Insights- Monetary Policy Review

October 01, 2025

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Finally, a dovish pause after the previous two hawkish policies, and this time, the market was not surprised. Two members voted to change the stance to "Accommodative," reflecting a split within the committee. The further sharp moderation in the inflation trajectory has opened the door for a rate cut, possibly the last one in this cycle. However, the currently resilient domestic economy gives the RBI time to assess the full impact of US tariff policies and the GST rate cut. FY26 inflation has been brought down to 2.6%, with Q2 and Q3 at 1.8%—below the RBI's lower threshold. A healthy monsoon and GST rate cuts bode well for the inflation outlook. FY26 GDP projections have been inched up to 6.8%, though this remains below potential. This dovish tilt will further boost expectations of a rate cut in the next monetary policy meeting and should help improve market sentiment. Current elevated market yields, combined with low running inflation, offer a favourable risk-reward profile for investors.

Key decisions/Highlights

No change in rates

- Policy repo rate at 5.50%
- Standing deposit facility (SDF) rate at 5.25%
- Marginal standing facility (MSF) rate and the Bank Rate changes at 5.75%

Policy stance retained as Neutral

- MPC voted with majority of 4 out of 6 members to retain the monetary policy stance as Neutral

FY26 Real GDP projected at 6.8%

- FY26 projection at 6.8% (up from 6.5%)
- Q2FY26 at 7.0% (up from 6.7%)
- Q3FY26 at 6.4% (down from 6.6%)
- Q4FY26 at 6.2% (down from 6.3%)
- Q1FY27 at 6.4% (down from 6.6%)

CPI projected at 2.6% for FY26

- FY26 projection at 2.6% (down from 3.1%)
- Q2FY26 at 1.8% (down from 2.1%)
- Q3FY26 at 1.8% (down from 3.1%)
- Q4FY26 at 4.0% (down from 4.4%)
- Q1FY27 at 4.5% (down from 4.9%)

A pause with a dovish tilt. At last!!!

After two consecutive hawkish policies in June and August, which weighed heavily on market sentiment, today's policy marks a welcome shift. A lot of factors had turned positive since the last MPC policy in August; the US Fed initiated its first rate cut in September, S&P upgraded India's sovereign rating after 18 years, the government announced a major GST rationalization reform with limited fiscal impact and domestic inflation softened significantly. Additionally, the H2FY26 G-sec borrowing calendar, set at Rs. 6.77 lakh crore aligns with market expectations and reinforces the Government's commitment to maintain fiscal prudence. However, external uncertainties intensified due to the US's higher tariffs on a broader range of products and changes to the H1B visa policy, exerting downward pressure on the INR.

Given this backdrop coupled with recent strong GDP print and sharp moderation in inflation, the RBI has adopted a wait & watch approach, allowing time to assess the impact of evolving macroeconomic conditions and previous policy actions. Today's dovish policy indicates there is room for one more rate cut in this cycle given the easing inflation trajectory and moderating growth. Further, the split in voting—with two members supporting a shift to an accommodative stance—signals an inclination within the committee to support growth.

MPC – Monetary Policy Committee, RBI – Reserve Bank of India; GDP- Gross Domestic Product; FY – Financial Year, Bps – Basis Points.
Data Source – RBI Monetary Policy Document, Governor's Statement, Bloomberg

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Sharp slowdown in inflation and benign commentary

RBI has substantially revised its inflation projections for FY26 by 50 bps to 2.6% and across all quarters, reflecting easing price pressures. Projections for Q2 and Q3 have been lowered to 1.8%, well below the RBI's lower tolerance threshold of 2%. Q4FY26 inflation projection is at 4% which is aligned with RBI's long term target. Even the Monterrey policy report has pegged the Q4FY27 inflation at 3.9%. On the core inflation, Governor sounded comfortable and expects to be largely contained going forward. This benign outlook is supported by softening food prices and recent GST rate cuts. Additionally, a favourable monsoon—with cumulative rainfall 8% above the long-period average and a sown area 2% higher than normal—is expected to further ease food inflation and support overall price stability. Inflation looks well contained now and is unlikely to pose a risk to monetary policy.

