SBI RESEARCH
ECOWRAP

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# A PURPOSEFUL POLICY!

**In line with market expectations, MPC has decided unanimously to reduce the repo rate by 25 basis points to 6.0%**. MPC also decided **to change the stance from neutral to accommodative**. RBI has **slashed its inflation projection for FY26 by 20 bps** to 4.0%. Further analysis of inflationary expectations shows that, RBI's stance may be adaptive to inflation sentiment, reflecting a pre-emptive approach to macroeconomic management. Given the exacerbated uncertainties due to recent trade tariffs, **RBI has reduced its real GDP growth projection for FY26 by 20 bps to 6.5%**.

The outlook for inflation will be largely shaped by food inflation trajectory (substantial and broad-based seasonal correction in vegetable price and robust kharif arrivals) and fall in crude oil prices. Buoyancy in the rural economy, resilient services sector, governments' efforts to spur household demand through tax incentives and healthy balance sheets of financial entities and corporates along with the easing of financing conditions are expected to give an impetus to growth.

**With 50 bps cumulative reduction in policy rates since Feb'25, transmission is expected in coming quarters**. Following RBI's 25 bps cut in repo rate in Feb'2025, PSBs reduced deposits rate by 6 bps, and FBs reduced 15 bps, while private banks increased rate by 2 bps. The analysis of WALR on fresh loans versus the repo rate reveals that WALR for PSB, PBs and SCBs closely follow the adjustments in the policy rate implying an effective and timely transmission mechanism.

On the regulatory and development policy front, **RBI has decided to widen the option for managing stressed assets**. It is proposed that a new market-based framework for securitization of stressed assets will be created, in addition to the existing ARC route under SARFAESI Act, 2002. This will give more flexibility on managing NPA.

Current guidelines on co-lending are applicable only to arrangements between banks and NBFCs for priority sector loans. Although co-lending is win-win situation for all parties the current model is still under examination. **The expansion of co-lending to all regulated entities** is welcome move but exact details are needed to gauge the impact and the scope of this new arrangement.

With **the recent spurt in gold loan portfolio coupled with increase in the gold prices and volatility, regulatory intervention on account of fear of loan to value limit breaches is natural.** Different set of lenders, regulated and unregulated, presently follow different loan matrix on Loan to Value (LTV), interest rate, distribution channels etc. **RBI will revisit and issue comprehensive regulations, on prudential norms and conduct related aspects, for gold loans**.

The proposed review to **harmonize and consolidate guidelines covering non-fund based facilities across all REs includes review of instructions on issuance of partial credit enhancement** (PCE), with a view to, inter alia, broadening funding sources for infrastructure financing is an welcome move and could facilitate infrastructure financing. **This announcement follows the announcement on similar lines in the Union Budget.** Present regulations for issuance of partial credit enhancement required capital for 100% of the bond amount even though PCE can be provided to only 20% of the bond. The PCE providing institution also has to provide a higher proportion of risk weightage for these instruments. RBI move could potentially be to revisit the capital requirements and to increase the exposure limits for PCE to make the instrument more market fit and also facilitate in deepening the bond market.

RBI permitted NPCI to upwardly revise transaction limits in UPI for person-to-merchant payments (P2M) based on evolving user needs. However, P2P transactions on UPI, however, will continue to be capped at ₹1 lakh, as hitherto. This will boost UPI payments in large value transactions like tax payments etc.

**In all, the evolving situation globally warranted policy agility to address the emerging challenges. Today policy has scored on this count and accommodation at this stage does pave way for more aggressive policy response if required during FY26. Development and regulatory policies appear routine but tied to emerging situation will ensure financial stability.**

