

## India rate cut deferred, not dismissed

The RBI has held its repo rate steady at 5.5% as it balances growth and currency risks. It has sharply cut its inflation forecast, but it's cautious about INR weakness. A rate cut in December is a distinct possibility, especially if India can't improve tariff terms with the US



Reserve Bank of India  
Governor, Sanjay  
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### Key rates left unchanged despite cutting inflation forecasts further

The Reserve Bank of India left the repo rate unchanged at 5.5%, in line with consensus but diverging from our forecast of a 25bp cut, while maintaining a neutral policy stance. Importantly, the policy hold comes despite the central bank revising its CPI inflation forecast for FY26 lower once again, from 3.1% to 2.6%, taking the cumulative downward revision to 110bp in just about two months.

On the growth front, the RBI raised its FY26 GDP forecast to 6.8% from 6.5% earlier, which didn't come as a surprise given the strong growth performance in the first half of the year. Overall, the Bank does acknowledge that *"the current macroeconomic conditions and the outlook have opened up policy space for further supporting growth"*.

## Why the RBI paused and triggers for a further cut

Firstly, the Monetary Policy Committee noted that the impact of the front-loaded monetary policy actions and the recent fiscal measures is still unfolding; therefore, it considered it prudent to wait for the impact of policy actions to play out and for greater clarity to emerge before charting the next course of action.

Secondly, the rate pause today suggests INR weakness likely played a key role in the RBI's monetary policy reaction function. The Indian rupee was one of the weakest regional currencies last month, weighed down not only by elevated tariffs on goods exports to the States, but also by potential setbacks to software exports from the recent announcement of higher H-1B visa fees by the US.

This suggests that for the RBI to consider further rate cuts, there must be clear evidence that the drag from tariffs on GDP growth is significant, and that the recent goods and service tax reductions are effectively translating into lower inflation.

## Rate cuts still on the table given the weak growth outlook

Looking ahead, GDP growth is expected to moderate over the coming quarters. Some slowdown was already evident in August's weaker-than-expected industrial production data, reflecting the initial impact of the 25% tariffs. While recent tax reductions may offer partial relief, the absence of meaningful export diversification suggests that the drag from 50% tariffs on US exports could be substantial.

Assuming a full tariff pass-through and no trade diversion, the direct hit would be 0.6-0.7% of GDP. Hence, we think a rate cut in December is very much on the table, particularly if trade negotiations between India and the White House fail to deliver meaningful tariff reductions.

## Goods and service tax cuts yet to be reflected in inflation

We estimate that a full pass-through of GST cuts to the consumer could lower CPI inflation by one percentage point. Even under a more conservative scenario, we could see inflation declining by around 50 basis points over the next six months, increasing the likelihood of the RBI's revised CPI target being achieved. This strengthens our case for further monetary policy easing. Moreover, elevated real policy rates of about 3% suggest further room for easing.

## Today's move should provide some support to INR

While both sides remain engaged in tariff negotiations, progress is slow. We anticipate that India will eventually secure a lower tariff rate, but in the meantime, the prevailing uncertainty may continue to dampen investor sentiment. That's evident in the foreign institutional investor (FII) outflows observed in August and September.

Active Reserve Bank of India intervention is expected to cap USD/INR around 89.0 amid external headwinds. However, the risk of further weakness persists if India fails to negotiate tariff levels lower.

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