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RBI MONETARY POLICY

AUGUST 2026

Highlights

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MPC holds, signals eventual recalibration

MPC's Third bi-monthly Monetary Policy Review: 2026-27

The MPC unanimously voted to keep the policy rate unchanged. Inflation projections were revised lower, reflecting a more benign near-term inflation outlook, while the policy statement conveyed increased confidence in the growth trajectory. The commentary also signaled the possibility of future policy recalibration as inflation normalizes from current benign levels and is expected to stabilize after peaking at around 6% in Q3, indicating a gradually evolving policy stance.

Policy Actions

Repo rate unchanged at 5.25%.

Consequently, SDF is at 5.00% and MSF is at 5.50%.

RBI & GOI actions:

The MPC unanimously retained policy rates, while announcing plans to harmonize guidelines on lending rates across regulated entities to enhance transparency, consistency, and customer understanding of loan pricing.

Growth-Inflation Dynamics

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Inflation projections for FY27 were revised downward by 10 bps to 5.0%, reflecting softer-than-expected Q1 inflation and limited evidence of broader second-round price pressures. The MPC's baseline outlook envisages inflation peaking just below 6% in Q3 before gradually moderating towards 5%, with current price pressures largely driven by supply-side factors and core inflation projected at 4.3% for the year. While inflation risks were assessed as broadly balanced, the MPC acknowledged the possibility of second-round effects from higher food, fuel, and input costs, particularly if supported by stronger nominal growth. The Committee indicated that it would seek greater clarity on monsoon developments and global factors before taking further action, though the policy language suggested a bias towards future recalibration as inflation normalizes from currently benign levels. Market pricing also reflects this view, with expectations for policy rates gradually moving towards a neutral level over time

FY27 GDP growth was projected at 6.7%, reflecting confidence in the resilience of domestic demand, supported by strong consumption trends, robust investment activity, government-led capex, and encouraging high-frequency economic indicators. While the growth outlook remains constructive, stronger nominal growth could also increase the risk of inflation transmission and second-round price pressures, warranting continued vigilance on the inflation front.

Liquidity And External Sector

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Liquidity guidance shifted back to ensuring “sufficient” system liquidity, indicating the RBI’s intent to proactively support money market conditions while aligning the WACR with the policy repo rate. However, structural liquidity may remain constrained by strong currency demand, FX forward maturities, and intervention-related liquidity absorption. The absence of a push towards materially easier liquidity conditions could keep longer-term interest rates elevated, reinforcing the market's expectation of a gradual normalization in the interest-rate environment.

The RBI continued to express comfort on India’s external sector, highlighting strong foreign exchange reserves, robust services exports, healthy remittance inflows, and a rebound in merchandise exports. The policy also reiterated its commitment to a market-determined exchange rate, with intervention limited to curbing excessive volatility and ensuring orderly market conditions, indicating continuity in the current FX management framework.

Policy Stance and Guidance

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While the MPC retained its neutral policy stance, the accompanying language emphasized the need for future policy recalibration in line with evolving growth-inflation dynamics as underlying inflation normalizes from previously benign levels. This indicates that while immediate action is unlikely, future rate hikes remain a possibility should inflationary pressures become broader-based.

Key Measures announced by the RBI

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Measures announced in chronological order in last 1 year.

Date	Measures Announced
February 7, 2025	• Introduction of Additional Factor of Authentication (AFA) for domestic digital payments and proposed to extend AFA to online international digital payments made to offshore merchants. • Proposed to include forward contracts in Government securities to facilitate long-term investors such as insurance funds to manage their interest rate risk across interest rate cycles. • Expand the access of NDS-OM for secondary market transactions in government securities, to non-bank brokers registered with SEBI. • Set-up working group to review of trading and settlement timings across various market segments, report to be submitted by 30th April of this year.
April 9, 2025	• Proposed to enable securitisation of stressed assets through market-based mechanism, in addition to the existing ARC route under the SARFAESI Act, 2002. • Co-lending arrangements are restricted to only priority sector loans by banks and NBFCs to be extended to all regulated entities for all loans. • RBI will introduce standardised guidelines for loans backed by gold jewellery and ornaments across all Res. • New norms will consolidate rules for non-fund based facilities like guarantees, letters of credit, and co-acceptances. • UPI Transaction limits to be made flexible by the NCPI in consultation with stakeholders. • RBI plans to shift the Regulatory Sandbox to an open-ended, theme-neutral format.
August 6, 2025	• Standardisation of procedure for settlement of claims in respect of deposit accounts of deceased customers of banks. • Introduction of Auto-bidding facilities in RBI Retail Direct for Investment and Re-investment in T-bills.
October 1, 2025	• Implementing the Expected Credit Loss framework and revised Basel III norms from April 2027 with glide path till 2031. • Enabling banks to finance corporate acquisitions and expand lending against shares/IPO financing • Easing infrastructure financing norms for NBFCs; considering new licences for urban co-operative banks; rationalising FEMA and ECB rules • Enhancing the consumer protection framework through an expanded Ombudsman scheme and digital banking access for basic accounts • RBI outlined steps to advance internationalisation of the rupee. • RBI proposes to publish a discussion paper on licensing of Urban Co-operative Banks (UCBs). • RBI proposes reforms in insurance premiums and lending limits

