

## RBI Monetary Policy: Rate cut accompanied by liquidity boost

Against a backdrop of divided market expectations, the RBI's MPC delivered a decisively dovish policy, unanimously reducing the repo rate by 25bps to 5.25%, its lowest level since July 2022, following two consecutive pauses. The policy stance was retained at 'neutral', with only one member (Prof. Ram Singh) voting for a change in stance to 'accommodative'. The decision was underpinned by a marked improvement in the inflation-growth dynamics. Average headline inflation in Q2 FY26 fell to 1.7%, breaching the lower tolerance band for the first time since the adoption of the flexible inflation-targeting (FIT) framework, while the near-term outlook remains benign—together creating the necessary policy space to reinforce the growth momentum. Complementing the rate cut, the RBI also announced liquidity-enhancing measures—OMOs of Rs 1 lakh crore and three-year USD/INR buy-sell swaps of US\$5 bn. These actions signal a nimble approach to managing durable liquidity following staggered CRR reductions and are aimed at strengthening the transmission of policy easing across the system.

The RBI expects the inflation outlook to remain benign, projecting FY26 headline inflation to ease by a further 60 bps to 2%, supported by favourable food supply conditions, healthy kharif and rabi harvests, adequate reservoir levels, and moderating global commodity prices. Both headline and core inflation in H1 FY27 are expected to hover around the 4% median target, with risks broadly balanced. On growth, while some moderation is expected after the stronger-than-anticipated H1 FY26 outturn, momentum is likely to remain healthy. FY26 GDP growth has been revised up by 50 bps to 7.3%, and H1 FY27 is projected to stay resilient, underpinned by solid domestic fundamentals, the lingering pass-through of earlier policy measures, and supportive financial conditions. External headwinds—subdued merchandise exports and global uncertainty—are assessed as posing only limited risks. With real policy rates (repo minus expected inflation) now around 1.25%, the scope for further easing appears narrow, even as another 25bps cut cannot be ruled out. Policy focus will increasingly shift toward liquidity management, transmission, and managing rupee volatility.

- **Rate cut of 25bps amid divided market expectations:** Against a backdrop of a divided market expectations, RBI's MPC unanimously reduced the policy repo rate by 25bps to 5.25%, its lowest level since July 2022. Accordingly, the Standing Deposit Facility (SDF) and the Marginal Standing Facility (MSF) rates — the lower and upper bounds of the Liquidity Adjustment Facility (LAF) corridor — were adjusted to 5% and 5.5% respectively, while the stance was retained as "Neutral." The MPC noted that the headline inflation has considerably eased and both core and headline prints are projected to be around 4%, while growth is expected to remain resilient, albeit soften marginally. Following two consecutive policies of status quo, the MPC assessed that the prevailing growth-inflation dynamics provided the right window and sufficient space for a rate reduction.
- **Inflation projections revised lower....:** Headline CPI inflation for FY26 was further revised lower to 2% (60 bps lower) with projections for Q3 and Q4 cut by 1.2pp and 1.1pp to 0.6% and 2.9% respectively. The sharper-than-anticipated downward revision in inflation projection this fiscal reflects a correction in food prices and broader softening across categories, which pushed the October headline print to an all-time low while core inflation (ex. gold and silver) moderated to 2.5 %. Looking ahead, favourable food supply conditions—higher kharif output, healthy rabi sowing, adequate reservoir levels, and supportive soil moisture—alongside moderating global commodity prices (barring some metals) reinforce the softer inflation outlook. With risks evenly balanced, headline CPI is projected at 3.9% and 4% in Q1 and Q2 of FY27, respectively.
- **...While growth revised higher:** RBI's MPC has revised the growth forecast upwards by 50bps to 7.3% for FY26, with Q3 and Q4 forecast revised to 7%

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*The RBI's MPC unanimously decided to reduce the policy repo rate by 25bps to 5.25%, its lowest level since July 2022, while maintaining the stance at "Neutral."*

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*FY26 inflation forecast has been reduced further to 2% , while growth projection has been revised higher by 50bps to 7.3%.*

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(+60bps) and 6.5% (+30bps). This translates into a total increase of 80bps since April 2025, with the current forecast being notably higher than IMF's recent projection of 6.6%. The upgrade reflects a much stronger-than-expected outturn in H1 supported by buoyant industrial and services activity, gains from fiscal and monetary policy rationalisation, front-loaded capex, congenial monetary and financial conditions and robust rural demand. Looking ahead, supportive domestic fundamentals and lingering passthrough of policy measures are expected to sustain the growth momentum, even as external headwinds—subdued merchandise exports and global uncertainties—keep the risks evenly balanced. The timely conclusion of various ongoing trade and investment negotiations is likely to provide upside potential. The outlook for Q1 and Q2 of FY27 is projected to soften, albeit remain healthy at 6.7% and 6.8%, respectively.

- **Proactive liquidity measures through OMOs and dollar swaps:** Banking system liquidity continues to remain in surplus, widening from an average of Rs 0.9 lakh crore in October to Rs 1.9 lakh crore in November. Supported by these congenial liquidity conditions, money market rates have aligned more closely to the policy rate while the transmission has been stronger on the deposit side than lending. The weighted average term deposit rates (*fresh deposits*) of SCBs declined by 105 bps, higher than the 69 bps fall in the weighted average lending rate (*fresh rupee loans*) during January-October. To ensure adequate durable liquidity and strengthen monetary policy transmission, the RBI plans to conduct OMOs Rs 1 lakh crore and undertake three-year USD/INR buy-sell swaps of US\$ 5 bn in December. Despite these proactive measures, the RBI is expected to remain nimble, calibrating liquidity through a mix of injections and absorptions in response to evolving market conditions.
- **Policy focus to shift to liquidity management and monetary transmission:** The December policy marks a clear dovish turn by the RBI, combining a policy rate cut with liquidity-enhancing measures—an indication of timely utilisation of the available policy space. With average inflation projected at around 4% in H1 FY27, the real policy rate now stands near 1.25%, suggesting that the room for further easing has narrowed, even as another 25bps cut cannot be ruled out if growth softens and inflation surprises on the downside. Upside risks to inflation and downside risks to growth appear limited, reinforcing a favourable growth–inflation balance. Policy attention is likely to shift toward liquidity management and rupee stability, with the RBI expected to remain nimble in supporting transmission and maintaining orderly financial conditions.

