India Economy

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RBI's frontloads hyper accommodation

RBI MPC REVIEW

Notwithstanding the positive financial market spillovers, the RBI's hyper-accommodative strategy, while aimed at reviving growth, faces skepticism due to structural headwinds and sustained procyclical fiscal tightening

The Reserve Bank of India's (RBI) policy measures since Dec'24, including a 50 basis point (bp) repo rate cut to 5.50% and a 100 bp reduction in the Cash Reserve Ratio (CRR), signal a highly accommodative stance reminiscent of pandemic-era policies. The cumulative liquidity infusion, estimated at INR 13.16 trillion (5.7% of bank deposits), underscores deep concerns about India's growth outlook, despite the reported 7.4% GDP growth in Q4FY25.

The RBI's frontloading of accommodative measures aims to stimulate household consumption and private capital expenditure (capex). However, the central bank has signaled limited scope for further easing, suggesting it has exhausted much of its monetary policy arsenal. This urgency reflects skepticism about the sustainability of recent growth figures and a need to counter persistent demand weakness, partly driven by global economic slowdown.

Growth and Inflation Outlook

The RBI projects FY26 GDP growth at 6.5%, but this optimism lacks robustness. Private investment, long touted as a growth driver, remains elusive, with MOSPI's latest survey indicating significant cutbacks in planned private capex for FY26. The RBI's growth forecast heavily relies on a strong performance from the less productive agricultural sector, bolstered by an expected above-normal monsoon. However, weak real income growth and insufficient productive employment continue to drag consumption demand, undermining the growth narrative.

The inflation projection of 3.7% for FY26 aligns with subdued demand, but the RBI's confidence in achieving a durable 4% target may underplay risks from weather-related uncertainties and global commodity price volatility.

Financial Stability and Leverage

The RBI's push for leveraged consumption through relaxed monetary and regulatory policies downplays financial stability concerns. The central bank asserts that asset quality (AQ), liquidity, and profitability issues in the lending sector have eased, with a declining credit-to-deposit ratio creating space for balance sheet leverage. However, dismissing worsening AQ as irrelevant to banks and non-banking financial companies (NBFCs) is questionable, given potential systemic risks.

Monetary accommodation vs structural headwinds

The RBI's acknowledgment of limited further accommodation highlights the structural nature of India's economic challenges, both domestic and global. Monetary policy alone cannot effectively address constraints like weak real income growth or global trade uncertainties. The central bank's aggressive liquidity measures may reflect an awareness of monetary policy's diminishing potency against these headwinds and the persistent pro-cyclical fiscal tightening.

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Accommodative RBI = Easy financial conditions

The liquidity surge is likely to boost market sentiment, particularly in rate-sensitive sectors. Easing interest rates may compress bank margins, as lending rates adjust faster than funding costs. However, banks benefit from trading profits, with 10-year government security (G-sec) yields dropping from 6.8% to 6.2% since March 2025. NBFCs, reliant on bank borrowings or market rates, face a favorable funding environment. Sectors like autos and real estate, driven by leveraged consumption, are poised for positive valuation impacts.

Overall, notwithstanding the positive financial market spillovers, the RBI's hyper-accommodative strategy, while aimed at reviving growth, faces skepticism due to structural economic.

Key points from RBI's MPC decision:

Repo Rate Cut by 50 Basis Points: The MPC voted to reduce the policy repo rate by 50 bps from 6.00% to 5.50% to stimulate economic growth. Five members supported the 50 bps cut, while one voted for a 25 bps cut.

Four staggered CRR cuts of 25 bps each during Spt-Nov'2025 equivalent to INR 2.5 trillion. With this the CRR will stand at 3% of NDTL of banks. With this the RBI would have eased CRR by 150bp since Dec'24, translating into liquidity infusion INR 2.5 trillion.

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RBI continues with a bazooka of liquidity: The cumulative liquidity infusion by the RBI including the latest CRR cuts since Dec'24 would stand at INR 13.16 trillion, comparable to the pandemic infusion. This amounts to 5.7% of aggregate deposits of banks. Thus, considering along with the cumulative 150 bps repo rate cut, RBI's current stance is de-facto hyper accommodative. This situation stands in sharp contrast to RBI's stated position of shifting from accommodative to neutral.

Shift to Neutral Policy Stance: The MPC changed its stance from accommodative to neutral, reflecting limited space for further rate cuts after a cumulative 100 bps reduction since February 2025.

Inflation Forecast Revised Downward: CPI inflation for FY26 is projected at 3.7%, down from 4.0%, with quarterly estimates: Q1 at 2.9%, Q2 at 3.4%, Q3 at 3.9%, and Q4 at 4.4%. The decline is driven by soft food inflation, benign core inflation, and moderating commodity prices, assuming a normal monsoon. Risks remain balanced.

GDP Growth Projection for FY26: Real GDP growth is forecasted at 6.5% for FY26, with quarterly projections: Q1 at 6.5%, Q2 at 6.7%, Q3 at 6.6%, and Q4 at 6.3%. Growth is supported by improving corporate balance sheets, government capex, and rural demand, though global uncertainties pose risks.

Economic Outlook and Drivers:

- Investment Activity: Expected improvement in private capex and continued government's capex.
- Trade: Global trade policy uncertainties persist.
- Agriculture: Bright prospects due to an above-normal monsoon.
- Services Sector: Expected to maintain momentum.

Inflation Dynamics:

a) Headline CPI inflation fell to a six-year low of 3.2% in April 2025, driven by a sixth consecutive month of declining food inflation. Fuel inflation turned positive due to LPG price hikes, while core inflation remained stable despite gold price pressures.

Rationale for Policy Decisions: a) Inflation now below the 4% target, expected to sustain, b) soft inflation outlook and subdued growth necessitate frontloading rate cuts to boost private consumption and investment amidst a challenging global environment.

Future Policy Approach: With limited monetary policy space, the MPC will monitor incoming data and global economic developments to guide future actions, aiming for an optimal growth-inflation balance.

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