



भारतीय रिजर्व बैंक
Reserve Bank of India



Monetary Policy Report

OCTOBER 2025



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Monetary Policy Report

OCTOBER 2025



Reserve Bank of India

Mumbai

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ABBREVIATIONS

AEs	- Advanced Economies	GDP	- Gross Domestic Product
ASEAN	- Association of Southeast Asian Nations	GoI	- Government of India
BE	- Budget Estimates	G-sec	- Government Securities
BIS	- Bank for International Settlements	GST	- Goods and Services Tax
bps	- Basis points	GVA	- Gross Value Added
BSE	- Bombay Stock Exchange	H1	- First Half of the Financial Year (April-September)
CAG	- Comptroller and Auditor General	H2	- Second Half of the Financial Year (October-March)
CASA	- Current Account and Savings Account	ICR	- Interest Coverage Ratio
CDs	- Certificates of Deposit	IIP	- Index of Industrial Production
CGA	- Controller General of Accounts	IMF	- International Monetary Fund
CI	- Confidence Interval	INR	- Indian Rupee
CiC	- Currency in Circulation	IPO	- Initial Public Offering
CII	- Confederation of Indian Industry	IT	- Information Technology
COVID	- Corona Virus Disease	LAF	- Liquidity Adjustment Facility
CPI	- Consumer Price Index	LPG	- Liquefied Petroleum Gas
CPs	- Commercial Papers	MCLR	- Marginal Cost of Funds-based Lending Rate
CRR	- Cash Reserve Ratio	m-o-m	- Month-on-Month
DCA	- Department of Consumer Affairs	MPC	- Monetary Policy Committee
DGCI&S	- Directorate General of Commercial Intelligence and Statistics	MPR	- Monetary Policy Report
DII	- Domestic Institutional Investor	MSCI	- Morgan Stanley Capital International
EBLR	- External Benchmark-based Lending Rate	MSF	- Marginal Standing Facility
ECI	- Eight Core Industries	MSME	- Micro, Small and Medium Enterprises
EM	- Emerging Market	NBFCs	- Non-Banking Financial Companies
EMEs	- Emerging Market Economies	NCAER	- National Council of Applied Economic Research
EPFO	- Employees' Provident Fund Organisation	NDTL	- Net Demand and Time Liabilities
EWMA	- Exponential Weighted Moving Average	NIMs	- Net Interest Margins
FCI	- Financial Conditions Index	NSDL	- National Securities Depository Limited
FDI	- Foreign Direct Investment	NSO	- National Statistics Office
FI	- Financial Institution	OECD	- Organisation for Economic Cooperation and Development
FPI	- Foreign Portfolio Investment/Investor		
GARCH	- Generalized Autoregressive Conditional Heteroskedasticity		

OID	- Overnight Indexed Swap	SAE	- Second Advance Estimates
OMOs	- Open Market Operations	SCBs	- Scheduled Commercial Banks
OPEC	- Organization of the Petroleum Exporting Countries	SDF	- Standing Deposit Facility
PCE	- Personal Consumption Expenditure	SIP	- Systematic Investment Plan
PFCE	- Private Final Consumption Expenditure	SLR	- Statutory Liquidity Ratio
PMI	- Purchasing Managers' Index	SPD	- Standalone Primary Dealers
POL	- Petroleum, Oil and Lubricants	T-bill	- Treasury Bill
PP	- Peak-to-peak	TMA	- Tractor and Mechanization Association
PSBs	- Public Sector Banks	TOP	- Tomato, Onion and Potato
PSUs	- Public Sector Undertakings	TT	- Trough-to-trough
PVBs	- Private Sector Banks	UK	- United Kingdom
Q1	- First Quarter	US	- United States of America
Q2	- Second Quarter	US\$	- US Dollar
Q3	- Third Quarter	UT	- Union Territory
Q4	- Fourth Quarter	VAR	- Vector Autoregression
q-o-q	- Quarter-on-Quarter	VRR	- Variable Rate Repo
QPM	- Quarterly Projection Model	VRRR	- Variable Rate Reverse Repo
RBI	- Reserve Bank of India	WACR	- Weighted Average Call Rate
RECO	- Revenue Expenditure to Capital Outlay	WADTDRs	- Weighted Average Domestic Term Deposit Rates
REER	- Real Effective Exchange Rate	WALRs	- Weighted Average Lending Rates
RHS	- Right Hand Side	WMA	- Ways and Means Advances
S&P	- Standard & Poor's	WPI	- Wholesale Price Index
SAAR	- Seasonally Adjusted Annualised Rate	y-o-y	- Year-on-Year

I. Macroeconomic Outlook

Amidst heightened trade uncertainties, India's economic outlook remains resilient, aided by improved consumption, investment demand and strong macroeconomic fundamentals. GST 2.0 reforms are expected to further boost domestic demand. Inflation is expected to gradually pick up from Q4:2025-26 on unfavourable base effect, despite the moderating impact of GST rationalisation. Against the backdrop of volatile global financial markets, elevated tariff-related risks, and continued geopolitical strife, monetary policy remains focussed on maintaining price stability and sustained economic growth.

I.1 Key Developments since the April 2025 MPR

Since the release of the Monetary Policy Report (MPR) in April 2025, global economic growth has remained steady, but still below its historical average.¹ Trade tensions, aggravated by tariff measures, along with geopolitical tensions continued to weigh on the global outlook. Headline inflation has moderated in several economies. However, it still remains above target in most jurisdictions, even as core inflation pressures eased. As a result, monetary policy pathways continue to diverge across countries. Several central banks moved cautiously into an easing cycle, although lingering inflation pressures necessitated a guarded approach. In contrast, some central banks have adopted a more accommodative stance to counter their slowing growth and rising unemployment.

Financial market volatility persisted, with global equities retreating in April 2025 amidst tariff-related uncertainties. Since then, markets have rebounded and reached new highs. Sovereign bond yields in major advanced economies (AEs) have hardened since April 2025, reflecting investor concerns over fiscal risks. At the same time, gold prices continued their upward trajectory as demand strengthened for safe-haven assets, underscoring persistent uncertainty. The United States (US) Dollar Index fell about 11 per cent from January 2025 till end of June, witnessing its steepest fall in over a decade. With modest rebound in the subsequent months, the index stabilised, though concerns over fiscal risks and expectation of rate cuts

continued to exert pressure. In September 2025, US financial markets displayed risk on sentiment with equity markets rallying amidst US Federal Reserve (Fed) rate cut and strong performance by technology companies. Bond yields softened and the dollar weakened in the first half of September following the Fed's rate cut; however, these trends reversed after the release of stronger-than-expected economic data.

Global commodity prices generally softened due to weakening demand and improved supply conditions, although volatility persisted across segments. Industrial metal prices fell sharply in April 2025 on account of demand concerns but firmed up in subsequent months. Agricultural prices eased overall, mainly led by cereals, even as vegetable oils increased on account of tighter supplies and stronger demand. Brent crude prices remained volatile, with a downward bias during this period, in response to shifting demand conditions and supply outlook.

Turning to the domestic economy, India's credit rating was recently upgraded to BBB+ (Stable) by Rating and Investment Information, Inc. (R&I), Japan, and to BBB (Stable) by Standard and Poor's (S&P) Global Ratings, reflecting confidence in the country's strong domestic demand, fiscal discipline, and external stability. Real gross domestic product (GDP) expanded by 7.8 per cent in Q1:2025-26, the fastest pace in seven quarters. Growth was driven by strong private and government consumption and buoyant gross fixed capital formation. On the supply side, real gross

¹ The estimates and projections in the October 2025 MPR are based on statistical information available till September 26, 2025, which may not reflect the latest available data in all cases.

value added (GVA) rose by 7.6 per cent, driven by a 9 per cent expansion in services, and robust growth in manufacturing. Agriculture and allied activities also improved with a 3.7 per cent increase.

Headline Consumer Price Index (CPI) inflation eased to 3.2 per cent in April 2025, from 4.7 per cent in H2:2024-25, aided by favourable base effects and falling food prices. It moderated further to 1.6 per cent in July 2025, the lowest reading in eight years, as food inflation turned negative in June and July 2025. Even in August, inflation remained benign at 2.1 per cent driven down by deflation in vegetables and pulses. Core inflation (*i.e.*, CPI excluding food and fuel), however, largely remained steady around 4 per cent.

The Monetary Policy Committee (MPC) continued its easing cycle, initiated in February 2025, with a 25 basis points (bps) cut in April 2025, followed by a frontloaded cut of 50 bps in June 2025, bringing the repo rate down to 5.5 per cent. The stance of policy was shifted to accommodative in April from neutral in February but reverted to neutral in June indicating the limited policy space for further easing. In addition, the RBI announced a phased 100 bps reduction in the cash reserve ratio (CRR) in four tranches starting September 2025 to ease liquidity conditions. At its August meeting, the MPC kept the repo rate unchanged at 5.5 per cent while retaining the neutral stance, reaffirming its commitment to aligning inflation with the target while supporting growth.

On the brink of the next review of the monetary policy framework due in March 2026², the Reserve Bank has issued a discussion paper on August 21, 2025, inviting public comments on four key aspects – the choice between headline and core inflation, the appropriateness of the 4 per cent inflation target,

potential revisions to the tolerance band of +/- 2 per cent, and whether to maintain a specific target level or only a range for inflation.

Monetary Policy Committee Meetings: April 2025 – September 2025

The MPC met in April 2025 amidst heightened global uncertainties from trade tariff measures which impeded global growth and inflation prospects. The dollar index declined sharply and equity sell-offs became broad-based especially in emerging markets. On the domestic front, sustained rural demand, higher government capital expenditure, and healthy balance sheet of corporates and banks supported growth and the investment outlook, although the headwinds from global trade disruptions posed downside risks. Consequently, the real GDP growth projection for 2025-26 was revised downwards by 20 bps to 6.5 per cent. Headline CPI inflation declined by 160 bps during January-February 2025, reaching a 21-month low of 3.8 per cent in February 2025 on account of falling food prices. The outlook for food inflation improved with a broad-based seasonal correction in vegetable prices. It was expected to soften further, aided by robust *kharif* arrivals and record wheat production, despite risks from global market uncertainties and adverse weather. Consequently, the CPI inflation projection for 2025-26 was revised downwards to 4 per cent. The MPC noted that there was greater confidence in the durable alignment of headline inflation with the target, but growth still remained on a recovery path. Accordingly, the MPC unanimously voted to reduce the policy repo rate by 25 bps to 6.0 per cent and change the stance from neutral to accommodative to continue supporting growth.

At the time of the June 2025 meeting, uncertainty around the global economic outlook had somewhat

² In May 2016, the Reserve Bank of India Act, 1934 was amended to provide a statutory basis for the inflation targeting framework in India. As per Section 45ZA of the Act, the Central Government, in consultation with the Reserve Bank, is required to set the CPI-based inflation target once in every five years. For the first cycle (2016–2021) and the ongoing second cycle (2021-2026), the RBI was tasked with maintaining inflation at 4 per cent, with a tolerance band of +/- 2 per cent. The next review is due by March 2026.

eased, though global sentiments remained weak. Domestic economic activity was, however, expected to maintain momentum in 2025-26, supported by private consumption, traction in fixed capital formation, and the conclusion of the Free Trade Agreement (FTA) with the United Kingdom. Given the expected domestic resilience amid challenging external environment, the projection of real GDP growth for 2025-26 was retained at 6.5 per cent. Headline CPI inflation continued to decline in March and April, led by falling food prices while core inflation remained largely stable. With the outlook for food inflation also staying favourable, CPI inflation projection for 2025-26 was again revised downwards by 30 bps to 3.7 per cent. The MPC noted that the near- and medium-term outlook for inflation gave confidence that headline inflation would remain durably aligned with the target, and might even undershoot it marginally. However, growth remained lower than aspirations. Accordingly, the MPC voted, by a 5-1 majority, to reduce the policy repo rate by 50 bps to 5.5 per cent, frontloading the rate cut to stimulate private consumption and investment through policy levers to step up the growth momentum. One member voted for a smaller 25 bps cut in the policy repo rate. The stance was also changed from accommodative to neutral, recognising that after a cumulative policy rate cut of 100 bps in quick succession, monetary policy had limited space to support growth further.

In the run up to the August 2025 meeting, headline CPI inflation declined for the eighth consecutive month to 2.1 per cent in June 2025, primarily driven by a fall in food prices to new lows. Assuming a normal monsoon, CPI inflation projection for 2025-26 was revised downwards to 3.1 per cent. Domestic growth remained resilient, with private consumption aided by rural demand and fixed investment supported by buoyant government capex. Lower inflation, rising capacity utilisation, and congenial financial conditions continued to support growth outlook. However,

prolonged geopolitical tensions, persisting global uncertainties and volatility in global financial markets posed risks. Nonetheless, real GDP projection for 2025-26 was retained at 6.5 per cent. The MPC noted that while growth has held up well, the decline in inflation was largely driven by food prices, especially vegetables. Inflation was expected to firm up from Q4:2025-26. It also underscored that uncertainties on tariffs were still evolving, and the impact of past policy rate cuts were still progressing through the economy. Accordingly, the MPC unanimously voted to keep the repo rate unchanged at 5.5 per cent and to maintain the neutral stance.

The MPC's voting pattern reflects the diversity in individual members' assessments, expectations and policy preferences – a characteristic also reflected in voting patterns of other central banks (Table I.1). With the pace of disinflation slowing down or even reversing in some AEs, central banks are moving cautiously in this easing cycle. Among AEs, the US cut its policy rate for the first time this calendar year while Japan kept its policy rates unchanged over its last four meetings.

Table I.1 Monetary Policy Committees Meetings and Policy Rate Voting Patterns

Country	Policy Meetings: April 2025 - September 2025			
	Total meetings	Meetings with full consensus	Meetings without full consensus	Variation in policy rate (basis points)
Brazil	4	4	0	75
Chile	4	4	0	-25
Colombia	3	1	2	-25
Czech Republic	4	3	1	-25
Hungary*	6	5	0	0
India	3	2	1	-75
Japan	4	3	1	0
South Africa	3	1	2	-50
Sweden	4	3	1	-50
Thailand	3	1	2	-50
UK	4	0	4	-50
US	4	2	2	-25

Notes: 1. Minus sign indicates a reduction in policy rate.

2. *: Total number of meetings happened is six. However, the minutes of last meeting (September 23, 2025) is not published to date.

Sources: Central bank websites.

Factors conditioning the Macroeconomic Outlook

Macroeconomic developments pertaining to inflation and economic activity during H1:2025-26 (April-September 2025) are analysed in Chapters II and III. Going forward, the outlook is premised on a set of baseline assumptions. First, the baseline assumption for crude oil prices (Indian basket) is retained at US\$ 70 per barrel for the second half of 2025-26 (Table I.2). International crude oil prices fell sharply in April due to demand concerns stemming from growth-disruptive tariff announcements, and continued its downward trajectory in May as supply outpaced demand, particularly from Organization of the Petroleum Exporting Countries *plus* (OPEC+) economies. In June, however, prices surged intermittently as escalating tensions between Russia and Ukraine, and intensifying conflict between Israel and Iran, heightened the risk premia amidst fears of supply chain disruptions. Since July, crude prices have resumed downward trend, supported by easing geopolitical tensions and improving fundamentals (Chart I.1a). The consistent rise in crude oil inventory levels since Q3:2024, and their sustained elevation through 2025, reflects underlying positive supply-side developments including increased output from

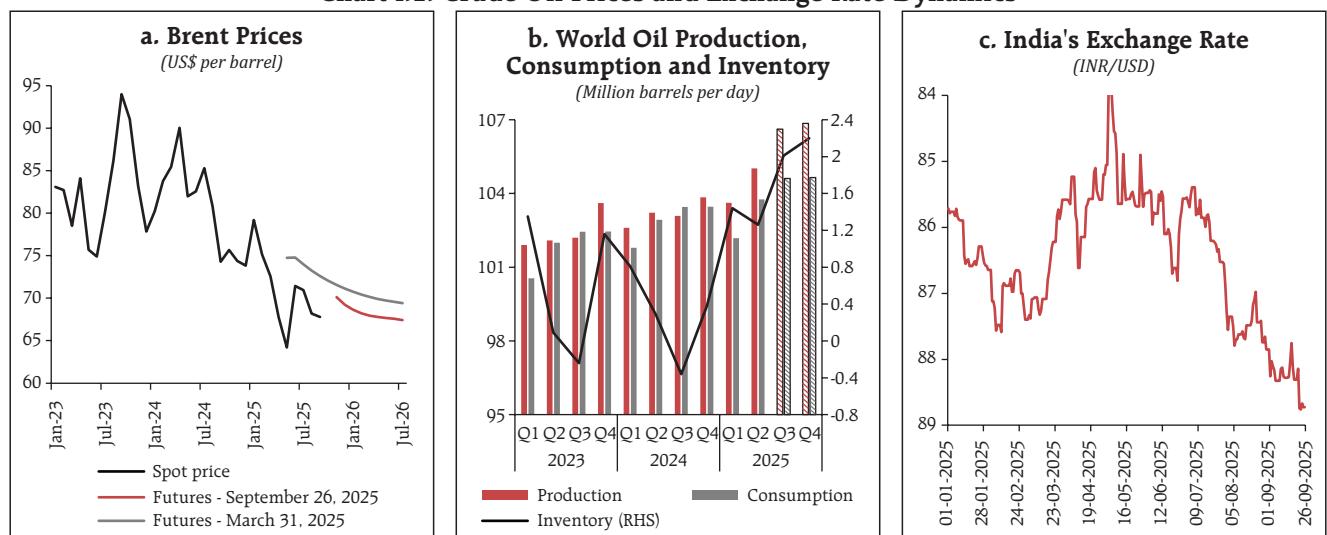
Table I.2: Baseline Assumptions for Projections

Indicator	MPR April 2025	MPR October 2025
Crude Oil (Indian Basket)	US\$ 70 per barrel during 2025-26	US\$ 70 per barrel during H2: 2025-26
Exchange rate	₹ 86/US\$ during 2025-26	₹ 88/US\$ during H2: 2025-26
Monsoon	Normal for 2025-26	Normal for 2026-27
Global growth	3.1 per cent in 2025 3.0 per cent in 2026	3.0 per cent in 2025 3.1 per cent in 2026
Fiscal deficit (Per cent of GDP)	To remain within BE 2025-26 Centre: 4.4 Combined: 7.1	To remain within BE 2025-26 Centre: 4.4 Combined: 7.4
Domestic macroeconomic/ structural policies during the forecast period	No major change	GST rationalisation

- Notes:**
1. The Indian basket of crude oil represents a derived numeraire comprising sour grade (Oman and Dubai average) and sweet grade (Brent) crude oil.
 2. The exchange rate path assumed here is for the purpose of generating the baseline projections and does not indicate any 'view' on the level of the exchange rate. The Reserve Bank is guided by the objective of containing excess volatility in the foreign exchange market and not by any specific level of and/or band around the exchange rate.
 3. BE: Budget estimates.
 4. Combined fiscal deficit refers to that of the Centre and States taken together.

Sources: RBI estimates; Budget documents; and the International Monetary Fund (IMF).

Chart I.1: Crude Oil Prices and Exchange Rate Dynamics



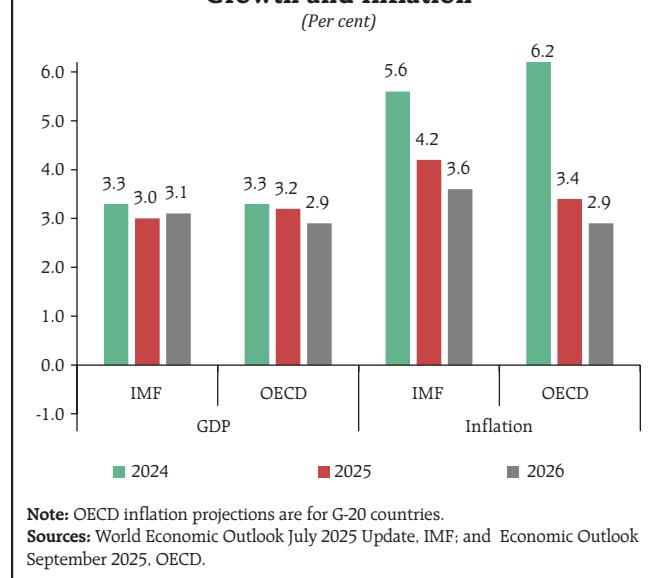
OPEC+ countries³ (Chart I.1b). Considering the downward shift in the oil futures curve since the April 2025 MPR, along with projections of higher production and continued inventory build-up, the supply-demand outlook for crude oil remains broadly favourable. Upside risks, however, persist due to heightened geopolitical uncertainty.

Second, in view of ongoing uncertainty surrounding the US dollar and the volatility in global capital flows, the baseline assumption for the exchange rate has been increased to ₹88 per US dollar for the second half of 2025-26, from ₹86 per US dollar in the April 2025 MPR. The Indian rupee appreciated by over 1 per cent (month-on-month [m-o-m]) in April 2025, in line with other emerging market currencies, mirroring the weakness of the US dollar amidst rising economic uncertainty in the US (Chart I.1c). Since May and up to the first half of July, the rupee remained largely stable, trading around ₹85 per US dollar, despite elevated trade tensions and geopolitical risks. From mid-July onwards, the rupee exhibited depreciating bias, moving within a range of ₹85.8-₹88.76. This movement was driven by portfolio outflows, increase in US tariff rates on Indian exports, and narrowing interest rate differentials. Nevertheless, India's strong macroeconomic fundamentals and growth prospects continue to provide underlying support to the currency. Overall, in H1:2025-26, the Indian rupee exhibited two-way movement, hovering close to ₹86.4 per US dollar, on average, with volatility lower than that of most other emerging market economy (EME) currencies.⁴

Third, according to the International Monetary Fund (IMF), the global economy is projected to grow at 3.0 per cent in 2025 and 3.1 per cent in 2026. These projections are below the estimated outcome of 3.3 per cent in 2024 and the pre-pandemic historical

average of 3.7 per cent (Chart I.2). The slowdown is broad-based, affecting both AEs and emerging market and developing economies (EMDEs). Growth in AEs is expected to decline to 1.5 per cent in 2025 from 1.8 per cent in 2024, while EMDEs are projected to grow at 4.1 per cent in 2025, marginally lower than 4.3 per cent in 2024. In its Economic Outlook (September 2025), the Organisation for Economic Cooperation and Development (OECD) also anticipates a slowdown, despite a marginal upwards revision for 2025. Global GDP growth is projected to decelerate from 3.3 per cent in 2024, to 3.2 per cent in 2025 and 2.9 per cent in 2026, as front-loading ceases and higher tariff rates and still-high policy uncertainty dampen investment and trade. World trade volume (goods and services), as projected by the IMF, is also expected to lose momentum, with growth slowing from 3.5 per cent in 2024 to 2.6 per cent in 2025 and further to 1.9 per cent in 2026. This is because the near-term boost from front-loading of trade flows is expected to wane in the rest of 2025. Global inflation is projected to ease, with

Chart I.2: IMF and OECD projections for Growth and Inflation



³ On August 3, OPEC+ members again agreed to accelerate their scheduled production increases. The 2.2 million barrels per day (b/d) of production cuts announced in November 2023 and initially scheduled to be fully unwound by September 2026 will now be fully unwound by September 2025. Also, on September 7, OPEC+ announced that it plans to raise production by 137 thousand b/d in October 2025.

⁴ Indian rupee was less volatile, calculated via standard deviation, than MSCI EME currency index during H1:2025-26.

headline inflation expected at 4.2 per cent in 2025 and 3.6 per cent in 2026, supported by softening energy prices and subdued demand conditions. Inflation dynamics are, however, expected to diverge across economies. In the US, tariffs are likely to function as a supply-side shock, gradually passing through to consumer prices and pushing inflation higher in the latter half of 2025. In contrast, higher tariffs are expected to dampen export demand and thereby exert downward pressure on inflation in other regions.

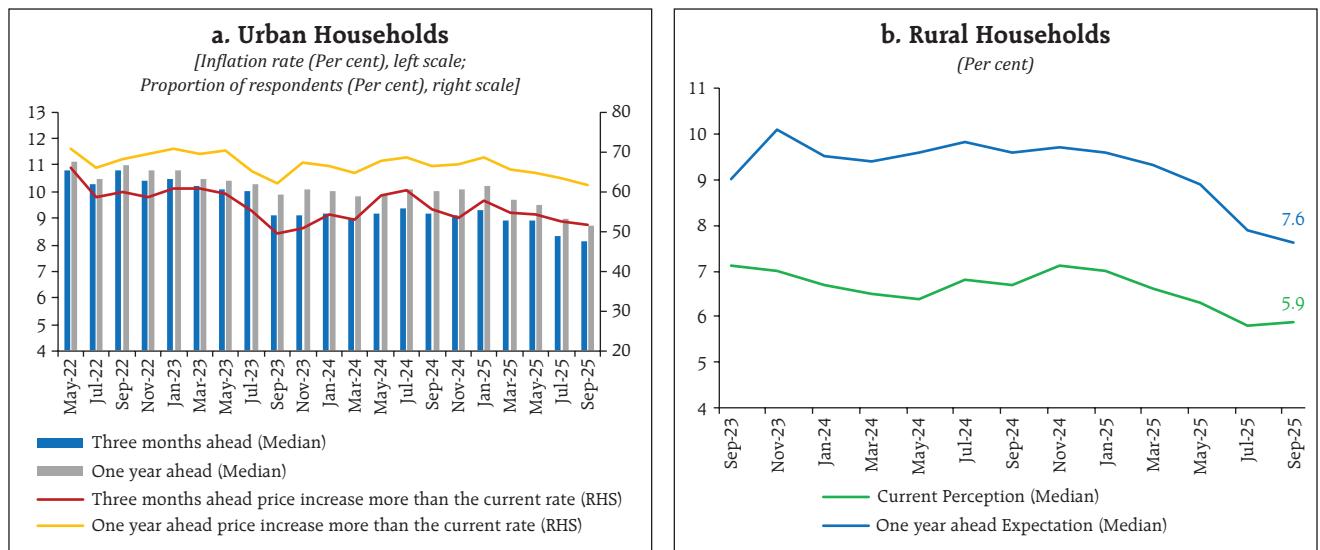
I.2 The Outlook for Inflation

In H1:2025-26 (up to August), headline inflation has remained well below 4 per cent driven by benign food prices and favourable base effects. However, it increased to 2.1 per cent in the month of August as compared to 1.6 per cent in July 2025 which is a first increase recorded after nine consecutive months of decline. In the September 2025 round of the Reserve Bank's bi-monthly households survey⁵, the three months and one year ahead inflation expectations of

urban households moderated by 20 bps to 8.1 per cent and 30 bps to 8.7 per cent, respectively. The shares of respondents anticipating a rise in inflation declined for the near term and year ahead compared to the previous round (Chart I.3a). Urban households' long-term expectations on inflation have been sequentially declining for the past four survey rounds. Additionally, as per the Reserve Bank's recent bi-monthly Rural Consumer Confidence Survey (RCCS)⁶, the current perception of inflation (*vis-à-vis* a year ago) of the rural and semi-urban households inched up by 10 bps to 5.9 per cent in September 2025 as compared with the previous round. However, their year ahead inflation expectations declined by 30 bps to 7.6 per cent (Chart I.3b). Rural households' long term expectations of inflation has been sequentially declining for the past five rounds of survey.

Manufacturing firms polled in the July-September 2025 round of the Reserve Bank's quarterly industrial outlook survey expect pressures from

Chart I.3: Inflation Expectations of Households



Sources: Inflation Expectations Survey of Households; and Rural Consumer Confidence Survey of Households, RBI.

⁵ The Reserve Bank's inflation expectations survey of households is being conducted in 19 cities since March 2021 (18 cities in the previous rounds) and the results of the September 2025 round are based on responses from 6,082 households.

⁶ The Reserve Bank's rural consumer confidence survey is being conducted across all Indian states and three major UTs since July 2024 and the results of the September 2025 round are based on responses from 8,848 respondents.

cost of raw materials to ease in Q3:2025-26. The growth in selling prices is expected to be higher vis-à-vis the previous quarter (Chart 1.4a).⁷ Services firms expect stable input cost pressures but higher growth in selling prices in Q3, while firms from infrastructure sector anticipate easing of cost pressures and expect lower growth in selling prices. (Chart 1.4b and 1.4c).⁸ In the Purchasing Managers' Index (PMI) surveys for August 2025, services firms reported a substantial increase in input and output prices vis-à-vis the previous month due to higher labour costs and robust demand conditions, while manufacturing firms reported only a marginal increase in both prices.

Professional forecasters surveyed by the Reserve Bank in September 2025 forecasted CPI inflation to decrease from 2.7 per cent in Q1:2025-26 to 1.9-2.0 per cent in Q2 and Q3. It is expected to increase gradually to 3.6 per cent in Q4 and further to 4.2 per cent in H1:2026-27 (Chart I.5a and Table I.3).⁹ Core inflation (i.e., CPI excluding food and beverages, pan, tobacco and intoxicants, and fuel and light) is expected to be

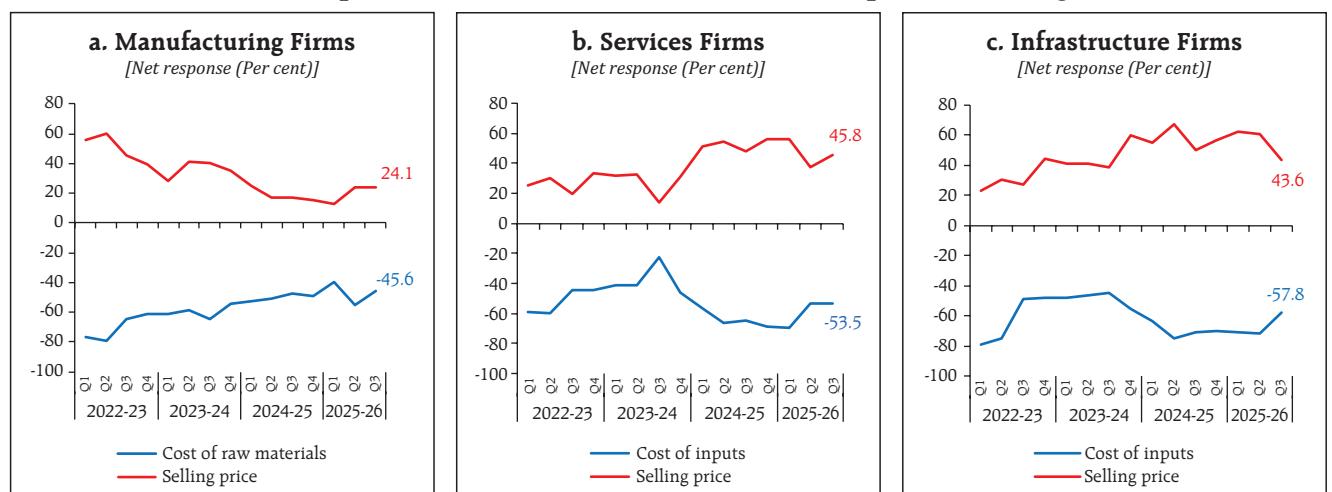
at 4.2 per cent during Q2:2025-26, thereafter, remain around 4.0 per cent till Q4 and further soften to 3.8-3.9 per cent in H1:2026-27.

Long-run inflation expectations of professional forecasters – measured by their five and ten years ahead expectations – have eased to 4.0 per cent in the current round (Chart 1.5b).

Looking ahead, the inflation outlook will depend upon several factors, both global and domestic. Assuming a normal monsoon and a sustained reduction in food inflation, the quarterly CPI inflation forecasts for 2025-26 have been adjusted downward in RBI staff projections. Nevertheless, inflation is expected to rise from the final quarter of this financial year, yet the recent GST rationalization among other favourable factors will help keep overall inflation low during 2025-26. While the uncertainties surrounding tariffs continue to remain, the impact of previous policy rate reductions are still unfolding.

Considering the initial conditions, signals from forward-looking surveys and estimates from time-

Chart I.4: Expectations about Cost of Raw Materials/Inputs and Selling Prices



Note: Net response is the difference between the share of respondents reporting optimism and those reporting pessimism. The range is -100 to 100. A positive/ negative value of net response is considered as optimistic/pessimistic from the viewpoint of respondent firms. Therefore, higher positive values of selling prices indicate increase in output prices while lower values for the cost of raw materials/cost of inputs indicate higher input price pressures and vice versa.

Sources: Industrial Outlook Survey and Services and Infrastructure Outlook Survey, RBI.

⁷ The results of the July-September 2025 round of the industrial outlook survey are based on responses from 1,106 companies.

⁸ Based on 614 services companies and 92 infrastructure firms polled in the July-September 2025 round of the services and infrastructure outlook survey.

⁹ Forty-eight panellists participated in the September 2025 round of the Reserve Bank's Survey of Professional Forecasters.

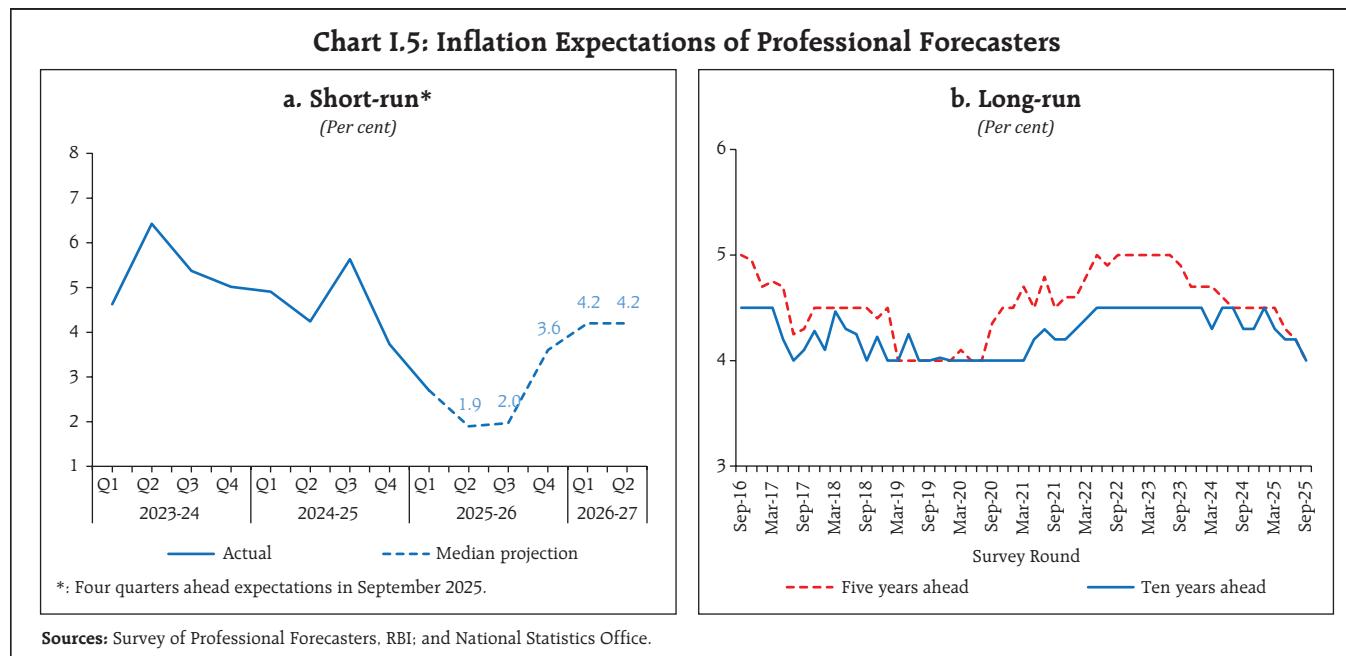


Table I.3: Projections - Reserve Bank and Professional Forecasters

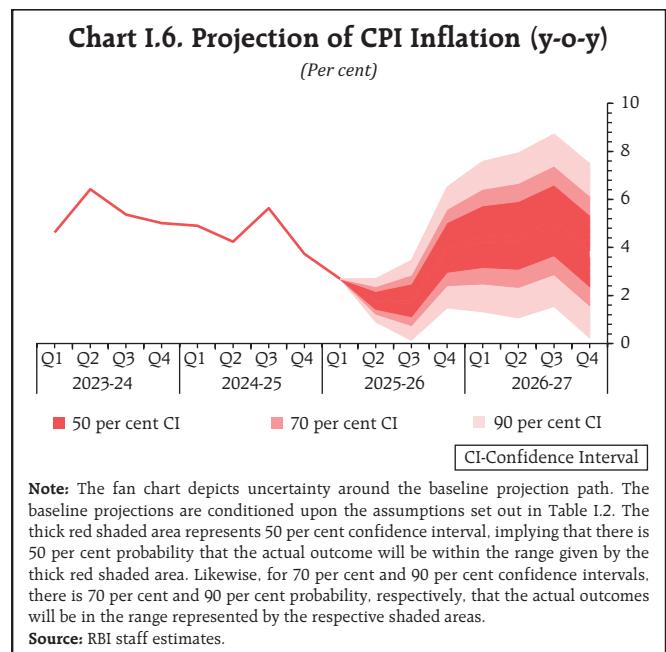
(Per cent)

	2025-26	2026-27
Reserve Bank's Baseline Projections		
Inflation	2.6	4.5
Real GDP growth	6.8	6.6
Median Projections of Professional Forecasters		
Inflation, Q4 (y-o-y)	3.6	-
Real GDP growth	6.7	6.5
Gross domestic saving (per cent of GNDI)	30.0	30.4
Gross capital formation (per cent of GDP)	32.8	33.0
Credit growth of scheduled commercial banks	11.0	11.5
Combined gross fiscal deficit (per cent of GDP)	7.4	7.1
Central government gross fiscal deficit (per cent of GDP)	4.4	4.2
Repo rate (end-period)	5.25	-
Yield on 91-days treasury bills (end-period)	5.5	6.0
Yield on 10-year central government securities (end-period)	6.4	6.5
Overall balance of payments (US\$ billion)	7.6	20.0
Merchandise exports growth	0.2	5.0
Merchandise imports growth	2.5	6.0
Current account balance (per cent of GDP)	-0.9	-0.9

Note: GNDI: Gross National Disposable Income.

Source: RBI staff estimates; and Survey of Professional Forecasters (September 2025).

series and structural models¹⁰, CPI inflation is projected to average 2.6 per cent in 2025-26 with 1.8 per cent in both Q2 and Q3 and 4.0 per cent in Q4, with risks evenly balanced (Chart I.6 and Table 1.3). The 50 per cent and the 70 per cent confidence intervals for headline inflation in Q4:2025-26 are



¹⁰ Joice John, Deepak Kumar, Asish Thomas George, Pratik Mitra, Muneesh Kapur and Michael Debabrata Patra (2023), "A Recalibrated Quarterly Projection Model (QPM 2.0) for India", *Reserve Bank of India Bulletin*, February, Volume LXXVII(2), pp.59-77.

3.0-5.0 per cent and 2.4-5.6 per cent, respectively. For 2026-27, assuming a normal monsoon, and no further exogenous or policy shocks, structural model estimates indicate that inflation will average 4.5 per cent with 4.5 per cent in both Q1 and Q2, 5.1 per cent in Q3 and 3.9 per cent in Q4. The 50 per cent and the 70 per cent confidence intervals for headline inflation in Q4:2026-27 are 2.4-5.3 per cent and 1.6-6.1 per cent, respectively.

The baseline forecasts are subject to several upside and downside risks. The upside risks emanate from supply disruptions caused by weather-related shocks and prolonged geopolitical conflicts. The downside risks could emanate from an early resolution of geopolitical conflicts and tariff related uncertainties; global growth moderation; softening commodity prices; and improvement in supply conditions.

I.3 Growth Outlook

Domestic economic activity remains resilient, supported by strong private consumption, government consumption and fixed investment. An above-normal southwest monsoon, congenial financial conditions, rising capacity utilisation, the government's continued thrust on capital expenditure, and GST 2.0 reforms augured well for the growth outlook. Improving credit conditions are also likely to spur aggregate demand conditions in the near-term (Box I.1). However, outlook remains uncertain due to external demand uncertainty driven by tariffs; prolonged geopolitical tensions; and volatility in global financial markets.

Turning to the key messages from forward-looking surveys, bi-monthly consumer confidence (the

Box I.1: The Effect of Credit Conditions on Monetary Policy

The interest rate channel is central to the conduct of monetary policy under inflation targeting: the central bank influences the price of credit (interest rates) through its control over the price of bank reserves. This, *ceteris paribus*, affects the quantity of lending and thereby demand conditions in the economy. This is considered the primary channel of macroeconomic stabilization through monetary policy. Yet, this textbook narrative and its underlying assumptions simplify the more sophisticated role played by credit-issuing financial institutions in modern monetary economies.

Changes in funding costs are an important determinant of portfolio management by credit-issuing financial institutions, with loan creation on the asset side being the key indicator of importance from a monetary policy perspective. However, credit supply is also influenced by macroeconomic outlook, financial stability concerns, regulatory requirements, institutional objectives, and broader uncertainties. Thus, the resulting financial strategies can generate shifts in credit supply, at times autonomous of monetary policy. These shifts nonetheless have implications for monetary policy.

Chart I.1.1.a presents an index of the supply of credit in the Indian economy in the post-Covid19 period, with a

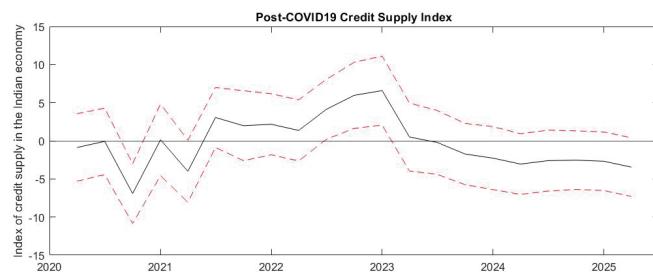
higher index indicating tighter credit supply. This index is estimated using India's credit-to-GDP gap series of the *Bank for International Settlements (BIS)*, controlling for aggregate demand conditions and the effects of monetary policy. Credit supply conditions eased substantively in response to counter the economic fallout of the Covid-19 pandemic, but tightened significantly thereafter to control the inflationary fallout of the Russia-Ukraine conflict. Subsequently, credit supply conditions have eased. In this context, the size of recent deviation of the credit supply index from its average value is used here to simulate the macroeconomic impact of shocks to credit supply in the Indian economy using the Quarterly Projection Model (QPM 2.0).

Chart I.1.1.b shows the baseline path and probability distribution of credit conditions of an expansionary shock to credit supply (a negative shock indicates looser credit conditions) as observed in the recent period with an assumption of no further shocks of any kind to the economy. In the baseline case, buoyant credit supply may spur aggregate demand conditions in the near-term (Chart I.1.1.c), with quantity effects moderating in the medium-term. However, such a shock may push up core

(Contd.)

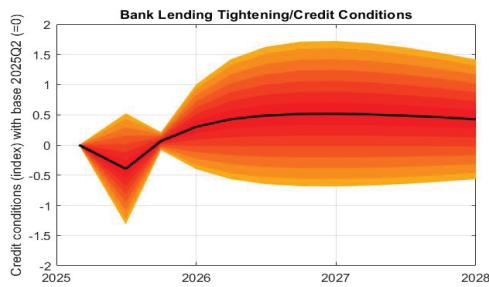
Chart I.1.1: Impact of Credit Conditions

a. An Index of Credit Supply in the Recent Period



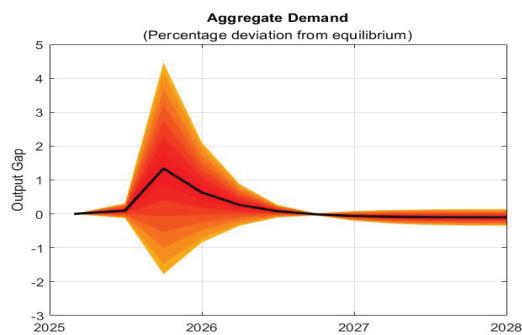
Note: The credit supply index here has been derived econometrically by regressing the credit-to-gdp gap on output gap with appropriate leads and lags. The residual series has been smoothed using a state-space model with stochastic volatility framework, and is an index of credit supply. The dotted lines represent one standard deviation dispersion. Higher index indicates tighter credit supply.

b. Effect of Changes in Credit Supply on Aggregate Credit Conditions

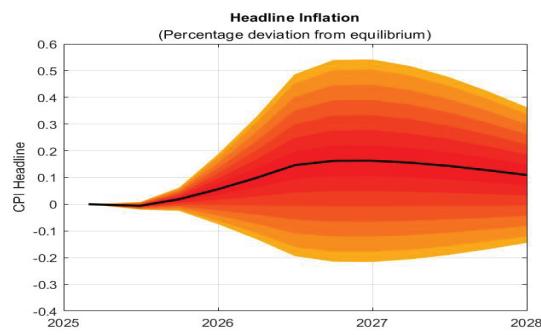


Note: higher index indicates tighter credit conditions. The dark line is the baseline case of expansionary shock to credit supply with the dispersion representing variance conditional on shock size. The subsequent path is under the assumption of no further macroeconomic shocks of any kind.

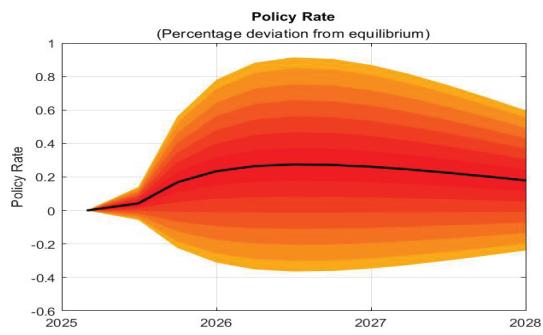
c. Effect of Changes in Credit Conditions on Aggregate Demand



d. Effect of Changes in Credit Conditions on Headline Inflation



e. Effect of Changes in Credit Conditions on the Projected Policy Rate Path



and therefore headline inflation (Chart I.1.1.d), with price rigidities leading to prolonged adjustment. Consequently, the projected policy rate path may harden to counter-cyclically stabilise the economy (Chart I.1.1.e). The spread of the fan charts indicate that the probability distribution in these macroeconomic variables is conditional upon the assumption of balanced risks and the change in credit conditions.

Reference:

Joice John, Deepak Kumar, Asish Thomas George, Pratik Mitra, Muneesh Kapur and Michael Debabrata Patra (2023), "A Recalibrated Quarterly Projection Model (QPM 2.0) for India", *Reserve Bank of India Bulletin*, February, Volume LXXVII(2), pp.59-77.

current situation index) for both urban¹¹ and rural¹² households improved marginally in September 2025 vis-à-vis the previous round on account of improved sentiments across most of the survey parameters. Although it remains in the pessimistic zone for urban households, it is in the optimistic zone for rural households.

Consumers' optimism for the year ahead, measured by the future expectations index, strengthened further for both urban and rural households, remaining in optimistic territory (Chart I.7).

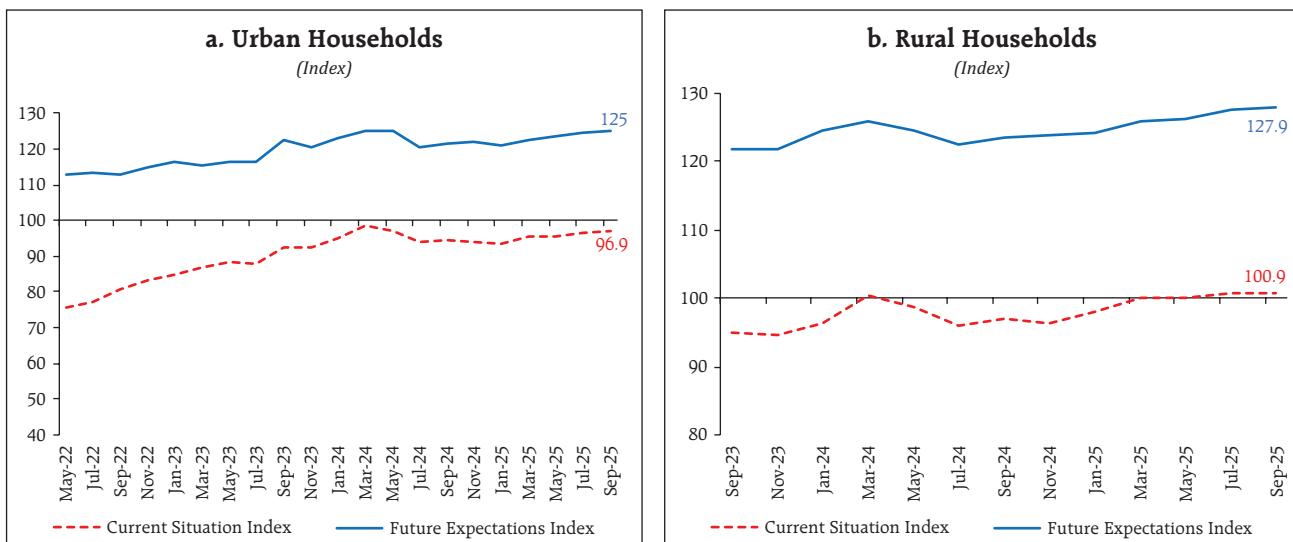
In the Reserve Bank's quarterly industrial outlook survey of July-September 2025, manufacturing firms continued to hold an optimistic business outlook (BAI/BEI)¹³ during Q3:2025-26 (Chart I.8a). The services and infrastructure companies also continue to remain optimistic on overall business situation in Q3:2025-26 (Charts I.8b and I.8c).

Recent surveys by other agencies indicate a mixed picture on business expectations relative to the previous round (Table I.4). In the PMI surveys for August 2025, both manufacturing and services firms reported improvements in a year ahead sentiment, driven by expectations of stronger demand.

Professional forecasters polled in September 2025 round of the Reserve Bank's survey projected real GDP growth at 6.8 per cent during Q2:2025-26. Growth is expected around 6.1-6.5 per cent during Q3:2025-26 to Q2:2026-27 (Chart I.9).

Real GDP growth was higher at 7.8 per cent in Q1:2025-26 as compared with 7.4 per cent in Q4:2024-25, mainly driven by robust fixed investment, private and Government consumption. Taking into account the baseline assumptions, survey indicators and model forecasts, real GDP growth is expected at 6.8 per cent in 2025-26 with 7.0 per cent in Q2; 6.4 per cent in Q3;

Chart I.7: Consumer Confidence

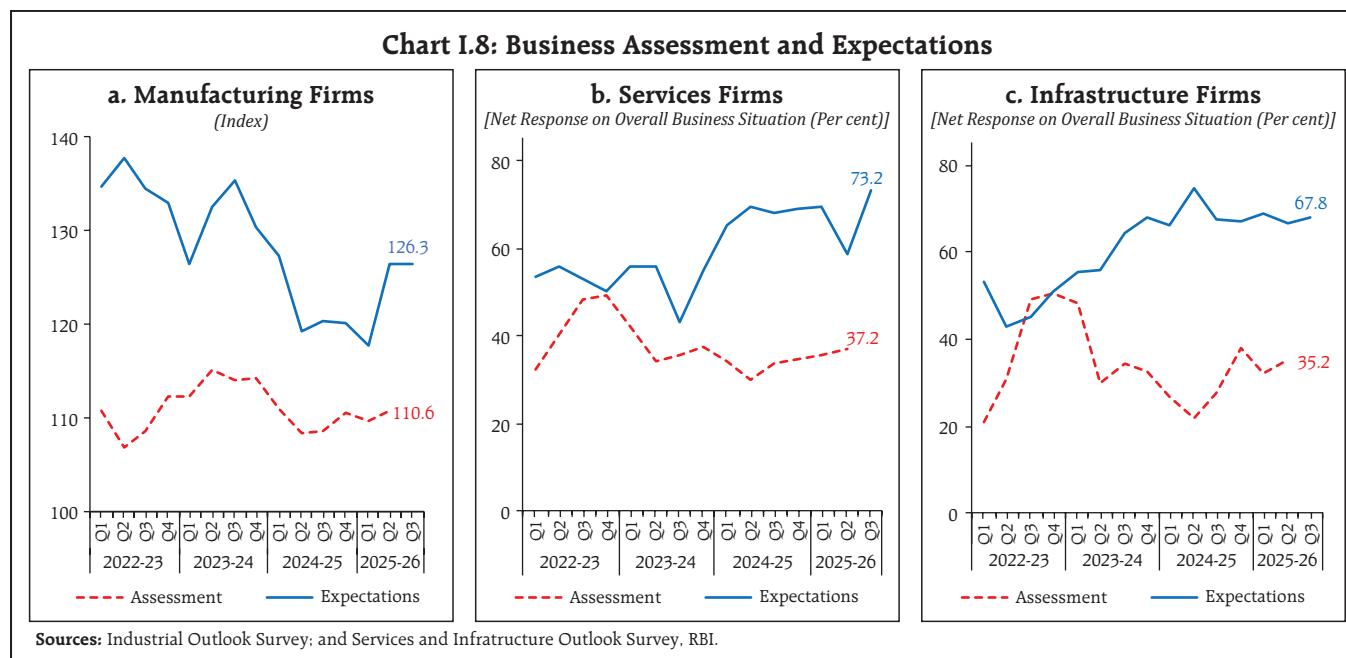


Sources: Urban Consumer Confidence Survey; and Rural Consumer Confidence Survey, RBI.

¹¹ The Reserve Bank's urban consumer confidence survey is being conducted in 19 cities since March 2021 (13 cities in the previous rounds) and the results of the September 2025 round are based on responses from 6,068 respondents.

¹² The Reserve Bank's rural consumer confidence survey is being conducted across all Indian states and three major UTs since July 2024 and the results of the September 2025 round are based on responses from 8,848 respondents.

¹³ Business Assessment Index (BAI)/Business Expectations Index (BEI) gives a snapshot of demand conditions in the manufacturing sector by combining nine parameters – (i) overall business situation, (ii) production, (iii) order books, (iv) inventory of raw material, (v) inventory of finished goods, (vi) profit margin, (vii) employment, (viii) exports and (ix) capacity utilisation. A value above 100 indicates an expansion of the overall business activity and value below 100 indicates contraction.



and 6.2 per cent in Q4 – and risks evenly balanced around this baseline path (Chart I.10 and Table I.3). Assuming a normal monsoon and no major exogenous or policy shocks, structural model estimates for 2026-27 indicate real GDP growth at 6.6 per cent, with Q1 at 6.4 per cent, Q2 at 6.6 per cent, Q3 at 6.8 per cent and Q4 at 6.5 per cent.

There are upside and downside risks to this baseline growth path. The upside risks emanate from revival in private investment; early resolution of global trade related issues; and sustained softening of global commodity prices. On the contrary, increasing trade fragmentation due to protectionist policies;

further escalation in geopolitical tensions; volatility in global financial markets; frequent weather-related disturbances; and supply chain disruptions pose downside risks to the baseline growth path.

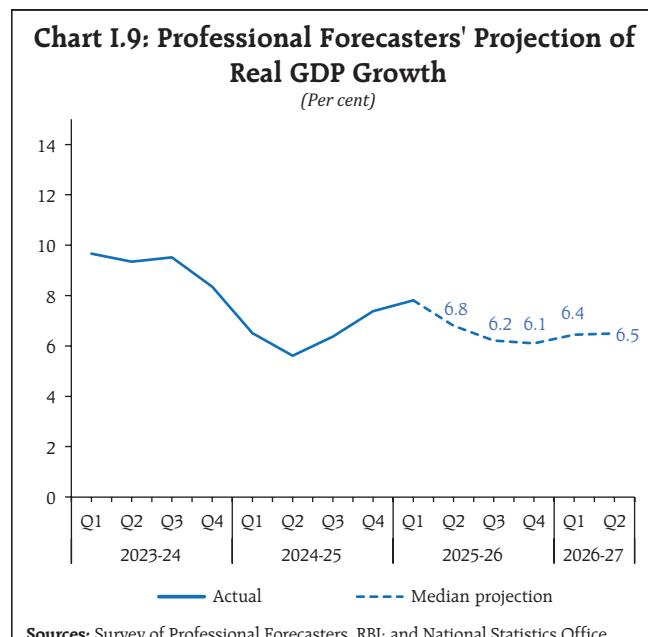
I.4 Balance of Risks

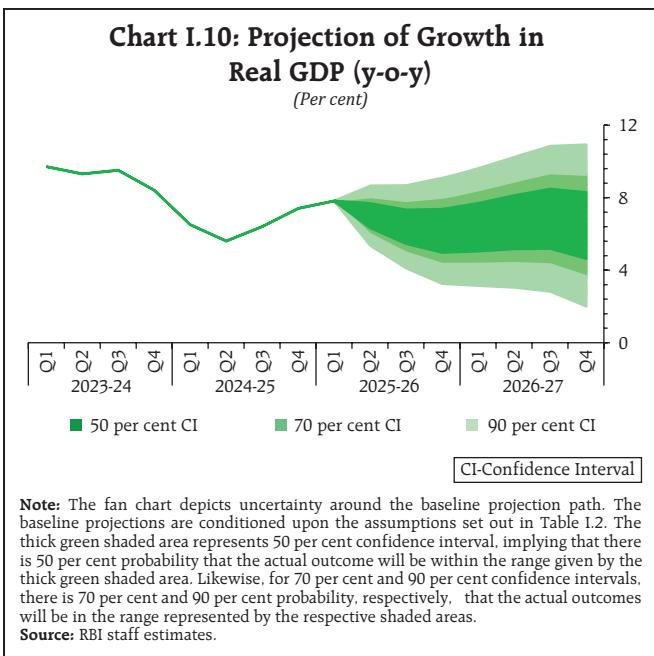
The baseline projections of growth and inflation are conditional on assumptions relating to key domestic and global macroeconomic variables that are set out

Item	NCAER Business Confidence Index (August 2025)	Dun and Bradstreet Composite Business Optimism Index (July 2025)
Current level of the index	149.4	117.5
Index as per previous survey	139.3	120.2
% change (q-o-q) sequential	7.3	-2.3
% change (y-o-y)	-0.3	4.8

Notes: 1. NCAER: National Council of Applied Economic Research.
2. Dun and Bradstreet Composite Business Optimism Index is for Q2:2025-26 and NCAER Business Confidence Index is for Q1:2025-26.

