

India's Economic Momentum Remains Resilient, with Policy Support Mitigating External Headwinds



- Amid trade uncertainties, the global economy has shown resilience, supported by trade diversification, bilateral agreements, and domestic policy measures in major economies.
- The IMF raised its 2025 global growth forecast by 20-bps to 3.2% YoY, with advanced economies projected to grow by 1.6% and emerging market & developing economies by 4.2%, reflecting notable upward revisions for the US, Euro Area, Japan, and India.
- India's economic momentum remains broadly resilient despite increased external headwinds, with domestic reforms and policy support continuing to cushion the economy from external shocks. We maintain India's FY26 real GDP growth projection at 6.8% YoY.
- Following stronger-than-expected Q1 growth, high-frequency indicators for Q2 suggest that economic momentum has largely been sustained, albeit with some sectoral unevenness.
- In Q2, industrial activity picked up, and agriculture maintained a healthy pace, although with some moderation, while services-sector indicators were mixed.
- Domestic demand indicators showed improvement, led by rural demand, while urban demand displayed a tentative yet uneven recovery. Early Q3 data indicate strong momentum during the festive season.
- The government continues to front-load CAPEX, though the pace of spending has moderated as expected. Meanwhile, there are tentative signs of a pickup in private investment, but activity remains concentrated in select industries.
- India's merchandise trade came under pressure in September as the full impact of the US's 50% tariff became evident. Ongoing export diversification efforts have helped cushion the impact.
- While downside risks from the US tariff persist, there are encouraging signs of progress in trade negotiations. Media reports suggest that India and the US are moving toward a potential interim agreement that could reduce US tariffs from 50% to around 15%–16%.
- The inflation outlook remains favourable. Headline CPI inflation eased to an eight-year low of ~1.5% in September 2025, driven by deflation in food & beverages and a favourable base effect. Inflation is expected to dip further in October (to ~0.5%) as GST rate cuts take effect.
- The ongoing disinflationary trend, reinforced by GST cuts, has widened the scope for further monetary easing. The US Federal Reserve's 25-bps rate cut, along with guidance for two additional cuts in 2025, further enhances the RBI's policy flexibility to support domestic growth.
- At present, we expect the RBI to deliver a 25-bps repo rate cut in December, though the timing could be influenced by macro developments and progress on US–India trade negotiations.

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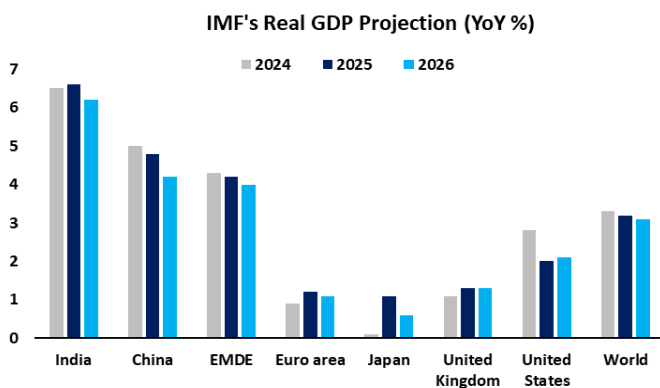
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Amid Continued Trade Uncertainties, the Global Economy Showed Resilience

As economies worldwide continue to adjust to US-led changes in the global trade system, the global economy has thus far demonstrated resilience. This has been supported by swift trade adjustments, including quick bilateral deals between the US and key trading partners, front-loading of shipments, and diversification of trade routes and suppliers, as well as rising domestic policy support in major economies.

IMF Raises Global Growth Projection for 2025



Source: IMF World Economic Outlook (WEO) October 2025 Update;
Note: For India, data and forecasts are presented on a fiscal year basis. EMDE refers to Emerging Market and Developing Economies.

Compared to its projection in the July report, the IMF has recently revised its global growth forecast for 2025 upward by 20-bps to 3.2%, while keeping the 2026 projection unchanged at 3.1%, compared to an estimated 3.3% in 2024. The upward revision for growth in 2025 reflects broad-based resilience, with growth projection for advanced economies raised by 10-bps to 1.6% and for emerging market and developing economies by a similar margin to 4.2%. Notable upward revisions were seen for the US, Japan, Euro Area, and India, reflecting trade adaptation and domestic policy support.

Macroeconomic policy around the world is likely to remain supportive of continued economic expansion in the period ahead. Following considerable monetary tightening in response to the post-COVID inflation surge, monetary policy continues to gradually shift from restrictive to neutral or accommodative in many of the world's largest economies. At the same time, fiscal policy is also poised to become looser in many of those same large economies. These policy shifts will help to underpin continued expansion in 2026.