## REPO RATE CUT BY 25 BPS TO 6.0%; CHANGE OF STANCE FROM NEUTRAL TO ACCOMMODATIVE

- As expected, MPC has decided unanimously to reduce the repo rate by 25 basis points to 6.0%. MPC also decided to change the stance from neutral to accommodative.
- RBI has slashed its inflation projection for FY26 by 20 bps to 4.0% with Q1 at 3.6% (earlier: 4.5%); Q2 at 3.9% (4.0%); Q3 at 3.8%; and Q4 at 4.4% (4.2%). The outlook for inflation will be largely shaped by food inflation trajectory (substantial and broad-based seasonal correction in vegetable price and robust kharif arrivals ) and fall in crude oil prices. The hike in trade tariffs by the US may also lead to low domestic inflation on back of possible dumping.
- Given the exacerbated uncertainties due to recent trade tariffs, RBI has reduced its real GDP growth projection for FY26 by 20 bps to 6.5% with Q1 at 6.5%; Q2 at 6.7%; and Q3 at 6.6% and Q4 at 6.3%.
- On the positive side, buoyancy in the rural economy, resilient services sector, governments' efforts to spur household demand through tax incentives and healthy balance sheets of financial entities and corporates along with the easing of financing conditions are expected to give an impetus to growth. While, continued geopolitical uncertainties, global trade disruptions, weather-related disturbances amidst high volatility in the global financial markets may pose downside risks to the outlook.
- While reciprocal tariff by the US will adversely impact India's net external demand, India's relative tariff advantage over its peer economies may contain the impact in the range of 40-50 bps of GDP.

## DEVELOPMENT AND REGULATORY MEASURES

- **Securitisation of Stressed Assets Framework**: The securitization volumes soared 80% year-on-year December 2024, as per rating agencies. It is expected that total securitization volumes will reach Rs 2.4 lakh crore. Given the possible increase in slippages RBI has decided to widen the option for managing stressed assets. It is proposed that a new market-based framework for securitisation of stressed assets will be created, in addition to the existing ARC route under SARFAESI Act, 2002. This will give more flexibility on managing NPA and will also lead better realization of haircut values etc.
- **Framework on Co-lending arrangements**: Current guidelines on co-lending are applicable only to arrangements between banks and NBFCs for priority sector loans. Although co-lending is win-win situation for all parties the current model is still under examination. The expansion of co-lending to all regulated entities is welcome move but exact details are needed to gauge the impact and the scope of this new arrangement.

**RBI Growth & Inflation Outlook for India**

| CPI Inflation (%) | Q4 FY25 | FY25 | Q1 FY26 | Q2 FY26 | Q3 FY26 | Q4 FY26 | FY26 |
|---|---|---|---|---|---|---|---|
| Apr'25 | 3.8* | 4.6* | 3.6 | 3.9 | 3.8 | 4.4 | 4.0 |
| Feb'25 | 4.4 | 4.8 | 4.5 | 4.0 | 3.8 | 4.2 | 4.2 |
| Dec'24 | 4.5 | 4.8 | 4.6 | 4.0 | - | - | - |
| **Real GDP Growth (%)** | **Q4 FY25** | **FY25** | **Q1 FY26** | **Q2 FY26** | | | |
| Apr'25 | 6.8-7.0* | 6.5 (NSO) | 6.5 | 6.7 | 6.6 | 6.3 | 6.5 |
| Feb'25 | 6.8* | 6.4 (NSO) | 6.7 | 7.0 | 6.5 | 6.5 | 6.7 |
| Dec'24 | 7.2 | 6.6 | 6.9 | 7.3 | - | - | |

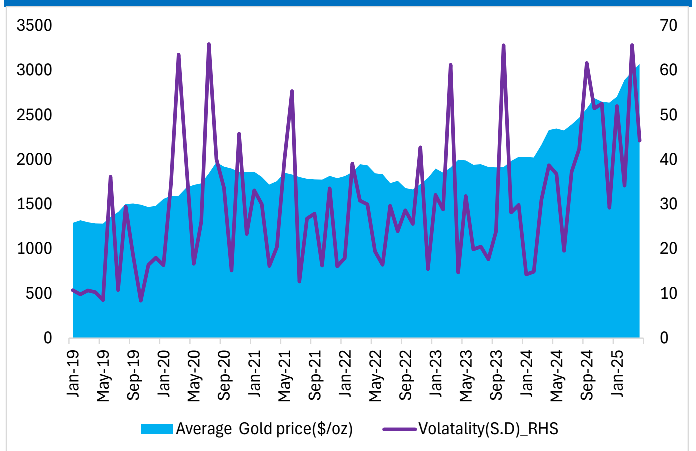
Source: RBI, SBI Research;*estimated from fan chart

