

# Monetary Policy Review

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**PRIME**  
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— Empowering decisions —

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## Beyond the Pause: RBI Is Fortifying India Against Global Headwinds

- ❑ The RBI's decision to pause was both sensible and widely anticipated. By pairing a neutral stance with a 50-basis-point upward revision to its baseline CPI forecast, the MPC signalled a clear-eyed acknowledgement of heightened global uncertainty — encompassing West Asia spill overs, rising energy costs, and monsoon-related risks. Rather than reaching for the blunt instrument of a rate hike, which risks choking a resilient domestic recovery (with the FY27 growth projection brought down to 6.6%), the Governor has opted to lean on administrative levers and capital-flow management to stabilise the currency and contain inflation.
- ❑ Demand-side pressures remain largely benign — core inflation, excluding precious metals, is well-contained — but the 50-bp upward revision to the CPI forecast has pushed the real repo rate below the estimated real neutral rate. This dynamic strengthens the case for calibrated monetary tightening at subsequent meetings, should imported inflation begin to pass through to the headline CPI.
- ❑ In the near term, the possibility of any further OMOs by the RBI in FY27 has now significantly reduced. Management of frictional liquidity imbalances (for instance tax outflows etc.) are likely to be addressed through fine tuning operations, and any FX interventions could be appropriately sterilised (as has been done by RBI over the last few weeks through buy/sell swaps).
- ❑ The policy's most consequential dimension lies in its aggressive effort to attract foreign capital inflows — both to defend the rupee and to cushion the economy against imported inflation.
- ❑ Exempting FPI debt investments from capital gains tax delivers an immediate, near-term boost to bond flows and rupee stability.
- ❑ Liberalised FPI limits in G-Secs, combined with lower hedging costs on External Commercial Borrowings (ECBs), help build forex reserves without compelling the MPC to embark on an aggressive rate cycle.
- ❑ The liberalisation of investment norms for NRIs, OCIs and other overseas individuals strengthens India's capital account at a time when external financing conditions remain dynamic, while also supporting rupee stability.

- ❑ Over the past two years, heavy domestic debt supply and robust banking credit demand have prevented policy transmission from feeding through to lower corporate borrowing costs. By incentivising PSUs and large corporates to tap overseas markets through improved ECB conditions, the RBI is easing domestic supply pressure and, in turn, organically pulling yields lower.
- ❑ The bond market's reaction confirms that structural measures — rather than the policy stance itself — are the primary driver.
- ❑ G-Sec yields softened by ~4 bps, reflecting steady sovereign demand. Corporate bond yields fell sharply by ~25 bps, meaningfully compressing credit spreads.
- ❑ This is a well-calibrated policy on balance. It reinforces confidence in India's macroeconomic footing — defending the currency, maintaining inflation discipline, and simultaneously creating a highly constructive environment for the corporate bond market — all without sacrificing the momentum of economic growth.

## Implication on Market:

- *While the exact quantum of capital inflows due to individual measures announced is difficult to quantify at this stage, the combined impact could certainly help bridge the \$40-50 billion gap on the balance of payments that we had estimated for FY27 (with the assumption of a 2.1% of CAD/GDP, oil average at \$90 pbl.). More than a decade ago, when similar measures were announced, cumulative ECB flows stood at \$12 billion and FCNR deposits were at \$26.6 billion for the full year 2013-14.*
- *We expect spot USDINR to settle closer to 95-96 levels by fiscal year-end after a period of some short-term gains, while 6.80-7.10% for the 10 year and an eventual move towards 7.20-7.40% by the year-end.*

## Change in Policy Rates

Date	CRR	Repo Rate
05-Jun-26	3.00%	5.25%
08-Apr-26	3.00%	5.25%
06-Feb-26	3.00%	5.25%
05-Dec-25	3.00%	5.25%
01-Oct-25	3.00%	5.50%
06-Aug-25	3.00%	5.50%
06-Jun-25	3.00%	5.50%
09-Apr-25	4.00%	6.00%
07-Feb-25	4.00%	6.25%
06-Dec-24	4.00%	6.50%
09-Oct-24	4.50%	6.50%

## Key Highlights

- ❑ The MPC voted **unanimously** to keep the policy repo rate under the liquidity adjustment facility (LAF) **unchanged** at 5.25%. Consequently, the standing deposit facility (SDF) rate remains at 5.00% and the marginal standing facility (MSF) rate and the Bank Rate remains at 5.50%. They also decided to continue with the **neutral stance**.

