

RBI MPC expected to hold policy repo rate at 5.50% in August amid likely downward revisions to inflation forecasts

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- Market polls suggest that the RBI MPC is likely to hold the policy repo rate at 5.50% in its meeting outcome on August 6. Market pricing based on futures models indicate a slightly dovish bias but not a 25bp rate cut.

- In a recent interview, the RBI Governor Shri Sanjay Malhotra stated that the change in policy stance to 'neutral' from 'accommodative' in June policy indicated that the bar for further easing was higher. He also noted that since monetary policy works with a lag, it needs to be forward looking, and therefore, take into consideration the outlook for both growth and inflation, in addition to actual data.

- Recent inflation prints have surprised on the downside, with headline CPI averaging 2.7% in Q1-FY26, below the RBI MPC's projection of 2.9%. For the full fiscal FY26, the MPC has penciled in average inflation at 3.7%. The ongoing sharper-than-expected pace of disinflation could prompt the MPC to further trim its forecast for FY26. The MPC will also be publishing its inflation estimate for Q1-FY27 that needs to be watched out for.

- High frequency data on economic activity remained muted in Q1. The actual GDP print is slated for release in end-August and will be available to the MPC for its policy decision in October. The MPC has projected real GDP growth of 6.5% for Q1, and also for the full fiscal FY26. In their latest outlook updates published in July, the IMF raised India's GDP growth forecast for FY26 by 0.2pp to 6.4%, while the ADB lowered it to 6.5% from 6.7%, citing US tariff impact.

- The US administration recently announced 25% tariffs on India's exports to the US, and an additional unstated penalty because of India's imports of Russian oil. Even as the impact from global trade uncertainties remain largely confined to volatility in financial markets and capital flows, weakness in the latest US labor market data could be a telltale signal of the road ahead.

- Domestically, liquidity conditions remain comfortable despite the VRRR auctions started by the RBI to keep the weighted average call rate (WACR) within the policy rate corridor. The effect of ample liquidity conditions is starting to reflect in policy transmission channels via lower lending and deposit rates, and nascent signs of improvement in credit growth. The healthy pace of capex at the Centre is also expected to support economic activity. The weakness in tax collections in Q1 needs to be watched out for in terms of impact on Centre's fiscal accounts, though there are factors, including the RBI's dividend, that could help offset some of these slippages.

High frequency data on economic activity remained mixed in Q1; CPI inflation continued to surprise on the downside

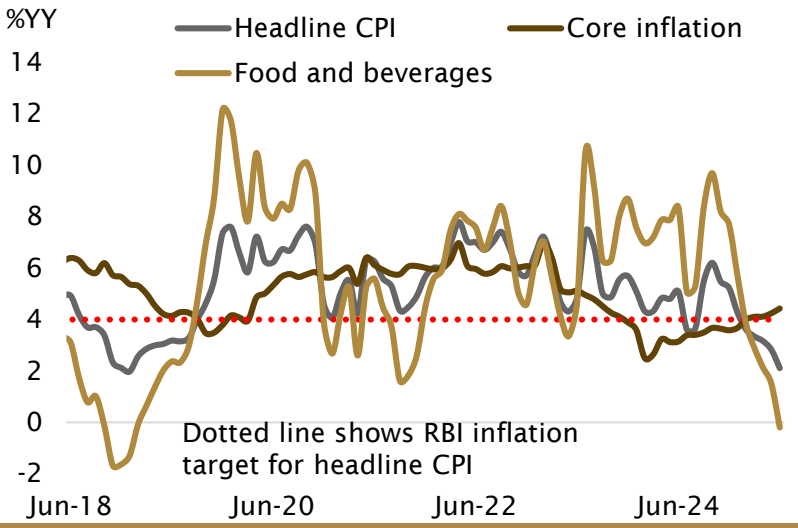
- In June, industrial production growth eased to ten-month low of 1.5%YY, averaging 2.0%YY for Q1-FY26. This marks a slowdown from the previous quarter's average of 4.0% and 5.5% growth in Q1-FY25. The trend captured the changes in manufacturing growth, even as the slump in mining and electricity in the latest quarter was notable. In terms of use-based groups, primary goods output fell for the first time in 18 quarters, consumer non-durables stayed in contraction for the fifth straight quarter, and the year-on-year growth in consumer durables output eased to the lowest in seven quarters. The weakness in these groups was partly offset by infrastructure-related segments, particularly capital goods that was the star performer in Q1-FY26, which could be somewhat attributable to healthy pace of capex by the Centre.
- Most other high frequency data on economic activity remained mixed in Q1-FY26 (table in appendix), and the data on GDP is slated for release in end-August. The MPC has penciled in 6.5%YY real GDP growth in Q1.
- Headline CPI stayed below 3% for the second straight month in June, marking a 77-month low at 2.1%. In Q1-FY26, inflation averaged 2.7%, undershooting the RBI MPC's forecast of 2.9%. The food index slipped into deflation for the first time since Feb-2019. Core inflation (ex-food, fuel) rose to 4.4% from 4.2% in May, and the fuel index posted inflation for the fourth straight month after remaining in deflation for 1.5 years. Inflation has been consistently surprising on the downside since its recent peak above 6% in Oct-2024 and it is likely that the RBI MPC lowers its forecasts for FY26 at its upcoming policy meetings in August or October.

