

India's Economic Outlook Improves as External Headwinds Ease and Domestic Activity Strengthens



- February has been an eventful month for India's macroeconomic landscape, with the Union Budget FY27, the interim India–US trade framework, the US Supreme Court's ruling striking down IEEPA-based tariffs, the RBI's policy meeting, and the revision of the CPI base year collectively shaping the outlook.
- The Union Budget FY27 reaffirmed fiscal consolidation and a sustained capex push, while advancing a broad-based reform agenda. The FY27 fiscal deficit is budgeted at 4.3% of GDP, with the fiscal consolidation anchor formally shifting to a debt-to-GDP target from FY27 onwards.
- The India–US interim trade framework, announced in early February 2026, has reduced bilateral trade frictions, removed the 25% surcharge linked to imports of Russian crude oil, and envisages a reduction in the reciprocal tariff from 25% to 18% once the interim agreement is formally signed.
- Subsequently, the US Supreme Court struck down the IEEPA-based tariffs. In response, the Trump Administration imposed a uniform 15% surcharge on most trading partners, including India. This rate remains lower than the earlier 25% imposed under IEEPA and below the 18% tariff envisaged for India's goods exports under the interim bilateral arrangement.
- The US Supreme Court ruling could strengthen India's negotiating position by reinforcing the primacy of statute-based trade remedies over executive emergency powers. This increases the possibility of a more favourable trade deal for India than was implied by the India–US joint statement.
- As a result, we are cautiously optimistic on the FY27 external trade outlook, with the drag from the external sector likely to diminish relative to recent quarters.
- Meanwhile, high-frequency indicators point to resilient domestic activity in Q3 and in early Q4. We estimate real GDP growth at around 7.5% YoY in Q3-FY26 (2011–12 base), imparting an upside bias to our FY26 growth estimate of 7.4%. We will recalibrate projections following the release of the new GDP series scheduled for the end of February.
- The new CPI series (base year 2024) showed a reduction in the weight of Food and Beverages, which should contribute to some moderation in headline inflation volatility over time. Under the new series, headline CPI inflation came in at 2.75% in January 2026, while underlying pressures remain subdued, with nearly half the basket recording inflation below 2%.
- The RBI kept the policy repo rate unchanged at 5.25% in February, with the Governor signalling a "lower for longer" bias on policy rates. We expect the RBI to remain on an extended pause, with policy rate action unlikely unless economic growth weakens materially or the macro environment deteriorates significantly.

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US Supreme Court Tariff Ruling to Have Limited Global Economic Effect

The United States Supreme Court's invalidation of US President Trump's global tariff regime will bring some renewed uncertainty to the global economy but is unlikely to inject material change into existing global economic conditions. The Trump Administration had instituted its sweeping tariffs under a US law titled the International Emergency Economic Powers Act (IEEPA), which the Administration claimed gave it nearly unfettered power to impose tariffs on US trading partners; the Supreme Court disagreed, striking down those tariffs. However, the Trump Administration has multiple alternative avenues to maintain many of the tariffs it has levied over the past year and is moving quickly to do so.

To replace the IEEPA-based tariffs, Mr. Trump has announced a new baseline tariff rate of 15% under Section 122 of the 1974 Trade Act. This provision allows the US to impose tariffs for up to 150 days without legislative approval. Such a baseline tariff rate will have a similar effect on the overall effective tariff rate faced by goods entering the US under the IEEPA provisions and import duties collected. Goods imported into the US that already were being tariffed under Sections 232 and 301 (more targeted tariffs under a different legal authority) will continue to be tariffed as they were prior to the Supreme Court ruling.

There is zero chance that the Trump Administration will be able to achieve legislative support for its desired trade and tariff policies. Nonetheless, chances are good that well-established rulemaking and trade investigations outlined in long-standing trade legislation will produce roughly the same outcome for the Administration as it had put in place under IEEPA.

