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Unlike many other Asian central banks, the MPC has maintained its pragmatic approach of using policy rates for inflation management while relying on other measures for currency support. The policy rate and neutral stance have been maintained despite elevated global uncertainty and energy prices. Nonetheless, the 50 bps increase in FY27 inflation projections to 5.1% and core inflation to 4.7% highlights forward-looking risks stemming from the prolonged West Asia conflict and monsoon-related uncertainties. The FY27 growth projection has also been moderated to 6.6%.

The reaffirmation of RBI's commitment to providing sufficient liquidity is a welcome relief. However, what clearly stole the show was the series of measures announced to boost dollar inflows, including an expanded FAR security universe, a concessionary hedged facility for ECBs, and fully hedged 3–5 year FCNR(B) deposits. Separately, the government has relaxed taxation rules for FPIs investing in G-Secs, which could also enhance the likelihood of their inclusion in the Bloomberg Global Bond Index.

Overall, while the overhang of potential policy rate hikes remains in forthcoming policies, immediate concerns have been adequately addressed and are likely to trigger a market rally across the yield curve.

Key decisions/Highlights



Repo rate Unchanged

- Policy repo rate kept unchanged at 5.25% with unanimous vote. Standing Deposit Facility (SDF) rate at 5.00%
- Marginal Standing Facility (MSF) rate and the Bank Rate remains at 5.50%.



Policy stance retained as Neutral

- MPC voted to retain the monetary policy stance as Neutral



FY27 Real GDP projected at 6.6%

- FY27 growth estimated at 6.6% (down from 6.9%)
- Q1FY27 at 6.6% (down from 6.8%)
- Q2FY27 at 6.3% (down from 6.7%)
- Q3FY27 at 6.5% (down from 7.0%)
- Q4FY27 at 6.8% (down from 7.2%)



CPI projected at 4.6% for FY27

- FY27 estimated at 5.1% (up from 4.6%)
- Q1FY27 at 4.2% (up from 4.0%)
- Q2FY27 at 5.1% (up from 4.4%)
- Q3FY27 at 5.9% (up from 5.2%)
- Q4FY27 at 5.4% (up from 4.7%)

MPC keeps the inflation and currency management separate; maintains status quo on policy rate...

With the West Asia conflict persisting despite a fragile truce, the global backdrop has further worsened since the last policy meeting. Prolonged supply chain disruptions and elevated energy prices are now weighing more visibly on the outlook, leading to softer growth and higher inflation projections compared to the April policy. At the same time, Asian country's currencies have come under pressure with many touching all time lows against the US Dollar. Facing difficult trade-offs, global monetary policy has turned more cautious, with major advanced economy central banks likely to shift toward tightening to control the inflation, while the Asian Central banks have recently hiked the policy rates to protect their currency against excessive depreciative pressure. Global markets are mixed, with equities buoyant on AI optimism, while sovereign bond yields have risen amid fiscal and inflation concerns. Meanwhile, the US dollar has strengthened due to shifting rate expectations and risk sentiment.

Against the backdrop of high currency pressures and inflationary concerns, market participants were cautious in terms of monetary policy response with many expecting a hawkish policy to support INR and guide the market for near-term policy rate hikes to tame the inflation. Unlike many other Asian Central banks, MPC maintains its pragmatic approach to use the policy rates for inflation management and use other policy measures for currency support. Policy rate and Neutral stance maintained even as the global uncertainty and energy prices are elevated. The MPC also retained its neutral policy stance, retaining the flexibility to respond judiciously to incoming information.

The MPC noted that there are significant risks to its baseline outlook for inflation and growth, stemming from deep uncertainty around the duration and intensity of the conflict, its spillover effects, and how quickly supply chains can normalize. At the same time, the food outlook remains clouded by concerns over a sub-normal south-west monsoon and the potential impact of El Niño. Even as upside risks to inflation have grown more pronounced, the MPC considered it prudent to wait for greater clarity before taking further action.

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...While announcing series of measures for external balance

RBI unleashed series of measures to boost dollar inflow into the economy in order to arrest the downward pressure on INR which has depreciated by ~6% since Jan 2026. RBI has now permitted PSU borrowers to get an access to concessional forex swap while raising ECBs – PSUs are active borrowers in the ECB markets and will tap this route assuming the concessions are material and brings the landed borrowing cost of ECBs within their domestic borrowing costs. Additionally, we saw a recap of the 2013-era FCNR (B) deposit scheme, albeit with a difference as RBI will bear the full hedging cost this time around. Both these measures will be available till September 2026 and are expected to be the major drivers of Dollar inflow over next few months. RBI also expanded the universe of securities under the FAR route by including the new auctioned 15, 30 & 40 year G-Sec issuances, which will provide greater access points for FPIs looking for investments in Indian G-Secs. The other announcements – like reducing the time for export realization and increasing NRI investment limits – will also add to the dollar inflow, although are likely to be smaller from an overall inflow perspective. While we await the actual mobilization of foreign currency, these measures can bridge the FY27 BoP deficit hole to a great extent and also help RBI unwind its more than USD 100 bn forward book.

