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RBI Steps Up Support for Economic Growth with a Second Consecutive Rate Cut and Shift in Policy Stance to Accommodative

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- In its April policy meeting, the RBI decisively shifted its approach, prioritising economic growth over inflation risks and sending a clear dovish signal.
- As a result, the RBI's Monetary Policy Committee (MPC) reduced the policy repo rate for a second consecutive meeting by 25 basis points (bps) to 6%. Also, it changed the policy stance from 'Neutral' to 'Accommodative'.
- The change in the policy stance signals the intended direction of future policy rates, implying that, absent any shocks, the MPC is considering only two options moving forward: status quo or a rate cut. It clarified that the stance is not linked to direction/outlook on liquidity.
- Regarding liquidity management, the RBI did not announce any new measures but assured the market of adequate systemic liquidity, with an indicative range of around 1% of Net Demand and Time Liabilities (NDTL) mentioned in the post-meeting presser (although it did not commit to a formal target/level).
- The MPC assessed that supporting growth is necessary amidst challenging global economic conditions, a benign inflation outlook, and moderate domestic economic growth.
- The RBI Governor emphasised that India will likely face relatively lower direct impact from US tariffs, but global trade disruptions continue to pose downside risks.
- As a result, the central bank revised its FY26 real GDP growth projection downward by 20 bps to 6.5% YoY, reflecting the impact of global trade disruptions and policy uncertainties.
- The RBI also revised its FY26 CPI inflation projection by 20 bps to 4%, reflecting greater confidence in its alignment with the 4% target over a 12-month horizon.
- Given downside risks to growth, contained inflation risks, and the dovish tone of the policy, we now anticipate cumulative 100 bps policy repo rate cuts in the current cycle, compared to the previous expectation of 75 bps.
- This suggests an additional 50 bps of rate cuts for the remainder of FY26. The timing of these cuts will depend on incoming data, the evolving economic outlook, and global trade policy developments.

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RBI cuts the policy rate and changes the stance to accommodative to boost economic growth

In its April policy meeting, the RBI adopted a decisive shift in its approach, prioritising economic growth over inflation risks. As a result, the RBI's Monetary Policy Committee (MPC) reduced the policy repo rate* for a second consecutive meeting *by 25 bps to 6%. It also changed its policy stance from 'Neutral' to 'Accommodative.' *The change in the policy stance signals the intended direction of policy rates, implying that going forward, absent any shocks, the MPC is considering only two options – status quo or a rate cut*. The MPC judged that amidst challenging global economic conditions, the benign inflation outlook, and moderate economic growth, the MPC needs to support growth. On liquidity management, the RBI did not announce any new measures but assured the market that it would ensure adequate systemic liquidity.

While the RBI Governor highlighted that India is likely to face relatively lower direct impact from US tariffs, he stated that the central bank is more concerned about the implications of tariffs and policy uncertainty for economic growth compared to inflation. He highlighted that inflation has moderated and is expected to remain subdued, supported by an improving outlook for food inflation. Accordingly, the MPC revised its FY26 real GDP growth projection downward by 20 bps to 6.5% YoY, and its inflation forecast was also lowered by 20 bps to 4% YoY. The downward revision in economic growth forecast largely reflects the anticipated effects of global trade disruptions and policy uncertainties.

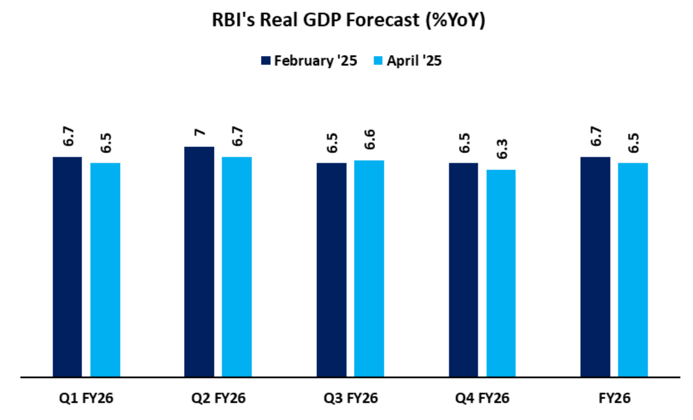
RBI's dovish tone and the domestic growth-inflation trajectory suggest room for additional 50 bps rate cuts in FY26

