

RBI MPC October 2026: The Policy Equation Changes

Higher Growth, Broader Inflation Pressures and a Shift to Tightening

Introduction

The Reserve Bank of India's Monetary Policy Committee (MPC) has raised the policy repo rate by 25 basis points to 5.50% and shifted its stance from neutral to calibrated tightening. The decision marks a clear change from the August meeting, when the MPC kept the repo rate at 5.25% and retained a neutral stance. The SDF rate now stands at 5.25%, while the MSF rate and Bank Rate are at 5.75%.

The move comes as the inflation picture has become less comfortable even though economic activity remains strong. CPI inflation rose to 4.8% in August from 4.5% in July, core inflation moved up to 4.2%, and price increases became more widespread across the food basket. Meanwhile, real GDP grew 7.8% in Q1 FY2026-27, prompting the RBI to raise its full-year growth forecast to 7.1%.

The policy equation has changed since August. Growth is strong enough to absorb some monetary restraint, while the broader inflation pressures leave less room for further easing. The October policy is therefore less about responding to weak demand and more about preventing a supply shock from becoming a wider and more persistent inflation problem.

Key Takeaways

- Repo rate raised by 25 bps to 5.50%; policy stance shifted from neutral to calibrated tightening.
- Rate cuts are off the table in the near term. The next move will be either a hike or a pause, depending on inflation and growth conditions.
- FY2026-27 GDP growth forecast raised to 7.1% from 6.7%.
- FY2026-27 CPI inflation forecast raised to 5.2% from 5.0%; Q3 inflation projected at 6.0%.
- Core inflation rose to 4.2% in August, while the share of CPI items recording inflation above 4% increased to around 37%.
- Bank credit growth accelerated to 18.1%, but capital and asset-quality indicators remain strong.
- Forex reserves stood at US\$734.6 billion as of October 2, providing around 11 months of import cover.

Table 1: RBI MPC - August vs October 2026

Indicator	Aug-26	Oct-26
Repo Rate	5.25%	5.50%
Policy Stance	Neutral	Calibrated Tightening
GDP Growth FY2026-27	6.70%	7.10%
CPI Inflation FY2026-27	5.00%	5.20%
Core Inflation FY2026-27	4.30%	4.40%

Source: RBI Governor's Statement, October 7, 2026

Rationale Behind the RBI's Policy Decision

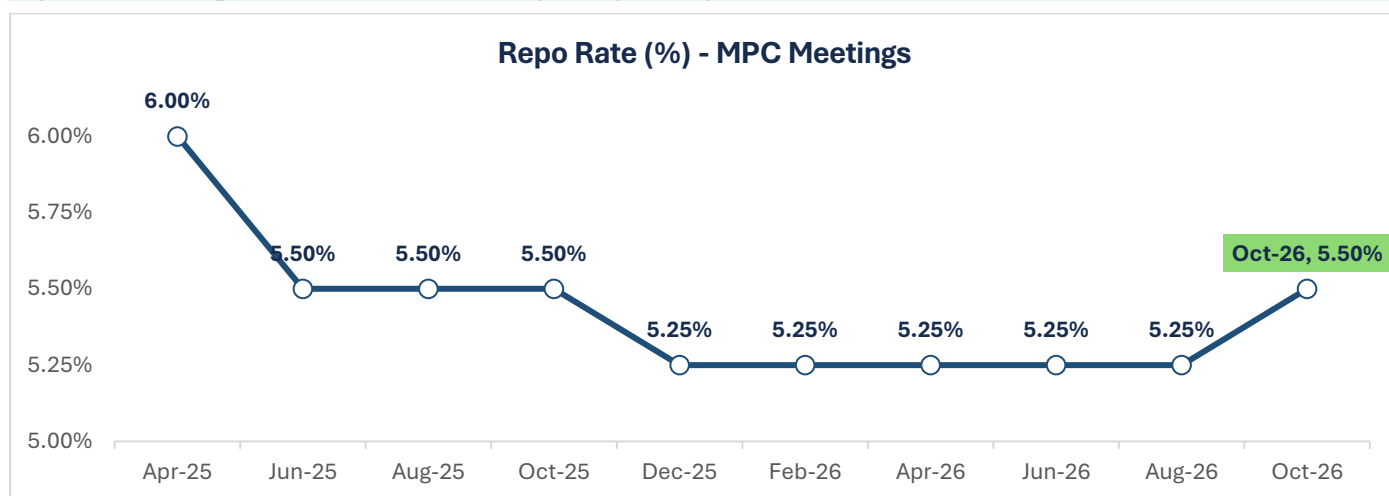
The October rate hike is not a response to weak economic activity. The immediate concern is inflation. CPI inflation has moved higher, core inflation has started to rise, and price increases are spreading across more parts of the consumer basket. The RBI now expects headline inflation to average almost 5.8% over the next three quarters, while core inflation is projected at 4.4% for FY2026-27.

