

## Policy rate remains unchanged at 5.5%

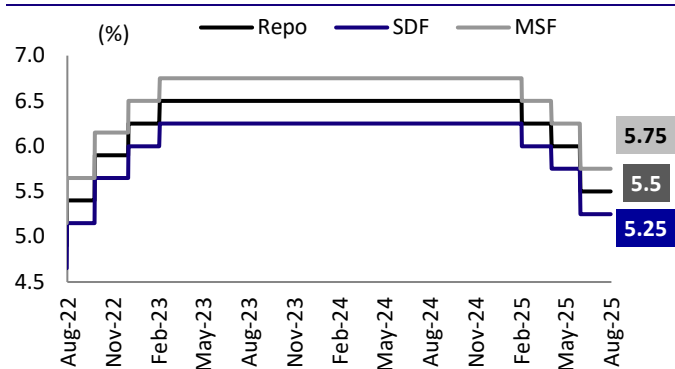
### Future rate cuts unlikely unless growth weakens significantly

- At its third meeting of FY26, the RBI's Monetary Policy Committee (MPC) unanimously decided to keep the benchmark repo rate unchanged at 5.5% and reiterated its neutral stance. The RBI's decision reflects a cautious approach, balancing easing inflation and lingering external uncertainties, particularly the evolving tariff-related developments. Headline inflation has dropped sharply, aided by declining food prices, but core inflation remains sticky. We believe the RBI is adopting a wait-and-watch approach, allowing the full impact of the 100bp rate cuts since Feb'25 to permeate the economy before considering any further monetary action.
- The RBI noted that real GDP growth remains robust but still falls short of aspirational levels. While rural demand has held up well—as evidenced by robust tractor and two-wheeler sales—urban discretionary spending remains tepid. Investment momentum is being supported by rising public capex and improving capacity utilization, though private investment is still uneven and sensitive to global uncertainties. On the supply side, steady monsoon progress has boosted kharif sowing and reservoir levels, which should support agricultural output and rural incomes. Services activity remains strong, with the Services PMI reaching an 11-month high, while construction continues to perform well. However, industrial output remains mixed, with weakness in electricity and mining offsetting strength in manufacturing PMI. Against this backdrop, the RBI has maintained its real GDP projection of 6.5% for FY26 (with 1Q/2Q/3Q/4Q at 6.5%/6.7%/6.6%/6.3%).
- Inflation has declined to a 77-month low of 2.1% in Jun'25, driven by a sharp deflation in vegetable and pulse prices. Core inflation rose slightly to 4.4% in Jun'25 due to rising gold prices. Food inflation recorded its first negative print since Feb'19 at -0.2% in Jun'25. "...the inflation outlook for FY26 has become more benign than expected in Jun'25. Large favorable base effects, along with steady progress of the southwest monsoon, healthy kharif sowing, adequate reservoir levels, and comfortable buffer stocks of foodgrains, have contributed to this moderation...", the MPC mentioned.
- However, CPI inflation is projected to rise above the 4% threshold by 4QFY26, reaching 4.4%, and further to 4.9% in 1QFY27. Core inflation is also expected to remain moderately above 4% for most of the year, barring any major input cost shocks. Key upside risks to the inflation outlook include weather-related disruptions, volatility in global commodity prices, and domestic supply-side frictions. Despite these concerns, the RBI has revised its CPI inflation forecast for FY26, down to 3.1% from 3.7% in the Jun'25 policy (with 2Q/3Q/4Q at 2.1%/3.1%/4.4%).
- Overall, MPC has decided to keep the policy repo rate steady at 5.5%, after cutting it by a total of 100bp over the past three meetings. It has also maintained a neutral stance, indicating that future decisions will depend on how inflation and growth evolve. The RBI has lowered its inflation forecast for FY26 to 3.1%, marking a sharp dip of 60bp, mainly due to the recent decline in food prices. However, inflation is expected to rise again to 4.9% in 1QFY27, largely due to the statistical impact of a low base in the previous year.
- On the growth front, the RBI continues to expect the economy to expand at a healthy pace of 6.5% in FY26, despite uncertainty caused by new global tariffs and weak external demand. However, with inflation expected to rise again and growth holding steady, the RBI may not find room for further rate cuts in the near term. A small window for one last rate cut might open during the Oct'25/Dec'25 policy meetings, but only if there is a clear and unexpected slowdown in economic activity. Overall, the RBI appears to be adopting a cautious, data-dependent approach going forward.

