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RBI MPC POLICY: REFORMS, REWARDS & RESILIENCE:POTENTIAL CAPITAL FLOWS OF AT LEAST $40 BN COULD PULL BACK RUPEE TOWARDS 92-93 LEVELS. PAUSE IN AUGUST POLICY LIKELY

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Coming against the backdrop of a foggy landscape and yet to fully unfold second/third order impacts, the MPC today assiduously set in motion a chain reaction heavy on addressing the continued volatility in exchange rate. Separately, the MPC unanimously decided to keep repo rate unchanged at 5.25% and continuing with the neutral stance, even as growth projections have been adjusted by 30 bps to 6.6%. RBI has also revised CPI inflation projection by 50 bps to 5.1% now (70 bps increase in Q2-Q4 estimates as compared to April policy). The estimate of core CPI are also enhanced by 30 bps to 4.7%.

Basis our deep dive, the language of the monetary policy has shifted towards inflation vigilance and external sector defense even as stance of the policy is neutral. This is prudent as it signals calm and confidence on part of the RBI and inhibits any self-fulfilling pessimistic beliefs that can potentially lead to a speculative attack on the rupee. It is worth noting that the policy statement has again emphasized in no uncertain terms that sometimes the rupee movement is not in sync with fundamentals. This puts to rest the recent unnecessary catcalls that the rupee should be allowed to move even towards 100! Such needless assertions create unnecessary heightened spells of speculations and allow incremental market positioning in taking fundamentally undesired bets against the rupee.

Most importantly, the slew of reforms announced in today's meet pivot it to a progressive and daring stand, one that augurs well for the economy and markets while keeping the growth momentum sacrosanct. Reforms in FAR category and General category are likely to pull much better flows, in sync with GoI's measures facilitating better post-tax returns for FPIs. By putting new 15, 30 and 40-year G-sec under FAR, RBI has made more long-tenor bonds freely accessible to foreign investors. Further, it should ensure higher FPI demand for G-secs, lower long-end yields, lower government borrowing cost, better liquidity in long-tenor bonds, and concomitant support for Rupee while offering tax incentives of around Rs 4000-5000 crore for the FPIs .

Concessional forex swap to incentivize ECBs issuances by PSUs should accelerate such offerings by PSUs in overseas markets, helping them access funds at competitive net pricing and upend total ECB/FCCB flows that fell by ~30% in FY26 to $42.9 Bn from the FY25 level ($61.2 Bn). Some of the major PSU that have raised ECB recently include PFC, REC, EXIM Bank, IOC, NaBFID, NTPC etc. This amount is $4.9 billion in FY26 which is ~11% of the total in FY26, most in the maturity period of 5-7 years.

Most importantly, the sharp 2016 redemption cycle (Post the 2013 inflows led by FCNB) underscores the importance of longer tenor FCNR(B) deposits, as longer maturities reduce rollover risk and enhance the stability. We believe a 5-year FCNR (B) deposit provides a longer and more predictable source of foreign currency funding than a 3-year deposit. Incidentally, with the RBI shouldering the hedging costs (@2.5% annually for the contract period), a successful deposit garner should largely alleviate constraints faced on domestic deposit mobilization front too and should have a sobering effect on loan pricing / other market based yields across CPs/CDs and G-secs, helping in true transmission.

With RBI bearing full hedging cost and also the SLR, CRR costs till 30th September, banks can offer more attractive FCNR (B) rates to NRIs without taking unhedged currency risk. Current FCNR (B) Rate is ~ 3.35% (3 years) Presently cost of hedging, forward premium is ~3.5%. Current Card rate for a 3-year deposit is 6.5%. Banks can thus offer attractive FCNR (B) pricing in the range of 5.5% and upwards (US treasury rates at ~4% of equivalent duration). Taking an annual hedging cost at ~2.5%, the total outgo comes to ~12.5% for a 5-year tenor, implying $125 mio cost embedded per billion raised. We believe FCNR(B) deposits could easily attract upwards of the levels of $34 bn that was mobilized in 2013.