Industrial output growth moderated to 10-month low in June; headline CPI inflation eased to 77-month low at 2.1%

%YY	Weight	Apr-25	May-25	Jun-25
Industrial production	100.0	2.6	1.9	1.5
Sector-based classification				
Mining	14.4	-0.2	-0.1	-8.7
Electricity	8.0	1.7	-4.7	-2.6
Manufacturing	77.6	3.1	3.2	3.9
Use-based/type of goods				
Primary goods	34.0	-0.2	-1.4	-3.0
Capital goods	8.2	14.0	13.3	3.5
Intermediate goods	17.2	4.9	4.7	5.5
Infra. /construction	12.3	4.7	6.7	7.2
Consumer durables	12.8	6.2	-0.9	2.9
Consumer non-durables	15.3	-2.7	-1.0	-0.4

Note: Color code is based on %3M3M, SAAR data.

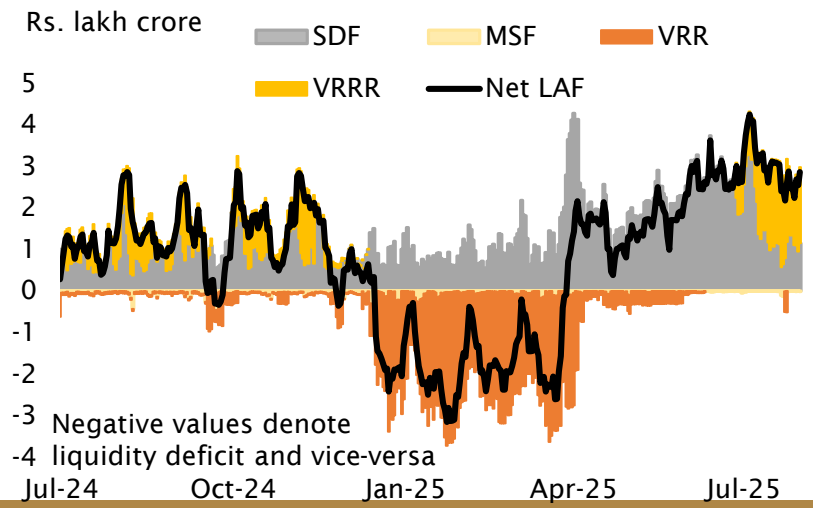
Green denotes high momentum, red indicates the opposite.



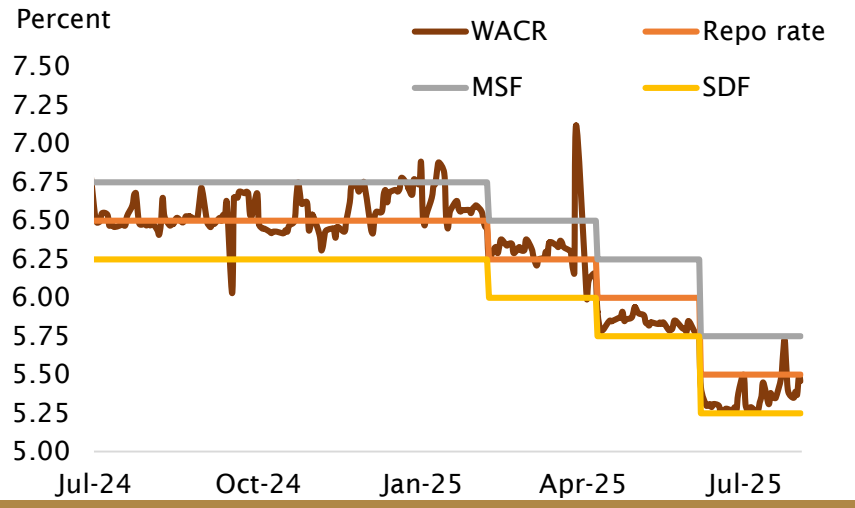
RBI adopted mix of VRR and VRRR tools to manage system liquidity and keep the call rate within the policy corridor

- As on July 31, liquidity under net LAF was in surplus of Rs.2.9 lakh crore. Adjusting for banks' excess cash reserves with the RBI, system liquidity surplus was higher at Rs.3.3 lakh crore. Since the last RBI MPC policy outcome on June 6, the RBI has conducted a mix of VRRs and VRRRs to modulate liquidity in a way that the operating target of monetary policy, the weighted average call rate (WACR), stayed within the rates corridor.
- With liquidity under the LAF in surplus since end-March, the RBI, post the policy outcome in June, decided to discontinue the daily VRR auctions that it had introduced in mid-January to address the deficit situation. Nonetheless, the RBI resorted to VRR in the fourth week of July, when the WACR hovered close to the MSF and funds parked under the SDF dwindled to below Rs.1lakh crore. This could be partly attributable to outflows due to quarterly GST payments. By the end of June, the RBI started VRRR auctions to prevent softening of WACR below the SDF rate. Banks have also increasingly allotted funds under VRRRs that yielded more than the SDF rate. The RBI has conducted ten VRRR auctions since end-June with maturities ranging from 1-7 days and absorbing liquidity of around Rs.10.5 lakh crore, against the notified amount of Rs.12.75 lakh crore.
- Data between June 13 and July 11 shows easing in core liquidity. In June and July, the RBI bought back G-sec worth Rs.62,919 crore maturing in FY27, with coupons ranging from 5.63% to 8.33%. Despite the buybacks and lower currency in circulation, durable liquidity eased. Amid mild rise in CRR, lower core liquidity suggests likely intervention in the FX market, as also reflected in fall in FX assets of the RBI and decline in reserves. However, the overall level of FX reserves remained healthy at USD698bn for the week ending July 25.

