

RBI MPC likely to ease policy repo rate by 25bps to 5.75% at June meet

June 5, 2025

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- Most market polls are pricing in 25bp rate cut at the RBI MPC meeting on June 6, which would take the policy repo rate to 5.75%. This would mark the third consecutive cut since the MPC started to ease in Feb-2025 when the policy rate was at 6.50%.

- Since the last MPC meet in April, domestic CPI inflation has continued to ease due to broad-based easing on food prices, and outlook has improved amid prospects of above normal monsoon and soft global commodity prices. On the growth front, both real GDP and GVA growth surprised on the upside in Q4-FY25, and the full year growth numbers were in line with the national statistical office's second advance estimates. Though pockets of weakness in economic activity remain, market participants have pared expectations regarding the steepness of the ongoing rate cut cycle due to higher-than-expected growth in Q4. Futures pricing is currently indicating one-year ahead terminal repo rate of 5.5%, implying an addition 25bp cut after the one in June.

- Banking system liquidity has remained in surplus since end-March, and is expected to enable transmission of rate cuts to support growth in an environment of easing domestic price pressures. In early June, liquidity reached Rs.3 lakh crore, level that was last seen in Jul-2022. It is probable that aside from the monetary policy decision, the RBI, at some point during the month announces liquidity easing measures to support the ongoing daily VRR operations that it started in January and the bond buyback that was held today (June 5).

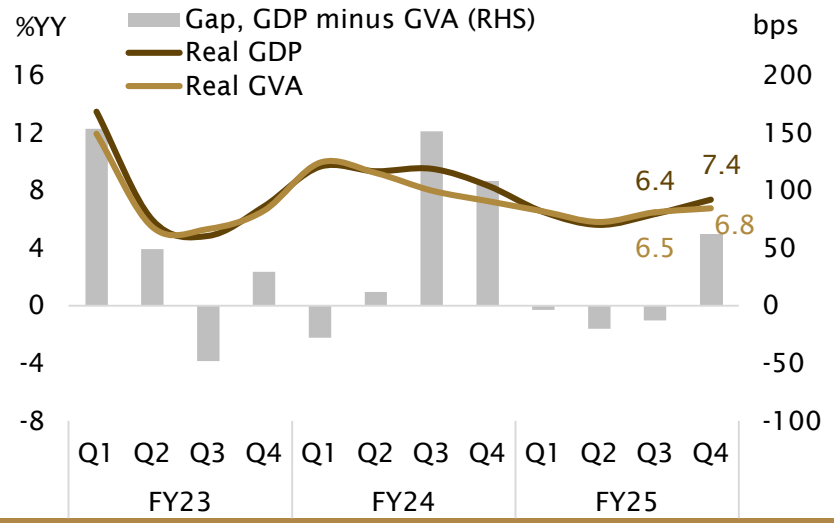
- Advance income tax payments are due in mid-June. Farm sector activity also picks up during the month that could cause currency leakages and prompt the RBI to infuse liquidity to ensure it stays at around 1% of NDTL. To attain this, the central bank could deploy any or a mix of measures from its toolkit that includes main (14-day) or term VRR auction(s), OMO purchase(s), USD/INR swap(s).

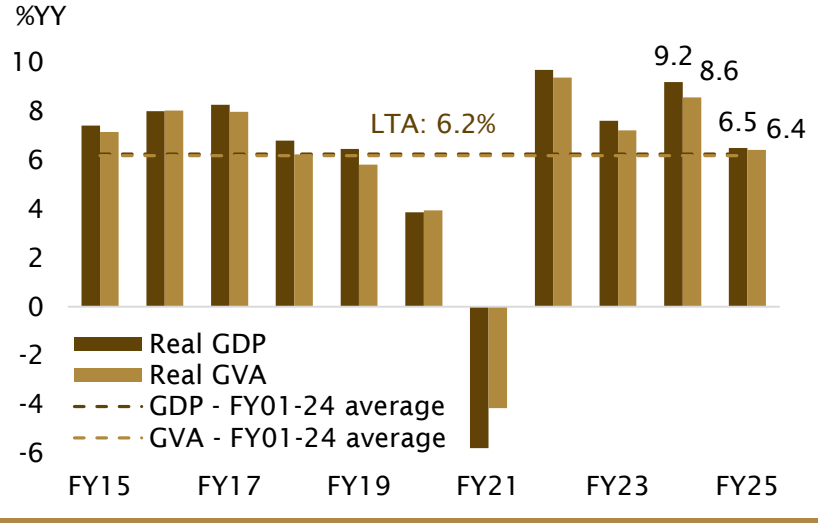
- Globally, uncertainties abound not only pertaining to the US trade policy but also its fiscal burden challenges. The resultant impact on investor sentiment is reflecting in financial markets via capital flows across regions and asset classes. This will remain an additional layer of complexity for monetary policy makers, as they account for the impact of these external vulnerabilities on their domestic currencies.

