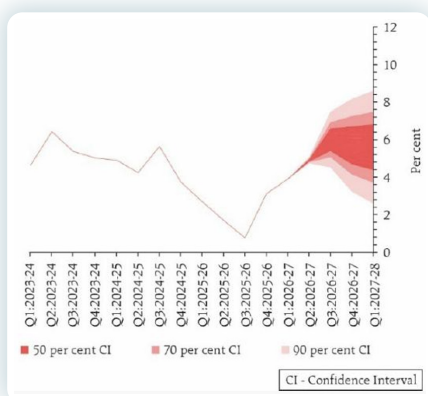


MPC Policy **October** 2026

The Monetary Policy Committee (MPC), in its October meeting, unanimously voted to increase the policy repo rate under the liquidity adjustment facility (LAF) by 25 bps to 5.50%. Consequently, the Standing Deposit Facility (SDF) rate stands adjusted at 5.25%, while the Marginal Standing Facility (MSF) rate and the Bank Rate stand at 5.75%. The MPC also decided to change its policy stance to calibrated tightening. The RBI acknowledged that inflation pressures have picked up, with headline CPI inflation expected to average almost 5.8% in the next three quarters and core inflation projected at 4.4% for this financial year. While domestic growth remains resilient, supported by robust private consumption, investment, and manufacturing and services activity, uncertainties surrounding geopolitical conflict in West Asia, high energy prices, deficient southwest monsoon, and global financial volatility continue to weigh on the outlook.

Assessment & Outlook on Inflation:



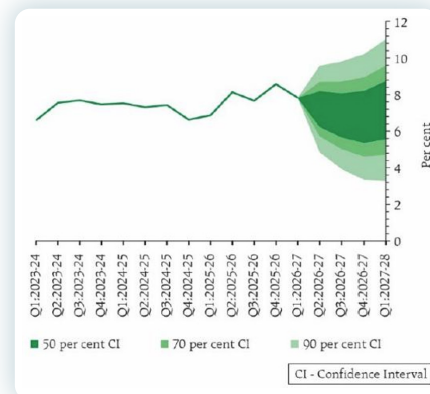
CPI inflation increased to 4.8% in August 2026 from 4.5% in July. The increase was predominantly on account of higher food and fuel inflation, alongside a broad-based pick-up in core inflation (which rose to 4.2% in August and 2.9% excluding precious metals). Food price increases have become more broad-based with notable spikes in sugar and onion. Going forward, supply-side pressures from the deficient monsoon, El Niño conditions, and volatile international oil prices remain major risks. Early signs of inflation generalisation are visible as weighted share of items recording inflation above 4% increased to ~37% in August.

Taking this into account, CPI inflation for FY27 is projected at 5.2% (up from 5.0%) with Q2 at 4.9%, Q3 at 6.0%, and Q4 at 5.7%. Inflation for Q1FY28 is projected at 5.6%. Core inflation for FY27 is expected at 4.4%.

Amidst persistent global uncertainty, domestic economic activity has exhibited resilience as reflected by high-frequency indicators and strong real GDP growth of 7.8% in Q1FY27. Private consumption continued to be driven by buoyant discretionary spending, while investment activity remains steady on the back of robust government infrastructure spending, private capex, and strong credit flows. Rebound in merchandise exports and sustained buoyancy in services exports further support growth. Looking ahead, deficient monsoon and El Niño conditions pose risks to rural demand, though healthy foodgrain buffers and resilient non-farm activity provide mitigation. Geopolitical tensions in West Asia, supply chain disruptions, elevated commodity prices, and global trade frictions pose downside risks.

Given this backdrop, real GDP growth for FY27 is projected higher at 7.1% (up from 6.7%) with Q2 at 7.2%, Q3 at 6.9%, and Q4 at 6.8%. Growth for Q1FY28 is projected at 7.1%.

Assessment & Outlook on Growth:



Liquidity and Financial Market Conditions:

System liquidity, as measured by the net position under the liquidity adjustment facility (LAF), stood at an average daily surplus of INR 5.9 lakh crore since the last MPC meeting, supported by measures undertaken to attract capital inflows. However, the measures taken to absorb liquidity (including 55 variable rate reverse repo [VRRR] auctions comprising 2 term VRRR auctions and OMO sales amounting to ₹1 lakh crore since the Aug-26 policy) combined with quarterly advance tax outflows moderated the surplus liquidity in Sept. Short-term money market rates moderated significantly in Aug-Sept, while G-Sec yields hardened from mid-Aug amidst West Asia tensions, higher global bond yields, and crude oil price increases. Credit transmission reflected dissimilar movements with WALR on fresh loans hardening by 8 bps while deposit rates moderated due to bulk deposit inflows from mobilisation of FCNR(B) deposits. Credit growth continues to remain robust (18.1% vs 10.4% a year ago). Through its conduct of two-way operations, the RBI will use an appropriate mix of liquidity management tools to align the WACR with the policy repo rate. Banks and NBFCs continue to exhibit strong financial health, supported by robust capital adequacy, liquidity, and improving asset quality (Scheduled Commercial Banks GNPA at 1.67%, NBFC GNPA at 2.5%).