Key Measures announced by the RBI

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Measures announced in chronological order in last 1 year.

Date	Measures Announced
February 6, 2026	• RBI to issue three draft guidelines on mis-selling, loan recovery and recovery agents, and limiting customer liability in unauthorised electronic banking transactions. Proposal to introduce a compensation framework up to ₹25,000 for customers affected by small-value fraudulent transactions. • Collateral-free loan limit for MSMEs proposed to be enhanced from ₹10 lakh to ₹20 lakh. • To support real estate financing, proposal to allow banks to lend to REITs with prudential safeguards. • Proposals for UCBs include higher financial limits on unsecured loans and loans to nominal members, and removal of tenor and moratorium requirements for housing loans by Tier III and Tier IV UCBs. • NBFCs with no public funds and no customer interface, and with asset size ≤ ₹1000 crore, proposed to be exempted from registration. • Proposal to remove the ₹2.5 lakh crore cap on investments via the Voluntary Retention Route (VRR); investments will instead follow category-wise ceilings under the General Route. • RBI proposes to issue regulatory frameworks for derivatives on corporate bond indices and total return swaps on corporate bonds. • Draft revised guidelines to be issued for Authorised Dealer banks and stand-alone primary dealers, providing greater flexibility in foreign exchange transactions.
April 8, 2026	• Proposed to remove the condition regarding NPA provisioning for inclusion of quarterly profits in CRAR computation. • Enhancing the borrowing limit of SPDs in the term money market to non-bank entities
June 5, 2026	• Expanded the universe of securities eligible under the Fully Accessible Route (FAR) to include all new issuances of 15-year, 30-year and 40-year government securities. • exempted FPIs from income tax on interest income and capital gains arising from investments in government securities, effective April 1, 2026. • Facility of concessional forex swap will be provided till 30th September 2026 to incentivize ECBs by PSUs • Facility for bearing the full hedging cost shall be provided till 30th September 2026 to AD banks for raising fresh 3–5-year FCNR (B) deposits. • Proposed to restore the time for realisation of export proceeds to nine months.

IMPACT ON THE MUTUAL FUND INDUSTRY

Impact on the Mutual Fund Industry

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Liquid Funds:

These schemes will continue to generate returns around the operating rate due to their portfolio composition i.e. being invested at the shorter end of the money market segment. Liquid funds have low average maturity as they concentrate more on high quality papers including CPs, CDs and other debt securities with residual maturity of upto 3 months.

Ultra Short Term / Low Duration / Money Market Funds (Maturity Up to 1 Year):

These schemes predominantly invest in below 1 year maturity paper. The strategy adopted by these schemes is to hold the paper till maturity and capitalize on the running yield. Hence, returns in this category will continue to remain relatively attractive depending on the positioning of the fund.

Short Duration Funds:

Schemes in this category are predominantly invested in Corporate Bonds, CPs and CDs while a few of them also have some exposure to G-Secs. We continue to remain bullish at the shorter end of the curve. Investors may consider these funds (with an investment horizon commensurate with the maturity profile of such funds) and gain from current accruals and capital appreciation in the event of a fall in yields.

Impact on the Mutual Fund Industry

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Medium Duration:
Given the flattened yield curve there are sufficient buffers in the intermediate duration (3-6 years) segment. Till the time RBI is anchoring the long end of the yield curve, the current yield curve may provide some cushion even if there are mark-to-market losses. Investors may consider those funds with high quality portfolios and where the investment horizon is commensurate with the maturity profile of the funds and also gain from current accruals and capital appreciation in the event of a fall in yields.

Credit Risk Funds:
We remain cautious on Credit Risk Funds as they have failed to prove their mettle in the last 2-3 years with the overhang of defaults and erosions of NAV on the back of mark-to-market impacts due to the aforementioned. The uncertainty around credit funds which are in an open-ended avatar continues to pose risks to investors. Much also depends on the liquidity conditions in the market and redemption pressure on these funds. Thus, we think there is a systemic risk in the market within the credit space. Hence, it makes sense for one to stay away from these funds.