The most important policy supports are coming from the world's two largest economies – China and the United States. While macro policy is not uber pro-growth as it has been in select points in the past 15 years (China post global financial crisis; US post Covid), both monetary and fiscal policy will be lending support in the year ahead. As present,

US policy support is poised to be larger and more broad-based; China's support will be more targeted.

The bulk of China's direct policy support is coming from the fiscal side. Government investment has been central to the speed at which China has become the dominant or one of the dominant producers of electric vehicles, other clean energy goods, biotechnology, and AI. Significant state support for these sectors will continue. Government support for households has been modest to date and given that the labour market is softer than that suggested by official statistics, additional policy support will be forthcoming. Such support is likely to take three possible forms: (i) income transfers to directly raise households' share of national income; (ii) an enhanced social safety net to alleviate savings pressure; and (iii) stronger job creation, be it via public-sector hiring or support for private hiring. Historical policy choices suggest that officials – likely when the next Five-Year Plan is released in March – will opt for measures intended to spur faster job creation.

Monetary policy is also helping to provide support through various channels. Directly, the PBOC has lowered the banking system's reserve requirements ratio (RRR) in recent years. Separately, the PBOC's currency management approach amidst generalized US Dollar weakness is resulting in a cheapening CNY against most currency pairs, boosting the attractiveness of China's exports. Indeed, China's total exports are at a record high despite the decline in US-China trade.

In the US, the Federal Reserve is poised to lower interest rates by another 25-bps in October, reducing the US central bank's policy rate to 3¼% – 4%. Odds are very high that officials will reduce the policy rate again in December, lowering the rate corridor to 3½% – 3¾%. Fed easing has helped to reduce benchmark bond yields and – importantly – private sector bond yield spreads and rates. Lending standards are also loosening, especially for corporate borrowers.

On the fiscal side, President Trump's so-called One Big Beautiful Bill that became law this summer has multiple disposable income boosting tax provisions that are retroactive to the start of calendar year 2025, but that households will not see the effect of until H1-2026. This is a by-product of two phenomena. First, nearly all employers adjust the amount of taxes withheld from employee pay checks only once a year, so some of the after-tax benefits from this summer's fiscal package won't appear in pay checks until early 2026. Second, many households are going to receive significant tax refunds for 2025 when they file their tax returns in March/April 2026. Moreover, the households that are poised to receive the largest (as a percentage of their income) refunds tend to have a

propensity to consume at or close to 1.0. The dollar value of these boosts to disposable income will total between three quarters and a full percentage point of GDP.

Solid, yet unspectacular, growth from China and the US will produce benefits for the global economy. Even with US President Trump's tariff regime, the US consumer remains an important driver of economic growth for many countries. And while import penetration to China remains modest, a solid Chinese economy has positive spillover into many countries in the region.

India: Economic Momentum Resilient in September and Early October, Despite Increased External Headwinds

India's macroeconomic outlook for FY26 remains broadly resilient despite increased external headwinds. Domestic reforms and policy support continue to cushion the economy against external shocks. Lower inflation has created space for monetary policy to focus on reviving domestic demand.

Following a stronger-than-expected economic growth in Q1, high-frequency economic indicators for Q2 suggest that momentum has picked up, albeit with some sectoral unevenness. Looking ahead, real GDP growth is expected to moderate in H2-FY26 as the favourable deflator impact wanes, government spending normalises, and US tariffs weigh on exports. However, economic growth drivers are likely to shift from public expenditure toward private consumption, complemented by a gradual revival in private capex during H2, helped by GST and income tax cuts as well as pass-through of monetary policy rate cuts. We maintain our growth forecast for India's FY26 real GDP at ~ 6.8%.

The key near-term policy challenge lies in sustaining the anticipated recovery in private consumption, which will be crucial for enabling a more balanced and durable upturn in FY27. If this momentum holds, the growth base could broaden, supporting a more stable and robust medium-term trajectory.

Navigating evolving trade frictions with the US remains an important external risk. We remain cautiously optimistic that an interim US-India trade deal could materialise by Q4-FY26, facilitating a partial rollback of US tariffs and paving the way for negotiations toward a Comprehensive Bilateral Trade Agreement (BTA). India's response, especially if sustained, to US sanctions on Russian oil conglomerates is likely a helpful development on this front.

