

RBI turns hawk-eyed

The MPC unanimously decided to raise policy rates by 25bps to 5.50%, a first since Feb'23. This has resulted in SDF and MSF rates higher at 5.25% and 5.75%. Stance of the monetary policy was also changed to calibrated tightening from neutral stance previously. This entails that while rate cuts are unlikely now, the rate hike and pause are likely given the evolving conditions. The quantum of future rate hike will now be contingent on the growth and inflation dynamics. Noting strong domestic fundamentals and resilience in growth (as visible in high frequency indicators) despite global headwinds, RBI has revised FY27 growth projection upward by 40bps to 7.1%. Inflation projection has also been revised higher to 5.2% for FY27 and is expected to peak at 6% in Q3FY27 (revised higher), before easing in Q4 and Q1FY28. We also believe that upside risks to inflation persist as monsoon was below normal and kharif sowing has also been lower than last year. Geopolitical uncertainty continues to persist due to lingering West Asia conflict which will continue to result in volatility for global oil and other commodity prices. Given these factors, we expect 2 more rate hikes by the central bank in FY27.

MPC decision:

RBI's monetary policy committee (MPC) voted unanimously to hike the policy repo rate by 25bps to 5.50%. Consequently, the SDF rate is higher at 5.25% and MSF at 5.75%. The MPC with a majority vote has also changed the stance from neutral to 'calibrated tightening' with two members, Dr Nagesh Kumar and Prof. Ram Singh favoured to retain the stance at neutral. It reiterated its commitment to its mandate of price stability as it work towards aligning inflation with its target level.

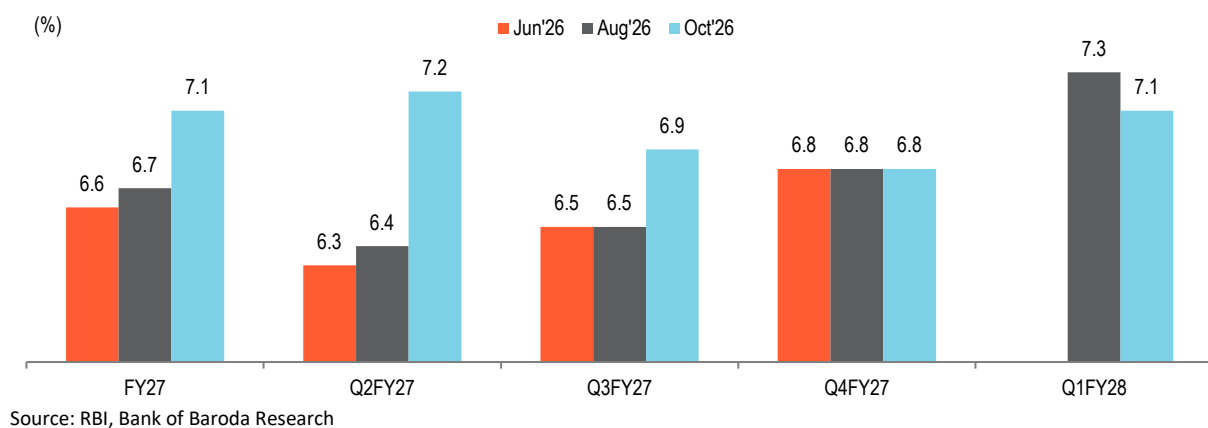
Assessment of growth outlook:

- RBI has revised GDP growth forecast for FY27 to 7.1% from 6.7% projected earlier in the Aug'26 policy. The 40bps upward revision is mainly on account of revisions to Q2 and Q3 numbers. Numbers for H2FY27 have also been revised higher by 20bps from last policy.
- MPC members agreed that despite facing global headwinds, the Indian economy continues to remain resilient as has been noted in Q1 growth which was higher than expected at 7.8%. This was led by strong investment, private consumption along with buoyancy in services exports.
- Even in Q2, the economy continues to exhibit strength as has been noted from the high-frequency indicators for July-Aug, supported by double digit growth in merchandise exports.
- The ongoing global economic uncertainty is expected to have some bearing on domestic growth outlook. The lingering West Asia conflict has continued to create supply chain pressure and elevated energy prices.
- Furthermore, below normal monsoon and strong El Nino conditions also pose risks to rural demand and agriculture growth outlook. However, given there are buffer stocks of food grains and active policy interventions have been taken by government, the impact is thus expected to be mitigated.
- Next, the central bank expects momentum in services sector to be maintained, and stable employment conditions is expected to provide support to urban demand. This along with robust

credit flow, government's thrust on infrastructure and strong capacity utilization is expected to support investment activity.

- Moreover, bilateral trade agreements will provide support to merchandise exports and services exports are expected to remain buoyant.
- As a result, Q2 and Q3 GDP projections were increased to 7.2% (+80bps from Aug'26 policy estimates) and 6.9% (+40bps) respectively, implying a cumulative 120bps upward revision.
- For Q4, numbers have been left unrevised for now. For the full year, growth is expected at 7.1%, 40bps higher than what was projected in Aug'26. For Q1FY28 growth has been revised down to 7.1% from 7.3% earlier, with overall risks evenly balanced for these projections.
- We retain our growth forecast 7.0-7.2% in FY27.

