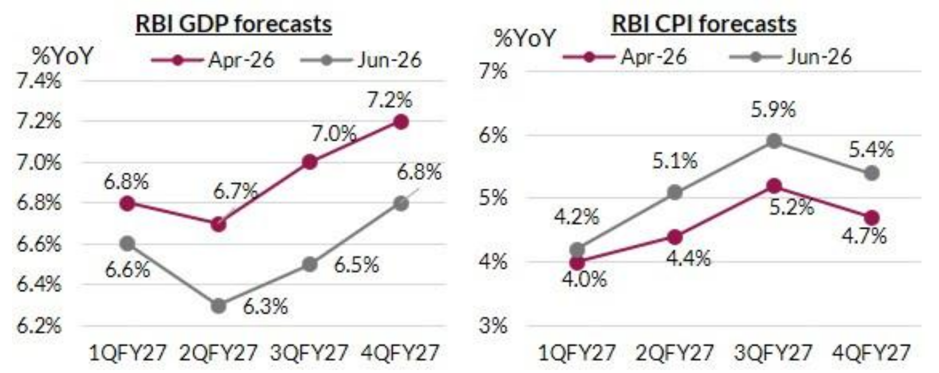
Economic Research | India

A policy pause, but a push to fortify the external front

The RBI kept rates unchanged at 5.25% with a neutral stance, adopting a "wait-and-watch" approach as growth forecasts were lowered to 6.6% and inflation raised to 5.1%. Near-term activity remains resilient, and while risks are building, we believe the sense of foreboding in markets is misplaced. The RBI also unveiled measures to boost capital inflows: eased FPI limits, incentivized ECBs & FCNR(B) deposits, and normalizing export timelines. Tax changes announced by the government may further support bond index inclusion. These are better measures than rates to stabilize the INR, in our view. If the Strait of Hormuz does not open in a few months, the case for a rate hike would build up.

05 Jun 2026
Monetary Policy
June MPC

Exhibit 1- Growth forecasts lowered, and inflation forecasts raised



Source: RBI, Axis Bank Research

RBI keeps the rate unchanged, in 'wait and watch' mode

The MPC held the repo rate unchanged at 5.25% and kept the stance neutral, reflecting the cut in growth projections (Fig 2: FY27 growth projected at 6.6% vs. 6.9% earlier). The growth in 1Q has remained robust so far as visible in the high-frequency indicators and thus the cuts are concentrated in the remaining three quarters. In addition, the RBI has increased inflation projections to 5.1% vs. 4.6% earlier (Fig 3). A notable change in the Governor's statement was that they will provide 'appropriate' liquidity vs. earlier statements emphasizing provision of 'sufficient' liquidity.

Measures to boost capital inflows and support balance of payment

The RBI took several steps to attract foreign capital: it expanded foreign access to long-tenor government bonds and eased FPI investment limits. Overseas equity participation norms were liberalised for NRIs and other non-residents. To bolster dollar liquidity, the central bank introduced concessional forex swaps for PSU ECBs (till 30th Sep-26) and a similar facility for bearing the full hedging costs for raising fresh 3-5 year FCNR(B) deposits. Additionally, export realisation timelines were normalised back to nine months. We expect these steps would lead to capital inflows of at least $40bn in the next one year.

Boost to benchmark index inclusion possibility and the rates outlook

The Govt. has also brought Income Tax amendment ordinance that seeks to exempt foreign investors on income earned from certain government bonds: we believe this can accelerate bod index inclusion and boost FPI inflows a (link). Despite all measures announced today, the risk that this window proves temporary remains. However, we believe the large FX interventions needed over the past three quarters were largely due to excessive hedging by importers and limited hedging by exporters. Stemming this panic will by itself stabilize flows. That said, if the Strait remains closed for longer than a few months, inflationary pressures globally can build up. The 3-month OIS is pricing in 86% chance of a hike in the Aug MPC.

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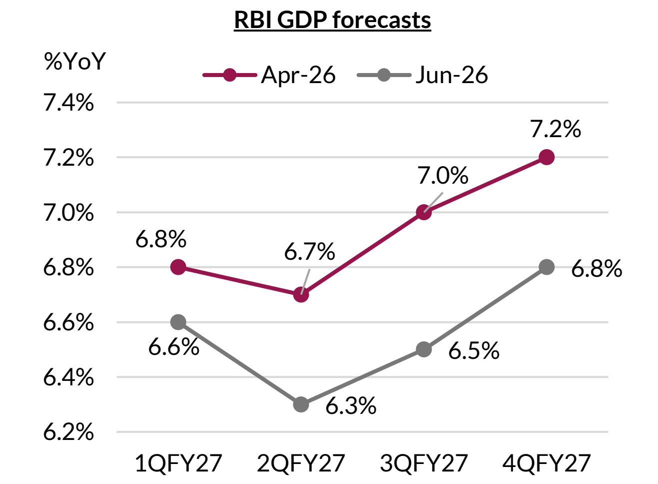
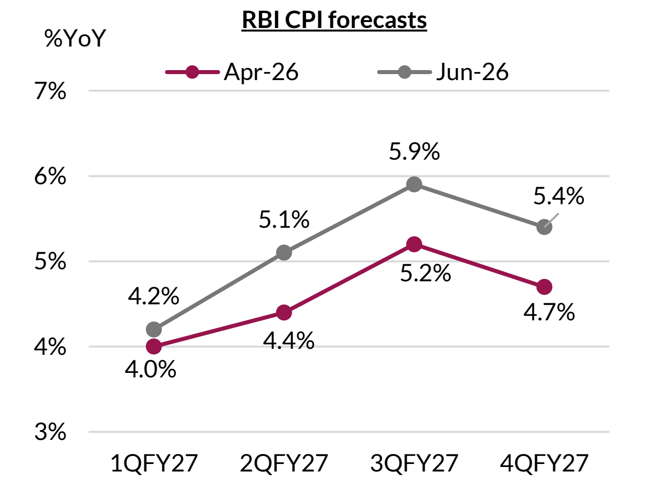
Exhibit 2 – FY27 growth forecasts lowered by 30 bps