On the monetary front, with inflation staying benign, the RBI has indicated policy space to further support growth. While the Monetary Policy Committee (MPC) maintained a pause in its October meeting to assess the impact of earlier rate cuts, GST rate reductions, and global trade uncertainties, we believe that an additional policy rate cut could play a vital role in reinforcing domestic demand recovery. This would

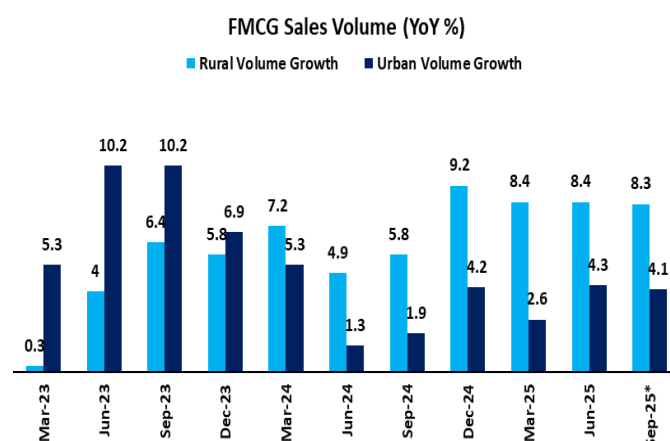
help ensure that the ongoing upturn becomes not only stronger but also more sustainable amid a still challenging global backdrop.

Consumer Demand Indicators Showed Signs of Improvement in Q2 FY26

In Q2 FY26, domestic demand indicators showed signs of improvement, with rural demand continuing to lead while urban demand displayed tentative yet uneven recovery. High-frequency indicators for rural activity strengthened through the quarter. Tractor sales surged by over a three-year high of 43% YoY in September, taking Q2-FY26 growth to 28% YoY (up from 8.7% in Q1). Two-wheeler registrations also rose to a four-month high of 6.8% YoY in September (vs 2.6% in August), supported by healthy agricultural activity and rising rural wage growth.

Urban demand also showed tentative recovery. Passenger vehicle registrations (a key proxy for urban consumption) rose by 6.2% YoY in Q2, compared to 4.4% in Q1, partly buoyed by accelerated purchases in late September following the GST rate cuts. However, some moderation was visible in other urban indicators such as domestic air passenger traffic and the banking industry's retail credit growth during July-August, relative to Q1-FY26.

Rural Demand Continues to Lead Consumption Recovery



Source: Nielsen IQ, Media Articles, RBI's Governor Statement. Note: * data is based on Jul-Aug from the RBI's Governor's Statement in the October MPC.

This divergence between rural and urban demand was also evident in early FMCG sector trends. According to NielsenIQ (Jul-Aug) data, FMCG rural sales volumes continued to grow at nearly twice the pace of their urban counterparts, although both segments showed resilience. There are also early indications of a strong festive season demand pickup, suggesting continued momentum into Q3.

GST Cuts Showing Positive Impact on Consumption Demand

The optimism around consumption demand is supported by early festive season estimates. According to data from the Confederation of All India Traders (CAIT), Diwali sales this year reached a record ₹5.4 lakh crore in goods, up 25% YoY, with services-related sales registering an additional ₹65,000 crore, aided by festival demand and GST rate cuts.

Further, positive consumer sentiment is reflected in the RBI's Urban Consumer Confidence Survey, where net responses on discretionary spending improved from the previous round and remained positive for the second consecutive survey round, which is the first such instance since 2019.

Overall, the outlook for Q3-FY26 appears favourable, with the GST cut providing a much-needed boost to consumption, particularly in urban segments, alongside the impact of earlier income tax reductions, lower inflation (supporting disposable incomes), expectation of healthy kharif output and buoyant rabi prospects, and the continued pass-through of monetary easing.

Labour Market Indicators Show Mixed Trends in September but FYTD Improvement

After notable improvement in the previous month, labour market indicators presented mixed signals in September, though FYTD trends remain stronger than last year. As per the CMIE data, the average unemployment rate eased to ~6.9% in FY26 (till September) from ~8% a year ago. In September, India's overall unemployment rate inched up slightly to 6.4% (vs 6.3% in August). Rural unemployment declined sharply from 6.3% in August to 5.2% in September, despite a seasonal fall in agriculture-related jobs, indicating a pickup in non-farm activity and jobs. In contrast, urban unemployment rose from 6.4% to 8.6%, due to a decline in lower-quality employment, even as salaried job creation remained strong.

