

RBI Monetary Policy: Beginning of a shallow tightening cycle

In line with market expectations, the RBI's Monetary Policy Committee (MPC) unanimously raised the repo rate by 25bps to 5.5% and shifted the stance to “*calibrated tightening*”, marking the first rate hike since February 2023. The policy tone was relatively hawkish, reflecting a less favourable growth-inflation balance and a clear reassessment of the inflation trajectory. The FY27 CPI inflation forecast was revised up by 20bps to 5.2%, with inflation expected to average at around 5.8% over the next three quarters. Core inflation is projected at 4.4%, indicating some broadening in underlying price pressures, although inflation remains predominantly supply-driven, with limited evidence so far of sustained demand-side pressures. At the same time, the FY27 GDP growth forecast was revised up by 40bps to 7.1%, supported by resilient private consumption, investment, manufacturing, services and exports. This resilience gives the RBI greater room to prioritise inflation containment without materially compromising growth at this stage.

The October action is likely to mark the beginning of a calibrated tightening cycle. With the policy rate at 5.5% and inflation projected to remain elevated over the coming quarters, the ex-ante real policy rate is likely to stay mildly negative initially. Further calibrated hikes could move real rates modestly into positive territory, although monetary conditions may still remain short of becoming significantly restrictive. Rate cuts therefore are unlikely in the near term, leaving the policy choice between a pause and further tightening. The terminal rate will depend on the persistence and breadth of inflation, the emergence of second-round effects and the degree to which higher rates begin to weigh on activity. Sizeable surplus liquidity remains an additional complication, as weaker transmission could dilute the intended tightening impulse, making active liquidity management imperative.

- First rate hike since February 2023; stance shifts to calibrated tightening....** In line with market expectations, the MPC unanimously raised the policy repo rate by 25 bps to 5.5% in its October meeting and changed the stance to “*calibrated tightening*.” This marks the first rate hike since February’23, after an extended period of status quo at 6.5% through February’25, followed by a cumulative 125 bps of easing between February and December 2025. The move reflects a less favourable growth-inflation balance, with resilient growth providing policy space even as inflation risks have strengthened. Accordingly, the SDF and MSF rates were raised to 5.25% and 5.75%, respectively.
- ...as inflation risks warrant policy recalibration:** The MPC noted that inflation and its outlook are no longer as benign as last year, with headline CPI expected to average 5.8% over the next three quarters and core inflation projected at 4.4% in FY27. The rate hike is therefore aimed at containing second-round effects and preventing supply shocks from becoming embedded in pricing behaviour. The shift in the stance to *calibrated tightening*, last adopted in October 2018, signals that rate cuts are off the table in the near term, with the policy choice now between a pause and further hikes. The extent and duration of tightening will remain contingent on underlying inflation, the broadening of price pressures, second-round effects and evolving demand conditions.
- Inflation outlook turns less benign....** The MPC noted that inflation pressures have become more broad-based, even as supply-side factors remain the dominant driver. Signs of generalisation are also visible in diffusion indicators, with the weighted share of CPI items recording inflation above 4% rising to around 37% in August. Reflecting the firmer trajectory, the RBI raised its FY27 headline CPI inflation forecast by 20 bps to 5.2%, with Q2 projected at 4.9%, Q3 at 6.0% and Q4 at 5.7%; Q1FY28 inflation is projected at 5.6%. Core inflation for FY27 is now projected at 4.4%. Going forward, deficient monsoon conditions, El Nino, elevated

The RBI's MPC unanimously decided to raise the policy repo rate by 25bps for the first time since February 2023, while changing the stance to “Calibrated tightening.”

FY27 inflation has been revised up by 20bps to 5.2% while GDP growth is projected to be 40bps higher at 7.1%.

crude oil prices and broader food-price pressures are expected to keep near-term inflation elevated, although signs of supply shocks becoming embedded in pricing behaviour remain limited.

- **...while growth projections see a significant upgrade:** Domestic economic activity has remained resilient despite persistent global headwinds, with Q1FY27 real GDP growth at 7.8%, supported by robust private consumption, strong investment activity and a positive contribution from net exports. High-frequency indicators suggest that momentum has continued into Q2, aided by firm manufacturing activity, resilient discretionary consumption, sustained services-sector expansion and strong credit flows. Reflecting this broad-based strength, the RBI raised its FY27 real GDP growth forecast sharply by 40 bps to 7.1%, with Q2 projected at 7.2% (+80bps), Q3 at 6.9% (+40 bps) and Q4 at 6.8%; Q1FY28 growth is projected at 7.1%. Going forward, continued infrastructure spending, a rebound in private capex, buoyant services exports and recent trade agreements are expected to support activity. However, lagged implication of deficient SW monsoon conditions and strong global El Nino on upcoming rabi season, elevated commodity prices, geopolitical tensions, trade frictions and tighter global financial conditions remain key downside risks.
- **Liquidity surplus widens; RBI steps up management to align WACR:** Banking-system liquidity increased substantially since the August policy, with the average daily surplus under the LAF rising to Rs 5.9 lakh crore (vs. Rs 1.2 lakh crore in July). The sizeable surplus kept the WACR largely in the lower half of the policy corridor, averaging around 14 bps below the repo rate since the August policy, while short-term money-market rates also softened. Transmission to bank rates remained uneven: the weighted average lending rate on fresh rupee loans hardened by 8bps during July–August, while fresh term-deposit rates declined by 28bps, partly reflecting abundant liquidity following FCNR (B) mobilisation. The RBI has responded through term VRRR auctions and OMO sales to align the WACR with the repo rate. Managing surplus liquidity will assume greater importance during the tightening phase, as persistent excess liquidity could dilute or delay transmission of higher policy rates.
- **The door opens for further calibrated rate hikes:** Today's 25bps hike is likely to mark the beginning of a shallow tightening cycle. With inflation projected to move closer to the upper end of the tolerance band, ex-ante real policy rates are likely to remain mildly negative initially, turning only modestly positive with further calibrated hikes. Even then, monetary conditions may tighten without becoming significantly restrictive. Inflation pressures are gradually becoming more broad-based, although core inflation, at around 4.4%, remains manageable and the firming up in inflation is still predominantly supply-driven, with demand-side pressures contained. Resilient growth gives the RBI room to normalise policy further, but the extent of tightening will depend on how quickly higher rates begin to constrain activity. At the same time, sizeable surplus liquidity creates an unusual policy configuration—higher policy rates alongside abundant banking system liquidity. Unless adequately managed, this surplus could dilute transmission of rate hikes to money-market and lending rates, making liquidity management critical to preserving the intended tightening impulse. To summarise, the direction of policy is clearer; the terminal rate will remain data dependent.