- **Review of Non-Fund Based Facilities**: The proposed review to harmonize and consolidate guidelines covering these facilities across all REs includes review of instructions on issuance of partial credit enhancement, with a view to, inter alia, broadening funding sources for infrastructure financing is an welcome move and could facilitate infrastructure financing.
- Present regulations for issuance of Partial Credit Guarantee (PCE) required capital for 100% of the bond amount even though PCE can be provided to only 20% of the bond. The PCE providing institution also has to provide a higher proportion of risk weightage for these instruments.
- Recent budget announcements proposed NaBFID to set up a 'Partial Credit Enhancement Facility' for corporate bonds for infrastructure. A PCE provided by Bank or NaBFID like development finance institution (DFI) will help the entity or infrastructure owning special purpose vehicle (SPV) to get better rating and pricing.
- RBI move could potentially be to revisit the capital requirements and to increase the exposure limits for PCE to make the instrument more market fit and also facilitate in deepening the bond market.
- **Enhancing transaction limits in UPI:** RBI permitted NPCI to upwardly revise transaction limits in UPI for person-to-merchant payments (P2M) based on evolving user needs. However, P2P transactions on UPI, however, will continue to be capped at ₹1 lakh, as hitherto. This will boost UPI payments in large value transactions like tax payments etc. This will enhance efficiency of UPI and will ease customer payments. However, banks shall continue to have the discretion to decide their own internal limits within the limits announced by NPCI.

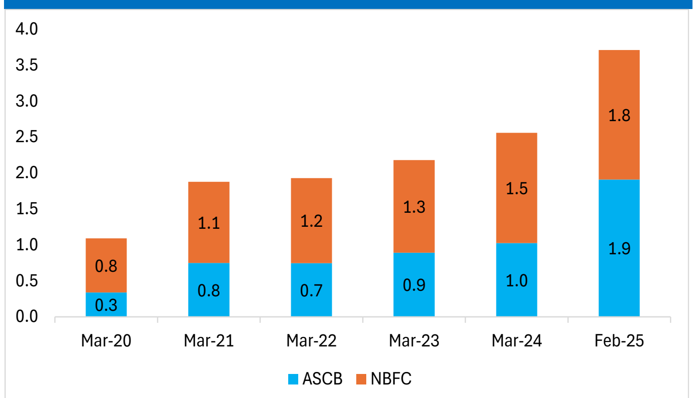
- **Review of Guidelines for Lending against Gold Jewellery**: The gold lending is a source for financing consumption and investment. Off late, gold loan portfolio of banks increased to Rs 1.9 lakh crore from Rs 0.9 lakh crore as of March'23. In NBFC also the same is increased to Rs 1.8 lakh crore from Rs 1.3 lakh crore during the same period.
- The gold loan industry has witnessed a significant transformation, with the co-lending model emerging as an innovative approach, combining the strengths of innovation and collaboration. Loans against the collateral of gold jewelry and ornaments are extended by regulated entities (REs) for both consumption and income-generation purposes.
- With the recent spurt in gold loan portfolio coupled with increase in the gold prices and volatility, regulatory intervention on account of fear of loan to value limit breaches is natural.
- Furthermore, after the US tariffs gold prices have started falling. A significant gold ore deposit has been discovered in central China which is claimed to be containing approximately 1,000 metric tons of gold eventually valued at around 600 billion yuan (US$83 billion). Gold deposit have also been discovered in State of Orissa. Additional supply is also expected to put a downward pressure on prices.
- Different set of lenders, regulated and unregulated, presently follow different loan matrix on Loan to Value (LTV), interest rate, distribution channels etc. To harmonizing regulations across REs considering their risk-taking capabilities, present announcement to revisit and issue comprehensive regulations, on prudential norms and conduct related aspects, for such loans is a prudent move from the regulators.

### TRANSMISSION OF POLICY RATE

- Following RBI's 25 bps cut in repo rate in Feb'2025, PSBs reduced deposits rate by 6 bps, and FBs reduced 15 bps, while private banks increased rate by 2 bps.
- As savings deposit share holds around 30% and remained sticky in interest rate. So, the overall transmission to deposit rates remained low as savings deposit rates remained unresponsive to policy rate changes. In addition, the decline in the share of current CASA deposits in total deposits, along with the higher transmission to term deposit rates vis-à-vis lending rates have exerted downward pressure on the NIMs of banks.



