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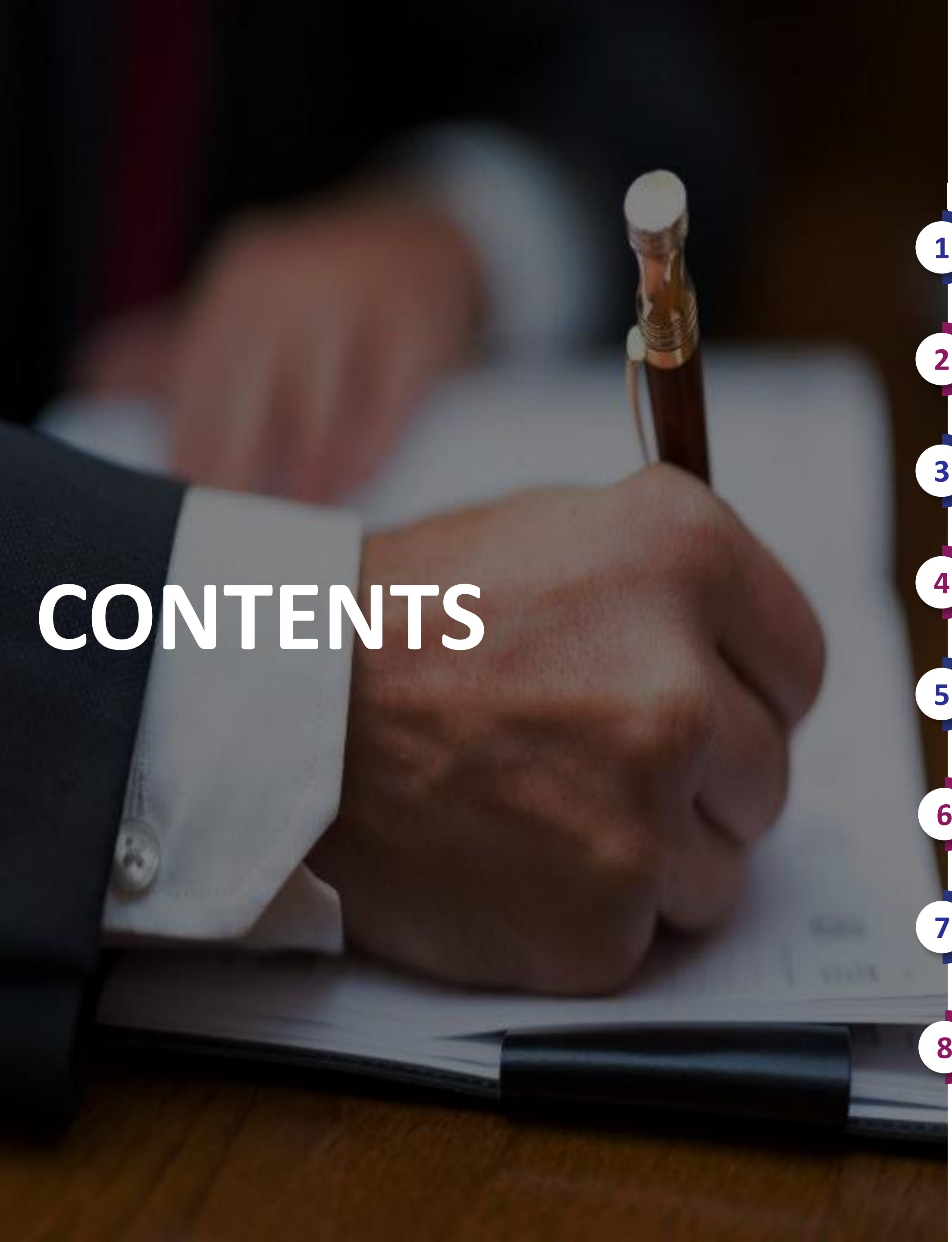
RBI MONETARY POLICY UPDATE

Inflation Battle Turns Into A Campaign For Growth

JUNE 2025



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EXECUTIVE SUMMARY (1/2)

De-escalation on the fast track: RBI salutes growth goals, slashes the repo rate to 5.50% and signals early conclusion of rate cut cycle

Frontloading policy action, the RBI's MPC resolved to reduce the repo rate by 50bps by a 5-1 vote. This decision was supported by lower inflation risk amidst continued uncertainty from global factors clouding growth. The Governor was categorical that the price mandate does not mean the RBI is challenged to use its tools to support growth and credit offtake. For the latter, the CRR has also been slashed by 100bps to 3%, potentially releasing Rs. 2.5 trn for credit needs.
The stance was changed to "Neutral" from "Accommodative". Given the stance indicates the direction of future policy and the statement reading that "policy has left with very limited space to support growth" this could mean a swift end to the cut cycle. Consequently, we anticipate future policy decisions to be data driven, with at max ~25bps of additional rate cuts.

Battle against inflation is over as downside risks dominate: global factors and an enormous food basket aiding the descent

The outlook for consumer prices stands significantly changed, epitomised by a 6-year low CPI print in Apr'25. A tariff pause has given time for global supply chains to readjust. The possibility of India getting a trade deal before China is high and its impact may be disinflationary as China dumps in non-US markets. At the same time, deceleration in global growth is expected to impact demand, leading to cooling commodity prices. Brent below USD 70/bbl bodes well, though its impact is usually indirect modulated through a web of levies. Finally, superior foodgrain production in FY25 and above-normal monsoon in FY26, will curb food inflation, which was an irritant through FY25. Accordingly, the RBI adjusted its CPI projection for FY26 down sharply to 3.7% y/y (earlier 4%). *We follow suit, slashing CPI forecast for FY26 to 3.9% y/y, though 20bps higher owing to potential risk from global factors and uneven spatial and temporal distribution of rains*

Domestic exuberance defends the growth front though global ghosts and reluctant private capex could be a chink in the armour

FY25 real GDP clocked 6.5% y/y, in line with forecast, with an exuberant Q4FY25 and robustness in indicators such as GST collections and Fastag revenues in early FY26 indicating that the momentum continues in Q1FY26. Private consumption surprised on the upside, and tax breaks for urban middle class combined with monsoon-driven rural prosperity promise succour in FY26 too. GFCF revived in Q4 against all odds and GFCE has ample scope for growth on a low base in FY26.
However, significant risks cloud this optimism. The carry over from the global glut could start hitting India, especially in H2FY26. Early signs can already be seen in poor hiring by IT majors despite no tariff impact on services. However, more than the direct impact, indirect impact due to unprecedented volatility in global investment environment is the cause of worry. NSO's survey shows that private capex intent is set to tank by 26% y/y in FY26 – this would more than offset any gains from GFCF. Accordingly, we retain our *FY26 GDP forecast of 6.2% real and 9% nominal growth, both below levels seen in FY25*

EXECUTIVE SUMMARY (2/2)

External front is volatile as INR carefully treads the line of control

Current account balance was manageable in FY25. FY26 could see some volatility with sudden realignments in global asset class allocations impacting capital flows into India. ECBs are expected to fare no better as rate differentials worsen as India cuts faster than the US. Further, EM currencies remain vulnerable as always. These factors will be offset partially by a moderation in trade deficit helped by petroleum imports and a hefty forex buffer standing guard. In the near term, the RBI is unwinding its hefty net short position on currency, which has reversed some of the recovery seen in the INR. On balance, *we expect that the INR would depreciate gradually, though many risks have aimed their guns towards the external front*