Since the August policy, the average liquidity surplus in the banking system has surged to Rs 5.9 lakh crore. As a result, the average WACR traded 14bps below the policy repo rate.

Table 1: Current policy rates

The policy repo rate was increased by 25bps to 5.5%. The stance was changed to “calibrated tightening”.

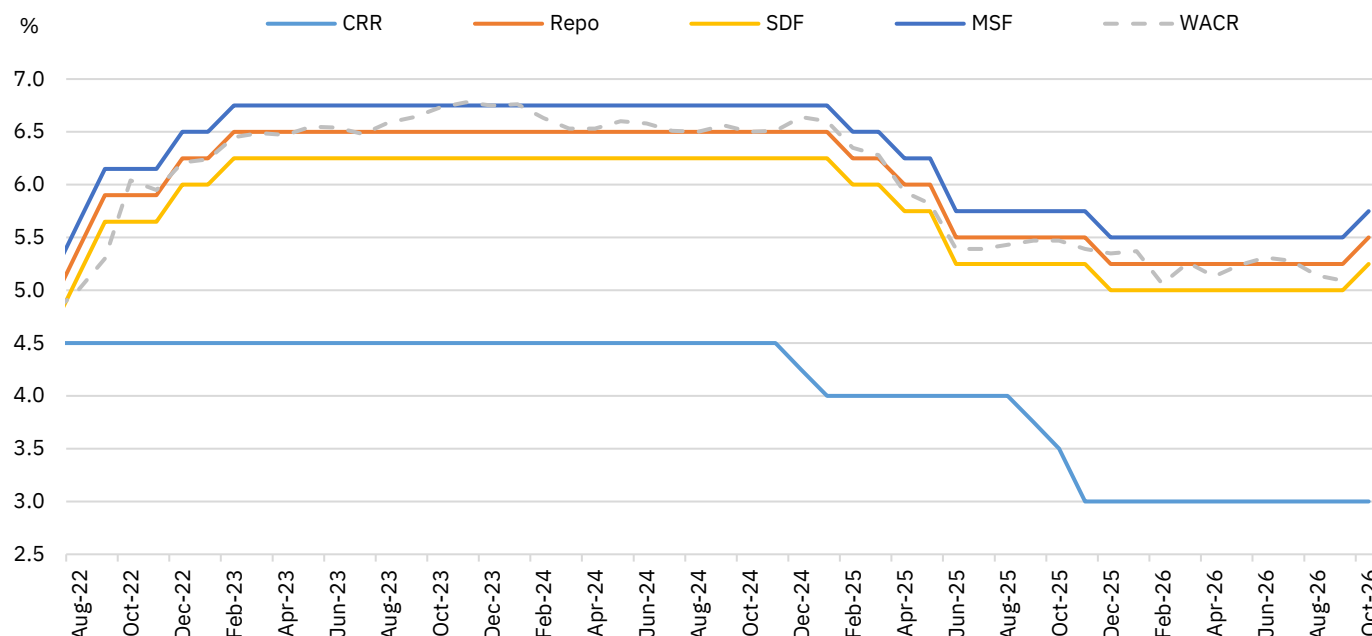
Key rates	April 2026	June 2026	August 2026	October 2026
Repo Rate	5.25%	5.25%	5.25%	5.50%
Standing Deposit Facility (SDF)*	5.00%	5.00%	5.00%	5.25%
Marginal Standing Facility (MSF)	5.50%	5.50%	5.50%	5.75%
Bank Rate	5.50%	5.50%	5.50%	5.75%
Cash Reserve Ratio (CRR)	3.00%	3.00%	3.00%	3.00%

Source: RBI, NSE EPR. * Introduced in April 2022 policy as the new floor of the LAF corridor.

