

RBI signals a hawkish pause

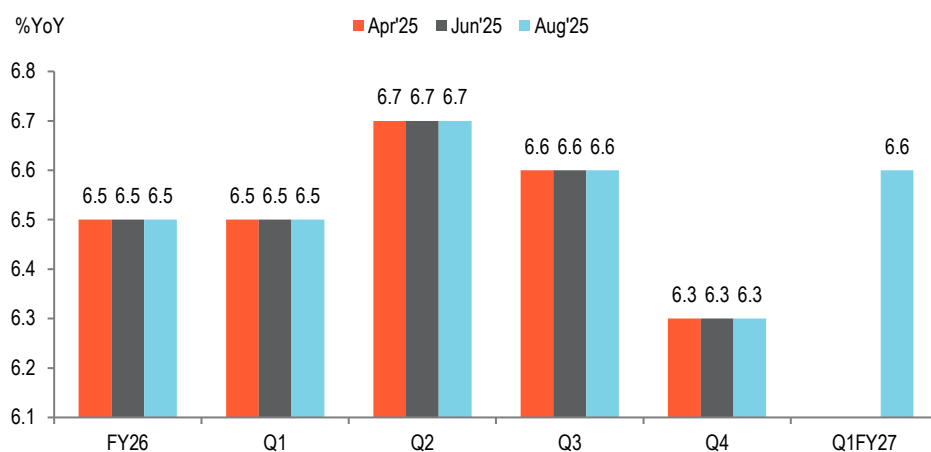
The MPC unanimously decided to keep the repo rate unchanged at 5.5%, after frontloading rate cuts in its previous policy meet and the impact of the same is still unfolding. The stance was also kept unchanged at 'neutral' signalling that there remains limited room for future rate cuts in near run. GDP projection has been retained, as RBI noted that the domestic growth has been holding up in line with its assessment. However, RBI has lowered its there could be low probability of further reduction in rates and there is limited room for the same given the inflation is projected to be higher and above the 4% mark both in Q4F26 and Q1FY27. However, if conditions change, we at most expect one rate cut of 25 bps in Q3FY26 as RBI will remain data dependent and closely track the evolving developments especially on external front.

Status quo: The monetary policy committee decided to keep repo rate unchanged in line with our expectations with repo rate at 5.5% with a unanimous vote. Consequently, the SDF rate continues at 5.25% and MSF at 5.75%. This is the first time RBI has maintained status quo on rates, since it began the easing cycle in Feb'25. Stance of the monetary policy was also been retained at 'neutral'.

Main takeaways from policy

- RBI has retained growth projections for FY26 at 6.5%. The quarterly forecast were also maintained with growth in Q1 at: 6.5%; Q2: 6.7; Q3: 6.6%; and Q4: 6.3%. RBI has suggested Q1FY27 growth at 6.6%. Risks are evenly balanced for these projections.
- The central bank noted that gradual the monsoon has been progressing well and is supporting Kharif sowing.
- Services activity has also been growing at a steady pace and the same has been evident with higher services PMI and other high frequency indicators.
- In contrast, industrial activity has been growing at a laggard pace as has been reflected in IIP growth along with uneven recovery, especially for electricity and mining.
- Furthermore, there is risk to external demand largely owing to the uncertain environment due to ongoing trade negotiations and tariff announcements.
- However, sustained growth has been noted in construction and trade sector, along with lower inflation, higher capacity utilization and supportive financial conditions, these are expected to provide requisite support to domestic economy.

Figure 1: RBI expects 6.5% growth in FY26

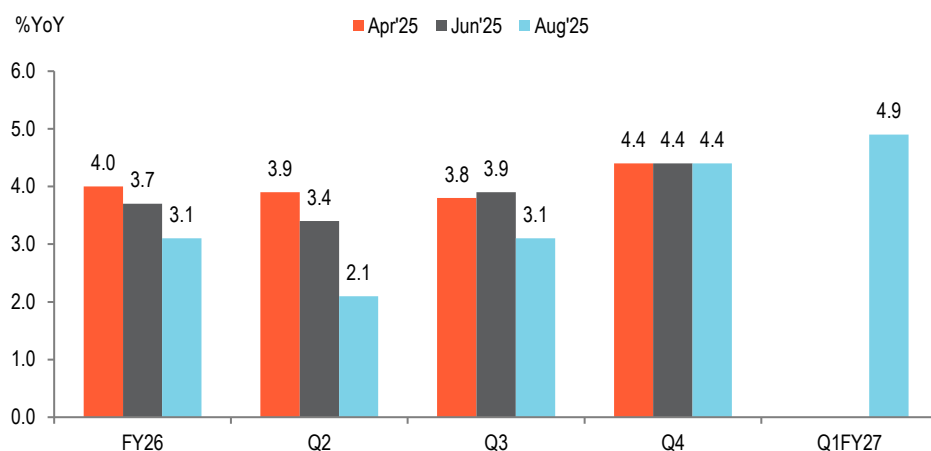


Source: RBI, Bank of Baroda Research

Inflation projections lowered

- In line with expectations, RBI has revised its inflation projections downward for FY26 to 3.1% from 3.7% earlier.
- This was on account of downward revisions made to Q2 and Q3 inflation forecasts, which have been brought down to 2.1% from 3.4% (Jun'25) and to 3.1% from 3.9%, respectively. The Q4 projection has been retained at 4.4%. Inflation for Q1FY27 has been projected at 4.9%. The risks are evenly balanced for these projections.
- RBI noted that the sharp moderation in headline inflation is largely driven by food inflation, which has been supported by supply side measure and higher agricultural activity. Notably, core inflation has edged up to 4.4% mark in Jun'25 amidst higher gold prices.
- Overall, as per RBI's assessment inflation outlook has been more benign than its expectation, supported by steady progress of monsoon and favorable base effect. Core inflation is projected at 4% in FY26, with any possible risk likely on account of weather related shocks.

Figure 2: Headline CPI forecasts for FY26 lowered to 3.1%



Source: RBI, Bank of Baroda Research

Liquidity

- Governor noted that the system liquidity continues to be in surplus and will find further support from the implementation of CRR cut in a staggered manner, starting Sep'25.
- Overall, transmission of lending rate has been broad based across sectors.
- It was stated that, RBI will remain flexible and nimble in its approach of liquidity management.
- On new liquidity management framework, as per the recommendations of the committee, there will be continuation of overnight WACR as operating target of monetary policy.

As part of *development and regulatory policy*, Governor has announced the introduction of auto-bidding facilities for T-bill, through systematic plan under the Retail Direct scheme.

Way forward

- RBI Governor, has cautioned of a hawkish pause signaling there is limited room for further easing. At most the next rate cut could be likely in Q3FY26. However, since the inflation in both Q4FY26 and Q1FY27 is above the 4% mark, the chances of rate cut has diminished to a great extent.
- We believe that the terminal rate will remain at 5.5% for some time in the near-term as RBI will be data dependent and closely monitor the ongoing development on external front, related to uncertainty due to trade negotiations.

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For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com