Current resilient domestic growth provided time to MPC to assess overall impact of recent events

GDP for Q1FY26 came at 7.8%, much higher than the market expectations and the Q2 projections suggest that growth is holding firm. The strength is reinforced by revival in consumption demand on back of recent GST rationalization, softening inflation, lower interest rates and healthy monsoon. Additionally, rising capacity utilization, pickup in investment activity and healthy agricultural outlook are expected to sustain growth momentum. However, external uncertainties such as ongoing tariff actions and geopolitical tensions pose downside risk to the outlook. While the impact of tariffs may be partially offset by GST rate cuts, these developments warrant close monitoring. The current domestic resilience gives the RBI time to evaluate these evolving factors before considering further policy action.

Growth slowdown in H2FY26 and moderate inflation will provide room for December rate cut

Inflation remains subdued and comfortably below the RBI's target range, abating concerns about price stability and creating space for the Central Bank to shift focus on supporting growth. The upward revision in FY26 growth is primarily driven by a strong H1FY26 performance, although overall growth still falls short of its potential. While Q1FY26 GDP surprised on the upside, projections for H2FY26 and Q1FY27 have been revised downward on back of mounting global uncertainties.

Recent GST rate cuts are expected to boost consumption, the Governor noted that they will only partially offset the adverse impact of US-imposed tariffs. The Governor emphasized the need for coordinated fiscal and monetary policy efforts to sustain growth, highlighting that the government has already acted through GST rate cuts, and the easing inflation trajectory has given room for growth supportive monetary policy. Against this backdrop, we expect a 25 bps rate cut in the December policy especially if growth momentum weakens further or external risks intensify.

Governor acknowledged recent hardening in G-Sec yields; hints at measures to be taken

During the press conference when asked about the rise in G-Sec yields, Governor acknowledged the upward movement and expressed confidence that market yields will moderate in response to policy rate cuts. Governor also hinted at potential measures to address this recent increase in yields like altering the G-Sec auction and tenor profile.

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Market sentiment has been cautious over last 3 months; this policy will provide relief

Market sentiment had turned negative after the June policy, when RBI adopted a hawkish tone & shifted policy stance to Neutral. In August month, yields further hardened following another hawkish RBI policy and market started fearing fiscal slippage amid slowing domestic growth & US imposed tariffs. Although fiscal pressures have eased since then and the impact of GST rate cuts appears manageable, market was still on caution due to MPC's overhang.

Today's policy signals a dovish tilt, driven by the benign inflation outlook and RBI's acknowledgement that growth needs support amid an expected slowdown in the second half of the fiscal. Additionally, the Governor's remark on addressing the recent yield hardening further reinforces the policy support and is likely to improve market sentiments.

Market reaction

Segment	Broad movement of yields in bps (as on October 01, 2025)	
	G-Sec	AAA Corporates
3 months	0 bps to -1 bps	-1 bps to -2 bps
6 months	0 bps to -1 bps	-7 bps to -8 bps
1 year	0 bps to -1 bps	-3 bps to -4 bps
2 -3 years	-5 bps	-2 bps to -3 bps
4 - 5 years	-8 bps	-2 bps to -3 bps
10 years	-6 bps	-1 bps to -2 bps
15 years	-6 bps	NA
30 years	-5 bps	NA

Source: Bloomberg

Current elevated market yields with likelihood of rate cut provides favourable risk-reward for investors

This policy keeps the door open for a potential rate cut ahead and will be helpful in turning the market sentiments positive. The benchmark 10 yr G-Sec yield had hardened by ~35-40 bps since the June policy and now with the dovish policy we expect some reversal of yields. Current elevated yields and the running inflow at ~2% provides a favourable risk reward for investors. Having said that, as we come to the last leg of the rate cut cycle, it is important to re-align the return expectations from fixed income strategies as capital gain opportunities may be limited.

The corporate bond spreads in the 1 to 5 years segment are elevated, offering an attractive investment opportunity from accrual perspective. Additionally, the steepness in 5 to 10 years segment of the G-sec yield curve presents a value buy opportunity on the back of favourable demand–supply dynamics in second half of FY26. Depending on the risk appetite, investors can consider funds like Low Duration Fund, Short Duration Fund, and Corporate Bond Fund to effectively position across the curve. Income plus Arbitrage Active Fund of Fund provides similar opportunities in a more tax efficient way for more than 2 years investment horizon.

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