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Financial Services

EcoScope
The Economy Observer

# RBI surprises the market with a 50bp reduction in repo rate and a 100bp CRR cut

**Future rate cuts will be data-dependent**

- **At its second meeting of FY26, the RBI's Monetary Policy Committee (MPC), with a majority of five out of six members, decided to reduce the benchmark repo rate by 50bp to 5.5% from 6.0% in the Apr'25 policy, marking its third consecutive cut. The RBI's decision to cut rates by 50bp came as a big surprise against both our and consensus expectations of a third consecutive 25bp rate cut. We view the RBI's decision as a strong and timely intervention to stimulate domestic demand.**
- **However, the MPC has also unanimously decided to change the stance to "neutral" from "accommodative", implying that the rates can now go either way, depending on the incoming data and evolving growth outlook. "…after having reduced the policy repo rate by 100 basis points in quick succession since February 2025 the Monetary Policy Committee also felt that under the present circumstances, monetary policy is now left with very limited space to support growth….", *the Governor mentioned*.**
- **Another big surprise came from the announcement of a CRR cut of 100bp to 3% of NDTL (much more than market expectations) from 4% earlier. The move will boost the banking system's liquidity and ease monetary conditions to bolster lending growth. This reduction will be carried out in four equal tranches of 25bp each, with effect from the fortnights beginning 6th Sep, 4th Oct, 1st Nov, and 29th Nov'25. The CRR cut would release primary liquidity of ~INR2.5t to the banking system by Dec'25."…besides providing durable liquidity, it will reduce the cost of funding of the banks, thereby helping in monetary policy transmission to the credit market…", *the Governor mentioned*.**
- **According to the provisional estimates released by the National Statistics Office (NSO), real GDP grew 6.5% in FY25, which was lower than the RBI's expectations. "…thus, it is imperative to continue to stimulate domestic private consumption and investment through policy levers to step up the growth momentum. This changed growth-inflation dynamics calls for not only continuing with the policy easing but also frontloading the rate cuts to support growth….", *the Governor mentioned*. The RBI maintained its real GDP projection of 6.5% for FY26 (with 1Q/2Q/3Q/4Q at 6.5%/6.7%/ 6.6%/6.3%).**
- **In line with our expectations, the RBI reduced its inflation projections for FY26 to 3.7% from 4.0% earlier. This was on account of sharp downward revisions made to 1Q and 2Q inflation forecasts, which have been brought down to 3.6% from 4.5% (Apr'25) and to 3.9% from 4.0%, respectively. Conversely, the estimate for 3Q has been revised upward to 3.9% from 3.8% earlier, while the 4Q projection has been retained at 4.4%.**
- **Overall, the monetary policy was a big surprise. We welcome the RBI's decision to reduce the repo rate by 50bp and view it as a bold and timely intervention to support domestic demand. Front-loading of rate cuts by the RBI addresses the need to spur growth and also shows the RBI's commitment to maintaining price stability while supporting growth. However, the change in stance to "neutral" from "accommodative" also cautions that there now remains 'limited' room for monetary policy to support growth. We, thus, believe that RBI would maintain a status quo in its next meeting in Aug'25. The RBI is likely to assess the impact of the 100bp cut announced so far before taking a call on its rate trajectory. Any future rate reduction will be more data-dependent and will be expected only if there is a significant downside to the RBI's growth projections.**
- **Long-term view: With inflation expected at 3.7% in FY26 and the current repo rate at 5.5%, the real rate comes out to be ~1.8%. Thus, in the long term, we believe that there is space for two more rate cuts of 25bp each, implying a terminal rate of 5%. This will bring the real rate down to ~1%, and we expect the RBI to maintain this level of real rate in the long term. Progress of the southwest monsoon, tariff policy, and geopolitical developments are the key monitorables for the next few months to evaluate the timing and intensity of future rate cuts.**

## I. RBI surprises the market with a 50bp reduction in repo rate and a 100bp CRR cut

- At its second meeting of FY26, the RBI's Monetary Policy Committee (MPC), with a majority of five out of six members, decided to reduce the benchmark repo rate by 50bp to 5.5% from 6.0% in the Apr'25 policy, marking its third successive cut. The RBI's decision to cut rates by 50bp came as a big surprise against both our and consensus expectations of a third consecutive 25bp rate cut. We view the RBI's decision as a strong and timely intervention to stimulate domestic demand.