## Indian Macro Environment:

### Economic Growth Snapshot

- Real GDP expanded by 7.8% in Q3FY26. Private consumption and gross fixed capital formation (GFCF) grew by 8.7% and 7.8%, respectively, in Q3FY26.
- GST E-way bills increased by 11.8% in April 2026, while toll collections increased by 12.6% in May 2026.
- Domestic air cargo posted a growth of 8.2% in April 2026. Motor vehicle sales (retail) grew by 5.7% in May 2026.
- Port cargo witnessed a growth of 7.1% in FY26.
- PMI services for May 2026 improved to 59.8 from 58.8 in April 2026 and manufacturing PMI rose to 55.0 in May 2026, up from 54.7 in April.
- Demand for work under the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) declined by 31.0% in April-May 2026.
- Capacity utilisation (CU) of the manufacturing sector at 75.2% in Q4FY26 was above the long-term average of 74.0%.
- The central government's capex is budgeted to expand by 11.5% in 2026-27.

## ▪ Inflation:

- Inflation in CPI food and beverages division increased to 3.7% and 4.0%, respectively, in March and April from 3.3% in February 2026.
- Core inflation remained stable at 3.7% during March-April. Excluding precious metals, core inflation was much lower at 2.1-2.2%.
- WPI inflation increased from 3.9% in March to 8.3% in April as the index recorded a MoM increase of 3.9%, the highest momentum observed so far in the current series (2011-12=100).
- Indian Crude Basket prices averaged \$114.5 in April and \$106.2 in May.

## ▪ Liquidity:

- The average daily net absorption under the LAF increased from Rs 1.7 lakh crore in March 2026 to Rs 3.9 lakh crore in April but thereafter moderated to Rs 1.7 lakh crore in May 2026. System liquidity averaged Rs 1.3 lakh crore in June (up to June 3)
- The Reserve Bank conducted long-term forex buy/sell swap auction of USD 5 billion in May 2026.
- Since the last MPC meeting in April, 11 VRR and 2 VRRR operations were conducted.
- On a YoY basis, bank credit registered a growth of 16.2% as on May 15, 2026, compared to 9.8% a year ago.

## ▪ Foreign Fund Flows:

- Gross FDI flows to India grew by 17.3% to a historical peak of US\$ 94.5 billion in FY26 from US\$ 80.6 billion in FY25. Net FDI inflows increased to US\$ 7.7 billion during FY26 from US\$ 1.0 billion in FY25.
- Net FPI to India, however, witnessed outflows of US\$ 13.7 billion, primarily in the equity segment. During April 1-June 2, 2026, net outflows from the equity and debt segments stood at 13.4 billion and US\$ 0.3 billion, respectively.

## Measures to Attract Foreign Capital

### ▪ Bond Markets:

- Foreign investment under the Fully Accessible Route (FAR) expanded the universe of 'specified securities' by including all new issuances of 15-, 30- and 40-year tenor G-secs from earlier 10-year.
- Limits pertaining to short-term investment, concentration and individual securities on FPI investment under the General Route are being removed.
- These measures along with the tax benefits provided by the government this morning should help attract foreign capital for government borrowing.

### ▪ Global Indians:

- The limits for investment by Non-Resident Indian (NRIs) and Overseas Citizen of India (OCIs) in equity instruments traded on the stock market without SEBI registration are being increased. Further, the same facility is being extended to all individual Persons Resident Outside India (PROIs) at par with NRIs and OCIs.

