

RBI MPC most likely to maintain pause at Oct meet; some market participants expect 25bp rate cut or a dovish bias

September 30, 2025

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Macro update

Economic activity

- In Q1-FY26, real GDP growth surprised on the upside at 7.8%YY, beating estimates of around 6.5%, partly due to low deflators. High frequency data continues to paint a mixed picture of economic activity. For instance, rural activity remains strong amid muted urban demand. IIP growth eased in August, even as core industries hit a 15-month high. The outlook remains clouded by trade tensions with the US, but the lagged impact of fiscal and monetary easing is expected to support domestic growth.

Inflation

- Despite uptick to 2.1% in August from 1.6% in July, CPI inflation remains low. Though there are risks from unfavorable base effects between Nov-Mar FY26 and any adverse climate events, outlook stays benign amid the progress in Kharif sowing, southwest monsoon rains, reservoir levels, and low crude oil prices. GST rate rationalization and the upcoming changes to CPI index in Feb-2026 further add to the downside bias.

Liquidity

- As on 28-Sep, liquidity under net LAF was in surplus of Rs.46,941 crore after briefly slipping into deficit between 22-24 Sep due to advance tax outflows. Since the last MPC decision in August, the RBI used a mix VRRR and VRR operations to manage liquidity conditions. Liquidity under net LAF averaged around Rs.3 lakh crore in the previous inter-meeting period versus Rs.2 lakh crore since the last MPC meet.

Bond yields

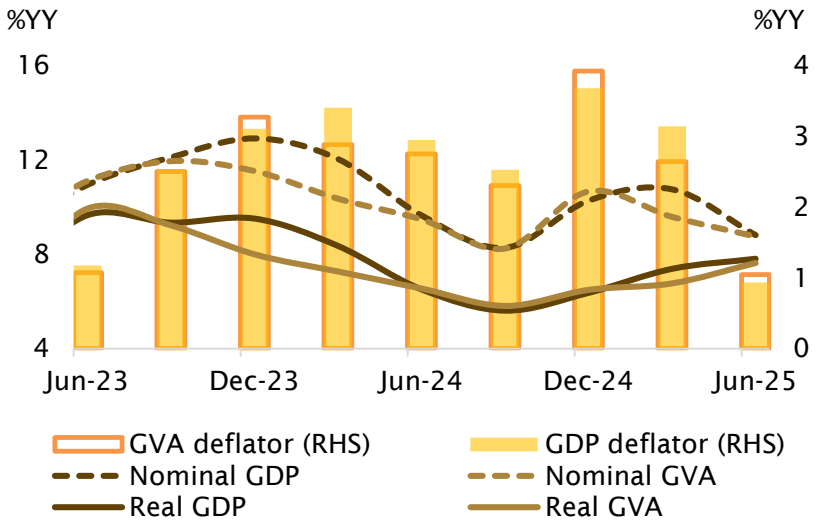
- The 10-year yield breached 6.6% in August, as high US tariffs became effective, and recently after the government announced its borrowing plan for H2-FY26. Since the last MPC meet, yields have increased, particularly at the mid- and long-end of the curve, reflecting: 1) India-US tariff tensions 2) nearing of domestic rate cut cycle post the front-loaded stimulus in June 3) risks of fiscal slippage due to lower GST rates and income tax relief 4) higher global yields amid fiscal sustainability and debt concerns.
- The overnight call rate has averaged below the policy repo rate since Apr-2025 but the differential has been narrowing after peaking in June and was stable in Aug-Sep. As liquidity inched close to deficit post mid-September, the call rate rose above the policy repo rate. Money market rates have averaged higher than in the previous inter-meeting period and the risk premium has increased. Term spreads, measured by t-bill and G-sec yield differentials against the 10Y, remain elevated post the easing in June.

RBI MPC Policy Outlook

- **US policy updates:** In its policy decision on 17-Sep, the US Fed cut the target range for the federal funds rate by 25bps to 4.00% - 4.25%, citing increase in downside risks to employment as the rationale. The dot plot showed diverse views with 9 out of 19 FOMC members indicating two more rate cuts in 2025 and 6 expecting a pause.
  The trade talks between the US and India have resumed. But new challenges have emerged, with the US administration hiking H-1B visa fees and the proposed Halting International Relocation of Employment (HIRE) Act that seeks to seeks to curb outsourcing by US companies. If passed, the bill could impede India's services exports. The risks from these uncertainties on the domestic economy remain high. The US administration also recently announced 100% tariffs on branded pharmaceutical drugs, though impact on India is expected to be limited, as majority of India's pharmaceutical exports to the US include generic drugs and also most Indian pharmaceutical companies have plants or subsidiaries in the US.
- **RBI MPC policy outlook:** At its upcoming policy decision due on 1-Oct, the RBI MPC is likely to maintain the policy rate at 5.50% and keep the stance at neutral. The rationale for an extended pause are manifold.
  1) As noted earlier, downside risks to CPI inflation in FY26 have increased. There are also concerns around disinflation in Asia, as excess capacity in China finds its way to regional peers. This raises the possibility of the MPC further lowering its inflation forecast for FY26 from 3.1% in August. But the balance of risks could be neutral in case of any adverse climate events or if demand rises due to policy easing that has already been implemented, and creates price pressures, particularly in FY27 if one accounts for the lag with which these measures work.
  2) Though growth surprised on the upside in Q1, high frequency data on economic activity remains mixed. The external risks weigh from uncertainties around the impending US-India trade deal. Due to these concerns, there is a section of market participants expecting a 25bp rate cut or at least a dovish undertone at the October meet. But the MPC might prefer to wait and assess the impact of high US tariffs and the time it takes to ink a potential trade deal, so as to preserve some policy space in case these headwinds exacerbate or take time to abate. The domestic economy is also expected to find support from the front-loaded monetary easing in June and the fiscal stimuli in the form of income tax relief announced in the Union Budget for FY26 and the recently announced GST rate cuts.
  3) There has been persistent equities selloff by foreign investors since July that has added pressure on the USDINR. The currency pair is currently finding support around 89/USD, marking depreciation of more than 1% since the August MPC meet. Though the Fed rate cut provides scope for EM central banks to ease, supporting the INR could be another reason for the MPC to hold the policy rate at current level.
  Among other developments, the issuance calendar of G-sec dated securities for H2-FY26 shows borrowing of Rs.6.77 lakh crore, taking full year borrowing to Rs.14.72 lakh crore, against budgeted amount of Rs.14.82 lakh crore. The maximum issuance is of 10Y (~28% share), with less supply penciled in at the long end of the curve.

