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With inflationary pressures tamed, RBI’s growth-inducing monetary policy tilt to continue

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Monetary Policy decisions in the current backdrop are nothing short of a difficult tightrope walk, with multiple uncertainties complicating economic policy decisions. Despite a better-than-expected GDP print for Q4FY25, the growth outlook for the Indian economy remains cautiously optimistic at best. While domestic growth momentum has strengthened from lows in the first half of FY25, multiple crosswinds in the economy have dragged the growth trend lower than the potential level of 7%. It’s also noteworthy that a large part of the uptick in Q4 GDP growth was driven by front loading of economic activities ahead of tariff deadlines- a phenomenon seen globally- and reflecting in high net exports growth in GDP data. Add to it the pickup in CAPEX by various government entities - union, state, and PSUs - to catch up with low capex deliveries in the first half of FY25, as reflecting in high construction sector activities. It is hence difficult to ascertain if the growth performance seen in Q4 is likely to persist in FY26 when subsequent quarters may not have these push factors driving growth performance despite higher domestic growth momentum. Most importantly, private capex is currently facing severe global headwinds. Constantly shifting stance on trade and the risk environment for key global economies put downside risks on global growth and investments, accentuating pressures on the domestic private investment cycle.

On the other hand, inflation data that has remained subdued provides the Central Bank with ample policy space to stimulate the economy without risking overheating. Inflation trajectory remains benign with prices of major food components expected to sustain at low levels, range bound oil prices on the back of lower global demand, and stable wage prices. In fact, all indications point towards a likely downward revision of RBI’s already benign 4% inflation forecast for FY26 in the upcoming MPC meeting. On the liquidity front, while the messaging will continue about undertaking liquidity management operations to ensure adequate liquidity in the financial system, RBI has already done its bit in maintaining surplus liquidity in 2025 and will likely not need further heavy lifting this year. Post RBI’s bumper dividend payment to the Central Government, systemic liquidity has hit around 2% of NDTL, indicating pretty comfortable liquidity conditions in the economy. RBI might however, amp up its focus on rate cut transmission to support key sectors that drive economic growth.

Overall, there is a strong case for maintaining a growth-supportive approach, as global uncertainties cloud the outlook and benign inflation dynamics provide plenty of policy space to cut the Repo rate in the upcoming MPC meeting. Severe global headwinds on the domestic private capex cycle warrant multiple rate cuts and liquidity support to counter global uncertainties. Several other major central banks will also likely take a similar stance as well to ease monetary policy further amid rising global tensions. The question that really remains to be answered is 'How much further can the policy rates be cut to support growth?'. Markets are keenly watching for any hint of a terminal rate in the current cycle. Domestic factors point towards policy space to cut rates by 50-75 basis points in the rest of FY26 to bring policy rates to neutral territory. The possibility of a deeper rate cut will hinge on whether global growth headwinds increase and pull overall India GDP growth below 6%, which is not the base case in current conditions.

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Rajni Thakur · ETBFSI
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Monetary Policy decisions in the current backdrop are nothing short of a difficult tightrope walk, with multiple uncertainties complicating economic policy decisions.

Despite a better-than-expected GDP print for Q4FY25, the growth outlook for the Indian economy remains cautiously optimistic at best. While domestic growth momentum has strengthened from lows in the first half of FY25, multiple crosswinds in the economy have dragged the growth trend lower than the potential level of 7%. It's also noteworthy that a large part of the uptick in Q4 GDP growth was driven by front loading of economic activities ahead of tariff deadlines- a phenomenon seen globally- and reflecting in high net exports growth in GDP data. Add to it the pickup in CAPEX by various government entities - union, state, and PSUs - to catch up with low capex deliveries in the first half of FY25, as reflecting in high construction sector activities. It is hence difficult to ascertain if the growth performance seen in Q4 is likely to persist in FY26 when subsequent quarters may not have these push factors driving growth performance despite higher domestic growth momentum. Most importantly, private capex is currently facing severe global headwinds. Constantly shifting stance on trade and the risk environment for key global economies put downside risks on global growth and investments, accentuating pressures on the domestic private investment cycle.

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