RBI continues to use heavy artillery to keep the system awash with liquidity

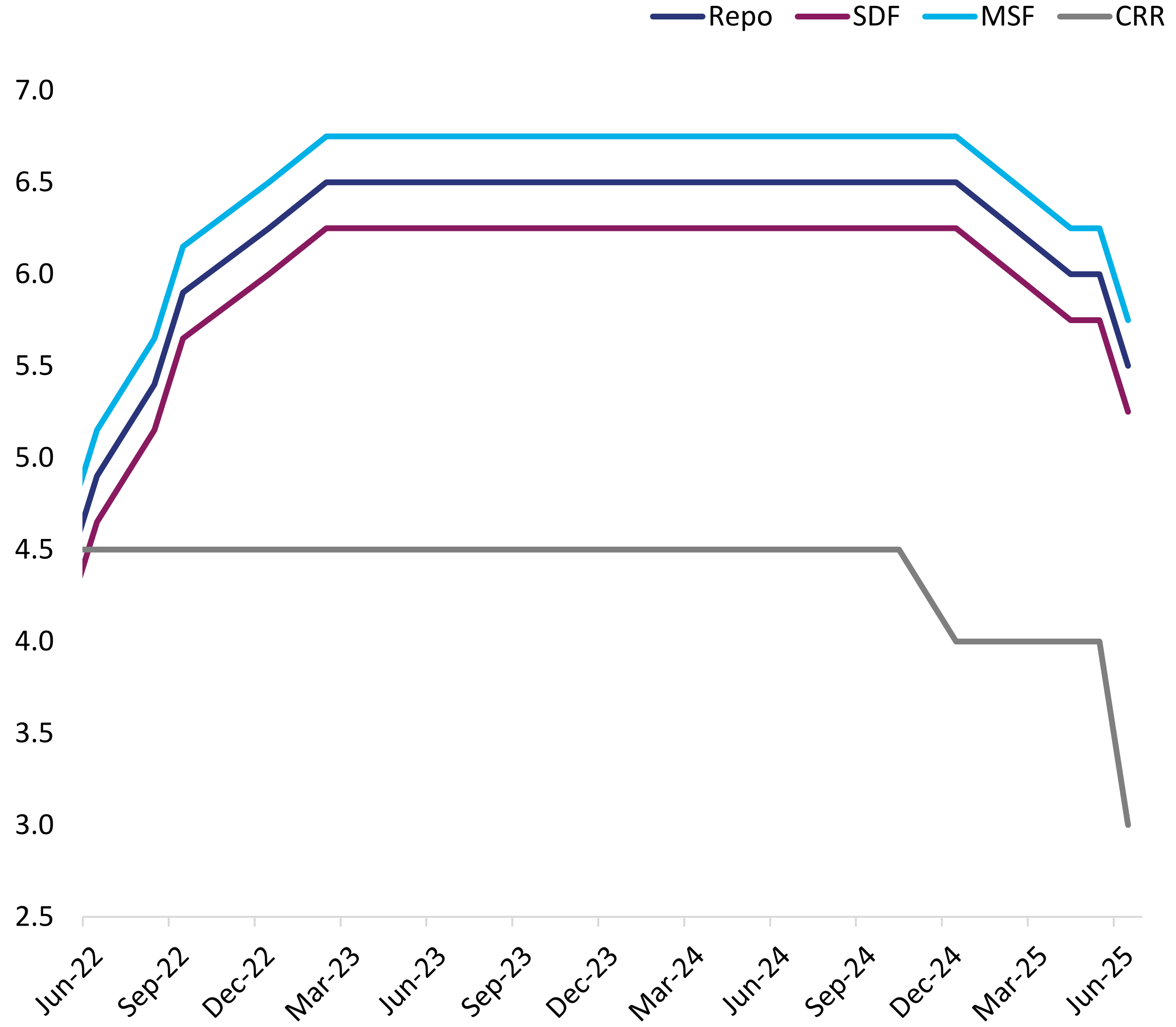
The Central Bank continues to keep liquidity in surplus, with a total of ~Rs. 9.5 trn of durable liquidity being injected since Jan'25. The CRR cut of 100 bps in 4 tranches of 25bps starting Sep'25 is expected to infuse another Rs. 2.5 trn by Dec'25. The flush liquidity has ensured effective transmission of rates, and this is best exemplified by the fact that WADTDR (fresh) has moved down ~30bps and WALR (fresh) has moved down ~18 bps, which is above usual for this point in cut cycle [between Feb'25 and Apr'25]. *Due to surplus liquidity and front-loading of rate cuts and potential CRR cut, transmission to lending and deposit rates would be swifter.*

Yields saw a peaceful descent though we may be nearing the trough

There has been a decline in 10Y Union G-sec bond yields by ~50bps from the beginning of 2025 to ~6.20% levels. Shorter tenor yields have dropped more precipitously (for instance 3Y G-sec has dipped by 1pp), creating a steeper yield curve than before. In the aftermath of the policy, yields remained flattish as the news of an outsized rate cut and CRR dip was offset by change in stance. *The rate cut cycle is likely near the end, with at most ~25bps of cuts left in the magazine.* Further, *the broader outlook remains sensitive to currency volatility and the RBI's operations. Given the higher risk premium, credit spreads—especially for AA-rated and below bonds—may widen slightly compared to last year as investors demand higher risk premia*

RBI OPTS FOR OUTSIZED CUT, SIGNALS END OF CUT CYCLE

KEY RATES (%)



STANCE OF POLICY

DATE	STANCE	VOTE
04-May-22	Remain accommodative, while focusing on withdrawal of accommodation	6-0
08-Jun-22 05-Aug-22	Withdrawal of Accommodation	6-0
30-Sep-22	Withdrawal of Accommodation	5-1
07-Dec-22 08-Feb-23	Withdrawal of Accommodation	4-2
06-Apr-23 08-Jun-23 10-Aug-23 06-Oct-23 08-Dec-23 08-Feb-24 05-Apr-24	Withdrawal of Accommodation	5-1
07-Jun-24 07-Aug-24	Withdrawal of Accommodation	4-2
09-Oct-24 05-Dec-24 07-Feb-25	Neutral	6-0
09-Apr-25	Accomodative	6-0
06-Jun-25	**Neutral**	**6-0**

- Frontloading policy action, the RBI's MPC resolved to reduce the repo rate by 50bps by a 5-1 vote. The CRR has also been slashed by 100bps to 3%, potentially releasing Rs. 2.5 trn for credit needs. The stance was changed to "Neutral" from "Accommodative"
- We anticipate future policy decisions to be data driven, with at max ~25bps of additional rate cuts

PRICES ARE NOW IN CONTROL, WITH CPI SET TO BE IN RBI'S EYESHOT

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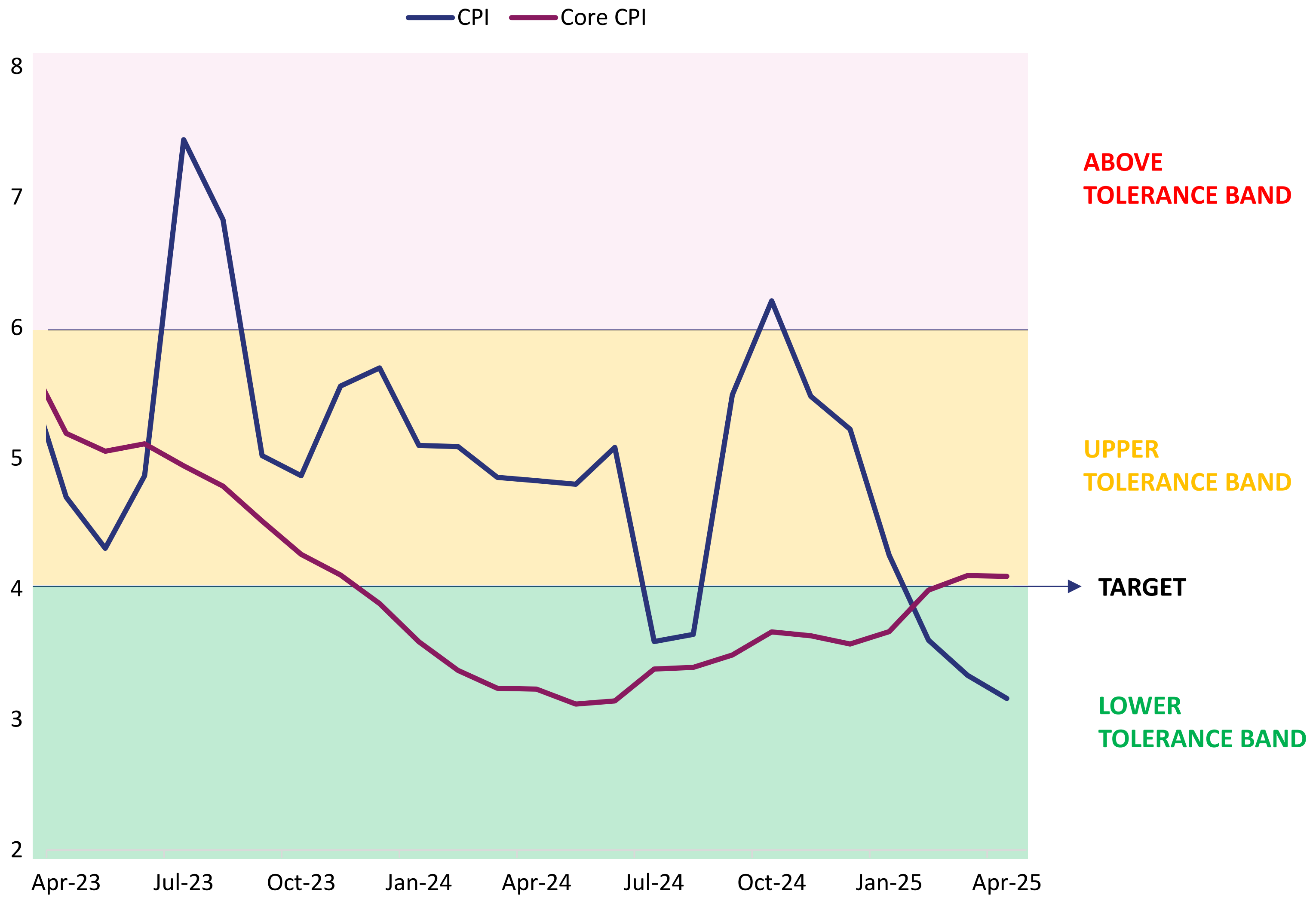
CPI AND CORE CPI (% Y/Y)