Both real GDP and GVA growth surprised on the upside in Q4; net indirect taxes lifted GDP growth above 7%

- In Q4-FY25, both real GDP and GVA growth printed above street estimates at 7.4%YY and 6.8%, respectively (Bloomberg survey estimates at 6.8% and 6.5%, respectively). For the full year FY25, real GDP and GVA growth was in line with national statistics office's second advance estimates of 6.5% and 6.4%, respectively.
- In Q4, subsidies fell about 40%YY in nominal terms that lifted net indirect taxes by around 23% and 13%, respectively in nominal and real terms, thereby lifting real GDP growth above that of GVA, a reversal from the trend in Q1-Q3 of FY25. But for the entire fiscal year, the GDP-GVA gap narrowed to eight basis points from 63bps in FY24, a year when the wedge between the two metrics was a key feature, particularly in H2.
- In the GDP data for Q4, private consumption growth eased compared to Q3 but remained firm at 6%YY. Interestingly though, while this component added the most to growth in Q3, net exports topped the list in terms of contribution to growth in Q4 amid a slump in imports that more that offset moderation in exports growth. Government consumption fell after rising strongly in Q3, while investment growth at 9.4% marked a six-quarter high. For the entire fiscal year, private consumption added the most to growth amid higher growth of 7.2% versus 5.6% in FY24. Investment growth eased to 7.1% from more than 8% in each of the previous two fiscal years. Net exports contributed positively to growth after acting as a drag in FY24, as imports fell in FY25 and exports growth improved. Government consumption growth eased to the softest in three years at 2.3%, after increasing by around 8% in FY24.

The gap between GDP-GVA growth increased in Q4 due to higher net indirect taxes, wedge was mild for entire year

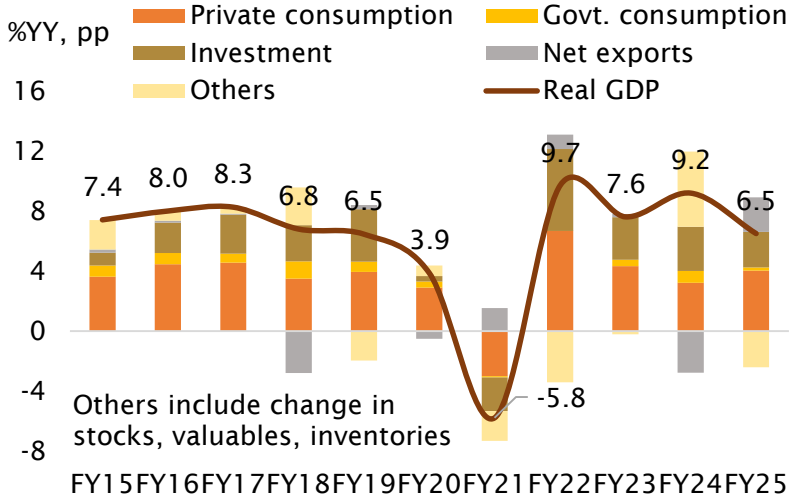


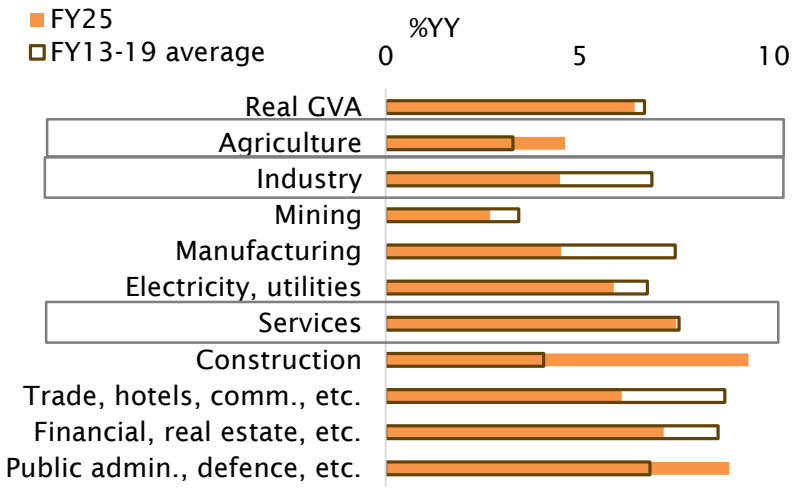


Global trade wars could exacerbate pockets of weakness in domestic industry

- The initial estimates for both real GDP and GVA growth in Q3 were pegged at 6.2%, and were revised higher in the latest update. Real GDP growth was raised to 6.4%YY, and GVA growth to 6.5%. On the GVA side, the improvement in growth to 6.8%YY in Q4 was driven by higher contribution from industry and services compared to Q3. Though the contribution of agriculture eased, it remained higher than the pre-pandemic average for the quarter and for the second straight print. In FY25, agriculture growth improved to 4.6% from 2.7% in FY24, and prospects for FY26 appear bright due to forecasts of an above normal monsoon.
- Despite moderation in growth to 7.5% from 9.2% in FY24, services sector continued to remain the mainstay of GVA growth in FY25, led by strong growth in construction and PADO (public administration, defence, and other services). However, industrial growth eased sharply due to slowdown in manufacturing. This was partly due to weak financials of petroleum industry, as also noted in the 'state of the economy' article of RBI's monthly bulletin for May. Data from the RBI's database shows year-on-year declines in the sector's operating profits across all quarters in FY25. The Ministry of Finance's monthly note on the economy attributed the decline in refinery output within the core infrastructure industries in April to waning global demand. Monthly trade data shows that on average, exports of petroleum products fell 22% in FY25, steeper than 13% decrease in FY24. The operating profits of iron and steel industry have also been falling for three straight quarters now, and this space needs to be watched out for in the context of the ongoing global tariff wars.

