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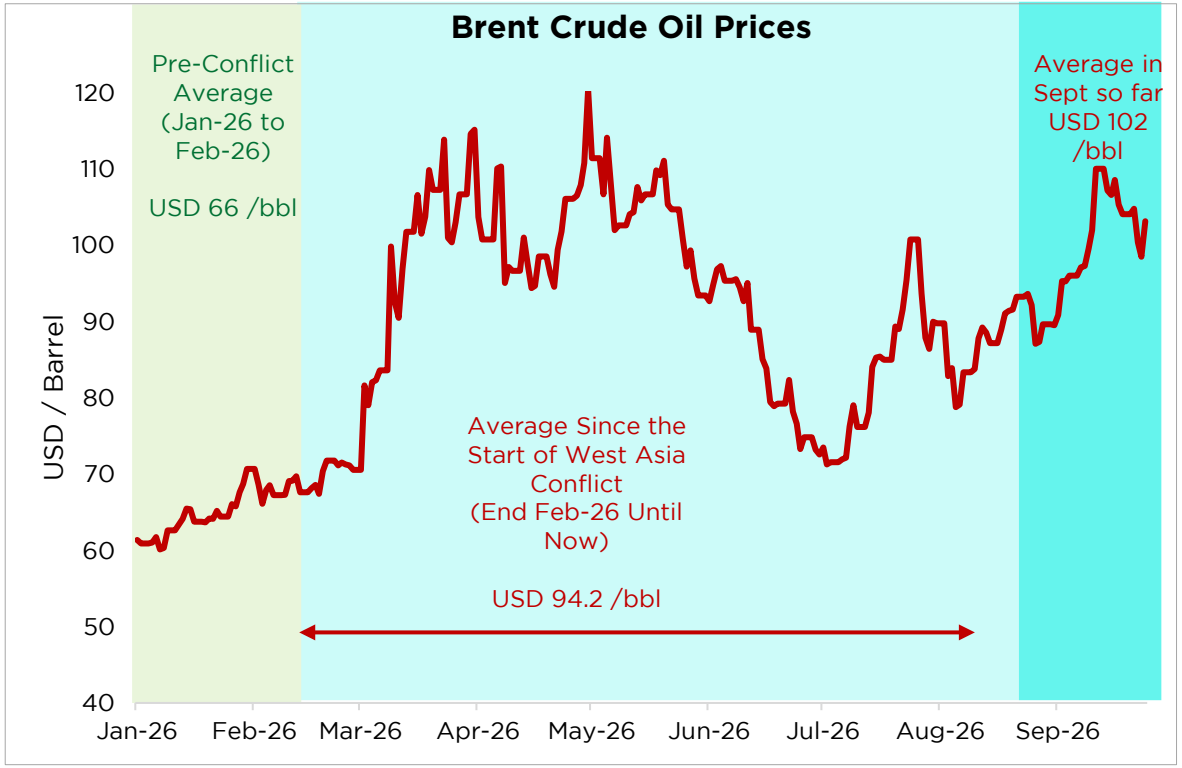
RBI-MPC Expectations: A Rate Hike Amid Rising Inflation; Liquidity Management Crucial

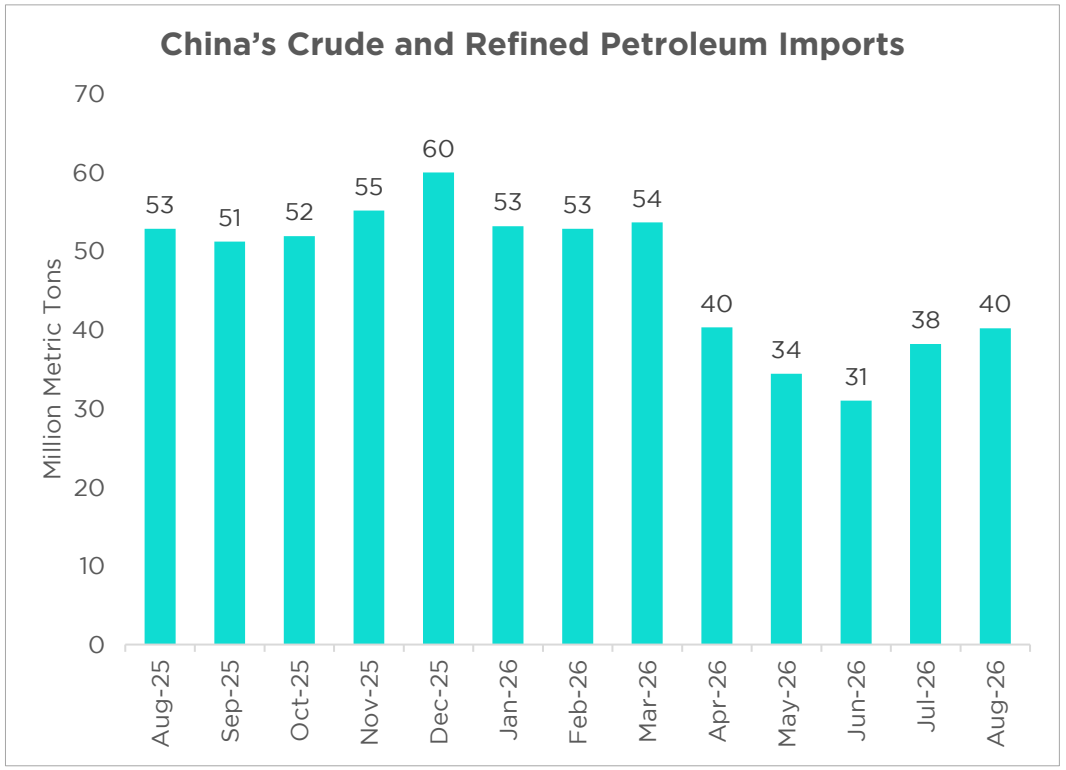
October 2026

Key Takeaways: Rate Hike Expected Amid Rising Price Pressures

- **Geopolitical tensions appear more persistent than initially expected,** with continued disruption to trade through the Hormuz Strait, while tensions along the Bab-el-Mandeb Strait are rising. Continued Ukrainian drone strikes on Russian refineries have also impacted energy prices.
- **Global energy prices remain volatile**, driven by geopolitical developments, attacks on critical oil infrastructure, and rising crude oil imports by China. Weaker Chinese imports helped limit the price spike in the initial months following the Iran war.
- **Inflation risks are rising,** largely due to elevated energy prices and adverse weather events impacting agricultural output. Signs of broadening price pressures and rising inflation expectations need to be monitored.
- **The growth outlook has remained resilient so far, despite global headwinds.** However, growth could moderate in H2 compared to H1 FY27.
- **Several major central banks have resumed policy tightening**, with markets pricing in further rate hikes by the US Federal Reserve and the ECB.
- **Global bond yields have also moved higher** amid growing inflationary pressures, expectations of tighter monetary policy, and fiscal concerns.
- **The weakness in USD/INR persists due to** elevated oil prices, volatile portfolio flows, and rising global bond yields. However, strong forex inflows through FCNR have given the RBI ample buffers to support the rupee amid a volatile external environment.
- **FCNR inflows have resulted in a substantial banking system liquidity surplus.** The RBI has started VRRR auctions and OMO sales to absorb liquidity.
- **RBI is likely to revise up real GDP growth projection for FY27 to above 7%, while CPI inflation is likely to be retained at 5.0%**
- **RBI's MPC likely to hike repo rate by 25 bps in the October meeting while maintaining the neutral stance.** A neutral stance would provide flexibility to the MPC to adjust policy rates as the situation evolves.
- **We expect this policy rate hiking cycle to be shallow, with a cumulative 50–75 bps hike in the repo rate.** Policy tightening should also support a weaker rupee.
- **The RBI is likely to focus on liquidity management,** as a rate hike without corresponding liquidity tightening would be ineffective. The market would look for further guidance on additional measures, particularly CRR or I-CRR hikes.

