EcoScope
The Economy Observer

RBI policy: End of India's easing cycle

- **The Monetary Policy Committee (MPC) kept the repo rate unchanged at 5.25%, signaling that the policy rate has likely reached its terminal level after a cumulative 125bp easing cycle, while retaining the neutral stance.**
- **The RBI marginally revised FY26 inflation upward to 2.1% from 2%, with 1QFY27 and 2QFY27 projected at 4.0% (3.9% earlier) and 4.2% (4% earlier), respectively; the upward adjustment is largely attributed to unfavorable base effects and higher precious metal prices rather than broad-based demand pressures. The Governor mentioned that underlying inflation remains subdued, supported by favorable food supply conditions, suggesting limited near-term risks to the disinflation trajectory.**
- **Real GDP growth is estimated at 7.4% for FY26, while projections for 1QFY27 and 2QFY27 have been upgraded to 6.9% (6.7% earlier) and 7.0 (6.8% earlier).**
- ***With inflation broadly stable and growth improving relative to earlier expectations, the RBI Governor underscored that the macroeconomic backdrop remains supportive for sustaining the ongoing expansion*.**
- **However, the MPC highlighted external risks, including geopolitical tensions, financial market volatility, and evolving trade dynamics, which could weigh on the growth outlook.**
- **Our view: The combination of low inflation, resilient domestic growth, and strong financial sector balance sheets suggests that the policy is now appropriately calibrated. We believe that the easing cycle has concluded, with the terminal repo rate at 5.25%. We expect the MPC to maintain a pause for FY27 unless the growth outlook materially derails. The focus now shifts towards pre-emptively managing liquidity and monitoring the evolving macro environment. The key to the next policy move is now dependent on the revision to the CPI and GDP series.**

Exhibit 1: RBI increased its FY26 inflation forecast to 2.1% in Feb'26 policy from 2% in the Dec'25 policy

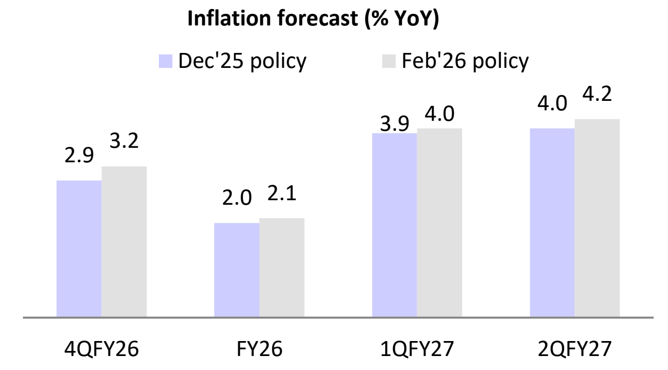
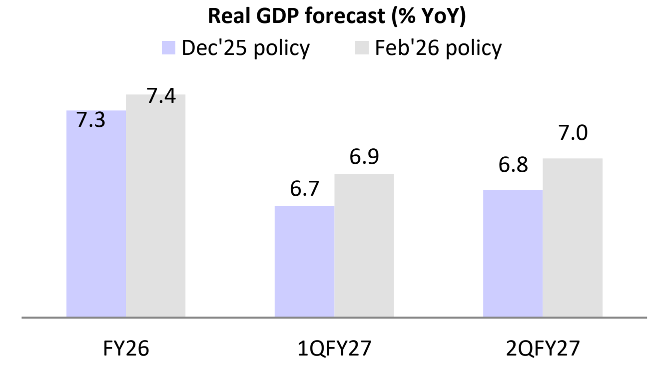


Exhibit 2: RBI increased its FY26 real GDP growth forecast to 7.4% in Feb'26 policy from 7.3% in the Dec'25 policy



Source: RBI, MOFSL

MPC Highlights

Policy pause marks the terminal rate at 5.25%

As widely expected, the RBI's MPC unanimously voted to keep the benchmark repo rate unchanged at 5.25%, following the cumulative 125bp easing delivered during CY25, as it assessed that the current policy rate remains appropriate amid a favorable inflation-growth balance. The stance was retained at neutral, highlighting the RBI's preference to remain data-dependent while preserving policy flexibility. (Exhibit 3).

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- **Inflation outlook remains benign despite marginal upward revisions**
  The MPC noted that the inflation outlook remains benign, with headline CPI staying below the tolerance band in recent months. The RBI has increased its inflation for FY26 to 2.1% from 2% in Dec'25 policy, with 4Q expected at 3.2% (2.9% earlier), largely reflecting unfavorable base effects rather than fresh price pressures. Looking ahead, CPI for 1QFY27 and 2QFY27 is projected at 4.0% and 4.2%, revised upwards from 3.9% and 4%. The Governor mentioned that the slight upward revision is primarily due to higher precious metal prices, while underlying inflation, excluding gold, remains muted. (Exhibit 1).
- **Growth outlook for FY27 improves**
  On the growth front, economic activity continues to exhibit resilience. Real GDP is estimated to grow by 7.4% in FY26, supported by private consumption and strong fixed investment, even as net exports remain a drag due to faster import growth. **The RBI revised 1QFY27 and 2QFY27 growth upward to 6.9% and 7.0%, respectively, from 6.7% and 6.8%.** (Exhibit 2).
  Rural demand is improving on the back of stronger agricultural prospects and labor market conditions, while high capacity utilization, accelerating bank credit, improving corporate profitability, and sustained government infrastructure spending are expected to support investment. However, the MPC flagged intensifying external headwinds, including geopolitical tensions, financial market volatility, and shifting trade patterns, as key risks to the outlook.

