Ending the Monetary Easing Cycle

Dr. T. K. Jayaraman

India's Consumer Price Index (CPI)-based year-on-year infla-tion — commonly known as head-line or retail inflation — has shown a consistent downward trend over the past nine months. The October reading, at just 0.25%, is the lowest in a decade since the CPI series began, effectively amounting to near-zero inflation. This raises an immediate question for savers, who are planning asset purchases as well as for investors: Will the Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) cut the repo rate during its bi-monthly meeting scheduled for December 3–5?

Background

After India recovered around mid-2021 from the global Covid-19 pandemic, the economy faced a prolonged infla-tionary phase that lasted far longer than the pandemic itself. Retail inflation remained above the RBI's target of 4% for nearly 30 consecutive months, from May 2021 to mid-2023.

While the Covid-19 recovery—driven by pent-up demand and the use of appropriate fiscal and monetary policies—was relatively smooth, the supply-chain disruptions caused by the pandemic had severe and lasting effects. Restrictions impeded the movement of food grains, vegetables and fruits. Given that food and energy constitute 55% of India's consumption basket, even modest supply shocks produced disproportionately large inflationary effects.

Inflation first climbed to 6.3% in May 2021, breaching the RBI's upper tolerance band of 6%. The Russia-Ukraine war, which escalated in early 2022, further raised global commodity prices—crude oil, natural gas, wheat, and edible oils. India, being a net importer of energy, saw sharp surges in food (vegetables, cereals, pulses) and fuel inflation. Retail inflation averaged 6.7% in 2022.

Even after global energy prices softened, climate-related supply shocks kept food inflation volatile. Inflation averaged 5.7% in 2023. RBI studies suggest that supply-side forces account for around 55% of India's inflation, with the rest driven by demand factors. Core inflation—which excludes food and fuel—remained more stable.

India's inflation target of 4%, with a ±2% tolerance band, is jointly endorsed by the government and RBI.

RBI's Policy Response

The RBI raised the repo rate incrementally until it reached 6.5% in February 2023, marking the end of the tightening cycle. The first cut came in February 2024—a cautious 25 basis points (bps) reduction to 6.25%.

As inflation showed a clear downward trajectory, RBI introduced two more cuts: April 2024: 25 bps and June 2024: 50 bps, (which brought the bringing the repo rate to 5.50% in June this year.)

With inflation falling to 3.15%, below the 4% target, the easing cycle strengthened.

The latest data for October—released November 12—shows inflation at 0.25%, now before the MPC for consideration at its upcoming December meeting.

TABLE : 1
INDIA: CPI inflation, Core inflation and REPO Rate (Nov 2024 - Nov 2025)

Year / Month	CPI Inflation	Core Inflation	Repo Rate
2024, Nov	5.480	3.7	6.50
2024, Dec	5.220	3.6	6.50
2025			
Jan	4.260	4.60	6.50
Feb	3.610	4.00	6.25
Mar	3.340	4.10	6.25
Apr	3.160	3.90	6.25
May	2.820	3.80	6.00
June	2.100	3.70	6.00
July	1.610	3.60	5.50
Aug	2.070	3.50	5.50
Sep	1.440	3.40	5.50
Oct	0.250	3.30	5.50

Source: MOSPI, RBI

A Rare Combination: Low Inflation and High Growth

Ultra-low inflation poses certain challenges. When real interest rates approach nominal rates, savings become less attractive, affecting investment. Consumers may delay purchases in expectation of further price reductions.

Yet India's growth performance has outpaced comparable emerging economies such as Brazil and Indonesia.

