RBI Unwraps Early Christmas Gifts: 25-bps Repo Cut and Durable Liquidity Injection

- The RBI delivered a “double bonanza”, cutting the policy repo rate by 25 bps to 5.25% and announcing measures for durable liquidity injection. The policy stance remained Neutral. The decision to cut the repo rate was unanimous, though one MPC member preferred shifting the stance to Accommodative.
- The RBI announced a durable liquidity infusion of ~Rs 1.45 lakh crore, comprising Rs 1 lakh crore of OMOs and a USD/INR 3-year buy–sell swap of USD 5 bn, to help meet seasonal liquidity needs and aid policy transmission.
- The decision to cut the repo rate was supported by a sharp moderation in inflation, driven by benign food prices, and a more favourable outlook. The RBI lowered its FY26 CPI inflation forecast to 2.0% (from 2.6%), with underlying inflation even softer after excluding the impact of elevated precious metals prices.
- The RBI’s revised inflation trajectory indicates a dovish bias, with projections for Q3-FY26 to Q1-FY27 below 4% and Q2-FY27 at 4%. This suggests some scope for further easing, though the MPC is expected to be data-dependent.
- On economic growth, the RBI raised its FY26 real GDP growth forecast from 6.8% to 7.3%, supported by a stronger Q2 print of 8.2%, and moderate upward revisions for H2.
- Economic momentum, however, is expected to ease going ahead relative to H1-FY26, with signs of softness in some of the early high-frequency economic data. As per the RBI, domestic fundamentals remain supportive, though external risks persist.
- Despite ongoing pressures on the exchange rate, the RBI noted that India’s external sector remains resilient and that it is confident of comfortably meeting the country’s external financing requirements. FX reserves remain large, covering over 11 months of imports.
- The INR has depreciated ~5.3% FYTD against the USD amid a widening trade deficit and capital flow pressures. Near-term recovery may hinge on the finalisation of a US–India trade deal and India’s G-sec inclusion in Bloomberg’s Global Aggregate Bond Index, while RBI interventions are likely to cap excessive volatility.
- Looking ahead, the Governor noted that the RBI will focus on policy transmission and follow a data-dependent, meeting-by-meeting approach. At this stage, we do not expect another rate cut in FY26 unless economic growth disappoints materially relative to current expectations.

Pramod Chowdhary
Chief Economist
pramod.chowdhary1@dmifinance.in

Bhawna Sachdeva
Economist
bhawna.sachdeva@dmifinance.in

Shantanu Sharma
Economist
shantanu.sharma@dmifinance.in

www.dmifinance.in

+91 11 4120 4444

DMI Finance Private Limited
Express Building, 9-10, 3rd Floor,
Bahadur Shah Zafar Marg,
Delhi – 110002.

RBI Delivers a Double Bonanza: Repo Rate Cut and Infuses Durable Liquidity

In line with our expectations, the RBI's Monetary Policy Committee (MPC) reduced the policy repo rate by 25-bps to 5.25% while maintaining the policy stance at "Neutral". Consequently, the standing deposit facility (SDF) rate has now been adjusted to 5.0% and the marginal standing facility (MSF) rate and the Bank Rate to 5.5%. This brings the cumulative repo rate cut in this easing cycle to 125-bps. The decision to cut the repo rate in the December meeting was unanimous. Although the policy stance is not formally put to a vote, one MPC member indicated a preference for shifting it from Neutral to Accommodative.

The rationale for policy easing stemmed primarily from a sharp moderation in inflationary pressures. The Governor highlighted that inflation has softened to exceptionally low levels due to benign food prices and that the outlook is now more favourable than earlier anticipated. As expected, the RBI revised its FY26 CPI headline inflation projection downward to 2.0% from 2.6%. We project CPI headline inflation at 2.1% in FY26. The Governor also noted that roughly 50 bps of inflation reflects the impact of higher precious metals prices, implying that underlying inflation pressures are even lower, further supporting the case for a rate cut.

