

RBI Holds Rates, Announces Measures to Boost Foreign Capital Inflows; Policy Rate Hikes Likely in H2 FY27



- The RBI's Monetary Policy Committee unanimously kept the policy repo rate unchanged at 5.25% and retained a neutral stance. The decision reflects a wait-and-watch approach amid uncertainty surrounding the duration of the Middle East conflict, its spillover effects, and the pace of supply chain normalisation.
- In view of ongoing pressures on the external account and the rupee, the RBI announced a package of measures to attract foreign capital inflows, including relaxation of FPI investment norms, expansion of the Fully Accessible Route (FAR), a concessional forex swap facility to incentivise ECBs by PSUs and a facility for bearing the full hedging cost to authorised dealer banks for raising fresh 3–5-year FCNR (B) deposits.
- The government also rationalised the tax treatment of FPI investments in government securities by exempting interest income and capital gains from taxation to support foreign portfolio inflows into the G-Sec market.
- In a separate data release, economic growth showed resilience despite external shocks. Q4 FY26 real GDP growth came in at 7.8%, moderating slightly from 8.0% in Q3. Private consumption remained the primary driver of growth, though it slowed from its Q3 pace. A pickup in investment activity, higher govt consumption, and a positive contribution from net exports provided support.
- Real GVA growth held relatively steady at 7.9% in Q4, broadly sustaining the pace of the previous quarter, supported by a resilient services sector and a pickup in agriculture and allied activities that partly offset a sharp deceleration in manufacturing growth.
- On outlook, we see increased downside risks to our FY27 real GDP growth forecast of 6.7% and upside risks to our CPI inflation forecast of 4.7%, given the prolonged Middle East conflict and related energy supply disruptions.
- The RBI revised its FY27 real GDP growth forecast downward to 6.6% from 6.9%, citing geopolitical tensions, global supply chain disruptions, financial market volatility, and a probable El Niño conditions as downside risks.
- According to the MPC's assessment, domestic demand is expected to remain supported by momentum in the services sector activity, GST rationalisation benefits, robust government capex, and healthy credit flows. However, rising inflation and heightened uncertainty could weigh on consumption and investment sentiment. The external environment will likely remain challenging.
- Given the sharp rise in energy prices, WPI inflation surged to a 42-month high of 8.3% in April from 3.9% in March, while CPI inflation remained below the 4% target. The wide divergence suggests substantial cost pressures have yet to be transmitted to retail prices, increasing the risk of broader CPI pass-through.
- The RBI raised its FY27 CPI inflation projection to 5.1% from 4.6%, with inflation expected to peak at 5.9% in Q3, then ease to 5.4% in Q4, remaining above the 4% target throughout FY27. Core inflation forecast was also revised up to 4.7% from 4.4%, reflecting pipeline cost pressures from elevated crude oil prices and broader input cost pass-through.
- Based on the RBI's revised FY27 inflation projections, we expect cumulative policy rate hikes of 50–75 bps in H2 FY27. Policy tightening could occur sooner if energy supply disruptions persist or rupee pressures fail to subside, while a credible and sustained reopening of the Strait of Hormuz could reduce or may even eliminate the need for policy rate action.

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RBI Keeps Policy Repo Rate Unchanged, Announces Measures to Boost Foreign Capital Inflows

As expected, the RBI's Monetary Policy Committee (MPC) unanimously kept the policy repo rate unchanged at 5.25%, while maintaining the neutral policy stance. It revised its FY27 real GDP growth projection downward and its CPI inflation projection upward. To ease pressures on the exchange rate, the RBI also announced a package of measures to boost foreign capital inflows. On the same day, the government promulgated a tax ordinance exempting foreign portfolio investors from tax on interest earned on government securities and on capital gains arising from the sale, exchange, or transfer of such securities.

RBI Holds Policy Repo Rate at 5.25%; FY27 Economic Growth Projection Revised Downward

The MPC voted unanimously to keep the policy repo rate unchanged at 5.25%, with the standing deposit facility rate remaining at 5.00% and the marginal standing facility rate and Bank Rate at 5.50%. The neutral policy stance was retained, preserving the RBI's flexibility to respond to evolving macroeconomic conditions.

