

RBI Policy Preview: Rate Cut Still a Possibility

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December Rate Cut Looks Likely

The upcoming December monetary policy meeting will be shaped by a sharp decline in inflation, a notable pickup in growth momentum, and persistent external headwinds. While the domestic economic environment remains broadly resilient, the continued imposition of higher 50% tariffs on Indian exports to the U.S. amid prolonged trade negotiations is a key concern. Globally, long-term risks stemming from geopolitical conflicts, financial stability concerns from stretched asset valuations, and rising pressure in sovereign bond markets amid elevated borrowing remain important factors to monitor.

However, the RBI is likely to take comfort from the sharp moderation in India's inflation, which eased to a decadal low of 0.3% in October. The favourable impact of GST rationalisation and deflation in the food and beverages category contributed significantly to the subdued inflation print. We expect inflation to remain below the 4% threshold in both the third and fourth quarters of the fiscal year. Factors such as stable Brent crude prices, healthy reservoir levels supporting rabi sowing, and muted price pressures arising from excess capacity in China should help prevent any sharp rise in inflation. This decline in inflation has created policy space for the RBI to consider rate cuts.

While inflation has been comfortably low, growth momentum has strengthened considerably. The GDP growth accelerated to 8.2% in Q2 after expanding by 7.8% in Q1 FY26. This improvement has been supported by robust agricultural activity, a reduced income tax burden from the previous budget, rationalised GST rates, past RBI rate cuts, an early festive-season boost to consumption, and front-loaded exports. Moreover, the GDP growth was also bolstered statistically by the low base of the previous year and the very low deflator in this period.

Although GDP growth averaged 8% in H1, we expect it to ease to around 7% in H2 as the boost from front-loaded exports fades and post-festival consumption moderates. By Q4 FY26, the impact of the low base will diminish, and the GDP deflator is also expected to rise from its currently depressed levels. For the full year FY26, we project GDP growth at a still healthy 7.5%.

Given the anticipated moderation in growth momentum in the second half, uncertainties surrounding the prolonged trade negotiations with the U.S., and the significant decline in inflation, we expect the RBI to adopt a forward-looking approach and deliver a 25-bps repo rate cut in the December policy meeting. Additionally, CPI inflation is expected to average around 3.7% over the next 12 months (Dec'2025–Nov'2026). At the current repo rate, this would place the real policy rate at roughly 1.8%—above the estimated neutral range of 1–1.5%—thereby indicating scope for a 25-bps rate cut.

The RBI to Lower Inflation Projection

The CPI inflation continued to stay on a downward trajectory, easing to 0.3% in October 2025. The positive impact of the GST rationalisation and deflation in the food and beverages category supported the lower inflation print. Deflation in the food basket deepened further to 3.7% in October, from 1.4% the previous month. A further acceleration in the already double-digit inflation in precious metals pushed core CPI to 4.4% in October. Excluding precious metals, core CPI inflation was benign at 2.5%. Inflation has likely bottomed out in October, but we

estimate it remains benign, averaging 0.9% in Q3 before rising to an average of 3.1% in Q4FY26. Factors such as stable Brent crude prices, GST cuts, healthy reservoir levels supporting rabi sowing, and muted price pressures arising from excess capacity in China should help cap upside in inflation.

Within the food basket of CPI, deflation widened in items such as vegetables (-27.6% YoY), pulses (-16.2%), and spices (-3.3%) in October. While inflation in edible oils witnessed some moderation, it continued to record double-digit inflation at 11.2% capping a further downside in overall food inflation. This trend remains a critical monitorable, particularly as global vegetable oil prices remain elevated, as reflected in the FAO Global Vegetable Oil Price Index, which rose 10.9% YoY in October. Furthermore, Kharif sowing of oilseeds has also been subdued, which could extend inflationary pressures in this category. Overall, we expect food inflation to remain at moderate levels, supported by healthy agricultural activity, comfortable reservoir levels

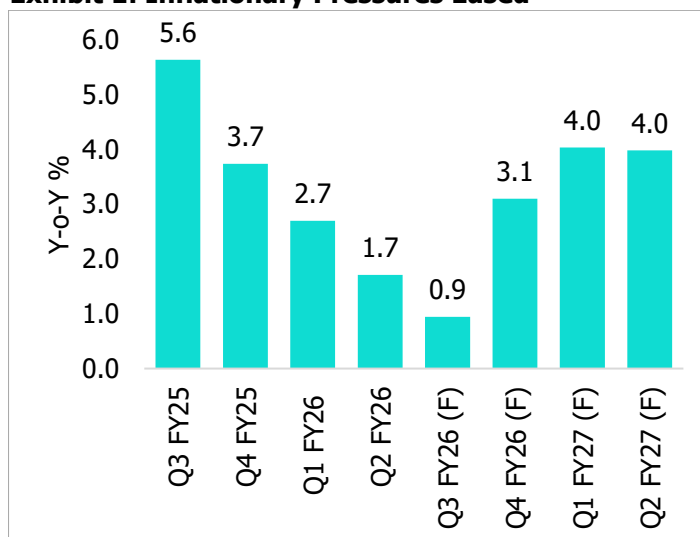
and a favourable base. With food inflation subdued, we project an average inflation rate of 2.1% for FY26 and core inflation at 4.1%. RBI revised its CPI inflation forecast for FY26 to 2.6% in October, down from an earlier projection of 3.1%. We expect the RBI to further revise down its inflation projections to around 2.1% in the December policy meeting. Given the low base of FY26, we expect average CPI inflation to be higher, around 4.1% in FY27. Additionally, the forthcoming introduction of the new CPI series with a 2023-24 base year will be an important development to watch.

