

RBI MPC decision in Dec to be a close call; communication on liquidity management, policy tone to be key

December 4, 2025

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Macro update

Economic activity

- In Q2-FY26, real growth printed above 8%YY, surpassing market estimates. Real GDP growth rose to 8.2% (Reuters poll: 7.3%, RBI MPC forecast: 7.0%) from 7.8% in Q1, taking H1-FY26 average growth to 8.0%. Real GVA growth improved to 8.1% from 7.6% in Q1.
- The momentum in private consumption continued to improve, offsetting the drag from net exports for the second straight quarter. While services remained the top contributor to real GVA growth, manufacturing (and therefore, industry) growth hit a six-quarter high.
- But concerns abound on the role of low deflators in propping up data in real terms and nominal growth that mildly decelerated further. Nominal growth remained below 9%YY, both in GDP and GVA terms. Also, even as high frequency indicators indicate that economic activity is holding up relatively well in Q3, myriad uncertainties are likely to weigh on growth in H2, which is expected to moderate compared to H1.

Inflation

- CPI inflation eased to record low of 0.25% in Oct from 1.44% in Sep, aided by food deflation and pass-through of GST rate cuts. In fact, excluding precious metals, CPI was in deflation. In FYTD terms, CPI inflation averaged 1.92% vs. 4.81% in Apr-Oct FY25.
- The outlook for food inflation remains benign with progress in Rabi sowing, reservoir levels, and Kharif harvesting. In fact, super core inflation (ex-food, fuel, petrol, diesel, gold, silver) has been below 4% for two years now. This suggests some slack in the economy and provides room for policy easing without any risks of overheating.

Liquidity and FX

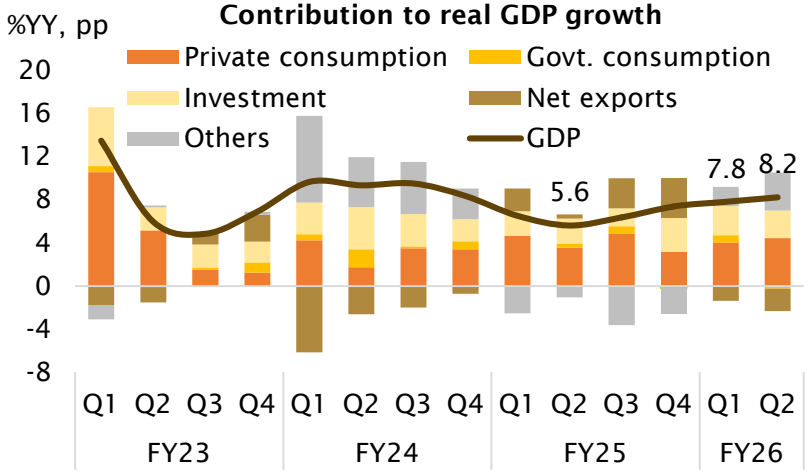
- As on 3-Dec, liquidity under net LAF was in surplus of Rs.2.56 lakh crore and averaged lower since the last MPC meet (~Rs.1.37 lakh crore) vis-à-vis previous inter-meeting period (~Rs.2.01 lakh crore). The RBI used a mix of VRRR and VRR operations to manage liquidity and also conducted OMO purchases in the secondary market (~Rs.27,280 crore as of mid-Nov). Liquidity slipped in deficit towards end-Oct for a few days due to tax-related outflows and RBI's intervention in the FX market to curb USDINR volatility. The USDINR has been in spotlight recently, breaching 90/USD level, in the backdrop of FPI equities selloff, widening trade gap, and balance of payments deficit in Q2-FY26.