PROJECTED CPI (Y/Y) AS PER RBI

Period	09-Apr-25 Meeting	06-Jun-25 Meeting
Q1FY26	3.6%	2.9% ↓
Q2FY26	3.9%	3.4% ↓
Q3FY26	3.8%	3.9% ↑
Q4FY26	4.4%	4.4%
FY26	4.0%	3.7% ↓

- CPI inflation reached a 6-year low in Apr'25 of 3.16% y/y as all components saw easing
- RBI dipped its projection for CPI in FY26 further to 3.7%, which is below the target
- We revise our CPI estimate down to ~3.9%, a whiff above RBI's forecast

EASING COMMODITY PRICES AND AMPLE FOOD WILL HELP CPI REMAIN IN CHECK

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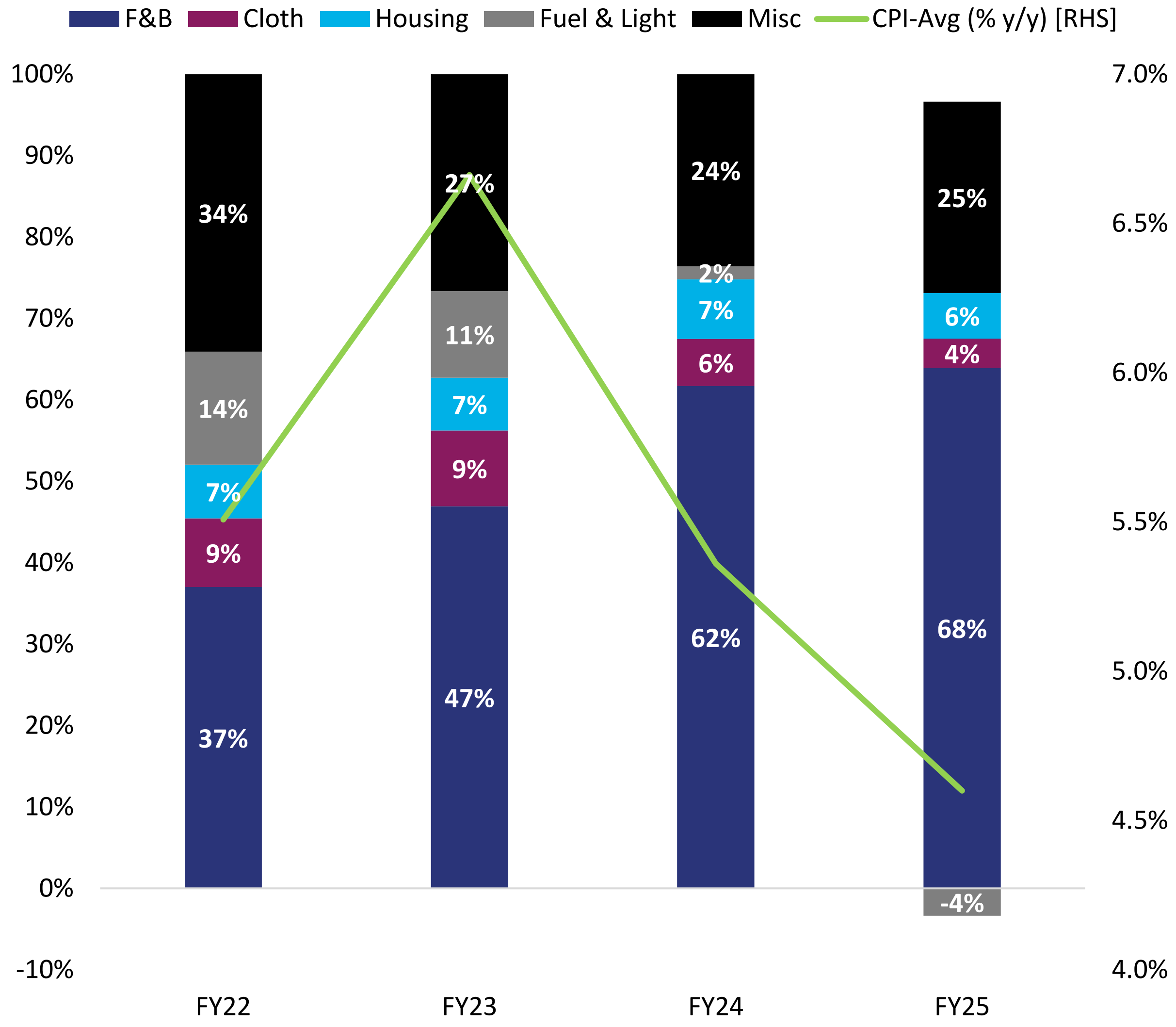
CONTRIBUTION TO Y/Y CHANGE IN CPI (%)



CHANGE IN PRICES OF KEY COMMODITIES

COMMODITY	%1M CHANGE	%1Y CHANGE
LME Metals Index	3%	-4%
Copper	3%	-2%
Aluminium	2%	-7%
Iron Ore 62% Fe*	-2%	-11%
Gold	1%	43%
Brent Crude	7%	-17%
Natural Gas	4%	33%
Newcastle Coal	7%	-24%

