RBI Extends its 'Wait-and-Watch' Mode

Policy Action

- The Monetary Policy Committee (MPC) unanimously voted 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) remains at 5.50%.
- The MPC also decided to maintain its neutral stance.

Assessment of Policy Action

The RBI's decision to keep policy rates unchanged was largely in line with market expectations. However, its accompanying commentary appeared somewhat more dovish than markets had expected.

Against the backdrop of volatile oil prices, lingering supply chain challenges and an increasingly hawkish global monetary policy environment, market participants had expected the RBI to deliver a more hawkish message while keeping rates unchanged.

Nevertheless, the RBI did not indicate any significant discomfort with the current monetary policy setting. Although it acknowledged that headline inflation is likely to edge higher, it emphasised that the projected increase is primarily driven by supply-side factors—particularly food and fuel prices—rather than broad-based demand pressures.

While on the growth front, the RBI pointed to a 'hazy outlook', despite current economic momentum remaining resilient.

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

	CPI Inflation (%)			GDP (%)		
	8-Apr-26	**5-Jun-26**	**5-Aug-26**	**8-Apr-26**	**5-Jun-26**	**5-Aug-26**
FY26	2.1	2.1		7.6	7.6	
Q1FY2027	4.0	4.2	3.9	6.8	6.6	7.0
Q2FY2027	4.4	5.1	4.7	6.7	6.3	6.4
Q3FY2027	5.2	5.9	5.9	7.0	6.5	6.5
Q4FY2027	4.7	5.4	5.5	7.2	6.8	6.8
FY27	**4.6**	**5.1**	**5.0**	**6.9**	**6.6**	**6.7**
Q1FY28			5.3			7.3

Source: RBI

Assessment of Inflation

The RBI lowered its average inflation forecast for FY27 to 5.0% from 5.1%, primarily reflecting the 30 bps lower-than-expected inflation in Q1 FY27 relative to its June projections.

Headline inflation has firmed up, with the June 2026 CPI reading moving above the RBI's 4% target, and CPI is expected to rise further in the coming months. However, the RBI assessed the uptick as being largely driven by higher food and fuel prices, with little sign of generalisation of price pressures so far. The RBI also highlighted that core inflation—excluding the impact of precious metals—remains benign, indicating that underlying inflationary momentum continues to be subdued.

That said, the RBI acknowledged that risks remain. It cautioned that elevated food, fuel and other input costs could trigger second-round effects, potentially leading to a broader pass-through into consumer prices and more generalised inflationary pressures.

Assessment of Growth

The RBI revised its FY27 growth forecast to 6.7%, from its earlier projection of 6.6%, noting the prevailing strength in economic activity despite geopolitical uncertainties.

With regard to GDP growth, the RBI took comfort in robust domestic demand, sustained momentum in services, the continuing impact of GST rationalisation and broadly stable employment conditions. It also expects strong capacity utilisation, robust credit flow and the government's continued thrust on infrastructure to sustain the investment activity.

On the other hand, the RBI also noted that renewed tensions in West Asia, disruptions to global supply chains, volatility in international financial markets and weather-related shocks pose downside risks to growth.

Liquidity Management

The RBI expressed comfort with the prevailing liquidity conditions, noting that the weighted average call rate continues to trade within the policy corridor. Looking ahead, it reiterated its commitment to ensuring appropriate liquidity in the banking system.

We expect system liquidity to ease in the coming months, aided by the usual drawdown in government cash balances and anticipated foreign currency inflows under the RBI's FCNR and ECB swap routes.

Notably, despite the prospect of substantial FCNR inflows and the associated accretion of rupee liquidity, the RBI did not signal any sterilisation or offsetting liquidity withdrawal. Instead, it reiterated its intention to maintain comfortable system liquidity and ensure effective policy transmission.

This stance is likely to keep overnight funding rates well anchored, limit volatility in money markets and provide a supportive backdrop for short-duration fixed-income assets.

Market Outlook

We expect the RBI to remain on hold and wait for evidence of second-round effects from the recent rise in inflation. We continue to expect a 50-75bps rate hike in the current monetary policy cycle, with the first rate increase possibly beginning in December 2026. However, the timing and extent of tightening will depend on inflationary pressures becoming persistent and broad-based.

Importantly, a significant part of this anticipated tightening appears to be already reflected in market pricing, particularly at the front end of the yield curve.

In line with our view of stable policy rates in the near term and an easy liquidity environment, we remain constructive on high-quality corporate bonds at the front end of the yield curve.

We continue to favour high-quality, accrual-oriented strategies in the 1–3-year duration segment, with some flexibility to capitalise on valuation opportunities and yield curve dislocations that may emerge at longer maturities.

UTI Mutual Fund

<u>Suggested asset allocation framework by time horizon</u>

- **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.