

5th December 2025

The Monetary Policy Committee (MPC) unanimously voted to reduce the policy repo rate by 25 bps to 5.25%. It also retained the ‘neutral’ policy stance, although one out of six members voted for stance to be changed from ‘neutral’ to ‘accommodative’.

Further, RBI announced OMO purchases of INR 1 trillion to be conducted in two tranches of INR 500 billion each along with USD 5 billion Buy / Sell swap in December 2025. Thus, infusing durable liquidity to the tune of ~INR 1.5 trillion.

On Growth: RBI noted global growth has defied expectations and has remained resilient, although heightened uncertain geopolitical environment and unsettled trade related issues continue to weigh on the outlook.

Domestic GDP growth surged in Q2FY26 to 8.2%, driven by robust domestic demand despite trade related uncertainty. Recent economic activity indicators suggest that growth continues to hold up well led by healthy rural and recovering urban consumption. Investment activity also remains steady. While overall growth remains healthy, RBI noted moderation in select indicators (IIP, Steel and cement consumption, power demand, etc.). Outlook on growth remains optimistic in view of favourable rural prospects, continuing positive impact of GST rationalisation, soft inflation and supportive financial conditions. However, uncertainty pertaining to trade and tariff and ongoing geopolitical issues poses risk to growth outlook. RBI revised up its growth estimate for FY26 by 50 bps to 7.3% while Q1FY27 growth forecast was also revised up by 30 bps. RBI noted quick conclusion of trade negotiation can push growth higher.

GDP Growth (%)	Oct-25E	Dec-25E
Q2FY26	7.0	8.2*
Q3FY26	6.4	7.0
Q4FY26	6.2	6.5
FY26	6.8	7.3
Q1FY27	6.4	6.7
Q2FY27		6.8

Source: RBI; *actual

On Inflation: After easing substantially in Q2FY26, CPI eased to all time low in October 2025 driven by sharp fall in food prices. Further, the core inflation has been benign and has seen broad based moderation, especially if the precious metal prices are excluded.

Going forward, inflation is expected to remain low or close to RBI’s target. This emanates from the prospect of adequate food production considering higher kharif production and Rabi sowing. Further, the core inflation is expected to remain modest too. RBI expects rise in commodity prices (except select metal prices) to moderate going forward.

CPI (%)	Oct-25E	Dec-25E
Q2FY26	1.8	1.7*
Q3FY26	1.8	0.6
Q4FY26	4.0	2.9
FY26	2.6	2.0
Q1FY27	4.5	3.9
Q2FY27		4.0

Source: RBI; *actual

Consequently, the average inflation forecast for FY26 was lowered by 60 bps to 2.0% (after 50 bps downward revision in the last policy). Further, RBI revised down Q1FY27 inflation estimate by 60 bps to 3.9% and expects it to average 4% in Q2FY26.

Conclusion and Outlook

RBI’s decision to reduce policy rate by 25 bps and upfront announcement of OMOs along with buy/sell swap of USD 5 bn pleasantly surprised the market participants. Further, the commentary along with the press conference was viewed as considerably dovish. Consequently, the Gsec yield curve shifted lower with yields falling by a few bps on strong volumes. Going forward, RBI is likely to

remain data dependent keeping one more rate cut hope alive in case growth or inflation surprises on the lower side. RBI also sounded comfortable with a benign inflation – headline as well as core (especially excluding precious metals which contributed 50 bps)- outlook citing structural factors at play and despite resilient growth outlook.

The medium-term outlook on Indian fixed income market remains favourable, considering:

- Benign inflation outlook likely to persist and average near RBI's target of 4%
- Liquidity is likely to be in ample surplus in the coming few months in view of constant assurance by RBI governor to maintain sufficient surplus to meet the real economy needs.
- External sector likely to remain comfortable in view of manageable CAD (on back of robust growth in services exports and healthy remittances) and adequate foreign exchange reserves.
- Low risk of additional market borrowings, despite risk of fiscal slippage, as it can manage the same by issuing short term cash management bills or using cash balance. Over the medium term, supply of market borrowings is likely to remain contained as government remains committed to its fiscal consolidation path
- Growth has likely reached its peak in Q2FY26, and impact of elevated tariffs and the durability of the consumption uplift following GST rationalisation remains uncertain.
- US policy rates are expected to come down over next 12 months and could provide space for RBI to reduce rates

Key risk to the favourable outlook

- Significant widening in fiscal deficit in view of GST rationalisation and slowing nominal GDP growth weighing on tax collections.
- Weather related uncertainty leads to rise in food prices

Overall, in our view, yields are likely to trend lower in view of congenial financial and monetary conditions. Subdued inflation, comfortable liquidity and proactive monetary policy are positives from yield perspective. Hence, one may consider investment in short to medium duration (schemes with duration of up to 5 years) categories especially corporate bonds focussed funds in line with individual risk appetite.

Moreover, as mentioned by RBI governor in his statement, "*changes in the short-term interest rates will transmit to various long-term rates*", we believe the spreads of longer-maturity bonds over 10-year G-secs could compress hence providing an opportunity for investors in long-duration space.

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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