PRAVIA
INVESTMENT ADVISORS

RBI Monetary Policy Meeting 10th June 2026

Backdrop to the meeting:

- The Indian Rupee, in the last 1 year, has **depreciated** significantly:
  - 10.01% v/s the US Dollar – affecting energy and commodity imports
  - 15.2% v/s the Chinese Yuan – affecting industrial and manufacturing imports

- Government **bond yields have increased** across tenures over the last 1 year:
  - **Only** very short-term (<1 year) yields are **stable**
  - **All maturities above 1 year until 40 years have increased by 0.57% to 0.75% depending on duration**

- PM Modi came on 2 occasions:
  1. On March 23, expressed concerns over the US-Iran war (**which still continues**) affecting the global economy significantly
  2. On May 10, **asked citizens to help defend the currency** by decreasing international travel and limiting gold buying as it is a major import

- **FIIs** have **sold Indian securities**:
  - **Equities** (due to valuations)**:** ~3 Lakh Cr in 2026 YTD, ~1.61 Lakh Cr in 2025
  - **Debt** (DM yields increased much more than India)**:** ~7,000 Cr in 2026 YTD, ~20,000 Crores in 2025

- As yields have increased over the last 1-year**,** Fixed income funds with duration more than 1 year have performed poorly

- Investments, especially into long duration bond funds and corporate bond funds have underperformed due to increase in government bond yields

Performance of funds

Category average	Mod Dur	1 Year
Overnight Fund	0.01	5.31
Liquid	0.10	6.15
Arbitrage Fund	0.37	6.32
Ultra Short Duration	0.41	6.24
Money Market	0.62	6.04
Low Duration	0.86	5.96
Floating Rate	1.86	5.44
Short Duration	2.15	4.72
Income plus Arbitrage	2.44	5.03
Corporate Bond	2.53	4.25
Medium Duration	3.01	5.07
Dynamic Bond	4.13	1.95
Medium to Long	5.16	1.90
Gilt Funds	7.53	1.49
Long Duration	10.21	-1.48

Source: Investing.com, ACE MF

However, we find fixed income attractive at current levels and believe that yields can moderate over the next 3 years, leading to price appreciation.

Executive Summary:

RBI has maintained a brave face and is showing confidence in its approach to **counter INR depreciation** – unlike many EM counterparts (**Indonesia** in particular has **hiked its interest rates by 75 bps since April, 2026**).

The RBI MPC met on the 3rd to 5th of June 2026 to decide the outcome for the 2nd Interest Rate decision of FY2027 keeping **interest rates and stance were kept unchanged**.

Data overview:

Particulars	Interest Rate (Repo)	Standing Deposit Facility (SDF)	Marginal Standing Facility (MSF)	Stance
Current	5.25%	5.00%	5.50%	Neutral
Meaning	Rate at which banks borrow from RBI (regular rate)	Rate at which RBI borrows from banks	Rate at which banks borrow from RBI (emergency rate)	Not biased towards increasing/decreasing interest rates

GDP growth (YoY) revised downwards: Earlier 6.9% → Now 6.6%

CPI (YoY) revised upwards: Earlier 4.6% → Now 5.1%

For FY27

While there have been no changes in taxation to Equities (other than raising limits for investment without SEBI registration), multiple incentives have been brought in to **attract foreign capital into Indian fixed income markets:**

- **Tax**: Interest and capital gains nullified for foreign investors
- **FCNR (Foreign Currency Non-Resident) Hedge**: RBI absorbing 100% of FX hedging costs on 3Y/5Y NRI deposits
- **FAR Expansion**: Extended to all new securities within the long-end basket – 15Y, 30Y, 40Y <u>targeting stable capital</u>

Our view:

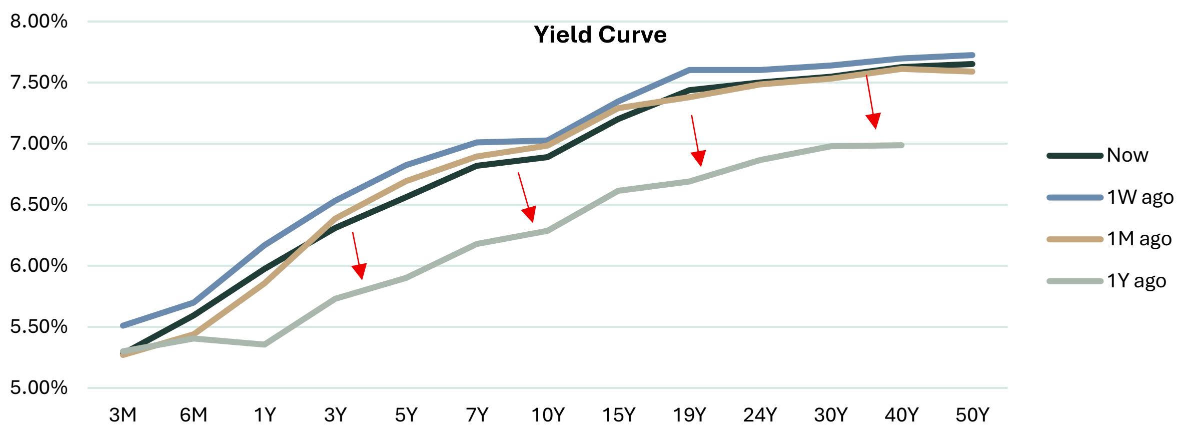
Building on a period of ongoing **policy coordination** between RBI and the government, their latest measures specifically **attract foreign capital** to support the INR and soften yields.

RBI's messaging is clear –

Growth via Capex
Govt's stated priority → Needs cheap capital
Viability sensitive to rates → Rate hikes unlikely
Unless inflation moves out of comfort zone

- That being said, there have been **emergency measures announced to attract capital into Indian debt markets** to support the currency and decrease yields. So far, the initial response is positive as yields have eased from the top:
  - Bond markets were factoring in ~3 rate hikes before the MPC → now has contracted to ~2 rate hikes due to the measures brought in by the RBI.
- Even if interest rates were to increase, yields will still find it difficult to go upwards. Yields can move sideways for some time before moving down eventually.
- In February, due to attractive valuations and dividend yields, **we had shifted asset allocation from fixed income into select equities – which has played out well**.

Investment implications

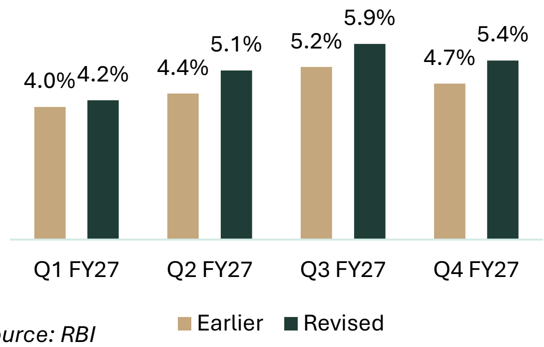


- **Fixed Income**: Returns over the past year have been poor, however **yields have a higher probability of decreasing from hereon**, and all durations look good – with long duration looking the most attractive.
- **Income plus arbitrage funds are <u>well placed</u>** for investors with a holding period >2 years as they are favourably taxed at 12.5% LTCG (vs tax slab rates for all other debt funds)
- **REITs/InvITs** look lucrative – After our recent note on REITs bucket highlighting our conviction on real assets and hedging against inflationary risks, InvITs will be our next area of focus.
- **Hybrid Mutual funds** – Given our positive outlook on equities and fixed income, select balanced advantage and aggressive hybrid funds look attractively placed

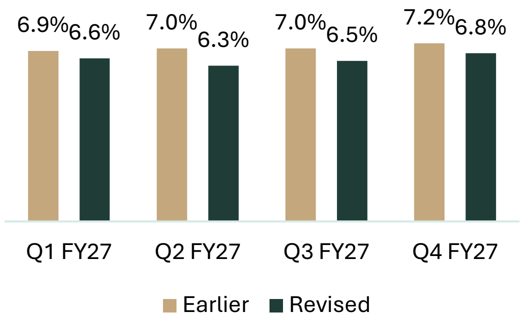
Detailed Note:

The RBI decreased growth forecasts and increased inflation forecasts – laying out projections indicating the 2nd half of this fiscal will face strong headwinds due to higher inflation on the back of elevated oil prices and Super El Nino concerns.