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*The weighted average call money rate has declined by 110 bps since the start of the rate cut cycle (till December 3<sup>rd</sup>), while transmission in deposit rates has been stronger than lending rates.*

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**Table 1: Current policy rates**

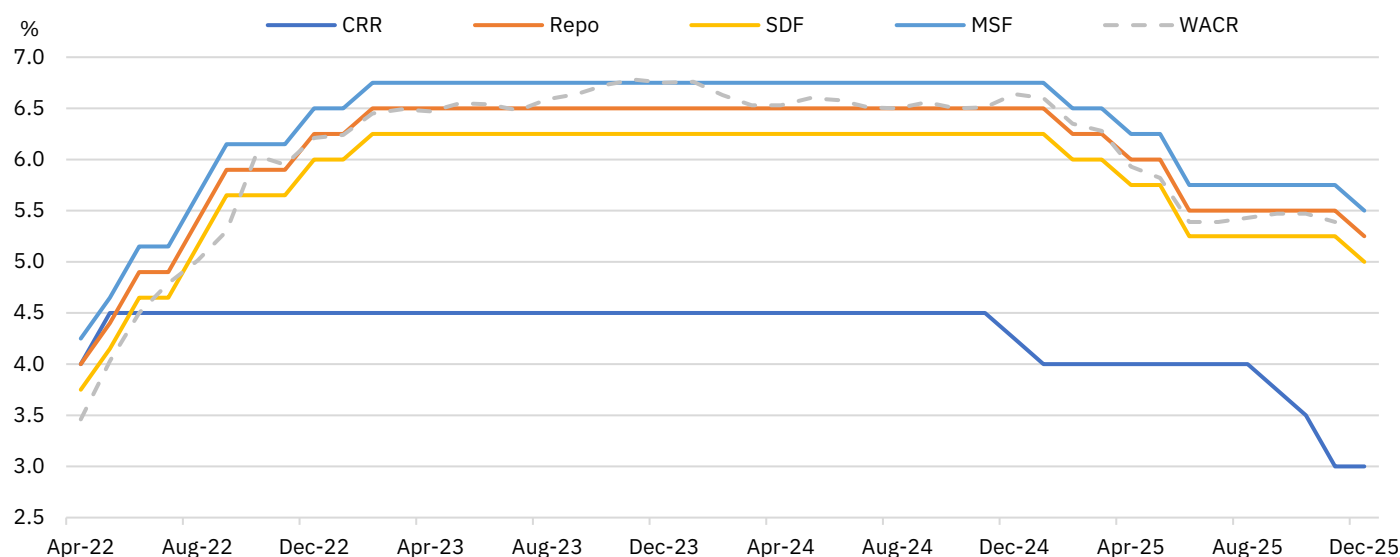
The policy repo rate was unanimously reduced by 25bps to 5.25% in the December policy, the lowest since July 2022 while the stance was retained at “Neutral”

| Key rates                        | June 2025          | August 2025        | October 2025       | December 2025 |
|----------------------------------|--------------------|--------------------|--------------------|---------------|
| Repo Rate                        | 5.50%              | 5.50%              | 5.50%              | 5.25%         |
| Standing Deposit Facility (SDF)* | 5.25%              | 5.25%              | 5.25%              | 5.00%         |
| Marginal Standing Facility (MSF) | 5.75%              | 5.75%              | 5.75%              | 5.50%         |
| Bank Rate                        | 5.75%              | 5.75%              | 5.75%              | 5.50%         |
| Cash Reserve Ratio (CRR)         | 3.00% <sup>1</sup> | 3.00% <sup>1</sup> | 3.00% <sup>1</sup> | 3.00%         |

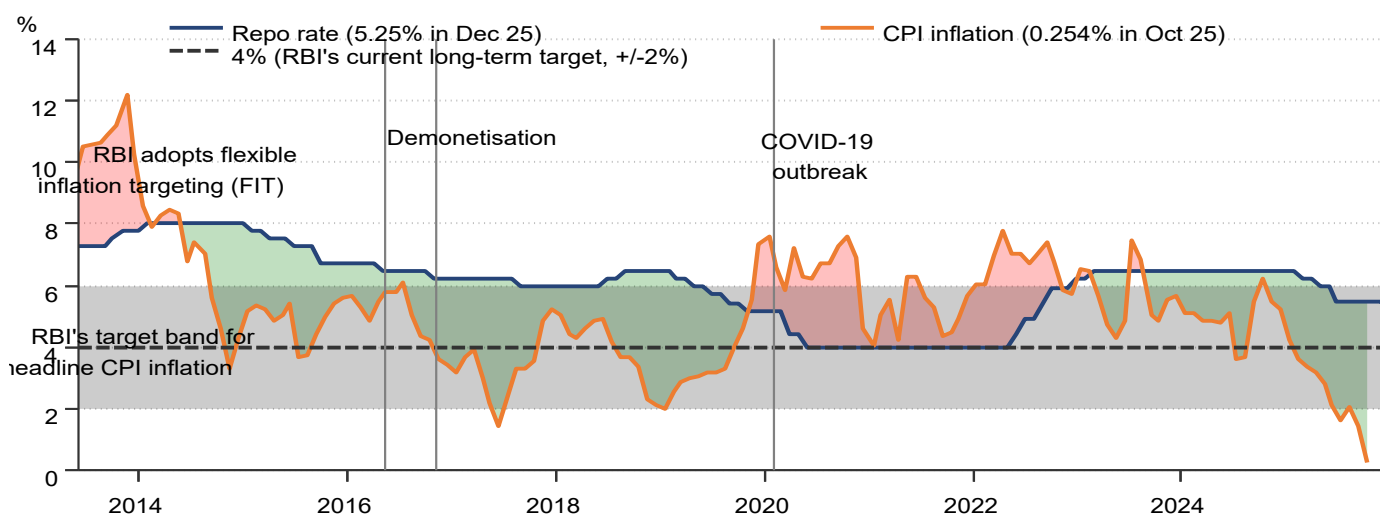
Source: RBI, NSE EPR. \* Introduced in April 2022 policy as the new floor of the LAF corridor.

**Figure 1: Movement in key policy rates**

The Weighted Average Call Rate (WACR) has declined by 110bps in the current easing cycle (till December 3<sup>rd</sup>, 2025) in response to the cumulative policy rate reduction of 100bps.

