

Fig.1: Downward revision of FY26 CPI to 3% from 3.6% not just led by (volatile) veggies; (contribution to change in FY26 CPI projection, bps)

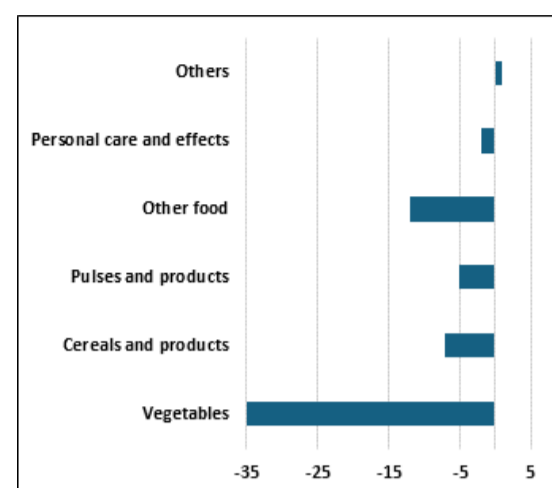


Fig.2: Resources mobilised by commercial sector has stayed broadly flat if we consider funding sources beyond bank credit; Rs lakh cr

Demand for funds (qtrly increment)		
Rs lakh cr	Jun-24	Jun-25
Bank credit	4.54	2.39
Corporate bond issuance (net)	0.82	1.80
CP issuance (net)	0.34	0.57
Total	5.70	4.76

Source: CEIC, NSDL, SEBI, UBI research

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The upcoming monetary policy decision, scheduled for August 4-6, 2025, will take place against the backdrop of ongoing global uncertainty. We expect the Monetary Policy Committee (MPC) to maintain the status quo on both the policy rate and its stance. That said, we do acknowledge the sharp undershooting of near-term inflation projections (FY26 CPI now tracking 3% vs MPC's 3.7% estimate). From the perspective of real rates (assuming at least 100bps), the 12-month forward inflation is key which is currently tracking ~4.5%. However, if the current trends of (food) inflation trailing seasonal trends persists, thereby pressuring FY27 inflation forecast towards 4% and growth numbers start to show signs of weakness, we see space open up for final leg of 25-50bps rate cuts in this cycle.

The question though is whether this is the right time or not. In our view, post the policy frontload and shift to neutral stance amid heightened global macro uncertainty, we believe it is prudent to preserve policy ammunition at the current juncture. Growth numbers are still chugging along, and we anticipate real GDP growth to be ~6.3%, slightly below the MPC's forecast of 6.5% for FY26. While there are downside risks on US-India trade deal stalemate, we think that the situation is fluid and will watch for trends in growth indicators before revising projections. On balance, we see status quo in August MPC, with a possibility of 25-50bps rate cuts in H2-FY26.

▪ **Inflation projections for FY26 may see sharp downward revision, yet stay elevated for FY27**

We are revising downward our FY26 inflation forecast from 3.6% previously (pl refer our report) to 3% as food inflation is trailing seasonal trends since the start of the year. Hence, as per our estimates, inflation is sharply undershooting MPC's projections, with Q2, Q3 & Q4 FY26 CPI tracking 2.3% (MPC: 3.4%), 3.0% (MPC: 3.9%) and 3.8% (MPC: 4.4%). It is crucial to note that while a lot has been made up out of the fact that the sharp downward revision in the inflation projection is primarily attributed to veggies, we would want to point out that after excluding the 50% contribution of veggies, even cereals and pulses which were showing sticky inflation till last year, have seen decline in inflation momentum. However, going forward, in FY27, the trajectory would be see an uptick towards 4% and beyond.

If we shift back by six months, when the rate cut cycle started, inflation was on a falling trajectory, with food prices continuing to fall well into the summer months trailing seasonal trends, relatively subdued oil & base metal prices on global growth worries. However, if we analyse the current situation, inflation is likely to bottom out at a record low of ~1.4/1.5% in July, yet we see an upward trajectory in the coming quarters. Hence, the FY27 inflation numbers stay elevated yet contingent on how food inflation pans out. If inflation continues to provide some surprise, some space for rate cuts may open up. In Q1-FY27, the quarter for which the MPC will provide forecast for the first time along with August decision, CPI inflation is currently tracking in the 4-4.5% range, much higher when compared to 2.7% recorded for Q1-FY26.