On the external front, global commodity prices are expected to remain broadly benign, given weak global growth prospects and overcapacity in China. However, it would be crucial to monitor geopolitical developments, such as US-Venezuela tensions and the war in Ukraine. OPEC+ alliance has this week decided to leave output levels unchanged for the first quarter of 2026 amid a looming market surplus and geopolitical uncertainty around Russia and Venezuela. The WPI inflation has remained in deflation in October (-1.2%) and is expected to average -0.1% in FY26.

RBI to Revise Growth Projections

Despite external headwinds, the Indian economy has shown resilience with a strong uptick in growth momentum in the H1. GDP growth accelerated to 8.2% in Q2, after growing 7.8% in Q1 FY26. Healthy agricultural activity, reduction in income tax burden in the previous budget, rationalisation in GST rates, previous RBI rate cuts, early festive season consumption boost, healthy services exports and front-loading of merchandise exports have bolstered the overall economic momentum. Moreover, there is statistical impact of low base of last year, and the low deflator that has pushed up the GDP growth number in Q2. On the expenditure side, growth in private final consumption expenditure accelerated further to 7.9% in Q2 from 7.0% in Q1. Several factors such as reductions in the income tax rate, GST rate rationalisation, and the easing inflationary pressures have boded well for the consumption growth. While rural demand conditions remain steady, a broadbased momentum in the domestic demand scenario remains critical for domestic growth going forward.

Exhibit 1: Inflationary Pressures Eased



Source: CareEdge Projections

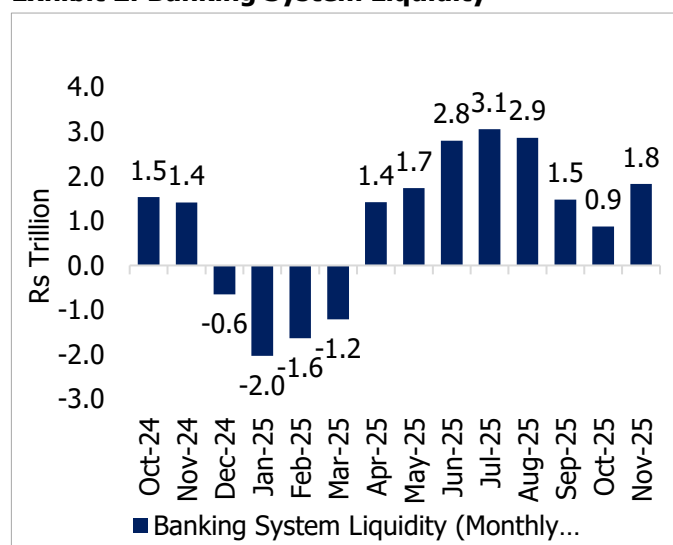
While government capex has remained strong led by both states and centre, there are early signs of revival in the capex by the Indian corporations which bode well for the overall investment growth. Major sectors like agriculture (3.5% growth), manufacturing (9.1%), construction (7.2%) and services (9.2%) have shown healthy momentum in Q2. However, the mining sector was impacted by the prolonged monsoon this year.

While, growth remained strong in H1, we expect some moderation in the growth momentum in H2. We expect the GDP growth to moderate to around 7% in H2 (vs 8% in H1) as the impact of front loading of exports fades and consumption demand moderates post festival season. By the fourth quarter of FY26, the low base effect will wane, and deflator will also increase from the current low levels. However, for the full year FY26, we estimate the GDP growth number to remain strong at 7.5%, mainly supported by strong H1 growth. Even with the trade related uncertainties lingering, we expect GDP growth at around 7% in FY27. Given the strong growth performance in H1, the RBI is likely to revise its FY26 growth forecast to around 7.5%, up from the earlier projection of 6.8%.

