

**CORE CPI INFLATION (EXCLUDING GOLD) DIP BELOW 3%...HEADLINE INFLATION AT 1.55% HIGHER THAN MARKET ESTIMATES AS FOOD INFLATION SHOW SLOWER RATE OF DECLINE REINFORCING THE POSSIBILITY OF 5.5% BEING THE TERMINAL RATE ..ARE G-SEC YIELDS INCREASINGLY BECOMING MORE OF A NON MERIT GOOD?**

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India's CPI inflation moderated to 98-month low of 1.55% in July'25, compared to 2.10% in June'25 and 3.60% in Jul'2024. The July reading is marking the ninth consecutive month of decline and mainly due to decline in food inflation, which is also at 78-month low. Food inflation declined by 75 bps in Jul'25, compared to June 2025. **The food inflation in July, 2025 is the lowest at -1.76%, after January, 2019, when it was at -2.24%.** The core inflation also decelerated sharply and for the first time in past 6 months stood below 4% (at 3.94%). **Excluding gold prices, the core inflation decelerated below 3% to 2.96% in Jul'25, almost 100 bps lower than the headline core CPI.**

Indian Inc. in Q1FY26, around 2500 listed entities, reported top line growth of 5.4% while EBIDTA grew by around 6%, as compared to 11% EBIDTA growth in the previous quarter and around 12% in Q1FY25. **In Q2, we may see revenue and margin pressure in export-oriented tariff affected sectors such as Textile, Gems and Jewellery, Leathers, Chemicals, Agriculture, Auto Components, etc. The overall US CPI inflation (not seasonally adjusted) has also registered a y-o-y growth of 2.7% in July which is 40 bps higher than reading in April indicating negative impact of tariffs.**

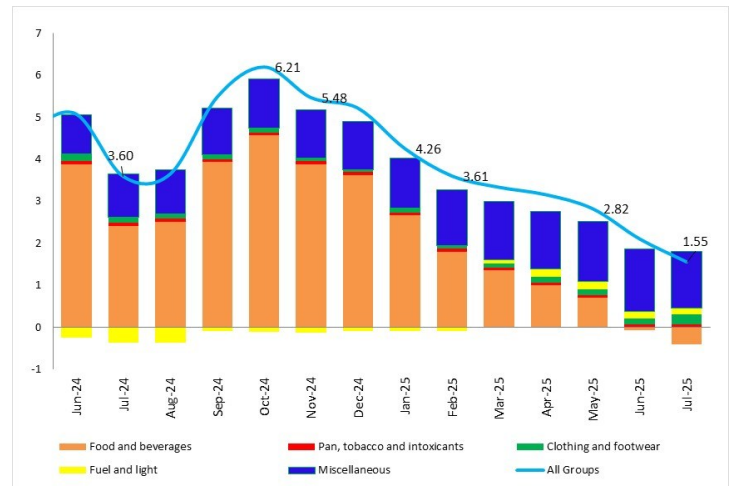
Since the MPC decided to cut rates in June and subsequent status quo in August, the 10-year yield has started rising. From hovering around 6.30% in July, it has now crossed the 6.45%-mark. The bond yield may not become moderate until and unless a clarity would descend regarding tariffs. In this context we again want to highlight that **yield curve is a public good**. In the Indian markets, it is common to find debt market players behaving differently. For example, if one set of players acts pro-cyclically with the RBI monetary policy stance, the other set of players acts counter-cyclically and sometimes both the players act combatively. **However, after the announcement of the June policy, almost all market participants are selling / behaving in the same manner. This is surprising and resulting in a skewed price discovery despite headline inflation at 8 year low.** Interestingly, the SDL auction held on Aug 12th surprised the market participants with cut-off yield being almost at the highest end of the expectations at 7.3%. Perhaps a central bank communication can assuage the market expectations.

On the projections side, in-house estimates point to a lower inflation print vis-à-vis the RBI's projection. However with August inflation print likely to top 2% and be closer to 2.3%, a rate cut in October looks difficult. Even a rate cut in December looks a tad difficult if growth numbers for Q1 and Q2 are taken into consideration.

#### CPI INFLATION AT 8-YEARS LOW OF 1.55% IN JULY'2025

- ♦ India's CPI inflation moderated to 98-month (lowest level since June 2017) low of 1.55% in July'25, compared to 2.10% in June'25 and 3.60% in Jul'2024. The July reading is marking the ninth consecutive month of decline and mainly due to decline in food inflation, which is also at 78-month low of -0.84%, lead by falling prices in pulses, vegetables, cereals, eggs, and sugar, as well as a favourable base effect (150 bps).
- ♦ Food inflation declined by 75 bps in Jul'25, compared to June 2025. The food inflation in July, 2025 is the lowest at -1.76%, after January, 2019, when it was at -2.24%.
- ♦ Vegetable prices continued its southward trend and decline by -20.69% in July. Pulse prices declined by -13.76% while spices prices also exhibited decline in July. Fruits inflation increased to 14.42% and Oil & fat CPI is also increased to 19.24%.