High yielding VRRR implied lower funds parked under SDF



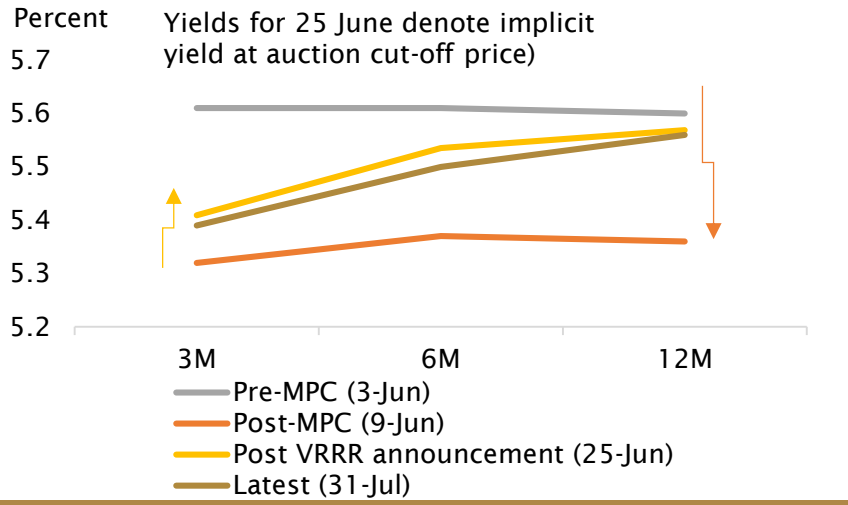
RBI started VRRR to keep WACR from slipping below SDF



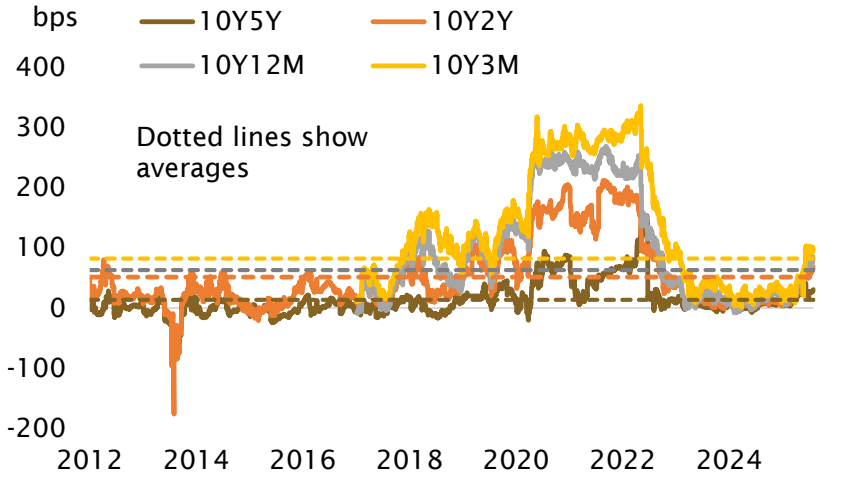
Money market rates continued to ease but less than in the prior inter-meeting period due to VRRR announcement

- Net liquidity under the LAF has been in surplus since end-March, so that the overnight WACR, which is the operating target of monetary policy, has averaged below the policy repo rate since April. But with the start of VRRR auctions towards end-June, the differential narrowed to 11bps on average in July from 20bps in June.
- In end-June, the RBI announced extension of trading hours for the overnight money market to help improve activity, particularly in the call money segment. Effective July 1, the call money market hours stand revised to 9:00AM-7:00PM (from 5:00PM). Effective August 1, trading hours of market repo and tri-party repo have been extended to 4:00PM from 2:30PM and 3:00PM, respectively, with the start time unchanged at 9:00AM.
- Despite ample liquidity, the announcement of VRRR auctions evinced a reaction in money market rates, including the t-bill curve. Money market rates continued to rally since the last MPC meet, but to a lesser extent than in the previous inter-meeting period. The yields on 3-month T-bills, certificates of deposit (CDs) and 3-month commercial papers (CPs) issued by NBFCs averaged lower by 46bps, 64bps, and 50bps, respectively between the latest (Jun 7 to Aug 1) and the previous inter-meeting period (Apr 10 to Jun 4). The average risk premia (3-month CP minus 91-day T-bill) eased mildly to 79 bps from 83 bps in the prior inter-meeting period but the term premium (10Y minus 3-month) rose to 96bps from 52bps in the previous inter-meeting period. An RBI article indicates that increase in term premium could be attributable to lagged transmission of policy easing to longer rates and increased sensitivity to global economic policy uncertainty.

