



ICRA COMMENTS ON RBI'S 3rd BI-MONTHLY MONETARY POLICY MEETING FOR 2025-26

Status quo on policy rates and stance in
August 2025; odds of extended pause
have risen

AUGUST 2025



HIGHLIGHTS



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Contrary to our expectations, the MPC unanimously kept the repo rate unchanged at 5.5% in August 2025.

The FY2026 CPI inflation forecast was pared by a sizeable 60 bps to 3.1%, even as the GDP growth projection was retained at 6.5%.

The 4%-plus CPI projections for Q4 FY2026 and Q1 FY2027 would limit the space for rate cuts, signalling the onset of an extended pause.

After the front-loaded rate cut of 50 bps in June 2025, the Monetary Policy Committee (MPC) unanimously maintained status quo in the August 2025 policy review, keeping the repo rate unchanged at 5.5%, as against ICRA's expectation of a final 25 bps rate cut. Additionally, it expectedly decided to maintain the monetary policy stance at neutral. The decision of a pause is likely to have been guided by the ongoing transmission of the 100-bps rate cut during February-June 2025, looming uptrend in inflation prints as well as tariff-related uncertainty surrounding growth outcomes. The CPI inflation forecast for FY2026 was pared by a sizeable 60 bps to 3.1% (ICRA P: +3.2%), amid softer-than-expected print in Q1 as well as sharp downward revision in the projections for Q2-Q3 FY2026. However, the GDP growth projection for the fiscal was surprisingly maintained at an optimistic 6.5% (ICRA P: +6.0%), despite tariff-related challenges. In ICRA's view, the expected uptrend in the forward-looking inflation trajectory, particularly the 4%-plus prints for Q4 FY2026 and Q1 FY2027, would limit the space for rate cuts in the upcoming policy meetings, thereby signalling the beginning of an extended pause.

- In the third bi-monthly monetary policy for FY2026, the MPC unanimously maintained status quo, keeping the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 5.50% in August 2025, after having cut rates by 100 bps over the previous three policy reviews. Moreover, the standing deposit facility (SDF) rate was held at 5.25%, and the marginal standing facility (MSF) rate and the Bank Rate at 5.75% each. Additionally, it decided to continue with the neutral monetary policy stance.
- The Committee pared its inflation expectation for FY2026 by 60 bps to 3.1% from 3.7% projected earlier in June 2025. Specifically, it reduced the CPI inflation projection for Q2 FY2026 (+2.1% in August 2025 vs. +3.4% in June 2025) and Q3 FY2026 (+3.1% vs. +3.9%) by 80-130 bps. While the projection for Q4 FY2026 was kept unchanged at 4.4%, the Committee expects the inflation to rise further to 4.9% in Q1 FY2027, with risks evenly balanced.
- The Committee expects the domestic private consumption and investment to remain upbeat in FY2026, while external outlook remains clouded by uncertainty regarding trade policies. Overall, it has maintained the annual GDP growth forecast for FY2026 at 6.5%, with Q1 FY2026 at 6.5%, Q2 FY2026 at 6.7%, Q3 FY2026 at 6.6% and Q4 FY2026 at 6.3%, in line with the levels indicated in June 2025. Additionally, it expects GDP growth to print at 6.6% in Q1 FY2027, with risks evenly balanced.
- The MPC emphasised the incomplete transmission of the current policy actions and highlighted the above-4.0% inflation projections for Q4 FY2026 and Q1 FY2027, which we believe signal an extended pause.

Outlook: We had expected that the MPC's August 2025 meeting would either bring a final rate cut, or kick-off the extended pause. With unchanged rates in this meeting, we anticipate that an extended pause is now underway. By the time the data starts showing a slowdown in quarterly GDP growth prints (Q3 print to be released at end-February 2026), inflation will likely have normalised to above 4%. This is likely to constrain further monetary easing, going ahead. Bond yields seem to concur with the expectations of a continued pause, with the 10-year yield having risen after the policy statement. We foresee the 10-year G-sec yield to remain in a range of 6.30-6.45%, unless further monetary easing appears imminent.

The MPC unanimously kept the policy repo rate unchanged at 5.50% in August 2025, citing incomplete transmission; it also maintained the monetary policy stance at neutral.

Going ahead, the Committee expects the CPI inflation to remain benign in the near term, amidst healthy progress of SW Monsoon and kharif sowing, and adequate reservoir levels.

