

RBI Monetary Policy Review

5 December 2025



Season's Greetings: A Dovish Cut - We see room for liquidity infusion & additional rate cut in 1H CY26

MPC delivers a dovish cut while taking a 'policy-by-policy' approach: The MPC in a unanimous vote decided to reduce the Repo Rate by 25bps to 5.25% while maintaining a neutral stance. We see today's policy decision as a dovish cut with the expectation of incremental policy easing being data dependent. We think the factors will play out positively for the RBI-MPC to reduce the Repo rate by another 25bps in 1H CY26 while in the meantime we think RBI might step up the liquidity measures, esp. in Q4FY26.

The MPC's policy rate outcome including the policy stance and policy undertone is in line with our expectation including the announcement of OMO Purchases. However, the surprise was the quantum, the timing of OMO Purchases as well as the three-year FX Buy/Sell Swap which would be conducted this month itself. On policy stance, while there is no voting, interestingly, one external member of the six panel members opined to change the policy stance to accommodative from neutral earlier.

The growth-inflation dynamics in the current global backdrop and the external headwinds to domestic growth have shaped the monetary policy outlook and policy tone. With India's retail inflation surprising positively, month after month, so far in FY26 and with inflation forecasted to hover at the lower bound of the Flexible Inflation Targeting (FIT) framework of 2.0% and hover near the medium-term target of 4.0% in 1HFY27 provides the policy space to reduce rates. Having said that, incoming data holds key to next set of actions. The long pending US-India trade deal and the economic growth momentum from Q4FY26 onwards would be closely watched.

Growth-inflation outlook: The sharp downward inflation revision in the Aug-Dec MPC policies reflect the rationale behind the changed policy tone, especially when compared to the Jun/Aug policies. While the near-term growth forecast has been upped, the same for GDP is forecasted to average to ~6.80% in 1H FY27, lower than the 8.0% growth we have seen for 1HFY26; at the Presser, while the Deputy Governor did cite that the base effects would be at play, softening the growth rate, to which the Governor added that the tariff-hit export sectors such as textiles, gems & jewellery, shrimps would possibly register weaker growth as well. Overall, the MPC has revised its forward-looking inflation forecasts lower (4% for Q2FY27, of which 0.50% can be attributed to precious metals) and that on growth still at sub 7% for H1 FY27. This, in our view, provides the wiggle room to the RBI MPC with policy easing, underpinned by liquidity infusion measures (also, largely to offset the liquidity drain caused by RBI's recent FX intervention).

Table 1: MPC's growth and inflation forecasts laid out below:

	Growth Forecast				Inflation Forecast			
Period	Aug-25	Oct-25	Dec-25	Revision	Aug-25	Oct-25	Dec-25	Revision
Q1 FY2026	6.50%	7.80%	7.80%	-	2.70%	2.70%	2.70%	-
Q2 FY2026*	6.70%	7.00%	8.20%	1.20%	2.10%	1.80%	1.70%	-0.10%
Q3 FY2026	6.60%	6.40%	7.00%	0.60%	3.10%	1.80%	0.60%	-1.20%
Q4 FY2026	6.30%	6.20%	6.50%	0.30%	4.40%	4.00%	2.90%	-1.10%
FY2026	6.50%	6.80%	7.30%	0.50%	3.10%	2.60%	2.00%	-0.60%
Q1FY27	6.60%	6.40%	6.70%	0.30%	4.90%	4.50%	3.90%	-0.60%
Q2FY27		-	6.80%	-		-	4.00%	-

Source: RBI MPC Policy Resolutions, Revision over last policy
 Note: *Provisional GDP data released in Nov'25

Liquidity: We have been speaking of the need to infuse durable liquidity which faced pressures from heightened FX intervention in the last couple of months and increased demand for cash. The RBI Governor in his speech stated, “While the objective of purchase (sale) under OMO is to provide (absorb) durable liquidity, the purpose of repo operations is to manage transient liquidity so as to align the operating target – the Weighted Average Call Rate (WACR) – to the policy repo rate. So, it is quite possible that we inject durable liquidity through purchase of government securities under OMO on the one hand while simultaneously withdrawing transient liquidity through a VRRR operation on the other hand.” At the Presser, the Governor cited that there will be sufficient system liquidity without setting-out any specific level as it did at the prior policy. On the currency, the Governor reiterated that it does not target any particular level for the currency and that it focuses on managing volatility.

Our Take:

The policy outcome is broadly in-line with our expectations, including our assessment on its growth-inflation outlook as well as a dovish policy undertone, even as it remains data-driven. While the Governor stated that the MPC will take a ‘policy-by-policy’ approach, the two-quarter ahead growth-inflation outlook, and the current ongoing uncertainty around US-India trade deal, leaves a little more wiggle room for monetary policy to remain growth-supportive. We continue to believe that the scope for another rate cut remains alive in 1H CY26, the risk to this view emanates from the base change of key economic indicators especially CPI which will release its first print under a new base from Feb’26 and that for GDP is scheduled to be released from May’26. In the meantime, the rationalization of GST rates, benign food price levels, good monsoon are likely to keep inflation aligned to the medium-term target with near term inflation projected to settle at ~2% near the lower band of the inflation targeting framework. The growth side story too appears a bit somber especially following the obstacles to a favourable trade deal, persisting tariffs and overall, a softer Nominal GDP growth trajectory for FY26. On liquidity, while the last two tranches of CRR cuts did ease banking system liquidity conditions, the base money creation has been weak. The FX intervention exacerbated the drain on system liquidity. While the RBI Governor has announced the OMO Purchases to the tune of INR 1 lakh crore, we expect another INR 1.5 lakh cr of OMOs to come through in the Jan-Mar quarter. This in turn should provide a favorable technical backdrop for softer bond yields.

Market View: All-in-all, today's RBI MPC outcome has come in line with our expectations of RBI easing rates, pushing the paddles on bringing in OMOs to ensure sufficient durable liquidity. Despite the various uncertainties in the lead-up to the policy, we have continued to remain constructive on duration and today's policy further reiterates our conviction. We remain positive on 8-15 year segment in IGBs which should benefit from OMO purchases, while looking at 30-40 yr segment more as a tactical call. We continue to remain underweight on SDLs in duration products given likely higher supply in Q4. We also like the 2-4 year corporate bond space which offers attractive spreads and sufficient liquidity is likely to provide an opportunity here for capturing spread compression. This we believe is a compelling investment opportunity in the current market backdrop.

Abbreviations:

RBI: Reserve Bank of India
MPC: Monetary Policy Committee
SDF: Standing Deposit Facility
MSF: Marginal Standing Facility
CRR: Cash Reserve Ratio
SDL: State Development Loan
OMO: Open Market Operations
GDP: Gross Domestic Product
CPI: Consumer Price Index
G-Sec: Government Securities
EMs: Emerging Markets
FX: Foreign Exchange
IGBs: Indian Government Bonds

Source - RBI MPC Policy Resolutions, HSBC MF Research, Data as on December 5, 2025.

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

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