Persistent Geopolitical Tensions Keeps Energy Prices Elevated

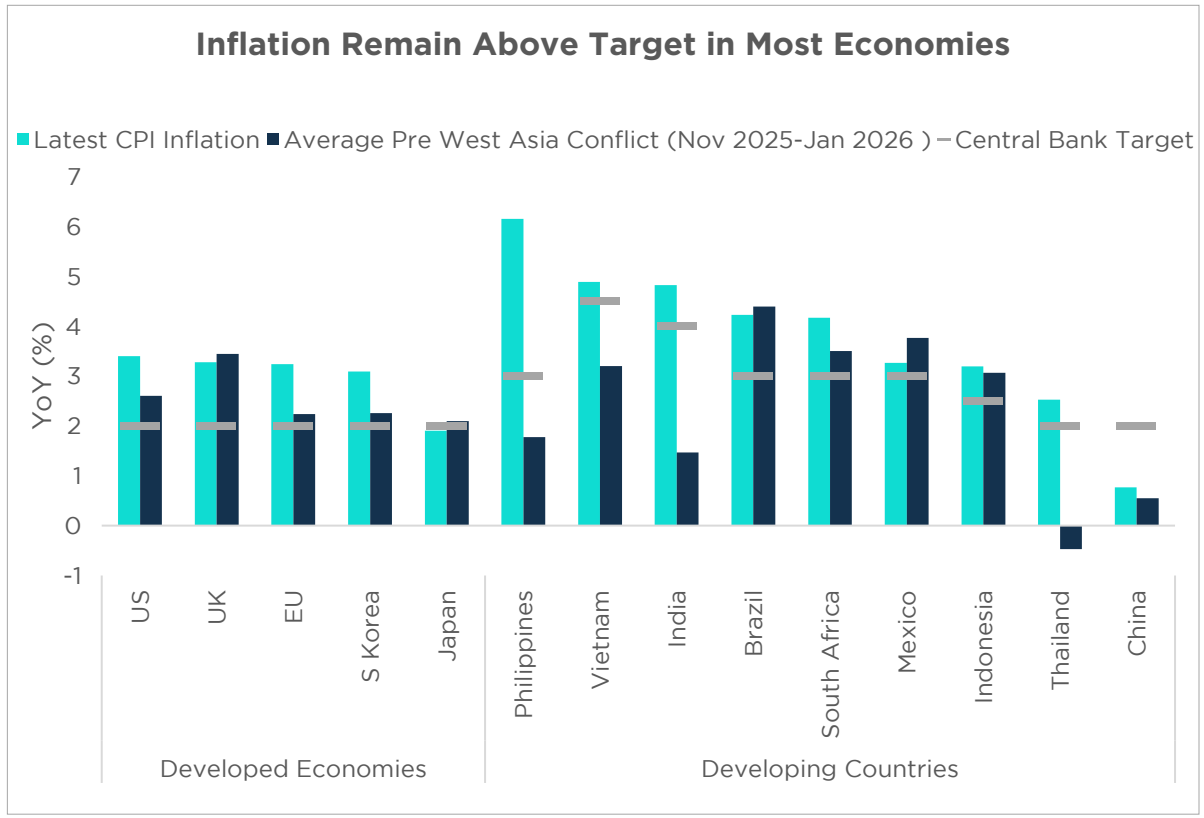


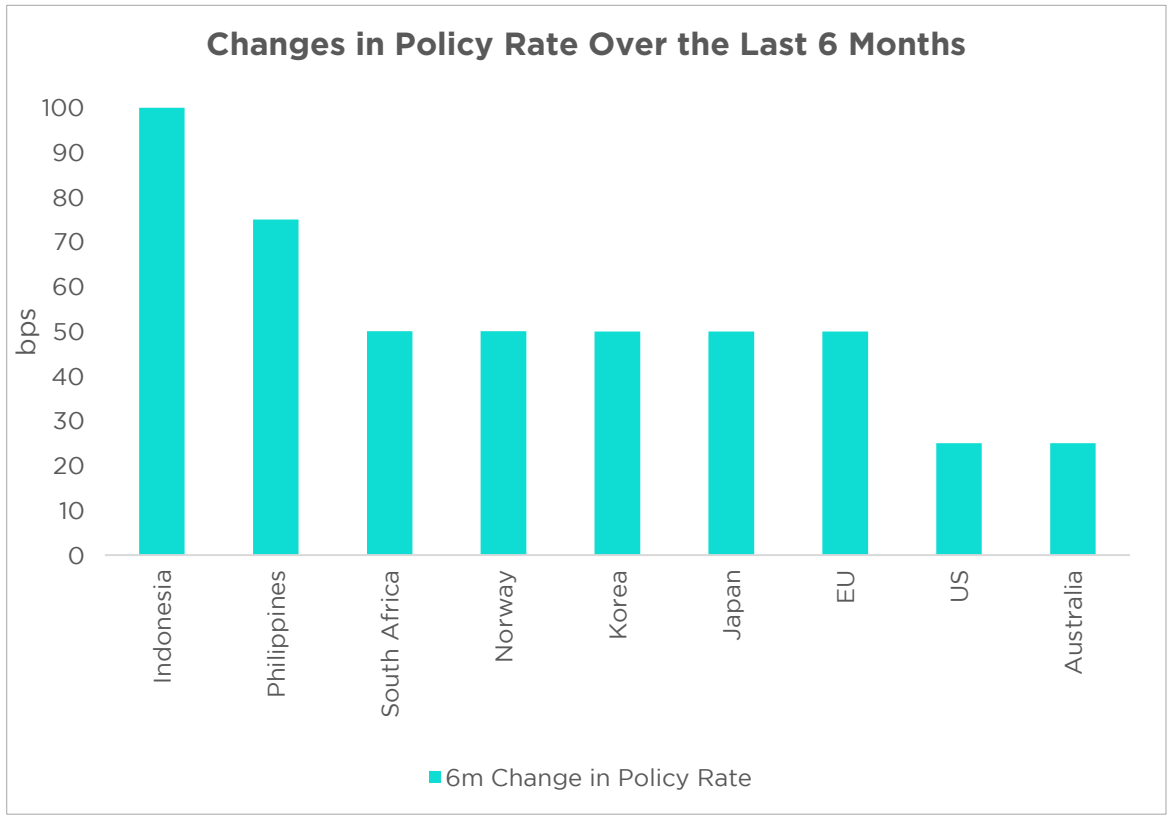


Source: EIA, IEA, General Administration of Customs of the People's Republic of China, Haver and CareEdge. Data as of 20th September 2026

- Geopolitical tensions impact key shipping routes. Brent crude averaged USD 102/bbl in September.
- China's crude imports are rising again, putting upward pressure on crude oil prices. Upcoming winter months in Europe to further strengthen energy demand. However, strategic petroleum releases by the US and other OECD nations are providing some support to the market.
- The EIA's September STEO projects an oil market deficit of 3 mbpd in Q3 2026 and 1.7 mbpd in Q4, before shifting to a surplus of 3 mbpd in Q1 2027.

Growing Inflationary Pressure Results in Global Policy Tightening

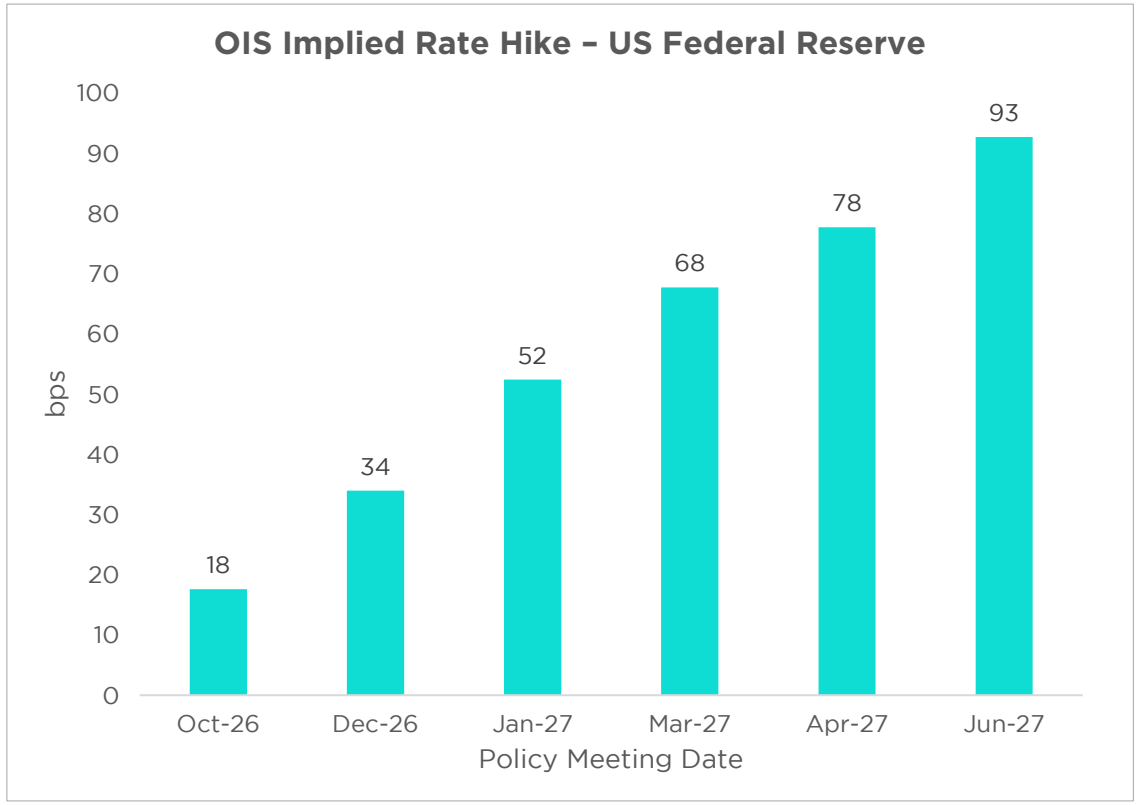


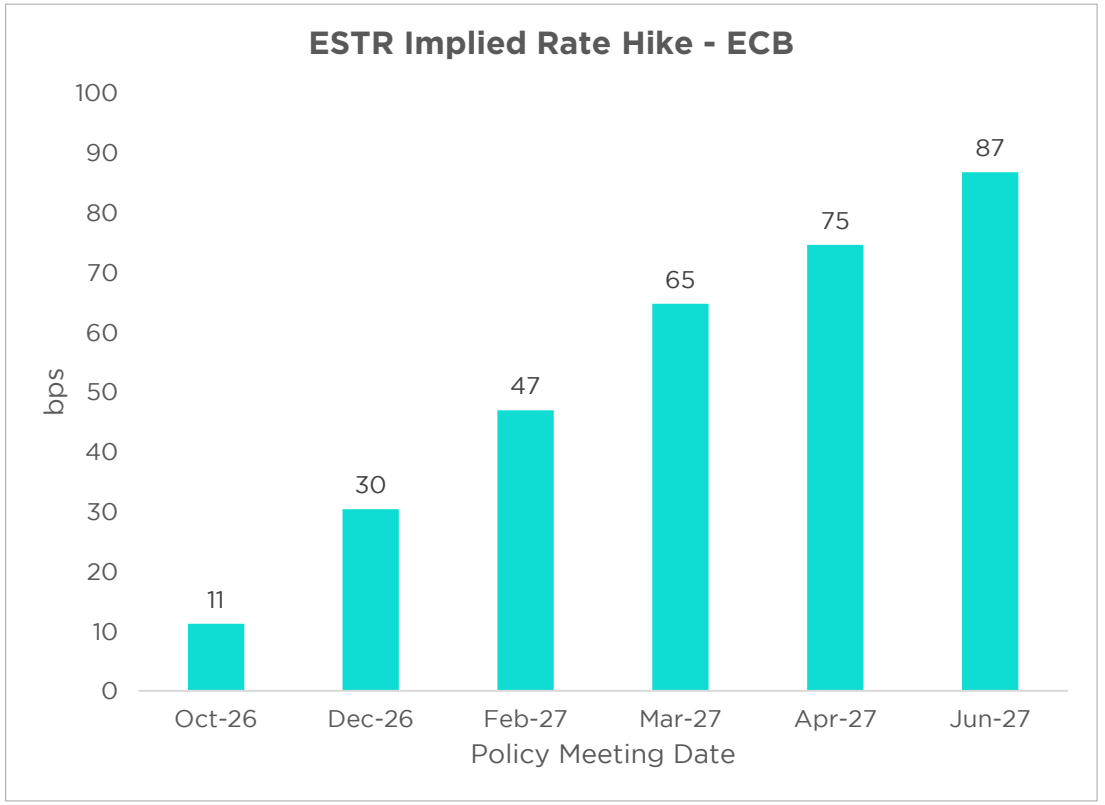


Source: Haver, Refinitiv, CareEdge. Data as of 27th September 2026

- Inflation remains persistently above central bank targets in most economies, driven by energy-price pressures, rising food inflation, including edible oils, cereals & sugar, and higher inflation in memory chip prices.
- Major central banks have embarked on a rate-hiking cycle. The US Fed, ECB, and BoJ raised policy rates in September.