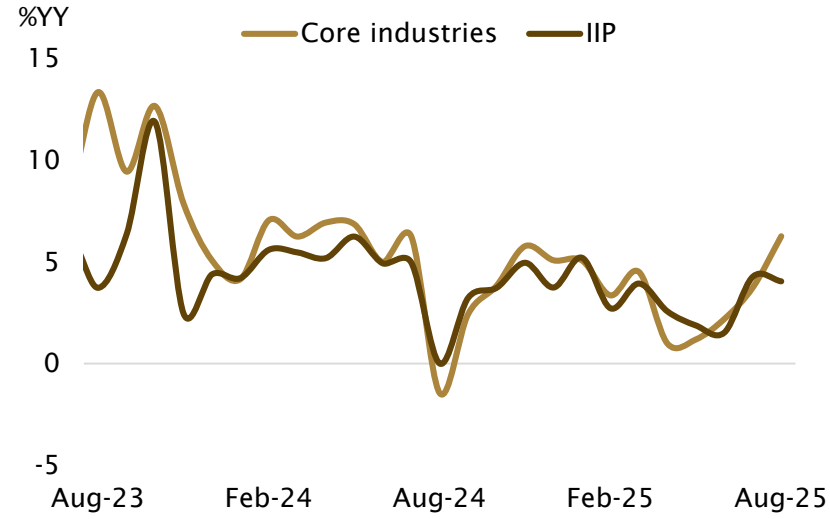
Real GDP growth surprised on the upside in Q1-FY26

Low deflators lifted real growth above 7.5%YY; consumption, investment (GDP), services (GVA) posted strong growth

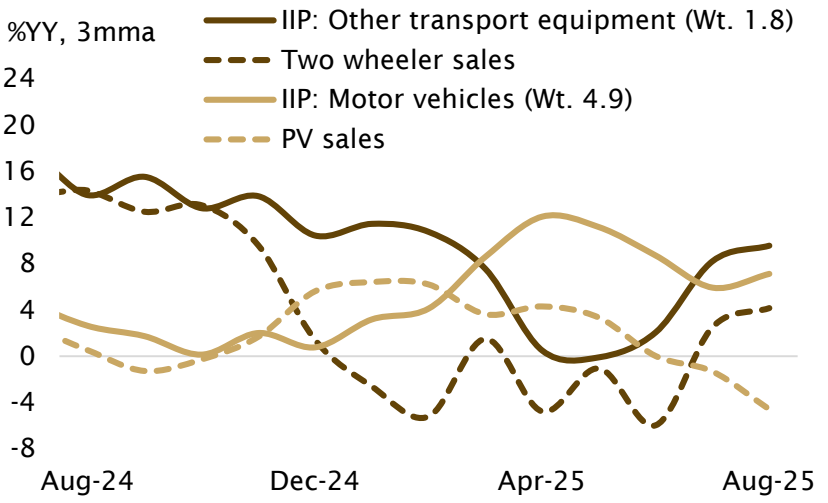




Core growth hit 15-month high in Aug, IIP moderated

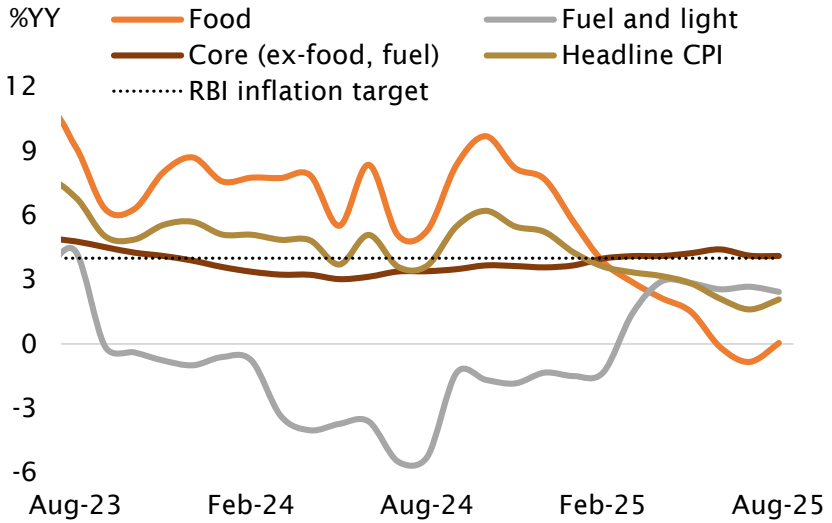


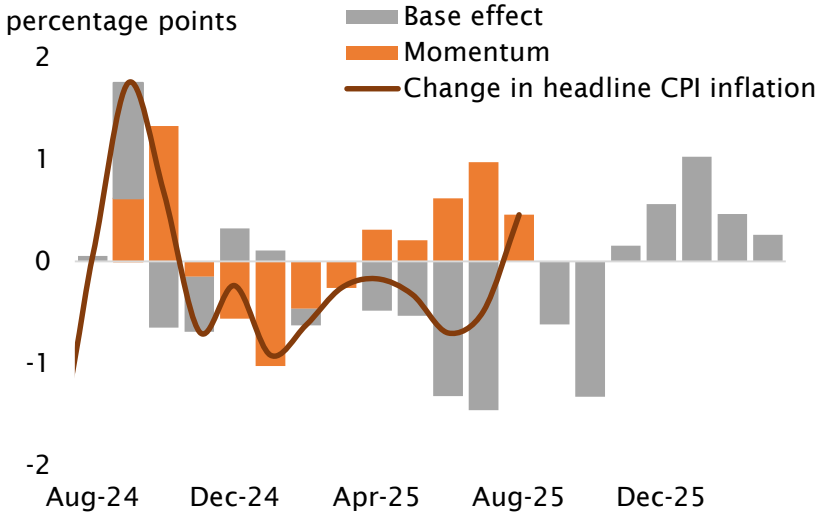
Rural demand remains strong, urban still lagging



