

October 01, 2025

In an expected move, the Monetary Policy Committee (MPC) decided to keep the policy repo rate unchanged at 5.5% and retained the 'neutral' policy stance. While the decision to keep repo rate unchanged was unanimous, two out of six members voted for stance to be changed to 'accommodative' from 'neutral'.

The Committee noted that the *"inflation outlook has turned even more benign"* due to favourable outlook on food inflation and recently implemented GST cuts. However, it emphasised that *"front-loaded monetary policy actions and the recent fiscal measures is still playing out"* and there are trade related uncertainties ahead which warrant a wait and watch approach.

The RBI however indicated that current macroeconomic conditions and outlook has opened space to further support growth which was distinct from the comment made in June policy review that *"monetary policy is left with very limited space to support growth."* This indicates that the current rate cut cycle is likely to get elongated with more rate cuts in future.

**On Growth:** The RBI highlighted the Global growth has been more resilient than earlier expected with US and China growth holding up well. However, it noted that the global growth outlook is mired by policy uncertainty.

GDP Growth (%)	Aug-25E	Oct-25E
Q2FY26	6.7	7.0
Q3FY26	6.6	6.4
Q4FY26	6.3	6.2
<b>FY26</b>	<b>6.5</b>	<b>6.8</b>
<b>Q1FY27</b>	<b>6.6</b>	<b>6.4</b>

Source: RBI

On domestic front the RBI noted Q1FY26 growth surprised on the upside and recent high frequency indicators suggest that growth has held up well. While rural growth remains strong due to good monsoon and higher agricultural activity, urban demand is also showing *'gradual recovery'*. Going forward, RBI expects growth to be supported by above normal monsoon, lower inflation, rising capacity utilisation and rationalisation of GST rates. However, trade and tariff related uncertainty and prolonged geopolitical tensions pose key risk to growth outlook. Taking all this into account, the RBI now expects GDP growth of 6.8% in FY26 (as against 6.5% projected during August review) mainly on account of the positive surprise in Q1FY26 GDP growth. The RBI has lowered its GDP forecast for Q3FY26 to Q1FY27 by 10-20bps.

**On Inflation:** The RBI noted *July CPI fell to eight years low of 1.6% YoY before rising to 2.1% YoY in August* mainly on back of falling food prices. Core inflation too *"remained largely contained"* and ex of precious metal prices, remained benign.

CPI (%)	Aug-25E	Oct-25E
Q2FY26	2.1	1.8
Q3FY26	3.1	1.8
Q4FY26	4.4	4.0
<b>FY26</b>	<b>3.1</b>	<b>2.6</b>
<b>Q1FY27</b>	<b>4.9</b>	<b>4.5</b>

Source: RBI

On inflation outlook, RBI highlighted that *"inflation outcome is likely to be softer than what was projected in the August MPC resolution,"* mainly because of GST rate cuts and softer food prices. However, the RBI emphasised that *"large unfavourable base effects are likely to exert upward pressure on headline CPI inflation, especially in Q4."*

Consequently, the CPI inflation forecast for FY26 was lowered by 50bps to 2.6%. Q4FY26 and Q1FY27 CPI inflation was also lowered by 40bps each to 4% and 4.5% respectively, mainly because of GST rate rationalization.

## Conclusion and Outlook

The RBI's decision to keep the policy rate and stance unchanged was on expected lines. However, RBI's signal that further policy space has opened up to support growth considering benign inflation outlook. This was a departure from recent resolution that *the monetary policy had limited space to support growth*. This clearly indicates RBI would be open to cut rates further to support growth especially amid tariff and trade related uncertainties. This was also indicated in its projections for inflation and growth. While the inflation forecast was lowered across, GDP growth projections were increased only to adjust for higher-than-expected Q1FY26 growth rate. GDP growth rate from Q3FY26 to Q1FY27 was lowered by 10-20bps. The 10-year G-sec yields went down by 4bps post the policy announcement.

In our view, RBI is likely to lower rates further as trade and tariff related uncertainties drag growth down and outlook for inflation is favourable due to cut in GST rates and favourable food inflation outlook.

Therefore, in our view, **medium term outlook on Indian fixed income market remains favourable, considering:**

- Headline CPI inflation is likely to significantly undershoot RBI target of 4% in FY26. Thereafter too the rise due to unfavourable base is likely to be contained.
- Liquidity is likely to be in ample surplus in the coming few months given RBI's past actions and CRR cut which will aid in better transmission of rates
- External sector could remain comfortable in view of steady growth in services exports, healthy remittances and adequate foreign exchange reserves.
- Government sticking to path of fiscal consolidation and reiterating to bring down its debt to GDP could bode well for supply of Gsec over the medium term
- Higher tariff on India likely to dampen growth to the extent of 20-40bps based on most estimates

### Key risks to the favourable outlook

- Weather related uncertainty leads to rise in food prices
- Flare up in geo-political tensions leading to higher crude oil prices

Overall, in our view, yields are likely to remain rangebound with a downward bias. Falling inflation and front loading of policy rate cuts is positive from yields perspective. Thus, in view of comfortable liquidity and attractive corporate bonds spreads (over Gsec), one may consider investment in medium duration (schemes with duration of upto 5 years) categories especially corporate bonds focussed funds in line with individual risk appetite. Further, as long bond spreads have widened over 10 year G-secs and given that Government has cut supply at the longer end in its 2H FY26 borrowing program, investors with a relatively longer investment horizon could continue with their allocation to longer duration funds in line with individual risk appetite.

Glossary	
BPS	Basis points (1 bps = 0.01%)
CPI	Consumer Price Index
CAD	Current Account Deficit
CRR	Cash Reserve Ratio
GDP	Gross Domestic Product
LCR	Liquidity coverage ratio
MSF	Marginal Standing Facility
PMI	Purchasing Manager Index
RBI	Reserve Bank of India
SDF	Standing Deposit Facility
SLR	Statutory Liquidity Ratio
AE	Advanced Economies
GST	Goods and Services Tax

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