Markets Pricing Further Rate Hikes by the US Fed and ECB

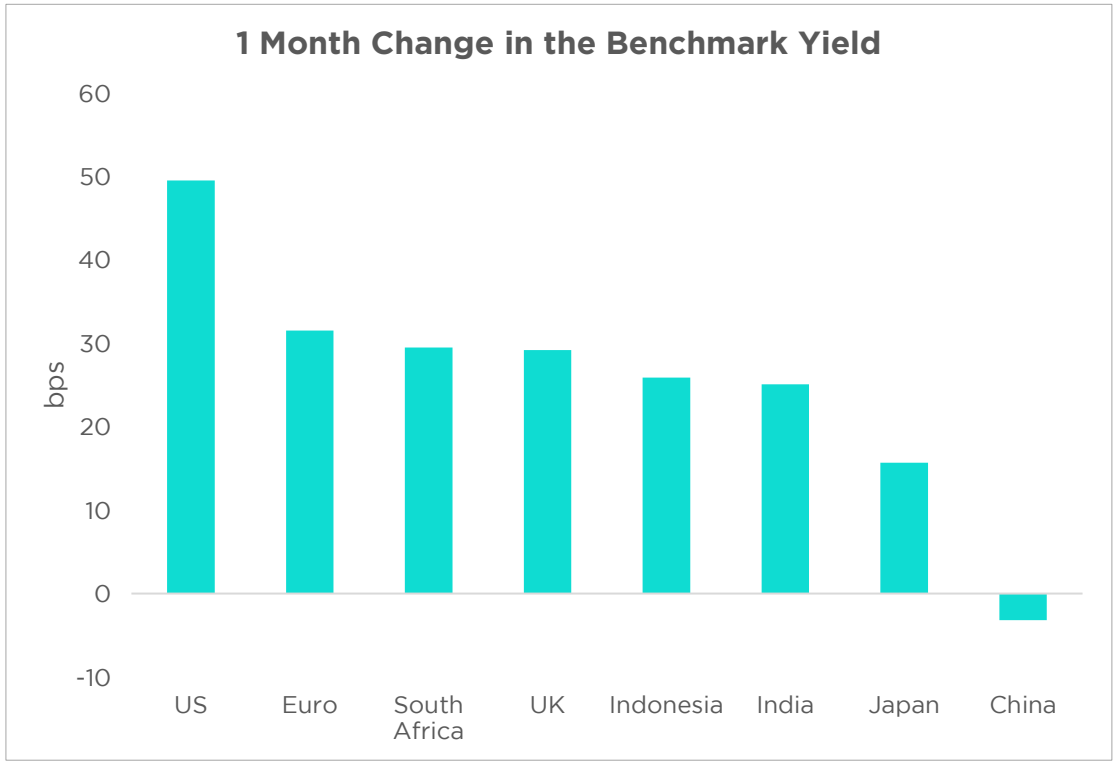


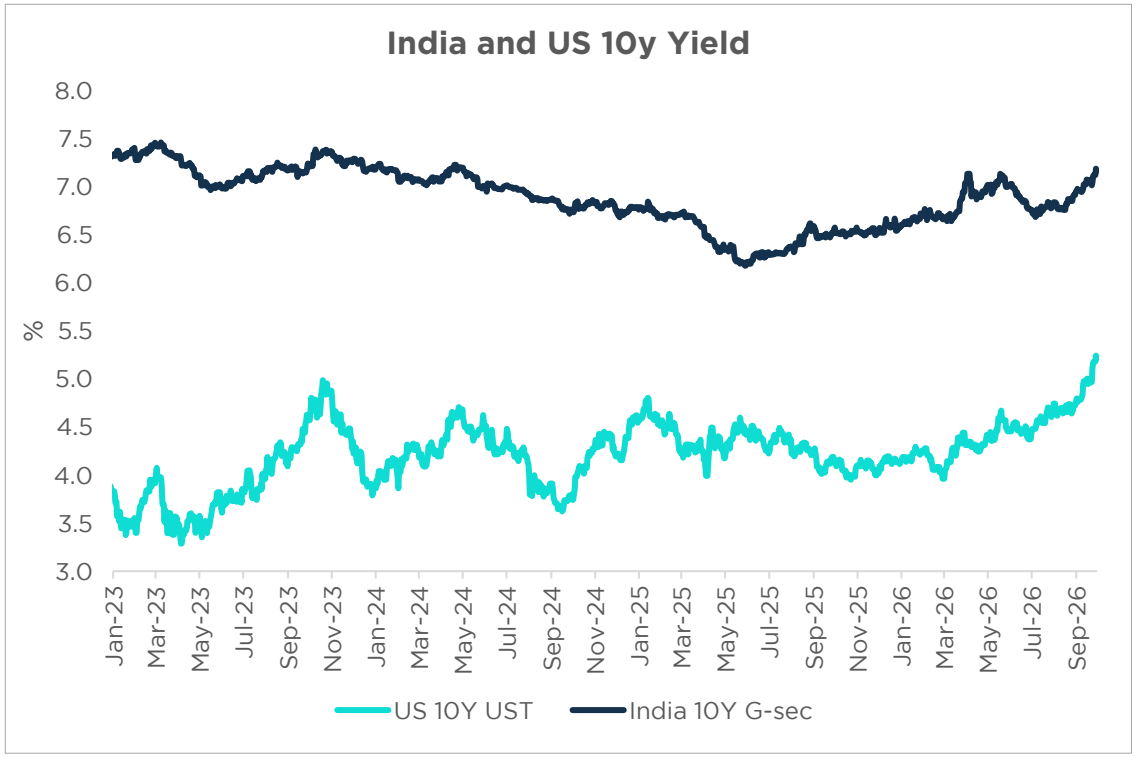


Source: Refinitiv, CareEdge. Data as of 28th September 2026

- Markets are pricing in three additional 25-bps rate hikes by the US Fed and ECB in the current cycle, based on the OIS Curve and the ESTR rate, respectively.
- We believe rate hikes look plausible in December 2026, March 2027 and June 2027 in these central banks.