Net exports added to growth in FY25; mfg. slowdown dragged industry growth; construction was star performer within services

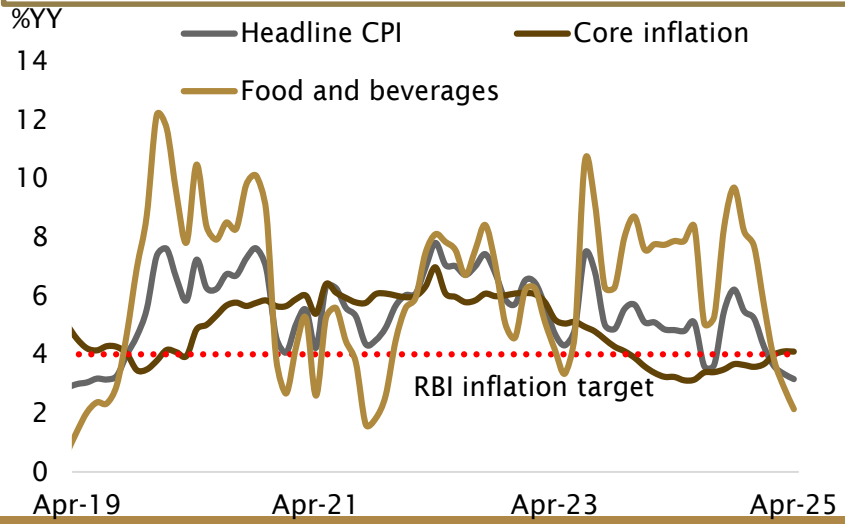


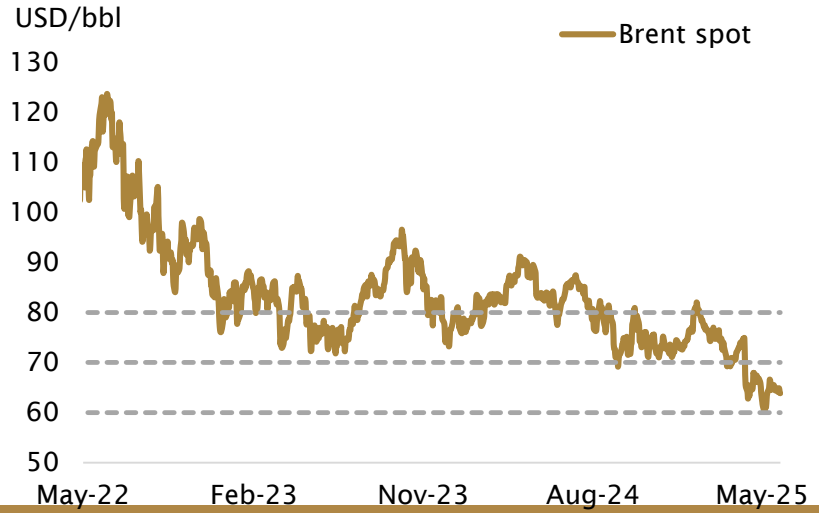


Easing domestic inflation, low global commodity prices keep policy space open to support growth

- Headline CPI inflation eased for the sixth successive month in April and printed below 4% for the third straight month at 3.16%, compared to 3.34% in March. The print marked the lowest in almost six years. Inflation remained below 4% across groups in April, except for the miscellaneous category, where it has been above 4% since Sep-2024, mainly reflecting higher prices of precious metals in the personal care sub-group.
- Food inflation eased to 42-month low of 2.14% from 2.88% in March, also marking the third straight print of sub-4%, in line with headline CPI. Inflation in the fuel and light index rose to 2.9% from 1.4% in March after remaining in deflation for 1.5 years. Core inflation (ex-food, fuel) was largely stable at 4.1%, though internals continue to show rising services inflation being partly offset by softening goods inflation.
- In early May, Brent spot moved closer to USD60/b and remains below USD65/b. In its latest note, the US EIA expects oil output to outpace demand growth in 2025 and 2026, and cut oil price forecasts for both years by USD2/b each to USD66/b and USD59/b, respectively. In its latest update in April, the World Bank has projected 12% broad-based fall in commodity prices in 2025, followed by another 5% decline in 2026, as weak global economic prospects weigh on demand. In addition to the prospects of low commodity prices, the forecast of above normal monsoon this year bodes well for domestic inflation outlook. In its latest update, the IMD raised forecast for southwest monsoon this year to 106% of LPA (from 105% earlier). The latest projection also holds for monsoon core zone that consists of rainfed farm areas. Except for the north-east, all regions are expected to receive normal to above normal rains.

Headline CPI stayed below 4% for third straight month in April; low crude oil prices to remain a tailwind for economy