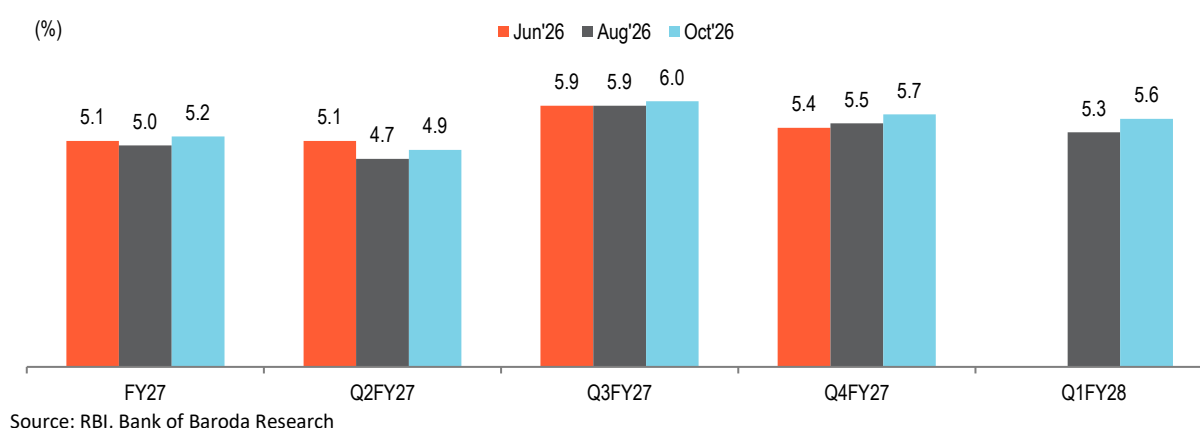
Figure 1: Growth projection for FY27 revised higher; sharp revision made to Q1 growth



Assessment of inflation outlook:

- RBI expects inflation to average higher at 5.2% in FY27, up by 20bps from RBI's Aug'26 estimate and core inflation is projected at 4.4%.
- This is primarily due to higher-than-expected inflation in Q2 (4.9% versus 4.7% estimated by RBI) and possibility of Q3 inflation also coming in higher by 10bps at 6%.
- Projection for Q4 have also been pegged higher at 5.7% (+20bps higher than last estimate). In Q1 next year, inflation is likely to inch up further to 5.6% up by 30bps.
- In Aug'26, both food and fuel inflation noted an uptick on the back of the surge in sugar and onion prices for food inflation and unfavourable base effect noted for fuel inflation.
- The central bank observed that the near-term outlook on inflation will be on account of "deficient monsoon, ongoing El Niño conditions and high energy and other commodity prices, the pass through of which is continuing".
- Headline inflation is expected to peak in Q3 at 6% led by acceleration in food and fuel components.
- This signals the need to continue with the quantitative tightening in the near-term.
- We expect CPI to range between 5-5.2% in FY27, as the upside risks remain persistent given the impact of El-Niño. Additionally, geopolitical uncertainty will continue to pose volatility for global commodity prices along with supply chain pressure building up.

Figure 2: Inflation projections revised lower



Monetary Policy Report

The macroeconomic outlook for growth and inflation by RBI is based on the baseline assumption, which projects these indicators at 7.1% and 5.2% respectively for FY27. The inflation projection has upside risk due to possible weather-related shocks and escalation of geopolitical tensions. While any de-escalation of geopolitical tension and easing global trade uncertainty can result in downside risk to these projections.

Table 1: Baseline Assumptions

Indicator	Apr'26	Oct'26
Crude Oil	US\$ 85/bbl for 2026-27 and US\$ 75/bbl for 2027-28	US\$ 95/bbl for H2:2026-27 and US\$ 85/bbl for 2027-28
Exchange rate	94/\$ for 2026-27	95/\$ for 2026-27
Monsoon	Normal for 2026-27 and 2027-28	Below normal for 2026-27 and normal for 2027-28
Global growth	2.9% for 2026 and 3% for 2027	3.0% in 2026 and 3.4% in 2027
Fiscal Deficit	To remain within BE 2026-27 Centre: 4.3 Combined:6.8	To remain within BE 2026-27 Centre: 4.3 Combined:7.0

Source: RBI, Bank of Baroda Research

Regulatory measures:

- The Reserve Bank has proposed a regulatory measure to implement interoperability among the NBFC-AA (account aggregator), with the aim to enhance customer convenience. Through this, the customers will be able to access and share financial information through any aggregators of their choice. Next, depositories regulated under SEBI can be facilitated to include information related to bank deposit accounts in CAS through NBFC-AA. This will help depositors in accessing information pertaining to both demat and bank deposit account at one place itself in CAS.
- It has also been decided to form a technical consultative committee for financial markets. The forum will serve as a place for structured engagement with market participants and stakeholders from RBI on policy, government securities and foreign exchange market.

Way forward: Today's statement by the RBI Governor had a hawkish tone. It was noted that the inflation outlook is not as benign as it was last year, with inflation projected to average 5.8% in the coming 3-quarters. Thereby, raising the need to recalibrate the policy rate now. It also noted that currently there might be limited signs of supply side pressure which are getting embedded in the price behaviour. This is also similar to the limited evidence noted of demand side pressure. However, there are also evidence of elevated inflation expectation. The change in stance to calibrated tightening, now reflects, there will be either a rate hike or a pause, the rate cuts are completely off the table for now. Post the policy, Sensex slipped marginally, rupee depreciated and 10Y yield inched up, inline with expectations. Going forward, given the evolving geopolitical dynamics, with higher risk of elevated crude prices along with spike of sovereign global yields and concerns around fiscal risk, India is placed at a much better position and somewhat insulated, though this external risk might have bearing on our projections. This along with inflation pressure building up due to sub-par monsoon, lower reservoir level along with lower kharif acreage and strengthening El Nino conditions, could push inflation higher. Based on the above, we expect 2 more hikes by the end of FY27, with 10Y yield expected in the range of 7.2-7.4% for the same period.

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