However, inflation is expected to inch up above 4% in Q4 FY2026 and Q1 FY2027, owing to a low base and demand-pull factors, with upside risks emanating from adverse weather shocks.

MPC UNANIMOUSLY KEPT REPO RATE UNCHANGED AT 5.50% IN AUGUST 2025; STANCE MAINTAINED AT NEUTRAL

In its third bi-monthly monetary policy meeting for FY2026, the MPC unanimously decided to keep the policy repo rate under the LAF unchanged at 5.50% (refer Exhibit 1), in contrast to ICRA's expectation of a 25 bps rate cut. This pause comes after cumulative rate cuts of 100 bps seen during February-June 2025. Accordingly, the SDF rate stands unchanged at 5.25%, and the MSF and Bank Rate at 5.75% each. The Committee decided to wait for further transmission of the front-loaded rate cuts to the credit market as well as the broader economy. Furthermore, the MPC resolved to "maintain a close vigil on the incoming data and the evolving domestic growth-inflation dynamics to chart out the appropriate monetary policy path"; accordingly, it unanimously decided to continue with the neutral stance.

MPC's CPI inflation projection for FY2026 pared by 60 bps to 3.1%: The year-on-year (YoY) CPI inflation moderated significantly to a 77-month low of 2.1% in June 2025 from 2.8% in May 2025. This was entirely driven by the unexpected 0.2% deflation in the food and beverages category after a gap of 75 months (+1.5% in May 2025), mainly led by vegetables and pulses. However, the core-CPI inflation (CPI excluding food and beverages, fuel and light, and petrol and diesel indices for vehicles) hardened to a 21-month high of 4.6% in June 2025 from 4.3% in May 2025, owing to a sharp uptick in gold prices (to a 58-month high +36.0% from +32.4%). However, excluding gold, this print was relatively benign at 3.6%.

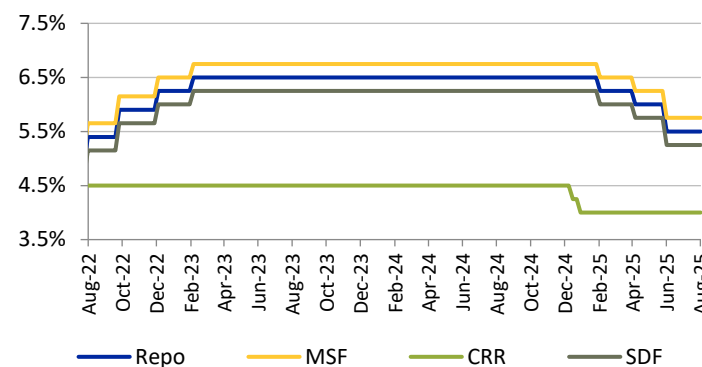
Going ahead, the MPC now expects the CPI inflation trajectory in the near term to be more benign than expected earlier. This is on account of the favourable progress on the Southwest Monsoon, adequate reservoir levels, healthy kharif sowing, and comfortable buffer stocks of foodgrains, as well as a high base. However, the Committee expects the CPI inflation to exceed 4% from Q4 FY2026 onwards, amid unfavourable base effects as well as demand side pressures owing to the policy actions. Core inflation is also likely to remain moderately above 4%, in the absence of any major shocks to input prices. Furthermore, weather-related disruptions continue to pose upside risks to the inflation outlook. Taking these factors into consideration as well as slightly lower-than-expected CPI inflation print in Q1 FY2026 (actual: +2.7% vs. MPC's June 2025 exp.: +2.9%), the Committee tempered its inflation expectation for FY2026 quite sharply by 60 bps to 3.1% from 3.7% projected earlier in June 2025. Notably, it has cut the CPI inflation projections for Q2 FY2026 (+2.1% in August 2025 vs. +3.4% in June 2025) and Q3 FY2026 (+3.1% vs. +3.9%) by a sizeable 80-130 bps. However, the MPC kept the projection for Q4 FY2026 unchanged at 4.4%. Subsequently, it expects inflation to rise to 4.9% in Q1 FY2027, with risks evenly balanced.

