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RBI GOVERNOR TURNS LUCAS BUT SPEAKS IN SIGNALS!

CALIBERATED COMMUNICATION FORTIFIES EXPECTATIONS, WHILE THE SURPRISE RATE CUT EVOKES THE LUCAS PARADIGM

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Monetary Policy Committee delivered a strong monetary policy stimulus by reducing the policy rate by 50 bps and slashing the CRR by 100 bps in staggered fashion from this September to December. This front-loaded larger cut will reinvigorate a credit cycle. Response was correctly anticipated by SBI in its pre-policy note. All members except one voted for 50 bps cut (one external member voted for 25 bps reduction). The **MPC also decided to change the stance from accommodative to neutral**.

The **CRR cut is the toast of the town which will reduce the M0, sparking a 20-30 bps surge in money multiplier and energizing liquidity**. The cut in CRR would release primary liquidity of about ₹2.5 lakh crore to the banking system by December 2025. Besides providing durable liquidity, it will reduce the cost of funding of the banks, thereby helping in monetary policy transmission to the credit market. This surprise move embodies Lucas Hypothesis illustrating how surprise policy actions can be meaningful in influencing real economic dynamics while at the same time effective communication ensures that expectations are anchored, balancing surprise with credibility for optimal monetary policy transmission.

On the macroeconomic side, **real GDP growth for FY26 is projected at 6.5%** owing to sustained rural economy, continued expansion in services sector, higher capacity utilization, improving balance sheets of financial and non-financial corporates, and government's capital expenditure push. Taking into consideration the factors like above normal monsoon, record Kharif crop prospects, moderation in the prices of key commodities, including crude oil, RBI has revised downwards its FY26 CPI inflation projection to 3.7% from 4.0% in last assessment.

Text mining analysis of Governor's speech strongly reflects prominence of growth-related terms over inflation in the analysis indicates that supporting economic expansion remains the RBI's primary concern, even as it carefully monitors inflationary pressures.

The cumulative reduction in the repo rates now stands at 100 bps since Feb 2025. **The impact of the policy stimulus is partially visible on both assets and liability sides of banks.**

Variance decomposition analysis using a VAR indicates strong transmission of monetary policy from the repo rate to the loan rate on outstanding loans in coming quarters.

Fixed deposits (FDs) rates have been reduced in the range of 30-70 bps since February 2025. Transmission to deposits rates is expected to be strong in the coming quarters with further rate cut in deposits expected from banks.

The historical changes in ASCB NIM against changes in policy rates suggest compression of NIM. Exact impact will vary with individual banks. With around 60% of ASCB loans linked to EBLR, immediate impact on average lending rate would be around 30 bps. However, the reduction in CRR will also cushion the impact of fall in average lending rate with some reduction in cost of fund.

Going ahead, the trajectory of the monetary policy will be data dependent and evolving situation as available headroom is narrow. The large transfer of RBI profit has improved headroom for fiscal policy to achieve the necessary stabilization. We expect status quo for the next quarter.

REPO RATE CUT BY 50 BPS TO 5.5%

- As correctly anticipated by SBI in its pre-policy note, MPC has decided to reduce the repo rate by 50 basis points to 5.5%. All members except one voted for 50 bps cut (one external member voted for 25 bps reduction). The MPC also decided to change the stance from accommodative to neutral.
- Taking into consideration the factors like above normal monsoon, record Kharif crop prospects, moderation in the prices of key commodities, including crude oil, RBI has revised downwards its FY26 CPI inflation projection to 3.7% (from 4.0%).
- Real GDP growth for FY26 is projected at 6.5% owing to sustained rural economic, continued expansion in services sector, higher capacity utilization, improving balance sheets of financial and non-financial corporates, and government's capital expenditure push.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q1 FY26	Q2 FY26	Q3 FY26	Q4 FY26	FY26
Jun'25	2.9	3.4	3.9	4.4	3.7
Apr'25	3.6	3.9	3.8	4.4	4.0
Feb'25	4.5	4.0	3.8	4.2	4.2
Real GDP Growth (%)	**Q1 FY26**	**Q2 FY26**	**Q3 FY26**	**Q4 FY26**	**FY26**
Jun'25	6.5	6.7	6.6	6.3	6.5
Apr'25	6.5	6.7	6.6	6.3	6.5
Feb'25	6.7	7.0	6.5	6.5	6.7