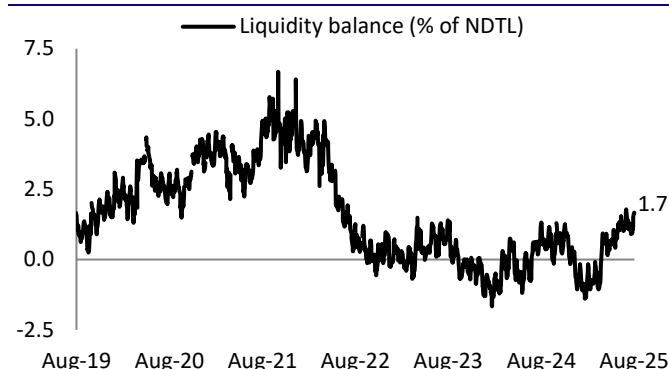
### I. RBI keeps the repo rate unchanged, reiterating a neutral stance

- At its third meeting of FY26, the RBI's MPC unanimously decided to keep the benchmark repo rate unchanged at 5.5% and reiterated its neutral stance. The RBI's decision reflects a cautious approach, balancing easing inflation and lingering external uncertainties, particularly the evolving tariff-related developments. Headline inflation has dropped sharply, aided by declining food prices, but core inflation remains sticky.
- We believe the RBI is adopting a wait-and-watch approach, allowing the full impact of the 100bp rate cuts since Feb'25 to permeate the economy before considering any further monetary action.

**Exhibit 1: Repo rate was unchanged at 5.5% in the Aug'25 policy**



**Exhibit 2: System liquidity remained in surplus over the last two months**



Updated as of 5<sup>th</sup> Aug'25

Source: RBI, MOFSL

## II. Real GDP growth forecast remains at 6.5% for FY26

- The RBI mentioned that real GDP growth remains robust but still falls short of the aspirational levels. While rural demand has held up well—evident from robust tractor and two-wheeler sales—urban discretionary spending remains tepid. Investment momentum is being supported by rising public capex and improving capacity utilization, though private investment is still uneven and sensitive to global uncertainties.
- On the supply side, steady monsoon progress has boosted kharif sowing and reservoir levels, which are expected to support agricultural output and rural incomes. Services activity remains strong, with the Services PMI reaching an 11-month high, and construction continues to perform well. However, industrial output remains mixed, with weakness in electricity and mining offsetting strength in manufacturing PMI. Against this backdrop, the RBI maintained its real GDP projection of 6.5% for FY26 (with 1Q/2Q/3Q/4Q at 6.5%/6.7%/6.6%/6.3%).

## III. Inflation projection reduces to 3.1% from 3.7%

- Inflation has declined to a 77-month low of 2.1% in Jun'25, driven by sharp deflation in vegetable and pulse prices. Core inflation rose slightly to 4.4% in Jun'25 due to rising gold prices. Food inflation recorded its first negative print since Feb'19 at -0.2% in Jun'25. "...the inflation outlook for FY26 has become more benign than expected in Jun'25. Large favorable base effects, along with steady progress of the southwest monsoon, healthy kharif sowing, adequate reservoir levels, and comfortable buffer stocks of foodgrains, have contributed to this moderation...", the MPC mentioned.
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#### IV. Our view