ICRA expects the CPI inflation to ease to 3.2% in FY2026 from 4.6% in FY2025, slightly higher than the MPC's revised forecast of 3.1%, albeit with risks tilted to the downside. We broadly concur with the upward quarterly CPI inflation trajectory envisaged by the MPC, including the 4%-plus prints for Q4 FY2026 and Q1 FY2027, barring marginal differences to the tune of 10-20 bps across quarters. ICRA believes that the strong emphasis on the CPI inflation estimates of over 4.0% from Q4 FY2026 onwards would limit the space for rate cuts in the upcoming policy meetings, thereby signalling the beginning of an extended pause. We currently expect the policy rates to remain unchanged in the October 2025 policy review, unless there are large surprises on the growth front, which lead to a material cut in growth projections.

The MPC pared its FY2026 CPI inflation projection to 3.1% in August 2025 from the earlier estimate of 3.7%.

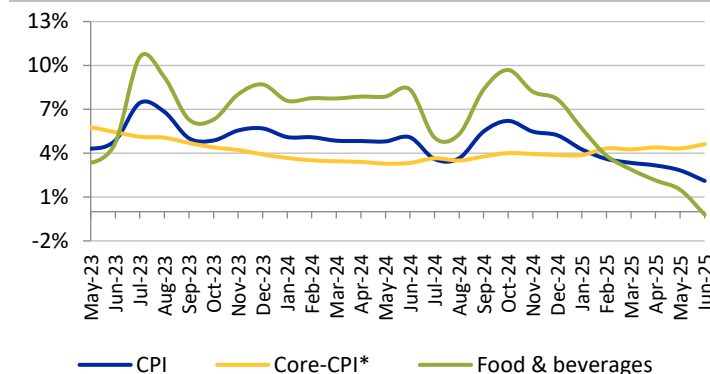
The Committee has revised its inflation projection for Q2-Q3 FY2026 downwards sharply by 80-130 bps, relative to June 2025; the forecast for Q4 has been kept unchanged at 4.4%, while it expects CPI inflation to print at 4.9% in Q1 FY2027.

EXHIBIT 1: Movement in Key Rates



Source: RBI; CEIC; ICRA Research

EXHIBIT 2: CPI Inflation, CPI-food and core-CPI inflation (YoY)



*Due to unavailability of data for March-May 2020, we have not excluded petrol and diesel indices for vehicles in computation of core CPI index for these months;
Source: NSO; CEIC; ICRA Research

EXHIBIT 3: RBI's earlier and current GDP growth and CPI inflation forecasts

| YoY (%) | CPI Inflation | | GDP Growth (at constant 2011-12 prices) | |
|---------------------------|---------------|-------------|---|-------------|
| | June 2025 | August 2025 | June 2025 | August 2025 |
| MPC Policy Reviews | | | | |
| Q1 FY2026 | | | 6.5% | 6.5% |
| Q2 FY2026 | 3.4% | 2.1% | 6.7% | 6.7% |
| Q3 FY2026 | 3.9% | 3.1% | 6.6% | 6.6% |
| Q4 FY2026 | 4.4% | 4.4% | 6.3% | 6.3% |
| FY2026 | 3.7% | 3.1% | 6.5% | 6.5% |
| Q1 FY2027 | | 4.9% | | 6.6% |

Source: RBI; ICRA Research

The Committee noted that the growth has held up well amid global uncertainties and is evolving in line with their assessment of 6.5% for FY2026.

While outlook for private consumption and investment activity appears upbeat, external outlook remains challenged by ongoing tariff announcements.

The MPC highlighted that the impact of 100 bps rate cut on the economy is unfolding, even as tariff uncertainty continues to linger.

MPC retained its FY2026 GDP growth forecast at 6.5%: The Committee assessed that the domestic growth has remained resilient and is evolving along the lines of their outlook, notwithstanding the challenging global environment triggered by trade negotiations. In Q1 FY2026, domestic private consumption held up, supported by rural demand, while sharp Government capex growth (on a low base) supported investment activity. The MPC noted that the agricultural outlook is upbeat, with steady Southwest Monsoon supporting kharif sowing, even as industrial output growth remained subdued and uneven across the sectors, weighed down by electricity and mining owing to surplus monsoons.

It anticipates domestic growth to remain healthy stemming from above-normal monsoons, lower inflation, rising capacity utilisation and stable financial conditions, amid supportive monetary, fiscal, and regulatory policies. Besides, the MPC expects the growth to pick up in the upcoming festive season, and the service sector to sustain its healthy momentum, with continued growth in construction and trade in the coming months. However, prospects for external demand remain decidedly uncertain, given the ongoing trade negotiations and tariff announcements. Overall, headwinds emanating from prolonged geopolitical tensions, persisting global uncertainties, and volatility in global financial markets pose risks to the growth outlook.