CPI (YoY) Revised Upwards



Real GDP growth (YoY) revised downwards

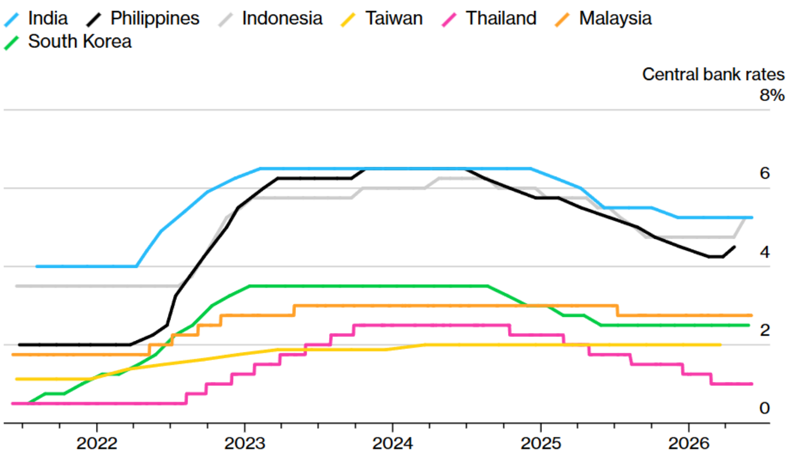


Source: RBI

Currency

INR has depreciated on the back of **supply-side disruptions**.

- Since Dec-24, RBI didn't cut rates aggressively (v/s peers who did) during its rate cut cycle, keeping inflation well in their target range while the world was struggling.
- Despite having higher rates than other peers, INR depreciated more



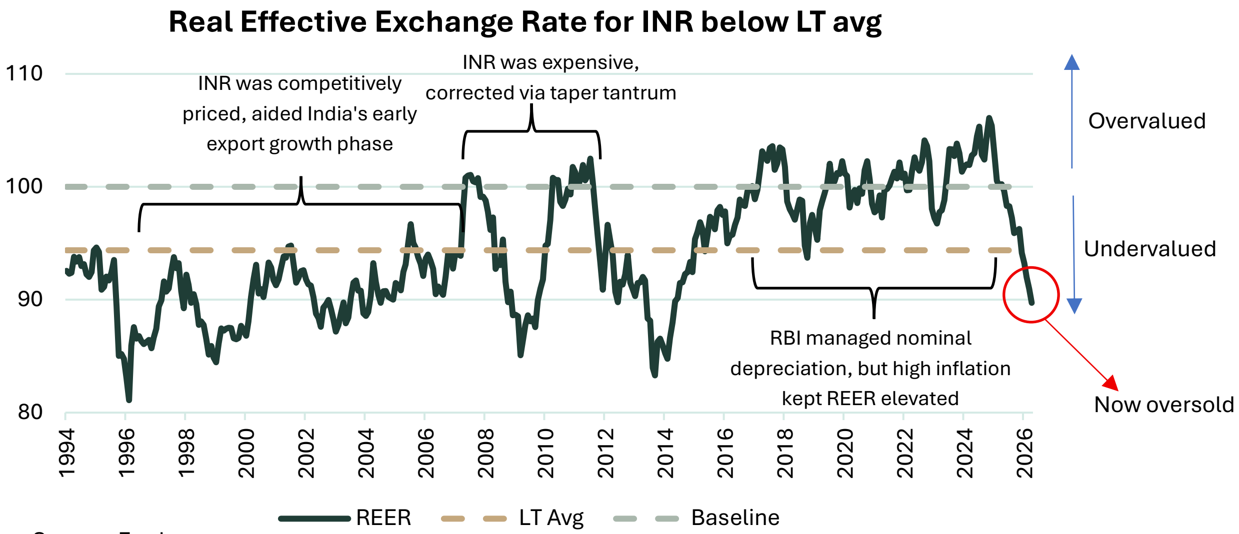
Source: Bloomberg

V/s USD	1Y Depreciation
South Korea	11.1%
India	10.0%
Phillipines	8.6%
Taiwan	5.2%
Indonesia	9.3%
Thailand	0.6%

