

# India Economic Outlook: Stagflationary Headwinds Rise as Middle East Conflict Prolongs



- With Kevin Warsh close to being confirmed as the next Federal Reserve Chairman, major changes are coming to US monetary policy. These changes will take time to materialize but given the US and Fed's role in the global economy, there will be global, not just US, implications.
- On geopolitical risks, the Middle East conflict has entered its ninth week, with uncertainty over a durable resolution remaining high. The initial two-week ceasefire has been extended on an open-ended basis, but commercial traffic through the Strait of Hormuz remains effectively at a standstill.
- Even if a provisional peace agreement between the US and Iran is reached over the next two to four weeks, implementation risks are likely to persist, and a full normalisation of energy and trade flows could take several months.
- Crude oil prices remain elevated, and the Indian Crude Basket price appears to have decoupled from Brent, averaging ~\$120/bbl since the start of the conflict, compared with a pre-conflict average of ~\$69/bbl in February. We therefore revise upward our FY27 Indian Crude Basket price assumption to \$90/bbl from \$85/bbl previously.
- Early signs of the conflict's impact on India's economic activity are visible in March. The Index of Eight Core Industries fell to a 19-month low; Manufacturing PMI declined to a near four-year low, and Services PMI moderated to a 14-month low, although both remained in expansion territory.
- Private consumption has broadly held up in March, with auto registrations remaining robust. However, consumer confidence has deteriorated, and employment has declined in the industrial and services sectors. Private sector new project announcements fell sharply in Q4 FY26, reversing the strong momentum seen in the first three quarters of FY26.
- External trade remains under pressure, with goods exports contracting further in March and GCC-linked trade severely disrupted. We expect the current account deficit to widen from ~1.0% of GDP in FY26 to ~1.7% of GDP in FY27.
- CPI inflation averaged ~2.1% in FY26, in line with our estimate, with inflation edging up to a 12-month high of 3.4% in March. Core inflation remained contained at ~3.4% in March, suggesting subdued underlying price pressures.
- We revise down our FY27 India's real GDP growth projection by 0.3 percentage points (pps) to 6.7% YoY and raise CPI inflation forecast by 0.4 pps to 4.7%, reflecting higher expected crude oil prices, the anticipated partial pass-through of elevated energy costs to end-users, and the potential impact of a below-normal monsoon. Downside risks to economic growth and upside risks to inflation persist.
- In its April policy meeting, the RBI held the policy repo rate at 5.25% with a neutral stance, projecting FY27 real GDP growth at 6.9% and CPI inflation at 4.6%. The RBI adopted a wait-and-watch approach, signalling that it will look through first-order energy price effects and focus on second-round impacts, which we view as appropriate given the elevated uncertainty and the nature of the shock.
- We expect the RBI to maintain a hold on policy rates through FY27. However, a further delay in conflict resolution, a re-escalation of tensions, and/or a larger-than-expected shortfall in monsoon rainfall could bring monetary policy tightening into consideration toward the end of FY27.

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## Geopolitical Risks Persist: De-escalation Tentative, Path to a Durable Resolution Uncertain

The Middle East conflict has entered its ninth week, with uncertainty over a durable resolution remaining high. There have been tentative signs of de-escalation in US-Iran tensions through April. The initial two-week ceasefire announced in early April has since been extended on an open-ended basis, with the US President indicating it would remain in place until Tehran submits a "unified proposal" and "discussions are concluded, one way or the other." Iran also briefly declared the Strait of Hormuz open for all commercial vessels, linked to a parallel Israel-Lebanon ceasefire, but reversed the decision within 24 hours after the US maintained its naval blockade. The US Navy subsequently intercepted and seized an Iranian-flagged cargo vessel in the Gulf of Oman, marking the first such action under the blockade. Commercial traffic through the Strait of Hormuz is effectively at a standstill.

Core sticking points remain unchanged: the US continues to demand that Iran relinquish its nuclear material and fully restore commercial shipping through Hormuz, while Tehran has refused to dismantle its nuclear programme or transfer enriched uranium, conditioning any return to negotiations on the removal of the US naval blockade. Even if a provisional peace agreement is reached between the US and Iran over the next two to four weeks, implementation risks are likely to persist, and a full normalisation of energy and trade flows could take several months, extending at least into Q2 FY27.

