

RBI keeps rate unchanged

The MPC unanimously decided to keep the repo rate unchanged at 5.5%, by a unanimous vote as it assesses the twin impact of tariff shock and GST rationalisation on growth. Stance of the monetary policy was kept at neutral, even as two members had a different view. RBI raised its growth forecast for the year upwards, while signalling a weaker growth trajectory in H2 FY26. Inflation projection received a significant downward revision, largely reflecting the impact of a lower base and correction in food inflation. RBI's projections on growth and inflation suggest that there might be room for further policy easing, although the magnitude will be limited. We expect the terminal repo rate at 5.25%; however, the timing of the next rate cut will be crucial.

Status quo: In line with our expectations, RBI's monetary policy committee voted to keep the repo rate unchanged at 5.50%. Stance of the monetary policy was also maintained at 'neutral'. While the vote to keep rate unchanged was unanimous, two MPC members voted to change the stance to accommodative.

Key takeaways from policy

- RBI revised its growth projection for FY26 upwards to 6.8% from 6.5% estimated earlier. This largely reflects an upward revision in H1 GDP, even as RBI expects growth in H2 to be lower. For Q2FY26, GDP growth has been revised up by 30bps. On the other hand, GDP growth in Q3 and Q4 is now projected to be lower by 20bps and 10bps respectively.
- For Q1FY27 as well, GDP growth is estimated lower at 6.4% versus 6.6% estimated earlier.
- The RBI Governor noted that while growth continues to be strong driven by robust domestic fundamentals, external headwinds pose a significant risk to the outlook.
- In this regard, recent measures including the revision in the GST structure are likely to offset some impact of trade related disruptions.

Figure 1: Growth projection for FY26 revised up

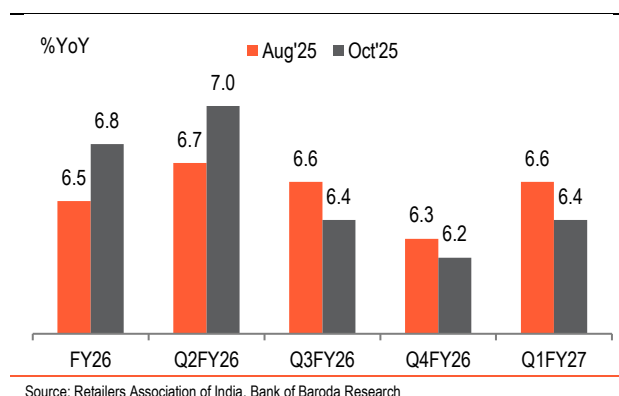
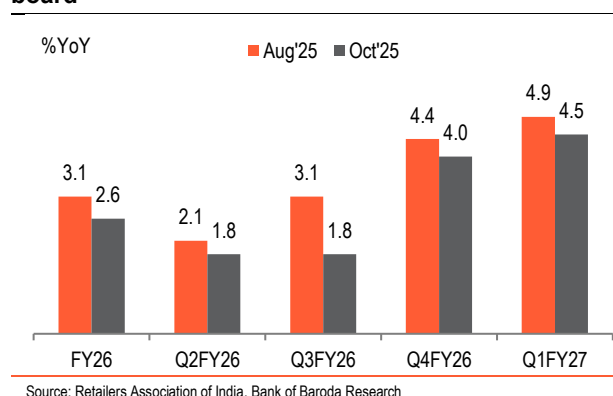


Figure 2: Inflation projections lowered across the board



- On inflation, RBI's assessment appeared to be quite optimistic based on the trends seen recently. In particular, the recent moderation in food inflation along with robust kharif production and adequate reservoir levels, suggests a benign outlook for food inflation. At the same time, core inflation is likely to find support from recent GST cut.
- Hence, the RBI decided to revise its inflation projections downward to 2.6% for FY26 (3.1% earlier). In fact, inflation projections for all the subsequent quarters were revised down. Most notably, RBI now expects inflation in Q3 FY26 at 1.8% versus 3.1% earlier.
- On liquidity and policy transmission, the Governor's statement noted that liquidity conditions are expected to remain comfortable and will be managed through RBI's continued two-way operations. Transmission of rate cuts has been broad-based and would get additional impetus from the scheduled CRR cuts.
- Banking system remains well capitalized, with healthy asset quality and improved profitability. The lower growth in bank credit can be explained by increase in non-bank sources of finance which have grown steadily in FY26 so far.

Banking related announcements:

- The RBI Governor also listed out a number of regulatory announcements aimed at regulatory compliance, improving flow of credit, foreign exchange management, customer protection and financial markets.
- Amongst major announcements, the expected credit loss (ECL) framework is expected to take effect from 1 April 2027. This move is likely to benefit banks, as it will provide them with enough time to transition to the new framework. Banks will also be given a glide path till 31 Mar 2031 to even out its impact on their books.
- The revised BASEL III norms, particularly regarding credit risk on capital charge will also be applicable by 1 Apr 2027. This is likely to lower risk weights on segments such as MSME and real estate, aiding banks.
- Banks are also likely to benefit from a lower deposit insurance premium as the RBI plans to introduce a risk-based framework for deposit insurance. Under this, banks which are "sound" to would pay a lower premium, doing away with the flat rate premium being paid at present.
- RBI also announced the removal of the guidelines on enhancing credit supply for large borrowers through market mechanisms. This will boost bank lending to large corporates, by removing the ceiling for exposure to large corporates at individual bank level.
- Banks will also be given greater flexibility in opening and operating current accounts, cash credit accounts and overdraft accounts. This is also likely to boost banks' business.
- Banks will also be required to provide digital services to BSBD accounts to enhance customer service.
- RBI also announced a slew of measures with regard to operation of foreign currency accounts, to ensure easy access for exporters.
- Banks will be permitted to lend to resident borrowers in Nepal, Bhutan and Sri Lanka in INR. This will increase the use of rupee in cross border transactions and boost banks' business in other countries.

Way forward

The monetary policy statement was on expected lines. However, a few points which stood out included the Governor's comment on below potential growth. The outlook on inflation was sanguine. The policy statement also noted that *"the current macroeconomic conditions and the outlook has opened up policy space for further supporting growth"*. RBI remains watchful of latest developments in trade policy noting that tariffs can have a negative impact on growth. At the same time, the impact of recent domestic structural changes, particularly the GST rationalization is also likely to play out in the coming months and will need to be monitored. Overall, this does open up the possibility of another rate cut of 25bps, which is also our base case.

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