We believe RBI will continue to look through inflation prints before taking a considerate call of a potential rate hike. We continue to believe that growth considerations could trump a more aggressive rate hike cycle as market expectations tend us to believe. We expect a pause in August policy.

MPC KEPT REPO RATE UNCHANGED AT 5.25%

- MPC unanimously decided to keep repo rate unchanged at 5.25%. The MPC also continued with the neutral stance. The future course of monetary policy will continue to remain data-dependent.
- RBI downgrade its FY27 real GDP growth projection by 30 bps to 6.6% with Q1 at 6.6%; Q2 at 6.3%; Q3 at 6.5% (50 bps decline from the April estimate); and Q4 at 6.8% owing to weak global demand, global supply chain disruptions, volatility in global financial markets, and weather-related shocks.
- Regarding inflation forecast, as expected, RBI revised CPI inflation projection by 50 bps to 5.1% (70 bps increase in Q2-Q4 estimates as compared to April policy). The estimate of core CPI also enhanced by 30 bps to 4.7%. The estimate largely hinges upon global commodity price shocks, uncertainty about the spatial and temporal distribution of the south-west monsoon along-with El Niño conditions (the National Oceanic and Atmospheric Administration, US, projects an 82% of probability of El Niño emerging during May-Jul'26) and global supply chain disruptions. RBI expect Q1 inflation at 4.2%; Q2 at 5.1%; Q3 at 5.9%; and Q4 at 5.4%.

RBI Growth & Inflation Outlook for India

FY27	CPI Inflation (%)			Real GDP Growth (%)		
	Apr'26	Jun'26	Change (in bps)	Apr'26	Jun'26	Change (in bps)
Q1	4.0	4.2	20	6.8	6.6	-20
Q2	4.4	5.1	70	6.7	6.3	-40
Q3	5.2	5.9	70	7.0	6.5	-50
Q4	4.7	5.4	70	7.2	6.8	-40
FY27	4.6	5.1	50	6.9	6.6	-30
Memo: Core CPI Inflation (%)						
FY27	4.4	7.7	30	-		

Source: RBI, SBI Research

MEASURES TO ATTRACT FOREIGN CAPITAL

- Currently the **FPI position in FAR** is Rs 3.24 lakh (limit utilisation of 6.8%) with an average tenure preference of 11 years. The inclusion of the new tenures along with the full tax exemption implies the post tax return in G-Sec is now higher which would lead to more inflows. As per the Government borrowing calendar, Rs 2.45 lakh crore G-sec belongs to the three new tenures, of which Rs 0.9 lakh crore has been issued, thus Rs 1.5 lakh crore that is yet to be issued will become part of FAR securities.
- The limit of 30% on short maturity has also been removed and we expect this maturity to see maximum demand give expectation of rise in rates. The available head room in both general route is Rs 4.06 lakh crore which is indicative of the potential inflows.
- **By putting new 15-, 30- and 40-year government securities under FAR,** RBI makes more long-tenor bonds freely accessible to foreign investors. Further, it will ensure more FPI demand for G-secs, lower long-end yields, lower government borrowing cost, better liquidity in long-tenor bonds, and some support for Rupee. Also, these measures can make India's case for inclusion in larger Global Bond indices stronger.
- We have estimated the amount of tax gain that FIIs would incur owing to exemption of tax on interest income and capital gains. We have taken weighted average yield to estimate the gains. FIIs are likely to gain around Rs 4000-5000 crore due to exemption on interest income and ~Rs 500-1000 crore due to capital gain tax exemption.