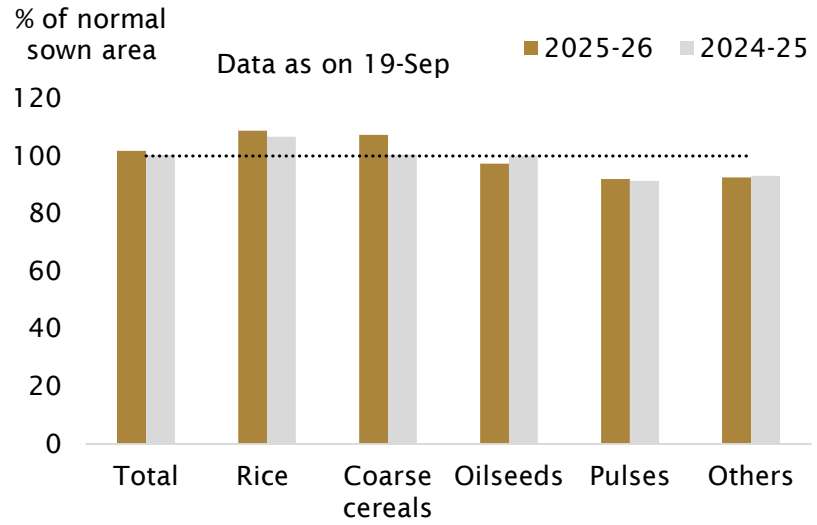
Inflation outlook benign amid Kharif sowing and monsoon progress, low crude oil prices

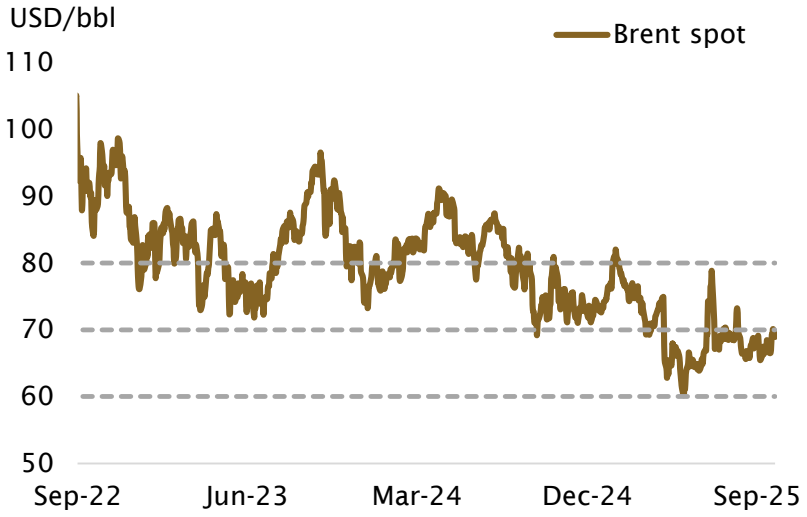
CPI inflation rose to 2.1% in Aug from 1.6% in Jul, as food moved out of deflation; base effect to be favorable in Sep-Oct





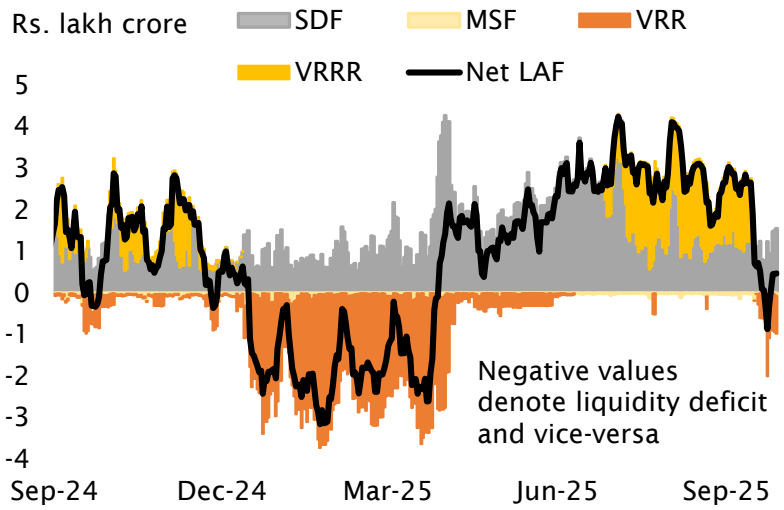
Progress in Kharif sowing, southwest monsoon rains, and low crude oil prices bode well for domestic inflation outlook