Separately, the Central Government has relaxed the taxation rules for FPIs investments in G-Sec...

The government has provided tax exemption on both interest as well as capital gains on G-Secs to FPIs. The benefit is applicable only for G-Secs and not for corporate bonds. The exemption shall be applicable w.e.f. 01.04.2026 – any interest or capital gains arising on or after 01.04.2026.

It is indeed a meaningful measure taken to rationalize FPI's tax structure which now brings Indian sovereign bonds at par with many other countries in terms of tax treatment. Indian macro factors remain relatively healthy characterized by political stability, large debt market – second to China amongst emerging countries, aided by steady economic growth, credible fiscal prudence, moderate inflation, and high absolute market yields. However, participation of FPIs in Indian G-Sec has remained very limited, owing to the previous tax challenges. Considering that Indian G-sec has relatively lower correlation with global yields, we expect these measures along with expanded FAR security universe, will drive healthy FPIs investments over a period of time. We also expect these changes to open doors for Indian G-Sec inclusion into Bloomberg global bond index fund which will put Indian G-Sec on global map and further attract inflows. As of now, tax changes have been made only for G-Sec. Similar tax treatment for other segments like SDLs and corporate bonds would have been also helpful considering the increasing debt issuances from States and Corporates.

Reassurance on sufficient market liquidity is a welcome relief ; Dollar inflows will also add INR liquidity in domestic market.

Liquidity had tightened significantly since the last policy in April as the RBI stepped up its forex intervention in market and CIC remained high on account of seasonality. Banking liquidity came down from around Rs 4 lakh crs in the beginning of April to Rs 1.8 lakh crs as on June 4, 2026. This led to a tightening of short-term rates with the 3-month CD rates moving up by 120-130 bps and subsequently spilling over to the rest of yield curve.

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The Governor re-iterated the commitment to provide appropriate liquidity in the banking system to meet the productive requirements of the economy and facilitate monetary policy transmission. The measures announced by RBI should bring in dollar inflows, thereby reducing the pressure on RBI towards forward intervention and supporting liquidity. Apart from the forex intervention, the season outflows due to CIC will also subside, thereby providing support to liquidity.

Growth projections moderated...

Although the economy has so far demonstrated resilience to the spillover effects of the conflict, early signs of strain are beginning to surface. Looking ahead, persistently high energy and commodity prices, combined with ongoing supply chain disruptions, are likely to weigh on economic activity. The extent of the impact, however, will depend on several factors — including how long the conflict endures, the pace at which supply chains return to normal, and how effectively the burden is shared among stakeholders.

At the same time, the outlook for the south-west monsoon points to a likely shortfall, which could affect agricultural output and dampen rural demand. That said, proactive measures such as crop diversification initiatives, improved water harvesting and conservation efforts, adoption of climate-resilient practices, and the use of short-duration crop varieties are expected to cushion the adverse effects and support stability in the sector.

Elevated inflationary pressures may warrant tightening of monetary policy in forthcoming policies...

Headline CPI inflation edged higher to 3.4% in March and 3.5% in April 2026, largely driven by a pickup in food prices. However, stripping out the volatility of precious metals, core inflation remained relatively muted at 2.1–2.2%, suggesting that underlying demand-side pressures are still contained. That said, the outlook is beginning to shift. Since May, retail fuel prices have risen significantly, with petrol up 7.4% and diesel 8.4% cumulatively. As higher fuel costs ripple through transportation, logistics, and production chains, second-order effects are likely to build in the coming months, gradually pushing CPI inflation higher. The second-round impact of rising input costs could exert further upward pressure on inflation, making the near-term trajectory of CPI more sensitive to these evolving cost dynamics. Additionally, overhang of sub-normal monsoon can un-anchor the inflation expectations. In line with the elevated crude prices, RBI has upped its FY27 inflation projection by a steep 50 bps to 5.1% as it has now considered average crude oil price at USD 95 per barrel for FY27 vs USD 85 considered in last policy meeting.

