Insights- Monetary Policy Review

June 06, 2025

Vikas Garg
Head – Fixed Income

The MPC has frontloaded economic growth support measures with a substantial policy rate cut of 50 bps and a phased CRR cut of 100 bps, far exceeding market expectations. However, in a balancing move, the policy stance has been changed back to "Neutral" from "Accommodative," after having shifted in the previous April policy. FY26 inflation projections have been moderated to 3.7% from the earlier 4.0%, citing benign food as well as core inflation. Growth projections have been maintained at 6.5% for FY26, although downside risks persist amidst global uncertainty. With the Neutral stance, future rate cuts will be data-dependent, based on growth-inflation dynamics. We believe that the current policy rate cut, along with the substantial liquidity surplus from the CRR cut, will gradually drive yields lower, with a curve steepening bias.

Key decisions/Highlights

Rate cut by 50 bps

- 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%.

Policy stance changed to Neutral

- MPC voted to **change the monetary policy stance to Neutral from Accommodative**

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)

CPI projected at 3.7% for FY26

- FY26 projection at 3.7% (down from 4%)
- Q1FY26 at 2.9% (down from 3.6%)
- Q2FY26 at 3.4% (down from 3.9%)
- Q3FY26 at 3.9% (up from 3.8%)
- Q4FY26 at 4.4% (retained)

In an extraordinary move, MPC surprises the market with an outsized 50 bps repo rate reduction and 100 bps CRR cut

Today MPC fired on all cylinders taking aggressive action to stimulate domestic economic growth. In the current times, when global environment remains uncertain, MPC responded proactively and appeared to be well ahead of the curve undertaking significant 50 bps repo rate cut and reduction in CRR by 100 bps in a phased manner. This is a strong response from RBI and has exceeded the market expectations which were at 25 bps repo rate cut with no change expected in CRR.

The rate easing cycle continues for third time in a row; policy stance changes to neutral from accommodative

MPC frontloads the rate cuts, delivering a cumulative reduction of 100 bps so far in this calendar year. The six-member MPC unanimously voted for a reduction in the policy repo rate but differed in the quantum of reductions. The MPC decided by 5-1 majority to reduce repo rate by 50 bps to 5.50%. Today's sequential rate cut was the continuation of its growth-centric approach and was aligned with its change in stance to 'accommodative' in the previous policy. The move comes at a pivotal time as growth remains lower than what India is aspiring for, while policy makers seek confidence from the sustained and durable softening of inflation.

Following the significant rate cut of 50 bps, MPC in a balancing act, changed the policy stance to 'Neutral' from 'Accommodative'. The Governor's statement that 'monetary policy is left with very limited space to support growth' suggests that now there is low probability of further rates cuts unless growth deteriorates significantly. From here on we expect RBI to adopt a data dependent approach before any further rate actions.

MPC – Monetary Policy Committee, RBI – Reserve Bank of India; GDP- Gross Domestic Product; FY – Financial Year, Bps – Basis Points, CRR – Cash Reserve Ratio
Data Source – RBI Monetary Policy Document, Governor's Statement, Bloomberg

Insights- Monetary Policy Review

June 06, 2025

Inflation projection significantly revised downwards to 3.7% for FY26

The Governor has delivered an optimistic outlook on inflation with an extremely benign inflation projections. Over the past six months, headline inflation has eased notably, dropping from above the 4% threshold in Oct'24 to well below the target levels. This decline has been primarily driven by a reduction in food inflation, which has been easing in recent months and steady core inflation. Looking ahead, several factors are expected to keep inflation low: earlier onset and an above-normal monsoon forecast, moderating crude oil prices, and a high base effect. All in all, inflation looks well contained as of now and may not pose risk to monetary policy. However, uncertain global environment and erratic weather conditions warrant monitoring.

A big boost to liquidity from a 100 bps cut in CRR

RBI announced reduction in CRR by 100 bps to 3% of net demand and time liabilities (NDTL) and will be implemented in four equal tranches over the course of this year. This move is expected to inject additional liquidity of ~Rs. 2.5 lakh crore into the banking system albeit in a staggered manner. Over the last few months, RBI has taken various measures to infuse durable liquidity through Open Market Operations (OMO) purchases, USD/INR Buy/Sell swaps auctions and daily Variable Repo Rate (VRR) auctions. Additionally, RBI has announced a record dividend of Rs. 2.68 lakh crore to the Government, which is also expected to further enhance liquidity in the system. This mammoth liquidity surplus should lead to faster rate transmission and drive down the yields at the short end of the yield curve.

GDP growth projections retained; global turmoil continues to be a cause of concern

The growth momentum exhibited resilience and improved in the H2FY25 compared to H1FY25. However, prolonged geo-political tensions, global trade war continue to weigh on the growth outlook. Acknowledging the need to spur growth, MPC responded with a deeper rate cut while taking comfort from ebbing inflation and inflationary expectations. Lower interest rates, resilient domestic demand, revival in investment activity, healthy agricultural outlook, and strong trade activity should help provide much needed fillip to growth. Given this backdrop, RBI retained the growth projections with real GDP growth for FY26 projected at 6.5%.

External factors remain comfortable to cushion the global uncertainty

Even as the global headwinds are putting pressure on emerging countries, India is expected to remain strong. Indian economy has remained resilient on back of strong service exports, moderating trade deficit, manageable current account deficit (CAD), moderating inflation and fiscal consolidation. India's forex reserves have grown to USD 691.5 billion this provides a healthy import cover of about 11 months and about 96% of external debt outstanding.

Insights- Monetary Policy Review

June 06, 2025

Market reaction

Debt market saw big swings during the day as the MPC unfolded the policy decisions. Market saw a huge rally across the curve on 50 bps policy rate cut, however the longer end gave up all the gains and turned negative as the policy stance got revised to "Neutral" which limited the chances for future rate cuts. While the outsized rate cut was expected to steepen the yield curve, we believe the negative market reaction in longer end was overdone as a knee-jerk reaction and accordingly expect it to recover over a period of time.

Segment	Broad movement of yields in bps (as on June 06, 2025)	
	G-Sec	AAA Corporates
3 months	- 20 bps	-30 bps
6 months	- 20 bps	-20 bps
1 year	- 20 bps	-20 bps
2 -3 years	- 6 bps	-20 bps
4 - 5 years	- 2 bps	-15 bps
10 years	+ 4 bps	0 bps
15 years	+ 9 bps	NA
30 years	+ 8 bps	NA

Source: Bloomberg

Overall fixed income market remains in a sweet spot

The more-than-expected rate cut coupled with the substantial liquidity surplus from the CRR cut is likely to drive yield lower in the near term, with a curve steepening bias. Overall, the shorter end of the curve remains supported by benign liquidity and steepening of the yield curve. We believe investors can capture this opportunity and look at increasing allocation to funds in upto 5 year tenure. Depending on the risk appetite, investors can consider funds like Ultra Short Duration Fund, Low Duration Fund, Short Duration Fund, Medium Duration Fund and Corporate Bond Fund. While the steep policy rate cut is favorable for the steepening of yield curve, long end of the curve provides tactical opportunities as the spread has widened sharply and is expected to compress in second half of FY26 when demand picks up from long investors.