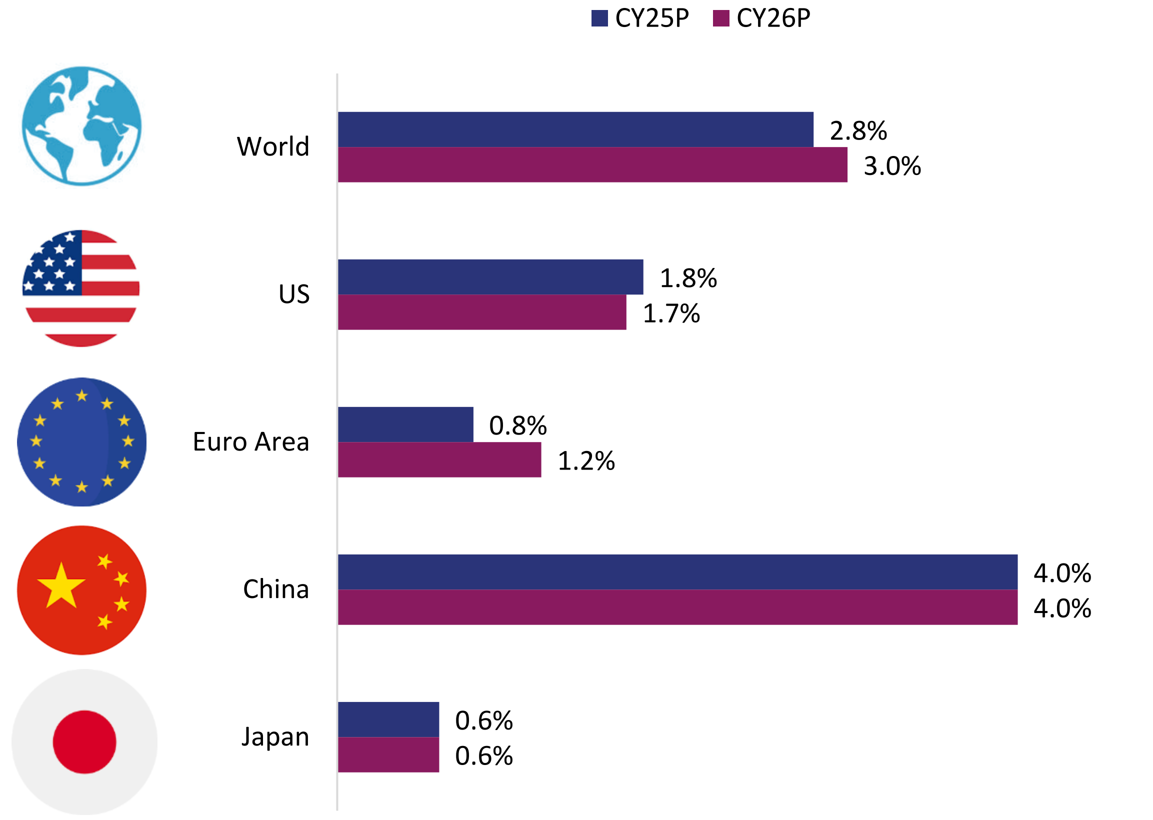
**As on 5 Jun'25*

- Contribution of food inflation to CPI reached a multi-year high in FY25. In FY26, food inflation is expected to ease significantly owing to generous foodgrain production in FY25, generous monsoon promising another bumper crop, and high base
- Fuel inflation is expected to be minimal owing to Brent prices being below USD 70/bbl. The incomplete pass-through of lower crude prices to CPI will ensure that this component does not fall as sharply as in WPI
- Core inflation likely bottomed out in FY25. However, the rise in FY26 will be mild and gradual as most commodities remain cheaper on year due to expectation of a global slowdown. Gold alone could add some shine to Core inflation

Note: F&B is Food and Beverage, and includes Pan, Tobacco & Intoxicants. Similarly, Cloth includes clothing & footwear; *Source: MoSPI, Bloomberg, CEIC, SBICAPS*

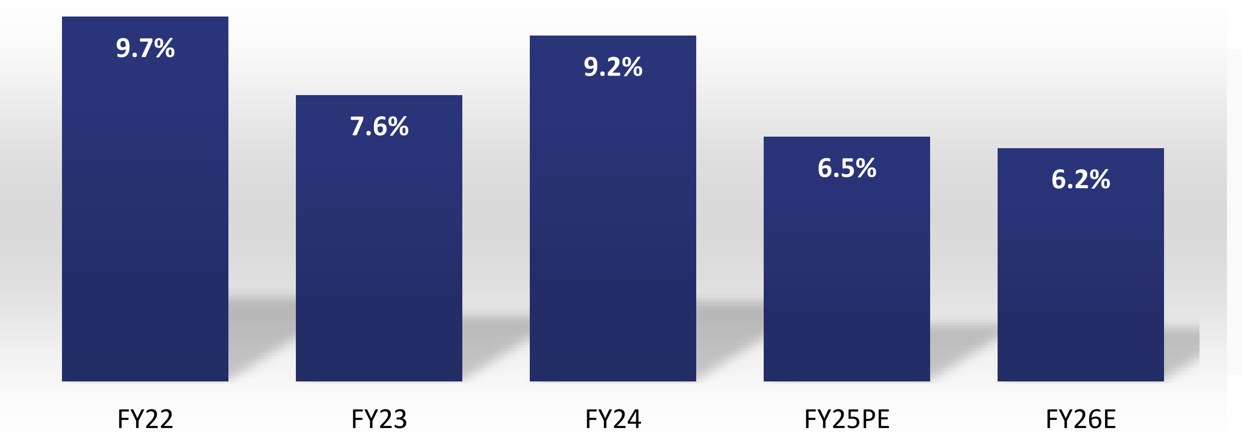
RISKS TO GROWTH STEM FROM GLOBAL FACTORS AND SULLEN CAPEX

REAL GDP GROWTH (Y/Y)

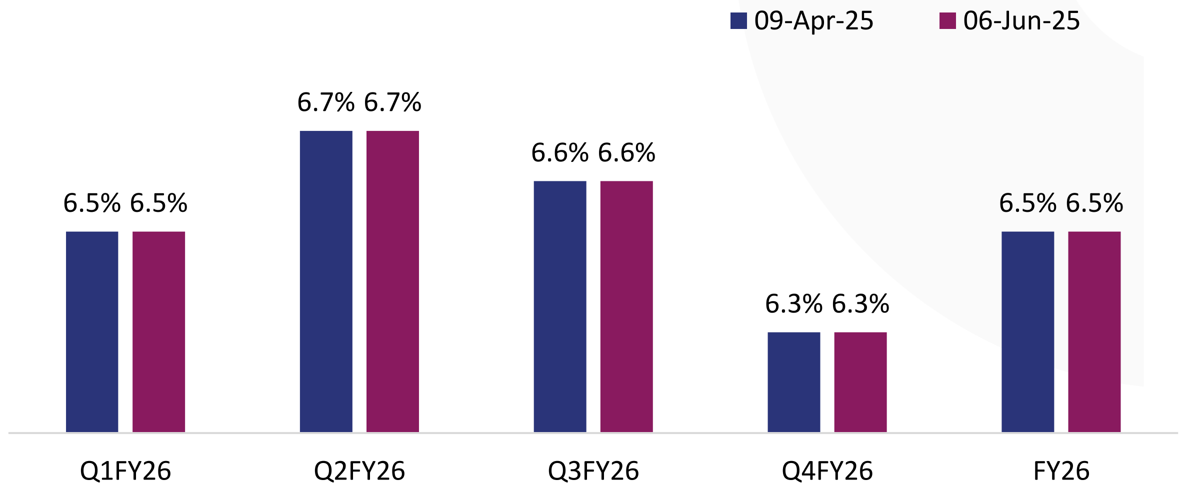


- Expectations for growth in global output were revised downwards by the IMF in Apr'25. However, since then a tariff pause, and trade deals are upward triggers
- *Domestic demand in India stays strong, though significant global challenges remain underpinning our FY26 GDP forecast of 6.2% y/y real and 9% nominal growth*

INDIA REAL GDP (Y/Y)



PROJECTED REAL GDP (Y/Y) AS PER RBI



FISCAL POSITION IS STRONG AND CAN MEET STIMULUS NEEDS WITH ALACRITY

ITEM (Rs. bn.)	FY24A	FY25PE	FY26BE	GROWTH FY25PE/ FY24A	GROWTH FY26BE/ FY25PE
Corporation Tax	9,111	9,868	10,820	8.3%	9.7%
Income Tax	10,447	11,830	14,380	13.2%	21.6%
Customs Duty	2,331	2,329	2,400	-0.1%	3.1%
Excise Duty	3,054	3,003	3,170	-1.7%	5.6%
Service Tax	4	0	1		
GST	9,572	10,316	11,780	7.8%	14.2%
Other Taxes	39	50	50	27.3%	0.0%
Gross tax revenue	**34,558**	**37,952**	**42,601**	**9.5%**	**12.5%**
(-) Transfer to States, UTs	11,295	12,869	14,224	13.9%	10.5%
Net tax revenue	**23,272**	**24,987**	**28,374**	**7.4%**	**13.6%**
Non-Tax Revenue	**4,018**	**5,375**	**5,830**	**33.8%**	**8.5%**
Non-debt Capital Receipts	**598**	**418**	**760**	**-30.0%**	**81.7%**
Total Receipts	**27,888**	**30,781**	**34,964**	**10.4%**	**13.6%**
Revenue Expenditure	34,943	36,035	39,443	3.1%	9.5%
Capital Expenditure	9,492	10,520	11,211	10.8%	6.6%
Total Expenditure	**44,434**	**46,555**	**50,653**	**4.8%**	**8.8%**
Revenue Deficit	**7,652**	**5,671**	**5,238**	**-25.9%**	**-7.6%**
Fiscal Deficit	**16,546**	**15,773**	**15,689**	**-4.7%**	**-0.5%**
Fiscal Deficit (as % of Nominal GDP)	**5.6%**	**4.8%**	**4.4%**		

- The Union met its fiscal deficit target of 4.8% in FY25PE despite a miss in revenue growth. This was helped by a fair nominal GDP

