

**We expect the MPC to hold rates steady this week, while signaling readiness to respond should inflation risks intensify and second-round pressures begin to emerge. While the percolation of the energy shock to the real sector is still unfolding, the RBI is likely to flag a cloudy Brent outlook amid a large drawdown in energy inventories and lingering geopolitical risks. This, in conjunction with the rising risk of El Niño, could lead the RBI to raise its FY27 inflation forecast, while adding downside risks to growth. Importantly, given the recent INR weakness, the RBI is likely to reiterate the clear delineation between monetary and FX policy under the inflation-targeting regime. Any future rate hike would be aimed at curbing domestic demand pressures or anchoring inflation expectations, rather than defending the INR. FX volatility will continue to be managed through reserves and regulatory measures. We will watch for policy measures aimed at encouraging USD inflows, including incentives for external borrowing and other capital flow channels.**

### **A cautious hold in June amid complex global and domestic macro backdrop**

The RBI MPC is expected to keep policy rates unchanged at this week's meeting while reiterating its vigilance and readiness to act should inflationary pressures show signs of becoming entrenched. Since the last MPC in April, the macro backdrop has evolved in several important ways: 1) Brent briefly surged to as high as USD126/bbl before retracing ~25% to ~USD94/bbl currently amid mixed optimism over a potential US-Iran agreement, although broader commodity prices have continued to firm, 2) INR pressures have intensified and the outlook is unsteady despite some stabilization (CYTD down ~5.5%), constraining the RBI's policy flexibility amid prevailing policy trilemmas, 3) delayed pass-through of elevated energy costs to consumers is now underway, with pump prices rising Rs7.5/ltr and CNG price hikes of Rs4-7/ltr, implying a direct inflation impact of ~40bps, 4) mixed activity data so far, not suggesting a material growth slowdown, (5) central banks across EM are turning more hawkish as price pressures continue to build, while expectations of a modest DM hiking cycle are also taking shape (*Refer to Exhibits 1-7*).

### **Stagflation concerns and oil market imbalances to shape RBI's cautious tone**

While our baseline anticipates the SoH reopening by late mid-year, a large drawdown in energy inventories and lingering geopolitical risks could keep Brent crude prices close to current levels. There are also risks of a sharp rise in oil prices unless SoH throughput normalizes to pre-conflict levels if the stalemate persists. The RBI is likely to acknowledge that a prolonged crisis poses risks to both India's internal and external balances and may revise its Brent crude assumptions higher. This, in conjunction with the rising probability of El Niño (IMD forecasts 10% below-normal monsoon) could prompt an upward revision to the FY27 inflation forecast of 4.6%, while the 6.9% growth projection faces downside risks. That said, large buffer stocks could cushion El Niño-related food price pressures, as seen during the 2015 super El Niño. We expect FY27 headline inflation to average 5.1%, incorporating a moderate El Niño impact. The MPC's cautious, wait-and-watch approach is likely to reflect its recently reiterated view in the MPC minutes that monetary policy cannot directly offset supply-driven inflation shocks but should respond only when second-round effects begin to emerge. (*Refer to Exhibits 8-13*).

### **FX weakness to be a key pain point, but conventional hikes may yield little**

We do not expect the RBI to use rate hikes for FX management, given the MPC's inflation-targeting mandate. If rates are raised, the objective would be to curb domestic demand pressures or anchor inflation expectations rather than defend the INR. The 2013 experience highlighted the limits of interest-rate defense. Instead, we expect the RBI to continue managing FX volatility through reserves and regulatory measures, while potentially exploring incentives to boost USD inflows via external loans and other channels. A repeat of subsidized FCNR(B) schemes could be more costly in the current environment. More broadly, policymakers have tended to prioritize growth-inflation objectives over FX stability, keeping rates relatively accommodative despite periods of external outflows. While this may have made FX arbitrage and speculative trades cheaper, higher rates alone may not attract durable capital flows that eventually follow credible growth and sectoral innovations. (*Refer to Exhibits 14-16*).

