

India

RBI remains vigilant of external risks

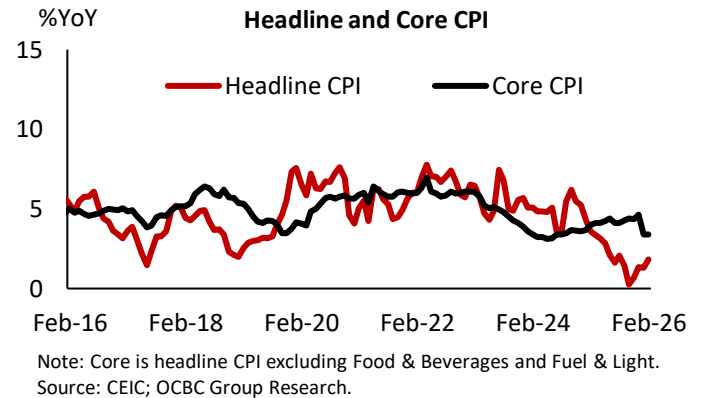
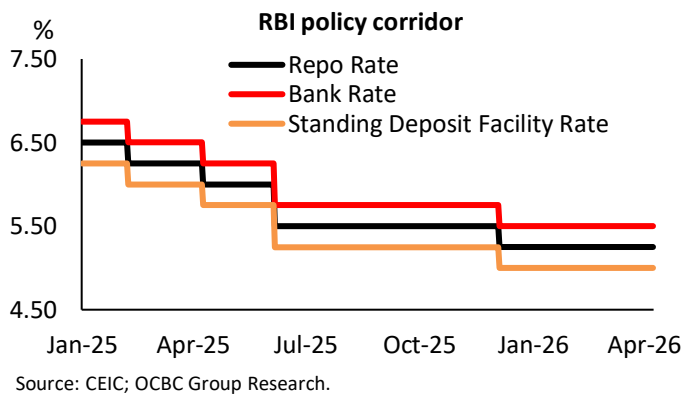
- The Reserve Bank of India (RBI) kept its policy rate unchanged at 5.25%, line with expectations.
- RBI struck a cautious note stating that the West Asia conflict had adversely impacted the growth-inflation outlook. RBI noted upside risks to its inflation forecast and downside risks to its GDP growth forecast for FY27 (i.e. year ending March 2027).
- Our baseline view remains for the RBI to keep its policy rate unchanged at 5.25% through FY27.

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Senior ASEAN Economist

The Reserve Bank of India (RBI) kept its policy rate unchanged at 5.25%, in line with consensus and our expectations. The decision was unanimous with all six members of the monetary policy committee voting for the outcome. RBI maintained its neutral policy stance.

Downside risks to growth and upside risks to inflation

Governor Sanjay Malhotra’s statement focused on the risks emanating from the crisis in West Asia even as he highlighted stronger macroeconomic fundamentals and better external buffers. RBI’s GDP growth forecast for FY27 (i.e. year ending March 2027) is projected to be 6.9% versus 7.6% in FY26. The statement, however, added that “further escalation of the conflict, its continuation over a wider geographical spread and uncertainty regarding the damage to the energy infrastructure, apart from weather related events, pose downside risks to the domestic growth outlook.” Our FY27 GDP growth forecast remains at 6.4%. Meanwhile, headline CPI is projected at 4.6% with the balance of risks skewed to the upside. Similarly, the risk to our FY27 headline CPI forecast of 4% is skewed to the upside. RBI introduced its core inflation forecast at 4.4% in FY27, highlighting its expectation for underlying inflationary pressures to remain contained.

