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RBI MONETARY POLICY

JUNE 2026

HIGHLIGHTS

MPC indicates hikes ahead, but measures blunt market impact

- **MPC's Second bi-monthly Monetary Policy Review: 2026-27**
  The MPC unanimously kept policy rates unchanged, maintaining a neutral stance. Inflation expectations were revised upward while growth projections were trimmed, with stronger emphasis on risks of higher inflation. The committee indicated that it is awaiting greater clarity and continues to monitor supply-side pressures, with current inflation expectations suggesting that rate hikes may lie ahead.

  Separately, the language suggests some tightening of liquidity, while measures taken to support the INR have helped moderate longer-term rate expectations.

- **Policy Actions**
  - Repo rate unchanged at 5.25%.
  - Consequently, SDF is at 5.00% and MSF is at 5.50%.

- **RBI & GOI actions:**
  - FAR universe expanded
  - Capital gains and interest taxes exempted for FPIs
  - Full hedge cost absorption for FCNR deposits
  - Concessional ECB swaps for PSUs

GROWTH-INFLATION DYNAMICS

- Inflation projections for FY27 have been revised upward to 5.1% (previous 4.6%), with the fan chart indicating upside risks. Our view remains that inflation could cool off in FY28, supported by relatively low underlying inflation; however, this outlook is subject to risks from stronger nominal growth and potential second-round inflationary effects.

  Beyond global commodity pressures, factors such as El Niño and a weak monsoon could drive inflation higher, although ample food stocks and healthy reservoir levels may provide a partial offset.

- India's FY27 GDP growth projections have been revised downward to 6.6% (previous 6.9%), with downside risks stemming from global developments and weather-related uncertainties. However, fiscal expansion through higher subsidies, along with potential support from weaker tax collections, is expected to partly offset these risks.

LIQUIDITY AND EXTERNAL SECTOR

- There was a notable shift in language around liquidity, moving from providing “sufficient” to “appropriate” levels of liquidity, likely alluding to research published in April. This suggests some degree of tightening, largely through reduced OMO purchases and a widening premium of long-term paper over policy rates.

- Multiple measures have been undertaken to support the INR, as outlined earlier. Changes in FPI taxation could potentially enable inclusion in the Bloomberg Global Aggregate Index, which may attract ~USD 50 billion of inflows over the next two years. In addition, swap facilities could add ~USD 60 billion to reserves, strengthening the INR defence buffer, although this would create future obligations that will need to be managed over time.

POLICY STANCE AND GUIDANCE

- **The policy stance has been maintained at neutral; however, the language suggests a tilt towards future rate hikes, with the possibility of a rate cut in the near term appearing very remote.**

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
February 7, 2025	• Introduction of Additional Factor of Authentication (AFA) for domestic digital payments and proposed to extend AFA to online international digital payments made to offshore merchants. • Proposed to include forward contracts in Government securities to facilitate long-term investors such as insurance funds to manage their interest rate risk across interest rate cycles. • Expand the access of NDS-OM for secondary market transactions in government securities, to non-bank brokers registered with SEBI. • Set-up working group to review of trading and settlement timings across various market segments, report to be submitted by 30th April of this year.
April 9, 2025	• Proposed to enable securitisation of stressed assets through market-based mechanism, in addition to the existing ARC route under the SARFAESI Act, 2002. • Co-lending arrangements are restricted to only priority sector loans by banks and NBFCs to be extended to all regulated entities for all loans. • RBI will introduce standardised guidelines for loans backed by gold jewellery and ornaments across all Res. • New norms will consolidate rules for non-fund based facilities like guarantees, letters of credit, and co-acceptances. • UPI Transaction limits to be made flexible by the NCPI in consultation with stakeholders. • RBI plans to shift the Regulatory Sandbox to an open-ended, theme-neutral format.
August 6, 2025	• Standardisation of procedure for settlement of claims in respect of deposit accounts of deceased customers of banks. • Introduction of Auto-bidding facilities in RBI Retail Direct for Investment and Re-investment in T-bills.
October 1, 2025	• Implementing the Expected Credit Loss framework and revised Basel III norms from April 2027 with glide path till 2031. • Enabling banks to finance corporate acquisitions and expand lending against shares/IPO financing • Easing infrastructure financing norms for NBFCs; considering new licences for urban co-operative banks; rationalising FEMA and ECB rules • Enhancing the consumer protection framework through an expanded Ombudsman scheme and digital banking access for basic accounts • RBI outlined steps to advance internationalisation of the rupee. • RBI proposes to publish a discussion paper on licensing of Urban Co-operative Banks (UCBs). • RBI proposes reforms in insurance premiums and lending limits

