

# The challenge before the Reserve Bank of India

■ Dr. T. K. Jayaraman

**R**eserve Bank of India (RBI) Governor Sanjay Malhotra will chair his fourth bi monthly Monetary Policy Committee (MPC) meeting from August 4–6. Since assuming office earlier this year, this will arguably be his most challenging task.

At the previous MPC meeting held from June 4–7, the RBI surprised markets by delivering a large cut of 50 basis points (bps) in the policy repo rate — from 6.00% to 5.50%. Explaining the decision at his press conference, Governor Malhotra noted that, while domestic conditions were favourable, external conditions were increasingly adverse due to global uncertainties. He specifically referred to U.S. President Donald Trump's renewed protectionist push, including higher tariffs on imports and measures reversing earlier pro globalization reforms related to trade, capital flows, and labour mobility.

## Economic backdrop

Following the post pandemic recovery, global growth picked up in 2023 and 2024, with India outperforming most economies (Table 1). However, Trump's return to power in early 2025 has created new headwinds. Several global agencies, including the Asian Development Bank, have

revised growth forecasts downwards, aligning closely with the RBI's own projections (Table 2).

**TABLE 2**  
**Growth Forecasts for FY 2025-26**  
**Rate (%)**

Particulars	Earlier	Latest
ADB	6.7	6.5
IMF	6.5	6.2
World Bank	6.3	6.3
India Ratings	6.6	6.3
RBI	6.5	6.5

Source: Livemint ( July 27, 2025)

## Domestic trends

On the domestic front, inflation has been on a sustained downward trend since October 2024, when it stood at 6.21%. By February 2025, it had fallen to 3.61% — below the RBI's 4% target — prompting a cautious 25 bps cut in the repo rate to 6.25%. Another 25 bps cut followed in April, bringing the rate to 6.00%.

When May inflation data showed a further drop to 2.82% — the lowest in six years — the RBI felt confident enough to deliver a 50 bps cut in June. Governor Malhotra declared that, although the fight against inflation that began in 2022 was largely won, the RBI would remain vigilant to safeguard price stability.

To complement the rate cuts, the RBI also announced a phased reduction in the cash reserve ratio (CRR) — totalling 100 bps over four instalments — from 4% to 3%, aimed at easing liquidity. With these steps, the RBI met its commitment to reduce the repo rate by 100 bps well before the end of the financial year. The monetary policy stance also shifted from “accommodative” to “neutral.”

## Limited immediate impact

Did these measures trigger a borrowing surge? Not yet. The transmission of policy rate cuts typically takes time. For instance, the 25 bps cut in February was only passed on by banks in mid May. Cuts in April and June will also take several months to fully filter through.

Several factors explain banks' reluctance to lower lending rates quickly:

- Risk aversion post COVID, with banks prioritising asset quality.
- Liquidity buffers — CRR reductions boosted liquidity, but banks used this to strengthen balance sheets rather than expand credit aggressively.

**TABLE 1**  
**Growth Estimates for Post Covid**  
**and Projections by IMF (July 2025)**  
**(in percent)**

Countries	YEAR			
	2023	2024	2025	2026
World	3.5	3.3	3.0	3.1
USA	2.9	2.8	1.9	2.0
Euro Area	0.9	0.5	0.9	1.2
UK	0.9	1.1	1.2	1.4
China	5.4	5.0	4.8	4.2
India	9.2	6.5	6.4	6.4

Source: IMF, World Economic Outlook, July 2025

**TABLE — 3 : Advanced Countries and India: Inflation and Central Banks' Policy Interest Rates (Percent)**

YEAR	Month	COUNTRIES					
		EURO AREA		UNITED KINGDOM		UNITED STATES	
		Inflation (Y-o-Y)	Interest Rate	Inflation (Y-o-Y)	Interest Rate	Inflation (Y-o-Y)	Interest Rate
2024	June	2.50	4.25	2.00	5.25	3.00	5.50
	July	2.60	4.25	2.20	5.25	2.90	5.50
	August	2.20	4.25	2.20	5.00	2.50	5.00
	September	1.70	3.65	1.70	5.00	2.40	5.00
	October	2.00	3.40	2.30	4.75	2.60	5.00
	November	2.20	3.40	2.60	4.75	2.70	4.75
2025	December	2.40	3.15	2.50	4.75	2.90	4.50
	Januray	2.50	2.90	3.00	4.75	3.00	4.50
	February	2.30	2.90	2.80	4.50	2.80	4.50
	March	2.20	2.65	2.60	4.50	2.40	4.50
	April	2.20	2.40	3.50	4.50	2.30	4.50
	May	1.90	2.40	3.40	4.25	2.40	4.50
	June	2.00	2.15	3.60	4.25	2.70	4.50
	July	TBA	2.15	TBA	TBA	TBA	TBA

Source : Trading Economics

Notes: TBA : To be Announced

- Global uncertainty — trade disruptions, supply chain risks, and recessionary fears have all made banks cautious.
- Although inflation has eased, the RBI is wary of sparking fresh price pressures through excessive lending.

### Looking ahead

Speaking at the Financial Express BFSI Summit in Mumbai on July 25, Governor Malhotra reiterated that future rate cuts will depend on the outlook for growth and inflation, not merely current readings. He highlighted that monetary policy works with a lag, and the effects of rate changes must be assessed over a 12 month horizon.

He noted that India's credit growth in FY25 was 12.1% — better than the decade long average of about 10% — but is currently lagging in FY26 by around 9%. Inflation is projected to rise to 4.4% in the second quarter of FY26.

### Global context

External developments remain crucial. **Table 3** developments in regard inflation and monetary policy changes effected by



various leading central banks over last 12 months (July 2024 to June 2025) On July 30, the U.S. Federal Reserve kept its policy rate unchanged at 4.25% (set in February) in a 6–2 vote, citing higher inflation from increased tariffs. U.S. inflation rose to 2.7% in June from 2.4% in May, above the Fed's 2% target. The Fed will review its stance at the September meeting after assessing July and August inflation data.

### Policy outlook

Given these factors, it appears likely that the RBI will maintain the repo rate at 5.50% and retain its neutral stance for at least the next two months. ■



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