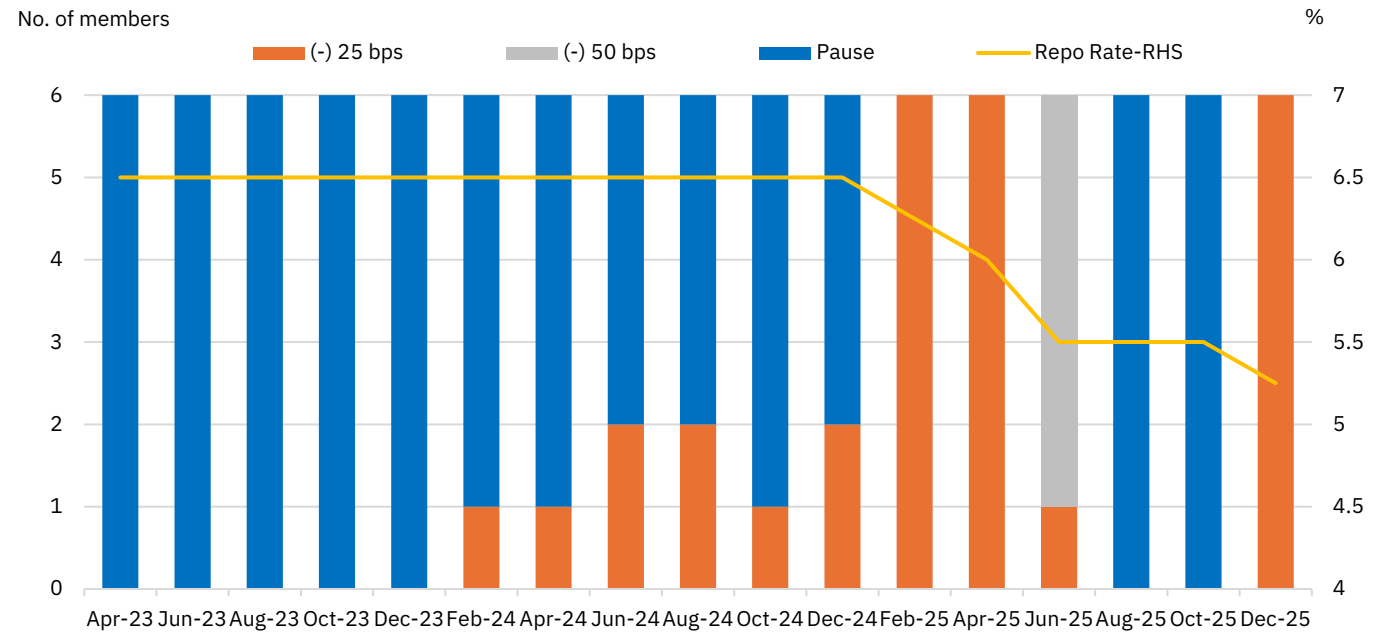


Source: CMIE Economic Outlook, NSE EPR.

**Figure 2: Movement in real interest rates**


Source: LSEG Workspace, NSE EPR.

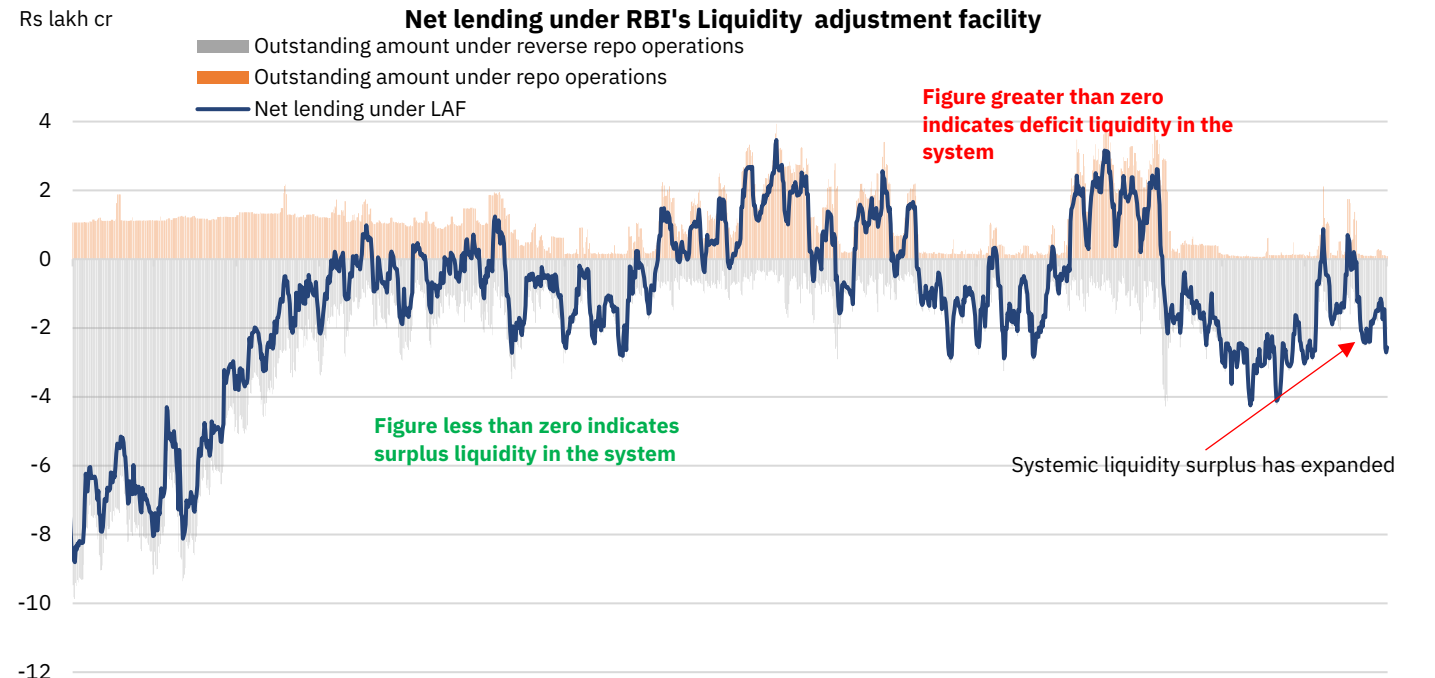
<sup>1</sup> This announcement of CRR cut of 50bps has been in the June'25 and will be reduced in a staggered manner of 25bps each in four separate tranches during September 2025 – November 2025