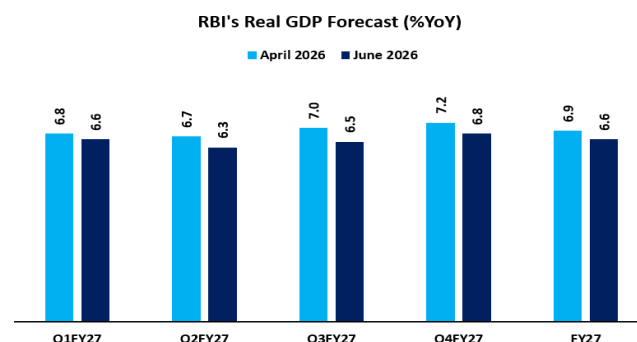
The MPC noted the deterioration in the global environment owing to the persistence of the Middle East conflict amid a fragile ceasefire and ongoing US-Iran negotiations. It was assessed that the Indian economy has broadly exhibited resilience to the external shock and spillovers from the conflict and associated supply disruptions, although the impact of cost pressures is becoming increasingly visible.

The MPC expects urban consumption to remain supported by services-sector momentum, GST rationalisation tailwinds, and broadly stable employment conditions, though rising inflation could weigh on household purchasing power. The sub-normal south-west monsoon forecast, with the IMD projecting rainfall at 90% of the long-period average, and the elevated probability of El Niño conditions developing during the monsoon season, poses downside risks to agricultural production and rural demand, though healthy reservoir levels, the ongoing efforts in crop diversification and climate-resilient practices are expected to provide partial mitigation. Government capex and credit flows from bank and non-bank sources should provide support to investment activity, but cost pressures, heightened uncertainty, likely slower global growth, and high logistics costs will pose headwinds for investment sentiment and merchandise exports, partially offset by possible continued resilience in services exports.

On the growth outlook, the RBI revised its FY27 real GDP growth projection from 6.9% to 6.6%, citing persistent global supply chain disruptions, volatility in global financial markets, and weather-related shocks as downside risks. The MPC noted that rising energy and input prices, continued supply

disruptions, and the pass-through of higher energy costs to retail prices are likely to weigh on economic activity. The Governor noted that several measures undertaken by the government, including support for the MSME and export sectors, efforts to raise domestic gas and crude production, import diversification for affected commodities, and encouragement of domestically produced alternatives to imported inputs, should help absorb external shocks.

RBI Lowers FY27 Real GDP Growth Forecast by 30 bps to 6.6%



Source: RBI; Note: April 2026 and June 2026 refer to projections given by the RBI in its April 2026 and June 2026 MPC updates, respectively

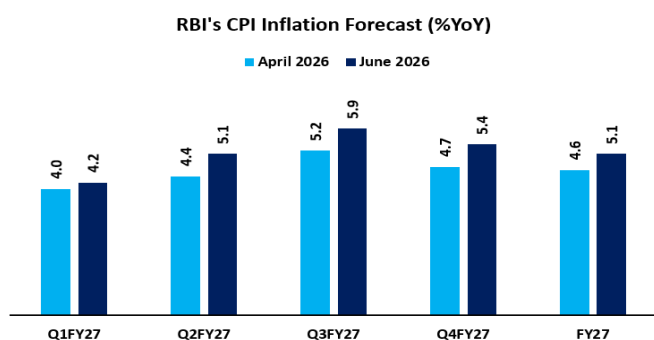
RBI Revises CPI Inflation Projection Upward; Policy Rate Hikes of 50-75 bps Likely in H2 FY27, Depending on Evolving Geopolitical and Weather Conditions

On inflation, the MPC noted that headline CPI remained below the 4% target despite edging up slightly in March and April from February levels, driven by food prices. Core inflation (CPI excluding food and beverages, electricity, gas and other fuels, and fuels and lubricants for personal transport equipment) remained steady at ~3.7% during March and April, with core inflation excluding precious metals remaining muted at around 2.1 to 2.2%. In contrast, WPI inflation surged to a 42-month high of 8.3% in April from 3.9% in March, driven by sharp increases in crude petroleum & natural gas and fuel & power prices. The unusually wide divergence between CPI and WPI inflation suggests substantial pipeline cost pressures have yet to be transmitted to retail prices, increasing the risk of a broader pass-through into CPI inflation over the coming quarters, particularly if crude oil prices remain elevated and retail fuel price revisions continue.

