

**RBI surprises with a cut**

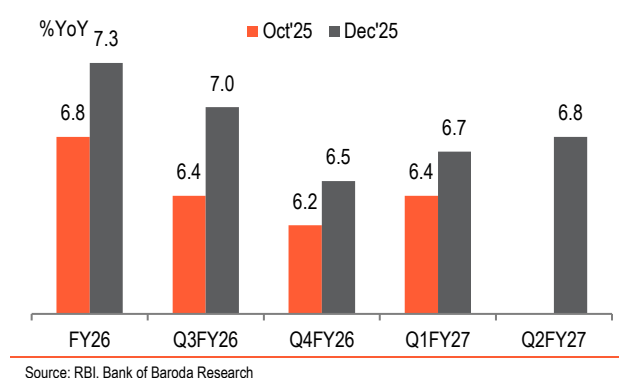
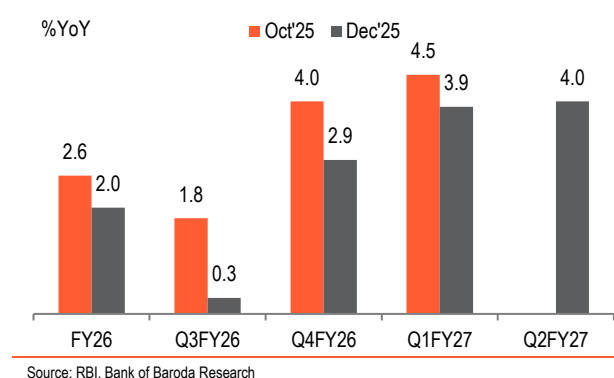
*The MPC unanimously decided to cut its policy repo rate by 25bps to 5.25%, after keeping it steady at each of its last two meetings. Stance of the monetary policy was retained at neutral, with one member favouring an accommodative stance. RBI also announced OMO auctions and USD/INR buy sell swap auction to inject durable liquidity into the system. These measures are likely to infuse additional liquidity of Rs. 1.45 lakh crores in the system. With regard to the MPC's assessment of the growth and inflation outlook, RBI revised its growth projections upwards based on the trends seen so far. At the same time, inflation projections received a significant downward revision. With this, growth in FY26 is estimated at 7.3% compared with 6.8% estimated earlier. Inflation is projected at 2.0% marking a downward revision of 60bps. More importantly, while the RBI sees some risks to the growth outlook from trade related uncertainties, it remains confident on the inflation trajectory. This makes us revisit our base scenario of the terminal rate settling at 5.25%. We now believe that there is a high probability of a further cut of 25bps in Feb'26, which will mark an end to its rate cut cycle.*

**MPC decision:**

RBI's monetary policy committee (MPC) voted unanimously to reduce the policy repo rate by 25bps to 5.25%. This was the first rate cut since Jun'25, when the policy rate was reduced by 50bps. The MPC also continued with the neutral stance, even though one MPC member, i.e. Prof. Ram Singh favoured changing the stance to accommodative.

**Assessment of growth and inflation outlook:**

- RBI revised its growth projection upwards by 50bps to 7.3%. Growth estimates for both Q3 and Q4 were revised higher to 7% (+60bps) and 6.5% (+30bps) respectively. For Q1 FY27 as well, growth is now projected higher at 6.7%, reflecting an upward revision of 30bps.
- For Q2FY27, GDP growth is estimated at 6.8%.
- As per RBI's assessment, benefits from income tax rationalization and GST rate cuts have supported growth in H1 FY26. At the same time, high frequency indicators suggest that economic activity held ground in Q3 FY26, even though there are pockets of stress.
- Agricultural growth is supported by robust kharif production and rabi sowing. Manufacturing activity and investment demand is showing steady recovery, while services growth has continued at a robust pace. Rural demand is buoyant, while urban demand too showed signs of recovery. However, merchandise exports contracted.
- In particular, the RBI remains wary of the risks to growth from trade related developments, while also noting that a swift progress in trade negotiations could push growth even higher.

**Figure 1: Growth projection for FY26 revised upwards****Figure 2: Inflation projections lowered significantly**

- The MPC noted that progress on inflation has been better than estimated with H1 FY26 inflation falling to 2.2%. This was led by a correction in food prices, with food inflation remaining in the deflation territory for the last 5 months.
- Food prices are likely to be supported by robust agricultural production. At the same time, core inflation is expected to remain steady at current levels.
- Based on this, inflation projection for FY26 was revised lower to 2.0% from 2.6% estimated in Oct'25.
- For all the subsequent quarters as well, RBI now estimates a lower inflation rate. Inflation projections for Q3 and Q4 FY26 have been revised lower by more than 100bps to 0.3% (1.8% earlier) and 2.9% (4.0% earlier).
- For Q1 FY27, the estimated inflation at 3.9% is lower than 4.5% projected by the RBI in its last meeting, while for Q2 FY27 RBI projects inflation at 4.0%.
- Hence, inflation is expected to remain below or at the 4% level until H2 FY27.

#### Liquidity measures:

- The Governor announced that the RBI will conduct OMO purchase auction of Rs. 1 lakh crores in two equal tranches and a USD/INR buy sell swap auction of US\$ 5bn in Dec'25 to inject durable liquidity into the system. This is based on the RBI's assessment of current liquidity situation as well as future outlook. Together, these operations are expected to infuse additional liquidity of ~Rs. 1.45 lakh crores into the system.
- At present the liquidity surplus in the system stands at Rs. 2.7 lakh crores. However, RBI's move to inject durable liquidity largely preempts stress on liquidity due to factors such as currency demand, forex operations and reserve maintenance in the coming days.
- This is essential for effective monetary policy transmission.
- RBI Governor also stressed on the fact that while OMOs and USD/INR buy sell swap auctions are aimed at maintaining durable liquidity in the system, these are likely to be supplemented by RBI's regular VRR/VRRR auctions which are aimed at smoothening transient liquidity requirements so as to ensure that the WACR remains closely aligned to the repo rate.

## Way forward

The RBI Governor in his statement noted that a “rare goldilocks” opportunity was provided in H1 FY26 with solid growth and benign inflation. This largely motivated the RBI to reduce its policy rate by 25bps. Inflation outlook is largely optimistic with continued moderation in food prices and range-bound core inflation. On the other hand, growth prospects though bright, face some pressures due to the drag from higher US tariffs. RBI’s assessment places H2 growth at 6.8% and inflation at an average rate of 1.6%, which provides an opportunity for a rate cut. We now expect that there is a high probability that the RBI is likely to follow up this rate cut with another in Feb’26, which will be the last in this monetary easing cycle. We can hence see the terminal repo rate at 5.0%.

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