#### Headline CPI Inflation Declined



Source: SBI Research

- ◆ India's core inflation also decelerated sharply and for the first time in past 6 months stood below 4% (at 3.94%). If we exclude gold from the core inflation it decelerated below 3% to 2.96% in Jul'25, almost 100 bps lower than the core CPI.

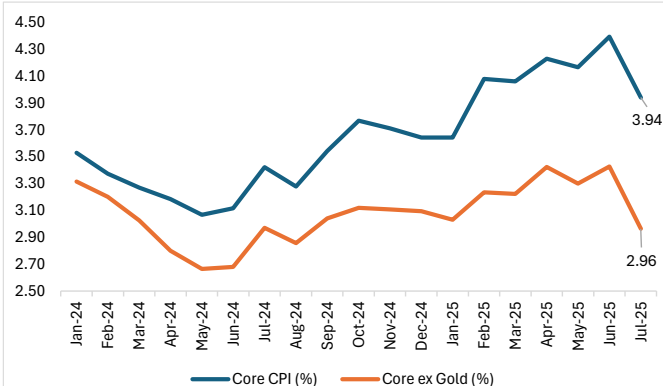
#### POTENTIAL RISK OF A "TYPE II" ERROR?

- ◆ The latest inflation print reinforces the pattern of persistent undershooting relative to the target, suggesting that what was initially viewed as a transitory deviation may, in fact, be gaining persistence. In our earlier analytical framework, we examined the impact of policy decisions through the lens of a hypothesis testing framework, employing a central bank loss function of the form  $L = [(\pi - \pi^*)^2 + \lambda (y - y^*)^2]$ . The expected losses associated with Type I error (over-tightening in response to inflationary pressures) when compared with Type II error (under-reacting to disinflationary trends), is higher.
- ◆ In this context, the current run of below-target inflation raises the possibility that the economy is edging towards a Type II policy error, wherein excessive caution in policy adjustment could inadvertently prolong suboptimal growth-inflation outcomes.

#### RBI COMMUNICATION AND BOND YIELDS

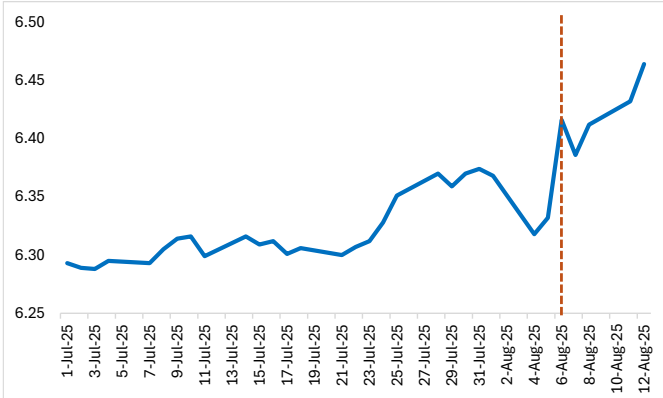
- ◆ Since the MPC has decided to maintain status quo the 10-year yield has started rising. From hovering around 6.30% in July, it has now crossed the 6.40%-mark. So how the market is reading the RBI's message.
- ◆ We believe that the current spike in bond yields indicate that the MPC's decision to go for a pause on rate decisions could be owing to volatile atmosphere engulfing the economy. The MPC's deliberations could be split almost equally between indigenous and exogenous factors to gauge patiently the aftermath of tariff impacts that may come with a lag as stockpiling, and advanced shipping and purchases somewhat camouflage the early numbers of Q1/H2 across borders. The bond yield may not moderate until and unless a clarity would descend regarding tariffs.
- ◆ In this context we again want to highlight that **yield curve is a public good**. In the Indian markets, it is common to find debt market players behaving differently. For example, if one set of players acts pro-cyclically with the RBI monetary policy stance, the other set of players acts counter-cyclically and sometimes both the players act com-batively. However, after the announcement of the June policy, almost all market participants are selling. Interestingly, the SDL auction held on Aug 12th surprised the market participants with cut-off yield being almost at the highest end of the expectations at 7.3%.