**Figure 3: MPC members' voting pattern**


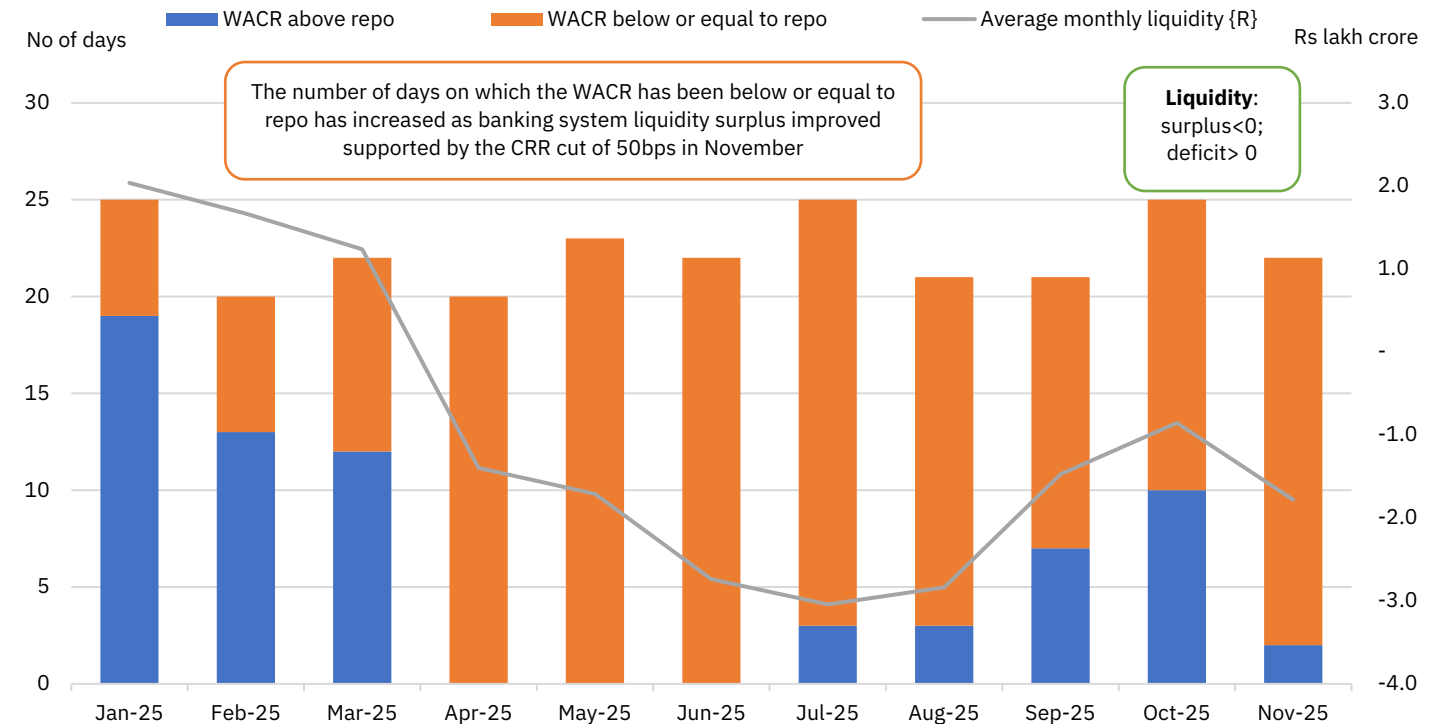
Source: RBI, NSE EPR.

**Figure 4: Net lending under RBI's Liquidity Adjustment Facility**

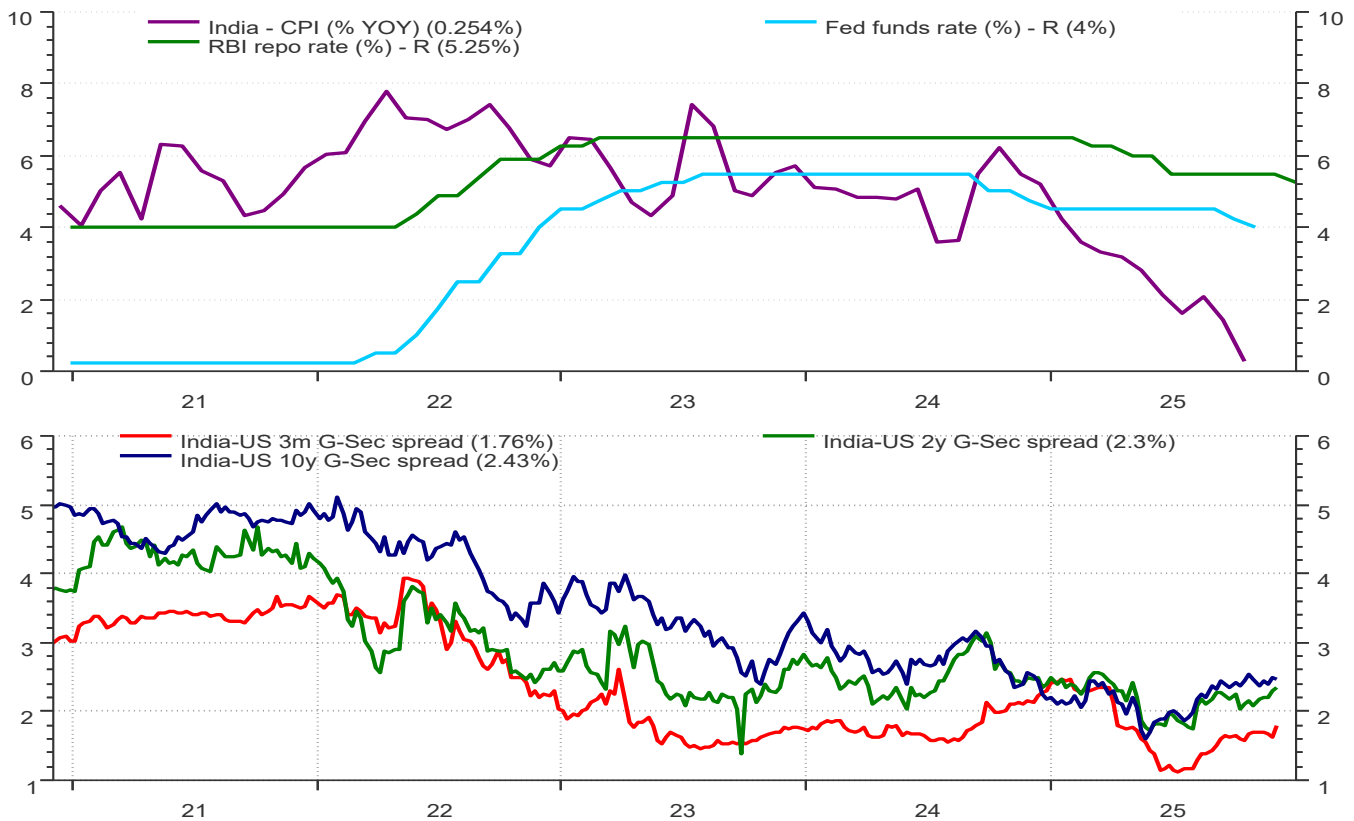
The banking system liquidity continues to remain in surplus and the average daily net absorption under the LAF has improved from Rs 0.9 lakh crore in October to Rs 1.9 lakh crore in November, albeit lower than the average of Rs 2.9 lakh crore in August.