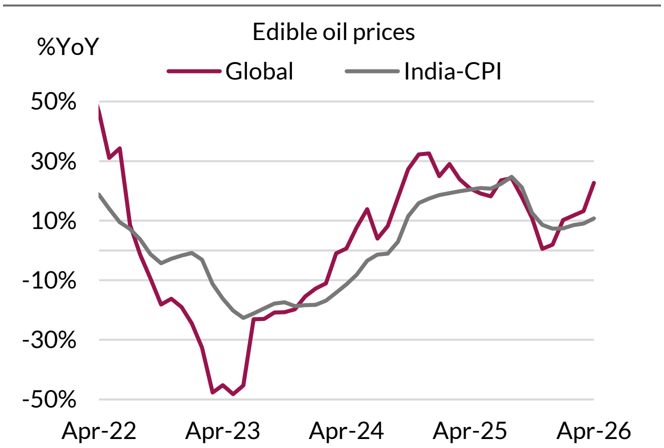
Source: RBI, Axis Bank Research

Exhibit 3 – FY27 inflation forecasts raised by 50 bps



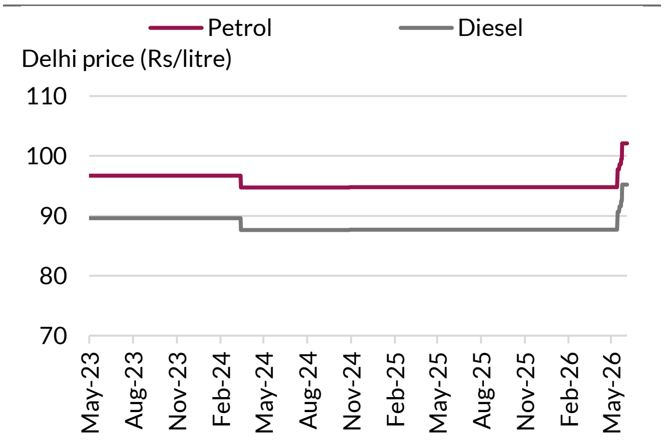
Source: RBI, Axis Bank Research

Exhibit 4 – Edible oil prices are likely to face upward pressure



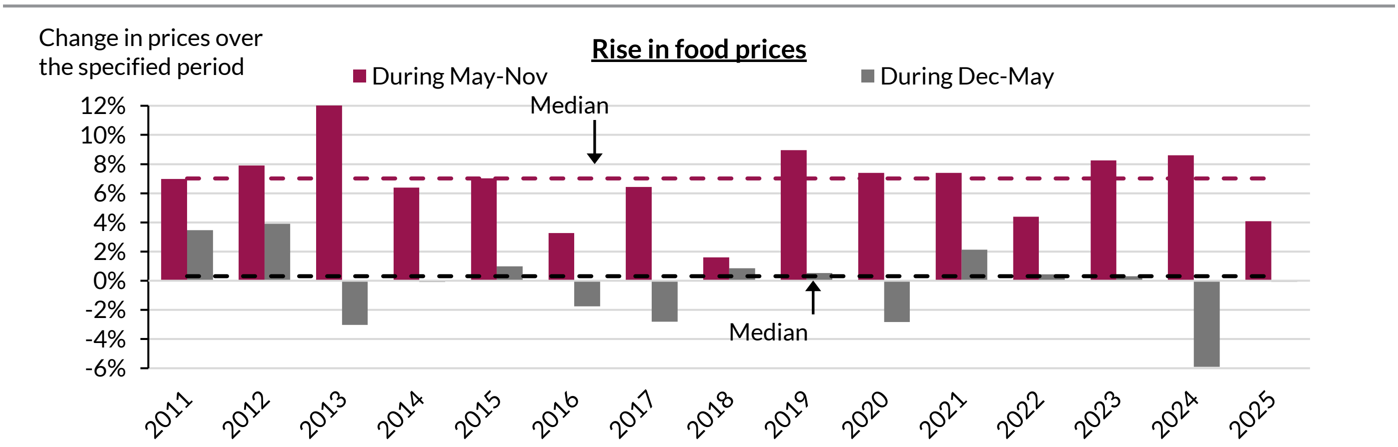
Source: FAO, MoSPI, Axis Bank Research

Exhibit 5 – Fuel hikes (we expect more to come) are expected to add 60bps to inflation



Source: CEIC, Axis Bank Research

Exhibit 6 - Food inflation to rise going forward, supply side shocks key



Source: MoSPI, Axis Bank Research

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