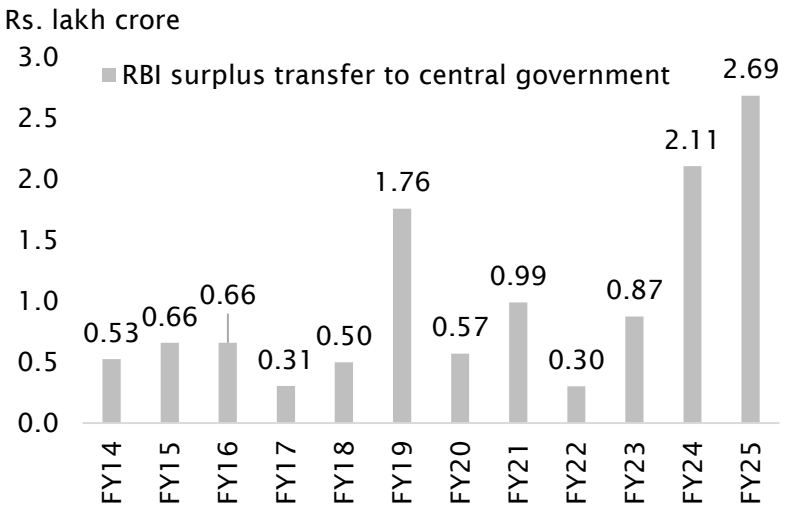


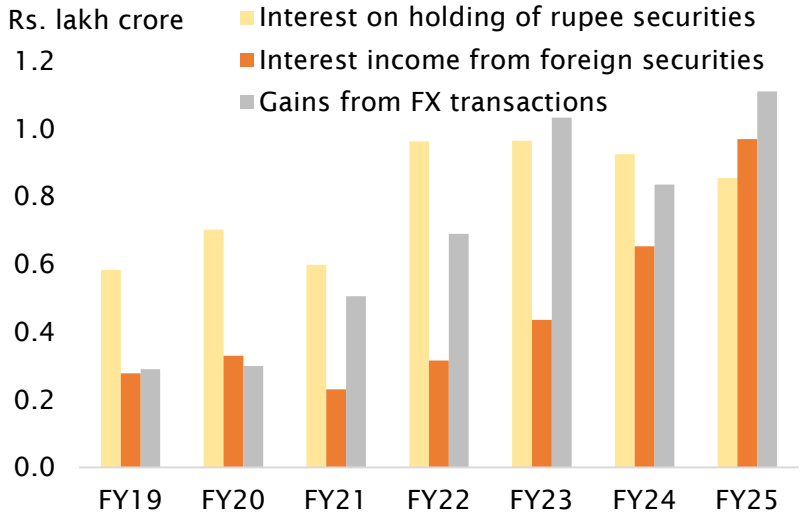


Revision in contingent risk buffer capped RBI dividend transfer; gains from FX transactions lifted RBI income

- Based on internal review of its Economic Capital Framework (ECF), the RBI's Central Board raised risk provisioning under contingent risk buffer to 6.0 ± 1.5% of balance sheet size (as against the existing level of 6.5%, with a lower bound of 5.5%). The contingent risk buffer includes buffers for monetary and financial stability risk, credit risk and operational risk. In addition to providing flexibility in the maintenance of risk buffers to ensure resilient balance sheet for the RBI in the prevailing macroeconomic backdrop, the widened range in the revised ECF is also expected to smoothen the transfers to the government.
- The surplus transfer of Rs.2.69 lakh crore to the central government for FY25 was slightly disappointing for certain segments of the market, as estimates ranged between Rs.2.5 to Rs.3.5 lakh crore. Despite being up 27% year-on-year, the increase in risk buffers kept the RBI dividend closer to lower end of the forecasts. But the transfer surpassed the budget estimate of Rs.2.56 lakh crore dividend collectively penciled in from the RBI, nationalized banks and financial institutions in the Union Budget for FY26.
- The central bank's income clocked in a higher growth of 23%YY versus 17% in FY24, led by gains from foreign exchange transactions and also interest income from foreign securities. In FY25, gross dollar sales surged to USD399bn from USD153bn in FY24, as the RBI intervened in FX market to curb excessive volatility. While income from foreign sources increased, earnings from domestic sources fell, particularly due to lower interest on rupee securities, holdings of which, in fact, increased 14%YY amid liquidity injection measures.

Higher provisioning for risk buffers capped the upside to RBI dividend; gains from FX transactions buoyed RBI income

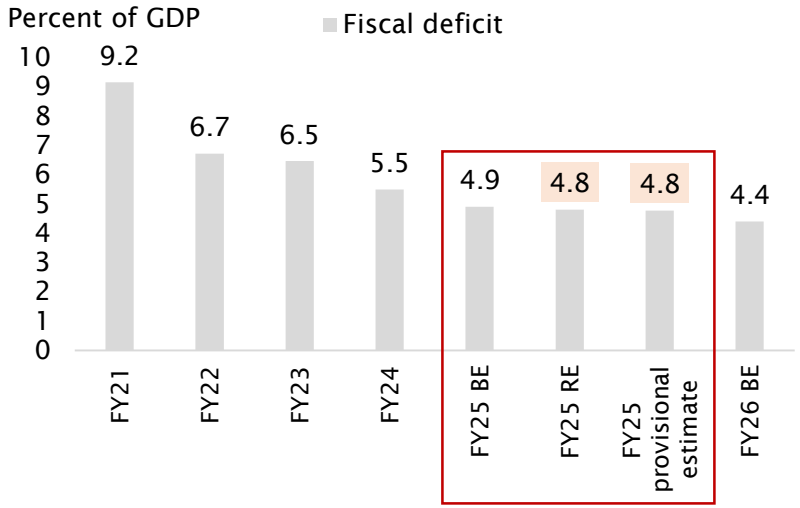




Fiscal consolidation on track with deficit for FY25 in line with revised estimate at 4.8% of GDP

- Fiscal deficit came in line with revised budget estimate for FY25 at 4.8% of GDP. Though there was a mild overshoot in fiscal deficit in value terms, nominal GDP growth was slightly higher than budget estimates, which kept the deficit in check as percent of GDP. Revenue deficit was below estimates, as receipts grew at a faster rate than spending. Primary deficit, while declining year-on-year, printed above FY25 RE.
- Both total receipts and expenditure were lower than estimates for FY25. On expenditure side, the overshoot in capex was offset by lower-than-budgeted revenue spending. The trend of low receipts from disinvestment continued for yet another year, keeping non-debt capital receipts muted. Non-tax revenues exceeded estimates, buoyed by strong dividend receipts from public firms, including the RBI. Despite gross tax revenues falling short of forecasts, devolution to States was intact at 100% of RE, paving the way for further undershoot in net tax revenues. Within tax revenues, direct tax receipts were strong, with corporate tax collections surpassing the downward revised estimates for FY25, and income tax revenues remaining strong. GST collections were also robust at 97% of FY25RE.
- On expenditure side, overshoot in capital spending was mainly due to higher-than-budgeted loans to States for capex. In case of revenue spend, interest payments and subsidies were below estimates.