Formal sector hiring trends stayed positive. The Naukri JobSpeak Index increased by 10.1% YoY in September, marking its sixth consecutive month of expansion. The recent GST cuts and festive demand are likely to support hiring in domestically oriented industries in the near term. However, potential job losses in export-dependent sectors, notably textiles, gems and jewellery, and leather, remain a concern until the US-India trade deal materialises.

Overall, ongoing policy support should continue to underpin the recovery in private consumption, though a more sustained revival beyond policy-driven measures will hinge on continued improvements in labour market conditions and salary/wage growth.

Support from Government Spending Expected to Taper Ahead

The government continues to front-load its capital expenditure (CAPEX), though the pace of spending has begun to moderate as anticipated. At the same time, there are tentative signs of a pickup in private investment, though activity remains concentrated in select sectors.

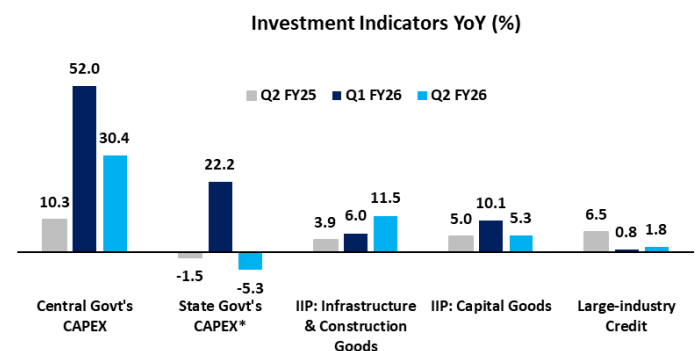
After a sharp rise in Q1-FY26, driven by front-loaded spending and a favourable base, the Centre's capital expenditure growth moderated in Q2 (Jul–Aug) to 30.4% YoY, compared with 52% in Q1, while states' CAPEX contracted during the same period. On an FYTD basis (till August), central government CAPEX rose 43.4%, against a full-year budget estimate of 6.6%. The implied CAPEX growth required during Sep–Mar to meet the FY26 target stands at -8.2%, suggesting that slower central government investment could weigh on economic growth momentum going forward.

This concern is compounded by weak revenue trends. The Centre's non-debt receipts grew only 5.4% during April–August, well below the full-year target of 13.6%, reflecting softer income tax collections and moderation in GST and customs revenues. With GST rate cuts likely to impact indirect tax collections further in H2, the central government may need to rationalise expenditure to remain aligned with the budget deficit target of 4.4% of GDP.

Private Sector Investment Momentum Showing Early Signs of Improvement

On a positive note, several high-frequency indicators, including capacity utilisation, infrastructure and construction goods output, and large industrial credit growth point to an improving private sector investment activity.

Tentative Signs of Pick-up in Private Investment, Even as Government's CAPEX Pace Slows



Source: CMIE; Note: The data for Q2-FY26 is based on Jul-Aug, except for IIP related indicators which are for July-Sept. * The State Govts' CAPEX is based on data of 18 states.

At the aggregate level, capacity utilisation (CU) in the manufacturing sector remains above its long-term average, even though it declined to 74.1% in Q1-FY26 from 77.7% in

the previous quarter (the highest in over a decade), reflecting the typical seasonal pattern. However, on a seasonally adjusted basis, CU rose 30-bps QoQ to 75.8% in Q1-FY26, which bodes well for the private investment outlook.

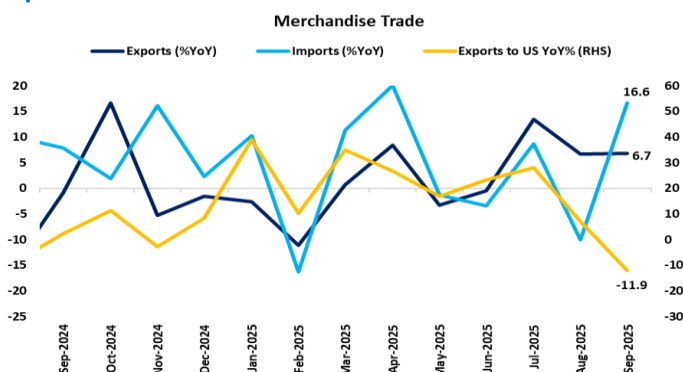
Further, the private sector's new investment project announcements (a key forward-looking indicator) increased by 60% YoY in H1-FY26, compared with a 26.4% contraction in the same period last year, signalling a tentative improvement in private investment sentiment, as per the CMIE data. This is encouraging, especially as government CAPEX momentum is expected to moderate in H2 following substantial front-loading in H1-FY26, and that stronger private investment spending has been a missing component of economic expansion. That said, new project announcements (for public and private sectors combined) remain highly concentrated, with five industries—metals and metal products, electricity, chemicals and chemical products, transport services, and machinery—accounting for nearly 79% of the total value of new projects announced in H1-FY26.