TABLE : 2
Compartative Macroeconomic Indicators For India, Brazil and Indonesia: 2021 -2025 (In percent for Indicators)

Country	Macroeconomic Indicators	2021	2022	2023	2024	2025
India	Target Inflation	4 ± 2	4 ± 2	4 ± 2	4 ± 2	4 ±2
	Actual Inflation	5.20	6.70	5.10	4.90	0.25
	Core Inflation	5.80	6.10	4.30	3.80	3.30
	Policy Interest Rate	4.00	5.90	6.50	6.25	5.50
	Growth	9.50	7.20	8.20	6.50	7.80
	Exch Rate (Rs/US$)					
	FX Reserves $ billion	634	560	600	695	690
Brazil						
	Target Inflation	3.75± 1.5	3.5±1.5	3.25±1.5	3.25±1.5	3.25±1.5
	Actual Inflation	8.3	5.9	4.5	4.2	3.8
	Core Inflation	7.5	6.3	5.5	5.2	5.31
	Policy Interest Rate	9.25	13.75	13.75	11.75	10.75
	Growth	4.8	3	3.2	3.4	2.5
	Real/US$)	5.4	5.2	4.9	5.1	5.4
	FX Reserves $ billion	362	325	340	350	335
Indonesia						
	Target Inflation	3.0±1.0	3.0±1.0	3.0±1.0	3.0±1.0	3.0±1.0
	Actual Inflation	1.9	5.5	3.5	2.8	2.5
	Core Inflation	1.7	4.9	3.2	5.8	5.3
	Policy Interest Rate	5.0	5.3	5.8	6.0	6.0
	Growth	3.5	5.3	5.8	6.9	6.0
	Exch Rate (Rupiah /US$)	14,300	15,200	15,300	15,600	16,690
	FX Reserves ($ billion)	144	137	146	141	143

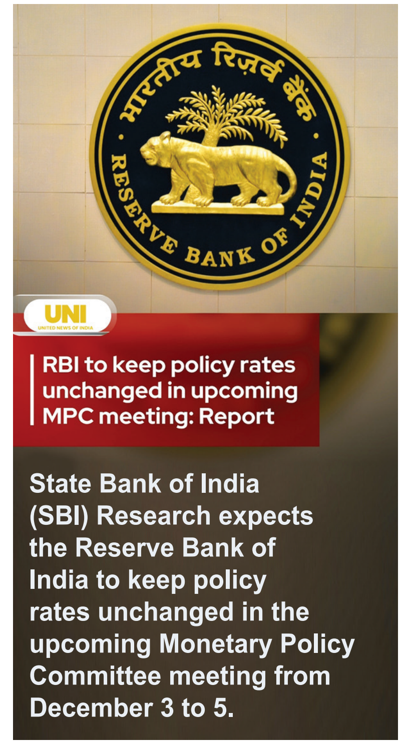
Source: MOSPI, RBI

A recent report by global ratings agency S&P estimates that:

- GDP grew 7.8% in April–June 2024, the fastest pace in five quarters.
- Growth is projected at 6.5% in FY 2026 and 6.7% in FY 2027, with balanced risks.

The IMF recently raised India's FY 2025–26 growth forecast to 6.6%. The World Bank, noting the likely effects of US tariff actions, revised India's FY26 forecast upward by 20 bps to 6.5%. On the other hand, the Ministry of Statistics and Project implementation last week reported that India's economy grew by 8.2% during quarter (Q2) of current FY 26, as against previous quarter (Q1) 7.8%); and 8% first half (H1) FY 2025-26, as compared to the growth rate of 6.1% in H1 of FY 25.

Domestic growth remains resilient despite the potential impact of the proposed penalty tariff of 25% along with the reciprocal tariffs of 25% by US on imports from



and the uncertainties associated with no sign of a bilateral trade agreement in the near future. Though the rupee has depreciated considerably in recent months, the foreign exchange reserves remain comfortable at $692.6 billion. This cushion provides the RBI with room to maneuver, even as global conditions remain volatile. Lowered GST rates, along with income-tax reductions and earlier interest-rate cuts, are expected to strengthen middle-class consumption. As a result, consumption may become a larger driver of growth than investment over FY 2024–25 and FY 2025–26.