KEY MEASURES ANNOUNCED BY THE RBI

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Date	Measures Announced
February 6, 2026	• RBI to issue three draft guidelines on mis-selling, loan recovery and recovery agents, and limiting customer liability in unauthorised electronic banking transactions. Proposal to introduce a compensation framework up to ₹25,000 for customers affected by small-value fraudulent transactions. • Collateral-free loan limit for MSMEs proposed to be enhanced from ₹10 lakh to ₹20 lakh. • To support real estate financing, proposal to allow banks to lend to REITs with prudential safeguards. • Proposals for UCBs include higher financial limits on unsecured loans and loans to nominal members, and removal of tenor and moratorium requirements for housing loans by Tier III and Tier IV UCBs. • NBFCs with no public funds and no customer interface, and with asset size ≤ ₹1000 crore, proposed to be exempted from registration. • Proposal to remove the ₹2.5 lakh crore cap on investments via the Voluntary Retention Route (VRR); investments will instead follow category-wise ceilings under the General Route. • RBI proposes to issue regulatory frameworks for derivatives on corporate bond indices and total return swaps on corporate bonds. • Draft revised guidelines to be issued for Authorised Dealer banks and stand-alone primary dealers, providing greater flexibility in foreign exchange transactions.
April 8, 2026	• Proposed to remove the condition regarding NPA provisioning for inclusion of quarterly profits in CRAR computation. • Enhancing the borrowing limit of SPDs in the term money market to non-bank entities
June 5, 2026	• Expanded the universe of securities eligible under the Fully Accessible Route (FAR) to include all new issuances of 15-year, 30-year and 40-year government securities. • exempted FPIs from income tax on interest income and capital gains arising from investments in government securities, effective April 1, 2026. • Facility of concessional forex swap will be provided till 30th September 2026 to incentivize ECBs by PSUs • Facility for bearing the full hedging cost shall be provided till 30th September 2026 to AD banks for raising fresh 3–5-year FCNR (B) deposits. • Proposed to restore the time for realisation of export proceeds to nine months.

IMPACT ON THE MUTUAL FUND INDUSTRY:

- **Liquid Funds**:

  These schemes will continue to generate returns around the operating rate due to their portfolio composition i.e. being invested at the shorter end of the money market segment. Liquid funds have low average maturity as they concentrate more on high quality papers including CPs, CDs and other debt securities with residual maturity of up to 3 months.

- **Ultra Short Term / Low Duration / Money Market Funds (Maturity Up to 1 Year):**

  These schemes predominantly invest in below 1 year maturity paper. The strategy adopted by these schemes is to hold the paper till maturity and capitalize on the running yield. Hence, returns in this category will continue to remain relatively attractive depending on the positioning of the fund.

- **Short Duration Funds**:

  Schemes in this category are predominantly invested in Corporate Bonds, CPs and CDs while a few of them also have some exposure to G-Secs. We continue to remain bullish at the shorter end of the curve. Investors may consider these funds (with an investment horizon commensurate with the maturity profile of such funds) and gain from current accruals and capital appreciation in the event of a fall in yields.

- **Medium Duration:**

  Given the flattened yield curve there are sufficient buffers in the intermediate duration (3-6 years) segment. Till the time RBI is anchoring the long end of the yield curve, the current yield curve may provide some cushion even if there are mark-to-market losses. Investors may consider those funds with high quality portfolios and where the investment horizon is commensurate with the maturity profile of the funds and also gain from current accruals and capital appreciation in the event of a fall in yields.

IMPACT ON THE MUTUAL FUND INDUSTRY:

- **Credit Risk Funds:**

  We remain cautious on Credit Risk Funds as they have failed to prove their mettle in the last 2-3 years with the overhang of defaults and erosions of NAV on the back of mark-to-market impacts due to the aforementioned. The uncertainty around credit funds which are in an open ended avatar continues to pose risks to investors. Much also depends on the liquidity conditions in the market and redemption pressure on these funds. Thus, we think there is a systemic risk in the market within the credit space. Hence, it makes sense for one to stay away from these funds.

