HSBC Mutual Fund

The Macro Sphere

RBI Monetary Policy Review

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Policy pivots to 'Calibrated Tightening' as Inflation Risks Build

The MPC in a unanimous vote decided to hike the policy rate by 25 basis points, taking the Repo Rate to 5.50% and changing the policy stance to 'calibrated tightening'.

Our View: The RBI has pivoted to a more hawkish but measured policy approach. On policy stance, while two MPC members dissented & preferred neutral stance, the change basically signals that rate cuts are off the table and that future action will be limited to further hikes or a pause. We expect 50 bps of additional tightening in our base case and overall, we expect it to be a shallow tightening cycle with the Repo Rate potentially reaching 6.00%. Any incremental tightening beyond 6.00% would likely require a renewed deterioration in inflation, particularly from oil, El Niño or second-round effects, or a materially higher global-rate environment.

While the MPC hiked policy rates, the RBI has retained a wait-and-watch approach on liquidity. We still believe that the RBI MPC is likely to continue draining surplus liquidity through VRRRs, OMO sales and potentially FX sell/buy swaps.

Key policy highlights and our take

The MPC highlighted increasing inflation risks, including the broadening of price pressures, elevated global commodity prices, deficient monsoon conditions and El Niño.

While there is some evidence of elevated inflation expectations and generalisation of inflation, there are limited signs of supply side pressures getting embedded in pricing behaviour. For now, the RBI remains focused on containing second-round effects of inflation.

Growth-inflation dynamics: The MPC revised its FY2026–27 real GDP growth forecast up by 40 bps to 7.1%, reflecting resilient domestic demand, strong investment and robust export activity despite global headwinds. In contrast, the CPI inflation forecast was raised to 5.2%, with inflation expected to peak at 6.0% in Q3 before moderating to 5.7% in Q4; core inflation is projected at 4.4%. The revisions point to a stronger growth outlook but a less benign and more persistent inflation environment.

Inflation risks are building, and the RBI in its bi-annual MPR did emphasize on how price pressures are starting to broaden. In the MPR, it explained how the distribution of CPI inflation points to a progressive broadening of inflationary pressures. In Aug'26, around 37% of the CPI basket registered inflation above 4% as compared to 23% in Apr'26.

On liquidity, the RBI stated that it will use an appropriate mix of liquidity-management tools and proactively manage system liquidity with the objective of aligning the weighted average call rate (WACR) with the policy repo rate. System liquidity was in substantial surplus during August and September, averaging INR 5.9 lakh crore under the liquidity adjustment facility (LAF) since the previous MPC meeting. The RBI conducted 55 variable-rate reverse repo auctions, including two term auctions, and undertook INR 1.0 lakh crore of OMO sales to absorb surplus liquidity; keeping the overnight rates near the lower bound of the policy corridor. We continue to believe that apart from seasonal leakage (via CiC during festive season, etc), the RBI is likely to use policy tools such as VRRRs, OMO Sales and possibly FX sell/buy swaps to continue to drain system liquidity surplus.

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Table 1: MPC's growth and inflation forecasts are laid out below:

	Growth Forecast					Inflation Forecast				
Period	Apr'26	Jun'26	Aug'26	Oct'26	Revision (last policy)	Apr'26	Jun'26	Aug'26	Oct'26	Revision (last policy)
01FY27	6.8%	6.6%	7.0%	7.8%	0.8%	4.0%	4.2%	3.9%	3.9%	0.0%
Q2FY27	6.7%	6.3%	6.4%	7.2%	0.8%	4.4%	5.1%	4.7%	4.9%	0.2%
Q3FY27	7.0%	6.5%	6.5%	6.9%	0.4%	5.2%	5.9%	5.9%	6.0%	0.1%
Q4FY27	7.2%	6.8%	6.8%	6.8%	0.0%	4.7%	5.4%	5.5%	5.7%	0.2%
FY27	6.9%	6.6%	6.7%	7.1%	0.4%	4.6%	5.1%	5.0%	5.2%	0.2%
Q1FY28	-	-	7.3%	7.1%	-0.2%	-	-	5.3%	5.6%	0.3%
FY28	-	-	-	-	-	-	-	-	-	-

Source: RBI MPC Policy Resolutions, Revision over last policy

In summary, the RBI has adopted a hawkish but measured policy approach, delivering its first 25 bps rate hike in 44 months and moving the stance from neutral to calibrated tightening. The decision signals that rate cuts are off the table in the near term but does not imply a predetermined or aggressive hiking cycle. In our view, the Repo rate could rise by a further 50 bps to 6.00% in this cycle, although additional tightening would require a renewed deterioration in the inflation outlook or a materially higher global-rate environment. In parallel, the RBI is likely to continue actively managing surplus liquidity while monitoring the impact of policy on growth and credit conditions.

Abbreviations:

IGBs: Indian Government Bonds
RBI: Reserve Bank of India
MPC: Monetary Policy Committee
SDF: Standing Deposit Facility
VRR: Variable Rate Repo
VRRRs: Variable Rate Reverse Repo
MSF: Marginal Standing Facility
CRR: Cash Reserve Ratio
SDL: State Development Loan
OMO: Open Market Operations
GDP: Gross Domestic Product
CPI: Consumer Price Index
G-Sec: Government Securities
EMs: Emerging Markets
FX: Foreign Exchange
FCNR(B): Foreign Currency Non-Resident (Bank)
NRIs: Non-Resident Indians
OCIs: Overseas Citizens of India

Source - RBI MPC Policy Resolutions, HSBC MF Research, Data as on October 07, 2026, or mentioned otherwise.

Past performance may or may not be sustained in future and is not a guarantee of any future returns.

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

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