Ongoing tensions are sustaining elevated energy costs and making it increasingly difficult for energy-intensive sectors globally to plan with confidence around future demand and resource requirements. At a broader macro level, economies with greater direct exposure to oil, LNG, and related refined products sourced from the Middle East are facing a more adverse growth-inflation trade-off, characterised by weaker economic growth alongside higher inflation. These include the UK, much of continental Europe, and several Asian economies.

Energy costs in recent weeks have levelled off, owing to a mix of diplomatic efforts, demand destruction from oil prices bouncing around \$100 per barrel and rising US exports. In the event oil prices were to hover around their current level for another month, the hit to global economic activity this summer likely would total something close to half a percentage point based on the historical rule of thumb that a \$10 per barrel rise in the price of oil reduces the pace of real economic growth by 0.1 to 0.2 percentage point depending on the economy. An economy such as the US – which is the world's largest producer of energy – will experience a hit to growth at the bottom end of that range, while an economy

such as Germany that is heavily dependent on imported energy will experience a hit to growth at the upper end.

The longer energy costs remain near prevailing levels, the greater the downside risk to the economy. Should prices move back up toward their brief highs recorded during the most intense part of the kinetic conflict, the potential adverse economic effects for certain countries may become non-linear in nature.

## Closer to the Start of Regime Change at the Federal Reserve

Away from these geopolitical matters, Kevin Warsh's nomination to be the next Chairman of the Federal Reserve has taken a major step forward. The timing of his confirmation as Fed Chairman has been uncertain due to the Trump Administration's criminal investigation into current Fed Chairman Jay Powell over cost overruns in the ongoing renovation of the Fed's Washington, D.C. headquarters. In recent days, the US Justice Department announced it was halting that investigation, clearing a path for Mr. Warsh's nomination to advance in the US Senate and for him likely to be confirmed as the new Chairman by mid-May when Mr. Powell's term as Chairman expires.

Mr. Warsh, in his confirmation hearing this week, articulated his goals for the Fed should he become Chairman, and both his prepared remarks and answers to the Senators' questions underscored the 'regime change' that a Chairman Warsh would be bringing to the Fed. (See our Special Focus Report [Kevin Warsh and US Federal Reserve 'Regime Change'](#) on this topic from February 2, 2026.)

Mr. Warsh characterized the existing monetary policy making process at the Fed as out-of-step with the prevailing realities of the US economy, emphasizing that certain aspects of policymaking remain in place solely due to inertia. He kept his remarks on this front general but – from our perspective – innovations such as 'forward guidance' that were introduced a dozen plus years ago to try to enhance monetary policy's effectiveness when nominal interest rates were at the zero lower bound live on today. Likewise, the so-called DOT plot – intended to reinforce policymakers' verbal guidance that monetary policy would remain highly accommodative until the economy reached escape velocity post the global financial crisis (GFC) – still is published – even as Fed officials themselves waive off its importance.

We suspect changes on these two fronts will be among the most visible, early shifts that a Chairman Warsh ushers in. Pre-signalling changes to policy rate that have been common in the past decade – either via near explicit comments by the Chair and/or well-sourced stories in the Wall Street Journal – are likely to fade away. In their place, will be a clearer articulation of the Fed's prevailing forward-

looking monetary policy framework that, hopefully, makes economic actors less captive to Fed officials' remarks and/or chosen media reporting. Similarly, the DOT seemingly still exists solely because of its longevity and with officials routinely dismissing its relevance, its existence is more distraction than value add.

Less visible but considerably more significant for actual policy decisions are the forthcoming (potentially sweeping) changes to the Fed staff and the materials it prepares for Federal Open Market Committee (FOMC) meetings. As we wrote in our Special Focus Report in early February, the staff has accumulated an historic amount of influence on the current Chair and the broader FOMC due to Mr. Powell – and many other senior FOMC members – being neither a professional economist nor real-world macro practitioner. The current econometric model-heavy staff forecast will have a smaller weight in Chairman Warsh's baseline macro-outlook than it does Chairman Powell's. A Warsh Fed is going to consume a significantly broader array of inputs as part of its policymaking process; it also is going to be less reliant upon backward-looking data analysis, placing a heavier weight on more thematic macro trends when formulating its assessment of the outlook. To be sure, these prospective changes may or may not produce a better policy outcome. But they lie ahead and will alter the conduct of US monetary policy.

