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Economics - Asia ex-Japan

India: A lower RBI terminal rate of 5%

We cut our FY26 GDP growth forecast to 5.8% (vs. 6%), and now expect a terminal policy rate of 5% (was 5.5%), implying 100bp more in cuts.

- The RBI delivered a dovish 25bp cut, with downgrades to its GDP growth and inflation forecasts (0.2pp each), a shift in its stance to accommodative (from neutral) and a commitment to keep liquidity in surplus of ~1% of net demand and time liabilities.
- We agree with the RBI's inflation outlook (~4% for FY26), but see its GDP growth forecast (of 6.5%) as optimistic. We have revised lower our FY26 GDP growth projection to 5.8% y-o-y (from 6.0%), reflecting the global tariff-driven disruptions.
- We have long held the view that this easing cycle was not shallow and terminal rates would settle around neutral. However, with growth below potential, falling oil prices and inflation durably aligned to target, policy rates need to be accommodative.
- Hence, we are lowering our terminal rate forecast to 5.00% (from 5.50%), which implies an additional 100bp in rate cuts by end-2025 (25bp in each of the consecutive meetings in June, August, October, and December).
- **Rates strategy:** We maintain a **maximum conviction (5/5) long 5y IGB recommendation, and increase the target to 5.75% (75bp gain from entry)**. We remain long 10y IGB and receive 2y NDOIS and adjust the target on the 2y NDOIS to 5.25% (95bp gain from entry). Given the RBI's guidance of keeping system liquidity in a surplus of ~1% of NDTL (INR2.5trn), we expect more OMOs in May and now expect MIBOR to trade below the repo rate on a sustained basis.

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A dovish cut

Rate cut + accommodative stance

The RBI's MPC voted unanimously (6-0) to cut the policy repo rate for the second consecutive time by 25bp to 6.00%, in line with consensus and our expectations. There was also a unanimous decision to change the policy stance to 'accommodative' from 'neutral'. The MPC attributed the dovish outturn to a "*decisive improvement*" in the inflation outlook and enhanced confidence of a "*durable alignment*" with the 4% inflation target. Meanwhile, the challenging global economic climate was flagged as the trigger for more policy easing. Governor Malhotra mentioned that the RBI's aim is for "*non-inflationary growth.*"

What the accommodative stance means

Governor Malhotra clarified that the policy stance offers guidance only on the policy rate and not liquidity, as liquidity management is the 'operational tool' for monetary policy changes. The accommodative stance indicates that "*absent any shocks, the MPC is considering only two options – status quo or a rate cut*" and that "*the policy trend is downward.*"

Commitment to keep liquidity in surplus

In the press conference, the RBI governor noted he wanted to keep system liquidity around 1% of NDTL (approximately INR2.5trn). The focus was on making sure the transmission of monetary policy happened quickly and efficiently.

Impact of Trump's tariffs

Governor Malhotra flagged that higher reciprocal tariffs and trade uncertainty were a negative for growth, while their impact on inflation was more balanced. GDP growth could be hit due to uncertainty dragging down business investment and consumption, weak global growth spilling into domestic growth and the negative impact of tariffs on net exports. However, the RBI has flagged that it is unsure about the elasticities of India's

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export and import demand, the government's policy measures and the trade deal with the US. The impact on inflation "*is not expected to be of high concern*", as the slowdown in growth and softer commodity and crude oil prices, could offset imported inflation due to a weaker currency.

GDP growth downgrade

Amid global tariff concerns, the RBI reduced its FY26 (year ending March 2026) GDP growth forecast by 0.2pp to 6.5% – the second downgrade (cut from 7.1% at the February meeting). The RBI now expects 6.6% in H1 (April-September) and ~6.5% in H2 (October-March 2026). The RBI remains optimistic on domestic drivers, including sustained demand in rural consumption, an expected pickup in urban consumption and fixed investment, amid healthy banking and corporate balance sheets. Its medium-term forecast pegs GDP growth at 6.7% y-o-y in FY27.