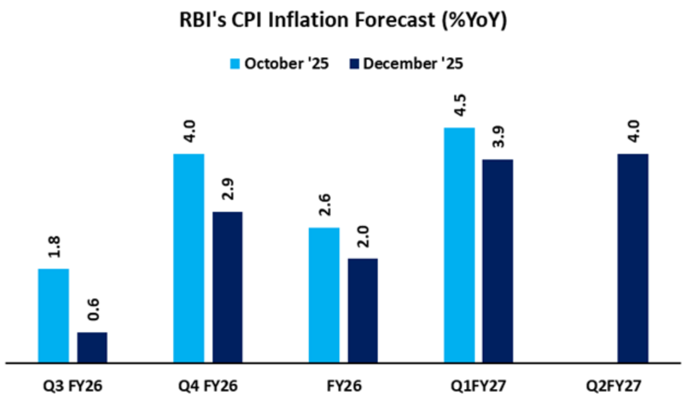
On economic growth, the RBI acknowledged the robust momentum in H1-FY26. It termed the favourable growth-inflation dynamics in H1, with inflation at a benign 2.2% and growth at 8.0%, as a rare goldilocks period. Its projections suggest that while inflation is likely to remain contained, economic momentum is expected to moderate in H2-FY26 and in early FY27, compared to H1-FY26, partly due to base effects, while persistent external headwinds continue to pose downside risks. This evolving growth–inflation configuration created the policy space for the MPC to support economic activity through a rate cut.

The RBI's dovish inflation trajectory also indicates scope for additional easing. Quarterly inflation forecasts for Q3-FY26 to Q1-FY27 remain below 4%, with Q2-FY27 at 4%, suggesting further flexibility if conditions warrant. The unchanged stance at "Neutral" reinforces the MPC's willingness to respond as the growth–inflation dynamics evolve. **The Governor noted that the RBI will focus on policy transmission and follow a data-dependent, meeting-by-meeting approach. At this stage, we do not expect another rate cut in FY26 unless growth disappoints materially relative to current expectations.**

RBI Lowers Inflation Projection; Inflation Projected to Stay Below or at 4% Through H1-FY27

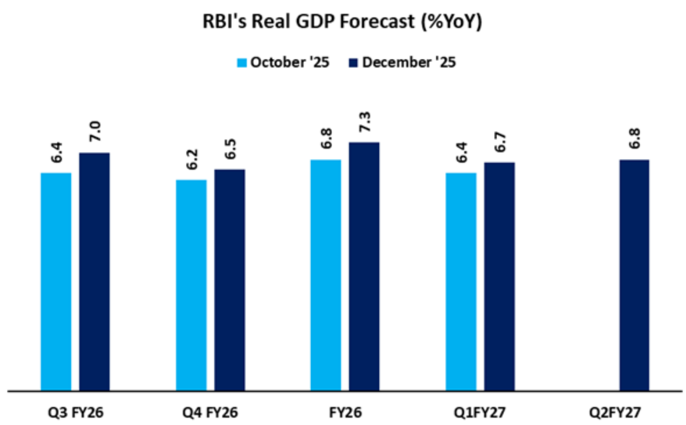
As anticipated, the RBI revised down the inflation projection for FY26 to 2.0% from 2.6%, with sizeable downward adjustments across the quarterly trajectory. The RBI sharply lowered its Q3 estimate to 0.6% from 1.8% earlier. The inflation outlook for the remainder of the year has also turned more benign, supported by healthy Kharif production, strong Rabi sowing, comfortable reservoir levels, and subdued commodity prices (excluding precious metals). Consequently, the RBI revised the Q4-FY26 and Q1-FY27 projections downward to 2.9% and 3.9%, from 4.0% and 4.5%, respectively. Inflation for Q2-FY27 is forecasted at 4.0%. Given these inflation projections, we see some scope for additional easing; however, this space will likely be utilised only if downside risks to economic growth intensify.

