

RBI Delivers a Dovish Pause, Keeps December Rate Cut in Play



- The RBI's Monetary Policy Committee (MPC) kept the policy repo rate unchanged at 5.50% and retained the neutral policy stance in its October meeting. The decision to maintain the status quo on the policy rate was unanimous, though two committee members favoured shifting the policy stance to accommodative.
- Despite a notable downward revision in the inflation forecast and expectations of slower growth in H2 FY26, the MPC's decision to keep the status quo on the policy rate reflects the committee's preference for a wait-and-watch approach to gauge the impact of past policy rate cuts, assess the effect of GST reductions, and await greater clarity on external trade-related uncertainties.
- The RBI lowered its FY26 CPI inflation projection to 2.6% (from 3.1%), citing faster-than-expected disinflation in recent prints and the moderating effect of GST measures.
- On economic growth, the RBI has raised its FY26 real GDP growth projection to 6.8% (from 6.5%), supported by a stronger-than-expected Q1 performance and steady momentum in Q2.
- However, it expects economic growth momentum to moderate in H2 FY26 as the US's tariff-related headwinds weigh on economic activity, partially offset by the positive boost from GST cuts.
- The RBI also announced a set of measures aimed at strengthening the banking sector's resilience and competitiveness, improving credit flow, enhancing the ease of doing business, simplifying foreign exchange management, improving consumer protection, and advancing the rupee's internationalisation.
- In our assessment, the RBI policy statement carried a distinctly dovish tilt, with lower inflation, heightened growth risks, and an explicit recognition of increased policy space (dropping the phrase "limited space"), compared with the previous meeting. This indicates a policy rate action is possible in the remainder of FY26.
- We believe that the policy meeting in December could present an opportune window for a rate cut, with greater clarity on the impact of GST cuts on festive demand and, hopefully, some progress on US–India trade negotiations.

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MPC Opts for a Status Quo for the Second Consecutive Meeting

The RBI's Monetary Policy Committee (MPC) decided to keep the policy repo rate unchanged at 5.50% and maintain the neutral policy stance in its October meeting. Accordingly, the Standing Deposit Facility (SDF) rate remains at 5.25%, while the Marginal Standing Facility (MSF) rate and Bank Rate remain at 5.75%. The MPC's decision to hold the repo rate at the current level was unanimous. Although the policy stance is not formally subject to voting, two committee members expressed a preference for shifting the stance from neutral to accommodative.

Tone of the Policy Had Dovish Leavings, Opening Policy Space for Additional Rate Cut

In our assessment, the policy statement signalled a dovish pause, reflecting increased policy space amid a more benign inflation outlook. The RBI revised its FY26 inflation forecast to 2.6% from 3.1%, while raising its economic growth projection to 6.8% from 6.5%, largely due to upward revisions to H1-FY26, even as H2-FY26 estimates were trimmed.

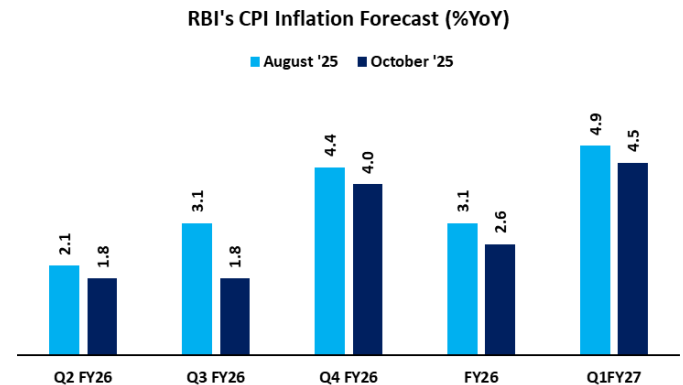
Despite the significant downward revision in inflation forecast and expectations of softer economic growth in the second half of the year, the MPC opted to remain on hold to gauge the impact of previous rate cuts, assess the effect of GST reductions, and await greater clarity on trade-related uncertainties.