Source: CMIE Economic Outlook, NSE EPR.

**Figure 5: Monthly trend in weighted call money rate and average monthly banking liquidity**


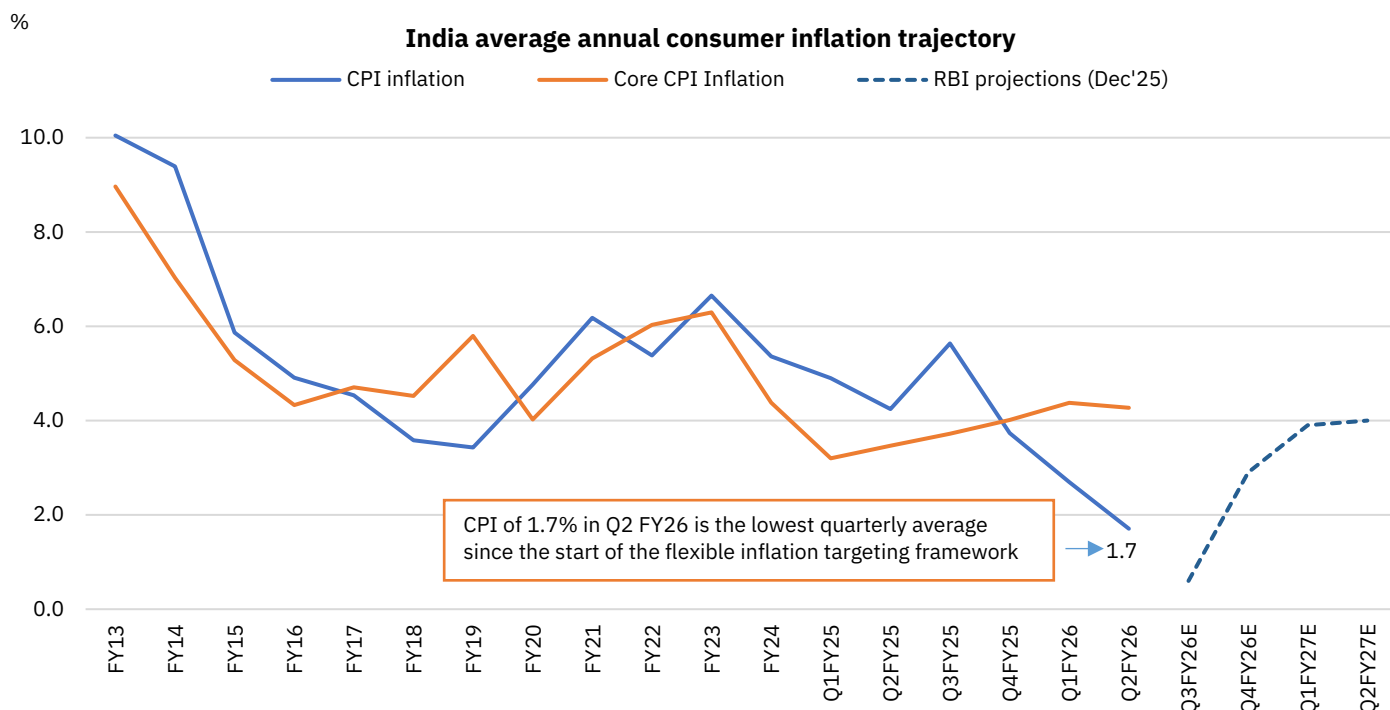
Source: CMIE Economic Outlook, NSE EPR. Note: 1) Positive values indicate deficit, while negative values indicate surplus 2) Data has been captured till December 3, 2025.

**Figure 6: India vs. US policy rates and yield differential**


Source: LSEG Workspace, NSE EPR.

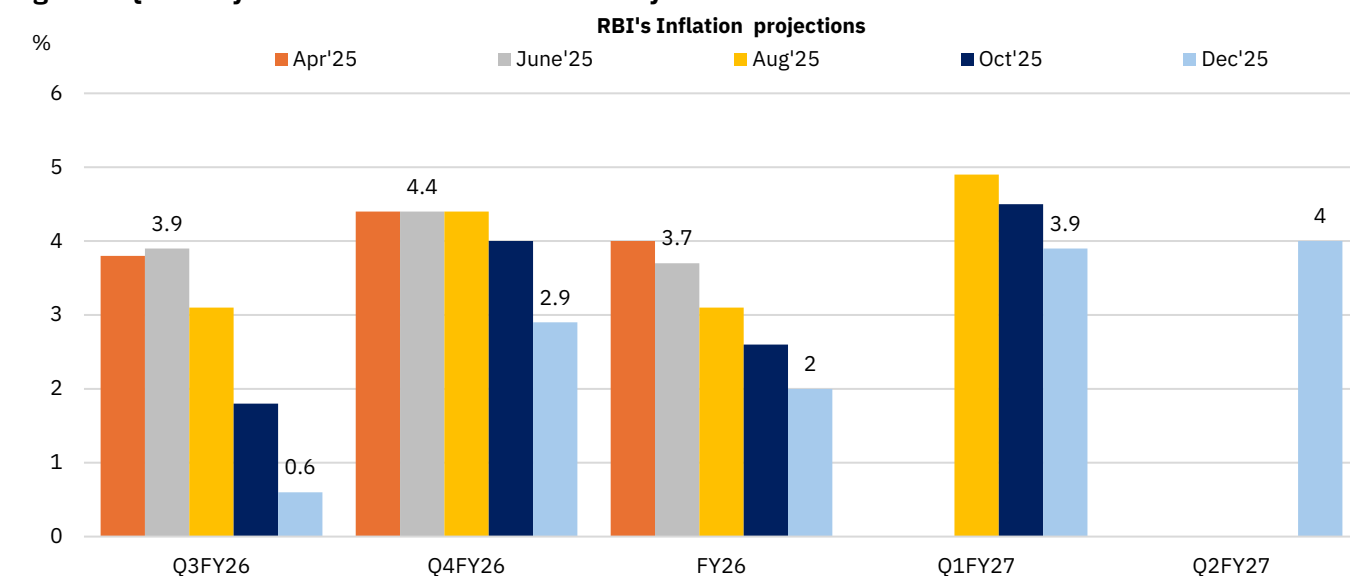
**Figure 7: India's consumer inflation trajectory and RBI's forecasts**

Headline inflation is projected to further decline by 60bps to 2% in FY26 with a sharp downward revision of 1.2pp and 1.1 pp to 0.6% and 2.9% in Q3 and Q4 respectively. The RBI projects both headline and core inflation to remain around 4% in the first half of FY27.