Sources: NCAER and Dun & Bradstreet Information Services India Pvt. Ltd.





in Table 1.2. These baseline assumptions are subject to uncertainties emanating from US trade policies, protracted geopolitical hostilities, volatility in global financial markets and adverse weather shocks. Against this backdrop, this section explores the balance of risks around the baseline projections of inflation and growth under plausible alternative scenarios.

(i) Global Growth Uncertainties

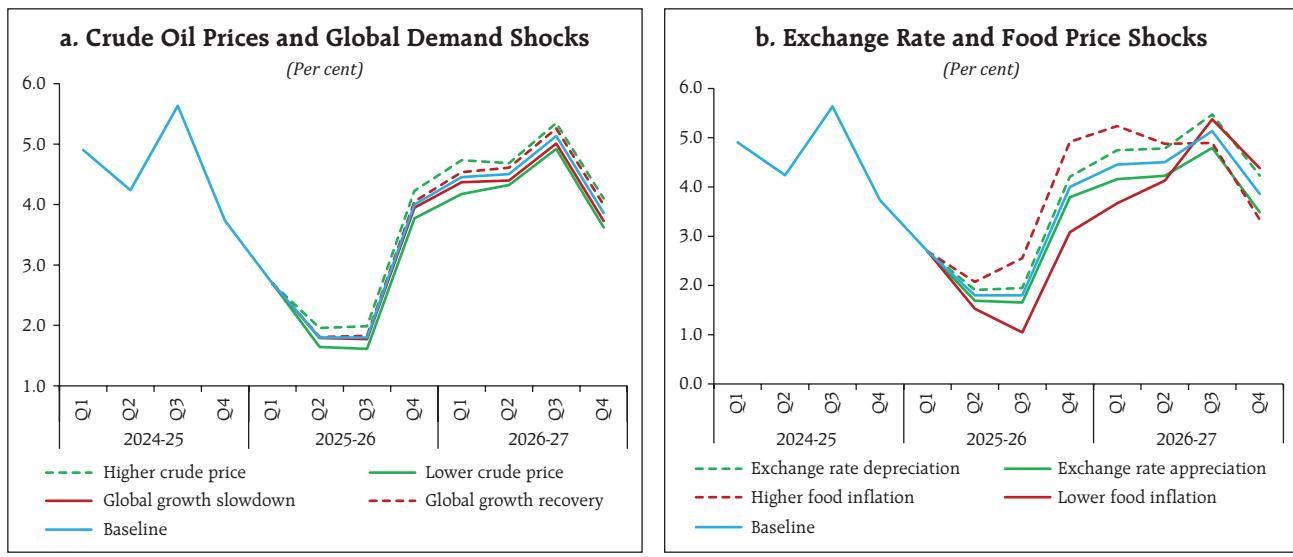
Global economic activity remained steady in H1:2025, but the driver of growth was mainly the frontloading of exports. The economic landscape world-wide remains in flux amidst shifting trade pattern and persisting uncertainty about US trade policies with key partners, posing considerable downside risks to global growth prospects. Additionally, heightened geopolitical tensions could further disrupt global supply chains and exacerbate upward pressure on commodity prices. Wider fiscal imbalances or a shift towards greater risk aversion could push up long-term interest rates and tighten global financial conditions. Along with concerns on geo-economic fragmentations, such developments may spark volatility in global financial markets with spillover effects in emerging market economies (EMEs). The persistent inflation pressures could prompt major central banks to keep

rates elevated despite weak growth. Global economic outlook is also subject to headwinds from adverse weather shocks and technological disruptions. Given this backdrop, if global growth turns out to be 100 bps below the baseline, domestic growth and inflation could be lower by around 30 bps and 15 bps, respectively. On the upside, a more constructive outcome from trade negotiations resulting in reduced tariffs and a stable framework could bolster global growth. Moreover, growth could improve if major economies work together on policies that stabilise prices and strengthen fiscal position, and push forward structural reforms. On the positive side, if global growth is higher by 50 bps relative to the baseline, domestic growth and inflation could turn out to be higher by around 15 bps and 7 bps, respectively (Charts I.11a and I.12a).

(ii) International Crude Oil Prices

Global crude oil prices exhibited a declining trend with Brent crude falling from a high of US\$ 77 per barrel in early-April 2025 to US\$ 68 per barrel during September 2025. Protracted geopolitical tensions resulting in reduced supply, sanctions on major oil producing countries, supply shortages due to lower investment in new oil projects owing to energy transitions and faster than expected recovery in global demand may put upward pressure on crude oil prices. In this scenario, if crude oil prices are higher by 10 per cent than the baseline, and assuming full pass-through to domestic product prices, inflation could turn out to be higher by 30 bps and growth may be lower by around 15 bps. Conversely, weak global demand conditions as discussed above, unwinding of production cuts by OPEC+ countries given effective spare capacity in major producing countries, and quicker resolution of geopolitical conflicts may dampen crude oil prices. If crude oil prices are lower by 10 per cent relative to the baseline, inflation could be lower by around 30 bps and boosting GDP growth by 15 bps (Charts I.11a and I.12a).

Chart I.11: Impact of Risk Scenarios on the Baseline Inflation Path



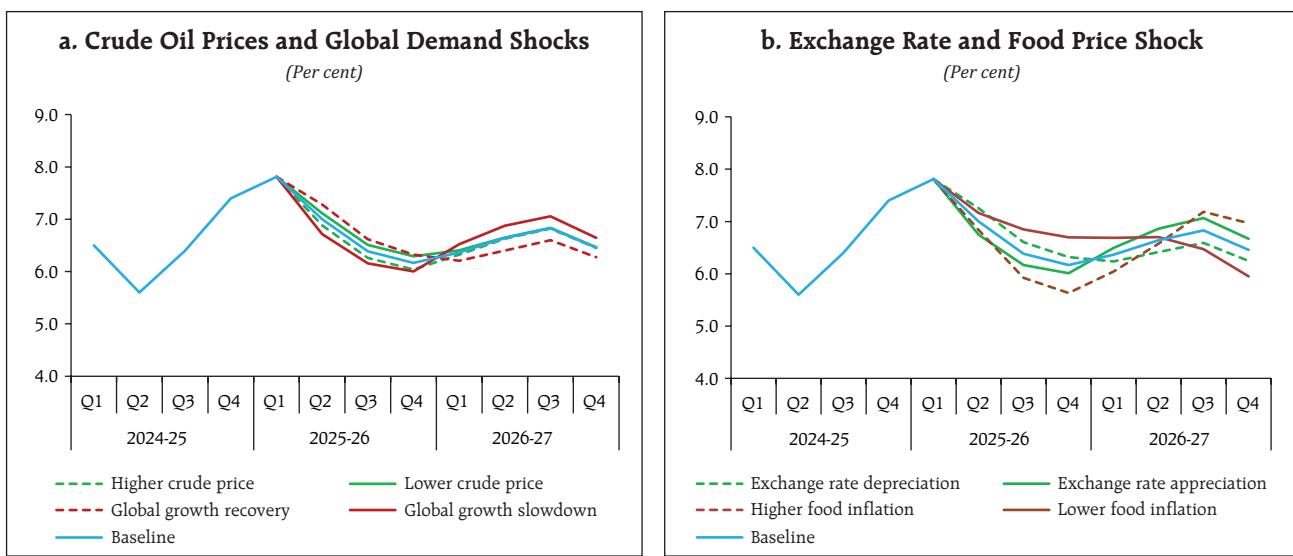
Sources: RBI staff estimates.

(iii) Exchange Rate

Notwithstanding intermittent phases of appreciation, the Indian Rupee (INR) depreciated *vis-à-vis* the US dollar during April-September 2025, largely owing to global trade uncertainties and capital outflows. Going ahead, volatility in global financial markets owing to slowing global trade and demand may exert downward pressure on the currency. This may be

exacerbated by growing risk aversion on EMEs among global investors. Strengthening of the US dollar may also lower the attractiveness of EME assets. Higher international crude oil prices due to sanctions and persisting geopolitical tensions may also contribute to weakening of the INR. In this scenario, if INR depreciates by 5 per cent over the baseline, inflation could be higher by around 35 bps and GDP growth

Chart I.12: Impact of Risk Scenarios on the Baseline Growth Path



Sources: RBI staff estimates.

may benefit by around 25 bps through the exports channel in the short term. On the other hand, the Indian rupee has been the least volatile among EMDE currencies, drawing confidence from stable inflation and resilient growth outlook. Going ahead, these positive sentiments along with greater than expected monetary policy accommodation by the major central banks and improved trade outlook may attract capital inflows, lending support to the INR. In this scenario, an appreciation of 5 per cent of the INR relative to the baseline would lead to a moderation in inflation and GDP growth by around 35 bps and 25 bps, respectively (Charts I.11b and I.12b).

(iv) Food Inflation

Food prices turned deflationary in recent months due to a sharp fall in vegetable prices owing to subdued seasonal uptick, supported by government's effective supply side measures, and favourable base effect. Soft prices prevailed across food categories, with pulses and spices continuing to remain in deflation, while cereal inflation exhibited a pronounced moderation. The strong monsoon and the resultant robust *kharif* sowing, large buffer stocks, and improved prospects for *rabi* crops from adequate reservoir levels could keep pressures on food inflation muted. In such a scenario, headline inflation may moderate by around 50 bps relative to the baseline. On the other hand, higher than expected momentum in the prices of perishable food items and lower agricultural production owing

to adverse weather events may increase food prices. These circumstances may result in higher headline inflation by 50 bps *vis-à-vis* the baseline (Charts I.11b and I.12b).

I.5 Conclusion

Domestic economic activity remains resilient and is expected to maintain momentum, supported by domestic drivers, despite weak external demand. The GST 2.0 reforms are expected to boost private consumption and domestic demand. Rising capacity utilisation, strong corporate and bank balance sheets, and favourable financial conditions are likely to further support investment and growth. India's recent credit rating upgrades reflect growing global confidence in the country's economic resilience and growth prospects. Headline inflation has seen significant moderation during H1:2025-26 (up to August), mainly due to a sharp correction in food prices. Inflation expectations of households and professional forecasters have also eased. Inflation is expected to remain broadly aligned with the target, despite edging up from Q4:2025-26 as favourable base effects wane and demand strengthens on the back of policy action. Core inflation is also expected to remain contained. Nonetheless, risks from adverse weather events, evolving tariff actions, and volatile global financial markets pose headwinds to growth and inflation. However, India's robust macroeconomic fundamentals, along with a strong external position, provide resilience against such shocks.

II. Prices and Costs

Headline CPI inflation continued on a declining trajectory during H1:2025-26, except for the pick-up in August. The decline in inflation was driven by the food group as favourable weather conditions and increase in production augmented supply. Core inflation remained rangebound around 4 per cent despite rising gold prices exerting significant upside pressures. Overall cost conditions remained benign, with industrial and farm input cost pressures staying soft and wage pressures remaining muted.

II.1 Introduction

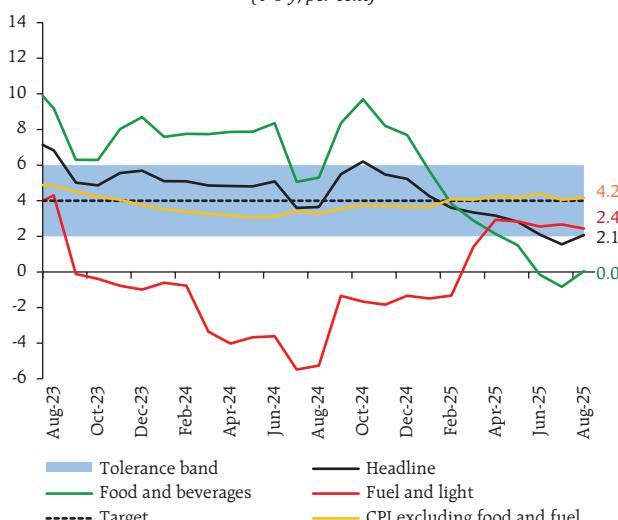
Headline consumer price index (CPI) inflation¹ declined for nine consecutive months to reach an 8-year low of 1.6 per cent in July 2025 before edging up to 2.1 per cent in August (Chart II.1). The decline in inflation was driven by the food group, as its contribution declined from a large positive to zero between October 2024² and August 2025 (Chart II.2). The contribution of the fuel group turned marginally positive from marginally negative while that of the

core group (CPI excluding food and fuel)³ registered a moderate increase during this period.

In terms of monthly trajectory of headline CPI during 2025-26, a positive momentum⁴ was observed across successive months during April-August. Up to July, favourable base effects, however, offset its impact, leading to a moderation in y-o-y inflation (Chart II.3). In the absence of any base effects, y-o-y inflation recorded an increase in August.⁵

Chart II.1: CPI Inflation

(Y-o-y, per cent)



Sources: National Statistical Office (NSO); and RBI staff estimates.

Chart II.2: Contributors to Decline in Headline Inflation

(Percentage points)



Sources: NSO; and RBI staff estimates.

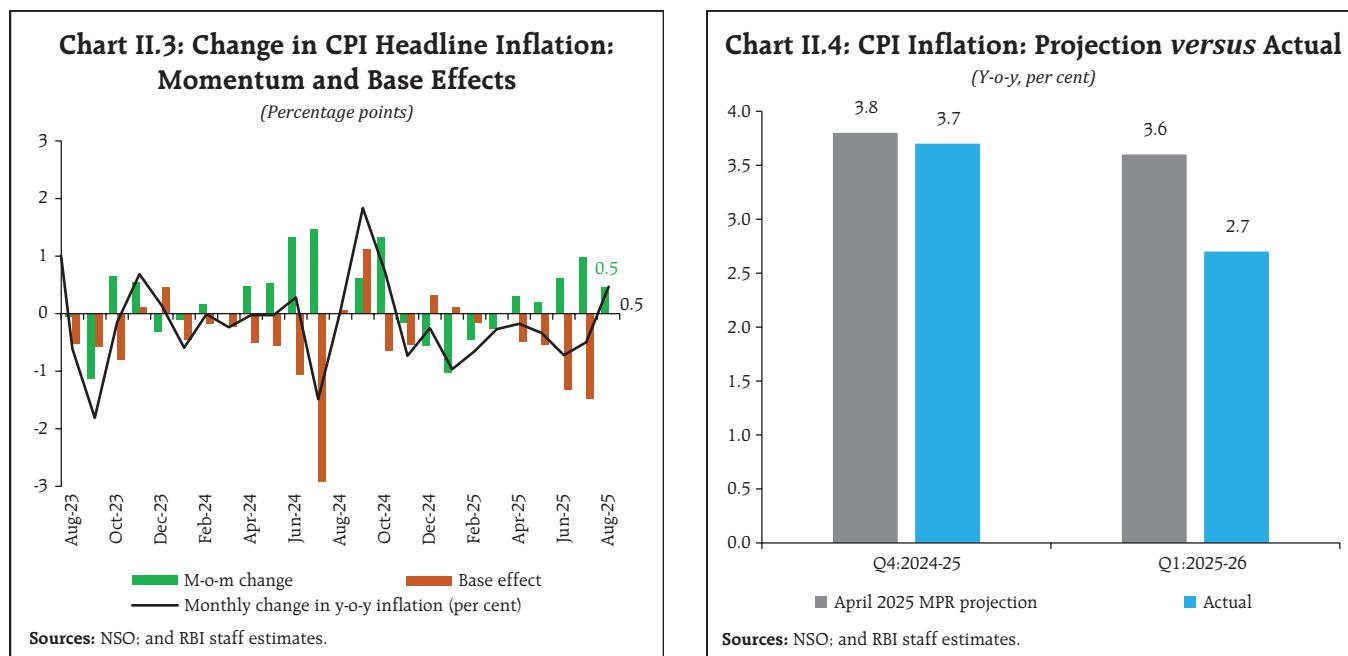
¹ Headline inflation is measured by year-on-year (y-o-y) changes in the all-India consumer price index (CPI) published by the National Statistical Office (NSO), Ministry of Statistics and Programme Implementation, Government of India.

² CPI inflation recorded an intra-year peak of 6.2 per cent in October 2024.

³ Core group CPI, i.e., CPI excluding food and fuel is worked out by eliminating the groups 'food and beverages' and 'fuel and light' from the headline CPI.

⁴ A change in CPI year-on-year (y-o-y) inflation between any two months is the difference between the current month-on-month (m-o-m) change in the price index (momentum) and the m-o-m change in the price index 12 months earlier (base effect). For more details, see Box I.1 of the MPR, September 2014.

⁵ Headline CPI remained unchanged between July and August 2024, leading to no base effect for August 2025.



The April 2025 MPR projected inflation at 3.8 per cent in Q4:2024-25 and 3.6 per cent in Q1:2025-26 (Chart II.4).⁶ The actual outcomes turned out to be lower than projections for Q1:2025-26 by 90 bps. Realised inflation lower than projections was primarily on account of faster than expected as well as a more protracted decline in food prices during the winter, which extended up to April, the longest (9 months) and steepest (10.5 per cent) consecutive decline in prices in the current CPI series. Thereafter, milder than usual summer temperatures dampened the extent of price reversals during the summer months, as reflected in below historical average price build-up leading to lower-than-expected realised inflation in Q1 and Q2:2025-26 so far.

II.2 Developments across Major Components of the CPI

CPI Food Group

Food and beverages group⁷ witnessed a sharp decline in inflation from a peak of 9.7 per cent (y-o-y)

in October 2024 to (-) 0.8 per cent (y-o-y) in July 2025. The decline in food inflation for nine consecutive months up to July, a first in the current CPI series (CPI:2012=100), was the largest both in terms of magnitude and duration (Table II.1). This was marked by two distinct phases. During November 2024-April 2025, prices declined in absolute levels (negative momentum), which drove the overall decline in CPI headline inflation. Since May, although food prices recorded a seasonal pick-up, large favourable base effects offset the muted

Table II.1: Major Episodes of Decline in Food Inflation

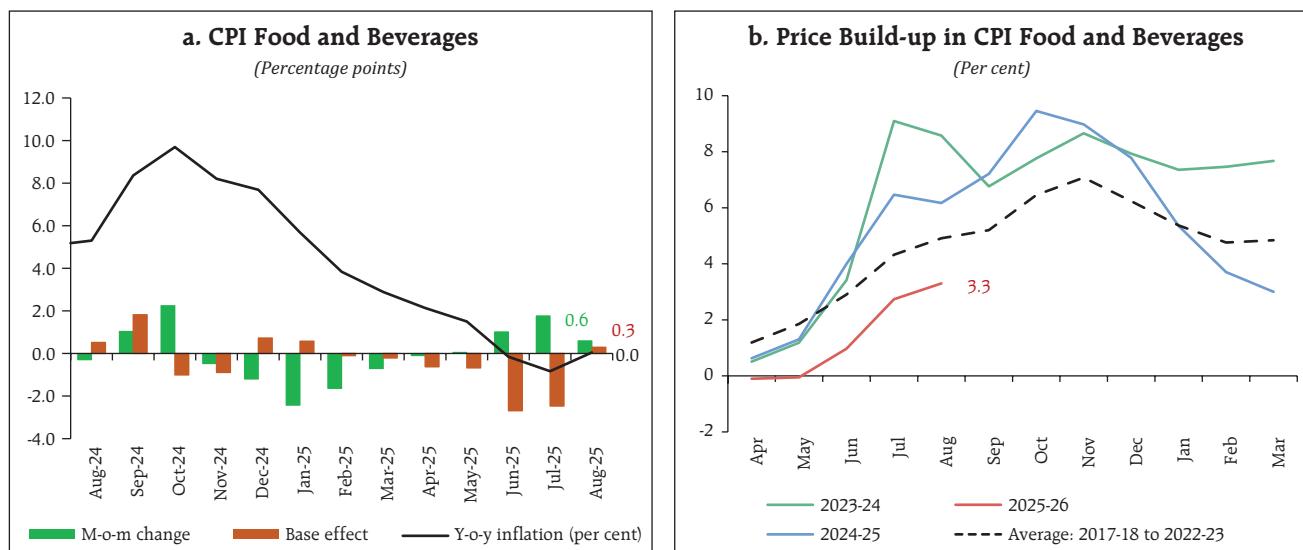
Period*	Cumulative Decline (Percentage points)	No. of Months
Nov-2024 to July-2025	-10.5	9
Dec-2013 to Feb-2014	-8.5	3
Nov-2020 to Jan-2021	-7.4	3
Aug-2014 to Nov-2014	-6.7	4
Aug-2016 to Jan-2017	-6.6	6

Note: *Includes episodes with more than 5 per cent cumulative decline.
Sources: NSO; and RBI staff estimates.

⁶ The Reserve Bank of India (RBI) Act, 1934 (amended in 2016) enjoins the RBI to set out deviations of actual inflation outcomes from projections, if any, and explain the underlying reasons thereof.

⁷ With a weight of 45.9 per cent for food and beverages group in the overall CPI-Combined basket, developments in food inflation have a major impact on the overall inflation trajectory.

Chart II.5: CPI Food Inflation



Sources: NSO; and RBI staff estimates.

positive momentum to keep y-o-y inflation on a declining trajectory (Chart II.5a). In August, a positive momentum and an unfavourable base effect together led to food prices coming out of deflation, recording near-zero inflation. Overall, during 2025-26 (up to August), the build-up in prices has been below both last year's trend and historical average (Chart II.5b).

A combination of favourable supply-side factors, such as comfortable stocks of foodgrains on higher domestic

production, wholesale market arrivals, favourable trade policies and proactive supply management, led the decline in food inflation. Notably, the absence of extreme weather events till August restricted the extent of volatility typically associated with food inflation. An analysis of food price cycles in India shows that there are considerable swings in food inflation, with downturns being longer than upswings, while the amplitudes of upward movements are greater than those of downward movements (Box II.1).

Box II.1: Sharp Rise and Slow Fade: Nature of Food Inflation Cycles in India

Food prices in India exhibit significant volatility while witnessing periods of booms and slumps.⁸ A number of studies have characterised the nature of food price volatility in the Indian context, although very few have covered on the nature of cycles in food price inflation in India (Sekhar et al., 2018). Based on identified turning points using cycle dating literature (Bry and Boschan, 1971) and subsequent refinements (Cashin et al., 2002; World Bank, 2025), the nature of food inflation cycles in India is examined for the period January 2012 to June 2025. Turning points for food inflation cycles are

identified through estimating local peaks and troughs by the following equations:

$$P_{t,peak} = \max(P_{t\pm k}), k = 1, 2, \dots, m, \text{ where } m \text{ is set to 12}$$

$$P_{t,trough} = \min(P_{t\pm k}), k = 1, 2, \dots, m, \text{ where } m \text{ is set to 12}$$

Based on the local peaks and troughs, duration and amplitudes of phases (booms and slumps) and full cycles [peak-to-peak (PP) and trough-to-trough (TT)] are marked off. Boom is defined as the duration in months between trough to peak, while slump is the duration in months between peak to trough. The full cycle PP is

(Contd.)

⁸ Boom refers to price spikes.

defined as slump followed by boom, while a cycle TT is defined as boom followed by a slump. Amplitude is the magnitude of price movements during the phase of boom and slump measured as log differences.

Price Cycles and Turning Points

Since January 2012, food inflation in India has exhibited recurrent cycles, witnessing five troughs and four peaks (Chart II.1.1a). At any particular month, certain food sub-groups' prices may be in a boom phase while others may be in a slump phase. A weighted share of sub-groups in slumps and booms reveals that, on average, 45 per cent were in a boom phase while 55 per cent were in a slump phase in any given month (Chart II.1.1b). Over the sample period, however, this exhibited large variation, with the share of food sub-groups in the boom phase peaking at 86 per cent in July 2012, while the slump phase share surpassed 91 per cent in May 2017 and June 2025.

Duration and Amplitude of Cycles

Booms last an average of 18 months while slumps persist for 21 months (Chart II.1.2a). Factors such as productivity gains that lead to increased supply over time, which in turn results in sustained low inflation could contribute to larger duration of slumps (World

Bank, 2025). Conversely, booms are often sharp but transient, as they are frequently induced by sudden supply-side disruptions such as extreme weather events or geopolitical shocks. Full cycles are characterised as PP and TT, with an average duration of 40 months each. Booms have an average amplitude of 17 per cent, far surpassing the slumps' amplitude of 9 per cent (Chart II.1.2b). The amplitudes of TT and PP are comparable for full cycles, and the wide interquartile ranges signify variable intensities of full cycles.

Cycle Characteristics across Food Sub-groups

Booms are characterised by a greater amplitude than slumps across all sub-groups. Pulses and products, and vegetables have experienced a larger amplitude and substantial variation. Slumps endure longer than booms across different food sub-groups, barring pulses and products, vegetables, spices, and fruits. Full cycle durations show that PP cycles across various food sub-groups exceed the duration of TT cycles.

Overall, the nature of food price cycles shows that downturns typically surpass upswings in terms of duration, but the amplitudes are greater for upward vis-à-vis downward movements. For most food sub-groups, downturns persist longer than upturns, barring pulses and products, fruits, spices and vegetables, which record

Chart II.1.1a. CPI Food and Beverages Inflation
(Y-o-y, per cent)

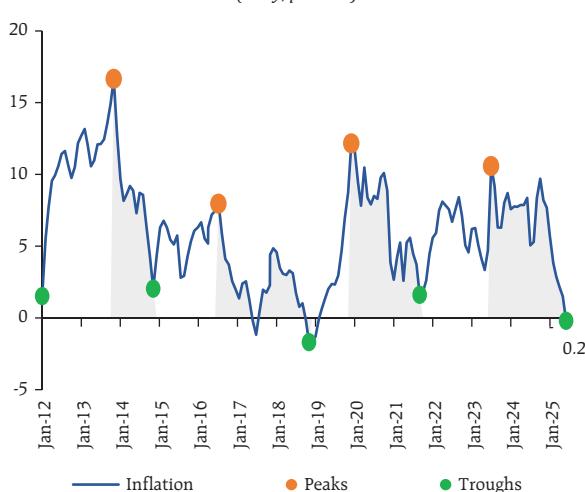
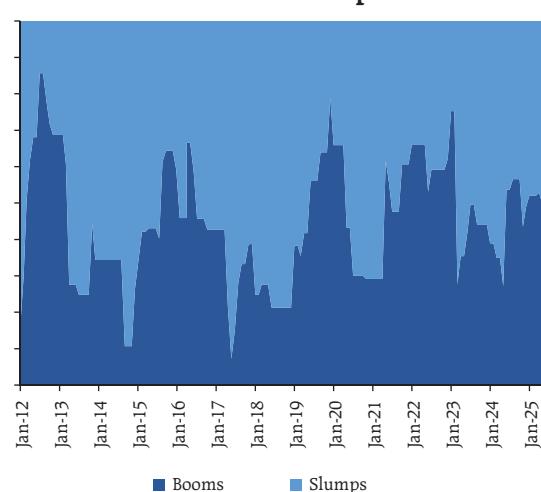


Chart II.1.1b. Weighted Share of Sub-groups in Booms and Slumps



Note: Data is from January 2012 to June 2025. Sample includes 12 CPI Food subgroups.

Sources: NSO; and RBI staff estimates.

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Chart II.1.2a. Duration of Phases and Full Cycles
(Months)

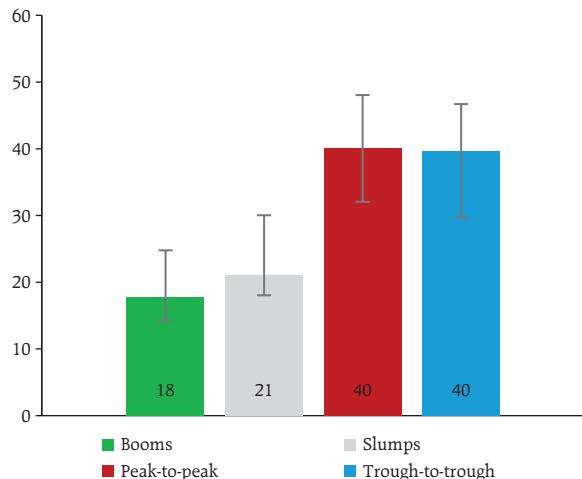
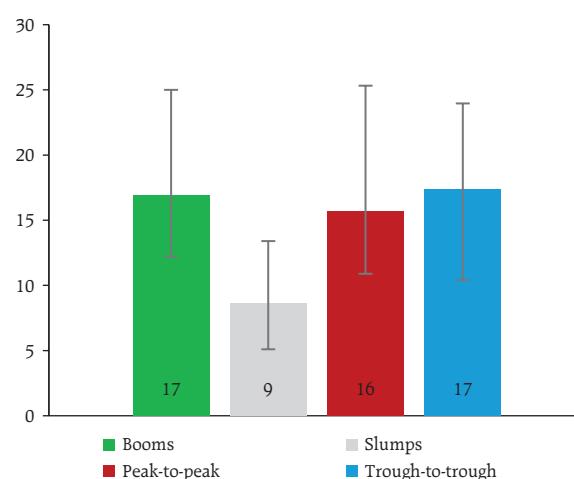


Chart II.1.2b. Amplitude of Phases and Full Cycles
(Per cent)



Note: Black whiskers indicate interquartile range.

Sources: NSO; and RBI staff estimates.

prolonged boom phases. Boom amplitudes consistently exceed slumps across all sub-groups. Intensity of price fluctuations across various sub-groups could be driven by divergent factors *viz.*, weather patterns for vegetables, temperature variations for eggs and poultry and global price cycles for edible oils, and pulses where our import dependency is high.

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World Bank (2025). Post Pandemic Commodity Cycles, A New Era? Special Focus, *Commodity Markets Outlook*, April.

At the sub-group level, vegetables, pulses and cereals witnessed a sharp moderation in inflation (Chart II.6). Vegetables sub-group⁹ exhibited an unusually muted and delayed summer season uptick in prices, not just confined to TOP (tomatoes, onions and potatoes), but also other vegetables, resulting in a y-o-y deflation of (-) 15.9 per cent in August (Chart II.7a). Robust domestic production in 2024-25¹⁰ of longer-duration crops and

record high fresh arrivals in wholesale markets for short-duration crops, bolstered by favourable weather conditions, such as a less intense summer, further contributed to the precipitous decline in vegetables inflation (Chart II.7b).

Among key vegetables, *viz.*, TOP¹¹, prices were significantly lower during April-August 2025 as compared with a year ago.¹² Fewer weather

⁹ Vegetables sub-group has a weight of 6.0 per cent in the overall CPI and 13.2 per cent in the food and beverages group.

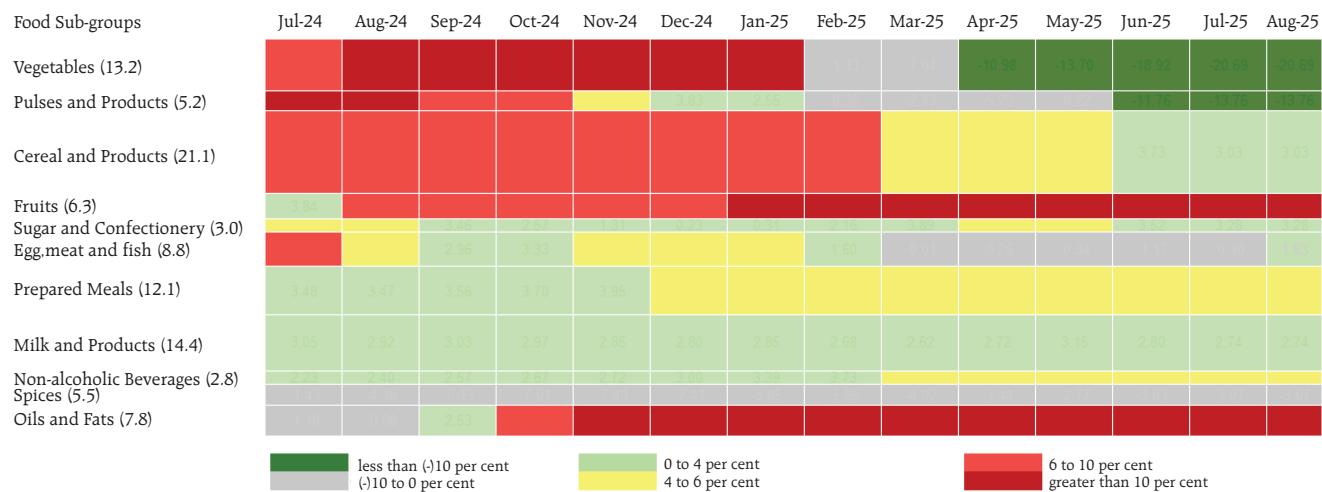
¹⁰ 6.0 per cent higher for vegetables, over 2023-24, as per Second Advance Estimates (AE).

¹¹ Tomato, onion and potato together constitute 36.5 per cent of CPI vegetables index.

¹² Tomato, onion and potato prices were 21.5 per cent, 24.6 per cent and 27.3 per cent lower, respectively, during April-August 2025 as compared with the corresponding period of the previous year.

Chart II.6: Food Sub-group-level Inflation

(Per cent)



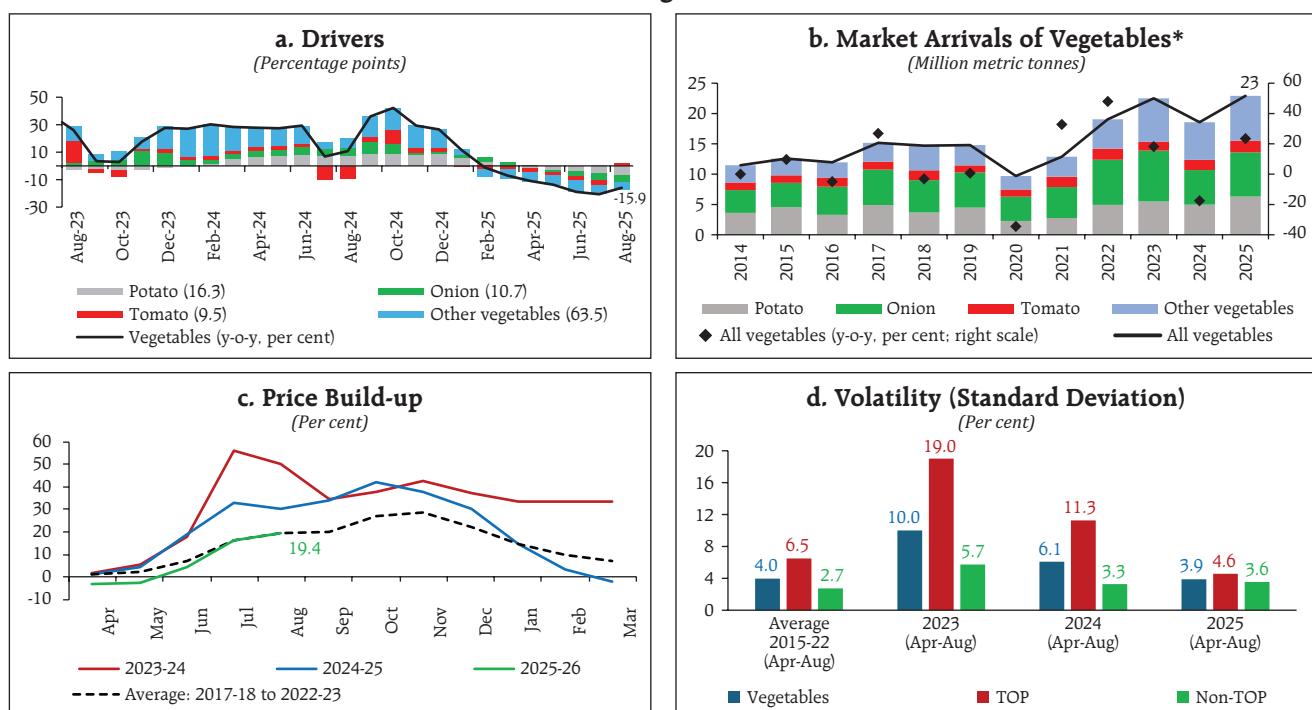
Note: Width of each row reflects the corresponding weight in the CPI food and beverages group (given in parentheses).

Sources: NSO; and RBI staff estimates.

disruptions led to steady availability of tomatoes in wholesale markets.¹³ The price build-up among

vegetables in 2025-26 so far was also lower in comparison to last two years (Chart II.7c).

Chart II.7: CPI Vegetables Inflation



Notes: 1. *: Data pertain to cumulative arrivals during April-August for each year.

2. Other vegetables include beans, brinjal, cabbage, carrot, cauliflower, *dhania*, garlic, ginger, gourd, green chillies, okra, lemon, *parwal*, peas and spinach.

3. Figures in parentheses indicate items' weights in CPI-Vegetables sub-group.

Sources: NSO; Agmarknet; and RBI staff estimates.

¹³ Although there are reports of crop losses on account of flash floods in many producing areas such as Himachal Pradesh, daily data on retail prices from Department of Consumer Affairs (DCA) is yet to show any significant pick-up in prices in September.

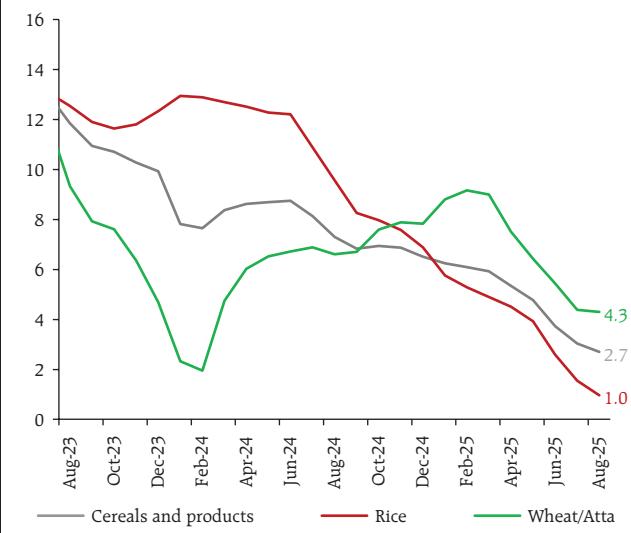
The price volatility in vegetables sub-group and TOP during April-August 2025 was also low (Chart II.7d).

Pulses¹⁴, the primary source of plant-based protein, was the other sub-group which recorded a double-digit deflation [(-)14.5 per cent in August 2025]. Pulses inflation has corrected on a sustained basis from June 2024 amidst augmented availability, primarily supported by government interventions and imports. According to Directorate General of Commercial Intelligence and Statistics, imports of pulses scaled a record 7.3 million metric tonnes in 2024-25, a 54 per cent increase from a year ago. Higher domestic production (4.1 per cent increase in 2024-25) and ample stocks also contributed to the moderation in prices. Pulses prices continued to correct during 2025-26 so far, contrary to the gradual pick-up witnessed during the previous years (Chart II.8).

Cereals¹⁵ was the third major sub-group which contributed to the fall in food inflation, as inflation in this category declined to 2.7 per cent in August 2025 (lowest since December 2021) from 7.3 per cent a year ago (Chart II.9). Record rice production (higher by 8.2

Chart II.9: Cereals Inflation

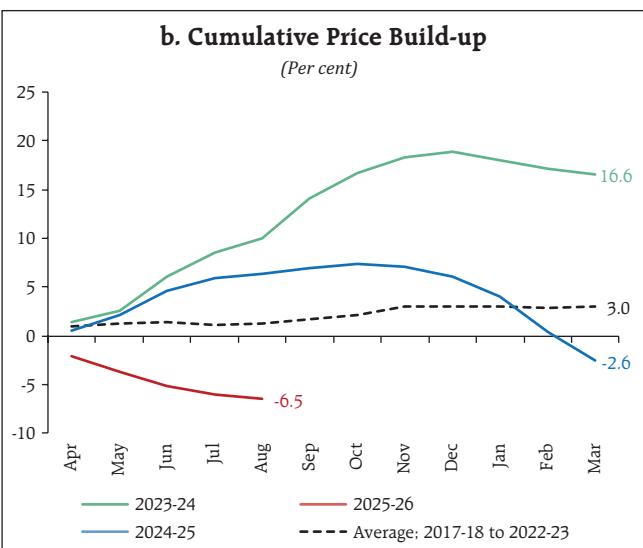
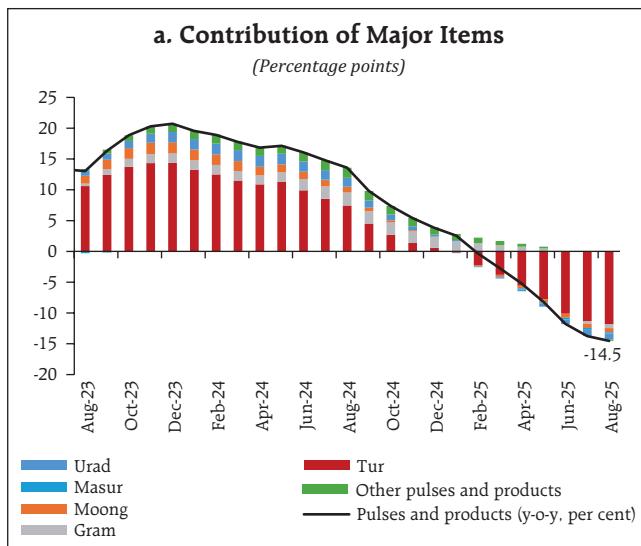
(Y-o-y, per cent)



Sources: NSO; and RBI staff estimates.

per cent in 2024-25) and high buffer stocks (3.5 times the norm as on September 16, 2025), contributed to the moderation in inflation. Wheat inflation softened from a recent high of 9.2 per cent in February 2025 to 4.3 per cent in August, aided by record production (3.7 per cent increase in 2024-25), comfortable buffer

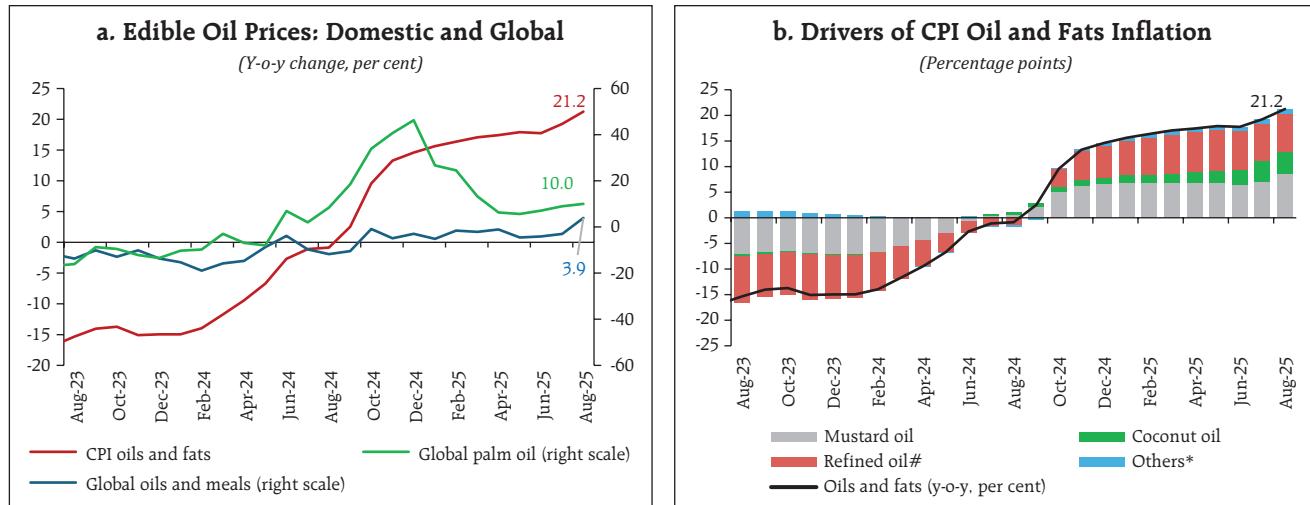
Chart II.8: CPI Pulses and Products Inflation



Sources: NSO; and RBI staff estimates.

¹⁴ Pulses sub-group has a weight of 2.4 per cent in the CPI and 5.2 per cent in the food and beverages group.

¹⁵ Cereals sub-group has a weight of 9.7 per cent in the CPI and 21.1 per cent in the food and beverages group.

Chart II.10: CPI Edible Oils and Fats Inflation

Notes: 1. #: Refined oil includes sunflower, soybean, saffola etc.
2. *: Includes groundnut oil and fats (ghee, butter, vanaspati / margarine)

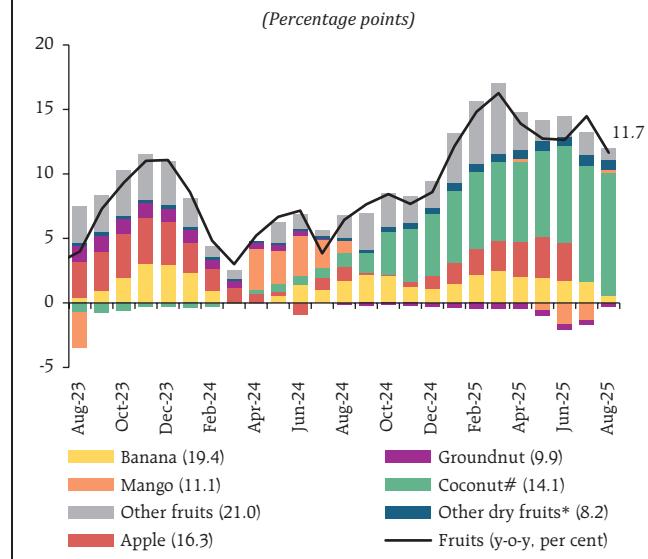
Sources: World Bank Pink Sheet; NSO; and RBI staff estimates.

stocks (1.2 times the norm as on September 16, 2025) and continued export restrictions.

While overall food inflation remained on a declining trajectory, 'oils and fats' and fruits sub-groups witnessed a contrarian trend. 'Oils and fats'¹⁶ inflation rose significantly to 21.2 per cent in August 2025 (Chart II.10). This was primarily driven by an increase in international palm oil prices, partly on account of an increased bio-diesel mandate in Indonesia exacerbating global demand-supply imbalance. Despite a 10-percentage points import duty cut on crude edible oil effective from the end of May 2025, prices did not witness any major correction as supply concerns amid geopolitical escalations offset the impact. Among domestically produced oilseeds, mustard and rapeseed and coconut recorded a decline in production in 2024-25¹⁷, adding to the price pressure. Ghee and butter price inflation, however, remained relatively moderate, driven by lower inflation in milk prices.

Fruits¹⁸ sub-group recorded double-digit inflation consistently since January 2025. The price pressures

were predominantly from coconut, as high temperatures and unseasonal rains led to lower production. Apple prices have also hardened during December 2024 to July 2025 (Chart II.11).

Chart II.11: Drivers of CPI Fruits Inflation

Notes: 1. #: Includes coconut, green coconut, and copra.
2. *: Includes dates, cashewnut, walnut, other nuts, raisin etc.
3. Figures in parentheses indicate items' weights in CPI-Fruits sub-group.

Sources: NSO; and RBI staff estimates.

¹⁶ With a weight of 3.6 per cent in the CPI and 7.8 per cent within the food and beverages group.

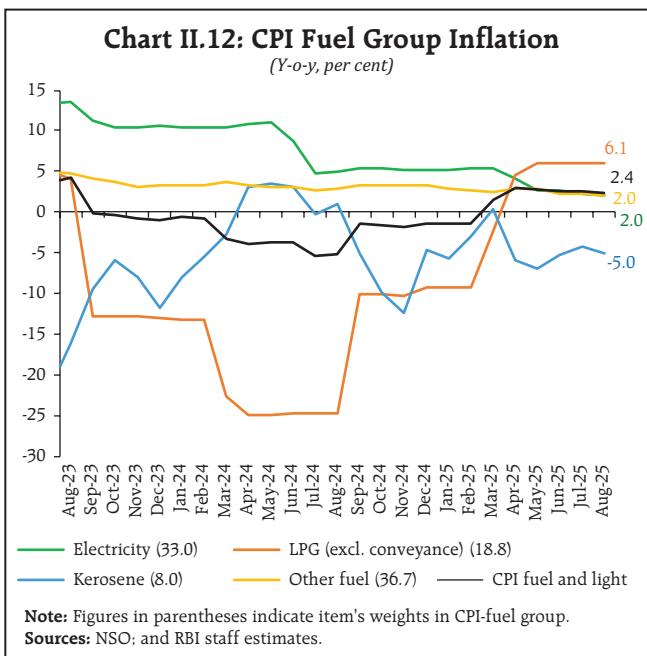
¹⁷ Mustard and rapeseed production declined by (-) 4.9 per cent in 2024-25 as per third AE of crop production. Coconut production declined by (-) 4.6 per cent in 2024-25 as per Second AE of horticulture production.

¹⁸ With a weight of 2.9 per cent in the CPI and 6.3 per cent within the food and beverages group.

Among other food items, spices continued to remain in deflation. Animal-based protein inflation declined marginally driven by lower prices of egg and meat. Prepared meals and non-alcoholic beverages, on the contrary, have registered a gradual increase in inflation during April-August 2025 over the corresponding period of last year.

CPI Fuel Group

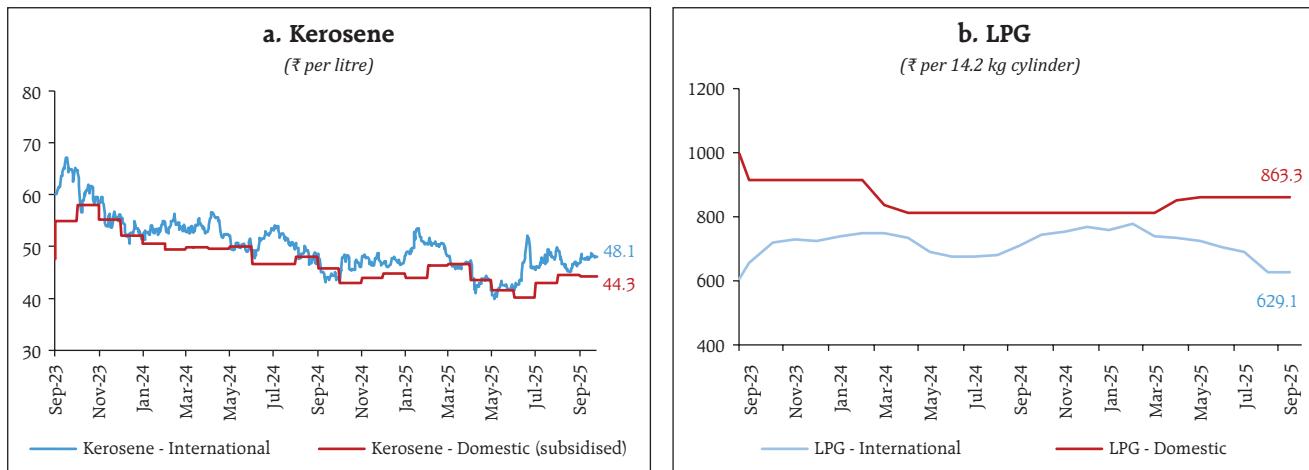
CPI fuel group came out of deflation in March 2025, recording a first positive print of y-o-y inflation after 18 months (Chart II.12). Despite a subsequent uptick in CPI fuel inflation on account of the hike in LPG prices by ₹50 per cylinder effective April 8, 2025, inflation remained in the range of 2.4-2.9 per cent during April-August 2025. Kerosene group largely remained in deflation, reflecting subdued international prices. Subsidised kerosene prices in metro cities were lowered thrice during April-June but were hiked again in July and August (Chart II.13). In May 2025, electricity tariff announcements by a number of states led to a spike in the electricity index. On a y-o-y basis, however, it moderated from 5.4 per cent in March to 2.0 per cent in August 2025 as the magnitude of increases were lower than that in the previous year.



Core CPI (CPI excluding Food and Fuel)

Core inflation (CPI excluding food and fuel) during April-August 2025 averaged 4.2 per cent, higher than 3.2 per cent recorded a year ago. In terms of monthly trajectory, it edged up to 4.2-4.4 per cent in April-June 2025 from 4.1 per cent in March, before moderating to 4.1-4.2 per cent in July-August. A major driver of core inflation this year has been the

Chart II.13: Domestic and International Fuel Prices



Notes: 1. The international price for LPG is based on spot prices for Saudi Butane and Propane, combined in the ratio of 60:40 respectively. These international product prices are indicative import prices. Further details are available at www.ppac.org.in.

2. The indicative international price for kerosene is the Singapore Jet Kero spot price.

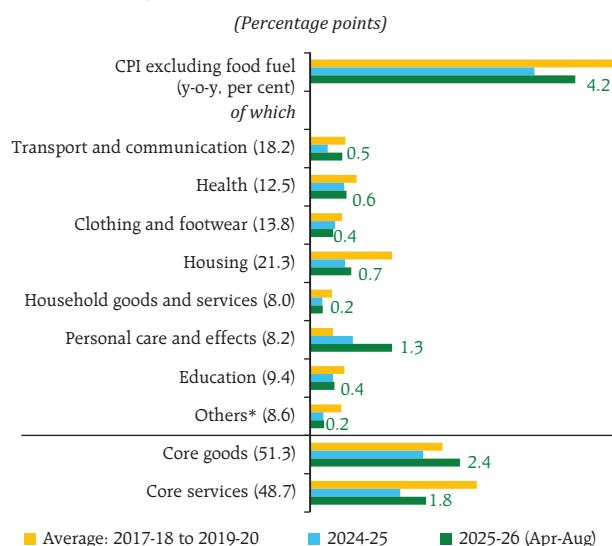
3. The domestic prices of LPG and kerosene represent the average prices of four and three metros, respectively, as reported by Indian Oil Corporation Limited (IOCL).

Sources: Bloomberg; IOCL; and RBI staff estimates.

rise in gold prices, which is part of the 'personal care and effects' sub-group. Between March and August 2025, gold prices rose by 14.7 per cent pushing its contribution to core inflation to 117 bps in August. Rise in international gold prices, driven by heightened global economic and geopolitical uncertainty that encouraged safe haven buying and sustained demand for gold as a financial asset by central banks and investors, drove domestic price increases. Housing, health, and transport and communication remained the other major contributors to core inflation (Chart II.14).

Although core inflation during April-August 2025 was higher than a year ago, its volatility remained comparable to last year. Both the level and variability of core inflation, however, remained below those seen in the immediate post-COVID years (Chart II.15). Other exclusion-based measures of underlying inflation, which exclude items such as petrol, diesel, gold and silver in addition to food and fuel recorded a similar trajectory (Table II.2). Inflation in CPI excluding food, fuel, petrol, diesel, gold and silver components eased

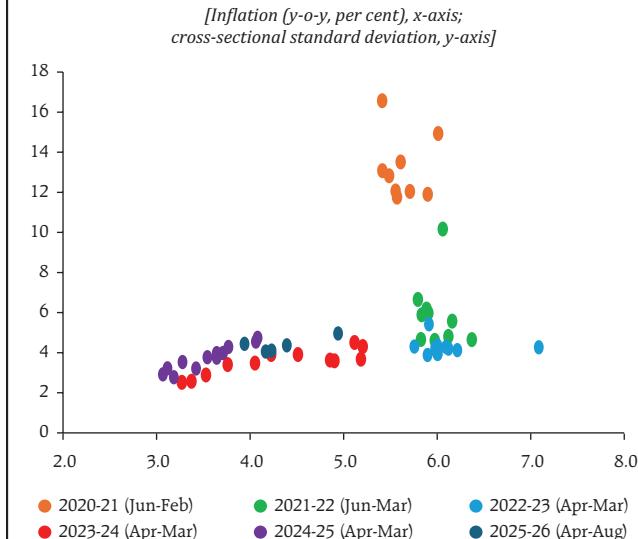
Chart II.14: Contribution to CPI Core Inflation



Notes: 1. Figures in parentheses indicate weights in CPI excluding food and fuel.
2. *: Includes Pan, tobacco and intoxicants; and Recreation and amusement.