India's crude oil basket price averaged ~US\$ 110 per barrel during April and May 2026. The RBI revised its crude oil price assumption for FY27 upward to ~US\$ 95 per barrel from ~US\$ 85 per barrel previously. With the cumulative increase of ~Rs 7.5 per litre in retail petrol and diesel prices implemented in May, and the possibility of further pass-through given ongoing under-recoveries by OMCs, upward pressure on inflation is likely to persist. The Governor also noted that prices of several inputs, including commercial LPG, industrial raw materials, chemicals, base metals,

rubber, and plastic products, have increased and could exert further upward pressure on CPI inflation as firms pass on higher input costs. Considering these factors, the RBI revised its FY27 CPI inflation projection from 4.6% to 5.1%, with inflation projected to peak at 5.9% in Q3 before easing to 5.4% in Q4, remaining above the 4% target throughout FY27. Core inflation forecast for FY27 was also revised up from 4.4% to 4.7%.

RBI Raises FY27 CPI Inflation by 50 bps to 5.1%



Source: RBI; Note: April 2026 and June 2026 refer to projections given by the RBI in its April 2026 and June 2026 MPC updates, respectively

The MPC assessed that the risks of higher inflation have increased but judged it prudent to await greater clarity. It noted considerable uncertainty around the duration and intensity of the conflict, the magnitude of spillover effects, and the pace of supply chain normalisation. The sub-normal monsoon forecast and elevated probability of El Niño conditions add to the upside risk to the inflation outlook. The MPC will remain data-dependent and closely monitor supply-side pressures, generalisation of inflation through second-round effects, and inflation expectations.

Based on the RBI's revised inflation projection of 5.1% for FY27, we expect the RBI to raise the policy repo rate by 50 to 75 basis points in H2 FY27. Policy tightening could come sooner if energy supply disruptions persist, inflation expectations shift, or rupee pressures fail to subside. Any material improvement in the geopolitical outlook, particularly a credible and sustained reopening of the Strait of Hormuz following a potential US-Iran agreement, could reduce or even eliminate the need for policy rate hikes in H2 FY27, depending on the pace of normalisation of energy supply flows and the resulting trajectory of domestic fuel costs and inflation.

RBI and Government Announce Package of Measures to Boost Foreign Capital Inflows

In the external sector, the rupee continues to remain under pressure, reflecting the risk of a wider current account deficit and sustained foreign capital outflows. The Governor noted that elevated energy prices and persistent trade policy uncertainties continue to pose upside risks to the current

account deficit, with services trade surplus and inward remittances expected to provide some offset.

India's foreign exchange reserves stood at US\$ 682.3 billion as of May 29, 2026, providing import cover of ~11 months and covering 89.1% of outstanding external debt. The Governor noted various policy initiatives expected to aid the balance of payments, including trade agreements with major trading partners, the opening of the insurance sector to 100% FDI, the ethanol blending programme, the push for the energy transition, easing FDI restrictions for land-bordering countries, and the liberalisation of the ECB framework. The government and the RBI also announced measures on June 5 to boost foreign capital inflows and push for faster realisation of exports earnings, as detailed below.

Government Announces Tax Exemption for Foreign Portfolio Investors in G-Sec

The government has rationalised the tax treatment applicable to investments by foreign portfolio investors in government securities by exempting such investments from income tax on interest income and capital gains, with effect from April 1, 2026. Prior to this measure, interest income on government securities was taxable at 20%, short-term capital gains from transfer of government securities were taxable at 30%, and long-term capital gains were taxable at 12.5% under section 210(1) of the Income-tax Act, 2025. The Bank for International Settlements is also provided the same exemption. This tax exemption announcement alongside the RBI's measures represents a coordinated step to enhance the post-tax attractiveness of Indian government securities for foreign investors and support foreign portfolio inflows into the debt market.

The RBI Governor announced five measures to boost foreign capital inflows and accelerate the realisation of export earnings, as listed below:

1. The RBI (and government) has decided to expand the list of specified securities under the Fully Accessible Route to include new issuances of government securities in tenors of 15, 30, and 40 years, as also Sovereign Green Bonds in the tenors of FAR-eligible securities. Further, limits pertaining to short-term investment, concentration, and individual securities on FPI investment under the General Route will be removed, while retaining the overall quantitative investment limits of 6% of the outstanding stock of central government securities and 2% of state government securities. The sub-categories of investment limits, namely the general and long-term sub-limits, will be merged into a single limit for investment in government securities and state government securities, respectively. These measures, alongside the government's tax ordinance announced on the same day,

are aimed at attracting foreign portfolio investment into the government securities market.