RBI MPC Policy Outlook

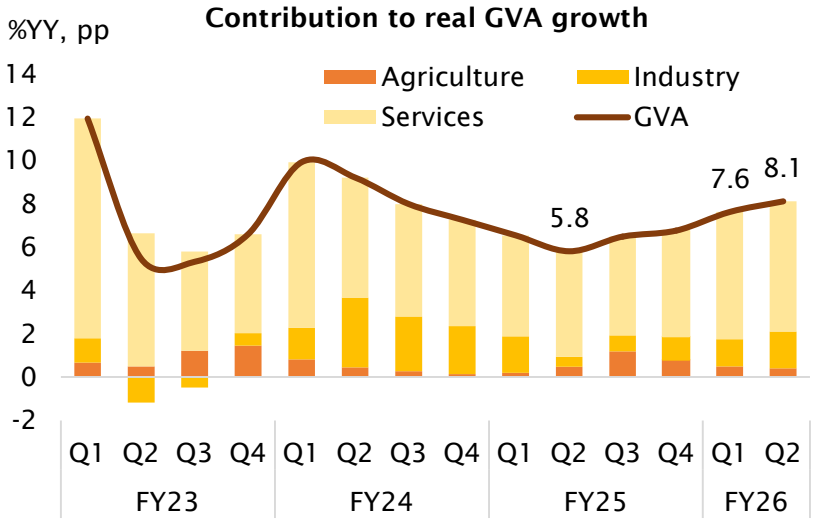
- **Growth and inflation forecasts:** In Q2, real GDP growth exceeded the RBI MPC's forecast by a wide margin of 1.2pp. Also, CPI inflation is tracking 1.9% FYTD (Apr-Oct) vis-à-vis MPC's FY26 forecast of 2.6%, indicating a fair chance of an undershoot. This could nudge the MPC to lift FY26 real GDP growth forecast and prune CPI inflation estimate. The committee would also be providing forecasts for Q2-FY27, and therefore some sense of direction for H1-FY27. Inflation control is the primary mandate of the MPC and lower forecasts than in the previous meeting would imply not only room to ease but also likely implications for growth via higher real interest rates. Many market polls are indicating a 25bp rate cut in Dec but probability has eased post strong Q2-FY26 GDP print.
- **Factors supportive of a rate cut:** The upside surprise in GDP growth in H1 was attributable to factors such as (i) frontloading of manufacturing and exports ahead of 50% US tariffs, effective 27-Aug (ii) consumption boost from income tax relief announced in Union Budget for FY26, support to rural incomes from farm activity due to above normal rains, festive season, GST rate cuts, and increase in purchasing power from low inflation.
- But outlook for H2 remains clouded by prolonged US-India trade talks that continue to weigh on sentiment and could impinge activity in certain industrial pockets. It also remains to be seen if the consumption momentum in H1 sustains in H2. To add to these headwinds, key economic variables such as GDP, IIP and CPI are undergoing revisions to their base years and methodologies, and are slated for release in Feb-2026. The MPC could deliver a rate cut in Dec to cushion the economy from these uncertainties and ensure that growth sustains at 'aspirational' rates of above 8%. Also, even as real growth rates are treading higher, nominal growth remains depressed.
- **Factors favoring a pause:** The growth argument is also relevant for a pause in Dec, as it has been consistently surprising on the upside for a couple of quarters now. Inflation dipped to a record low in Oct. The MPC could choose to pause in this backdrop, particularly when the USDINR has been under pressure recently. The pair breached the 90/USD mark and the balance of payments posted deficit in Q2-FY26 amid sequential widening of current account deficit and lower capital account surplus. These factors could warrant caution and a pause.
- In addition to policy rate cut(s) in 2025, the RBI's regulatory credit easing measures have started to improve the flow of credit to the economy to the extent that deposit growth rate is now below credit growth. At this point, a rate cut could further exacerbate the credit-deposit gap and not necessarily achieve the intended transmission.
- **Focus on liquidity management and policy tone:** Even as the Fed FOMC is widely expected to deliver a 25bp rate cut on 10-Dec, the USDINR could remain under pressure, as foreign portfolio investors square off positions towards the calendar year-end. As RBI's intervention in the foreign exchange market gains prominence to curb excessive FX volatility, its use of liquidity management tools to manage core liquidity, such as OMO operations and FX swaps, will be keenly eyed by market participants at the MPC's Dec meet. In the backdrop of conflicting economic signals and uncertainties, the policy tone would be watched out for in terms of future guidance.

Both real GDP and GVA posted growth above 8%YY in Q2-FY26; growth remained sub-9%YY in nominal terms

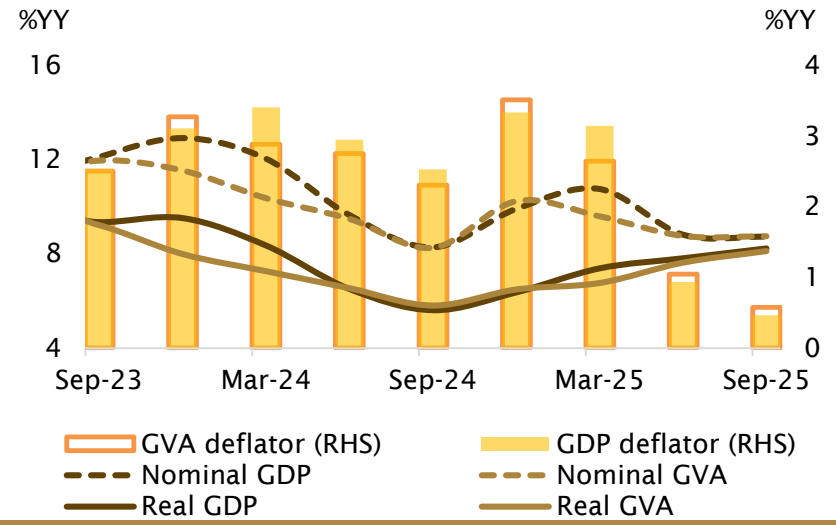
Private consumption growth exceeded investment, industrial growth at six-quarter high, services growth stable at 9%YY

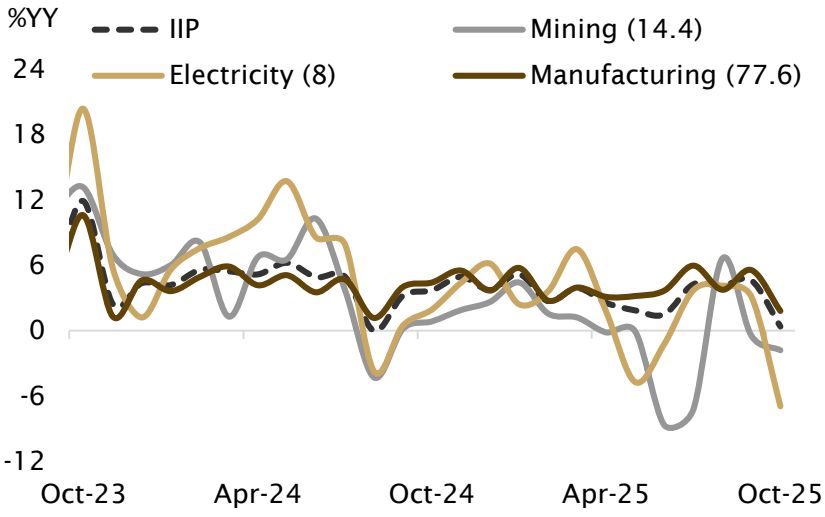


Others include discrepancies, valuables, change in stocks



Nominal growth stayed sub-9%; IIP dipped in Oct amid early onset of festive season, US tariff hit on exports-led sectors

