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Bank of Baroda

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Economic Round-up: Jul 2026

The West Asia conflict remained a focal point, keeping the global market on the edge. This was on the back of the exchange of military hostilities between the US and Iran, with attacks even spreading across the Gulf towards the Red Sea and the Mediterranean facility. However, recently there have been been news reports that the strikes have been paused after 2 weeks and a peace deal has been proposed which is contingent on reopening of the Strait of Hormuz as well as bringing an end to Iran's nuclear programme as part of the deal. The talks currently are underway with Saudi Arabia and Oman's counterparts. As a result, crude price moderated, surrounded by optimism around the ongoing talks. On the macro front, major global central banks kept policy rates unchanged with a hawkish hold. On the domestic front, the focus would shift towards the RBI which is also expected to maintain the status quo. The recent news of Bloomberg deferring the inclusion of Indian bonds in the Global aggregate bond index could put some pressure on the rupee and even push yields higher, given the delay in inflows. On the positive side, RBI has reported that US$ 40.8bn was mobilised through FCNR (B), OFCBs and ECBs route, till 31 Jul'26, out of which US$ 36.7bn was mobilised through FCNR (B) deposits. This is expected to push inflows and support the rupee. On the rural front, the recent deluge has resulted in surplus rains in Jul'26 against a deficit noted in Jun'26. However, IMD has projected below normal rain in Aug'26 which needs to be tracked as moderate risks of El Nino persist.

Global central banks: Recent commentaries by monetary policymaker globally suggest that they will continue to track inflation risks amidst the ongoing tensions in the Middle East. Major Central Banks had decided to keep the policy rates on hold in their last meeting. However, there is a growing likelihood of tightening in the near term especially by US Fed and ECB. Given that the US Fed has recently delivered a hawkish hold with 3-dissenters voting for a rate hike. ECB continued with the hawkish rhetoric given the recent commentary by the ECB chief wherein she reiterated the upside risk to inflation and this was further supported by Eurozone inflation which ticked up in Jul'26 and thereby strengthened prospects of rate hike in Sep'25. On the domestic front, RBI is expected to maintain status quo and retain its stance in the upcoming policy meeting. Though, we see this could be the right opportunity for the central bank to prepare markets for a future hike. Growth and inflation forecasts will also be left unchanged. Members will also remain watchful regarding inflation, given volatility in international oil prices and weak monsoon. A clear picture on sowing will also be available by Sep'26. We estimate upside risks to inflation to prevail, even if the international oil prices come down, in the form of higher insurance cost for shipping through the Strait of Hormuz and Red Sea, and domestic food prices. Therefore, we are pricing in at least one rate hike in H2FY27.

Monsoon to be closely watched: The cumulative rainfall so far (2 Aug 2026) has been 12% below LPA. From 1st Jun to 2nd Aug 2026, 56% of subdivisions have received normal rainfall, while 33% have received deficient rainfall. The storage level for 166 reservoir as % of total capacity stands at 44% as on 30 Jul 2026 (68% last year).

Macro developments

Global financial markets showed some correction

Global equity indices seesawed as fragile truce between US-Iran with retaliatory strikes added to the ongoing uncertainty. For the month of Jul’26, Dow Jones was down by 0.2% while Nikkei declined sharply by 7.8%. Korean equity index witnessed historic sell-off as it tumbled by 22%, with deep losses noted in technology related, memory chipmaker stocks, led by concerns of over valuations. Since then, the index has marginally recovered. On the other hand, both Sensex and FTSE registered improvement for the same period.

Global currencies were trading mixed. DXY weakened by 1% in Jul’26 over 2.3% increase in Jun’26 amidst weaker macro data (US GDP registered slower growth than anticipated, weak labour market and consumer confidence). JPY rose by 1.1% amidst a recent joint intervention between US and Japan, given the currency was under pressure after BoJ’s dovish approach. INR depreciated following higher oil prices and is expected to appreciate in the near term supported by recent measures by RBI which will improve foreign capital flows.

Global bond yields hardened. US treasury yields spiked noting hawkish bias by Fed and rising crude prices.UK (+22.5bps) and Japan’s (+12.5bps) 10Y yield followed the trend with recent policy rate decision. India’s 10Y yield too inched up amidst subdued global cues and elevated crude price.

Global commodity prices accelerated as international crude prices surged by 20% and it inched closer to the US$ 90/bbl mark after declining by 31% in the previous month on the back of the escalated tensions over the West Asia conflict as the Strait of Hormuz continue to remain closed. The prices of Gold, Copper and aluminium all edged up in Jul’25 from last month.