Global Yields Rise Sharply, India–US Yield Differential Narrow

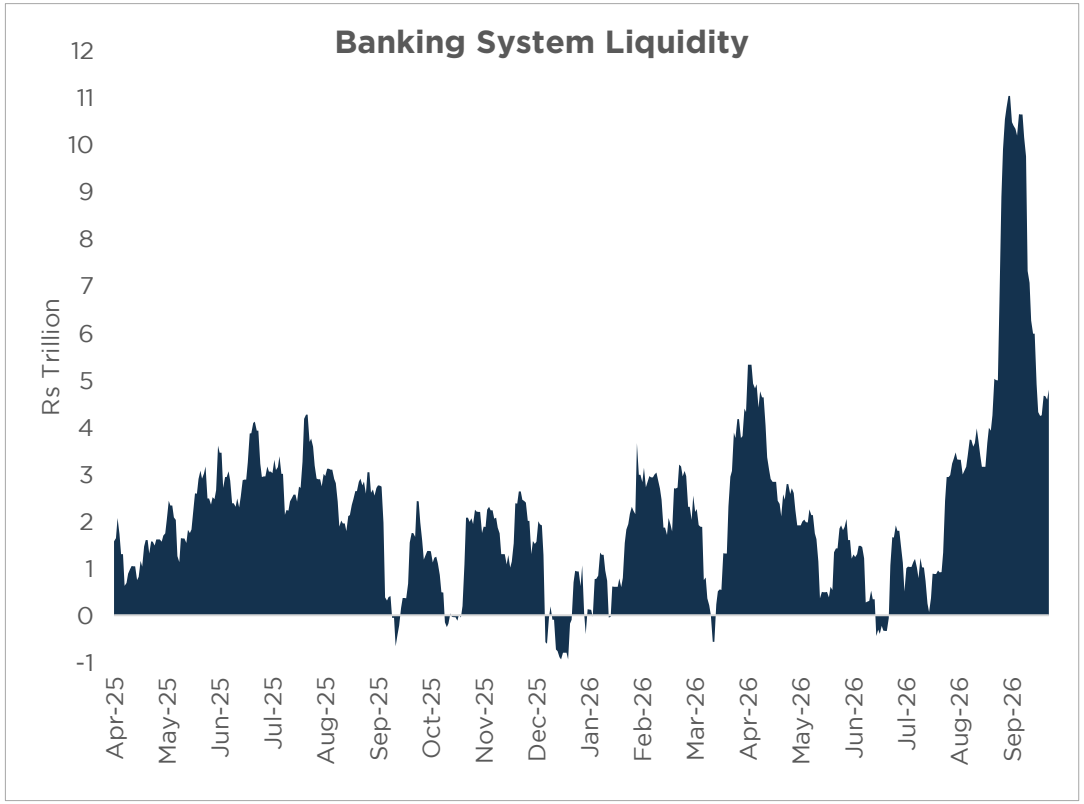


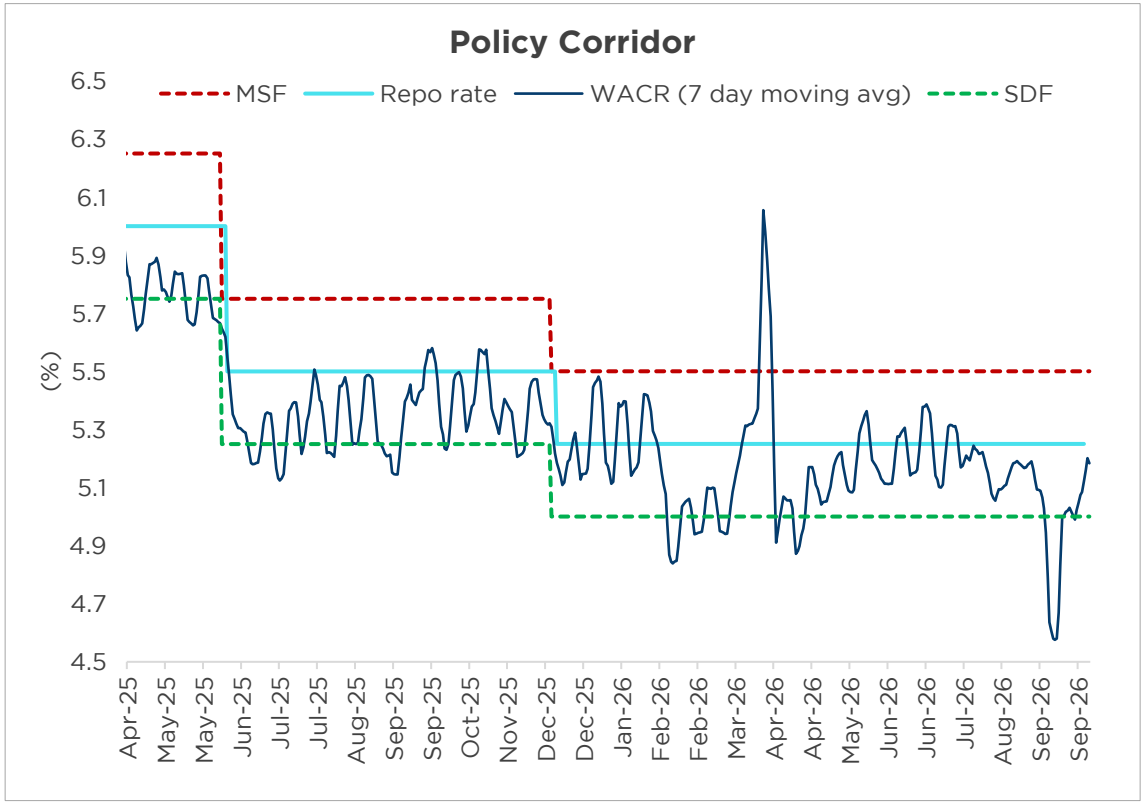


Source: Haver, Refinitiv, CareEdge. Data as of 28th September 2026.

- Global bond markets are increasingly reflecting concerns over fiscal sustainability and inflation, with rising long-term yields indicating higher term premia. The global rate-hiking cycle is likely to put further upward pressure on yields.
- The US Treasury bought back USD 4.1 billion in 20- to 30-year bonds as part of its ongoing buyback program to support market liquidity, lower than the USD 6 billion announced earlier. Recent bond-market interventions and statements highlight policymakers' concerns over a sharp uptick in bond yields.
- With rising US yields, the India-US 10-year yield differential narrowed to 200 bps in September, down from 240 bps a year ago.

Huge FCNR Inflows Widens Liquidity Surplus

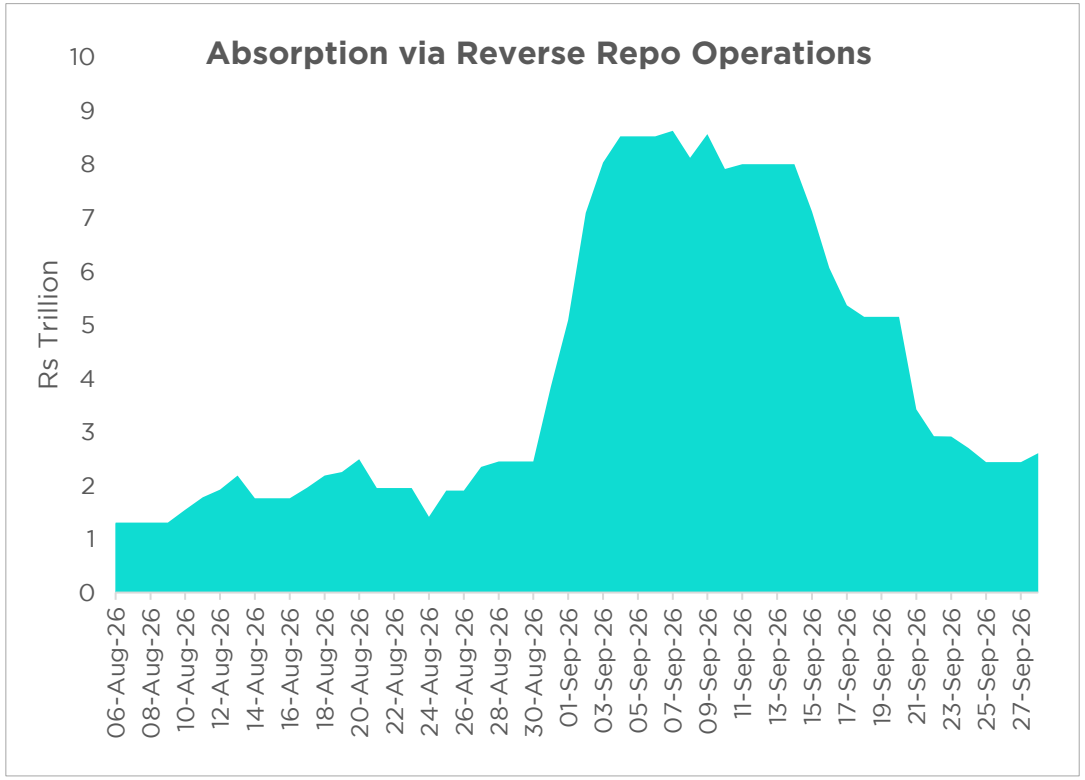


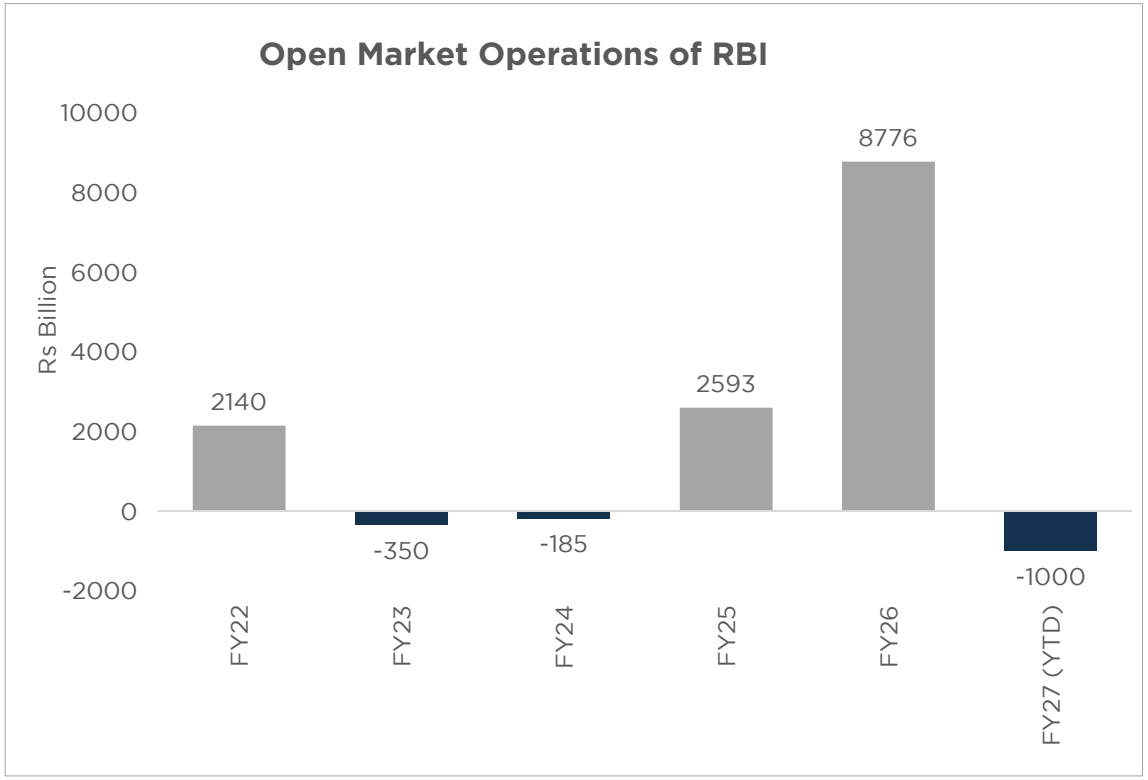


Source: Refinitiv, CareEdge. Data as of 28th September 2026.

- The FCNR(B) inflows have also injected substantial rupee liquidity into the banking system. Daily surplus liquidity increased from an average of Rs 3.7 trillion in August to a peak of Rs 11 trillion in the first week of September.
- Systemic liquidity declined to around Rs 4.8 trillion as of 28 September following OMO sales and VRRR auctions by the RBI. However, it is well above the average of Rs 1.9 trillion seen during H1 CY 2026.
- On the back of RBI's liquidity absorption measures, the WACR has moved within the policy corridor over the past week, but it remains below the repo rate.