FY25 fiscal deficit at 4.8% of GDP in line with estimate

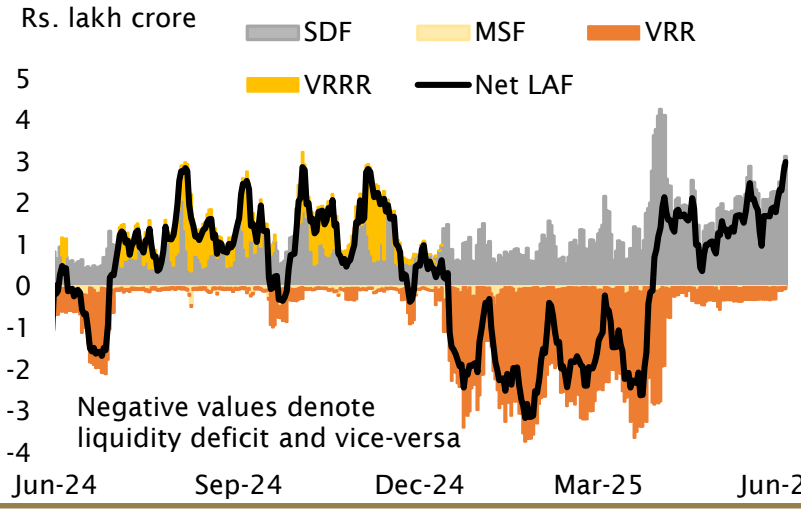


	FY25 - actual		FY25RE	
	Rs. bn	%YY	Rs. bn	(% of RE)
Revenue receipts	**30,364**	**11**	**30,880**	**98.3**
Gross tax revenue	**37,952**	**10**	**38,535**	**98.5**
Net tax revenue	**24,989**	**7**	**25,570**	**97.7**
Direct taxes	**22,305**	**14**	**22,420**	**99.5**
Indirect taxes	**15,596**	**4**	**16,070**	**97.1**
Taxes on UT	51	1	95	53.9
Transfer to NDRF	95	8	96	98.4
Assignment to states	12,869	14	12,869	100.0
Non-tax revenues	**5,375**	**34**	**5,310**	**101.2**
Non-debt capital receipts	**418**	**(31)**	**590**	**70.9**
Recovery of loans	246	(10)	260	94.7
Disinvestment	172	(48)	330	52.1
Total receipts	**30,782**	**10**	**31,470**	**97.8**
Total expenditure	**46,555**	**5**	**47,165**	**98.7**
Revenue expenditure	**36,035**	**3**	**36,981**	**97.4**
Capital expenditure	**10,520**	**11**	**10,184**	**103.3**
Fiscal deficit	**15,773**	**(5)**	**15,695**	**100.5**
Primary deficit	**4,609**	**(22)**	**4,316**	**106.8**
Revenue deficit	**5,671**	**(26)**	**6,101**	**92.9**

Liquidity has remained in surplus since end-March, aided by continued RBI measures

- System liquidity has stayed in surplus since the time it switched from deficit towards end-March, following a slew of infusion measures by the RBI. There were instances of moderation due to outflows from GST tax payments in both April and May, but government spending that tends to pick up towards month-end, and continued RBI steps ensured that liquidity remained in surplus. By mid-May, both core and system liquidity were close to 1% of NDTL. Since then system liquidity has further improved to Rs.3.0 lakh crore (as on June 3), the level last reached in Jul-2022.
- The RBI conducted four OMO purchase auctions in each of the months of April and May, infusing liquidity to the tune of Rs.1.99 lakh crore. In April, ahead of GST outflows, the RBI injected Rs.25,731 crore via one term repo auction of 43 days. Also, since the last MPC meet held in April (until June 4), the RBI has held one main and 35 fine-tuning VRR operations (ranging from one to four days) that added liquidity of Rs.2.47 lakh crore, against notified amount of Rs.13.5 lakh crore.
- So far, the RBI has not stated OMO purchases in June but on May 30, it announced buyback of securities worth Rs.25,000 crore to be conducted on June 5 and accordingly, bought back securities worth Rs.23,856 crore. This step indicates prudent public debt management by retiring high-coupon securities maturing in FY27 in the backdrop of falling interest rates, and could also provide some cushion to system liquidity that could come under pressure ahead of advance income tax payments due in mid-June.

Liquidity surplus rose to Rs.3 lakh crore in early June



RBI durable liquidity measures in FY26 so far

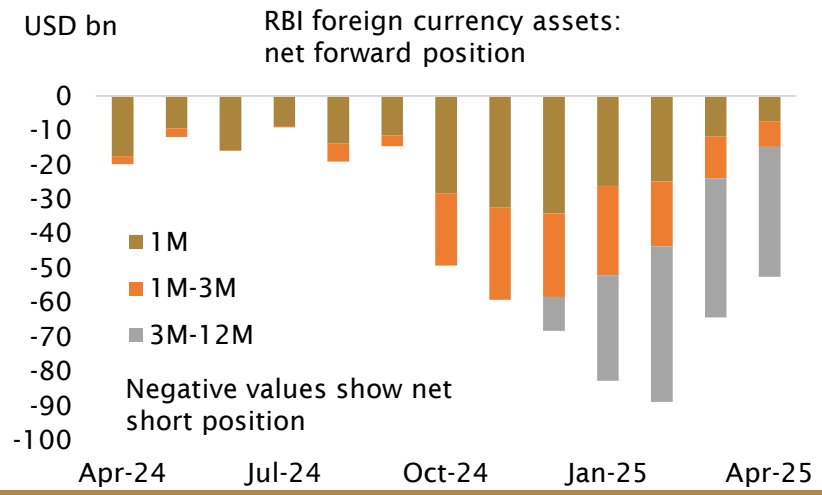
(Rs. crore)

