

Monetary policy | **First cut**

Resounding pause

June 5, 2026

MPC stands pat on rates, eases norms for capital inflows

- The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) kept policy rates unchanged at its June meeting. The repo rate stands at 5.25%, standing deposit facility rate at 5.00% and the marginal standing facility rate at 5.50%
- The MPC maintained its neutral stance, keeping its data-dependent approach for monetary policy actions
- The committee sees higher inflation risks compared with the previous policy. It raised its projection for consumer price index (CPI) inflation by 50 basis points (bps) to 5.1% in fiscal 2027
- The MPC also expects weaker economic growth, and reduced its projection for gross domestic product (GDP) growth by 30 bps to 6.6% for fiscal 2027
- The RBI also announced several regulatory-easing measures to attract foreign capital inflows – the key pain point for the rupee over the past year. The measures are aimed at attracting capital through several channels – from the bond market to external commercial borrowings (ECBs), and foreign currency non-resident bank (FCNR (B)) deposits (*details given later*)

Crisil's view

The MPC's status quo was in line with our expectations. With a data-driven approach, the MPC is monitoring risks on inflation and growth that are yet to materialise meaningfully. Headline inflation has been below MPC's 4% target thus far.

We expect the MPC to keep policy rates unchanged this fiscal. We forecast 5.1% CPI inflation and 6.6% GDP growth for fiscal 2027, same as the MPC. Accordingly, headline inflation should broadly stay within the MPC's target range of 2-6% this fiscal.

We do expect inflationary pressure to rise in the coming months, driven by the gradual rise in retail fuel prices and producers passing their cost pressure to consumers. Food inflation has already been rising and faces upside risk from below-normal monsoon this fiscal. However, lingering benefits from GST cuts should cap the rise in inflation. If energy prices normalise in the coming months, we expect the MPC to look through the short-term rise in inflation. We currently expect Brent crude prices to average \$90-95 per barrel this fiscal.

GDP growth also faces downside risks from deepening cost pressure to industry and a weaker export environment. The impact of a below-normal monsoon on agricultural production and rural demand is an additional risk.

Amid the uneasy tradeoff between rising inflation and weaker GDP growth, the MPC is expected to stay put on policy rates in the short term.

The rupee's movement has been bigger in recent months during the peak period of global volatility. The RBI adopted non-interest rate measures to attract foreign capital flows, and support the rupee. These measures can help revive foreign capital, but heightened global uncertainties remain a risk for capital flows in the short term.

Factors behind MPC's pause in June

- **Inflation seen within the tolerance limit:** CPI inflation rose only moderately to 3.5% in April, compared with 3.2% in February before the West Asia conflict, while staying on the lower side of MPC's 2-6% target range.

Stable retail fuel prices until April, and lingering benefits from GST cuts have contributed to benign inflation thus far. Food inflation has been rising, but was contained at 4.2% in April.

The MPC projects inflation to rise from 4.2% in the first quarter of this fiscal to 5.9% in the third—close to its upper tolerance limit—before easing to 5.4% in the fourth quarter. Risks were seen tilted to the upside.

The MPC expects pressure from higher retail transport fuel prices and increasing passthrough of broader cost pressure by producers. Core inflation is now projected 30 bps higher at 4.7% this fiscal.

Though the MPC sees risk from a below-normal monsoon, adequate food stocks and reservoir levels gave comfort.

The MPC is also cautious of the impact of rising prices on inflation expectations, which should lead to further generalisation of inflation pressure in the economy.

- **Growth slowdown ahead:** The MPC views domestic growth holding up thus far, but initial signs of moderation have been visible on some sectors. The impact of cost pressure from higher crude oil prices, as well as other inputs were also seen, which are expected to drag economic activity.

The MPC expects GDP growth to slow from 6.6% in the first quarter of this fiscal to 6.3% in the second, before recovering partially to 6.5% in the third and 6.8% in the fourth quarter. The risks are to the downside.

The MPC expects the high energy prices and broader supply-chain disruptions to weaken growth. The duration of the West Asia conflict and the time taken for normalisation of supply chains will determine the hit to domestic growth.

The impact of expected below-normal monsoon on agricultural production and rural demand remains a risk.

That said, the MPC remains optimistic on government capex, healthy services, spillovers from GST rationalisation and stable employment conditions to support growth.

RBI adopts several easing measures to revival foreign capital

- The RBI announced today several regulatory easing measures to attract foreign capital through various instruments:

1. **Debt market:** The RBI increased the range of government securities (G-Secs) FPIs could invest in the debt market. Under the fully accessible route (FAR), longer-tenor G-Secs of 15, 30, 40-year tenors will now be available for FPIs, compared with limiting them under 10-year tenors earlier.
 - a. The government also removed taxes on FPI's capital gains and interest income on G-Secs today, making them effective from April 1, 2026.
 - b. According to Crisil Intelligence, these steps directly address the structural competitiveness gap of Indian bonds with international peers. While this will support FPI flows in the debt segment, current global risk-off sentiment amid the West Asia conflict can limit the gains. Besides, elevated US rates somewhat cap relative attractiveness of EM sovereign debt currently.
 2. **Equity market:** the RBI increased limits for non-resident Indians (NRIs) and overseas citizens of India (OCIs) for investment without SEBI registration
 3. **External commercial borrowing:** To tide over short-term forex stress, the RBI announced concessional forex swap until September 30, 2026, intended for public sector undertakings (PSUs) to raise funds through ECBs.
 4. **FCNR (B) deposits:** Another facility for funding hedging costs was also announced for banks raising 3-5-year FCNR(B) deposits till 30th September 2026
 5. The time for realisation of export proceeds has been restored to 9 months from 15 months earlier
- These measures to attract foreign capital can improve sentiments, and support the rupee. Weak capital inflows, especially the foreign portfolio investment (FPIs), have been the key driver of rupee weakness so far. The rupee has depreciated 1.1% against the US dollar since the start of fiscal 2027, and 5.3% since the outbreak of the West Asia conflict.
 - Outside the policy, the RBI has been intervening forex markets to support the rupee, as reflected in the fall in its reserves. The RBI's reserves of foreign currency assets have fallen ~9.8 billion since the start of this fiscal to \$543 billion as on May 22. That said, the RBI's overall reserves - including gold - are higher at \$681 billion, covering about 11 months of imports
 - The RBI reiterated that its rupee management remains rooted in curbing excessive volatility and speculation rather than defending a specific level.