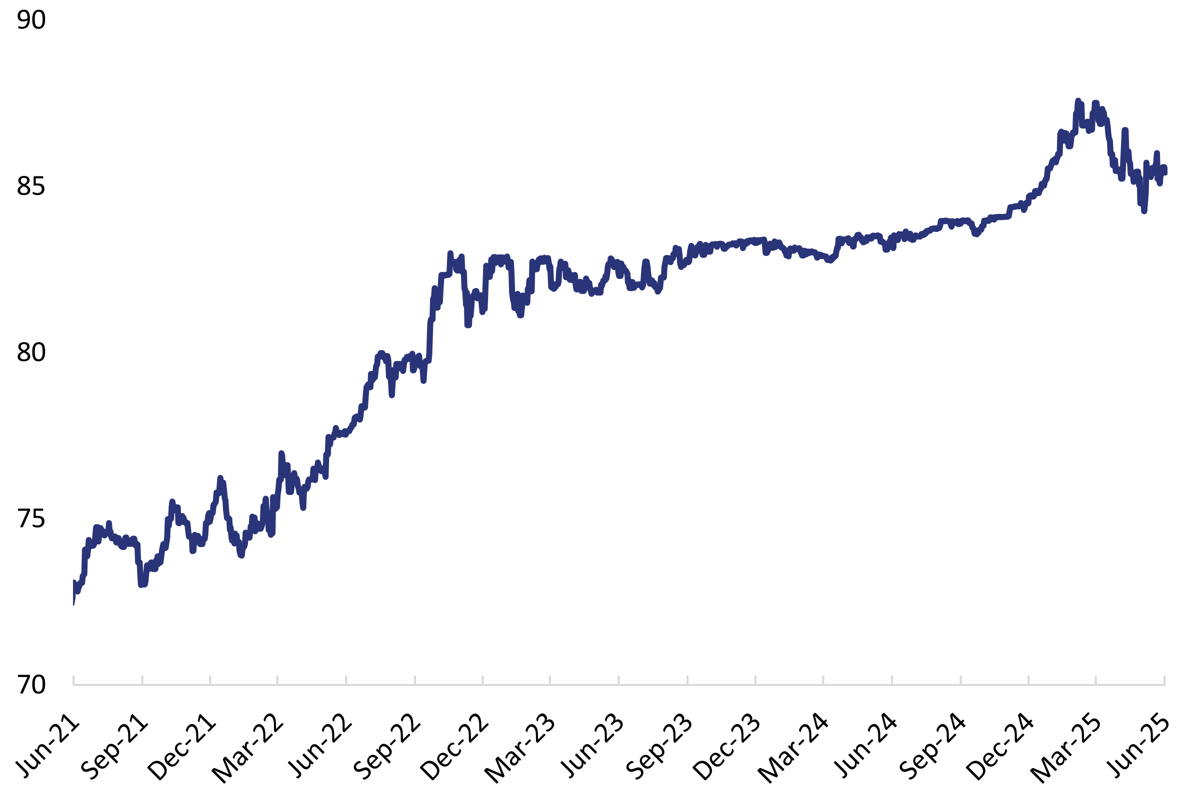
- The government overachieved its revised capex target for FY25, with revex seeing only a moderate rise owing to low subsidy payments in Q4FY25

- Increase in excise duty and higher dividend payout would balance potential minor shortfall in direct tax collections in FY26

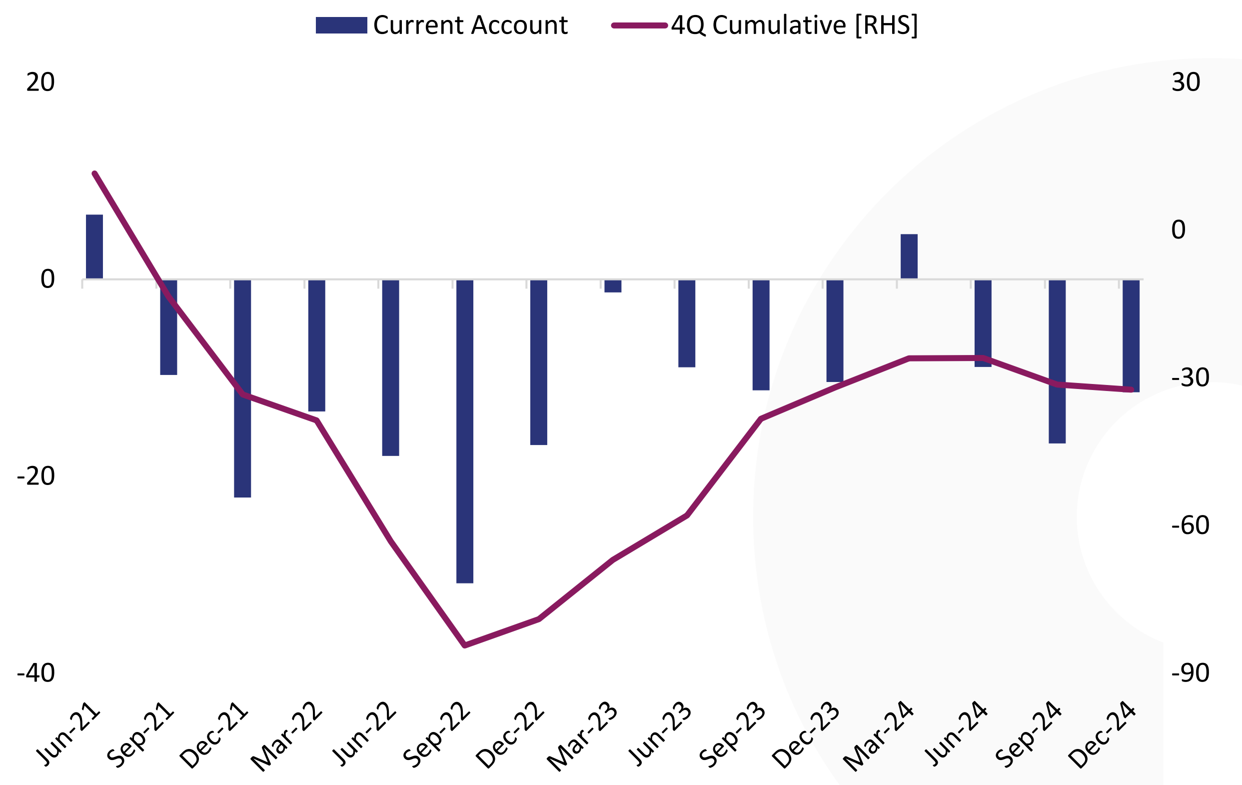
Source: Union Budget Documents, CGA, SBICAPS

EXTERNAL POSITION COMFORTABLE BUT NEEDS CONTINUOUS MONITORING

USD/INR EXCHANGE RATE (Rs. per USD)



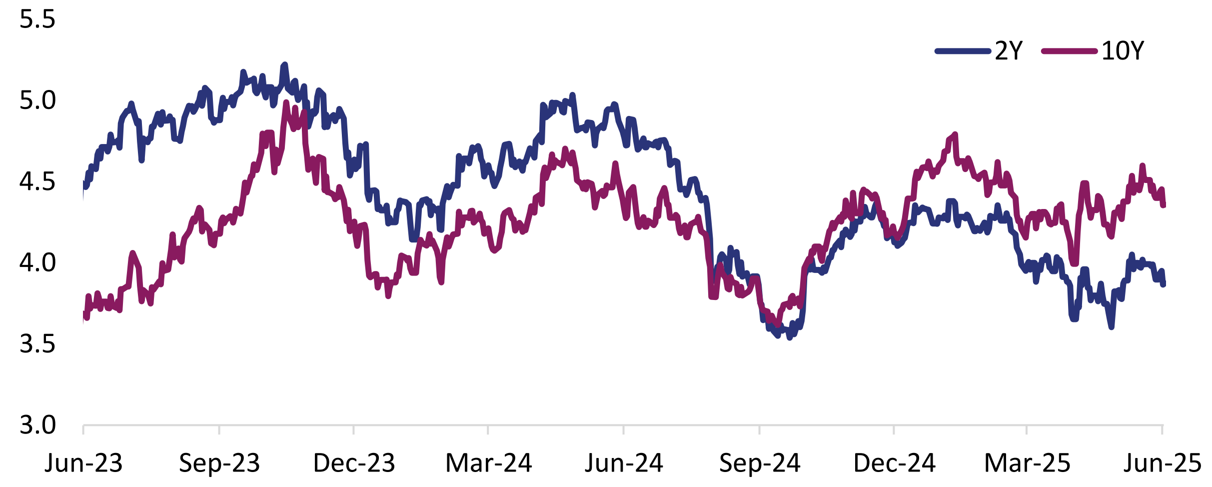
CURRENT ACCOUNT BALANCE (USD bn)