Table 2: Key metrics in the last five tightening cycles

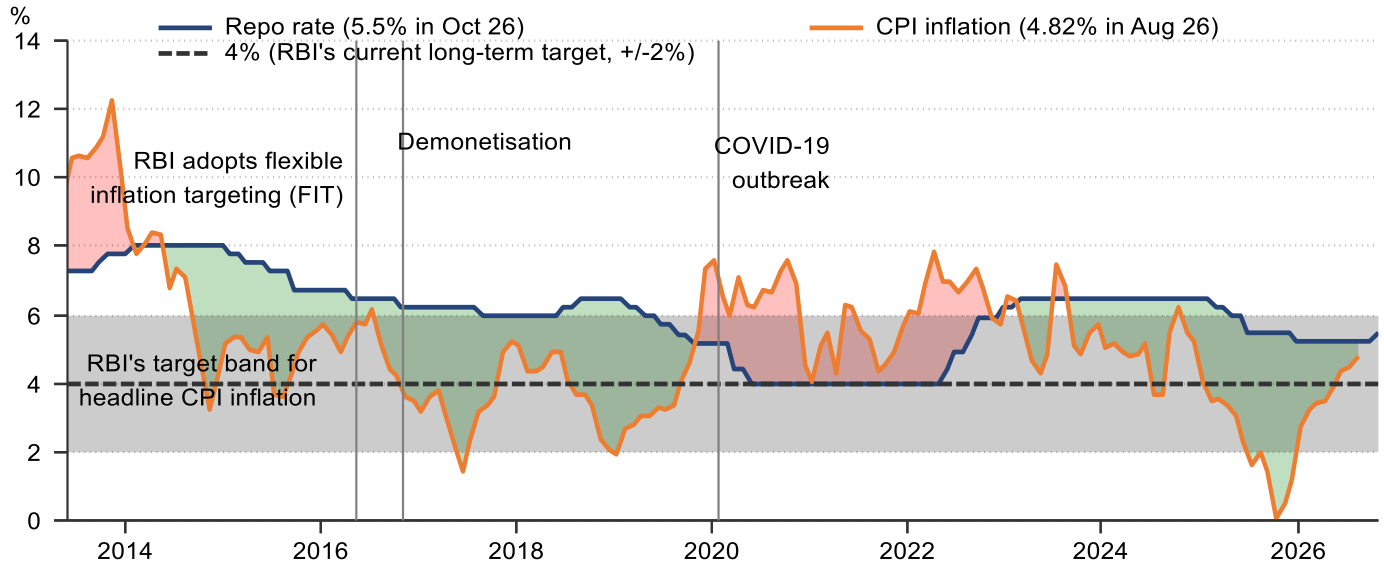
Period	Sep'05-Sep'08	Feb'10-Mar'12	Aug'13-Dec'14	May'18-Jan'19	Apr'22-Jan'25
Policy repo rate (start of the cycle)	6.00%	4.75%	7.25%	6.00%	4.00%
Policy repo rate (end of the cycle)	9.00%	8.50%	8.00%	6.50%	6.50%
Hike (bps)	300	375	75	50	250
CPI inflation (average)	6.4%	9.9%	7.6%	3.5%	5.7%
CPI inflation (peak during the period)	9.7%	14.8%	11.5%	4.9%	7.8%
Real GDP growth	9.7%	8.9%	7.0%	6.5%	7.8%

Source: RBI, NSE EPR. Note: CPI inflation for the periods 2005-08 and 2010-12 corresponds to CPI-IW due to lack of data. CPI inflation and Real GDP growth across all periods corresponds to 2011-12 base year for comparability.

Figure 1: Movement in key policy rates


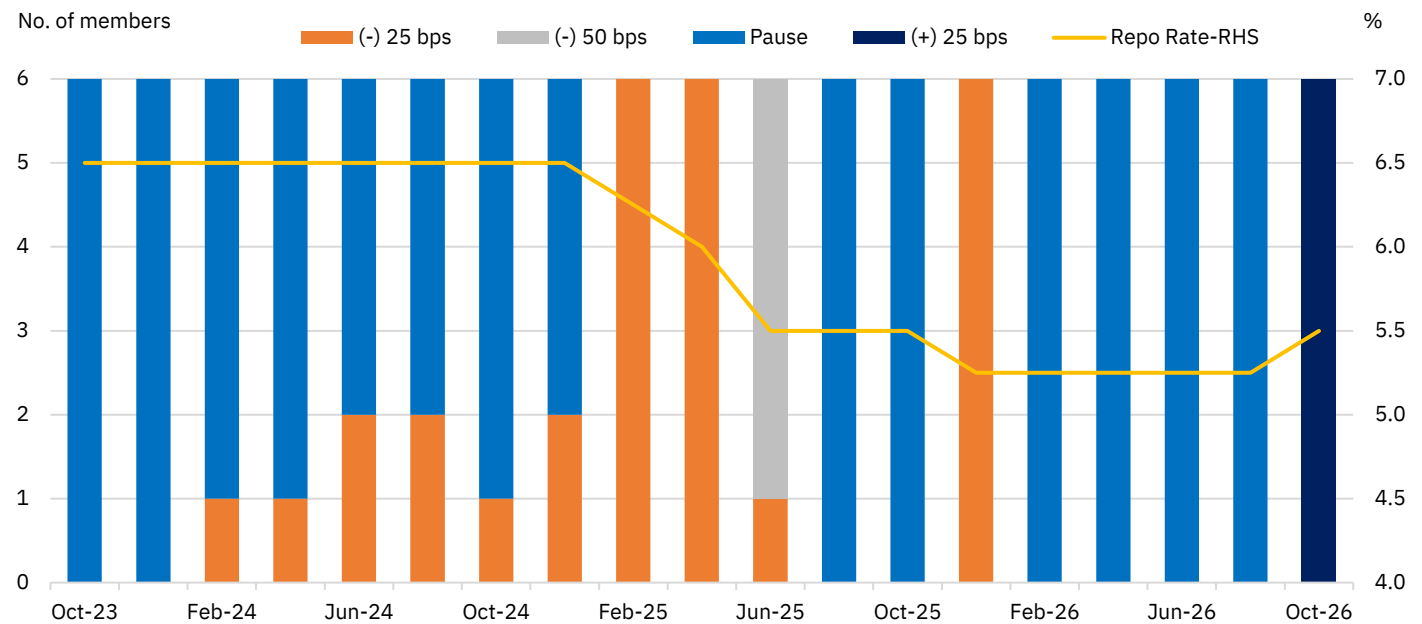
Source: CMIE Economic Outlook, NSE EPR. Notes: 1) Data for WACR has been captured till September 30th, 2026

Figure 2: Movement in real interest rates



Source: LSEG Workspace, NSE EPR.