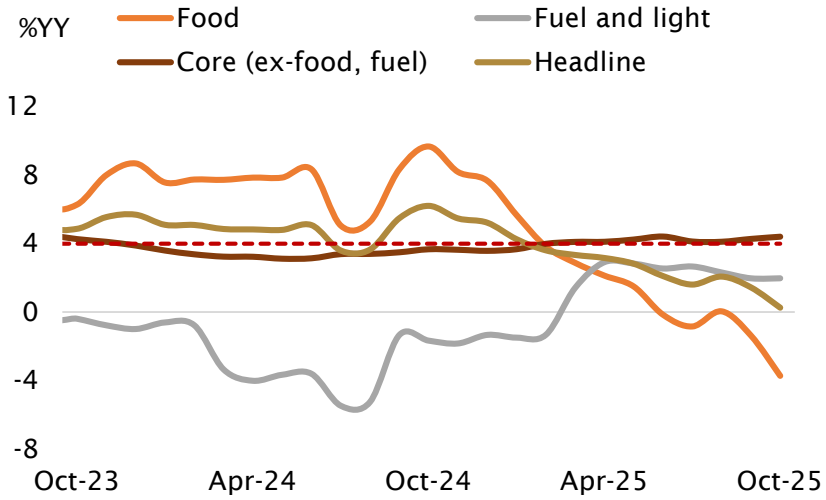


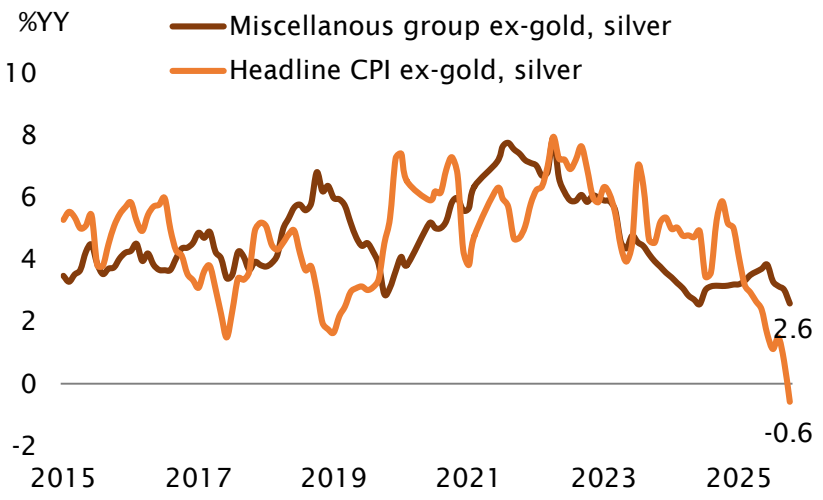


CPI inflation at series low in Oct-2025; low crude oil prices, benign food inflation outlook to offset unfavorable base effects

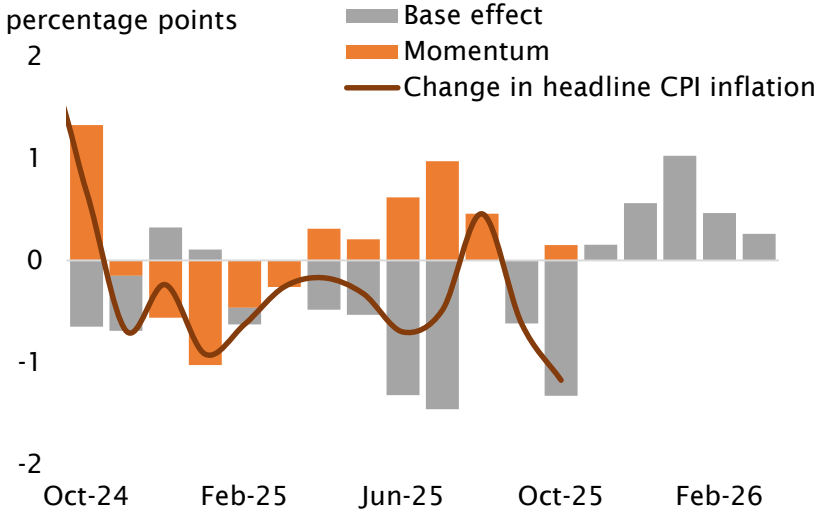
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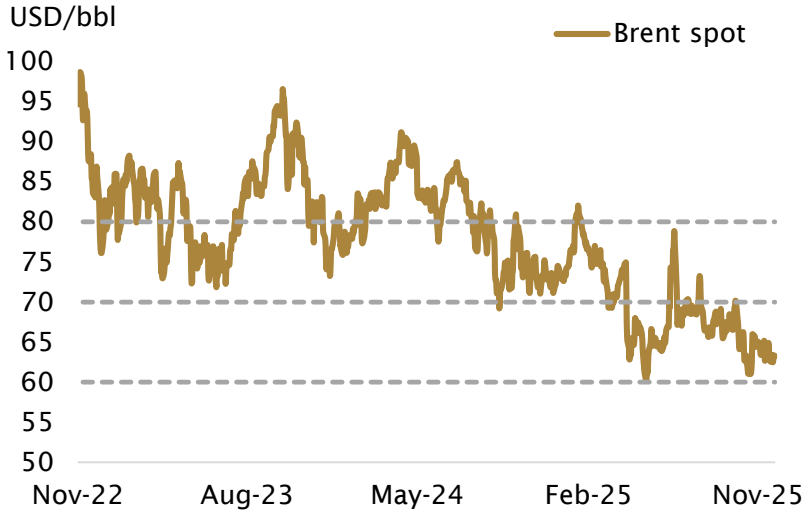
CPI inflation slipped to series record low of 0.25% in Oct-2025; in fact, posted deflation excluding precious metal prices





