

## Status quo but building up cases for future rate hikes

*A lot has changed since the last monetary policy meeting of RBI. There have reports of a 60-day extension of ceasefire albeit constant uncertainty surrounding the same. International crude prices have shown some correction following the news. However, volatility in crude prices cannot be ruled out, going forward, unless a formal peace deal arrived. The most notable change since the last policy has been the hike in petrol and diesel prices which was much anticipated. RBI's inflation projection is likely to incorporate the same. We expect the RBI's CPI projection for FY27 to be revised upward. Another important development has been the volatility in INR. This does not fall under the ambit of monetary policy. We may expect status quo on rates as the impact on growth due to the crisis is still difficult to ascertain and on inflation front, an increasing trend is imminent. On stance we expect RBI to maintain it at neutral since it has the flexibility of responding to incoming data, as highlighted by RBI in its previous policies.*

### What has changed since last policy?

Major change since the last policy has been:

1. Reports of possible 60-day extension of ceasefire between US and Iran albeit constant back and forth of military strikes. Market variables have responded accordingly with rebalancing of risk sentiments. Since the last policy (8 Apr 2026), international crude prices have remained at the same level. Any disruption in the ceasefire and visible signs of escalation, might again upend the process.
2. On domestic front, the major development is the hike in petrol, diesel and CNG prices. On a cumulative basis, petrol and diesel prices in Delhi have increased by Rs 7.35 and Rs 7.50/ltr, respectively, since 15 May in four phases. The pass-through to inflation print is yet to show its impact in the coming print. Given the higher weightage of petrol diesel of ~ 4.81% in the current series compared to 2.33% in the previous series, this will be an interesting thing to watch. CPI has shown slight momentum since the last policy yet remaining below the 4% mark. The impact of West Asia crisis is yet to show its impact on the print.
3. The volatility in INR continued. Since the last policy it has depreciated by 2.5%. This is despite a softer dollar. In Apr'26, net FPI outflow was US\$ 7.6bn and in May'26, the net outflow was at a softer pace of US\$ 3.1bn.

**Table 1. Snapshot of major macro and market variables**

Major variables	27-Feb-26 (Start of the war)	Last policy-8Apr	Current*
Brent, USD/bbl	72.5	94.8	95.0
WPI	-	2.3	8.3
CPI	-	3.2	3.5
DXY Index	97.61	92.58	99.20
US10Y yield (%)	3.37	3.79	4.45
India 10Y yield (%)	6.66	6.90	7.02

Major variables	27-Feb-26 (Start of the war)	Last policy-8Apr	Current*
Gold, USD/troy ounce	5,279	<b>4,720</b>	<b>4,485</b>
Sensex	81,287	77,563	74,267
INR/USD	90.98	<b>92.58</b>	<b>95</b>
Liquidity, Rs crore (+/-: surplus/deficit)	2.9	<b>4.6</b>	<b>0.9</b>
Credit, % YoY	13.6	13.8	16.2
Deposit, % YoY	11.2	10.8	12.2
WACR	5.11	5.08	5.30
WADTDR- Fresh, SCBs (April)	5.65	6.07	5.77
WALR-Fresh, SCBs (April)	8.44	8.4	8.5

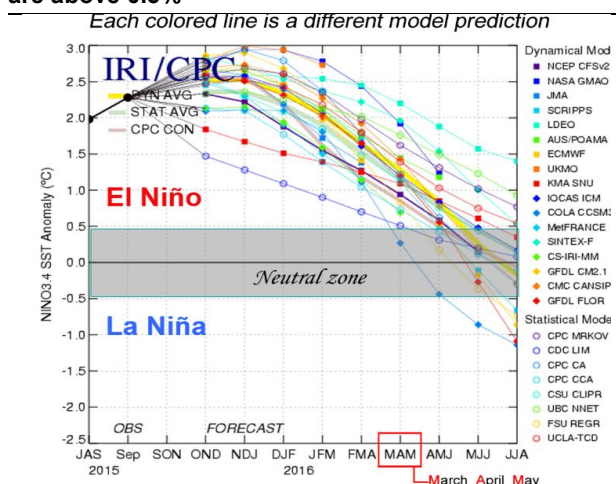
Source: Bloomberg, RBI, Bank of Baroda Research, Red highlighted ones are the variable noticing significant change, \* As of 1 Jun 2026

