

RBI Begins Policy Tightening Cycle with 25-bps Repo Rate Hike; “Calibrated Tightening” Stance Signals Further Hikes Ahead



- The RBI's Monetary Policy Committee (MPC) unanimously raised the repo rate by 25 bps to 5.50% and shifted its policy stance from “Neutral” to “Calibrated Tightening”. The stance shift effectively rules out near-term rate cuts, leaving either a pause or a further hike as the next policy action.
- The RBI indicated that the duration and extent of the tightening cycle will depend on underlying inflation, the broadening of price pressures, second-round effects from supply shocks and the impact of demand impulses. The Governor clarified that “calibrated” signals a “milder form of tightening”, with policy decisions to be measured and calibrated to evolving macroeconomic conditions, making the policy path data-dependent rather than pre-determined.
- The RBI raised its FY27 real GDP growth projection by 40 bps to 7.1%, reflecting resilient domestic demand and stronger-than-expected economic activity, while it revised Q1 FY28 growth down to 7.1% from 7.3%.
- The RBI's assessment of the inflation outlook has turned more cautious, with headline CPI expected to average almost 5.8% over the next three quarters. The FY27 CPI inflation forecast was revised up by 20 bps to 5.2%, with inflation projected to peak at 6.0% in Q3 before easing. FY27 core inflation is projected at 4.4%, while the Q1 FY28 CPI inflation forecast was raised to 5.6% from 5.3%.
- Food and fuel price pressures have strengthened, while core inflation rose to 4.2%, and the weighted share of CPI items recording inflation above 4% rose to around 37% in August, according to the RBI's diffusion measure. The RBI sees some broadening of price pressures, but limited evidence so far that supply shocks have become entrenched in pricing behaviour.
- The banking-system liquidity surplus remains large despite recent moderation, while the WACR has stayed largely in the lower half of the policy corridor. The RBI did not announce any additional liquidity-absorption measures in the October policy. However, it reiterated that it would use an appropriate mix of liquidity-management tools to align the WACR more closely with the repo rate.
- We expect VRRRs and OMO sales to remain the RBI's primary liquidity-management tools, with FX sell-buy swaps used selectively depending on FX-market and forward-market conditions. CRR measures are likely to remain one of the RBI's least-preferred options and could be considered if surplus liquidity remains persistently elevated.
- In our view, the October policy statement was hawkish, as reflected in the rate hike, stance change and upward revision to the inflation trajectory, while the stronger growth assessment gives the RBI greater policy space to tighten. We expect cumulative policy tightening of 75 bps, taking the expected terminal repo rate to 6.0%.
- Risks around our terminal-rate call are two-sided. More tightening would become likely if crude oil prices remain elevated for longer, global monetary tightening proves more persistent, or food inflation broadens further, while geopolitical de-escalation, a sustained fall in crude oil prices and faster-than-expected inflation moderation could limit cumulative tightening to less than 75 bps.

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RBI Hikes Repo Rate by 25 bps; Hawkish Shift, but Further Tightening to Remain Calibrated to Evolving Macroeconomic Conditions

As we expected, the RBI's Monetary Policy Committee (MPC) unanimously voted to raise the policy repo rate by 25 bps to 5.50%, with the standing deposit facility rate now at 5.25% and the marginal standing facility rate and Bank Rate at 5.75%. The policy stance was also changed from "Neutral" to "Calibrated Tightening", with two members expressing their view that the stance should be retained as "Neutral". The change in policy stance effectively takes rate cuts off the table in the near term, implying that, if this stance remains in place, the next policy action would be either a pause or a further rate hike. The Governor clarified that "calibrated" signals a "milder form of tightening", with policy decisions to be measured and calibrated to evolving macroeconomic conditions, making the policy path more data-dependent rather than pre-determined.

On the future course of policy, the Governor stated: *"The duration and extent of the rate hike cycle would be contingent on the actual growth-inflation developments and outlook, especially that of underlying inflation, the extent of broadening of price pressures and second round effects of the supply shock, as also the impact of demand impulses."* The RBI raised its FY27 real GDP growth projection by 40 bps to 7.1%, and CPI inflation forecast by 20 bps to 5.2%. Its assessment of the inflation outlook has turned more cautious, with headline CPI inflation expected to average almost 5.8% over the next three quarters and core inflation projected at 4.4% in FY27, strengthening the case for a policy rate adjustment. The MPC also sees early signs of broader price pressures and higher inflation expectations, although evidence of the supply shock becoming embedded in pricing behaviour remains limited. It assesses demand-side pressures as limited for now, while flagging risks from strong growth in monetary and credit aggregates.

In our view, the October policy statement was hawkish, reflected in the rate hike, the change in stance, and the upward revision to the inflation trajectory, while the stronger growth assessment gives the RBI greater policy space to tighten. Accordingly, we now expect cumulative repo rate hikes of 75 bps in the current tightening cycle, including the October increase, taking the terminal policy repo rate to 6.0%.