In line with our expectations, the MPC unanimously voted to reduce the repo rate by 25 bps to 6.0% for the second consecutive meeting. Consequently, effective immediately, the standing deposit facility (SDF) and marginal standing facility (MSF) rates have been adjusted to 5.75% and 6.25%, respectively. Additionally, it decided to change the policy stance from 'Neutral' to 'Accommodative,' signalling a more growth-supportive approach. We assess that the overall tone of the policy statement is dovish, with concerns over economic growth taking precedence amid increasing global volatility. The central bank now has greater confidence in a durable alignment of headline inflation with the target of 4% over a 12-month horizon. ***Given the downside risks to economic growth, contained inflation pressures, and the dovish tone of the policy, we now expect cumulative policy repo rate cuts of 100 bps in the current cycle, up from our earlier forecast of 75 bps. This implies an additional 50 bps of rate cuts in the remainder of FY26.*** However, the timing of these cuts will depend on the incoming data, evolving economic outlook, and developments related to global trade policies.

Global risks pose downside risks to the economic growth outlook

The RBI revised its economic growth forecast for FY26 downward, from 6.7% YoY to 6.5%, acknowledging the negative impact of global trade disruptions and policy uncertainties. It noted that headwinds from global trade disruptions continue to pose downward risks to economic growth. The MPC highlighted the implications of recent global trade and related policy uncertainties, including the negative impact of uncertainty on investment and spending decisions of businesses and households, the possible spillover from lower global growth to domestic growth, and the direct adverse effects of higher tariffs on net exports. However, the exact impact is hard to quantify due to several unknowns, including the effects of relative tariffs, the elasticities of India's export and import demand, and progress on trade negotiations with the US. Meanwhile, favourable agricultural prospects are expected to support rural demand, while urban demand shows signs of recovery. Investment growth is projected to benefit from higher-capacity utilisation, healthy corporate and bank balance sheets, and the government's continued focus on investment spending.

RBI revises FY26 growth projection downward to 6.5%



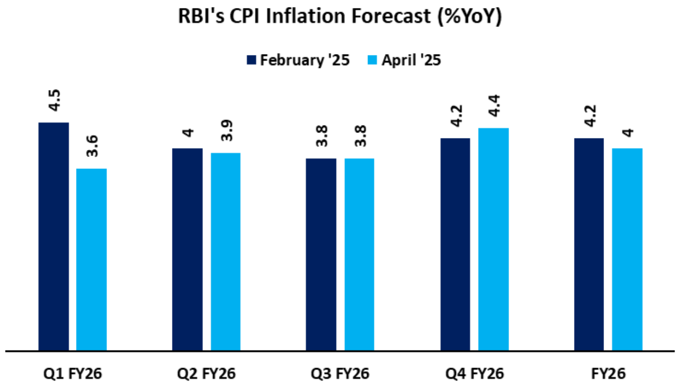
Source: RBI; Note: February '25 and April '25 refer to projections given by the RBI in its February 2025 and April 2025 MPC updates, respectively.

However, our estimate for FY26 is slightly more conservative at around 6.4% YoY, given emerging risks from the global trade war, though policy measures such as monetary policy easing and income tax reductions will be positive. While the initial estimate of the impact of US tariffs on India is moderate (please refer to our report on US reciprocal tariffs), the situation is highly dynamic and rapidly evolving. There will also be indirect impacts from several channels, as the RBI also noted. Accordingly, we see downside risks to our economic growth projection for FY26 and believe further policy measures will be necessary to support economic recovery.

Inflation outlook aligns with the RBI's target

The MPC noted that CPI inflation is now below the target of 4%, supported by a sharp fall in food inflation. Further, there is a decisive improvement in the inflation outlook, giving it greater confidence in a durable alignment of headline inflation with the target of 4% over a 12-month horizon. This is also reflected in the downward revision in the RBI's FY26 inflation projection by 20 bps to 4%, with the central bank expecting inflation to remain below the 4% target in the first three quarters of FY26. It projects the CPI inflation in Q1 and Q2 at 3.6% and 3.9%, respectively, from earlier estimates of 4.5% and 4.0%, while Q3 is estimated at 3.8% (unchanged from the previous forecast), and the Q4 estimate has been revised slightly upwards to 4.4% (vs 4.2% earlier). Uncertainties regarding rabi crops have largely cleared, with record wheat production and higher pulse yields expected to contribute to a durable softening of food inflation. Furthermore, the expectation of a normal monsoon for the current year will also support the easing of food inflation. Additionally, a sharp decline in inflation expectations and lower crude oil prices bode well for the inflation outlook. However, risks remain from global market uncertainties and potential weather-related supply disruptions.