**RBI in its upcoming policy is expected to encounter a trilemma encompassing 1) inflationary risks 2) depreciating INR and 3) tighter liquidity. Thus, against this backdrop what can be expected from RBI? Let's chart out these risks in details:**

**A. Inflationary risks persist:** Apart from the fuel related concerns already highlighted before, the primary risk on inflation this year is the higher possibility of El Niño which poses upside risk to food inflation. Global food prices have also remained elevated especially oil index, post the West Asia crisis where India is a major importer. The spillover from fuel to food inflation needs to be monitored closely. Thus, policy approach by RBI is expected to be more data dependent and contingent on the extent of actual pass-through of these shocks on headline CPI.

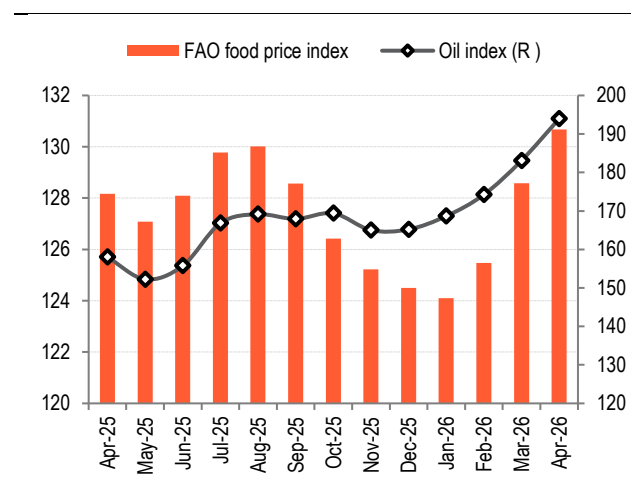
On CPI front, we expect the impact of the fuel price 50-60 bps on annualised basis. The second-order impact likely to be watched with caution. Any sharp divergence of CPI print in the coming months from RBI's projection, might call for rate action. We expect RBI to revise its inflation projection for FY27 upward, incorporating the recent fuel price hike. Our projection of CPI for FY27 is at 4.8-5.2%.

**Figure 1: El Niño conditions building up as more lines are above 0.5%**



Source: <https://www.ncei.noaa.gov/>, Bank of Baroda Research

**Figure 2: Global food index is inching up**



Source: FAO, Bank of Baroda Research

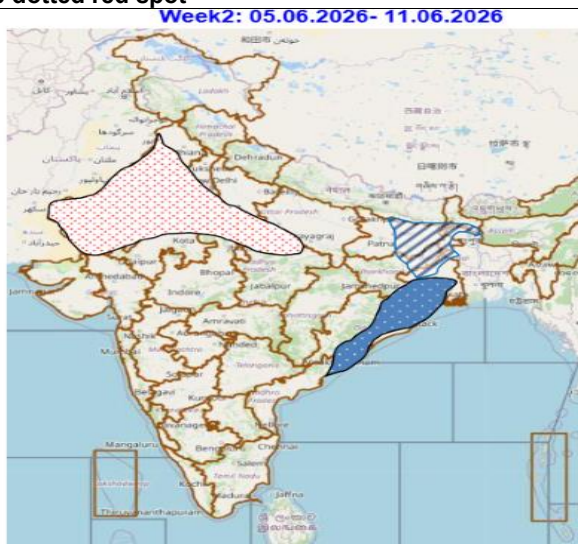
Another issue that is building up is the **rising wedge between WPI and CPI**. Currently the gap between the two is 4.8%, far higher than historical averages. Thus, some pass-through of input price prices to

retailers might be visible in the coming months. Financial results of companies have also hinted at pass-through of input cost based on evolving demand conditions. In particular, companies are reporting an increase in prices of key inputs as well as higher freight and logistics charges. While a few industries have been looking at ways to limit the impact of crisis through cost management, others have responded by raising final prices. Industries such as paints, FMCG and auto have already raised prices, and have also not ruled out further price hikes in case global commodity prices remain elevated.

