



Economy • RBI Policy

RBI's Rate-Hike Cycle Begins

Why the First Increase Since 2023 Matters
More Than the 25 Basis Points

The Reserve Bank of India has formally changed the direction of monetary policy. On October 7, 2026, the Monetary Policy Committee unanimously increased the repo rate by 25 basis points from 5.25% to 5.50%, marking the first increase since February 2023.

However, the rate increase itself was not the most important part of the announcement. The RBI also changed its policy stance from “neutral” to “calibrated tightening.” This means that, under present conditions, rate cuts are no longer under consideration. The central bank’s next decision is expected to be either another increase or a pau



The change comes at an unusual time. India’s economy remains strong, with the RBI raising its FY2026–27 GDP growth forecast from 6.7% to 7.1%. At the same time, inflation is expected to increase significantly during the second half of the financial year because of elevated crude-oil prices, an inadequate monsoon, El Niño conditions and broadening food and input-cost pressures.

The RBI now expects retail inflation to average 5.2% in FY2026–27 and reach 6% in the third quarter. Therefore, the central bank is tightening policy not because economic growth has collapsed, but because growth remains strong enough to tolerate higher interest rates while inflation risks are rising.

What's Happening?

The Monetary Policy Committee voted unanimously to increase the repo rate to 5.50%. Consequently, the Standing Deposit Facility rate increased to 5.25%, while the Marginal Standing Facility and Bank Rate moved to 5.75%.

The repo rate is the rate at which the RBI lends short-term funds to banks against eligible securities. Changes in this rate influence bank funding costs, lending rates, bond yields, deposit returns, corporate borrowing costs and the value assigned to financial assets.

The RBI took the following major decisions:

- Repo rate increased from 5.25% to 5.50%.
- Policy stance changed from neutral to calibrated tightening.
- FY2026-27 GDP forecast increased from 6.7% to 7.1%.
- FY2026-27 inflation forecast increased from 5% to 5.2%.
- Rate cuts were effectively removed from consideration in the near term.
- Future policy action will be either a rate increase or a pause.

While all six MPC members supported the 25-basis-point hike, two members preferred retaining a neutral stance. This distinction is important. There was complete agreement that current rates were insufficient, but some disagreement over how clearly the RBI should signal further tightening.

Why Has the RBI Raised Rates Now?

Inflation Is Spreading Beyond a Few Products

India's retail inflation increased from 4.5% in July to 4.8% in August. Inflation remained within the RBI's statutory 2–6% tolerance range but exceeded the 4% medium-term target for the third consecutive month. More importantly, the RBI is concerned that inflation is becoming broader.

Food and fuel were initially the primary drivers, but core inflation also increased to 4.2%. Even after excluding precious metals, core inflation stood at 2.9%. The share of items in the Consumer Price Index basket recording inflation above 4% increased to approximately 37%. This breadth matters because inflation caused by one vegetable or food product may decline quickly when supply improves. Inflation spread across food, services, fuel, transportation and manufactured goods is more persistent.

Businesses facing repeated increases in transport, energy, packaging and wage costs may start raising prices more frequently. Workers may demand higher wages to protect purchasing power. These reactions can transform a temporary supply shock into a continuing inflation cycle.

Inflation Could Reach 6% in the Third Quarter

The central bank expects inflation to rise sharply during the second half of the financial year.

Its revised projections are:

- Q2 FY2026–27: 4.9%
- Q3 FY2026–27: 6%
- Q4 FY2026–27: 5.7%
- Full-year FY2026–27: 5.2%
- Q1 FY2027–28: 5.6%
- FY2026–27 core inflation: 4.4%

The RBI expects headline inflation to average almost 5.8% over the next three quarters. This is considerably above the 4% target and close to the upper limit of the tolerance range.

A central bank cannot wait until inflation is already deeply embedded before acting because monetary policy operates with a delay. A rate increase today may take several months to influence borrowing, spending, investment and corporate pricing behaviour.

The October increase is therefore partly a pre-emptive decision based on the inflation forecast rather than only the latest reported number.

Global Interest Rates and the Rupee

India's monetary policy cannot be decided in complete isolation from global interest rates. The US Federal Reserve increased rates by 25 basis points in September, while US Treasury yields have moved sharply higher. The US 10-year yield recently reached approximately 5.3%, while India's 10-year government-bond yield was around 7.2%.

This leaves an interest-rate difference of less than two percentage points. If American yields rise while Indian rates remain unchanged, global investors may decide that US bonds offer attractive returns without emerging-market currency risk. That can encourage foreign capital to leave Indian equities and debt.

Such outflows increase demand for dollars and put pressure on the rupee. A weaker rupee then makes imported crude oil, electronics, machinery and other goods more expensive, contributing further to inflation. The RBI's rate increase cannot completely protect the currency, especially while crude remains elevated. However, a more hawkish stance signals that the central bank is unwilling to ignore inflation and external-sector risks.

Why the Change in Stance Matters More Than the Hike

A 25-basis-point increase is relatively small. The more important development is the shift from neutral to calibrated tightening.

Under a neutral stance, the RBI could theoretically increase, reduce or hold rates depending on economic conditions. Under calibrated tightening, the central bank has removed rate cuts from the near-term policy menu.

The RBI has clarified that the next decision can only be:

- Another rate increase; or
- A pause at the existing rate.