### **Key Highlights:**

- **Cautious wait-and-watch as external and inflation risks mount**
- **FY27 inflation forecast likely to move higher (Emkay: 5.1%)**
- **Any rate hike to target inflation and curtail demand, not to defend the INR**
- **Watch for measures to attract USD inflows**

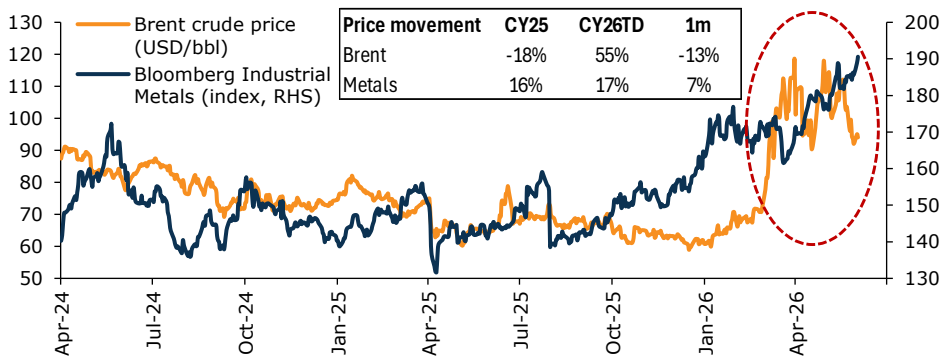
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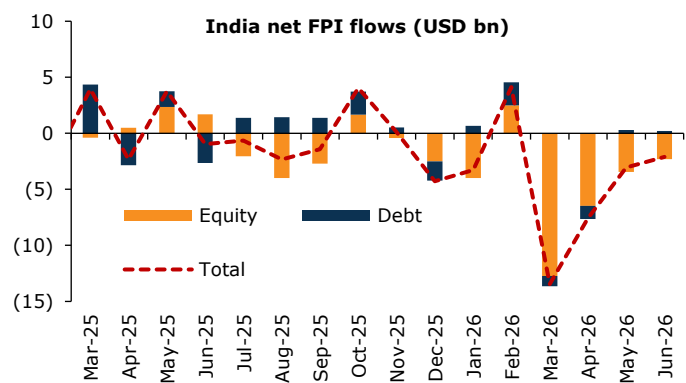
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Exhibit 1: Despite correcting in recent weeks, Brent prices remain elevated in CY26TD



Source: Bloomberg, Emkay Research

Exhibit 2: India has seen heavy FPI outflows since the start of the crisis...



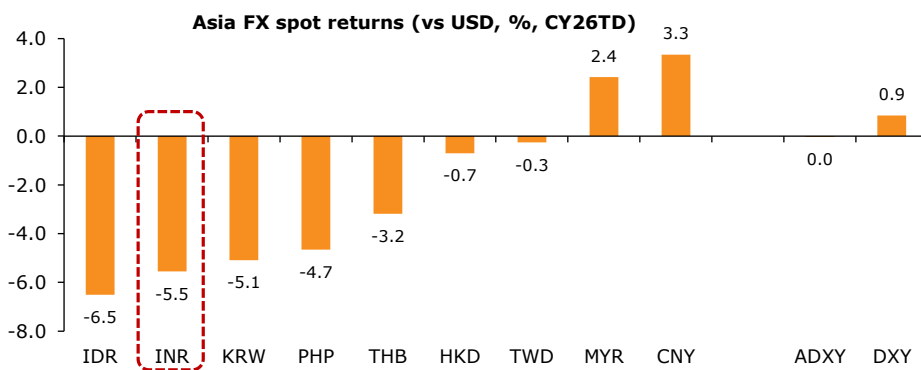
Source: CEIC, Emkay Research

Exhibit 3: ...while it has also been relatively worse-off when compared to FPI flows to rest of Asia