State of the global economy

US economy rose at much slower pace of 1.5% in Q2CY26 (3.8% in Q2CY25) compared with 2.1% growth registered in Q1CY26. The weakness reflected the ramifications of the ongoing war with Iran which had resulted in surge in crude prices. This in turn pushed US gasoline prices higher and in turn resulted in additional pressure which was reflected with declining imports growth at 1.5%. Despite the moderation, the economy continue to show signs of resilience with consumer spending which contributes to two-third to the economic activity was up by 3.2% (from 0.5% in Q1) and business investment in equipment was up by 15.2% for the same period. The pickup in spending can be attributed to the bigger tax refunds, based on the new ‘one big beautiful bill’ along with the recent sporting tournament (FIFA) which could have caused a spur in spending. Additionally, strong domestic demand also pushed investment in AI even as there were some concerns pertaining to the valuations. US PCE (personal consumption expenditure) which is Fed’s preferred gauge of inflation slowed to 3.7% in Jun’26 from 4.1% in May’26 and core PCE came in at 3.3% for Jun’26. The moderation was due to recent retreat in oil prices post the fragile truce between US-Iran. Since then, the hostilities have retuned and truce has been broken. Consumer spending, adjusted for inflation rose at a same pace at 0.4% in Jun’26 as in the previous month, while personal income was up by 0.2% (0.7% in May’26). The saving rate was down to 2.7% from 2.8% in May’26. On labour front, jobless claims inched up by 9,000 to 197,000 for the week ending 25 July, with the 4-week moving average down from last week to 202,650 level (lowest since Jan’24). The unemployment rate was 4.2% in Jun’26. Next, even as households view on labour market remained weak, the consumer confidence also turned pessimistic as it slipped to 90.8 in Jun’26 from 92.2 in Jun’26, with present situation index down to 114.9 reflected some amount of caution being exercised in this period. The recent policy decision by Fed gave mixed signals to market participants given that they have decided to do away with forwards guidance. Fed had decided to hold benchmark rates at 3.5-3.75%

while 3-members (out of 12) had dissented to hike rates by 25bps. Given there are 2 monthly readings on inflation and job market, expected before the next decision, which could provide more guidance on a labour market. Analysts are now pricing in much higher likelihood of a rate hike rates, as per the CME Fedwatch. Post, the Fed decision, short end yield steepened sharply, this is generally tied to rate expectations by Fed and are more sensitive than long dated securities.

GDP growth in the **Euro Area and EU** expanded by 1% (0.5% in Q1) and 1.2% (0.8% in Q1) respectively in Q2CY26. The growth was much better than expected on the back of pick up in AI investment, higher government spending, which even offset the losses due to spike in energy prices due to the ongoing West Asia conflict. Despite concerns, labour market continue to reflect resilience with unemployment rate steady at 6.3% in Jun'26. Spain's economy continue to showcase robust growth at 0.7% for Q2CY26 , Netherlands economy rose by 0.4%, while following economies namely, Germany, France and Italy all of them expanded by 0.2% for the same period. As per the flash estimate, Euro Area is expected to inch up by 2.9% in Jul'26 from 2.8% in Jun'26. The uptick could partly be attributed to higher energy inflation. Core inflation is also expected to be higher at 2.2% in Jul'26.

In **Japan**, GDP growth forecast has been revised lower to 0.9% for FY27 from 1.3% expected back in Jan'26. This is on account of the lower household spending and corporate profits on the back of the elevated energy prices due to ongoing conflict. On the price front, inflation accelerated to 1.7% in Jun'26 from 1.5% in May'26. For Jul'26, Tokyo CPI (excluding food) rose to 1.9% in Jul'26 and core inflation (excluding food and energy) edged up by 2% for the same period. Factory output surged by 4.2% in Jun'26 after declining by 2.1% in May'26.

In China, high frequency indicator showed mixed signals. Manufacturing PMI slipped in to contraction to 49.2 (5-month low) in Jul'26 from 50.3 in Jun'26 on the back of the weakness in domestic demand partly due to typhoon related disruption. Non-manufacturing PMI also dropped down to 49 in Jul'26 after expanding to 50.2 level in the previous month. Industrial profits rose at slower pace with 15.1% growth in Jul'26 from 21.1% in May'26. For H1CY26, profits have climbed up by 18.7% against 18.8% growth for Jan-May'26 period. On inflation front, CPI eased to 1% in Jun'26 from 1.2% in May'26. Core prices also rose at the same pace while food prices continue to remain in the deflation zone as it declined by 1.6% after falling by 1.7% for the previous month. In contrast, PPI surged to 4-year high to 4.1% compared with 3.9% in May'26. Next, the focus will turn towards key policy meeting wherein measures related to stimulus based package could be shared.