Figure 3: MPC members' voting pattern



Source: RBI, NSE EPR.

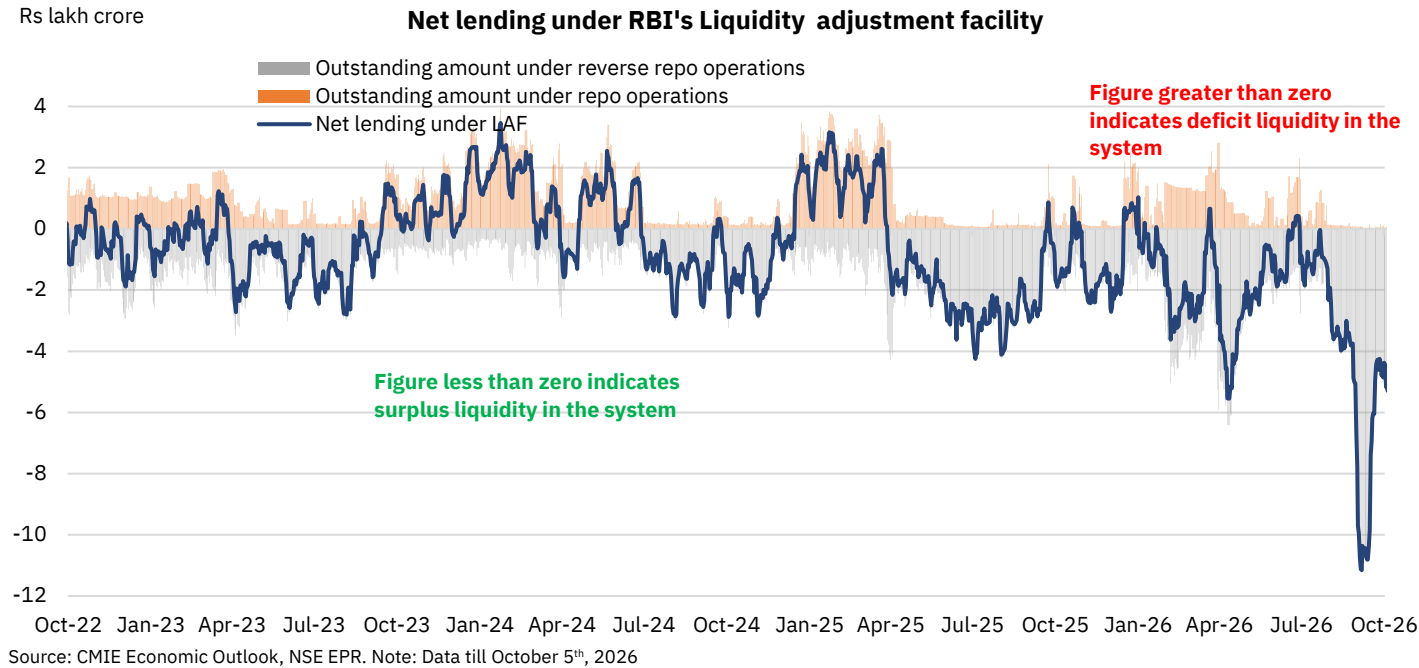
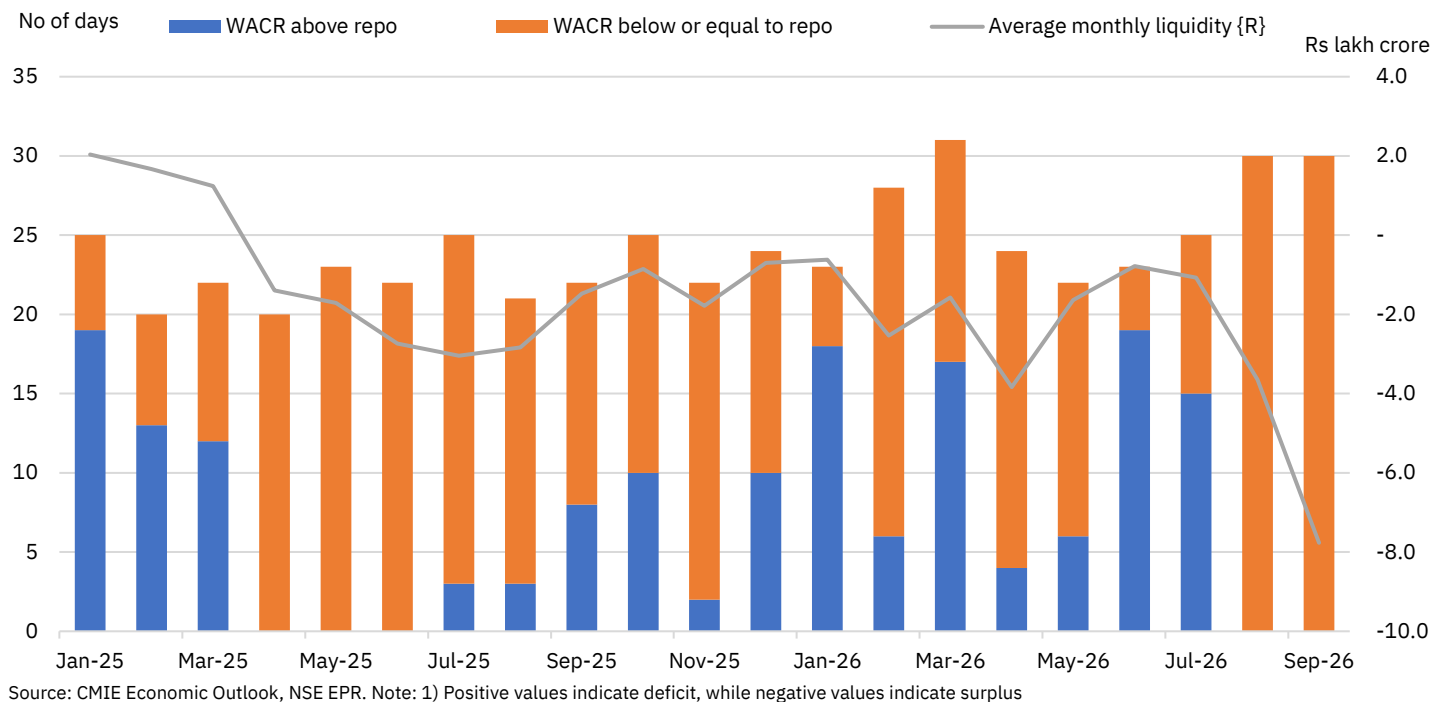
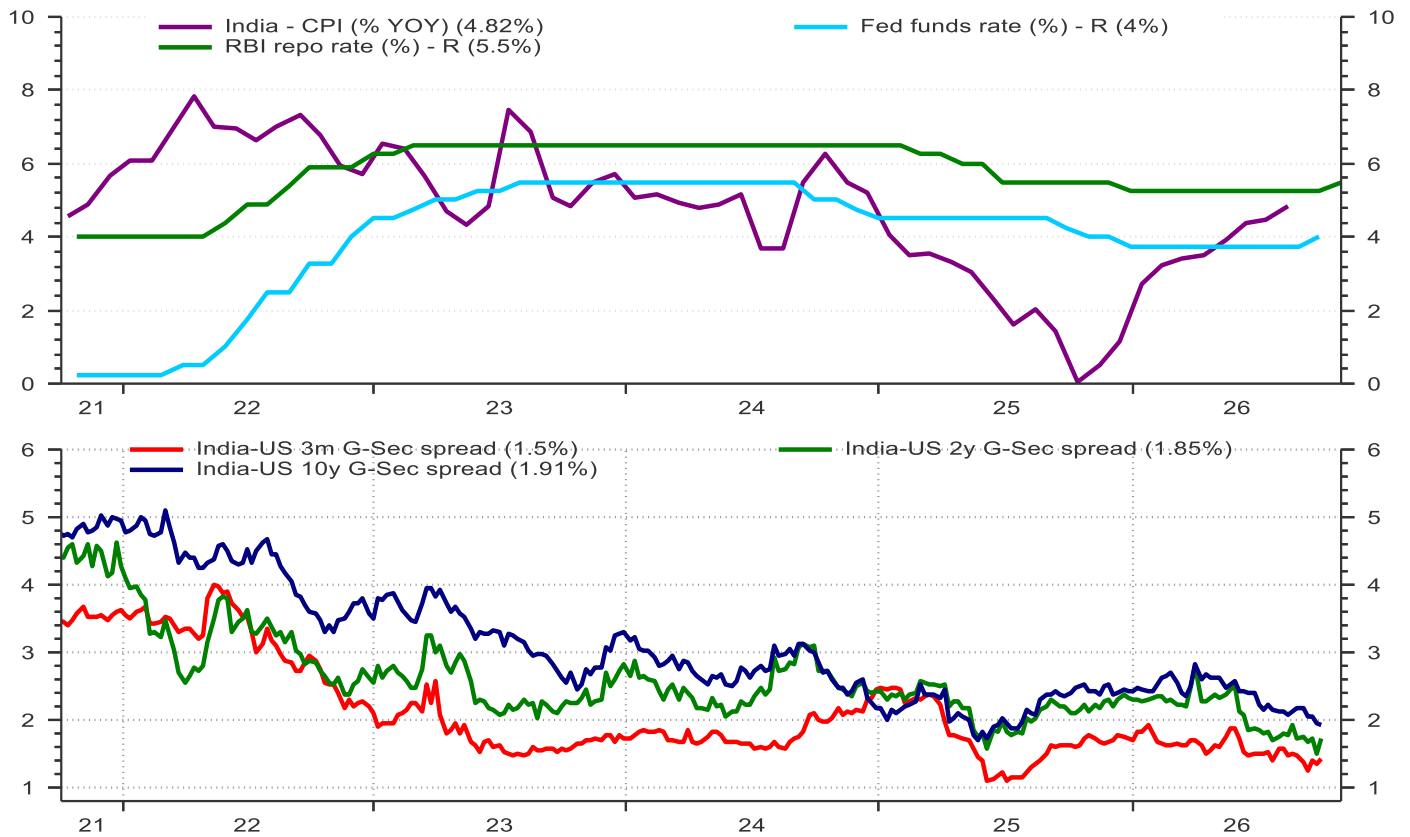
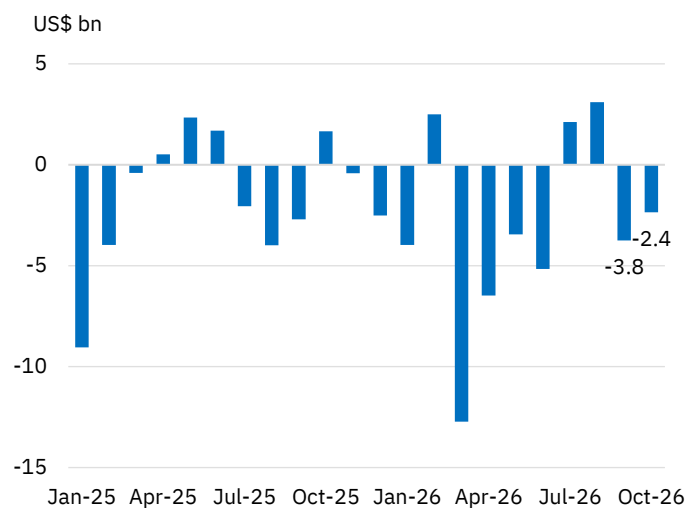
Figure 4: Net lending under RBI's Liquidity Adjustment Facility

Figure 5: Monthly trend in weighted call money rate and average monthly banking liquidity


Figure 6: India vs. US policy rates and yield differential


Source: LSEG Workspace, NSE EPR.