This creates an asymmetric outlook. Rates may move higher but are unlikely to decline soon.

Businesses and investors will consequently begin planning for the possibility that the repo rate moves towards 5.75% or 6% rather than returning to 5.25%.

The stance influences expectations before the next increase occurs. Banks may raise loan and deposit rates, bond investors may demand higher yields and equity investors may reduce the valuations they are willing to pay for future earnings.

This is why financial markets reacted negatively even though the 25-basis-point increase itself was broadly expected.



How Will Borrowers Be Affected?

Loans linked to external benchmarks generally reprice more quickly after a repo-rate change. These include many floating-rate home, vehicle, personal and MSME loans.

Consider an illustrative ₹50 lakh home loan with 20 years remaining:

- At an interest rate of 8.50%, the monthly EMI is approximately ₹43,391.
- At 8.75%, the EMI increases to approximately ₹44,186.
- The monthly increase is around ₹795.
- Over 20 years, the additional payment would be approximately ₹1.91 lakh if the higher rate remained unchanged.

If the bank keeps the EMI constant instead, the loan's remaining tenure could increase by approximately 12 months.

The immediate effect of one increase may appear manageable. However, if the RBI raises the repo rate by another 50–75 basis points and banks fully transmit the increase, the cumulative effect becomes more significant.

Borrowers with large floating-rate loans should examine whether their bank adjusts the EMI, extends the tenure or uses a combination of both. Longer tenures can increase total interest substantially even when the monthly EMI changes only slightly.

Why Did the Stock Market React So Sharply?

The Sensex fell 1,045 points, or 1.4%, on October 8, while the Nifty declined 1.6% to 22,231. All major sectoral indices closed lower, with real estate, metals and oil and gas among the weakest.

The repo increase had been widely anticipated. The negative surprise was the shift to calibrated tightening, which increased the probability of further hikes.

Foreign investors had also sold equities worth approximately ₹6,121 crore on the previous day, while the rupee traded near ₹96.8 to the dollar. High crude prices added to pressure on both corporate earnings and the external balance.

The market is consequently facing three simultaneous pressures:

- Earnings risk from higher energy and input costs.
- Valuation compression from rising interest rates.
- Foreign outflows caused by high US yields and currency risk.

A strong second-quarter earnings season could provide support, but companies will need to demonstrate that revenue growth and pricing power can offset higher costs.

Is the RBI Tightening Too Early?

There is a reasonable argument that much of the current inflation is supply-driven. Higher crude prices, inadequate rainfall and food shortages cannot be solved by raising interest rates. Core inflation excluding precious metals also remains relatively contained at 2.9%, suggesting underlying demand pressure is not yet extreme.

However, the RBI's concern is not simply the current source of inflation. It is the risk that repeated supply shocks alter expectations and pricing behaviour. The central bank has chosen to act while growth is above 7% rather than wait for inflation to approach or exceed the upper tolerance limit.

This is essentially an insurance strategy. The RBI is accepting some risk to growth and financial markets to reduce the probability that inflation becomes entrenched. Whether this decision proves correct will depend on crude prices, food inflation and the strength of the second-round effects over the coming months.

What Does This Mean for Investors?

Investors should not react to the policy as if every company will be affected equally.

The following factors should be examined at the company level:

- Total debt and net debt.
- Percentage of floating-rate borrowings.
- Interest-coverage ratio.
- Debt due for refinancing over the next two years.
- Ability to pass higher costs to customers.
- Dependence on financed consumer demand.
- Sensitivity to crude oil and imported inputs.
- Exposure to rural demand.
- Free-cash-flow generation.
- Valuation relative to bond yields.

For banks, investors should monitor deposit growth, cost of deposits, net interest margins, credit growth and asset quality.

For NBFCs, the focus should be on funding costs, liability duration and the speed at which loan yields can be increased.

For real-estate and automobile companies, booking trends, cancellations and financing penetration will be important.

For industrial companies, investors should assess whether planned capital expenditure still earns sufficient returns at a higher cost of capital.

The rate hike does not automatically mean that equities will generate poor long-term returns. Strong companies can continue compounding through interest-rate cycles. However, the margin for valuation error becomes smaller when money is no longer becoming cheaper.

What's Next?

The October policy statement has established a clear decision framework: the RBI will either raise rates again or remain on hold. The MPC minutes will be released on October 21, providing more detail on the disagreement over the change in stance. The next policy meeting is scheduled for December 2–4.

Some economists expect another 25-basis-point increase in December, while more aggressive forecasts envisage total tightening of 75–100 basis points during the cycle. However, the RBI has avoided committing to a predetermined path. The October policy decision marks the beginning of a new phase for India's economy and financial markets.

The 25-basis-point increase is manageable in isolation. The larger message is that the era of expecting lower rates has ended for the time being. Inflation is forecast to remain well above target, crude oil is elevated, food risks are increasing and global interest rates remain high. At the same time, India's growth remains strong enough for the RBI to prioritise inflation control without immediately threatening economic stability.

For investors, the coming cycle will reward balance-sheet strength, cash generation, pricing power and reasonable valuations. Businesses that depend on cheap debt, aggressive refinancing or distant earnings will face a more difficult environment.

The most important variable will not be whether the repo rate is 5.50% today. It will be how high the rate eventually rises, how long it remains elevated and whether inflation begins moderating before higher borrowing costs significantly weaken growth.



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