Measure	Description	Auction date	Amount injected
OMO purchase auctions		03-Apr-25	20,000
		08-Apr-25	20,000
		22-Apr-25	20,000
		29-Apr-25	20,000
		06-May-25	50,000
		09-May-25	25,000
		15-May-25	25,000
		19-May-25	19,203
Term repo auction	43-day VRR	17-Apr-25	25,731
Buyback of GoI dated securities	Maturity in FY27 with coupons ranging from 6.97% - 8.24%	05-Jun-25	23,856
		Total	**2,48,790**

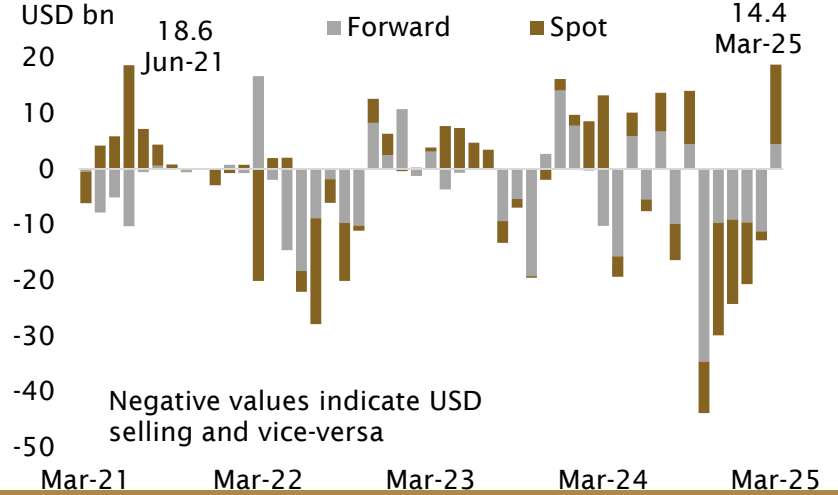
Unwinding of short positions in FX market partly explains RBI's continued liquidity easing despite surplus conditions

- In the post policy conference after the April RBI MPC meet, the Governor cited surplus liquidity to the tune of 1% of NDTL as comfortable to enable transmission of recent rate cuts to the system and support growth in the economy. However, despite attaining these liquidity conditions by mid-May, the RBI has continued with daily VRR operations. In addition to enabling sustenance of liquidity conditions at certain levels, the ongoing easing bias is expected to support the recent unwinding of short forward positions in the FX market that that RBI had been accumulating since Oct-2024 to prevent undue volatility in the USDINR levels.
- After weakening to 87.6/USD in early February from 84.0/USD average in Oct-2024, the USDINR appreciated by over 2% by end-May, enabled by easier monetary conditions, improvement in domestic growth-inflation dynamics, weak USD. In mid-April, the dollar index slipped below 100 level for the first time since Jul-2023, and between bouts of volatility above that level, remained sub-100 as of end-May. However, the period has been marked by volatility for the INR due to global tariff wars and Indo-Pak border tensions in early May.
- Latest RBI data shows that the USD/INR swap auction in March led to the highest net purchase of USD since mid-2021. Foreign exchange reserves reflect the impact of interventions in the FX market. Monthly data suggests that after falling between Oct-2024 to Jan-2025, there has been accretion to headline FX reserves.
- The immediate impact of uncertainties emanating from US trade and fiscal policies continue to feed through financial markets, and are keeping portfolio flows volatile across economies, including India. This channel of vulnerability and its impact on the INR is likely to remain an added complexity for the RBI to grapple with.

RBI has started to cut forward positions in FX market



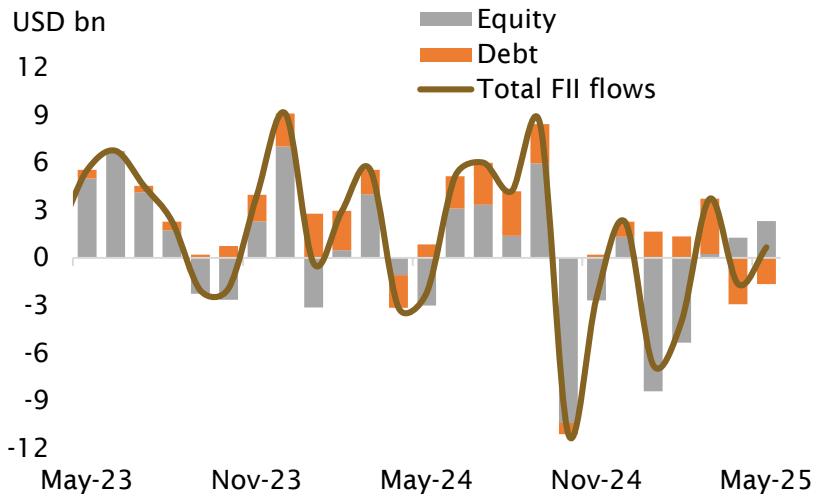
Net purchase of USD surged in March due to FX swap