However, what has come as a respite is that heatwave conditions which were intense in the past two weeks are pacifying. As per IMD's outlook for the next two weeks, there is lower probability of heatwave. Also, arrival statistics of TOP (Tomato, Onion and Potato) vegetables have remained satisfactory bearing no significant impact of heatwave on production as of now. However, the coming days is crucial to see the Cobweb impact on prices for these perishable items.

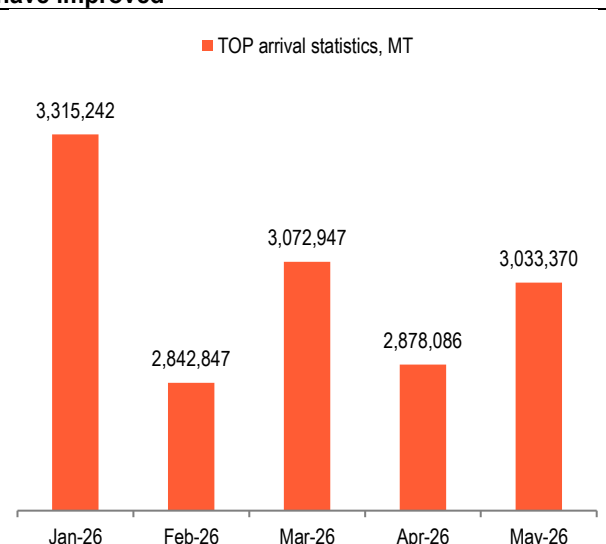
Thus, RBI is expected to weigh all these factors into account before taking any call on rates.

**Figure 3: Low probability of heatwave indicated by the dotted red spot**



Source: IMD, Bank of Baroda Research

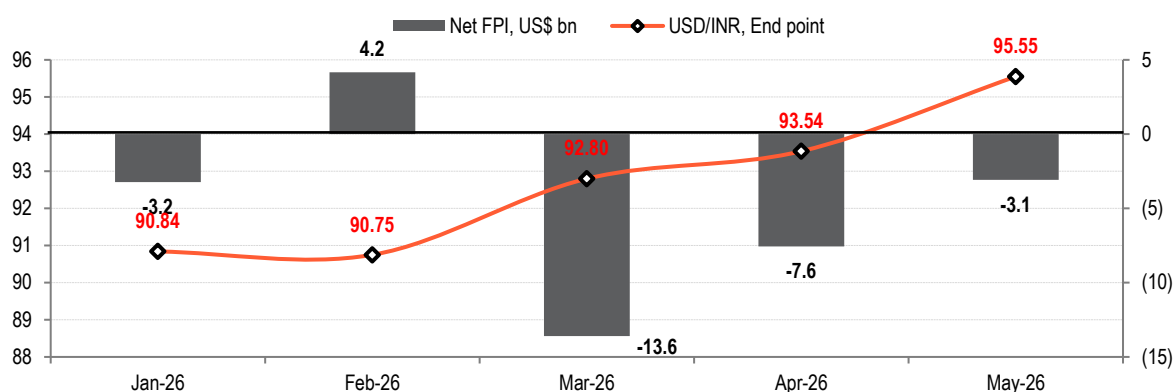
**Figure 4 Arrivals of Tomato, Onion and Potato (TOP) have improved**



Source: Upaj, Bank of Baroda Research

**B. Depreciating INR & FII:** INR has come under pressure despite a softening DXY. India being one of the major oil importing nations have impacted investor sentiments adversely. FII outflows continued albeit at a softer pace. Currently the gap between India and US 10Y yield has is maintained at 255bps. Thus, one logic could be for RBI to defend the currency by raising rates and attracting higher capital flows. However, currency management through rate action does not directly fall under the ambit of monetary policy. Hence, we expect RBI to maintain status quo on rates and let INR find its own desirable level. RBI's intervention through spot and forward purchase/sell is likely to continue.