**Tanisha Ladha– Research Analyst** (Tanisha.Ladha@MotilalOswal.com)

- However, the MPC has also unanimously decided to change the stance to "neutral" from "accommodative", implying that the rates can now go either way, depending on the incoming data and evolving growth outlook. "…after having reduced the policy repo rate by 100 basis points in quick succession since February 2025 the Monetary Policy Committee also felt that under the present circumstances, monetary policy is now left with very limited space to support growth….", *the Governor mentioned.*
- Another big surprise came from the announcement of a CRR cut of 100bp to 3% of NDTL (much more than market expectations) from 4% earlier. The move will boost the banking system's liquidity and ease monetary conditions to bolster lending growth. This reduction will be carried out in four equal tranches of 25bp each, with effect from the fortnights beginning 6th Sep, 4th Oct, 1st Nov, and 29th Nov'25. The CRR cut would release primary liquidity of ~INR2.5t to the banking system by Dec'25."…besides providing durable liquidity, it will reduce the cost of funding of the banks, thereby helping in monetary policy transmission to the credit market…", *the Governor mentioned.*

**Exhibit 1: Repo rate cut to 5.5% in the Jun'25 policy, a 50bp reduction**

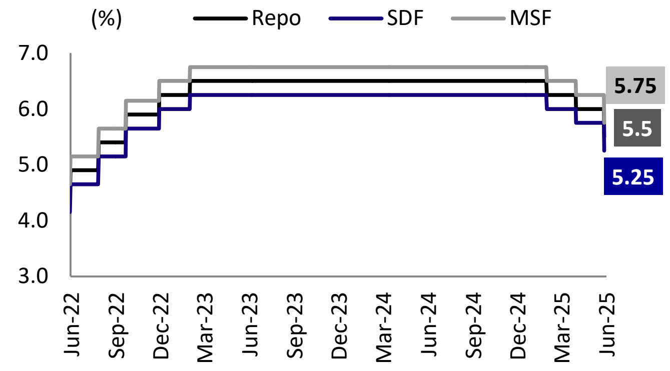
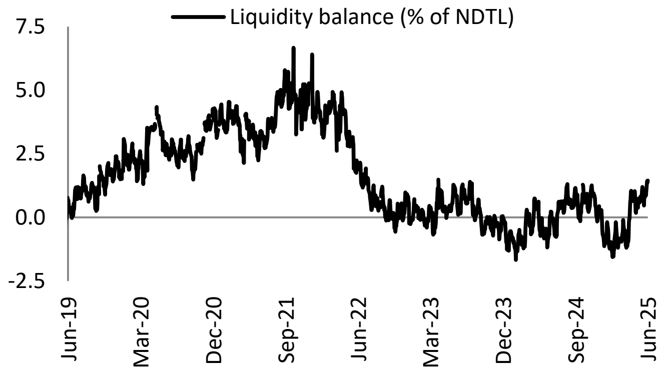



**Exhibit 2: System liquidity remained in surplus during the last two months**




Updated as of 5th Jun'25

Source: RBI, MOFSL

## II. Real GDP growth forecast maintained at 6.5% for FY26

- According to the provisional estimates released by the National Statistics Office (NSO), real GDP grew 6.5% in FY25, which was lower than the RBI's expectations. "…thus, it is imperative to continue to stimulate domestic private consumption and investment through policy levers to step up the growth momentum. This changed growth-inflation dynamics calls for not only continuing with the policy easing but also frontloading the rate cuts to support growth….", *the Governor mentioned.*
- In FY26 so far, domestic economic activity has remained healthy. Going forward, the outlook for the agricultural sector and rural demand is expected to receive further impetus from the expected above-normal southwest monsoon rainfall. Manufacturing activity is showing signs of revival, while services sector activity continues to be resilient. Sustained resilience in services activity would support urban consumption. The government's continued thrust on capex and elevated capacity utilization would help revive investment activity. However, protracted geopolitical tensions, global trade, and weather-related uncertainties pose downside risks to growth. Against this backdrop, the RBI maintained its real GDP projection of 6.5% for FY26 (with 1Q/2Q/3Q/4Q at 6.5%/6.7%/6.6%/6.3%).

