RBI MPC Preview

A cautiously constructive hold

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Economic Update ▸ Monetary Policy ▸ August 03, 2026

We expect the MPC to keep its rates and neutral stance unchanged this week, while reiterating a data-driven wait-and-watch approach. The policy tone is likely to be cautious albeit constructive, balancing uncertainties from the Middle East conflict, tighter global financial conditions, and El Niño risks as against resilient domestic growth and robust FCNR+ inflows. We do not expect any meaningful changes to the RBI's growth or inflation forecasts. Instead, the focus is likely to be on the impact of FCNR+ inflows on external accounts, the INR, and liquidity management. We reckon that the RBI has offset a large part of the FCNR-driven liquidity injection by taking delivery of its forward positions, although core liquidity remains elevated at ~Rs5.4trn due to high government cash balances. We expect core liquidity to peak in 2QFY27 before normalizing in 2HFY27, as the FCNR+ window closes and currency leakage picks up. Accordingly, the RBI is more likely to rely on temporary liquidity absorption measures rather than tighten its policy stance.

Unchanged rates; cautious but constructive tone

The RBI MPC is expected to keep its policy rates and neutral stance unchanged this week while reinforcing a data-driven wait-and-watch approach. We do not expect any material changes in growth and inflation forecasts from June. The policy tone is likely to remain cautiously constructive, highlighting resilient domestic growth momentum and FCNR+ inflows while acknowledging geopolitical, global financial market, and El Niño risks. Since the June policy, Brent has been volatile, rising by ~40% before dropping by ~18%, and the UST curve has bear-steepened amid evolving Fed expectations. Despite 1Q inflation undershooting RBI's forecast, the MPC is likely to retain its emphasis on El Niño risks, while reiterating that any near-term price pressures would largely be supply-driven unless they broaden into second-round inflation effects. FX and liquidity are expected to remain key discussion points, including FCNR inflows, system liquidity management, the RBI's FX forward book, and INR positioning.

Inflation forecast likely to be retained…

The 30bps undershoot in 1Q headline CPI inflation vs the RBI's forecast has raised market expectations of a downward revision to its FY27 inflation forecast (currently 5.1%; Emkay: 5.1%). However, upward revision and cautious tone in the June policy were driven by Middle East geopolitical risks and El Niño-related weather uncertainty, both of which persist. Oil price risks continue to evolve, although Brent has eased from the $95/bbl FY27 assumption. Meanwhile, probability of a strong El Niño has risen from 62% to 81%, while monsoon rainfall is 12% below normal and kharif sowing trails last year's by ~3%. We believe the RBI's forecast already embeds some monsoon risk, though it is still likely to reiterate upside food-shock risks owing to El Niño-related disruptions, while acknowledging comfortable buffer stocks. We estimate that core-core CPI inflation would be contained at ~2.5%.

…while confidence in growth is likely to be retained

On growth, the MPC is likely to retain a constructive assessment, supported by robust 1QFY27 growth momentum led by high-frequency indicators that suggest limited spillovers from the ME conflict so far. Credit growth, auto sales, early 2Q corporate earnings, and industrial activity, all seem to point to a cyclical recovery gaining traction. That said, downside risks from geopolitical tensions and El Niño-related weather uncertainty remain. We therefore expect the RBI to leave its FY27 growth forecast unchanged at 6.6%.

FCNR+ flows buys policymakers time

The RBI's June capital inflow measures have provided significant policy space to remain on pause, with the FCNR+ window yielding $41bn so far. This is expected to lift FY27 BoP surplus to ~$35bn, with CAD/GDP at ~1.5%, supporting INR stability, boosting FX reserves, and allowing the RBI to focus on the domestic growth-inflation trade-off rather than external vulnerabilities. That said, banking system liquidity surplus remains moderate currently, averaging at ~Rs1.1trn (0.4% of NDTL) in July, despite core liquidity at ~Rs5.4trn owing to elevated government cash surplus. This largely reflects the offset from the RBI allowing existing buy-sell FX swaps to mature, alongside likely spot FX intervention. Meanwhile, unimpressive INR movement also mirrors weak EMFX dynamics. In our view, while RBI's net short forward book will decline as near-term swaps are allowed to mature, these will be largely replaced by longer-tenor FCNR+ swaps. Separately, core liquidity is likely to peak in 2QFY27 before normalizing in 2HFY27 as the FCNR+ window closes and currency leakage rises. Consequently, the RBI is more likely to use temporary liquidity absorption tools than tighten its policy stance ahead, while system liquidity should improve as government spending accelerates.

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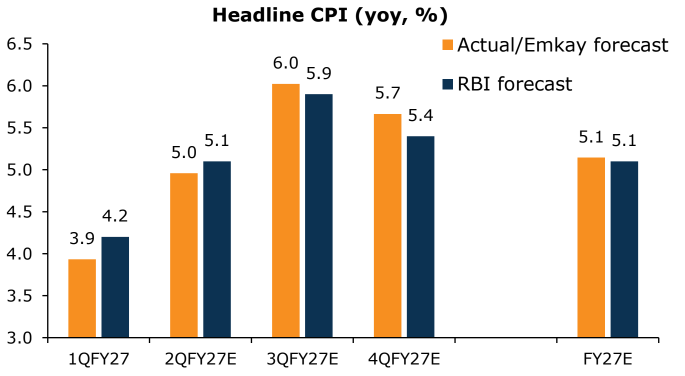
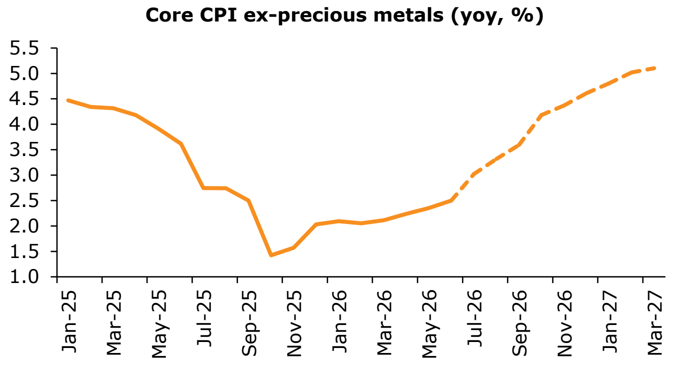
Exhibit 1: Despite inflation undershooting in 1Q vs RBI forecasts, FY27E forecast likely to be unchanged…