Sources: NSO; and RBI staff estimates.

Chart II.15: CPI Inflation excluding Food and Fuel: Persistence



Note: Each dot represents a month, plotting the y-o-y inflation level (x-axis) against the cross-sectional standard deviation across all items (y-axis). Dots with the same colour correspond to months within the same financial year.

Sources: NSO; and RBI staff estimates.

to 3.1 per cent in August, 103 bps below conventional core inflation (*i.e.*, excluding food and fuel).

Decomposing CPI inflation excluding food, fuel, petrol, diesel, gold, and silver into its goods and services components¹⁹ shows that goods inflation

Table II.2: Exclusion-based Measures of Inflation

(y-o-y, per cent)

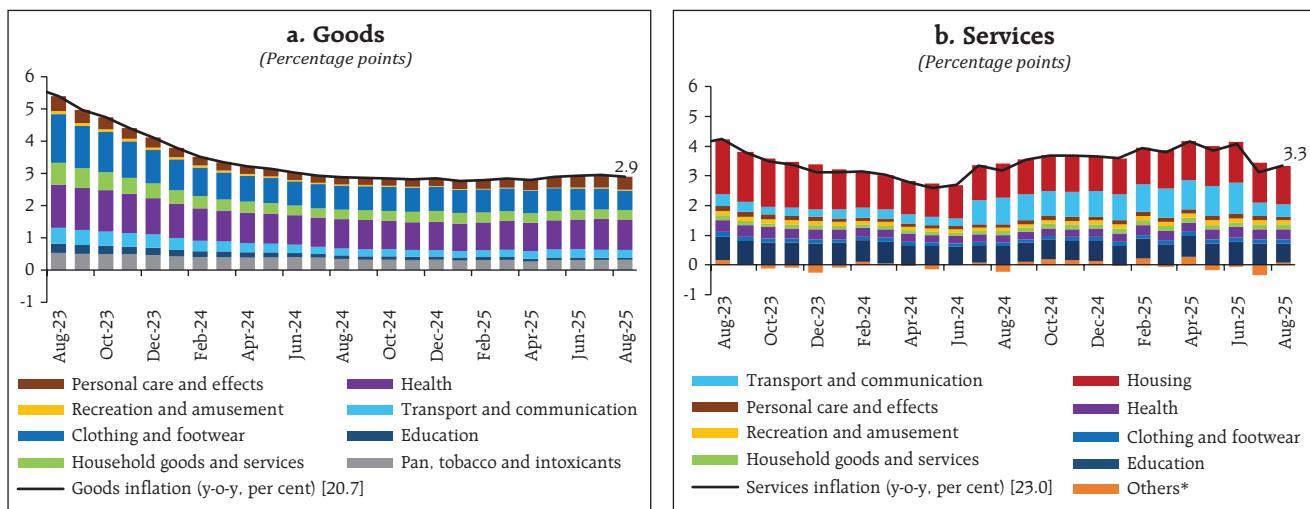
Period	CPI excluding food and fuel (47.3)	CPI excluding food fuel petrol diesel (45.0)	CPI excluding food fuel petrol diesel gold silver (43.8)
Aug-24	3.3	3.5	3.0
Sep-24	3.5	3.8	3.2
Oct-24	3.8	4.0	3.3
Nov-24	3.7	3.9	3.3
Dec-24	3.6	3.9	3.3
Jan-25	3.6	3.9	3.2
Feb-25	4.1	4.3	3.4
Mar-25	4.1	4.3	3.3
Apr-25	4.2	4.4	3.5
May-25	4.2	4.3	3.4
Jun-25	4.4	4.6	3.5
Jul-25	4.1	4.2	3.2
Aug-25	4.2	4.3	3.1

Notes: 1. Figures in parentheses indicate weights in CPI.
2. Derived as a residual from headline CPI.

Sources: NSO; and RBI staff estimates.

¹⁹ Goods component in CPI excluding food, fuel, petrol, diesel, gold and silver has a weight of 20.7 per cent in the headline CPI and that of services component is 23.0 per cent.

Chart II.16: Contributions to CPI Inflation excluding Food, Fuel, Petrol, Diesel, Gold, and Silver



Notes: 1. Figures in parentheses indicate weights in CPI.
2. *: Represents balancing item to reconcile divergence in CPI index between CPI items indices aggregated vertically, across items and the published sub-group/group/overall CPI index.

Sources: NSO; and RBI staff estimates.

remained steady around 2.9 per cent for the last one year while services inflation recorded a gradual uptick till June. However, there was a sharp decline in the services inflation from 4.1 per cent in June to 3.3 per cent in August driven by a huge favourable base effect which was most prominent in the transport and communication sub-group on account of the mobile tariff hike of July 2024. Core services inflation was at 3.3 per cent in August 2025 (Chart II.16).

II.3 Decoding the Inflation Dynamics

Statistical Properties

Statistical properties of inflation provide insights into the nature of inflation dynamics, both in terms of the trajectory and underlying changes in trend. The distribution of CPI inflation in 2025 so far (January-August 2025) vis-à-vis 2024 indicates a relatively milder positive skew, reflecting a broad-based easing of price pressures. The distribution also

recorded a narrowing in width, suggesting reduced inflation volatility among sub-groups (Chart II.17).

In terms of monthly trajectory, the decline in inflationary pressures since April has been accompanied by a widening of the inflation divergence across quantiles (Chart II.18). The widening of inflation divergence across CPI sub-groups highlights the role of a few sub-groups in driving headline numbers to ultra-low levels.

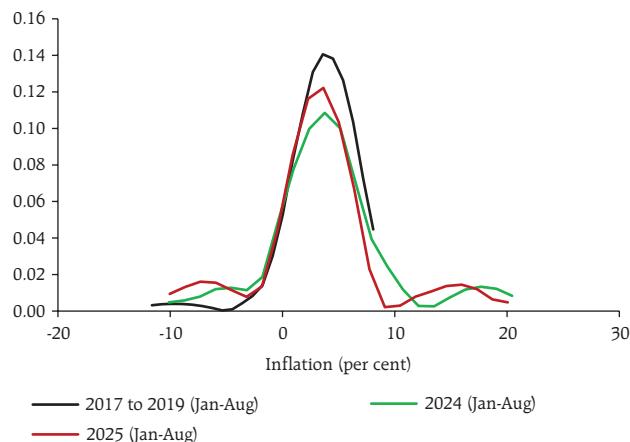
Other measures of underlying inflation such as the trimmed mean measures and the weighted median²⁰ remained at a much lower level than CPI excluding food and fuel inflation (Table II.3). In terms of trajectory, they remain largely aligned with the conventional core inflation.

Diffusion indices²¹ generally moderated during 2025-26 so far except in July and August, indicating that the number of items within CPI experiencing price

²⁰ While exclusion-based measures drop a fixed set of volatile items (for example, food and fuel) in each period, trimmed measures exclude items located in the tails of the inflation distribution - items displaying changes more than the specified threshold in prices each month are excluded, and the items dropped differ from month to month. The weighted median inflation rate is defined as the inflation rate corresponding to the item that lies at the 50th percentile in the distribution of price changes within the CPI basket, weighted using CPI weights.

²¹ The CPI diffusion index, a measure of dispersion of price changes, categorises items in the CPI basket according to whether their m-o-m seasonally adjusted prices have risen, remained stagnant or fallen over the previous month. The higher the reading above 50, the broader is the expansion or generalisation of price increases; the further is the reading below 50, the broader is the price decline across items.

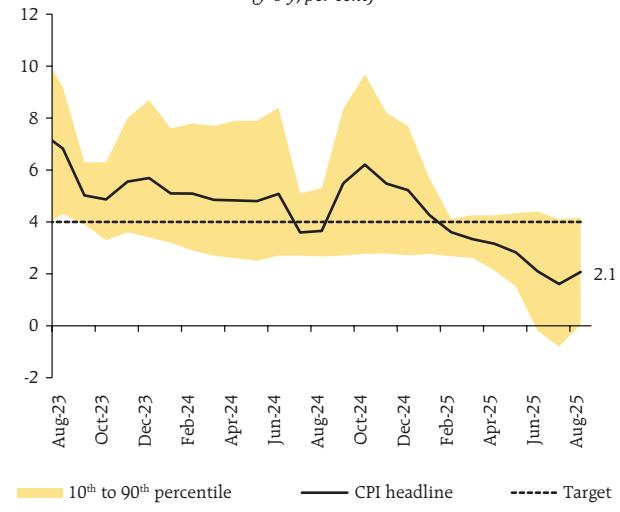
**Chart II.17: Average CPI Inflation (y-o-y)
(Kernel Density Estimates)**



Note: Kernel density estimation is a statistical technique that creates a smooth estimate of a probability density function from a dataset by summing up localized kernel functions centered on each data point.

Sources: NSO; and RBI staff estimates.

**Chart II.18: CPI Sub-Group/
Group Inflation Range
(y-o-y, per cent)**



August stood at 15.5 per cent, the lowest since August 2017 (Chart II.19b).

Inflation across goods and services

Another measure to gauge the underlying inflation dynamics is to classify the products across goods (both perishable and non-perishable) and services²². Goods (with a weight of 76.6 per cent in the overall CPI) contributed to around 70 per cent of headline inflation between March and May 2025 but their contribution dropped to around 53 per cent in June and July 2025. The negative contribution of perishable items, including vegetables, spices, fruits and other food items such as milk, meat and fish and prepared meals, drove this moderation. The contribution of semi-perishables consisting of cereals, pulses, and personal care to overall inflation remained broadly stable till July, while that of durables rose, primarily reflecting the surge in gold prices. The trends, however, reversed in August 2025 with contribution of goods inflation (driven by perishables) climbing

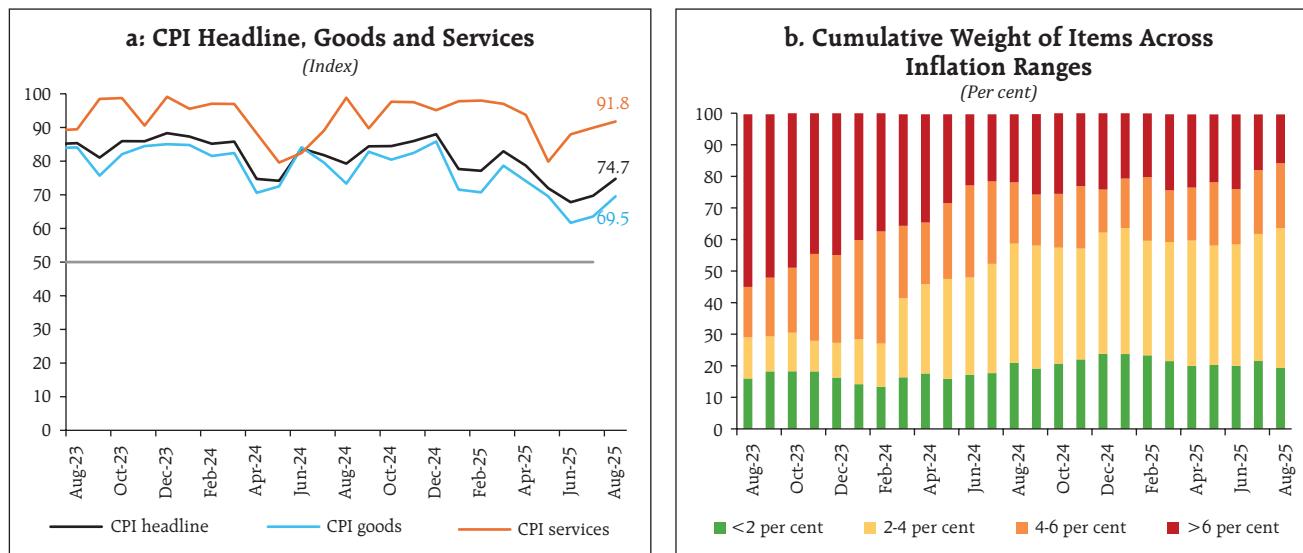
**Table II.3: Measures of Underlying Inflation:
Trimmed Mean Measures and Weighted Median
(y-o-y, per cent)**

Month	5% trimmed	10% trimmed	25% trimmed	Weighted Median
Aug-24	3.9	3.7	3.3	3.0
Sep-24	4.4	3.9	3.5	3.0
Oct-24	4.6	4.1	3.5	3.0
Nov-24	4.6	4.1	3.5	3.2
Dec-24	4.5	4.1	3.5	3.1
Jan-25	4.1	3.7	3.4	2.9
Feb-25	3.7	3.5	3.3	2.9
Mar-25	3.6	3.4	3.2	2.9
Apr-25	3.3	3.4	3.3	3.0
May-25	3.1	3.3	3.3	3.2
Jun-25	2.8	3.1	3.1	3.1
Jul-25	2.7	3.0	3.1	3.0
Aug-25	2.9	2.9	2.9	2.9

Sources: NSO; and RBI staff estimates.

²² The CPI weighting diagrams use the modified mixed reference period (MMRP) data based on the 2011-12 Consumer Expenditure Survey conducted by the National Sample Survey Office. Under MMRP, data are collected on expenditure incurred during the last seven days for frequently purchased items like edible oil, eggs, fish, meat, vegetables, fruits, spices, beverages, processed foods, pan, tobacco and intoxicants; expenditure incurred during the last 365 days for items like clothing, bedding, footwear, education, medical (institutional), durable goods; and expenditure incurred in the last 30 days for all other food, fuel and light, miscellaneous goods and services including non-institutional medical services, rents and taxes.

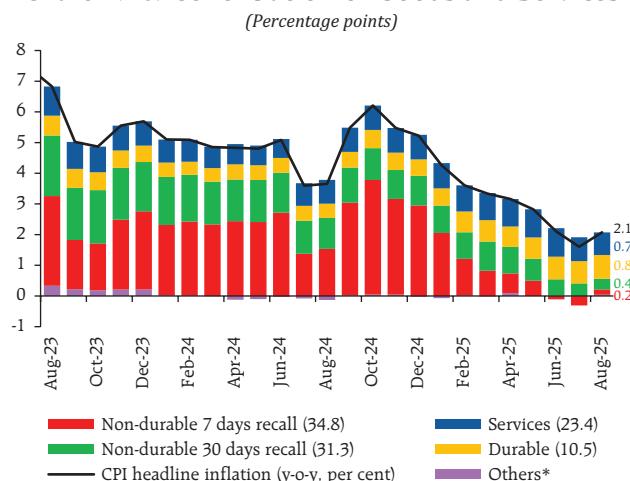
Chart II.19: CPI Diffusion Indices (M-o-M Seasonally Adjusted)



Sources: NSO; and RBI staff estimates.

up to 62.5 per cent of headline inflation, even as the contribution of semi-perishables and durables came down. Meanwhile, services (with a weight of 23.4 per cent) saw their contribution increase from around 26 per cent in March to 48 per cent in July, before moderating to 37.5 per cent in August (Chart II.20).

Chart II.20: Contribution of Goods and Services



Notes: 1. Figures in parentheses indicate weights in CPI.

2. *: Represents balancing item to reconcile divergence in CPI between CPI items indices aggregated vertically, across items and the published sub-group/group/overall CPI.

Sources: NSO; and RBI staff estimates.

Regional Trends in Inflation

Turning to inflation trajectory across regions, both urban and rural areas have been experiencing a sustained easing since October 2024. The higher weight of food in the rural CPI basket, coupled with a larger magnitude of decline in food inflation, resulted in rural inflation remaining below urban levels since March 2025 (Chart II.21).

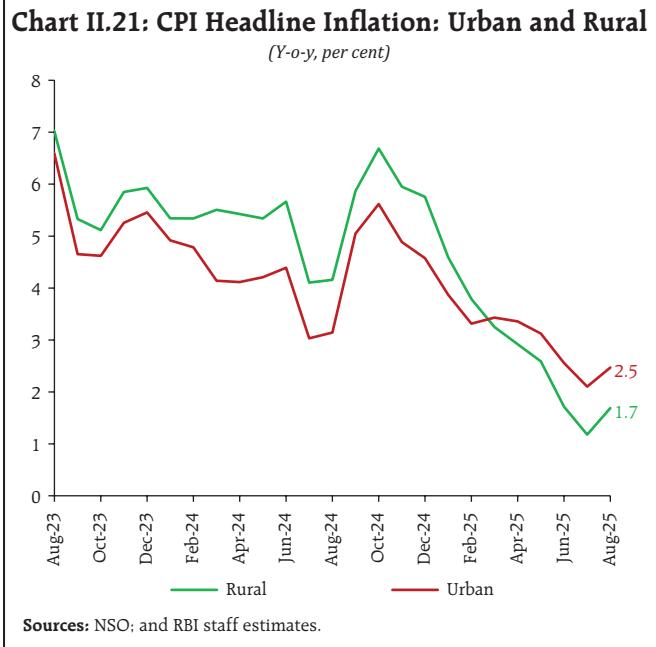
There was a marked decline in the number of states witnessing high inflation during April–August 2025 as compared with the corresponding period of last year. 30 out of the 36 States/UTs recorded inflation below 4 per cent during this period (Table II.4). One state, Kerala, where headline inflation has risen sharply in recent months, devotes a larger share of their consumption basket to coconut and coconut oil²³, prices of which have increased meteorically.²⁴

II.4 Drivers of Inflation Trajectory

While the disaggregated analysis provides a commodity level understanding of inflation dynamics, the drill down into factors that condition the overall inflation

²³ As per the Household Consumption Expenditure Survey 2011-12 (basis of current CPI 2012=100), adjusted for differences in state-level Monthly per Capita Expenditure (MPCE) relative to the All-India MPCE, coconut consumption in Kerala is about 6 times more than the all-India consumption, whereas coconut oil consumption in Kerala is about 16 times more than the all-India consumption.

²⁴ Coconut and coconut oil recorded an average inflation of 52.0 per cent and 102.1 per cent during April-August 2025.



trajectory such as imported inflation, costs, wages and other macroeconomic factors provide insights into the underlying drivers of inflation.

Imported Inflation

The contribution of imported components²⁵ to headline inflation remained modest till July 2025 on the back of moderate energy prices²⁶, despite a sharp uptick in the global prices of gold and silver. The uptick seen in August 2025 was mainly driven by gold, silver, and edible oils (Chart II.22).

Costs

Input cost inflation, as measured by Wholesale Price Index (WPI) inflation in industrial raw materials and farm inputs, recorded deflation during April to August 2025 (Chart II.23). The pass-through of moderation in international commodity prices, barring that of precious metals, contributed significantly to this moderation. Among industrial inputs, aviation turbine fuel, high-speed diesel, naphtha, and furnace oil prices witnessed a decline in inflation. For farm

Table II.4: Distribution of Headline Inflation across States/UTs: Number of States[#]

Headline Inflation Range (Per cent)	2024-25 (Apr-Aug)	2025-26 (Apr-Aug)
Between 0 to 2.0	3	14
Between 2.0 to 4.0	14	16
Between 4.0 to 6.0	18	5
Greater than 6.0	1	1

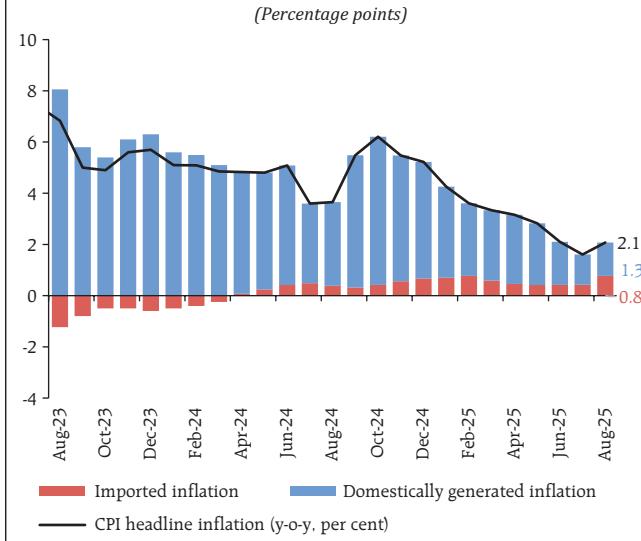
Note: # Accounted for the unification of Daman and Diu with Dadra & Nagar Haveli and the formation of Ladakh as a Union Territory.

Sources: NSO; and RBI staff estimates.

inputs, deflation is led by declining prices of diesel and fertilisers.

Rural labour cost, reflected in nominal rural wage growth was range-bound between 6.4-6.6 per cent in Q1:2025-26, with agricultural wages recording a faster growth (Chart II.24). Growth in agricultural wages was broad-based across occupations with seasonal uptick seen for horticultural workers, harvesting and picking workers, inland fishermen, and ploughing/tilling workers. Real rural wages (deflated by CPI rural index) increased at a faster rate as inflation moderated.

Chart II.22: Contribution of Imported Inflation to Headline Inflation (Percentage points)



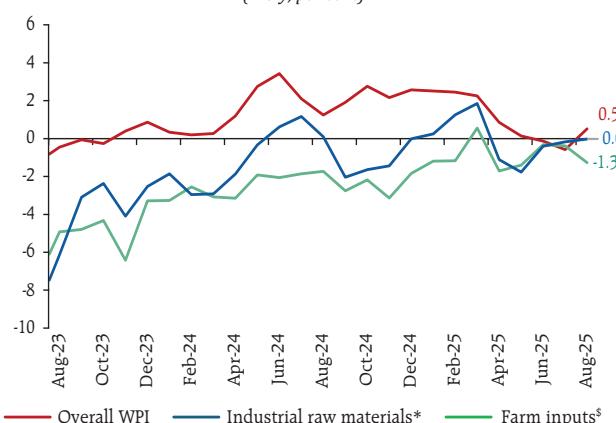
Sources: NSO; and RBI staff estimates.

²⁵ Global commodities that drive domestic prices include petroleum products; coal; electronic goods; gold; silver; chemical products; metal products; textiles; cereals; milk products, and vegetables oils – these together have a weight of 36.4 per cent in the CPI basket (adjusted weights based on pass-through from international prices is at 8.4 per cent).

²⁶ Lower International crude petroleum, kerosene, propane and butane prices.

Chart II.23: Farm and Non-farm Input Cost Inflation

(Y-o-y, per cent)



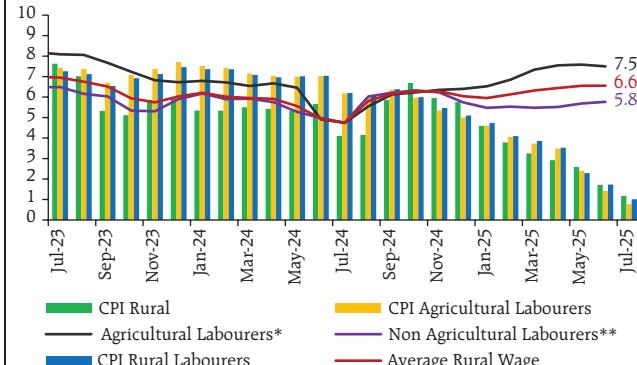
Notes:

1. *: Comprises primary non-food articles, minerals, coal, aviation turbine fuel, high speed diesel, naphtha, bitumen, furnace oil, lube oil, petroleum coke, electricity, cotton yarn and paper and pulp from WPI.
2. \$: Comprises high speed diesel, fodder, electricity, fertilizers, pesticides, and agricultural and forestry machinery from WPI.
3. WPI Electricity captures unit revenue data from selected power generators.

Sources: Ministry of Commerce and Industry; and RBI staff estimates.

Chart II.24: Wage Growth and Inflation in Rural Areas

(Y-o-y, per cent)



Notes:

1. Data for CPI-Agricultural Labourers and CPI-Rural Labourers during May-July 2025 pertains to the rebased series with base 2019=100, published by Labour Bureau, Ministry of Labour & Employment on July 18, 2025.
2. *: Comprises ploughing, sowing, harvesting, picking, horticulture workers, fishermen inland, fishermen coastal, loggers and wood cutters, animal husbandry, packaging, general agriculture labourers, plant protection workers.
3. **: Comprises carpenter, blacksmith, mason, weavers, beedi makers, bamboo, cane basket weavers, handicraft workers, plumbers, electrician, construction workers, light motor vehicle & tractor drivers, sweeping/cleaning workers, and other non-agricultural labourers.

Sources: NSO; Labour Bureau; and RBI staff estimates.

In the organised sector, staff cost growth (y-o-y) edged up for manufacturing sector during Q4:2024-25 and Q1:2025-26 following the slump in Q3:2024-25. In the services sector, staff cost growth remained muted in Q1:2025-26 (Chart II.25).

In terms of assessment of cost conditions, manufacturing firms polled for the purchasing

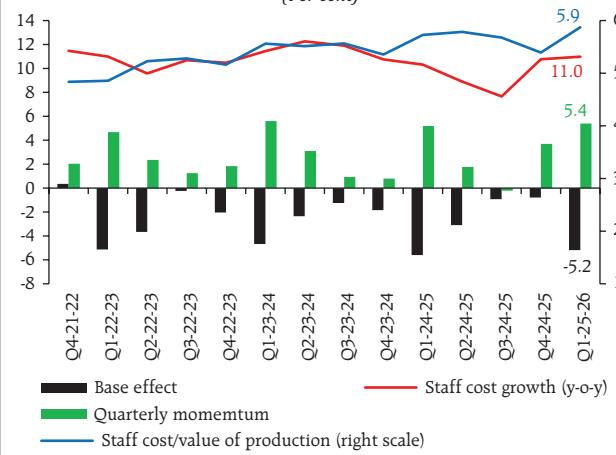
managers' index (PMI) reported an expansion in input prices for August 2025. Movements in output prices charged by manufacturing firms broadly mirrored the trend in input prices (Chart II.26a).

Operating expenses of services sector reflected in PMI services increased in August 2025 with prices charged by services firms also moving in tandem. The input-

Chart II.25: Staff Cost in Manufacturing and Services Sectors

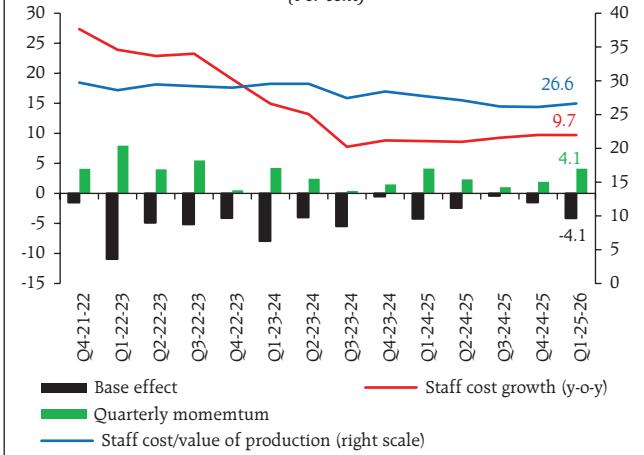
a. Manufacturing Sector

(Per cent)



b. Services Sector

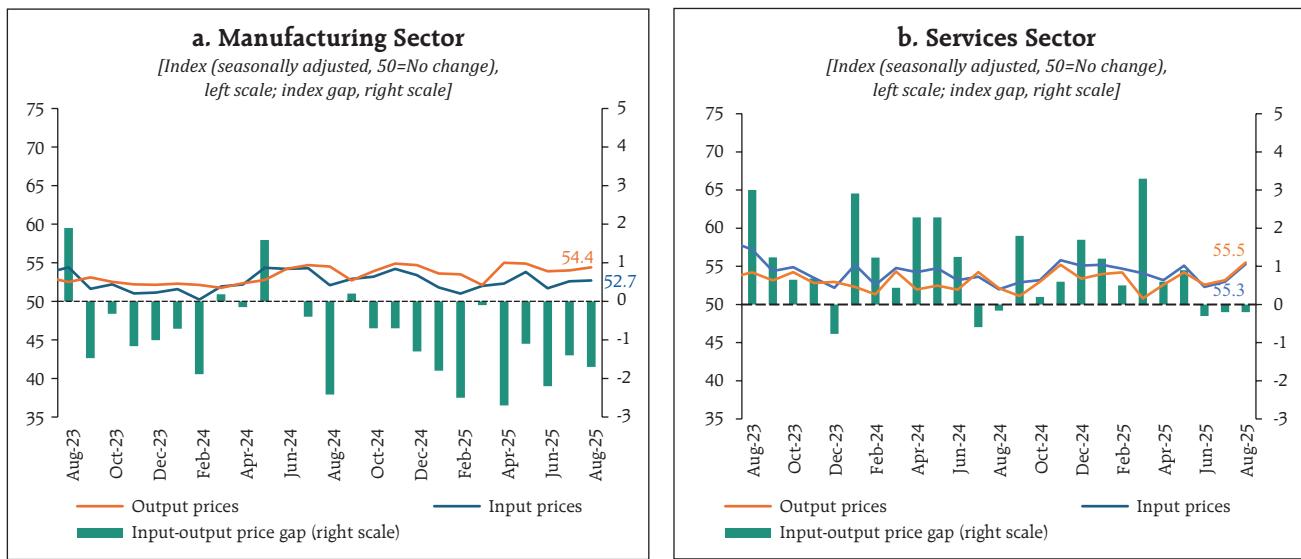
(Per cent)



Note: Staff cost growth (y-o-y) is based on a common set of companies.

Sources: Capitaline database; and RBI staff estimates.

Chart II.26: PMI Input-Output Price Gap



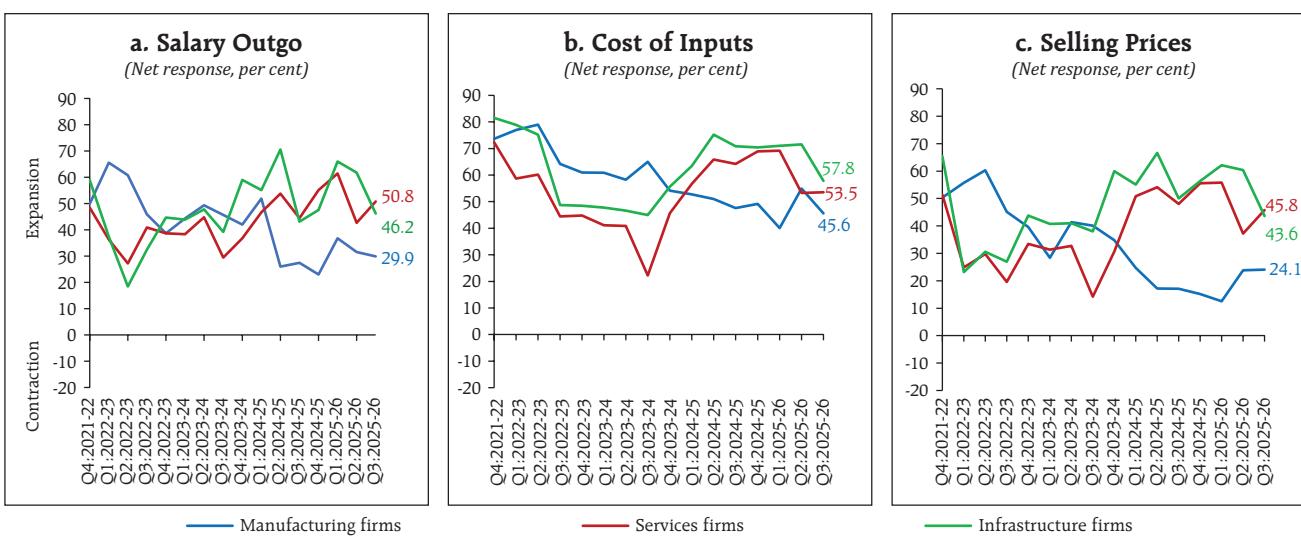
Sources: S&P Global; and RBI staff estimates.

output price gap for both manufacturing and services sector firms do not indicate any pent-up pass-through (Chart II.26b).

On the assessment and outlook of cost conditions, as per the firms polled in the Reserve Bank's enterprise surveys²⁷, salary outgo pressures are expected to

ease in manufacturing and infrastructure sectors during Q3:2025-26, but pick up in the services sector (Chart II.27a). During Q3:2025-26, input cost and selling price pressures are expected to moderate for the infrastructure sector whereas both are expected to harden for the services sector (Chart II.27b and II.27c).

Chart II.27: Expectations of Cost and Price Conditions



Note: 'Net response' is the difference between the percentage of respondents reporting an increase in prices and those reporting decrease.

Sources: Reserve Bank's Industrial Outlook Survey; Services & Infrastructure Outlook survey; and RBI staff estimates.

²⁷ Industrial Outlook Survey; and Services and Infrastructure Outlook Survey.

Margins

The absolute retail price margins²⁸ remained steady in case of select cereals (rice, wheat and atta), pulses and edible oils, during April-September 2025 (Chart II.28). The stable retail price margins of edible oils post import-tariff duty reduction in May 2025 indicate that there is no pent-up price transmission post the duty reduction with domestic prices firming up in both wholesale and retail markets. Retail margins decreased in TOP vegetables in September 2025 after some increase seen during July-August 2025.²⁹

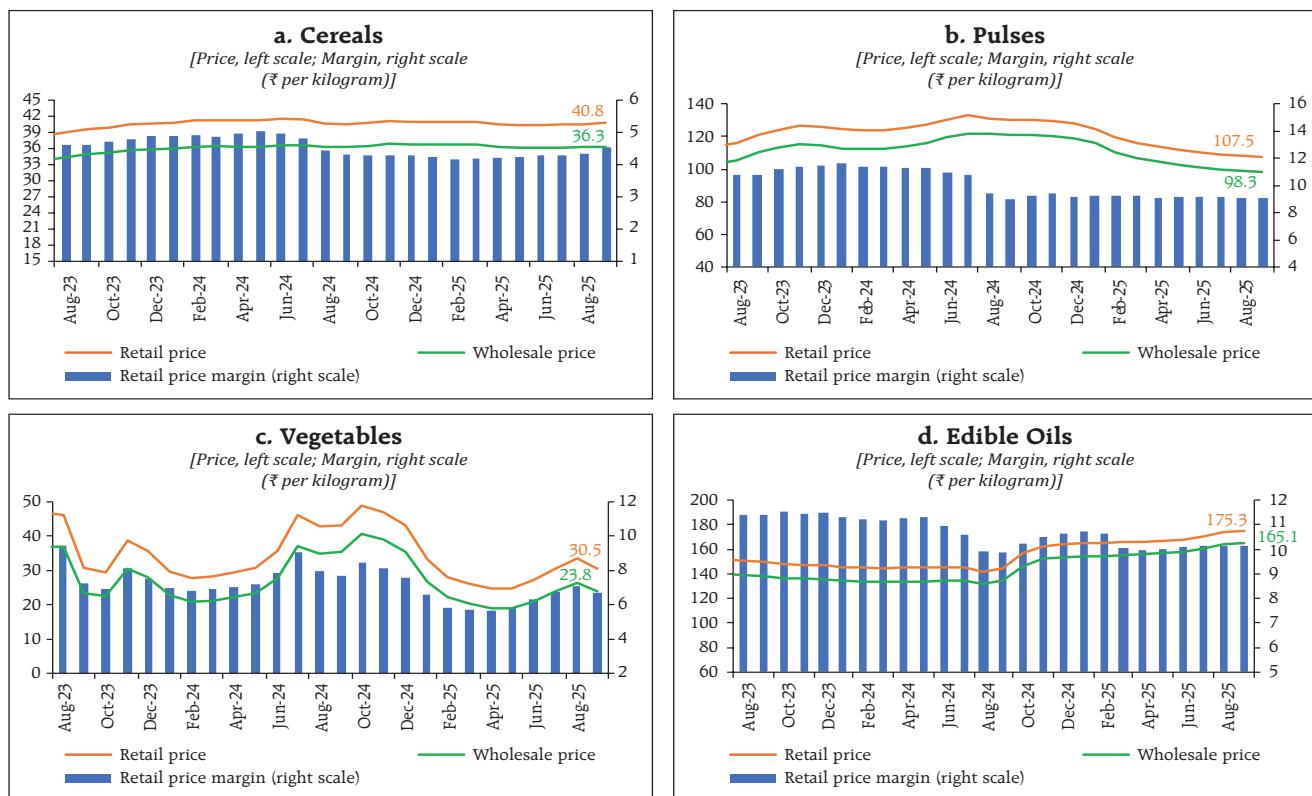
GST Rationalisation

The Government has implemented GST rate rationalisation measures effective September 22,

2025, aimed at simplifying tax rates and lowering prices for the final consumer. A mapping of changes in GST rates to the CPI shows that about 11.4 per cent of the CPI basket would be impacted by the recent changes, with the magnitude varying significantly across product groups (Table II.5). The overall impact of GST changes on CPI inflation would be conditional on the extent of the pass-through which is likely to remain partial on account of offsetting changes in input tax credit and compensation cess, as well as various forms of price rigidities.

Overall, the historical decomposition of inflation using a VAR³⁰ model indicates that the moderation in inflation witnessed during Q4:2024-25 to Q2:2025-26

Chart II.28: Retail, Wholesale Prices, and Margins



Sources: Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution; and RBI staff estimates.

²⁸ Defined as the difference between retail and wholesale prices based on the data collected by DCA.

²⁹ September month price margins are calculated based on daily wholesale and retail price data till September 24, 2025.

³⁰ Historical decomposition estimates the contribution of each shock to the movements in inflation over the sample period (Q4:2010-11 to Q2:2025-26) based on a VAR with the following variables (represented as the vector Y_t) – crude oil prices (US\$ per barrel); exchange rate (INR per US\$), asset price (BSE Sensex), CPI; the output gap; rural wages; the policy repo rate; and money supply ($M3$). All variables other than policy repo rate are y-o-y growth rates. The VAR can be written in reduced form as: $Y_t = c + A Y_{t-1} + e_t$; where e_t represents a vector of shocks. Using Wold decomposition, Y_t can be represented as a function of its deterministic trend and sum of all the shocks e_t .

Table II.5: GST Slabs mapped to item-level CPI ^

Major Items	GST 1.0 Rate (per cent)	GST 2.0 Rate (per cent)	Difference (percentage points)	CPI Weight (per cent)
Primary food articles (Cereals, Pulses, Vegetables, Fresh Fruits, Raw Milk, etc.)	0	0	0	61.3
Gold and Silver	3	3	0	1.2
Clothing and Footwear (less than ₹1000), Fuel (LPG, kerosene), some household items	5	5	0	18.9
Electrical fittings, small electronic items, washing soap, private tuition fees, etc.	18	18	0	6.1
Coal	5	18	0*	0.04
Demerit goods like pan, tobacco, intoxicants	28	40	0\$	1.1
Stationery items like notebooks, exercise books, pencils, etc.	12	0	-12	0.4
Milk products, Dry fruits, Utensils, Medicines, Sugar, Clothing and Footwear (between ₹1000 and ₹2500), etc.	12	5	-7	4.6
FMCG items: biscuits, soaps, shampoo, shaving kits, etc.	18	5	-13	3.5
White goods like AC, refrigerator, etc.	28	18	-10	2.2
Packaged cooked meal	5	0	-5	0.7
Decreased (Weight in CPI)				11.4
No change (Weight in CPI)				88.6

Notes: 1. ^ : Weights are adjusted for assumed proportion of pre-packaged and labelled price quotations collected by NSO for an item under CPI basket.

2. *: Coal attracted, prior to rate rationalization, 5% GST+ Compensation cess of Rs 400/ton. The GST Council has recommended to end compensation cess and hence the rate has been merged with GST. There is no additional tax burden.

3. \$: For cigarettes, chewing tobacco products etc. (excluding bidi, where the GST rate was cut), the existing rates of GST and compensation cess will continue to apply, and the new rates will be implemented at a later date to be notified, based on discharging of entire loan and interest liabilities on account of compensation cess. Hence, for these goods, rates are taken as unchanged.

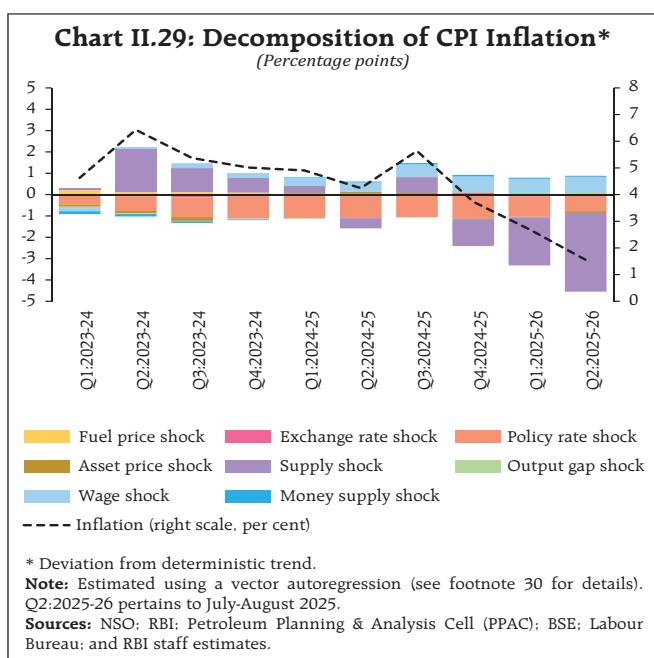
Sources: Goods and Services Tax Council; NSO; and RBI staff estimates.

was primarily on account of favourable supply shocks (Chart II.29).

II.5 Conclusion

Headline inflation declined significantly during FY2025-26 (April-August), driven by a faster

than anticipated moderation in food prices. The moderation in inflation has also turned out to be more generalised with core inflation remaining largely rangebound despite pressure exerted by sharp increases in gold prices. Going forward, the progress of southwest monsoon, higher *kharif* crop sowing as well as record reservoir levels, which could help the *rabi* sowing are all pointing towards a benign food price scenario. Recent reduction in GST rates could further aid in keeping overall inflation low and below the target during 2025-26, on an average basis. CPI inflation, however, is likely to edge up, especially during Q4:2025-26, as unfavourable base effects kick in, and demand side stimulus from policy easing come into play. Although benign inflation conditions are expected to prevail in the near-term, uncertainties emanating from unexpected weather shocks as well as international commodity prices continue to pose major risks to the inflation trajectory.



III. Demand and Output

Domestic economic activity remained buoyant in H1:2025-26, driven by strong private consumption and robust investment. External demand continues to face headwinds from global trade uncertainties and US tariffs. Manufacturing activity gained strength, while the services sector sustained its momentum. Structural reforms, including GST 2.0, are expected to support momentum in domestic demand and output.

Domestic economic activity exhibited resilience in H1:2025-26, with accelerated real GDP growth in Q1. Aggregate demand continued to be strong, underpinned by buoyant private consumption and strengthening investment activity. Government consumption also held up well. Net external demand, however, remained weak and acted as a drag on aggregate demand. On the supply side, manufacturing activity gained further steam, while the services sector held its momentum. Agricultural activity also expanded at a healthy pace. Going forward, the high US tariffs, unless resolved, could reduce India's merchandise exports to the largest export destination, adversely impacting net external demand. The recent structural reforms, including the implementation of GST 2.0, are expected to boost domestic demand and output, which may mitigate the adverse impact of US tariffs. The protracted geopolitical tensions, rising geoeconomic fragmentations and global financial market volatility continue to pose downside risk to the growth outlook.

III.1 Aggregate Demand

Aggregate demand conditions improved further as reflected in the growth of real gross domestic product (GDP) at 7.8 per cent year-on-year (y-o-y) in Q1:2025-26 as compared to 7.4 per cent in the previous quarter. This was driven by buoyant private consumption, government consumption and fixed investment – all three components posted growth of 7 per cent or above – while net exports acted as a drag on aggregate demand (Table III.1 and Chart III.1). The momentum of GDP – quarter-on-quarter (q-o-q) seasonally adjusted annualised growth rate (SAAR) – was placed at 6.7 per cent (Chart III.1b).

GDP Projections versus Actual Outcomes

The actual growth for Q1:2025-26 turned out to be higher than projected in the Monetary Policy Report (MPR) of April 2025 (Chart III.2). This was mainly on account of a stronger than anticipated performance of private consumption and government final consumption expenditure.

Table III.1: Real GDP Growth

(Y-o-y, per cent) ^

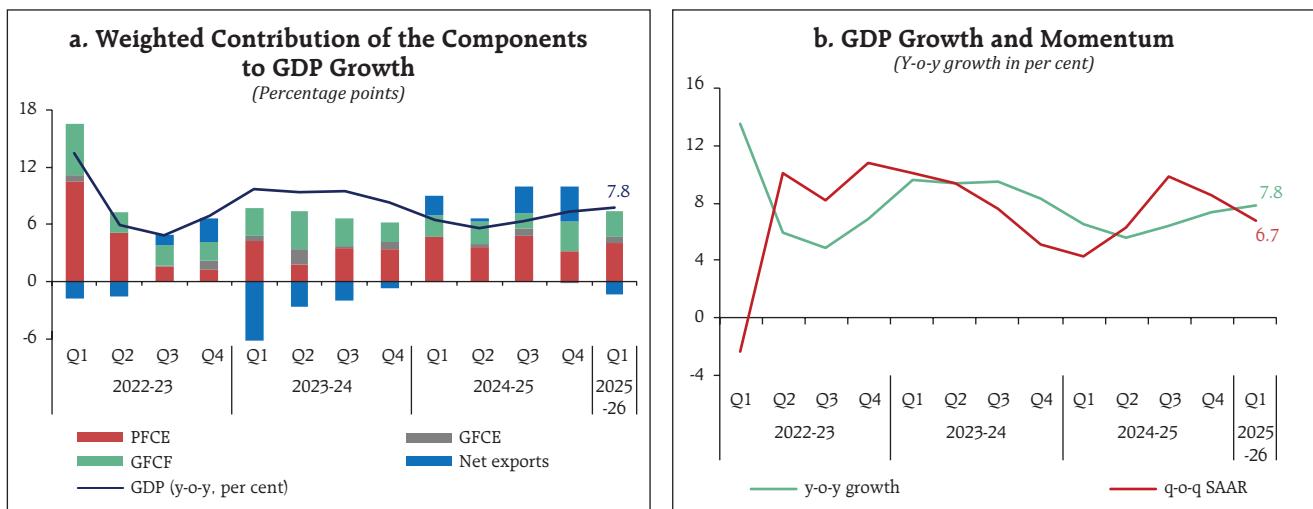
Item	2023-24	2024-25	Weighted Contribution*		2024-25				2025-26
	(FRE)	(PE)	2023-24	2024-25	Q1	Q2	Q3	Q4	Q1
Private final consumption expenditure	5.6	7.2	3.2	4.0	8.3	6.4	8.1	6.0	7.0
Government final consumption expenditure	8.1	2.3	0.8	0.2	-0.3	4.3	9.3	-1.8	7.4
Gross fixed capital formation	8.8	7.1	3.0	2.4	6.7	6.7	5.2	9.4	7.8
Exports	2.2	6.3	0.5	1.4	8.3	3.0	10.8	3.9	6.3
Imports	13.8	-3.7	3.3	-0.9	-1.6	1.0	-2.1	-12.7	10.9
GDP at market prices	9.2	6.5	9.2	6.5	6.5	5.6	6.4	7.4	7.8

Note: *: Component-wise contributions to growth do not add up to GDP growth because change in stocks, valuables and discrepancies are not included.

^ : Unless specified otherwise, all discussions on growth rates in this chapter are on year-on-year (y-o-y) basis.

FRE: First revised estimates; PE: Provisional estimates.

Sources: National Statistical Office (NSO); and RBI staff estimates.

Chart III.1: GDP Growth and its Constituents

Notes: PFCE: Private final consumption expenditure; GFCE: Government final consumption expenditure; GFCF: Gross fixed capital formation; SAAR – Seasonally adjusted annualised rate.

Sources: NSO; and RBI staff estimates.

III.1.1 Private Final Consumption Expenditure

Private final consumption expenditure – the mainstay of aggregate demand – rebounded and grew by 7.0 per cent (y-o-y), contributing 4.0 percentage points to overall GDP growth in Q1:2025-26. The strong growth in private consumption in Q1 indicates revival in the discretionary spending of households. The decline in interest rates, lower inflation and steady employment

conditions are supporting discretionary spending and private consumption.

Latest high frequency indicators (HFIs) show some signs of improvement in urban demand in Q2:2025-26 (Table III.2). The consumer durables output expanded at a strong pace in July 2025, while the sales of fast-moving consumer goods in urban areas improved during July-August. Passenger vehicle sales posted positive growth in July 2025 but turned negative in August. Growth in bank credit to households (personal loans) remained robust during July-August, despite moderating from the last year's levels. Domestic air passenger traffic contracted during July-August, partly on account of monsoon rains.

As per the latest round of the Reserve Bank's Consumer Confidence Survey, households are optimistic about their one-year-ahead economic conditions, and the consumer confidence also recorded improvement in September 2025. Consumer expectations, shaped by the stance of monetary policy and the signals conveyed by key macroeconomic indicators, are also indicating improvement in private consumption (Box.III.1).

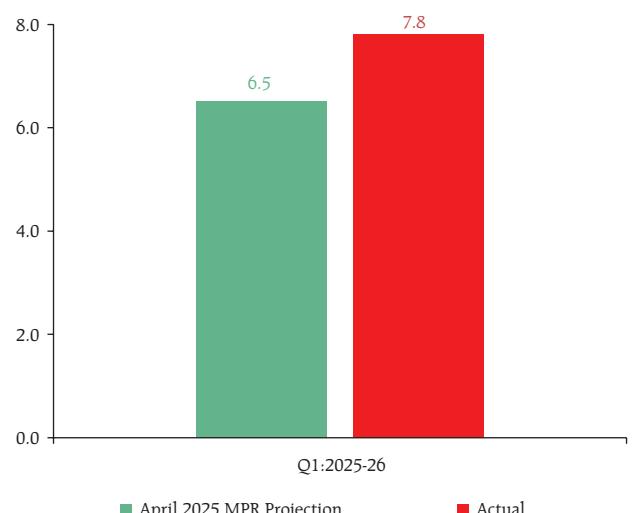
Chart III.2: GDP Growth - Projection versus Actual (Y-o-y growth in per cent)

Table III.2: Indicators of Consumption

(Y-o-y, per cent)

Indicators	2023-24				2024-25				2025-26		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Jul	Aug
Urban demand											
Domestic air passenger traffic	19.1	23.0	9.1	5.2	5.6	7.3	11.4	12.0	5.3	-2.5	-0.5
Passenger vehicle sales	9.6	5.8	8.6	10.8	20.2	-1.3	5.1	3.6	-1.4	1.5 [#]	-9.0 [#]
IIP: Consumer durables	-2.7	1.1	5.3	11.2	10.7	6.6	9.0	5.9	2.6	7.7	
Personal loans	21.3	30.0	28.4	27.5	25.6	13.4	12.0	11.6	12.1	11.9	
Vehicle loans	19.3	21.2	16.4	14.2	15.5	13.3	8.8	8.6	10.8	8.9	
Credit card outstanding	37.6	31.4	32.6	25.6	23.3	18.0	15.6	10.6	7.2	5.6	
Rural demand											
Tractor sales	-1.9	-5.8	-4.9	-18.9	0.5	0.7	13.5	17.3	9.2	8.0	28.3
Motorcycle sales	13.8	-2.9	22.1	27.0	16.8	10.2	-1.9	-3.5	-9.2	4.7	4.3
IIP: Consumer non-durables	6.8	7.0	2.5	0.7	-0.2	-2.2	-1.6	-2.0	-1.5	0.5	
Fertiliser sales	-2.9	6.0	2.4	-5.3	2.4	-7.3	0.4	-0.6	-14.7		
MGNREGA work demand	4.4	15.1	1.3	-8.3	-16.1	-16.6	1.7	6.5	1.3	-12.3	-26.1
FMCG sales											
Rural							5.7	9.1	8.3	8.4	8.5
Urban							1.9	4.0	2.4	4.1	3.9
All India							3.5	6.2	4.9	5.9	5.9

#: Doesn't include Tata Motors.

Sources: Directorate General of Civil Aviation (DGCA), Society of Indian Automobile Manufacturers (SIAM); NSO; RBI; Tractor and Mechanization Association (TMA); Ministry of Chemicals and Fertilisers (MoC&F); Ministry of Rural Development (MoRD); NielsenIQ's Retail Audit Service; and RBI staff estimates.

Box III.1: Consumer Confidence Channel: The Perception Pathway in Policy Transmission to Private Consumption

Private consumption, being the main driver of growth in the Indian economy, is tracked actively by analysts as well as policymakers. Though high frequency indicators are generally used to monitor the emerging trends in consumption, the qualitative assessment through the consumer confidence channel is also found to be of significance for monetary policy. The Reserve Bank of India's Consumer Confidence Survey serves as a barometer of public sentiment regarding key economic dimensions such as income, employment, inflation, and households' spending. It captures consumer perceptions of the prevailing economic conditions through the Current Confidence Index and anticipated conditions over the short to medium term through the Future Expectations Index. A fall in consumer confidence, especially during

downturns, can lead to reduced spending, reinforcing the slowdown through a negative feedback loop (Ilut & Saito, 2020). Recognising the importance of confidence channel, a mixed data sampling (MIDAS) regression is estimated to examine the impact of macroeconomic conditions (GDP growth, government expenditure, and policy interest rates) on the Current Confidence Index and the Future Expectations Index (Lahiri & Monokroussos, 2016). In the next step, the autoregressive distributed lags (ARDL) model is estimated, based on quarterly data spanning Q1:2011-12 to Q4:2024-25, to investigate the influence of consumer sentiment, captured through the Current Confidence Index and the Future Expectations Index, on actual private consumption.

(Contd.)

Table III.1.1: Relationship between Macroeconomic Variables, Consumer Confidence and Private Consumption

Explanatory Variables	Dependent Variables		
	CCI	FEI	PFCE
Intercept	3.01 (23.78)	-25.19* (13.98)	-0.02 (0.10)
PFCE (Lag 1)			0.08 (0.16)
CCI		0.14 (0.13)	1.70*** (0.33)
CCI (Lag 1)			-1.38*** (0.27)
FEI (Lag 2)			0.38* (0.19)
GDP	1.20*** (0.36)	0.77*** (0.26)	
GDP (Lag 1)	1.18** (0.43)	-0.16 (0.30)	
GDP (Lag 2)	0.92* (0.45)	-0.02 (0.29)	
Govt expenditure	0.99 (1.02)	1.38** (0.61)	
WACR# (Lag 1)	-0.28* (0.16)	-0.21*** (0.10)	
Residual standard error	8.64	5.08	0.69
Multiple R-squared	0.92	0.88	0.64
Adjusted R-squared	0.81	0.70	0.56
F-statistic	8.12***	4.82***	7.43***

Notes: 1. Seasonal variables have been seasonally adjusted, and the analysis has been conducted using the difference of WACR and log differences of other variables. The bi-monthly survey results have been converted to a quarterly frequency by aligning them with the reference periods of the corresponding survey rounds.

2. Figures in parenthesis denote corresponding standard errors.

3. CCI: Current Confidence Index; FEI: Future Expectations Index; WACR: Weighted Average Call Rate.

: Co-efficients for subsequent immediate lags are also significant.

*** p<0.01, ** p<0.05, * p<0.1

The results suggest that macroeconomic conditions (especially GDP growth and policy rate) impact consumer sentiment, which in turn is found to have a positive relationship with private consumption (Table III.1.1). GDP growth influences both Current Confidence Index and Future Expectations Index, underscoring its role as a key economic signal. Policy rate changes also impact both the Current Confidence Index and the Future Expectations Index in the positive direction, although the extent of impact varies across lags, reflecting dynamic adjustment in consumers' expectations. The findings of the ARDL model suggest that the Current Confidence Index and lagged Future Expectations Index have a statistically significant positive relationship with private consumption. The negative effect of the lagged Current Confidence Index may reflect adjustments based on past uncertainties. Overall, the results indicate the working of a feedback loop wherein macroeconomic conditions impact consumer sentiment, which in turn affects private consumption. Thus, consumer sentiments could provide valuable insights into the evolving trends in private consumption that contribute significantly to aggregate demand.

