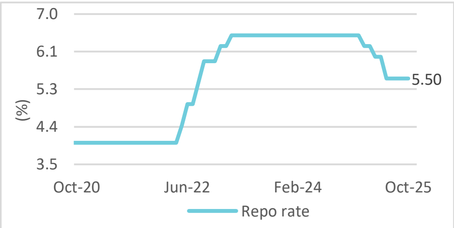
RBI POLICY REVIEW

MACRO MUSINGS

REPO RATE



Source: CMIE, Nuvama Research

Pause with a hint of future easing

The MPC left the repo rate unchanged at 5.5% (unanimous) and the policy stance 'neutral', although it noted that the space for further easing has opened up given a more benign inflation outlook. For now, policymakers want to wait for the full effect of their past actions to play out. Perhaps, INR weakness also played a role. Meanwhile, the RBI raised its growth forecast (on strong Q1, but lowered for 2H) and reduced its inflation forecast for FY26 further in the wake of GST cuts.

In our view, demand is weak and inflation is undershooting. Hence, the RBI's wait-and-watch approach is not very convincing. Timeliness of rate cuts is as critical as quantum of rate cuts. In any case, we expect 50–75bp of more rate cuts in this cycle. Expect recovery to be slow.

RBI sees domestic growth resilient, but highlights external risks

According to the RBI, domestic growth remains resilient as seen in the Q1FY26 real GDP print. Furthermore, a good monsoon, transmission of past rate cuts and GST cuts should support domestic demand. The risks are mainly on the external front as tariffs' impact starts to kick in. As regards forecasts, the RBI has upgraded the FY26 real GDP projections by 30bp to 6.8% YoY. The upgrade is entirely owing to the higher Q1FY26 print as H2FY26 forecasts have been marked lower by 10–20bp to ~6.3% YoY. Essentially, the RBI is forecasting a sharp deceleration in growth.

In our view, however, the RBI is optimistic in its growth assessment. Nominal GDP (NGDP) rather than real GDP is a better metric of growth (refer to Of Cycles, Trend and Hysterisis). On that front, activity has slowed notably versus a year ago and the growth dynamic is not very constructive either. As we argued in our recent note, excessive focus on stability over scale is now inhibiting future capacity creation. It is imperative that the RBI resumes easing quickly to reverse slowdown.

FY26 inflation projection revised down

FY26 CPI projection has been further lowered to 2.6% from 3.1% earlier. This is a very benign level with a rather sanguine outlook for both food (normal monsoon) and core inflation (GST cuts). Against this, it is a surprise that the RBI maintained a neutral stance, although it did mention that the policy easing space could be opening up.

Outlook: We expect rate cuts down the line

As argued above, domestic growth-inflation mix and evolving global environment warrant further monetary easing—both globally and in India. The RBI should resume easing soon. Volatility on capital flows may have weighed on its mind. In our view, the pace of cuts is equally important as the quantum. Additionally, the RBI should welcome INR depreciation as it is the best antidote for tariffs. We expect the RBI to resume easing soon, and forecast another 50–75bp of cuts in this cycle.

Overall, we do not anticipate a quick recovery in overall demand, although consumption demand is likely to do better than exports and domestic capex.

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