Source: Google finance

- We believe the **INR looks to be in an oversold zone** v/s other EM peer. As the US-Iran war resolves, there should be more positivity around both Indian yields (started by policy changes made by the RBI in this MPC) and currency

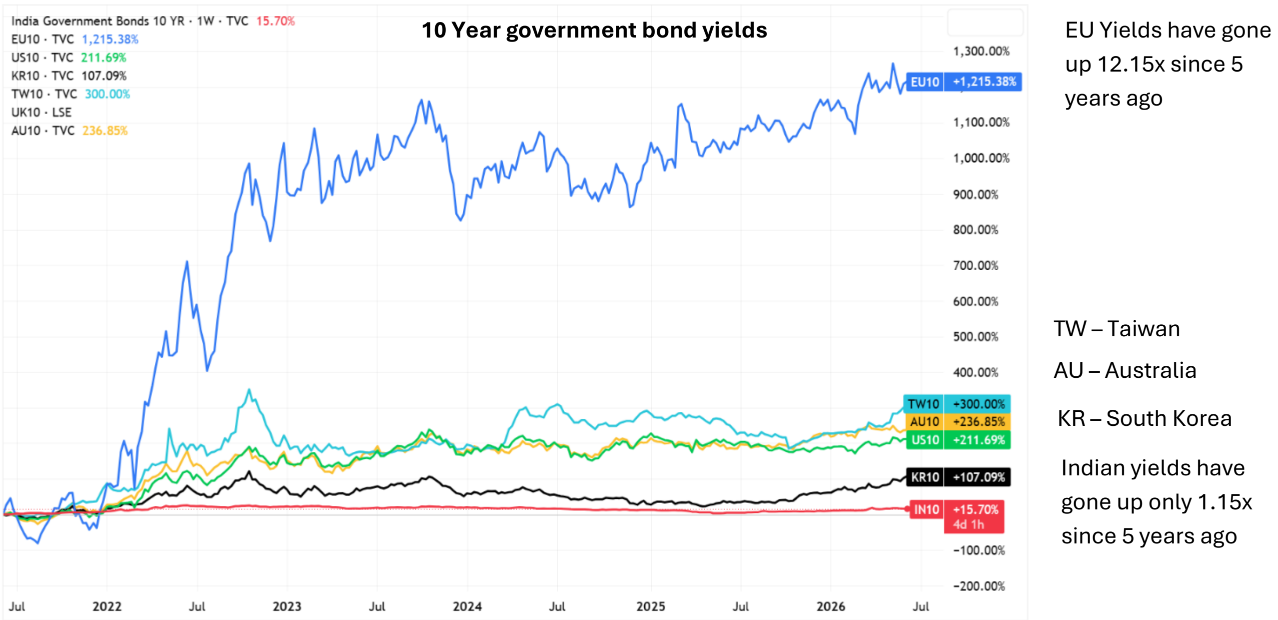
- REER is the exchange rate **adjusted for inflation** - which tells you the ***actual*** purchasing power competitiveness of a currency, not just its nominal price. Currently, it indicates that the **INR is in an oversold territory** (as it is below the base of 100) and **can see a phase of appreciation**



Source: Fred

<u>Why are FIIs staying away from Indian bonds?</u>

Global central banks have hiked interest rates aggressively over the past five years, pushing bond yields sharply higher across developed markets. Indian yields, by contrast, have barely moved.