Against this backdrop, Mr. Warsh also made the case for revamping of the Fed's inflation framework. The Fed's 2020 shift to flexible average inflation targeting – where it acquiesced to 2%+ inflation to “make up for” prior undershooting of the 2% inflation target – has been a failure, as highlighted by the now five years and counting that core PCE inflation has been above target. A Chairman Warsh would seek to eliminate that framework.

However, some of his comments on a prospective new inflation framework seemed not yet fully formed and/or potentially problematic. With respect to the latter, for instance, he advocated for alternative measures of inflation to the traditional core PCE price index. The trimmed mean measures that Mr. Warsh cited in his testimony are subject to the same issues that plague other alternative inflation measures that Fed officials and other central bankers around the world sometimes latch on to as part of their policymaking process. Namely, every measure of inflation has its pros and cons. Sometimes a certain measure conveys the result a policymaker is hoping for and at other times that same measure does not.

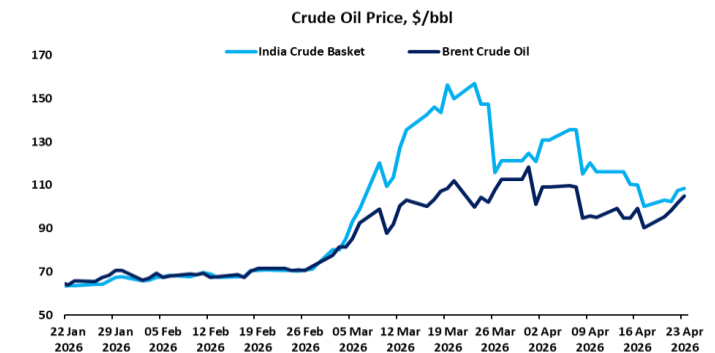
Mr. Warsh also left no doubt that he favours a substantial reduction in the size of the Fed's balance sheet and will be seeking to reduce the balance sheet once confirmed as Chairman. He has been telegraphing this view – and his

rationale – for years so his general comments on this front were anticipated. Nonetheless, he emphasized strongly that such changes would unfold gradually to minimize disruption and would require coordination with other parts of the US Government.

### India's FY27 Economic Growth Projection Revised Lower and Inflation Forecast Higher Amid Elevated Energy Prices and Prolonged Supply Disruptions

Early signs of the Middle East conflict's impact on India's economic activity are already emerging, albeit alongside pockets of resilience, with pressures expected to intensify as initial buffers erode. Further, crude oil prices, which softened in early April on the ceasefire announcement, have resumed an upward trajectory as prospects of a swift resolution have diminished.

### Indian Crude Basket Trading at a Premium to Brent Since the Onset of the Middle East Conflict



Source: Bloomberg, PPAC

Brent crude price rose from ~\$73/bbl at the onset of the conflict in late February to an average of ~\$100/bbl in March and April (till 24<sup>th</sup>). The Indian Crude Basket price appears to have diverged sharply from Brent, reaching a record high of ~\$157/bbl on March 23 and averaging ~\$120/bbl in March and April (till 23<sup>rd</sup>), significantly above February's average of ~\$69/bbl. The Indian Crude Basket average premium over Brent widened to ~\$14–25/bbl in March and April (MTD), compared with near-zero levels as recently as late February. Reflecting these developments, we revise our FY27 Indian Crude Basket price assumption to \$90/bbl, up from \$85/bbl previously.

As full normalisation of energy and trade routes is likely to take several months and extend well into Q2 FY27, we revise our FY27 real GDP growth projection down by 0.3 percentage points (pps) to 6.7% YoY (compared to projected ~7.4% in FY26) and our CPI inflation forecast upward by 0.4 pps to 4.7% YoY (vs ~2.1% in FY26). We continue to see downside risks to the economic growth projection and upside risks to the inflation forecast until there is a clear pathway to a durable conflict resolution. We also incorporate a limited potential impact from a possibly deficient monsoon in FY27: the IMD expects India's south-west monsoon to be

"below normal" this year, with rainfall projected at 92% of the Long Period Average during June-September 2026.

