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THE RBI OPTED FOR A PAUSE, CITING TARIFF, TRANSMISSION ISSUES

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I. Introduction:

The MPC in its August 2025 policy has kept its policy rate unchanged at 5.50 per cent highlighting the increasing uncertainties related to tariffs as well as providing more time to realise the impact of the transmission which is still awaited. The impact of the 100-bps rate cut since February 2025 on the economy is still recounting.

Though the headline inflation has cooled off due to reduced vegetable prices, but the core inflation is hovering a bit higher at around four per cent. ***The RBI will wait for further visible impact of transmission of the front-loaded rate cut to the credit markets and the larger economy.*** The RBI also maintains its neutral stance depending on the incoming data.

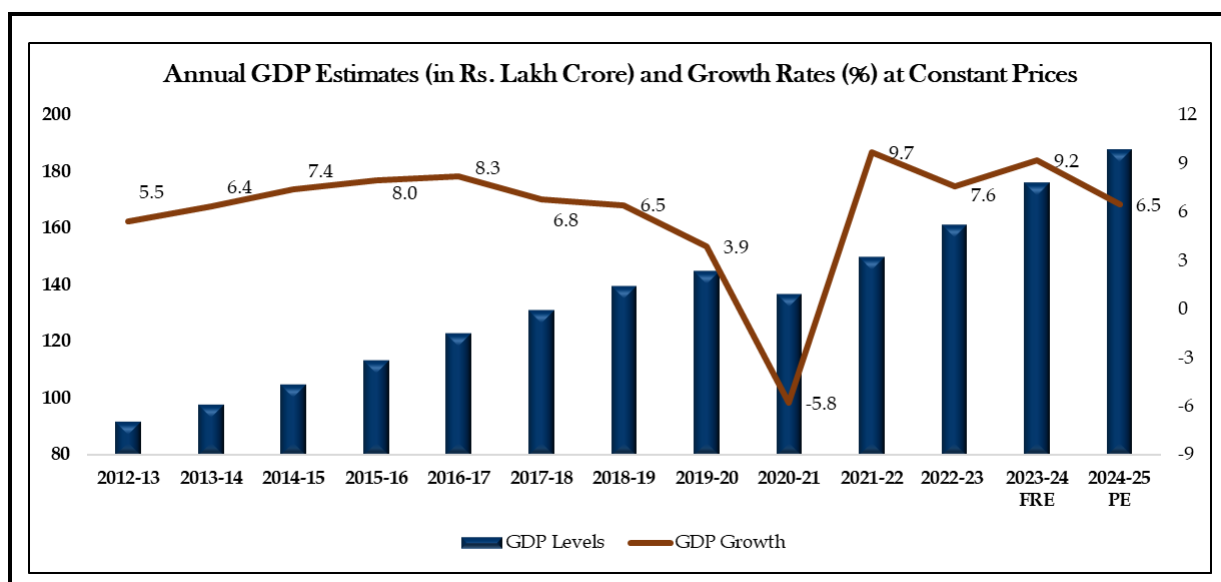


II. The Growth and Inflation Outlook:

Though the above normal southwest monsoon, lower inflation, rising capacity utilisation remain favourable for sustaining growth for the Indian economy, *prospects of external demand remain uncertain amidst ongoing tariff announcements and trade negotiations*. The headwinds emanating from prolonged geopolitical tensions, persisting global uncertainties, and volatility in global financial markets pose risks to the growth outlook.

Considering the above-mentioned factors, real GDP growth for 2025-26 is projected at 6.5 per cent with the following quarterly projections:

- Q1 at 6.5 per cent.
- Q2 at 6.7 per cent.
- Q3 at 6.6 per cent.
- Q4 at 6.3 per cent.
- Real GDP growth for Q1:2026-27 is projected at 6.6 per cent.