Compared to the previous meeting, the RBI's communication carried an apparent dovish tilt, with lower inflation projection, heightened risks to economic growth, and an explicit recognition of increased policy space (dropping the reference to "limited space"); all of which keep the door open for further easing.

We continue to see scope for a 25-bps rate cut in December, contingent on evolving economic data and US-India trade talks. By then, there should be greater clarity on the impact of GST cuts on festive season demand and, hopefully, some progress will have been made in US-India trade negotiations.

Market Reaction: India's G-Sec 10-year benchmark yield eased to ~6.52%, compared with the previous day's close of 6.58%, possibly reflecting the dovish leaning of the policy statement. Meanwhile, the equity market reacted positively, with the NIFTY50 closing 0.9% higher than yesterday, supported by regulatory announcements such as enhanced limits for lending by banks against shares and for IPO financing, and a proposed framework for banks to finance acquisitions by Indian corporates, etc.

RBI Sharply Revises Inflation Projections Downward



Source: RBI; Note: August '25 and October '25 refer to projections provided by the RBI in its August 2025 and October 2025 MPC updates, respectively.

According to the RBI's assessment, the CPI inflation outlook has become more benign compared to the previous policy meeting, reflecting quicker-than-expected moderation in recent inflation prints and the expected disinflationary impact of the GST measures announced in September. In Q2-FY26 so far, the average CPI inflation (Jul-Aug) is tracking lower at 1.8% (vs the RBI's earlier forecast of 2.1%), primarily driven by a sharp easing in food inflation, while core inflation remained broadly contained at around 4.2% in August.

The CPI inflation outlook for the remainder of the year is also favourable, underpinned by healthy Kharif sowing, adequate reservoir levels, and contained crude oil prices. The GST rate cuts will further support disinflation. Accordingly, the RBI has revised down its FY26 inflation projection to 2.6% (close to our forecast of 2.5%) from 3.1% previously, with broad-based downward adjustments across quarterly profiles. This inflation trajectory provides the RBI with ample policy space for additional rate cuts in the remainder of FY26. Looking ahead, the RBI also revised its Q1-FY27 inflation forecast down to 4.5% (from 4.9%), while FY27 is projected at 4.5% as per RBI's Monetary Policy Report.

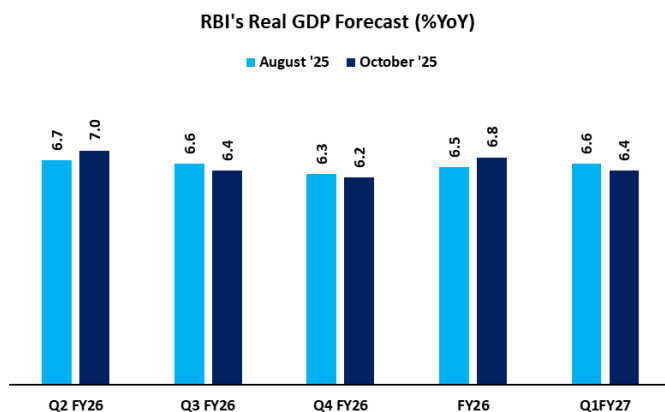
Growth Forecast for FY26 Revised Upwards Due to Robust Growth in H1

Regarding the economic growth outlook, the RBI revised its FY26 projection upward to 6.8% (from 6.5% previously), reflecting a stronger H1 performance, despite lower H2 projections. The upgrade largely captures the robust Q1-FY26 GDP print of 7.8%, which was supported by a low deflator and front-loaded government spending, both of which are expected to fade in H2. High-frequency indicators for Q2-FY26 suggest that momentum has continued, as evident in robust PMI readings, early signs of a pickup in urban consumption (notably higher auto registrations), and resilient rural demand.