Figure 7: Monthly net inflows by FPIs in Indian equity


Source: NSDL, NSE EPR. Note: FY27TD corresponds to October 6th, 2026.

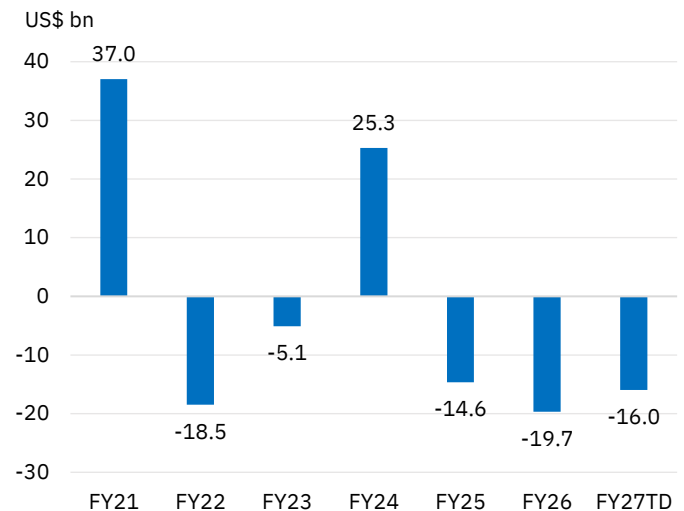