	Select Asia FPI flows (USD bn, latest available data)					
	MTD			CYTD		
	Debt	Equity	Total	Debt	Equity	Total
China	(18.9)	(64.4)	(83.3)	(29.4)	17.9	(11.5)
India	0.2	(2.3)	(2.1)	1.1	(26.4)	(25.4)
Indonesia	(0.1)	(0.2)	(0.3)	(0.8)	(3.2)	(4.0)
Japan	7.2	21.9	29.1	56.7	73.6	130.3
Malaysia	(1.3)	(0.5)	(1.8)	0.8	(0.2)	0.7
Philippines	1.4	(0.0)	1.4	3.1	(0.2)	2.9
S. Korea	0.4	(1.3)	(0.9)	30.6	(65.7)	(35.0)
Thailand	0.6	0.1	0.7	1.5	0.7	2.2

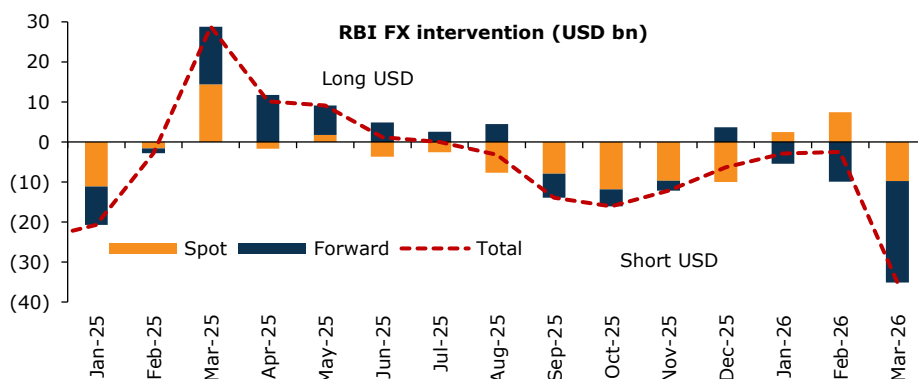
Source: Bloomberg, Emkay Research

Exhibit 4: INR has been among the worst-performing Asia FX in CY26



Source: Bloomberg, Emkay Research. Data as of 2 June 2026

**Exhibit 5: RBI intervention spiked to USD35bn in March, with INR under immense pressure**



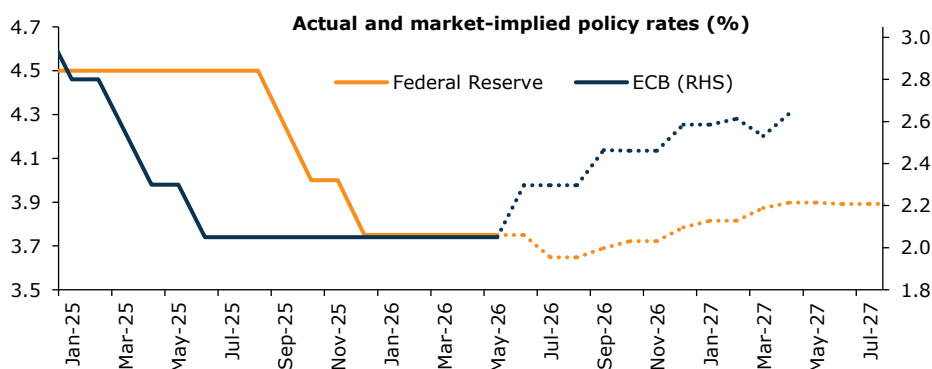
Source: RBI, Emkay Research

**Exhibit 6: EM central banks are turning hawkish in the face of the ongoing energy crisis**

Country	Most recent central bank rate action	Rate move (bps)	Tone	Comments
Indonesia	Hike	50	Hawkish	Surprise large hike to defend currency and control inflation
Philippines	Hike	25	Hawkish	Sharp and urgent pivot away from easing bias; stance to remain restrictive ahead
South Korea	Hold	-	Hawkish	Hawkish hold; "rate hike justified"; hikes likely ahead
Thailand	Hold	-	Neutral	No worries around stagflation; "wait and watch" approach ahead
Malaysia	Hold	-	Neutral	No immediate pressure to hike (Malaysia is a net energy exporter)
Brazil	Cut	25	Mildly hawkish	Pace of easing to slow; will not allow inflation expectations to de-anchor
Mexico	Cut	25	Mildly hawkish	End of easing cycle; likely to hold going ahead