Experts have reduced India's inflation forecast to 2.5% for FY 2025, given unexpectedly soft food prices. Food inflation is expected to normalise to around 5% by FY 2027.

Despite global uncertainties and the absence of a final trade agreement with the US, India's external posi-tion remains relatively stable. Recent foreign exchange reserves stand at a comfortable $692.58 billion (as of November 14), though capital outflows have contributed to some rupee weakness.

One More Cut to Complete the Easing Cycle

With the inflation battle largely won, the easing cycle that began in February 2024 is nearing completion. Economists widely expect one final 25 bps cut in early December 2025, which would bring the repo rate to 5.25%.

Using the Taylor Rule—a guideline introduced by Stanford economist John B. Taylor in 1992 that compares actual inflation and output with desired levels—Dr. Kaushik Das of Deutsche Bank recently suggested that 5.25% represents the appropriate "terminal rate" for the current cycle. which would enable the monetary policy remain neither too loose or too tight. That is the rate at which monetary policy is neither stimulating nor slowing the economy.

Dr Soumya Kanti Ghosh of the State Bank of India Group observed:

"Missed easing cycles have a more damaging impact than easing early."

It is therefore an opportune moment for the RBI to act decisively and end the ongoing easing cycle with the terminal rate at 5.25%. ■

— Dr. T. K. Jayaraman is a former Senior Economist with the Asian Development Bank, Manila, and a retired IAS officer from the Gujarat cadre. He was a recipient of Fulbright and East-West Center grants for his doctoral studies at the University of Hawaii. His website is : http://www.tkjayaraman.com

Rupee has weakened

■ *Tirthankar Mitra*

The rupee has weakened significantly over the past year, falling from 84.7 to 89.7 against the US dollar. Its depreciation has been even sharper against the euro (9.4 per cent) and the British pound (14.3 per cent). It has also lost value against the Japanese yen and the Chinese yuan. In nominal terms, therefore, the rupee has depreciated against all major global currencies.

This depreciation comes at a time when price inflation in India is low — lower than inflation in the US, the UK, the Eurozone, and Japan.

The rupee's Real Effective Exchange Rate (REER) has also declined. Reserve Bank of India data shows the REER index falling from an all-time high of 108.1 in November 2024 to 97.5 in October 2025. In other words, the rupee has shifted from being overvalued to being undervalued.

From a foreign trade perspective, this shift is not necessarily negative. India's merchandise trade deficit reached a record $41.7 billion in October, in the backdrop of twin global shocks: US President Donald Trump's unilateral tariff actions and China's aggressive redirection of its exports toward the rest of the world.

In such a scenario, an artificially strong rupee is the last thing the economy needs. A mildly undervalued currency, as India now has, can help boost exports and cushion the domestic market from a surge of cheap Chinese imports. Exchange rates serve as effective shock absorbers and are often better tools for correcting trade imbalances and improving competitiveness than tariffs or subsidies.

In recent years, Indian policymakers relied on a mix of an

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overvalued exchange rate and protectionist trade measures — including tariffs, export bans, and quality-control orders — to control inflation and shield domestic industries. That approach has shifted. Under the current governor, the Reserve Bank of India has adopted a more flexible exchange-rate policy, allowing the rupee to move in a more calibrated manner.

The willingness to permit steady depreciation partly stems from easing inflation. The earlier fear that a weaker rupee would make imports costlier and fuel domestic prices has receded amid global deflationary pressures. A bigger factor, however, may be the shock from Trump's tariffs, combined with China's export surge driven by excess industrial capacity.

India's current account deficit, rooted in a widening gap between exports and imports, cannot remain unaddressed indefinitely. Exchange-rate policy must adapt to this reality. ■

Finance & Economy

Indian Banks – Looking Forward to Scalability

■ *Saptarshi Roy Bardhan*

Two key figures of India's financial architecture—the Finance Minister, Smt. Nirmala Sitharaman, and the RBI Governor, Mr. Malhotra—have recently articulated their vision for building larger, stronger, and more scalable banks. While the Finance Minister spoke of creating many world-class banks, the RBI Governor emphasised the need for large-scale, carefully calibrated reforms to strengthen an already robust banking ecosystem.

