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RBI MPC Holds Repo Rate at 5.25% — Monetary Policy, Neutral Stance, and What It Means for India's Economy

7 February 2026

SUBJECTS COVERED

ECONOMY

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WHY IN NEWS

The Reserve Bank of India's Monetary Policy Committee (MPC) held the repo rate steady at 5.25% in its February 2026 review, retaining a "neutral" stance while revising the FY26 GDP growth forecast upward to 7.4% — signalling confidence in economic resilience even as the easing cycle pauses.

HOW MONETARY POLICY WORKS IN INDIA

The Reserve Bank of India (RBI) operates a **flexible inflation targeting (FIT)** framework, mandated by the RBI Act (as amended in 2016). The primary objective is to maintain **retail (CPI) inflation at 4%**, with a tolerance band of $\pm 2\%$ (i.e., 2–6%). The Monetary Policy Committee (MPC) — a six-member statutory body (three RBI officials including the Governor + three external government-nominated members) — meets every two months to set the **policy repo rate**: the rate at which the RBI lends overnight funds to commercial banks.

The repo rate functions as a **signal and lever**: when raised, it makes borrowing costlier (tightening, fighting inflation); when cut, it makes credit cheaper (easing, stimulating growth). Rate changes transmit through the financial system via:

Changes in bank lending rates (MCLR / Repo-Linked Lending Rates)

Changes in government bond yields (affects cost of government borrowing)

Changes in exchange rate expectations (affecting capital flows)

THE FEBRUARY 2026 DECISION

In February 2026, the MPC voted to **hold the repo rate at 5.25%** with a "neutral" stance. Key data points informing the decision:

Retail inflation: December 2025 headline CPI was **1.33%** — well below the 4% target, and close to the lower bound of the 2–6% tolerance band. Food inflation — historically the most volatile component — had declined sharply due to a good kharif harvest, easing vegetable prices.

GDP growth: Advance estimates for FY26 placed GDP growth at **7.3%**; the MPC revised this upward to **7.4%**, reflecting strong services exports and domestic consumption data.

Global context: US Federal Reserve had held rates steady in its January 2026 meeting; the European Central Bank was in a cautious easing mode. Elevated global uncertainty (trade tensions, commodity price volatility) argued for caution.

Credit growth: Bank credit growth remained healthy at ~14% year-on-year as of December 2025.

The “**neutral**” stance means the MPC is data-dependent — neither committed to another cut in the near term nor considering a hike. With inflation at 1.33% (very low) and growth holding above 7%, the MPC faces an unusual situation: space for further easing exists on inflation grounds, but strong growth reduces urgency.

THE EASING CYCLE — WHERE WE ARE

The current easing cycle began in late 2024. The cumulative rate reduction to date is **125 basis points** (1.25 percentage points). The February 2026 hold is the second consecutive pause, following the December 2025 cut of 25 bps.

Date	Rate Change	Repo Rate
Pre-cycle (2023–24 peak)	—	6.50%
First cut (June 2024)	–25 bps	6.25%
Second cut (August 2024)	–25 bps	6.00%
Third cut (October 2024)	–25 bps	5.75%
Fourth cut (December 2024)	–25 bps	5.50%
Fifth cut (December 2025)	–25 bps	5.25%
February 2026	Hold	5.25%

The easing cycle tracks the trajectory of inflation. India’s CPI inflation peaked at ~7% in late 2022 and has since declined significantly, enabling the RBI to ease monetary conditions.

KEY RATES AND INSTRUMENTS

The repo rate is the most prominent, but RBI uses several instruments:

Instrument	Rate (Feb 2026)	Purpose
Repo Rate	5.25%	Short-term lending to banks
Reverse Repo Rate	~3.35%	Short-term borrowing from banks
Marginal Standing Facility	5.50%	Emergency overnight borrowing by banks
Cash Reserve Ratio (CRR)	4.0%	Mandatory deposit with RBI (% of NDTL)
Statutory Liquidity Ratio (SLR)	18.0%	Mandatory holding in liquid assets
Bank Rate	5.50%	Long-term loans; penalty rate for SLR deficiency

TRANSMISSION — WHY RATE CHANGES TAKE TIME

A key challenge in monetary policy is **transmission**: how quickly do RBI's rate decisions affect the final borrower (home loan customer, MSME owner, farmer via Kisan Credit Card)?