That said, growth momentum is expected to moderate in H2-FY26, with external trade-related headwinds weighing on activity, partly offset by the positive boost from GST rationalisation. Growth will continue to be supported by domestic drivers, including a favourable agricultural outlook, a resilient services sector, and a consumption revival driven by GST cuts, moderating inflation, and the pass-through of policy rate cuts. Rising capacity utilisation, coupled with stronger consumption, is also expected to encourage private investment.

The RBI has revised its Q3 and Q4-FY26 projections to 6.4% and 6.2% (down from 6.6% and 6.3% earlier, respectively). The Q1-FY27 forecast has also been lowered to 6.4% (from 6.6%). According to the October Monetary Policy Report, real GDP growth for FY27 is projected at 6.6%. As per the RBI, growth continues to be below its aspirations. Given this softer growth trajectory relative to earlier expectations, the RBI retains scope to provide additional policy support in the remainder of FY26.

RBI Revises FY26 Growth Forecast Upward, even as the Growth Forecast for H2-FY26 Has Been Lowered



Source: RBI; Note: August '25 and October '25 refer to projections provided by the RBI in its August 2025 and October 2025 MPC updates, respectively.

RBI Will Continue to Manage Liquidity to Align the Overnight Rate Closer to the Policy Rate

Regarding liquidity, the systemic surplus in the banking system decreased from ₹2.9 lakh crore in August to ₹1.5 lakh crore in September, primarily due to direct tax outflows (including income tax filings and advance tax payments) and GST-related outflows. As a result, the average WACR in September increased to ~5.41% from ~5.33% in August, although it remained below the repo rate.

Looking ahead, the RBI expects liquidity conditions to improve in the coming weeks, supported by higher government spending and the phased implementation of the 100-bps CRR cut through November. The central bank reiterated that it would continue to manage evolving liquidity

conditions through two-way operations, to anchor overnight rates close to the policy repo rate.

Additionally, the RBI announced a revised liquidity framework yesterday. Under the new framework, the overnight weighted average call rate (WACR) will continue to serve as the operating target of monetary policy, while the RBI will also monitor movements in other overnight money market segments to ensure the orderly evolution of money market rates.

As anticipated, the RBI has discontinued the 14-day VRR/VRRR operations as the main operation to manage short-term liquidity. Going forward, short-term liquidity will be managed through 7-day VRR/VRRR operations, supplemented by variable-rate operations with tenors ranging from overnight up to 14 days, enabling banks to manage their liquidity more efficiently.

To reduce uncertainty about the tenor, quantum, and timing of its repo/reverse repo operations, the RBI has decided to provide at least one day's advance notice to market participants. However, it has retained the flexibility to conduct same-day operations if warranted by circumstances. Furthermore, Standalone Primary Dealers (SPDs) will have access to the SDF, overnight reverse repo operations, and all repo operations, regardless of tenor, thereby broadening their participation in the liquidity management framework.

RBI noted ongoing INR depreciation, accompanied by phases of volatility. The governor stated that the central bank is keeping a close watch on movements of the INR and will take appropriate steps, as warranted. India's foreign exchange reserves (US\$700.2 billion as of September 26, 2025) provide sufficient coverage to meet more than 11 months of merchandise imports and act as a buffer to cushion against external shocks.

Other Developmental and Regulatory Measures

The RBI also announced several measures aimed at strengthening the resilience and competitiveness of the banking sector, improving the flow of credit, promoting ease of doing business, simplifying foreign exchange management, enhancing consumer satisfaction, and advancing internationalisation of the Indian Rupee.

Strengthening the resilience and competitiveness of the banking sector

- **Expected Credit Loss (ECL) framework for provisioning:** With a view to strengthening the resilience of the banking sector, the RBI will issue the draft Reserve Bank (Asset Classification, Provisioning and Income Recognition) Directions,

2025 for Scheduled Commercial Banks and All India Financial Institutions.