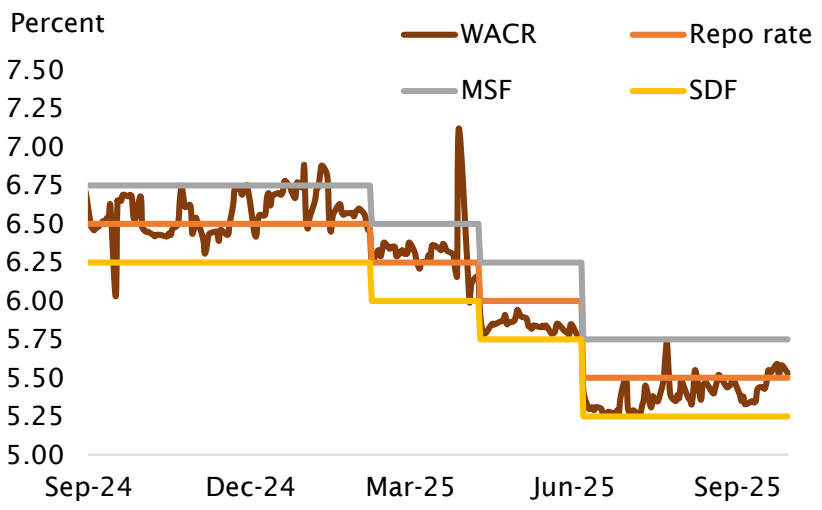




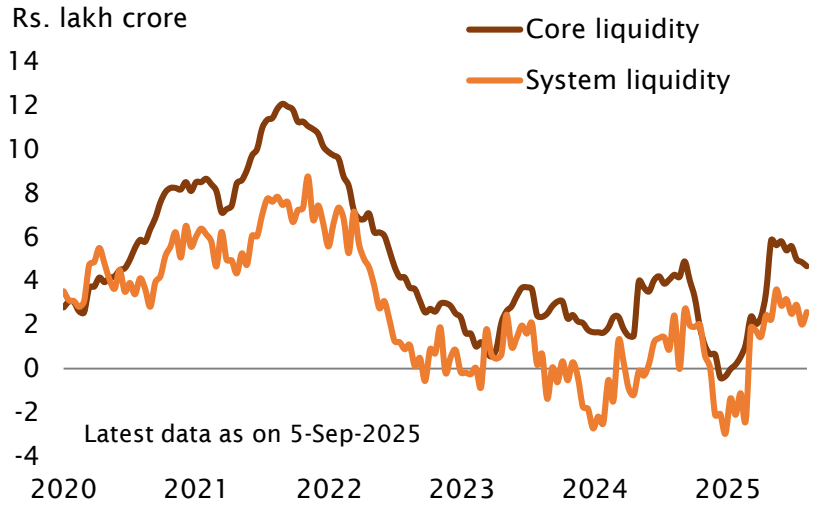
Net liquidity under LAF slipped into deficit briefly after being in surplus since end-March

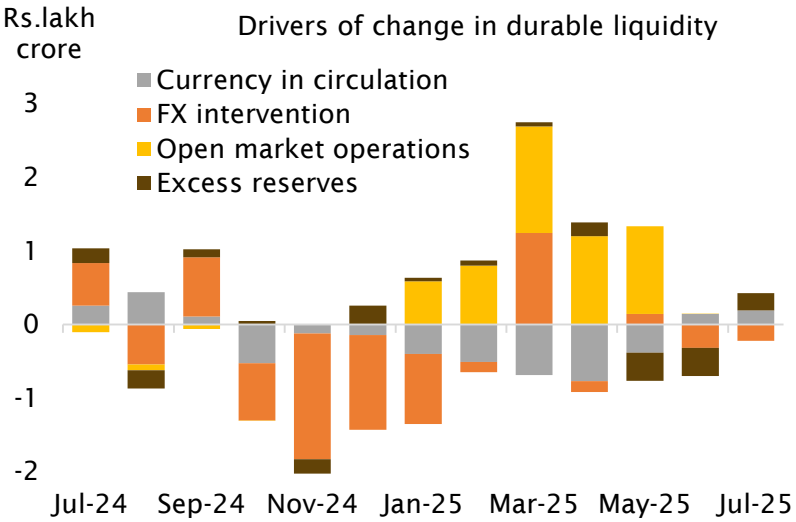
Net liquidity under LAF slipped in deficit briefly after being in surplus since end-March; o/n WACR above policy repo rate





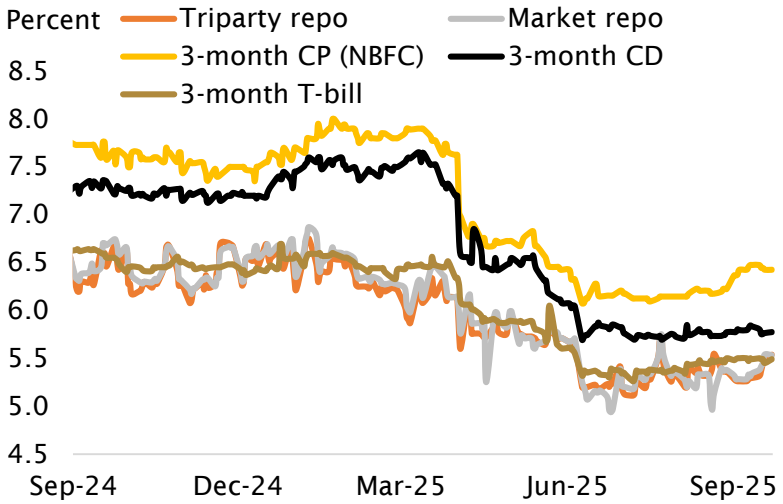
Both system and core or durable liquidity (net of government cash balances) have eased in recent months