VRRR and OMO Sale for Liquidity Absorption

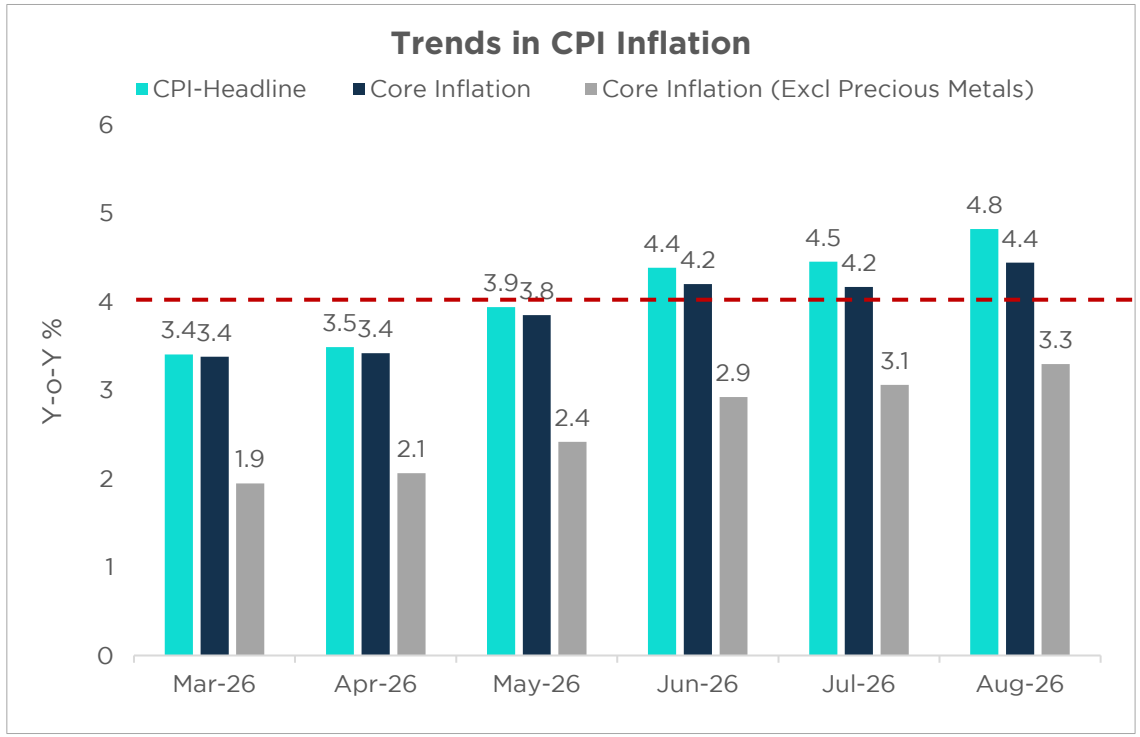




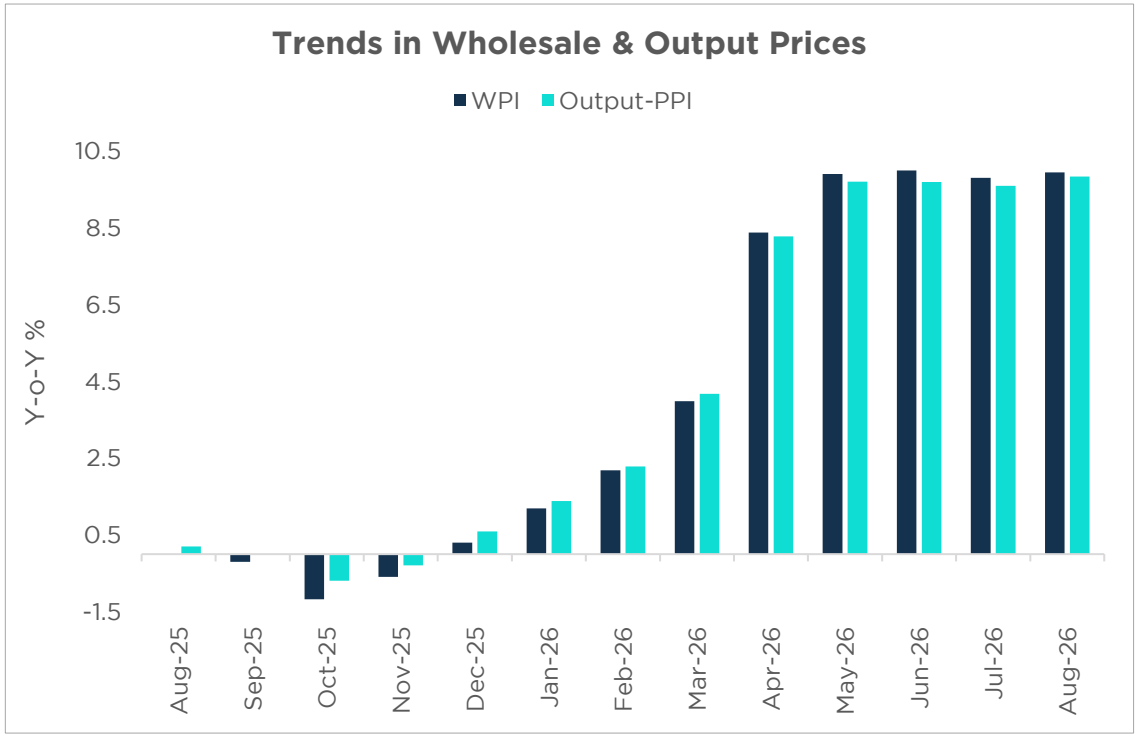
Source: Refinitiv, CareEdge. Data as of 29th September 2026. Negative number indicate OMO sale.

- The RBI has begun absorbing surplus liquidity. The RBI has so far absorbed Rs 2.6 trillion and Rs 1 trillion via VRRR operations and OMO sales, respectively.
- Part of the excess liquidity should be absorbed by festive-season currency demand, the maturity of the RBI's short-dollar forward positions, and higher CRR requirements linked to deposit growth.
- A rate hike without liquidity tightening could weaken policy rate transmission. The market will look for guidance on additional measures, such as CRR/I-CRR hikes.