Long Term Income Funds / Gilt Funds / Dynamic Bond Funds:
The Indian fixed income market remains relatively resilient despite ongoing global uncertainties, supported by improving liquidity conditions, stable domestic macroeconomic fundamentals and expectations of continued policy support. While geopolitical tensions in West Asia and crude oil volatility remain key risks, Indian government bond yields have remained range-bound as strong domestic demand and improving foreign investor participation provide stability.

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The RBI's evolving policy framework has become a key driver of debt market sentiment. Over time, the central bank has moved beyond relying solely on interest rate actions and now uses a broader mix of liquidity, regulatory, FX and capital-flow measures to address market stress. Recent crises have shown that targeted liquidity support and market-stabilisation measures are often more effective than rate hikes alone.

The current challenge is largely external, driven by FPI outflows, higher crude oil prices and global capital shifts. In response, the RBI and Government have introduced measures such as FCNR(B) mobilisation, ECB incentives and FAR expansion to support the rupee, strengthen external balances and maintain market stability.

Meanwhile, Bloomberg's decision to defer India's inclusion in the Global Aggregate Index postpones a potential US$20-25 billion inflow opportunity, though it is viewed as a delay rather than a setback. India's ongoing reforms, improving market access and strong macroeconomic fundamentals continue to support the long-term investment case for Indian debt.

Looking ahead, liquidity is expected to remain the primary driver for bond markets. Recent RBI measures, including FCNR(B) incentives, ECB facilitation and other foreign currency inflow initiatives, should support liquidity, strengthen the rupee and cushion the impact of external sector pressures. Although Bloomberg's decision to defer inclusion of Indian government bonds in its Global Aggregate Index delays a potential source of foreign inflows, it does not alter the medium-term structural attractiveness of Indian debt markets.

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On the policy front, the RBI is widely expected to maintain a pause in the upcoming MPC meeting. However, inflation risks are gradually building, with Axis Bank Economics projecting CPI inflation at around 5.0% for FY27. Higher petrochemical prices, weather-related supply disruptions, elevated edible oil prices and strong credit growth could exert upward pressure on inflation over time. As a result, while the RBI is likely to remain on hold in the near term, markets will closely watch for any change in policy language, particularly around inflation risks and liquidity management. A shallow tightening cycle of 50-75 bps, if required, appears more likely than the steeper hikes currently priced by markets.

Overall, abundant liquidity, stable borrowing requirements and improved external sector dynamics continue to provide a supportive backdrop for fixed income. We remain constructive on high-quality accrual strategies, particularly in the 1-3 year segment, while selectively adding duration on yield spikes. Investors should continue to favour portfolios focused on quality securities, with returns likely to be driven more by carry than capital gains. The 10-year G-Sec yield is expected to trade in the 6.60%-7.00% range in the near term.

The 10-year Indian benchmark bond yield fell ~4 bps from the previous close at 6.83% (at the time of writing the note) while from the previous policy it is down by ~13 bps.

Conservative Hybrid Funds *(Erstwhile: Monthly Income Plans (MIPs)*:
With a 10% to 25% allocation to equity, returns of CHFs are largely determined by the vagaries of the equity markets as against the debt markets. These funds are therefore suitable for investors who have a reasonably long-time horizon & are comfortable with taking exposure to equities.

OUTLOOK

Impact on the Mutual Fund Industry

The Axis Bank economist continue to expect a gradual normalization of policy rates towards a neutral level of around 6.0%, with December emerging as the earliest meeting at which a rate hike could become a live possibility. While the RBI has retained its neutral stance, the policy language indicates an increasing focus on recalibrating rates as underlying inflation normalizes from previously benign levels. Globally, higher effective interest rates continue to transmit through financial markets, and Indian fixed income remains relatively less attractive on both hedged and unhedged yield differentials versus peers. Consequently, in the absence of liquidity-driven demand support, longer-end bond yields are likely to remain biased upwards.

On the currency front, the INR is expected to depreciate gradually, although the pace may moderate as valuation models suggest fair value levels are being approached. Nonetheless, exchange rate dynamics and the need to maintain external balance, alongside domestic inflation considerations, reinforce the case for a gradual normalization of interest rates over time.

We remain constructive on the short to medium end of the yield curve. Short Duration funds, Banking & PSU Debt funds, Corporate Bond funds, Medium Duration funds, Money Market funds, Low Duration funds and Ultra Short Duration can be considered by investors with an investment horizon commensurate with the maturity profile of the schemes. Investors can consider **tactical allocation in Medium to Long Duration yield curve**, as per their risk appetite with an investment horizon of at least 2-3 years to avoid any intermittent volatility.

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