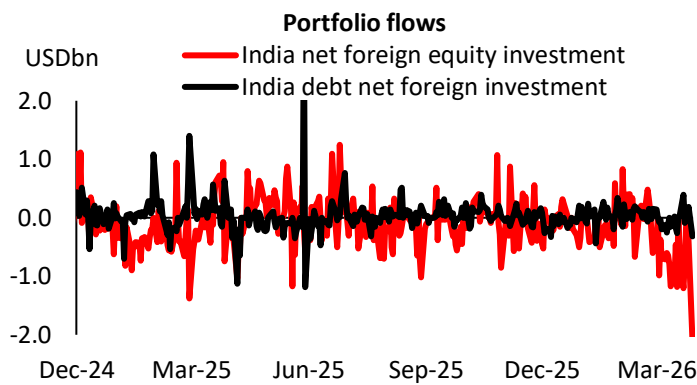


Channels of assessment of the geopolitical shock

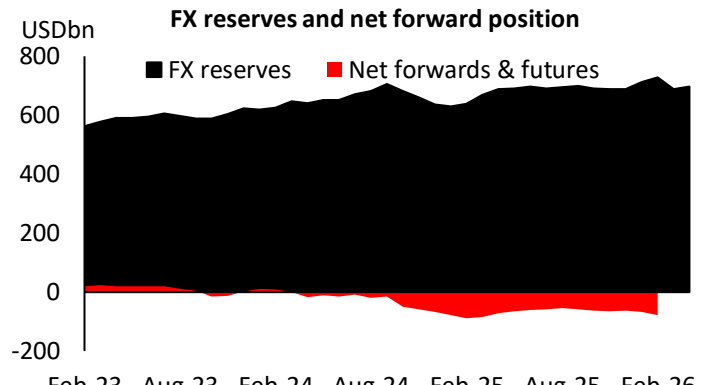
RBI’s assessment on the channels of transmission from the West Asia conflict include first, elevated crude oil prices raising imported inflation and widening the current account deficit; second, disruptions in energy markets, fertilizers and other commodities adversely affecting industries, agriculture and services and reducing domestic output; third, heightened uncertainty, increased risk aversion and safe haven demand impacting domestic liquidity conditions, economic activity, consumption and investment; fourth, weaker global growth prospects dampening external demand and reducing remittance flows; fifth, adverse spillovers from global financial markets tightening domestic financial conditions and raising the cost of borrowing. RBI noted that the impact of the last channel has been noticeable over the past month. Importantly, RBI assessed that this supply shock could transform into a demand shock over the medium-term if the restoration of supply chains is delayed.

On the external demand, RBI noted that global trade is expected to slow due to lingering tariff related uncertainties, ongoing West Asia conflict, and elevated energy prices. However, robustness in services exports and inbound remittances inflows should keep the current account deficit within sustainable levels in FY26. Rising global uncertainties and higher prices of energy commodities pose some widening risk to the current account deficit
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in FY27. On external financing, FDI inflows were reportedly strong for FY26 with the economy remaining attractive for greenfield investments. On the portfolio front, net equity outflows remained large at USD16.5bn in FY26, with year-to-date outflows of more than USD5bn (as of 6 April). Notwithstanding, India’s FX reserves stood at USD697.1bn, meeting standard metrics of adequacy (for example, 11 months of import cover).



Source: Bloomberg; OCBC Group Research.



Source: CEIC; OCBC Group Research.

Watching the currency

The Governor noted that intervention in the foreign exchange market is “aimed at smoothing excessive and disruptive volatility without targeting any specific level or band or price for the exchange rate”. This is consistent with RBI’s “longstanding policy of exchange rates being market determined” and RBI will “judiciously continue to contain excessive or disruptive volatility to ensure that self-fulfilling expectations do not exacerbate currency movements beyond what is warranted by fundamentals.” System liquidity stood at an average surplus of INR2.3lakh crore since the previous MPC meeting. We do not rule out further measures to shore up capital flows in order to better support the current account deficit. However, the timing of RBI’s meeting proved fortuitous with the temporary US-Iran ceasefire allowing for some lift in global market sentiment, with USD/INR trading last seen at 92.59.

The RBI noted that “in this environment, monetary policy faces a difficult trade-off – anchoring inflation expectations through policy tightening while minimising its impact on growth forgone.” The governor noted that the central bank will “remain vigilant of the evolving situation”.

Our baseline view remains for the RBI to keep its policy rate unchanged at 5.25% through FY27. A return of external risks associated with geopolitics, and/or heightened trade related headwinds could open the door for further monetary policy recalibration.

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