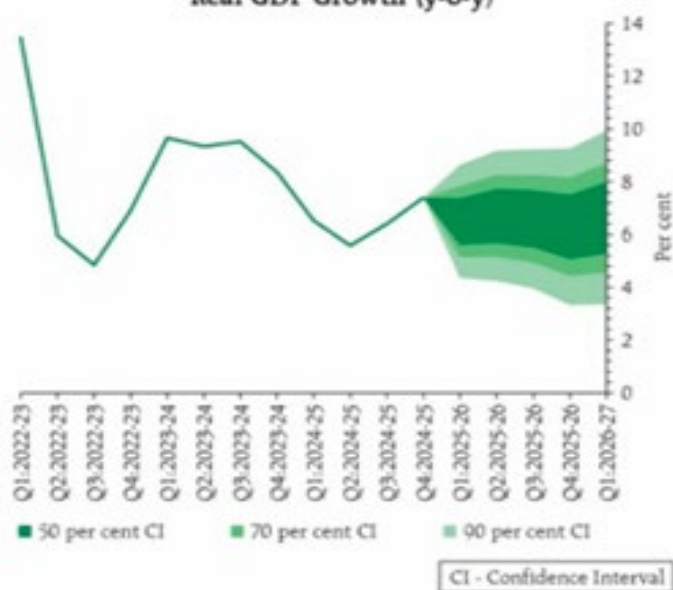
Overall, the MPC has decided to keep the policy repo rate steady at 5.5%, after cutting it by a total of 100bp over the past three meetings. It has also reiterated its neutral stance, indicating that future decisions will depend on how inflation and growth evolve. The RBI has lowered its inflation forecast for FY26 to 3.1%, marking a sharp drop of 60bp, mainly due to the recent fall in food prices. However, inflation is expected to rise again to 4.9% in 1QFY27, largely due to the statistical impact of a low base in the previous year.

On the growth front, the RBI continues to expect the economy to expand at a healthy pace of 6.5% in FY26, despite uncertainty caused by new global tariffs and weak external demand. However, with inflation expected to rise again and growth holding steady, the RBI may not find room for further rate cuts in the near term. A small window for one last rate cut might open during the Oct'25/Dec'25 policy meetings, but only if there is a clear and unexpected slowdown in economic activity. Overall, the RBI appears to be adopting a cautious, data-dependent approach going forward.

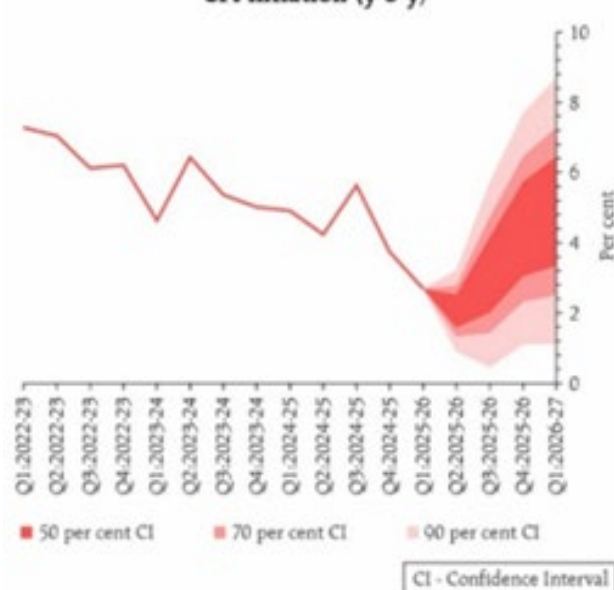
**Exhibit 3: Real GDP growth projected at 6.5%...**

**Exhibit 4: ...with inflation estimated at 3.1% for FY26**

**Chart 1: Quarterly Projection of Real GDP Growth (y-o-y)**



**Chart 2: Quarterly Projection of CPI Inflation (y-o-y)**



Source: RBI, MOFSL

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NOTES

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