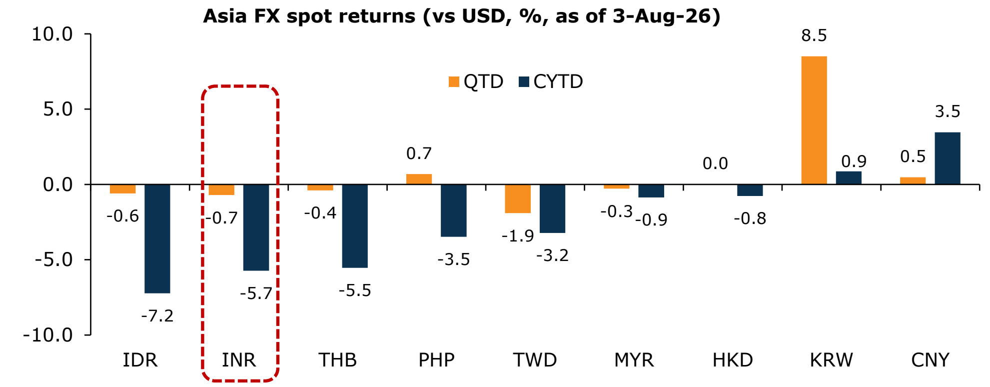
Source: CEIC, RBI, Emkay Research estimates

Exhibit 2: …with an increase in core CPI expected in coming months, led by an unfavorable base and spillover from food prices



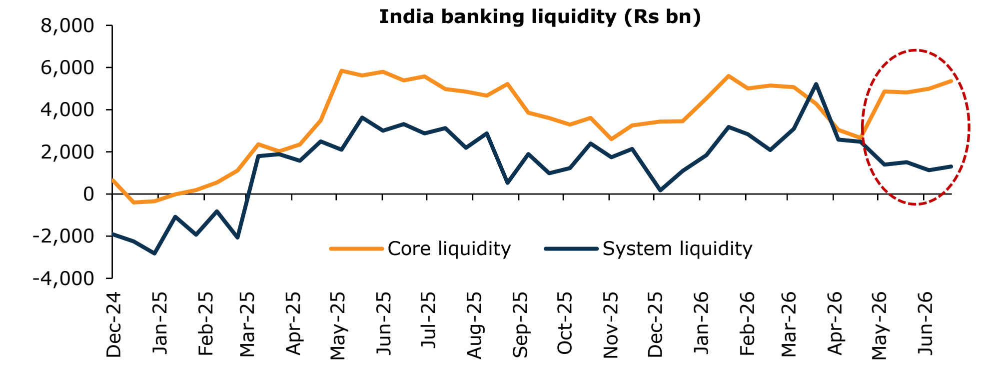
Source: CEIC, Emkay Research estimates

Exhibit 3: The INR has remained a weaker currency among Asia FX peers, in CY26



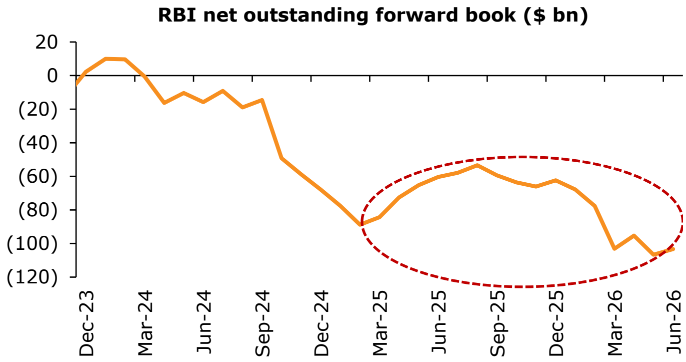
Source: Bloomberg, Emkay Research

Exhibit 4: Banking system liquidity remains moderate despite healthy FCNR+ flows due to large government cash balances



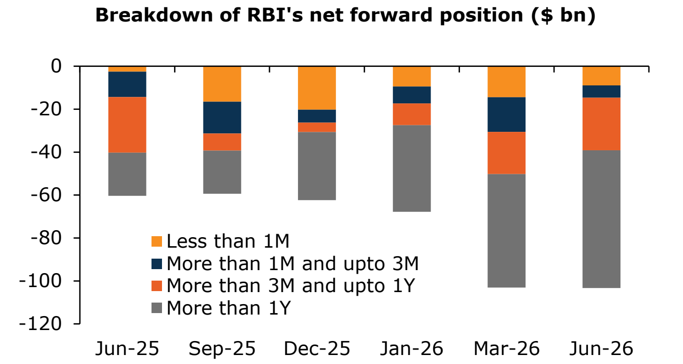
Source: CEIC, Emkay Research

Exhibit 5: RBI's short forward position is seen increasing once again…



Source: Bloomberg, Emkay Research

Exhibit 6: …with long tenor positions replacing short tenor ones



Source: CEIC, Emkay Research

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ADD	5-15% upside
REDUCE	5% upside to 15% downside
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