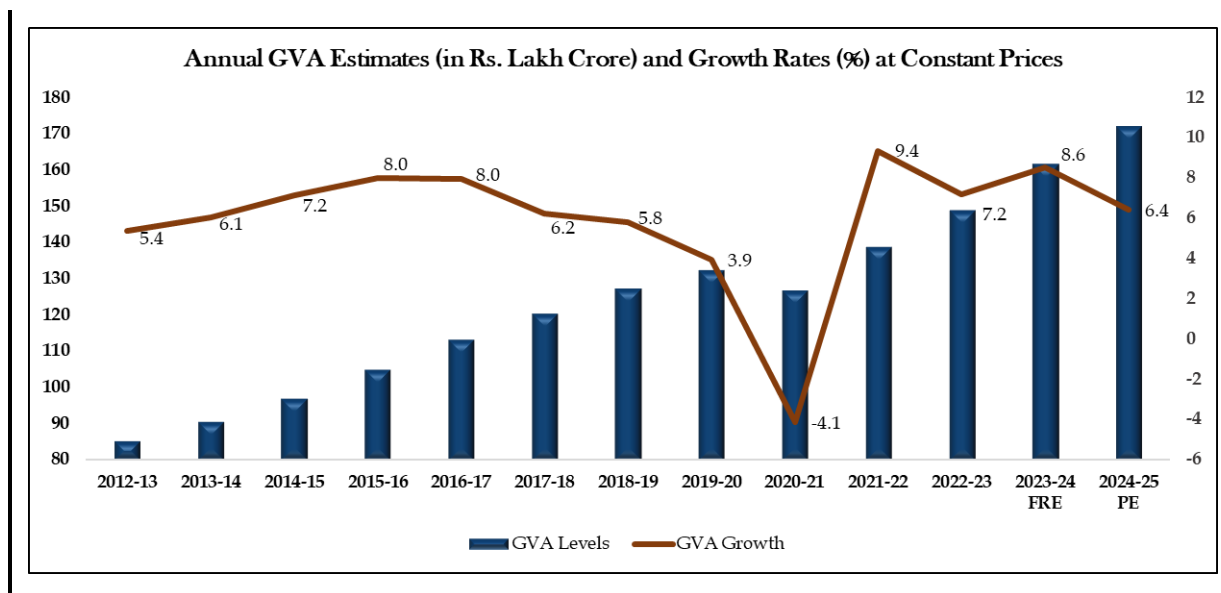


Chart 1: Annual GDP and GVA Estimates (Y-o-Y Growth Rates) at Constant Prices(%)

Source: MOSPI

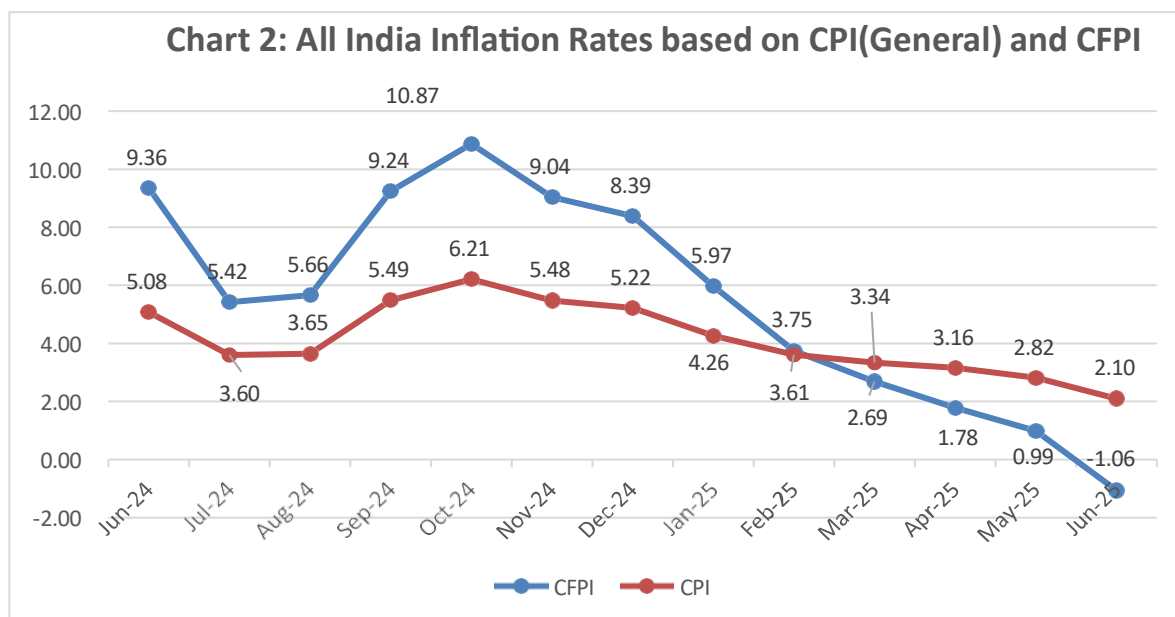
The Consumer Price Index (CPI) headline inflation declined for the eighth consecutive month to a 77-month low of 2.1 per cent in June'25, largely driven by a sharp decline in food inflation. High frequency price indicators signal a continuation of the lower price momentum in food prices to July'25 as well. Fuel group inflation moderated over two successive months to record 2.6 per cent in June'25.