T-bill yield curve reaction to VRRR announcement



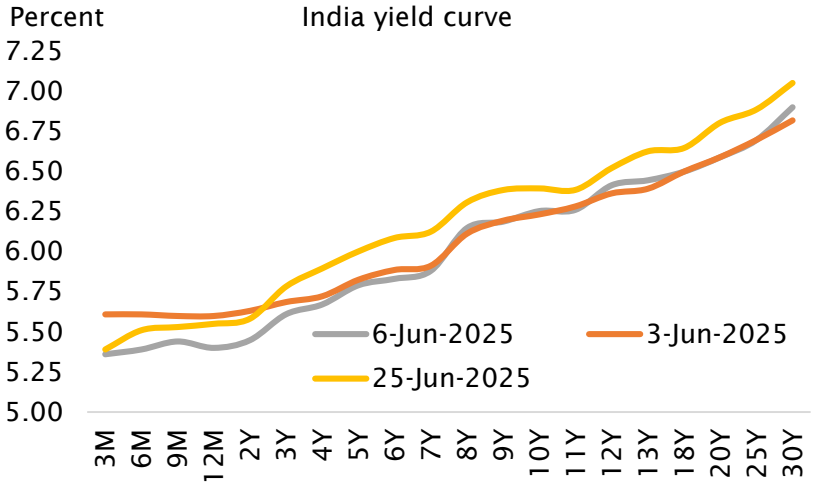
Recent rise in term premium mildly above prior trends

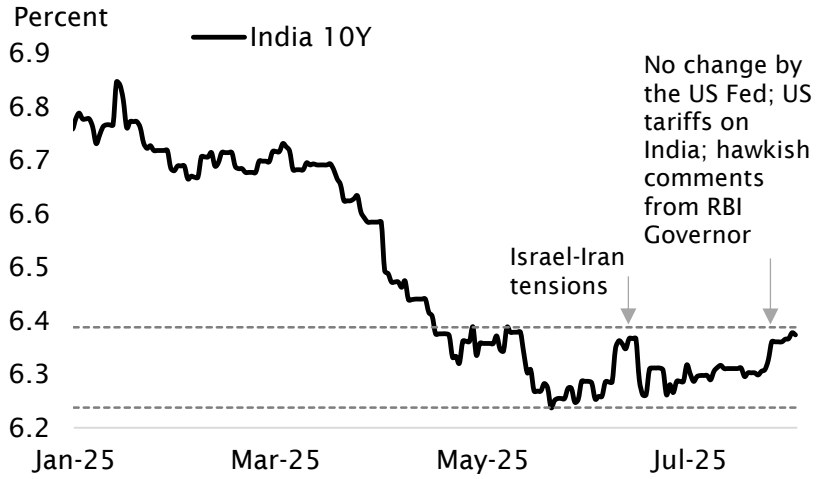


India 10Y remained range-bound amid vulnerability to global woes, cues from RBI Governor comments

- The front end of the yield curve rallied post the June MPC meeting but trimmed gains post announcement of VRRR auctions towards end-June. On the other hand, since the last RBI MPC meeting that concluded on June 6 and until August 1, the 10 year yield has increased by nine bps to 6.37%. The 10Y yield has been range-bound between 6.24% - 6.39% since May despite volatility due to geopolitical and geo-economic woes.
- 1) The escalation of Iran-Israel tensions in June triggered a spike in crude oil prices and an increase in bond yields. 2) Even as crude oil prices eased, more recently, comments from the RBI Governor regarding the war against inflation being a continuing one pared expectations of further policy easing. The Governor noted in a recent interview that the change in stance to neutral implied that the bar for further easing is higher than it would have been under accommodative stance. 3) The Governor's comments came in just days before the negative surprise developments on the trade front with the US that is likely to have triggered a sell-off in domestic financial markets, driving yields higher. 4) The 10Y India benchmark also took cues from its US counterpart that rose post the Fed policy outcome on July 30 where it held the policy rate range at 4.25% - 4.50% for the fifth straight meeting despite acknowledging moderation in economic activity in H1-2025.
- Market polls indicate no rate action by the RBI MPC on August 6, though there is a slight easing bias suggested by futures pricing. There is also a section of market participants anticipating a 25bp rate cut, following the escalation of trade tensions with the US and its impact on domestic growth, particularly in the backdrop of ongoing weakness in economic activity indicators.

Short-end of curve vulnerable to policy changes; 10Y range-bound amid reactions to global cues, RBI Governor comments