### III. Inflation projection reduced to 3.7% from 4.0%

- In line with our expectations, the RBI reduced its inflation projections for FY26 to 3.7% from 4.0% earlier. This was on account of sharp downward revisions made to 1Q and 2Q inflation forecasts, which have been brought down to 3.6% from 4.5% (Apr'25) and to 3.9% from 4.0%, respectively. Conversely, the estimate for 3Q has been revised upward to 3.9% from 3.8% earlier, while the 4Q projection has been retained at 4.4%.
- In 1HFY26, inflation is expected to be lower than previously expected on account of the low base and significant moderation seen in food prices. This trend will be further supported by the expectation of above-normal monsoon and early onset of rains. The central bank notes that core inflation also remains contained, despite the recent price rise seen in gold. Upside risks to these forecasts may emerge due to uncertainties related to tariffs and global commodity prices.

### IV. Our view

Overall, the monetary policy was a big surprise. We welcome the RBI's decision to reduce the repo rate by 50bp and view it as a bold and timely intervention to support domestic demand. Front-loading of rate cuts by the RBI addresses the need to spur growth and also shows the RBI's commitment to maintaining price stability while supporting growth. However, the change in stance to "neutral" from "accommodative" also cautions that there now remains 'limited' room for monetary policy to support growth. We, thus, believe that RBI would maintain a status quo in its next meeting in Aug'25. The RBI is likely to assess the impact of the 100bp cut announced so far before taking a call on its rate trajectory. Any future rate reduction will be more data-dependent and will be expected only if there is a significant downside to the RBI's growth projections.

**Long-term view:** With inflation expected at 3.7% in FY26 and the current repo rate at 5.5%, the real rate comes out to be ~1.8%. Thus, in the long term, we believe that there is space for two more rate cuts of 25bp each, implying a terminal rate of 5%. This will bring the real rate down to ~1%, and we expect the RBI to maintain this level of real rate in the long term. Progress of the southwest monsoon, tariff policy, and geopolitical developments are the key monitorables for the next few months to evaluate the timing and intensity of future rate cuts.

**Exhibit 3: Real GDP growth projected at 6.5%...**

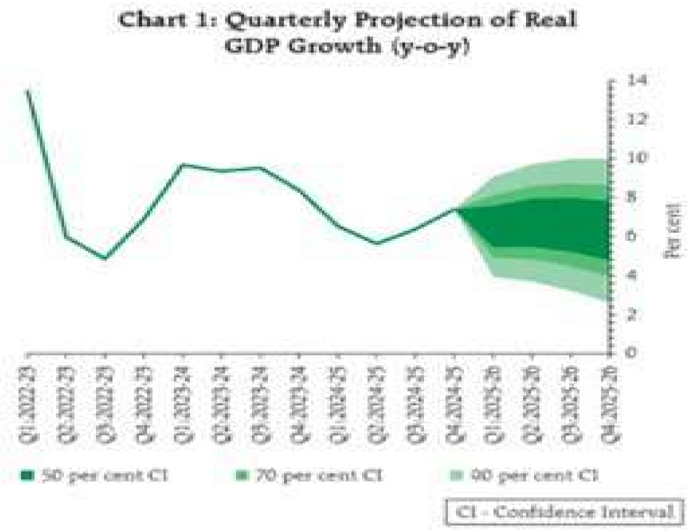
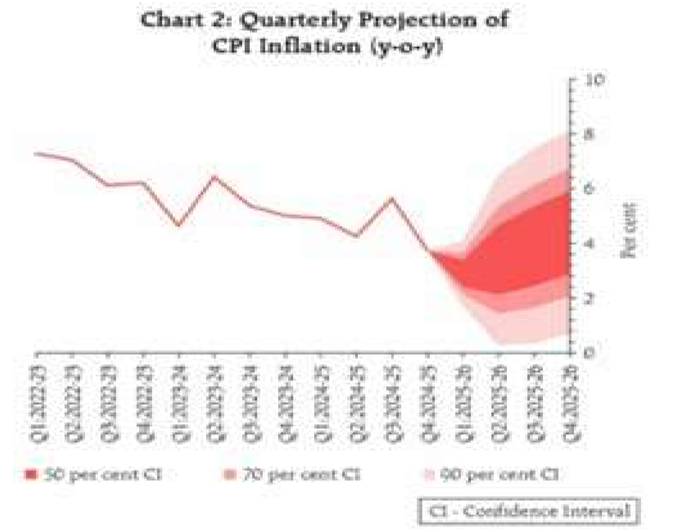



**Exhibit 4: ...with inflation estimated at 3.7% for FY26**




Source: RBI, MOFSL

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