CPI inflation, however, is likely to increase above 4 per cent in Q4:2025-26 and beyond due to adverse base effects. Excluding any major negative shock to input prices, core inflation is likely to remain moderately above 4 per cent during the year. Weather-related shocks pose risks to inflation outlook.

Therefore, following are the major inflation threats:

- Weather-related uncertainties.
- Possible transmission of tariff related concerns towards global commodity prices.
- Potential upward thrusts on core inflation.

Considering the abovementioned factors, CPI inflation for 2025-26 is now projected at 3.1 per cent with Q2 at 2.1 per cent; Q3 at 3.1 per cent; and Q4 at 4.4 per cent. CPI inflation for Q1:2026-27 is projected at 4.9 per cent.



Source: MOSPI.

III. The liquidity issue:

In the credit market, the weighted average lending rate (WALR) of Scheduled Commercial Banks (SCBs) declined by 71 basis points for fresh rupee loans (of which 55 bps is due to interest rate reduction) and 39 basis points for outstanding rupee loans from February 2025 to June 2025.

On the deposit side, the weighted average domestic term deposit rate (WADTDR) on fresh deposits moderated by 87 bps during the same period. According to an Internal Working Group report, 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. Further, ***WACR is found to be effective in transmitting signals to other money market instruments across maturities.***

Therefore, the Group has recommended continuation of overnight WACR as the operating target of monetary policy. The Group has, inter alia, also recommended to continue 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.

IV: Financial Stability issue:

Bank credit grew at 12.1 per cent during 2024-25, slower than the growth rate of 16.3 per cent in 2023-24. *Large corporates increasingly relied on market-based instruments such as commercial paper and corporate bonds to source funds, reducing their reliance on bank credit.*

For the Scheduled Commercial Banks (SCBs), the outstanding credit and deposit on a y-o-y basis increased by 9.9 per cent and 10.5 per cent, respectively, between June-24 and June-25. The system-level Capital to Risk Weighted Assets Ratio (CRAR) of 17.44 per cent in June 2025 was above the regulatory minimum level. Ratio of non-performing loans improved (GNPA ratio at 2.24 per cent in June 2025 vis-à-vis 2.67 per cent in June 2024, NNPA Ratio at 0.53 per cent in June 2025 vis-à-vis 0.60 per cent in June 2024).

Liquidity buffers remain healthy, whereas the annualised return on assets (RoA) and return on equity (RoE) stood at 1.34 per cent and 12.70 per cent, respectively, in June 2025. Net Interest Margin was 3.24 per cent for June 2025 (3.54 per cent in June 2024).