External Sector:

India's current account deficit remained low and sustainable at 0.5% of GDP in Q1FY27 (\$4.2bn) despite external shocks. Widening merchandise trade deficit during Jul-Aug (\$58.7 billion) was offset by strong services surplus (\$85.8 bn during Apr - Aug) and inward remittances (\$53.9 bn during Apr-July). External financing saw sustained improvement with net FDI inflows rising to \$13.8 bn during Apr-Aug. Capital flow measures undertaken in June have supported inflows, ensuring the balance of payments records a healthy surplus this year. Foreign exchange reserves (\$734.6 bn as on 2nd Oct) remain adequate with import cover of around 11 months and external debt cover of 94.4%. The exchange rate will remain market-driven, with RBI acting to curb excessive volatility.

Fixed Income Macro & Market Outlook:**Broader Macro View:**

- The global rate-hike cycle is firmly underway, with the pace and terminal level of hikes remaining uncertain amid evolving geopolitical risks, commodity supply disruptions and the resultant inflationary pressures.
- The Fed is expected to deliver another 50–75 bps of hikes, while the BoJ is also likely to continue normalising policy, keeping global financial conditions tight.
- Persistent risk-off sentiment, a narrower India–US rate differential and elevated crude prices could keep the INR under pressure, with the currency potentially trading in the 97–97.5 range over the next 6–8 months.

RBI Rate Expectations:

- INR depreciation and a narrowing India–US 10-year yield differential now below 190 bps versus a historical average of ~300–350 bps could weigh on FPI demand for Indian debt and potentially lead to further outflows.
- With real policy rates only marginally positive at ~30 bps (Mar-27 CPI expectation of 5.2% versus the current repo rate of 5.5%), the RBI is likely to seek a more meaningful positive real-rate buffer of 75 bps - 100 bps to anchor inflation expectations and support the currency.
- We therefore expect 4–5 repo rate hikes over the next 6–9 months, taking the terminal repo rate towards 6.25–6.50%, assuming inflationary pressures remain manageable.
- As expected, the October MPC delivered a 25 bps hike and shifted its stance to “calibrated tightening,” sending a clear hawkish signal to markets. The move echoes the RBI's October 2018 stance shift under Governor Urjit Patel, when currency weakness, elevated crude prices and aggressive Fed tightening warranted a more explicit tightening bias.

Impact on Bond Yields & Deployment Strategy:

- With the RBI shifting firmly towards a tightening bias, 10-year G-Sec yields could move towards 7.4–7.5% in the near-to-medium term. Until there is greater visibility on inflation and the terminal policy rate, duration should therefore be avoided.
- The preferred approach is to prioritise accrual and carry. Short-duration debt funds may face near-term mark-to-market volatility, but higher reinvestment yields should support returns over a 3–4 month horizon, with returns gradually moving closer to portfolio YTM's.
- We recommend allocating up to 60% of the fixed-income portfolio to accrual-oriented strategies, with average maturities of up to 3 years, providing relatively lower sensitivity to further rate increases while locking in attractive yields.
- The remaining ~40% can be allocated to high-yielding assets, where attractive credit spreads can provide an additional source of carry. Opportunities in less liquid and less rate-sensitive credit, including Credit AIFs and 2–3 year NCDs rated below A-, can be considered for investors with the appropriate risk appetite.

Debt Market Yields & Spreads (Key Tenors):

Tenor	Peak Rate Cycle			Rate Cut Cycle			Rate Unchanged		Rate Cut	Rate Unchanged			Rate Hike	Spread
	Oct-23 (A)	Feb-24 (B)	Oct-24 (C)	Feb-25 (D)	Apr-25 (E)	Jun-25 (F)	Aug-25 (G)	Oct-25 (H)		Feb-26 (J)	Jun-26 (K)	Aug-26 (L)	Oct-26 (M)	
Repo	6.50%	6.50%	6.50%	6.25%	6.00%	5.50%	5.50%	5.50%	5.25%	5.25%	5.25%	5.25%	5.50%	-100
3Y G- Sec	7.34%	7.00%	6.75%	6.69%	6.23%	6.23%	5.97%	5.88%	5.75%	6.11%	6.34%	6.34%	7.00%	-34
10Y G- Sec	7.35%	7.08%	6.87%	6.62%	6.45%	6.23%	6.39%	6.54%	6.48%	6.71%	6.95%	6.95%	7.25%	-10

Source: Bloomberg, RBI

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