The draft directions propose replacing the extant framework based on incurred loss with an Expected Credit Loss (ECL) approach, subject to a prudential floor, while retaining the existing asset classification norms. The ECL framework has been proposed to be made applicable to all Scheduled Commercial Banks (excluding Small Finance Banks (SFBs), Payment Banks (PBs), Regional Rural Banks (RRBs)) and All India Financial Institutions (AIFIs) with effect from 1st April 2027. These entities will be given a glide path (till March 31, 2031) to smooth the one-time impact of higher provisioning on their existing books.

- **Basel III Guidelines on Capital Charge for Credit Risk – Standardised Approach:** The RBI will issue draft guidelines on implementing the revised Basel framework for the Standardised Approach to Credit Risk for Scheduled Commercial Banks (excluding Small Finance Banks, Payments Banks, and Regional Rural Banks). The revised framework will help align India's guidelines with international practices, while strengthening the capital adequacy framework for banks and AIFIs.

Under the revised approach, the central bank has proposed lower risk weights on certain segments, which is likely to reduce the overall capital requirements, particularly for MSMEs and residential real estate (including home loans). Also, it has been proposed to make the revised Basel III capital adequacy norms effective for commercial banks from 1st April 2027.

- **Forms of Business and Prudential Regulation for Investments:** The draft guidelines on forms of business and investment for banks, issued in October 2024, have been finalised and will soon be released by the RBI. The proposed regulatory restriction on overlap in the businesses undertaken by a bank and its group entity(ies) is being removed from the final guidelines. Further, the strategic allocation of business streams among group entities will be left to the wisdom of Bank Boards.
- **Introduction of a Risk-Based Premium Framework for Deposit Insurance in India:** The RBI has proposed introducing risk-based deposit insurance premiums, with the currently applicable flat rate of premium (12 paise per ₹100 of assessable deposits) serving as the ceiling. This should incentivise sound risk management by banks

and reduce premiums to be paid by better-rated banks. The RBI will issue a detailed notification, effective from the next financial year.

Improving the flow of credit

- **Review of Capital Market Exposures Guidelines for Banks:** Capital market exposures (CME) of regulated entities (REs), which include lending against securities to individuals and lending to capital market intermediaries, have been subject to prudential regulations relating to sectoral exposure limits, single borrower limits, margin requirements, etc.

There has been significant growth and development in the capital market structure, along with the strengthening of the banking system. Considering these, the RBI now has proposed (1) to provide an enabling framework for banks to finance acquisitions by Indian corporates, (2) remove the regulatory ceiling on lending against listed debt securities (3) enhance limits for lending by banks against shares from Rs. 20 lakhs to Rs. 1 crore and for IPO financing from Rs. 10 lakhs to Rs. 25 lakhs per person, and (4) put in place a more principle-based framework for lending to capital market intermediaries. The draft guidelines shall be issued shortly.

- **Guidelines on Enhancing Credit Supply for Large Borrowers through Market Mechanism – Withdrawal:** The RBI has proposed to withdraw the framework introduced in 2016, which disincentivised lending by banks to specified borrowers (with a credit limit from the banking system of Rs. 10,000 crore and above). The framework introduced in 2016 was designed to mitigate the concentration risk resulting from the banking system's aggregate credit exposure to a single large corporate. The RBI specified that systemic risks, as deemed necessary, will be managed through macroprudential tools, while banks will continue to face individual exposure caps under the Large Exposure Framework. The draft circular in this regard will be issued for public comments.
- **Risk Weights on Infrastructure Lending by NBFCs:** With the aim of reducing the cost of infrastructure financing by NBFCs, the RBI has proposed reducing the risk weights applicable to lending by NBFCs to operational, high-quality infrastructure projects. Draft regulations will be issued for public consultation.

- **Discussion Paper on Licensing Framework for New Urban Co-operative Banks (UCBs):** Since 2004, the issuance of new licenses for UCBs has been paused due to the weak financial health of the UCB Sector. Considering that more than two decades have passed since then, with positive developments in the sector, the RBI will issue a discussion paper on the licensing of new Urban Co-operative Banks (UCBs).