Looking ahead, we expect investment in domestically oriented industries to witness a gradual recovery in H2-FY26, while export-oriented sectors are likely to adopt a wait-and-watch approach until progress is made toward a US–India trade agreement.

Exports Growth Steady Even as Exports to the US Slump

India's merchandise trade came under pressure in September as the full impact of the 50% US tariff (implemented on 27th August) became evident. Exports to the US contracted by ~12% YoY in September, after growing 20.3% YoY during FY26 till August. Sequentially, the decline was sharper, with shipments to the US falling 20.4% MoM to ~US\$5.5 billion in September.

Exports to the US Fell Sharply Following the 50% Tariff Implementation



Source: CMIE

Despite the sharp fall in exports to the US, India's overall exports displayed resilience, rising ~6.7% YoY in

September, broadly maintaining the growth pace of the previous month. This likely reflects diversification of export markets, with gains recorded in shipments to the UAE, China, Hong Kong, Bangladesh, and Saudi Arabia.

Export growth was primarily driven by petroleum products (up 15.2% YoY), while non-oil export growth moderated to a three-month low of 5.5%. Within non-oil exports, the slowdown was relatively pronounced in textiles, leather products, and ceramics & glassware, underscoring the adverse effects of the US tariff shock. Electronics exports (exempt from US tariff) maintained robust momentum, rising by 50.5% YoY in September (41.9% FTYD).

In late September, the US administration announced a 100% tariff on imports of branded or patented pharmaceutical products, effective 1st October, unless the exporting company establishes a manufacturing facility in the U.S. While the US is India's largest pharma export market, the majority of these exports consist of generic drugs, which are currently excluded from the announced tariff. Additionally, large Indian pharmaceutical players already maintain manufacturing facilities in the US, mitigating the immediate impact of the tariff.

On the import side, India's imports rose sharply by 16.6% YoY in September, led by strong increases in gold (up 106.9%) and silver (up 139%) imports, reflecting festive demand as well as elevated prices. Fertiliser imports surged 202% YoY, while non-oil, non-gold & silver imports also recorded double-digit growth of 12.7%, partly due to a favourable base. As a result, the trade deficit widened to a 13-month high of US\$32.1 billion in September.

The services trade surplus remained steady at US\$15.5 billion in September (vs US\$ 15.6 billion in August). On a fiscal year-to-date basis, services exports have grown 6.1%, while imports have remained broadly flat, helping sustain an overall services trade balance.

While downside risks from the US tariff may persist, there are encouraging signs of progress in trade negotiations. Media reports indicate that India and the US are moving towards a potential interim agreement that could reduce tariffs from 50% to around 15%–16%, possibly including provisions on India's crude oil imports from Russia.

During FY26 to date (Apr–Aug), India sourced roughly 33% of its crude oil imports from Russia, at an average discount of about US\$ 3/bbl, compared with ~US\$ 10/bbl in FY2023. Given narrowing discounts, the impact of any reduced reliance on imports of Russian crude oil is likely to have a limited impact on India's current account deficit. However, any realignment in sourcing could temporarily tighten global oil supply and exert upward pressure on prices – fortunately, however, key oil-producing countries have shown a

willingness to maintain crude prices near current levels, which could limit the degree of upward price pressure.

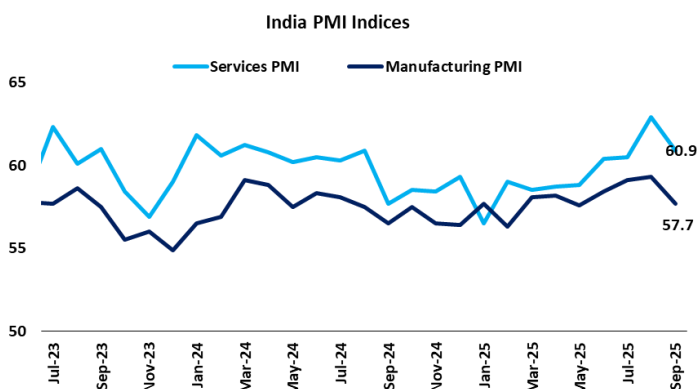
The recent US administration announcement of sanctions on Russia's major oil exporting companies led to a rise in Brent crude oil prices by 7.6% to USD 65.94/per barrel last week. Despite the uptick, Brent oil prices averaged ~USD 67/per barrel, ~14% lower in FYTD (till 24th October) compared to the average of FY25. The rise was capped by a favourable supply situation (IEA projects supply glut in 2026), aided by the rising OPEC output (and indication of further increase if needed) and potential increased supply from other producers such as the U.S., Canada, Brazil and Guyana.

