

Supply Shock, Steady Anchor: Update on RBI monetary policy

Policy Action

- The Monetary Policy Committee (MPC) voted unanimously to keep the policy repo rate unchanged at 5.25%.
- Consequently, the standing deposit facility (SDF) rate remains at 5.00% while the marginal standing facility (MSF) rate remains at 5.50%.
- The MPC also decided to maintain its neutral stance, retaining the flexibility to respond “judiciously” to incoming information.

Assessment of Policy Action

The policy was broadly in line with expectations. In our view, the key message from the RBI is that it does not plan to use interest rates as a first line of defence for the currency. Instead, the policy framework remains anchored in inflation targeting, while seeking to preserve growth momentum through adequate liquidity, effective policy transmission and regulatory measures that improve ease of doing business for financial institutions. The resolution explicitly notes that India is facing a supply shock from the West Asia conflict and that it is prudent to “wait and watch” while retaining flexibility under the neutral stance.

This is important because, ahead of the policy, some market participants had begun to worry that persistent currency pressure could force a more defensive policy posture, resulting in hawkish forward guidance.

Below are key RBI estimates on the growth and inflation trajectory for the next year compared to their previous forecasts:

	CPI Inflation (%)			GDP (%)		
	5-Dec-25	6-Feb-25	8-Apr-26	5-Dec-25	6-Feb-25	8-Apr-26
Q4FY26	2.9	3.2	3.1	6.5		6.7
FY26	2.0	2.1	2.1	7.3	7.4	7.6
Q1FY2027	3.9	4.0	4.0	6.7	6.9	6.8
Q2FY2027	4.0	4.2	4.4	6.8	7.0	6.7
Q3FY2027			5.2			7.0
Q4FY2027			4.7			7.2
FY27			4.6			6.9

Source: RBI

Assessment of Inflation

The RBI revised its inflation forecasts upwards, incorporating near-term inflation risks from energy and commodity volatility linked to the West Asia conflict, as well as possible El Nino conditions. For FY27, the RBI projects **CPI at 4.6%**. Two key revisions in assumption are notable: crude at **US\$85/bbl** (from US\$70) and USD/INR at **94** (from 88).

Despite adverse geopolitical conditions, the RBI expects core inflation for FY27 to remain muted at 4.4%. The RBI expects inflation to rise to 5% for FY27 if crude averages US\$95/bbl, with growth at 6.7%, implying a slightly worse stagflationary mix.

Assessment of Growth

The RBI revised down its growth forecasts due to supply and external demand shocks arising from the West Asia conflict. However, the RBI expects growth in H2FY27 to pick up, supported by services momentum, rising manufacturing capacity utilisation, healthy balance sheets of financial institutions and corporates, and the government's focus on domestic manufacturing.

The RBI mentioned that, in case global growth turns out to be 100 bps below its baseline (2.9%) due to prolonged trade and geopolitical tensions, domestic growth and inflation could be lower by around 30 bps and 15 bps, respectively.

Liquidity Management

The central bank appears committed to ensuring that funding conditions remain supportive and that money market rates evolve in line with the policy corridor, rather than tighten due to temporary frictions. The MPR explicitly states that the guiding principle of liquidity management is to align the weighted average call rate with the policy repo rate.

The RBI notes that system liquidity remained in surplus in H2:2025-26. It undertook several measures, including OMO purchases, buy/sell forex swaps and long-term repos, to inject durable liquidity. Across FY2025-26, RBI liquidity measures included approximately ₹7.39 lakh crore of OMO purchases, about ₹2.27 lakh crore through USD/INR buy-sell swap auctions, and about ₹1.62 lakh crore through term repos, apart from the CRR reduction.

We expect liquidity conditions to improve further in May-June with the transfer of the RBI dividend, which, in our view, could exceed ₹2.5 trillion. That should provide an additional cushion to system liquidity, support transmission and reduce the probability of any unintended tightening in front-end funding conditions.

Market Outlook

Reinforcing “lower for longer bias”

We expect inflation to remain contained and policy rates to stay lower for longer, as long as geopolitical tensions do not intensify materially. If the ceasefire holds and crude oil remains below US\$90/bbl, inflation should remain reasonably well managed.

Accordingly, we remain constructive for high-quality accrual-based strategies in the one-three-year duration segment.

Suggested asset allocation framework by time horizon

- **3–12 months:** Investors may consider Money Market Funds or Low Duration Funds, which are suitable for managing short-term surplus, while maintaining liquidity.
- **12-24 months:** Investors may consider Short Duration Funds and Corporate Bond Funds, which are well-positioned to benefit from a liquidity-rich environment.
- **More than 24 months:** Investors may consider Income plus Arbitrage strategies for tax-efficient return generation.

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Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.