Promoting Ease of Doing Business

- **Consolidation of Regulatory Instructions:** To reduce the compliance costs faced by regulated entities, the RBI has undertaken an exercise to consolidate regulatory instructions. The drafts of about 250 Master Directions consolidating extant instructions on up to 30 areas for 11 types of regulated entities will be issued for public consultation.
- **Review of Restrictions on Transaction Accounts:** The RBI has proposed to provide greater flexibility to banks for opening and maintaining transaction accounts of borrowers, viz, Current Accounts (CA), Cash Credit Accounts (CC) and Overdraft Accounts (OD) ("Transaction Accounts"), particularly in the case of borrowers being entities regulated by a financial sector regulator. The RBI also proposed withdrawing restrictions on collection accounts. The central bank will issue draft guidelines.
- **Measures for the exports sector:** To strengthen the exports sector and enhance ease of doing business, the RBI has decided to (1) extend the time period for repatriation from foreign currency accounts of Indian exporters in IFSC (International Financial Service Centre), from one month to three months, (2) to increase the period for forex outlay for Merchanting Trade transactions, from four months to six months, and (3) to simplify the process of reconciliation of outstanding entries related to exports and imports in the respective reporting portals. The amendments to regulations will be notified separately.

Simplifying foreign exchange management

- **Review of External Commercial Borrowing Framework:** With the objective of rationalising and simplifying the regulations governing External Commercial Borrowings (ECBs), the RBI has undertaken a review of the existing provisions under the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018. Based on the review,

a revised framework that provides for expansion of the eligible borrower and recognised lender base, rationalisation of borrowing limits, rationalisation of restrictions on the average maturity period, removal of restrictions on the cost of borrowing for ECBs, review of end-use restrictions and simplification of reporting requirements, will be introduced. The draft Framework will be issued shortly by the RBI.

- **The extant regulations for "Establishment in India of a Branch Office or a Liaison Office or a Project Office or any other place of business"** were issued by the Reserve Bank in 2016. After reviewing, the revised draft regulations will be issued, which are principle-driven and enable the delegation of more powers to AD (Authorised Dealer) banks, thereby reducing the compliance burden and further enhancing the ease of doing business in India.

Enhancing consumer satisfaction

- **Review of Instructions on Basic Savings Bank Deposit (BSBD) Account:** The BSBD Account is a savings bank account introduced to promote financial inclusion. The extant instructions on BSBD accounts require banks to provide certain minimum facilities free of charge, without requiring a minimum balance, to account holders. The ongoing digitalisation in the banking sector necessitates an expansion of services offered to BSBD account holders to include digital banking. Therefore, the RBI has decided to review the extant instructions on BSBD accounts to provide affordable banking facilities to the public and encourage increased usage of BSBD accounts, thereby deepening financial inclusion.
- The RBI has proposed revising the **Internal Ombudsman mechanism** to strengthen it, making grievance redressal by regulated entities more effective. Furthermore, the RBI has decided to bring State Co-operative Banks and District Central Cooperative Banks, which were previously under the purview of NABARD, within the scope of the RBI Ombudsman Scheme, enabling customers of rural co-operative banks to access the RBI Ombudsman mechanism. Notification will be issued shortly in this regard.

Internationalising the Indian Rupee

- To further prompt the use of the Indian Rupee for international trade, the RBI has proposed three measures: (1) permit AD banks to lend in Indian Rupees to non-residents from Bhutan, Nepal and Sri

Lanka for cross-border trade transactions, (2) establish transparent reference rates for currencies of India's major trading partners to facilitate INR-based transactions. Currently, Financial Benchmarks India Private Limited (FBIL) publishes reference rates for the USD, EUR, GBP, and JPY against the INR. The central bank has now proposed to include select currencies of India's major trading partners in the list of reference rates published by FBIL, and (3) permit wider use of SRVA (Special Rupee Vostro Accounts) balances by making them eligible for investment in corporate bonds and commercial papers, which was earlier limited to government securities, including treasury bills.

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