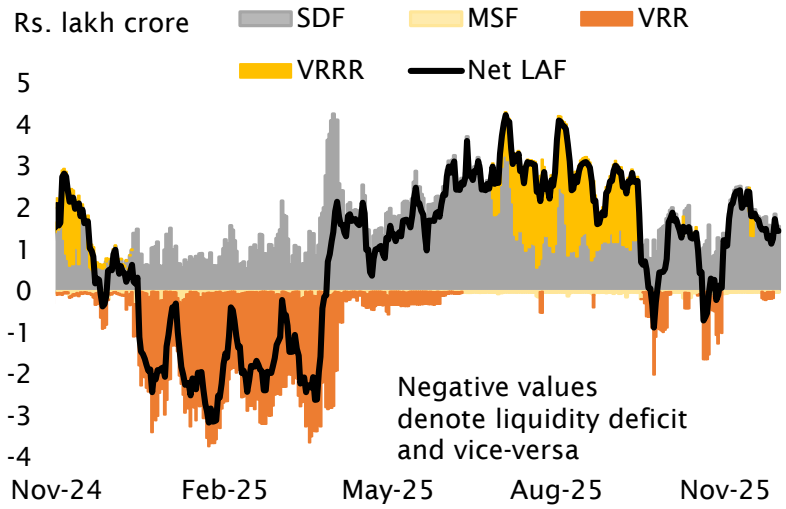
Base effects to be unfavorable for remainder of FY26; soft crude oil prices, benign food inflation outlook to be tailwinds

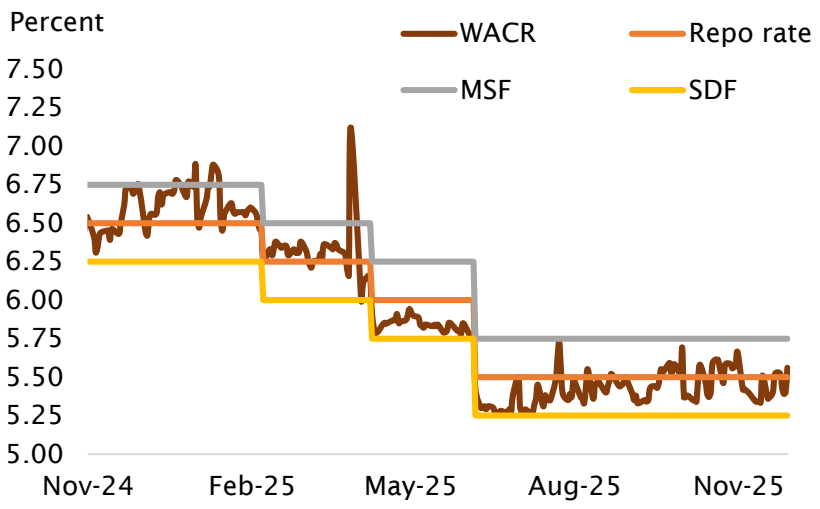




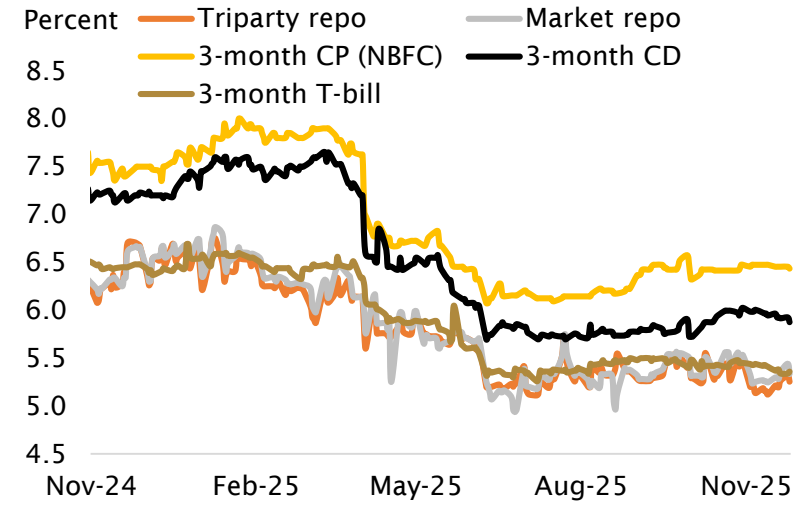
RBI conducted mix of VRR and VRRR operations to adjust liquidity conditions since last MPC