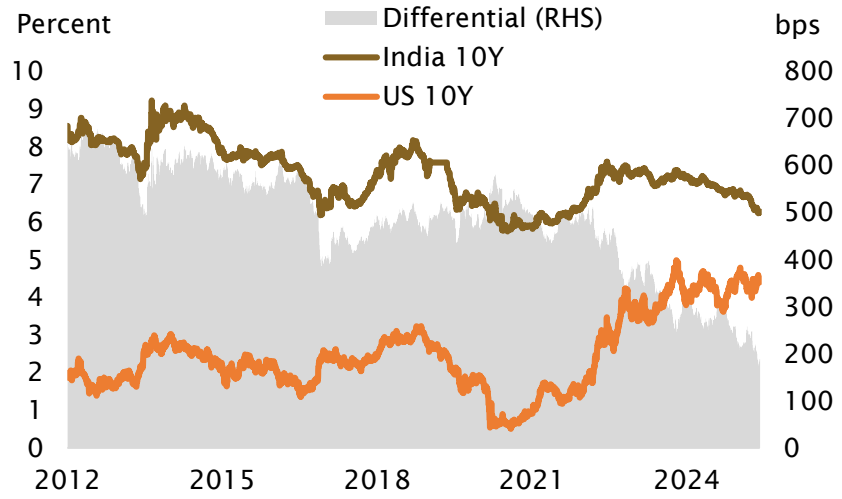


Portfolio flows remain volatile, US-India 10Y differential narrowed sharply in May

- As noted earlier, portfolio flows into India remain volatile amid global uncertainties. However, in the months of April and May, equity flows turned positive, and there were outflows from debt instruments. One of the reasons for the latter could be narrowing yield differentials vis-à-vis major advanced economies. In a recent measure to encourage foreign participation in the domestic debt market, the RBI relaxed investment norms for corporate bonds by removing short-term investment and concentration limits.
- US bond yields remain volatile due to shifting stance of the US administration in the ongoing tariff wars. In addition to trade policy uncertainty, concerns around the fiscal burden and debt sustainability are weighing on investor sentiment, and were partly the reasons for Moody's recent downgrade of US sovereign credit rating. The passage of reconciliation package, which includes tax cuts and spending reforms in the US, by a key congressional committee further soured sentiment and the US 10Y climbed to the highest rate in more than three months at 4.60% on May 21. On the same day, the India 10Y rallied to the lowest in more than 3.5 years to close at 6.24% (Data source: Bloomberg), narrowing the 10Y yield differential to 164 bps.
- Since the last RBI MPC meeting in April, India 10Y has rallied by around 15bps to 6.29% on May 31, aided by factors such as 1) improving growth-inflation dynamics in the domestic economy that remain supportive of policy rate cut at the MPC meet in June 2) RBI measures to ensure surplus liquidity 3) fiscal deficit for FY25 that was in line with budget estimates 4) low crude oil prices and prospects of soft global commodity prices.

In Apr-May, foreign investors bought Indian equities and sold debt; US-India 10Y differential narrowed sharply in May





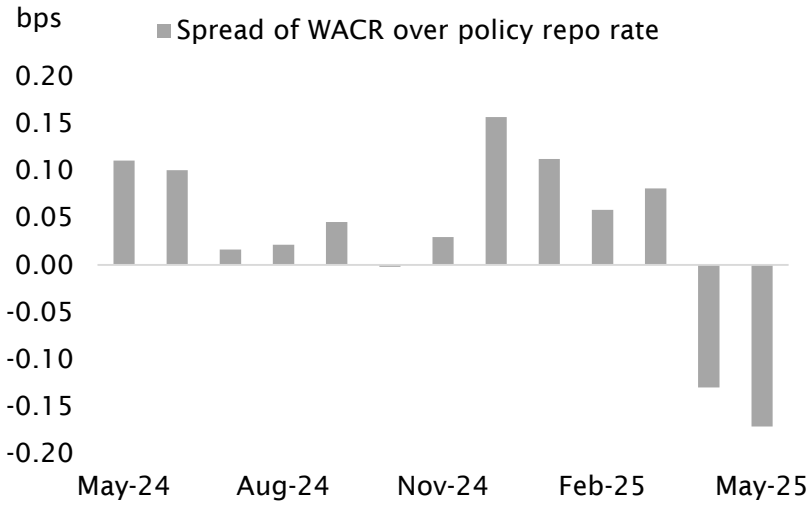
Overnight rates averaged below 6% policy repo rate in both April and May amid surplus liquidity

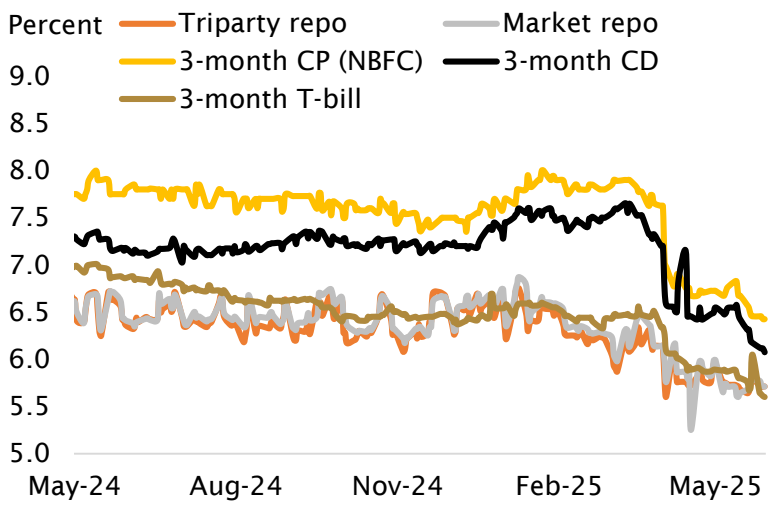
- The surplus in system liquidity that has been persisting since end-March have kept overnight rates below 6% policy repo rate and close to floor of the LAF corridor or the SDF rate of 5.75%. In both April and May, the weighted average call rate (WACR) and rates in the collateralized segment averaged below the policy rate.