▪ **We see growth slowing in FY26 even as MPC likely to keep growth forecast flat at 6.5%**

Growth numbers are still chugging along and have not seen sharp moderation. Till now US has not slipped into a recession and corporate earnings in the US have broadly seen an improvement. With Trump's 25% tariffs on India, we estimate the impact of ~30bps on India's GDP growth with absolute impact seen at ~10-12bn via exports channel. However, we do not expect any major revision by the RBI in growth forecast for FY26 at 6.5% as overall situation stays fluid and volatile. We need to watch whether another TACO (Trump Always Chickens Out) happens (Please refer report "[US-India trade deal stalemate: Impact on macros & markets](#)"). Also, as the RBI Governor accorded priority to the growth trends as well as part of the flexible inflation targeting framework, in a recent media interview, it is crucial to note that high frequency growth indicators have held up in the last few months.

Despite structural shifts underway in global trade on Trump's tariff decisions, our Q1 FY26 projection for GVA, a better proxy for economic activity, for Apr-June 2025 quarter is tracking same as Jan-March 2025 qtr at ~6.7 and GDP is also seen at ~7% vs MPC's projection of 6.5%. Corporate earnings results by companies in Q1FY26 was mixed. As the RBI July Bulletin states, "domestic economic activity held up, with improving kharif agricultural season prospects, continuation of strong momentum in the services sector and modest growth in industrial activity." We believe that consistent government spending this year vis-à-vis same period last year on elections led volatility and the frontloaded monetary policy stimulus are bearing fruit.

- **Credit offtake may not be waning as flagged by bank credit**

In the credit channel of monetary policy transmission, typically policy transmission of rate cuts into credit growth takes 4-5 qtrs with recovery in GDP growth preceding that for credit. It is still ongoing with +ve impact likely to be seen with a lag. Despite a notable slowdown in incremental bank credit growth in Q1-FY26 (down nearly 50% YoY), overall credit demand hasn't significantly weakened. Instead, the composition of credit sources has shifted. Easier monetary policy and ample liquidity from the RBI have accelerated transmission through capital markets and NBFCs, while banks lag due to slower MCLR adjustments. As a result, corporate bond and commercial paper issuances have surged, compensating for weaker bank lending (*Fig 2 and 3*). Highly rated corporates are tapping cheaper market-based funding, MSMEs remain banks' key focus, and retail borrowers are becoming cautious. Total credit flow to the commercial sector has remained broadly flat YoY (~₹5-6 lakh crore). We can see that the credit demand hasn't tapered, but its channels have diversified. So further policy easing may not boost demand meaningfully at this stage. Overall, we believe that when the impact of the previous steroid dose is working itself through the banking system, it may not be the right time for the RBI to inject another steroid dose with the final leg of the current leg of rate cut cycle as some space has opened up on lower-than-expected inflation numbers.

With respect to the interest rate channel of monetary policy transmission, the progress is underway and has been faster in this cycle (Savings deposit rate cuts by 25-50bps across banks & Retail Term Deposit rate cuts in terms of best rate offered of 50-70bps along with 25-50bps cuts in Marginal Cost lending rate (MCLR)). Our analysis of past rate cut cycles shows that a liquidity surplus greatly enhances transmission during rate cut cycles, with the time lag for full transmission of repo rate cuts into lending rates (9-11 qtrs) higher versus that for deposit rates (less than 9 qtrs) as banks intend to save margins as well. While past cycles have shown that transmission into MCLR is usually not complete and ends at ~70-80%, it is still underway in the current cycle and pace has been relatively fast.

- **Liquidity stayed in surplus boosting transmission; RBI stays active for aligning call rate close to repo**

The RBI and MPC have prudently frontloaded a combination of rate cuts and liquidity measures (total of ~Rs 11 lakh cr and additional Rs 2.5 lakh cr impending on CRR cuts) to expedite the transmission of policy easing in the current cycle. System liquidity remained in surplus through much of July, peaking above Rs 4 lakh crore. The RBI conducted frequent Variable Rate Reverse Repo (VRRR) auctions to absorb the excess liquidity. However, mid-month GST payments and tax outflows led to temporary tightness, pushing the Weighted Average Call Rate (WACR) to 5.62% and TREPS to 5.70%, briefly crossing the 5.50% repo rate and even exceeding the Marginal Standing Facility (MSF) ceiling. In response, the RBI injected funds through overnight Variable Rate Repo (VRR) operations, stabilizing funding costs and reinforcing its commitment to keeping overnight rates within the policy corridor. This signals the central bank's commitment to provide adequate liquidity and ensure that the WACR, operating target of monetary policy stays close to the repo rate.