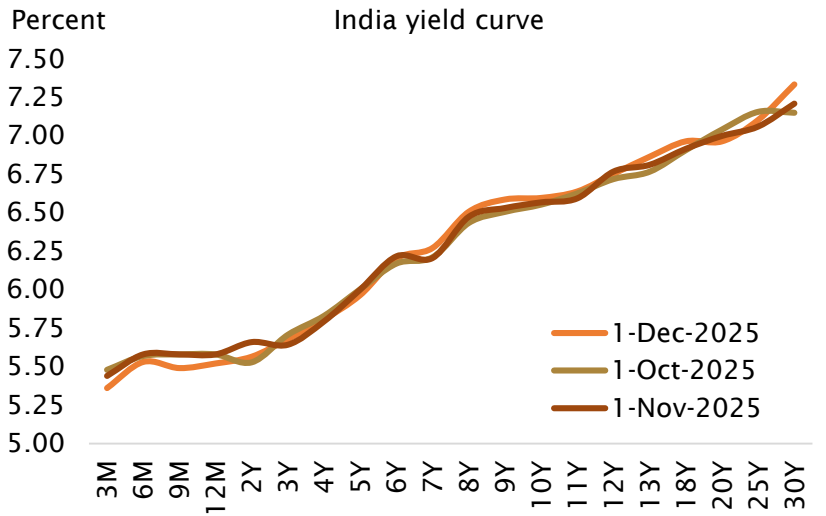
Net liquidity under LAF averaged lower than in the previous inter-meeting period, even as conditions eased in Nov-2025





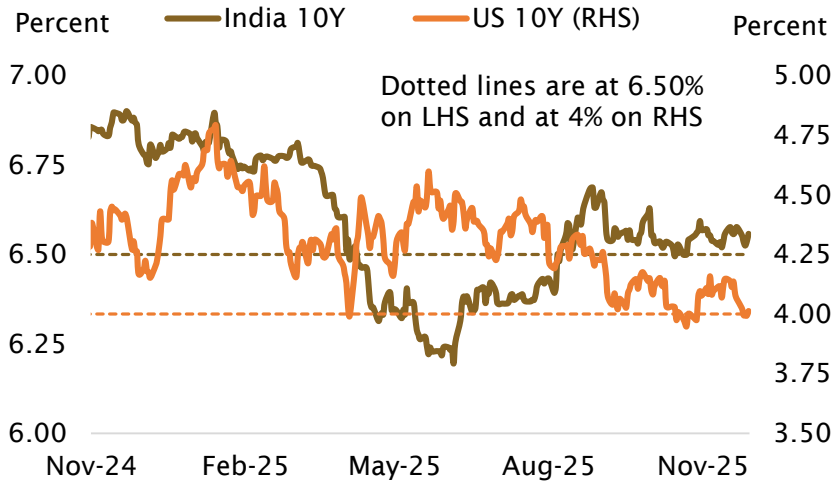
Mixed money market trends since last inter-meeting period amid easing at short-end of curve, steepening at long end

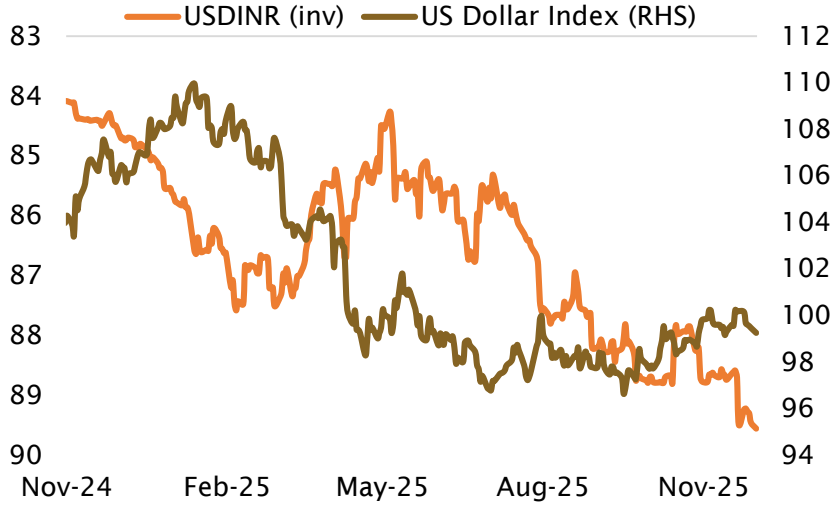




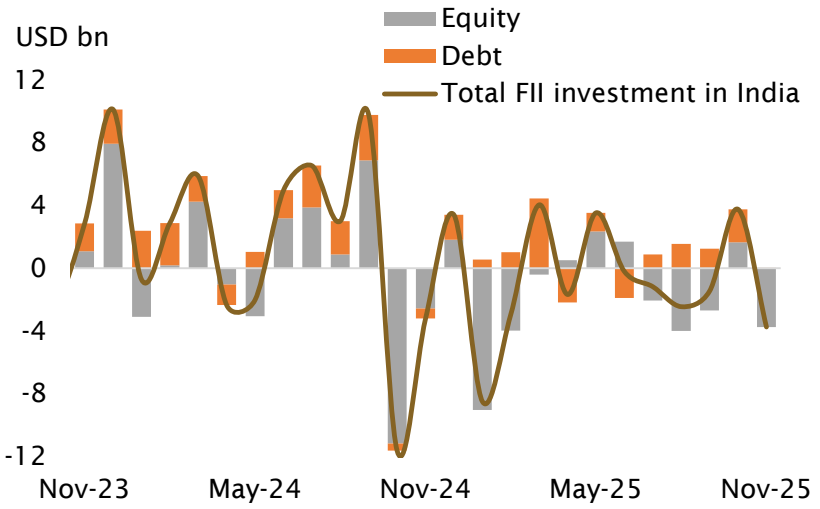
USDINR continues to remain under pressure; US treasury yields indicate market pricing of Fed FOMC rate cut in Dec