Much of the initial inflation shock has come from food, fuel and crude oil. Interest rates cannot directly bring down these prices. The RBI's concern is what happens after the first-round shock: whether higher input costs start influencing inflation expectations, firms' pricing decisions and broader measures of inflation. The Governor noted some evidence of higher inflation expectations and wider price pressures, although there are still limited signs of supply-side shocks becoming firmly embedded in pricing behaviour.

The growth and credit numbers also matter. GDP grew 7.8% in Q1 FY2026-27 and bank credit expanded 18.1% year-on-year by September 15, compared with 10.4% a year earlier. The RBI does not see strong evidence of demand-driven inflation at present, but rapid credit and monetary growth increase the risk of price pressures becoming more persistent.

The RBI is therefore trying to contain the second-round effects of the supply shock rather than directly suppress the initial increase in food or crude prices. The Governor has also kept the door open for a pause: future action will depend on underlying inflation, the breadth of price increases and the extent to which the supply shock feeds into expectations and pricing behaviour.

Figure 1: RBI Repo Rate Moves from Easing to Tightening



Source: RBI

Growth Outlook: Stronger Activity Gives RBI Room to Tighten

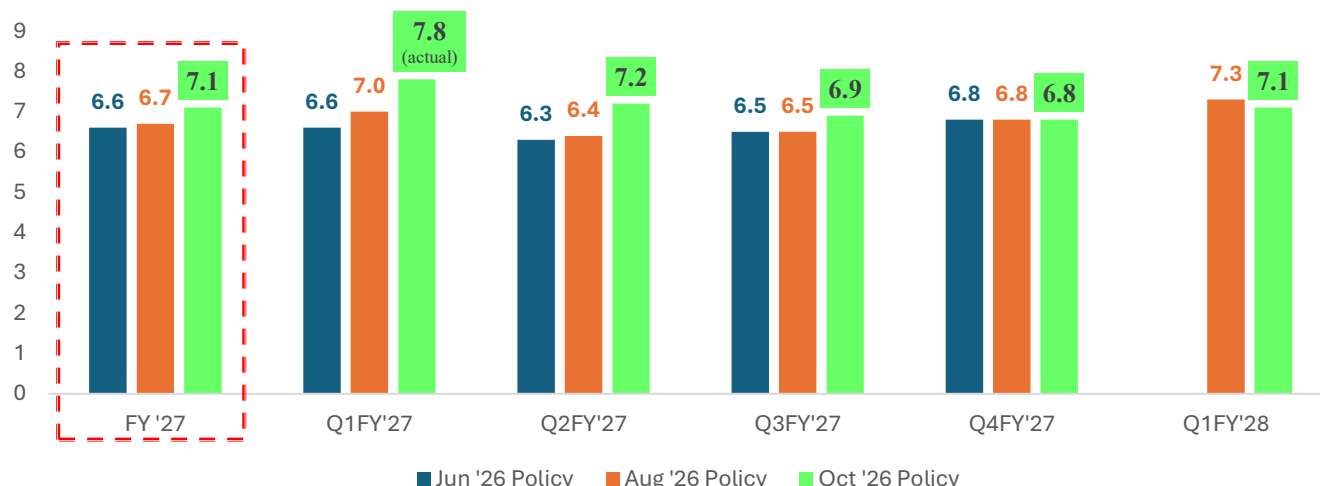
The growth outlook has improved since the August policy. Real GDP grew 7.8% in Q1 FY2026-27, supported by private consumption, investment and a positive contribution from net exports. High-frequency indicators suggest that activity has remained firm in Q2, although the pace has moderated from the previous quarter. Manufacturing and services continue to expand, while consumption and investment remain supportive.

