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A Hawkish Pause! The MPC has held the policy rate at 5.5% after cutting it by a cumulative 100 bps over the previous three meetings, while maintaining a neutral stance. The FY26 headline inflation projection has been moderated by 60 bps to 3.1% on the back of benign food prices; however, Q1FY27 inflation is projected at 4.9% due to an unfavourable base effect. Growth projections remain healthy at 6.5% for FY26, despite global tariff-related uncertainties. Forward-looking growth-inflation dynamics set a high bar for any future rate cuts. A small window for a possible final rate cut may open in the October or December policy meetings, but only if economic growth surprises meaningfully on the downside. Comforting commentary on adequate banking liquidity provides some relief. Currently elevated market yields, combined with low running inflation, offer a favourable risk-reward profile for investors.

Key decisions/Highlights



No change in rates

- Policy repo rate at 5.50%
- Standing deposit facility (SDF) rate at 5.25%
- Marginal standing facility (MSF) rate and the Bank Rate changes at 5.75%.



Status quo on policy stance

- MPC voted unanimously to retain the monetary policy stance to Neutral



FY26 Real GDP projected at 6.5%

- FY26 projection at 6.5% (retained)
- Q1FY26 at 6.5% (retained)
- Q2FY26 at 6.7% (retained)
- Q3FY26 at 6.6% (retained)
- Q4FY26 at 6.3% (retained)
- Q1FY27 at 6.6%



CPI projected at 3.1% for FY26

- FY26 projection at 3.1% (down from 3.7%)
- Q2FY26 at 2.1% (down from 3.4%)
- Q3FY26 at 3.1% (down from 3.9%)
- Q4FY26 at 4.4% (retained)
- Q1FY27 at 4.9%

MPC opts for hawkish pause with neutral policy stance

This monetary policy was setup in an interesting backdrop. In the previous June 2025 policy, MPC had surprised positively with a substantial 50 bps rate cut and a 100 bps CRR cut. However, MPC in a balancing act had given a hawkish messaging as it revised the policy stance to neutral and also indicated the use of Variable Rate Reverse Repo (VRRRs) to absorb the banking liquidity.

Since the last policy, many factors had turned a bit more favorable for the MPC to deliver a balanced August policy. For instance, headline inflation for the month of May and June had come substantially lower than the expectations, largely led by the sharp fall in food prices. Monsoon has been better than expected as the cumulative rainfall till 4th August is 4% above long term average. This has resulted in healthy Kharif sowing and higher reservoir levels, helpful in containing food inflation, going forward.

On global front also, US treasury yields have come down by 20-25 bps since the last MPC as the recent Nonfarm payroll data came much lower than expected which has reignited the hopes of US's rate cut in next forthcoming policy in September. Further, the US has imposed higher than expected tariff of 25% with additional penalties which could be incrementally negative for domestic economic growth.

Against the backdrop of relatively more benign US's rate outlook, domestic inflation expected to remain substantially lower than the 4% target in FY26 and growth pressures due to tariff related uncertainties, market was expecting to see a dovish pause by MPC and to provide some guidance of future rate cut possibility. Some market participants had even expected a rate cut in this policy itself in order to support the growth. MPC, however, delivered a hawkish pause whereby it clearly set the bar higher for future rate cuts depending upon the incoming data on growth-inflation dynamics.

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FY26 inflation lowered substantially. However, Q1FY27 inflation is expected to be above 4%. Core inflation is also steady at ~4%

The inflation outlook has turned favourable with RBI revising FY26 CPI projections downwards to 3.1% from earlier 3.7%. The CPI print for June'25 eased significantly to 2.1%, marking the lowest level since January 2019 on the back of a sharp moderation in food inflation. Looking ahead, good monsoons, healthy sowing and comfortable reservoir levels are expected to keep food price pressure contained. While core inflation inched up slightly to 4.4% in June due to an increase in gold prices, it remains within comfortable levels on ex-gold basis. The combination of recent CPI trends and RBI's downward revision in quarterly inflation projections reinforces confidence in a stable inflation trajectory over the coming quarters. However, CPI inflation is expected to edge above 4% from Q4FY26 onwards owing to an unfavorable base effect. We believe MPC will remain vigilant of emerging global risks - such as trade disruptions and commodity price volatility - even as the domestic inflationary factors recede.

