

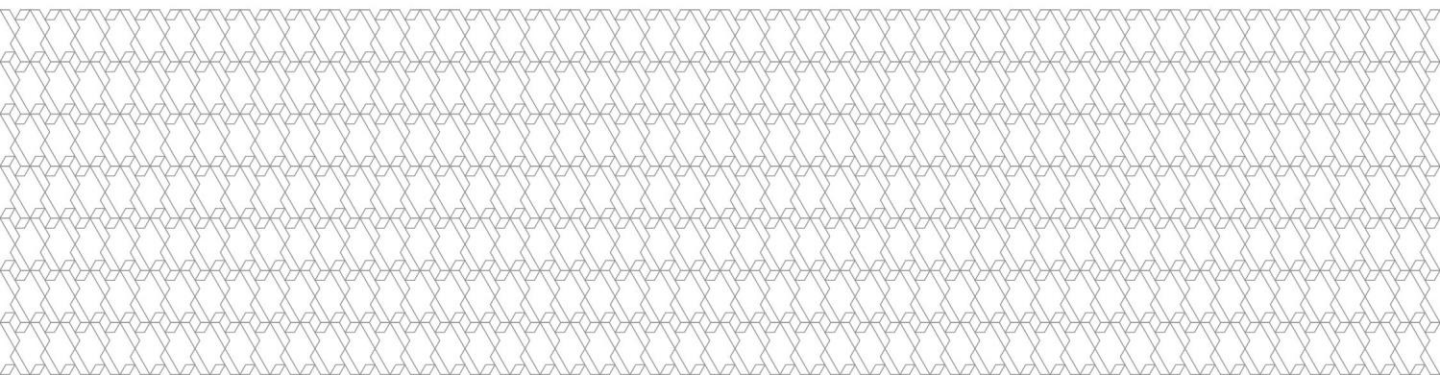


Burgundy

Wealth Management | Axis Bank

RBI MONETARY POLICY

JUNE 2025



HIGHLIGHTS

MPC frontloads cuts, provides liquidity visibility to spur growth

- **MPC's second bi-monthly Monetary Policy Review: 2025-26**

The MPC voted 5-1 in favor for a 50 bps rate cut, with 1 member dissenting in favor of a 25 bps move. The MPC also decided to change the stance from accommodative to neutral. We note that going forward, they will be carefully assessing the incoming data and the evolving outlook to chart out the future course of monetary policy to strike the right growth-inflation balance.

Policy geared towards providing clarity to institutions on conditions remaining easy – with CRR cut around 100 bps at the time of seasonal tightness.

- **Policy Actions**

Repo rate cut by 50 bps to 5.50%.

Consequently, SDF is at 5.25% and MSF is at 5.75%.

RBI cuts CRR by 100 bps to 3.00%, 25 bps each over Sep-Nov 2025

GROWTH-INFLATION DYNAMICS

- FY26 inflation has been revised downward to 3.7% from the earlier estimate of 4%, supported by above normal monsoon prospects, higher wheat stocks and moderating global commodity prices, food stock trends and muted core inflation.

Inflation outlook remains benign under current conditions, however, there is potential for inflation to exceed 4% in FY27, primarily due to a low base effect.

- FY26 GDP growth projections are held at 6.5% with the rural sector bolstered by good crop trends and urban sector supported by recovery in the service sector.

However, growth is viewed as moderate and remains below long-term aspirations. Transmission of monetary easing continues to be gradual and slow. We note that GDP has yet not closed the gap from the pre-pandemic trend.

LIQUIDITY AND EXTERNAL SECTOR

- RBI's CRR cuts provides assurance of ample liquidity over the year, especially at times when conditions seasonally tighten. Assurance on easy conditions likely to spur transmission. However, easy liquidity implies OMO purchases are all but over.
- Comments around the external sector continued to exude confidence, with limited concern around the large portfolio of forward shorts

POLICY STANCE AND GUIDANCE

- **The policy stance is shifted back to neutral, with the MPC now seeing limited space for policy to support growth – with monetary policy a necessary but not sufficient driver of the recovery.**