Source: SBI Research



Source: SBI Research; RBI; Since May 2024, a bank has changed the classification of a category of agricultural loan into "Loans against gold jewellery" under retail segment.
*NBFC Feb 25 is SBI estimate

**Net Interest margin (NIM) of SCBs**

| | PSBs | PBs | Foreign Banks | ASCB |
|---|---|---|---|---|
| FY20 | 2.50 | 3.60 | 3.40 | 2.90 |
| FY21 | 2.90 | 4.00 | 4.20 | 3.30 |
| FY22 | 2.90 | 4.10 | 4.00 | 3.40 |
| FY23 | 3.10 | 4.40 | 4.20 | 3.70 |
| FY24 | 3.10 | 4.30 | 4.30 | 3.60 |
| H1 FY25 | 3.00 | 4.10 | 4.10 | 3.50 |
| 9MFY25 | - | - | - | 3.49 |

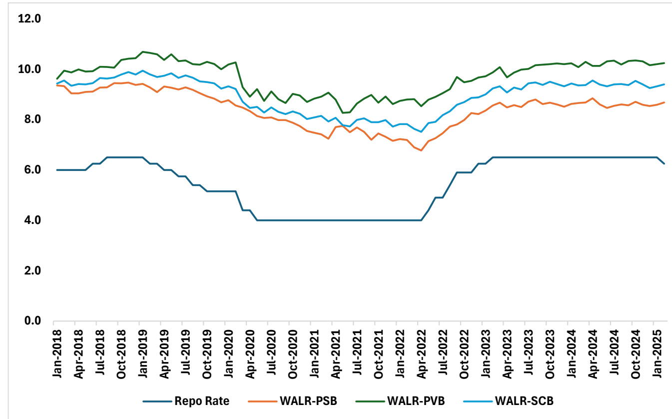
Source: RBI FSR

- The analysis of WALR on fresh loans versus the repo rate reveals that WALR for PSBs, PBs and SCBs closely follow the adjustments in the policy rate implying a effective and timely transmission mechanism for India. The graph indicates that while WALRs broadly follow the repo rate trend, the pace and extent of adjustment varies across the banking segment categories. PSBs have shown broadly following the trend with some fluctuations during Covid-19 pandemic. Thus, this aligns with the theory on interest rate pass-through.

## INFLATION EXPECTATIONS AND POLICY SHIFTS

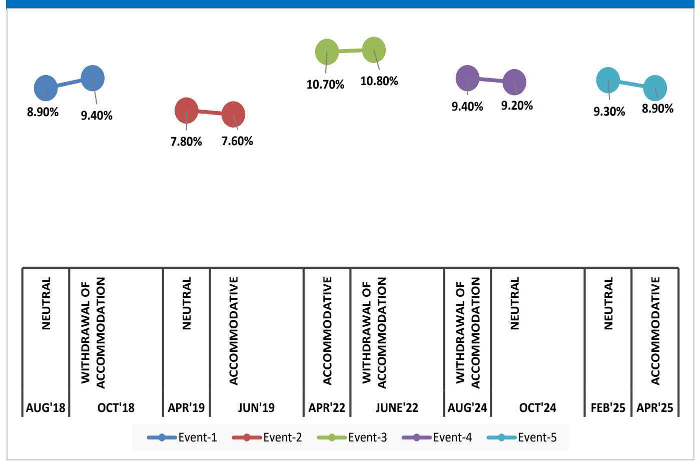
- We explore whether shifts in RBI's monetary policy stance have followed changes in household inflation expectations. Specifically, we hypothesize that the RBI's stance responds to directional changes in inflation expectations—tightening policy when expectations rise and easing or normalizing policy when expectations moderate.
- Using data of three months ahead inflation expectations from five episodes between 2018 and 2024 where the MPC altered its stance, we compare inflation expectations immediately preceding and following each change. This pattern indicates that the RBI's stance may be adaptive to inflation sentiment, reflecting a pre-emptive approach to macroeconomic management. In line with standard New Keynesian frameworks, anchoring expectations is critical to maintaining price stability. The recent stance also indicates that on account of moderating inflation expectations, (8.9% for 3 months ahead) RBI has changed its stance from neutral to accommodative. Thus, the RBI's policy stance is not only backward-looking but also forward-looking.

**WALR ON FRESH LOANS VS REPO RATE**




Source: SBI Research; RBI;

**Inflation sentiments and monetary policy turns**




Source: SBI Research

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