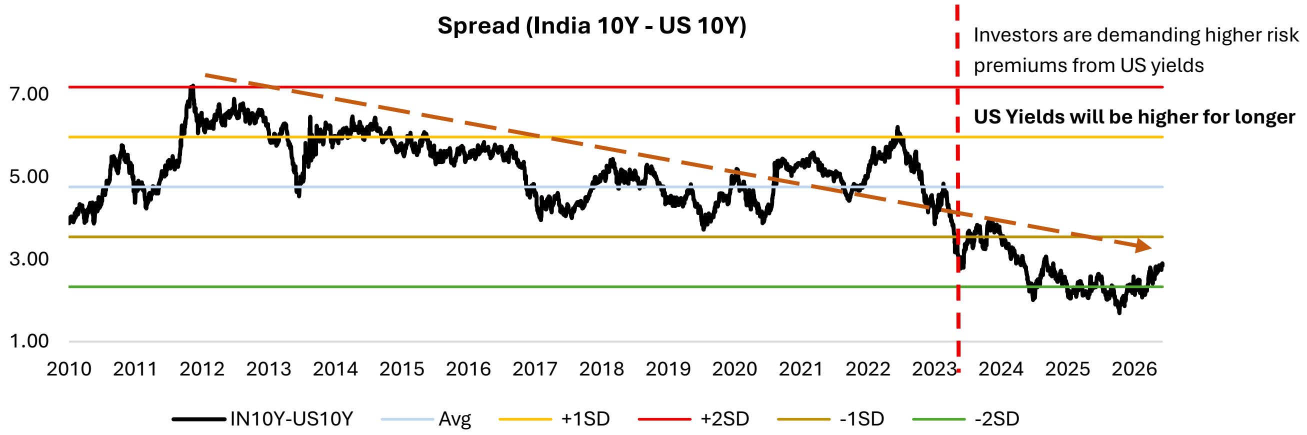


All values are indexed to 100 from 5 Years ago; Source: Tradingview

We can interpret this in 2 ways – and give <u>weightage to the latter point</u>:

1. Indian 10-year yields **haven't kept pace with global peers**, leaving little yield spread for foreign investors already holding higher-yielding DM debt
2. Spreads between India and US 10Y have compressed as US yields have risen due to **de-dollarization, fiscal spending and higher interest payments**. Indian government bond yields, by contrast, have remained stable over the past 5 years

Hence, there has been a shrinking IND10Y - US 10Y spread – because US debt requires a higher yield to compensate for the risk it holds.



Source: Investing.com

<u>RBI and the Government appear to be coordinating policy responses in pursuit of growth:</u>

The RBI and the Government of India are pursuing a coordinated policy response to achieve growth while inflation in check. There will be different tools used, **keeping interest rate hikes as a measure of last resort**, to counter inflation and lower yields across the board.

- We believe RBI may **not hike rates** and increase cost of capital **unless inflation comes in at substantially different range from the 4% (+/-) 2% mandate.**
- At the same time, the government is trying to diversify its international exposure to these central problems so the RBI has more space to not hike rates:
    - Diversified oil suppliers from 27 to 41 countries
    - OMCs to bear the large upfront cost to protect consumers
    - Increasing refineries production of LPG to maximum output
    - Actively trying to diversify fertilizer dependency