- **Revised Liquidity Management Framework on watch**

As per media reports, the liquidity management framework review is expected to conclude by August 6, alongside the next monetary policy announcement and markets are anticipating a blend of continuity in operating targets and meaningful upgrades to liquidity tools. We expect the following:

- **Retaining WACR as the Operating Target:** WACR is expected to remain the RBI's core operating target due to its strong alignment with the repo rate and its critical role in monetary transmission.
- **Choice between WACR vs TREPS vs SORR:** While rising TREPS volumes (~70% of overnight market volumes vs less than 5% for WACR) have raised questions about WACR's relevance, the RBI Governor in a recent interview signaled that the two rates are highly correlated (~98%). Hence, WACR remains preferred given its relatively better regulatory oversight (banks and PDs while TREPS has other participants like mutual funds etc) and transmission effectiveness. Meanwhile, some market participants have flagged use of Secured Overnight Reference Rate (SORR) which is a blend of TREPS and basket repo, we still believe that the RBI may prefer WACR given that the trend in the rate is visible tick by tick while former is announced only once a day.
- **SORR May Replace MIBOR:** SORR may soon become the new benchmark for overnight rates, offering greater transparency and market alignment. This was flagged in the Dec'24 MPC statement as well.

These anticipated changes reflect the RBI's broader objective of modernizing its liquidity toolkit, reducing reliance on legacy instruments, and ensuring that short-term interest rates remain stable, predictable, and closely aligned with the policy stance. As per media reports, some banks are requesting a return to fixed-rate daily repos for more predictable access during liquidity stress, although RBI is unlikely to reintroduce this facility and remains committed to variable-rate operations that reflect market-based pricing. Additionally, banks have sought relaxation in the daily CRR maintenance requirement, from 90% currently, which may be considered.

Fig 3: Resources mobilised by commercial sector has stayed broadly flat if we consider funding sources beyond bank credit

Rs lakh cr	Demand for funds								
	Jun-24	Mar-25	Jun-25	Jun-24	Mar-25	Jun-25	Jun-24	Mar-25	Jun-25
	Outstanding			Quarterly Increment			% YoY		
Bank credit	168.9	182.4	184.8	4.54	5.01	2.39	17.40	11.03	9.46
Corporate bond issuance (net)	48.1	53.5*	55.3*	0.82	1.89*	1.80*	10.00	13.06	14.88
CP issuance (net)	4.2	4.4	5.0	0.34	0.07	0.57	-2.48	13.98	18.36
Total	221.2	240.3	245.1	5.70	6.97	4.76	15.26	11.53	10.81

*using incremental data from NSDL as SEBI has not published outstanding corporate bonds data since Dec'24

Fig 4: We see possibility of a downward revision by MPC to FY26 CPI projections even as growth forecasts may be kept unchanged; % YoY

UBI vs MPC projection comparison					
	GDP		CPI		
	RBI MPC	UBI	RBI MPC	UBI	
Q1	6.5	6.4	2.9	2.7 (actual)	↓
Q2	6.7	6.4	3.4	2.3	
Q3	6.6	6.4	3.9	3.0	
Q4	6.3	6.1	4.4	3.8	
FY26	6.5	6.3	3.7	3.6	
Q1 FY27			-	~4.5	

Fig 5: CPI likely to slip towards 3% FY26; % YoY

FY26 (currently tracking)					
%, y/y	Q1FY26 (A)	Q2FY26	Q3FY26	Q4FY26	FY26
Headline	2.7	2.3	3.0	3.8	3.0
Food	1.1	0.3	2.0	3.4	1.7
Core	4.3	4.2	4.2	4.3	4.3
FY27 (currently tracking)					
%, y/y	Q1FY27	Q2FY27	Q3FY27	Q4FY27	FY27
Headline	4.6	4.8	4.1	5.0	4.6
Food	5.4	5.4	3.7	5.3	5.0
Core	4.3	4.5	4.7	4.8	4.6