India's transmission has historically been **slower** than in advanced economies because:

- A large portion of bank loans are at **fixed rates** (home loans pre-2019 era)

- Banks are reluctant to pass on cuts quickly when their own deposit rates are sticky

- Approximately 30–35% of formal credit goes through cooperative banks, NBFCs, and MFIs — which don't all follow the repo rate directly

Since October 2019, the RBI mandated that all floating-rate retail and MSME loans be linked to an **external benchmark** (primarily the repo rate, via RLLR — Repo Linked Lending Rate). This has improved transmission significantly for new loans.

GDP FORECAST AT 7.4% — COMPOSITION OF GROWTH

The MPC's revised FY26 GDP forecast of 7.4% reflects:

- Private consumption:** Recovering as rural incomes improve (good kharif 2025-26 harvest; MNRGS demand moderating as rural wages rise)

- Investment:** Government capex (~Rs 11.2 lakh crore budgeted for FY26) continues to crowd in private investment

- Services exports:** IT services and GCC (Global Capability Centres) expansion maintaining momentum

- Manufacturing:** Mixed picture; PLI scheme beneficiary sectors (electronics, pharma, auto components) growing strongly but others subdued

Risks: Global trade slowdown (US tariff policy uncertainty); El Niño risk for kharif 2026-27; fiscal space constraints post-budget.

UPSC RELEVANCE

Repo rate 5.25% (neutral stance, February 2026); MPC composition (6 members: 3 RBI + 3 external); CPI inflation target 4% \pm 2% (band 2–6%); RBI Act (1934, amended 2016 for FIT); CRR 4%, SLR 18%; RLLR (Repo Linked Lending Rate, mandatory for floating rate loans since October 2019); MSF rate 5.50%; Bank Rate 5.50%.

Flexible inflation targeting framework; monetary policy transmission challenges in India; composition and mandate of MPC; relationship between monetary policy and growth-inflation trade-off; CRR/SLR as liquidity management tools; role of RBI in macroeconomic stabilisation.

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RBI MPC — FEBRUARY 2026 DECISION:

- Repo Rate: **5.25%** (hold; neutral stance)
- Last change: 25 bps cut in **December 2025**
- Cumulative easing (cycle): **125 bps** (from 6.50% peak)
- FY26 GDP forecast (revised): **7.4%**
- FY26 CPI inflation projection: **2.1%**
- December 2025 headline CPI: **1.33%**

MPC — COMPOSITION AND MANDATE:

- Members: **6** (RBI Governor chairs + 2 Deputy Governors + 3 government-nominated external)
- Constituted under: **RBI Act, 1934** (amended 2016)
- Meeting frequency: **6 times per year** (bimonthly)
- Inflation target: **4% CPI** (tolerance band: **2–6%**)
- If inflation outside band for 3 consecutive quarters: RBI must explain to government

KEY POLICY RATES (FEBRUARY 2026):

- Repo rate: **5.25%**
- Reverse Repo Rate: **~3.35%**
- Marginal Standing Facility (MSF): **5.50%**
- Bank Rate: **5.50%**
- CRR: **4.0%**
- SLR: **18.0%**

TRANSMISSION MECHANISM:

- RLLR (Repo Linked Lending Rate): Mandatory for floating-rate retail + MSME loans (since October 2019)
- Transmission improves: banks must reset RLLR within **3 months** of repo rate change

OTHER RELEVANT FACTS:

- Flexible Inflation Targeting (FIT) adopted: **2016** (5-year renewable framework; renewed in 2021)
- NDTL: Net Demand and Time Liabilities (base for CRR/SLR calculation)
- US Fed rate decision (January 2026): Hold — relevant global context
- Monetary Policy Report: RBI publishes twice yearly alongside April and October MPC reviews

Sources: AffairsCloud, Drishti IAS

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