CPI Inflation Rise; Weather Risks to Impact Food Inflation



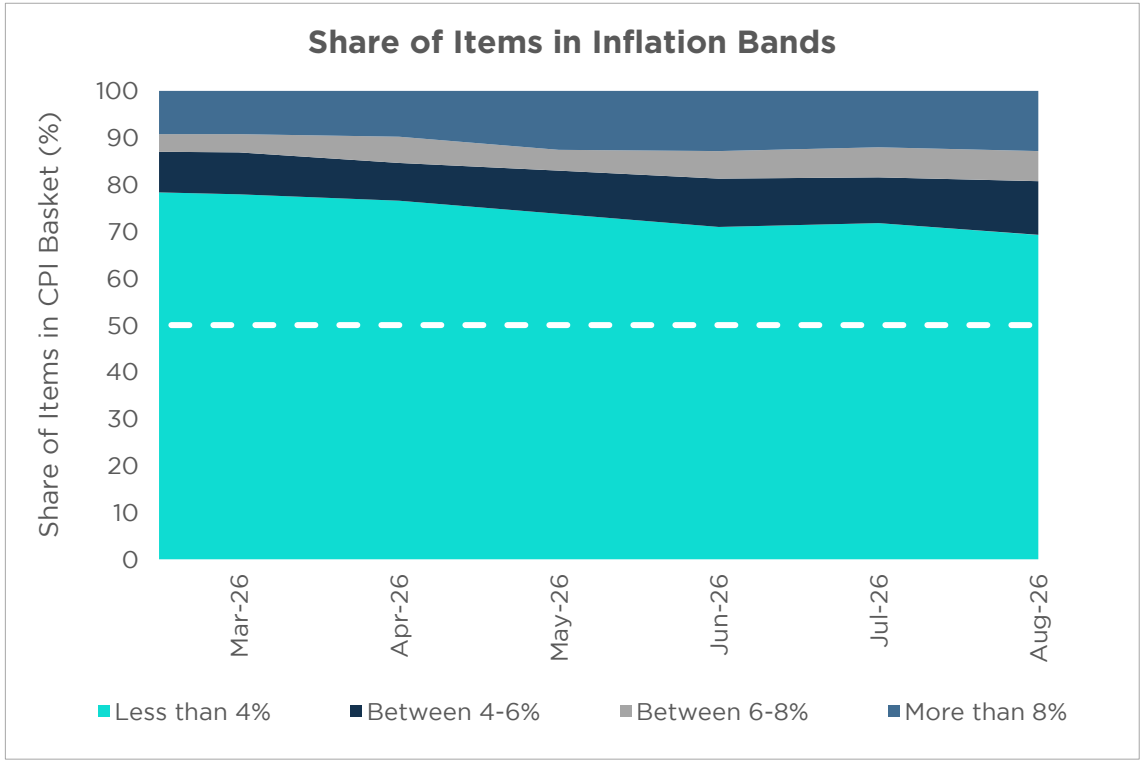
Source: MOSPI, CEIC, CareEdge



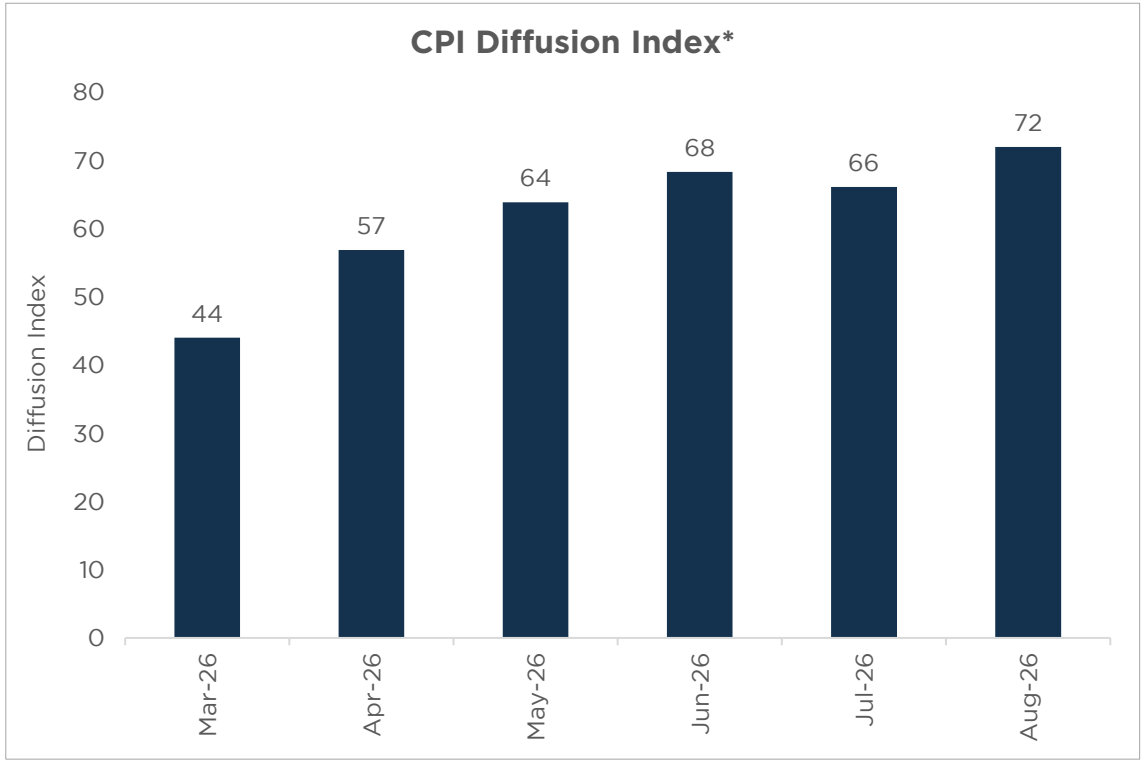
Source: CEIC, CMIE, CareEdge

- CPI inflation shows signs of inflationary pressures broadening. Price pressures stem from elevated energy prices and a rise in food inflation.
- The impact of El Niño-related disruptions is becoming visible. Maharashtra has declared drought in about 265 of the state's 358 talukas, covering nearly 74% of the state. The Union Agriculture Minister has raised concerns about possibility of drought in other states - Karnataka, Telangana, Andhra Pradesh, and Rajasthan.
- Reservoir levels in India are 20% lower than last year's levels. This could also impact rabi crop. Reports of El Niño spilling over into 2027 remain a key monitorable.
- El Niño conditions in Asia have pushed up food inflation, driven largely by double-digit increases in edible oil prices (16.4% YoY) and cereal prices (10% YoY).
- Overall, CPI inflation is projected to peak at 6% in Q3 and average around 5% in FY27. Weather-related risks and volatile energy prices remain the key risks.
- WPI and output PPI inflation remained elevated at 9.9% and 9.8%, respectively in August. Higher WPI inflation can transmit to CPI basket with a lag.

CPI Inflation Shows Broadening Trends



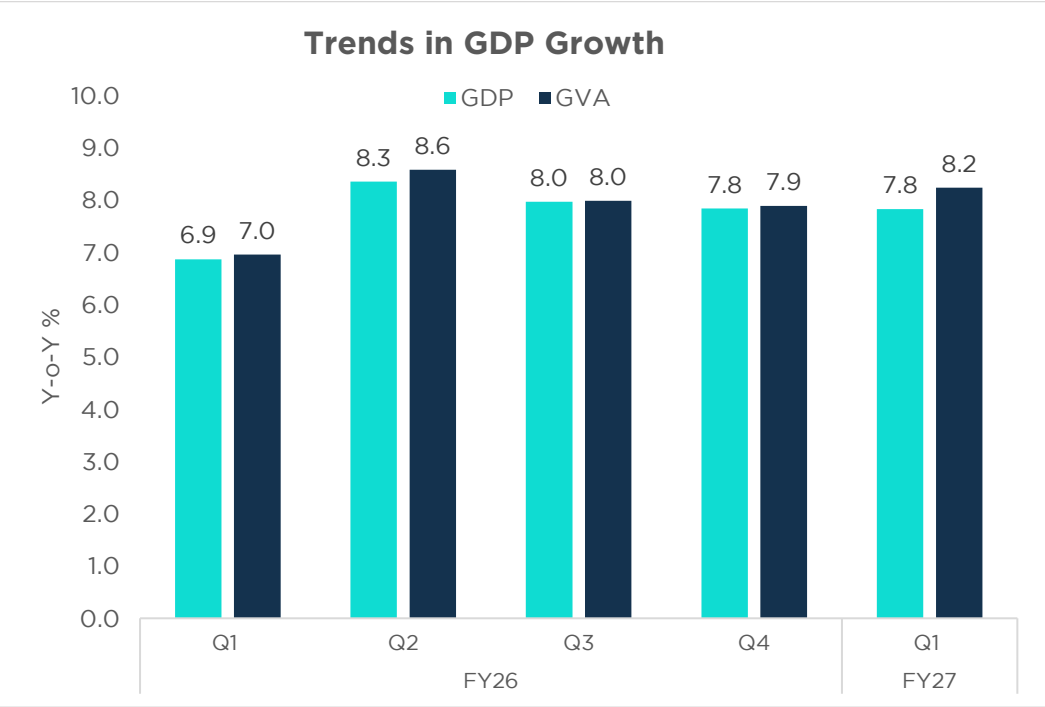
Source: CEIC, CareEdge

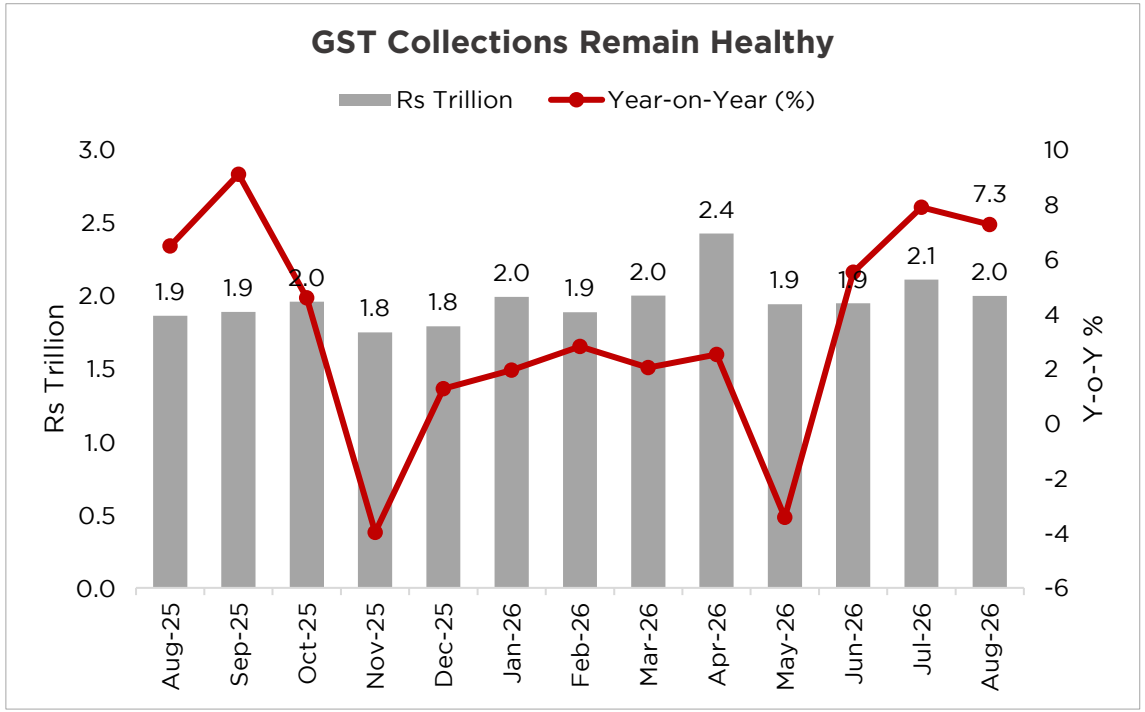


Source: CEIC, CareEdge; *A reading above 50 indicates that more components are recording rising inflation than falling

- In August, around 19% of the 358 items in the CPI basket recorded inflation above 6%, up from 13% in March.
- The CPI diffusion index, which measures the breadth of price increases across categories, rose to 72 from 44 in March.
- Median households' inflation expectations (current expectations) have also inched up from 6.6% in November 2025 to 7.8% in July 2026.
- This broadening of price pressures, along with rising inflation expectations, raises the risk that inflation becomes entrenched and inflation expectations become unanchored.
- Overall, the inflation outlook remains vulnerable to both external and weather risks. We project average CPI inflation of around 5.0% in FY27.

