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RBI holds interest rates steady: What drove the decision?

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Reserve Bank of India (RBI) Governor Sanjay Malhotra attends a press conference after a monetary policy review in Mumbai in December 2025. (Express photo by Sankhadeep Banerjee)

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The Reserve Bank of India's Monetary Policy Committee (MPC) on Friday (February 6) decided to maintain the status quo on interest rates, keeping the repo rate — the central bank's key policy rate — unchanged at 5.25 per cent. As a result, lending and deposit rates are expected to remain stable, with no change in equated monthly instalments (EMIs) on home and other personal loans of banks.

The policy panel also revised the GDP growth rate higher at 7.4 per cent as against the earlier projection of 7.3 per cent and retail inflation at 2.1 per cent as against 2 per cent in FY 2026.

Days after India announced trade agreements with the US and the European Union, the MPC also chose to retain its neutral policy stance, indicating that the RBI will keep its options open and will adjust policy depending on the prevailing factors.

The decision to pause, taken after the presentation of the Union Budget, comes on the heels of a rate cut in December, **when the six-member committee lowered the repo rate** by 25 basis points to 5.25 per cent. This brought the cumulative reduction in policy rates in 2025 to 125 basis points, marking a period of sustained monetary easing.

Why the RBI held rates steady

Announcing the policy, RBI Governor Sanjay Malhotra said several measures announced in the Budget are likely to boost growth. The MPC's decision reflects a favourable inflation outlook, strong growth momentum, and lingering external risks. Domestic economic conditions remain broadly resilient.

Since the December policy review, India has signed four trade agreements — with the US, the EU, Oman and New Zealand — which are expected to soften the impact of global uncertainties and support growth over the medium to long term. However, despite this added cushion on the external front, evolving geopolitical developments worldwide continue to require close monitoring. While external headwinds have intensified, the successful completion of the trade deal with the US augurs well for the economy. “Trade pact will boost India’s exports and investments,” he said.

Economic growth is being supported by robust consumption, projected to expand by about 7 per cent in FY26. The consumption outlook has been bolstered by several factors, including income tax cuts announced in the FY26 Union Budget, GST rate rationalisation, subdued inflation, and earlier RBI rate reductions. In addition, statistical factors such as a low GDP deflator (a result of low inflation) contributed to stronger growth in the first half of the fiscal year.

Malhotra said the MPC noted that since the last policy meeting, external headwinds have intensified, though the successful completion of trade deals augurs well for the economic outlook. Overall, the near-term domestic inflation and growth outlook remain positive, he said.

Headline inflation during November and December remained below the tolerance band of the inflation target. The revised outlook for CPI inflation in Q1 and Q2 of next year at 4 per cent and 4.2 per cent, respectively revised slightly upwards, continues to be benign and near the inflation target. “The slight upward revision in the inflation outlook is primarily due to increase in prices of precious metals, which contribute about 60 to 70 basis points. The underlying inflation continues to be low,” Malhotra said.

Impact on lending and deposit rates

With the repo rate left unchanged, lending and deposit rates are expected to stay broadly stable in the near term. Loans linked to external benchmarks — especially those linked directly to the repo rate — will not be affected immediately. This means borrowers with repo-linked loans are unlikely to see any change in their equated monthly instalments (EMIs), offering a measure of certainty on repayment obligations.

That said, interest rates on loans linked to the marginal cost of funds-based lending rate (MCLR) could still move. This is because banks retain the flexibility to revise MCLR-based lending rates depending on their funding costs, liquidity conditions, and deposit mobilisation. On the deposit side as well, rates are expected to remain steady for now, unless banks face a sustained shift in liquidity or funding pressures that prompts a reassessment of deposit pricing.

Growth and inflation outlook raised marginally

The central bank has marginally hiked its growth and inflation projections. In its December policy review, the RBI raised its GDP growth forecast for FY26 by 50 basis points to 7.3 per cent, citing improved economic momentum. It has now increased the projection to 7.4 per cent. The government's first advance estimates peg real GDP growth for FY26 slightly higher at 7.4 per cent. "Underlying data shows strong growth momentum," Malhotra said.

On the growth front, economic activity remains resilient, he said. The first advance estimates suggest continuing growth momentum, driven by domestic factors amidst a challenging external environment. "The growth outlook, too, remains favourable. Based on a comprehensive review of the domestic macroeconomic conditions and the outlook, the MPC therefore was of the view that the current policy rate is appropriate and accordingly it voted to continue with the existing policy rate. It also agreed to retain the neutral stance. Going forward, the MPC will be guided by the evolving macroeconomic conditions and the outlook," Malhotra said.

The Economic Survey has forecast GDP to grow between 6.8-7.2 per cent in the fiscal year 2026-27 on the back of strong domestic demand.

The RBI has now raised the projection marginally higher at 2.1 per cent as against 2 per cent earlier. Headline inflation during November and December remained below the tolerance band of the inflation target. "The revised outlook for CPI inflation in Q1 and Q2 of next year at 4 per cent and 4.2 per cent, respectively revised slightly upwards, continues to be benign and near the inflation target. The slight upward revision in the inflation outlook is primarily due to increase in prices of precious metals, which contribute about 60 to 70 basis points. The underlying inflation continues to be low," Malhotra said.

Retail inflation, as measured by the Consumer Price Index (CPI), edged up from 0.71 per cent to 1.33 per cent in December 2025. Despite the increase, inflation remained comfortably below the Reserve Bank of India's 2–6 per cent target range, largely due to ongoing — though easing — deflation in food prices.

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The road ahead

The RBI appears comfortable with a cautious, wait-and-watch approach. With economic growth holding firm, inflation under control and fiscal spending providing support, there is no immediate urgency to alter policy rates. Trade agreements with EU and the US are likely to boost the growth rate. At the same time, risks persist, ranging from geopolitical tensions and volatile crude oil prices to shifts in global monetary conditions.

Malhotra said the signing of a landmark trade deal with the European Union and the US trade agreement in sight, growth momentum is likely to be sustained for a longer period. Global growth, supported by tech investments, accommodative financial conditions and large-scale fiscal stimulus is expected to be marginally stronger this year than projected earlier.

“However, the confluence of escalating geopolitical frictions and rising trade tensions is unravelling the existing world economic order. Inflation outcomes are heterogeneous across jurisdictions, remaining above target in most advanced economies, prompting divergence in monetary policy actions as central banks near the end of their current easing cycles,” Malhotra said.

For borrowers, the current policy offers reassurance, as repo-linked loan rates remain steady. For the central bank, the real test will come if external shocks threaten growth or if inflation rises faster than expected. The February policy decision, therefore, represents a deliberate pause — one aimed at preserving flexibility in an increasingly uncertain global environment. “With the government remaining on course its fiscal consolidation path, we don’t expect any material impact on the direction of monetary policy,” said Radhika Rao, Senior Economist, DBS Group Research.