**Figure 5: FPI outflows have impinged on INR**

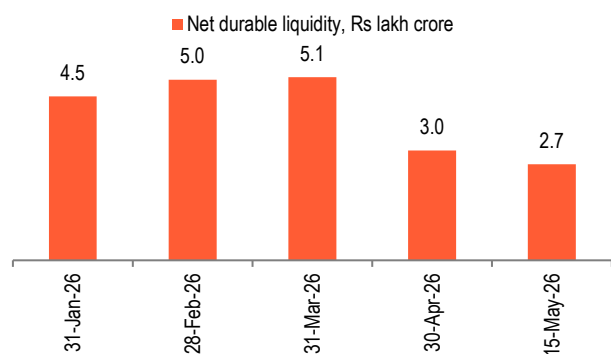


Source: Bloomberg, Bank of Baroda Research

C. **Tighter liquidity:** Net durable liquidity has exhibited some pressure lately with pickup in currency in circulation (on YoY basis, Currency in circulation is at its highest since 19 Mar 2021). Apart from this, the draw down of foreign exchange reserves have also posed pressure on durable liquidity. However, we believe, system liquidity will be maintained at the 1% NDTL level, currently it is ~ 0.4% of NDTL. RBI dividend is also expected to lend support to durable liquidity. More OMO purchase and USD/INR swap announcements might be forthcoming to support durable liquidity.

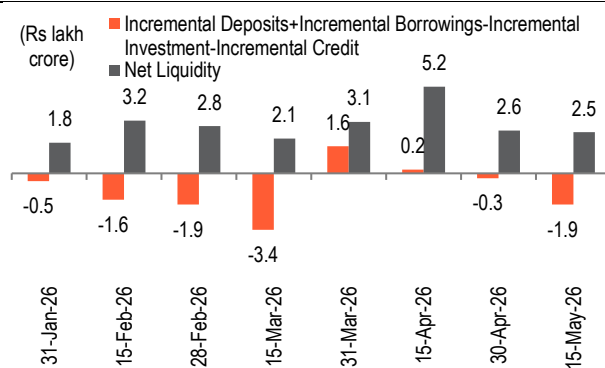
Banking liquidity is expected to normalise, and the current number is in deficit as it is the starting months of the financial year.

**Figure 6: Durable liquidity under pressure**



Source: CEIC, Bank of Baroda Research

**Figure 7: Banking liquidity and system liquidity**



Source: CEIC, Bank of Baroda Research

### Growth calls for status quo?

High frequency data of growth is showing mixed performance. On one hand, diesel consumption, e-way bills, toll collection showed moderation, bank credit, deposit continued to maintain its momentum, vehicle registration and air passenger traffic was stable. However, the headwinds are expected to outweigh the tailwinds on growth front in FY27. The main hurdle might emerge from downside pressure on exports especially from refinery exports whose share is at 12% of total. The mounting pressure on imports from higher oil prices, inflationary impact on consumption and uncertainty on pickup in investment climate amidst supply chain disruption, all point towards a

downside pressure on GDP in FY27. We expect RBI also to revise its quarterly growth projections downward in the current policy. Hence from growth standpoint it seems feasible to hold rates.

### **To sum it up**

Thus, balancing and counterbalancing all macro and geopolitical factors, we believe at this current juncture RBI is expected to follow a data dependent approach before taking any call on rates. From growth standpoint as well, a status quo seems to be the preferred choice. Headline CPI-the main policy variable of RBI has not yet fully shown the impact of pass-through of higher costs. However, the current policy is expected to be more hawkish in terms of upward revision in inflation projections for FY27 and flagging off higher inflationary risks in the near term.

We believe there remains scope for at least one or two rate hikes in the entire cycle. The 9-month OIS is also hovering at ~ 5.92. Any pre-emptive action by RBI might also send signals in terms of a rising yield. On regulatory development, we expect policy redirected towards attracting NRI deposits by giving further incentives to FCNR (B) deposits, relaxing ECB limit and efforts to boost FII flows.

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