References:

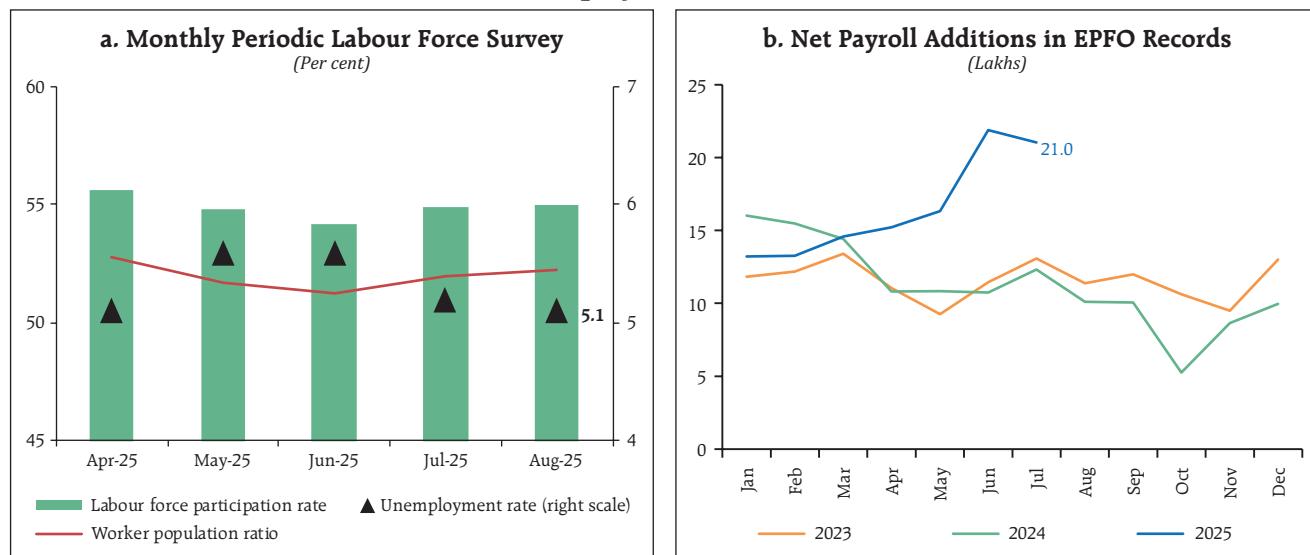
Ilut, C., and Saijo, H. (2021). Learning, confidence, and business cycles. *Journal of Monetary Economics*, 117, 354-376.

Lahiri, K., Monokroussos, G., and Zhao, Y. (2016). Forecasting consumption: The role of consumer confidence in real time with many predictors. *Journal of Applied Econometrics*, 31(7), 1254-1275.

Rural demand continues to remain resilient on the back of robust *rabi* and summer crops production, and a positive outlook for *kharif* output conditioned by the above-normal south-west monsoon. Tractor sales remained upbeat during July-August 2025, and motorcycle sales witnessed a revival during this period after contracting in preceding months. The demand for work under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)

dropped significantly in July-August, reflecting an improvement in farm sector employment. The strong growth in fast-moving consumer goods sales in rural areas also attests to buoyant demand conditions (Table III.2). The above normal south-west monsoon (SWM) rainfall, higher cumulative *kharif* sowing and improved reservoir level augur well for sustaining the momentum in rural demand.

Chart III.3: Employment Situation in India



Sources: Ministry of Statistics and Programme Implementation (MoSPI); and Employees' Provident Fund Organisation (EPFO).

Employment conditions remained steady in 2025-26. The labour force participation rate (LFPR) and the worker population ratio (WPR) as per the monthly Periodic Labour Force Survey (PLFS) improved for both rural and urban areas. The unemployment rate declined to 5.1 per cent in August 2025 (Chart III.3a). The Employees' Provident Fund Organisation (EPFO) payroll data also indicate strengthening of formal employment as average net payroll additions during April-July rose to 17.3 lakh (Chart III.3b).

III.1.2 Gross Fixed Capital Formation

Gross fixed capital formation expanded at a strong pace in Q1:2025-26, aided by robust government capex. The share of gross fixed capital formation in GDP improved to 34.6 per cent in Q1 from 33.9 per cent in the previous quarter. The congenial financial conditions, engendered by monetary policy easing, along with healthy twin balance sheets (banks and corporates) and rising capacity utilisation continue to support fixed investment. Among

coincident indicators of construction activity, steel consumption and cement production, exhibited strong growth during July-August 2025, sustaining healthy momentum. Domestic production of capital goods recorded modest growth in July after witnessing strong growth in Q1. Import of capital goods grew sharply in July before contracting in the month of August (Table III.3).

Capacity utilisation in the manufacturing sector¹ increased marginally to 74.1 per cent in Q1:2025-26 from the same quarter last year. Seasonally adjusted capacity utilisation at 75.8 per cent in Q1, increased by 30 basis points from the previous quarter and was well above the long-period average of 73.9 per cent² (Chart III.4). Stretched capacity utilisation generally necessitates new capacity additions to keep pace with underlying domestic demand. Funds raised for capex by private corporates during Q1 through the different channels (Banks/Financial Institutions, External Commercial Borrowings, Initial Public Offerings) remained stable, despite heightened uncertainties.

¹ Based on RBI's survey of order books, inventories, and capacity utilisation.

² Long term average is for the period Q1:2008-09 to Q1:2025-26 excluding Q1:2020-21.

Table III.3: Indicators of Investment Demand

(Y-o-y, per cent)

Indicators	2024-25				2025-26		
	Q1	Q2	Q3	Q4	Q1	Jul	Aug
Import of capital goods	10.0	11.7	6.0	7.9	14.3	12.0	-1.3
IIP: Capital goods	3.0	4.9	7.4	7.0	9.8	5.0	
Finished steel consumption	15.3	11.8	7.8	11.9	7.9	7.3	10.0
Cement production	0.4	3.2	8.7	12.4	8.0	11.6	6.1

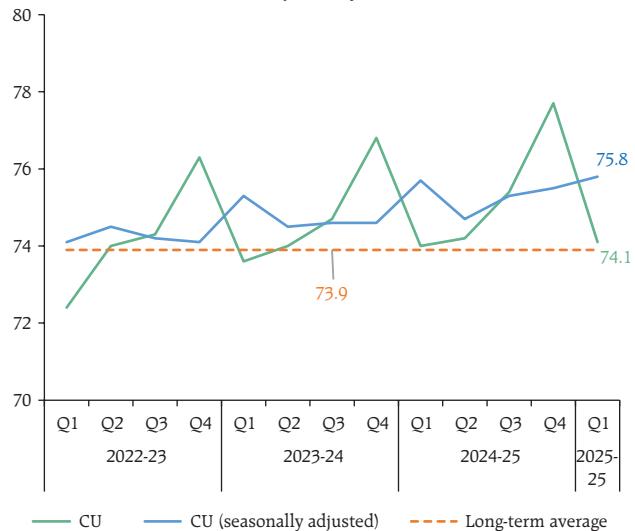
Sources: Directorate General of Commercial Intelligence and Statistics (DGCI&S); NSO; Joint Plant Committee; and Office of Economic Adviser.

On the other hand, private capex, especially in export-intensive sectors, faced headwinds from global trade uncertainty (Box III.2).

The interest coverage ratio (ICR)³ of the listed private manufacturing companies improved in Q1:2025-26, indicating strong debt servicing capacity. Within the services sector, while interest coverage ratio of non-IT services remained stable above the threshold

Chart III.4: Capacity Utilisation in Manufacturing

(Per cent)



level of one, the elevated interest coverage ratio of IT firms inched up further (Table III.4). This, in conjunction with congenial financial conditions and improving domestic demand, should encourage firms to undertake new capacity creation.

Box III.2: External Demand and Fixed Investment Dynamics: An Empirical Investigation with Firm-level Data

Significant deleveraging of corporate balance sheets took place post-COVID, owing to improved profitability and easy financial conditions. Strengthening of balance sheets generally tends to have positive impact on corporates' investment (Gupta *et al.*, 2023; Wang *et al.*, 2013). The healthy balance sheet of the banking sector coupled with congenial financial conditions have eased the financing constraints of corporates for investments. Notwithstanding all these supporting factors, the revival in corporate investment cycle is yet to become broad-based, as new investment is witnessed only in a few select sectors.

The extant literature underlines the importance of foreign market access (exports) and uncertainty in

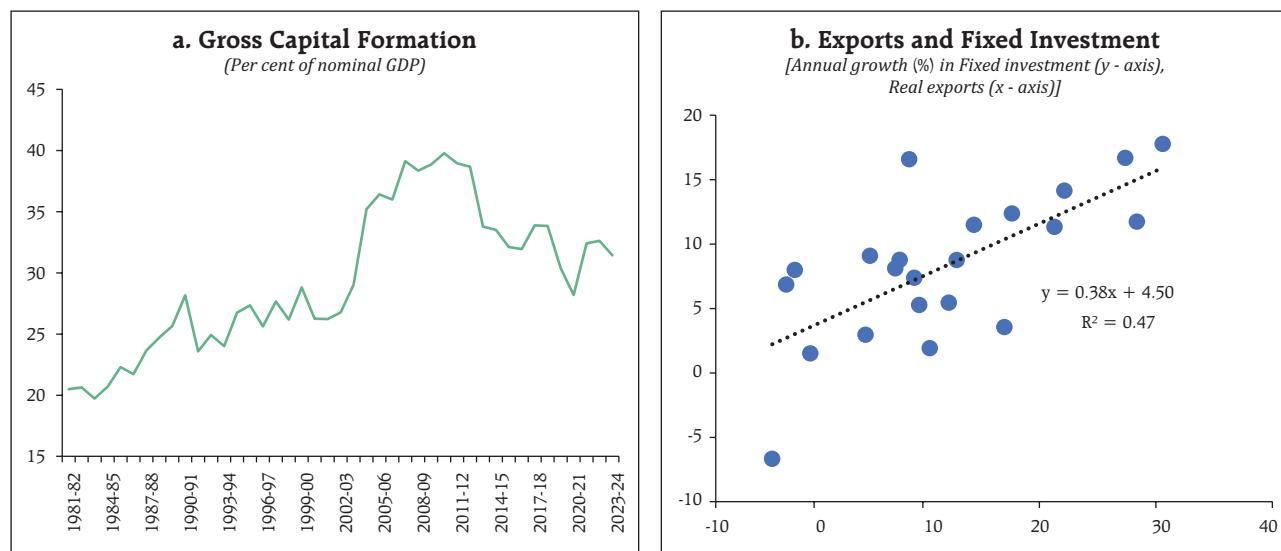
firms' investment decisions. In this regard, Fabling and Sanderson (2013) emphasised that exports provide stable cash flows and ease financial constraints, often leading to firms' increased investment in fixed assets. In India too, it has been observed that investment and exports move in tandem, suggesting that export performance boosts investment (Chart III.2.1).

In this backdrop, a fixed effects panel regression is estimated, based on data spanning 2004 to 2024, to examine the impact of exports on firms' investment in fixed assets. The change in firms' investment in fixed capital is taken as dependent variable. Apart from firms' exports earnings, firm-level control variables

(Contd.)

³ Interest coverage ratio is the ratio of earnings before interest and taxes (EBIT) to interest expenses and measures a company's capacity to make interest payments on its debt. The minimum value for a viable ICR is 1.

Chart III.2.1: Investment trends



Sources: Ministry of Statistics and Programme Implementation (MoSPI); and RBI staff estimates.

(interest coverage ratio) and aggregate merchandise exports are considered as explanatory variables. The results suggest that export growth at both the firm level and at the aggregate level has a statistically significant positive impact on fixed investment growth (Table

Table III.2.1: Relationship between Exports and Corporate Investment (2004-2024)

Variables	I	II	III	IV	V	VI
ICR (lag 1)		0.12*** (0.005)				
Export Firm	0.95*** (0.141)	0.28* (0.146)				
Taper tantrum					-0.29*** (0.009)	
Forex earnings growth			0.03*** (0.001)	0.02*** (0.001)	0.02*** (0.001)	0.02*** (0.001)
Exports growth					0.06*** (0.004)	0.24*** (0.008)
Constant	14.35*** (0.081)	12.05*** (0.099)	13.50*** (0.028)	18.58*** (0.399)	12.98*** (0.044)	12.34*** (0.053)
Observations	115,694	91,300	104,271	104,271	104,271	104,271
R-squared	0.000	0.006	0.008	0.058	0.011	0.026
Number of firms			14,655	14,655	14,655	14,655
Firm FE			YES	YES	YES	YES
Year FE				YES	NO	NO

Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

Notes: 1. Export Firm is defined as firms with exports to sales ratio higher than 30 per cent.

2. Investment is defined as ratio of the annual change in fixed asset with total fixed asset as at end of the financial year.

III.2.1). Exporting firms' investment is roughly 1 per cent more than that of non-exporting firms. Even after controlling for firm leverage, export-oriented firms invest about 0.28 per cent higher than non-exporting firms. Based on these results, it may be inferred that elevated global economic uncertainty due to multiple shocks post COVID coupled with uneven export performance during the last few years, may also be contributing to a delayed revival in private corporate investment cycle.

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Table III.4: Interest Coverage Ratio

(Ratio)

Industry	2023-24				2024-25				2025-26
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Manufacturing	6.8	7.5	7.4	7.5	7.9	7.9	7.6	8.7	9.1
Services (non-IT)	1.6	1.4	1.8	1.7	1.8	1.7	2.1	2.1	2.1
IT	44.5	43.2	41.2	44.1	42.9	45.6	40.9	44.0	44.3

Note: Data for Q1:2025-26 are based on results of 3,079 listed non-government non-financial companies.

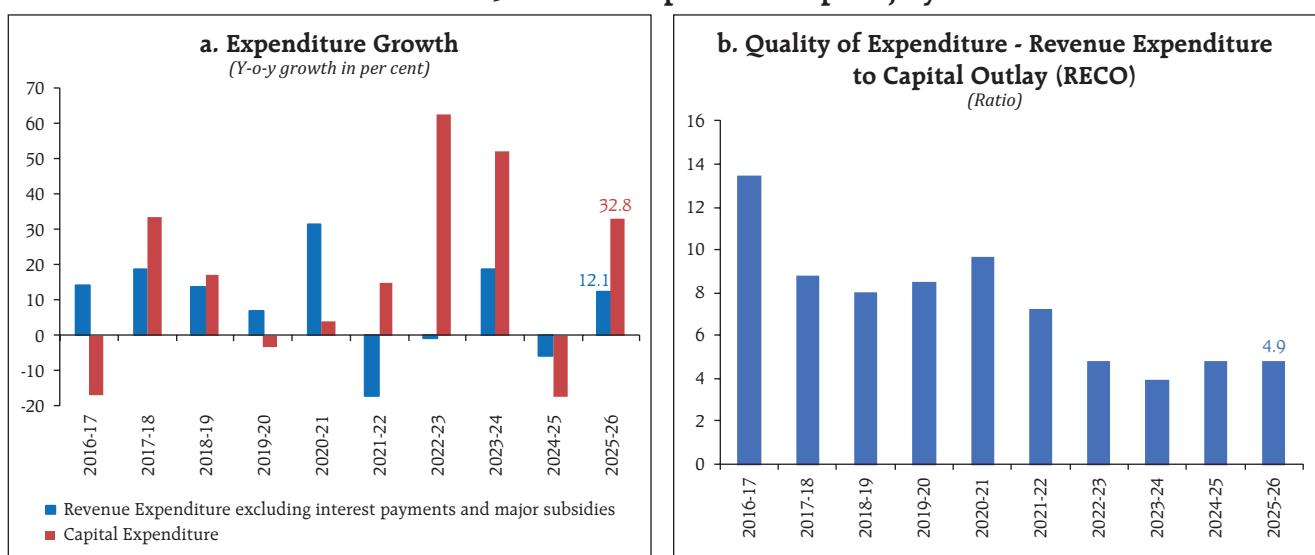
Source: RBI staff estimates.

III.1.3 Government Consumption

Government final consumption expenditure grew by 7.4 per cent (y-o-y) during Q1:2025-26, as against a contraction in the preceding quarter (Table III.1). Revenue expenditure of the central government (excluding interest payments and major subsidies) recorded double-digit growth during April-July 2025. This marks a significant turnaround from a modest increase in Q4:2024-25 and a contraction in the corresponding period of the previous year. Capital expenditure registered a high growth of 32.8 per cent in April-July (Chart III.5a). On an annual basis, the central government's revenue expenditure to capital outlay (RECO) ratio has been moderating since 2020-21, indicating sustained improvement in the

quality of expenditure. During April-July 2025, this ratio remained close to corresponding level of last year (Chart III.5b). This reflects the government's continued thrust on fiscal consolidation without compromising the quality of expenditure. Continued fiscal consolidation and improvement in the quality of government expenditure, along with strong macroeconomic fundamentals, have contributed to India's sovereign rating upgrade by S&P Global Ratings in August 2025 - the first upgrade in 18 years.

On the revenue receipts front, the central government's gross tax revenue recorded a muted growth of 0.8 per cent during April-July 2025. Indirect tax revenue rose by 6.7 per cent, buoyed by higher receipts from goods and services tax and union excise duties. Direct tax collections, on the other hand, recorded a decline of 4.0 per cent, mainly due to contraction in personal income tax collections (Table III.5). Gross goods and services tax collections (Centre plus States) expanded by 9.9 per cent during April-August 2025, underscoring the sustained momentum in economic activity (Chart III.6). The central government has recently undertaken a detailed overhaul of the GST framework, encompassing three pillars – structural reforms, rate rationalisation

Chart III.5: Centre's Expenditure: April - July

Sources: Controller General of Accounts (CGA); and RBI staff estimates.

Table III.5: Central Government's Tax Collections

Item	₹ thousand crore				Per cent			
	BE		Actuals		Per cent to BE		Growth Rate	
	2023-24	2024-25	Apr-Jul 2024	Apr-Jul 2025	Apr-Jul 2024	Apr-Jul 2025	Apr-Jul 2024	Apr-Jul 2025
A. Direct taxes	2,207	2,520	596	572	27.0	22.7	35.9	-4.0
Of which								
1. Corporation tax	1,020	1,082	185	199	18.1	18.4	4.8	7.6
2. Income tax	1,150	1,360	394	355	34.3	26.1	53.4	-9.9
B. Indirect taxes	1,633	1,750	488	521	29.9	29.8	7.1	6.7
Of which								
1. Total GST	1,067	1,183	341	375	32.0	31.7	9.5	9.8
2. Custom duties	238	240	68	61	28.4	25.2	3.8	-10.4
3. Union excise duties	319	317	77	84	24.1	26.5	0.8	9.3
C. Gross tax revenue	3,840	4,270	1084	1093	28.2	25.6	21.3	0.8
D. Assignment to States/UTs	1,247	1,422	367	429	29.4	30.1	18.5	16.9
E. Net tax revenue	2,583	2,837	715	662	27.7	23.3	22.8	-7.5

Note: BE: Budget Estimates.

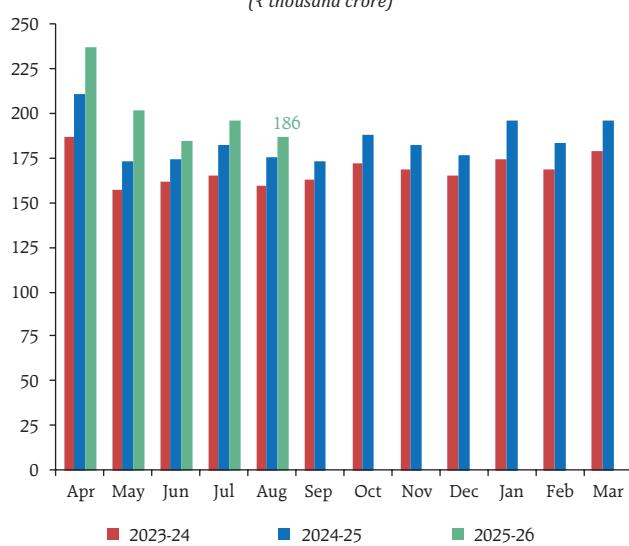
Sources: Union Budget Documents; and Controller General of Accounts (CGA).

and ease of living. The GST rate structure has been converted mainly into two slabs of 5 per cent and 18 per cent with a special 40 per cent rate for luxury and sin goods.⁴

Non-tax revenue of the central government posted a high growth of 33.7 per cent during April-July

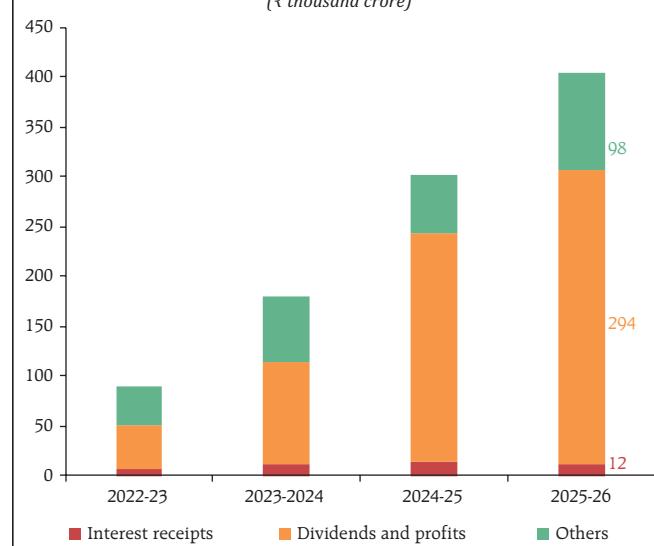
2025, mainly due to the large surplus transfer of ₹2.69 lakh crore by the Reserve Bank of India in May 2025 (Chart III.7). Centre's gross fiscal deficit stood at 29.9 per cent of its full year budget estimates (BE) during April-July 2025, higher than 17.2 per cent recorded in the same period last year.

Chart III.6: GST Collections (Centre plus States)
(₹ thousand crore)



Sources: Press information bureau (PIB); and GST website.

Chart III.7: Centre's Non-tax Revenue: April-July
(₹ thousand crore)



Source: Controller General of Accounts (CGA).

⁴ <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2156708>

Table III.6: State Government Finances - Key Deficit Indicators

(Per cent to GDP)

	2023-24	2024-25 (PA)	2025-26 (BE)
Revenue deficit	0.3	0.6	0.2
Gross fiscal deficit	2.9	3.3	3.3
Primary deficit	1.2	1.7	1.5

Notes: 1. Data pertain to 31 States/UTs.

2. PA: Provisional Accounts; BE: Budget Estimates.

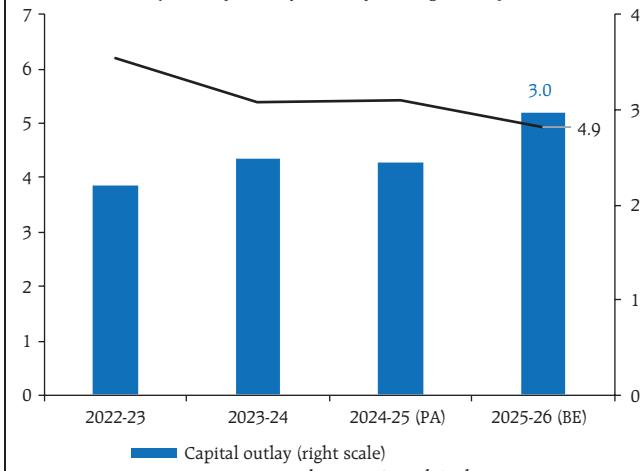
Sources: Budget Documents of State/UTs; and Comptroller and Auditor General (CAG) of India.

The consolidated gross fiscal deficit of State governments and Union Territories is budgeted at 3.3 per cent of GDP for 2025-26, same as in the provisional estimates of 2024-25 (Table III.6). State governments continue to prioritise capital expenditure, as evidenced by an improvement in the Revenue Expenditure to Capital Outlay (RECO) ratio, which moderated to 4.9 in 2025-26 (BE) from 6.2 in 2022-2023 (Chart III.8). The states' capital expenditure is also supported by the central government through the 'Scheme for Special Assistance to States for Capital Investment', under which ₹1.5 lakh crore has been allocated for 2025-26.

As per the available data for April-July 2025, the key deficit indicators of state governments, as a proportion

Chart III.8: States' Capital Outlay

(Ratio, left scale; per cent of GDP, right scale)

**Notes:** 1. Data pertain to 31 States/UTs.

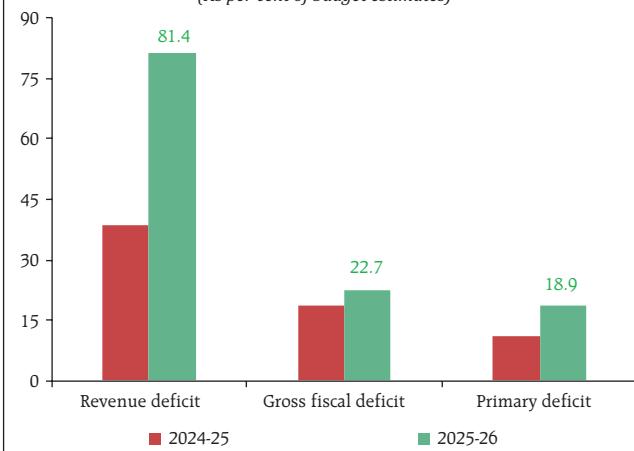
2. PA: Provisional Accounts; BE: Budget Estimates.

Sources: Budget Documents of States/UTs; and CAG.

of their budget estimates, were higher compared to the corresponding period of last year, primarily due to deceleration in revenue receipts growth (Chart III.9a). The slowdown in receipts was led by moderation in the growth of state goods and service tax and sales tax/Value Added Tax (VAT) collections, even as state excise duties and stamp duties and registration fees remained robust. Non-tax revenues increased at a slower pace relative to the previous year and grants

Chart III.9: States' Key Fiscal Performance Indicators: April-July

a. Deficit Indicators
(As per cent of budget estimates)



b. Revenue and Expenditure
(Y-o-y growth in per cent)

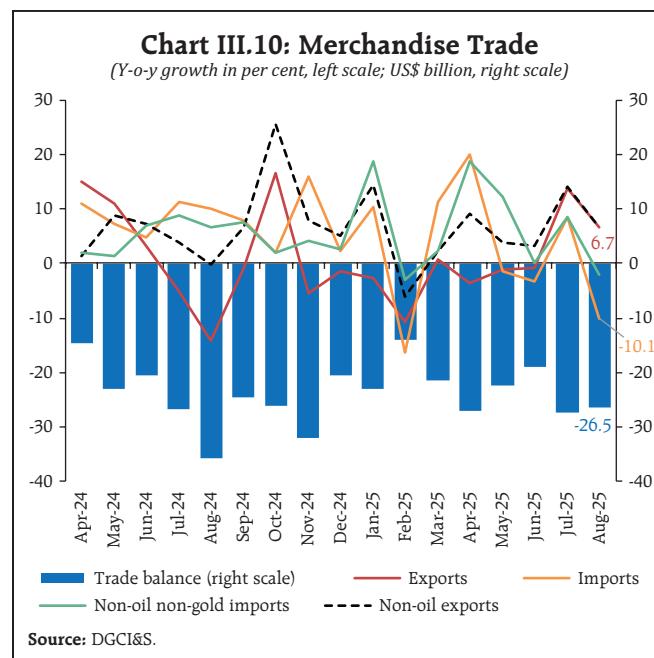
**Note:** Data pertain to 24 States/UTs.**Source:** CAG.

from the central government contracted further. On the expenditure front, revenue expenditure growth remained robust and capital expenditure recorded a sharp upturn, aided partly by the low base (Chart III.9b).

In the Union Budget for 2025-26, gross and net market borrowings through dated securities were provided at ₹14.8 lakh crore and ₹11.5 lakh crore, respectively. During the H1:2025-26 (up to September 26, 2025), gross market borrowings raised by the centre stood at ₹7.95 lakh crore, constituting 53.6 per cent of the annual budgeted amount (Table III.7). The weighted average cost of the issuances at 6.6 per cent was lower than 7.0 per cent in 2024-25. The weighted average maturity of the issuances declined to 19.6 years from 20.7 years in the previous fiscal. During H2:2025-26, the centre is expected to raise ₹6.8 lakh crore through dated securities. States mobilised ₹4.7 lakh crore through gross market borrowings during H1 (up to September 26, 2025), as against the indicative calendar amount of ₹5.6 lakh crore. In order to bridge temporary mismatches between receipts and expenditures, the Ways and Means Advances (WMA) limit for the central government was fixed at ₹1.5 lakh crore for H1:2025-26 and has been revised to ₹50,000 crore for H2.

III.1.4 External Demand

Amidst persisting global trade uncertainty, India's merchandise exports exhibited uneven performance. During April-August 2025, merchandise exports (in US dollar terms) registered an expansion of 2.5 per cent, while merchandise imports rose by 2.1 per cent. The merchandise trade deficit during April-August 2025 widened marginally to US\$122.4 billion from



US\$120.5 billion in the same period last year (Chart III.10). Services exports maintained buoyancy with double digit growth during April-July 2025. According to provisional estimates released by the National Statistical Office (NSO), real exports and imports of goods and services grew by 6.3 per cent and 10.9 per cent, respectively, in Q1:2025-26 (Table III.1).

The increase in merchandise exports during H1:2025-26 (April-August) was primarily driven by strong performances in electronic goods, engineering goods, pharmaceuticals, marine products, and readymade garments. On the other hand, petroleum products, iron ore, oil meals, cotton yarn, fabrics, made ups, and handloom products dragged down the overall export growth. Exports of petroleum, oil, and lubricants (POL) declined by 19.4 per cent y-o-y, amounting to US\$ 26.1 billion during April-August 2025. In contrast, non-POL, non-gems and jewellery exports posted

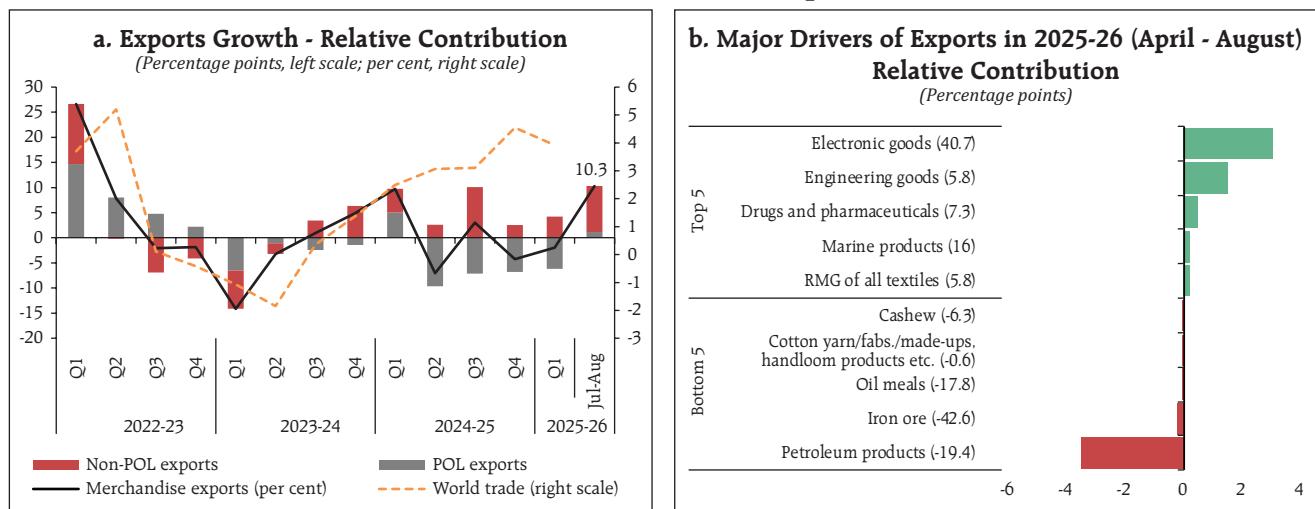
Table III.7: Government Market Borrowings

(₹ crore)

	2024-25			2025-26 (till September 26, 2025)		
	Centre	States	Total	Centre	States	Total
Net borrowings	11,62,879	7,53,345	19,16,224	5,88,299	3,21,992	9,10,291
Gross borrowings	14,00,697	10,73,310	24,74,007	7,95,000	4,66,692	12,61,692

Sources: Government of India (GoI); and RBI staff estimates.

Chart III.11: Merchandise Exports



Notes: 1. World trade data is available up to June 2025.

2. Figures in parentheses in chart b are y-o-y percent change in exports of the commodity during the period.

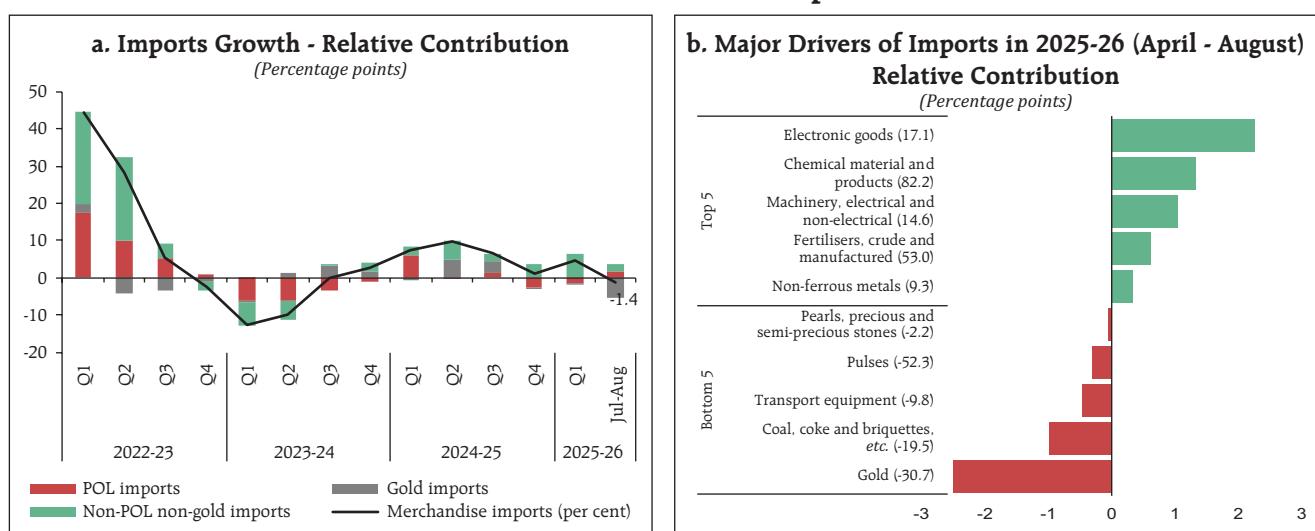
Sources: DGCI&S; CPB Netherlands; and RBI staff estimates.

a robust growth of 7.8 per cent, reaching US\$ 146.7 billion during the same period (Chart III.11).

The growth in merchandise imports during H1:2025-26 (April-August) was primarily driven by imports of electronic goods, chemical materials and products, machinery (both electrical and non-electrical), fertilisers, and non-ferrous metals. On the other hand, imports of gold, coal, coke and briquettes, transport

equipment, pulses, and pearls, precious and semi-precious stones declined, dampening overall growth in imports. Petroleum, oil, and lubricants (POL) imports contracted marginally by 0.1 per cent to US\$ 78.1 billion during this period. On the contrary, non-POL, non-gold imports saw a robust expansion of 7.1 per cent, reaching US\$ 211.5 billion, indicating strong domestic demand (Chart III.12).

Chart III.12: Merchandise Imports



Note: Figures in parentheses in chart b are y-o-y percent change in imports of the commodity during the period.

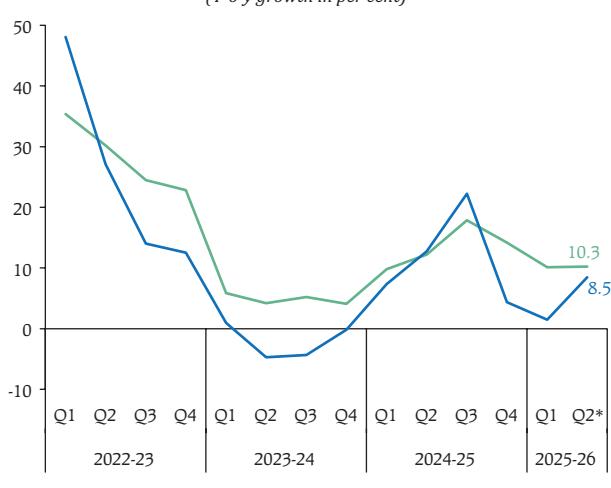
Sources: DGCI&S; and RBI staff estimates.

India's services exports remained buoyant during April-July 2025, registering a robust growth of 10.1 per cent, supported by sustained global demand for Indian services (Chart III.13). The expansion was primarily driven by strong performance in software and business services. Reflecting this resilience, India retained its position among the top five service-exporting nations in terms of export growth in Q1:2025-26. Services imports growth moderated to 1.5 per cent in Q1:2025-26 but accelerated to 8.5 per cent in July.

On a balance of payments basis, India's current account deficit (CAD) stood at 0.2 per cent of GDP in Q1:2025-26, as against 0.9 per cent in Q1:2024-25. This improvement in CAD was underpinned by robust services exports and strong inflow of remittances that significantly offset the high merchandise trade deficit (Chart III.14). Amidst heightened global uncertainty, India continues to receive robust private remittances (US\$ 35.3 billion during Q1:2025-26) and remain the largest recipient of private remittances in the world.

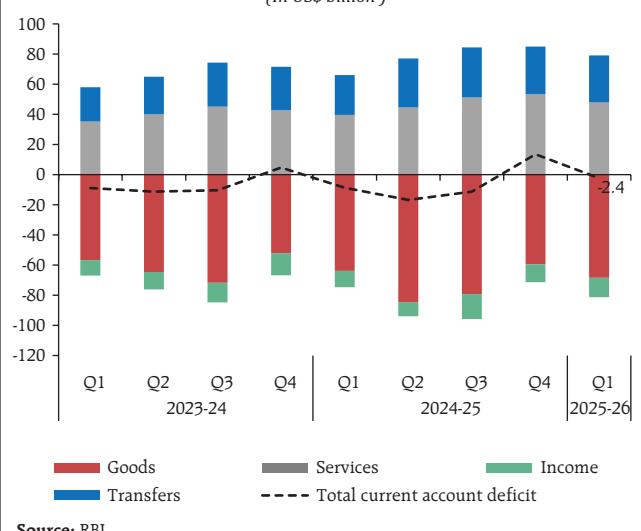
On the financial account, gross inward foreign direct investment (FDI) was resilient in 2024-25, expanding by 13.1 per cent to US\$ 80.6 billion. On a net basis, FDI inflows moderated significantly to US\$ 1.0 billion, largely due to elevated repatriations and outward FDI. Global investment sentiment has also weakened, as evidenced by a contraction in global FDI flows⁵ for the second consecutive year in 2024. During April-July 2025, gross FDI inflows remained strong at US\$ 37.7 billion, underscoring India's continued appeal as a preferred investment destination. Net FDI inflows at US\$ 10.8 billion during this period was also higher as compared to US\$ 3.5 billion a year ago, primarily on account of a rise in gross inflows and a moderation in FDI repatriation. Singapore, the United States, Mauritius, the United Arab Emirates and the Netherlands emerged as the top sources of FDI in April-July 2025, collectively accounting for 76.0 per cent of total inflows. Manufacturing, computer services, business services, communication services, and electricity generation and distribution attracted the bulk of FDI equity inflows, comprising 74.2 per cent of the total.

Chart III.13: Services Trade
(Y-o-y growth in per cent)



Note: * Data is for July 2025
Source: RBI.

Chart III.14: Components of Current Account Deficit
(In US\$ billion)



Source: RBI.

⁵ Excluding financial flows from European conduit economies with elevated volatility.

Table III.8: Net Foreign Direct and Portfolio Investment

(US\$ billion)

	2023-24				2024-25				2025-26	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Net FDI	4.7	-0.8	4.0	2.3	6.2	-2.8	-2.8	0.4	5.7	5.0 [#]
Net FPI	16.1	5.3	11.7	11.6	0.9	19.8	-11.4	-6.0	2.5	-5.5*

Notes: #: Data is for July 2025.

*: Net FPI data for Q1:2025-26 are based on balance of payments (BoP) statistics of RBI, while data for Q2:2025-26 is sourced from daily data, published by NSDL; and data is up to September 26

Sources: National Securities Depository Limited (NSDL); and RBI.

Persistent geopolitical tensions, rise in global trade barriers, heightened policy uncertainty, and elevated U.S. bond yields have collectively dampened foreign investors sentiment towards emerging market economies, especially in equity inflows in recent years. Reflecting this sentiment, foreign portfolio investment in India recorded a net outflow of US\$ 3.0 billion during H1:2025-26 (up to September 26), mainly owing to outflows in the equity segment. Notably, FPI flows had turned positive in Q1:2025-26 after two consecutive quarters of outflows, indicating a brief recovery in investor confidence (Table III.8). This momentum reversed in Q2 (up to September 26), as global risk aversion intensified, compounded by U.S. tariffs.

External commercial borrowing inflows decreased to US\$ 3.7 billion during April-August 2025 from US\$ 4.9 billion a year earlier. Of these borrowings, approximately 60.6 per cent were hedged, reflecting a prudent approach in the wake of high global financial volatility. Net accretions to non-resident deposits during April-July 2025 moderated to US\$ 4.7 billion from US\$ 5.8 billion in the same period last year. This decline was driven mainly by reduced inflows in Foreign Currency Non-Resident Bank [FCNR(B)] deposits. As of September 19, 2025, India's foreign exchange reserves stood at US\$ 702.6 billion, sufficient to cover 11.5 months of annualised merchandise imports (on a balance of payments basis) or 95.4 per cent of the country's outstanding external debt as of end-March 2025.

III.2 Aggregate Supply

Aggregate supply – measured by real gross value added at basic prices – expanded by 7.6 per cent in Q1:2025-26 (6.8 per cent in the preceding quarter) – marking a six-quarter high supported by a recovery in manufacturing and buoyancy in services. Manufacturing and all four major subsectors of services recorded strong growth and cumulatively contributed around 94.3 per cent to total gross value added (Table III.9). The seasonally adjusted momentum of gross value added moderated in Q1 from the previous quarter (Chart III.15b).

III.2.1 Agriculture

Agriculture sector prospects remain favourable, supported by above normal monsoons, adequate reservoir levels, and supportive policy interventions. Real gross value added in the agriculture, forestry, and fishing sector expanded by 3.7 per cent in Q1:2025-26, lower than 5.4 per cent in Q4:2024-25 but higher than 1.5 per cent in the same period of last year. Southwest monsoon commenced eight days ahead of its normal schedule,⁶ and gained significant momentum, covering the entire country by June 29. As of September 26, 2025, the cumulative rainfall was 7 per cent above the Long Period Average (Chart III.16a). Regionally, rainfall exceeded the Long Period Average across all regions, except in East and Northeast India.

Kharif sowing recorded an increase of 0.6 per cent as on September 26, 2025 over the last year, on the back of good progress of southwest monsoon and also exceeding season's normal sown area. The rise in kharif

⁶ https://internal.imd.gov.in/press_release/20250524_pr_3998.pdf

Table III.9: Real Gross Value Added Growth

(Y-o-y, per cent)

Sector	2023-24	2024-25	Weighted Contribution		2023-24				2024-25				2025-26
	(FRE)	(PE)	2022-23	2023-24	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Agriculture, forestry and fishing	2.7	4.6	0.4	0.7	5.7	3.7	1.5	0.9	1.5	4.1	6.6	5.4	3.7
Industry	11.0	4.5	2.4	1.0	6.6	15.3	12.6	9.9	7.8	2.1	3.5	4.7	5.8
Mining and quarrying	3.2	2.7	0.1	-0.2	4.1	4.1	4.7	0.8	6.6	-0.4	1.3	2.5	-3.1
Manufacturing	12.3	4.5	2.1	5.4	7.3	17.0	14.0	11.3	7.6	2.2	3.6	4.8	7.7
Electricity, gas, water supply and other utilities	8.6	5.9	0.2	-0.5	4.1	11.7	10.1	8.8	10.2	3.0	5.1	5.4	0.5
Services	9.2	7.5	5.8	4.8	12.1	8.3	8.5	8.0	7.2	7.4	7.5	7.9	9.0
Construction	10.4	9.4	0.9	8.7	9.2	14.6	10.0	8.7	10.1	8.4	7.9	10.8	7.6
Trade, hotels, transport, communication	7.5	6.1	1.4	-7.3	11.0	5.4	8.0	6.2	5.4	6.1	6.7	6.0	8.6
Financial, real estate and professional services	10.3	7.2	2.4	-1.3	15.0	8.3	8.4	9.0	6.6	7.2	7.1	7.8	9.5
Public administration, defence and other services	8.8	8.9	1.1	0.8	9.3	8.9	8.4	8.7	9.0	8.9	8.9	8.7	9.8
GVA at basic prices	8.6	6.4	8.6	6.4	9.9	9.2	8.0	7.3	6.5	5.8	6.5	6.8	7.6

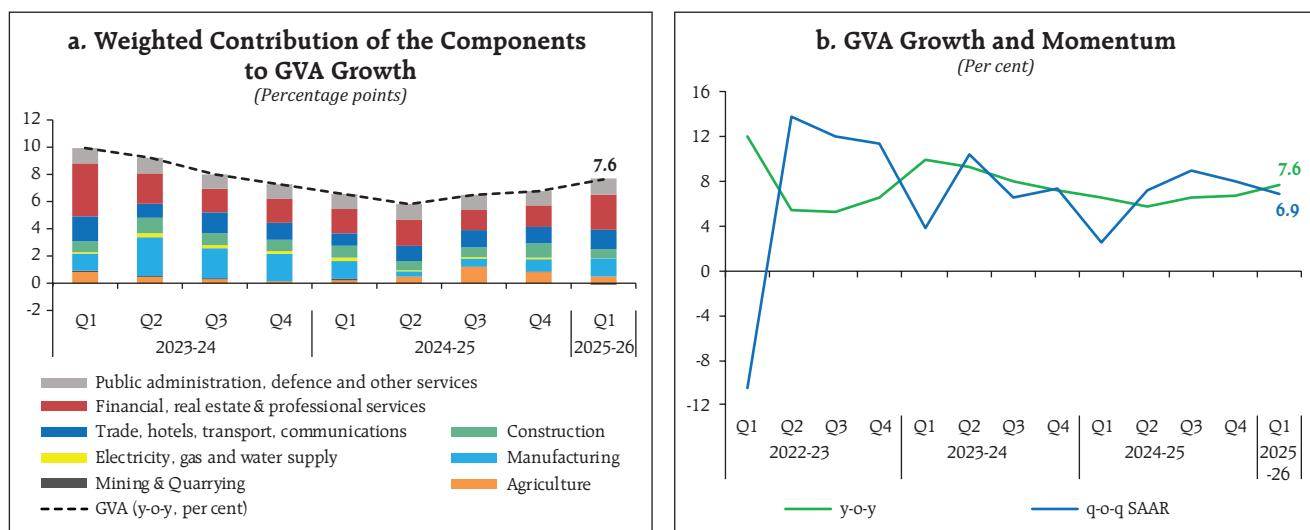
Note: FRE: First revised estimates; PE: Provisional estimates.

Sources: NSO; and RBI staff estimates.

acreage was primarily led by rice, maize, urad and sugarcane (Chart III.16b). As of September 25, 2025, reservoir levels stood at 90 per cent of total capacity, exceeding the levels recorded a year ago as well as the decadal average (Chart III.16c). Furthermore, as of September 26, 2025, the production-weighted

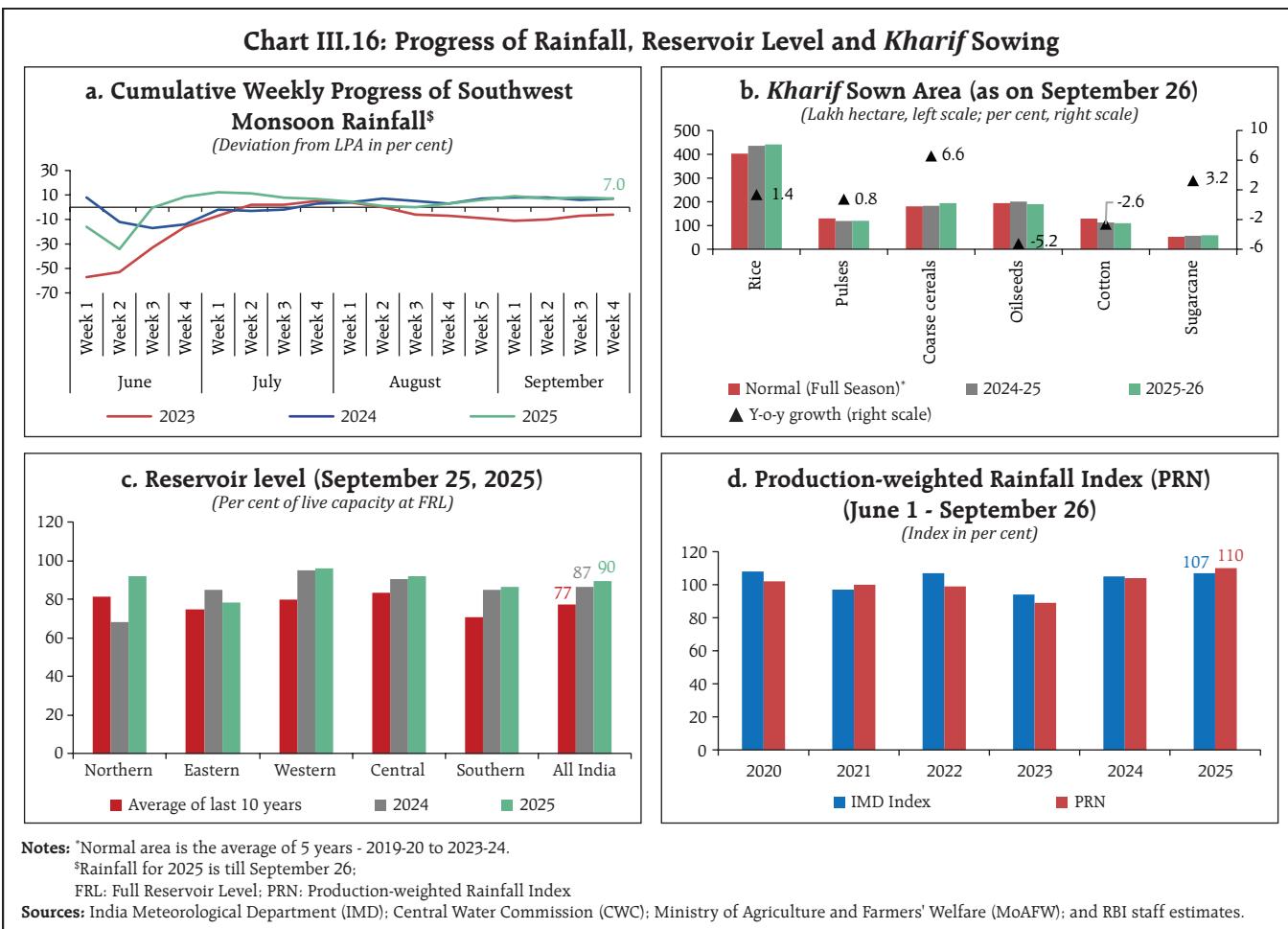
rainfall index (PRN) stood at 110 per cent, indicating relatively higher rainfall in major foodgrain producing states (Chart III.16d). Adequate soil moisture conditions coupled with healthy reservoir storage are expected to boost the Rabi prospects.

Chart III.15: Gross Value Added Growth and its Constituents



Note: SAAR – Seasonally adjusted annualised rate.

Sources: NSO; and RBI staff estimates.



According to the third advance estimates of crops production for 2024-25, total foodgrain output increased by 6.5 per cent to 3,540 lakh tonnes. Except for sugarcane, cotton, and jute and mesta, all major crops have recorded an increase in production (Table III.10).

The Government announced Minimum Support Prices for kharif crops for the 2025-26 marketing season, increasing in the range of 1.0-13.9 per cent.⁷ The relative changes in Minimum Support Price are expected to promote crop diversification, address demand-supply imbalances, and foster sustainable agricultural practices.

III.2.2 Industry

Gross value added of the industrial sector expanded by 5.8 per cent in Q1:2025-26, as compared to 4.7 per cent

in the previous quarter (7.8 per cent a year ago). This was primarily driven by a rebound in manufacturing activity with improving profit margins due to low input costs. Mining and quarrying contracted, while electricity, gas, water supply, and other utility services increased marginally during Q1 (Chart III.17).

Index of industrial production (IIP) expanded by 2.0 per cent during April-July 2025 (Table III.11). As alluded to earlier, the expansion in industrial production was mainly driven by higher growth in manufacturing output, which registered a six-month high in July. Mining and quarrying output contracted during April-July 2025, partly owing to monsoon-related disruptions. Electricity generation remained muted, due to lower than usual summer temperature. Within manufacturing, production of

⁷ <https://desagri.gov.in/wp-content/uploads/2025/06/MSP-Notification-KMS-2025-26-English.pdf>

Table III.10: Agricultural Production in 2024-25

(Lakh tonnes)

Crop	2023-24	2024-25		Variation in 2024-25 (Per cent)	
	Final	SAE	TAE	Over Final 2023-24	Over SAE 2024-25*
Foodgrains	3323.0	3309.2	3539.6	6.5	1.3
Kharif	1557.7	1663.9	1680.7	7.9	1.0
Rabi	1600.1	1645.3	1672.2	4.5	1.6
Summer	165.2	-	186.8	13.0	-
Rice	1378.3	1364.4	1490.7	8.2	0.8
Wheat	1132.9	1154.3	1175.1	3.7	1.8
Coarse cereals	569.4	560.3	621.4	9.1	2.2
Pulses	242.5	230.2	252.4	4.1	-0.2
Oilseeds	396.7	416.7	426.1	7.4	-0.7
Sugarcane	4531.6	4350.8	4501.2	-0.7	3.5
Cotton *	325.2	294.3	306.9	-5.6	4.3
Jute & Mesta **	96.9	86.2	87.5	-9.8	1.4

Notes: *: SAE covers production of Kharif and Rabi crops only. Growth is calculated accordingly.

#: Lakh bales of 170 kgs each; **: Lakh bales of 180 kgs each. SAE: Second Advance Estimates. TAE: Third Advance Estimates.

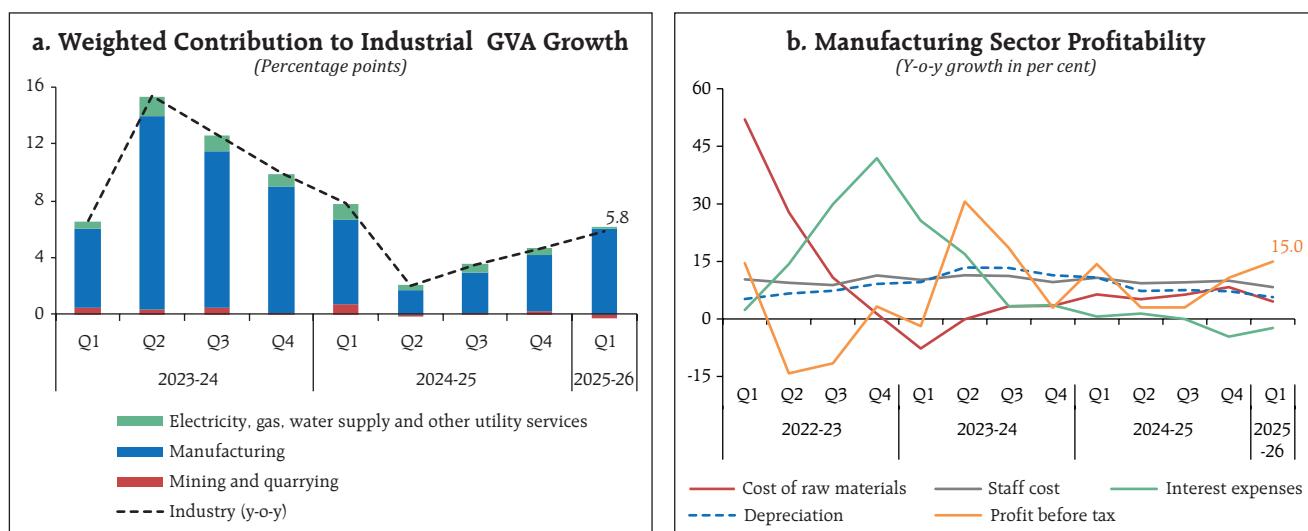
Sources: MoAFW; and GoI.

basic metal electrical equipment, motor vehicles, trailers and semi-trailers, machinery and equipment, and fabricated metal products were the growth drivers, while chemicals, beverages, printing, paper, leather, and other manufacturing products acted as a drag. In terms of use-based classification, capital, infrastructure, intermediate, and consumer durables rose during April-July. On the other hand, primary

goods and consumer non-durable goods contracted during this period.

Gross value added of electricity, gas, water supply, and other utility services grew modestly in Q1:2025-26, compared to a double-digit growth last year, mainly due to a decline in electricity generation. Conventional power generation declined during April-August 2025, reflecting both reduced demand in the face of subdued

Chart III.17: Industrial GVA Growth



Note: Data for Q1:2025-26 in chart b are based on results of 1,736 listed private manufacturing companies.