Industrial Activity Picked up in Q2, Services Indicators Showed a Mixed Picture, while Agriculture Prospects Remain Favourable

From the production side, high-frequency indicators suggest a broad-based improvement in Q2 compared with the previous quarter. The Index of Industrial Production (IIP) expanded 4.0% YoY in September, almost similar to 4.1% in August. In Q2, IIP growth stood at 4.1%, more than double the 2.0% growth recorded in Q1-FY26.

This improvement was driven by manufacturing, electricity, and mining, with growth particularly led by infrastructure and construction goods, supported by government capex and early signs of private investment revival. The consumer durables segment also showed improvement, pointing to a gradual recovery in demand, while non-durables continued to contract.

PMIs Indicate Robust Momentum in Manufacturing and Services Despite Slight Moderation



Source: CMIE

The manufacturing PMI for September remained robust at 57.7, easing slightly from August's historic highs but staying well above its long-term average, signalling continued resilience. Going forward, GST rate cuts are expected to further support industrial activity. Although tariff-related uncertainty poses a downside risk for export-oriented industries, the improving outlook for trade negotiations could provide a meaningful tailwind.

The services sector presented a mixed picture in Q2-FY26. The Services PMI indicated strong expansion, supported by healthy demand that drove growth in new orders, exports, and business activity. Port cargo traffic also rose sharply, up 11.5% YoY in September, a six-month high, taking average growth to 6.0% in Q2 (vs 5.6% in Q1).

However, some indicators, such as domestic air passenger, air cargo traffic, and services exports, showed signs of moderation. Despite this, the overall outlook for services remains positive, buoyed by urban consumption recovery and the festive season demand. This optimism is further supported by the RBI's forward-looking surveys, which indicate that companies remain upbeat about business conditions.

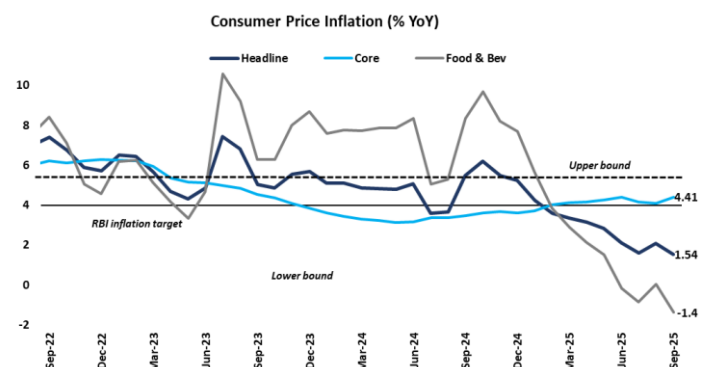
Meanwhile, agricultural activity maintained a healthy pace despite some moderation. The rainfall during the southwest monsoon season ended around 8% above the long-period average, supporting a favourable Kharif outcome. The area under cultivation rose by 0.6% YoY during the Kharif sowing season, though growth was partly weighed down by lower acreage under oilseeds and cotton. In contrast, the area under sugarcane and maize rose to a record high. Looking ahead, Rabi crop prospects remain bright, supported by the government's MSP hikes of 4%–10% for the 2026–27 marketing season and reservoir levels at ~91% of full capacity (as on 16th Oct).

Inflation Outlook Remains Favourable

The inflation outlook remains favourable, aided by recent GST rate cuts, which are expected to contribute to a softer inflation trajectory and expand the RBI's policy space.

Headline CPI inflation eased sharply to 1.5% in September 2025, the lowest in over eight years, driven by a deflation in food & beverages prices and a favourable base effect. This marks the second instance in FY26 where CPI headline inflation has fallen below the RBI's lower tolerance band of 2%–6%.

CPI Headline Inflation Falls to an Eight-Year Low



Source: CMIE

The food and beverages category slipped back into deflation (-1.4% YoY) in September after a flat reading in August, marking three deflationary months out of six so far in FY26. Nine of twelve food subcategories recorded lower inflation, led by deeper deflation in vegetable and pulses prices.