RBI to Raise GDP Growth Projections

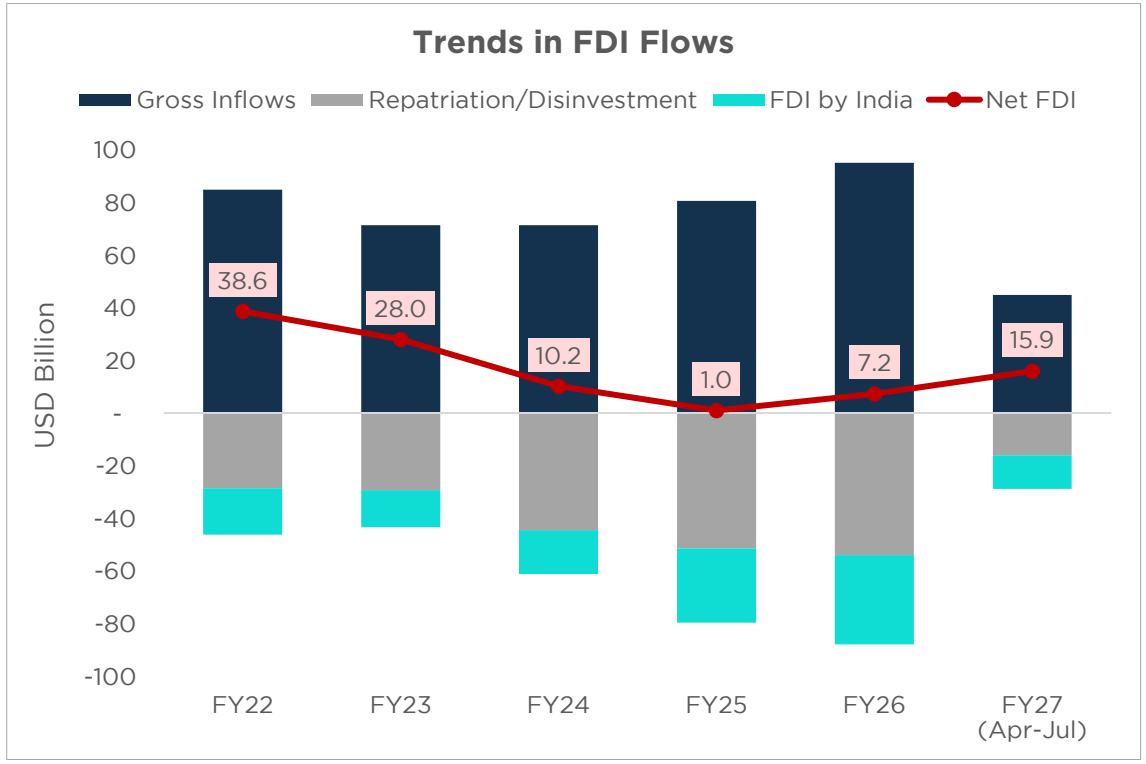


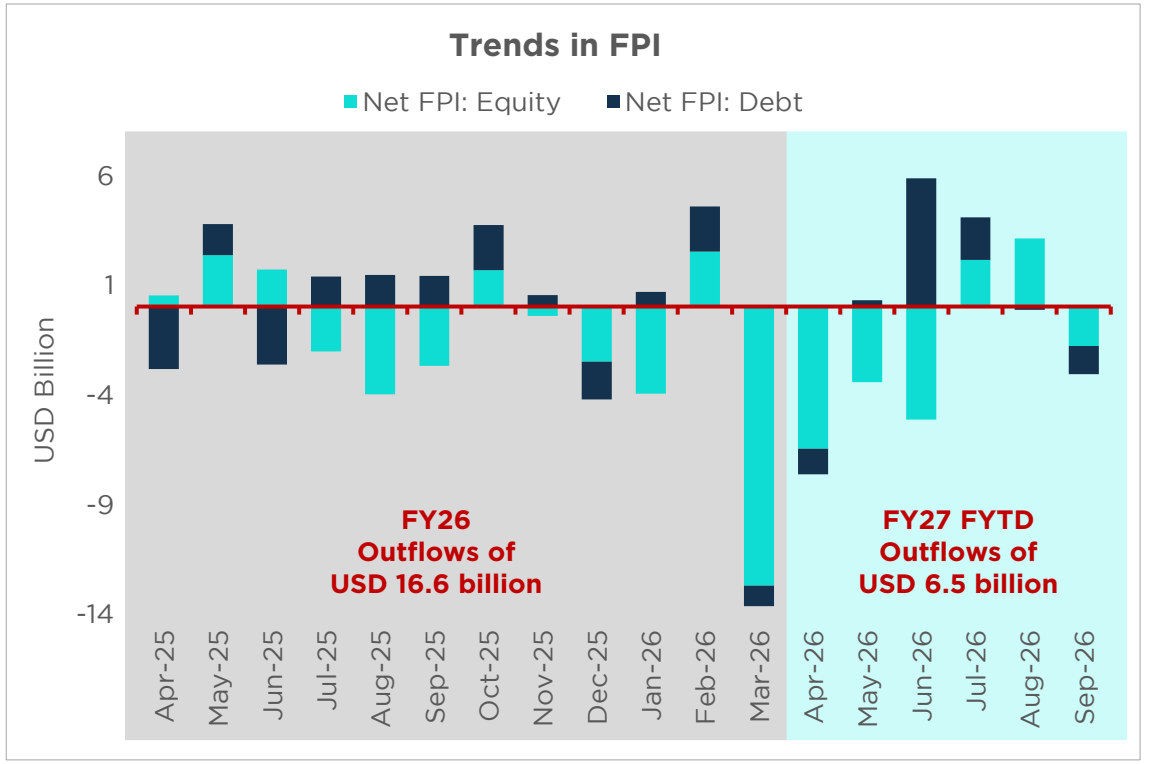


Sources: MoSPI, CEIC, CareEdge

- Indian economy remained resilient in Q1 FY27, with GDP growth at a better-than-expected 7.8%, despite a challenging global environment.
- Consumption, investment, and robust export growth have supported the overall growth momentum in Q1. High-frequency indicators such as GST collections, auto sales, and bank credit have remained healthy.
- Following the strong Q1 growth momentum, we now project FY27 growth at 7.3%. The RBI is expected to raise its GDP growth projection closer to our estimate from its previous estimate of 6.7%.
- Given rising headwinds, growth could moderate to 7.1% in H2 (projected), compared to an estimated 7.5% in H1 FY27.
- Underlying risks to growth from geopolitical tensions, rising inflationary pressures, trade policy uncertainty, and weather-related disruptions remain.

FDI Inflows Healthy; FPI's Remain Volatile

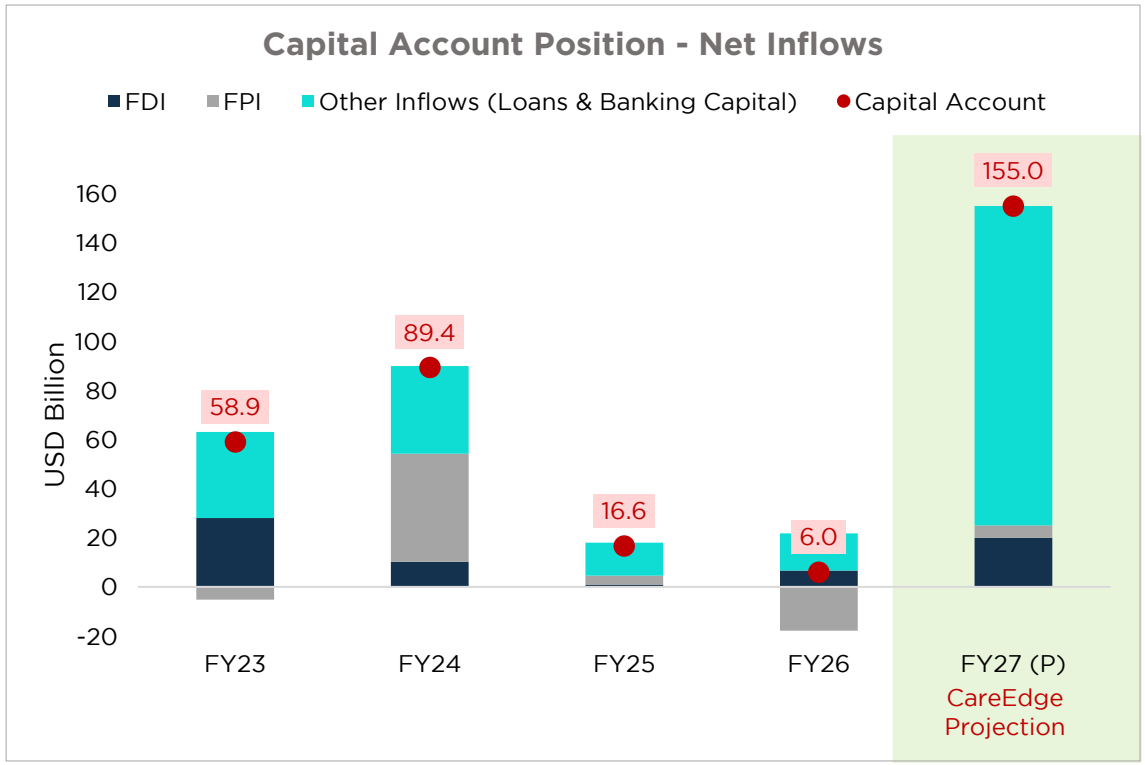


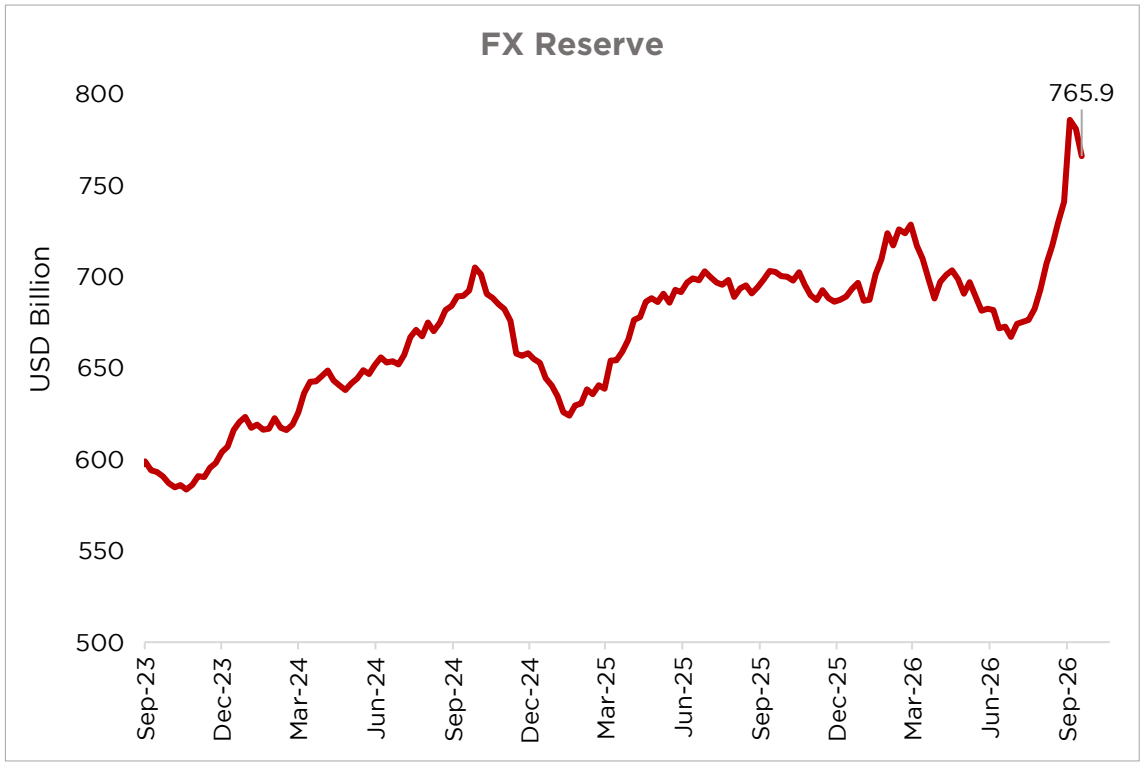


Source: RBI, CMIE, NSDL, CareEdge

- Gross FDI inflows have jumped by 16.4% to USD 44.8 billion during 4M FY27.
- Moreover, lower repatriations and a slowing pace of FDI outflows have aided net FDI inflows of USD 15.9 billion during 4M FY27.
- FPI inflows into India turned negative in September following positive flows during June-August.
- Rising US bond yields, elevated crude oil prices, and a weakening rupee impacted FPI flows.