Source: CMIE Economic Outlook, RBI, NSE EPR. Core inflation is calculated as CPI inflation excluding food, pan, tobacco & intoxicants and fuel & light.

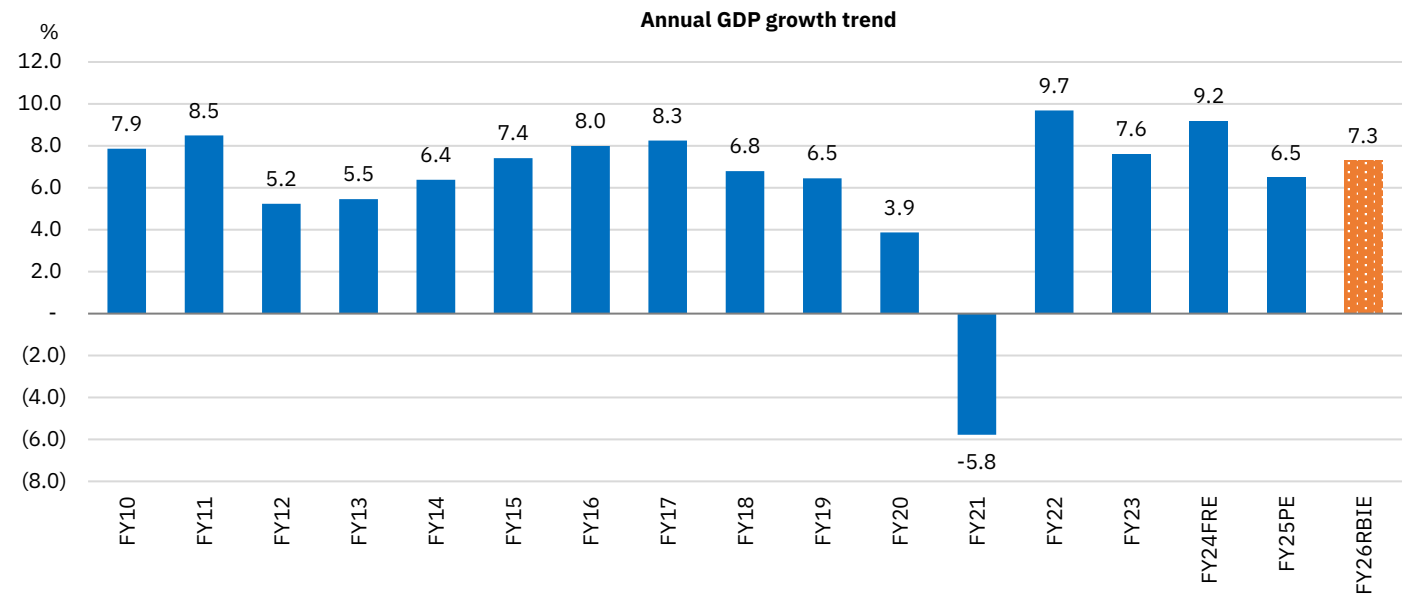
**Figure 8: Quarterly and annual inflation forecasts by RBI**



Source: RBI, NSE EPR

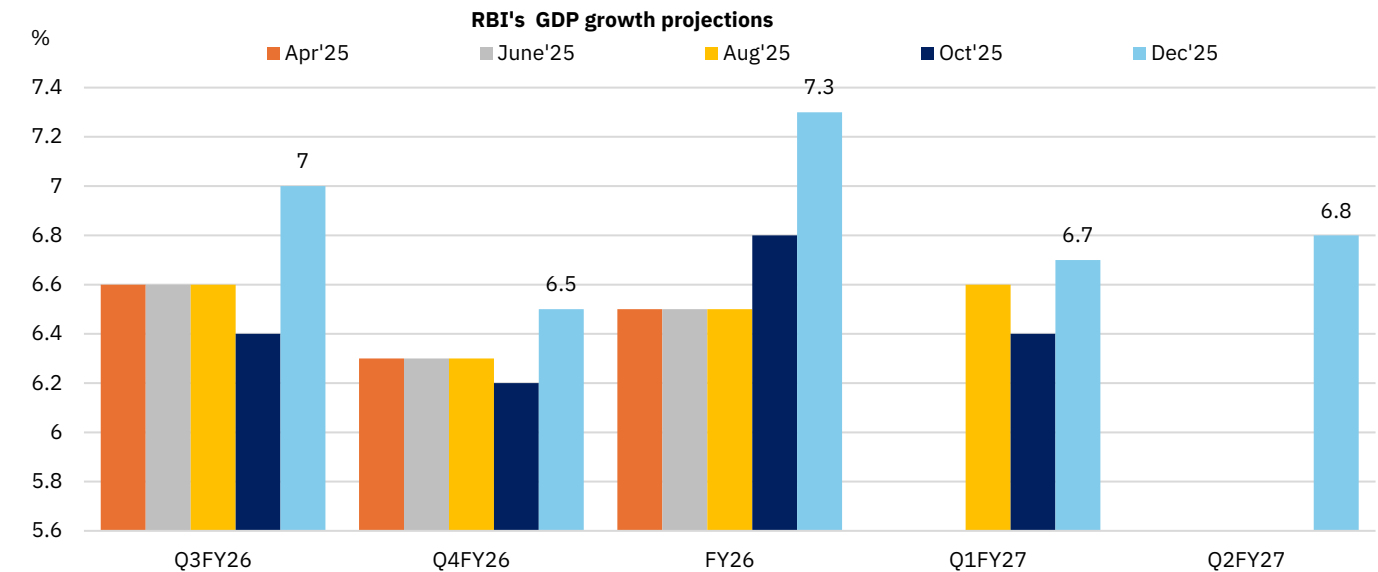
**Figure 9: GDP growth trend and RBI's estimates**

The GDP growth projection has been revised higher by 50bps to 7.3% in FY26, higher than IMF's estimate of 6.6%. The forecast for Q1 and Q2 of FY27 remains healthy at 6.7% and 6.8% respectively.



