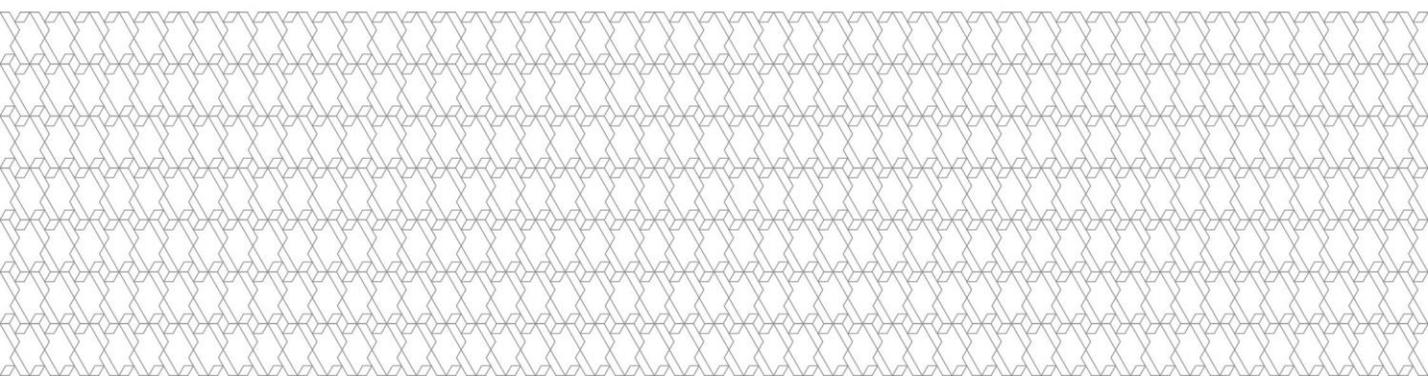




Burgundy

Wealth Management | Axis Bank

RBI MONETARY POLICY
FEBRUARY 2026



HIGHLIGHTS

Fluid macro developments persuades MPC to stay put

- **MPC's Sixth bi-monthly Monetary Policy Review: 2025-26**

The MPC voted unanimously (6–0) to keep policy rates unchanged and maintained its neutral monetary policy stance, with only one member in favour of shifting to an accommodative stance. H1FY27 growth projections were revised up by 20 bps, supported by recent trade agreements that are expected to enhance India's export coverage. Inflation projections were also raised following further increase in prices of gold, though underlying inflation rightly continued to be seen as muted. We note that prices of vegetables currently are only mildly above those last year, despite the latter being unusually low. Future decisions are to be based on new inflation and GDP series. Ease-of-doing-business measures aimed at improving credit access, institutional expansion, and better market discovery.
- **Policy Actions**

Repo rate unchanged at 5.25%.
Consequently, SDF is at 5.00% and MSF is at 5.50%.

GROWTH-INFLATION DYNAMICS

- Underlying inflation remains subdued, as reflected across several filtered core indicators, with trends appearing even softer after the recent GST reductions. However, inflation projections have been revised up by 10–20 bps due to the continued rise in gold and silver prices. Greater clarity on current inflation dynamics is expected once the new CPI series is released later this month. Notably, Axis Bank's inflation forecasts remain higher than those of the RBI.
- GDP growth has been revised upward for H1FY27, supported by strong momentum across a broad set of high-frequency indicators. Healthy crop output and improving rural consumption, a recovery in urban demand, stronger performance in trade and transportation reflecting value-chain improvements, elevated capacity utilisation, and robust credit growth all point to a resilient growth backdrop. Despite this, Axis Bank's growth projection remains higher, at 7.5% for FY27.

LIQUIDITY AND EXTERNAL SECTOR

- The Governor's statement noted transmission of 125 bps repo rate cuts: a 105 bps fall in rates on fresh loans and 94 bps on fresh deposits, but also liquidity conditions had tightened in January. This is a major concern, in our view, with 3M and 12M CD-OIS spreads well over 1.5pp. The resultant rise in bank funding costs has pushed up rates on deposits in the last 2 months, as well as future rate expectations. Continued volatility in and rise in government balances have contributed, and recent liquidity actions have not been fully successful, with mutual funds preparing to hold cash at rates 100 bps below repo over assets. With a large ~INR 3tn RBI dividend expected in April, the RBI may be cautious in intervening aggressively but might need to.

- We continue to see the external sector constrained by capital outflows as strong domestic demand for financial and physical assets allows foreign holders to exit. Indians are also seen buying assets overseas. While FX reserves are boosted by gold valuation and forward shorts, the drain through intervention continues, ostensibly to smooth long-term depreciation currently in progress.