Fig 6: Bank Credit-Deposit growth gap narrowed

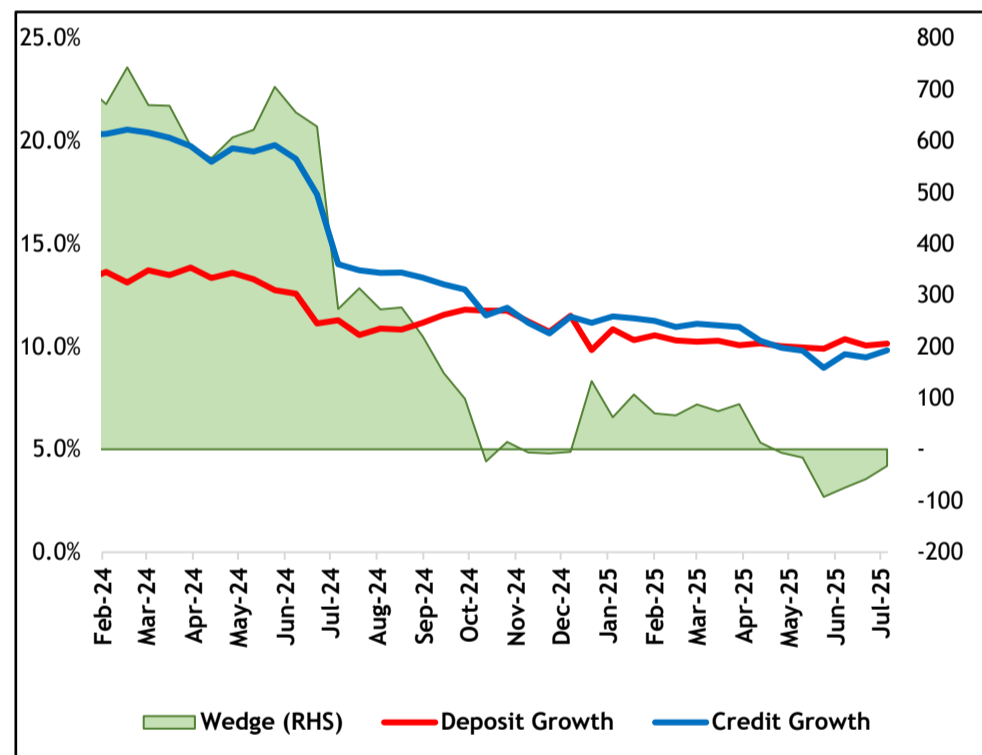


Fig 7: WACR bounced above repo rate for a short while yet RBI measures helped bring it back towards repo rate

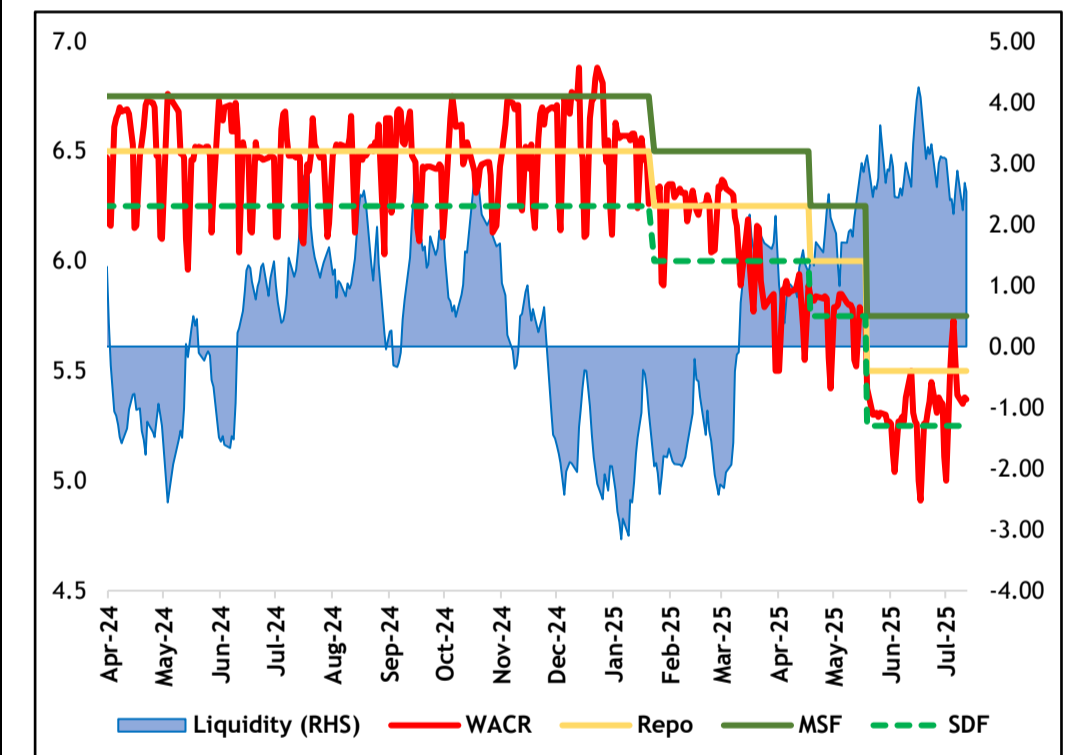


Fig 8: Trends in monetary policy transmission (relatively faster in this cycle)