The RBI has raised its FY2026-27 growth forecast by 40 basis points to 7.1%. Growth is projected at 7.2% in Q2, 6.9% in Q3 and 6.8% in Q4, with Q1 FY2027-28 at 7.1%. The revision is sizeable given the external environment, which includes higher energy prices, geopolitical tensions, trade uncertainty and tighter global financial conditions.

Domestic demand remains the main support. Government infrastructure spending, a recovery in private capital expenditure and strong credit flows should sustain investment. Services activity and relatively stable employment should support urban consumption, while non-farm activity could provide some support to rural demand despite the weaker monsoon. Merchandise exports grew 22.8% and services exports 13.5% during July-August 2026.

The risks are more visible on the supply and external side. The southwest monsoon ended 13% below the Long Period Average, while strong El Niño conditions could affect the rabi crop and rural demand. Higher crude prices, prolonged geopolitical tensions, trade frictions and tighter global financial conditions could weigh on activity if they persist.

Figure 2: RBI Raises FY2026-27 Growth Forecast as Activity Strengthens (%)



Source: RBI Governor Statements – June '26 Policy, August '26 Policy and October '26 Policy

Inflation Outlook: From Supply Shock to Broader Price Pressure

Inflation has become the main reason for the RBI's change in stance. CPI inflation rose to 4.8% in August from 4.5% in July, largely because of higher food and fuel prices. Core inflation also moved up to 4.2% after remaining at 3.9% for three consecutive months.

The spread of inflation across the CPI basket has widened as well. The weighted share of items recording inflation above 4% increased to around 37% in August. The concern has therefore moved beyond a few food commodities and crude oil. More components of the basket are now showing price increases, while core inflation has started to move higher.

The RBI has raised its FY2026-27 CPI inflation forecast to 5.2% from 5.0% in August. Inflation is projected at 4.9% in Q2, 6.0% in Q3 and 5.7% in Q4, while Q1 FY2027-28 inflation is projected at 5.6%. Core inflation is expected to average 4.4% during FY2026-27.

Food supply, crude oil and weather will determine much of the inflation path over the next few quarters. The southwest monsoon ended 13% below the Long Period Average, while the Indian basket of crude rose from an average of US\$82 per barrel in July to US\$116.1 per barrel in September.

For monetary policy, the question is no longer whether inflation will rise temporarily, but whether the current supply shock will alter underlying inflation behaviour.

Table 2: CPI Inflation — Actuals and RBI Forecast Revisions

Figure: CPI Inflation — Actuals and RBI Forecast Revisions

Actual inflation rose in August; the October MPC raised the FY2026-27 forecast to 5.2%.

RECENT ACTUAL CPI INFLATION

JULY 2026	AUGUST 2026
4.5%	4.8%

QUARTERLY RBI FORECASTS

MPC vintage	Q2	Q3	Q4	Q1 FY2027-28
June MPC	5.1%	5.9%	5.4%	5.3%
October MPC	4.9%	6.0%	5.7%	5.6%
Revision	-20 bps	+10 bps	+30 bps	+30 bps

FY2026-27 CPI FORECAST PATH

June 5.1% → August 5.0% → October 5.2%

Source: RBI

Table 3: Inflation Risk Indicators

Indicator	Latest
Headline CPI	4.80%
Core CPI	4.20%
Core CPI excluding precious metals	2.90%
CPI items with inflation above 4%	~37%
Indian crude basket	US\$116.1/bbl
FY2026-27 CPI forecast	5.20%

Source: RBI

Liquidity and Monetary Transmission

System liquidity remained in substantial surplus during August and September, with the average daily surplus under the Liquidity Adjustment Facility at ₹5.9 lakh crore since the August policy. The surplus pushed the weighted average call rate into the lower half of the policy corridor, with the rate trading on average 14 basis points below the repo rate.

The RBI responded through liquidity absorption operations, including variable-rate reverse repo auctions and open market sales. It conducted 55 VRRR auctions and OMO sales amounting to ₹1.0 lakh crore since the August policy. The central bank has said it will continue using liquidity tools to bring the weighted average call rate in line with the policy repo rate.

With the repo rate now at 5.50%, the transmission of tighter monetary policy will depend partly on how quickly surplus liquidity is absorbed. The policy rate has moved higher, but money-market conditions will determine how much of that change reaches the wider financial system.