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
April 5, 2024	<ul style="list-style-type: none">Trading of Sovereign Green Bonds in IFSC.RBI Retail Direct Scheme - Introduction of Mobile App.Small Finance Banks (SFBs) are permitted to use only Interest Rate Futures (IRFs) for proprietary hedging. It has now been decided to allow SFBs to use permissible rupee interest derivative products.Enabling UPI for Cash Deposit Facility.UPI Access for Prepaid Payment Instruments (PPIs) through Third Party Apps.Distribution of Central Bank Digital Currency (CBDC) through Non-bank Payment System Operators.Review of Liquidity Coverage Ratio (LCR) Framework.
June 7, 2024	<ul style="list-style-type: none">Proposed to revise the definition of bulk deposits as 'Single Rupee term deposit of Rs.3 crore and above' for SCBs (excluding RRBs) and SFBs.Proposed to rationalise the extant FEMA guidelines on export and import of goods and services.Proposed to establish a Digital Payments Intelligence Platform for network level intelligence and real-time data sharing across the digital payments' ecosystem.Inclusion of Recurring Payments with Auto-Replenishment Facility under the e-mandate FrameworkIntroduction of Auto-Replenishment of UPI Lite Wallet – Inclusion under the e-mandate Framework.
August 8, 2024	<ul style="list-style-type: none">Proposes to create a public repository of digital lending apps (DLAs) deployed by its regulated entities. The regulated entities will report and update information about their DLAs in this repository.Proposed to increase the frequency of reporting of credit information to credit information companies (CICs) on a fortnightly basis or at shorter intervals.Enhance the limit for tax payments through UPI from ₹1 lakh to ₹5 lakh per transaction.Proposed to reduce the clearing cycle by introducing continuous clearing with 'on-realisation-settlement' in CTS.
October 9, 2024	<ul style="list-style-type: none">Banks and NBFCs are not permitted to levy foreclosure charges/ pre-payment penalties on any floating rate term loan sanctioned to individual borrowers for purposes, other than business and now proposed to include loans availed by micro and small enterprises or MSEs as well.To increase the per-transaction limit in UPI123Pay from Rs 5,000 to Rs 10,000; and raise the UPI Lite wallet limit from Rs 2,000 to Rs 5,000 and per-transaction limit from Rs 500 to Rs 1,000.RBI will issue a discussion paper on capital raising avenues for Urban Co-operative Banking (UCB) Sector.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order in last 1 year.

Date	Measures Announced
October 9, 2024	<ul style="list-style-type: none">Proposes to create a data repository for climate risk assessment, namely, the Reserve Bank – Climate Risk Information System (RB-CRIS)Proposes to introduce Beneficiary Account Name Look-up Facility for RTGS and NEFT system. This facility will enable the remitter to verify the name of the account holder before effecting funds transfer to him/her through RTGS / NEFT.
December 6, 2024	<ul style="list-style-type: none">Expanding the reach of FX-Retail Platform through Linkages with Bharat Connect platform of NPCI.Proposes to introduce a new benchmark - the Secured Overnight Rupee Rate (SORR) - based on all secured money market transactions – overnight market repo as well as TREPS.To increase the limit for collateral-free agriculture loans from ₹1.6 lakh to ₹2 lakh per borrower.to permit Small Finance Banks also to extend pre-sanctioned credit lines through the UPI.Experts committee to set up a Framework for Responsible and Ethical Enablement of AI (FREE-AI) in the financial sector.
February 7, 2025	<ul style="list-style-type: none">Introduction of Additional Factor of Authentication (AFA) for domestic digital payments and proposed to extend AFA to online international digital payments made to offshore merchants.Proposed to include forward contracts in Government securities to facilitate long-term investors such as insurance funds to manage their interest rate risk across interest rate cycles.Expand the access of NDS-OM for secondary market transactions in government securities, to non-bank brokers registered with SEBI.Set-up working group to review of trading and settlement timings across various market segments, report to be submitted by 30th April of this year.
April 9, 2025	<ul style="list-style-type: none">Proposed to enable securitisation of stressed assets through market-based mechanism, in addition to the existing ARC route under the SARFAESI Act, 2002.Co-lending arrangements are restricted to only priority sector loans by banks and NBFCs to be extended to all regulated entities for all loans.RBI will introduce standardised guidelines for loans backed by gold jewellery and ornaments across all Res.New norms will consolidate rules for non-fund based facilities like guarantees, letters of credit, and co-acceptances.UPI Transaction limits to be made flexible by the NCPI in consultation with stakeholders.RBI plans to shift the Regulatory Sandbox to an open-ended, theme-neutral format.

IMPACT ON THE MUTUAL FUND INDUSTRY:

- **Liquid Funds:**

These schemes will continue to generate returns around the operating rate due to their portfolio composition i.e. being invested at the shorter end of the money market segment. Liquid funds have low average maturity as they concentrate more on high quality papers including CPs, CDs and other debt securities with residual maturity of up to 3 months.

- **Ultra Short Term / Low Duration / Money Market Funds (Maturity Up to 1 Year):**

These schemes predominantly invest in below 1 year maturity paper. The strategy adopted by these schemes is to hold the paper till maturity and capitalize on the running yield. Hence, returns in this category will continue to remain relatively attractive depending on the positioning of the fund.

- **Short Duration Funds:**

Schemes in this category are predominantly invested in Corporate Bonds, CPs and CDs while a few of them also have some exposure to G-Secs. We continue to remain bullish at the shorter end of the curve. Investors may consider these funds (with an investment horizon commensurate with the maturity profile of such funds) and gain from current accruals and capital appreciation in the event of a fall in yields.