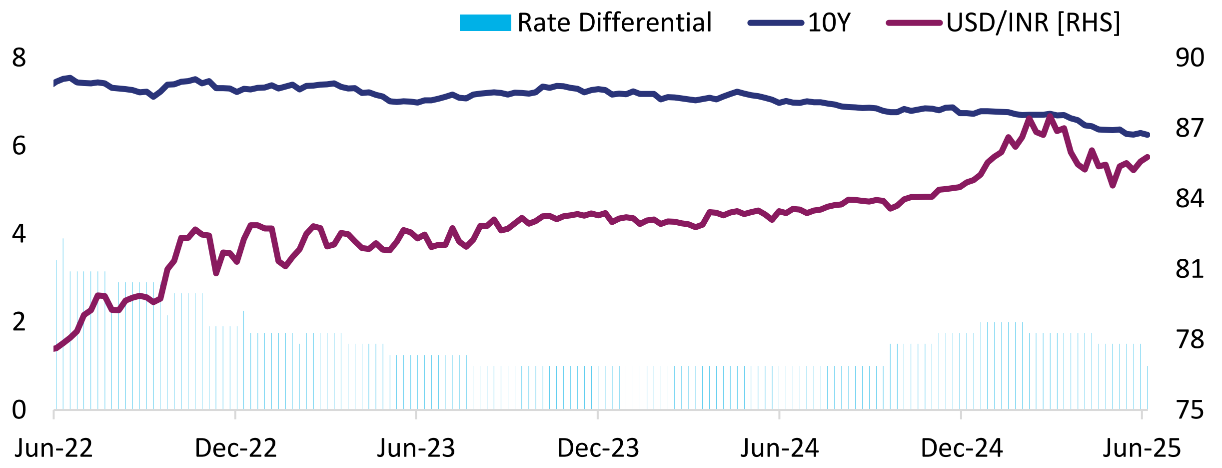
- RBI's net short position in the currency market had reached a whopping USD 88.7 bn in Feb'25, the highest on record. In Mar'25 the position started going down and the same likely continued in early FY26. This meant that the INR reversed some of its gains has dropped about 2% m/m, though remaining clear of lows reaching some months earlier
- *Going forward, the INR is expected to depreciate gradually as a moderate trade balance due to decrease in petroleum imports is met with subdued capital flows. Any sudden movements in EM currencies, especially CNY, could impose carry-over impacts on the INR as has been seen in the past*

SHALLOWER RATE CUTS IN US LIKELY AS INFLATION RISKS LOOM

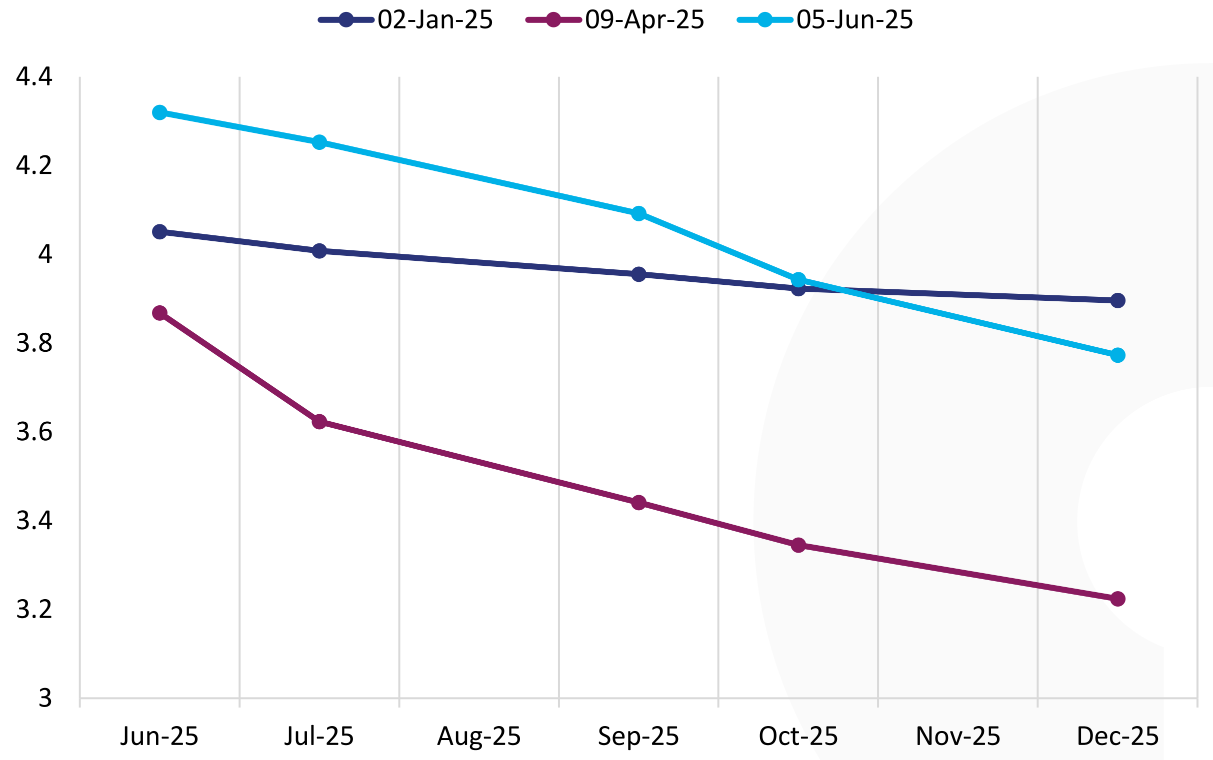
US G-SEC YIELDS (%)



INDIA-US POLICY RATE DIFFERENTIAL VS. INDIA YIELD VS. CURRENCY



MARKET-IMPLIED PATH OF US FED POLICY RATE (IN %)



- While inflation is not yet imminent helped by inventory stocking in the US, Fed speakers have been unanimous in saying that it remains a challenge. Most of them, including Chair Mr. Powell remain reluctant to cut rates in a hurry
- With India cutting rates as usual and the Fed likely to stay put, differentials could again narrow, putting pressure on capital flows and the INR