Inflation forecasts also lowered

The RBI lowered its FY26 CPI inflation forecast to 4.0% y-o-y from 4.2%, with inflation likely to remain below the RBI's 4% target through Q1-Q3 (April-December). In FY27, it forecasts CPI inflation of 4.3%. According to the RBI, the food inflation outlook has "*turned decisively positive*", with robust food production, a sharp decline in inflation expectations, and a fall in crude oil prices. That said, global market uncertainties and adverse weather-related disruptions are upside risks.

Fig. 1: RBI versus Nomura macro forecasts

RBI vs Nomura macro forecasts								
	GDP (% y-o-y)				CPI (% y-o-y)			
	RBI	RBI	Change	Nomura	RBI	RBI	Change	Nomura
	Apr-25	Feb-25			Apr-25	Feb-25		
Q1 FY26	6.5	6.7	-0.2	6.0	3.6	4.5	-0.9	3.4
Q2 FY26	6.7	7.0	-0.3	5.5	3.9	4.0	-0.1	3.6
Q3 FY26	6.6	6.5	0.1	5.3	3.8	3.8	0.0	3.9
Q4 FY26	6.3	6.5	-0.2	6.1	4.4	4.2	0.2	5.4
Q1 FY27	6.5				4.5			
Q2 FY27	6.4				4.3			
Q3 FY27	6.8				4.4			
Q4 FY27	6.8				4.3			
FY26	6.5	6.7	-0.2	5.8	4.0	4.2	-0.2	4.1
FY27	6.7			6.8	4.3			4.4

Note: Yellow shaded sections denote forecasts from the April 2025 version of the half-yearly Monetary Policy Report
Source: RBI, CEIC and Nomura Global Economics

Nomura's view: Lowering our terminal rate

A dovish cut

While the RBI's 25bp cut of the repo rate and the lowering of the GDP growth outlook was in line with our expectations, the change of stance to accommodative, combined with the trimming of the inflation outlook was a positive surprise. We also welcome Governor Malhotra's clear communication that the accommodative stance signals lower or stable policy rates and is not linked to liquidity, which is a break from the muddled messaging over policy stance in the past. Overall, today's policy decision was clearly dovish.

Agree on inflation, disagree on growth

On inflation, we are broadly in line with the RBI's outlook. Core inflation pressures remain muted, for both goods and services, due to soft domestic demand and lower wage growth, and lower oil prices are disinflationary. Hence, we expect inflation to remain below 4% in 2025, and see the RBI's forecast of 4% for FY26 as reasonable.

On GDP growth though, we believe the RBI's forecasts are optimistic, despite the downgrade to 6.5% for FY26. Even before Trump's reciprocal tariffs, domestic growth drags included weak urban consumption, the uneven *rural recovery*, tepid private capex, *household balance sheet stress* and the negative credit impulse. There are opportunities for India from trade diversion and medium-term supply chain shifts, but we expect higher tariffs, uncertainty and negative wealth effects to further weigh on exports, investment and consumer discretionary demand this year. Hence, we recently *downgraded* our 2025 GDP growth forecast to 5.9% (from 6.0%) and FY26 to 5.8% (from 6.0%).

A deeper easing cycle

We have long held the view that this easing cycle was not shallow and terminal rates would settle around neutral (~5.5%). However, with growth below potential, falling oil prices and inflation durably aligned to target, policy rates will need to move into the accommodative zone. Hence, we are lowering our terminal rate forecast to 5.00% (from 5.50%), which implies an additional 100bp in rate cuts by end-2025 (25bp in each of the consecutive meetings in June, August, October and December).

The barrage of liquidity injections, policy rate easing, the change of stance to accommodative, and the downgrade of both growth and inflation forecasts, also suggest that the RBI is signalling that a deeper rate cut cycle is in the works, and it wants faster transmission via its commitment on surplus liquidity.

Rates strategy

The RBI managed to meet the dovish expectations of the market, by shifting its stance to accommodative and offering a dovish take on the liquidity outlook. INR yields and swaps have moved lower in a steepening manner.

