

October 07, 2026

The Monetary Policy Committee (MPC) unanimously decided to raise the policy repo rate by 25 bps to 5.5%. The Committee also changed the monetary policy stance from '*neutral*' to '*calibrated tightening*'. Notably, two external members were against the stance change and voted in favour the retention of Neutral stance.

The Governor noted that *the sudden re-escalation of the West Asia conflict in September and the consequent hardening and volatility in global crude prices soured global economic sentiments and heightened financial market volatility*. However, he stressed on the fact that despite heightened external uncertainty, India's growth has been resilient and momentum remains strong. However, he warned that inflation faces continued pressure from supply side factors such as deficient southwest monsoon and volatility in international crude oil prices. Importantly, he highlighted that the demand side inflationary pressure remained benign.

On Growth: The RBI noted that though global growth has remained resilient, it faces significant downside risk due to continued West Asia conflict, tightening global financial conditions and high sovereign public debt, especially in Advance Economies. For India, the RBI highlighted that growth has remained resilient as evidenced from Q1FY27 GDP growth and continued momentum in Q2. Going forward, it noted that while domestic growth faces near term headwind from external uncertainty and supply side pressures, continued momentum in services sector, strong capacity utilisation and robust credit flows can help sustain growth momentum. Taking all this into consideration, GDP growth for FY27 has been revised up by 40bps to 7.1% (from 6.7% in the previous policy) while GDP growth for Q1FY28 has been revised down by 20bps to 7.1%, with risks evenly balanced.

GDP Growth (%)	Aug-26E	Oct-26E
Q2FY27	6.4%	7.2%
Q3FY27	6.5%	6.9%
Q4FY27	6.8%	6.8%
FY27	6.7%	7.1%
Q1FY28	7.3%	7.1%

Source: RBI

On Inflation: The RBI indicated that though the recent uptick in inflation was primarily driven by food and fuel groups, there is some evidence of broadening price pressures reflecting in inch up of core inflation and rise in diffusion index. Going forward, it highlighted that inflation could inch higher driven by several supply side disruptions such as deficient southwest monsoon, ongoing El Nino conditions, higher commodity prices and rise in input prices. Thus, FY27 CPI inflation was revised upwards to 5.2% (from 5.0% earlier). Estimate of core inflation (excluding food and fuel) for FY27 was also revised up to 4.4% (from 4.3% earlier). CPI inflation for Q1FY28 is now projected at 5.6% (from 5.3% earlier), with risks evenly balanced.

CPI (%)	Aug-26E	Oct-26E
Q2FY27	4.7%	4.9%
Q3FY27	5.9%	6.0%
Q4FY27	5.5%	5.7%
FY27	5.0%	5.2%
Q1FY28	5.3%	5.6%

Source: RBI

Conclusion and Outlook

The decision of MPC to hike policy repo rate by 25bps was on expected lines although the change in stance from '*neutral*' to '*calibrated tightening*' might have come as a negative surprise as a large section of the markets expected no change in stance. Thus, today's decision by RBI was perceived as *hawkish* and yields reacted negatively immediately after the announcement. However, it recovered most of the losses as day progressed, as the Governor clarified in the press conference that *calibrated tightening* is milder form of tightening and rate decisions will remain data dependent. Further, the absence of liquidity measures such as OMOs or CRR adjustments also aided the market sentiments.

Today's MPC was held in the backdrop of challenging global environment, volatile crude prices, elevated global yields, strong domestic growth momentum and rising inflation risks globally. While the change in monetary policy stance was perceived as hawkish, we believe stance change reflects the direction of the policy rate and not

necessarily the magnitude. Hence, in our view, it was done to retain policy flexibility to react to evolving global / geopolitical events and not necessarily implies an aggressive rate hike cycle.

Apart from the above, there are several factors which should help contain the upward pressure on the yields from hereon. Risk of fiscal slippage remains low, despite global uncertainties due to robust direct tax and expectation of disinvestment receipts exceeding budget estimates. Further, Balance of Payments (BoP) remains well positioned due to manageable current account deficit (CAD) and large inflows under FCNR(B) deposits which should support INR stability.

Since the August 2026 policy, the Indian 10-year benchmark yield has already risen by approximately 50 bps, effectively pricing in a significant portion of RBI's tightening as well as higher US yields. With the spread between the 1-year OIS and the 10-year G sec now near the long-term average of ~100 bps, a substantial amount of negative information is already reflected in valuations. Accordingly, we do not expect sustained sell-off from the current levels and remain constructive from a medium to long term perspective. Our view is subject to two key risks: crude oil prices remaining elevated for an extended period and US sovereign yields rising further from current levels.

In view of the above and given the substantial liquidity influx driven by FCNR(B) flows is likely to support selective segments, particularly corporate bonds. Investors may consider allocating to high-quality corporate bonds focused funds with the duration of 2- to 4-year segment from a medium-term perspective. Further, given the elevated absolute yield levels at the longer end of the G-sec curve, one may also consider a staggered increase in exposure to long-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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