POLICY STANCE AND GUIDANCE

- **The policy stance was of waiting to see signals in new growth and inflation series. Meanwhile, non-monetary steps to ease credit conditions – EODB – remain in progress.**

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
December 6, 2024	<ul style="list-style-type: none"> Expanding the reach of FX-Retail Platform through Linkages with Bharat Connect platform of NPCI. Proposes to introduce a new benchmark - the Secured Overnight Rupee Rate (SORR) - based on all secured money market transactions – overnight market repo as well as TREPS. To increase the limit for collateral-free agriculture loans from ₹1.6 lakh to ₹2 lakh per borrower. to permit Small Finance Banks also to extend pre-sanctioned credit lines through the UPI. Experts committee to set up a Framework for Responsible and Ethical Enablement of AI (FREE-AI) in the financial sector.
February 7, 2025	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
October 1, 2025	<ul style="list-style-type: none"> • 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
December 5, 2025	<ul style="list-style-type: none"> • The RBI will conduct a two-month campaign from January next year to address grievances pending for more than a month with the RBI Ombudsman.
February 6, 2026	<ul style="list-style-type: none"> • 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.

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 market enters 2026 with a stable but cautious undertone as the RBI kept the repo rate unchanged at 5.25% and maintained a neutral stance, balancing resilient domestic growth against global uncertainties. The upward revision in growth projections, combined with inflation holding near target, reinforces macro stability. Additional measures, including expanded MSME collateral-free lending, digital fraud compensation norms, NBFC and UCB relaxations, and removal of investment caps under the voluntary retention route—further strengthen the financial ecosystem. Despite heightened geopolitical tensions, India remains well positioned, supported by strong growth, low inflation, and improving trade prospects, including the EU deal and the potential US agreement.

While no OMOs were announced, the RBI emphasized proactive and pre-emptive liquidity management to ensure adequate system liquidity and smooth policy transmission. However, fiscal dynamics remain challenging. The Centre has continued to pursue consolidation with a fiscal deficit target of 4.3% for FY27, even as the fiscal anchor shifts from deficit-to-GDP to debt-to-GDP. The rise in government securities supply—₹17.2 trillion in FY27, an 18% increase—coupled with weaker investment demand, has deepened the supply-demand mismatch, increasing reliance on RBI for absorption.

IMPACT ON THE MUTUAL FUND INDUSTRY:

Globally, monetary policy in 2026 is expected to remain less supportive. Constraints on aggressive Fed easing, Japan's policy normalization, and broader uncertainty keep global risk-free rates firm. Against this backdrop, India's neutral stance provides flexibility, but meaningful rate cuts appear unlikely. The steep yield curve reflects muted long-end demand, changes in taxation, lower SLR purchases, and waning foreign inflows. Even with the RBI's liquidity support through late 2025 and early 2026, yields remain sticky due to currency pressures and weaker structural demand.

The 2026 fixed-income outlook thus builds on a volatile 2025 marked by tariff shocks, strong growth despite low inflation, 125 bps of prior RBI rate cuts, and geopolitical uncertainty. While global growth remains resilient, the scope for domestic monetary easing is limited. Elevated borrowing numbers and the absence of targeted measures to boost bond demand imply persistent upward pressure on yields. Near-term market behaviour will therefore hinge significantly on RBI liquidity operations, which remain crucial to stabilizing longer-end rates.

Overall, India's macro fundamentals remain solid, supporting medium-term resilience. The bond market is expected to consolidate with a lower-for-longer rate environment, making carry-focused strategies attractive. The 10-year yield is likely to trade in a 6.00%–6.70% range, while the 1–5-year segment offers superior risk-reward. Accrual-based positioning remains prudent, complemented by selective duration calls on the long end depending on risk appetite, inflation trends, fiscal signals, and global conditions.

The 10-year Indian benchmark bond yield fell ~7 bps from the previous close to 6.74% (at the time of writing the note) while from previous police it is up by ~25 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

- We see monetary policy effectively at an end, looking at a long pause ahead – as flagged by our higher inflation and growth forecasts, as well as inability of domestic assets to attract adequate global savings translating to a shock in imported inflation – over and above higher global commodity prices.
- However, steps to better manage liquidity and credit conditions are a net positive, while return of bank demand (LCR now at margin) and heavy OMOs ahead (intervention and currency demand outflows) effectively bring G-sec yields lower.
- We remain constructive on the short to medium 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 in **Medium Duration** as per their risk appetite with an investment horizon of at least 2-3 years to avoid any intermittent volatility.

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