Indian Economy

High frequency indicators signalling strength

Early indicators are pointing towards some resilience in economic activity in Jun'26. The same has been reflected by the surge in industrial production to a near 2-year high to 7.3% (from 5% in May'26), strong credit (18.6% from 17.7%) and deposit (13.3% from 12.2%) growth, supported by GST collections (up by 13.9%) as well as higher growth registered in vehicle registration and port cargo volume. Moreover, uptick in auto sales, especially in the PV sales segment along with improvement in electronic imports, reflected strong urban consumption demand. On the other hand, tad moderation in both manufacturing (54.2 from 55) and services (57.4 from 59.8) PMI along with slower exports growth was also noted during this period.

Monsoon advances

South West monsoon has advanced but continues to remain below normal rainfall at 13% below LPA till 31 Jul 2026 on a cumulative basis. This has resulted in lower sown area of kharif crops compared with last year. Pulses, rice and coarse cereals have registered lower acreage. Out of 36, 19 sub-divisions (57% of the country) have received normal to excess rainfall during this period, while 16 states are in the deficient zone. Region-wise, a broad based deviation has been noted across all the regions. East and North eastern India reported deficient rainfall (-30%), followed by Southern Peninsula (-23%) and North Western (-12%) while central region (4%) have reported normal rainfall. There is a clear reversal seen in rainfall after being in the deficient zone in the month of Jun'26 to being in surplus for the month of Jul'26 (1% above LPA) reflecting the deluge. Even as El Nino concerns continue to hover, revival in monsoon with better distribution could be a positive for food inflation in the near term and requires careful monitoring as we head towards the second half of the Southwest monsoon.

What has driven the rupee of late?

INR traded cautiously in Jul'26 amidst an escalation in geo-political conflict. It depreciated by only 0.8% in the month even as oil prices increased by over 20% in the month. INR found support from a weaker dollar and buoyancy in dollar inflows. FPI inflows rose to a 22-month high, driven by a pickup in equity inflows. On the other hand, RBI's measures also led to inflows of US$ 40.8bn. Reports also indicated that RBI stepped up the defence of the currency by intervening in the forex market. Uncertainty regarding the war in West Asia is likely to prevail for some time, which will keep oil prices elevated. While this makes a case for a weaker rupee, the extent of the decline will be limited by dollar inflows and RBI intervention. Overall, we expect INR to trade in the range of 95.25-95.75/$ in the near-term.

Where are yields headed

Global yields showed stickiness in Jul'26 as war situation worsened and impact was immediately seen on international oil prices which erased most of its decline seen in Jun'26. Inflationary concerns and expected tightness of monetary policy for global central banks remained in hindsight for investors. Major impact was felt in the 10Y yields of Germany and UK. For US, 10Y yield did not show much momentum as inflation is showing only modest increase. For India, the major downward correction in 10Y yield that happened in Jun'26 is remaining. The impact of increase in international oil prices in Jul'26 on yields is not yet visible. But if war situation escalates, and global yields firm up, India's 10Y yield will also not be insulated. System liquidity is also far below 1% NDTL level. Inflation outlook hinges on the progress and spatial distribution of monsoon, which can further weigh on outlook of yield, going forward. Weighing all the factors, we expect India's 10Y yield to trade in the range of 6.70-6.85% in the remaining part of Jul'26, with risks tilted to the upside. In term of India's 10Y outlook-

- India's 10Y yield is expected to remain in the range of 6.70-6.85% in the near term, with risks tilted to the upside. The trajectory of India's 10Y yield is now contingent on international oil prices. Other key upside risks to domestic yield emerge from the outlook for inflation which has also an upward bias due to deficient monsoon and moderate pace of sowing. Only coming months will tell us about the actual impact.
- Regulatory measures have attracted capital flows especially through the FAR route. Net inflows through the FAR route in Jun'26 was at US$ 2.3bn and by another US$ 0.3bn in Jul'26.

