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ECOWRAP

OCTOBER AND DECEMBER MPC MEETS CAN BE PERFECT PITCH FOR NUANCED RATE HIKE CALLS OF 25 BPS EACH

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India's retail inflation, based on the CPI (new base), rose to 4.82% in August 2026, up from 4.45% in July, due to broad based increase in almost all divisions, with rural inflation at 5.23% smarting its urban counterpart at 4.31%. Food inflation reached a high of 5.66% level due to elevated prices for select items. Concomitantly, Core inflation (ex food and fuel house hold and transport) rose to 4.16% in Aug from 3.87% in July.

Our study of data till Aug'26, indicates that the process of inflation getting generalized has started. In Jan'26, 22 commodities explained 90% of CPI's weighted contribution. In August this number of commodities increased to 51. Further, the top 25 commodities' (ex gold/silver), contribution has declined from 83% in Jan'26 to 62% in Aug'26.

Going forward, we believe CPI inflation may cross-6.5% mark before dropping to less than 6% in the early 2027. Time to build moats through a 25-bps hike in October and Dec MPC each, and then to pause and take stock with upcoming data!

With West Asia conflict gaining both depth and breadth, crude oil price are expected to stay over $100 per barrel in the near future with higher volatility. Imported inflation remained elevated in August 2026, rising 7.75% YoY at the All-India level compared with headline inflation of 4.82%. While the pass through of rise in crude price remains partial until retail prices are revised, the fiscal implications and pass through proliferate at multiple levers, affecting pricing dynamics and allocation.

The overall situation further gets nuanced when looking at steepening of borrowing costs globally where capital, and its mobility can get scarce each passing day, with a price tag that disproportionately and severely impacts the operational and investment efficiency of all factors, as also trust in governments ability to push through the forward agenda. We have seen select sovereign ratings taking a knock as fiscal problems balloon and with higher interest servicing costs (as a percentage of sovereign GDP as also revenue generating capacity), there can be a vicious spiral in the offing that can put the best laid plans to test.

The steepening of benchmark yield today towards 7.10% (we had given a call of rates moving 10-15 bps in short horizon in our last Ecowrap on Friday), there is a genuine threat of yields vaulting towards 7.25% First, and then inching towards ~7.50%, more a reaction to global phenomenon than any local issues but the damage can be done nonetheless. In addition, there is a Twin problem of Corporate borrowing slowdown from Capital Markets in most tenors and Exchange rate susceptible to movement of interest rate vagaries. We believe the situation should worsen as energy security and supply concerns mount and a forced era of Savings Dearth emerges wherein Capital, and its Allocation-Pricing quotient changes for a longer time, if not for good. That, without any borrowed intelligence, calls for counter cultural hard answers lest the incoming tempest snowballs in a hurricane.

CPI INFLATION INCREASED TO 4.82% IN AUGUST 2026

- India's retail inflation based on the CPI (new base) rose to 4.82% in August 2026, up from 4.45% in July, due to broad based increase in almost all divisions. Inflation remained higher in rural India at 5.23%, while urban areas registered a lower rate of 4.31%.
- Food inflation reached 5.66% level due to elevated prices for items like onions, ginger, and garlic. Information and communication inflation, which was merely less than 1% till now has crossed 2% mark in Aug'26.
- Core inflation (ex food and fuel house hold and transport) rose to 4.16% in Aug from 3.87% in July.

India's CPI Inflation (% YoY)

YoY	Apr-26	May-26	Jun-26	Jul-26	Aug-26
General Index	3.48	3.94	4.38	4.45	4.82
Food and beverages	4.0	4.5	5.1	5.2	5.7
Paan, tobacco and intoxicants	4.8	4.8	4.8	4.8	4.7
Clothing and footwear	2.8	3.0	3.2	3.4	3.6
Housing, water, electricity, gas and other fuels	1.7	1.7	2.0	2.2	2.6
Furnishings, household equipment and routine household maintenance	1.6	1.9	2.2	2.4	2.7
Health	1.6	1.5	1.4	1.3	1.3
Transport	0.0	1.8	4.3	4.4	4.6
Information and communication	0.5	0.3	0.4	0.6	2.0
Recreation, sport and culture	2.1	2.0	1.7	1.6	1.7
Education services	3.2	3.0	3.3	3.6	3.7
Restaurants and accommodation services	4.2	5.7	6.9	7.7	8.4
Personal care, social protection and miscellaneous goods and services	17.7	18.5	16.7	14.8	15.2