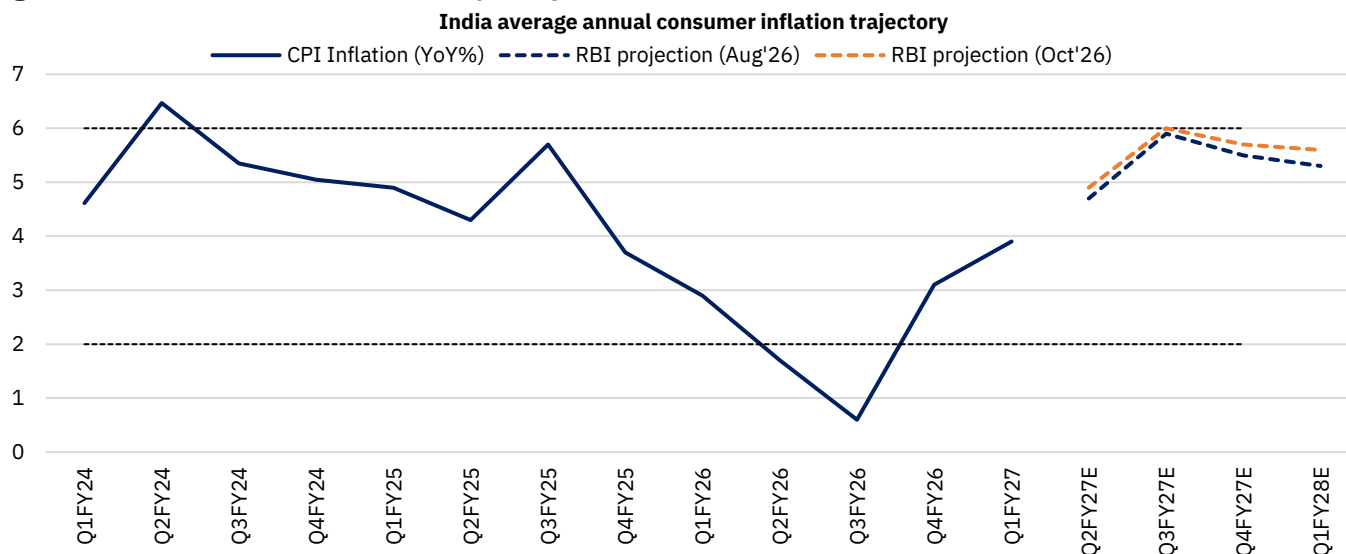
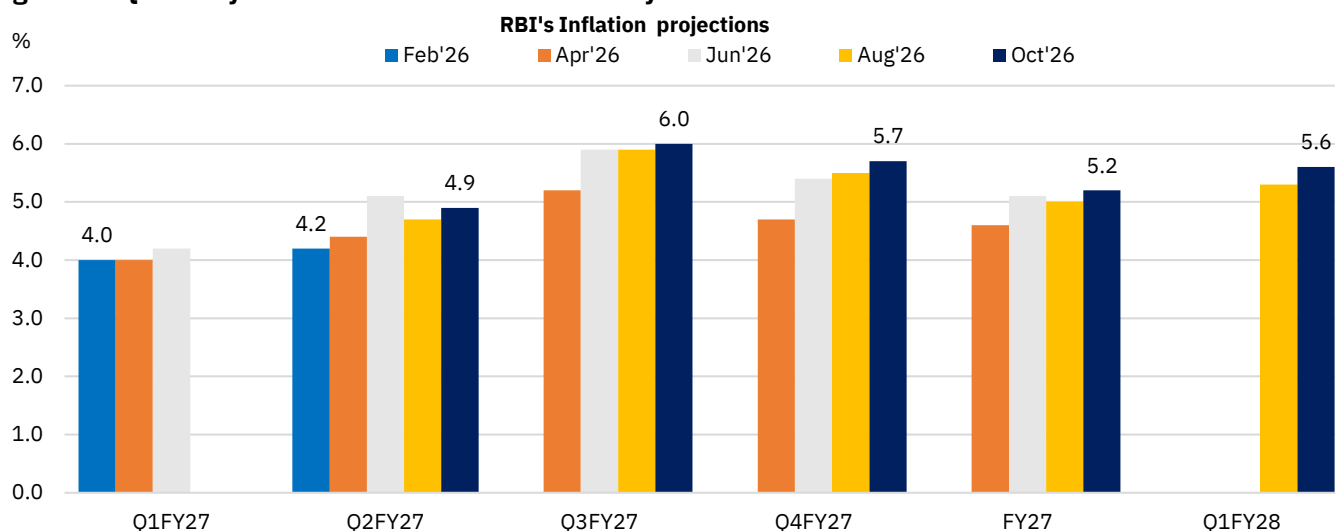
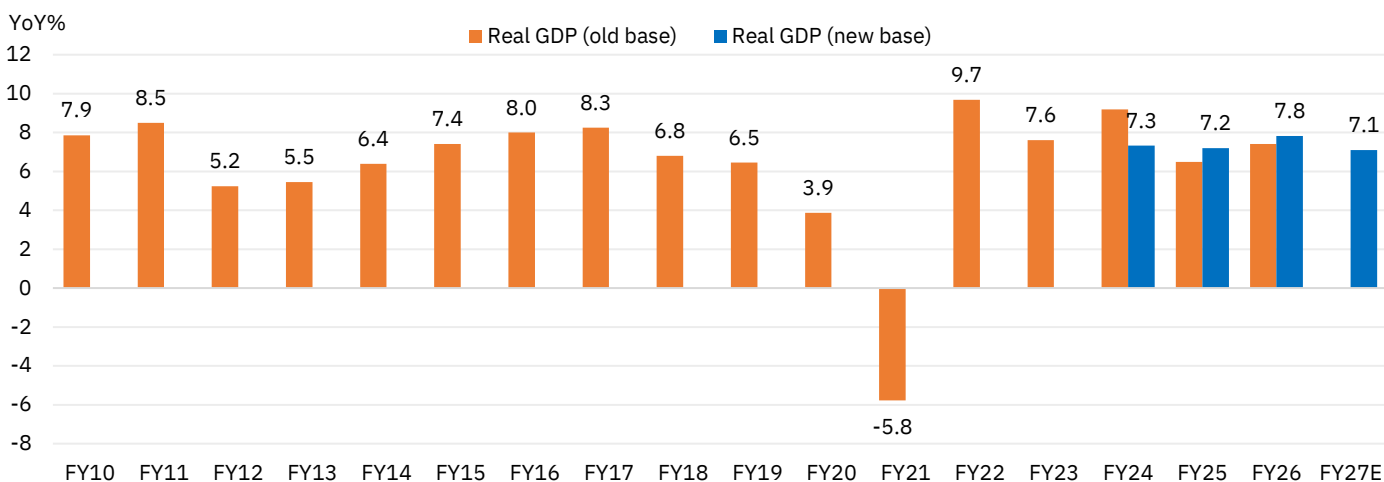
Figure 8: Annual net inflows by FPIs in Indian equity