Sources: Capitaline and RBI staff calculations.

Table III.11: Industrial Sector y-o-y growth

(Y-o-y, Per cent)

	Indicators	2024-25				2025-26			
		Q1	Q2	Q3	Q4	Q1	Jul	Aug	Sep
1	PMI: Manufacturing (>50 indicates growth over previous month)	58.2	57.4	56.8	57.4	58.1	59.1	59.3	58.5*
2	Index of Industrial Production (IIP)	5.5	2.7	4.1	4.0	2.0	3.5		
3	IIP: Manufacturing	4.3	3.3	4.5	4.2	3.3	5.4		
4	IIP: Primary goods	6.9	1.6	3.0	4.1	-1.4	-1.7		
5	IIP: Capital goods	3.0	4.9	7.4	7.0	9.8	5.0		
6	IIP: Intermediate goods	3.5	4.8	5.3	3.4	5.0	5.8		
7	IIP: Infrastructure and construction goods	8.1	3.9	7.0	8.1	6.0	11.9		
8	IIP: Consumer durables	10.7	6.6	9.0	5.9	2.6	7.7		
9	IIP: Consumer non-durables	-0.2	-2.2	-1.6	-2.0	-1.5	0.5		
10	Eight Core Industries (ECI)	6.3	2.4	4.9	4.3	1.5	3.7	6.3	
11	ECI: Steel	8.4	4.3	7.8	6.8	7.2	16.6	14.2	
12	ECI: Cement	0.4	3.2	8.7	12.4	8.0	11.6	6.1	
13	Electricity demand	11.8	12.6	12.8	11.5	8.5	2.6	3.8	
Production of Automobiles									
14	Passenger vehicles	6.2	-0.5	3.3	6.4	4.9	0.1#	-4.1#	
15	Two wheelers	19.6	12.5	8.0	5.8	0.7	12.3	10.0	
16	Three wheelers	9.5	6.3	-2.6	9.5	9.8	24.0	15.8	
17	Tractors	1.0	3.2	12.1	11.7	12.7	11.5	9.4	

Notes: #: Doesn't include Tata Motors; and * : Flash PMI release.**Sources:** CMIE; CEIC; HSBC, S&P Global; Office of Economic Advisor; NSO; SIAM; TMA; and RBI staff estimates.

summer and strong expansion in renewable energy sources. Given India's continued thrust on greener energy, renewable energy sources expanded by 24.8 per cent during April-August, accounting for about 18 per cent of total electricity generation. Region-wise,

electricity demand declined across all regions in Q1, with the sharpest drop in the northern region, as the early monsoon kept power demand low. Demand in all the regions, except the northern region, picked up during July-August (Table III.12).

Table III.12: Electricity Generation and Consumption

(Y-o-y, per cent)

Indicators	2023-24				2024-25				2025-26		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Jul	Aug
Electricity Generation											
Thermal	2.1	14.7	14.3	10.1	12.0	-1.4	0.0	0.4	-8.1	-4.7	0.4
Nuclear	-6.4	16.7	10.0	-2.2	28.3	18.4	11.4	16.9	11.3	-5.5	-25.2
Hydro	-10.0	-13.4	-30.7	-20.2	1.3	6.2	28.3	19.8	13.4	23.4	9.0
Renewables	8.1	21.9	7.0	5.6	7.0	7.3	17.2	22.8	24.8	26.4	22.7
Electricity Consumption											
Northern region	-8.9	8.4	6.0	8.3	22.0	3.1	9.5	1.6	-3.0	-5.4	1.5
Western region	3.5	20.8	7.7	7.1	5.5	-6.7	0.4	4.4	-0.3	7.6	9.3
Southern region	10.7	16.3	18.2	9.3	3.3	0.8	-2.3	3.1	-1.3	9.5	-0.9
Eastern region	4.9	6.6	9.2	7.9	9.8	0.6	3.9	3.9	-1.7	2.0	7.3
All-India	1.5	13.4	9.9	8.1	10.2	-0.7	2.6	3.2	-1.5	2.6	3.8

Sources: Central Electricity Authority (CEA); and Power System Operation Corporation Limited (POSOCO).

Manufacturing purchasing managers index (PMI) signalled further improvement in overall business conditions, rising to 59.2 in July-August 2025 from 58.1 in Q1:2025-26, supported by strong domestic orders. Business expectations for manufacturing exhibited continued optimism, while the new export orders index recorded a moderation, displaying the US tariffs-related impact. India's flash manufacturing PMI stood at 58.5 in September, well above its long-run average (Chart III.18a).

To enhance competitiveness and ease of doing business, the government has implemented a simplified two slab GST 2.0 with effect from September 22, 2025.⁸ In addition, the Government has announced a host of other structural reforms which would improve productivity, competitiveness, and boost potential of the industrial sector (Table III.13).

III.2.3 Services

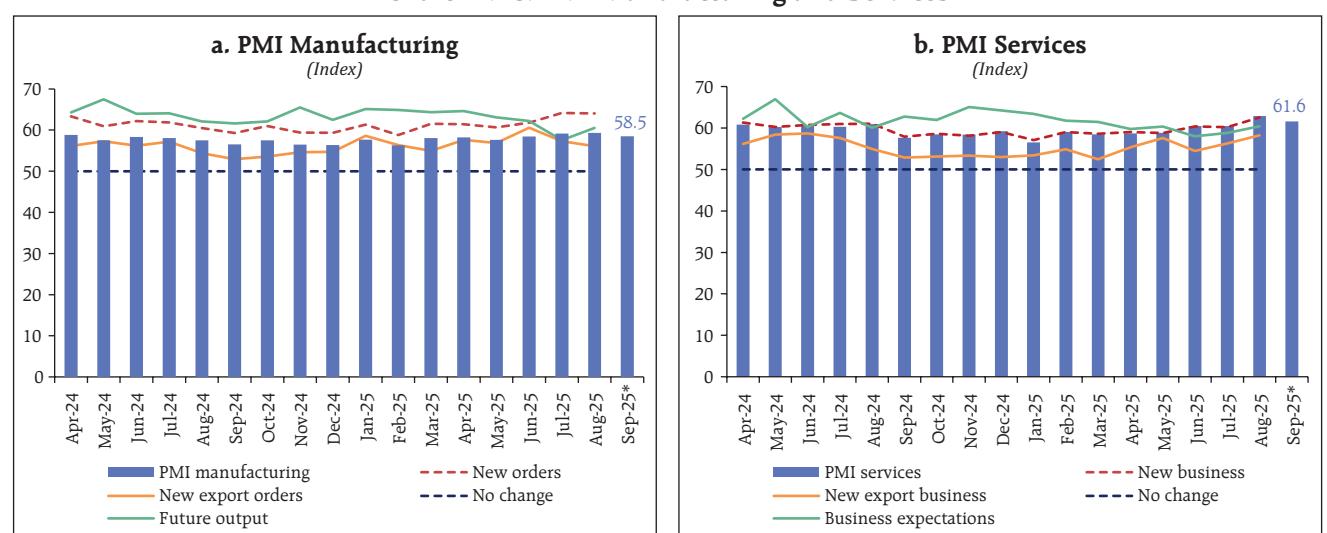
Services sector remained the main driver of gross value added in the economy, recording an eight-quarter high growth of 9.0 per cent in Q1:2025-26 and contributed more than three-fourth to overall growth.

The momentum was driven by an upsurge in trade, hotels, transport, communication, and services related to broadcasting; financial, real estate and professional services; and public administration, defence and other services (Chart III.19a).

Construction activity, which is labour-intensive, recorded strong growth in Q1:2025-26, partly owing to higher government's infrastructure spending. High frequency indicators of construction – steel consumption and cement production – remained steady during July-August (Chart III.19b).

Real gross value added of trade, hotels, transport, communication, and services relating to broadcasting inched up by 8.6 per cent in Q1:2025-26 (6.0 per cent in Q4:2024-25). Trade activity continued to exhibit resilience in Q2, as indicated by robust growth in issuances of e-way bills and healthy expansion in GST collections during July-August. Indicators of transportation services displayed a mixed picture in Q2 – toll collections remained robust in July-August, while domestic air passenger traffic contracted during the same period. Air and port cargo traffic remained in expansionary zone with modest growth in July.

Chart III.18: PMI Manufacturing and Services



Notes: PMI>50: Expansion; PMI< 50: Contraction; and * Flash PMI release.

Source: HSBC, S&P Global.

⁸ <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2163555>

Table III.13: Key Government Initiatives to Support Industrial Growth and Energy Self-Reliance

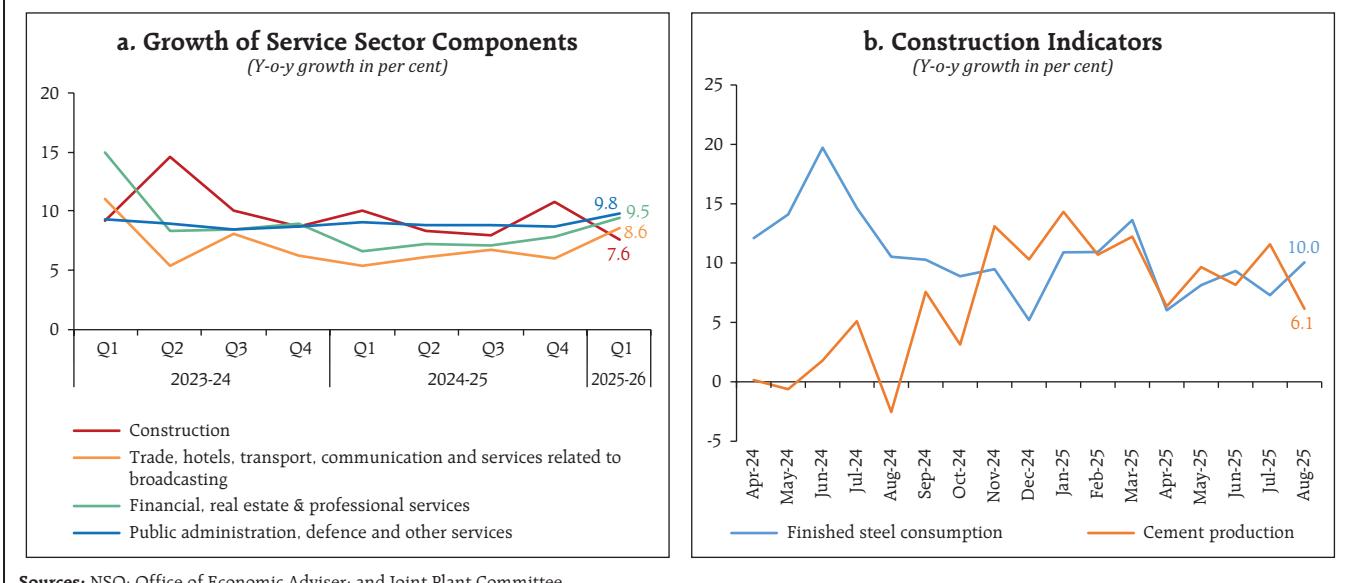
Measures	Details and Purpose
National Deepwater Exploration Mission	To harness India's offshore energy resources, boosting energy self-reliance and reducing dependence on foreign fuel imports, advancing India's energy security.
Task Force for Next-Generation Reforms	To evaluate and streamline laws, rules, and procedures related to economic activities, reducing compliance costs and fostering innovation, entrepreneurship, and growth for startups, MSMEs, and entrepreneurs.
Opening Nuclear Sector to Private Players	To enable private sector participation in nuclear energy and technology, expanding opportunities in energy and technological innovation.
PM Viksit Bharat Rozgar Yojana	A ₹1 lakh crore employment scheme providing ₹15,000 to newly employed youth, aimed at benefiting 3 crore young Indians and supporting inclusive economic development.
National Critical Minerals Mission	To explore 1,200 sites to secure minerals vital for energy, industry, and defence, ensuring access to critical resources for strategic sectors.
Made in India Semiconductor Chip	To launch the country's first domestically manufactured semiconductor chip by year-end, marking a major step in strengthening domestic technology manufacturing.
High-Powered Demography Mission	To address national security challenges arising from illegal migration and demographic imbalances in border areas, thereby enhancing border security and stability.

Source: Press Information Bureau (PIB).

Financial, real estate and professional services rose by 9.5 per cent in Q1:2025-26, contributing a major part to service sector growth (43.8 per cent) as well as to aggregate growth (33.7 per cent). Bank credit growth improved during Q2 from the last quarter, while bank deposit growth witnessed moderation. Life insurance premium expanded at a robust pace in July, while non-life insurance premium registered modest growth (Table III.14). All these indicators suggest

that financial services have kept the momentum during Q2.

Corporate performance in services sector strengthened in Q1:2025-26. Operating profit of information technology firms improved to 5.4 per cent during Q1 from 2.4 per cent in the previous quarter due to moderated growth in staff costs. Non-IT services firms recorded robust operating profit of 11.3 per cent during Q1, despite having moderated from the previous quarter (Chart III.20).

Chart III.19: Services Sector

Sources: NSO; Office of Economic Adviser; and Joint Plant Committee.

Table III.14: Services Sector y-o-y growth

(Y-o-y, per cent)

Indicators	2024-25				2025-26			
	Q1	Q2	Q3	Q4	Q1	Jul	Aug	Sep
1 PMI: Services (>50 indicates growth over previous month)	60.5	59.6	58.7	58.0	59.3	60.5	62.9	61.6*
Construction								
2 Steel consumption	15.3	11.8	7.8	11.9	7.9	7.3	10.0	
3 Cement production	0.4	3.2	8.7	12.4	8.0	11.6	6.1	
Trade, Hotels, Transport, Communication and Services related to Broadcasting								
4 Commercial vehicle sales	3.7	-11.0	1.2	1.5	-0.6			
5 Domestic air passenger traffic	5.6	7.2	11.4	12.0	5.3	-2.5	-0.5	
6 Domestic air cargo	7.1	7.6	4.6	3.1	6.6	4.8	7.1	
7 International air cargo	18.4	21.9	15.0	1.3	4.7	4.2	4.5	
8 Freight traffic	5.1	0.4	1.5	-0.4	2.4	0.0		
9 Port cargo	3.9	6.2	-1.7	9.0	5.6	4.0	2.5	
10 Toll collection: volume	5.6	7.6	9.8	15.1	16.2	14.8	16.1	
11 Petroleum consumption	3.9	1.0	5.4	-1.8	0.5	-3.9	2.6	
12 GST E-way bill	16.0	16.8	16.9	19.4	20.5	25.8	22.4	
13 GST revenue	10.1	8.9	8.3	10.4	11.8	7.5	6.5	
Financial, Real Estate and Professional Services								
14 Credit outstanding	13.9*	13.0	11.2	11.0	9.5	10.0	10.0	10.4
15 Bank deposits	10.6*	11.5	9.8	10.3	10.1	10.2	10.2	9.5
16 Life insurance premium	22.9	16.5	-6.6	-4.3	4.3	22.4	-5.2	
17 Non-life insurance premium	13.5	1.8	10.8	1.7	8.8	2.6	1.6	

Notes: #: Excluding impact of merger; * : Flash PMI release.

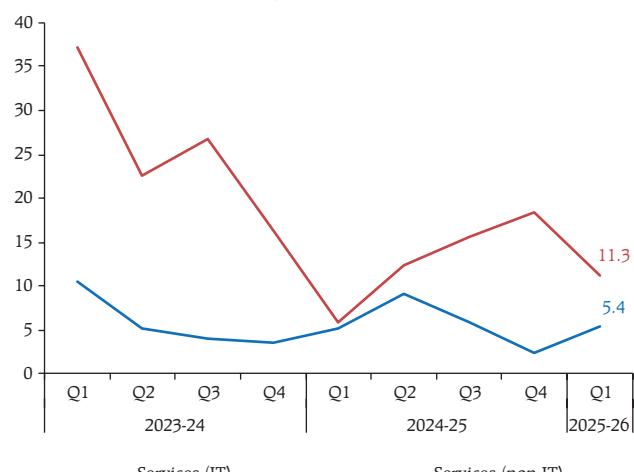
Sources: CEIC; NSO; HSBC, S&P Global; MOSPI; Insurance Regulatory and Development Authority of India (IRDAI); and RBI staff estimates.

Real estate activity displayed buoyancy in Q1:2025-26 as reflected in robust registration and stamp

duty collections of state governments (Chart III.21a). All-India housing prices recorded a modest growth in Q4:2024-25, with prices declining in Delhi (Chart III.21b). Public administration, defence, and other services (PADO) grew at a 12-quarter high of 9.8 per cent in Q1. The centre's revenue expenditure, excluding interest payments and subsidies, expanded by 18.6 per cent during July-August. Growth in other services like health, education and other personal services remained strong, alongside a recovery in government consumption in Q1.

Services PMI indicated strong expansion, as it, rose to 61.7 in July-August 2025 from an average of 59.3 in Q1:2025-26. The strong reading of services PMI was supported by robust demand and new business activity (Table III.14). The composite PMI index inched up from 60.0 in Q1 to 62.1 in Q2 (up to August). PMI manufacturing and PMI services readings for India

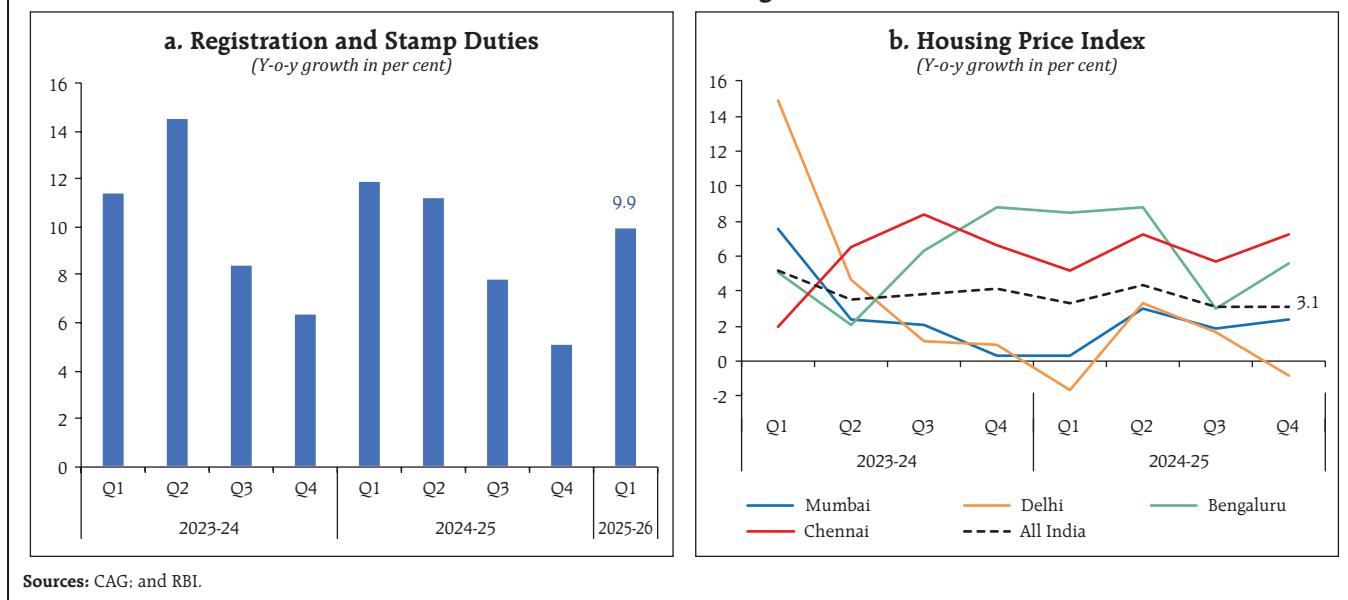
Chart III.20: Operating Profit Growth
(Y-o-y growth in per cent)



Note: Results are based on 2,951 listed non-government non-financial companies for Q1:2025-26.

Source: RBI staff estimates.

Chart III.21: Housing Sector



Sources: CAG; and RBI.

have remained the highest globally since July 2022 and April 2023, respectively.

III.3 Conclusion

Economic activity remained resilient, mainly supported by strong rural demand and robust government expenditure. Revival in manufacturing and persistent strong performance of services sector drove the recent momentum in aggregate output. Going ahead, sustained buoyancy in rural economy,

resilient services sector, healthy balance sheets of financial entities and corporates, and congenial financial conditions are expected to boost aggregate demand and growth. Structural reforms and GST rationalisation are likely to mitigate the adverse impact of trade uncertainty surrounding US tariffs. The headwinds emanating from prolonged geopolitical tensions, persisting global uncertainties, and volatility in global financial markets continue to pose risks to the growth outlook.

IV. Liquidity Conditions and Financial Markets

Domestic financial markets remained resilient and relatively stable in contrast to volatile global markets during H1:2025-26. The Reserve Bank ensured sufficient liquidity in the banking system. Money market rates moved in tandem with the policy repo rate and shifts in liquidity conditions. Transmission to lending and deposit rates remained robust. Market-based, non-bank sources of financing more than made up for the moderation in bank credit growth in H1.

Introduction

During H1:2025-26, global financial markets turned intermittently volatile amidst heightened trade-related and geopolitical uncertainties. Advanced economy central banks have adopted a cautious data-dependent approach, given large uncertainties clouding the macroeconomic outlook. Global bond yields, especially at the longer end, hardened in the wake of elevated and rising public debt. Global equity markets gained in H1 amidst recurrent bouts of sell-offs. The US dollar traded with a weakening bias, reflecting trade policy uncertainty, fiscal concerns, and shifting expectations about the Fed's policy path (see Chapter V for details).

In contrast to volatile global markets, domestic financial markets remained resilient and relatively stable during H1. The Monetary Policy Committee reduced the policy rate cumulatively by 75 bps during H1. Liquidity in the banking system remained in surplus, mainly supported by durable liquidity injections by the Reserve Bank and pick-up in government spending. Money market rates remained largely aligned to the policy rate, facilitating transmission to other markets (bond and credit markets). Monetary policy transmission was aided by a sizeable and faster decline in lending and deposit rates in the current easing cycle. Bank credit growth, despite lower than last year, continues to be healthy and supportive of real economic activity. The financing from non-bank sources has increased, reflecting higher reliance on market-based funding and offsetting the drag from muted bank credit growth.

IV.1 Liquidity Conditions and the Operating Procedure of Monetary Policy

The Reserve Bank of India Act, 1934 requires the Reserve Bank to place the operating procedure relating to the implementation of monetary policy and changes thereto from time to time, if any, in the public domain. The Reserve Bank's extant Liquidity Management Framework, implemented in February 2020, has been operative for more than five years.¹ Since then, the financial landscape has undergone several structural changes, including the expanding footprint of digital payments, operationalisation of a 24×365 payment systems and adoption of "Just-in-Time" release of funds for centrally sponsored schemes. These developments have profoundly altered the liquidity management paradigm of the banking system, further compounded by volatile capital flows with their attendant implications for system liquidity.

A disconcerting development from a liquidity management perspective of the Reserve Bank has been the gradual shrinking of the share of uncollateralised call money market in total overnight money market volume. In this regard, questions were raised on the appropriateness and efficacy of the weighted average call rate (WACR) as the operating target of monetary policy. Against this backdrop, the Reserve Bank constituted an Internal Working Group whose major recommendations suggested *status quo* in continuing with the existing framework (Box IV.1).

¹ The revised liquidity management framework was announced on February 6, 2020, in the Statement on Developmental and Regulatory Policies, and operationalised on February 14, 2020. The salient features of the framework were given in the Monetary Policy Report of April 2024.

Box IV.1: Review of the Extant Liquidity Management Framework – Major Recommendations

Operating Target

- The WACR should continue as the operating target of monetary policy. WACR, being an uncollateralised rate, reflects credit/counterparty risk that is not masked by collateral. Furthermore, WACR exhibits a high degree of correlation with other money market rates. With the participants in the call money market being entities under its regulatory purview, the Reserve Bank has better control over the WACR. From this perspective, the collateralised market rates were not deemed to be appropriate as the operating target as these segments are dominated by non-bank entities not regulated by the Reserve Bank and, as such, do not reflect the dynamics of the inter-bank market for reserves.

Policy Corridor

- With regard to the appropriate corridor width, it was noted that while a wider corridor can encourage higher inter-bank activity, it also entails greater volatility in overnight rates, thereby hindering the transmission to short-term rates. At the same time, a narrow corridor, while providing the advantage of better anchoring of short-term rates, may come at the cost of reduced incentives for banks to transact among themselves. On balance, it was decided to continue with the existing symmetric corridor of 50 bps width, with the policy repo rate at the middle.

Liquidity Management Instruments

- Banks faced challenges in forecasting their liquidity position for a longer period resulting in their lower participation in 14-day main operations. This undermined the efficacy of main operations for liquidity management. Accordingly, 14-day Variable Rate Repo/Variable Rate Reverse Repo (VRR/VRRR) auctions were discontinued as the main operation.

- Transient liquidity shall be managed primarily through 7-day repo/ reverse repo operations and other operations of tenors from overnight up to 14 days at the discretion of the Reserve Bank, based on its assessment of the system liquidity requirement.
- The variable rate auction mechanism shall be continued for conducting repo/reverse repo operations as bids received in such auctions provide useful signal for assessing the true extent of funds required from (or to be deployed with) the central bank. Instruments under the extant Liquidity Management Framework were deemed to be sufficient for meeting the durable liquidity needs of the system and hence, the toolkit to manage durable liquidity remains unchanged.

Minimum Daily Reserve Requirement

- It was decided to continue with the daily minimum requirement of 90 per cent of the prescribed cash reserve ratio (CRR). While acknowledging that reducing the minimum daily requirement may provide greater headroom to banks to effectively manage their liquidity over the maintenance period, it entailed risks of inducing greater volatility in the WACR, especially towards the end of the reporting cycle. The case for no change was also due to the observation that at the system level, banks rarely maintain daily reserve balances below 95 per cent of the prescribed CRR.

Standalone Primary Dealers' (SPDs) Participation in LAF Operations

- SPDs were already allowed to participate in all repo operations irrespective of the tenor effective March 26, 2025. Therefore, SPDs need not be given access to the Marginal Standing Facility (MSF), as, unlike banks, they have neither reserve requirements nor unforeseen payment obligations beyond market hours.

During H1:2025-26, the Monetary Policy Committee reduced the policy repo rate by 75 basis points (bps) – a 25 bps cut in April followed by a 50 bps cut in June. With a cumulative rate cut of 100 bps since February 2025, the Monetary Policy Committee in its June policy noted that monetary policy was left with very limited space to support growth under the prevailing circumstances. Accordingly, it recalibrated the stance of monetary policy to neutral from accommodative. The Reserve Bank also announced a reduction in the CRR by 100 bps to 3.0 per cent of net demand and time liabilities (NDTL) in a staggered manner during September-November 2025. This reduction in four equal tranches of 25 bps each with effect from the fortnights beginning September 6, October 4, November 1, and November 29, 2025 will release primary liquidity of about ₹2.5 lakh crore into the banking system by December 2025. Besides providing durable liquidity, the CRR cut would also reduce the cost of funds for the banks, thereby facilitating transmission to the credit market.

In view of surplus liquidity conditions, the Reserve Bank discontinued the daily variable rate repo (VRR)

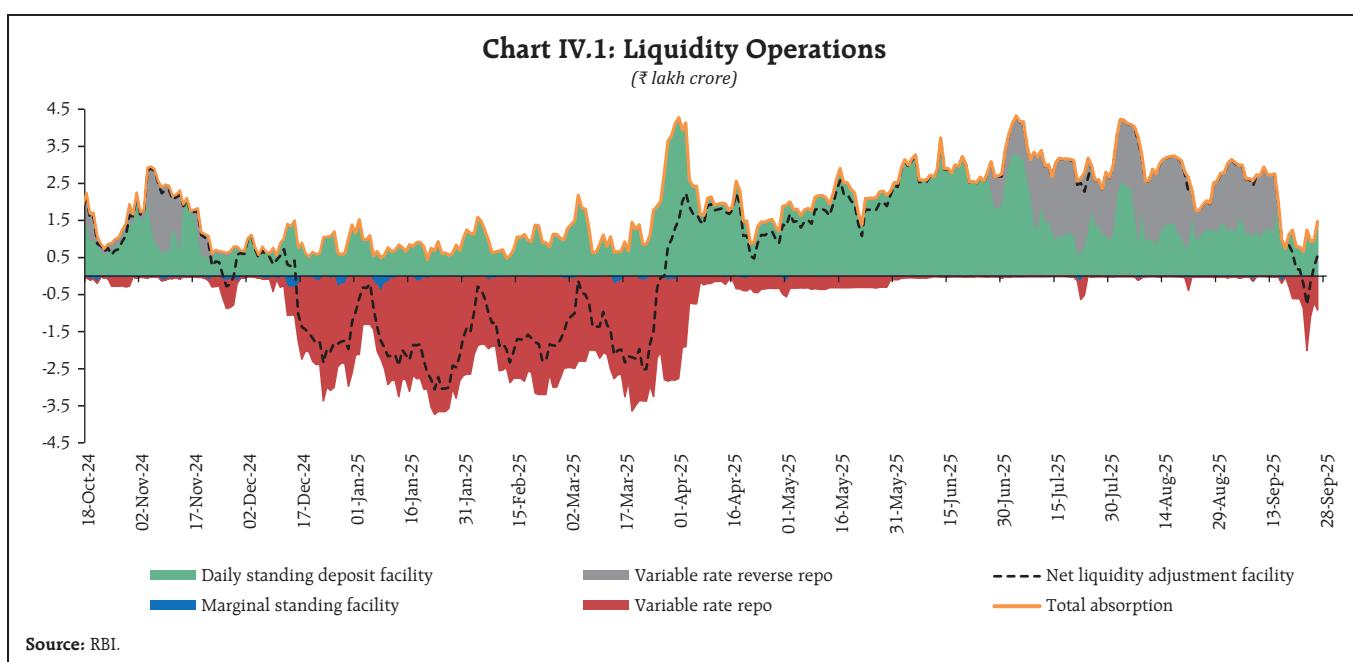
auctions effective June 11, 2025 and started variable rate reverse repo (VRRR) auctions from June 27, 2025. On June 25, 2025, the Reserve Bank announced extension in the market timings of both collateralised and uncollateralised segments of the money market to facilitate market development, enhance price discovery, and help banks optimise their liquidity requirements. Furthermore, the aggregate limit available to Standalone Primary Dealers (SPDs) under the Standing Liquidity Facility was increased from ₹10,000 crore to ₹15,000 crore beginning April 2, 2025.

Drivers and Management of Liquidity

System liquidity, as measured by the net balances under the liquidity adjustment facility (LAF), transitioned to surplus in H1:2025-26 from deficit in H2:2024-25 (Chart IV.1). The Reserve Bank's durable liquidity injections during Q4:2024-25 along with increase in government spending drove this transition.

On a net basis, average daily absorption amounted to ₹2.31 lakh crore in H1 (up to September 28, 2025) as against average daily injection of ₹0.36 lakh

Chart IV.1: Liquidity Operations
(₹ lakh crore)



crore in H2:2024-25. Changes in the Government of India (GoI) cash balances, expansion in currency in circulation (CiC) and volatile capital flows emerged as the major drivers of liquidity during H1. The leakage in the banking system liquidity due to the increase in currency demand, buildup in GoI cash balances and the Reserve Bank's forex market operations was more than compensated by the reduction in CRR and the Reserve Bank's durable liquidity augmenting measures during H2:2024-25 and H1:2025-26. The Reserve Bank's Open Market Operations (OMOs) purchases and term repo operations in Q1:2025-26 more than offset the drag on liquidity from the seasonal expansion in currency in circulation (CiC). Liquidity conditions, however, moderated in Q2 on account of buildup in GoI cash balances and RBI's forex operations (Table IV.1).

With liquidity conditions remaining in surplus, banks' recourse to the MSF averaged at ₹0.02 lakh crore during H1:2025-26, while daily standing deposit

facility (SDF) balances remained elevated. Of the average total absorption under the LAF at ₹2.52 lakh crore during H1, average placement under the SDF constituted about 72.6 per cent (₹1.84 lakh crore), while the remaining surplus was absorbed through VRRR auctions. Banks' holding of elevated SDF balances, *inter alia*, reflects their high precautionary demand for liquidity given the changing payments system landscape. Moreover, lower credit demand resulted in a larger deployment of funds by banks under the SDF.

To improve monetary transmission during the current easing cycle, the Reserve Bank complemented frontloaded rate cuts with the infusion of sufficient liquidity in the banking system. Continuing its liquidity injection measures of Q4:2024-25, the Reserve Bank injected durable liquidity amounting to ₹2.65 lakh crore through nine OMO purchases and one term VRR auction during April-May 2025 (Table IV.2).

Table IV.1: Liquidity – Key Drivers and Management

(₹ crore)

	2024-25		2025-26		
	H1	H2	Q1	Q2*	H1*
Drivers					
(i) CiC [withdrawal (-) / return (+)]	33.551	-2,37,928	-1,00,724	22,792	-77,932
(ii) Net Forex Purchases (+)/ Sales (-)	70,402	-3,61,635	3,892	-1,45,483	-1,41,591
(iii) GoI Cash Balances [build-up (-) / drawdown (+)]	-1,50,494	1,85,231	-96,083	-1,34,720	-2,30,803
(iv) Excess Reserves [build-up (-) / drawdown (+)]	36,768	1,572	34,163	-4,704	29,459
Management					
(i) Net OMO Purchases (+)/ Sales (-)	-24,040	2,83,386	2,39,213	10	2,39,223
(ii) Required Reserves [including both change in NDTL and CRR]	-55,613	76,450	-25,190	40,865	15,675
(iii) Term Repo Auctions	-	1,82,964	25,731	-	25,731
Memo Item					
(i) Long term Forex Swaps Buy/Sell (+)/ Sell/Buy (-)	-	2,19,245 ^	-	-	-
(ii) Net Absorption (+)/ Injection (-) as at end-period	84,651	-172	3,07,793	56,274	56,274

Note: 1. (+) / (-) sign suggests accretion/depletion in banking system liquidity.

2. Data pertains to the last Friday of the respective period.

3. *: Data for Q2 and H1:2025-26 are up to September 26, 2025.

4. ^ : approximate values.

Source: RBI.

Table IV.2: Reserve Bank's Liquidity Measures since January 2025

Period	Liquidity Measures	Amount Injected (in ₹ crore)
Q4:2024-25	a. OMO purchases (6) b. Term VRRs (3) c. Forex Swaps (3)	2,44,561 1,82,964 2,19,245*
April 2025	a. OMO purchases (5) b. Term VRR (1)	1,20,000 25,731
May 2025	a. OMO purchases (4)	1,19,203
Total		9,11,704*

Note: Figures in parentheses denote number of auctions.

*: Indicates approximate value.

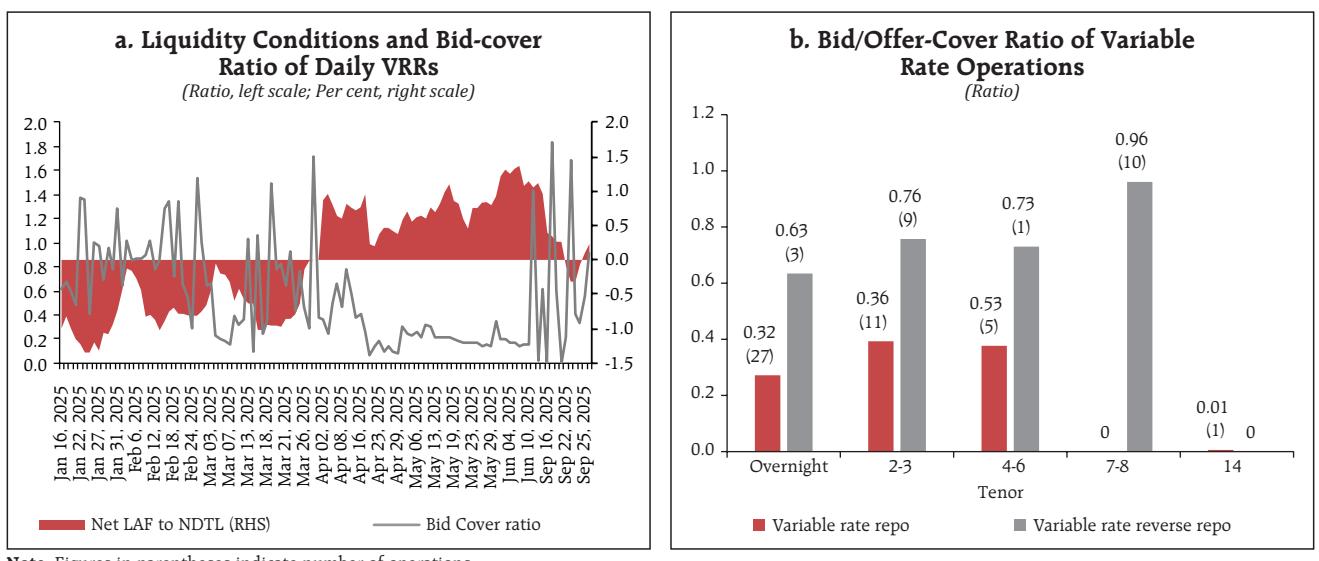
Source: RBI.

The Reserve Bank remained nimble and agile in its liquidity management operations and ensured sufficient liquidity in the banking system to support transmission to money and credit markets. With liquidity conditions improving during H1:2025-26, the demand for transitory liquidity moderated since April 2025, as reflected in the low bid-cover ratios in the daily VRR auctions (Chart IV.2a). Tepid response amidst sufficient surplus liquidity prompted the Reserve Bank to discontinue the daily VRR auctions effective June 11, 2025. As overnight

rates hovered near the floor of the LAF corridor amidst large surplus liquidity, the Reserve Bank resumed VRRR auction on June 27, 2025, after a gap of nearly eight months. Since then, the Reserve Bank has conducted 23 VRRR auctions of maturity ranging from overnight to 8-days. In general, the auctions elicited better response from banks, with an average offer-cover ratio of 0.83, compared to the response received in VRR auctions (Chart IV.2b). When the banking system faced transient liquidity tightness due to tax related outflows on select days, thirteen VRR auctions of overnight to 6-day maturity were also conducted in Q2:2025-26. The Reserve Bank maintained sufficient liquidity in the banking system during H1 to meet the productive requirements of the economy.

As on September 26, 2025, reserve money expanded by 4.5 per cent (y-o-y) as against 6.0 per cent a year ago. Adjusted for the CRR change, growth in reserve money stood at 8.4 per cent (7.4 per cent a year ago). The higher growth in reserve money reflected the expansion in currency in circulation. As on September 19, 2025, growth in money supply (M3)

Chart IV.2: Offer/Bid-cover Ratio and Banks' Preference for Liquidity



decelerated to 9.2 per cent (y-o-y) from 10.4 per cent a year ago primarily reflecting a deceleration in aggregate deposit growth. The money multiplier increased to 5.8 as on September 19, 2025, from 5.6 a year ago, reflecting the impact of the CRR cut.

IV.2 Domestic Financial Markets

Domestic financial markets remained resilient and relatively stable. Money market rates evolved in sync with the policy rate trajectory and transition in system liquidity. Long-term government bond yields eased during the current easing cycle, *albeit*

to a lesser extent than short-term yields, in response to domestic developments and global cues. Equity markets remained buoyant, despite bouts of volatility amidst tariff related uncertainty. The Indian rupee traded with a depreciating bias against the US dollar in H1 but remained amongst the least volatile major EM currencies. Overall, monetary policy, along with liquidity easing measures, has contributed to favourable financial conditions by influencing both money and bond markets (Box IV.2). In the credit market, growth in bank credit has witnessed an uptick in the recent months.

Box IV.2: Impact of Monetary Policy Surprises on Financial Conditions

Monetary policy primarily influences short-term interest rates in an economy through changes in the policy rate. Its impact on the real economy, however, is routed through the changes in overall financial conditions across market segments. Therefore, the effectiveness of monetary policy can be gauged from its effect on financial conditions. Accordingly, to examine the impact of monetary policy shocks on overall financial conditions in the Indian context, a high-frequency financial conditions index (FCI), based on select indicators from money, government securities (G-sec), corporate bond, equity, and forex markets is used (Bandyopadhyay *et al.*, 2025). In the extant literature, it is common to use high-frequency interest rate changes around central bank policy announcements for identifying monetary policy shocks. Following this approach, policy shocks are estimated as the first principal component of policy-day changes in the Overnight Indexed Swap (OIS) rates of various maturities (Barakchian and Crowe, 2013; Nakamura and Steinsson, 2018).² Further, to examine the response of FCI to monetary policy shocks, a local projections framework is employed for the sample period January 2014 to August 2025 with the following

long-difference specification with lagged controls (Jordà and Taylor, 2025)³:

$$\Delta y_{t+h} = \alpha + \beta^h mps_t + \gamma^h \Delta y_{t-1} + \varepsilon_t \text{ for } h \in \{0, 1, 2, \dots, N\} \quad (1)$$

where $\Delta y_{t+h} = y_{t+h} - y_{t-1}$ is the cumulative change in FCI over a window of h days, mps_t is the policy shock at time t and β^h traces the cumulative change in FCI over a window of h days following the policy shock.

Related literature also suggests asymmetric impact of monetary policy on financial market indicators. Financial frictions, credit constraints, and time-varying risk premia are some of the potential drivers of this asymmetric impact. To test the differential impact of monetary policy tightening *vis-à-vis* easing on financial conditions, equation (1) is modified as follows (Adrian *et al.*, 2024):

$$\Delta y_{t+h} = \alpha + \rho^h mps_t mps_t^- + \delta^h mps_t mps_t^+ + \gamma^h \Delta y_{t-1} + \varepsilon_t \quad (2)$$

where mps_t^+ and mps_t^- are indicator variables to capture policy tightening and easing, respectively. mps_t^+ and mps_t^- take the value of 1 when mps_t is positive and negative, respectively, and 0 otherwise. So, while δ^h traces the response for policy tightening, ρ^h traces the response for policy easing.

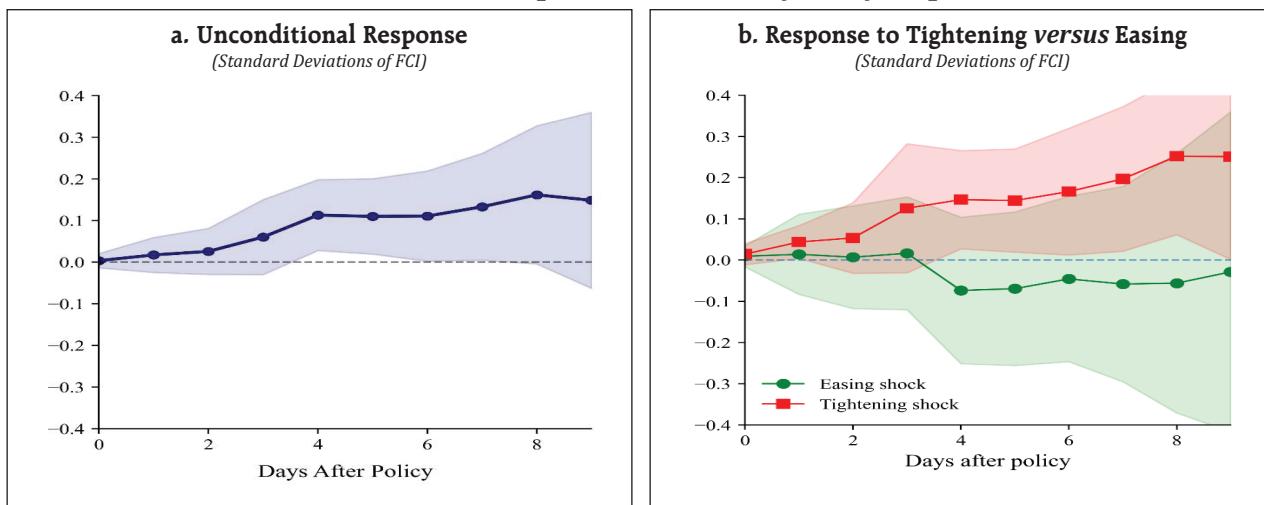
² OIS rates of 1, 3, 6, 9-month and 1-year maturities are used.

³ Jordà and Taylor (2025) show that local projections using the long difference specification considerably alleviates the problem of bias and autocorrelation in small samples.

The results indicate that a policy surprise equivalent to a 100 basis points increase in the 1-year OIS rate is associated with a 0.13 standard deviation tightening in FCI over the week following the policy shock (Chart IV.2.1 a). Moreover, the findings also reaffirm the asymmetric impact of monetary policy tightening vis-

à-vis easing as a positive shock is found to have a larger tightening impact on FCI than the easing impact of a negative shock (Chart IV.2.1 b). This finding highlights the need for judicious use of forward guidance and liquidity measures along with rate actions to reinforce the effect of policy easing.

Chart IV.2.1: Response to a Monetary Policy Surprise



Notes: The left chart plots the estimates of β^h from (1) while the right chart plots the estimates of $-\rho^h$ (to signify easing surprise) and δ^h (tightening surprise) from (2); Shaded areas represent the 90 per cent confidence bands constructed using Newey-West adjusted standard errors.

Source: RBI Staff estimates.

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Adrian, T., Gelos, G., Lamersdorf, N., & Moench, E. (2024). *The asymmetric and persistent effects of Fed policy on global bond yields*. Bank for International Settlements, Working paper-1195.

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Jordà, Ò., & Taylor, A. M. (2025). Local projections. *Journal of Economic Literature*, 63(1), 59-110.

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IV.2.1 Money Market

During H1:2025-26, money market rates largely moved in line with the policy repo rate and the evolving liquidity conditions. The weighted average call rate (WACR) – the operating target of monetary policy – remained within the policy corridor and hovered

near its floor during April to early July reflecting large surplus liquidity in the banking system. With VRRR auctions absorbing surplus liquidity since end-June, the WACR increased and traded closer to the policy rate since mid-July 2025.⁴ Generally, movements in the WACR reflected transient liquidity conditions,

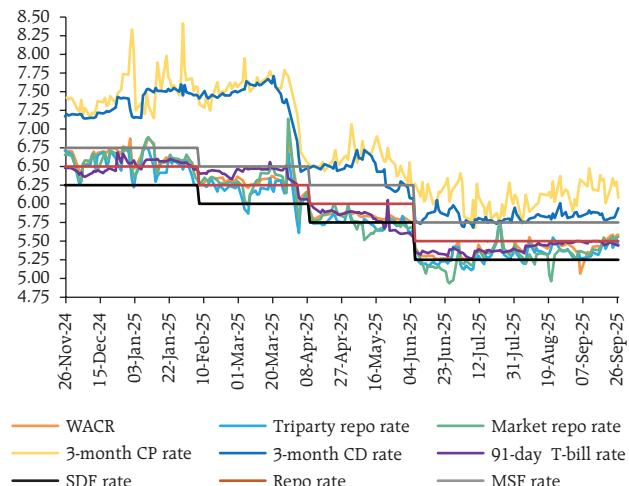
⁴ The WACR moved close to the ceiling of the LAF corridor (MSF Rate) on July 23, 2025, mainly due to Goods and Services Tax outflows, causing liquidity strain.

softening at the beginning of the month on higher government spending and hardening during the latter half due to tax outflows. The WACR showed better alignment with the policy repo rate in Q2:2025-26, with its spread over the policy repo rate narrowing to (-)8 bps compared to (-)17 bps in Q1 (Chart IV.3a). Volatility in the WACR, as measured by the exponential weighted moving average (EWMA)⁵, declined since April 2025 after remaining elevated in H2:2024-25 (Chart IV.3.b). Overnight rates in the collateralised segment, i.e., triparty repo and market repo, broadly moved in tandem with the WACR during H1:2025-26 (Chart IV.4.)

Money market activity was dominated by the collateralised segments (triparty and market repo), although their share in overnight money market volume declined slightly to 97 per cent. Concomitantly, the uncollateralised segment, i.e., the call money market witnessed a modest increase in its share to above 3 per cent in September 2025. This could be partly attributed to the extension of call money market timings effective July 1, 2025 (Table IV.3).

Chart IV.4: Money Market Rates and Policy Corridor

(Per cent)

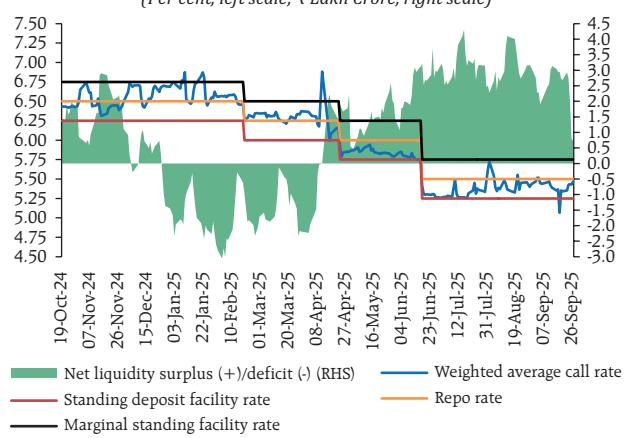


Sources: Financial Benchmarks India Pvt Ltd.; and RBI.

Mutual funds remained major lenders in tri-party repo, with their share increasing by 2 percentage points to 68 per cent in H1:2025-26 from H2:2024-25. However, in the market repo segment, the share of mutual funds' lending reduced to 40 per cent in H1:2025-26 from 46 per cent in H2:2024-25. The share

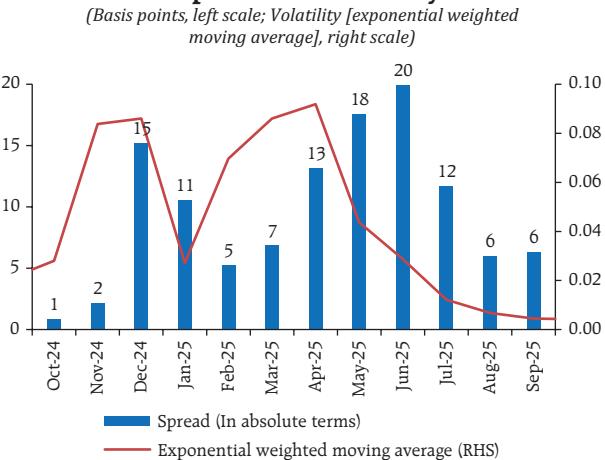
Chart IV.3: Policy Corridor and WACR

a. Liquidity, Policy Corridor and Weighted Average Call Rate
(Per cent, left scale; ₹ Lakh Crore, right scale)



Sources: RBI; and RBI staff calculations.

b. Average Spread of WACR over Repo Rate and Volatility
(Basis points, left scale; Volatility [exponential weighted moving average], right scale)



⁵ EWMA is an improvement over simple variance as it assigns greater weight to more recent observations. EWMA expresses volatility as a weighted average of past volatility with higher weights assigned to more recent observations.

Table IV.3: Average Volume and Share in Overnight Money Market

(₹ Lakh Crore)

	2024-25		2025-26		
	H1	H2	Q1	Q2*	H1*
Call/Notice	0.10(2.1)	0.11(2.2)	0.15(2.7)	0.16(2.9)	0.16(2.8)
Triparty Repo	3.30(68)	3.62(70)	3.70(66)	3.67(66)	3.68(66)
Market Repo	1.48(30)	1.42(28)	1.74(31)	1.71(31)	1.73(31)
Total	4.88(100)	5.16(100)	5.59(100)	5.54(100)	5.57(100)

Notes: 1. Figures in parentheses denote share of each segment in overnight money market. Figure may not add up to total due to rounding off.

2. *: Up to September 26, 2025.

Sources: Clearing Corporation of India Ltd.; and RBI.

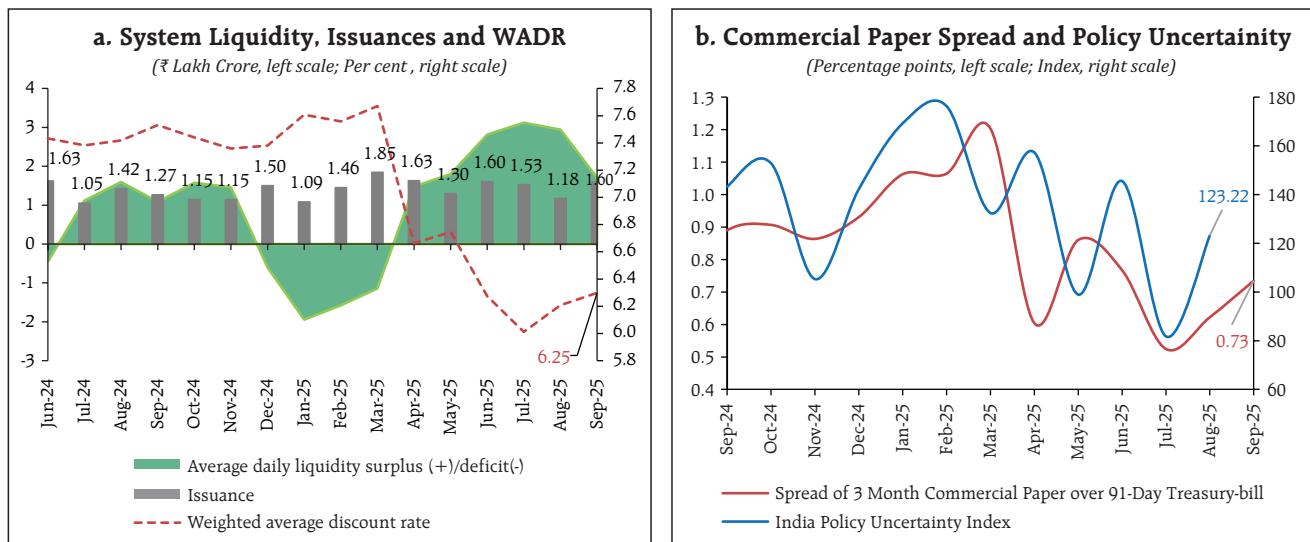
of foreign banks' lending in market repo also declined to 29 per cent from 31 per cent during the same period. On the borrowing side, public sector banks (PSBs) remained the major players in tri-party repo, although their share reduced to 28 per cent in H1:2025-26 from 40 per cent in H2:2024-25. During the same period, the share of private sector banks increased to 28 per cent from 22 per cent. PSBs had a relatively smaller presence in market repo, with their share remaining steady at 6 per cent over the same period.

The term segments of the money market witnessed faster monetary policy transmission aided by surplus liquidity conditions. The rates on commercial paper

(CP) and certificates of deposit (CDs) declined by around 150 bps from end-March 2025 to end-August 2025, larger than the policy rate reduction of 100 bps since February. The average spread of CDs and CPs over the policy repo rate also narrowed substantially to 36 bps and 59 bps, respectively, in H1:2025-26 from 91 bps and 105 bps, respectively, in H2:2024-25. The average spread of treasury bills (T-Bills) over the policy repo rate turned negative, amidst ample liquidity in the banking system (Chart IV.4).

Fresh issuances of CDs declined to ₹4.8 lakh crore in H1:2025-26 from ₹6.6 lakh crore in H2:2024-25, reflecting the narrowing of the wedge in deposit and credit growth. Tenor-wise, CD issuances in the shorter tenor (up to 91-day) increased on account of declining interest rate. There was a concomitant decline in longer tenor issuances (Table IV.4). The issuances of CPs in the primary market increased to ₹8.8 lakh crore during H1:2025-26 from ₹8.2 lakh crore in H2:2024-25 (Chart IV.5a). The money market risk premia (spread of 3-month CP rate over 91-day T-bills rate) declined in July but increased subsequently in August, broadly tracking the movement in the policy uncertainty index (Chart IV.5.b).

Chart IV.5: Primary Issuances of Commercial Paper



Note: Net liquidity adjustment facility represents absorption (through SDF and VRRR) net of injection (through MSF and VRR).

Sources: RBI; Clearing Corporation of India Limited F-TRAC; www.policyuncertainty.com; and RBI staff estimates.

Table IV.4: Tenor wise Break up for CD Issuances

(₹ Lakh Crore)

	2024-25		2025-26		
	H1	H2	Q1	Q2*	H1*
Up to 91 Days	3.93(73)	3.74(57)	1.95(83)	1.55(64)	3.50(74)
92-180 Days	0.20(4)	0.17(3)	0.11(5)	0.34(14)	0.45(9)
181-365 Days	1.22(23)	2.64(40)	0.28(12)	0.53(22)	0.81(17)
Total	5.35(100)	6.56(100)	2.34(100)	2.42(100)	4.76(100)

Notes: 1. Figures in parentheses denote share of each maturity profile.

2. Figure may not add up to total due to rounding off.

3. *: Up to September 26, 2025.

Sources: Clearing Corporation of India Limited; and RBI staff estimates.

