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RBI'S JUNE 2025 POLICY - RATE CUT ON

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The global setting is characterized by heightened geopolitical tensions, viz., Russia-Ukraine war, the Middle Eastern situation, etc., and a precarious fisc with "*tremendous*" pressures for more spending on defense, climate, and aging populations. These aspects are starkly reflected in global public debt mounting to 100 % of global GDP by the end of the decade (IMF's *Fiscal Monitor*) and higher long-term borrowing costs. An uncertain global trading system marked by trade protectionism and tariff turmoil causes extensive concern.

Geopolitical events heightened economic instability, amplified sector-specific risks, and intensified regulatory uncertainties. These geopolitical events accentuated global tensions, disrupted trade, and made the global markets volatile, affecting investor confidence and capital flows into emerging markets like India. This assumes greater significance for energy, infrastructure, and manufacturing, which are sensitive to international trade dynamics and supply chain disruptions.

The Court of International Trade struck down President Donald Trump's sweeping "*Liberation Day*" tariffs, ruling that he lacked the "*unbounded authority*" to impose across-the-board import taxes on the entire world under the International Emergency Economic Powers Act. These concerns have been exacerbated by President Donald Trump's 1000-page "*Big, Beautiful Bill*." While the Bill is "*big*," there have been concerns about its "*beautiful*" nature due to a hike in the USA's already bloated and unsustainable deficit resulting from extended tax cuts and an aggravated skew in the distribution of income and wealth.

The economy of the US grew by 2.8 % in 2024. But in January-March 2025, growth turned -0.2 % due to policy uncertainties and geopolitical risks. The Fed is wary of cutting rates, despite declining growth prospects. Further, the labour market was expected to weaken, with the unemployment rate likely to exceed its natural rate by the end of this year. Overall, risks are tilted to the downside.

Despite ongoing policy uncertainty, the Eurozone's Economic Sentiment Indicator rose 1 point to 94.8 in May because of an upgraded outlook for household finances and industrial performance.

In the UK, a sustainable world trading system is basic to the economy. While trade facilitates specialization and productivity, post-COVID supply-chain frailty has damaged the rules-based system. The ominous impact of trade wars and escalating tariffs on growth and inflation across countries has been effectively demonstrated. Shared prosperity necessitates a more connected, secure, and efficient trading environment - an environment marked by strong standards and international cooperation as partners in development.

Major central banks, including the US Federal Reserve, the European Central Bank, and the Bank of England, are expected to adopt a dovish stance, keeping interest rates low to bolster languishing economic growth.

The Indian Macroeconomy

India's economy rose 7.4% in Q4 of FY 2025, exceeding expectations, despite heightened global uncertainties. This is the strongest quarterly growth in FY 25, accelerating from 5.6 % growth in Q2 and 6.4% in Q3. India's GDP growth rose 6.5% in FY 25, the lowest in four years (9.2 % in FY 24 and 7.6 % in FY23).

The growth outlook in Asia's third-largest economy remains relatively robust, making it the world's fastest-growing major economy again, thanks to strong domestic consumption, government investments, and a relatively lower dependence on exports. Sectorally, manufacturing, construction, financial real estate, professional services, and public administration, defence, etc., performed well.

However, private consumption growth slowed, and government final consumption expenditure shrank in Q4 of FY25 after two quarters.

"*Improving domestic consumption is likely to support industrial activity... domestic consumption demand to improve, driven by healthy agricultural growth, easing inflation, supporting discretionary spend and income tax relief this fiscal*". But this growth will require continued recovery in domestic demand and support from both monetary and fiscal stimulus. The real GDP growth reflects the economy's underlying strength and resilience, driven by robust domestic demand, sustained government capex, and gradual recovery in private investment.

Industrial production rose modestly to an eight-month low of 2.7% in April 2025 (5.2% in April 2024), and a 4% rise in industrial output in FY 25, which was the lowest in four years. While manufacturing **(**3.4%) and electricity **(**1.1%) grew**,** mining shrank (0.2%) in April, the first since August 2024. Persisting contraction in consumer non-durables' output for the third successive month is manifested in low rural consumption despite CPI inflation reaching an almost 6-year low at 3.16% in April.

India's foodgrain production rose 6.6 % to reach 354 million tonne (MT) in FY 25, including record production of all major crops, rice, paddy, maize, wheat, etc.

India's economic trajectory remains resilient despite global headwinds and regional geopolitical tensions, including persistent border concerns with Pakistan, because of a "*pickup in private consumption, healthy balance sheets of banks and corporates, easing financial conditions, and the government's continued thrust on capital expenditure*".