Key Data releases of the month

RBI in wait and watch mode

Globally, tensions between US and Iran have resurfaced which have once again engulfed countries in the Middle East and threat has also expanded from the Strait of Hormuz to the Red Sea. This has led to 11% increase in oil prices since the last US-Iran peace deal (17 Jun) and 21% increase in Jul'26 alone (MoM basis). Even though news reports are indicative of back-channelling of peace talks between US and Iran, fresh military strikes by both signals otherwise. On the domestic front, high frequency indicators are pointing towards slight moderation in service sector activity, while corporate performance remains steady despite surge in price pressures.

Given that RBI estimates for Q1 growth had already factored in the impact of US-Iran war on Indian economy, we expect growth to come in line with these estimates (6.6-6.8%) and gives no reason for the central bank to alter its forecasts at this stage. In case of inflation, upside risks remain with elevated global oil prices, weak monsoon at home and lower water reservoir levels. IMD also expects El Nino to move to 'very strong' category in Oct-Dec'26 period. We expect MPC members will remain watchful of the progress of the monsoon and its impact on food inflation. Given this backdrop we expect RBI to remain on hold for now and also keep the stance unchanged. However, this is also the right opportunity for the central bank to signal the markets that RBI may hike rates in future, by taking a cautious tone. We expect at least one rate hike in H2FY27 depending on the inflation trajectory.

Industrial production quickens in Jun'26

Industrial production growth scaled to a near 2-year high as registered a growth of 7.3% in Jun'26 from 2.2% growth noted in Jun'25. Compared with previous year (Jun'25), higher growth was noted primarily in manufacturing and electricity generation. Mining growth and water supply, sewage output noted deceleration. Manufacturing growth came in at 7.8%, supported by manufacture of electric equipment and motor vehicles. Within electricity, higher growth was noted under non-renewable sources (13% from -9.4% in Jun'25). On the other hand, water supply output noted moderation with 4.5% growth in Jun'26 against 7.6% growth last year for the same period. In comparison with last year, output of capital, FMCG and consumer durable goods continue to perform much better in Jun'26. The recent pause in the strikes has raised hope of de-escalation once again in the ongoing West Asia conflict which is expected to be positive for industrial sector. However, given the situation remain fluid, careful monitoring is required.

Trade deficit widens in Q1 due to higher prices:

Trade India's trade deficit widened to US$ 30.4bn in Jun'26 as imports increased. Export growth maintained momentum as well. In Q1 FY27, while merchandise exports performed well, imports also accelerated, reflecting higher commodity prices, especially oil prices. Export growth in Q1 has been broad-based with engineering, gems and jewellery and electronic exports continuing to outperform. On imports side, traction is also seen in non-oil-non-gold imports, such as electronics, machinery, fertilizers and pulses. Going ahead, with continued uncertainty on the global front, the CAD will remain under pressure. However, due to the recent measures by the RBI and government, the impact on the BoP position would not be significant. Overall, we estimate CAD at 1.8-2% of GDP in FY27. We remain watchful of the evolving war situation in the Middle East.

Wholesale inflation remains elevated

For Jun'26, headline WPI (2022-23=100) has risen to 9.9% from (-) 0.4% in Jun'25. At the same time, output PPI indicates that headline index rose by 9.6% versus (-) 0.1% last year. In the latest WPI series, all major group heads (food, fuel and manufactured products) have contributed to the elevated inflation print. Food inflation remains a major driver, with vegetables, fruits, milk, eggs and meat product all exhibiting upside pressures. Within fuel inflation, mineral oil index remains on the higher side, with index for crude petroleum, natural gas, ATF, LPG, Naphtha all rising notably. Similar trends can be noted in output PPI as well. In contrast, input PPI shows that upside pressure (MoM) was visible in only 8 of the 21 manufactured product indices (basic metals, machinery, beverages, textiles, electrical equipment, etc.). Going forward, with renewed tensions between US and Iran and possible imposition of safety tax (20%) by the US, upside risks remain for international oil prices. Oil prices in Jul'26 so far have already risen by ~19% since end-Jun and are hovering above US$ 85/bbl. This will reignite pressure on domestic inflation.