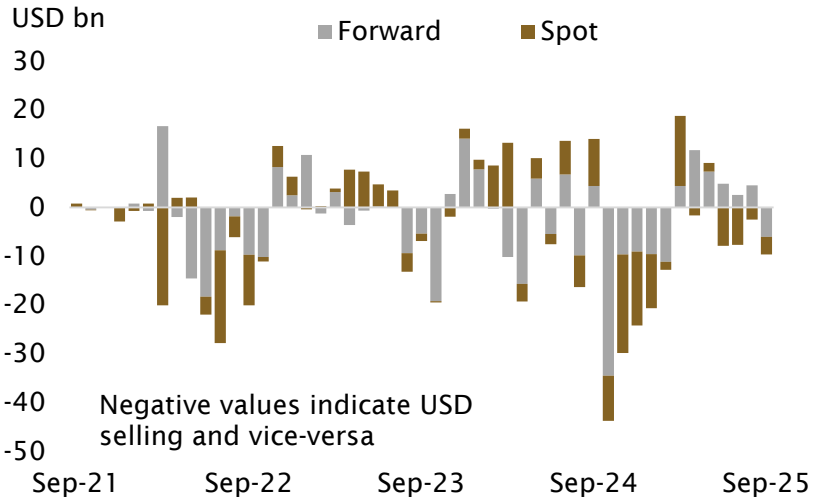
US yields have rallied since last FOMC meet in anticipation of rate cut in Dec; USDINR continues to breach new low levels





USDINR also under pressure from FII selloff in equities; RBI sold USD in both spot and forward markets in Sep





In Q2-FY26, overall balance of payments slipped into deficit after remaining in surplus for two quarters

- In Q2-FY26, the current account deficit narrowed to 1.3% of GDP (USD12bn) from 2.2% (USD21bn) in Q2-FY25. The moderation was due to slightly lower deficit in goods trade and higher surplus in services trade and remittances. In Q1-FY26, the current account deficit was lower at 0.3% of GDP (USD3bn).

- The capital account surplus sharply eased to 0.1% of GDP (USD1bn) in Q2-FY26 from 4.3% (USD40bn) in Q2-FY25. The moderation was on account of FPI outflows, lower external loans and banking capital (including NRI deposits), which offset positive FDI inflows. In Q1-FY26, the capital account surplus was at 0.8% of GDP (USD8bn), reflecting higher ECBs, positive FPI and stronger FDI inflows than in the latest quarter.

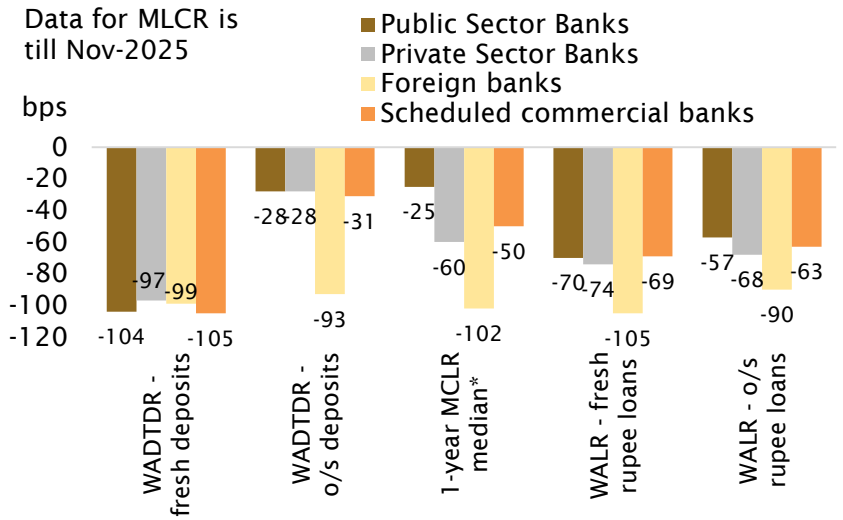
- The overall balance of payments slipped into deficit at 1.1% of GDP (USD11bn) after remaining in surplus for two successive quarters. In the same quarter of FY25 as well, BoP was in surplus at 2.0% of GDP (USD19bn).

