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A Fourth Hold: The MPC Cuts Inflation, Raises Growth, Moves Nothing

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A Fourth Hold: The MPC Cuts Inflation, Raises Growth, Moves Nothing

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> *The Monetary Policy Committee, which met from August 3 to 5, 2026, voted unanimously on August 5 to keep the policy repo rate unchanged at 5.25 per cent and to retain the neutral stance. It is the fourth consecutive hold. The FY27 CPI inflation projection was lowered to 5.0 per cent from 5.1 per cent, and the FY27 real GDP growth projection was raised to 6.7 per cent from 6.6 per cent.*

THE POLICY CORRIDOR

RATE	LEVEL
Policy repo rate	**5.25 per cent**
Standing Deposit Facility (SDF)	**5.00 per cent**
Marginal Standing Facility (MSF)	**5.50 per cent**
Bank Rate	**5.50 per cent**
Stance	**Neutral**
Decision	**Unanimous**
Meeting dates	3 to 5 August 2026; next meeting **5 to 7 October 2026**

Learn the corridor as a structure rather than as four separate numbers. The **SDF is the floor** of the Liquidity Adjustment Facility corridor, the rate at which the RBI absorbs surplus liquidity from banks **without collateral**. The **MSF is the ceiling**, at which banks borrow overnight against SLR securities, dipping into the statutory requirement. The **repo rate sits between them**, and the corridor here is symmetric, 25 basis points on either side.

The **Standing Deposit Facility** is the item most often misremembered. It was introduced in **April 2022**, replacing the fixed-rate reverse repo as the operational floor, and its distinguishing feature is that it requires **no collateral**, which removed the constraint that the RBI's own securities holdings placed on absorption capacity.

THE TWO FORECASTS, READ TOGETHER

PROJECTION	REVISED TO	FROM
FY27 CPI inflation	**5.0 per cent**	5.1 per cent
FY27 real GDP growth	**6.7 per cent**	6.6 per cent

A forecast of lower inflation with higher growth is, on its face, an unambiguously favourable revision, and it is the sort of combination that would ordinarily invite an easing. The Committee did not ease, and the reasoning is where the exam value lies.

WHY THE COMMITTEE LOOKED THROUGH THE NUMBER

Governor **Sanjay Malhotra** framed the decision around a distinction between headline and underlying inflation. Headline CPI is running above the 4 per cent target, but the pressure is concentrated in **food and fuel**, with, in his words, little sign so far of the generalisation of price pressures. **Core inflation** is projected at **4.3 per cent for FY27**. The far lower figure quoted in much of the coverage, **2.3 to 2.5 per cent**, is core inflation **excluding precious metals**, for May and June 2026, and the distinction matters: gold prices are what separate the two, so stripping them out is what makes underlying pressure look contained.

That gap is the analytical heart of the item.

MEASURE	BEHAVIOUR	POLICY SIGNIFICANCE
Headline CPI	Above target, driven by food and fuel	The statutory target variable
Core CPI	**4.3 per cent** projected for FY27; **2.3 to 2.5 per cent** excluding precious metals in May and June 2026	The component monetary policy can actually influence. The gap between the two is gold

The case for looking through is that monetary policy operates on **demand**, and food and fuel price shocks in India are predominantly **supply-side**: monsoon performance, crop cycles, global crude, and administered price changes. Raising the repo rate does not produce rain or lower Brent. It compresses demand elsewhere in the economy to offset a price rise it cannot address at source, which is a real cost for no corresponding benefit.

The case against is equally serious, and a good answer states it. India's statutory mandate is **headline CPI**, not core, and the Governor said explicitly that the RBI remains guided by headline. Food carries a weight of roughly **46 per cent** in the CPI basket, so a measure that persistently excludes food excludes most of what

Indian households actually experience as inflation. And the danger of looking through repeatedly is **de-anchoring**: if households and firms come to expect that above-target headline inflation will not be resisted, expectations adjust upward and the supply shock becomes a permanent price level shift.

Malhotra's characterisation of the Committee as **"neither dovish nor hawkish"**, wanting greater clarity before acting, is the balance being struck between these two positions.

The projected path makes the judgement legible. CPI is expected at **4.7 per cent in Q2, peaking at 5.9 per cent in Q3 and easing to 5.5 per cent in Q4**, with 5.3 per cent in Q1 of the following year. A committee that expects inflation to peak two quarters out and then recede has a coherent reason to wait rather than to act now, and the quarterly path is what makes that reasoning visible.

THE CONSTRAINT NOBODY MENTIONS

There is a quieter point that a strong answer can make. With the repo at 5.25 per cent and projected inflation at 5.0 per cent, the **real repo rate is roughly 0.25 percentage points**.

That is close to zero. It means the current stance is already accommodative in real terms, and it means the room available to cut if growth disappoints is thin without going to a negative real rate. A central bank that holds at a real rate this low is not sitting comfortably in the middle; it is closer to the bottom of its conventional room than the headline nominal rate suggests.

THE REGULATORY ANNOUNCEMENT

The **Statement on Developmental and Regulatory Policies** issued alongside the resolution carried a proposal of practical consequence: to **harmonise and standardise the regulatory framework for interest rates on advances across all regulated entities**, to improve transparency in loan pricing and strengthen consumer protection.