Growth projections maintained despite the tariff related disruptions

RBI has retained its FY26 GDP projections at 6.5% reflecting continued confidence in domestic resilience amid global uncertainties. Domestically, high frequency growth data has been mixed, with manufacturing and services activity showing a sequential pick up, while urban demand remains subdued. Nonetheless, combination of softening inflation, lower interest rates, healthy monsoon, rising capacity utilisation, revival in investment activity, healthy agricultural outlook and supportive policy measures are expected to sustain growth momentum. However, downside risks from global trade disruptions and uncertainties warrants close monitoring.

Forward looking growth-inflation dynamics set a high bar for any future rate cuts

MPC's decision reflects a data dependent approach as RBI evaluates the transmission of previous rate cuts and monitors the evolving macro-economic condition. Even as RBI has lowered the inflation projections for FY26 sharply, the forecast for Q1FY27 has edged up largely on account of unfavorable base effect. Meanwhile, growth projection for FY26 has been retained despite mounting global uncertainties. Given the forward-looking growth-inflation dynamics, MPC has substantially raised the bar for any future rate cuts.

A small window can open up later in October / December policy only if the growth gets revised downwards meaningfully

While the parameters are evolving fast amidst global uncertainty, we believe that a small window may open up in October'25 or at the latest in December'25 policy meeting for a possible final rate cut, but for that domestic economic growth has to come under pressure meaningfully.

RBI has retained its GDP projections for FY26 and across quarters for FY27, signaling confidence in the domestic economy's resilience. However, the recent imposition of a 25% tariff by the US and threats of additional penalties have raised concerns about potential headwinds to growth. While the Governor reaffirmed India's ability to withstand external pressures, any material deterioration in the growth outlook or a significant downside surprise in GDP data could prompt the MPC to consider one final rate cut during this calendar year.

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Some relief on liquidity as RBI reassures adequate banking liquidity to support credit growth; new liquidity framework may not be very different

System liquidity continues to be in surplus with average daily liquidity at Rs. 3.0 lakh crore since the last monetary policy announcement, significantly higher the Rs. 1.6 lakh crore seen in preceding months. From September onwards, the staggered Cash Reserve Ratio (CRR) cut will come into effect, which will further inject additional liquidity into the system. RBI has reaffirmed its commitment to manage ample liquidity in the system to support credit growth and smooth market functioning. Additionally, the RBI is reviewing the liquidity management framework, and the internal group has submitted a report on the same which will be released for public consultation shortly. The group has recommended continuation of overnight weighted average call rate (WACR) as the operating target of monetary policy and to continue with the variable rate auction mechanism for repo and reverse repo operations of various tenors with the objective of maintaining the operating target rate at the policy rate. These are comforting measures as it suggests that the new liquidity framework may not be very different from the existing one.

Market reaction

| Segment | Broad movement of yields in bps (as on August 06, 2025) | |
|-------------|---|----------------|
| | G-Sec | AAA Corporates |
| 3 months | + 3 to 5 bps | + 3 to 5 bps |
| 6 months | + 3 to 5 bps | + 3 to 5 bps |
| 1 year | + 3 to 5 bps | + 3 to 5 bps |
| 2 -3 years | + 7 bps | + 8 to 10 bps |
| 4 - 5 years | + 7 bps | + 8 to 10 bps |
| 10 years | + 8 bps | + 5 to 7 bps |
| 15 years | + 9 bps | NA |
| 30 years | + 7 bps | NA |

Source: Bloomberg

Currently elevated market yields along with the low running inflation gives a favourable risk-reward for investors

As we come to the last leg of the rate cut cycle, it is important to re-align the return expectations from fixed income strategies as capital gain opportunities may be limited. Having said that, risk-reward continues to remain favourable for the debt funds.

Market yields have further gone up by 6-8 bps post policy announcement from an already elevated level. Since the June policy rate cut of 50 bps, 5 year as well as 10 year G-Sec yields have gone up by approximately 18-20 bps. At the same time, headline inflation has dropped sharply to close to 2% and is also expected to remain moderate this year.

The corporate bond spreads in the 1 to 5 years segment are elevated, offering an attractive investment opportunity from accrual perspective. Additionally, the steepness in 5 to 10 years segment of the G-sec yield curve presents a value buy opportunity on the back of favourable demand–supply dynamics. Depending on the risk appetite, investors can consider funds like Low Duration Fund, Short Duration Fund, and Corporate Bond Fund to effectively position across the curve. Income plus Arbitrage Active Fund of Fund provides similar opportunities in a more tax efficient way for more than 2 years investment horizon.

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