Both were speaking at the recently concluded SBI Banking and Economic Conclave.

India's banking sector has scaled new heights in the 21st century. In the aftermath of the 2007–08 Global Financial Crisis—which exposed overleveraged corporates, stressed bank balance sheets and external vulnerabilities—India was even placed among the "Fragile Five" emerging economies (Turkey, Indonesia, Brazil, South Africa, and India).

That phase marked the beginning of deep structural corrections.

From 2014 onwards, a comprehensive clean-up began, driven by regulatory measures focused on recognition, resolution, and recapitalisation. A crucial milestone was the 2015 Asset Quality Review (AQR), which forced banks to disclose the true extent of NPAs. The Prompt Corrective Action (PCA) framework helped restore the health of weak banks, while enhanced supervisory tools such as periodic stress tests ensured sustained discipline.

This was followed by consolidation—27 public sector banks were merged into 12 by 2020. A massive recapitalisation programme during the pandemic further strengthened capital buffers and helped banks revive healthy lending practices.

The introduction of the Insolvency and Bankruptcy Code (IBC) in 2016 transformed India's credit culture. Over the last nine years, cumulative debt recovery has reached approximately ₹48 lakh crore across more than 1,200 cases.

Parallel reforms strengthened monetary and macroeconomic stability: adoption of flexible inflation targeting, deepening of forex markets, and gradual capital account liberalisation. Simultaneously, the growth of NBFCs, MFIs and FinTechs has reshaped the financial landscape—they now play a major role in credit sourcing and distribution. Capital markets have matured, enabling credit risk transfer through securitisation. New Project Finance Directions have addressed risks linked to land and regulatory approvals. The upcoming Expected Credit Loss (ECL) regime is expected to ensure earlier and more accurate recognition of asset quality deterioration.

Over time, Indian banking has matured significantly and is now closer to global standards. As the RBI Governor noted, strong bank balance sheets have contributed to India's remarkable resilience amid global headwinds—steering steady growth, maintaining stability, and attracting investment even as many economies slow.

The numbers reinforce this confidence. Credit and deposits have nearly tripled. CRAR has risen from 13.5% (March 2015) to 17.5% (March 2025). GNPA and NNPA ratios have declined to 2.3% and 0.5% respectively. Profitability has improved sharply—between FY 2017–18 and FY 2024–25, Return on Assets increased from –0.24% to 1.37%, while Return on Equity rose from –2% to 14%.

At this juncture, the Finance Minister's vision appears both realistic and timely. She emphasised creating an ecosystem where more banks can grow and scale. With the number of state-run banks reduced from 27 to 12 through mergers in 2017 and 2019, her suggestion that the government and RBI are exploring multiple models—including fresh mergers and creation of new institutions—gains importance.

However, in an era when the government prioritises financial inclusion, technology becomes indispensable. The Finance Minister stressed India's cautious approach to AI—encouraging innovation while ensuring national security and ethical safeguards through a "soft-touch" regulatory framework.

Yet, she also reminded public sector banks to retain the "human touch"—such as deploying staff who understand local languages and communities. While technology boosts efficiency, productivity and profitability, customer experience still depends on empathetic human engagement.

The broader strategy for banking expansion must therefore be calibrated: allowing banks commercial freedom to innovate and grow, while safeguarding against emerging risks to preserve financial stability.

As the RBI Governor concluded, "We have set ourselves an ambitious goal of becoming an advanced economy by 2047. The financial sector has a large role to play in it. RBI remains steadfastly committed to this goal. We will ensure that our financial system evolves responsibly to support innovation, growth, and long-term economic resilience." ■