System liquidity remained in surplus in Jan'26

- The average daily net absorption under the liquidity adjustment facility (LAF) remained in surplus during Dec'25/Jan'26, though lower than in Nov'25. It stood at INR0.7t in Dec'25 and INR0.6t in Jan'26 compared to an average daily surplus of INR1.8t in Nov'25. (Exhibits 5 & 6). The central bank reiterated its commitment to proactive liquidity management to ensure adequate credit flow and facilitate smoother monetary transmission. Lending rates have declined materially following past rate cuts, indicating broad-based transmission.

Our view: Easing cycle concluded; prolonged pause likely

- The combination of low inflation, resilient domestic growth, and strong financial sector balance sheets suggests that the policy is now appropriately calibrated. We believe that the easing cycle has concluded, with the terminal repo rate at 5.25%, and expect the MPC to maintain a pause, shifting its focus toward monitoring the evolving macro environment and the implications of the upcoming CPI and GDP series before considering any further policy action.

Exhibit 3: Repo rate was unchanged at 5.25% in the Feb'26 policy

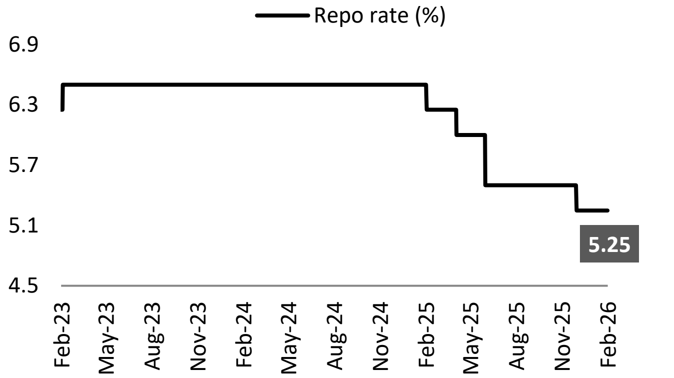
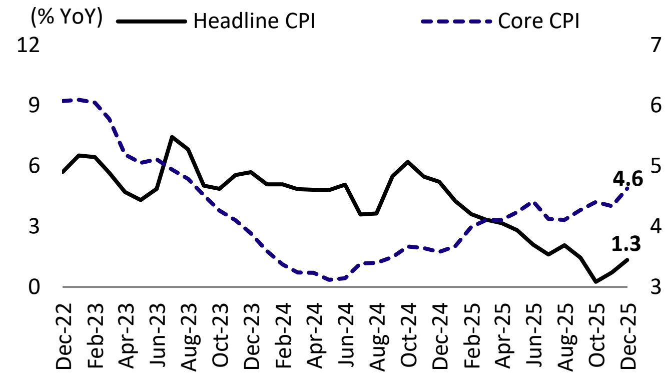
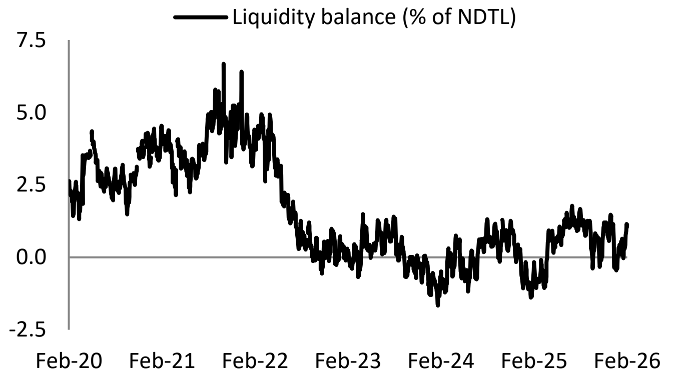


Exhibit 4: Inflation remained below the RBI's 4% target in Dec'25



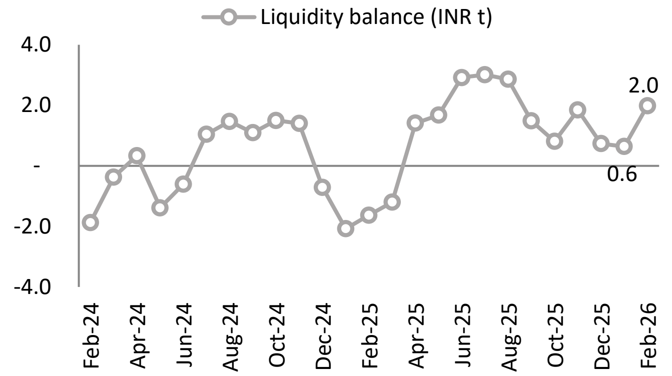
Source: RBI, MOFSL

Exhibit 5: System liquidity averaged to a surplus of 0.3% of NDTL in Jan'26, down from 0.4% in Dec'25



Updated as of 30th Sep'25

Exhibit 6: System liquidity remained in surplus for the last 11 months in a row



{(-) means deficit, (+) means surplus}

Source: RBI, MOFSL

Key measures for banks/NBFCs:

- Banks allowed to lend to REITs (INVEITs were already allowed).
- Limit for collateral-free loan to MSMEs increased from INR1mn to INR2mn. This makes credit more affordable for smaller SMEs.
- Exemption from registration with RBI for type 1 NBFCs (asset size < INR10bn).
- NBFCs engaged in the business of lending against gold collateral with over 1,000 branches are not required to obtain RBI approval before opening any new branches.

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