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INDIA

A tighter RBI, but not a hawkish one

The RBI delivered its first hike in four years, raised growth and inflation forecasts, and signalled calibrated tightening. While rate cuts are off the table, we expect only a gradual hiking cycle, with another 50bp of rate hikes likely as the RBI monitors the pass-through of food and energy prices to underlying inflation



The Reserve Bank of India has delivered its first rate hike in four years

RBI hikes policy rate as expected

The MPC unanimously voted to raise the policy repo rate by 25bp to 5.50%, marking its first rate hike in four years. It also shifted its policy stance to calibrated tightening, signalling that rate cuts are off the table in the near term. The MPC emphasised that future policy choices would be limited to either a rate hike or a pause, depending on evolving economic conditions and the inflation outlook.

The pace and extent of further tightening will hinge on growth and inflation dynamics, particularly the trajectory of underlying inflation, the broadening of price pressures, the risk of second-round effects from supply shocks, and the strength of demand conditions.

Reflecting a resilient growth outlook, the RBI revised up its GDP growth forecast to 7.1% YoY from 6.7%, while also nudging its inflation forecast higher to 5.2% YoY from 5.1%.

Outlook: Cautious tightening, not an aggressive hiking cycle

The RBI's message was one of cautious tightening rather than outright hawkishness. While rate cuts are clearly off the table, the central bank does not appear to be in a hurry to embark on an aggressive hiking cycle or materially tighten liquidity conditions. Instead, policymakers are likely to remain data-dependent, carefully assessing whether recent inflation pressures prove temporary or become more entrenched.

Much of that assessment will depend on external inflation drivers. Key risks stem from international oil prices, exchange rate dynamics, and global monetary conditions. While we expect Brent crude prices to decline towards US$80/bbl in the fourth quarter, upside risks remain. At the same time, further Fed tightening could keep the US dollar stronger for longer, maintaining depreciation pressure on the INR and increasing the risk of imported inflation.

As a result, barring a significant inflation surprise from persistently elevated oil prices, a stronger-than-expected El Niño impact on food prices, or a sharper INR depreciation, we expect the RBI to continue tightening gradually. Our base case is for a further 50bp of rate hikes, taking the Repo rate to a terminal rate of 6% over the next six months, with policymakers closely monitoring the pass-through of food and energy shocks into core inflation and the emergence of second-round effects.

Such a path would be consistent with the RBI's inflation outlook. With inflation projected at 5.2% for FY27, an additional 50bp of tightening would lift the real repo rate to around 50bp. While this would move policy into positive real-rate territory and back within its historical range, it would remain below the RBI's longer-term comfort level of around 1%, suggesting there is room for further normalisation if inflation risks persist.

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