Taking all these factors into account, the Committee decided to retain the FY2026 GDP growth forecast at 6.5%, in line with the level indicated in June 2025. In quarterly terms, the growth projections for Q1 FY2026 (at +6.5%), Q2 FY2026 (at +6.7%), Q3 FY2026 (at +6.6%) and Q4 FY2026 (at +6.3%) have been retained at the levels pencilled in the June 2025 policy. Further, it provided a fresh growth projection for Q1 FY2027 at 6.6%, with risks evenly balanced.

ICRA broadly concurs with the MPC's outlook on private consumption and Government investment, which appears resilient, given the personal income tax relief, rate cuts of 100 bps, above-normal monsoon, dip in food inflation, and a healthy growth in Government capex. However, the potential adverse impact of the tariff-related developments as well as the heightened uncertainty on India's exports and private capex suggest that growth in H2 FY2026 may trail the MPC's forecasts. We had recently reduced our growth projection for India's FY2026 GDP to 6.0% from 6.2%.

The size of the average systemic liquidity surplus rose from Rs. 1.6 trillion during April-May 2025 to Rs. 2.8 trillion in June 2025, and further to a sizeable Rs. 3.1 trillion in July 2025.

The improvement in liquidity surplus in June-July 2025 was supported by the dip in Gol's cash balances, seasonally lower demand for cash and buy-backs of G-secs.

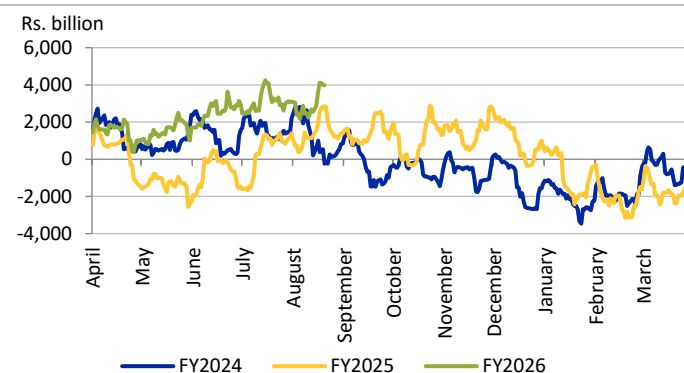
Correspondingly, the durable liquidity surplus remained sizeable in excess of Rs. 5.0 trillion since end-May 2025, touching near three-year high of Rs. 5.9 trillion.

Systemic liquidity surplus augmented in June-July 2025: The size of the average systemic liquidity surplus rose appreciably from Rs. 1.6 trillion (+0.7% of NDTL) during April-May 2025 to Rs. 2.8 trillion in June 2025 (+1.2% of NDTL), and further to a sizeable Rs. 3.1 trillion in July 2025 (+1.3% of NDTL). After a series of measures taken by the RBI that improved liquidity conditions in April-May 2025, the size of the surplus widened in June-July 2025, also supported by a dip in the Government of India's (Gol) cash balances (to Rs. 2.2 trillion as on July 11, 2025 from Rs. 3.6 trillion as on May 30, 2025). Besides, the Central Bank conducted four buy-back auctions of G-secs worth Rs. 1.06 trillion during June-July 2025, of which ~82% or Rs. 868 billion was accepted and thus injected liquidity into the system. While the RBI also conducted VRRs in these two months that injected liquidity to the tune of Rs. 811 billion, the frequency of such operations reduced from April-May 2025 levels (Rs. 3.5 trillion), given the significant cooling in liquidity conditions.

In addition, the FPIs injected \$1.7 billion into Indian capital markets in June 2025 but subsequently withdrew \$2.1 billion in July 2025. Nevertheless, the seasonally lower demand for currency (Rs. 75 billion as on July 11, 2025 over May 30 vs. Rs. 1.2 trillion in April-May 2025) seems to have partly supported liquidity conditions in June-July 2025.

