

6<sup>th</sup> June 2025

In an unexpected move, the Monetary Policy Committee (MPC) decided to lower the policy repo rate by 50bps to 5.5% and to change policy stance from ‘accommodative’ to ‘neutral’. Five out of six members voted in favour of 50bps cut in policy repo rate while one member voted for a 25bps cut. In another unexpected move, the RBI decided to reduce Cash Reserve Ratio (CRR) by 100bps in 4 tranches of 25bps each (with effect from the 4 weeks beginning September 6, October 4, November 1 and November 29, 2025). This is expected to release extra liquidity of ~₹2.5 trillion by December 2025.

*The Committee noted that “After having reduced the policy repo rate by 100 bps in quick succession since February 2025, under the current circumstances, monetary policy is left with very limited space to support growth”* 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 prioritised growth and has frontloaded its actions as it believes that inflation is not only ‘durably aligned’ but is likely to ‘undershoot the target at the margin’ and therefore it makes sense to support domestic consumption and investment at this juncture.

**On Growth:** The RBI highlighted that the recent trade negotiations and temporary halt on reciprocal tariffs are positive developments from global growth point of view. However, uncertainty remains high and could weigh on sentiments and growth prospects going forward.

GDP Growth (%)	Apr-25E	Jun-25E
Q1FY26	6.5	6.5
Q2FY26	6.7	6.7
Q3FY26	6.6	6.6
Q4FY26	6.3	6.3
<b>FY26</b>	<b>6.5</b>	<b>6.5</b>

Source: RBI

On domestic front the RBI noted that the growth momentum has continued in FY26 as well. While prospects for rural demand remains bright on the back of better rabi output and prospects of a good monsoon, urban demand is also likely to get a boost from sustained growth in services sector. The key near term risks to the growth outlook are rise in geo-political tensions, trade uncertainty and adverse weather conditions. The RBI left its FY26 GDP growth forecast unchanged from last policy review at 6.5%.

**On Inflation:** The RBI noted CPI inflation continued to moderate since their last meeting on back of falling food prices and core inflation too remains ‘steady and contained’.

CPI (%)	Apr-25E	Jun-25E
Q1FY26	3.6	2.9
Q2FY26	3.9	3.4
Q3FY26	3.8	3.9
Q4FY26	4.4	4.4
<b>FY26</b>	<b>4.0</b>	<b>3.7</b>

Source: RBI

Outlook for inflation remains benign across most constituents. The prospect for food inflation remains bright due to good *rabi* harvest and expectation of an above normal monsoon which should ensure healthy *kharif* output as well. The RBI stressed that the inflation is not only likely to be ‘durably aligned’ (as noted in the previous policy) but is ‘likely to undershoot the target at the margin.’ Consequently, CPI inflation forecast for FY26 was lowered by 30bps to 3.7%.

## Conclusion and Outlook

The RBI’s decision to lower policy repo rate by 50bps was a surprise as the market was expecting RBI to lower the policy rate by 25bps. This coupled with the fact that RBI also decided to lower CRR by 100bps (in four tranches of 25bps each) suggests RBI decided to prioritise growth and front load

its actions to remove any ambiguity. Its acknowledgement that after these actions '*monetary policy is left very limited space to support growth*' and change in stance from accommodative to neutral suggests that RBI would like to wait and assess the impact of their actions on growth-inflation dynamics before taking further action. The yield curve steepened post policy with curve upto 5 years rallied by 5-8bps while beyond 6 year it sold off by 3-6bps.

As highlighted by RBI, CPI inflation is likely to remain below RBI's mid-point target of 4% in FY26. Going forward, the RBI is likely to take a wait and watch approach 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. Also, domestic growth and Core CPI momentum remains subdued.
- Liquidity is likely to be in ample surplus given RBI's past actions and CRR cut today
- 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 G-Sec over the medium term
- Uncertainty around tariffs dampens growth sentiments

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, and attractive corporate bonds spreads (over G-Sec), 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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