Source: MOSPI

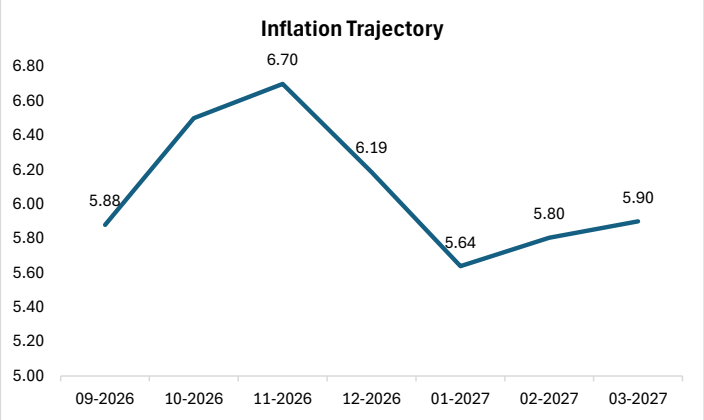
- Restaurant inflation rose sharply to 8.4% in Aug'26 as onions, edible oils and LPG became more expensive, while higher transport cost and other operating costs added to more pressure. This came with lag due to menu cost frictions.
- Our research of data till Aug'26, indicate that the process of generalization has started. In Jan'26, 22 commodities explained 90% of CPI's weighted contribution. In August this number of commodities increased to 51. **Further, the top 25 commodities' (ex gold/silver), contribution has declined from 83% in Jan'26 to 62% in Aug'26.**
- The negative output-input price differential of -0.66% for crude petroleum & natural gas reflects stronger inflation in intermediate input costs relative to output prices. The widening cost pressures were driven by elevated global crude oil prices and higher freight and insurance costs, and increased input price pressures. costs of production inputs, further pass-through to output prices could occur in the coming period, potentially narrowing the exiting differential.
- Going forward, we believe CPI inflation may cross-6.5% mark before dropped to less than 6% in the early 2027.

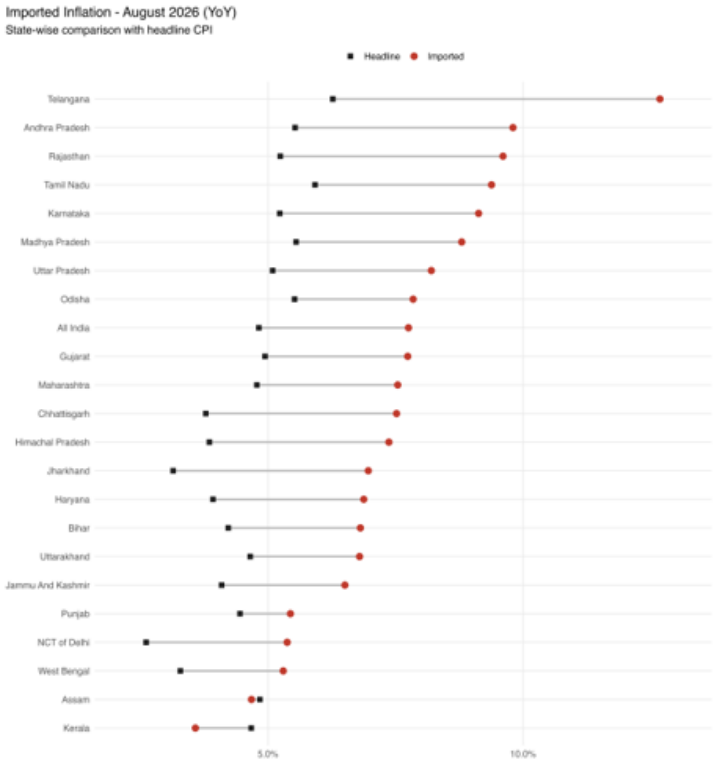
OIL PRICE RISK AND CPI INFLATION

- The crude oil price has risen significantly after the War in West Asia spread to Red Sea with Houthi rebels advance down Yemen's western coast capturing vital strategic points. The dated Brent is trading at $105.7 today. The Indian basket has risen significantly since July from $82.04 to $90.19 in August and $109.76 in September.
- However, the pass through of rise in crude price remains partial until retail prices are revised. Electricity, gas and other fuel sub-component of CPI rose 3.09% in August which is at variance with fuel and power sub-component of WPI rising by 22.93% in August.
- The crude oil price are expected to stay over $100 per barrel in the near future high volatility.
- Imported inflation remained elevated in August 2026, rising 7.75% YoY at the All-India level compared with headline inflation of 4.82%. Telangana recorded the highest imported inflation at 12.68% .