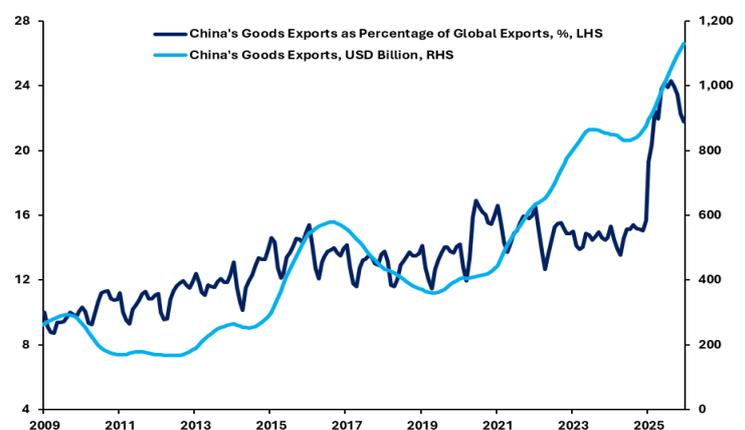
Specifically, Section 232, which pertains to national security matters, will allow the Administration to maintain import duties on products such as semiconductors, steel and aluminium. Section 301 focuses on trading partners' "discriminatory" trade practices and requires the relevant US Government agency to investigate prior to imposing tariffs. With the definition of "discriminatory" largely subject to interpretation, the Administration will be able to reimpose tariffs on non-national security related goods through this avenue.

The global macro issue raised by the Supreme Court's decision is the extent to which it boosts uncertainty regarding previously negotiated trade agreements. All such agreements have been more memorandum of understanding than formal (i.e. legally binding) agreements. In some cases, countries will face higher effective tariff rates on their exports to the US than they do now, post the Supreme Court ruling. More generally, the Trump

Administration was shifting its focus away from the nitty-gritty of trade toward other priorities, so the future of Section 301 trade actions is unknown.

Accordingly, the contours of global trade are likely to change little in the coming months and quarters. As a result, the relative price of goods exported to the US – still the dominant destination for exports – will remain broadly the same, thereby having no measurable economic effect. Meanwhile, China may be able to increase further its share of global trade – especially if uncertainty over future US Section 232 & 301 actions leads other nations to strike new trade agreements with China. As shown in the chart below, China has recently increased its share of global trade considerably and now exports well over USD 1 trillion in goods annually.

China Continues to Gain Share in the Global Trade



Source: National Bureau of Statistics of China.

India's Economic Outlook Improves as External Headwinds Expected to Subside and Domestic Activity Strengthens

February has been an eventful month for India's macroeconomic landscape. The Union Budget FY27, the interim India-US trade framework, the US Supreme Court's landmark ruling striking down IEEPA-based tariffs, the RBI's February policy meeting, and the revision of the CPI base year have collectively shaped the near-term outlook. The upcoming release of the new GDP series (with revised base year 2022-23) adds another important dimension to monitor.

The Union Budget FY27 advanced a broad-based reform agenda while reaffirming fiscal consolidation and sustaining the public capex push. Meanwhile, the RBI signalled an extended pause in policy rates, with near-term emphasis on improving policy transmission and maintaining proactive liquidity management. Although the new CPI series reflected an uptick in headline inflation in January, underlying price pressures remain contained, with limited implications for the current monetary policy trajectory.

India and the US agreed on an interim trade framework in early February 2026, significantly reducing tariff rates and easing bilateral frictions. Subsequently, on

February 20, the US Supreme Court struck down IEEPA-based tariffs, and the Trump Administration then imposed a 15% tariff under Section 122. For India, the net tariff burden on goods exports has declined materially relative to the IEEPA-era baseline, which bodes well for exports in FY27. That said, near-term uncertainty is likely to persist as the US Administration explores alternative tariff channels in the wake of the SCOTUS ruling. In January, India concluded a Free Trade Agreement with the European Union, expected to be operationalised later this year, providing an additional tailwind to trade and capital flows. Accordingly, we are cautiously optimistic on the FY27 external trade outlook, with the drag from the external sector likely to moderate relative to recent quarters.

Meanwhile, high-frequency indicators suggest economic activity remained firm in Q3, with early Q4 signals pointing to continued resilience supported by domestic demand. Incorporating these developments, we estimate real GDP growth at around 7.5% YoY in Q3 (2011–12 base), imparting an upside bias to our FY26 real GDP growth estimate of 7.4%. We also see upside bias to our FY27 real GDP growth projection of 6.5%–7.0%, as external headwinds likely to ease and domestic momentum strengthens. We will recalibrate these projections after the release of the new GDP series with a change in the base year and methodology, scheduled for the end of February.

