

6th August 2025

In an expected move, the Monetary Policy Committee (MPC) unanimously decided to keep the policy repo rate unchanged at 5.5% and retained the ‘neutral’ policy stance.

The Committee noted that it should “*wait for further transmission of the front-loaded rate cuts to the credit markets and the broader economy*” before taking any further action on rates and stance, suggesting RBI would like to pause and assess the impact of its steps and analyse incoming data before taking any further action.

The RBI has emphasised that even though near-term CPI inflation outlook is benign it is due to volatile food prices while core inflation remains elevated. Furthermore, it noted that inflation is likely to edge up above target from Q4FY26 onwards and therefore the need “*to a close vigil on the incoming data and the evolving domestic growth-inflation dynamics to chart out the appropriate monetary policy path.*”

On Growth: The RBI highlighted that though financial markets volatility and geopolitical uncertainties have abated recently, trade related uncertainties continue to linger and could have a bearing on global growth which is already subdued.

GDP Growth (%)	Jun-25E	Aug-25E
Q1FY26	6.5	6.5
Q2FY26	6.7	6.7
Q3FY26	6.6	6.6
Q4FY26	6.3	6.3
FY26	6.5	6.5
Q1FY27	NA	6.6

Source: RBI

On domestic front the RBI noted even though growth has held up well, high frequency indicators continue to present a mixed picture. While rural growth remains resilient, urban demand continues to be soft. Going forward, RBI expects growth to be supported by above normal monsoon, lower inflation, rising capacity utilisation and supportive monetary and regulatory environment. Taking all this into account, the RBI left its FY26 GDP growth forecast unchanged from last policy review at 6.5%. RBI expects GDP growth of 6.6% in Q1FY27.

On Inflation: The RBI noted that June CPI print fell to more than 6 years low on back of falling food prices even though core inflation has inched up lately “*driven partly by a continued increase in gold prices.*”

CPI (%)	Jun-25E	Aug-25E
Q2FY26	3.4	2.1
Q3FY26	3.9	3.1
Q4FY26	4.4	4.4
FY26	3.7	3.1
Q1FY27	NA	4.9

Source: RBI

On inflation outlook, RBI’s take was more nuanced. It noted that while near term inflation outlook has become benign due to favourable base, above normal monsoon and adequate buffer stocks, inflation is likely to go above 4% by Q4FY26 and beyond as ‘*unfavourable base effects, and demand side factors from policy actions come into play.*’ Consequently, the CPI inflation forecast for FY26 was lowered by 60bps to 3.1%. However, RBI expects CPI inflation to reach 4.4% in Q4FY26 and 4.9% in Q1FY27, which is above RBI’s target of 4%.

Conclusion and Outlook

The RBI's decision to keep the policy rate and stance unchanged was on expected lines. The RBI emphasised on the point that the transmission of past policy actions is still under process and the outlook for inflation has become unfavourable given base effect turns adverse from Q4FY26 onwards. It also noted that the current headline inflation is benign due to falling food prices while core inflation has edged higher even after stripping the precious metal prices. The 10 year G-sec yields went up by 8bps post the policy announcement.

As highlighted by RBI, CPI inflation is likely to remain below RBI's mid-point target of 4% in FY26 but rise to 4.9% by Q1FY27. In our view, in case the incoming data surprises on the downside due to global trade uncertainties, RBI could lower policy rate further as the neutral stance provides RBI with flexibility to move in either direction.

In our view, medium term outlook on Indian fixed income market remains favourable, considering:

- Headline CPI inflation is likely to undershoot RBI target of 4% in FY26. Thereafter too the rise due to unfavourable base is likely to be contained.
- Liquidity is likely to be in ample surplus given RBI's past actions and CRR cut effective later during the year
- External sector could remain comfortable in view of steady growth in services exports, decline in oil prices and adequate foreign exchange reserves.
- Government sticking to path of fiscal consolidation and reiterating to bring down its debt to GDP bodes well for supply of Gsec over the medium term
- Higher tariff on India likely to dampen growth to the extent of 20-40bps based on most estimates

Key risk to the favourable outlook

- Below normal monsoon posing risk to food prices

Overall, in our view, yields are likely to remain rangebound with a downward bias. Falling inflation and front loading of policy rate cuts is positive from yields perspective. Thus, in view of significant liquidity provision, convergence of short-term rates and healthy corporate bonds spreads (over Gsec), one may consider investment in medium duration (schemes with duration of upto 5 years) categories especially corporate bonds focussed funds in line with individual risk appetite. Further, as long bond spreads have widened over 10 year G-secs, investors with a relatively longer investment horizon could continue with their allocation to longer duration funds in line with individual risk appetite.

Glossary	
BPS	Basis points (1 bps = 0.01%)
CPI	Consumer Price Index
CAD	Current Account Deficit
CRR	Cash Reserve Ratio
GDP	Gross Domestic Product
LCR	Liquidity coverage ratio
MSF	Marginal Standing Facility
PMI	Purchasing Manager Index
RBI	Reserve Bank of India
SDF	Standing Deposit Facility
SLR	Statutory Liquidity Ratio
AE	Advanced Economies
GST	Goods and Services Tax

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