Balance of Payments – Key highlights

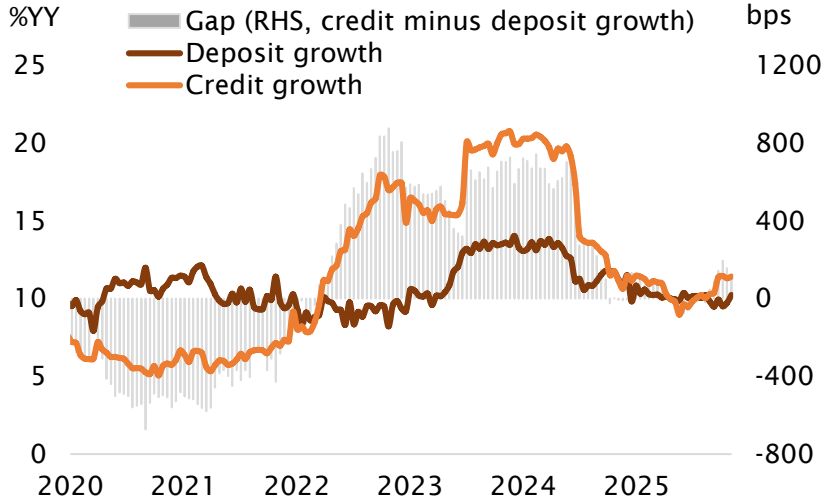
			FY25				FY26	
USD bn	FY24	FY25	Q1	Q2	Q3	Q4	Q1	Q2
Current account	-26.1	-23.1	-4.5	-20.9	-11.3	13.6	-2.7	-12.3
% of GDP	*-0.7*	*-0.6*	*-0.5*	*-2.2*	*-1.1*	*1.3*	*-0.3*	*-1.3*
Trade balance	-244.9	-286.9	-59.8	-88.5	-79.3	-59.3	-68.9	-87.4
Merchandise exports	441.4	442.1	115.2	100.6	109.8	116.5	112.7	109.4
Merchandise imports	686.4	729.0	175.0	189.2	189.1	175.8	181.6	196.8
Invisibles	218.8	263.9	55.3	67.7	68.0	72.9	66.1	75.1
Services	162.8	188.8	39.9	44.5	51.2	53.3	47.9	50.9
Transfers	105.8	123.4	26.3	32.4	33.2	31.5	31.0	36.4
Income	-49.7	-48.3	-10.8	-9.2	-16.4	-11.9	-12.8	-12.2
Capital account	89.4	16.6	8.9	39.9	-26.6	-5.6	8.0	0.6
% of GDP	*2.5*	*0.4*	*0.9*	*4.3*	*-2.7*	*-0.5*	*0.8*	*0.1*
FDI	10.2	1.0	6.2	-2.8	-2.8	0.4	4.9	2.9
FPI	44.1	3.6	0.9	19.9	-11.4	-5.9	1.6	-5.7
Loans	6.5	29.3	5.1	9.5	9.1	5.7	5.2	3.4
of which, ECB	-0.1	15.9	1.5	2.0	4.4	8.0	4.6	0.0
of which, ST credit	-0.8	7.2	2.2	5.3	4.0	-4.4	-0.1	2.9
Banking capital	40.5	-9.8	2.9	6.1	-9.8	-9.0	-1.6	1.9
of which, NRI deposits	14.7	16.2	4.0	6.2	3.1	2.8	3.6	2.5
Others	-11.8	-7.4	-6.2	7.3	-11.7	3.2	-2.1	-1.8
Errors and omissions	0.3	1.5	0.8	-0.4	0.3	0.8	-0.7	0.8
Balance of payments	63.7	-5.0	5.2	18.6	-37.7	8.8	4.5	-10.9
% of GDP	*1.7*	*-0.1*	*0.6*	*2.0*	*-3.8*	*0.9*	*0.4*	*-1.1*

Credit growth has been above deposit growth since Sep; non-food credit growth at 12%YY in Oct

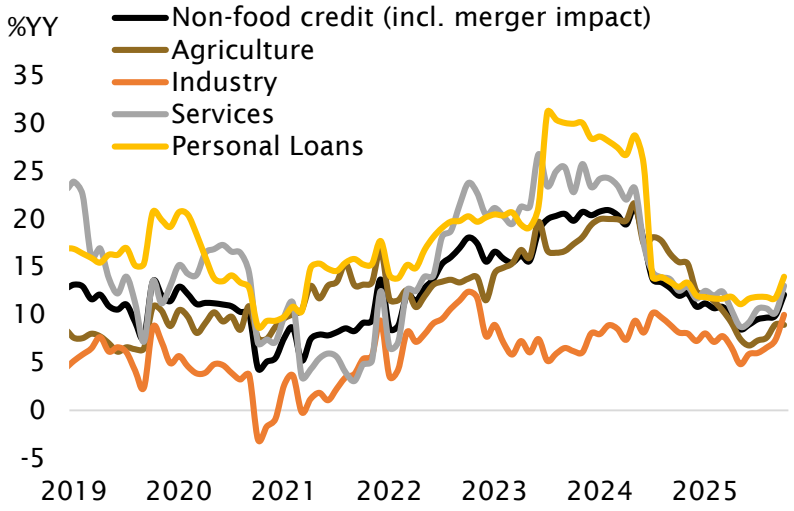
Transmission of 100bps cut since Feb-2025 till October

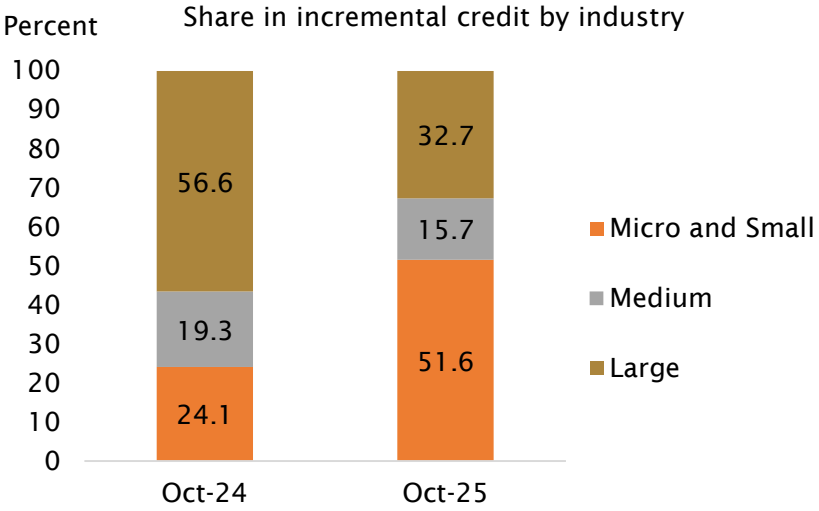


Credit growth has been above deposit growth since Sep



Credit growth at 12%YY in Oct, led by personal loans; within industry, largest share of incremental credit to small firms