India–US Interim Trade Framework and the SCOTUS Ruling

In a positive development, India and the US agreed on an interim trade framework in early February 2026, removing the 25% surcharge linked to India’s crude oil imports from Russia and resetting the country-specific IEEPA tariff rate on Indian goods exports to 18%, down from 25%, subject to the formal signing of the interim trade agreement, which is targeted by March–April. The framework also provides a pathway toward further reciprocal tariff reductions, potentially to zero for a meaningful share of goods exports, contingent on the conclusion of a formal Bilateral Trade Agreement (BTA). This outcome is broadly consistent with our earlier expectation of an interim agreement by Q4 FY26, although the realised tariff relief has been somewhat more favourable than the 20–25% reciprocal tariff range we had anticipated. Please refer to our report, [India–US Interim Trade Framework](#), for more details.

As discussed above, the US Supreme Court subsequently struck down the US IEEPA-based tariff regime on February 20, 2026, and in response, the Trump Administration – relying on other US trade laws – instituted new tariffs.

For India, the near-term tariff environment has improved relative to the IEEPA-based tariff peak. Under the new

framework, Indian goods exports to the US will now face a 15% (under the section 122) tariff in the near-term, in addition to existing Section 232 duties where applicable, still broadly lower than the earlier 25% IEEPA-era tariff rate and below the 18% rate envisaged under the interim bilateral arrangement. Sectoral exemptions for certain electronics, pharmaceuticals, energy products, and select agricultural items are likely to continue. More broadly, the risk of abrupt, open-ended tariff escalation under emergency authority has materially receded. The US Supreme Court ruling raises the legal threshold for sweeping tariff action and strengthens India’s negotiating position by reinforcing the primacy of statute-based trade remedies over executive emergency powers. As India–US negotiations progress toward a broader BTA under the February framework, the balance of risks therefore shifts toward procedural predictability. **Presently, India and the US have deferred the next round of talks to finalise the interim trade agreement. Collectively, these developments increase the possibility of a more favourable trade deal for India than was implied by the India–US joint statement.**

High-Frequency Data Signal Resilient Domestic Activity

High-frequency indicators in Q3 and early Q4 point to a resilient pace of domestic economic activity, even as external headwinds persisted. Private consumption remained firm, reflected in rising auto registrations, accelerating retail credit growth, improving IIP output for consumer durables and non-durables, and a recovery in air passenger traffic.

Private Consumption Indicators Remain Firm

Indicators (YoY%)	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26
Vehicle registrations	4.0	6.0	5.7	-3.6	3.8	6.5	41.7	2.9	15.6	17.7
Two-wheeler registrations	2.8	7.8	5.2	-6.1	2.7	7.3	52.7	-2.6	10.0	20.9
IIP- Consumer durables	6.2	-0.9	2.8	7.3	3.5	10.0	-1.3	11.2	12.3	
IIP- Consumer non-durables	-2.7	-1.0	-0.9	0.5	-6.4	-0.3	-5.2	8.0	8.3	
Retail credit growth	11.9	11.1	12.1	11.9	11.8	11.7	14.0	12.8	14.4	
Domestic Air Passenger Traffic	9.7	2.6	3.7	-2.5	-0.5	-2.5	3.5	7.0	-4.9	2.9
Unemployment Rate (%)	7.7	6.7	7.1	7.1	6.3	6.3	7.5	6.5	6.9	6.9
Rural	7.5	5.8	6.7	6.8	6.3	5.0	7.6	6.1	7.0	6.0
Urban	8.1	8.3	7.7	7.8	6.4	8.5	7.3	7.2	6.8	8.3
Naurki JobSpeak Index	8.9	0.3	10.5	6.8	3.4	10.1	-9.3	23.5	13.2	3.4

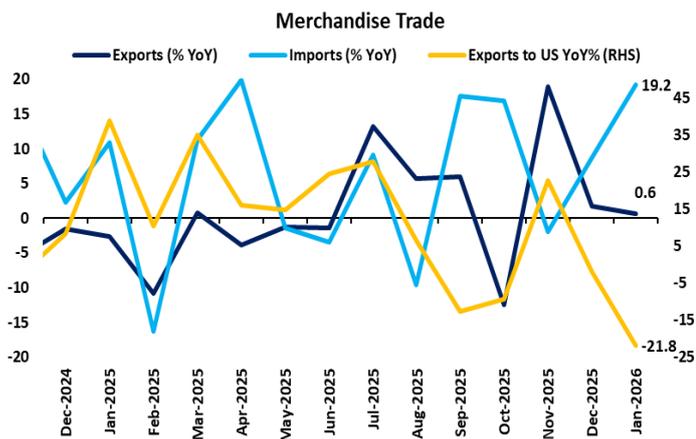
Source: CMIE. Numbers shown are YoY% except for unemployment rates, which are in percentage points.