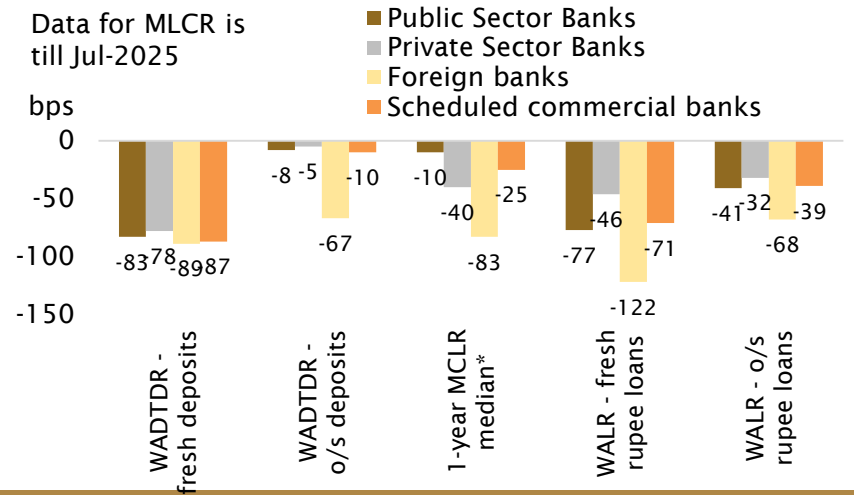




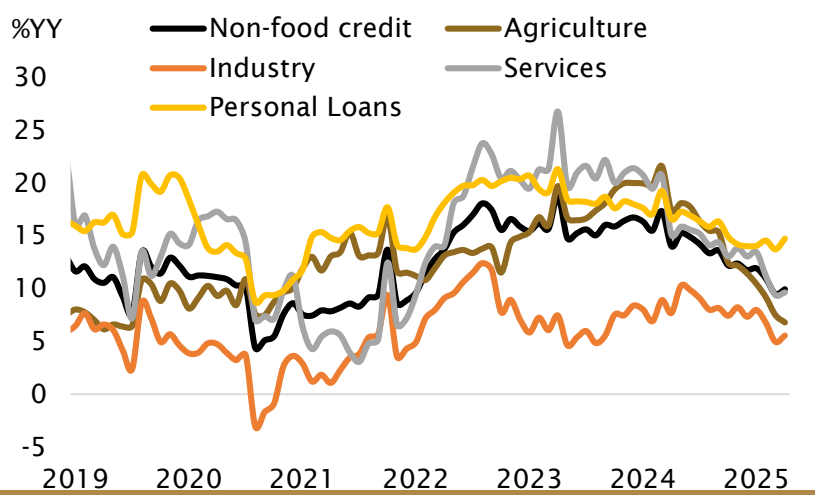
Transmission of policy rate cuts progressing well; non-food credit growth improved mildly in June

- The RBI MPC has cut the policy repo rate by 100bps so far since the time it started to ease in Feb-2025. Latest data on banks' lending and deposit rates for June suggests that the transmission is progressing well. Foreign banks are leading in the transmission cycle, as was the case for most part of the tightening phase. Also, the transmission has been sharper in case of fresh loans, followed by fresh deposits across banks.
- Non-food credit growth (excluding merger impact) remained in single digits for the second straight month in June but there was improvement to 9.9%YY from 9.5% in May. The increase was across sectors, except agriculture where growth has been easing for almost a year now. In terms of share in incremental credit (y-o-y nominal change), the largest portion accrued to personal loans where growth remained in double digits.
- Within sectors, interesting trends have emerged over the past couple of months (charts in the appendix). 1) Including merger impact, credit growth to micro and small industries has swung to double-digits, while that to large industries has dwindled. In a recent interview, the RBI Governor noted that this is attributable to other sources of financing available to large industries. 2) Within services, credit growth to NBFCs picked up after falling in May but stayed below that in Jun-2024. There was improvement in flow of y-o-y incremental credit to trade but easing in case of NBFCs and real estate. 3) In case of personal loans, gold loans continued to surge, while loans for consumer non-durables remained in contraction. The largest portion of incremental credit continued to be towards housing, though the share moderated y-o-y. By industry, the largest share of credit continued to accrue to infrastructure but y-o-y growth remained negative for third consecutive month.

Transmission of 100bps cut since Feb-2025 till June



Non-food credit growth improved mildly in June



In Q1-FY26, higher fiscal deficit at the Centre vis-à-vis a year ago was marked by weak tax revenues, healthy pace of capex

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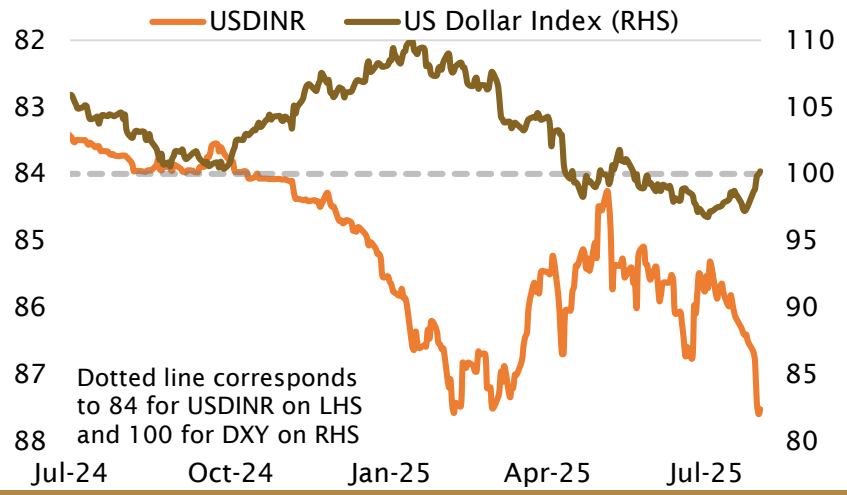
- In Q1-FY26, Centre's total receipts were in line with the levels in the same quarter a year ago in terms of percent of budget (or revised) estimates at around 27%. But total expenditure was higher in the latest quarter amid higher spending both on the revenue and capital expenditure fronts.
- Receipts were buoyed by non-tax revenues and non-debt capital receipts. Dividend from the RBI aided non-tax revenues, and there was some progress on disinvestment as well that lifted non-debt capital receipts.
- Both gross and net tax revenues fell short of levels seen in Q1-FY25 in terms of percent of BE. There was an improvement in indirect tax collections vis-à-vis a year ago due to GST revenues but the weakness in direct tax revenues, both income and corporate was palpable amid year-on-year declines (charts in the appendix).
- On the expenditure front, interest payments weighed on revenue spending, while subsidies and transfers to States were on the lower side and in fact, fell year-on-year. Capital spending that was delayed last year due to general elections, seems to be on track this year at 25% of FY26BE in Apr-Jun period. Capex in key sectors of defence, railways and roads were in the lead, even as loans to States for capex were lower, both year-on-year and compared to levels in terms of percent of BE.
- The fiscal deficit was around 18% of BE, up from 9% in Apr-Jun FY25. It would be early to gauge whether the Centre will meet its deficit target or not but RBI's dividend and a portion of capex set aside under the Department of Economic Affairs should help offset slippages in tax revenues.