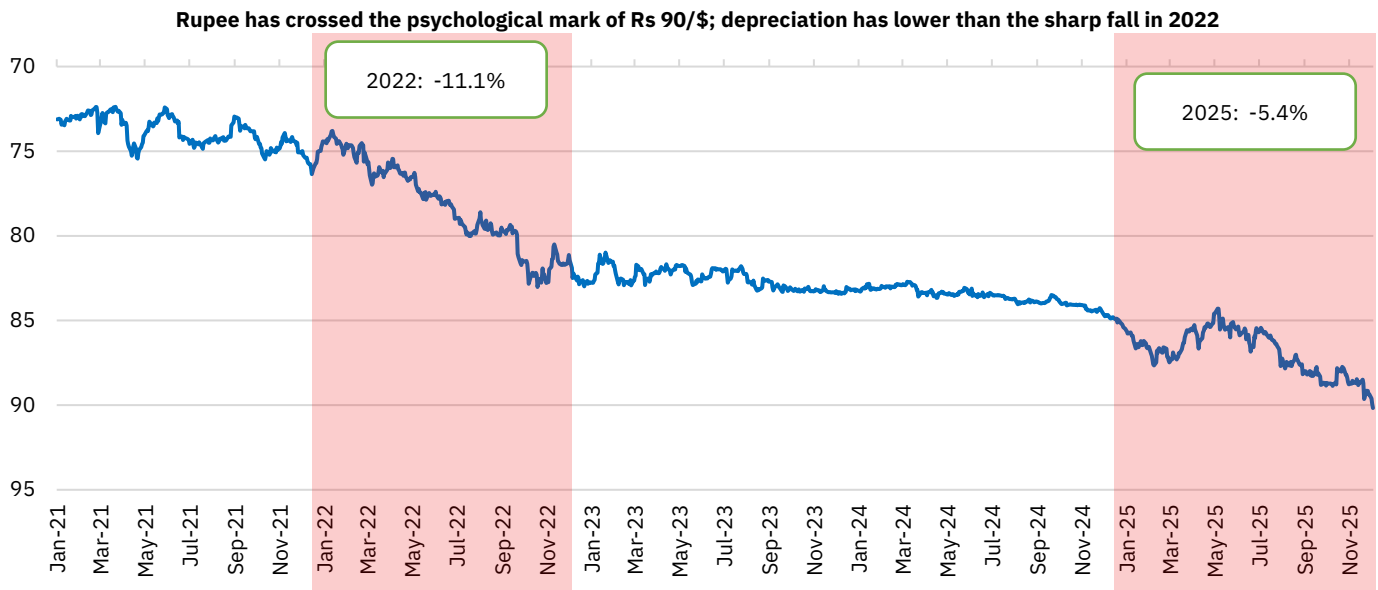
Source: CMIE Economic Outlook, RBI, NSE EPR. RBIE = RBI estimate, FRE= First Revised Estimates, PE= Provisional estimates

**Figure 10: RBI's quarterly and annual GDP growth forecasts**



Source: RBI, NSE EPR.

**Figure 11: Daily trends in the rupee-US dollar exchange rate during the last five years**



Source: LSEG Workspace, NSE EPR.

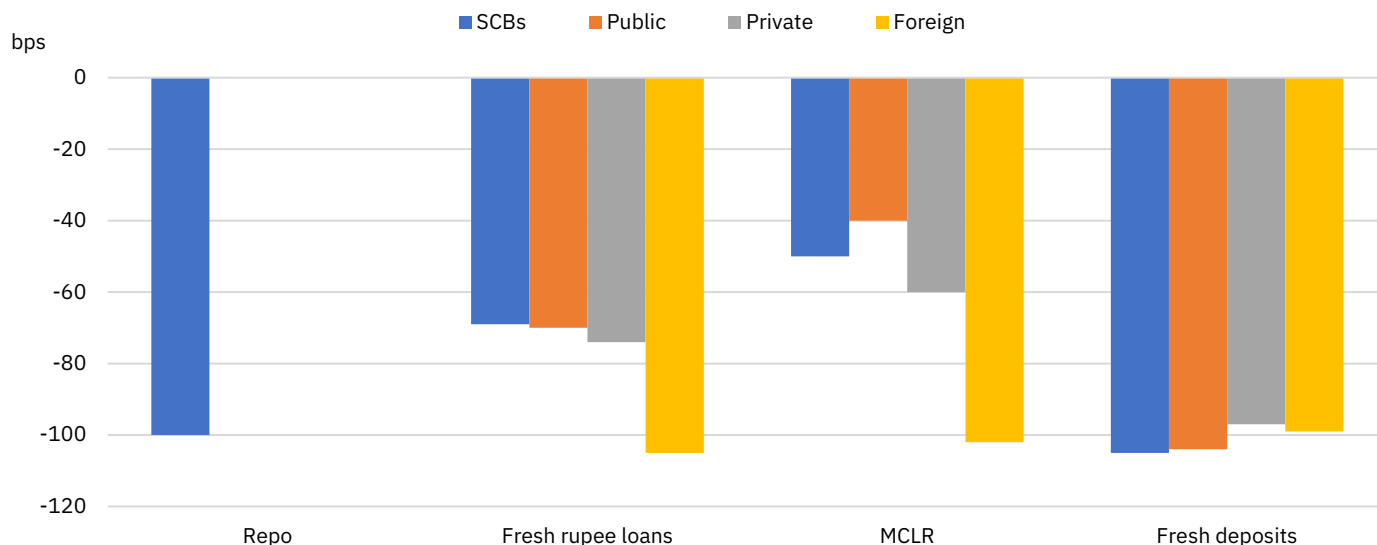
**Table 2: Trends in exchange rate movements and fundamental & domestic factors**