Source: Bloomberg, Emkay Research assessment

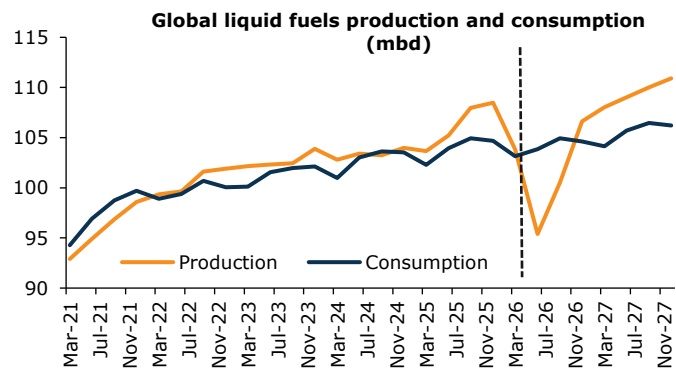
**Exhibit 7: The Fed and ECB are also expected to raise rates imminently**



Source: Bloomberg, Emkay Research

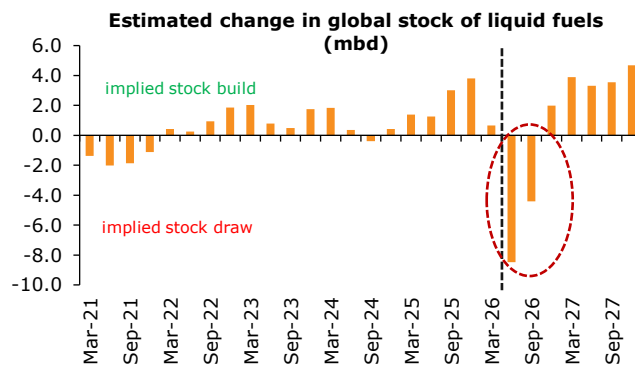
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**Exhibit 8: Global oil production has dropped significantly since the start of the West Asia crisis...**