Items Group wise input Output spillovers

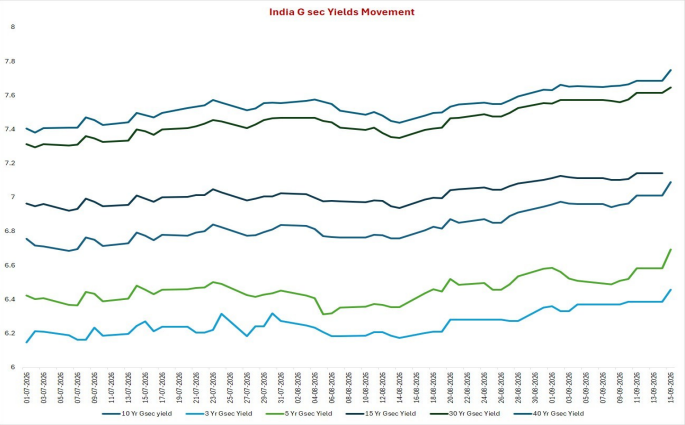
Item Group	Difference between input and output price (%)	Share in imported basket
Crude Petroleum & Natural Gas	-0.66	31.30
Manufacture of Beverages	0.10	
Manufacture of Wood and Products of Wood and Cork, Except Furniture; Manufacture of Articles of Straw and Plaiting Materials	0.92	
Manufacture of Chemicals and Chemical Products	0.06	17.51
Manufacture of Basic Pharmaceutical Products and Pharmaceutical Preparations	0.24	
Manufacture of Fabricated Metal Products, Except Machinery and Equipment	0.86	
Manufacture of Computer, Electronic and Optical Products	2.33	
Manufacture of Electrical Equipment	3.80	
Manufacture of Machinery and Equipment N.E.C.	0.16	
Manufacture of Furniture	1.23	
Source: MoSPI, SBI Research		





DECODING THE YIELDS STEEPENING

- The global bond market is undergoing a profound repricing—but calling it a uniform rise in yields would miss the more important story. Long-duration sovereign yields are pressing towards multi-year highs as investors demand greater compensation for fiscal risk, elevated government borrowing, persistent inflation uncertainty and the erosion of the low-rate regime. The U.S. 10-year Treasury has finally breached 5%, while Japan's 10-year yield has touched 3% (its highest level since 1996); European and UK yields also moving materially higher.
- Yet the movement across curves is far from homogeneous. In some economies, the front end remains anchored by expectations of monetary accommodation or eventual disinflation, while the long end is being driven higher by term premium and fiscal supply. Elsewhere, inflation expectations and the possibility of additional policy tightening are pushing the short end higher faster than the long end. The result is a mosaic of steepening, flattening and re-steepening curves rather than a single global cycle.
- This matters because the bond market is increasingly distinguishing between inflation risk, policy risk and sovereign-duration risk as a rise in the 2Y yield says something very different from a rise in the 30-year yield. The former reflects expectations about central-bank reaction functions; the latter increasingly reflects the price investors demand for absorbing structurally larger quantities of government and corporate debt.
- The supply dimension is becoming particularly powerful. Large fiscal deficits are colliding with enormous refinancing requirements, while AI-related capital expenditure is generating additional corporate bond issuance, with U.S. hyperscalers creating a demand vortex that can ultimately create an era of Savings dearth.
- The implication is subtle but consequential: the global neutral rate may not be rising uniformly, but the price of duration is. Central banks can influence the front end but they cannot indefinitely dictate the term premium. The bond vigilante is therefore returning—not as a single global force, but as a collection of country-specific investors demanding compensation for fiscal, inflation and duration risk.