- **Long Term Income Funds / Gilt Funds / Dynamic Bond Funds**:

  India's debt mutual fund market is navigating a volatile phase, with geopolitical tensions in West Asia, elevated crude oil prices, rupee weakness, and tightening domestic liquidity conditions reshaping the fixed income outlook. The initial oil shock has evolved into broader concerns around inflation persistence, currency stability, and the RBI's policy response, pushing yields higher as markets price in a potential externally driven inflation cycle.

  Fixed income yields remained elevated in May 2026 amid uncertainty around the West Asia conflict and its impact on inflation and the external account, with markets aggressively pricing multiple rate hikes. However, the oil shock appears manageable rather than systemic. The RBI's June stance of "pause with vigilance" indicates a wait-and-watch approach until there is clearer visibility on monsoon trends, crude prices, growth momentum, and geopolitical risks.

  Domestic liquidity remains tight, with elevated credit-deposit ratios limiting SLR demand and increasing reliance on CDs and bulk deposits, thereby pressuring yields. Corporate bond and CP issuances are muted as bank lending rates remain more attractive. On the external front, weaker dollar inflows have led to rupee depreciation, with stability dependent on easing geopolitical tensions or improved capital inflows. Fiscal pressures are also rising as the government absorbs part of the cost shock through subsidies, increasing the risk of slippage.

  Despite these challenges, the rise in yields appears more cyclical than structural, supported by softer core inflation, stronger balance sheets, and a credible policy

IMPACT ON THE MUTUAL FUND INDUSTRY:

framework. Markets appear to be pricing an aggressive tightening cycle ahead of the RBI, even as policymakers retain multiple tools to manage volatility, reducing the likelihood of sharp rate actions. The yield curve reflects this divergence, with the front-end repricing sharply while the long end remains relatively stable, suggesting continued confidence in medium-term macro stability.

Globally, elevated inflation and high government borrowing have priced out Fed rate cuts, making long-duration bonds vulnerable, while shorter-duration assets remain attractive due to higher carry. In India, yields have risen across segments, with a steepening curve driven by strong credit demand and elevated government borrowing, leading to a tight demand–supply environment.

Policy normalization is expected to be gradual, with much of the uncertainty already priced into yields, offering a potential entry point for debt investors. Any easing in geopolitical tensions and moderation in crude prices could drive a faster correction in yields, improving inflation, external balances, and currency stability, with opportunities emerging in the intermediate segment, as rate hike fears begin to recede.

From an investment perspective, caution remains key. Lower duration and high-quality credit in the 1–3 year segment offer better risk–reward, with accrual strategies preferred. While near-term risks persist, the medium- to long-term outlook remains constructive. Returns are likely to be driven more by carry, with the 10-year yield expected in the 6.85%–7.10% range, and limited appetite for lower-quality credit.

The 10-year Indian benchmark bond yield fell ~6 bps from the previous close at 7.01%% (at the time of writing the note) while from previous policy it is up by ~3 bps.

- **Conservative Hybrid Funds *(Erstwhile: Monthly Income Plans (MIPs)*:**

  With a 10% to 25% allocation to equity, returns of CHFs are largely determined by the vagaries of the equity markets as against the debt markets. These funds are therefore suitable for investors who have a reasonably long-time horizon & are comfortable with taking exposure to equities.

OUTLOOK

- While tighter domestic liquidity may point to wider term premia for G-secs, this is likely to be partly offset by index inclusion-related flows as well as improved deposit mobilization via the FCNR route, reducing pressure on banks to sell government securities. Overall, this may remain modestly supportive for G-secs in the near term but does not alter the longer-term convergence toward a fair value slightly above 7%.

- Axis Bank economist expect further INR depreciation, although this is likely to be gradual and orderly rather than sharp. Additionally, there is potential for policy rates to be raised toward neutral levels in line with global conditions, accelerated by higher medium-term inflation, which could imply 50–75 bps of rate hikes. While supportive measures may delay the expansion of the 10-year G-sec term premium in the near term, any resultant inflows are likely to be utilized primarily for rebuilding FX reserves and closing RBI's short positions.

- We remain constructive on the shorter end of the yield curve. **Short Duration funds, Banking & PSU Debt funds, Corporate Bond funds, Medium Duration funds, Money Market funds, Low Duration funds and Ultra Short Duration funds** can be considered by investors with an investment horizon commensurate with the maturity profile of the schemes. Investors can consider investing tactically in **Medium to Long** end of the yield curve as per their risk appetite with an investment horizon of at least 2-3 years to avoid any intermittent volatility.

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