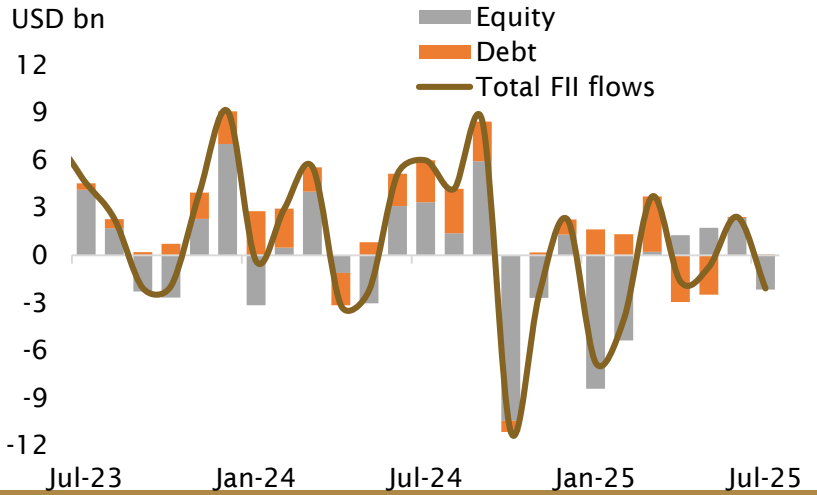
	FYTD (Rs. bn)		FYTD (%YY)	FY26BE		FY25RE	
	Jun-25	Jun-24	Jun-25	Rs. bn	(% of BE)	Rs. bn	(% of RE)
Revenue receipts	**9,134**	**8,297**	**10**	**34,204**	**27**	**30,880**	**27**
Gross tax revenue	**8,690**	**8,308**	**5**	**42,702**	**20**	**38,535**	**22**
Net tax revenue	**5,403**	**5,496**	**(2)**	**28,374**	**19**	**25,570**	**21**
Direct taxes	**4,716**	**4,756**	**(1)**	**25,250**	**19**	**22,420**	**21**
Indirect taxes	**3,952**	**3,543**	**12**	**17,401**	**23**	**16,070**	**22**
Taxes on UT	8	9	(11)	101	8	95	9
Transfer to NDRF	18	17	5	104	17	96	17
Assignment to states	3,269	2,795	17	14,224	23	12,869	22
Non-tax revenues	**3,731**	**2,800**	**33**	**5,830**	**64**	**5,310**	**53**
Non-debt capital receipts	**280**	**45**	**520**	**760**	**37**	**590**	**8**
Recovery of loans	54	45	19	290	19	260	17
Disinvestment	226	0		470	48	330	0
Total receipts	**9,414**	**8,342**	**13**	**34,964**	**27**	**31,470**	**27**
Total expenditure	**12,221**	**9,699**	**26**	**50,653**	**24**	**47,165**	**21**
Revenue expenditure	**9,470**	**7,889**	**20**	**39,443**	**24**	**36,981**	**21**
Capital expenditure	**2,751**	**1,811**	**52**	**11,211**	**25**	**10,184**	**18**
Fiscal deficit	**2,807**	**1,357**	**107**	**15,689**	**18**	**15,695**	**9**
Primary deficit	**(1,053)**	**(1,283)**	**(18)**	**2,926**	**(36)**	**4,316**	**(30)**
Revenue deficit	**336**	**(408)**	**(182)**	**5,238**	**6**	**6,101**	**(7)**
FD/GDP (%)				4.4		4.8	

Uncertainties around trade policies are reflecting in financial market volatility and capital flows

