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RBI: Expect status quo

Given that there is no pressing concern around growth or inflation, RBI is expected to hold rates unchanged in its upcoming policy. Neutral stance is also likely to be maintained, as the central bank may want to keep option open for one more rate cut if needed. However, for now it seems we have come to an end of the rate cutting cycle. Focus will be more on infusing liquidity. In both Dec'25 and Jan'26, level of liquidity surplus has come down, despite RBI conducting OMO purchases of Rs 3.5 lakh crore in the same period. Yields remain elevated as investors react to postponement of India's inclusion in Bloomberg's global aggregate index and also evaluate government's gross borrowing program announcement in the budget. As a result, we expect the central bank may announce OMO purchases worth ~Rs 1 lakh crore for Feb-Mar'26 period. We do not expect any changes in GDP or inflation forecasts, as MPC may choose to evaluate actual numbers based on new base year before changing its forecasts. However, possibility of inflation going up due to base year revision may be weighed in.

What has changed since the last policy?: Since the last policy, RBI will be evaluating the GDP estimates released by NSO and will also gauge the impact of budget announcements and US-India trade deal on economic growth going forward. Apart from this, plausible change in trend of inflation due to adoption of new index will also be weighed in.

Expectations from MPC: We expect the RBI to keep the repo rate steady at 5.25% in its Feb'26 policy. The stance is also expected to be maintained at neutral. However, there maybe an announcement of CRR cut to infuse permanent liquidity though the chances may be low.

Rationale for this decision:

1. **Domestic growth scenario:** Latest data release by Mospi shows that economic activity has maintained momentum in FY26 as GDP growth is projected at 7.4%, following 6.5% increase in FY25. In nominal terms, growth will be driven by higher government consumption and investment. Exports too will have a positive impact, helped by diversification. Growth in private consumption is expected to remain steady. For next year as well, latest economic survey has projected growth at 6.8-7.2%. CEA expects Indian economy to rise by 7.4% also if we include the impact of recent US-India trade deal. We believe RBI is unlikely to tweak its growth forecast as it will await NSO data based on new index (base year 2022-23 versus 20111- base) for making any revisions.

2. **Budget 2026-27:** Central government continues to remain on the path of fiscal consolidation, as it aims to lower its fiscal deficit (% of GDP) to 4.3% in FY27BE from 4.4% in FY26RE. The debt level will also be reduced from 56.1% in FY26RE to 55.6% in FY27BE. Glide path to reduce this level to 50±1% has also been committed to, implying that government aims to keep the budget non-inflationary. The announcements were also visionary in nature as the target is to build long-term capabilities of the country in order to achieve the Viksit Bharat dream. Capex growth at 11.5% (Rs 12.2 lakh crore) is also more in line with projected nominal GDP (10%) growth. This will help boost investor confidence and crowd in private investments.

3. **Domestic inflation:** Currently CPI remains below RBI's targeted band at 1.3% in Dec'25. It has remained below the 2% mark for 6 months in a row now. Dec'25 reading was helped by continued deflation in the food index, led by vegetables and pulses. While core inflation remains higher (4.6%), however that is primarily due to elevated gold prices. Excluding, gold, pan tobacco, core CPI remains muted at 2.6%. However, going forward, as base year becomes unfavourable, CPI is expected be higher in FY27. We expect it to range between 4-4.5%. In addition, MPC is also expected to deliberate upon the possible impact of revision of base year index for CPI as well, which will be in effect from Jan'26 data. As per our in-house analysis, base year revision may lead to CPI noting an upward bias of 25-40bps, as the weights of core components have been increased and newer services (e-commerce, OTT) have also been added. We do not expect RBI to change its inflation forecasts immediately, however in case it does, it will do so accounting for revision of the base year.

4. **Banking sector growth:** Bank credit has seen pickup in momentum as it has risen by 10.4% in FYTD26 so far (Apr'25-15 Jan'26) versus 8.3% growth last year during the same period (till 10th Jan'25). Even deposit growth has remained stable, registering 8.5% this year so far versus 8.2% last year. As of Dec'25, credit to industries (13.3% versus 7.5%), services (15.3%versus 11.5%), and personal loan segment (14.4% versus 12%)—all have recorded substantial increase compared with last year. Industrial sector has witnessed broad-based growth. Within services, growth is led by computer software, tourism, shipping, aviation and wholesale trade segment. Within personal loans, vehicle loans and loans against gold jewellery are the key drivers.

5. **Transmission of rates:** In measuring how transmission of interest rates as of Dec'25 across different spectrum have fared, the change is taken from Jan'25 just before RBI embarked on the journey of rate cuts.

   In case of PSBs, the transmission on fresh term deposits has seen a decrease of 94bps, while on the lending side, WALR has fallen by 98bps. For PVBs the decrease on fresh deposits is lower at 85bps, while that on loans is higher at 106bps.

Table 1. Fresh term deposit and lending rates

Transmission of rates	Jan'25	Sep'25	Oct'25	Nov'25	Dec'25
WADTDR: PSBs	7.06	6.04	6.02	6.05	6.12
WADTDR: PVBs	6.70	5.76	5.73	5.77	5.85
WALR: PSBs	8.59	7.80	7.89	8.05	7.61
WALR: PVBs	10.20	9.14	9.44	9.44	9.14

Source: RBI, Bank of Baroda Research

6. **Global developments:** For India, there has been a positive development on US-India trade deal front. As per the preliminary details available, US tariffs on made in India products will be lowered to 18% from 50% earlier. Further details on our oil imports from Russia and our tariffs on US goods are still awaited. Conclusion of trade negotiations will be positive for growth, foreign fund inflows and currency. On the other hand, if tensions between US and Iran escalate any further, then it might add to upside risks to oil and other commodity prices. This will impact us through WPI and INR. Another key point to consider is that of Fed's rate

trajectory in 2026. Current Fed Chair Jerome Powell has indicated that given that the economic activity and labour market remains steady, there is no urgency to cut rates at a faster pace. However, President Donald Trump has announced that Kevin Warsh will succeed Jerome Powell after his tenure ends in May’26. Investors are expecting slightly more dovish stance of Fed after he takes over.

System liquidity: On an average, liquidity has remained in surplus in CY26 so far (1 Jan-3 Feb) at Rs 74,123 crore, similar to what it was in Dec’25. This is despite conducting OMO purchase of Rs 2 lakh crore in Jan’26 alone. Shrinking liquidity surplus and elevated yields indicates that RBI is likely to announce more OMOs in its latest policy (~Rs 1 lakh crore between Feb-Mar’26). It is also possible that it may announce a CRR cut to infuse permanent liquidity into the system.

Sovereign yields: Since the last policy, yields on 10Y G-sec have risen by ~21bps and are currently trading at around the 6.71% mark, compared with 6.49% before the Dec’25 policy. There are 2 factors which have impacted yields since then. The first is the news of postponement of India’s inclusion in its flagship Global Aggregate Index. The second is higher than expected gross borrowing numbers announced by the government in its budget. However, announcement of US lowering tariffs on Indian goods has been a positive for yields. More liquidity easing measures from the RBI will also help bring yields further down.

To sum up: We expect RBI to hold policy repo rate unchanged at 5.25% and keep the stance as neutral. This will be mainly to give itself firepower if the need arises to cut rates one more time in future. However, we believe we might be at the end of the rate cutting cycle now. Measures maybe announced to infuse more liquidity. For this, RBI may announce an OMO purchase calendar of ~Rs 1 lakh crore for Feb-Mar’26 and could also opt for a CRR cut in case it decides to infuse permanent liquidity into the system.

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