#### Core CPI vis-à-vis Core ex Gold (% yoy)



Source: SBI Research

#### 10-year G-sec Yield (%)



Source: SBI Research

#### WAY FORWARD

- ◆ Our in-house estimates point to an even lower inflation print vis-à-vis the RBI's projections; up to 50 points lower, which increases the onus of a rate cut by the regulator going forward although time is of the essence. Can there then be a rate cut with a large intervening gap from June, even when growth is supposed to be strong on a front-loaded basis (Q1 and Q2 growth is strong according to RBI projections with Q2 being even higher than Q1, thus rate cuts in October and December look a tad difficult) and inflationary concerns significantly in check?

**CORPORATE RESULT Q1FY26 – EBIDTA GREW BY 6%, REVENUE REPORTED GROWTH OF 5%**

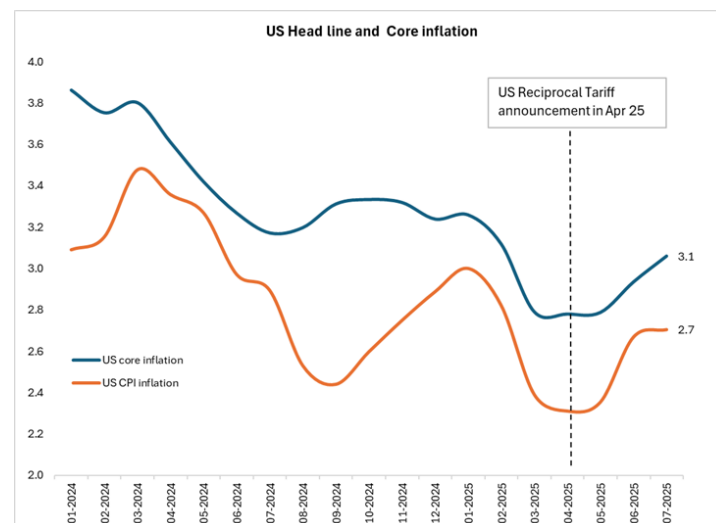
- ◆ Indian Inc. in Q1FY26, around 2500 listed entities, reported top line growth of 5.4% while EBIDTA grew by around 6%, as compared to 11% EBIDTA growth in the previous quarter and around 12% in Q1FY25.
- ◆ Further, Corporate results, for Q1FY26, ex BFSI represented by around 2000 listed entities shows, revenue growth of 4% while EBIDTA grew by around 8%.
- ◆ If we see Corporate GVA, which increased by around 10.9% in Q1FY25 and 8.8% in Q4FY25, increased by 6.5% in Q1FY25, as derived from the results of around 2500 listed entities. In Q2, we may see affect in revenue and margin pressure in export-oriented tariff affected sectors such as Textile, Gems and Jewellery, leathers, Chemicals, Agriculture, Auto Components, etc.

**US INFLATION TRAJECTORY SHOWS UPTICK**

- ◆ Since the announcement of reciprocal tariffs in April 2025, the US CPI inflation is indicating steady build-up of inflation. This is evident from the adjoining Chart.
- ◆ The overall CPI inflation (not seasonally adjusted) has registered a y-o-y growth of 2.7% in July which is 40 bps higher than reading in April.
- ◆ The core inflation that factors out the food and energy prices show the pass through of tariffs on consumers. The core inflation in July registered a growth of 3.1%, which was higher than April reading of 2.8%. The core CPI had bottomed out in April and its reversal after tariffs indicates possible higher inflation in coming months.
- ◆ Thus Federal Reserve rate decision may be impacted with core CPI showing a rising trend, **THOUGH WE BELIEVE** September could see a Fed rate cut.

Corporate GVA		
Qtr	No of Companies	Growth (%)
Q1FY23	3856	31.35
Q2FY23	3853	-1.78
Q3FY23	3899	11.23
Q4FY23	3908	20.12
Q1FY24	3958	28.62
Q2FY24	3904	46.79
Q3FY24	3959	26.28
Q4FY24	4162	17.18
Q1FY25	4155	10.90
Q2FY25	4015	6.64
Q3FY25	4077	9.55
Q4FY25	4291	8.76
Q1FY26	2426	6.49

Source: SBI Research; CLIne; listed entities; GVA as measured by EBIDTA+Employee expenses



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**Contact Details:**

Dr. Soumya Kanti Ghosh  
Group Chief Economic Adviser  
State Bank of India, Corporate Centre  
M C Road, Nariman Point, Mumbai - 400021  
Email: [soumya.ghosh@sbi.co.in](mailto:soumya.ghosh@sbi.co.in),  
[gcea.erd@sbi.co.in](mailto:gcea.erd@sbi.co.in)  
Phone: 022-22742440  
 : [kantisoumya](#)