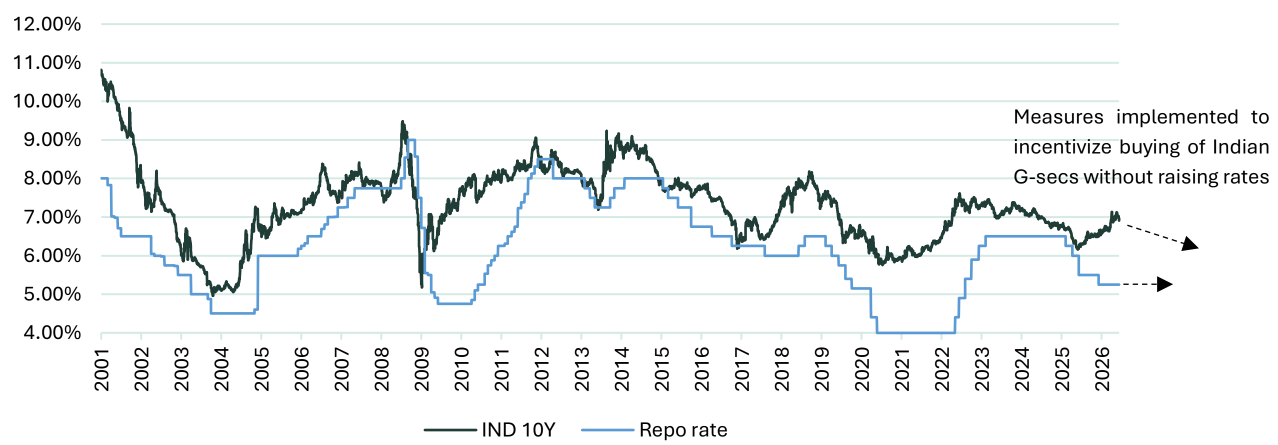
Improving Capital Flow Measures

The RBI and the Government of India announced a comprehensive package of measures to attract foreign capital flows:

- **FPI Tax Nullification:** The government eliminated both withholding tax on coupon income and capital gains tax on government bonds for FPI investors – a move well above market expectations. This materially improves India's eligibility for inclusion in major global bond indices (e.g., Bloomberg Global Aggregate)
- **(Foreign Currency Non-Resident) FCNR Full Hedge Coverage:** RBI will absorb the full currency hedging cost on 3 and 5-year FCNR deposits raised by banks – enabling banks to offer competitive deposit rates to NRIs and OCIs.
- **Increased range of FAR securities:** Fully Accessible Route (FAR) now including 15-year, 30-year, and 40-year tenures strategically extends the bond duration available to foreign investors, **attracting stable, patient capital** from long-horizon global allocators like pension funds and sovereign wealth funds.
    - This structural maturity elongation anchors the ultra-long end of the sovereign curve, successfully shifting the foreign investor mix away from speculative money and **reinforcing long-term balance-of-payments stability.**
- **Increased investment limits**: For NRIs and OCIs, limits for investing in listed equity instruments without SEBI registration has been increased.

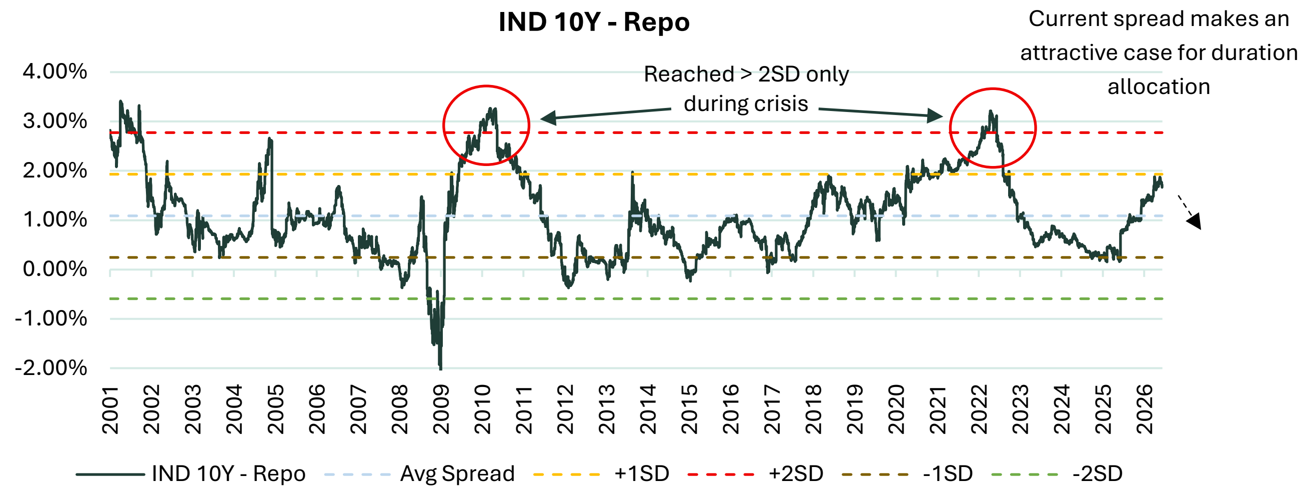
These measures paint a bullish scenario for bonds. We are already observing the positive effects as yields ease

Spread over Repo rates:



Source: Investing.com

10Y Spread over the Repo reached ~3.2% during the peak of Russia-Ukraine war in 2022. Current spread is 1.63%.