As per CMIE data, labour market indicators were mixed: overall unemployment was slightly lower in January than the previous month, led by rural areas, while the urban unemployment rate rose sharply. Overall, the unemployment rate remained on an average of ~1.1 percentage points lower than a year ago, while the Naukri JobSpeak Index recorded average growth of 7.1% during April–January FY26, compared with 1.7% in the corresponding period of FY25. Rural wage growth and urban salary growth (proxied by compensation of employees of listed firms) also maintained a positive momentum.

On the investment front, central government capex remained in contraction (-24.5% YoY in December), following front-loading in H1 FY26 which limited subsequent spending headroom. The private investment outlook, however, continues to gradually improve. Capacity utilisation in the manufacturing sector rose to 74.3% in Q2 FY26, up 20 bps QoQ and 10 bps YoY. Fixed asset growth among listed private companies in Q3 suggests a pick-up in activity, and the private sector's new project announcements have increased sharply, albeit concentrated in select industries. With the drag from US tariffs likely to ease materially, private investment momentum could strengthen further.

External pressures, however, presently remain visible in trade data. India's goods exports grew by a muted 0.6% YoY in January, while goods exports to the US declined sharply by 21.8%, following a 1.8% contraction in the previous month, reflecting the impact of IEEPA-era tariffs. With US tariff rates now expected to decline, this drag should ease in the coming months. On the import side, a surge in precious metals imports widened the merchandise trade deficit to USD 34.7 billion in January 2026 from USD 23.4 billion in January 2025. Meanwhile, services exports accelerated sharply in January (+26.3% YoY as per preliminary data), pushing the net services account surplus to a record high, though this was insufficient to offset the wider goods deficit, leaving the overall trade balance under pressure.

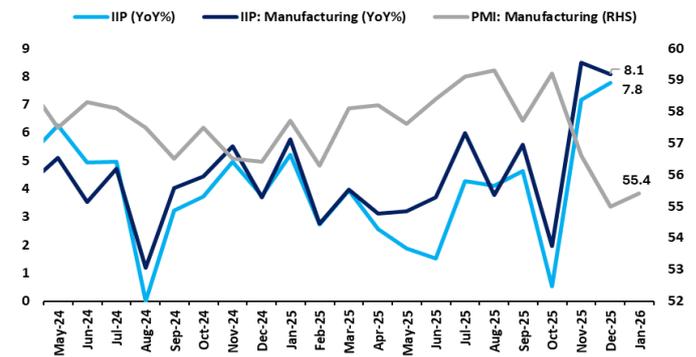
Goods Exports Growth Muted as Exports to the US Slump



Source: CMIE

From the supply side, industrial activity rebounded strongly in December, with IIP growth accelerating to a 26-month high of 7.8% YoY, following an upward-revised 7.2% in November. The recovery was broad-based, led by manufacturing, which sustained growth above 8% for a second consecutive month. The Manufacturing PMI rose to 55.4 in January from 55.0 in December, driven by faster growth in new orders, output, employment, and input purchases.

Industrial Activity Shows Sharp Acceleration



Source: CMIE

Services indicators were mixed but showed activity remained broadly resilient. The Services PMI rose to 58.5 in January from 58.0 in December, reflecting stronger output and a pick-up in new orders. While domestic demand remained the primary driver, export orders also expanded, driven by gains in South and Southeast Asian markets. Meanwhile, bank credit, international passenger traffic and service exports picked up, while e-way bills and cargo traffic showed some moderation.