- Money market rates have also softened since the last MPC meet, reflecting the impact of surplus liquidity. The yields on 3-month T-bills, certificates of deposit (CDs) and 3-month commercial papers (CPs) issued by NBFCs have averaged lower by 57bps, 93bps, and 103bps, respectively between the latest (Apr 10 to May 31) and the previous inter-meeting period (Feb 8 to Apr 8). The average risk premia (3-month CP minus 91-day T-bill) has decreased to 83 bps from 130 bps in the prior inter-meeting period.

- The one-year OIS, which tends to reflect market expectations about the repo rate, eased by around 23bps since the last RBI MPC meeting in April to 5.59% on May 31. It reached a low of 5.54% on May 26 but market participants pared expectations of a steeper rate cut cycle post higher-than-expected GDP data for Q4-FY25. Futures pricing indicates one-year ahead easing by not more than around 50bps from the current rate of 6%, implying terminal policy repo rate of 5.5%. Most market surveys, including Bloomberg, indicate expectations of 25bp cut at the MPC meet in June that would take the repo rate to 5.75%.

Overnight rates averaged below policy repo rate in Apr-May amid surplus liquidity; money market rates have eased

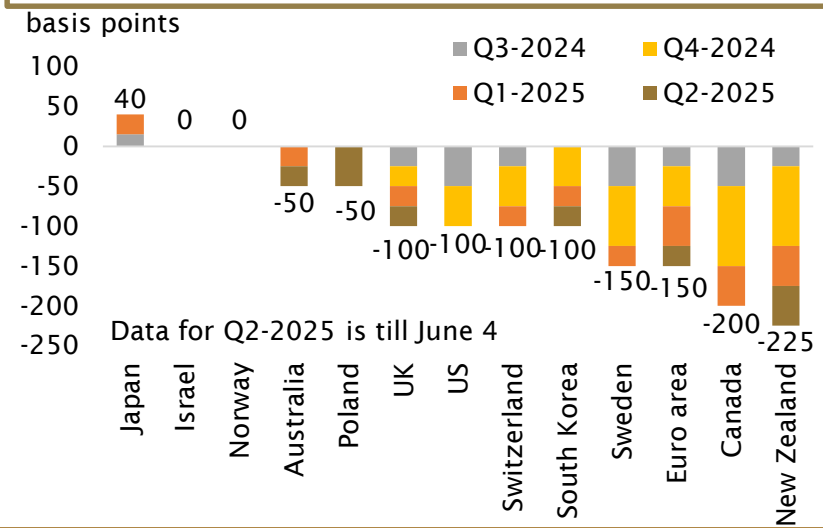


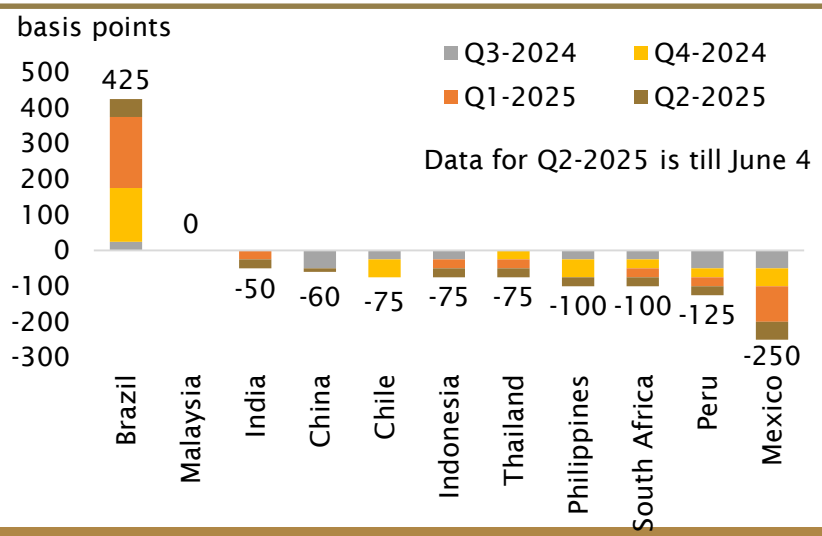


Central banks remain cautious while easing amid external headwinds

- Since the last RBI MPC meeting held in April, the Bank of England reduced its policy or bank rate by 25bps to 4.25% in May. The European Central Bank is scheduled to meet today (June 5). At its meeting in April, the ECB had slashed key policy rates by 25bps each, taking the benchmark deposit facility rate to 2.25%. After cumulative 100bp cut to policy rates between Sep-Dec 2024, the US Fed has held the federal funds target range stable at 4.25%-4.50%. In early May, the People's Bank of China eased key the benchmark 7-day reverse repo rate by 10bps and the required reserve ratio (RRR) by 50bps. However, exceptions remain with Banco Central do Brasil continuing to hike to combat domestic inflationary pressures.
- Major central banks in advanced economies had started to ease by mid-2024, as they made progress in the their last mile of disinflation. The need for policy support was further prompted by the onset of global tariff wars that exacerbated external headwinds across regions. However, policy makers remain cautious while easing as uncertainties persist pertaining to developments around trade wars. With multilateralism taking a backset, many economies, including India, are attempting to strike bilateral trade deals among themselves and with the US. The UK and China have already signed interim trade deals with the US in the first half of May and talks abound that India might also ink a similar agreement by late June before the pause on US reciprocal tariffs expires on July 9. Recently, India also concluded free trade agreement negotiations with the UK, and is also likely to sign a similar deal with the EU by year-end.

Since last MPC meet in April, both ECB and BoE have eased by 25bps each; China has cut benchmark rate by 10bps





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