Source: Investing.com

<u>Our View:</u>

Our **base case** remains that the **Repo rate may not move materially lower** while geopolitical and inflationary risks persist. The government will work to ease supply-side pressure by diversifying suppliers of key commodities and energy. RBI's capital flow measures have started to have an effect as bond yields eased post the announcement.

The mandate remains growth with price stability. India's multi-decade Capex cycle demands a lower cost of capital

- That being said, there have been **emergence measures announced to attract capital into Indian debt markets** to support the currency and decrease yields. So far, the initial response is positive as yields have eased from the top:
    - Bond markets were factoring in 65 bps of rate hikes before the MPC → now contracted to 53 bps (~2 rate hikes) due to the measures brought in by the RBI.
- Even if interest rates were to increase, there is a good possibility that yields won't. Yields can move sideways for some time before moving down eventually.
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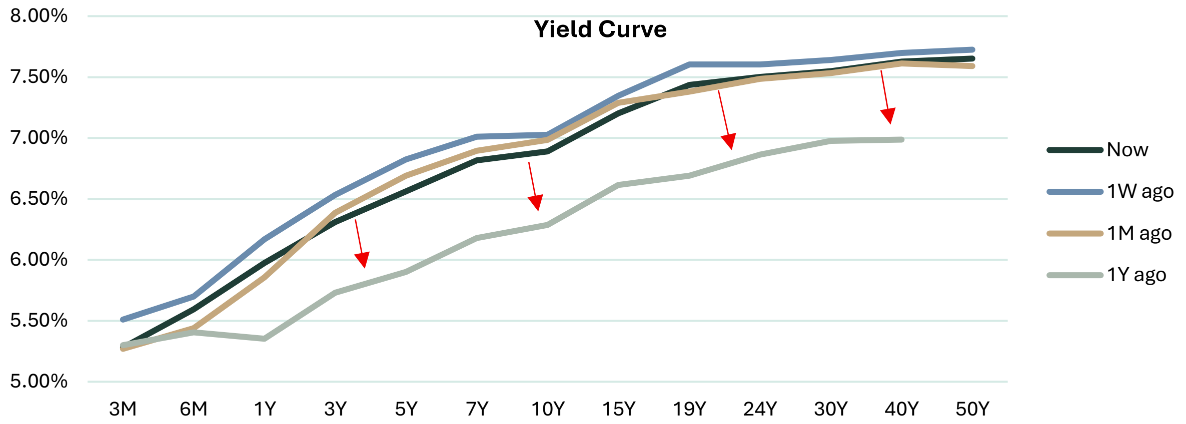

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- Pravia Investment Advisors Private Limited: CIN: U66309MH2025PTC451047; Regd Off Address: 801, A-Wing 215 Atrium, CTS No 215, Andheri-Kurla Road, Andheri East, Chakala MIDC, Mumbai - 400093; Contact: **+91 9004139937**
- Corporate Investment Adviser SEBI Registration no. INA000021322, Validity of Registration: Nov 04, 2025 – Perpetual. BSE Enlistment No.2375,
- Principal Officer: Ms. Vaibhavi Shah (E-mail: info@pravia.in), Contact: **+91 9004139937**
- Compliance Officer and Grievances Redressal Officer: Mr. Sachin Dwiwedi (E-mail: compliance@pravia.in) Contact: **+91 9004139937**

SEBI Regional Office: SEBI Bhavan, Plot No. C-4 A, G Block, Bandra Kurla Complex, Bandra East, Mumbai 400 051.