RBI Sharply Revises Inflation Projections Downward



Source: RBI; Note: October '25 and December '25 refer to projections provided by the RBI in its October 2025 and December 2025 MPC updates, respectively.

Real GDP Growth Forecast for FY26 Revised Upwards to 7.3%



Source: RBI; Note: October '25 and December '25 refer to projections provided by the RBI in its October 2025 and December 2025 MPC updates, respectively.

Regarding the economic growth outlook, the RBI upgraded its real GDP growth projection for FY26 by 50 bps to 7.3%, partly reflecting the stronger-than-expected Q2-FY26 outcome. Real GDP expanded by a six-quarter high of 8.2% in Q2, supported by a favourable base, a lower GDP deflator, and front-loaded government capital expenditure. As a result, economic growth in H1-FY26 remained robust, with real GDP rising by 8%.

That said, the economic momentum is expected to moderate in the second half of the year. High-frequency indicators already point to some softening, including slower manufacturing PMI print, weaker IIP, a moderation in auto registrations in November, and a renewed contraction in government capex. According to the RBI, domestic drivers such as healthy agricultural prospects, the continued benefits of GST rationalisation, benign inflation, and strong corporate and financial sector balance sheets, alongside supportive monetary and financial conditions, will support economic activity. External headwinds, however, remain a risk unless trade negotiations with the US conclude swiftly. Reflecting the revised outlook, the RBI raised its real GDP growth projections for Q3 and Q4 FY26 slightly to 7.0% and 6.5%, respectively, though still below the H1 pace. The economic growth projection for Q1-FY27 has been revised up to 6.7%, while Q2-FY27 is forecast at 6.8%.

RBI Announced Durable Liquidity Injection to Aid Policy Transmission

On liquidity management, the RBI reaffirmed that it would continue to provide adequate liquidity to facilitate policy transmission and meet the productive requirements of the economy. Systemic liquidity returned to surplus in November and early December (averaging Rs 2.2 lakh crore over the past 7 days) after two volatile months, as festival-related currency leakage and FX interventions were partly offset by the implementation of the CRR cut and government spending. Consequently, the weighted average call rate is hovering closer to the policy repo rate at 5.43% (vs. the earlier repo of 5.5%) as on 4th Dec. In response to the cumulative 100-bps cut in the policy repo rate before the December policy, the weighted average lending rate (WALR) of Scheduled Commercial Banks has declined by 69-bps for fresh rupee loans during February-October 2025 and for outstanding rupee loans by 63-bps, with transmission being broad-based across sectors, as per the RBI.

Looking ahead, systemic liquidity needs are likely to rise due to seasonal factors in Q4 and continued FX interventions aimed at containing sharp rupee volatility. Taking this into account, the RBI announced liquidity-augmenting measures, including Rs 1 lakh crore of OMO purchases (in two tranches of Rs 50,000 crore each on December 11 and December 18, 2025) and a USD 5 billion USD/INR buy–sell swap auction with a three-year tenor (scheduled for December 16, 2025). Together, these operations will inject ~Rs 1.45 lakh crore of durable liquidity to aid transmission. Overall, we expect the RBI to remain committed to ensuring adequate liquidity in the banking system. With the RBI delivering on both policy rate and liquidity fronts, the markets reacted positively. The 10-year benchmark G-sec yield fell to an intra-day low of 6.46% after the policy statement, before rising moderately to trade around 6.50%. Meanwhile, the Nifty 50 index rose by 0.6%, and the INR/USD rate ended broadly unchanged at around 89.98.