India will continue to be the fastest-growing major economy in the world and consolidate its economic size and heft in the comity of nations. While external uncertainties, such as supply chain disruptions and energy market volatility, pose challenges, India continues to benefit from demographic dividend, ascendant middle class, huge markets with rising consumption demand, robust service sector performance, an accent on infrastructure and capex, a stable banking system, and improving manufacturing output under schemes like PLI. External sector risks, tariff disputes, ease of doing business, credit delivery to the target group, tax reforms, and expenditure rationalization, however, cause some concern.

Bank Credit

Credit growth is expected to remain robust, driven by economic growth, consumption, and investment. Bank credit moderated to 11.2 % as on April 18, 2025, compared to 15.3 % in the previous year.

Bond Yields

Domestic bond yields fell to multi-year lows because of successive rate cuts and liquidity-boosting measures by the RBI. Both credit and monetary conditions are in sync with the RBI's plan to support the economy while containing inflation.

Liquidity

Liquidity remains volatile because of advance tax and GST outflows and government cash balances with the RBI. Liquidity remained in surplus as reflected in average daily net absorption under the liquidity adjustment facility (LAF), increasing to ₹1,605 crore during FY25 from ₹485 crore in FY24. The RBI conducted market operations, including open market operations (OMO) purchases, USD/INR buy/sell swaps, and longer tenor variable rate repo (VRR) operations, besides, reducing the CRR by 50 bps (in two tranches of 25 bps each), to provide durable liquidity to the system. The RBI transferred ₹2.69 lakh crore surplus to the government.

Inflation

Inflation remained within the target in FY 25, aided by easing vegetable prices. Headline inflation moderated to 4.6 % during FY 25 from 5.4 % in the previous year, largely driven by moderating core (CPI excluding food and fuel) inflation to 3.5 % and deflation in fuel at 2.5 %. However, the rise in core inflation in the second half of the year occurred because of surging global gold prices. Other tailwinds are above normal monsoon, early arrival of the southwest monsoon, elevated reservoir level, favourable rainfall outlook, and softening food inflation.

Crude prices are expected to remain volatile because of global demand, supply disruptions, and geopolitical tensions.

CPI inflation softened to 3.2 % in April, the lowest since July 2019, from 3.3 % in March because of a sustained fall in food prices. CPI inflation is expected to remain range-bound, driven by factors such as food prices, fuel prices, and economic growth. With benign inflation (inflation remaining below 4 % from February to April 2025) and plunging inflation, the CPI is likely to durably align with the 4 % target over two months, inducing the RBI to cut policy rates by 25 bps to 5.75 % in June. A downward bias in FY26 CPI inflation will be symptomatic of the depth of the rate-cutting cycle.

CPI is expected to moderate from 4.9% in FY25 to 4.3% in FY26. However, inflationary risks persist because of global commodity prices and any escalation in geopolitical tensions. Under the flexible inflation targeting (FIT) framework, the RBI has been mandated by the government to maintain CPI at 4 % with a band of +/-2 %. Decelerating inflation and moderating growth warrant "*monetary policy to be growth supportive, while remaining watchful about the rapidly evolving global macroeconomic conditions*" (RBI's *Annual Report* for 2024-25).

Revised GDP and inflation forecasts

The RBI is likely to revise its projections on real GDP and inflation for FY26.

Rate Action - Receding Inflation Concerns, Focus on Growth

The RBI has already cut the Repo Rate twice in 2025- in February and in April, by 25 bps on each occasion. These cuts reduced the key lending rate to 6%. Further, the RBI also changed its stance from 'neutral' to 'accommodative' in April. Accordingly, most banks reduced their repo-linked lending rates. Lenders also lowered their marginal cost of funds-based lending rate (MCLR). This had a beneficial impact on interest-rate sensitive segments, viz., real estate, small businesses, and home loans.

A further 25-bps cut in the Repo Rate will drive economic traction, promote borrowing, investment, and growth, and enhance job creation by making it cheaper for people to borrow money. A 25-bps reduction in the Repo Rate will cause a corresponding drop in all external benchmark lending rates (EBLR), with equated monthly installments (EMIs) on home and personal loans decreasing by 25 bps. A boost in the real estate sector will have a multiplier effect on the economy, particularly in cement, steel, and construction equipment.

This would be the third consecutive reduction in the Repo rate since February 2025. Since inflation is within the RBI's target band, and given the likely growth-inflation dynamics, we expect another reduction of 50 bps in FY26.

Policy Stance

The MPC is likely to retain the ‘accommodative’ monetary policy stance adopted in April 2025.