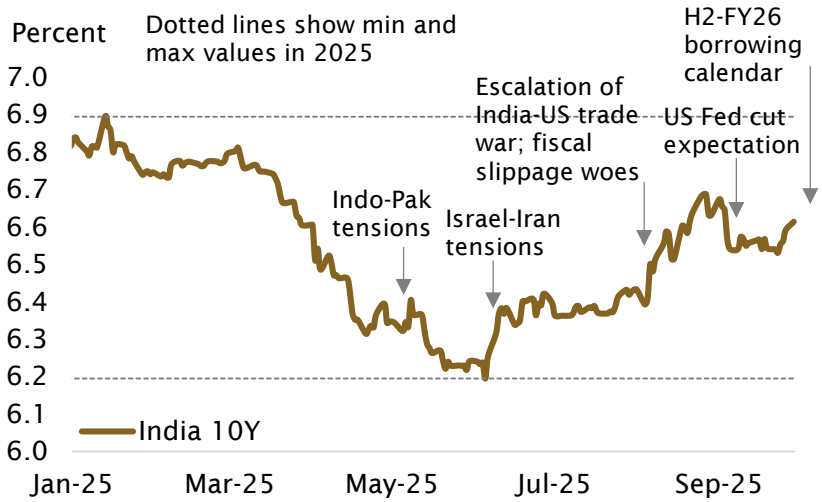




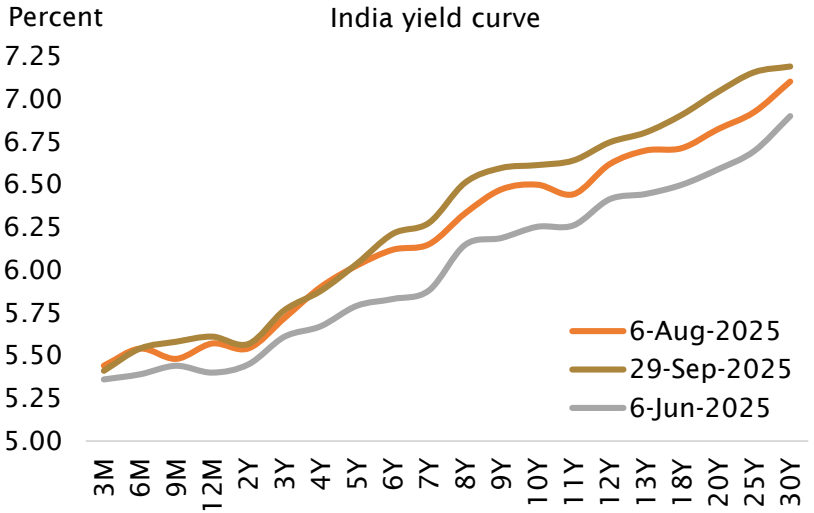
Since the last two RBI MPC meetings, bond yields have increased across the curve

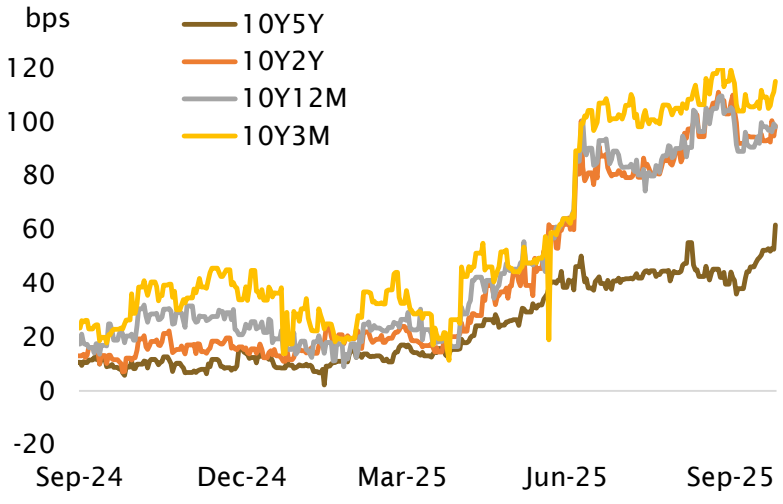
Money market rates average more than in prior inter-meeting period; 10Y crossed 6.6% on US tariffs, H2 borrowing plan





Since the last two RBI MPC meetings, yields have increased across the curve; term premium remains elevated