On liquidity, the RBI noted how it wants to provide sufficient system liquidity. In the press conference the Governor noted he wants to keep system liquidity at approximately 1% of NDTL (INR2.5trn). As current system liquidity is approximately INR1.5trn, this would suggest there is still some room to go. There was a clear focus on the transmission of policy to the system, which suggests to us that the RBI wants to see repo/call rates closer to the bottom end of the corridor, which is also in line with our view that above a INR1trn surplus in the banking system, MIBOR will likely be below repo rate (see *INR rates: Liquidity update – a sustained banking surplus is on the horizon*, 18 March 2025).

In terms of how the RBI will provide more liquidity, we continue to believe that the bar is low for OMO purchases, and we would expect the RBI to announce another set of auctions for May for around INR0.75-1trn (Figure 2), this would keep banking system liquidity around INR2trn. The RBI could do more (short-dated buy-sell swaps) if it feels transmission remains incomplete. Other measures (VRR, long-dated VRRs) will also be used in conjunction especially around tax flows.

Fig. 2: Liquidity projections

INR bn	interbank liq	Durable liquidity (ve = injection)					Issuance (Drain)		Redemptions / Int (Injection)			Net iss	Change in
Week beg		FX int / swap	CIC	OMO-Gsec	Buy Back	Δ durable liq	Tbill	G-sec	Tbill	G-sec	G-sec Int	TB+GS	govt cash (ve = withdrawel)
7-Apr	1,829	-80	-251	200	0	-131	190	360	322	0	102	126	0
14-Apr	1,571	-40	-61	0	0	-101	190	320	421	0	195	-106	750
21-Apr	827	0	-61	200	0	139	190	300	359	0	242	-111	0
28-Apr	1,078	0	-61	200	0	139	190	270	291	0	40	129	-1,000
5-May	2,088	0	-199	200	0	1	190	360	335	0	183	32	0
12-May	2,056	0	-199	200	0	1	190	320	289	0	111	110	0
19-May	1,947	0	57	200	0	257	190	250	114	554	128	-356	750
26-May	1,810	0	57	200	0	257	190	270	311	0	123	26	-1,500
2-Jun	3,541	0	-71	0	0	-71	190	360	331	0	233	-14	0
9-Jun	3,484	0	-71	0	0	-71	190	320	269	797	325	-881	0
16-Jun	4,294	0	102	0	0	102	190	300	108	0	430	-48	1,500
23-Jun	2,944	0	102	0	0	102	190	270	120	0	41	299	0

Source: RBI, Nomura

On the liquidity management framework, the RBI noted it is continuing to look into the guidelines for potential revisions. It noted the drop in the volume on call rates and the need to review whether it remained the effective operative rate. However, there did not appear to be a sense of urgency from the RBI, so this will likely take some time.

On strategy, we retain our bullishness on India rates. We retain **our *maximum conviction* (5 out of 5) long on the 5y IGB, as well as receive 2y NDOIS and long 10y IGB recommendations**. Our bias *remains* for the curve to steepen. For the bond curve, with the prospect of more OMO auctions, this *further skews the SLR supply/demand equation* in favour of lower yields, especially as SDL supply is likely to remain extremely low (was just INR35bn this week). We **adjust the target on our long 5y to 5.75% by June end (from 6.0%, now a 75bp gain from entry)** to reflect our economists forecast of 5% terminal rates. We eventually see the 5y trading at 5.5%. We expect the IGB curve to steepen.

For the NDOIS curve, we maintain our **Jun-IMM receive 2y recommendation**, but **adjust the target to 5.25% (from 5.6%, targeting a 95bp gain from entry)**. For the NDOIS curve, we prefer to be more nimble because of the global backdrop and the higher beta nature of the swap curve to global rates, but maintain a receive bias on spikes. We have adjusted our expectations for MIBOR from flat to the repo to -7.5bp until the next meeting (June), and after June we believe MIBOR will trade on average -15bp below. Under these assumptions, the fair value for 1y assuming 50bp more in rate cuts is 5.66%, and assuming 100bp it is 5.43%, which compares with the current level of 5.82%. Hence, we still see meaningful moves for INR rates, especially at the front end of the curve.

Please see Strategy portfolio update (21 March 2025) for our full portfolio.

Appendix A-1

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