LIQUIDITY CONDITIONS REMAIN EASY, TUGGING DOWN SHORT END RATES

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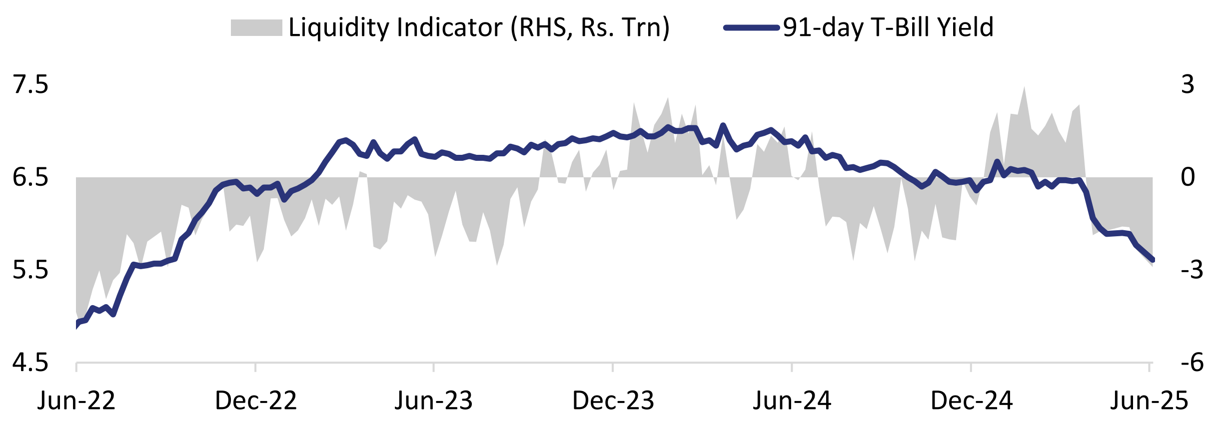
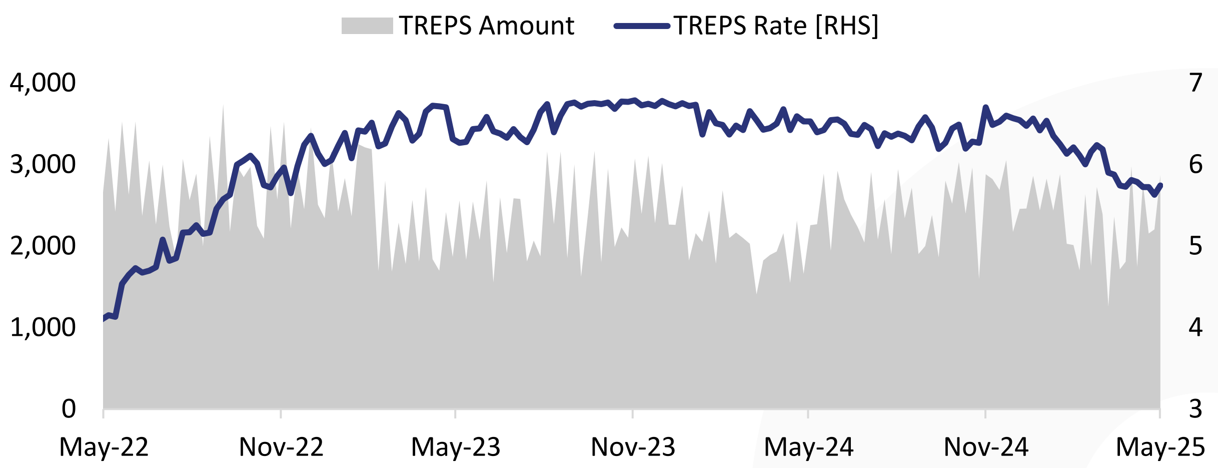
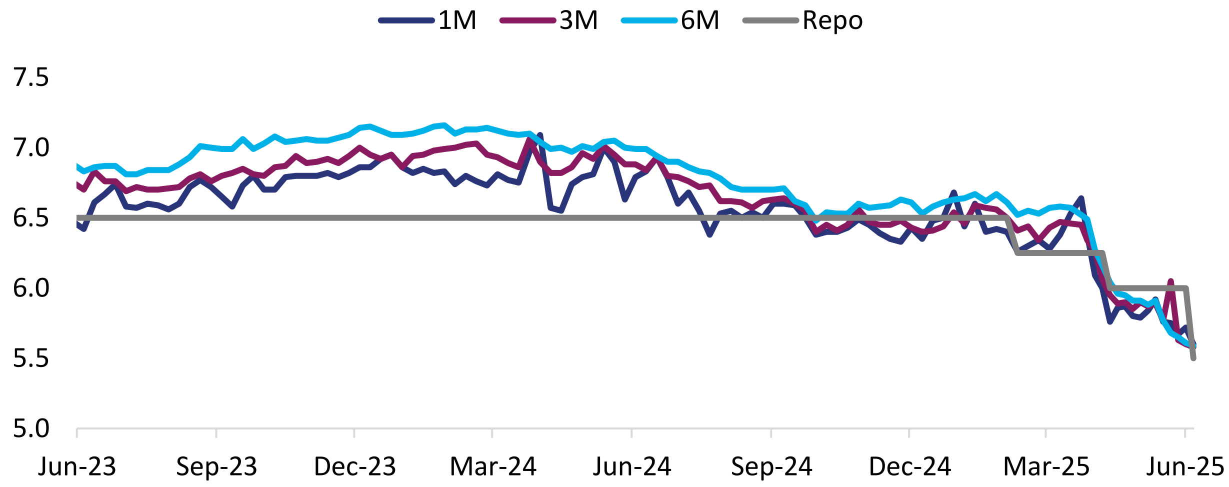
91-DAY T-BILL YIELD VS. BANKING LIQUIDITY*



TREPS DAILY AVG VOLUME (Rs. trn) AND RATE (%)



T-BILL SECONDARY YIELDS VS. REPO

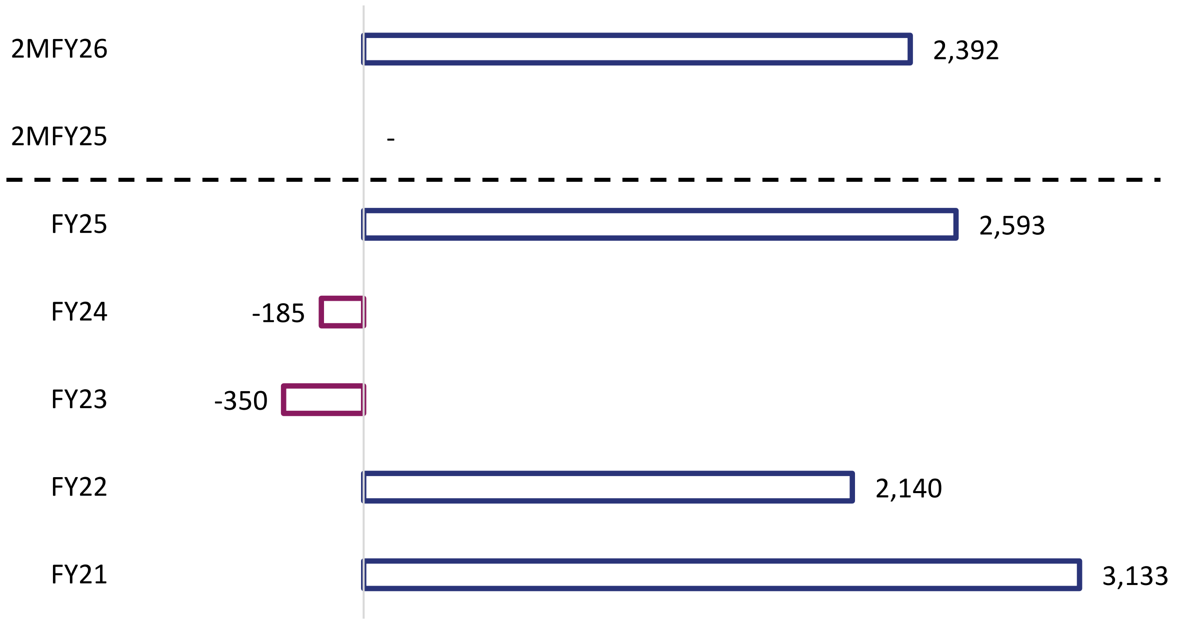


- Ample liquidity has ensured effective rate transmission and pulling lower end rates down. A cumulative Rs. 9.5 trn of durable liquidity has been released since Jan’25
- The CRR will be cut four times on 6 Sep’25, 4 Oct’25, 1 Nov’25, and 29 Nov’25 by 25 bps each, releasing a further Rs. 2.5 trn into the banking system
- WADTDR (fresh) has moved down ~30bps and WALR (fresh) has moved down ~18 bps, which is above usual for this point in cut cycle [between Feb’25 and Apr’25]

Source: Bloomberg, RBI, SBICAPS; *Negative values indicate surplus

RBI EASED MONEY MARKET BY INFUSING AMPLE LIQUIDITY IN YTDCY25

CUMULATIVE NET OMO PURCHASES (Rs. bn)



- Net OMO purchases in YTDCY25 have surpassed Rs. 5.2 trn. This has meant that systemic liquidity is close to 1% of NDTL in recent times and could grow further. We anticipate the RBI will maintain ample liquidity through H1

- While the RBI seems to have won this round, unwinding of large forward positions (which is already in progress) could pressure liquidity and the INR a bit in the near term

DURABLE LIQUIDITY MEASURES BY RBI

MEASURE	DESCRIPTION	AUCTION DATE	AMOUNT INJECTED (Rs. bn)
OMO Purchase	Through NDS OM	Jan'25	388
OMO Purchase Auctions	Auction Process	30th Jan	200
		13th Feb	400
		20th Feb	400
		12th Mar	500
		18th Mar	500
		25th Mar	445
		3rd Apr	200
		8th Apr	200
		17th Apr	400
		22th Apr	200
		29th Apr	200
		6th May	500
		9th May	250
		15th May	250
		19th May	192
Term Repo Auctions	56-day	7th Feb	500
	49-day	14th Feb	750
	45-day	21st Feb	580
	43-day	17th Apr	257
USD/INR Buy/Sell Swap Auction	6M Tenor	31st Jan	440
	3Y Tenor	28th Feb	880
	3Y Tenor	24th Mar	880

