Our Views

The Next RBI Policy: Likely More of the Same

The RBI's decision to keep the repo rate unchanged at 5.25% and retain its neutral stance was widely expected. What stood out in the August policy, however, was not the decision itself but the tone of the Governor's communication. Markets had briefly begun pricing in the possibility of a more hawkish stance following heightened geopolitical tensions in the Gulf, volatile crude oil prices and renewed inflation concerns. Yet, none of this translated into a sense of urgency in the RBI's commentary. In this environment, consistency itself appears to be the policy choice.

The message was reassuringly clear: the long pause that began after the December 2025 rate cut remains firmly in place.

Headline inflation rose to 4.4% in June 2026 after remaining below the RBI's 4% inflation target for sixteen consecutive months. Even so, the central bank continues to view the recent uptick as neither broad based nor demand led. Its focus remains on core inflation excluding food and fuel, which remained stable at 3.9% during May and June. With inflation expected to peak in the third quarter before moderating, the RBI appears comfortable looking through what it considers to be temporary supply side pressures rather than responding with tighter monetary policy.

That assessment broadly aligns with market expectations. Conversations across trading desks suggest a common view that the current inflation cycle is episodic rather than structural, driven primarily by food price volatility and supply disruptions. Central banks typically tighten policy when inflation becomes entrenched across sectors and begins feeding into wages and pricing behaviour. The RBI's assessment suggests that India has not yet reached that stage.

The external environment, however, continues to warrant close attention. The U.S. Federal Reserve has adopted a more hawkish tone in recent months, keeping U.S. bond yields elevated and the dollar relatively firm. As the yield differential between India and the U.S. has narrowed, investors have become increasingly focused on its implications for capital flows and currency stability. So far, the RBI has shown little inclination to respond through higher policy rates, preferring instead to manage currency pressures through foreign exchange operations. The FCNR(B) mobilisation scheme, which is expected to attract significant foreign currency inflows, has further strengthened external liquidity and will be watched closely by markets. Nevertheless, the future trajectory of U.S. monetary policy is likely to remain an important consideration for the RBI's own policy decisions.

Meanwhile, domestic financial conditions have already tightened, even without any change in the policy rate. Over the past year, five year and ten year government bond yields have risen by around 35 and 45 basis points respectively. At the same time, intense competition for deposits has pushed up banks' funding costs, leading to a gradual increase in lending rates. In effect, market forces have delivered a degree of monetary tightening independent of RBI action. The transmission mechanism is already doing some of the work that policy action would otherwise seek to achieve.

The market's response to the policy reflected this continuity. Equities and bonds saw little repricing, while the rupee weakened only marginally. Investors appeared to interpret the policy not as a change in direction but as confirmation that the RBI remains comfortable with its current assessment of the economy.

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That confidence stems from inflation that is elevated but not entrenched, financial conditions that have already tightened organically, and liquidity that remains well supported. While global uncertainties persist, they have not yet compelled the RBI to adopt a more defensive posture.

Looking ahead, the October policy is therefore likely to bring more of the same. Unless inflation becomes materially more broad based, crude oil prices witness a sustained and sharp increase, or global financial conditions tighten significantly, there appears little reason for the RBI to alter either its stance or the policy rate.

The significance of this policy lies less in what the RBI did than in what it chose not to do. Despite recent geopolitical developments and renewed inflation concerns, it has reaffirmed its preference for patience over pre emptive action. For now, the central bank appears content to let time, incoming data and evolving global conditions determine the next move. Policy itself does not need to do the heavy lifting at this stage.

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