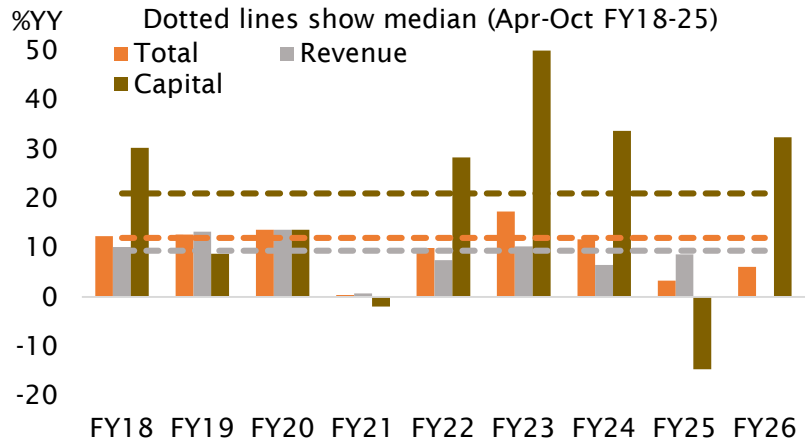
Fiscal deficit at 53% of FY26BE in Apr-Oct FY26 vs. 47% of FY25BE in same period of FY25; tax revenues need to catch up

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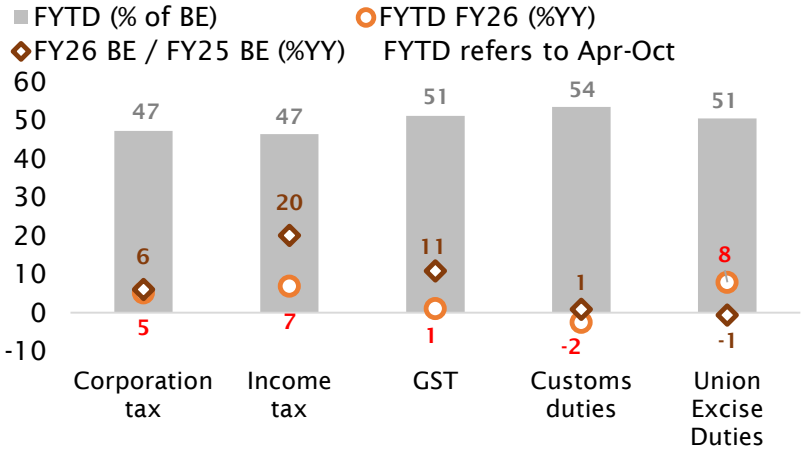
Fiscal deficit higher than in the same period of FY25 but on track to meet FY26BE; tax revenues need to catch up to meet BE

	(Rs. bn)	FYTD (Rs. bn)		FYTD (%YY)		FY26BE		FY25BE		FY26BE	
	Oct-25	Oct-25	Oct-24	Oct-25	Oct-24	Rs. bn	(% of BE)	Rs. bn	(% of BE)	Current run rate	Required run rate
Revenue receipts	679	17,634	17,043	3	9	34,204	52	31,292	54	2,519	3,314
Gross tax revenue	2,490	21,144	20,326	4	11	42,702	50	38,402	53	3,021	4,312
Net tax revenue	449	12,743	13,050	(2)	0	28,374	45	25,835	51	1,820	3,126
Direct taxes	1,301	12,167	11,497	6	12	25,250	48	22,120	52	1,738	2,617
Indirect taxes	1,184	8,952	8,810	2	9	17,401	51	16,237	54	1,279	1,690
Assignment to states	2,032	8,350	7,230	15	37	14,224	59	12,472	58	1,193	1,175
Non-tax revenues	230	4,891	3,993	22	50	5,830	84	5,457	73	699	188
Non-debt capital receipts	23	371	188	97	(18)	760	49	780	24	53	78
Total receipts	703	18,005	17,231	4	8	34,964	51	32,072	54	2,572	3,392
Total expenditure	3,223	26,256	24,739	6	3.3	50,653	52	48,205	51	3,751	4,879
Revenue expenditure	2,853	20,079	20,074	0.03	9	39,443	51	37,094	54	2,868	3,873
Capital expenditure	370	6,177	4,665	32	(15)	11,211	55	11,111	42	882	1,007
Fiscal deficit	2,520	8,251	7,508	10	(7)	15,689	53	16,133	47	1,179	1,488
Primary deficit	1,565	1,514	1,545	(2)	(40)	2,926	52	4,504	34	216	282
Revenue deficit	2,173	2,445	3,031	(19)	8	5,238	47	5,802	52	349	559

Healthy capex growth at the Centre in Apr-Oct FY26



Tax revenue growth muted amid cuts and relief steps



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