(in bps)	Repo rate	10 yr Gsec yield	3M T-Bill	5yr AAA rated Corp bond	1 yr CD rate	WADTDR o/s deposits	WADTDR fresh deposits	WALR fresh Rupee Loans	WALR o/s loans	1 yr median MCLR
07 th Feb'19 to 22 nd May'20	-250	-161	-338	-217	-388	-91	-170	-166	-61	-95
04 th May'22 to 6 th Feb'25	250	-72	243	17	224	199	254	181	115	178
07 th Feb'25 to latest	-100	-29	-108	-49	-128	-9*	-87*	-71*	-40*	-25*

*data as of June-2025, with MCLR data as of July-2025; Source: RBI, CEIC, NSDL, SEBI, UBI research

High frequency lead indicators present a mixed picture and remain on close watch

MACRO-ECONOMIC DASHBOARD													
	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24	Jan-25	Feb-25	Mar-25	Apr-25	May-25	Jun-25
Industrial Sector													
IIP (YoY Gr%)	4.9	5.0	0.0	3.2	3.7	5.0	3.7	5.2	2.7	3.9	2.6	1.9	1.5
Mining (YoY Gr%)	10.3	3.8	-4.3	0.2	0.9	1.9	2.7	4.4	1.6	1.2	-0.2	-0.1	-8.7
Manufacturing (YoY Gr%)	3.5	4.7	1.2	4.0	4.4	5.5	3.7	5.8	2.8	4.0	3.1	3.2	3.9
Electricity (YoY Gr%)	8.6	7.9	-3.7	0.5	2.0	4.4	6.2	2.4	3.6	7.5	1.7	-4.7	-2.6
Core Infra Growth (YoY Gr%)	5.0	6.3	-1.5	2.4	3.8	5.8	5.1	5.1	3.4	4.5	1.0	1.2	1.7
Cement Production (YoY Gr%)	1.8	5.1	-2.5	7.6	3.1	13.1	10.3	14.3	10.7	12.2	6.3	9.7	9.2
Steel Production (YoY Gr%)	6.3	7.0	4.1	1.8	5.7	10.5	7.3	4.7	6.9	8.7	4.4	7.4	9.3
Petroleum Products (YoY Gr%)	-1.5	6.6	-1.0	5.8	5.2	2.9	2.8	8.3	0.8	0.2	-4.5	1.1	3.4
Fertilizers Production (YoY Gr%)	2.4	5.3	3.2	1.9	0.4	2.0	1.7	3.0	10.2	8.8	-4.2	-5.9	-1.2
Coal Production (YoY Gr%)	14.8	6.8	-8.1	2.6	7.8	7.5	5.3	4.6	1.7	1.6	3.5	2.8	-6.8
Capital Goods Production (YoY Gr%)	3.6	11.7	0.0	3.5	2.9	8.9	10.5	10.2	8.2	3.6	14.0	13.3	3.5
PMI Manufacturing	58.3	58.1	57.5	56.5	57.5	56.5	56.4	57.7	56.3	58.1	58.2	57.6	58.4
PMI Services	60.5	60.3	60.9	57.7	58.5	58.4	59.3	56.5	59.0	58.5	58.7	58.8	60.4
Banking Sector													
Bank Credit (YoY Gr%)	17.3	13.7	13.6	13.0	11.5	10.6	11.2	11.4	11.0	11.0	10.3	9.0	9.5
Agriculture Credit (YoY Gr%)	17.4	18.1	17.7	16.4	15.5	15.3	12.5	12.2	11.4	10.4	9.2	7.5	6.8
Industry Credit (YoY Gr%)	8.1	10.2	9.7	8.9	7.9	8.0	7.2	8.0	7.1	7.8	6.6	4.8	5.5
Services Credit (YoY Gr%)	17.4	14.5	13.9	13.7	12.7	13.0	11.7	12.5	12.0	12.4	10.5	8.7	9.0
Retail Credit (YoY Gr%)	25.6	13.9	13.9	13.4	12.9	13.3	12.0	11.8	11.7	11.6	11.9	11.1	12.1
Bank Deposits (YoY Gr%)	11.1	10.6	12.7	10.4	11.5	11.2	9.8	12.1	12.0	10.3	9.8	9.9	10.1