For NBFCs, total capital to risk weighted assets (CRAR) was 25.78 per cent and Tier I CRAR was 23.83 per cent in June 2025, above the minimum regulatory requirements. GNPA ratio has improved from 2.47 per cent in June 2024 to 2.21 per cent in June 2025, while NNPA ratio also improved from 1.08 per cent in June 2024 to 0.95 per cent in June 2025.

The return on assets (RoA) for the sector decreased from 3.23 per cent in June 2024 to 3.11 per cent in June 2025, and the net interest margin (NIM) has decreased from 4.82% in June 2024 to 4.40% in June 2025.

V. Report of the Internal Working Group (IWG) to Review the Liquidity Management Framework:

The RBI has constituted an Internal Working Group (IWG) to review the liquidity management framework, which submitted its report on 30 July'25. While the Group recommends for continuing the Weighted Average Call Rate (WACR) as the operating target for monetary policy, it also suggests tracking rates in other overnight money market segments to ensure orderly evolution of money market rates and smooth transmission, and maintaining the existing symmetric corridor system with repo rate at the middle of the corridor while the other two rates, namely MSF and SDF at either side of the corridor. The Group recommends 7-day repo/reverse repo operations instead of 14-day VRR/VRRR operations, as well as continuation of variable rate auction mechanism for conducting repo and reverse repo operations under the LAF, while for handling liquidity mismatches of longer term, the Group recommends that the repo/reverse repo operations of appropriately longer tenor may be conducted through variable rate auctions. The Group recommends the Reserve Bank to retain the extant daily minimum requirement of 90 per cent of the prescribed CRR.

VI. Regulatory Measures:

Under the provisions of Banking Regulation Act, 1949, nomination facility is available in respect of deposit accounts, articles kept in safe custody or safe deposit lockers. This is intended to facilitate expeditious settlement of claims or return of articles or release of contents of safe deposit locker upon death of a customer and to minimise hardship caused to family members. The extant instructions require banks to adopt a simplified procedure to facilitate expeditious and hassle-free settlement of claims made by survivors/ nominees/ legal heirs, the procedures vary across banks.

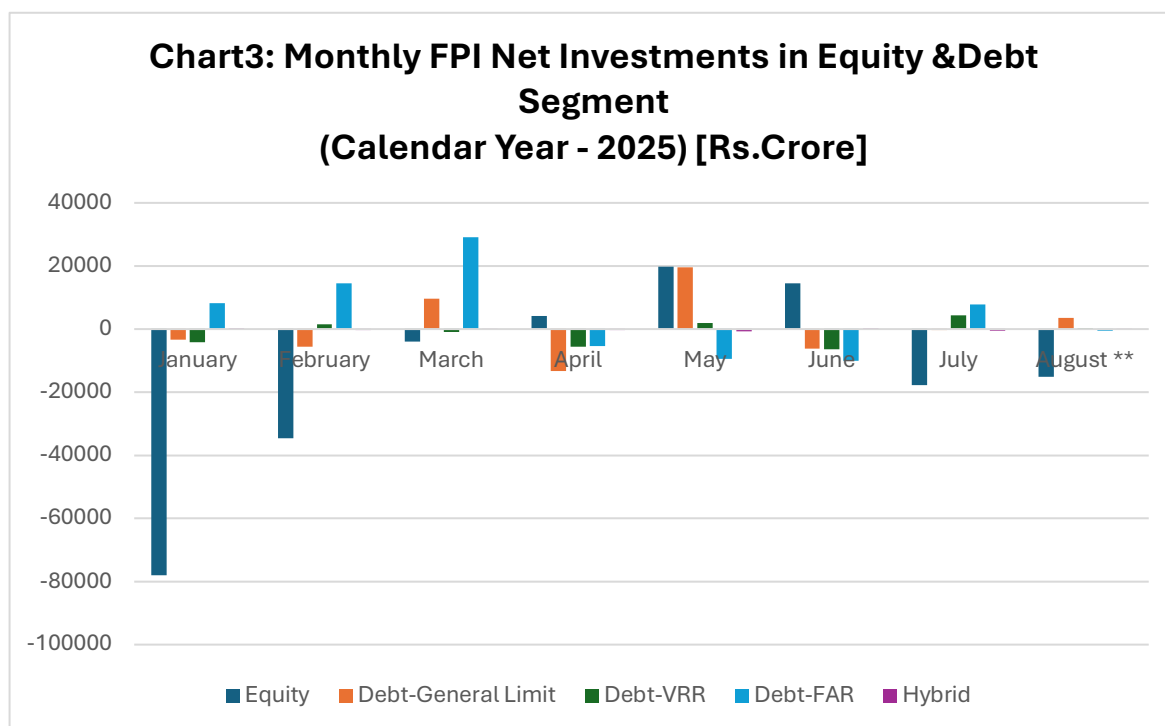
With a view to enhance customer service standards, it has been decided to streamline the procedures and standardise the documentation to be submitted to the banks.