Services Sector Activity Remains Resilient

Indicators (YoY%)	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26
PMI Services	58.7	58.8	60.4	60.5	62.9	60.9	58.9	59.8	58.0	58.5
International Passenger Traffic	13.0	5.0	3.4	5.5	7.7	7.3	9.7	7.5	6.0	6.8
Port Cargo Traffic	7.0	4.3	5.6	4.0	2.5	11.5	11.9	14.5	12.8	7.6
GST E-way Bills	23.4	18.9	19.3	25.8	22.4	21.0	8.2	27.6	23.5	15.8
Services Exports	8.9	9.6	12.0	10.3	2.8	12.5	2.2	6.7	13.0	26.3
Banking Non-Food Credit	10.2	8.8	9.3	9.9	9.9	10.2	11.1	11.4	14.4	

Source: CMIE. Numbers shown are YoY% except for PMI, which is an Index (above 50 showing expansion)

The agriculture outlook remains positive, with rabi crops sowing up 2.4% YoY at the end of the season. For FY27, potential El Niño conditions could pose risks to the monsoon, thereby to kharif crops, and warrant close monitoring

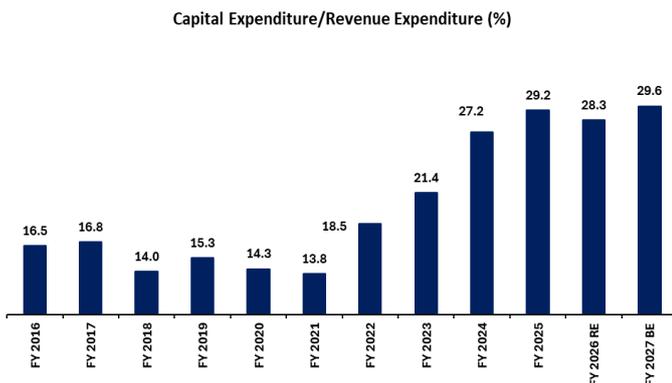
Union Budget FY27: Consolidation, Capex Continuity, and Reform

The FY27 Union Budget was broadly in line with expectations, reaffirming fiscal consolidation, a sustained capex thrust, and reform continuity.

The FY26 fiscal deficit has been retained at 4.4% of GDP in the Revised Estimate, with revenue expenditure rationalisation and stronger non-tax revenues helping offset shortfalls in direct tax collections. From FY27, the fiscal consolidation anchor formally shifts from the deficit-to-GDP ratio to the debt-to-GDP ratio. In line with the medium-term objective of reducing central government debt to 50±1% of GDP by FY31, debt is budgeted to decline to 55.6% of GDP in FY27 from 56.1% in FY26 (RE), with the FY27 fiscal deficit budgeted at 4.3% of GDP, indicating a measured and credible consolidation path.

Total expenditure is budgeted to rise 7.7% YoY over FY26 RE, though the expenditure-to-GDP ratio moderates to 13.6% from 13.9%, reflecting contained revenue expenditure growth of 6.6% and higher nominal GDP. **Capital expenditure is budgeted to grow 11.5% YoY, maintained at 3.1% of GDP, with the capital-to-revenue expenditure ratio rising to a near two-decade high of 29.6%, reflecting a sustained improvement in expenditure quality** and a continued pivot toward growth-enhancing outlays.

Capital-to-Revenue Expenditure Ratio Near Two-Decade High



Source: CMIE, budget documents

Tax revenue assumptions appear broadly realistic, though income tax projections look somewhat optimistic. Fiscal sensitivities persist around reliance on non-tax revenues, including RBI dividend transfers, and divestment proceeds.

For FY27, the central government's gross and net market borrowings through dated securities are budgeted at Rs 17.2 lakh crore and Rs 11.7 lakh crore, respectively, compared with Rs 14.6 lakh crore (gross) and Rs 10.4 lakh crore (net, adjusted for buybacks and switches) in FY26 RE. The increase in gross borrowing partly reflects elevated redemptions scheduled for FY27.

Beyond the fiscal arithmetic, the budget advances reforms across productivity, human capital, ease of doing business, and inclusion. The reform thrust, however, is incremental and dispersed rather than anchored in one or two bold structural pivots. Many initiatives span multiple sectors and institutional frameworks and are inherently medium-term in design. Accordingly, while directionally supportive of growth and investment, the transmission to tangible gains in output, employment, and productivity is likely to materialise over the medium term, with likely limited near-term transformational impact. Please refer to the report [FY27 Budget: Fiscal Prudence and CAPEX Continuity, with Reforms Dispersed and Back-Ended](#) for more details.