DIFFERENTIAL TRANSMISSION HAS STEEPENED YIELD CURVE

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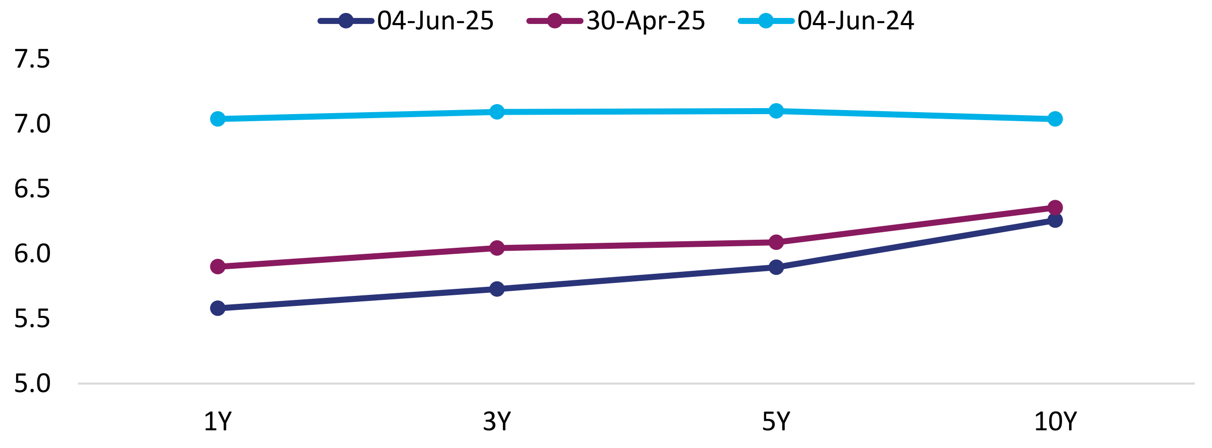
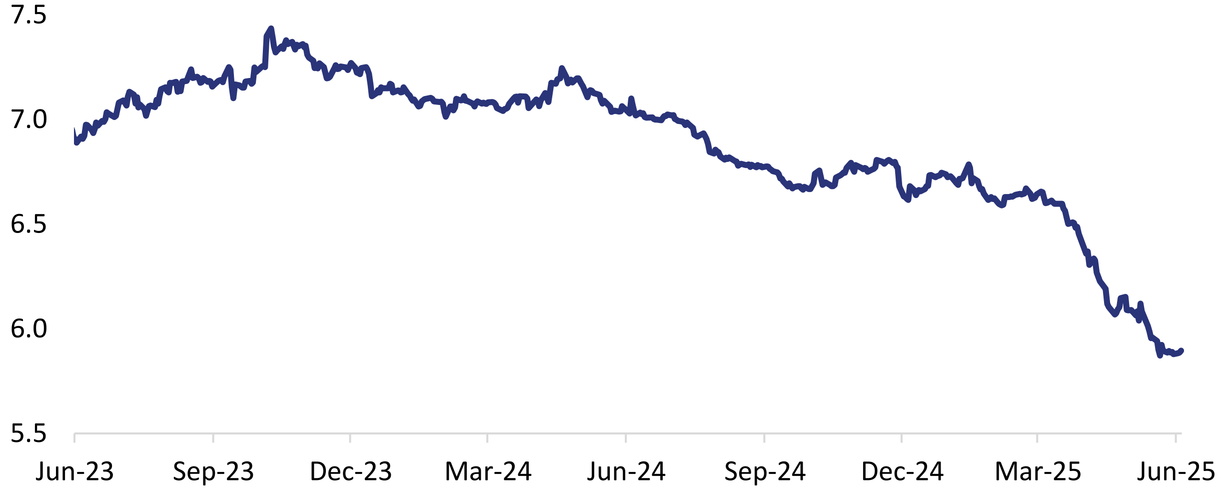
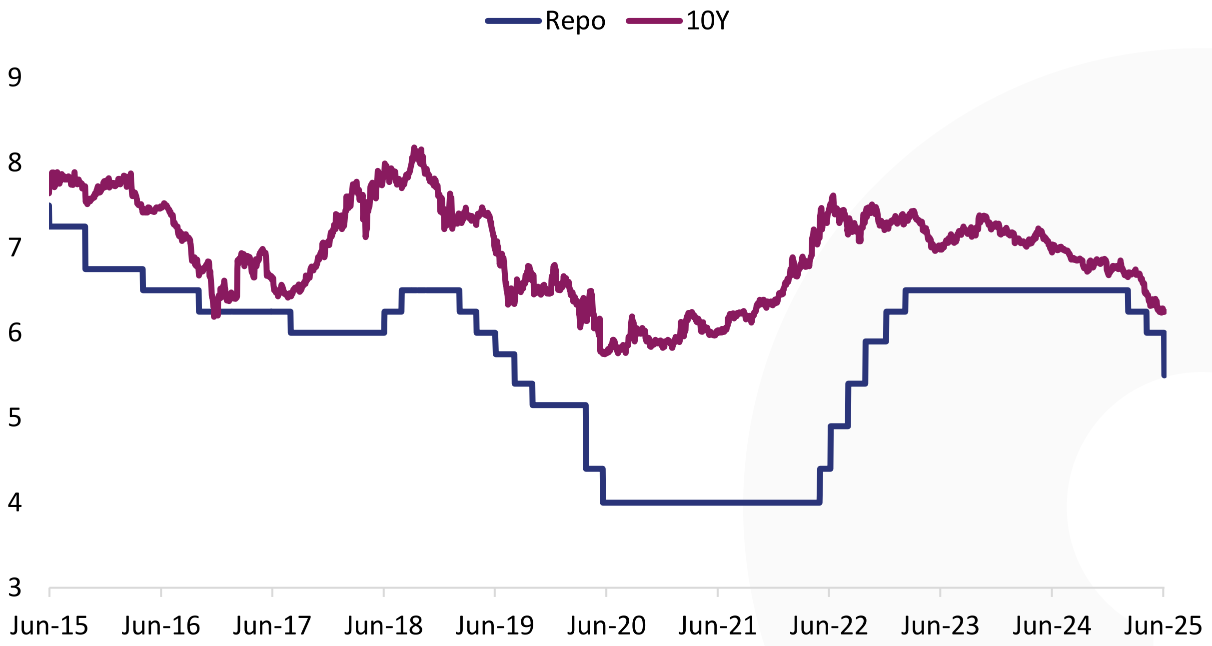
YIELD CURVE (%)



G-SEC YIELD (5 YEARS) (%)



UNION G-SEC YIELD (10 YEARS) VS REPO (%)



- Benchmark Union G-sec yields dropped sharply in the new fiscal and 10Y yields are hovering ~6.2%. The yield curve has steepened in the process. B*roader outlook remains sensitive to currency volatility and the RBI's operations*
- Banks would see a rapid reset in rates on EBLR credit, which would squeeze their margins more than earlier anticipated. This would be partially offset by CRR cut and gain on investments

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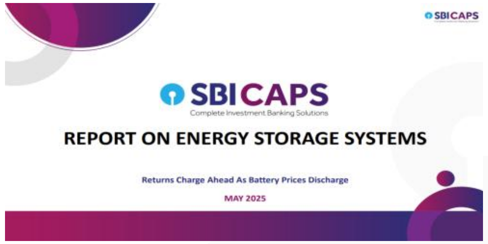
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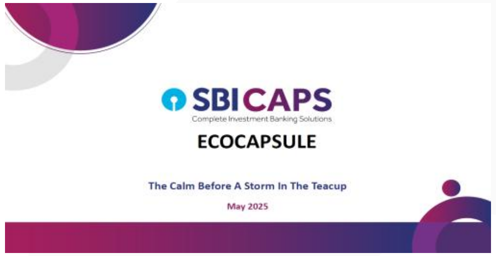
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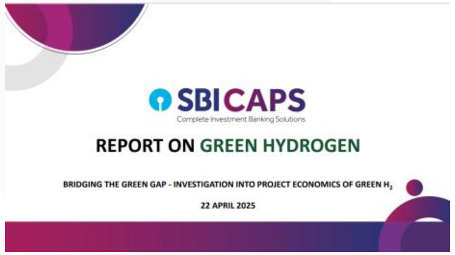
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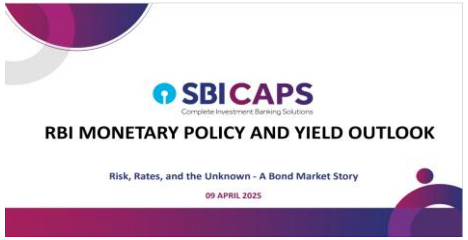
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