CPI crossed the 4% level

CPI inched up in Jun'26, crossing the 4% mark, bearing the impact of higher food and fuel inflation. Other than these major components of core inflation remained sticky. The upward momentum of restaurant and accommodation services may be a pass through of earlier price hike of commercial cylinder. The Jul'26 cut is expected to soften the component a tad. The fine prints of transport component shows that the increase is attributable to diesel, petrol and the CNG component which showed sequential increase of 4.9% and 4.3% and 4.4%, respectively in Jun'26. The risks of food inflation is also likely to intensify in the coming days. As per WMO update, El Nino conditions have already formed and are likely to be pronounced in the coming months. FAO has also highlighted that "El Niño risks can weaken the summer monsoon across much of India, putting rainfed crops such as rice and maize under stress during the critical growing season." Further IMD rainfall statistics have also shown that 40% of States are still in deficient rainfall. Sowing statistics is also far below compared to same period of previous year. Core was stable at 3.9%. The abridged core (Core excl. pan, tobacco, gold, silver and precious metals) is still lower at 2.2% compared to previous month's level of 2.1%. However, we believe for core as well, the risks are tilted to the upside as underlying demand conditions have been buoyant.
We expect CPI between 5-5.2% and core between 4.7-4.9% in FY27. Since the war situation has again worsened so our risks are tilted to the upside.

Central bank actions

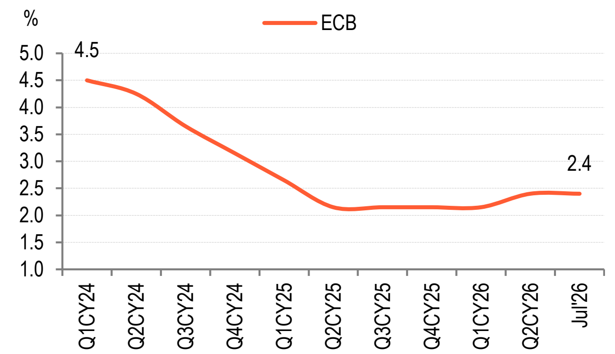
Global central banks has been following the easing cycle for the last 2-years with the exception of BoJ, which is moving out of the sub-zero rates and has been on the rate hike spree. In its last policy, **US Fed** kept policy rates unchanged at 3.5-3.75% for the 5th time in a row with 9-3 vote in favour. The dissent by 3-members, reflected internal divide that has actually raised expectation of rate hike in the upcoming meeting scheduled in Sep'26 as per analysts. However, there was no clear signal provided in the commentary by the Fed Chair Warsh wherein he stated the rate decision should be seen as the 'review of economic situation' rather than reading it just as pause.

Bank of England (BoE) maintained status quo with rates at 3.75% with a split vote of 6-3. Analysts have pared back rate hike expectations based on the dovish signals by the BoE Governor. He raised concerns around the uncertainty over the US-Iran conflict which could adversely impact inflation. He stated the 'overall assessment on second-round effects remains tentative' which is likely if the conflict persists for a long term. He noted that the CPI print is encouraging as it remains below their expectation. As per the projection, BoE expects inflation to peak 3.2% level by Q4CY26 before slipping down to 1.7% in Q1CY28. On growth, GDP is expected at 1.1% in both Q2 and Q3CY27 and surge to 1.7% in Q3CY28.

After hiking rates by 25bps in the last policy meeting, the **Bank of Japan (BoJ)** kept interest rate steady at 1% mark but gave hawkish signals regarding underlying risk to inflation. The decision came with 8-1 vote in favour of a hold, even as it warned of core inflation accelerating above the 2% mark in the H2FY26. Governor Ueda warned that the risk of inflation overshooting the target is 'too big to ignore'. The bank revised its headline inflation projection, excluding fresh food to 2.3-2.7% from 2.8-3% earlier. It has also revised core inflation forecast to 2.5% from 2.6% earlier.

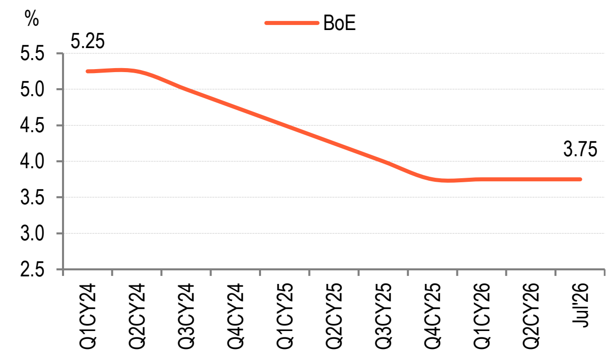
In line with expectations, **ECB** also kept rates on hold. One of the factors responsible for status quo this time was the disappearance of second-round effects due to energy spike as was initially anticipated. Despite holding rates, ECB kept the room open for a possible rate hike in the next meeting, given hawkish comments by ECB chief. Analysts are pricing in 3 imminent hikes by the end of Q1CY27. Moreover, the recent uptick in headline inflation at 2.9% from 2.8% as well as acceleration in both core (2.5% from 2.4%) and service inflation (3.3%) has also strengthened case for a rate hike.

