SPECIAL UPDATE
Monetary Policy

Union Mutual Fund

Jun 06, 2026

Union Mutual Fund - Registration No. MF/066/11/01

Monetary Measures

- Monetary Policy Committee (MPC) voted unanimously to keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 5.25 per cent.
- Consequently, the Standing Deposit Facility (SDF) rate remains at 5.00 per cent and the Marginal Standing Facility (MSF) rate and the Bank Rate remains at 5.50 per cent.
- The MPC also decided to continue with the neutral stance.

Analysis & Outlook

- **Inflation:** Since May 2026, however, retail fuel prices have been raised cumulatively by 7.4 per cent for petrol and 8.4 per cent for diesel. The increase implies a direct impact of about 36 basis points on headline inflation, which, along with second order effects, would get reflected in CPI inflation in the coming months. Pass-through of higher global energy prices are also visible in several other inputs such as commercial LPG, industrial raw materials, chemicals, rubber and plastic products. The second-round impact of higher input costs could exert upside pressure on CPI inflation going forward. Considering all these factors, CPI inflation for 2026-27 is projected to be 5.1 per cent with Q1 at 4.2 per cent; Q2 at 5.1 per cent; Q3 at 5.9 per cent; and Q4 at 5.4 per cent. Core inflation is projected at 4.7 per cent for 2026-27. Excluding precious metals, core inflation is projected to be lower, suggesting that demand pressures remain contained. These forecasts are subject to upside risks due to global supply chain disruptions and uncertainty about the spatial and temporal distribution of monsoon.

- **Growth:** As per several high frequency indicators, domestic economic activity remained largely steady since the outbreak of the conflict. Private consumption has been resilient, while fixed investment maintained its momentum despite cost pressures. Merchandise exports recorded strong growth in April 2026, though elevated freight and insurance costs remain a drag. Services exports continued to be robust. While the economy has withstood the conflict spillovers with limited impact so far; the strains are increasingly becoming visible. Looking ahead, elevated energy and other commodity prices coupled with continued supply disruptions are likely to affect economic activity. While import diversification in affected commodities has helped in improving supply, it comes at a higher cost. The full impact, however, will depend on the duration of the conflict, time taken for normalisation of supply chains and the burden-sharing approach among the stakeholders. The south-west monsoon is expected to be deficient, with implications for agricultural activity and rural demand. However, the programmes and initiatives for crop diversification, water harvesting and conservation, climate-resilient practices and short-duration crops, among others, are expected to mitigate the impact. Furthermore, sustained momentum in services, continuing impact of GST rationalisation, and broadly stable employment conditions should continue to support urban consumption. Strong capacity utilisation, sustained credit flows from bank and non-bank sources, and the government's capex are expected to support investment activity. While weak global demand and elevated freight and insurance costs are headwinds for merchandise exports, services exports are expected to remain steady. Taking all these factors into consideration, real GDP growth for 2026-27 is projected at 6.6 per cent, with Q1 at 6.6 per cent; Q2 at 6.3 per cent; Q3 at 6.5 per cent; and Q4 at 6.8 per cent

- Liquidity: The Reserve Bank would ensure appropriate liquidity in the banking system to meet the productive requirements of the economy and facilitate monetary policy transmission.

- Yields in the across gsec tenor fell by around 5 bps from yesterday's close at the time of writing.

Position of Funds

Duration funds:

- The absolute yield levels are attractive from a medium to long-term investment horizon. Therefore, it represents a good opportunity for investors to invest in fixed income duration funds with a medium to long-term horizon.
- However geopolitical risks remain key risks. Markets may remain volatile in the near term.

Money market funds:

- The yields at the shorter end of the curve will move in tandem with the liquidity in the system. The short-end rates are expected to be anchored around the repo rate.