

RBI Remains in 'Wait and Watch' Mode

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.

Measures to attract foreign capital

- Expanded the investable G-sec universe for foreign investors by including 15-, 30-, and 40-year tenor bonds under the Fully Accessible Route (FAR), while removing restrictions on short-term limits, concentration and individual securities under the General Route.
- Enhanced investment limits for NRIs and OCIs in listed equities without requiring SEBI registration.
- Introduced a concessional forex swap window for PSUs raising ECBs until September 30, 2026.
- RBI to bear the full hedging cost on fresh three-to-five-year FCNR Deposits raised by AD Banks.
- Proposed restoring the timeline for realisation of export proceeds to nine months.

Assessment of Policy Action

The policy was largely in line with expectations. The RBI Governor maintained a cautious tone, highlighting upside risks to inflation and downside risks to growth arising from the West Asia conflict and potential monsoon-related disruptions.

The resolution emphasised that, although inflation risks have increased, it is prudent to await greater clarity given the significant uncertainties surrounding the duration and intensity of the conflict, its spillover effects and the pace of supply chain normalisation.

Ahead of the policy announcement, concerns had emerged among market participants that persistent currency pressures could influence the MPC's stance, potentially leading to a more hawkish tone or policy action.

However, the statement gave comfort that the MPC does not intend to use interest rates as the primary tool for defending the currency. Instead, it remains focused on its inflation-targeting framework while supporting growth momentum.

To shore up forex reserves, the RBI separately announced a slew of measures. Most notably, the concessional forex swap window for external commercial borrowings and the hedging facility for FCNR(B) (Foreign Currency Non-Resident Bank) deposits could attract significant foreign capital inflows.

The RBI had introduced a similar FCNR deposit scheme following the 2013 Taper-Tantrum episode, which attracted USD 26 billion in NRI deposits and helped stabilise the INR.

Below are the RBI's key estimates for the growth and inflation trajectory over the next year, compared with its previous forecasts:

	CPI Inflation (%)			GDP (%)		
	6-Feb-25	8-Apr-26	5-Jun-26	6-Feb-25	8-Apr-26	5-Jun-26
FY26	2.1	2.1	2.1	7.4	7.6	7.6

Q1FY2027	4.0	4.0	4.2	6.9	6.8	6.6
Q2FY2027	4.2	4.4	5.1	7.0	6.7	6.3
Q3FY2027		5.2	5.9		7.0	6.5
Q4FY2027		4.7	5.4		7.2	6.8
FY27		4.6	5.1		6.9	6.6

Source: RBI

Assessment of Inflation

The RBI raised its inflation forecast once again, from 4.6% to 5.1% for FY27, incorporating persistently high crude oil prices and the growing pass-through to retail prices since the April review.

It also highlighted upside risks to inflation from supply chain disruptions and uncertainty surrounding the spatial and temporal distribution of the monsoon.

Assessment of Growth

The RBI revised down its growth forecast for FY27 to 6.6%, noting that higher energy and other input costs, coupled with supply disruptions, are likely to weigh on economic activity going forward. It also flagged risks from the projected deficiency in the Southwest Monsoon, which could have implications for agricultural production and rural demand.

While the RBI expects sustained momentum in services, it also expects the continuing impact of GST rationalisation, broadly stable employment conditions, elevated manufacturing capacity utilisation and healthy credit offtake to support growth momentum and limit downside risks.

Liquidity Management

The RBI expressed comfort with the prevailing liquidity conditions, which remain in surplus mode, and noted that the weighted average call rate has been trading within the policy corridor. However, it highlighted that transmission in the credit market moderated during March-April, with some hardening in deposit and lending rates.

Going forward, the RBI reiterated its commitment to ensuring adequate liquidity in the banking system.

Our team expects liquidity conditions to ease in the coming months, aided by the usual drawdown of government cash balances following the RBI's surplus transfer of Rs. 2.87 trillion and the seasonal return of currency during the monsoon season. Potential forex inflows under the ECB or FCNR routes could also add to domestic liquidity.

Market Outlook

We expect the RBI to remain on hold and await clarity on the actual growth and inflation trajectory amid volatile energy prices and heightened uncertainty surrounding the West Asia conflict. Furthermore, it would be prudent to monitor monsoon progress and initial sowing trends to have a clearer assessment of the inflation outlook.

If the conflict is resolved and crude oil prices fall below US\$90/bbl, inflation should remain reasonably well contained.

In line with our view of a long pause on rates, we remain constructive on high-quality corporate bonds in the up-to-three-year segment. The RBI's measures to boost capital inflows through FCNR deposits and ECBs should also be supportive for short-end corporate bonds, while adding to domestic liquidity.

We continue to favour high-quality accrual-based strategies in the 1–3-year duration segment, with some flexibility to exploit curve dislocations as they emerge at the longer end.

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 benign macro backdrop and 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.