Figure 1: Rate movement by ECB



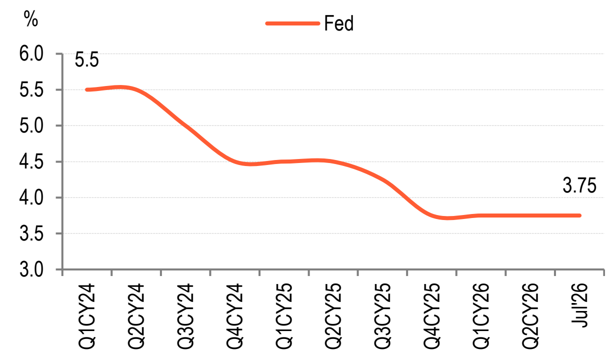
Source: Bloomberg, Bank of Baroda Research

Figure 2: BoE-rate action



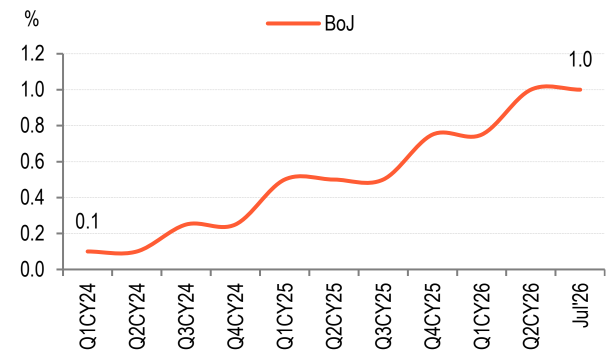
Source: Bloomberg, Bank of Baroda Research

Figure 3: Fed-rate trajectory



Source: Bloomberg, Bank of Baroda Research

Figure 4: BoJ- Rate movement over the years



Source: Bloomberg, Bank of Baroda Research

Thematic studies of the month (For more reports refer to https://bankofbaroda.bank.in/economic-scenario)

India-UK FTA

The historic India-UK Comprehensive Economic and Trade Agreement (CETA) came into force on 15 Jul 2026. The comprehensive agreement, which was signed roughly a year ago, covers both goods and services trade between India and UK. As per the terms of the agreement, around 99% of India's exports to the UK will now attract 0% tariff, providing a huge boost to exports. At the same time, India has also pledged to reduce tariffs on 90% tariff lines for UK's exports. The agreement is expected to boost bilateral ties between the two countries and provide a huge impetus to trade.

The major conclusions are:

1. India UK CETA is a positive step toward strengthening India's external position in the World and promoting exports. UK represents a US$ 900bn market, out of which only about US$ 14bn is supplied by India. Hence, the export potential is huge. Elimination on tariffs particularly for labour intensive sectors such as textiles and leather, will increase the competitiveness of Indian exports, benefitting MSMEs and women entrepreneurs. Further, India's agricultural exports such as rice, spices and marine products would also enjoy tariff free access in UK's market, offering a significant cost advantage. At the same time, manufacturing exports such as electronics, drugs and pharmaceuticals and gems and jewellery too will benefit from the preferential tariff rate.

2. On imports, the government has adopted a cautious approach. Sensitive sectors such as dairy and agriculture have been excluded, while phased reduction in tariffs has been offered on other items such as silver, alcohol and automobiles. We expect the total trade between India and UK to increase to US$ 41bn in the next 5 years from US$ 25bn in FY26. While India's exports to the UK are expected to register a CAGR of 12.5%, imports from the UK are estimated to increase at a CAGR of 7.3%. Hence, India's trade surplus with the UK is expected to increase to US$ 7.5bn by FY31 from US$ 1.7bn at present.

How spread dynamics of entities evolved in FYTD27

The spreads on bonds for PSU FIs& Banks (PFBs), NBFCs and Corporates indicate how the risk premium has evolved over time. These spreads are benchmarked to the risk-free GSec. Besides the movement in these yields, business environment at both the macro and micro levels hold the cue for the direction of spreads. Under the current scenario, the outlook of India's 10Y yield remains uncertain and depends on the evolving global conditions relating to war, liquidity conditions, inflation, and government borrowing among other factors. RBI's current rate cycle is likely to be cautious even if there is no rate hike. Hence, we believe that there remains upside risks to India's 10Y yield. In that case, coupled with uncertain macro conditions the risk premium for different entities is also likely to be higher and have a bearing on these bond spreads.

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