- Limits on investment by non-resident Indians and Overseas Citizens of India in equity instruments traded on stock exchanges without SEBI registration will be increased. The facility will be extended to all individual Persons Resident Outside India at par with NRIs and OCIs.
- A concessional foreign exchange swap facility will be made available till September 30, 2026, to incentivise external commercial borrowings by public sector undertakings.
- A facility under which the RBI will bear the full hedging cost will be available till September 30, 2026, to authorised dealer banks for raising fresh three to five-year FCNR(B) deposits. This is broadly similar to the 2013 FCNR(B) concessional swap arrangement we referenced in our monthly report as a potential instrument for stabilising the exchange rate.
- The time permitted for the realisation of export proceeds will be reduced from 15 months to 9 months to accelerate the inflow of export earnings into the country.

A separate data release showed India's economic growth accelerating in FY26, with growth remaining resilient in Q4. We discuss key highlights from the GDP/GVA data release below.

GDP: Strong FY26 Outturn; FY27 Outlook Clouded by Middle East Conflict

Real GDP growth came in at 7.7% in FY26, above the second advance estimate of 7.6% and higher than 7.1% in FY25. Growth was led by an acceleration in private consumption and investment (GFCF), contributing approximately 56% and 34% of headline growth, respectively, while government consumption and net exports played a relatively smaller role. Policy measures, including income tax reductions, GST rationalisation, and monetary policy easing, boosted private consumption during the year, while investment was supported by government capex in the early part of the year and a tentative revival in private sector capital formation.

In Q4 FY26, real GDP growth came in at 7.8%, moderating slightly from 8.0% in the previous quarter. Private consumption continued to drive overall growth but slowed from the robust pace seen in Q3, when festive demand and GST rationalisation provided a significant demand impulse. It nonetheless remained healthy, aided by the continued pass-through of GST benefits, retail credit growth, healthy auto sales, and resilient rural demand. Investment activity picked up pace in Q4 compared to the previous quarter,

supported by a pickup in select pockets of private-sector investment, even as central government capex remained in contraction. Government consumption growth edged up from the previous quarter, aided by higher revenue expenditure. Net exports were a small positive contributor to headline growth in Q4, in contrast to the drag recorded in the previous quarter, reflecting a sharp moderation in real import growth.

India's GDP Estimates at a Constant Price

(GDP Constant Prices)	% YoY									
	Q1-FY25	Q2-FY25	Q3-FY25	Q4-FY25	FY25	Q1-FY26	Q2-FY26	Q3-FY26	Q4-FY26	FY26
Private Consumption	6.1	5.6	6.0	5.6	5.8	8.7	7.2	8.2	7.1	7.7
Government Consumption	7.5	7.0	7.6	3.6	6.5	5.8	6.6	4.6	4.9	5.5
Gross Fixed Capital Formation	6.5	6.6	6.3	6.2	6.4	4.9	8.4	8.2	10.8	8.2
Exports	7.3	3.1	10.5	5.4	6.6	6.6	9.7	5.8	3.7	6.3
Less Imports	8.3	4.6	2.9	5.5	5.3	7.0	6.0	7.2	1.9	5.6
Real GDP	7.5	6.6	7.4	7.0	7.1	6.8	8.3	8.0	7.8	7.7

Source: CMIE

Going ahead, we expect FY27 real GDP growth to slow to around 6.7%, with downside risks rising due to the persistence of the Middle East conflict and associated disruptions to energy supply and trade routes. Private consumption is expected to face headwinds from the pass-through of higher energy costs, which would weigh on household purchasing power, while heightened uncertainty could induce greater caution in spending. Private investment momentum is expected to moderate in the near term, with a gradual recovery contingent on the resolution of the conflict in the Middle East. On the fiscal side, the government will face pressure to rationalise expenditure as a higher subsidy bill and lower OMC dividend transfers pose risks to the fiscal deficit target. The external environment remains challenging and will weigh on merchandise exports, though the lower US tariff baseline relative to the IEEPA era, recently concluded trade agreements, and resilient services exports should provide partial support.