Demand (YoY Gr%)	6.2	8.2	20.6	7.2	10.2	7.7	5.4	13.2	14.2	10.4	6.0	19.2	18.1
Time (YoY Gr%)	11.8	10.9	11.7	10.8	11.7	11.7	10.4	11.9	11.7	10.3	10.3	8.6	8.9
C-D Ratio (%)	79.3	79.3	78.4	79.2	79.4	79.5	80.4	80.3	80.4	80.8	79.7	78.9	78.9
Weighted Average Lending Rate Fresh Rupee Loans (%)	9.3	9.4	9.4	9.4	9.5	9.4	9.3	9.3	9.4	9.4	9.3	9.2	8.6
Weighted Average Deposit Rate (%)	7.0	7.0	7.0	7.0	7.0	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.0
UPI (No. in Cr)	1389	1444	1496	1504	1658	1548	1673	1700	1611	1830	1789	1868	1840
IMPS (No. in Cr)	51.7	49.0	45.3	43.0	46.7	40.8	44.1	44.4	40.5	46.2	44.9	46.4	44.8
NPCI Retail Transaction value (YoY Gr%)	22.8	23.0	20.5	20.6	29.6	14.9	19.5	20.5	12.3	17.0	15.9	16.7	14.9
NPCI Retail transactions volume (YoY Gr%)	44.1	39.0	37.4	39.0	43.2	31.8	34.4	35.2	29.3	31.6	30.1	30.0	28.5
Inflation													
CPI (YoY Gr%)	5.1	3.6	3.7	5.5	6.2	5.5	5.2	4.3	3.6	3.3	3.2	2.8	2.1
Core CPI (YoY Gr%)	3.1	3.4	3.4	3.5	3.7	3.6	3.6	3.7	4.0	4.1	4.1	4.2	4.4
WPI (YoY Gr%)	3.4	2.1	1.2	1.9	2.8	2.2	2.6	2.5	2.4	2.2	0.9	0.4	-0.1
Consumer													
Electricity Consumption (YoY Gr%)	8.0	4.0	-5.0	-0.8	-0.4	3.7	5.1	1.3	2.4	5.7	2.8	-4.8	-1.9
Petroleum Consumption (YoY Gr%)	9.0	7.4	0.3	-10.6	8.4	2.0	4.0	1.4	-11.3	3.7	-4.1	6.9	0.4
Consumer Durables (YoY Gr%)	8.8	8.2	5.4	6.3	5.5	14.1	8.1	7.1	3.7	6.9	6.2	-0.9	2.9
Consumer Non Durables (YoY Gr%)	-1.0	-4.2	-4.4	2.2	2.8	0.6	-7.1	0.1	-2.1	-4.0	-2.7	-1.0	-0.4
Trade													
Merchandise Export (YoY Gr%)	2.4	0.6	-9.9	-0.3	16.6	-5.3	-1.5	-2.6	-11.1	0.7	8.6	-2.3	-0.1
Merchandise Import (YoY Gr%)	4.6	11.2	10.0	7.8	1.9	16.1	2.3	10.3	-16.3	11.4	19.1	-1.7	-3.7
Service Export (YoY Gr%)	3.2	16.6	5.7	14.6	22.7	14.2	16.9	12.1	11.7	18.7	8.8	9.6	12.0
Service Import (YoY Gr%)	-3.1	16.0	9.1	13.5	28.0	26.1	13.9	12.6	-4.7	5.3	1.0	-1.0	5.1
Logistics													
E Way bill generated (Nos. in Cr)	10.0	10.5	10.5	10.9	11.7	10.2	11.2	11.8	11.2	12.5	11.9	12.3	11.9
Air Freight (YoY Gr%)	15.9	18.1	12.5	18.0	14.5	9.7	8.0	7.0	-4.9	3.8	11.5	5.0	0.2
Fiscal													
GST Collection (YoY Gr%)	7.6	10.3	10.0	6.5	8.9	8.5	7.3	12.3	9.1	9.9	12.6	16.4	6.2
Govt. Expenditure (YoY Gr%)	-18.4	0.1	20.9	2.6	31.7	3.6	22.1	12.4	-17.7	9.7	10.0	40.3	37.4

Source: RBI, UBI research

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