Meanwhile, core inflation edged up slightly to 4.4% (from 4.1% in August), driven primarily by higher inflation in personal care and effects (reflecting elevated gold and silver prices) and an increase in the housing component. Excluding gold, core inflation remained subdued at 3.3% (vs 3.1% in August).

So far in FY26, CPI inflation has averaged 2.2%, with Q2-FY26 inflation at 1.74%, broadly in line with both our and the RBI's projection of 1.8% for the quarter. Looking ahead, we expect inflation to dip further in October (to around 0.5%) as the impact of the GST rate cuts filters through and given a favourable base effect, before rising gradually thereafter. We maintain the FY26 CPI inflation projection at 2.5%, which gives the central bank policy flexibility to cut the policy rate.

Favourable Inflation Trajectory Expands Scope for Additional Monetary Easing

The ongoing disinflationary trend, reinforced by the recent GST rate cuts, has widened the scope for further monetary easing. The US Federal Reserve's 25-bps rate cut, along with guidance for two additional cuts in 2025, further enhances the RBI's policy flexibility to support domestic growth.

Following its front-loaded rate cut in June, the RBI's MPC kept the repo rate unchanged at 5.5% and maintained a neutral stance in both August and October meetings. The RBI's October policy statement conveyed a dovish pause, reflecting greater policy space amid a more benign inflation outlook. The RBI revised its FY26 CPI inflation forecast down to 2.6% (from 3.1%), while upgrading its economic growth projection to 6.8% (from 6.5%), citing stronger H1-FY26 momentum even as H2 estimates were trimmed.

Despite lower inflation and expectations of softer economic growth in H2, the MPC chose to stay on hold to evaluate the impact of earlier rate cuts, assess the pass-through from GST reductions, and monitor external trade uncertainties. Compared with the previous meeting, policy communication carried a markedly dovish tone, highlighting subdued inflation, downside risks to growth, and an explicit acknowledgement of expanded policy space (with the earlier reference to "limited space" dropped). These developments keep the door open for additional easing during the remainder of FY26.

We believe the December policy meeting could provide an opportune window for a rate cut, contingent on clearer evidence of GST-led festive demand recovery and progress

on the US-India trade negotiations. Additional monetary easing could help consolidate the transition in growth drivers from a public-sector-led recovery to one increasingly anchored by private consumption and private investment.

Additionally, the RBI and the government may also introduce targeted support measures for sectors adversely affected by US tariffs, potentially drawing on elements of the COVID-era toolkit such as regulatory forbearance, enhanced guarantees, and liquidity support, through coordinated fiscal-monetary action.

Meanwhile, the RBI has announced a set of structural and regulatory measures to strengthen the banking sector's resilience and competitiveness, enhance the ease of doing business, improve credit flow, simplify foreign exchange management, enhance consumer protection, and advance rupee internationalisation (see [RBI Policy Review Report](#) for details).

RBI's Revised Liquidity Management Framework

In late September, the RBI announced a revised liquidity management framework. Under this framework, the overnight Weighted Average Call Rate (WACR) will continue to serve as the operating target of monetary policy, while the RBI will also monitor other overnight money market segments to ensure the orderly evolution of rates.

As anticipated, the RBI has discontinued the 14-day VRR/VRRR operations as the main tool for short-term liquidity management. Going forward, short-term liquidity will be managed primarily through 7-day VRR/VRRR operations, supplemented by variable-rate operations with tenors ranging from overnight to 14 days, enabling banks to manage liquidity more efficiently.

On liquidity conditions, systemic liquidity declined from an average surplus of Rs 2.9 lakh crore in August to Rs 1.5 lakh crore in September, briefly turning deficit for a few days—the first instance in FY26. This was largely driven by advance tax outflows, the RBI's forex interventions, and seasonal currency demand ahead of festivals. Liquidity subsequently returned to surplus by late September and early October, supported by the second 25-bps tranche of the 100-bps CRR cut (effective 4th October), the RBI's VRR auctions and the Government's spending. However, the system liquidity tightened again, from a surplus of ~Rs 1.6 lakh crore in the first half of October to a deficit of Rs 0.9 lakh crore in the week of 20th October, reflecting the RBI's forex interventions, higher currency in circulation, and GST outflows.