GVA: Services Sector Anchors Growth in Q4; Manufacturing Faces Near-Term Headwinds

Real GVA growth in FY26 came in at 7.9%, above the second advance estimate of 7.7% and up from 7.3% in FY25. Growth was led by strong services sector activity, which accounted for nearly 61% of headline real GVA growth, followed by around 30% from the secondary sector, with agriculture and allied activities and the mining sector contributing the remainder.

In Q4 FY26, real GVA growth came in at 7.9%, broadly sustaining the pace of the previous quarter, driven by continued robust services sector activity and a pickup in construction and agriculture and allied activities, partly offsetting a sharp moderation in manufacturing sector growth.

India's GVA Estimates at a Constant Price

(GVA Constant Prices)	% YoY									
	Q1-FY25	Q2-FY25	Q3-FY25	Q4-FY25	FY25	Q1-FY26	Q2-FY26	Q3-FY26	Q4-FY26	FY26
Agriculture, Forestry & Fishing	2.6	4.1	5.8	3.8	4.2	4.4	2.7	1.7	3.6	3.0
Mining & Quarrying	11.9	8.3	13.1	12.9	11.7	4.5	6.1	4.7	5.4	5.2
Secondary	9.1	4.8	8.4	9.8	8.0	7.3	10.6	9.8	7.4	8.8
Manufacturing	9.4	4.9	10.8	11.8	9.3	10.4	12.7	12.8	7.3	10.7
Electricity and Other Utility Services	9.2	-0.2	0.6	2.1	2.9	-2.0	3.6	1.5	4.1	1.7
Construction	8.7	6.1	6.4	8.0	7.3	5.3	8.9	6.7	8.4	7.4
Services	8.5	8.1	8.2	6.8	7.9	8.0	9.2	9.9	9.9	9.3
Trade, Hotels, Transport, Communication etc	6.9	6.6	6.7	6.3	6.6	9.7	10.5	11.2	12.5	11.0
Financial, Real Estate & Professional Services	10.3	10.0	11.1	8.8	10.0	9.2	10.3	11.6	10.4	10.4
Public Administration, Defence and Other Services	6.9	6.0	4.4	3.2	5.0	4.0	5.4	4.9	5.8	5.0
Gross Value Added (at Basic Price)	7.6	6.5	7.8	7.1	7.3	7.1	8.6	8.0	7.9	7.9

Source: CMIE

Services sector growth remained resilient at 9.9% in Q4, aided by a pickup in Trade, Hotels, Transport & Communication and Public Administration, Defence & Other Services, which offset moderation in Financial, Real Estate, IT, and Professional Services. In the secondary sector, manufacturing growth slowed sharply to 7.3% in Q4 from 12.8% in the previous quarter, reflecting the impact of US tariff uncertainty early in the quarter and spillover effects from higher energy prices and supply disruptions in March following the onset of the Middle East conflict. Construction activity and Electricity and other utility services staged a healthy recovery from slower growth in Q3, supported by robust underlying domestic activity. Mining and quarrying also posted healthy growth in Q4 after slowing in the previous quarter. Consistent with robust rabi crop output and strong government wheat procurement, agriculture and allied activities accelerated to 3.6% from muted growth of 1.7% in the previous quarter.

Going ahead, spillovers from the Middle East conflict in the form of elevated energy costs, supply disruptions, and heightened uncertainty are likely to weigh on manufacturing sector growth, while the services sector is expected to remain relatively resilient, though growth will moderate from the robust pace of FY26. Agriculture and allied activities face headwinds in FY27 from higher input and fuel costs, disruptions to fertiliser supply, and the risk of a weaker monsoon. A potentially deficient monsoon rainfall could weigh on agricultural output and rural demand, though adequate reservoir levels should provide some cushion.

Overall, we see increased downside risks to our FY27 real GDP growth forecast of 6.7% and upside risks to CPI inflation forecast of 4.7%, given that the Middle East conflict and associated disruptions have persisted longer than expected. On policy outlook, we expect the RBI to raise the policy repo rate by 50 to 75 basis points in H2 FY27, depending on the evolving geopolitical and weather outlook.

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