RBI Assess the External Sector as Resilient and confident of Meeting External Financing Requirements Comfortably

The RBI noted that India's external sector remains resilient and is confident of comfortably meeting the country's external financing requirements. On the exchange rate, the INR/USD recently crossed the 90 level amid a widening trade deficit and foreign portfolio capital outflows, resulting in a ~5.3% depreciation FYTD (as of 4th December). According to the RBI, a 5% depreciation in the rupee raises inflation by ~35 bps and boosts GDP growth by ~25-bps in the short term through the export channel. Despite near-term pressures, the RBI remains confident of comfortably meeting external financing requirements. The current account deficit narrowed to 1.3% of GDP in Q2-FY26 (from 2.2% in Q2-FY25), supported by strong services exports and remittances. FDI inflows strengthened in H1, while FPI registered modest net outflows and other capital flows moderated. India's external debt declined to 18.9% of GDP at end-June 2025 (from 19.1% in March 2025), and FX reserves remain substantial, covering over 11 months of goods imports, and roughly 93% of outstanding external debt. Risks from unhedged ECBs have also declined, with their share falling to 26.1% in March 2025 from 32.9% in September 2024. Some INR recovery in Q4 is possible if the US–India trade deal concludes and if Bloomberg confirms India's G-sec inclusion in its Global Aggregate Bond Index (decision expected by January 2026), which could attract USD 20–25 billion in inflows over time. Meanwhile, the RBI is likely to intervene in the foreign exchange market to curb excessive volatility in the domestic currency.

Other Developmental and Regulatory Measures

Regarding other measures, the RBI emphasised its focus on improving customer service, including online applications for its services, Re-KYC initiatives, financial inclusion efforts, and transparent monthly service metrics — with 99.8% of applications reportedly resolved within stipulated timelines. The RBI flagged rising grievance volumes and increased pendency with the RBI's Ombudsman. To address this, the RBI has initiated a two-month campaign from 1 January 2026 to clear all grievances that have been pending for more than a month.

DISCLAIMER

This research report/material (the "Report") is for the personal information of the authorised recipient(s) and is not for public distribution and should not be reproduced or redistributed to any other person or in any form without DMI's prior permission.

In the preparation of this Report, DMI has used information that is publicly available as well as data gathered from third party sources. Information gathered and material used in this Report is believed to have been obtained from reliable sources. DMI, however makes no warranty, representation or undertaking, whether expressed or implied, that such information is accurate, complete or up to date or current as of the date of reading of the Report, nor does it assume any legal liability, whether direct or indirect or responsibility for the accuracy, completeness, currency or usefulness of any information in this Report. Additionally, no third party will assume any direct or indirect liability. It is the responsibility of the user or recipient of this Report to make its/his/her own decisions or enquiries about the accuracy, currency, reliability and correctness of information found in this Report.

Any statement expressed as recommendation in this Report is general in nature and should be construed strictly as current opinion of DMI as of the date of the Report and may be subject to change from time to time without prior intimation or notice. The readers of this Report should carefully read, understand and investigate or enquire (either with or without professional advisors) into the risks arising out of or attached to taking any decisions based on the information or opinions contained in this Report. DMI or its officers, directors, personnel and employees, including persons involved in the preparation or issuance of this Report may have potential conflict of interest with respect to any recommendation and related information and opinions.

Neither DMI nor any of its officers, directors, personnel and employees shall be liable for any loss, claim, damage of whatsoever any nature, including but not limited to, direct, indirect, punitive, special, exemplary, consequential, as also any loss of profit in any way arising from the use of this Report or the information therein or reliance of opinions contained in this Report, in any manner.

No part of this Report may be duplicated or copied in whole or in part in any form and or redistributed without the prior written consent of DMI. Any reproduction, adaptation, distribution or dissemination of the information available in this Report for commercial purpose or use is strictly prohibited unless prior written authorization is obtained from DMI. The Report has been prepared in India and the Report shall be subject only to Indian laws. Any foreign reader(s) or foreign recipient(s) of this Report are requested to kindly take note of this fact. Any disputes relating to the Report shall be subject to jurisdiction of Republic of India only.