

A Tightrope Walk: RBI Navigates Tough External Environment

External Factors: Ongoing US–Iran / West Asia conflict has disrupted global energy markets, with Brent crude peaking near **\$120/bbl** and currently around **\$96/bbl**, driving supply and shipping concerns. Fed remains cautious, with Fed fund futures indicating possibility of hikes ahead.

Inflation: While CPI remains benign at **3.48%**, underlying inflation pressures are rising sharply, with WPI at **8.30%**, led by **fuel inflation at 24.71%**; reflecting crude-led cost pressures. Retail fuel price pass-through has just begun, while risks from a **below-normal monsoon (El Niño)** could reverse the currently favourable food inflation trend.

Growth: India's growth remains strong at **7.6% (FY26)** as per second advance estimate, but the forward trajectory is becoming less certain. External shocks from the **West Asia conflict**, higher energy costs, and weaker global demand are expected to drag growth lower.

Indian Bond Market: RBI has actively maintained **comfortable system liquidity**, however Bond market is reflecting rising macro uncertainty, with the **10Y G-sec yield hardening to ~7.00%** and the spread over US yields widening to **~250 bps**. Elevated yields indicate **higher risk premia** amid global volatility and crude-led uncertainty, with markets already **pricing in tightening bias**, even as RBI navigates a complex trade-off.

Policy Expectation:

Given the backdrop, we expect the Governor's commentary to skew distinctly to hawkish with RBI signalling the following:

- **Upward revision in inflation projections (closer to 4.80–4.90% for FY27)**
- **Marginal downward revision in GDP growth (possibly to 6.7–6.8%)**
- **Continued emphasis on non-monetary tools for rupee defence—forex interventions, swap auctions, and possibly corridor-widening measures**

We expect the RBI to maintain the repo rate at 5.25%, with only a slim possibility of a hike, while keeping its policy stance neutral.

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