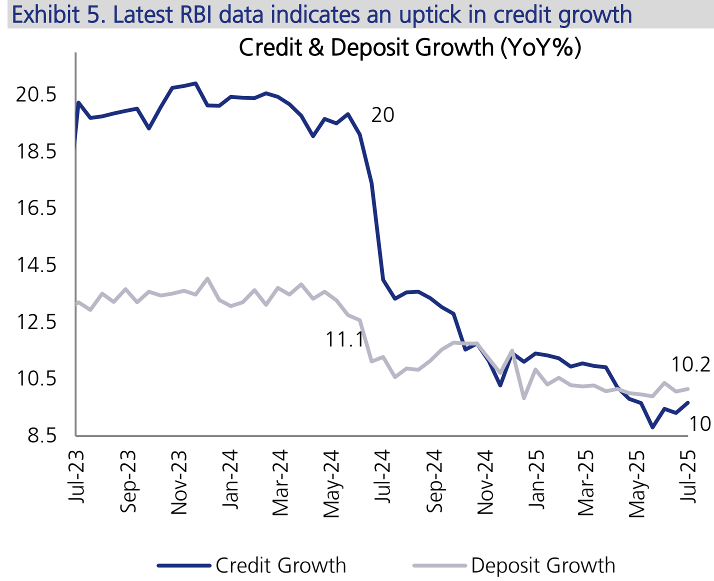
Source: RBI, JM Financial | negative figures denotes VRR

Exhibit 4. Benchmark yields indicate an end to policy easing



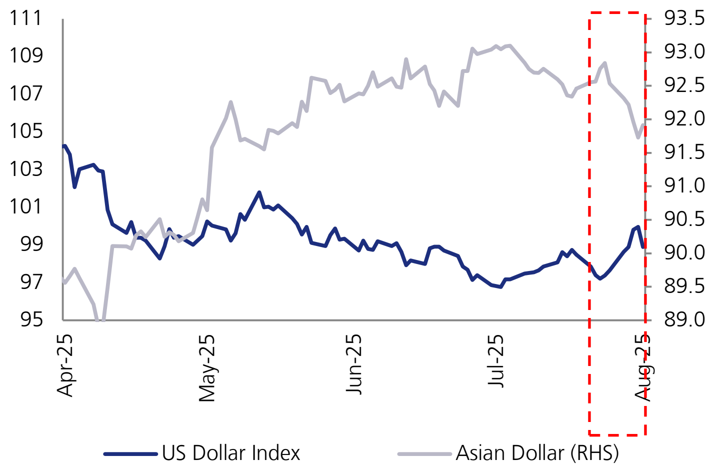

Source: CMIE, JM Financial

Exhibit 5. Latest RBI data indicates an uptick in credit growth



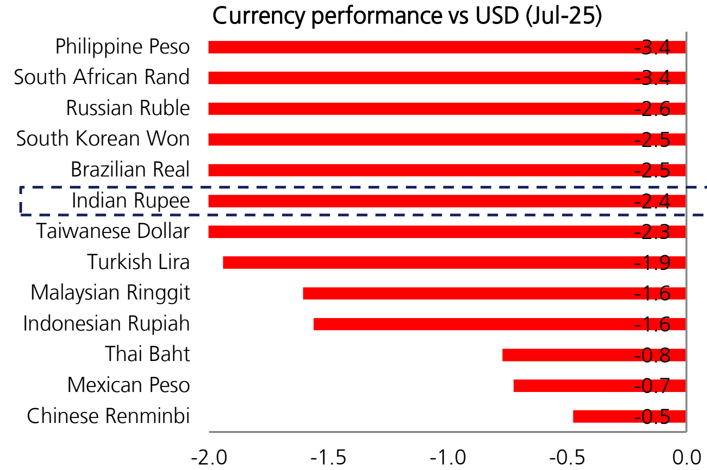

Source: CMIE, JM Financial

### Exhibit 6. Strengthening USD exerted pressure on EM currencies



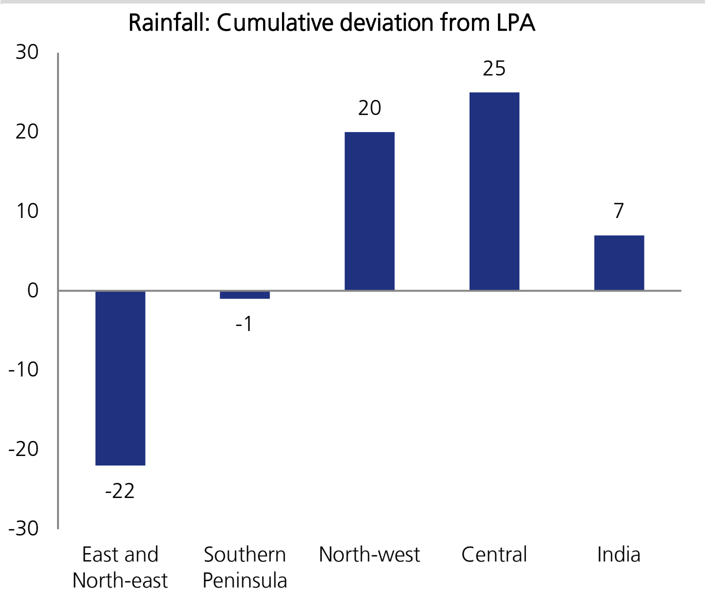

Source: Bloomberg, JM Financial

### Exhibit 7. Which reflected in INR's steep depreciation in July




Source: JM Financial

### Exhibit 8. Deficient rainfall in North east and south




Source: CMIE, JM Financial | As on 31st July

### Exhibit 9. US tariffs on India higher vs its peers

| Countries | Reciprocal Tariffs |
|---|---|
| India | 25% |
| Bangladesh | 20% |
| Sri Lanka | 20% |
| Taiwan | 20% |
| Vietnam | 20% |
| Cambodia | 19% |
| Indonesia | 19% |
| Malaysia | 19% |
| Pakistan | 19% |
| Philippines | 19% |
| Thailand | 19% |
| South Korea | 15% |
| Brazil | 10% |

Source: White house, JM Financial

# APPENDIX I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|---|---|
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