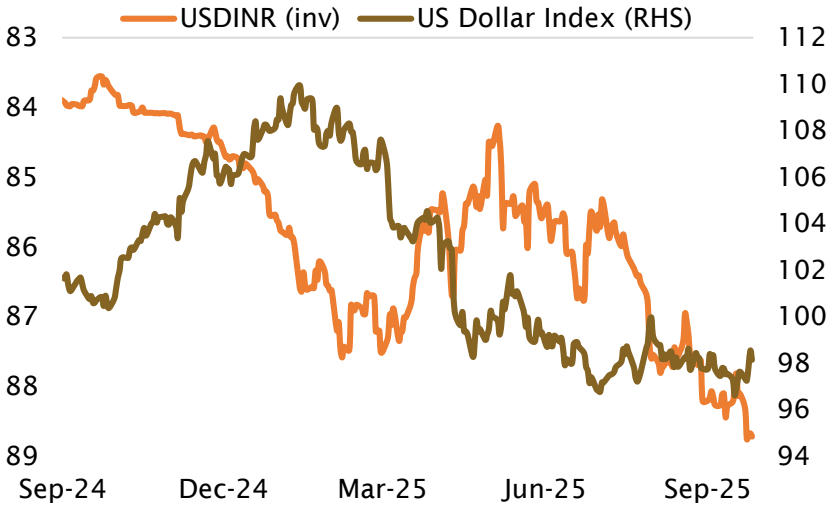


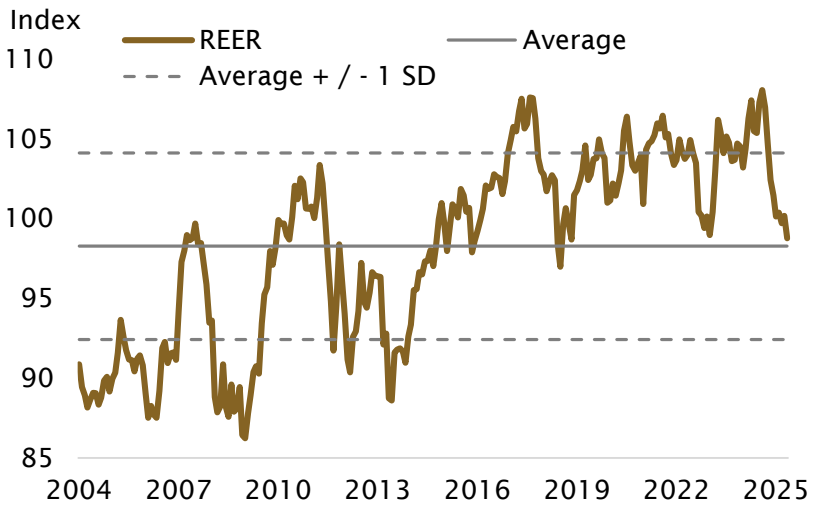


USDINR remains under pressure amid ongoing trade tensions with the US

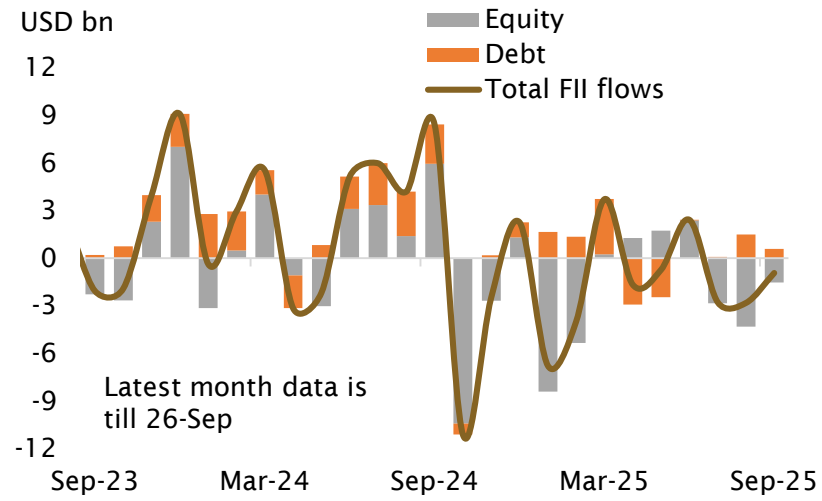
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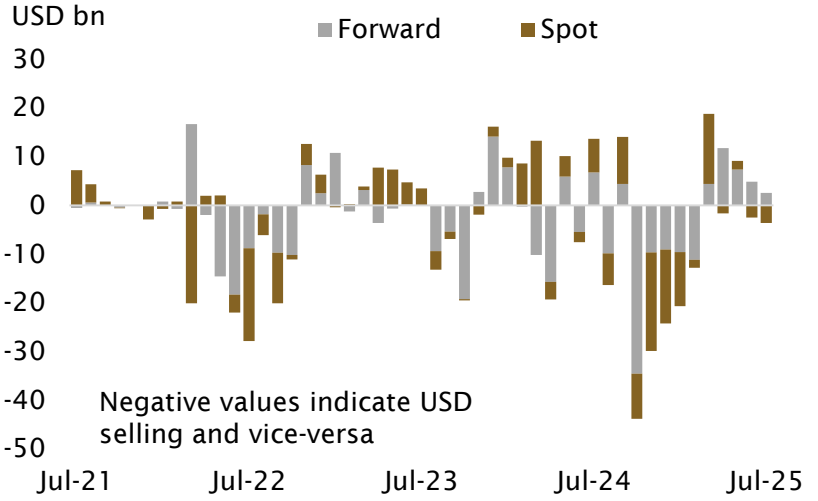
USDINR under pressure since the onset of US tariff woes; INR close to fair valuation or long term average in REER terms





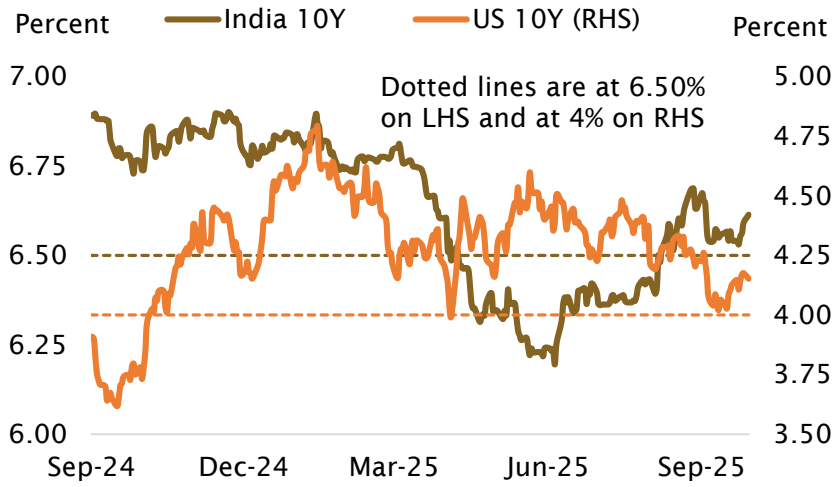
FPI equity outflows have continued unabated since Jul; RBI sold USD in spot market for second straight month in Jul

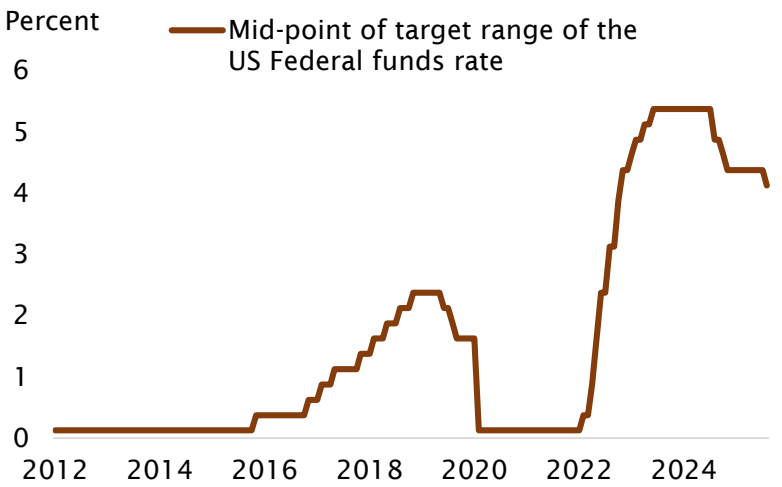




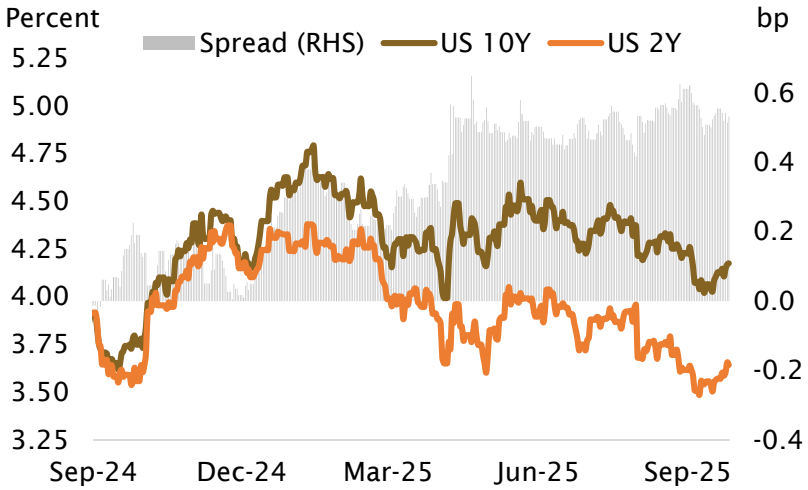
Latest Fed dot plot shows possibility of two more rate cuts by end-2025, even as some FOMC members indicated no change