Source: RBI, SBI Research

CRR CUT BY 100 BPS IN PHASED MANNER STARTING FROM SEPT 2025

- RBI decided to cut CRR by 100 bps to 3% in a phased manner (25 bps each starting from 06 Sept., 04 Oct, 01 Nov and 29 Nov 2025). With this cut CRR would reached to per-pandemic level of 3% (27 March 2020).
- Interestingly, SBI Research in its report dated 06th Dec'2024, followed by many reports in 2025, has suggested 100 bps cut in CRR, to reduce the liquidity stress.
- The cut in CRR would release primary liquidity of about ₹2.5 lakh crore to the banking system by December 2025. Besides providing durable liquidity, it will reduce the cost of funding of the banks, thereby helping in monetary policy transmission to the credit market.
- The reduction in CRR may not mathematically translate to any change in deposits and lending rates, however, it may have positive impact on margins (3-5 bps on NIM) of the banks. The CRR cut will reduce the M0, so, the money multiplier will increase by 20-30 bps.

TRANSMISSION OF POLICY RATE

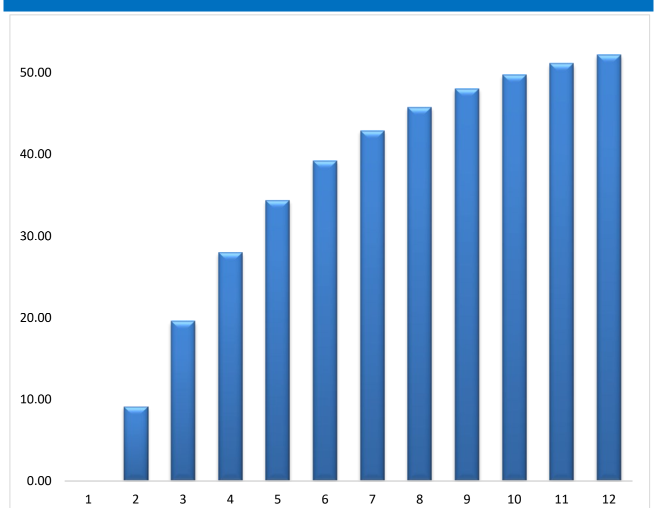
- We anticipate a 50 bps cut can reinvigorate credit cycle. The cumulative reduction of 100 bps in repo rate will transmit to both asset and liabilities.
- Following the 50-bps repo rate cut by RBI in February and April 2025, banks repo-linked EBLRs already reduced by similar magnitude. While the MCLR linked rates, has a longer reset period may get adjusted with some lag. Now with around 60.2% of the loans are linked to EBLR and 35.9% are linked to MCLR, present cut will be immediately transmitted to majority of loan portfolio.
- To reduce the stress on margins, some banks have already reduced interest rates on savings accounts. Also, fixed deposits rates have been reduced in the range of 30-70 bps since February 2025. Transmission to deposits rates is expected to be strong in the coming quarters with further rate cut in deposits expected from banks.
- Further, as inflation is declining and assets/loans are repricing quickly than liabilities, we believe that banks may tinker with savings bank rate, to cushion margins.
- Variance decomposition analysis using a VAR model to examine the transmission of monetary policy from the repo rate to the loan rate on outstanding loans demonstrate a gradual but meaningful impact of repo rate shocks on the variance of loan rates over a 12-month horizon. At the first month, the loan rate variance is fully explained by its own shocks, reflecting the inertia in outstanding loan rates to immediate policy changes.
- However, by the end of the first month itself, about 9% of the loan rate variance is explained by repo rate innovations. This influence steadily increases over the year, reaching over 52% by the twelfth month, indicating a strong and persistent pass-through effect.
- The increasing share of loan rate variance explained by repo rate shocks—from about 9% in the first month to over 52% by the twelfth month—indicates a strong and effective transmission mechanism. Such a pattern confirms that the recent 50 bps rate cut is likely to translate into lower borrowing costs for borrowers over the medium term, thereby supporting credit growth.