These factors coupled with the fact that the current 5.25% policy rate is within touching distance of FY27 inflation projection of 5.1% leaves the real policy rate at a narrow level, warranting future rate hikes going forward. While we expect 50 bps rate hike in CY2026 at this point in time, actual quantum and timing can be greatly influenced by West-Asia conflict duration

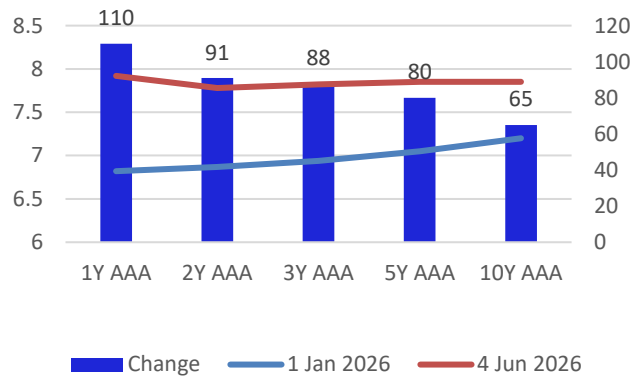
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Market yields had jumped sharply higher led by the West Asia conflict and policy overhang; Easing on both fronts triggered 15-25 bps rally...

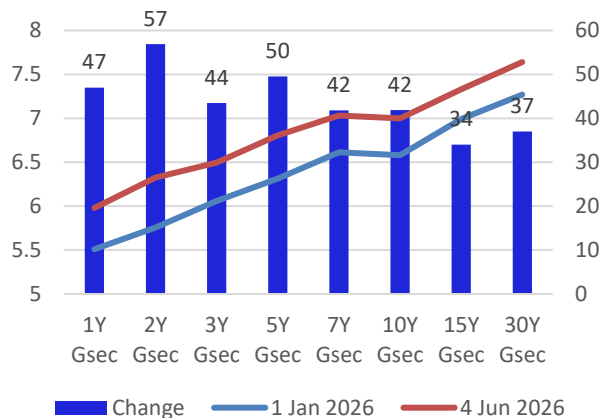
Since the onset of the West Asian conflict, yields across the curve had risen significantly. The sovereign yield curve had shifted upward in a largely parallel manner, with an increase of over 35 basis points across maturities. In contrast, the corporate bond curve had underperformed its sovereign counterpart, exhibiting a flattening bias with yields hardening by approximately 65 to 110 basis points.

The energy price shock, which exerted pressure on the currency, led to market expectations of a steep rate-hiking cycle, drawing parallel from the 2013 taper tantrum when RBI had increased the rates by 200 bps to stem the currency pressure. Spreads on the AAA-rated corporate curve, particularly up to the 3-year segment, had widened to historical highs, with absolute yields also trading at elevated levels. The sovereign curve similarly hardened, with the 10-year benchmark yield rising to a high of 7.15% before moderating to around 7.05% ahead of the policy announcement.

AAA PSU yield curve



Sovereign Yield Curve



The RBI's balanced policy stance—maintaining the status quo on rates while providing liquidity assurances and introducing measures to support foreign exchange inflows—has helped alleviate market concerns to an extent. This has, in turn, led to a rally in the corporate bond segment, with yields declining by 15–25 basis points following the policy announcement. The Sovereign curve also exhibited steepening bias post policy with softening of 4 to 15 basis points across curve

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Market Reaction

Segment	Broad movement of yields in bps (as on June 05, 2026)	
	G-Sec	AAA Corporates
3 months	-10 bps	-15 bps
6 months	-10 bps	-15 bps
1 year	-10 bps	-15 bps
2 -3 years	-15 bps	-15 to -20 bps
4 - 5 years	-15 bps	-15 to -20 bps
10 years	-2 bps	-10 bps
15 years	-3 bps	NA
30 years	-4 bps	NA

Source: Bloomberg

Despite the sharp rally, market yields still remain elevated; making risk-reward favorable..

Current yields are still elevated from a risk-reward perspective. Market yields had jumped sharply higher led by the West Asia conflict and policy overhang; Easing on both fronts triggered 15-25 bps rally.

Although there is still some uncertainty that interest rates might be raised in the future, the key short-term worries have now been taken care of. Because of this, markets are likely to feel more confident, which could push bond prices up (and yields down) across the yield curve. The spreads on the AAA curve are still at elevated levels particularly in 2-5 year tenor, compared to their long-term averages. If the measures taken by RBI to attract foreign capital give the desired results, we may see the improvement in banking deposits. Such creation of deposits may lead to eased supply pressures taking the yields on the shorter end of the curve lower. Hence, we may expect the spreads on AAA over repo to revert to their mean over a period of time. At the same time, G-Sec yield curve may get the benefit from the tax relaxations and expanded FAR security universe which can also open the doors for inclusion in Bloomberg global bond index.

MPC – Monetary Policy Committee, RBI – Reserve Bank of India; FY – Financial Year; CY – Calendar Year ; Bps – Basis Points.

Data Source – RBI Monetary Policy Document, Governor’s Statement, Bloomberg

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