RBI to Support Liquidity Conditions

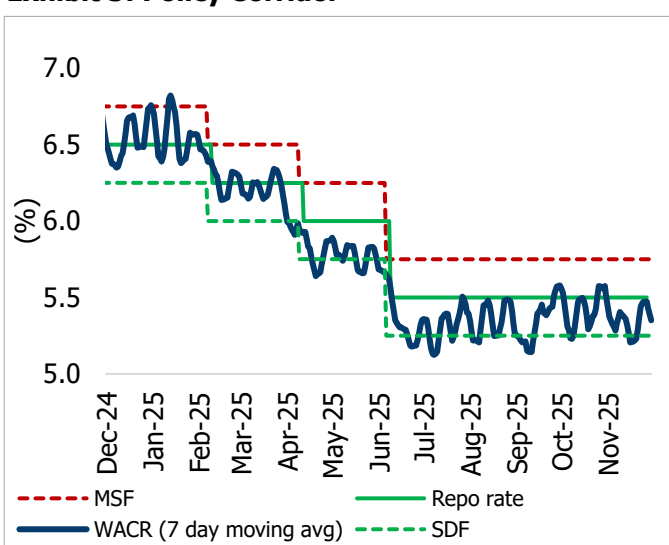
Currently, the banking system liquidity surplus stands at Rs 2.4 trillion (as of 1st Dec 2025), equivalent to about 0.95% of NDTL. The average systemic liquidity in November 2025 rose to Rs 1.8 trillion from Rs 0.9 trillion in October 2025. The liquidity surplus had narrowed in October amidst tax outflows and the RBI's intervention in the forex market. However, RBI's VRR auctions, last tranche of CRR cut (injecting ~Rs 600 billion in end November) and RBI's OMO purchases in the secondary market (Rs 273 billion as of mid-November) are likely to support liquidity conditions.

Exhibit 2: Banking System Liquidity



Source: RBI, CEIC, CareEdge.

Exhibit 3: Policy Corridor



With the liquidity support, average call money rate has largely remained below the repo rate in the month of November. We expect the RBI to support liquidity conditions, keeping them in surplus (1-1.5% of NDTL). Surplus liquidity conditions would continue to ensure smoother transmission of the policy rates. We expect that the RBI will continue to ensure favourable money market conditions and support credit growth.

External Sector Remains Resilient Despite Headwinds

The external environment continues to be a key source of headwinds for the domestic economy. The IMF's October projections indicate a slowdown in global economic growth to 3.1% in 2026, down from 3.2% in 2025. Geopolitical

risks remain elevated, with U.S.–Venezuela tensions and the ongoing war in Ukraine. Trade policy uncertainties also persist, as India continues to face a 50% tariff on exports to the U.S. amid prolonged trade negotiations. Additionally, financial-stability concerns stemming from stretched asset valuations and rising pressures in sovereign bond markets—particularly in highly leveraged economies such as Japan—continue to weigh on global financial markets.

Foreign portfolio investor (FPI) outflows from the equity market resumed in November (–USD 425 million as of 28 November), following a brief return to inflows in October after three consecutive months of outflows (July–September). Meanwhile, Indian government bond market global index inclusion has supported steady FPI inflows into the debt market over the past five months. So far in FY26, the debt market has recorded a net inflow of USD 2.7 billion, while the equity market has seen outflows of USD 2.9 billion (as of 27th November). Recent rate cuts by the U.S. Federal Reserve have helped contain further outflows. We expect the Fed to cut rates by another 25 bps at the December policy meeting in response to rising unemployment and weakening labour market conditions.

FDI inflows, have strengthened relative to last year. Net FDI inflows (gross inflows minus repatriation/disinvestment and FDI by India) increased to USD 7.6 billion in Apr–Sep FY26, up from USD 3.4 billion in the same period of FY25. A 16.1% YoY rise in gross inflows so far in this fiscal year has supported this improvement. Nevertheless, given the global uncertainty, overall FDI activity is expected to remain somewhat subdued.

The rupee depreciated by around 1.6% against the U.S. dollar over the past month, driven largely by delays in the U.S.–India trade deal, weak equity FPI flows, and a widening trade deficit. However, RBI intervention and optimism surrounding India's potential inclusion in the Bloomberg Global Aggregate Index helped limit the downside. On a REER basis, the rupee appears undervalued, suggesting some room for medium-term appreciation. We forecast USD/INR at around 87 by the end of FY26, supported by expectations of further Fed rate cuts, a stable yuan, a manageable CAD, and progress on the U.S.–India trade agreement.

Despite recent challenges, India's external position remains resilient. Foreign exchange reserves have risen by USD 27 billion so far in this fiscal year, reaching USD 693 billion as of mid-November. We expect the CAD to remain manageable at around 1% of GDP in FY26, supported by better-than-expected goods export growth, benign crude oil prices, and healthy services exports. We project non-oil goods exports to grow by about 2.5% in FY26, while services exports are expected to expand by roughly 8.5%. High FX reserves, a manageable CAD, and recent dollar weakness continue to provide a buffer against rising external headwinds.

Way Forward

Despite strong growth momentum, we believe that there is a possibility of a 25-bps rate cut by the RBI in December. The subdued inflation prints have created a space for the RBI to consider a rate cut amidst global uncertainties. On the growth front, the MPC will consider that part of the robust H1 growth was supported by statistical factors, including a favourable base and a low deflator. Moreover, the GDP growth is expected to moderate in the second half of the year. The prolonged tariff negotiations with the U.S. add to the external headwinds. With likely 25 bps rate cut, we expect the MPC to maintain its neutral stance, signalling a likely end to the current easing cycle. However, if the RBI chooses to not cut the policy rate amidst strong GDP growth data, the Governor will opt for a dovish tone to keep the option open to cut later.

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