FY27 Capital Flows to get a Boost from FCNR Inflows

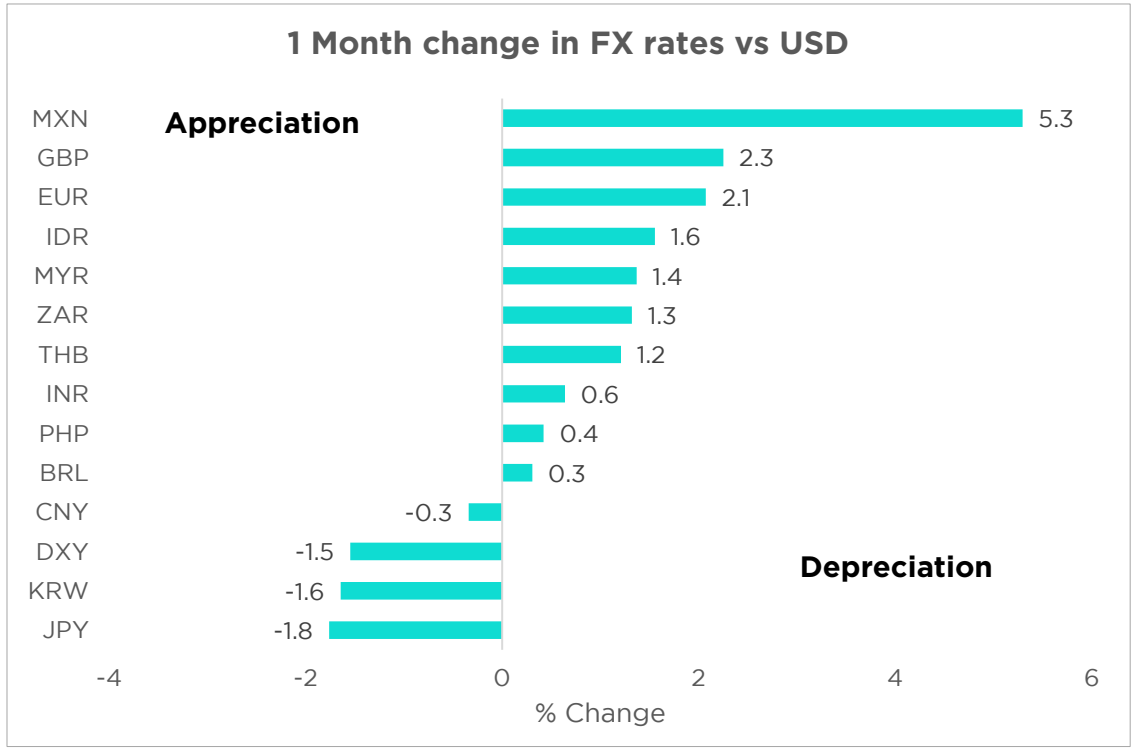


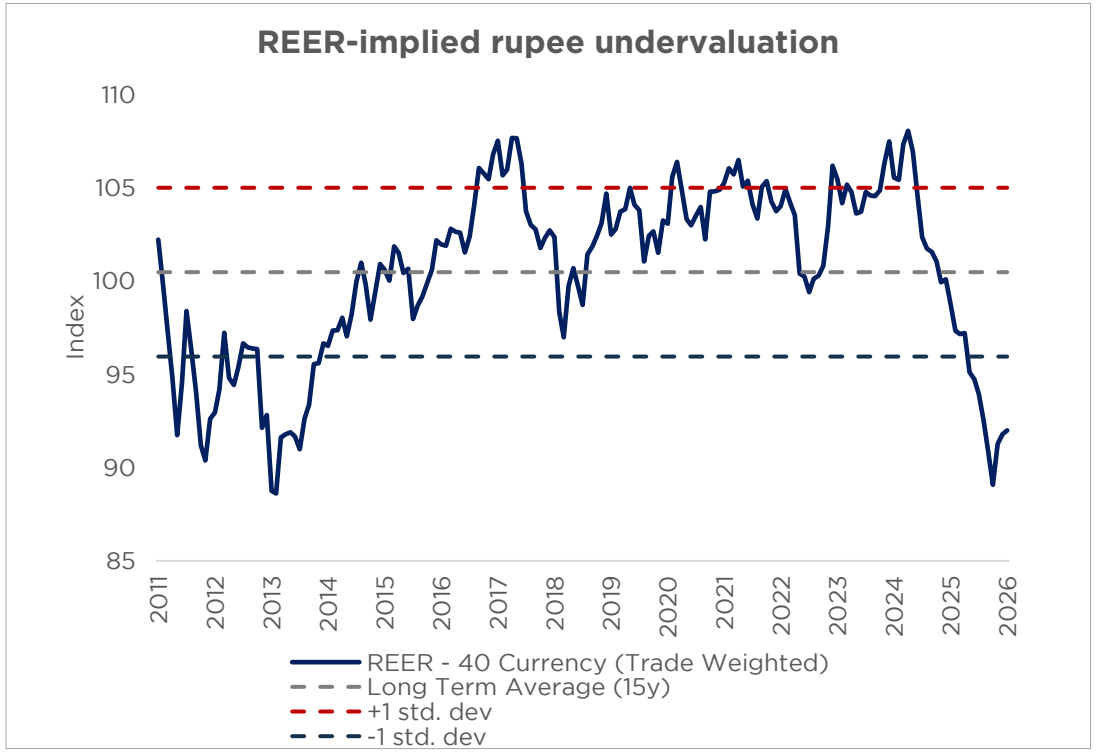


Source: RBI. CEIC, CMIE, CareEdge; Note: (P): CareEdge Projections

- The concessional swap windows for FCNR(B) deposits, ECBs and OFCBs, amongst other policy measures announced in June, have seen a strong response.
- Total inflows from FCNR deposits, ECBs and OFCBs amount to Rs 133 billion as of 18th September.
- Reflecting stronger-than-expected banking-sector and investment inflows, we have revised our FY27 external sector projections.
- We now expect the capital account surplus to rise sharply to USD 155 billion in FY27 from USD 1.9 billion in FY26.
- RBI's forex reserves have increased by USD 84 billion as of 18th September, since 5th June, when the FCNR scheme was announced.
- Current Account Deficit to remain between 0.8-1.2% of GDP in FY27. Aided by strong services and merchandise export.

External Developments Can Keep Rupee Volatile





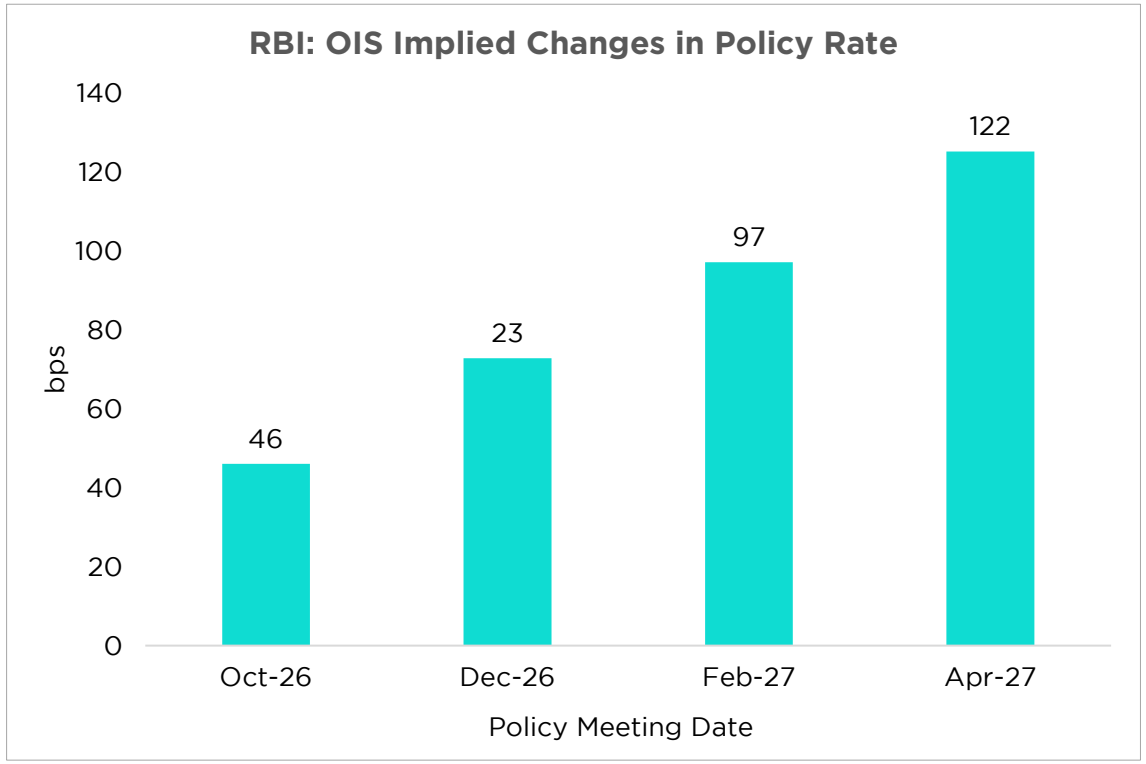
Source: CEIC, RBI, CareEdge. Negative Value denotes appreciation. Data as of 28th September.

- Despite a robust FCNR inflow and a projected BoP surplus, external developments keep the rupee volatile. Elevated global crude oil prices, volatile FII flows, rising US yields and the Fed's rate-hiking cycle are likely to add to depreciation pressures on the rupee.

- Additionally, rising domestic inflation in Q3 will scale back the extent of Real Effective Exchange Rate (REER)-implied undervaluation. As per the REER, the rupee is now undervalued by 8.2% in July 2026, compared with 11% in May 2026.

- The RBI's rate hike to support rupee. We expect USD/INR to trade in the 94-96 range by end-FY27.

A Shallow Rate Hiking Cycle by the RBI



Source: Haver, Refinitiv, CareEdge. Data as of 28th September

- **RBI's MPC likely to hike repo rate by 25 bps in the October meeting while maintaining the neutral stance.**
- A neutral stance would provide flexibility to MPC to adjust policy rates as situation evolves. The governor's statement to have a cautious undertone
- The OIS curve indicates that markets are pricing in about four 25-bps rate hikes across the remaining FY27 MPC meetings.
- **We expect this policy rate hiking cycle to be shallow, with a cumulative 50–75 bps hike in the repo rate**. Policy tightening should also support a weaker rupee. Going ahead, the RBI MPC'S will monitor the evolving growth-inflation dynamics closely.

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