US-India 10Y spread widened since last MPC meet in Aug; the Fed cut policy rate range by 25bps to 4.00%-4.25% in Sep





US yields rose despite Fed rate cut due to cautious policy tone; latest dot plot shows two more cuts likely by end-2025

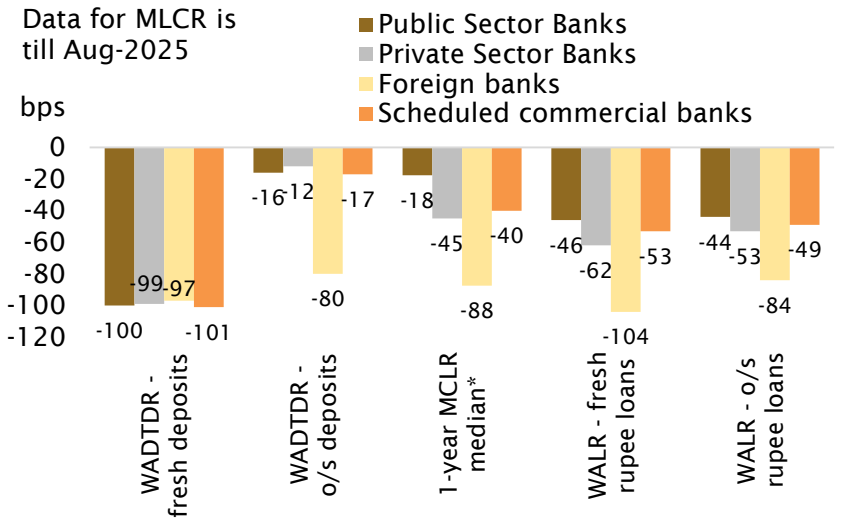


Dot plot for median mid-point of target range of Federal funds rate for 2025 →

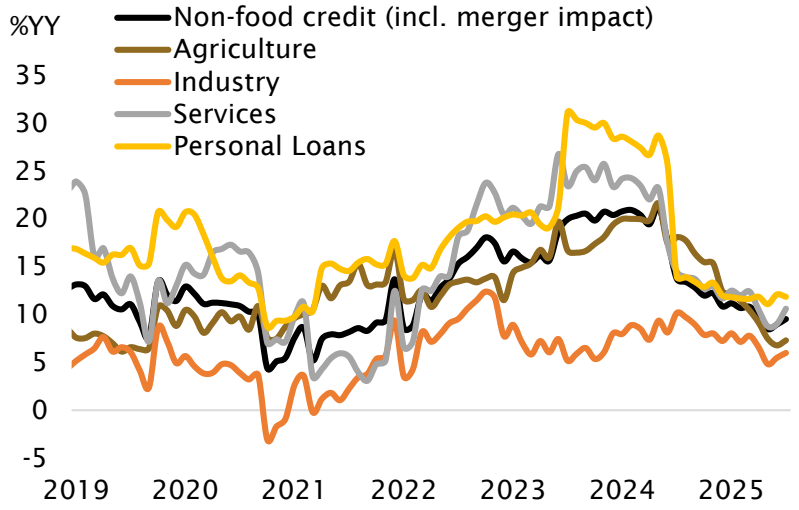
Percent	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
4.50					
		•	••••	•••••••	•
4.25					
	•	•••	••••	••	••••••
4.00					
	•	••••••••••	•••••••••	••••••••	••
3.75					
	•••	•••	••	••	•••••••••
3.50					
	••••••	•			
3.25					
	••••••	•			
3.00					
	••				•
2.75					

Transmission of RBI policy rate cuts progressing well; credit growth improved in June-July

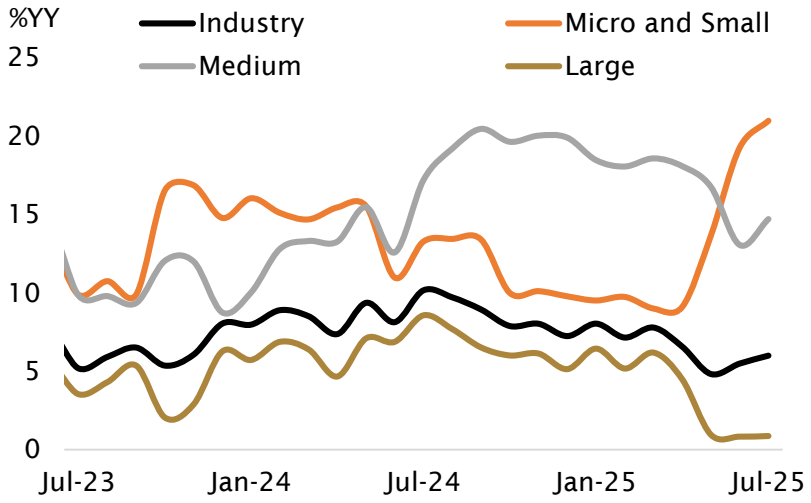
Transmission of 100bps cut since Feb-2025 till July