Malhotra clarified the scope, and the clarification matters because early commentary overstated it. This does **not** move non-banking financial companies onto the External Benchmark Linked Lending Rate regime, and it does not overhaul the existing framework. It addresses operational divergence in how the MCLR and EBLR frameworks are applied, including standardising the **day-count convention**, which is the basis on which interest accrual is calculated over a period.

FRAMEWORK	BASIS
Base Rate (2010)	Bank's own cost of funds; replaced the Benchmark Prime Lending Rate
MCLR (2016)	Marginal cost of funds-based lending rate; internal benchmark, marginal rather than average cost
EBLR (October 2019)	Mandatory external benchmark for retail and MSME floating-rate loans: repo rate, or a 3-month or 6-month T-bill yield, or another published benchmark

The EBLR mandate exists because transmission through internal benchmarks was slow and asymmetric, banks passing rate cuts more slowly than rate rises. Harmonising the residual operational differences is a transmission measure, and for a household borrower the day-count convention can matter more than a 25 basis point repo move.

The Committee also decided to **resume "on tap" licensing of Urban Co-operative Banks** after nearly two decades. Note the status carefully: the draft guidelines were **not released on the day**, and the RBI said they **will be issued shortly** for stakeholder consultation. The same is true of the interest-rate harmonisation, where draft directions are also still to come.

Separately, and not part of the Statement on Developmental and Regulatory Policies, the RBI announced a **seven-day Variable Rate Reverse Repo auction of Rs 1.5 lakh crore** on 6 August, its first VRRR since April, after surplus liquidity crossed Rs 3 lakh crore.

UPSC RELEVANCE

GS Paper 3: Indian economy; monetary policy; banking; inclusive growth; mobilisation of resources.

Prelims pointers:

- **Repo 5.25 per cent, SDF 5.00, MSF 5.50, Bank Rate 5.50**; stance **neutral**; decision **unanimous**; fourth consecutive hold.
- FY27 CPI projection **5.0 per cent** (from 5.1), with the quarterly path **Q2 4.7, Q3 5.9 (peak), Q4 5.5**; FY27 real GDP **6.7 per cent** (from 6.6), quarterly **Q1 7.0, Q2 6.4, Q3 6.5, Q4 6.8**. Core inflation **4.3 per cent** for FY27; **2.3 to 2.5 per cent excluding precious metals** in May and June 2026.
- The **MPC has six members**: the Governor as chair with a **casting vote**, a Deputy Governor in charge of monetary policy, one RBI officer nominated by the Central Board, and **three external members** appointed by the Central Government. Statutory basis: **Section 45ZB of the RBI Act, 1934**, inserted by the **Finance Act, 2016**.
- The inflation target is **4 per cent CPI with a tolerance band of plus or minus 2 per cent**, notified by the **Central Government** under **Section 45ZA**, not by the RBI.
- The **SDF**, introduced in **April 2022**, is the LAF floor and is **uncollateralised**; the **MSF** is the ceiling and is collateralised against SLR securities.
- Governor: **Sanjay Malhotra**. Next MPC meeting: **5 to 7 October 2026**.

Mains question: "A monetary authority with a statutory headline inflation target that repeatedly looks through food and fuel is either applying flexible inflation targeting correctly or redefining its mandate by practice." Examine this claim with reference to the August 2026 decision, and assess whether India should target core rather than headline inflation. (250 words)

> *repo held at 5.25 per cent, unanimous, neutral stance, fourth consecutive hold. SDF 5.00, MSF 5.50, Bank Rate 5.50. MPC met 3 to 5 August 2026; next meeting 5 to 7 October 2026.*
>
> *FY27 CPI cut to 5.0 per cent from 5.1, path Q2 4.7, Q3 5.9 peak, Q4 5.5; FY27 real GDP raised to 6.7 per cent from 6.6, path Q1 7.0, Q2 6.4, Q3 6.5, Q4 6.8. Core inflation 4.3 per cent for FY27, and 2.3 to 2.5 per cent excluding precious metals in May and June 2026.*
>
> *inflation target of 4 per cent CPI with a plus or minus 2 per cent band, notified by the Central Government under Section 45ZA of the RBI Act, 1934. The MPC is constituted under Section 45ZB, has six members, and the Governor holds a casting vote.*
>
> *SDF is the uncollateralised floor, introduced April 2022; MSF is the collateralised ceiling; the repo sits between them, symmetric at 25 basis points either side.*
>
> *harmonising interest-rate-on-advances rules across regulated entities, including day-count conventions and benchmark reset dates; and resuming "on tap" licensing of Urban Co-operative Banks. In both cases the draft directions are still to be issued for consultation, not released on the day. NBFCs are not being moved to EBLR. Separately, a seven-day VRRR auction of Rs 1.5 lakh crore on 6 August, the first since April.*
>
> *Base Rate (2010), MCLR (2016), EBLR (October 2019, mandatory for retail and MSME floating-rate loans).*

Sources: Reserve Bank of India, Business Standard, Ministry of Finance

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