RBI revises its inflation projection for FY26 downward by 20 bps to 4.0%

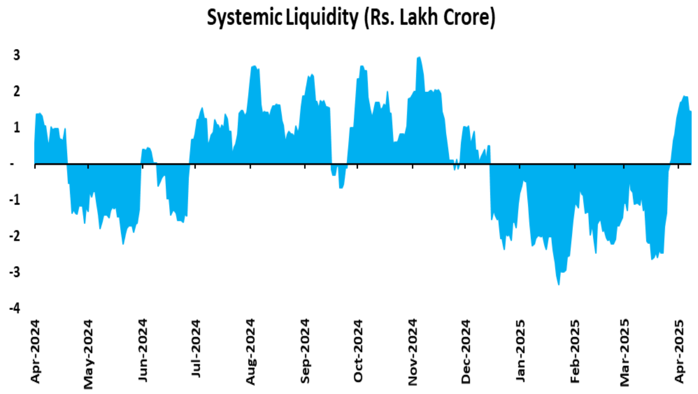


Source: RBI; Note: February '25 and April '25 refer to projections given by the RBI in its February 2025 and April 2025 MPC updates, respectively.

RBI commits to providing sufficient system liquidity

On liquidity management, the RBI did not announce any new measures but assured sufficient liquidity. Systemic liquidity has shifted into a surplus after more than three months of large deficits. Recent data from the RBI indicates surplus liquidity of approximately Rs 1.4 lakh crore, significantly improving from the average deficits of Rs 1.2 lakh crore in February and Rs 1.6 lakh crore in January. This shift is primarily attributed to government spending and the RBI's liquidity support measures, including dollar-rupee swap auctions and open market operations (OMOs). These measures have helped keep the overnight call rate close to the policy repo rate. Going forward, the Governor stated that the central bank intends to have surplus liquidity, with an indicative range of around 1% of Net Demand and Time Liabilities (NDTL) of the banking sector to aid with policy rate transmission. However, he clarified that this indicative level is not a formal target, and the central bank will take measures as needed. We expect the RBI to continue to take measures, including OMOs, VRR, and USD/INR Buy/Sell Swaps, to provide adequate liquidity.

Systemic liquidity shifts to surplus after more than three months of large deficits



Source: CMIE; Note: Data for liquidity is till 8th April.

The RBI also announced the developmental and regulatory policy measures listed below:

Regulations

- **Securitisation of Stressed Assets Framework:** The RBI has proposed a new framework with a market-based securitisation mechanism to improve risk distribution and offer lenders an exit route from stressed assets. The framework will supplement the existing ARC (Asset restructuring companies) route under the SARFAESI Act, 2002. The draft framework has been issued for public comments.
- **Framework on Co-lending Arrangements:** To cater to a broader range of credit demands, the RBI proposed expanding the scope of co-lending arrangements to all regulated entities (REs) and to all loans (priority sector or otherwise). Presently, co-lending applies only to arrangements between banks and NBFCs and is restricted to priority sector loans. The RBI has issued draft guidelines for public comments.
- **Review of Guidelines for Lending against Gold Jewellery:** The RBI has proposed comprehensive regulations on prudential norms and conduct related aspects for gold loans across all REs. This aims to

strengthen oversight, ensure responsible lending and safeguard borrower interests. The draft guidelines have been issued for public comments.

- **Review of Non-Fund-Based Facilities:** The RBI has proposed to harmonise and consolidate guidelines covering non-fund-based facilities, such as guarantees, letters of credit, etc., across all REs. It has also proposed revising the guidelines on partial credit enhancement (PCE) by REs to broaden funding sources for infrastructure financing. Draft guidelines have been issued for public comments.

Fintech and Payment Systems

- **Enhancing Transaction Limits in UPI:** To enable UPI to support evolving user needs and new high-value use cases, NPCI may revise transaction limits for specific use cases in consultation with key stakeholders while ensuring appropriate risk safeguards. Banks will retain the flexibility to set their internal limits within NPCI's framework. While the Rs. 1 lakh limit for P2P transactions will stay the same, P2M limits can be modified. Currently, some P2M transactions have higher limits; some at Rs 2 lakh and others at Rs 5 lakh.

- **'On Tap' Application Facility under Theme Neutral Regulatory Sandbox**: The RBI also announced plans to make its Regulatory Sandbox framework 'Theme Neutral' and 'On Tap'. This facility is intended to help in continuous innovation and constructive engagement with innovators and proactively respond to the evolving FinTech scenario.

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