With favourable interest rates incentivising market-based financing, corporates dominated the CP primary market, with an average share of 48 per cent for H1:2025-26. The average share of non-banking financial companies (NBFCs), however, reduced to 29 per cent in H1:2025-26 from 33 per cent in H2:2024-25. It could be partly attributed to the reversal of risk weights on bank lending to NBFCs effective from April 1, 2025, improving the overall credit availability to NBFCs (Chart IV.6). In terms of maturity profile, the 91-180 days segment had the largest share (51 per cent) in fresh CP issuances, followed by the 31-90 days segment (Table IV.5).

Table IV.5: Maturity Profile of CP Issuances

(₹ Lakh Crore)

Tenor	H2: 2023-24	H1: 2024-25	H2: 2024-25	H1: 2025-26*
7- 30 days	0.48(7)	0.63(8)	0.51(6)	0.42(5)
31-90 days	2.32(35)	2.35(31)	2.33(28)	3.06(35)
91-180 days	3.11(47)	3.94(52)	4.24(52)	4.54(51)
181-365 days	0.77(12)	0.64(8)	1.11(14)	0.82(9)
Total	6.67(100)	7.55(100)	8.19(100)	8.84(100)
Outstanding (as at end-period)	3.89	3.98	4.43	4.89

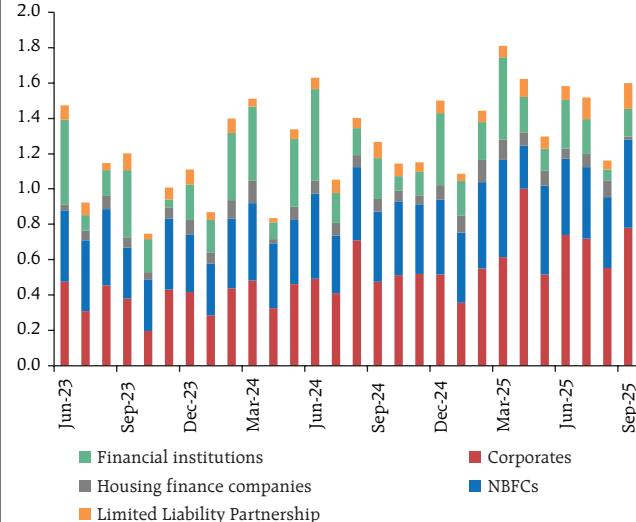
Notes: 1. Figures in parentheses denote share of each maturity profile.

2. Figure may not add up to total due to rounding off.

3. *: Up to September 26, 2025.

Sources: Clearing Corporation of India Limited F-TRAC; and RBI.**Chart IV.6: Issuer Profile of Commercial Paper**

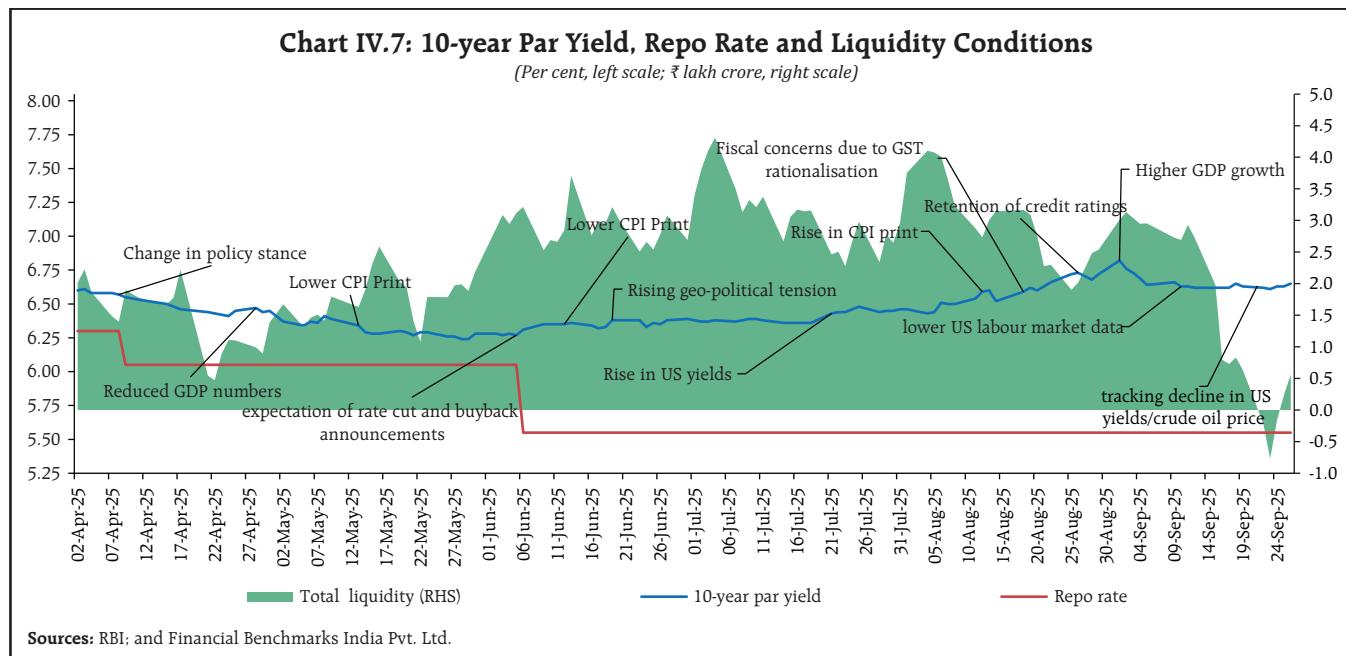
(₹ Lakh Crore)

**Sources:** RBI; Clearing Corporation of India Limited F-TRAC; and RBI staff estimates.

IV.2.2 Government Securities (G-sec) Market

The Government Securities (G-sec) market remained broadly resilient, *albeit* volatile during H1:2025-26 amidst favourable domestic outlook but a challenging global environment. The 10-year G-sec yield moved in the range of 6.19 - 6.77 per cent during H1:2025-26 (up to September 26, 2025). At the beginning of H1, yields softened reflecting the reduction in the policy repo rate, change in the policy stance from neutral to accommodative, open market operation (OMO) purchases by the Reserve Bank, and softening crude oil prices. Yields declined further in May and early June, driven by lower-than-expected April CPI inflation print, market expectations of a rate cut in June, continued OMO purchases by the Reserve Bank and record surplus transfer from the Reserve Bank to the Government of India.

G-sec yields firmed up post the June policy announcement, as the change in stance from 'accommodative' to 'neutral' diminished market expectations of a deeper rate cut cycle. After remaining broadly stable in the first half of July,



G-sec yields began to harden in the second half amidst uncertainty surrounding the US trade deals and rise in crude oil prices. In August, yields continued to harden, tracking movements in US yields and heightened trade uncertainties from the imposition of additional tariffs on India. Yields softened briefly on S&P's upgrade of India's sovereign ratings on August 14, 2025 but rose again on fiscal concerns stemming from lower growth in direct tax collections and rationalisation of GST rates (Chart IV.7). Beginning September, yields have eased on receding fiscal concerns, softening US yields and declining crude oil prices.

The yields on T-bills softened during April and May amidst the policy repo rate cut and large surplus liquidity. The higher-than-expected repo rate cut and persistent surplus liquidity led to further moderation in yields in June. Yields hardened in August amidst the uncertainty on the interest rate trajectory with the MPC maintaining *status quo* on both rate and stance, and liquidity absorption by the Reserve Bank that raised short-term rates. T-bill rates softened at the short end till the three-month

tenor and hardened at the longer end in September (Chart IV.8).

The average trading volume in G-secs and T-bills increased in H1:2025-26 relative to H2:2024-25 (Chart IV.9). The weighted average yield (WAY) on traded maturities for G-secs and T-bills declined by 38 bps and 89 bps, respectively, in H1 as compared to H2:2024-25.

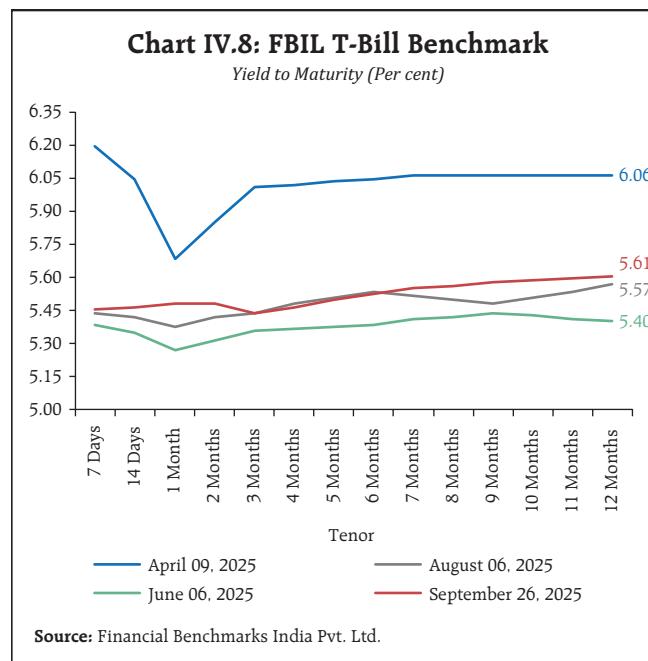
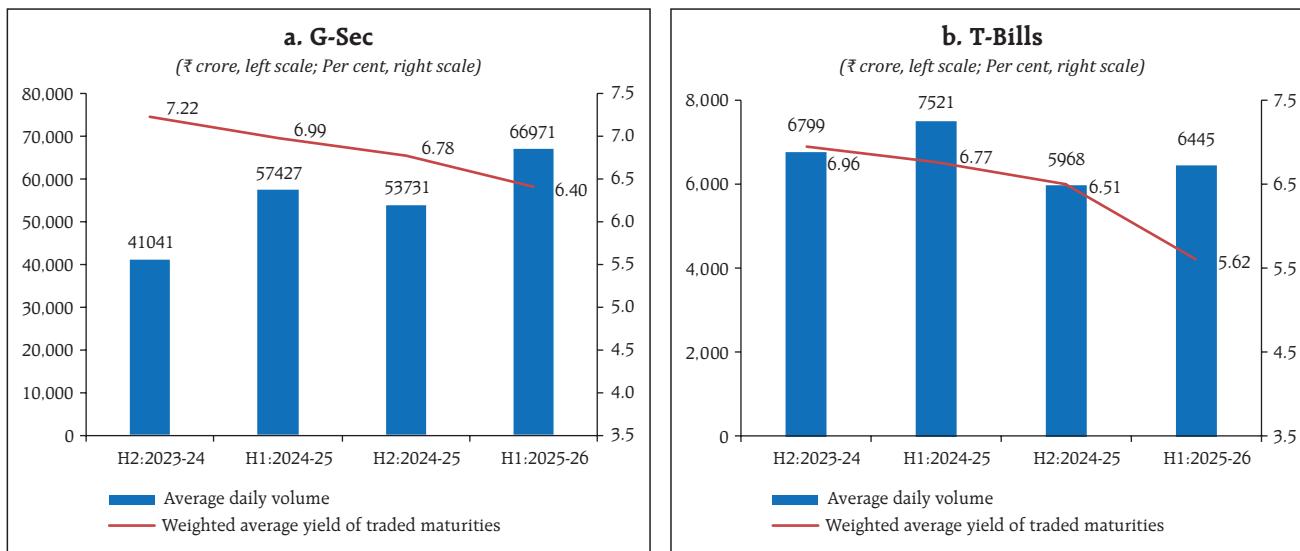
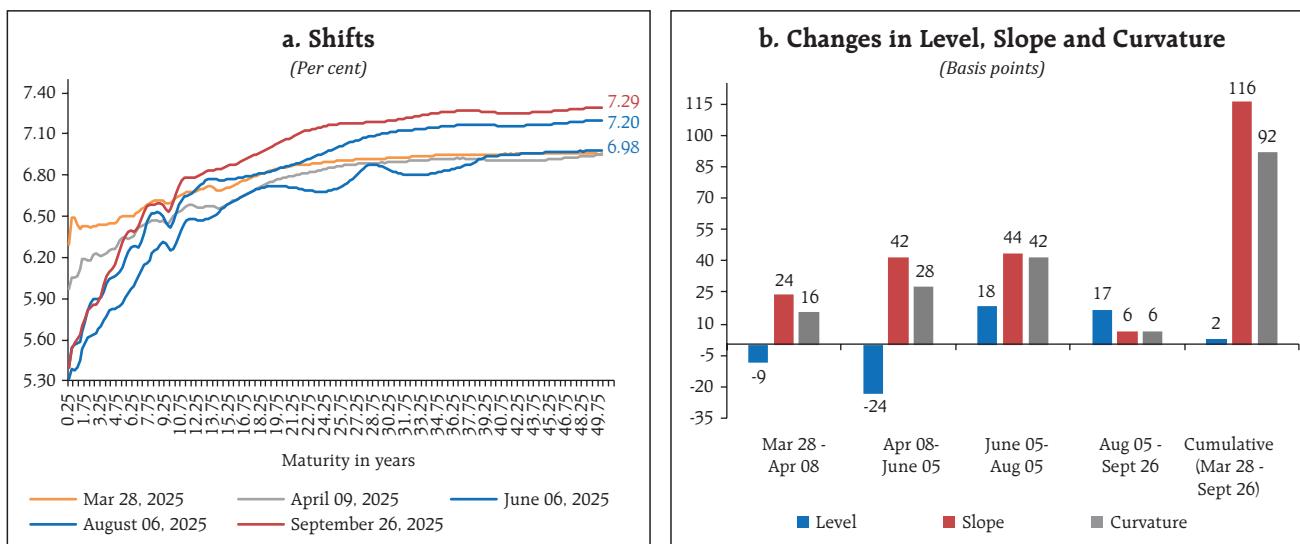


Chart IV.9: Trading Volumes and Yield

Sources: Clearing Corporation of India Limited; and RBI staff estimates.

The overall dynamics of the yield curve are captured by its latent factors, viz., level, slope and curvature⁶. Yields have declined at the short end, while they have hardened at the long end of the term structure. This bear steepening of the yield curve during H1:2025-

26 widened the term spread (Chart IV.10a), which is partly attributed to (i) demand-supply mismatches in the G-sec market; and (ii) shift in investment pattern of insurance companies, pension and provident funds from government bonds to equities and corporate

Chart IV.10: G-Sec Yield Curve

bonds. The average level of yields increased by 2 bps, while the slope of the yield curve steepened by 116 bps (Chart IV.10b). The curvature, on the other hand, also increased by 92 bps, reflecting the hardening bias in the mid-segment. In the Indian context, the level and curvature of the yield curve are found to have more information content on future macroeconomic outcomes than the slope owing to market segmentation, unlike in AEs (Patra *et al.* 2022)⁷.

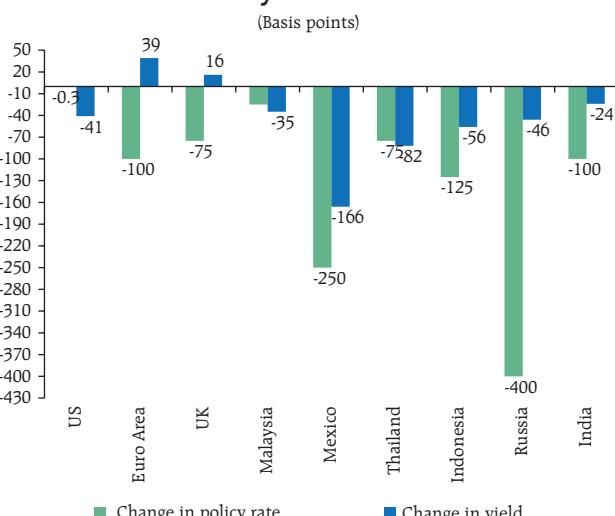
Cross-country evidence broadly suggests that G-sec yields have not declined proportionately to the changes in policy rate by central banks during the current easing cycle, although there are variations across countries. These variations reflect varying initial conditions, heterogeneous impact of trade and geopolitical uncertainties on macroeconomic conditions and the outlook, inflation expectations and investor sentiment across countries (Chart IV.11).

As part of active debt consolidation, the Reserve Bank conducted seven switch auctions on behalf of the

Government of India amounting to ₹1,29,697 crore during H1:2025-26. Even as the weighted average maturity of the outstanding stock of G-secs increased from 13.24 years at end-March 2025 to 13.58 years as on September 26, 2025, the weighted average coupon declined from 7.25 per cent to 7.21 per cent over the same period. During H1:2025-26, four buyback auctions were announced for an aggregate amount of ₹1.06 lakh crore with a view to retiring some of the Government of India's debt, in the backdrop of improved cash position. The market response to the auctions was modest with the Reserve Bank accepting offers aggregating to only ₹0.87 lakh crore against the notified amount of ₹1.06 lakh crore.

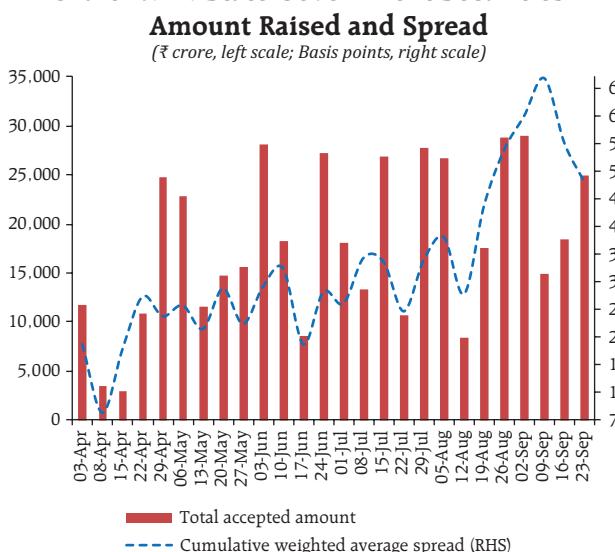
The weighted average spread of cut-off yields on state government securities over G-sec yields of comparable maturities was 38 bps in H1:2025-26 (up to September 26) (Chart IV.12) as against 30 bps in H2:2024-25. The average inter-state spread on securities of 10-year tenor (fresh issuances) was 5 bps in H1:2025-26 (up to September 26) as against 4 bps in H2:2024-25.

Chart IV.11: Changes in Policy Rate and 10-year Yields



Source: Bloomberg; CEIC; and RBI Staff estimates.

Chart IV.12: State Government Securities - Amount Raised and Spread



Source: Financial Benchmarks India Pvt. Ltd.

⁷ Patra, M.D., Joice, J., Kushwaha, K.M., and I. Bhattacharyya (2022), "What is the Yield Curve telling us about the Economy?", Reserve Bank of India Bulletin, June.

IV.2.3 Corporate Bond Market

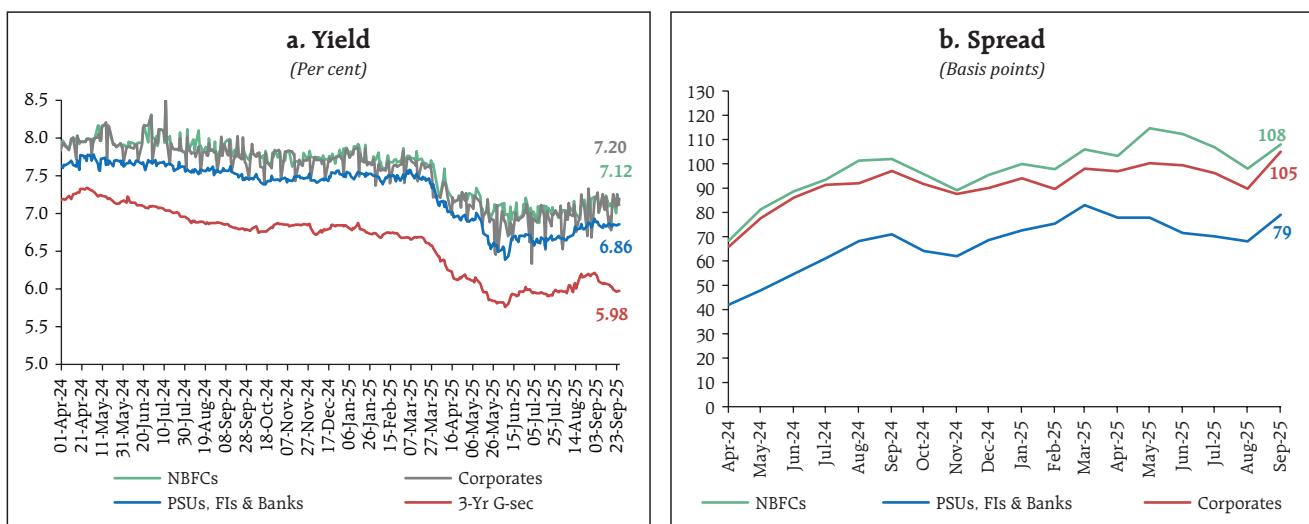
Corporate bond yields declined tracking softening of G-sec yields while spreads exhibited a mixed trend during H1:2025-26 (up to September 25). Issuer-wise, the average yield on AAA-rated 3-year bonds of public sector undertakings (PSUs), financial institutions (FIs) and banks softened by 62 bps (to 6.86 per cent), while those of non-banking financial companies (NBFCs) and corporates declined by 56 bps (to 7.15 per cent) and 50 bps (to 7.12 per cent), respectively, in September 2025 (up to September 25) over March 2025 (Chart IV.13a). The average bond market risk premium (*i.e.*, the spread of 3-year AAA corporate bond yields over 3-year G-sec yields) reduced from 83 bps to 79 bps for PSUs, FIs and banks; while it increased from 106 bps to 108 bps for NBFCs; and from 98 bps to 105 bps for corporates in H1:2025-26 (in September 2025 over March 2025), amidst mixed corporate earnings results for Q1:2025-26 (Chart IV.13b).

The risk premia generally moderated for higher rated bonds, while it widened for lower rated bonds amidst mixed corporate performance in Q1:2025-

26 and uncertainty about the growth outlook (Table IV.6). The average 3-year credit default swap spreads (trading overseas for the State Bank of India and ICICI Bank) increased by 5 bps and 3 bps, respectively, in H1:2025-26 (up to September 26) over H2:2024-25.

Primary issuances of listed corporate bonds in domestic markets increased to ₹4.0 lakh crore during H1:2025-26 (up to August 2025) from ₹3.3 lakh crore during the corresponding period of the previous year due to favourable cost conditions engendered by monetary policy easing (Chart IV.14a). Overseas issuances declined significantly to ₹3,243 crore during H1:2025-26 (up to August 2025) from ₹23,014 crore during the same period last year amidst conducive environment for raising resources in domestic markets. Almost the entire resource mobilisation in the corporate bond market (*i.e.*, 98.9 per cent) was through the private placement route in H1 (up to August 2025). Outstanding investments by foreign portfolio investors (FPIs) in corporate bonds stood at ₹1.29 lakh crore as on September 26, 2025 as against ₹1.21 lakh crore at end-March 2025, with the utilisation of investment limits declining marginally to 15.7 per cent from 15.8 per

Chart IV.13: AAA-rated 3-Year Corporate Bond Yield and Spreads



Note: Chart 1b plots monthly average spreads over G-secs. Data is up to September 25, 2025.

Source: Fixed Income Money Market and Derivatives Association of India.

Table IV.6: Financial Markets - Rates and Spread

Instrument	Interest Rates (Per cent)			Spread (bps) (over corresponding risk-free rate)		
	September 2024	March 2025	September 2025	September 2024	March 2025	September 2025
1	2	3	4	5	6	7
<i>Corporate Bonds</i>						
(i) AAA (1-yr)	7.92	7.76	6.67	117	115	98
(ii) AAA (3-yr)	7.80	7.62	7.12	97	98	105
(iii) AAA (5-yr)	7.70	7.60	7.21	86	89	86
(iv) AA (3-yr)	8.55	8.43	8.21	172	178	215
(v) BBB-minus (3-yr)	12.14	12.09	11.89	531	544	583

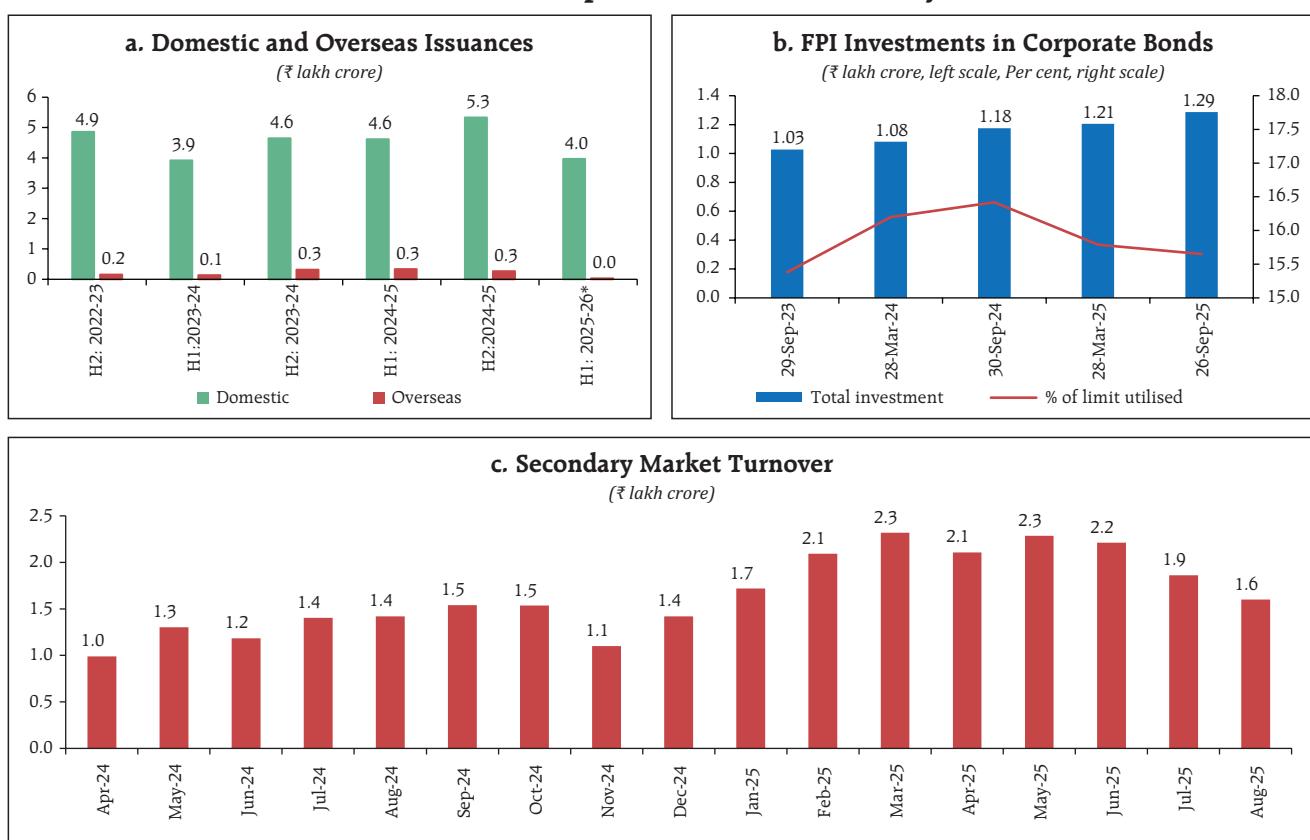
Note: Yields and spreads are computed as monthly averages. Data is up to September 25, 2025.

Source: Fixed Income Money Market and Derivatives Association of India.

cent (Chart IV.14b). Secondary market activity picked up, with trading volume at ₹10.1 lakh crore during H1:2025-26 (up to August 2025) vis-à-vis ₹6.3 lakh crore during the corresponding period last year (Chart IV.14c).

IV.2.4 Equity Market

During H1:2025-26 so far (up to September 26), Indian equity markets remained on an upward trajectory, despite bouts of volatility amidst trade policy uncertainty and geopolitical tensions. After

Chart IV.14: Corporate Bond Market Activity

*: Data is up to August 2025.

Sources: Securities and Exchange Board of India; National Securities Depository Limited; and Prime Database.

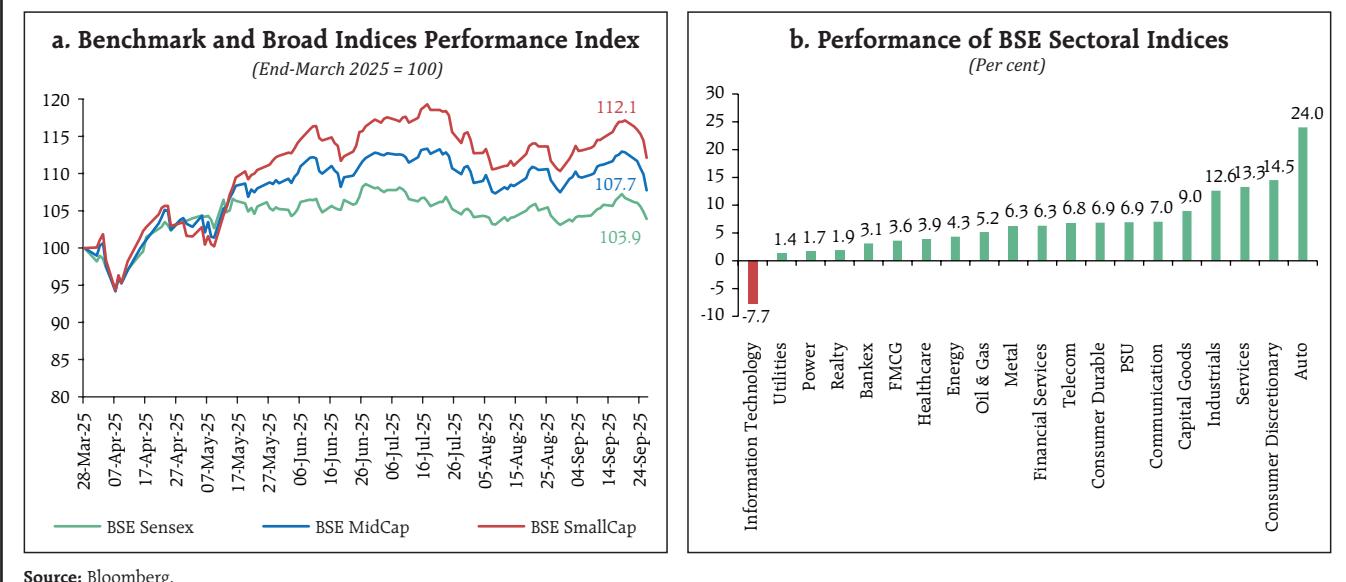
an initial decline, markets recovered in April as tariff-pause announcements by the US and low domestic CPI inflation print for March 2025 lifted sentiments. Markets again came under pressure with the escalation of India-Pakistan conflict in early May, but rose sharply thereafter in mid-May, following the announcement of a ceasefire agreement and a record surplus transfer by the Reserve Bank to the Government of India. The rally continued in June aided by the front loading of monetary policy easing by the Reserve Bank, although a rise in geopolitical tensions in the Middle-East led to some correction. In July, markets underperformed other global markets amidst amplified tariff uncertainty and mixed corporate earnings results for Q1:2025-26. Equity markets gained in mid-August amidst India's sovereign rating upgrade by a major global credit rating agency and the announcement of GST reforms, before negative global cues contributed to market losses in late-August. Investor sentiment revived in early-September, buoyed by the release of higher-than-expected GDP growth data for Q1:2025-26 and strong manufacturing and services PMI data releases. However, markets declined in the second half of

September amidst a steep hike in H1B visa fees and reports of fresh tariffs by the US.

Overall, the BSE Sensex increased by 3.9 per cent in H1:2025-26 (up to September 26). The broader market indices outperformed the benchmark during H1, with the BSE MidCap and BSE SmallCap index gaining by 7.7 per cent and 12.1 per cent, respectively (Chart IV.15a). India Volatility Index, a measure of short-term expected volatility of Nifty 50, declined by 10.2 per cent during the same period. All BSE sectoral indices, except BSE Information Technology Index registered gains during the period (Chart IV.15b).

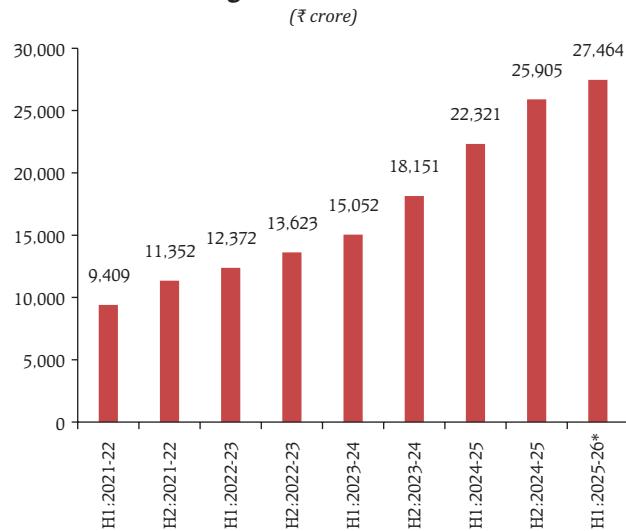
After remaining net buyers in Q1:2025-26, FPIs turned net sellers in Q2. The Domestic Institutional Investors (DIIs), especially mutual funds, acted as a counterbalancing force by remaining net buyers and provided resilience to the Indian equity markets. The inflows into mutual funds have been supported by sustained and expanding reach of systematic investment plans (SIPs). Average monthly contribution to mutual funds through the SIP route increased to ₹27,464 crore in H1:2025-26 (up to August) as against ₹25,905 crore during H2:2024-25 (Chart IV.16).

Chart IV.15: Stock Market Performance



Source: Bloomberg.

Chart IV.16 Average Resource Mobilisation in SIPs



*: Up to August 2025.

Source: Association of Mutual Funds of India.

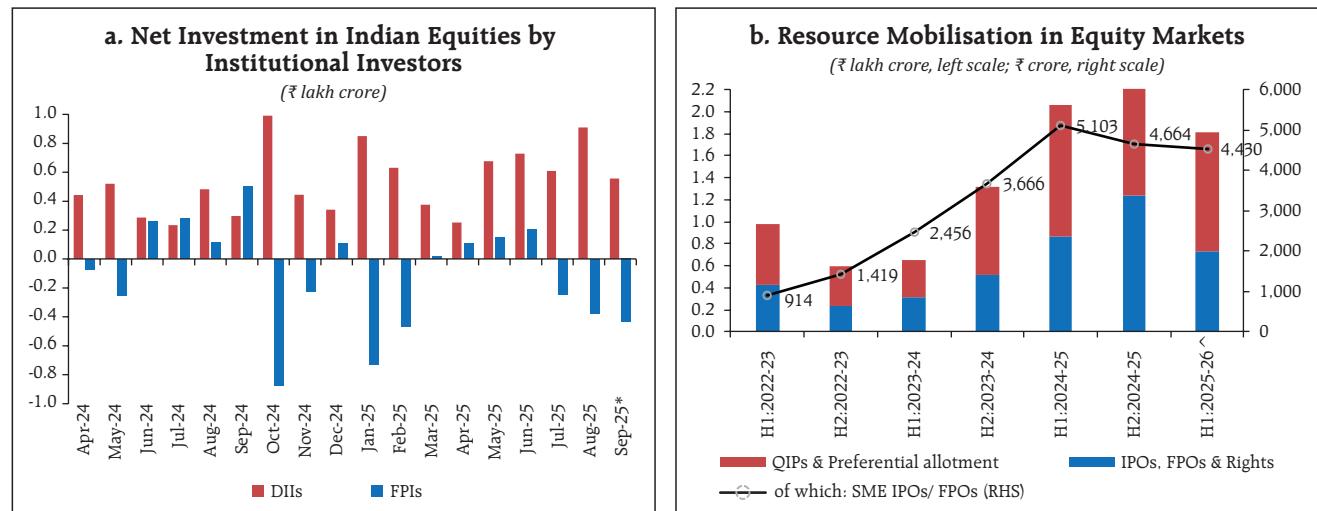
Overall, FPIs were net sellers (₹0.7 lakh crore up to September 26) while DIIs were net buyers (₹3.7 lakh crore up to September 26) in the equity market during H1:2025-26 (Chart IV.17a.). Resource mobilisation in primary equity markets stood at ₹1.8 lakh crore during H1:2025-26 (up to August 2025) as against ₹2.2 lakh crore in H2:2024-25 (Chart IV.17b). The amount raised by small and medium enterprises

through public issues aggregated to ₹4,430 crore (i.e., about 2.4 per cent of the total primary issuances) during H1 (up to August 2025) as against ₹4,664 crore in H2:2024-25.

IV.2.5 Foreign Exchange Market

The global foreign exchange market experienced increased volatility during April–September 2025, reflecting shifts in US policy expectations, evolving trade frictions, and fluctuating risk sentiments. The US dollar, after reflecting weakness in early 2025, remained range-bound with intermittent bouts of volatility, mirroring the uncertainties around trade, fiscal, and monetary policy trajectories in the US. In this environment, while most emerging market (EM) currencies recorded appreciations, the Indian rupee (INR) exhibited two-way movements with a depreciating bias. After trading with an appreciating bias during April and early May 2025, the INR depreciated in June–September due to the escalation in the US-India trade tensions, widening trade deficit and FPI outflows (Chart IV.18a). The INR also experienced higher volatility in Q1 as reflected by the option-implied volatility as well as

Chart IV.17: Institutional Investments and Resource Mobilisation

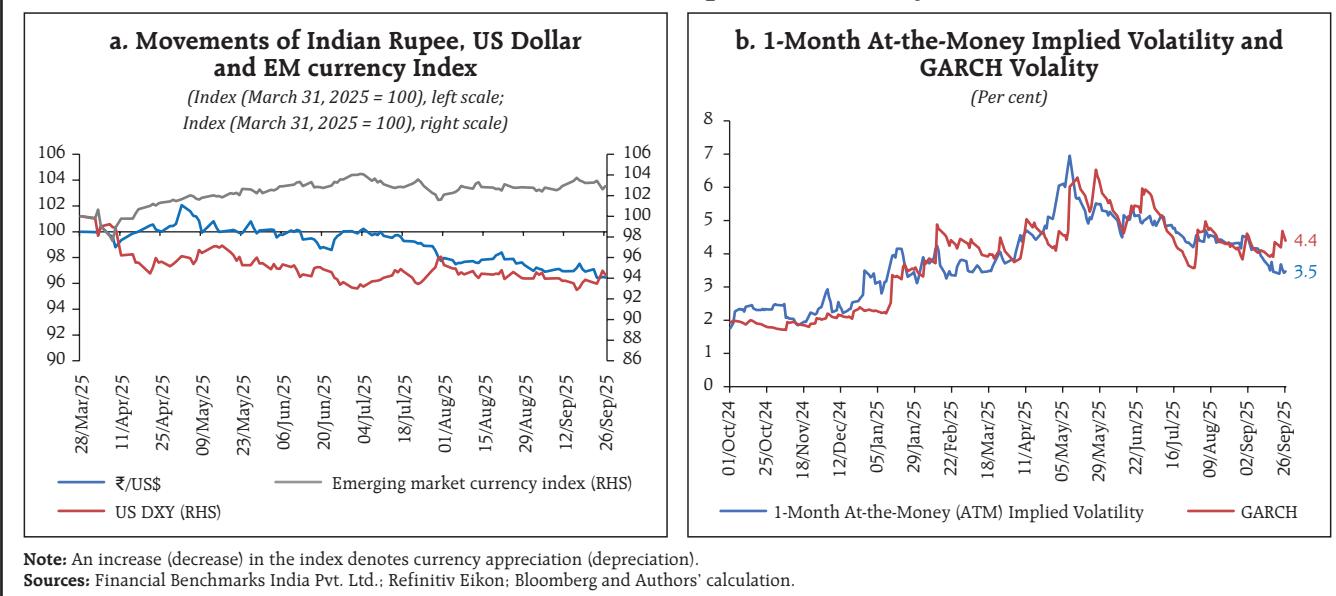


Note: IPO: Initial Public Offer. QIP: Qualified Institutional Placement. FPO: Follow-on Public Offer.

*: Up to September 26; ^: up to August 2025.

Sources: Capitaline; National Securities Depository Limited; and Securities and Exchange Board of India.

Chart IV.18: Indian Rupee and Volatility



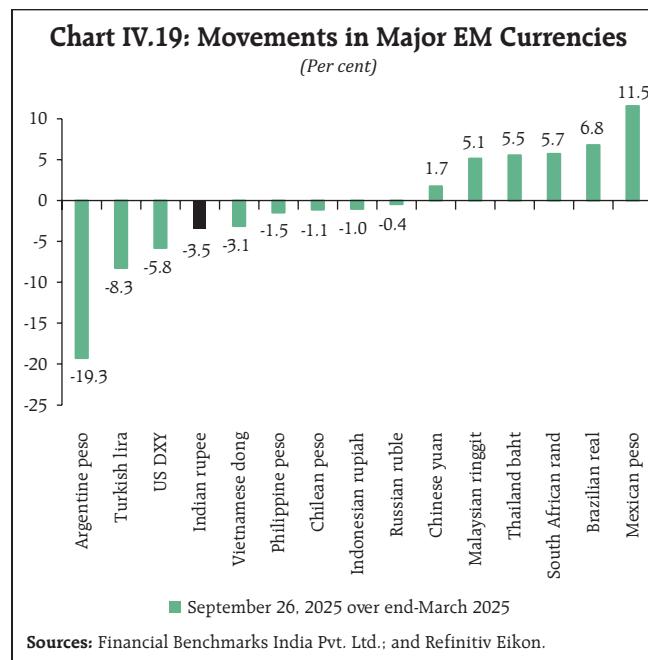
GARCH⁸ estimates, but volatility moderated in August as global risk sentiment stabilised and markets priced in trade-related risks (Chart IV.18.b). Notwithstanding these movements, the INR remained among the least volatile EM currencies during this period, supported by strong fundamentals as evident from a narrower current account deficit, steady services exports, resilient private remittances and robust foreign exchange reserves.

The INR depreciated by 3.5 per cent against the US dollar on September 26 over end-March 2025, as opposed to the appreciating trends registered by several peer EM currencies (Chart IV.19). A few peer EM currencies like Argentine peso and Turkish lira however, recorded higher depreciation than INR during this period.

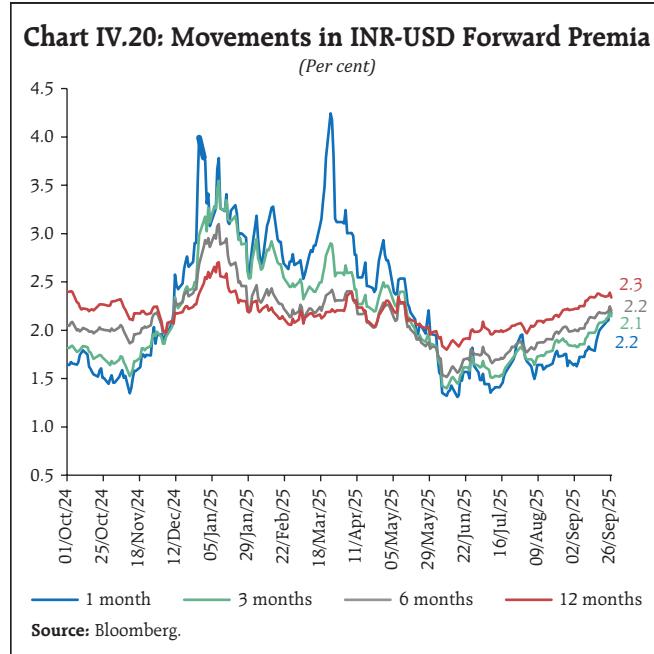
Forward premia declined sharply at the beginning of H1:2025-26 and continued to ease till May 2025 but rose moderately thereafter (Chart IV.20). On an average, the 1-month forward premia eased to 1.94 per cent in H1 (up to September 26) from 2.51 per cent in H2:2024-25, in tandem with the narrowing interest rate differential between the US and India.

The decline was moderate for longer maturities, as the 12-month premia declined modestly to 2.11 per cent in H1 (up to September 26) from 2.25 per cent in H2:2024-25.

The 40-currency real effective exchange rate (REER) of the INR depreciated by 2.6 per cent between March 2025 and August 2025 in line with the movement



⁸ Generalised Autoregressive Conditional Heteroskedasticity (GARCH)



in nominal effective terms (Chart IV.21a). The depreciation of INR's 40-currency REER remained modest relative to that of some major economies (Chart IV.21.b).

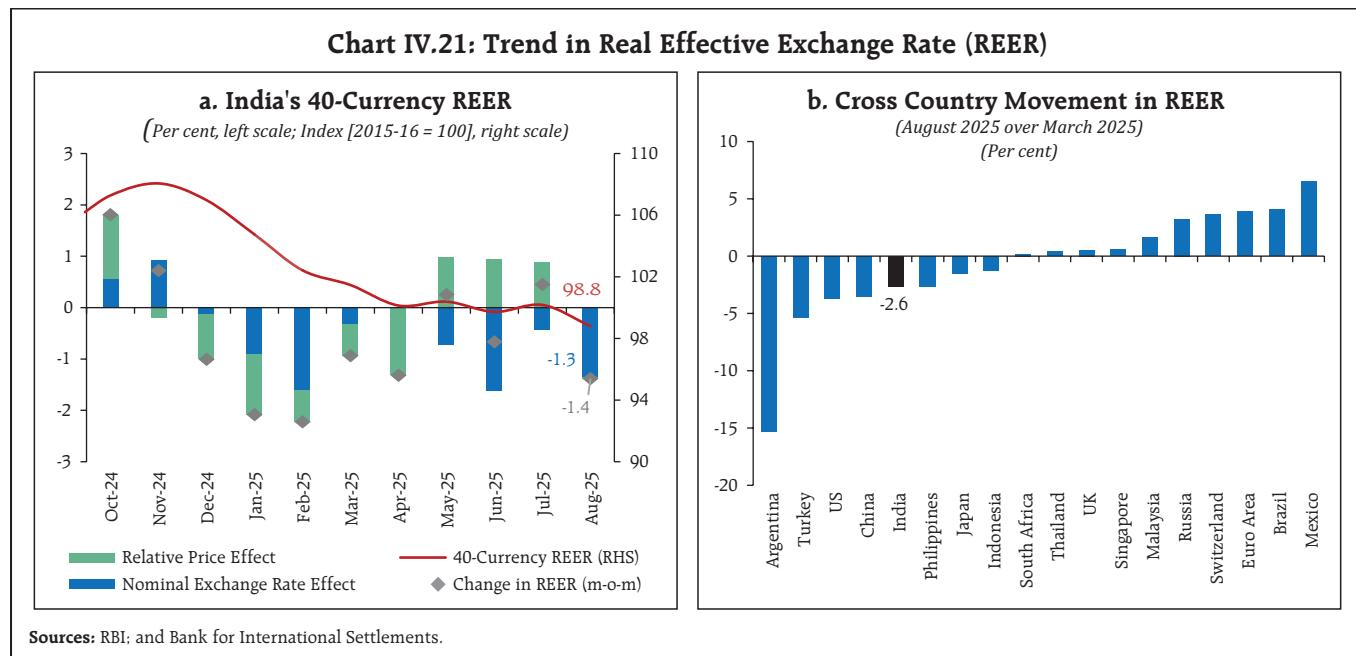
Overall Financial Conditions

Overall financial conditions eased beginning mid-March until July with a softening trend observed across the money, G-sec and corporate bond markets, as suggested by the financial conditions index based on twenty Indian financial market indicators⁹ at daily frequency. Since August, financial conditions tightened marginally on account of tightness in money and corporate bond markets (Chart IV.22). Overall financial conditions remain benign, auguring well for domestic economic activity, going forward.

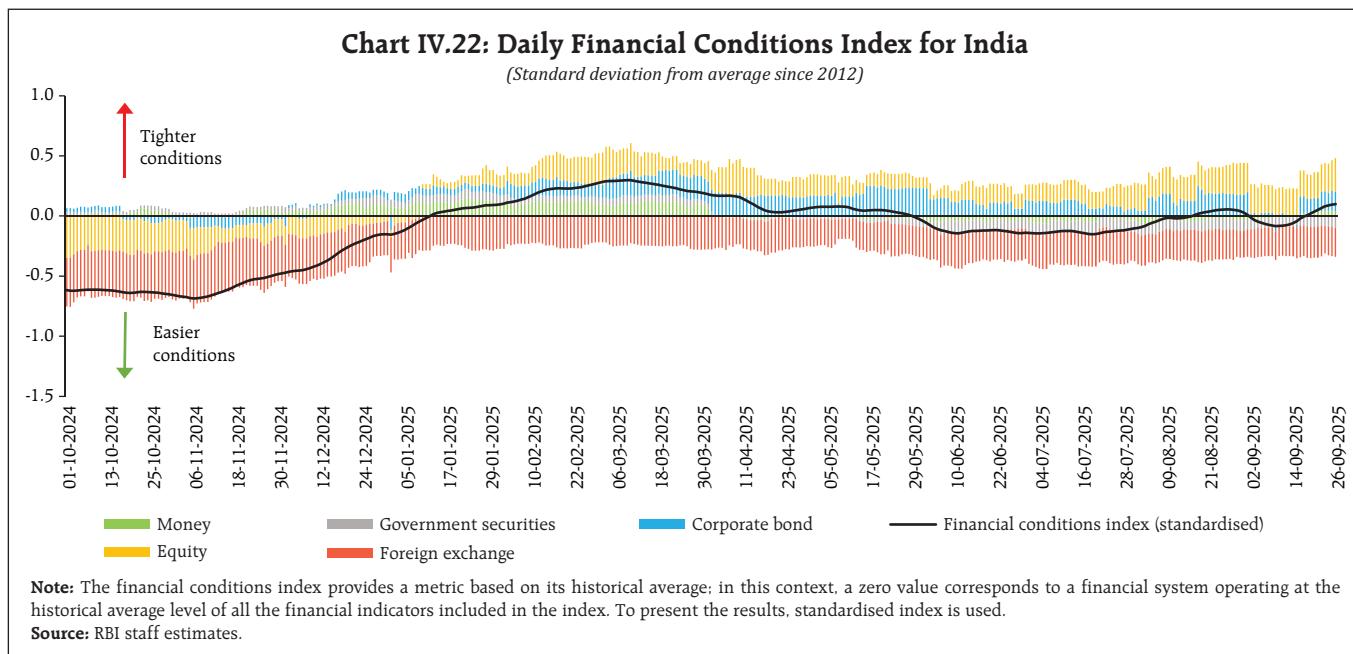
IV.2.6 Bank and Non-Bank Credit

Bank Credit: Aggregate Trends

Growth in bank credit moderated in H1:2025-26, although the recent data shows signs of an uptick. Across bank groups, credit growth of public sector banks (PSBs) remained higher (11.4 per cent) than



⁹ The chosen indicators represent five market segments, namely (i) the money market; (ii) the G-sec market; (iii) the corporate bond market; (iv) the forex market; and (v) the equity market. For detailed methodology, refer to Bandyopadhyay, P., Kumar, A., Kumar, P. and Bhattacharyya, I. (2025), 'Financial Condition Index for India: A High-frequency Approach'; Reserve Bank of India Bulletin, June. https://rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=23451

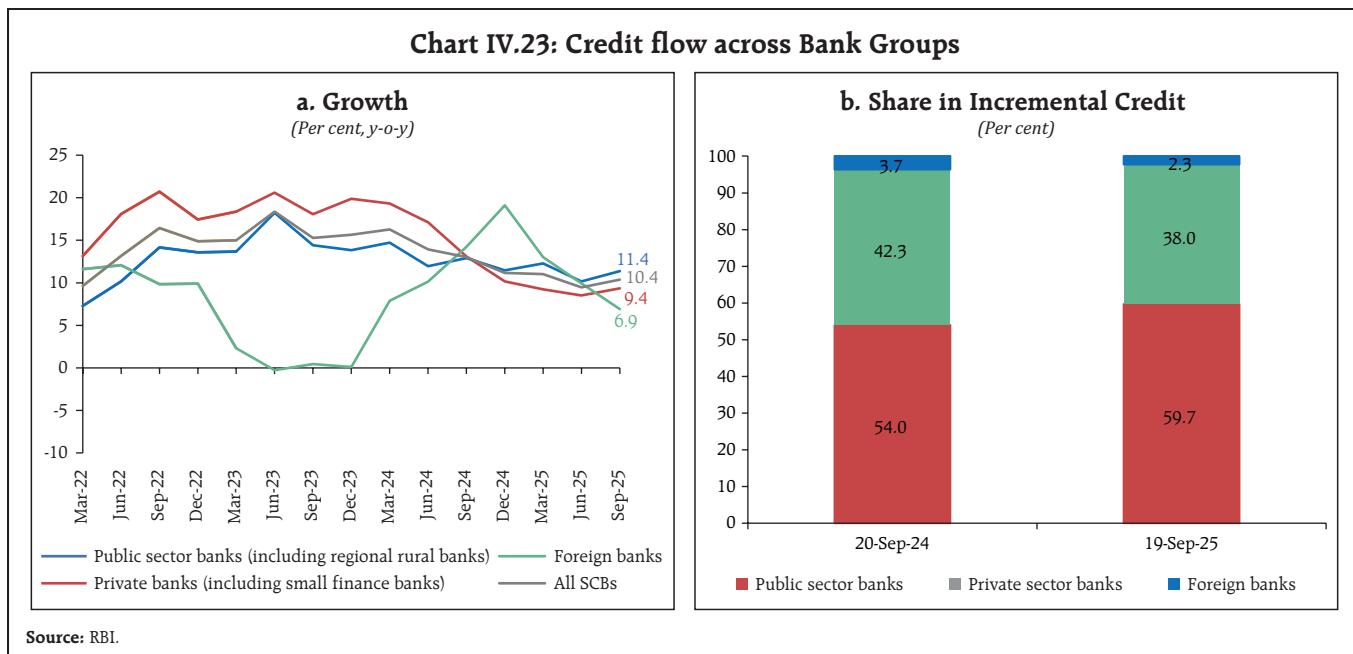


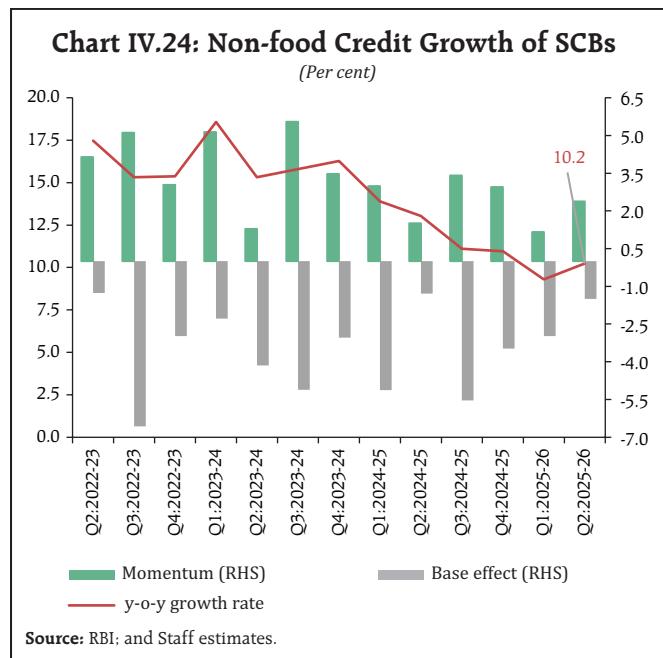
that of private sector banks (PVBs) (9.4 per cent), while credit growth of foreign banks decelerated (Chart IV.23a). On an annual basis (as on September 19, 2025), PSBs continued to account for the largest share of the incremental credit and their share rose further *vis-à-vis* PVBs and foreign banks (Chart IV.23.b).

Growth in non-food bank credit of scheduled commercial banks (SCBs) decelerated to 10.2 per cent

(y-o-y) as on September 19, 2025 from 13.0 per cent a year ago, although an uptick in momentum was witnessed in Q2 (Chart IV.24).

The asset quality of SCBs improved during 2025-26 (up to June 2025), with the overall gross non-performing assets (NPA) ratio declining to 2.3 per cent in June 2025 from 2.7 per cent a year ago (Chart IV.25a). Asset quality improved across all





major sectors, except the agriculture sector (Chart IV.25.b).