Estimated Gain to FII due to tax exemption (Rs cr)

Total holdings (FAR+General)	380487
Withholding Tax rate (%)	20
Capital Gain tax (%)	12.5
Weighted average yield on FAR	6.9
Weighted average yield on General	7.1
Gain on interest income	4000-5000
Gain due to Capital gain tax exemption	500-1000

- **Concessional forex swap to incentivize ECBs issuances by PSUs** (till 30th Sep) should be counter intuitive to crowding-in of raising resources by better rated corporates locally, giving a breather to domestic capital markets that have seen yields detaching from policy rates and also enable a better visibility to marquee names from India Inc. overseas as they entrench in liquid global financial markets. Cumulatively, PSEs had ~11% share in India's ECB issuance of $43 Bn during FY26, but a favorable regime in terms of swaps can encourage accelerated borrowings during the currency of this window that can have a soothing effect on exchange rate curve, apart from capex/investments planned.
- The sharp 2016 redemption cycle underscores the importance of longer tenor FCNR(B) deposits, as longer maturities reduce rollover risk and enhance the stability. We believe a 5-year FCNR(B) deposit provides a longer and more predictable source of foreign currency funding than a 3-year deposit.
- Incidentally, with the RBI shouldering the hedging costs (@2.5% annually for the contract period), a successful deposit garner should largely alleviate constraints faced on domestic deposit mobilization front too and should have a sobering effect on loan pricing / other market based yields across CPs/CDs and G-secs, helping in true transmission.

- **Time for realisation of export proceeds**: It is obligatory on the part of the exporter to realise and repatriate the full value of goods / software / services to India within a stipulated period from the date of export. Currently this is 15 months (increased from 9 months during the Covid-19). Now, RBI has again restored the time for realisation of export proceeds to 9 months. We believe this is an excellent measure as faster realization will bring more foreign currency (USD) to India at earliest. However, exporters will need to monitor their overseas collections and outstanding payments much more closely to avoid compliance issues.

CREDIT GROWTH BROAD BASED IN FY27 SO FAR

- As per the RBI, credit from all sources grew by 15.4% (YoY) in 2025-26 as compared to 12.1% a year ago. In the current year 2026-27 so far, bank credit growth continued to remain robust
- On a year-on-year basis, bank credit registered a growth of 16.2% as on May 15, 2026, compared to 9.8% a year ago. Sector-wise data indicates buoyant credit flows to retail and service sector. Industrial credit strengthened further, aided by sustained credit growth in MSMEs and pickup in credit to large industries. Agricultural credit grew at a steady pace.
- ♦ With the proactive measures by RBI, the system liquidity has remained in surplus, with an average Rs 1.39 lakh crore in June (till 04 June), compared to Rs 1.68 lakh crore in May. As the surplus liquidity narrowed, reflecting tighter funding conditions and funding cost increased, with the rise in CP/CD rates.
- ♦ Going ahead, with the drawdown of government cash balances after the RBI's surplus transfer and the return of currency during the monsoon season will aid banking system liquidity in the near-term.

Average Outstanding Liquidity Position (Rs lakh crore)

Indicator	FY26 Average	FY 27 Average	5-Jun-26
Total Repo Outstanding	0.53	0.53	0.29
Reverse Repo Total	0.50	0.50	0.00
SDF	2.02	2.79	2.28
Net LAF (-absorption)	-1.80	-2.57	-1.89
Government Cash Balance *	2.42	1.04	0.78
Net durable liquidity [surplus (-)]**	-4.19	-3.59	-2.66

Source: SBI Research, RBI,* estimated from previous fortnight core liquidity, **fortnight outstanding

Funding Cost Increased

Months	3M CD Rate	1Y CD Rate	CP Rate	Fresh Rupee Bank TDR
May-26	7.0	7.5	7.4	-
Apr-26	6.3	7.1	6.6	5.77
Mar-26	7.3	7.1	6.7	6.07
Feb-26	7.1	7.0	7.3	5.65
Jan-26	6.7	6.9	7.2	5.66

Source: RBI, SBI Research

Financial Stability Indicators FY26: SCBs vs NBFC

Parameters	SCB	NBFC
CRAR	17.68	24.70
GNPA	1.73	2.25
NNPA	0.40	0.98
NIM	3.26	4.56

Source: RBI, SBI Research

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Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in, gcea.erd@sbi.co.in
Phone:022-22742440
: @kantisoumya