- Ahead of August 1 expiration of pause on reciprocal tariffs, the US administration, on July 31, announced revised tariffs on around 70 economies, including India. As a result, effective August 7, tariffs on India's exports to the US stand adjusted to 25% from the baseline 10% tariff that was applicable till August 1. Despite agreement on terms of reference for a bilateral trade deal, negotiations between India and the US were facing hiccups due to issues pertaining to access to India's farm and diary sectors. The US President also alluded to penalty on India for Russian oil imports. India's Ministry of External Affairs has issued a statement, referring to the US and the EU importing goods from Russia, and that India would "take all necessary measures to safeguard its national interests and economic security." Media reports indicate that India and the US are slated to hold the next round of talks on trade deal from August 25.
- The uncertainties around trade policies and implications across economies are yet to reflect in data, though weakness in the latest US labor market print could be a precursor to the road ahead. The data for July on non-farm payrolls, one of the key indicators of the US labor market conditions, not only surprised on the downside, but the sharp downward revisions to data for May and June belie the underlying strength cited by the US Fed to hold rates until now. Financial markets are reflecting the uncertainties in economic policies, with capital flows staying volatile, and sharp reactions in the foreign exchange markets. Since the last RBI MPC meet in June and until August 1, the USDINR depreciated by over 2%. FII debt flows were tepid in both June and July, while equities posted net outflows in July after four months of inflows (Data source: CSDL).

USRINR slid on US imposition of 25% tariffs on India and amid USD strength; FII posted net outflows from India in July





Appendix I – Select high frequency indicators

Colour codes based on minimum and maximum Z-score values since April 2023 for respective variables; green shows improvement, red indicates weakening. (Reversed for MGNREGA data where a fall implies improved farm activity)

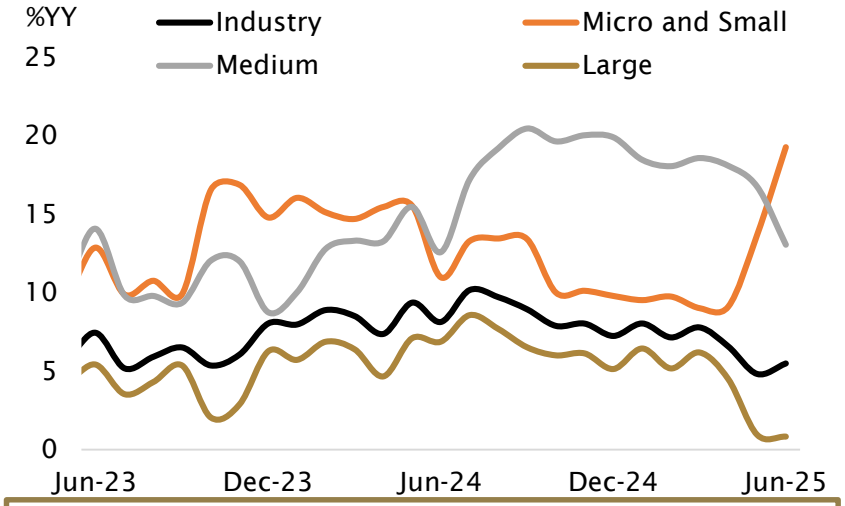
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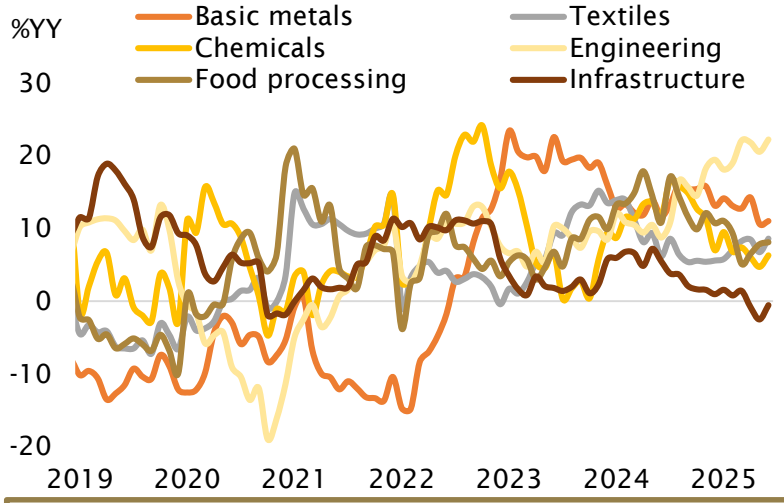
(%YY, unless mentioned otherwise)		Dec-24	Jan-25	Feb-25	Mar-25	Apr-25	May-25	Jun-25	Jul-25
Agriculture and rural sector	Tractor sales	13.3	11.1	30.9	21.6	7.0	8.4	10.2	
	Tractor registrations	25.8	5.2	-14.5	-5.7	7.6	2.8	8.7	
	Two wheeler sales	-8.8	2.1	-9.0	11.4	-16.8	2.2	-3.4	
	Two-wheeler registrations	-17.6	4.2	-6.3	-1.8	2.3	7.3	4.7	
	Three-wheeler registrations	-4.6	6.9	-1.9	-5.7	24.5	6.3	6.7	
	Household work demand under MGNREGA	8.2	14.4	2.8	2.2	-6.5	4.4	4.4	-12.6
Industry, construction and urban sector	Industrial production	3.2	5.0	2.9	3.0	2.7	1.2	1.5	
	Core sector output	4.0	4.6	2.9	3.8	0.5	0.7	1.7	
	Cement production	10.3	14.3	10.7	12.2	6.3	9.7	9.2	
	Natural gas production	-2.1	-2.3	-6.7	-4.8	-1.7	-4.1		
	Electricity requirement	5.1	1.3	2.0	5.7	2.8	-4.8	-2.3	
	Steel consumption	7.7	9.5	10.8	14.2	6.1	8.4	9.1	
	Fuel consumption	2.0	3.0	-5.2	-3.1	0.2	1.1	1.9	
	Passenger vehicle sales	12.9	3.5	3.7	3.7	5.5	0.8	-6.3	
	Passenger vehicle registrations	-2.0	15.5	-10.3	6.3	1.6	-3.1	2.5	
Services	Commercial vehicle sales				1.5				
	Commercial vehicle registrations	-5.2	8.2	-8.6	2.7	-6.9	-3.7	6.6	
	Railway freight traffic	1.6	1.7	-2.4	2.9	4.5	3.1	1.2	
	Port cargo traffic	3.4	7.6	3.6	13.3	7.0	4.4	5.6	
	Toll collection (volume)	9.8	14.8	18.7	11.9	16.6	16.4	15.5	
	Domestic air cargo traffic	4.3	6.9	-2.5	4.9	16.6	2.3	2.6	
	International air cargo traffic	10.5	7.1	-6.3	3.3	8.6	6.8	-1.2	
	Domestic air passenger traffic	10.8	14.0	12.1	9.9	9.7	2.6	3.7	
	International air passenger traffic	9.2	11.0	7.7	6.7	12.9	5.0	3.4	
	Tourist arrivals	-6.6	-0.2	-8.6	-13.7	-3.8			
	GST e-way bills (total)	17.6	23.1	14.7	20.2	23.4	18.9	19.3	
	GST revenue collection	7.3	13.6	9.1	10.2	12.7	16.4	6.2	
PMI (Index)	PMI Manufacturing	56.4	57.7	56.3	58.1	58.2	57.6	58.4	59.1
	PMI Services	59.3	56.5	59.0	58.5	58.7	58.8	60.4	59.8