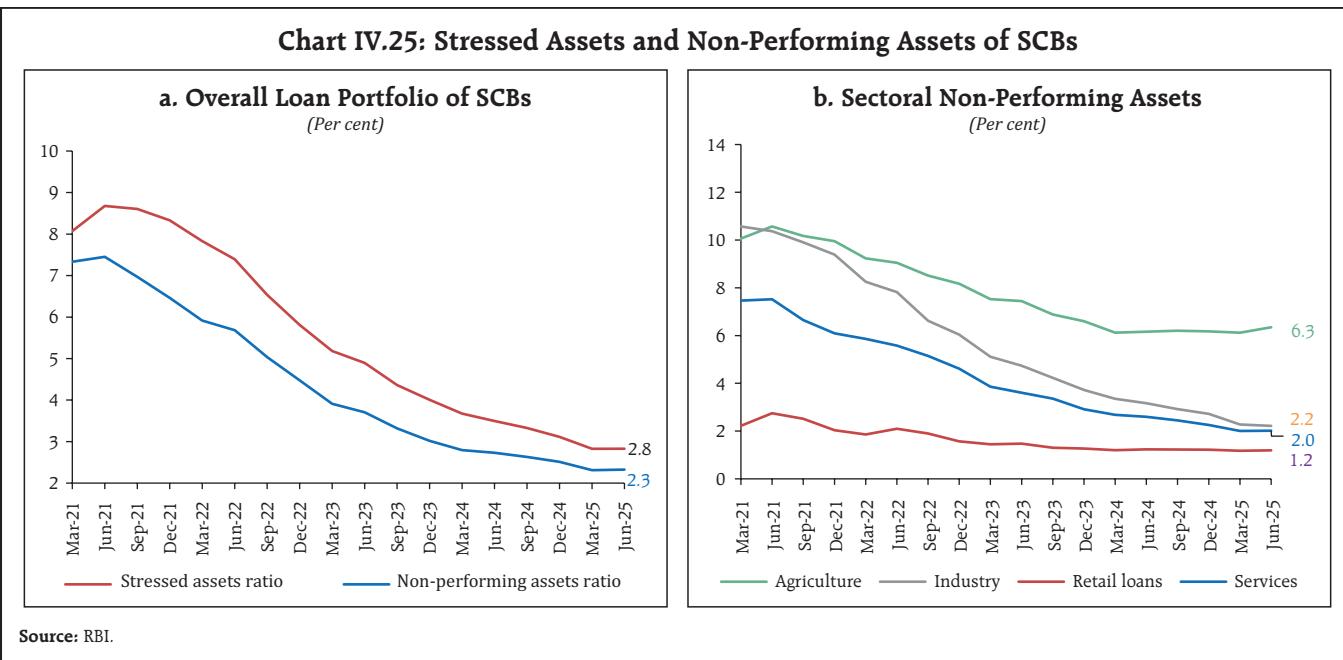
Growth in non-SLR investments of banks (comprising investments in CPs, bonds, debentures, and shares of public and private corporates) increased to 5.3 per

cent in H1:2025-26 from 1.2 per cent in H2:2024-25 (Chart IV.26a). The growth in adjusted non-food credit (*i.e.*, non-food bank credit *plus* non-SLR investments by banks) was lower at 10.1 per cent in as on September 2025, as compared to 12.9 per cent in the previous year (Chart IV.26.b).

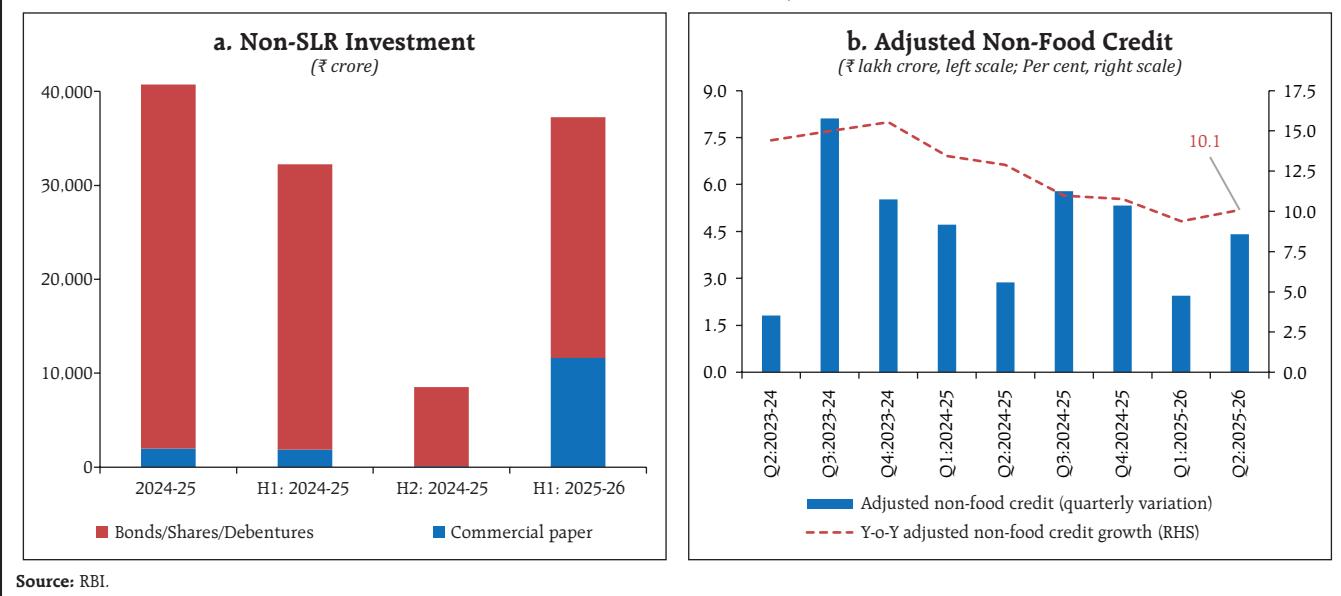
As on August 22, 2025, excess holdings of statutory liquidity ratio (SLR) securities by SCBs decreased to 7.9 per cent of their net demand and time liabilities (NDTL) from 8.5 per cent at end-March 2025 (Chart IV.27). Excess SLR holdings are a component of the liquidity coverage ratio (LCR). They also provide collateral buffers to banks for availing funds under the LAF as well as wholesale funding in the triparty repo and market repo segments.

Bank Credit¹⁰: A Sectoral Perspective

Disaggregated trends in bank credit show moderation in credit growth across sectors. Although industrial credit softened, it remained modestly above its historical 10-year average, with nascent signs of



¹⁰ Overall bank credit and non-food credit data are based on fortnightly Section-42 return, which covers all scheduled commercial banks (SCBs) while sectoral non-food credit data are based on sector-wise and industry-wise bank credit (SIBC) return, covering select banks accounting for about 95 per cent of the total outstanding non-food credit extended by all SCBs. Data pertain to the last reporting Friday of the month. Data include the impact of merger of a non-bank with a bank.

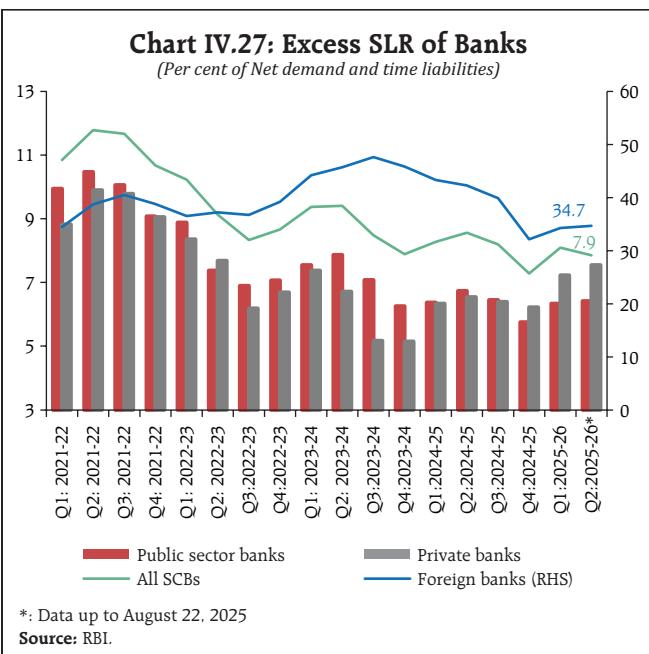
Chart IV.26: Non-SLR Investment and Adjusted Non-food Credit

Source: RBI.

growth uptick in recent months (Table IV.7). Despite moderation in growth, personal loans and services sector credit remained the main drivers of overall bank credit growth (Chart IV.28 a and b). Agricultural and allied activities registered muted credit growth, with gradual firming up in recent months.

Within the industrial sector, credit to MSMEs¹¹ segment continued to remain buoyant, with a significant acceleration in growth during recent months primarily contributing to its overall growth (Chart IV.29). Some regulatory measures such as revised guidelines on voluntary pledge of gold and silver jewellery as collateral for small business loans as well as the measures announced in the Union Budget helped in improving credit flow to the MSME segment. The revision in MSMEs classification, wherein investment limits and turnover thresholds have been raised substantially, also contributed to high growth in the recent past. In contrast, large industry credit registered tepid growth in H1:2025-26¹².

Among the major industrial sub-sectors, infrastructure sector credit growth has been on a declining path since last year, though there has been a marginal improvement since July 2025. On the other hand, credit to all engineering and textile segments witnessed stable growth (Table IV.8).



*: Data up to August 22, 2025

Source: RBI.

¹¹ Pertains to credit to micro, small and medium segments within industry.¹² H1:2025-26 data up to August 2025.

Table IV.7: Credit Growth (y-o-y, per cent)

Sectors/Sub-Sectors	Long-Term*	Post-COVID**	Nov-23	Mar-24	Aug-24	Dec-24	Mar-25	Jul-25	Aug-25
Bank Credit	10.9	15.0	20.7	20.2	13.6	11.2	11.0	10.0	10.0
Sectoral Deployment of Bank Credit									
Agriculture (13.2)	11.5	14.7	18.1	20.0	17.7	12.5	10.4	7.3	7.6
Industry (22.6)	4.2	7.9	6.1	8.5	9.7	7.2	7.7	6.0	6.5
<i>Micro and small (5.1)</i>	8.5	15.9	16.9	14.7	13.4	9.8	8.8	21.0	20.9
<i>Medium (2.1)</i>	12.9	19.1	12.0	13.3	19.2	19.9	18.6	14.7	13.1
<i>MSMEs (7.2)</i>	9.5	16.8	15.4	14.3	15.1	12.7	11.7	19.1	18.5
<i>Large (15.5)</i>	2.7	4.9	2.9	6.4	7.7	5.1	6.2	0.9	1.8
<i>Infrastructure (7.5)</i>	3.9	4.3	2.3	6.6	3.7	1.0	1.4	1.9	2.1
Services (29.1)	13.9	18.1	25.7	23.5	13.9	11.7	12.4	10.6	10.6
<i>Services excluding NBFCs (20.2)</i>	12.5	18.8	29.6	28.1	14.9	14.3	15.8	14.5	14.2
<i>NBFCs (8.9)</i>	19.0	17.2	18.9	15.3	11.9	6.7	5.7	2.6	3.4
Personal loans (35.1)	17.8	19.7	30.0	27.5	13.9	12.0	11.7	11.9	11.8
Personal loans with unchanged risk weight (23.8)	17.3	19.6	32.6	31.9	14.3	12.7	13.2	13.8	13.8
<i>Housing (Including Priority Sector Housing) (17.6)</i>	17.1	20.0	36.7	36.5	13.1	11.1	10.7	9.6	9.7
<i>Vehicle loans (3.7)</i>	18.1	15.4	20.6	17.6	14.5	8.8	8.6	8.9	8.7
<i>Education (0.8)</i>	8.1	16.4	23.0	23.7	18.4	15.8	15.1	15.0	14.6
Personal loans with increased risk weight (11.3)	19.2	20.1	25.3	19.7	13.2	10.7	8.6	8.1	7.9
<i>Credit cards (1.6)</i>	25.2	23.8	34.2	25.6	19.9	15.6	10.6	5.6	4.4
<i>Other personal loans (8.7)</i>	20.8	19.6	24.9	20.7	12.3	9.2	8.0	8.1	8.1

Notes: 1. Provisional data.

2. Bank credit data is based on fortnightly Section-42 return, which covers all scheduled commercial banks, while sectoral non-food credit data are based on sector-wise and industry-wise bank credit (SIBC) return, which covers select banks accounting for about 95 per cent of the total outstanding non-food credit extended by all SCBs, pertaining to the last reporting Friday of the month.

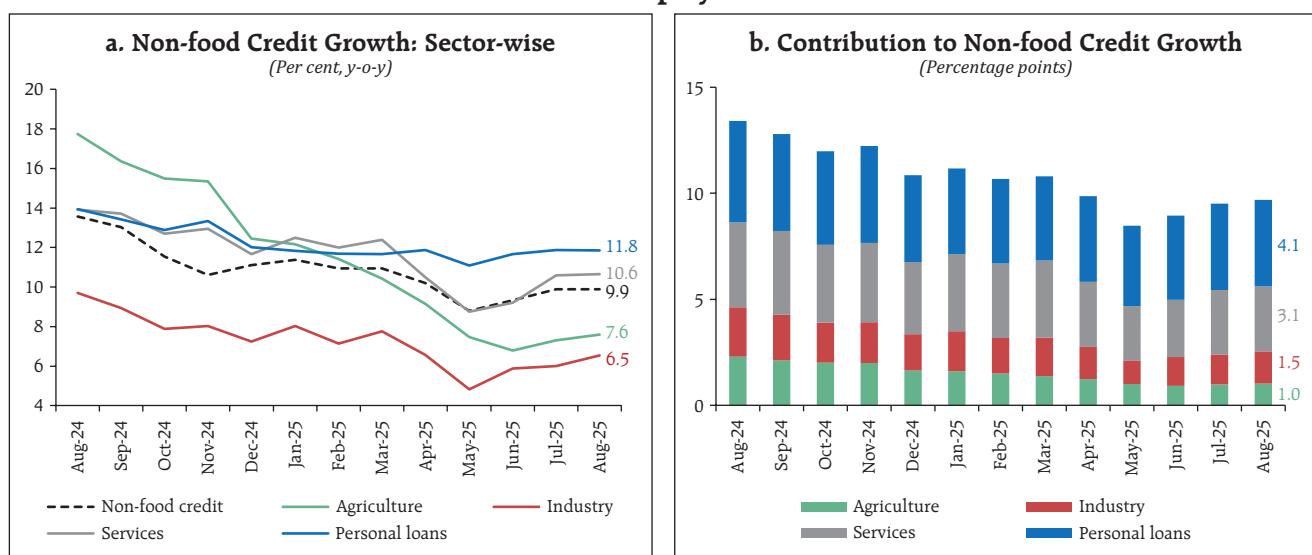
3. *: Average of growth from August 2015 to August 2025.

4. **: Average of growth from April 2022 to August 2025

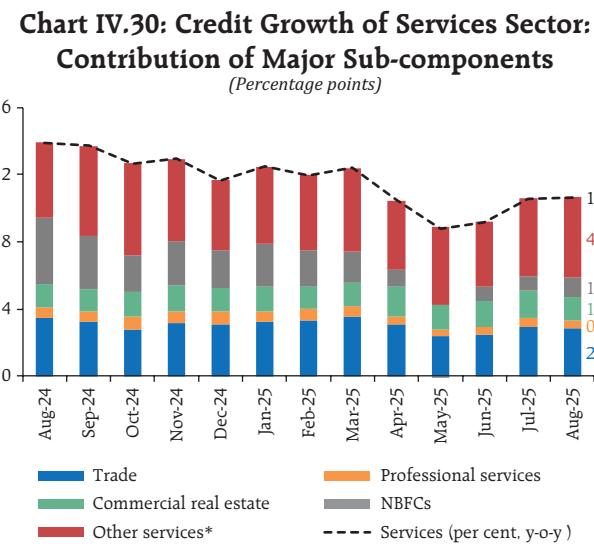
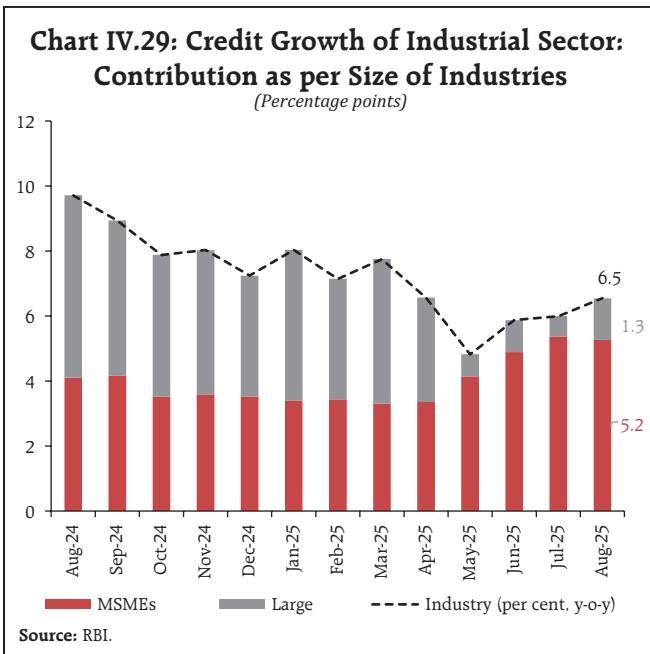
5. Figures in parentheses against each sector denote share in total non-food credit as per the latest data.

Source: RBI.

Chart IV.28: Sectoral Deployment of Bank Credit



Source: RBI.



Although growth of credit to the services sector moderated during H1:2025-26, a gradual strengthening has been recorded in recent months (Chart IV.30). Non-banking finance companies (NBFCs) remained the largest recipient of bank credit within the services sector, and there are signs of improvement in credit to NBFCs following the withdrawal of the additional risk weights w.e.f. April 01, 2025¹³. On the other hand, credit to services excluding NBFCs expanded at a steady pace above its long-term

average, with segments such as trade and commercial real estate recording healthy growth (Chart IV.30 and Tables IV.7 & IV.9).

Credit growth in the personal loans segment remained buoyant although decelerating from last year, with housing and vehicle loans being the major contributors (Chart IV.31). In the backdrop of exuberant growth in certain components of consumer credit, risk weights were raised on unsecured personal loans in November 2023. This prudential measure contributed to a sharp

Table IV.8: Credit Growth in Major Sub-sectors of Industry (y-o-y, per cent)

Growth	Aug-24	Sep-24	Dec-24	Mar-25	Jun-25	Jul-25	Aug-25
Infrastructure	3.7	2.1	1.0	1.4	-0.5	1.9	2.1
Basic metal and metal product	16.1	15.4	13.1	12.8	11.0	9.5	8.9
Textiles	6.4	5.4	5.6	8.3	8.6	6.0	6.4
Chemicals and chemical products	15.9	14.9	7.0	7.4	6.3	5.5	6.7
All engineering	16.6	15.7	19.5	22.1	22.3	23.1	19.9
Food processing	14.4	11.6	10.7	5.1	8.1	5.2	6.1
<hr/>							
Low							High

Note: Within a row, darker shade of green pertains to acceleration in credit growth, while red indicates deceleration in credit growth.
Source: RBI

¹³ <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT120A97A4D3CBCCE4AEBAE1B7DB7DCF177D.PDF>

Table IV.9: Impact of Change in Risk Weights on Credit Growth (y-o-y, per cent)

Growth	Nov-23	Mar-24	Aug-24	Mar-25	Apr-25	May-25	Jun-25	Jul-25	Aug-25
Personal loans (with change in risk weight)	25.3	19.7	13.2	8.6	9.7	8.2	7.9	8.1	7.9
NBFCs (with change in risk weight)*	18.9	15.3	11.9	5.7	2.9	-0.3	2.6	2.6	3.4
Personal loans (no change in risk weight)	32.6	31.9	14.3	13.2	12.9	12.6	13.6	13.8	13.8
Services excluding NBFCs (no change in risk weight)	29.6	28.1	14.9	15.8	14.4	13.3	12.4	14.5	14.2

Low  High

Notes: 1. *Risk weights were restored for NBFCs in April 2025.

2. Within a row, darker shade of green pertains to acceleration in credit growth, while red indicates deceleration in credit growth.

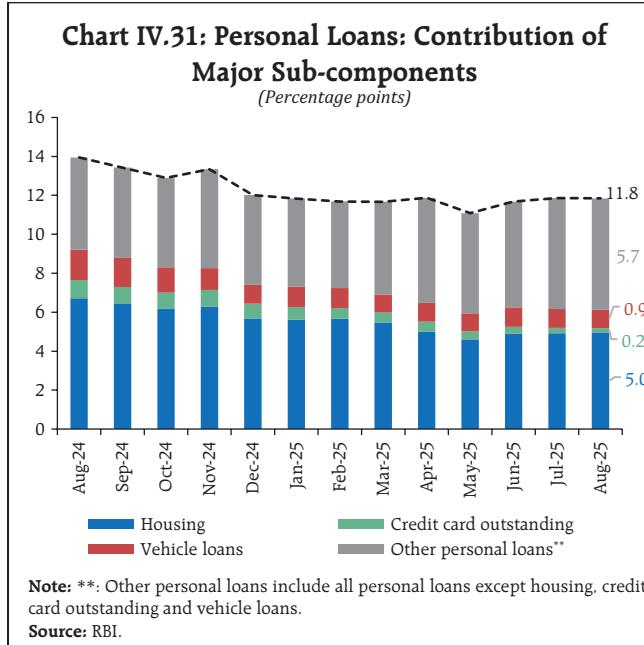
Source: RBI

moderation, with growth in unsecured personal lending declining to about one-third of its level in November 2023. Personal loans with unchanged risk weights grew at a robust pace (Table IV.9). Housing loans, which constitute nearly half of the lending under personal loans, remained range bound while growth of vehicle loans decelerated.

Though there has been a moderation in bank credit growth, total credit to the economy remained resilient, supported by strong non-bank intermediation. Resource mobilisation by non-financial corporates through market instruments such as corporate bond issuances and commercial papers has increased. The deceleration in bank credit growth, therefore, may be interpreted in the context of a broader and increasingly diversified credit ecosystem, wherein non-bank channels have also emerged as key sources of funding.

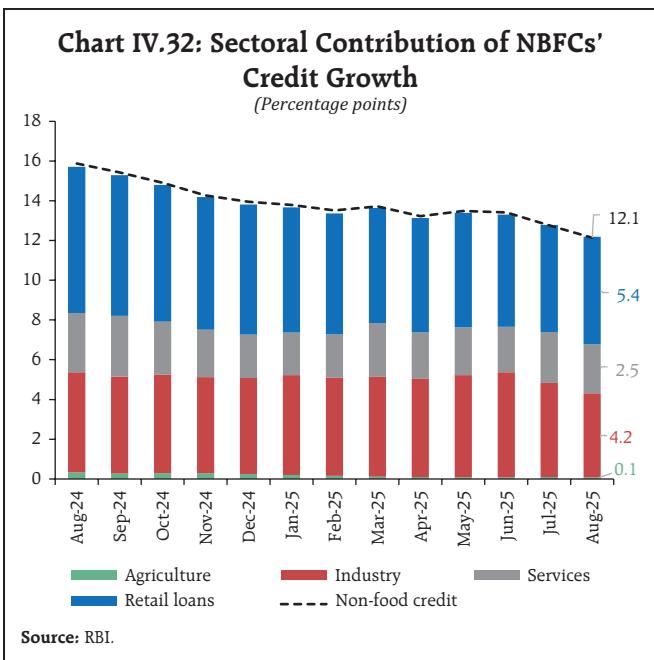
NBFCs Credit¹⁴

Despite some deceleration in lending, NBFCs' credit growth remained strong at double-digit levels. Industrial credit, which forms the dominant portion of NBFCs' credit portfolio, displayed stable growth, underscoring the importance of NBFCs as a crucial conduit for extending credit to the economy. Lending to retail loans and services segments expanded at a healthy pace in H1:2025-26¹⁵ contributing to overall credit deployment by NBFCs (Chart IV.32).



¹⁴ Data on sectoral deployment of outstanding credit from select NBFCs pertain to last day of every month. As a pilot work, the collection of monthly sectoral credit information from select NBFCs has been initiated. These NBFCs represent around 88 per cent of total credit extended by all NBFCs in upper and middle layers.

¹⁵ H1:2025-26 data up to August 2025.



IV.3 Transmission to Lending and Deposit Rates

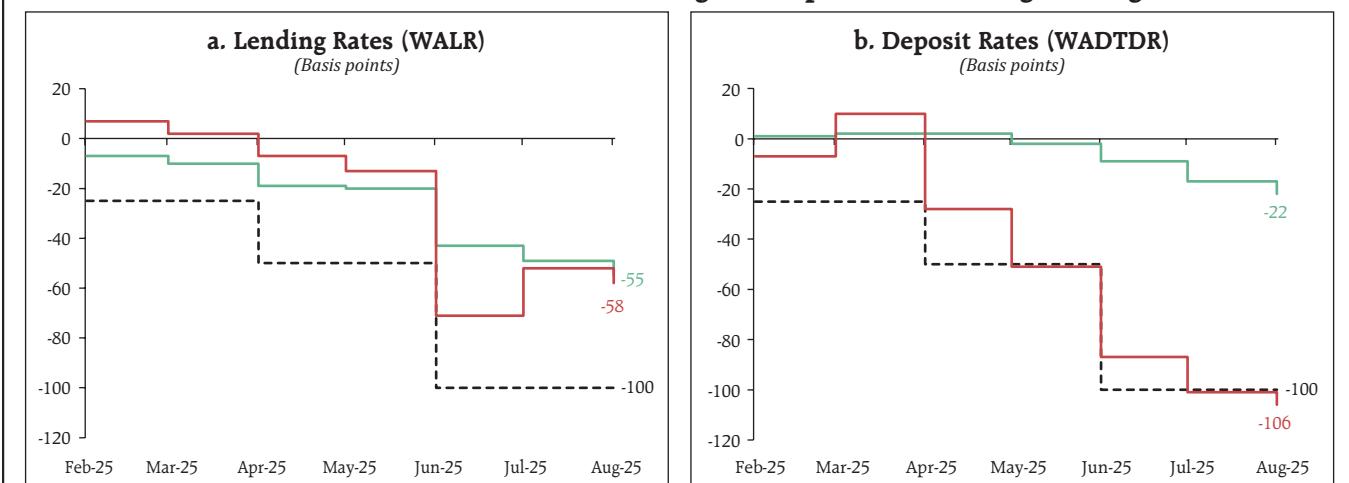
Transmission of the cumulative policy rate cut of 100 basis points to lending and deposit rates has been quick in the current easing cycle commencing February 2025. Banks have adjusted their lending and deposit rates downwards in H1:2025-26 in response

to the policy rate cuts and moderation in cost of funds (Chart IV.33a). The decline in deposit rates has been mainly led by bulk deposits in the wake of large surplus liquidity conditions and moderation in credit demand (Chart IV.33.b).

Since the onset of the current easing cycle in February 2025, banks have adjusted their repo-linked lending rates downward by 100 bps. The marginal cost of funds-based lending rate, which has a longer reset period, has also declined. The 1-year median marginal cost of funds-based lending rate of scheduled commercial banks softened by 40 bps during February-August 2025. Consequently, the weighted average lending rates on fresh and outstanding rupee loans declined by 58 bps (interest rate effect accounts for 71 bps)¹⁶ and 55 bps, respectively, during the same period. On the deposit side, the weighted average domestic term deposit rates on fresh and outstanding deposits declined by 106 bps and 22 bps, respectively (Table IV.10).

The share of the external benchmark-based lending rate linked loans in total outstanding floating rate loans of scheduled commercial banks increased to

Chart IV.33: Transmission to Banks' Lending and Deposit Rates during Feb-Aug 2025



WALR: Weighted average lending rate; WADTDR: Weighted average domestic term deposit rate.

Source: RBI.

¹⁶ The interest rate effect can be arrived at by keeping the weight constant, with the residual change in the weighted average landing rate attributed to the weight effect.

Table IV.10: Transmission to Banks' Deposit and Lending Rates

(Basis points)

Period	Repo Rate	Term Deposit Rates			Lending Rates				
		WADTDR Fresh Deposits		WADTDR Outstanding Deposits	EBLR	1-Yr. MCLR (Median)	WALR Fresh Rupee Loans		WALR Outstanding Rupee Loans
		Retail Deposits	Retail and Bulk Deposits	Retail and Bulk Deposits			Overall Effect	Interest Rate Effect [#]	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Tightening Period May 2022 to Jan 2025	+250	190	259	206	250	175	182	191	115
Easing Phase Feb 2025 to Aug 2025	-100	-64	-106	-22	-100	-40	-58	-71	-55
Memo									
Jun – 2025	-50	-26	-36	-7	-50	-5	-58	-30	-23
Jul – 2025	0	-11	-14	-8	0	-15	19	-4	-6
Aug – 2025	0	-7	-5	-5	0	-15	-6	-11	-6

Notes: Data on EBLR pertain to 32 domestic banks.

: At constant weight.

WALR: Weighted average lending rate; WADTDR: Weighted average domestic term deposit rate; MCLR: Marginal cost of funds-based lending rate; EBLR: External benchmark-based lending rate.

Sources: MPD06 return; and RBI.

62.9 per cent as at end-June 2025 from 61.6 per cent as at end-March 2025. Consequently, the share of marginal cost of funds-based lending rates linked loans declined (Table IV.11). Increasing share of loans linked to external benchmark has quickened the pace of transmission to lending rates.

Public sector banks still have a significant proportion of their loans linked to marginal cost of funds-based lending rates (Chart IV.34a). On the other hand, private

banks extend a large part of their loans at external benchmark-based lending rates (Chart IV.34.b). The marginal cost of funds-based lending rates and other legacy rates – based on internal benchmarks and having longer reset periods – act as an impediment to faster policy transmission.

Bank group-wise, the transmission to weighted average lending rates on fresh and outstanding rupee loans of private banks was higher than that of public sector banks (Chart IV.35a). As alluded to earlier, the large share of external-benchmark based loans led to better transmission in case of private banks compared to public sector banks. However, lending rates of private banks remained above those of public sector banks (Chart IV.35.b). The maximum pass-through to lending rates was witnessed among foreign banks, reflecting their higher share of external benchmark-based lending rates and higher share of low-cost and wholesale deposits of lower maturity.¹⁷

Table IV.11: Share of Outstanding Floating Rate Loans across Interest Rate Benchmarks

Regime	June 2024	March 2025	June 2025
MCLR	38.2	34.9	33.8
EBLR	57.9	61.6	62.9
Others	3.9	3.5	3.3

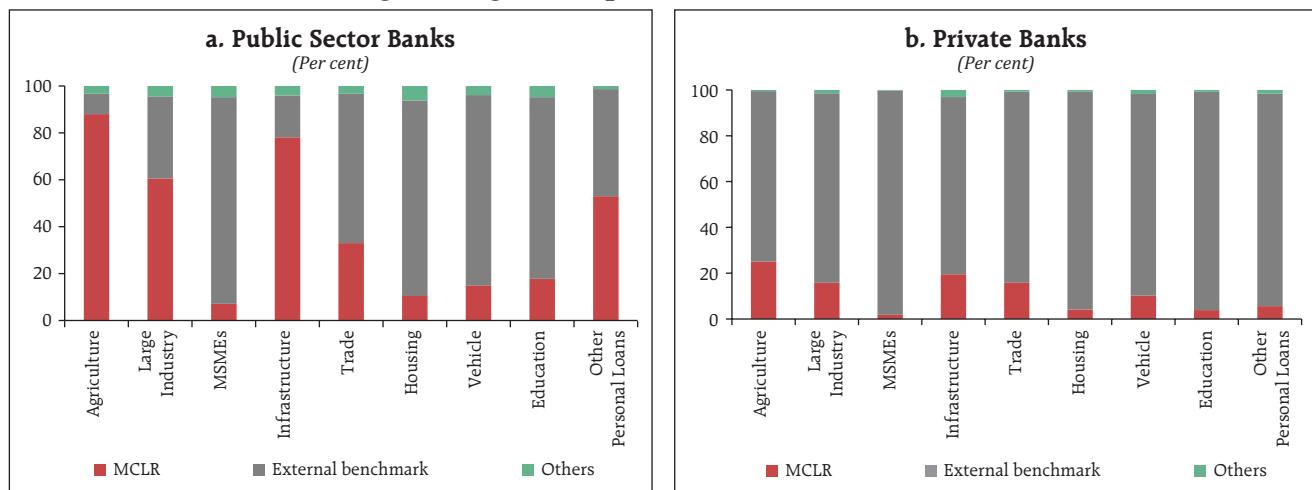
Notes: 1. 'Others' include benchmark prime lending rate, base rate and other internal benchmarks.

2. Data pertain to 74 scheduled commercial banks.

3. EBLR: External benchmark-based lending rate; MCLR: Marginal cost of funds-based lending rate.

Source: RBI.

¹⁷ The proportion of external benchmark-based lending rate linked loans was the highest for foreign banks (93.5 per cent), followed by private banks (87.9 per cent) and public sector banks (47.2 per cent) as at end-June 2025.

Chart IV.34: Outstanding Floating Rate Rupee Loans of SCBs across Interest Rate Benchmarks

Notes: 1. MCLR: Marginal cost of funds-based lending rate.

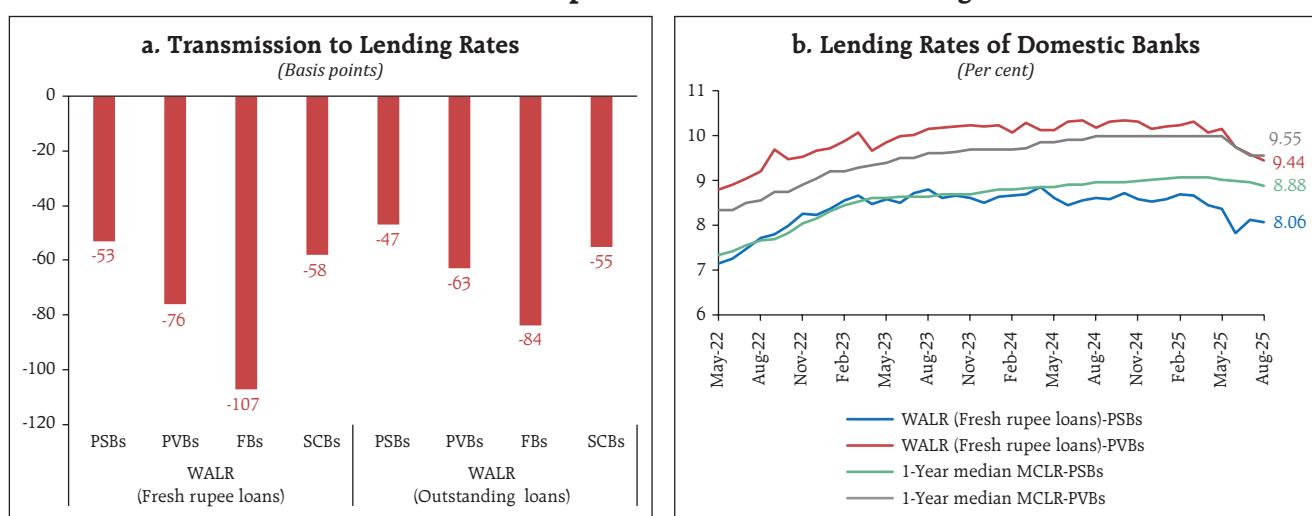
2. Data pertains to end-June 2025.

3. 'Others' include benchmark prime lending rate, base rate and other internal benchmarks.

Source: Ad-hoc survey.

Sectoral analysis shows that the transmission to lending rates on fresh and outstanding loans has been broad-based. The pace of transmission varied across sectors due to varying proportion of credit portfolios linked to fixed and floating interest rates and differential spreads charged by banks. Even though lending rates moderated, the shifts in volumes across

banks/sectors towards higher interest rate slabs may reduce the extent of transmission during an easing cycle. Hence, changes in the weighted average lending rate may be decomposed into interest rate effect and volume effect for assessing transmission to lending rates, especially on fresh loans during a policy cycle.¹⁸ During the current easing cycle (Feb-Aug 2025), the

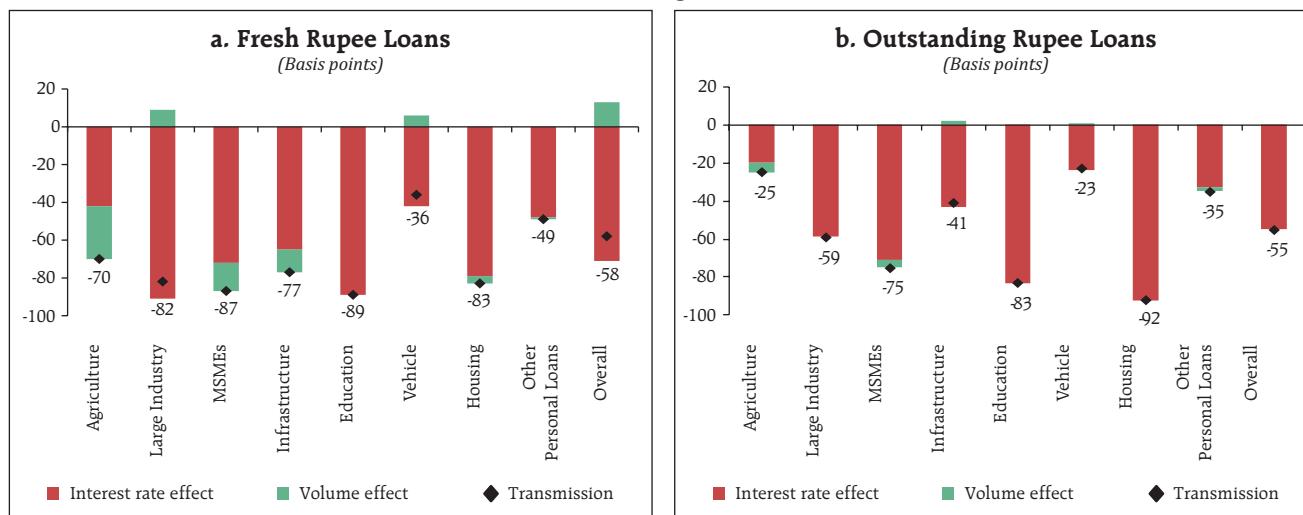
Chart IV.35: Bank Group-wise Transmission to Lending Rates

Notes: PSBs: Public sector banks; PVBs: Private banks; FBS: Foreign banks; SCBs: Scheduled commercial banks; WALR: Weighted average lending rate; MCLR: Marginal cost of funds-based lending rate.

Source: RBI.

¹⁸ The interest rate effect can be arrived at by keeping the weight constant, with the residual change in the weighted average lending rate attributed to the weight effect.

**Chart IV.36: Sector-wise Transmission to Weighted Average Lending Rates
(Feb - Aug 2025)**



Sources: MPD06 return; and RBI.

volume effect partially damped transmission in large industry and vehicle loans, whereas it complemented interest rate effect in other sectors, thereby enhancing transmission in these sectors (Chart IV.36).

For external benchmark-based lending rate loans, banks have increased their spreads (charged over and above the benchmark rate), which damped the extent of transmission (Table IV.12). The spread on fresh rupee loans was the highest for education loans, followed by other personal loans, and micro, small and medium enterprises loans. Among

domestic bank groups, public sector banks charged a lower spread than private banks for housing, vehicle, education, and other personal loans. Public sector banks, however, charged a higher spread for micro, small and medium enterprises loans as compared to private banks.

Non-banking financial companies have been playing an increasingly important role in meeting the credit needs of the economy. They extend the last mile credit to *hitherto* unbanked areas and provide *niche* financing to various sectors ranging from real estate and infrastructure to agriculture

Table IV.12: Spread of Weighted Average Lending Rates on Fresh Rupee Loans*

Sectors	Jan-25			Aug-25		
	Public sector banks	Private banks	Domestic banks	Public sector banks	Private banks	Domestic banks
MSME Loans	3.43	3.12	3.20	3.48	3.33	3.36
Personal Loans						
Housing		2.09	2.44	2.34	2.11	2.51
Vehicle		2.63	4.03	3.07	2.69	4.26
Education		3.84	4.76	4.41	3.42	5.55
Other personal loans		3.01	5.38	3.36	3.30	3.51

Note: Other personal loans include loans other than housing, vehicle, education and credit card loans.

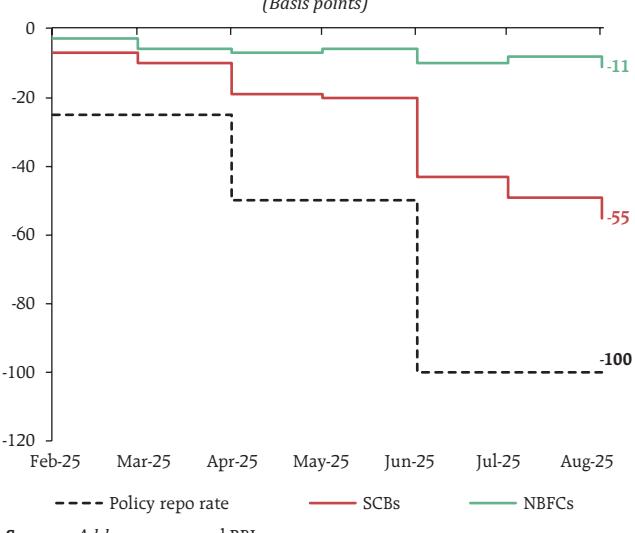
* : Calculated over the repo rate for loans linked to external benchmarks.

Sources: MPD06 return; and RBI staff estimates.

and micro loans. Thus, non-banking financial companies enhance the reach of the credit channel of monetary transmission. The lending rates of non-banking financial companies generally tend to be higher than those of commercial banks. This reflects, *inter alia*, their liability structure and the risk profile of their borrowers. The degree of monetary policy transmission, therefore, differs between non-banking financial companies and scheduled commercial banks (Chart IV.37).

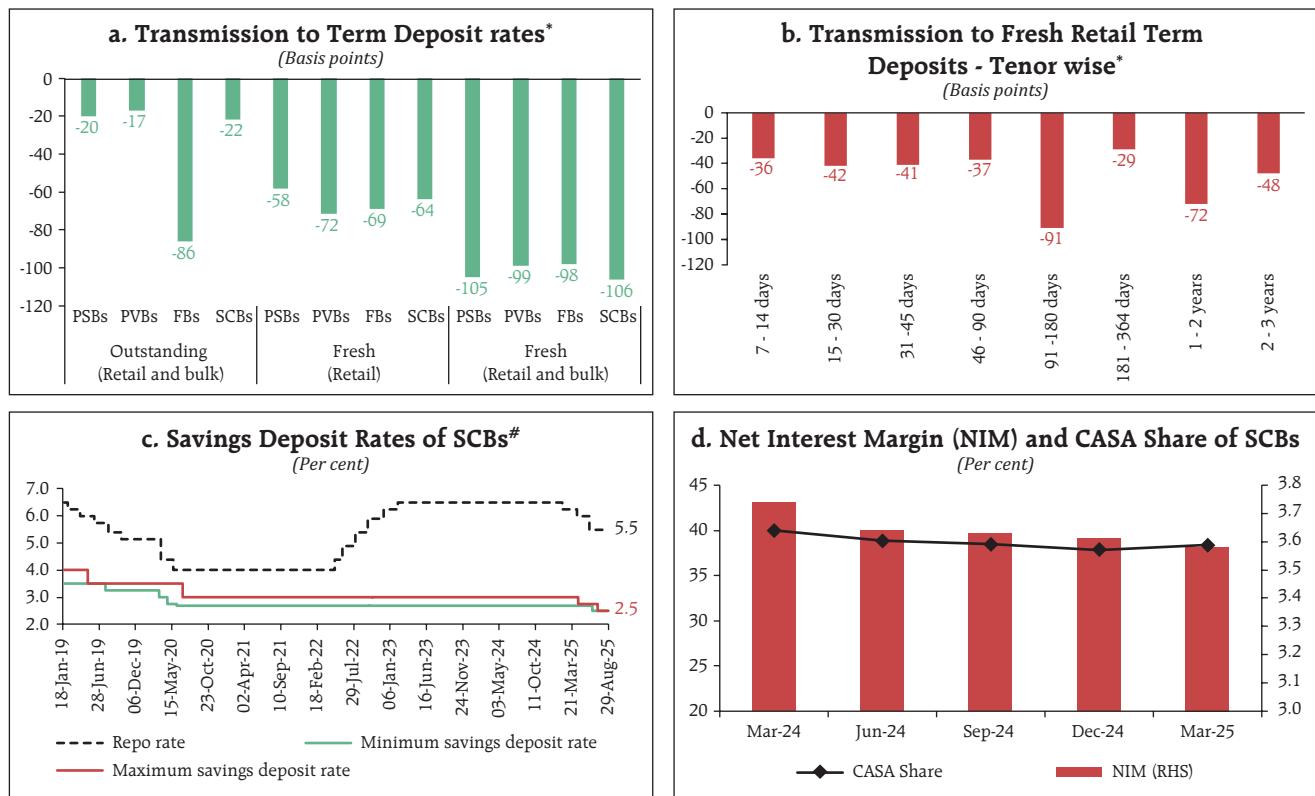
Across bank groups, the pass-through to weighted average domestic term deposit rates on fresh and outstanding deposits was higher for public sector banks than private banks during February-August 2025 (Chart IV.38a). Interest rates on fresh retail deposits moderated across tenors, although the extent varied

Chart IV.37: Monetary Policy Transmission to Outstanding Lending Rates of NBFCs
(Basis points)



(Chart IV.38.b). The interest rates on savings bank deposits that comprise about 30 per cent of total

Chart IV.38: Deposit Rates and Banks' Profitability



Notes: PSBs: Public sector banks; PVBs: Private banks; FBs: Foreign banks; SCBs: Scheduled commercial banks; WADTDR: Weighted average domestic term deposit rate; CASA: Current account and savings account; NIM: Net interest margin.

*: Transmission is calculated for the period February-August 2025. #: Savings deposit rates pertain to five major banks and relate to account balances of up to Rs 1 lakh.

Sources: MPD06 return; and RBI.

Table IV.13: Interest Rates on Small Savings Instruments – Q3:2025-26

Small Savings Scheme	Maturity (years)	Spread\$ (Percentage point)	Average G-sec yield# (Per cent)	Formula-based rate of Interest (Per cent)	Government Announced Rate of Interest (Per cent)	Difference (Percentage point)
(1)	(2)	(3)	(4)	(5) = (3) + (4)	(6)	(7) = (6) - (5)
Savings Deposit	-	-			4.00	-
Public Provident Fund	15	0.25	6.58	6.83	7.10	0.27
Term Deposits						
1 Year	1	0	5.46	5.46	6.90	1.44
2 Year	2	0	5.62	5.62	7.00	1.38
3 Year	3	0	5.79	5.79	7.10	1.31
5 Year	5	0.25	6.12	6.37	7.50	1.13
Recurring Deposit Account	5	0	5.79	5.79	6.70	0.91
Monthly Income Scheme	5	0.25	6.09	6.34	7.40	1.06
Kisan Vikas Patra	115 Months	0	6.58	6.58	7.50	0.92
NSC VIII issue	5	0.25	6.26	6.51	7.70	1.19
Senior Citizens Saving Scheme	5	1.00	6.12	7.12	8.20	1.08
Sukanya Samridhi Account Scheme	21	0.75	6.58	7.33	8.20	0.87

\$: Spreads for fixing small saving rates as per the Government of India Press Release of February 2016.

#: Based on semi-annualised yield on G-sec of corresponding maturity for the period Jun-Aug 2025.

Note: Compounding frequency varies across instruments.

Sources: Government of India; Financial Benchmarks India Pvt. Ltd; and RBI staff estimates.

deposits have also declined in the current easing cycle (Chart IV.38.c). Banks are generally prompt in reducing their savings deposit rates in an easing cycle. Large surplus liquidity amidst moderation in credit demand enabled banks to transmit rate cuts faster to their liability side, which helped them to manage their margins effectively (Chart IV.38.d).

The Government of India reviewed the interest rates on various small savings instruments, which are linked to secondary market yields on G-secs of comparable maturities and kept them unchanged for Q3:2025-26. This led to a widening of gap between the interest rates on most small saving instruments and their formula-based rates (Table IV.13). The widening gaps may be limiting the transmission of policy rates to banks' deposit rates, especially in an easing cycle, because of the potential substitution effect. A large interest rate differential in favour of small savings could lead to a migration of deposits away from banks.

IV.4 Conclusion

System liquidity remained in surplus during H1 on the back of Reserve Bank's liquidity augmenting measures and increase in government spending. Domestic financial markets remained resilient amidst increased volatility in global financial markets induced by trade and geopolitical uncertainties. Money market rates moved in tandem with the policy repo rate. Long term bond yields eased at the beginning of the year but hardened from June onwards amidst domestic developments and global cues. Indian equity markets demonstrated resilience and generally maintained an upward trajectory with intermittent corrections. The INR remained range-bound in Q1 but came under depreciating pressures in Q2. The credit market registered robust transmission with lending and deposits rates declining faster in the current easing cycle. Going forward, the Reserve Bank will remain agile and nimble in liquidity management operations to ensure adequate liquidity in the system to meet the productive requirements of the economy while safeguarding financial stability.

V. External Environment

Global growth remains below its long-term average and is projected to decelerate in 2025 amid elevated uncertainties and higher tariffs. Inflation continues to moderate but remains above target for several economies with recent upticks observed in some advanced economies. Central banks remain cautious in normalising monetary policy as they assess the unfolding impact of tariffs. Financial markets stay volatile responding to shifting policy signals, even as equities rebounded strongly. Trade policy uncertainty, geoeconomic fragmentation, lingering geopolitical risks, stretched equity valuations, rising fiscal concerns and inflation persistence pose downside risks to the global growth outlook.

The global economy, growing below its long-term average, is projected to slow in 2025. The near-term growth outlook is clouded by trade policy uncertainty, geoeconomic fragmentation, geopolitical risks, and financial market volatility. The recent uptick in inflation, particularly in advanced economies (AEs), coupled with unfolding impact of high tariffs has impeded the disinflation process, posing risks to price stability. Consequently, central banks have adopted a cautious approach in their policy decisions carefully weighing incoming data. Global financial markets remained volatile, reflecting shifting risk perceptions amid elevated trade policy uncertainty. Equity markets scaled new highs driven by tech stocks. Short-term bond yields generally softened in anticipation of rate cuts. Long-term yields have risen in AEs on fiscal concerns but declined in emerging market economies (EMEs), as investors seeking portfolio diversification show renewed interest in EME assets. The US dollar has weakened, reflecting trade policy uncertainty, fiscal imbalances, fragile investor confidence, and shifting expectations about the rate cut by the Federal Reserve.

V.1 Global Economic Conditions

In 2025 so far, global economic activity has remained resilient. High frequency indicators for Q3:2025 point to a tepid manufacturing activity, but services sector remain buoyant. Monetary easing and other

policy support in some economies could support global growth during the rest of H2. Trade deals struck during the year so far have lowered trade policy uncertainty but it remains elevated. In its World Economic Outlook update of July 2025, the International Monetary Fund (IMF) revised up its global growth projections to 3.0 per cent from 2.8 per cent for 2025, and to 3.1 per cent from 3.0 per cent for 2026. EMEs face several challenges ranging from weaker global growth, trade policy uncertainty to climate-related disruptions which could adversely affect their economic prospects.

Among AEs, the US economy has remained resilient despite some fragility in its labour market. Real GDP grew by 3.8 per cent [quarter-on-quarter seasonally adjusted annualized rate (q-o-q, saar)] in Q2:2025, rebounding from the contraction of 0.6 per cent in the first quarter (Table V.1). The growth in Q2 was propelled by lower net imports and strong consumer spending, partially offset by decline in investment. Labour market showed signs of weakness as additions to non-farm payrolls in August were underwhelming. The unemployment rate also edged up to 4.3 per cent, but remained low. In August, the US Composite Purchasing Managers Index (PMI) remained robust supported by a buoyant services sector and recovery in manufacturing activity. Consumer sentiment, as measured by the

Table V.1: Real GDP Growth

(Per cent)

Country	Q3-2024	Q4-2024	Q1-2025	Q2-2025	2024	2025 (P)	2026 (P)
Quarter-on-quarter, seasonally adjusted, annualised rate (q-o-q, saar)							
Canada	2.4	2.1	2.0	-1.6			
Euro area	1.6	1.6	2.3	0.5			
Japan	2.3	2.1	0.3	2.2			
South Korea	0.4	0.3	-0.9	2.7			
UK	0.0	0.4	3.0	1.4			
US	3.3	1.9	-0.6	3.8			
(Year-on-year)							
Advanced Economies							
Canada	1.9	2.3	2.3	1.2	1.6	1.6	1.9
Euro area	0.9	1.3	1.6	1.5	0.9	1.0	1.2
Japan	0.8	1.2	1.7	1.7	0.2	0.7	0.5
South Korea	1.4	1.1	0.0	0.6	2.0	0.8	1.8
UK	1.2	1.5	1.3	1.2	1.1	1.2	1.4
US	2.8	2.4	2.0	2.1	2.8	1.9	2.0
Emerging Market Economies							
Brazil	4.1	3.6	2.9	2.2	3.4	2.3	2.1
China	4.6	5.4	5.4	5.2	5.0	4.8	4.2
India	5.6	6.4	7.4	7.8	6.5	6.4	6.4
Indonesia	5.0	5.0	4.9	5.1	5.0	4.8	4.8
Philippines	5.2	5.3	5.4	5.5	5.7	5.5	5.9
Russia	3.3	4.5	1.4	1.1	4.3	0.9	1.0
South Africa	0.4	0.8	0.8	0.6	0.5	1.0	1.3
Thailand	3.0	3.3	3.2	2.8	2.5	2.0	1.7
Memo:							
World	2024		2025 (P)		2026 (P)		
Year-on-year							
Output		3.3		3.0		3.1	
Trade volume		3.5		2.6		1.9	

P: Projection

Notes: 1. India's data correspond to fiscal year (April-March); e.g., 2025 pertains to April 2025-March 2026.

2. Projections for 2025 and 2026 are taken from the IMF WEO, July 2025 update.

Sources: Official statistical agencies; Bloomberg; International Monetary Fund World Economic Outlook Update, July 2025 and RBI staff estimates.

University of Michigan survey, retreated in August on inflation fears even as readings remained above April-May 2025 levels. Going forward, economic activity will depend largely on how well the US absorbs tariff related pass-throughs and the course of monetary policy.

Japan's GDP grew by 2.2 per cent (q-o-q, saar) in Q2:2025, driven by consumer spending amid tariff headwinds and political uncertainty. The Composite PMI at 52.0 in August showed buoyant private sector activity, *albeit* driven by services. High inflation, weaker exports and a volatile currency remain key challenges for the economy.

Real GDP growth in the Euro area decelerated in Q2 to 0.5 per cent (q-o-q, saar) from 2.3 per cent in Q1, marking the weakest quarter since Q4:2023 as GDP contracted in Germany and Italy. Labour markets, however, stayed resilient with unemployment steady at around 6.2 per cent. The Composite PMI stayed in expansion zone, driven by services. Looking ahead, higher defence and infrastructure spending, accompanied by easing of inflationary pressures, should support growth.

GDP growth in the UK moderated to 1.4 per cent (q-o-q, saar) in Q2:2025 from 3.0 per cent in Q1, due to a weak production sector. The unemployment rate at 4.7 per cent in Q2 remained at a four-year high. The UK Composite PMI at 53.5 in August indicated resilient private sector activity as services sector remained a pillar of strength amidst conclusion of US-UK trade deal. Elevated levels of services inflation and persistent softness in manufacturing, however, remain a cause of concern.

Amongst major EMEs, some have shown signs of weakness including Brazil and Russia as elevated tariffs are likely to have an adverse impact on growth. The Chinese economy, however, remained resilient, expanding by 5.2 per cent year-on-year (y-o-y)

in Q2, marking a slight slowdown from 5.4 per cent in Q1. The property sector woes continue to weigh on growth momentum. Property investments plunged, while retail sales and industrial output remained sluggish in Q3. China's exports remained resilient as shipments to ASEAN¹ increased in the wake of tariffs. Policymakers undertook both fiscal and monetary measures to bolster economic activity. Deflation, a languishing property sector, subdued consumer expenditure and trade policy uncertainty pose downside risks to China's growth prospects during the rest of H2.

Brazil's GDP growth decelerated to 2.2 per cent (y-o-y) in Q2:2025 from 2.9 per cent in Q1 due to moderation in domestic spending and investment. The labour market, however, remained tight as the unemployment rate continued to fall, reaching 5.6 per cent in the quarter ending July. Private sector activity remained weak in Q2 and Q3 (up to August) as indicated by the Composite PMI. Political uncertainty ahead of the 2026 elections and weather-related events pose further downside risks to Brazil's growth amidst a challenging external environment. Economic recovery in South Africa remained fragile as its GDP grew by 0.6 per cent (y-o-y) in Q2:2025, down from 0.8 per cent in the previous quarter, due to slower gross fixed capital formation. Both consumer confidence and business confidence in Q2 reflected overall pessimism, along with labour market pressures that have remained acute during the year so far, with the unemployment rate edging up in Q2. The Composite PMI showed modest expansion in private sector activity in Q3 (up to August). In Russia, growth led by defence spending has been cooling off, with its GDP growing by 1.1 per cent in Q2:2025, slowing from 1.4 per cent in the previous

quarter. Business confidence in Russia weakened in August, as manufacturing activity remained tepid as indicated by the PMI.