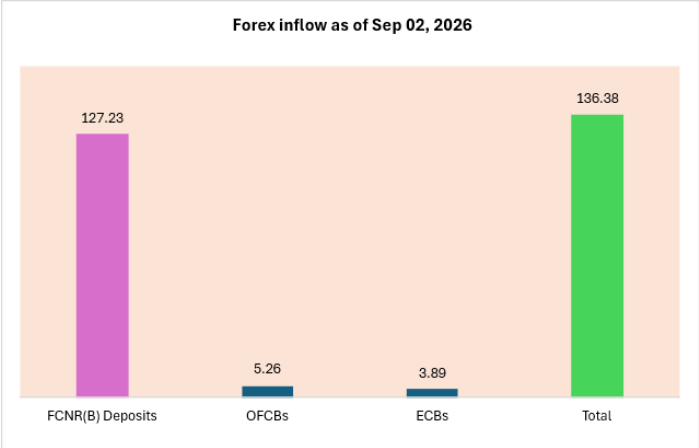
- India enters this global bond repricing with a relatively credible fiscal narrative, but not without significant supply pressure. The Centre's FY2026-27 revised gross market borrowing stands at ₹16.09 lakh crore, with ₹8.20 lakh crore—about 51%—scheduled for the first half. Wherein the 10-year segment carries the largest allocation at 29%. States, on the other hand, have borrowed ₹4.27 lakh cr till 08 Sept (vis-à-vis announced ₹5.04 lakh cr and last year's total ₹12.36 lakh cr) and can be the collateral damage in an environment where yields can remain irrationally exuberant.
- The domestic supply equation is being reinforced by the corporate sector wherein higher yields have already been suppressing issuance: Indian companies raised about ₹61,760 crore through private-placement bonds in August, down 45% from July as borrowing costs rose again, particularly at the short end. At the same time, large issuers are exploiting windows of strong institutional demand; in particular on the near medium curve where FCNRB flows have created a benign environment.
- With benchmark Indian yields vaulting today lock, stock and barrel (~7.10% as we had predicted in our last report on 11 Sept), we reiterate that bouts of domestic liquidity can support the front end to some extent though not necessarily eliminating long-end pressure as an oil shock can work through several channels simultaneously, imported inflation, possible exchange-rate pressure, changes in the expected RBI response, and the compensation investors require for uncertainty. That pretty well checkmates the Mint Street strategy to keep volatility low and borrowing costs in check, signaling 10Y yields to now inch towards 7.25% FIRST, and then attempt somewhere ~7.50%, if the supply side shocks and energy security worsens.

EXPECTED DRAWDOWN OF SURPLUS FUNDS

- The FCNR (B) inflows have swelled the banks lendable resources while creating a surplus liquidity in the banking system.
- The expected future drawdown of the surplus fund in the banking system will be a function of currency demand as addressed above and the extent to which the FCNR (B) funds the fast growth in advances seen in current financial year.
- Timelines and expected trends become crucial. At the start of the FY27, the expected advances growth of banks was in the range of 16-17% and the deposits growth was expected in the range of 11-12%.
- Translated in nominal terms an anticipated funds gap for FY27 at Rs 12.5 lakh crore.
- **By design or by fluke, the mobilized amount of $127 billion almost matches the fund gap in banking system. This implies that the current spike will have a natural drawdown given the strong demand for credit supported by equally strong Q1 FY27 GDP growth figures.**
- **Thus, in all likelihood, the system liquidity will level out by the end of FY27 if the anticipated credit demand is met. The RBI Bank Lending Survey for Q1:2026-27 also indicates strong credit demand in H2 FY27.**

RBI POLICY OPTION FOR LIQUIDITY MANAGEMENT

- The policy option at the disposal of RBI has to be factored in the context of current surge in bank liquidity which is fundamentally different from the those seen during demonetization or COVID-19 pandemic.



Incremental (Out /In) flow of funds in banking system (Rs Lakh Crore)

	Apr-26	Jun-26	Aug-26	Mar-27
Advances	36.3			
Deposits (Net CRR & SLR)	23.8			
Anticipated Gap	12.5			
FCNR (B)		12.1		
Anticipated Gap	0.4			

RBI POLICY OPTION FOR LIQUIDITY MANAGEMENT

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- **Aggressive withdrawal of liquidity may create a deep deficit in Q3 and Q4 which are traditionally better month from the perspective of seasonal demand for credit and cash. Liquidity management may target a short horizon thus, adjusted as per evolving situation.**

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