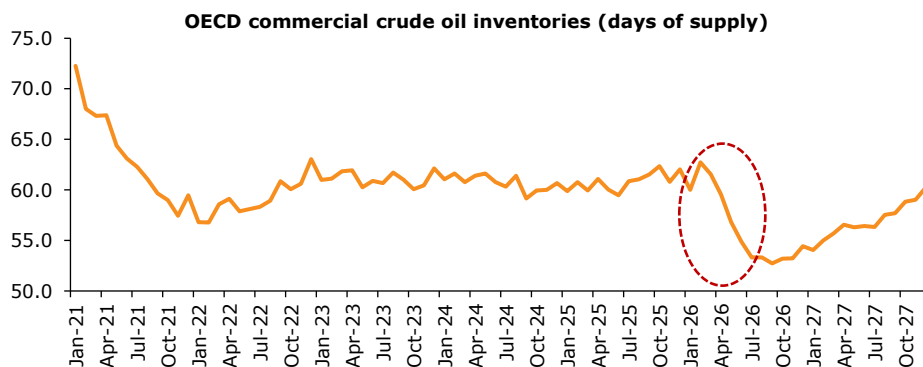
Source: EIA, Emkay Research

**Exhibit 9: ...leading to unprecedented levels of oil inventory drawdowns**



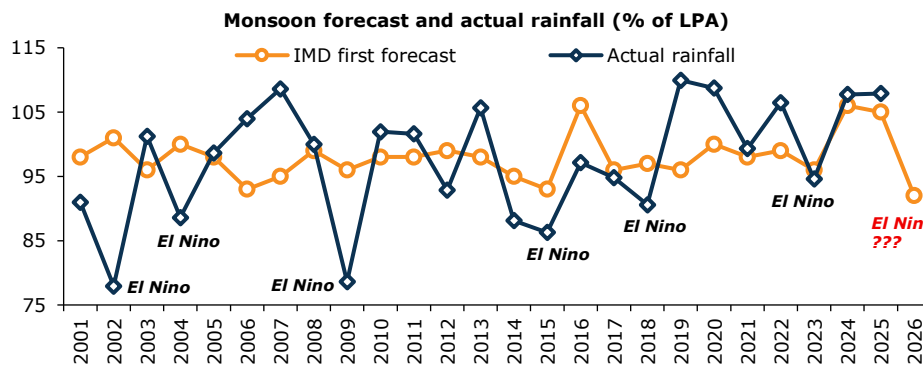
Source: EIA, Emkay Research

**Exhibit 10: OECD commercial oil inventories are estimated to have dropped to ~55 days of supply**



Source: EIA, Emkay Research

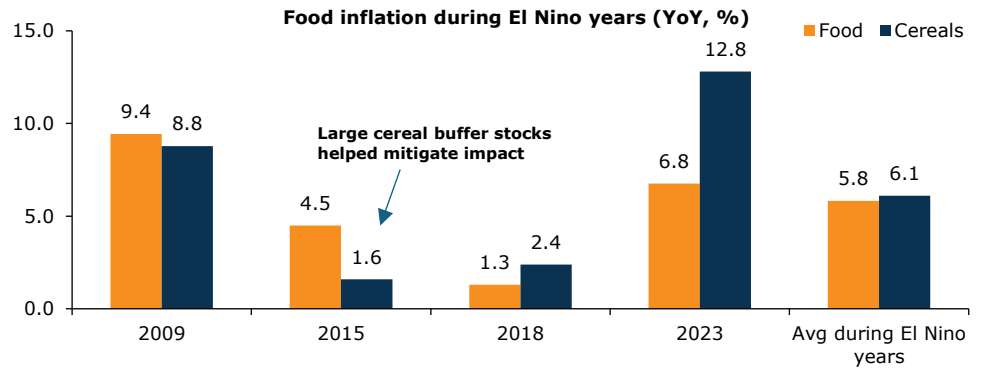
**Exhibit 11: IMD's monsoon forecast is at its lowest ever, with India having seen poor monsoon during each El Nino year in the past 25 years**



Source: Bloomberg, Emkay Research

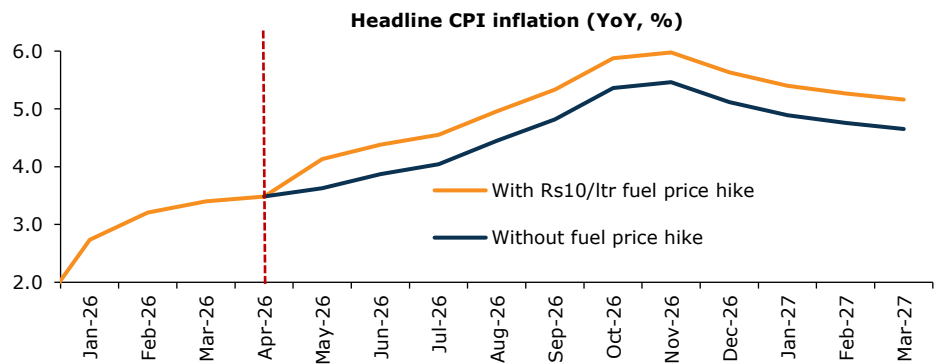
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**Exhibit 12: While El Nino hurts rainfall immediately, the impact on food inflation has been mixed**