Figure 9: India's consumer inflation trajectory and RBI's forecasts


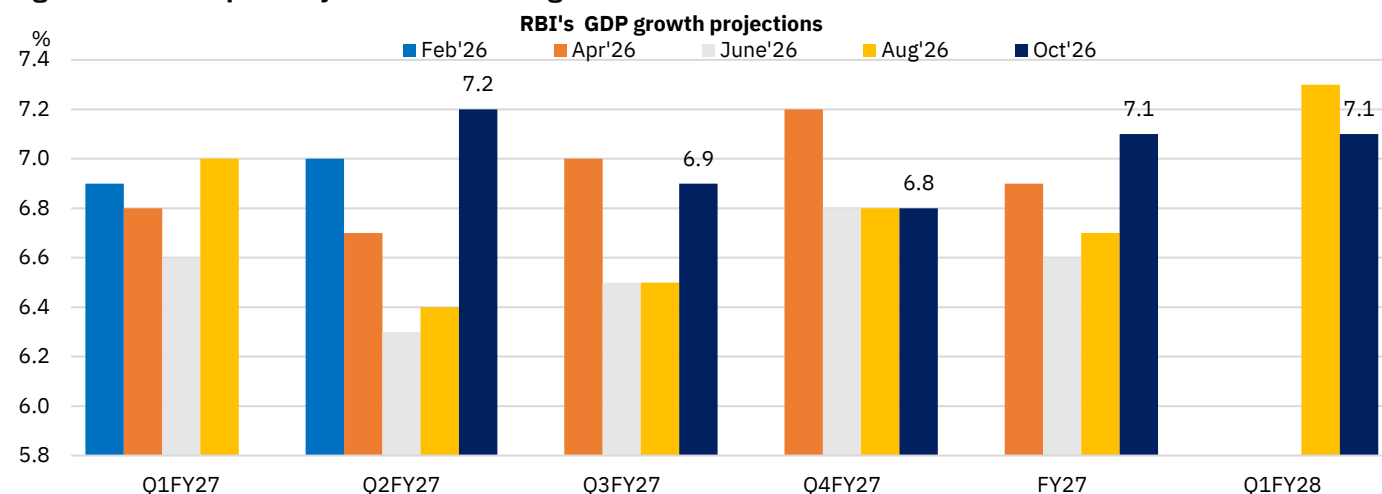
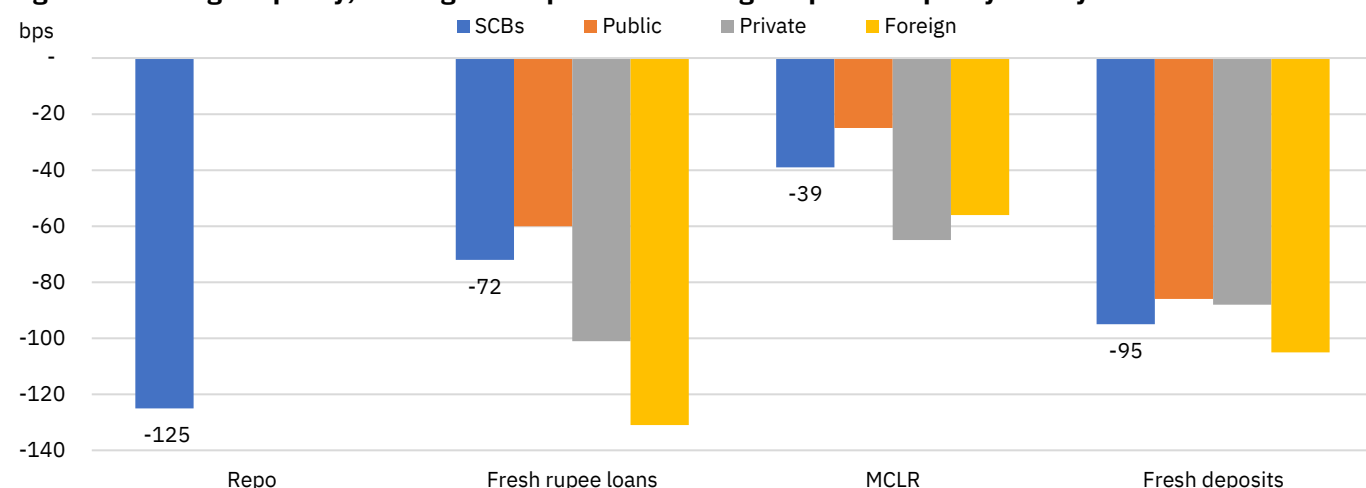
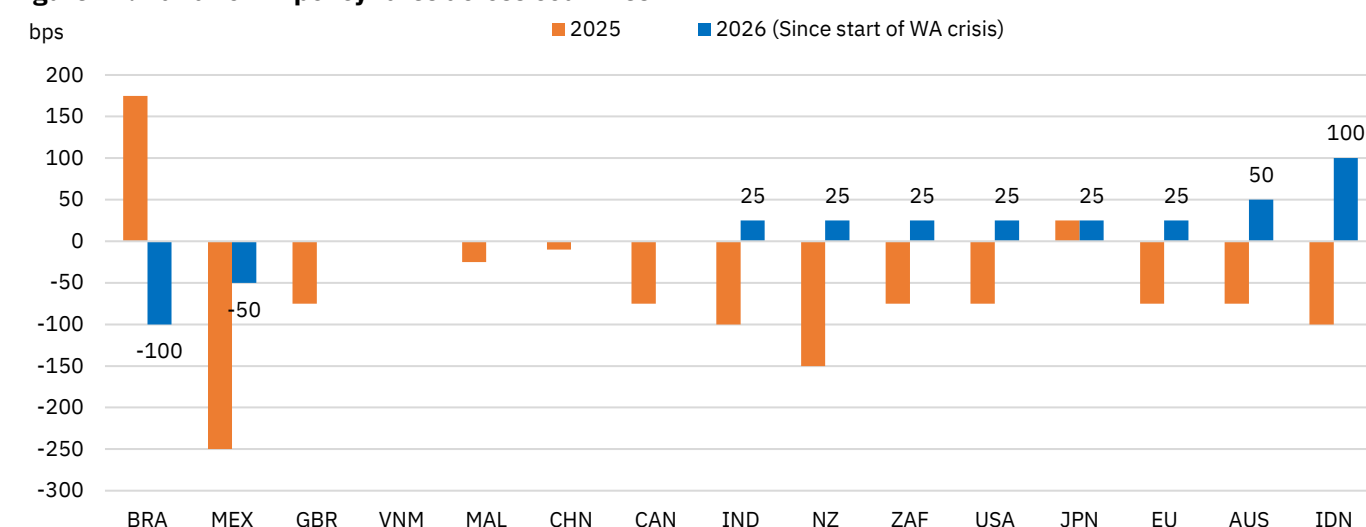
Source: CMIE Economic Outlook, RBI, NSE EPR.

Figure 10: Quarterly and annual inflation forecasts by RBI


Source: RBI, NSE EPR

Figure 11: GDP growth trend and RBI's estimates


Source: CMIE Economic Outlook, RBI, NSE EPR. FY27E = RBI estimate

Figure 12: RBI's quarterly and annual GDP growth forecasts

Figure 13: Change in policy, lending and deposit rate during the previous policy rate cycle

Figure 14: Variation in policy rates across countries


Source: CEIC, LSEG Workspace, NSE EPR. Notes: 1) For China, the loan prime rate for 1 year has been considered for computation 3) AUS = Australia, BRA = Brazil, CAN = Canada, CHN= China, EU = European Union, IND= India, INDO=Indonesia, JAP= Japan, MEX=Mexico, MAL=Malaysia, SA= South Africa, USA=United States of America, VIE=Vietnam, UK=United Kingdom, NZ= New Zealand. 2) Data captured for other countries is end-September 2026, data captured for India also incorporates the latest change in October 2026 meet.

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