Despite this volatility, the WACR eased from an average of ~5.41% in September to ~5.37% (till 24th October), though it did rise above the policy repo rate in recent sessions amid temporary liquidity deficits. In the near term, liquidity may

face pressures from festive demand, state elections, and the RBI's FX operations, though conditions should improve with the government's month-end spending and the implementation of the third 25-bps tranche of the 100-bps CRR cut on 1st November. The RBI may also supplement this with liquidity injections through VRR operations or USD/INR buy-sell swaps if required.

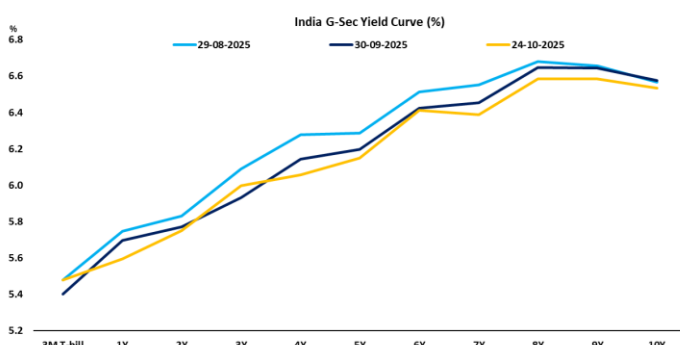
Market Update

Bond Market: After rising in August, the G-Sec yields eased in September, but the curve remained steepened, as yields at the shorter end and belly of the curve declined, while the 10-year benchmark yield ended the month at a nearly unchanged level (~6.58%) compared with August-end level, amid volatility. The spread between the 10-year and 2-year G-Sec widened from 73.6-bps at the end of August to 80.5-bps by the end of September.

In October, yields declined across most of the G-Sec curve, supported by lower inflation prints, slightly lower planned H2-FY26 central government borrowings, and dovish signals from the RBI in its policy meeting. By mid-October, the 10-year G-Sec yield had fallen to ~6.48%, roughly 10-bps below September-end levels. Subsequently, the 10-year G-Sec yield rose to 6.53% by 24th October following media reports of a potential US-India trade deal, which weighed on expectations of the RBI's future rate cut. The 10-year/2-year G-Sec spread narrowed slightly to 78.3-bps by 24th October.

Looking ahead, expectations of the RBI's policy actions and developments around the US-India trade negotiations are likely to be the key drivers of near-term bond market movements.

G-Sec Yields Eased from August Levels, but the Curve Remains Steepened



Source: Bloomberg

Equity Market: The equity market started September on a strong note, buoyed by the announcement of GST rationalisation and expectations of a US Fed rate cut. However, momentum slowed in the second half of the month following announcements by the US administration, including the H1B visa fee hike and the imposition of a 100% tariff on branded/patented pharmaceutical imports, which

weighed on the Nifty IT and Nifty Pharma, leading to these sectoral indices declining by 4.3% MoM and 1.6% MoM, respectively. Despite these headwinds, the Nifty50 Index posted gains of 0.75% MoM, reversing the 1.38% decline in August. FIIs remained net sellers for the third consecutive month, amid global uncertainties and tariff concerns, while DIIs continued to provide support.

The index rebounded strongly in October, gaining approximately 4.8% as of 24th October relative to the previous month's close. Gains were supported by the RBI's dovish guidance, regulatory measures aimed at strengthening banking sector resilience and improving credit flow, and expectations of a potential US-India trade deal. In October, FIIs turned net buyers, driven by positive signals on US-India trade negotiations.

Looking ahead, the equity market is likely to be influenced by corporate earnings reports, crude oil price movements, and external developments, particularly progress on US-India trade deal negotiations.

Currency Market: The Indian rupee experienced pressure in September, hitting a low of ₹88.79/USD on 30th September, a 0.66% depreciation from the previous month's close. The weakness was primarily driven by US-India trade tensions, the H-1B visa fee hike, FII outflows from equities, and market caution ahead of the RBI's policy decision.

In the first half of October, the rupee remained near historical lows but thereafter showed signs of recovery, closing at ₹87.85 against the USD, on 24th October, a 1.06% appreciation from September's close. The rebound was supported by RBI interventions in the FX market, foreign portfolio investors' capital inflows, and optimism around a US-India trade deal. This was partly countered by a rise in crude oil prices last week following US sanctions on major Russian oil exporting companies, though the global oil supply outlook capped the increase in prices.

Further, the rupee appears undervalued, as indicated by the RBI's 40-Currency Basket REER index, which fell to 97.65 by September from 105.24 in FY25. In the near term, its trajectory will be shaped by US trade policy decisions, crude oil price movements, and the scale of the RBI interventions.

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