CPI Base Revision: Inflation Remains Contained

The revision of the CPI base year from 2012 to 2024 marks a significant upgrade to India's inflation measurement

framework. The new CPI series expands item coverage, incorporates online markets, adopts the UN's COICOP 2018 classification, and better aligns with consumption patterns captured in the latest household consumption expenditure survey.

The most material structural shift is the decline in the weight of Food and Beverages. Under the old classification, the food and beverages weight would have declined from 45.86% to 40.10%; under the new framework, it is lower at 36.75%, down from 42.62% previously, reflecting both reclassification effects and a diversification of household expenditure toward services and non-food items. The cereals segment registered the sharpest weight reduction, followed by vegetables, while fruits gained share. The combined weight of vegetables and fruits (which are typically more volatile) remains broadly unchanged, implying that food-related volatility is likely to moderate, though not materially. The higher weight accorded to core categories should also help reduce headline CPI volatility over time. Separately, gold and silver prices are now captured through jewellery prices rather than metal prices, providing a more accurate representation of consumer-level expenditure.

Division-wise Weights As Per New (2024) Structure

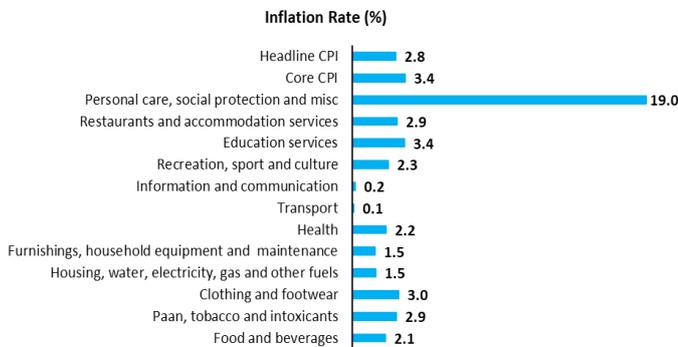
Divisions	Weights, %		Change in Weights, %
	CPI 2012	CPI 2024	
Food and beverages	42.6	36.8	-5.9
Cereals and cereal products	9.7	5.9	-3.7
Vegetables	6.0	5.1	-1.0
Fruits	2.9	3.7	0.8
Milk and Dairy products	6.6	6.8	0.2
Paan, tobacco and intoxicants	2.4	3.0	0.6
Clothing and footwear	6.5	6.4	-0.1
Housing, water, electricity, gas and other fuels	16.9	17.7	0.8
Furnishings, household equipment and routine household maintenance	3.7	4.5	0.8
Health	5.9	6.1	0.2
Transport	6.4	8.8	2.4
Information and communication	3.3	3.6	0.3
Recreation, sport and culture	1.5	1.5	0.0
Education Services	3.5	3.3	-0.2
Restaurants and accommodation services	3.2	3.3	0.1
Personal care, social protection and miscellaneous goods and services	4.0	5.0	1.0
Gold /diamond /platinum jewellery	1.1	0.6	-0.5
Silver jewellery	0.1	0.3	0.2

Source: PIB. Weights for 2012 are mapped to item classifications under the new CPI series. Weights for cereals and cereal products, fruits, vegetables, milk and dairy products, gold/diamond/platinum jewellery, and silver jewellery are based on division-level weights in the 2012 and 2024 series, respectively. Sub-categories may not have an exact one-to-one correspondence across the two series.

Under the new series, headline CPI inflation rose to 2.75% in January 2026 from 1.17% in December on the back series, driven primarily by precious metals and food. Food & beverages inflation turned positive at 2.1% after four months of deflation, reflecting easing vegetable deflation and firmer prices across cereals, meat, fruits, and dairy. CPI core inflation, with a weight of 57.9%, stood at ~3.4%, indicating broad-based moderation. Personal Care, Social Protection & Misc. Goods & Services recorded the highest inflation at 19%. Within this, inflation in silver jewellery (160%) and gold/diamond/platinum jewellery (47%) remains elevated, reflecting global precious metal price dynamics. Overall,

underlying pressures remain subdued: nearly half of the revised CPI basket recorded inflation below 2%, while only 18% of items show inflation above 4% in January.

Inflation Remains Subdued, With Most Major Categories Recording Inflation Below 4%



Source: CMIE

With a lower food & beverages weight and underlying pressures contained, we expect CPI inflation to gravitate toward the lower end of our 4.0%–4.5% projection range in FY27.