### ▪ External Commercial Borrowings:

- A facility of concessional forex swap will be provided till 30th September 2026 to incentivise ECBs by PSUs.

### ▪ FCNR (B) Deposit

- A similar facility will be available to Authorised Dealer banks for raising fresh FCNR(B) deposits with maturities of 3-5 years. RBI will bear the full hedging cost under this scheme until September 30, 2026, which should incentivise mobilisation of foreign currency deposits.

### ▪ Export Realisation:

- Restored the time for realisation of export proceeds to nine months from three months from fifteen month.

## RBI's Inflation Expectation: Inflation at 5.1% for FY27

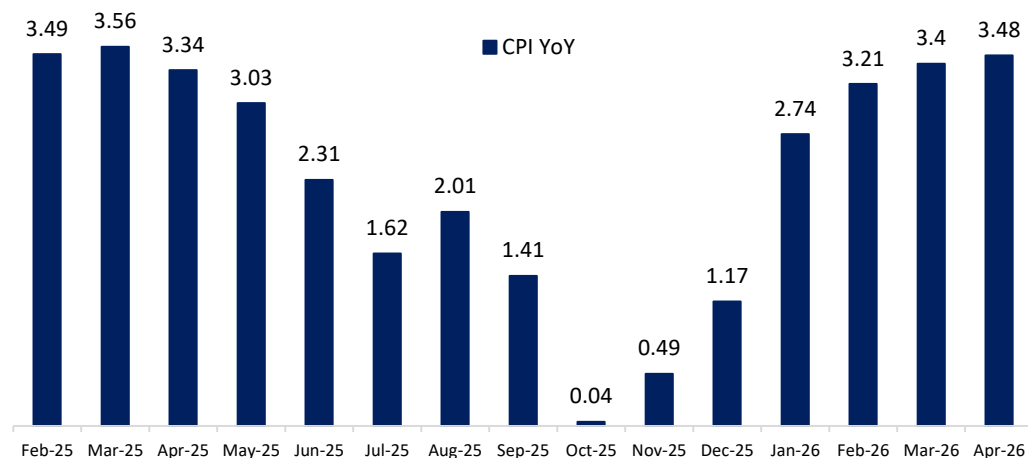
Outlook	5-Jun-26	8-Apr-26	6-Feb-26	5-Dec-25	1-Oct-25	6-Aug-25
<b>Inflation Growth (%)</b>						
1Q FY27	4.2	4.0	4.0	3.9	4.5	4.9
2Q FY27	5.1	4.4	4.2	4.0	n/a	n/a
3Q FY27	5.9	5.2	n/a	n/a	n/a	n/a
4Q FY27	5.4	4.7	n/a	n/a	n/a	n/a
FY27	5.1	4.6	n/a	n/a	n/a	n/a

## RBI's Growth projections: GDP growth at 6.6% for FY27

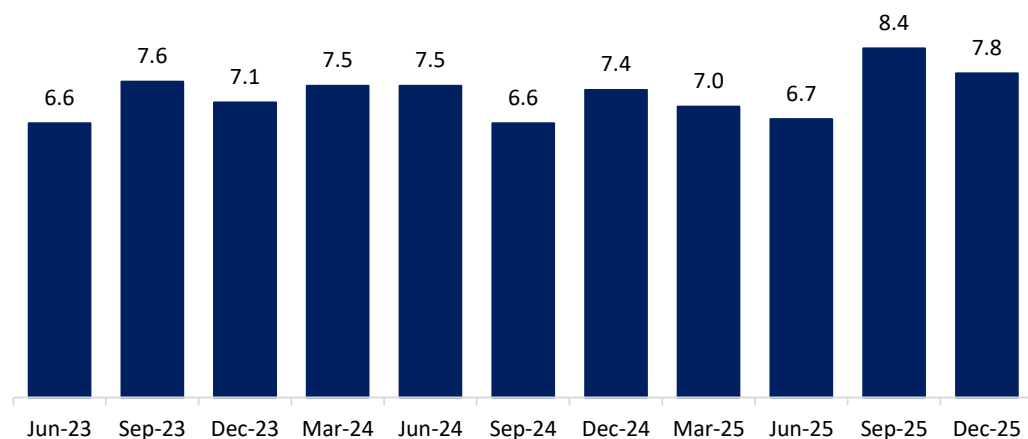
Outlook	5-Jun-26	8-Apr-26	6-Feb-26	5-Dec-25	1-Oct-25	6-Aug-25
<b>Real GDP Growth (%)</b>						
1Q FY27	6.6	6.8	6.9	6.7	6.4	6.6
2Q FY27	6.3	6.7	7.0	6.8	n/a	n/a
3Q FY27	6.5	7.0	n/a	n/a	n/a	n/a
4Q FY27	6.8	7.2	n/a	n/a	n/a	n/a
FY27	6.6	6.9	n/a	n/a	n/a	n/a