| Month  | Average ER (Rs/US\$) | US dollar index | FPI flows (total) US\$ mn | Trade balance US\$ mn | Services (net) US\$ mn | India-US 10Y diff (pp) | Net forward position US\$ mn | Net forward in next 3 months US\$ mn | Liquidity Rs crore | RBI dollar purchase (net) |
|--------|----------------------|-----------------|---------------------------|-----------------------|------------------------|------------------------|------------------------------|--------------------------------------|--------------------|---------------------------|
| Sep-24 | 83.80                | 101.06          | 11,162                    | -24,646               | 16,033                 | 2.34                   | -14,580                      | -14,580                              | -1,00,916          | 9,639                     |
| Oct-24 | 84.04                | 103.31          | -11,473                   | -26,086               | 17,179                 | 2.46                   | -49,180                      | -49,180                              | -1,50,012          | -9,275                    |
| Nov-24 | 84.36                | 105.86          | -2,541                    | -31,988               | 14,863                 | 2.71                   | -58,850                      | -58,850                              | -1,38,553          | -20,228                   |
| Dec-24 | 84.99                | 107.24          | 3,070                     | -20,674               | 19,168                 | 2.71                   | -67,938                      | -58,063                              | 68,470             | -15,150                   |
| Jan-25 | 86.26                | 108.64          | -8,963                    | -23,091               | 18,035                 | 2.13                   | -77,528                      | -46,923                              | 2,03,564           | -11,139                   |
| Feb-25 | 87.04                | 107.32          | -2,797                    | -14,054               | 17,133                 | 2.25                   | -88,753                      | -33,576                              | 1,66,647           | -1,621                    |
| Mar-25 | 86.50                | 104.13          | 3,845                     | -21,459               | 18,140                 | 2.39                   | -84,345                      | -23,955                              | 1,23,664           | 14,355                    |
| Apr-25 | 85.57                | 100.67          | -2,335                    | -27,092               | 15,934                 | 2.14                   | -72,575                      | -14,725                              | -1,39,759          | -1,660                    |
| May-25 | 85.20                | 100.09          | 3,636                     | -22,552               | 15,758                 | 1.84                   | -65,215                      | -15,060                              | -1,71,075          | 1,764                     |
| Jun-25 | 85.92                | 98.39           | -904                      | -19,117               | 15,260                 | 1.89                   | -60,390                      | -14,385                              | -2,73,829          | -3,661                    |
| Jul-25 | 86.17                | 97.96           | -634                      | -27,535               | 15,630                 | 1.94                   | -57,850                      | -18,530                              | -3,04,272          | -2,540                    |
| Aug-25 | 87.53                | 98.26           | -2,338                    | -26,685               | 16,610                 | 2.21                   | -53,355                      | -20,295                              | -2,83,668          | -7,695                    |
| Sep-25 | 88.28                | 97.69           | -1,412                    | -32,161               | 15,530                 | 2.38                   | -59,405                      | -31,315                              | -1,47,282          | -7,910                    |
| Oct-25 | 88.38                | 98.76           | 4,030                     | -41,685               | 17,438                 | 2.47                   |                              |                                      | -85,536            |                           |
| Nov-25 | 88.84                | 99.74           | 320                       |                       |                        | 2.44                   |                              |                                      | -1,78,223          |                           |
| Dec-25 | 89.90                | 99.21           | -1204                     |                       |                        | 2.45                   |                              |                                      |                    |                           |

Source: CMIE Economic Outlook, LSEG Workspace, NSE EPR Notes 1) The average ER, US dollar index, FPI flows and India-US 10Y diff for December 2025 pertains to the first three days of the month 2) For blank spaces in the table, there is no data available

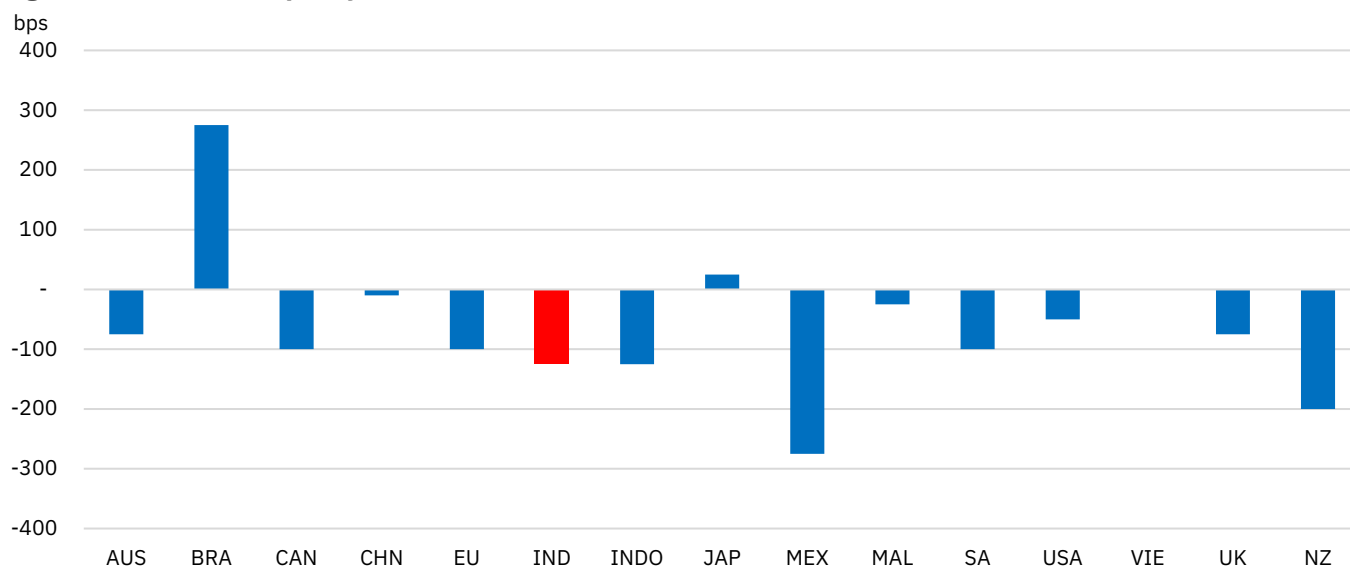


**Figure 12: Change in policy, lending and deposit rate during the current policy rate cycle**



Source: CMIE Economic Outlook, NSE EPR; Notes: 1) The change in repo rate, fresh rupee loans and fresh deposits is between January'25 and October'25, while in case of MCLR, the change is between January'25 and November'25

**Figure 13: Variation in policy rates across countries since the start of 2025**



Source: CEIC, LSEG Workspace, NSE EPR. Notes: 1) The variation in policy rates for all countries (barring India) has been computed from the start of the calendar year till policy actions undertaken till November 31<sup>st</sup>, 2025 2) For China, the loan prime rate for 1 year has been considered for computation 3) AUS = Australia, BRA = Brazil, CAN = Canada, CHN= China, EU = European Union, IND= India, INDO=Indonesia, JAP= Japan, MEX=Mexico, MAL=Malaysia, SA= South Africa, USA=United States of America, VIE=Vietnam, UK=United Kingdom, NZ= New Zealand.

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