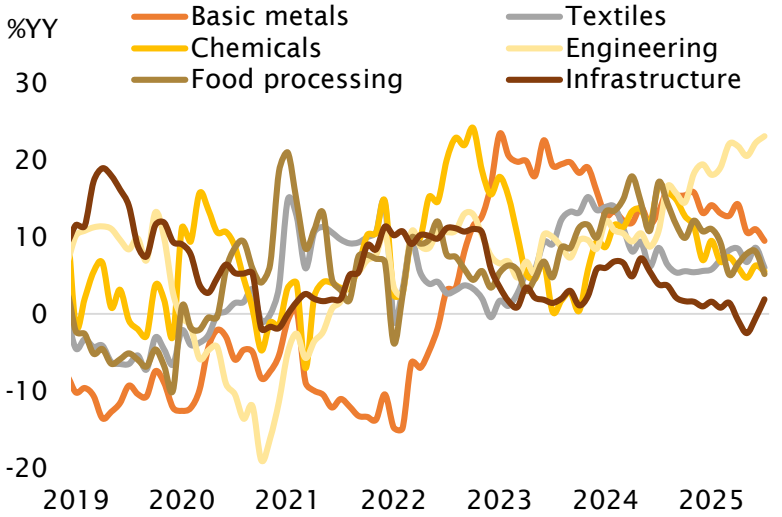


Non-food credit growth improved in June-July



Credit to micro and small firms have surged; credit to infrastructure rebounded in July after declining for three months





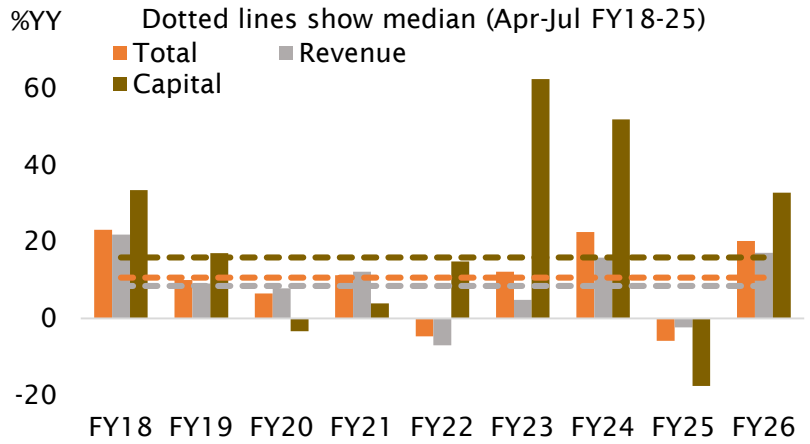
Fiscal deficit at 30% of FY26 BE in Apr-Jul FY26 vs. 18% of FY25 RE in Apr-Jul FY25

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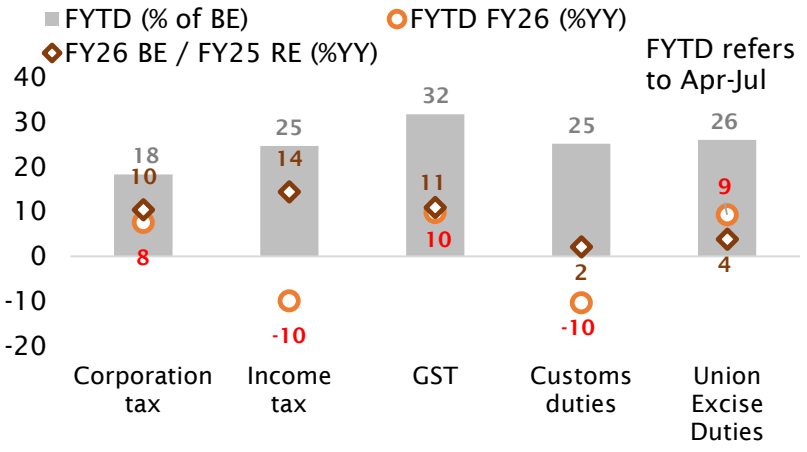
Pace of revenue and capital spend higher than in Apr-Jul FY25; revenue receipts lagging mainly due to fall in direct tax receipts

	(Rs. bn)	FYTD (Rs. bn)		FYTD (%YY)		FY26BE		FY25RE		FY26BE	
	Jul-25	Jul-25	Jul-24	Jul-25	Jul-24	Rs. bn	(% of BE)	Rs. bn	(% of RE)	Current run rate	Required run rate
Revenue receipts	1,520	10,654	10,170	5	34	34,204	31	30,880	33	2,664	2,944
Gross tax revenue	2,239	10,929	10,842	1	21	42,702	26	38,535	28	2,732	3,972
Net tax revenue	1,215	6,618	7,152	(7)	23	28,374	23	25,570	28	1,655	2,719
Direct taxes	1,006	5,736	5,984	(4)	36	25,250	23	22,420	27	1,434	2,439
Indirect taxes	1,229	5,182	4,849	7	7	17,401	30	16,070	30	1,295	1,527
Assignment to states	1,016	4,285	3,666	17	18	14,224	30	12,869	28	1,071	1,242
Non-tax revenues	305	4,036	3,018	34	69	5,830	69	5,310	57	1,009	224
Non-debt capital receipts	18	298	64	366	(53)	760	39	590	11	74	58
Total receipts	1,538	10,952	10,234	7	32	34,964	31	31,470	33	2,738	3,002
Total expenditure	3,415	15,636	13,004	20	(6)	50,653	31	47,165	28	3,909	4,377
Revenue expenditure	2,697	12,167	10,391	17	(2)	39,443	31	36,981	28	3,042	3,409
Capital expenditure	718	3,469	2,613	33	(18)	11,211	31	10,184	26	867	968
Fiscal deficit	1,877	4,684	2,769	69	(54)	15,689	30	15,695	18	1,171	1,376
Primary deficit	1,270	217	(509)	(143)	(117)	2,926	7	4,316	(12)	54	339
Revenue deficit	1,177	1,513	221	585	(93)	5,238	29	6,101	4	378	466

Healthy capex growth at the Centre in Apr-Jul FY26



Income tax collections were down year-on-year till Jul



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