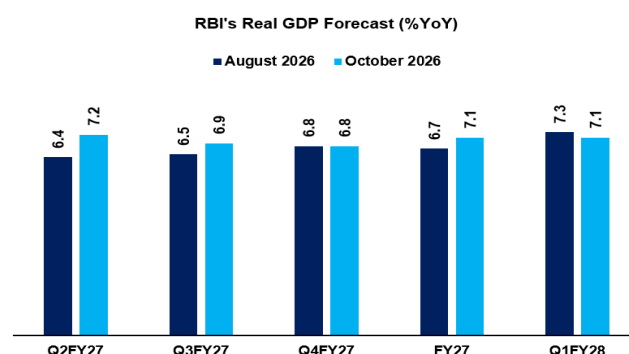
Separately, in the Monetary Policy Report, the RBI projects FY28 real GDP growth and CPI inflation at 7.0% and 5.0%, respectively. With Q1 FY28 inflation projected at 5.6%, the full-year projection of 5.0% implies an average inflation of around 4.8% during Q2-Q4 FY28. This suggests that the RBI expects inflation to moderate meaningfully after Q1 FY28 and, in our assessment, reduces the case for tightening beyond our baseline, absent further shocks or persistent

energy-supply disruptions. However, the geopolitical environment remains highly dynamic, and the evolution and potential impact of El Niño remain uncertain, leaving the inflation trajectory and future policy course exposed to significant supply-side risks. Policy tightening beyond our current expectations would become more likely if crude oil prices remain elevated for longer, global monetary tightening proves more persistent, or food inflation proves sharper and more persistent, further broadening inflation pressures. Conversely, cumulative policy tightening of less than 75 bps would become more likely if geopolitical de-escalation, including a potential US-Iran agreement, leads to a sharp and sustained decline in crude oil prices, inflation moderates faster than expected, and second-round effects remain contained.

Growth Outlook: Resilient Domestic Momentum Supports Upward Growth Revision

In the RBI's assessment, the West Asia conflict and volatile crude oil prices continue to cloud the global outlook, while tighter monetary policy and elevated bond yields have further tightened global financial conditions. Despite these headwinds, India's economy remains resilient, with Q1 FY27 GDP growth at 7.8%, supported by strong private consumption and investment, alongside a positive contribution from net exports. High-frequency indicators suggest that domestic growth momentum remained firm in Q2, with resilient demand and double-digit merchandise export growth.

RBI Raises FY27 Growth Projection on Stronger Momentum; Q1 FY28 Estimate Revised Lower



Source: RBI; Note: August 2026 and October 2026 refer to projections released by the RBI in its August 2026 and October 2026 MPC updates, respectively.

Looking ahead, the RBI notes that global uncertainty, elevated energy prices and supply-chain disruptions could weigh on domestic activity. Deficient monsoon conditions and El Niño conditions also pose risks to agriculture and rural demand, although foodgrain buffers and policy support should provide some cushion. Continued momentum in services and broadly stable employment conditions, coupled with robust credit flows and government infrastructure spending, are expected to continue supporting domestic

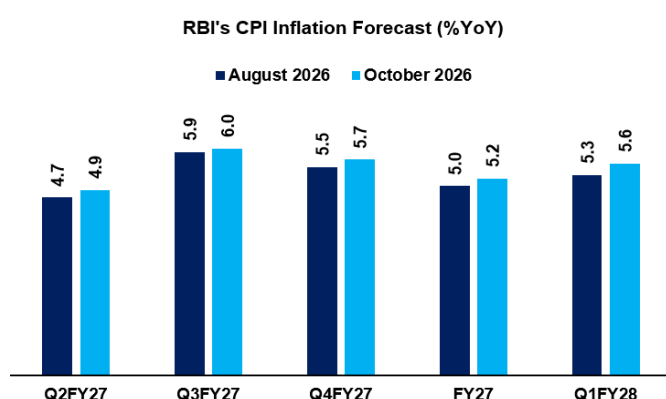
demand and investment. Reflecting the stronger-than-expected growth momentum, the RBI raised its FY27 real GDP growth projection by 40 bps to 7.1%, slightly below our projection of 7.2%, with Q2 at 7.2%, Q3 at 6.9% and Q4 at 6.8%. The Q1 FY28 growth projection was revised lower to 7.1% from 7.3% earlier, with risks evenly balanced.

Inflation Outlook: Price Pressures Broaden as Supply-Side Risks Persist

CPI inflation rose to 4.8% in August from 4.5% in July, driven mainly by food and fuel, while core inflation also increased to 4.2%, suggesting some broadening of price pressures. Food inflation became more broad-based, with notable increases in sugar and onion prices, while the weighted share of CPI items recording inflation above 4% rose to about 37% in August according to the RBI's diffusion measure. Core inflation, excluding precious metals, also rose to 2.9% in August, though it remained relatively contained.