The Retail Direct portal was launched in November 2021 to facilitate retail investors to open their Gilt accounts with the Reserve Bank under the Retail Direct Scheme. The scheme allows retail investors to buy Government Securities (G-Secs) in primary

auctions as well as buy and sell G-Secs in the secondary market. *To enable investors to systematically plan their investments, an auto-bidding facility for Treasury bills (T-bills), covering both investment and re-investment options, has been enabled in Retail Direct, which helps investors to mandate automatic placement of bids in primary auctions of T-bills. Therefore, RBI is in the process of expanding the functionality in RBI Retail-Direct platform to enable retail investors to invest in treasury bills through systematic investment plans.*

Market Impact: After a 50-bps jumbo rate cut in its June'25 monetary policy, RBI has taken a pause in its Aug'25 policy citing tariff related uncertainty and providing more time for the transmission, since the effect of such policy action becomes visible after a lag. The Trump's tariffs on many countries including India have already heightened market volatility and uncertainty. The India volatility index (VIX) increased 2.95% to 12.03, trading above its short-term averages, reflecting heightened trader caution. FPIs withdraw almost around ₹18,000 crore (₹17924 crore) from equities in Aug'25 (up to 08 Aug'25) on trade tension, weakening rupee and disappointing earnings. The total outflow by Foreign Portfolio Investors (FPIs) in equities has reached ₹1.13 lakh crore so far in 2025. Foreign investors had pulled out ₹17,741 crore on a net basis in July'25 from the equity segment. On 7 Aug'25, FII has sold in the cash segment ₹4997.19 crore while DII bought ₹10864.04 crore. The yield on the Indian 10-year G-Sec rose toward the 6.4% threshold in Aug'25. Tenor-wise, 9Y-10Y G-Sec maturing by 2035 remains at 6.33% on average during Aug'25(08Aug'25).

The Nifty 50 ended August 8 at a three-month low, dropping 233 points amid concerns over U.S. tariffs on Indian exports and weaker momentum indicators. Nonetheless, the BSE SENSEX has gained 0.93% on 11 Aug'25 reaching at 80,604.08. BSE SENSEX 50 and Next 50 have also gained.



Source: NSDL.

V. Concluding Remarks:

The RBI in its August'2025 policy remains cautious at keeping the policy repo rate unchanged due to tariff related uncertainties as well as allowing more time to realise visible transmission of the 50-bps rate cut in its previous June'25 policy (given the lowest CPI and food inflation scenario). Despite the CPI inflation being at its lowest at 2.1 per cent in its June'25 policy, the core inflation inching higher.

However, scope for improvement of further policy rate transmission mechanism exists. Therefore, in the Aug'25 policy RBI has opted for a 'wait and watch' mode to gauge the future course of the growth-inflation dynamics.