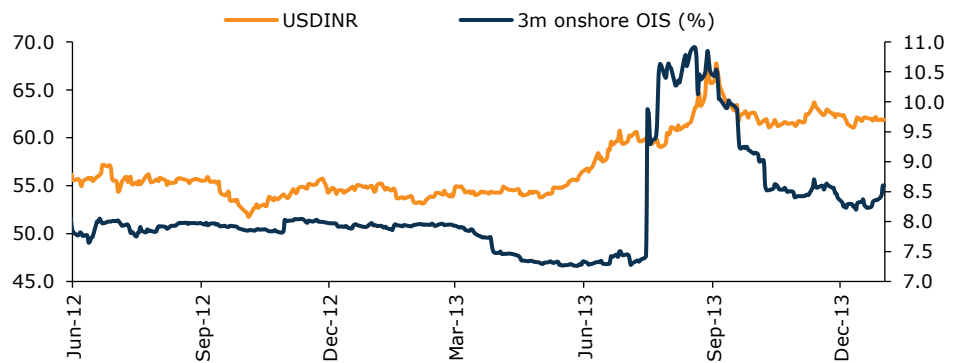
Source: CEIC, Emkay Research

**Exhibit 13: FY27E headline CPI at 5.1% after Rs10/ltr fuel hikes and moderate El Nino impact**



Source: CEIC, Emkay Research estimates

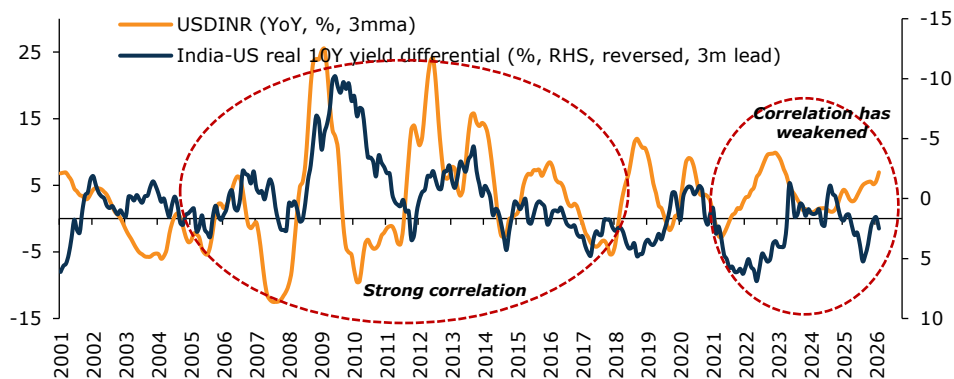
**Exhibit 14: RBI's interest-rate defense of the rupee failed in 2013**



Source: Bloomberg, Emkay Research

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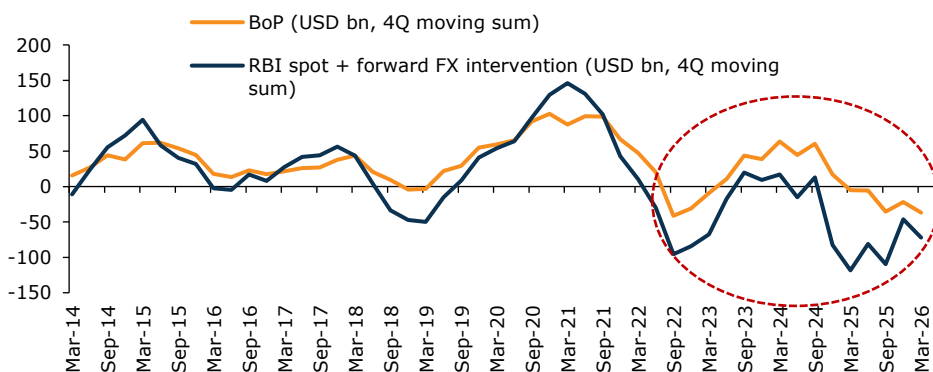
**Exhibit 15: Correlation between India-US real rate differential and USDINR has weakened post-Covid**



Source: Bloomberg, Emkay Research

*RBI's FX intervention has generally been in line with the fundamental requirements of the economy (ie the BoP surplus/deficit). However, it has been intervening far more than the BoP would imply over the past couple of years, which contributed to keeping the INR relatively overvalued/undervalued. The BoP deficit for FY25 and FY26 combined would be <USD70bn, while FX spot + forward intervention over the same period has been >USD200bn, reflecting the RBI's need and intent to manage currency speculation.*

**Exhibit 16: RBI's FX intervention has recently been far higher than the BoP would warrant**



Source: CEIC, Emkay Research

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