Transmission to Banks' Deposit and Lending Rates (Variation in basis points)

Period		Easing Phase	Tightening Phase	Easing Phase		
		Jan'19 to Apr'22	May'22 to Jan'25	Feb'25	Apr'25	Jun'25
Repo Rate		-250	250	-25	-25	-50
Term Deposit Rates	WADTDR_Fresh Deposits	-	253	-27		
	WADTDR_Outstanding Deposits	-188	199	-1		
Lending Rates	EBLR	-	250	-50		
	1-Yr. MCLR (Median)	-155	175	0		
	WALR_Fresh Rupee Loans	-244	181	-6		
	WALR_Outstanding Rupee Loans	-152	113	-17		

Source: SBI Research, RBI

Variance Decomposition of WALR using Cholesky Factors



Source: SBI Research

GROWTH LEADS THE CONVERSATION !!

- The vibrant threads of growth shine more brilliantly than those of inflation, illustrating a clear emphasis on expansion outpacing price pressures!
- Our text mining analysis of Governor's speech strongly reflects the RBI's decision to cut the policy rate by 50 basis points, underscoring its accommodative approach to navigating the current economic landscape. The prominence of growth-related terms over inflation in the speech indicates that supporting economic expansion remains the RBI's primary concern, even as it carefully monitors inflationary pressures.
- Key themes such as growth, global, liquidity, stability, and demand highlight the multifaceted challenges the RBI is addressing through its policy stance. While inflation remains important, the data suggests that fostering sustainable growth takes precedence, signaling confidence in the overall recovery momentum.
- Amid a fluid and fragile global outlook, the sentiment analysis suggests "global" continues to loom large in economic discourse, reflecting persistent attentiveness to international developments.
- Negative words like "uncertainty" are present but limited, reflecting a cautiously optimistic outlook amid ongoing global and domestic challenges. This balance reveals the RBI's careful calibration of policy measures — aiming to stimulate growth while ensuring inflation does not spiral out of control. Overall, the text mining results align with the RBI's commitment to maintain stability and promote economic resilience.
- However, after the 100 bps cumulative rate cut since Feb'25, there exists a limited scope of monetary policy to further spurt growth and hence the stance has been changed from accommodative to neutral.

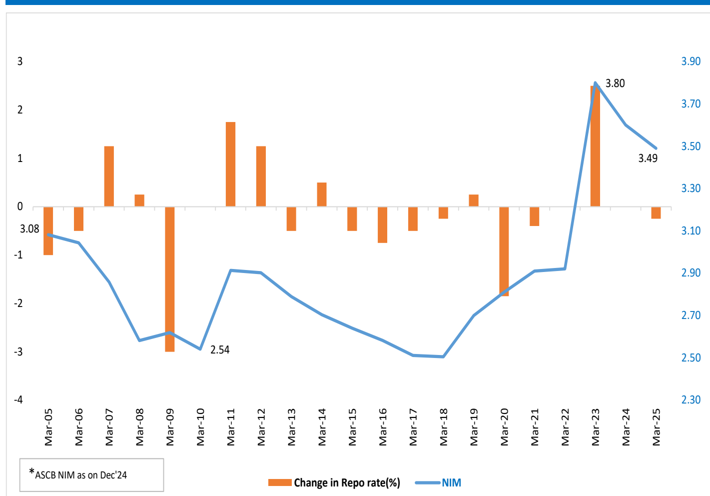
POLICY IMPACT ON BANKING

- The steep cut on policy rates is expected to pass on to the EBLR linked loan book immediately with ASCB share of 60%. Thus immediate impact on average lending rate could be around 30 . However, the reduction in CRR will also cushion the impact of fall in average lending rate with some reduction in cost of fund.

Text Mining of RBI Governor's Statement

Source: SBI Research

ASCB NIM vs. Rate cut/hike



Source: SBI Research

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