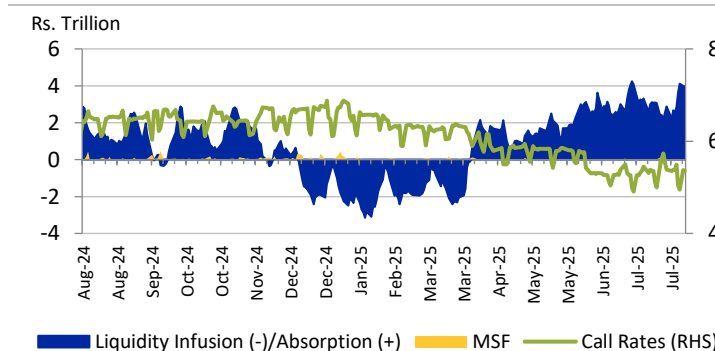
Durable liquidity surplus exceeds Rs. 5 trillion since May 30, 2025: The durable liquidity surplus rose materially to Rs. 5.9 trillion as on May 30, 2025 from Rs. 1.1 trillion as on March 21, 2025, aided by aforesaid liquidity injection through various tools (OMOs and forex swaps). Thereafter, it stayed elevated at Rs. 5.8 trillion as on June 27, 2025, before easing slightly to Rs. 5.4 trillion as on July 11, 2025. Notably, the reversal of the 6-month buy-sell USD/INR swap auction of \$5 billion, conducted on January 31, 2025, is likely to have impacted liquidity to the tune of Rs. 440 billion on August 4, 2025.

EXHIBIT 4: Liquidity Infusion (-)/ absorption (+)



*Data for FY2026 is shown up to August 5, 2025; Source: RBI; ICRA Research

EXHIBIT 5: Call money rates



Source: RBI; ICRA Research

The RBI conducted 10 VRRRs to address surplus liquidity in the banking system, which impounded liquidity to the tune of Rs. 10.5 trillion of the notified Rs. 12.8 trillion.

The upcoming CRR reduction of 100 bps is likely to further support liquidity conditions, which would be opportune for the festive season demand.

VRRRs commenced from late-June 2025 to absorb surplus liquidity: For the first time in FY2026, the RBI started VRRRs from June 27, 2025, onwards to manage the substantial surplus available in the banking system. It conducted 10 such operations between June 27, 2025 and August 1, 2025 spread across 1-7 day tenures (of which 8 were conducted in July 2025), with a combined notified amount of Rs. 12.75 trillion, that impounded liquidity to the tune of Rs. 10.5 trillion.

CRR cut of 100 bps to come into effect in phased manner from early-September 2025: After the durable injection of Rs. 9.5 trillion since January 2025 via term VRRs, OMO purchase of G-secs and USD/INR buy-sell swaps, the RBI had announced in the June 2025 policy to reduce the CRR by 100 bps to 3.00% of NDTL in four equal tranches with effect from the fortnight of September 6, 2025. This is expected to release primary liquidity of Rs. 2.5 trillion to the banking system by December 2025, which would further support liquidity conditions and augment the transmission of policy rate cuts to bank lending rates.

Continued transmission of rate cuts to money, bond and credit markets: The monthly weighted average call money rate (WACR) moderated appreciably from 5.92% in April 2025, to 5.82% in May 2025, and further to 5.39% each in June-July 2025, printing below the average repo rate in each of these months. With cumulative repo rate cuts of 100 bps since February 2025, the WACR has seen a moderation of 108 bps till August 4, 2025. Similarly, the 3-month T-bill rate declined by 110 bps, 3-month CP issued by NBFCs by 161 bps and 3-month CD rate by 170 bps since the February 2025 policy.

In the credit market, the weighted average lending rate (WALR) of scheduled commercial banks on outstanding rupee loans and fresh rupee loans declined by ~40 bps and 71 bps, respectively, between February 2025 and June 2025. Notably, of this total magnitude, the dip of 22 bps and 58 bps happened in June 2025 itself, supported by the front-loaded 50 bps rate cut. On the deposit side, the weighted average domestic term deposit rate (WADTDR) on fresh deposits moderated by 87 bps (to 5.75% from 6.62%) during the same period.

Forward looking statement: Going ahead, the RBI stated that it is likely to maintain sufficient liquidity in the banking system so that the productive requirements of the economy are met and transmission to money markets and credit markets remains smooth. As per the initial findings of the internal Working Group on RBI's extant Liquidity Management Framework (LMF), operative since February 2020, the weighted average call rate (WACR) is found to be highly correlated with other overnight money market rates (TREPS and Market Repo) in the collateralised segments. Thus, the Group has recommended continuation of overnight WACR as the operating target of monetary policy.

While the Group has also recommended continuing with the variable rate auction mechanism for repo and reverse repo operations of various tenors with the objective of maintaining the operating target rate at the policy rate, it is yet to be seen if there will be any changes with respect to changing the duration of the main auction of VRRR/VRR.

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