Source: RBI, HSL Prime Research

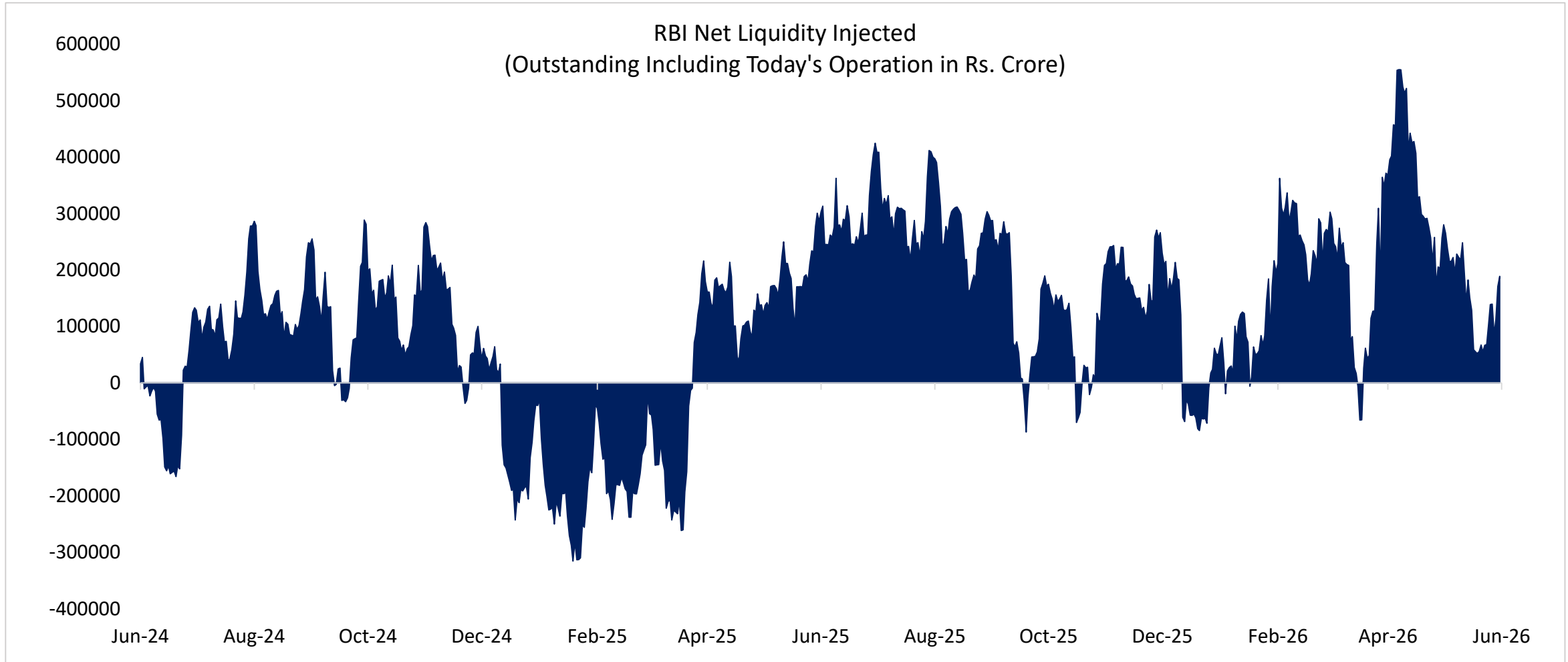
## India Inflation Trends



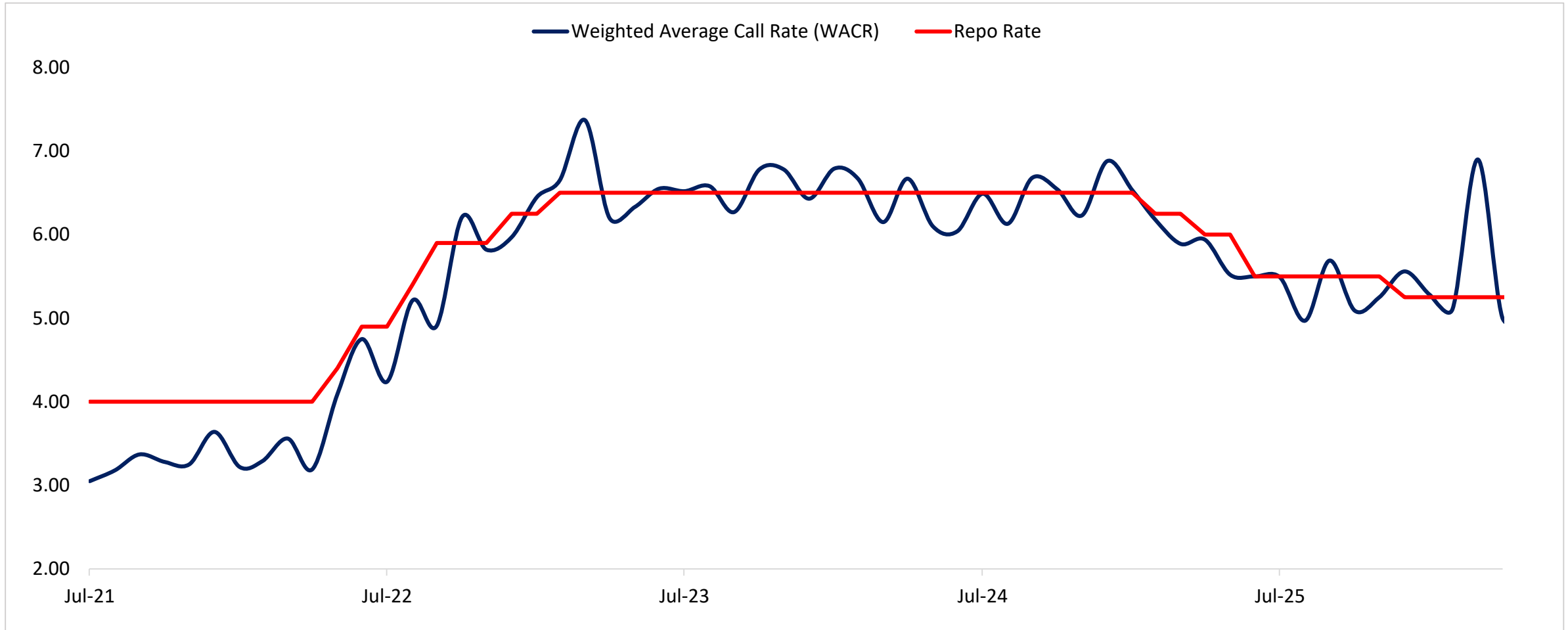
## India Quarterly GDP YoY % Growth



## Liquidity Remained in Surplus



## Weighed Average Call Rate (WACR) vs Repo Rate



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