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RBI expected to hold rates

The monetary policy committee (MPC) of the RBI is likely to keep its policy rate and stance unchanged for the second consecutive meeting in Dec'25. Strong growth and rangebound inflation are expected to provide the MPC space to keep rates steady as it navigates a challenging and uncertain external environment. Growth has held ground in Q3, largely supported by GST cuts and festive demand. At the same time, lower food inflation has kept a lid on headline inflation. Given this backdrop, the MPC is likely to move on rates only in case the risks to growth materialise in Q4 FY26. Given the recent numbers, we expect the MPC to revise its growth projection upwards, while inflation estimates are likely to see a downward revision. Further, while liquidity has remained in surplus in Nov'25, some liquidity measures in the form of OMOs can be expected to account for the strain on liquidity from RBI's forex intervention to stabilise the rupee.

Expectations from the MPC: *We expect the RBI to keep the repo rate steady at 5.50% in its Dec'25. The stance is also expected to be maintained at neutral.* At 8.2% in Q2 FY26, India's GDP growth surpassed all estimates. The economy is expected to have maintained momentum in Q3 FY26 as well supported by a recovery in urban consumption and resilient rural demand. Private investment is also witnessing signs of a recovery with a pickup in credit demand. At the same time, inflation has continued to moderate. In Oct'25, CPI inflation eased to a series low of 0.25% due to a sustained decline in food prices. Inflation is expected to moderate further and is likely to undershoot RBI's estimates. Ample rainfall, timely supply side interventions and improved production have brightened the food inflation outlook significantly. Core inflation has remained above 4%, but much of it can be attributed to higher gold prices and is not demand driven. This has been partially offset by the benefits of lower GST rates. While this opens room for a rate cut, RBI is likely to adopt a cautious approach in this meeting, particularly since growth remains on a strong footing. Need for further support can arise later particularly if the tariff situation does not improve. This will also provide ample time for previous rate cuts to fully transmit into the system.

GDP and inflation forecasts: Q2 FY26 GDP at 8.2% was significantly above the RBI's forecast of 7%. With the H1 GDP print at 8%, we expect the RBI to revise its growth forecasts upwards from 6.8% currently. On the other hand, inflation forecasts are likely to see a downward revision as actual inflation is tracking much below the RBI's estimates. Our own growth forecast stands at 7.4-7.6% for FY26. We expect inflation to range between 2.4-2.5% in FY26.

Liquidity measures: System liquidity has remained in surplus in each of the last 8-months. In Nov'25 as well, liquidity surplus increased to Rs. 1.8 lakh crores compared with Rs. 0.9 lakh crores in Oct'25. Incidentally, two CRR cuts of 25bps each were implemented this month, which supported the liquidity surplus. There can be some pressure on liquidity due to RBI's forex intervention to support to the rupee. Hence, we can expect some measures to maintain the liquidity surplus at ~1% of NDTL in the form of OMOs.

Banking developments: Bank deposits have grown by 10.2% (11.2%) as of November 14, 2025. In contrast growth in credit has been higher at 11.4% compared with 11.2% last year during the same period.

In response to the rate cuts this year, the WALR on fresh loans is down for banks from 9.33% in January to 8.64% in October while that on deposits (WADTDR) came down from 6.62% to 5.57% during this period.

Bond yields: The 10-year bond yield has been range bound in the region of 6.50-6.55% since the last rate cut and will be looking for direction in the policy both through action and articulation.

Overview of the economy and future outlook: High frequency indicators suggest a continued momentum in economic activity in Q3 FY26. While lower than last month, India's manufacturing PMI has remained firmly above the 50-mark indicating an expansion in economic activity. Services PMI too has shown steady growth in the services sector activity. Private consumption has received a significant boost from GST rate cuts. Rural consumption has continued to be buoyant supported by two successive years of good rainfall, improved sowing activities and higher MSPs. There has been a significant uptick in sales of two-wheelers as well as tractors. Urban demand too is seeing a revival as reflected in sales of PV and higher non-oil-non-gold imports. E-way bill generations and fuel demand have seen a significant pickup in Oct'25. Credit growth too is showing signs of a revival, even as deposits growth has remained muted. This suggests that the economy maintained momentum in Q3 FY26.

On the inflation side, risks remain contained. Food prices are showing a downward momentum, driven by easing prices of vegetables, pulses and cereals. Core inflation while above 4%, is not a cause for concern at the moment. Hence, a pause at this policy will allow the RBI to monitor external developments more closely. Higher US tariffs can impact India's growth trajectory, however there are hopes that a trade deal can be forged before the end of the year. Hence, a pause at this juncture would be a prudent call. We believe that the RBI is likely to take a call on rates in Feb'26 awaiting more clarity on growth and inflation outlook.

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