In line with our view, the RBI assesses the near-term inflation outlook as being subject to continued supply-side pressures from the deficient monsoon, ongoing El Niño conditions and elevated energy and other commodity prices, with further pass-through risks remaining. Against this backdrop, the RBI raised its FY27 CPI inflation projection by 20 bps to 5.2%, slightly above our projection of 5.1%, with Q2 at 4.9%, Q3 at 6.0% and Q4 at 5.7%. Q1 FY28 inflation is projected at 5.6% (vs. 5.3% earlier), while the FY27 core inflation projection was raised by 10 bps to 4.4%.

RBI Raises Inflation Trajectory Through Q1 FY28 as Price Pressures Broaden



Source: RBI; **Note:** August 2026 and October 2026 refer to projections released by the RBI in its August 2026 and October 2026 MPC updates, respectively.

The higher projected inflation path, alongside emerging evidence of broader price pressures, underpins the RBI's decision to begin recalibrating the policy rate. The RBI also highlighted that, in the case of supply-driven inflation, the role of monetary policy is primarily to prevent the initial shock from becoming more persistent through its impact on inflation expectations and firms' pricing decisions. Identifying these second-round effects remains difficult, as core inflation

and diffusion measures may also capture the indirect pass-through of higher energy and other input costs. On balance, the RBI sees some broadening of price pressures, but limited evidence so far that these have become entrenched in pricing behaviour. Demand-side pressures also remain limited for now, though strong growth in monetary and credit aggregates poses risks.

Liquidity and Monetary Transmission: Large Surplus Keeps WACR Alignment in Focus

The RBI also acknowledged the large banking-system liquidity surplus and its implications for monetary-policy transmission. System liquidity increased sharply during August-September after the RBI announced capital-flow measures in June. Average daily net absorption under the LAF rose from Rs 1.2 trillion in July to Rs 5.8 trillion in August and further to Rs 7.8 trillion in September.

Liquidity conditions moderated in the second half of September as RBI absorption measures and quarterly advance-tax outflows drained part of the surplus. Despite this moderation, banking-system liquidity remained substantially in surplus, and the WACR largely traded in the lower half of the policy corridor. This has kept the alignment of WACR with the policy repo rate, and therefore monetary-policy transmission, firmly in focus.

While the RBI did not announce any additional liquidity-absorption measures as part of the October policy, it kept the door open for further action. The Governor stated that the RBI would use an appropriate mix of liquidity-management tools and strive to align the WACR with the policy repo rate. In our assessment, VRRRs and OMO sales are likely to remain the RBI's preferred first-line liquidity-management tools, given their flexibility and ability to calibrate liquidity absorption. FX sell-buy swaps could supplement these measures where appropriate, although their use will also depend on prevailing FX-market conditions, forward-market dynamics and the RBI's broader FX-management objectives. Seasonal increases in currency demand and any RBI spot dollar sales in the FX market should also absorb some banking-system liquidity. CRR measures are likely to remain one of the RBI's least-preferred options and could be considered if surplus liquidity remains persistently elevated.

External Sector: Buffers Remain Comfortable Despite Higher Risks

The RBI continues to assess India's external position as largely resilient despite risks from elevated energy prices, weaker global trade and trade-policy uncertainty, with the CAD remaining modest in Q1 FY27. FX reserves remain comfortable, providing around 11 months of import cover and covering 94.4% of external debt. The RBI reiterated its commitment to contain excessive exchange-rate volatility

and ensure orderly adjustment in line with macroeconomic fundamentals.

In addition to the above policy announcements, the RBI announced two additional measures:

1. Measures to enhance customer convenience through the Account Aggregator framework

The RBI decided to implement interoperability among NBFC-Account Aggregators (NBFC-AAs). This will enable customers to access and share their financial information across different Financial Information Providers through any NBFC-AA of their choice. Additionally, SEBI-regulated depositories will be able to include information related to bank deposit accounts in their Consolidated Account Statement (CAS) through NBFC-AAs. This will enable demat account holders to view information relating to their demat account holdings and bank deposit accounts in one place in the CAS. Both measures are expected to be implemented by December 31, 2026.

2. Constitution of the Financial Market Consultative Committee (FMCC)

Against the backdrop of rapidly evolving financial markets, the RBI decided to constitute the Financial Market Consultative Committee (FMCC), a Technical Consultative Committee for Financial Markets. The Committee is intended to serve as a forum for structured engagement with market participants and other stakeholders on policy and operational matters related to money, government securities and foreign exchange markets, as well as the respective derivative markets and infrastructure. The composition and terms of reference of the Committee will be notified separately.

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