The ASEAN economies are navigating a challenging landscape. The Asian Development Bank in July revised down Southeast Asia's growth projections to 4.2 per cent from 4.7 per cent for 2025; for 2026 it was revised down to 4.3 per cent from 4.7 per cent. Growth in BRICS² economies, except India, is likely to remain subdued as these economies grapple with multiple domestic headwinds as alluded to earlier (Table V.2). A challenging external environment might aggravate country-specific risks.

Turning to high frequency indicators, the Organisation for Economic Co-operation and Development's composite leading indicator showed that most economies remained above the long-term trend during Q3:2025 (up to August) (Chart V.1a). The Global Composite PMI remained in expansion zone during April – August 2025, with services being the main driver of growth (Chart V.1b). Global Manufacturing PMI, however, remained in the contraction zone in April and May before expanding marginally in June and again in August.

The US tariff announcements since April 2025 and the subsequent bilateral trade deals have introduced far-reaching shifts in global trade dynamics, posing significant risks to the free flow of goods across the globe. Despite these jolts to international trade, global merchandise trade volume grew for six consecutive quarters up to Q2:2025, and it continued to grow in Q3:2025 (July 2025), with faster growth in 2025 so far. The growth, however, hides the weakness in trade as it was primarily driven by front-loading before the US tariff hikes came into

¹ Association of Southeast Asian Nations (ASEAN) includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

² The BRICS includes group of 10 countries - Brazil, China, Egypt, Ethiopia, India, Indonesia, Iran, Russian Federation, South Africa, and United Arab Emirates.

Table V.2: Select Macroeconomic Indicators for BRICS

Real GDP growth rate (y-o-y, per cent)	Country	2024	2025(P)	2026(P)	General Government gross debt (per cent of GDP)	Country	2024	2025(P)	2026(P)
		3.4	2.3	2.1		Brazil	87.3	92.0	96.0
	Russia	4.3	0.9	1.0		Russia	20.3	21.4	22.5
	India	6.5	6.4	6.4		India	81.3	80.4	79.6
	China	5.0	4.8	4.2		China	88.3	96.3	102.3
	South Africa	0.5	1.0	1.3		South Africa	76.4	79.6	81.7
CPI inflation rate (y-o-y, per cent)	Country	2024	2025(P)	2026(P)	Current account balance (per cent of GDP)	Country	2024	2025(P)	2026(P)
		4.4	5.3	4.3		Brazil	-2.8	-2.3	-2.2
	Russia	8.4	9.3	5.5		Russia	2.9	1.9	1.8
	India	4.6	4.2	4.1		India	-0.6	-0.9	-1.4
	China	0.2	0.0	0.6		China	2.3	1.9	1.7
	South Africa	4.4	3.8	4.5		South Africa	-0.6	-1.2	-1.4
General Government net lending/borrowing (per cent of GDP)	Country	2024	2025(P)	2026(P)	Forex reserves* (in US\$ billion)	Country	2023	2024	2025
		-6.6	-8.5	-7.7		Brazil	355.0	329.7	350.8
	Russia	-2.2	-1.0	-1.2		Russia	598.6	609.1	689.5
	India	-7.4	-6.9	-7.2		India	622.5	635.7	702.6
	China	-7.3	-8.6	-8.5		China	3449.7	3455.6	3602.1
	South Africa	-6.1	-6.6	-6.1		South Africa	62.5	65.5	69.2

P: Projection

*: Forex reserves for 2025 pertain to July for all countries except for Brazil and Russia (August 2025) and India (September 19).

Notes: 1. India's data correspond to fiscal year (April–March) except data on forex reserves which are as per calendar year.

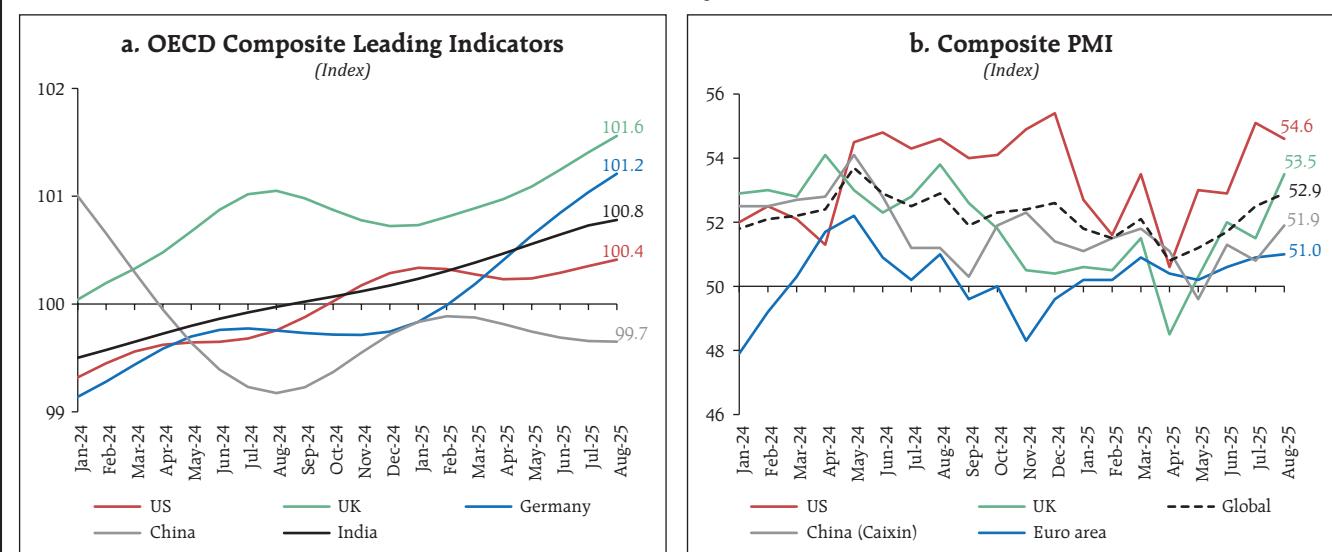
2. Projections for 2025 and 2026 are taken from the IMF WEO, July 2025 update.

Sources: Official statistical agencies; World Economic Outlook April 2025 database and July 2025 Update, IMF; International Reserve and Foreign Currency Liquidity (IRFCL), IMF; and RBI.

effect (Chart V.2a). The emerging market economies were the major drivers of growth in Q2 and Q3 (up to July 2025). The Freightos Baltic Global Index –

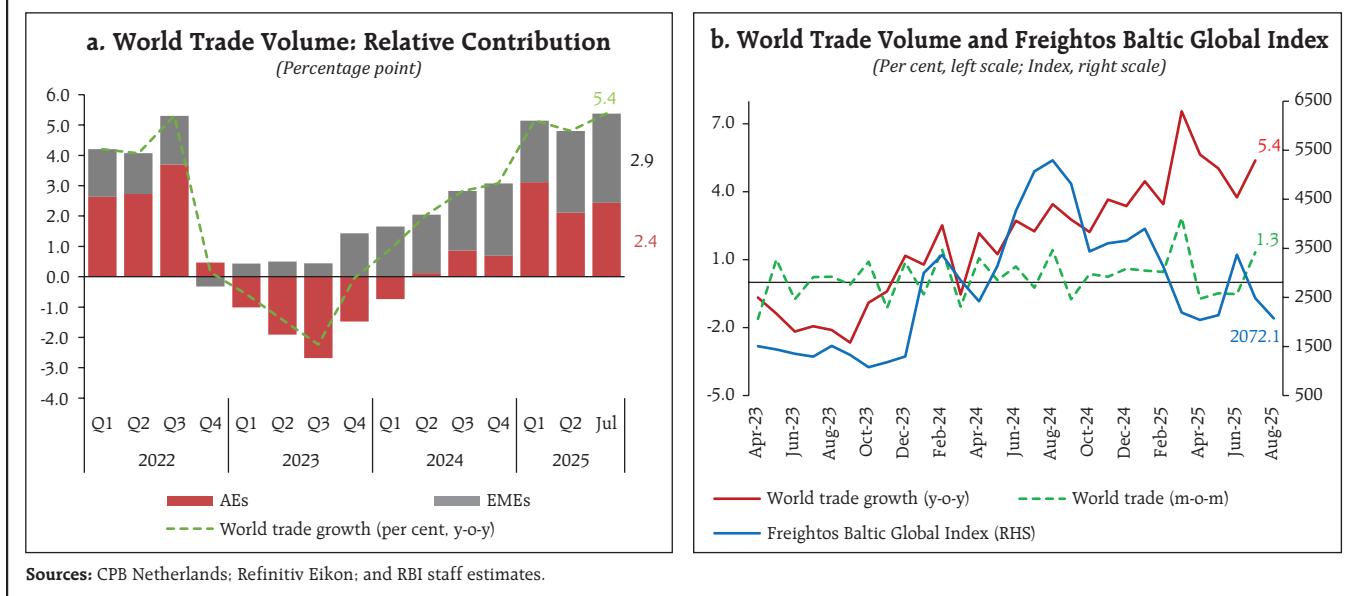
the global ocean freight container pricing index that measures 40-feet container prices – trended below the 2024 average during most of 2025 (Chart V.2b).

Chart V.1: Survey Indicators



Sources: Organisation for Economic Co-operation and Development (OECD); and Bloomberg.

Chart V.2: World Trade Volume



Sources: CPB Netherlands; Refinitiv Eikon; and RBI staff estimates.

The World Trade Organisation's latest Goods Trade Barometer for June 2025 indicates that strong trade volume growth witnessed before the implementation of higher US tariffs might slow down during the rest of 2025. In August 2025, the World Trade Organisation projected world merchandise trade to grow by 0.9 per cent in 2025, an improvement from the 0.2 per cent contraction estimated in April 2025, mainly reflecting front-loading of imports in the US. It, however, revised down the growth projection for 2026 to 1.8 per cent from the previous estimate of 2.5 per cent.

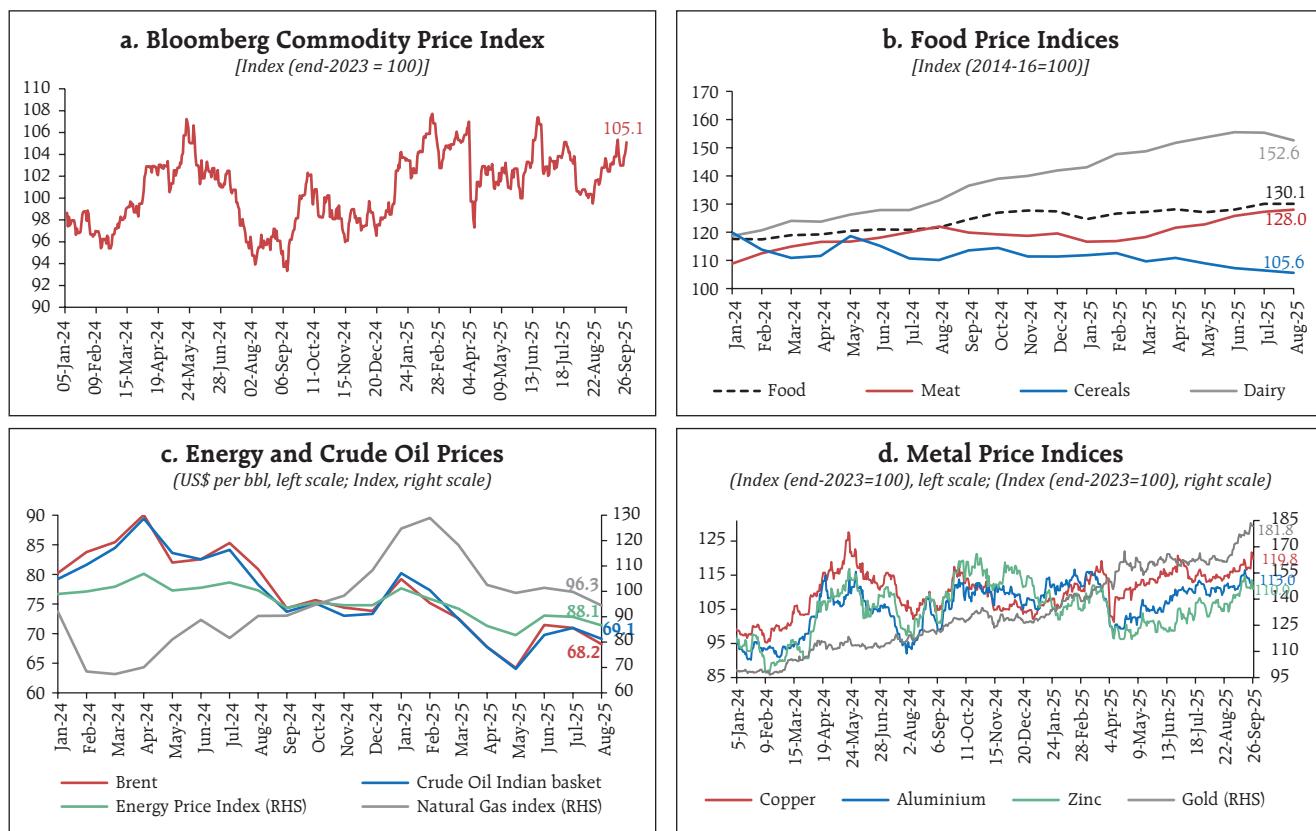
V.2 Commodity Prices and Inflation

Global commodity prices exhibited volatility in Q2, on account of geopolitical tensions and uncertainty surrounding US tariffs. As measured by the Bloomberg Commodity Price Index, commodity prices fell in April mainly due to a decline in energy and base metal prices reflecting a bleak demand outlook. The fall continued in May led by lower agricultural prices. In June, announcements of new US tariffs increased global uncertainty, engendering spike in

commodity prices, particularly in energy and metals. Prices softened in July as energy and industrial metal prices declined due to oversupply and weak demand. Commodity prices rose in August and September driven by precious metals on safe haven demand amid elevated uncertainty (Chart V.3a). According to the Food and Agriculture Organization, global food prices firmed up modestly in Q2, primarily due to rise in dairy and meat prices, partially offset by the fall in sugar and cereal prices. Food prices edged up in Q3 (up to August) as gains in meat and vegetable oil prices outweighed declines in cereals and sugar (Chart V.3b).

Crude oil prices have generally remained subdued since April 2025 on the OPEC+ decision to raise production. The OPEC+ reversed its previous strategy of production cuts, opting instead to phase out 2.2 million barrels per day of voluntary output reductions. Oil prices firmed up in June and July as geopolitical risks rose, driving up prices before the de-escalation of conflict between Iran and Israel led to a softening of prices in Q2. Oil prices remained range-bound in Q3

Chart V.3: Commodity Prices



amid ample supply and weak global growth outlook (Chart V.3c).

Metal prices exhibited a mixed trend in Q2, influenced by fluctuating demand-supply dynamics in China and global economic conditions, including US trade policies. Base metal prices remained subdued in Q3 due to weak demand from China. As per the World Gold Council data, the demand for gold surged to 1249 tonnes in Q2, a 3.0 per cent (y-o-y) rise, fuelled by strong investment demand – mainly into exchange traded funds (ETFs) – due to safe-haven demand amidst global uncertainties. Globally, central banks added 166 tonnes of gold to official reserves further boosting its demand. Gold prices remained elevated in Q3, surging to all time high in September (Chart V.3d).

Consumer Price Inflation

Global consumer price inflation continued to moderate gradually, though at an uneven pace. While disinflation slowed in AEs, it continued in EMEs with China facing deflation. Persistent tightness in labour markets kept underlying inflation elevated in many economies, though softening commodity prices contained the rise. Headline inflation remains above central bank targets in several countries as well as above their pre-pandemic levels. As per IMF's World Economic Outlook (July 2025 update), global headline inflation is projected at 4.2 per cent for 2025 and 3.6 per cent for 2026 (Table V.3). Accordingly, central banks in AEs remain focused on ensuring that inflation returns to target, while considering risks to output and employment. Many EMEs are

pursuing monetary easing to support growth amidst easing inflation pressures.

In the US, the disinflation process slowed as both headline and core inflation witnessed an uptick in Q2 and Q3 with elevated shelter costs. The headline CPI and core inflation (y-o-y) rose to 2.9 per cent and 3.1 per cent, respectively, in August up from 2.4 per cent and 2.8 per cent in March 2025, marking the highest levels since February. The recent uptick partly reflects the impact of tariffs and their pass-through to core components. Inflation, measured by the personal consumption expenditure (PCE) price index — the Federal Reserve's preferred inflation metric — also witnessed a similar uptick, rising from 2.4 per cent in March to 2.7 per cent in August (Chart V.4a). Core PCE inflation registered an increase from 2.7 per cent in March to 2.9 per cent in August (Chart V.4b).

In the UK, headline inflation rose to 3.8 per cent in August from 2.6 per cent in March 2025, reaching the highest level since January 2024 due to elevated services inflation. Core inflation also remained elevated.

In the Euro area, headline inflation marginally declined from 2.2 per cent in March to 2.0 per cent in August, aligning with the European Central Bank's target of 2.0 per cent. Inflation in the Euro area was driven by food and services, partially offset by weak energy prices. Core inflation (excluding energy, food, alcohol, and tobacco) remained steady at 2.3 per cent since May, after moderating from 2.7 per cent in April. In Japan, CPI inflation excluding fresh food — the Bank of Japan's preferred inflation metric — declined from 3.2 per cent in March to 2.7 per cent in August. Headline CPI inflation decelerated to 2.7 per cent in August from 3.6 per cent in March, primarily due to subdued electricity prices (Chart V.4b).

Inflation in EMEs has been broadly moderating since the April MPR. The risk of deflation is evident across several Asian economies, driven by a combination of subdued demand, sluggish wage growth and excess supply.

In Brazil, inflation moderated from 5.5 per cent in March to 5.1 per cent in August, driven by lower inflation in transport, and falling food prices, amidst high interest rates (Chart V.4c). Core inflation in Brazil, however, picked up from 4.9 per cent in March to 5.4 per cent during June-August (Chart V.4d). South

Table V.3: Consumer Price Inflation

(Y-o-y, Per cent)

Country	Inflation Target	Q3: 2024	Q4: 2024	Q1: 2025	Q2: 2025	Jul - 25	Aug - 25
Advanced Economies							
Canada	2.0 ± 1.0	2.0	1.9	2.3	1.8	1.7	1.9
Euro area	2.0	2.2	2.2	2.3	2.0	2.0	2.0
Japan	2.0	2.8	2.9	3.8	3.5	3.1	2.7
South Korea	2.0	2.1	1.6	2.1	2.1	2.1	1.7
United Kingdom	2.0	2.0	2.5	2.8	3.5	3.8	3.8
United States	CPI	-	2.6	2.7	2.5	2.7	2.9
	PCE	2.0	2.4	2.6	2.6	2.5	2.6
Emerging Market Economies							
Brazil	3.0 ± 1.5	4.4	4.8	5.0	5.4	5.2	5.1
Russia	4.0	8.9	9.0	10.1	9.8	8.8	8.1
India	4.0 ± 2.0	4.2	5.6	3.7	2.7	1.6	2.1
China	2.0	0.5	0.2	-0.1	0.0	0.0	-0.4
South Africa	3.0 - 6.0	4.3	2.9	3.0	2.9	3.5	3.3
Mexico	3.0 ± 1.0	5.0	4.5	3.7	4.2	3.5	3.6
Indonesia	2.5 ± 1.0	2.0	1.6	0.6	1.8	2.4	2.3
Philippines	3.0 ± 1.0	3.2	2.6	2.3	1.4	0.9	1.5
Thailand	1.0 - 3.0	0.6	1.0	1.1	-0.3	-0.7	-0.8
Turkey	5.0 ± 2.0	54.4	46.7	39.8	36.1	33.5	33.0

Memo:

	2023	2024	2025 (P)	2026 (P)
World consumer price inflation	6.6	5.6	4.2	3.6

P: Projection

Note: Inflation target for China is around 2.0 per cent for 2025

Sources: Central bank websites; IMF; and Bloomberg.

Africa saw a rise in headline inflation from 2.7 per cent to 3.3 per cent over the same period, whereas core inflation remained steady at around 3.0 per cent during March-August. In Russia, headline inflation moderated from 10.3 per cent in March to 8.1 per cent in August. Inflation, however, remains elevated and well above the target of 4.0 per cent.

China remained in deflation during February-May before registering a meagre price rise of 0.1 per cent in June and no change in the consumer price index in July. However, prices fell again by 0.4 per cent largely due to lower food prices. The core inflation broadly remained steady across EMEs.

Since the April 2025 MPR, the final phase of disinflation has been prolonged with a noticeable slowdown in disinflation process in major AEs. In

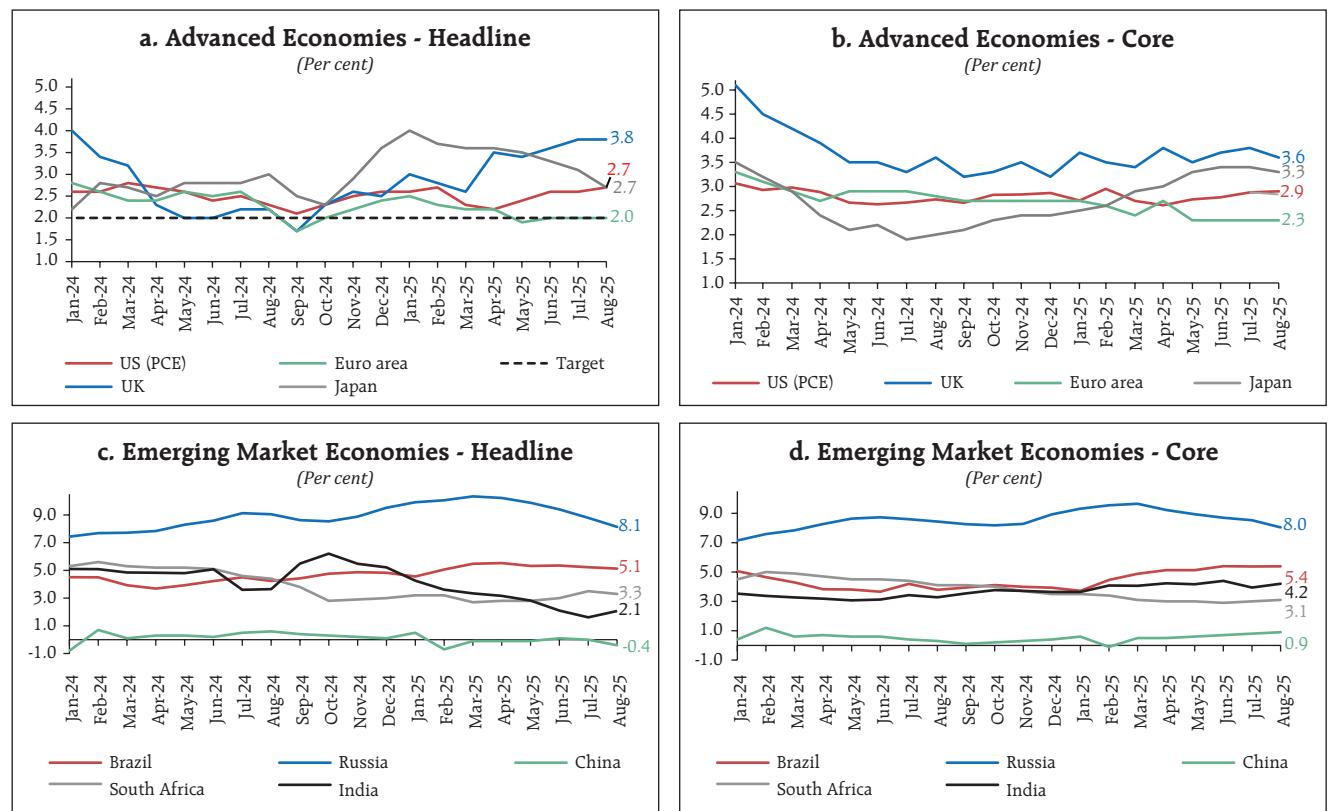
contrast, disinflation is continuing in EMEs (Chart V.5a & b).

V.3 Monetary Policy Stance

During Q2 and Q3, central banks adopted divergent monetary policy paths, driven by their domestic growth-inflation dynamics and other macroeconomic developments amidst rising global tariffs. Continued disinflation in some major EMEs and a soft US dollar has provided EMEs with space for monetary easing.

The Federal Reserve maintained a pause on its target range for the federal funds rate in all the meetings during January – July. In September, the Federal Open Market Committee lowered the range by 25 basis points (bps) to 4.00-4.25 per cent in view of rise in

Chart V.4: CPI Inflation (y-o-y) – Select Economies



Notes: 1. For India, core CPI, i.e., CPI excluding food and fuel is worked out by eliminating the groups 'food and beverages' and 'fuel and light' from the headline CPI.
2. Chart V.4b refers to CPI inflation in all items less fresh food and energy.

Sources: Official statistical agencies; Bloomberg; and RBI staff estimates.

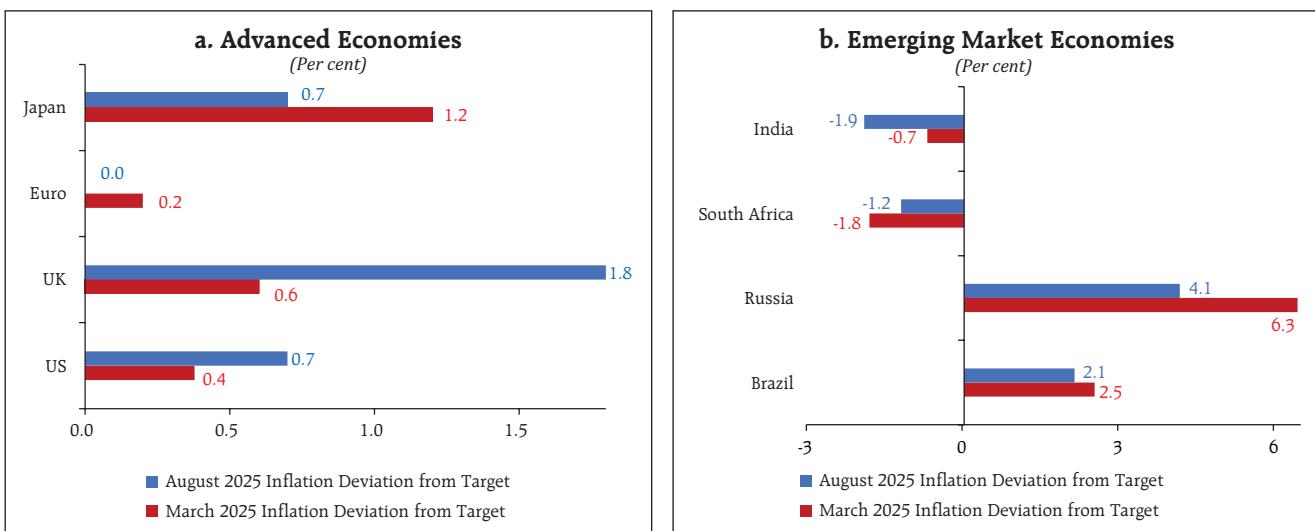
downside risks to employment. The Committee also stated that in considering additional adjustments to the target range for the federal funds rate, it would carefully assess incoming data, the evolving outlook, and the balance of risks. As per the summary of economic projections released in the September 2025, the Committee expected the target range for the federal funds rate to be at 3.50-3.75 per cent by the end of 2025, indicating two more rate cuts of 25 bps each. In September 2025, the Federal Reserve revised its monetary policy framework. The revised framework removed effective lower bound as a defining feature of the framework, returned to flexible inflation targeting by abandoning average inflation targeting and de-emphasised the 'shortfall' from the maximum employment.

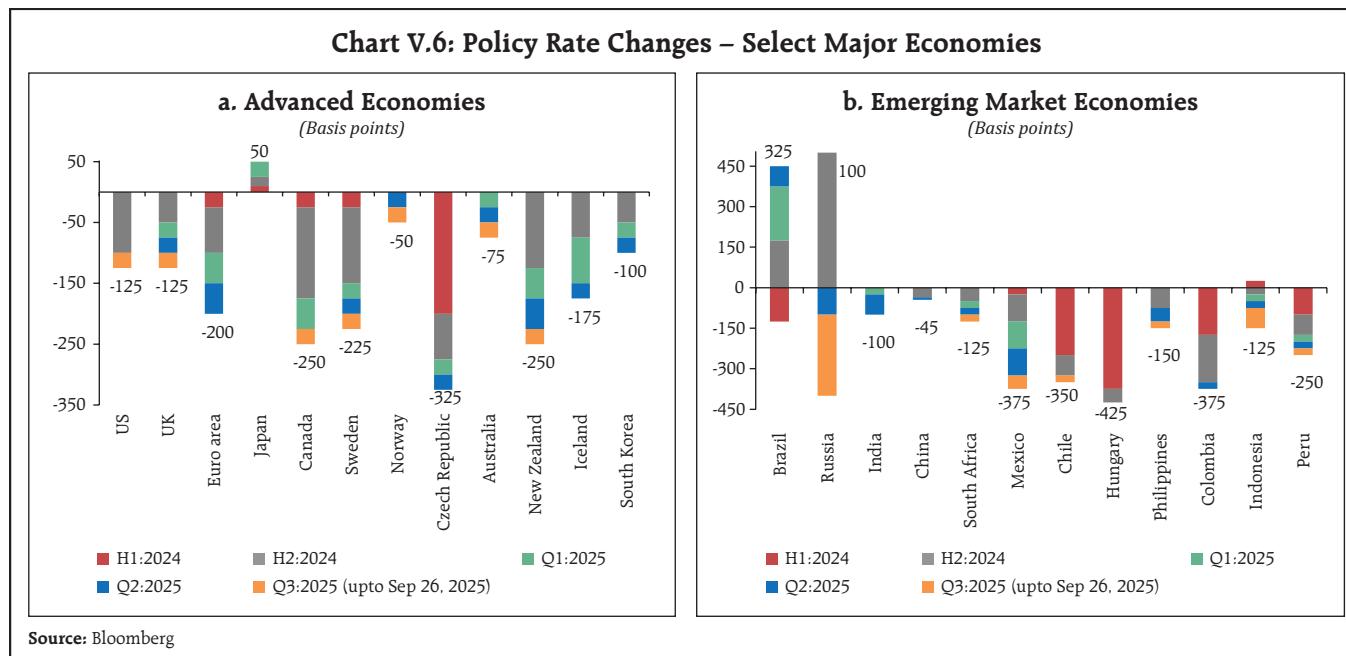
The Bank of England reduced its policy rate by 25 bps each in May and August 2025 to support economic activity amidst flagging growth in the second quarter and uncertainty surrounding the global trade order despite the successful conclusion of a trade deal with the US. The Bank of England, however, maintained status quo in September in view of renewed

inflationary pressures. The European Central Bank continued with the easing cycle, lowering its key rates by 25 bps each in April and June 2025 meetings. In Q3, the bank kept the rates unchanged. The Bank of Japan maintained *status quo* over the last five meetings, after hiking by 25 bps in January 2025 (Chart V.6a).

Among other AEs, Australia reduced its policy rate in May and August as inflation eased. Canada reduced its policy rate by 25 bps in September considering a weaker economy and less upside risk to inflation. New Zealand lowered its policy rate by 75 bps during April-August 2025 on benign inflation outlook. Norway undertook a cautious easing of monetary policy, cutting rate by 50 bps during 2025 as inflation evolved as projected and unemployment increased somewhat. South Korea and Switzerland each have delivered rate cut of 25 bps since April whereas Sweden reduced the benchmark rate by 50 bps during the same period. Israel has kept the policy rate unchanged since February 2024. Elevated uncertainty surrounding global trade negotiations has made central banks cautious, complicating decisions on rate cut. Futures and Overnight Index Swap (OIS) markets, however,

Chart V.5: Last Mile of Disinflation



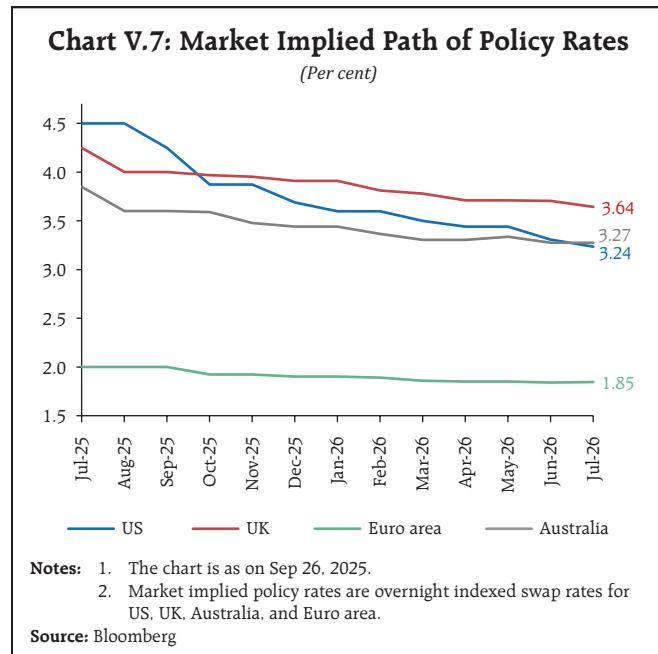


are pricing in lower policy rates in major AEs going forward (Chart V.7).

Monetary policy in EMEs remained broadly supportive of growth as inflation pressures eased, with Brazil being a notable exception. Among the BRICS, Brazil raised its policy rate by a total of 275 bps to 15.0 per cent during January – June 2025 before pausing in July and September, as inflationary pressures remained persistent. On the contrary, Russia has reduced interest rate cumulatively by 400 bps during 2025 so far. China reduced its loan prime rates by 10 bps in May but left them unchanged thereafter as the economy remained resilient, adopting a wait-and-watch approach. In this regard, China has preferred structural support over repeated rate cuts.³ South Africa reduced rates by 25 bps each in May and July amid concerns over weak growth and moderation of inflation expectations.

In Asia, Malaysia cut its policy rate by 25 bps in July – the first reduction in five years – citing trade uncertainty, as the economy remained resilient

with subdued inflation. It, however, kept the policy rate unchanged at 2.75 per cent in its September meeting. Indonesia eased rates by 100 bps during May-September to support growth and stabilize its currency amid declining inflation. The Philippines



³ The Chinese authorities intensified policy support through targeted fiscal measures to bolster consumers spending.

lowered rates in April, June and August as inflation fell to a multi-year low. Thailand cut the interest rate in April and August by 25 bps each to combat deflation. In Latin America, monetary policy was broadly accommodative with Mexico leading rate cuts among its peers. Many Latin American central banks have been frontrunning the Fed, as a softer US dollar provided additional policy space to support growth. Mexico extended its easing cycle with a 150 bps rate cut between May and September. Colombia maintained a pause after a 25 bps rate cut in April. Chile cut its rate by 25 bps in July amid global trade policy uncertainty, marking the first cut in 2025. Peru cut the policy rate by 25 bps in May and September each. Among the key European EMEs, Hungary kept rates unchanged through 2025, whereas Poland eased intermittently, by cutting its policy rate by a total of 100 bps in 2025 so far (Chart V.6b).

V.4 Global Financial Markets

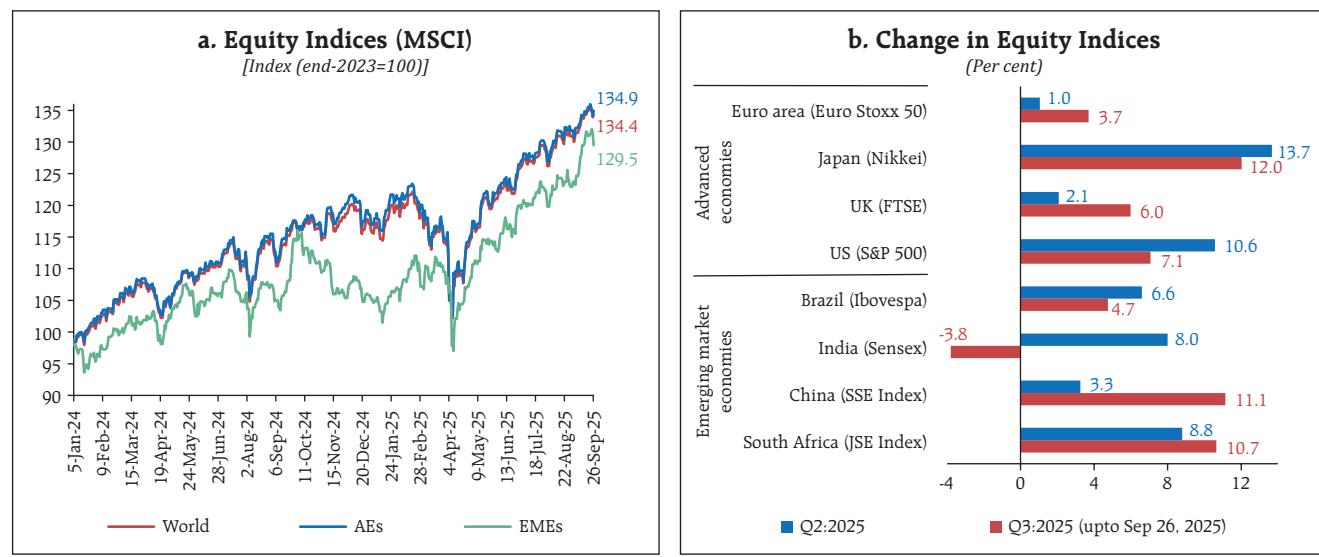
Notwithstanding divergent trends in the real economy, financial markets remain buoyant across countries with bouts of volatility amidst uncertainty around trade policy, the Federal Reserve's rate decisions and geopolitical tensions. After a sharp fall in April, global financial markets rebounded strongly through Q2 and Q3, driven by a reassessment of tariff risks to be less severe than initially anticipated. Equity markets surged to record highs in many economies, supported by optimism surrounding de-escalation of the tariff war and an easing of geopolitical tensions. Enthusiasm over artificial intelligence drove strong gains in technology stocks. Government bond yields in many AEs rose, reflecting rising concerns about the debt sustainability. Tariff-induced inflation pressures also kept monetary policy restrictive, exerting additional upward pressure on yields. In contrast, yields softened in many EMEs, as investors rebalanced portfolios away from traditional safe-haven assets towards higher-yielding EME securities.

The US dollar depreciated sharply since April, on fiscal sustainability worries, trade policy uncertainty, and concerns over autonomy of institutions, while most EME currencies strengthened.

Global equity markets fell sharply in April after the announcement of reciprocal tariffs by the US. Markets rebounded subsequently as the implementation of tariffs was postponed and bilateral trade deals were signed. As measured by the MSCI World Index, equity markets gained by 18.1 per cent during April - September 2025, reflecting gains in both AEs and EMEs (Chart V.8a). Among AEs, S&P 500 in the US exhibited heightened volatility in April due to higher policy uncertainty (Chart V.9b). The subsequent easing of trade tensions, however, spurred a sharp rebound in equity markets. The upward trajectory continued in rest of Q2, supported by the US-China trade deal amid intermittent bout of volatility stemming from the Israel-Iran conflict. Later, increased bets on rate cuts by the Fed (Chart V.9a) and strong performance by technology companies further drove the index to record levels in August and September. Valuations in equity markets, however, remain stretched. Overall, the S&P 500 Index rose by 18.4 per cent from April to September.

European stocks began Q2 on a tumultuous note as announcements of steep tariffs led to selling pressures. They ended the quarter on a subdued note as lingering trade uncertainty and a strong euro triggered risk-off sentiment. In Q3, European stock markets performed better than in Q2, boosted by the trade deal towards end-July and a steady inflation print. European equities, however, remained underwhelming compared to its peers due to weak second-quarter corporate earnings and downgrading of France's sovereign credit score by Fitch amid political uncertainty (Chart V.8b). The UK's stock indices performed better than European markets, supported by its improving economy and the Bank

Chart V.8: Equity Markets

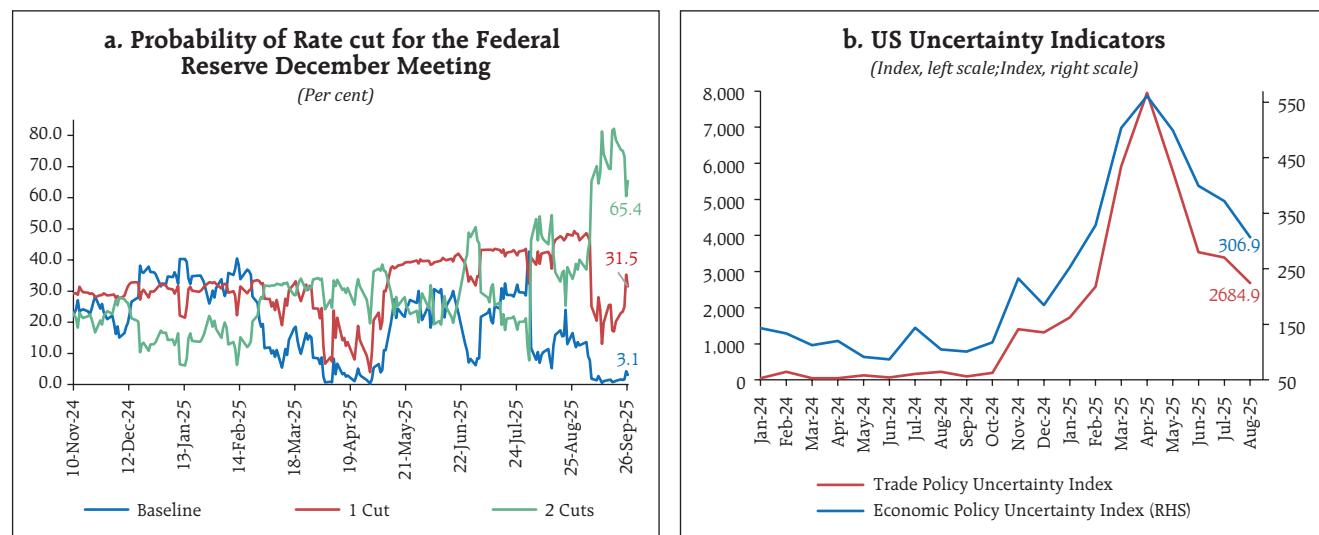


of England's rate cuts. It helped the Financial Times Stock Exchange reach record levels. It scaled new heights in Q3 as global investors diversified their portfolios. Japanese markets outperformed other AEs in both quarters, buoyed by the US–Japan trade deal, a weakening yen, and strong corporate earnings.

Among EMEs, China's equity market underperformed

its peers in Q2 as trade deal uncertainty made investors cautious. Following the interim agreement, however, Chinese stocks outperformed in Q3, supported by various government stimulus measures and growth in tech stocks. Brazil's equity market gained during April–September with occasional pullbacks driven by shifting global sentiment, political uncertainty ahead of the 2026 elections, and soft commodity

Chart V.9: Sources of Uncertainty: Monetary and Economic Policy



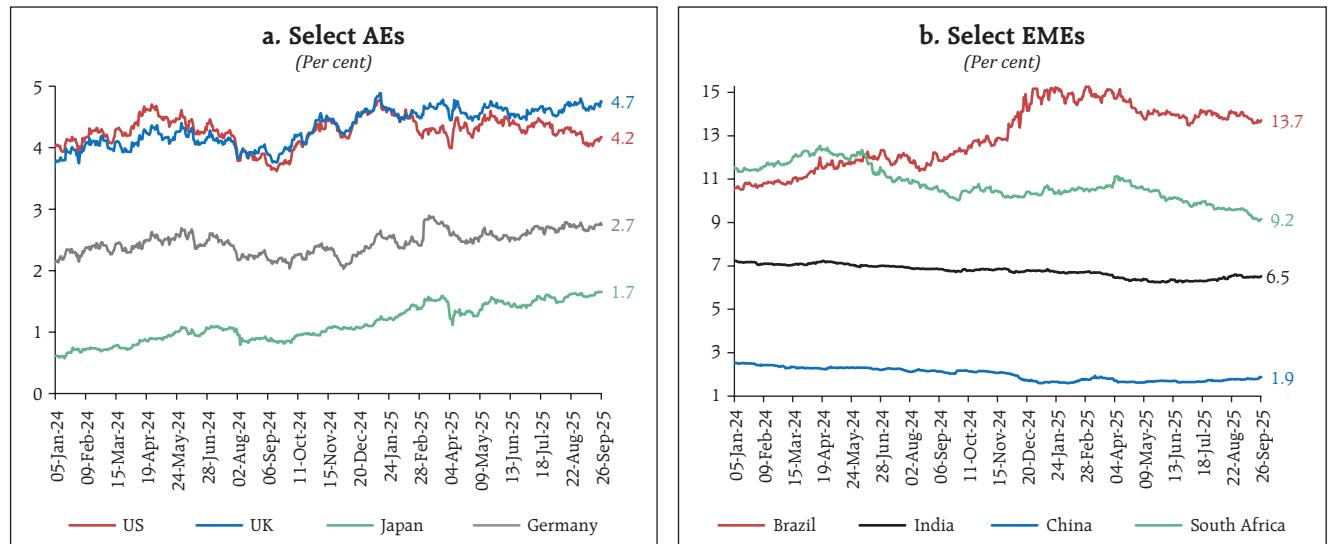
prices. Equity market in India rallied in Q2; however, the imposition of a 50 per cent US tariff damped investor sentiment, leading to a 3.8 per cent decline in India's equity index (BSE Sensex) in Q3 despite rating upgrade by S&P Global in August.

Sovereign bond yields across major AEs largely declined in Q2, reflecting continued monetary policy easing. In the UK, 10-year yields fell as the government moved toward shorter-term borrowing amidst slowing growth. Japanese bond yields also declined, as government bond issuance was expected to be trimmed and the Bank of Japan signalled a more cautious approach to interest rate hikes considering tariff risks. In contrast, US Treasury yields firmed up due to the introduction of the 'One Big Beautiful Bill' which raised concerns about fiscal sustainability and fears of increased bond supply (Chart V.10a). In the US, yields, particularly the 30-year, spiked after the passing of the bill by the Congress and an upward revision of inflation projections by the FOMC in June. Yields, however, eased through most of Q3 on rising expectations of rate cuts, driven by weak employment data. They

hardened toward the end of September following a significant upward revision to GDP numbers and tracking changes in rate cut expectations. UK yields hardened in Q3 on fiscal concerns ahead of the autumn budget, diminishing rate-cut expectations, and renewed inflationary pressures. The German 10-year bund yields also firmed up as spending on defence and infrastructure was expected to rise, while the US-EU trade deal reduced demand for bonds as a safe-haven asset. The Japanese government bond yields rose in Q3 amidst political uncertainty and elevated inflation. The Bank of Japan's gradual reduction in bond purchases also exerted hardening pressure on yields.

In contrast, 10-year sovereign bond yields in many EMEs largely eased since the last MPR, as investors diversified away from traditional safe-haven assets due to policy uncertainty triggered by the US tariffs. At the same time, several EME central banks supported growth by reducing policy rates. In China, however, government stimulus measures and ongoing trade negotiations fueled risk-on sentiment. As a result, investors shifted to equity from bonds, leading to rise

Chart V.10: 10-Year Sovereign Bond Yields



Source: Bloomberg.

in yields (Chart V.10b). Globally, US treasury yields exert sizeable and statistically significant spillover

effects on EME yields, particularly in medium and long-term maturities (Box V.1).

Box V.1: Pass-through of US Treasury Yields to Emerging Market Bond Yields

The pass-through of US financial conditions to emerging market economies (EMEs) is a major conduit of global financial spillovers, with movements in US Treasury yields playing a pivotal role. In fact, US monetary policy significantly shapes international bond markets (Albagli *et al.*, 2018), and decline in long-term US yields boost foreign ownership of EME debt (Moore *et al.*, 2013). Moreover, US treasury yields are also found to have large effects on AEs' government bond yields (Avalos *et al.*, 2025). Yield movements in EMEs are suggestive of spillover impact from US Treasury yields (Chart V.1.1).

To assess the pass-through of US yields to the short-term (3-month), medium-term (2-year), and long-term (10-year and 30-year) maturities of EMEs, a dynamic panel GMM (Ogaki, 1999) is estimated based on

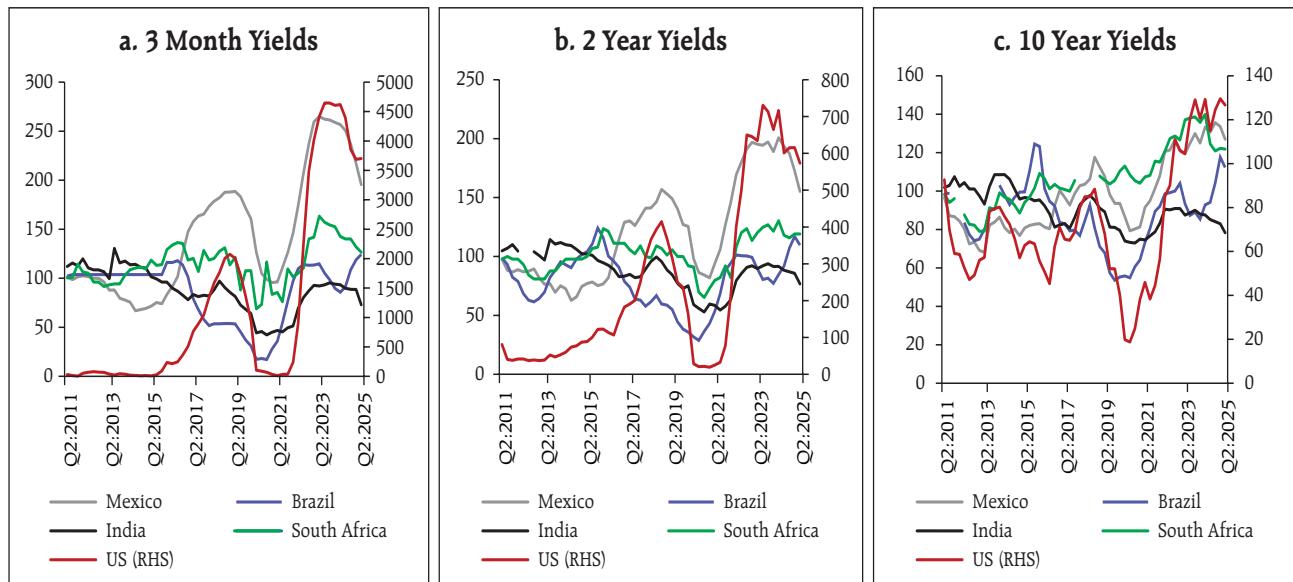
quarterly data spanning Q1:2011 to Q2:2025⁴, with the following specification

$$Y_{it} = \alpha + \beta_1 r_{it} + \beta_2 CPI_{it} + \beta_3 FB_{it} + \beta_4 US_t + \beta_5 Ex_{it} + \delta_i + \varepsilon_{it}$$

Y_{it} : EME bond yields, r_{it} : central bank policy rate, CPI_{it} : consumer price inflation (year-on-year), FB_{it} : fiscal balance to GDP ratio, US_t : US bond yields, Ex_{it} : change in exchange rate (year-on-year) δ_i : country fixed effect, i indexes country, t indexes time, ε_{it} : idiosyncratic error term.

The impact of domestic macroeconomic indicators is on expected lines. US treasury yields have the strongest spillover impact on 10-year tenor, with noticeable effects on the 2-year and 30-year maturities; however, the impact on 3-month yields is negligible.

Chart V.1.1: Emerging Markets Yields Movements
Index



(Contd.)

⁴ The EMEs country list here includes Brazil, Colombia, India, Mexico, the Philippines, Poland, Russia, South Africa, and Thailand. For the 30-year tenor, the sample spans Q4:2015 to Q2:2025 for eight countries (excluding Poland), while a 15-year tenor is used for Colombia due to data limitations.

System GMM Results – EMEs Government Bond Yields

Variable	3M Yield	2Y Yield	10Y Yield	30Y Yield
Policy rate	0.943***	0.196***	0.115***	0.069***
CPI	-0.082	0.168***	0.108***	0.048
Fiscal balance to GDP	0.029	-0.036*	-0.048***	-0.060**
US yield	0.610	0.407***	0.534***	0.381**
Exchange Rate	0.009	-0.004**	-0.010***	0.001
Constant	0.005	-0.016	-0.028	0.007

- Notes:**
1. $p < 0.01 = ***$, $p < 0.05 = **$, $p < 0.1 = *$
 2. Presumed exogenous variables are the policy rate and fiscal balance. The model specification is consistent with the Hansen J-test of instrument validity.
 3. A positive fiscal balance means fiscal surplus and negative balance means fiscal deficit. Similarly, a positive change in exchange rate means appreciation and negative change means depreciation.

This maturity-specific impact indicates that while domestic factors anchor short-term rates, US yields exert greater influence on term premia and long-term yields that can reduce the diversification benefits for international investors. Overall, the findings

underscore the sensitivity of EME debt markets to US financial conditions.

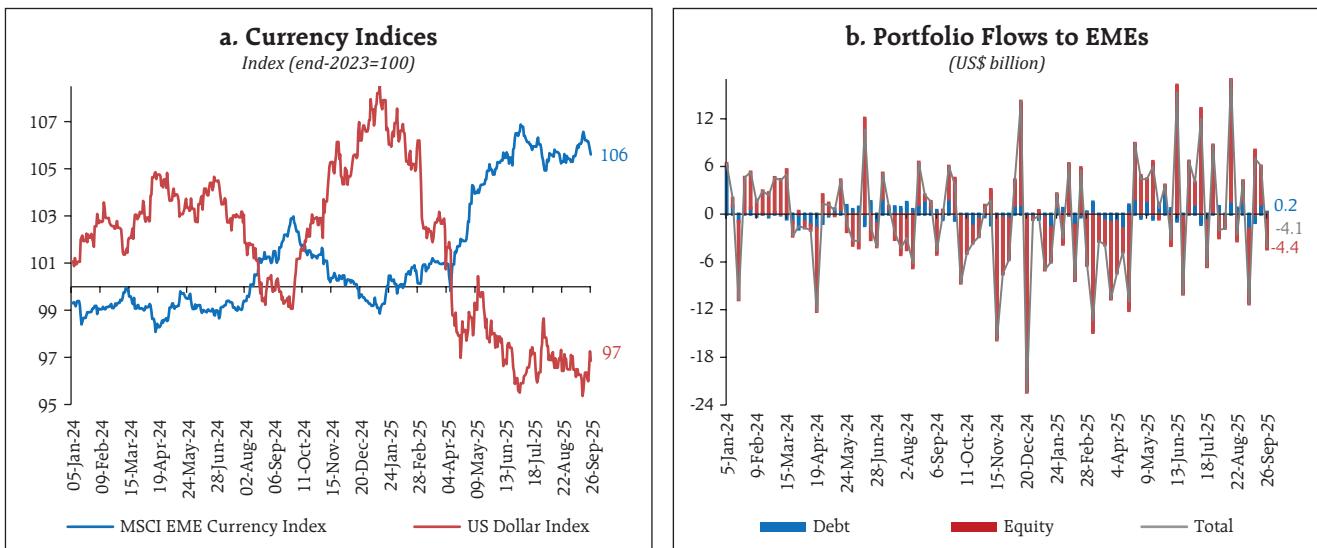
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In the currency market, the US dollar remained subdued, while emerging market currencies gained as investors diversified towards emerging market assets (Chart V.11a). The US dollar rebounded in the

first half of May after depreciating in April, supported by the US–China interim trade deal and strong employment data. In the latter half of Q2, however, the dollar depreciated significantly as investors grew

Chart V.11: Currency Movements and Capital Flows



wary of its safe-haven appeal amidst rising public debt concerns. In July, the dollar appreciated on optimism surrounding multiple trade agreements and the de-escalation of conflict between Iran and Israel, easing fears of potential US involvement. The dollar remained volatile in Q3, with changing investor sentiment amid incoming data releases. In 2025 so far, the US dollar has fallen by 9.5 per cent, as unpredictable policy decisions unsettled investors. These movements were mirrored in EME currencies, exacerbated by swings in capital flows (Chart V.11b). The MSCI emerging market currency index rose by 5.3 per cent in Q2; however, Q3 saw a reversal due

to local developments, including political instability in Indonesia, renewed tariff risks in Latin America, India and weak Chinese economic data.

V.5 Conclusion

The global macroeconomic environment remains fraught with considerable risks. The rise in tariffs has heightened the risk of supply chain disruptions that could impede the ongoing disinflation process and constrain the space for monetary policy easing. For emerging market economies, the external environment poses several challenges including weak global growth, high tariffs, heightened uncertainty, volatile capital flows, and geopolitical tensions.



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