RBI Policy Outlook: Extended Pause with Near-term Focus on Transmission

In line with our expectations, the RBI’s MPC unanimously kept the policy repo rate unchanged at 5.25% at its February meeting, while retaining a neutral stance to preserve flexibility amid evolving domestic and global conditions. The decision reflects benign underlying inflation and a resilient economic growth outlook, supported by firm domestic demand and improving trade prospects. The RBI marginally revised up its H1 FY27 inflation and growth projections, while deferring full-year FY27 forecasts to the April meeting pending the release of the new CPI and GDP series. Please refer to the report [RBI Policy Review](#) for more details.

The Governor signalled a “lower for longer” bias on policy rates and, in our assessment, an extended pause remains the base case unless economic growth weakens materially or the macro environment deteriorates significantly.

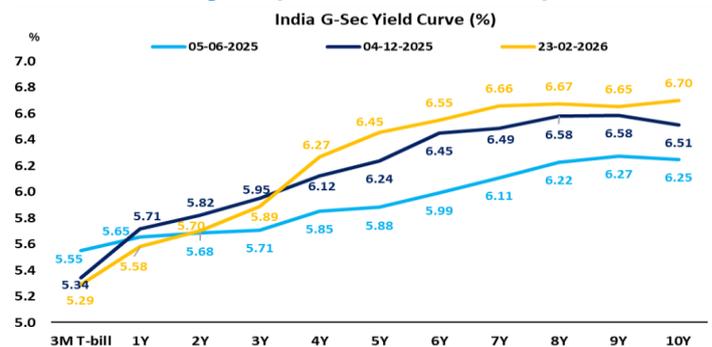
On liquidity management, the RBI reiterated its focus on strengthening policy transmission and maintaining proactive liquidity management. It has infused sizeable durable liquidity through multiple measures since the December meeting. As a result, average systemic surplus liquidity rose to ~Rs 2.7 lakh crore by February 20, pushing the weighted average call rate sharply below the policy repo rate. With seasonal pressures persisting through Q4-FY26, further interventions remain likely. We expect the RBI to manage system liquidity at ~1% of Net Demand and Time Liabilities, calibrating operations to meet seasonal demand while maintaining orderly money market conditions.

Market Update

Bond Market: Combined Centre and State governments’ elevated market borrowings have kept the G-Sec curve steep. Since the December RBI Policy meeting, G-Sec yields have hardened further, reflecting expectations that the policy easing cycle is nearing its end, a higher-than-anticipated Central government’s borrowing programme for FY27, and Bloomberg’s decision to defer India’s G-Sec inclusion in the Global Aggregate Bond Index.

The government’s sizeable borrowing requirement is likely to remain an overhang for bond markets. Since the budget, the RBI conducted switch operations of ~Rs 1 lakh crore to help ease pressures on G-Sec yields. In FY27, continued RBI support through open market operations, switch and buyback operations will be important in absorbing elevated bond supply and anchoring G-Sec yields.

Fiscal Overhang Keeps G-Sec Curve Steep



Source: Bloomberg

Equity Market: India’s equity markets came under pressure in January, with the Nifty 50 Index declining 3.1% MoM amid mixed global cues, rising geopolitical tensions, delays in the India–US trade talks, and FPI outflows. The stock market reacted positively to the announcement of the interim India–US trade framework. It was further supported by relatively healthy corporate earnings and a return of FPI inflows after months of sustained selling.

Sentiment remained volatile, as crude oil prices rose to a near seven-month high of USD 71.7 per barrel amid escalating US–Iran tensions. However, the SCOTUS ruling on IEEPA tariffs provided a near-term offset, with the Nifty 50 Index posting a 1.5% gain MTD as of February 23.

Foreign Exchange Market: The Indian rupee recovered in February after depreciating 2.4% MoM against the USD in January. The INR appreciated around 1.2% MTD to trade ~90.88 per USD as of February 23, supported by improved sentiment following the India–US trade framework and renewed FPI inflows, partly offset by higher crude oil prices.

In the near term, geopolitical developments and their impact on crude prices are likely to be the primary drivers of currency movements. RBI’s intervention and evolving US trade policy will also remain key determinants of the rupee’s trajectory.

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