Source: National Offices, Bloomberg, Refinitiv

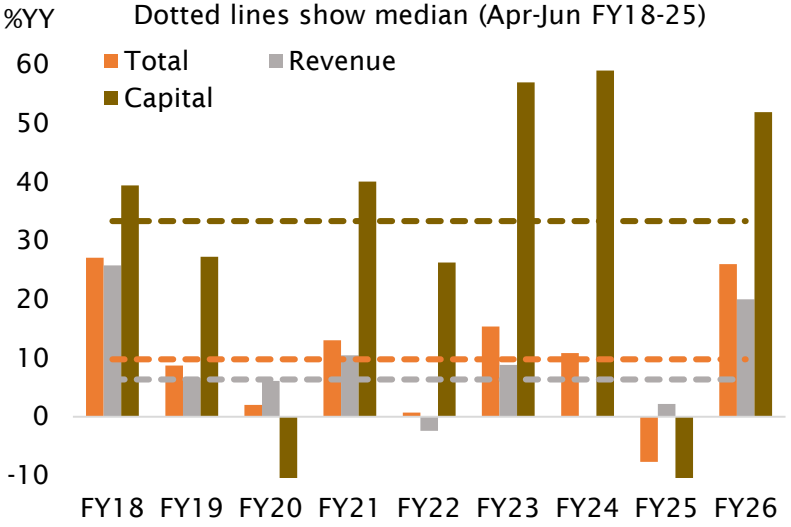
Appendix II – Select data on bank credit growth and Centre's fiscal accounts

Credit growth to large industries has eased amid higher incremental portion accruing to small firms. By industry type, one-third share of credit goes to infrastructure that stayed in y-o-y contraction for the third straight month in June.

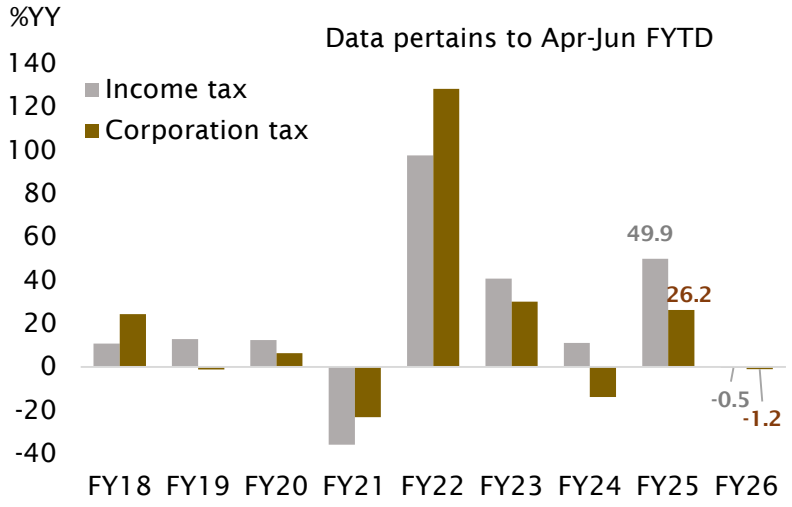




Healthy capex growth at the Centre in Apr-Jun FY26



Year-on-year decline in direct tax collections in Apr-Jun



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