External Sector: Strong Buffers, Higher Trade Risks

India's external position remains comfortable, supported by a strong services surplus and robust remittance inflows. The current account deficit stood at 0.5% of GDP in Q1 FY2026-27, while the services trade surplus reached US\$85.8 billion during April-August 2026. Net remittance receipts increased to US\$53.9 billion during April-July 2026.

Merchandise trade remains the weaker part of the external account. Exports increased 22.8% during July-August 2026 to US\$88.1 billion, but imports rose 15.8% to US\$146.9 billion, driven mainly by electronics and petroleum products. The merchandise trade deficit widened to US\$58.7 billion from US\$55.1 billion a year earlier.

Net FDI inflows increased to US\$13.8 billion during April-August, while forex reserves stood at US\$734.6 billion as of October 2, equivalent to around 11 months of import cover. These buffers leave India in a relatively strong position to absorb external financing pressures, although sustained crude prices could widen the trade and current account deficits.

Table 4: India's External Sector Position

Indicator	Latest
CAD, Q1 FY2026-27	0.5% of GDP
Services trade surplus, Apr-Aug 2026	US\$85.8 bn
Net remittances, Apr-Jul 2026	US\$53.9 bn
Net FDI, Apr-Aug 2026	US\$13.8 bn
Forex reserves, Oct 2, 2026	US\$734.6 bn
Import cover	11 months

Source: RBI

Financial Stability: Strong Balance Sheets, Faster Credit

The financial system is entering the tightening phase with strong balance sheets. Scheduled commercial banks continue to maintain comfortable capital, liquidity and asset-quality positions. Their CRAR stood at 17.87% in June 2026, while the GNPA ratio improved to 1.67% from 2.22% a year earlier.

Credit growth, however, has accelerated sharply. Bank credit expanded 18.1% year-on-year as of September 15, compared with 10.4% a year earlier, with growth spread across retail, services, industry, MSMEs and agriculture. Strong credit demand is supporting economic activity, but its pace will matter more as financing conditions tighten.

Table 5: Financial System Indicators - Latest Available Position

Credit Momentum		Balance-Sheet Strength	
Indicator	Latest Position	Indicator	Latest Position
Bank credit growth (y-o-y)	18.10%	SCB CRAR	17.87%
Deposit growth (y-o-y)	17.30%	SCB GNPA ratio	1.67%
Credit-deposit gap	81 bps	SCB NNPA ratio	0.39%
Bank credit growth, year ago	10.40%	SCB LCR	126.74%

Note: Latest available data as reported in the RBI Governor's Statement dated October 7, 2026. Credit and deposit growth are as of September 15, 2026; capital, asset quality and liquidity indicators are as of June 2026. Source: RBI

NBFCs also remain well capitalised. Their CRAR stood at 25.50% in June 2026, while GNPA declined to 2.50% from 3.09% a year earlier. The strong starting position should help the sector absorb some increase in funding costs, although margins and credit demand could come under pressure if the tightening phase extends.

Additional Measures

Account Aggregator Interoperability

The RBI will allow interoperability among NBFC Account Aggregators and facilitate SEBI-regulated depositories in including deposit-account information in consolidated account statements. The measures are scheduled for implementation by December 31, 2026.

Technical Consultative Committee for Financial Markets

The RBI will establish a Technical Consultative Committee to provide a structured forum for engagement with market participants and stakeholders on policy and operational matters relating to financial markets.

Implications and Perspective

Businesses and borrowers

The 25-bps hike will raise borrowing costs at the margin, particularly for interest-sensitive segments such as housing, automobiles and consumer finance. The effect on investment should remain manageable in the near term because domestic demand is strong and the RBI has raised its growth forecast. The pressure will become more meaningful for highly leveraged businesses if the tightening phase continues.

Banks and financial institutions

Banks and NBFCs enter this phase with strong capital and asset-quality buffers. The immediate financial-stability impact should therefore be limited. Deposit pricing, lending rates and liquidity conditions will matter more from here, particularly as the RBI works to bring money-market rates closer to the policy rate.

Monetary policy

The October policy has removed much of the uncertainty around the immediate direction of rates. The Governor has said that rate cuts are off the table in the near term, leaving a pause or another hike as the possible next moves. The deciding factor will be whether the rise in food and energy prices starts feeding more consistently into core inflation, inflation expectations and firms' pricing behaviour.



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