- **Medium Duration:**

Given the flattened yield curve there are sufficient buffers in the intermediate duration (3-6 years) segment. Till the time RBI is anchoring the long end of the yield curve, the current yield curve may provide some cushion even if there are mark-to-market losses. Investors may consider those funds with high quality portfolios and where the investment horizon is commensurate with the maturity profile of the funds and also gain from current accruals and capital appreciation in the event of a fall in yields.

IMPACT ON THE MUTUAL FUND INDUSTRY:

- **Credit Risk Funds:**

We remain cautious on Credit Risk Funds as they have failed to prove their mettle in the last 2-3 years with the overhang of defaults and erosions of NAV on the back of mark-to-market impacts due to the aforementioned. The uncertainty around credit funds which are in an open ended avatar continues to pose risks to investors. Much also depends on the liquidity conditions in the market and redemption pressure on these funds. Thus, we think there is a systemic risk in the market within the credit space. Hence, it makes sense for one to stay away from these funds.

- **Long Term Income Funds / Gilt Funds / Dynamic Bond Funds:**

The MPC cut rates by a higher-than-expected 50bps and announced an unexpected 100bps cut in CRR over Sep-Nov (when seasonal factors can tighten system liquidity). Front-loaded easing and clarity on monetary conditions is aimed at spurring transmission and boosting growth. FY26 inflation forecast was cut to 3.7% from 4%, but the change of stance to Neutral acknowledges the limited room to ease further unless growth deteriorates. We expect credit growth to pick up faster given this push thus supporting GDP growth. Easy liquidity also indicates an end to OMO purchases, but the demand for bonds may be boosted by faster transmission helping need for high-quality liquid assets (HQLA) assets.

The current global economic outlook remains clouded amidst uncertainties around U.S. trade policies and weak consumer sentiment. Sending shockwaves across the global market, Moody's Ratings downgraded U.S. credit rating, citing the country's growing debt level as their rationale. However, the US FED will probably restart its rate cut cycle in the coming months given the expectations of weakening US growth, driven by tariff related impact on both investment and consumption. Overall, the minutes confirmed that there is a need to remain cautious in policy setting until the dust clears about the outlook. The recent Federal court ruling of ceasing the reciprocal and fentanyl tariffs probably adds to the uncertainty given that the Trump administration has appealed the decision to the Supreme Court. It could take a few more months until the final tariff structure is ascertained. We anticipate the FOMC could maintain status quo in the June policy meeting.

IMPACT ON THE MUTUAL FUND INDUSTRY:

Domestic bond yield curve saw a steepening bias, where short-end yields moved lower amid easy liquidity conditions. However, 10-year yield inched a tad higher due to GDP growth surprising positively and relatively weak demand at the G-sec auction. The upside surprise came from higher government capex along with manufacturing and construction. Although this is unlikely to be the trend rate of growth, there are a number of positives in the year to warrant growth sustains at around the current yearly pace of growth of 6.5%. Hence, domestic yields moved higher on as odds of a deeper rate cut cycle reduced.

Given the above, India could navigate the global headwinds, supported by improving macroeconomic fundamentals and a congenial business environment. Inflation pressure has eased, falling crude oil prices could reduce the strain on India's import bill, the RBI directed measures to infuse liquidity into the system and India's service sector has rebounded. FY26 is shaping up as a year of easy liquidity and front-loads rate cuts monetary policy in India, paralleling other emerging markets and showing some decoupling from U.S. trends. So far, a 100-bps rate cut has been delivered, after which rate decisions will be more cautious. Thus, we see the 10-year benchmark yields trading in range of 6.20% - 6.50% in the near-term. We anticipate volatility to continue in near term. We believe the 1 to 5-years segment offers a favorable position from a risk-reward perspective, with a quality approach to bonds.

Indian 10-year benchmark bond yields fell by 5 bps (at the time of writing the note), on the rate cut and change in stance.

- **Conservative Hybrid Funds (*Erstwhile: Monthly Income Plans (MIPs)*):**

With a 10% to 25% allocation to equity, returns of CHFs are largely determined by the vagaries of the equity markets as against the debt markets. These funds are therefore suitable for investors who have a reasonably long-time horizon & are comfortable with taking exposure to equities.

OUTLOOK

- Indian bond yields are now expected to trade in a tight range, with H2 heavy on the supply front and hoped-for OMO purchases now unlikely. We continue to see risks from global curve steepening; however, these are expected to be largely offset by improved transmission to credit and deposits, driving demand for high-quality liquid assets (HQLA) investments.
- We remain constructive on the short to medium end of the yield curve. **Short Duration funds, Banking & PSU Debt funds, Corporate Bond funds, Medium Duration funds, Floating Rate funds, Money Market funds, Low Duration funds and Ultra Short Duration funds** can be considered by investors with an investment horizon commensurate with the maturity profile of the schemes. Investors can consider investing upto **Medium Duration** as per their risk appetite with an investment horizon of at least 2-3 years to avoid any intermittent volatility.

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