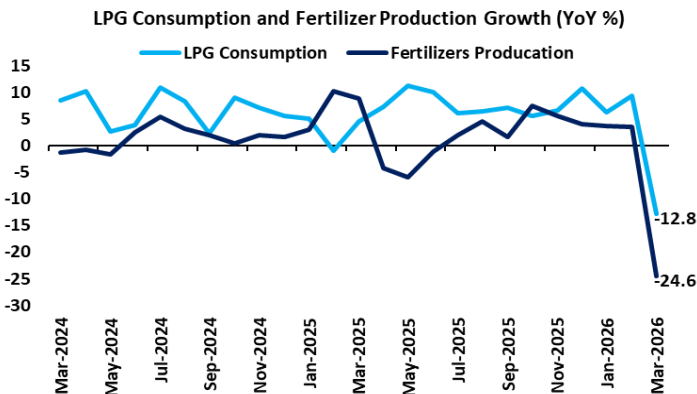
Given these dynamics, we expect the RBI to remain data-dependent, focusing, critically, on second-round effects of elevated energy prices and the evolving monsoon situation. Under our baseline assumption of a US-Iran peace agreement in the coming weeks and a gradual normalisation of energy and trade routes from May-June, we expect the RBI to maintain a hold on policy rates through FY27.

However, a further delay in resolution, a re-escalation of the conflict, and/or a more severe monsoon shortfall could bring monetary policy tightening into consideration toward the end of FY27. Any such tightening would likely be aimed at preserving the RBI's hard-earned inflation credibility and maintaining macroeconomic stability.

### India's Economic Activity: Early Signs of Impact, Some Pockets of Resilience

Ongoing Middle East geopolitical tensions, the closure of the Strait of Hormuz, and the associated energy price and supply shocks have begun to weigh on economic activity. Industrial activity remained steady in February, with IIP growth at 5.2% YoY, broadly unchanged from 5.1% in the prior month, supported by an acceleration in manufacturing output. However, the Index of Eight Core Industries contracted by 0.4% YoY in March, falling to a 19-month low, driven by declines in fertilisers, crude oil, coal, and electricity production. Fertiliser output dropped sharply by 24.6% YoY in March as the conflict disrupted the availability of key feedstock; with continued constraints on gas imports, these pressures are likely to persist despite government efforts to ramp up domestic production and diversify sourcing. LPG consumption contracted sharply, declining ~16% MoM and ~13% YoY in March due to supply disruptions, while automotive fuels saw a pick-up, with diesel (HSD) and petrol (Motor Spirits) consumption rising ~14% MoM and ~12% MoM respectively, likely reflecting precautionary buying amid supply concerns.

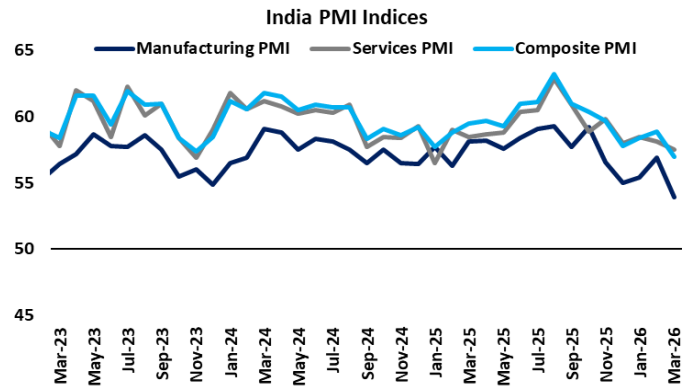
### Gas Supply Shortages Impacted LPG Consumption and Fertiliser Production



Source: CMIE

Forward-looking indicators point to further near-term softening. Manufacturing PMI eased to 53.9 in March from 56.9 in February, marking the weakest improvement in operating conditions in nearly four years, driven by moderating demand, with new orders and output expanding at their slowest pace since mid-2022 amid challenging market conditions, cost pressures, and elevated geopolitical uncertainty. The April flash PMI points to some recovery, though this likely reflects precautionary frontloading of demand and production amid concerns over prolonged supply disruptions and higher input costs ahead.

### Middle East Conflict Weighs on PMI Indices



Source: CMIE

In services, visible signs of impact from geopolitical uncertainty and the supply-side shock have begun to emerge. International air passenger traffic contracted in March as the Middle East conflict disrupted flight routes, while port cargo growth slowed sharply relative to the healthy pace seen in preceding months. As per preliminary data, services export growth turned negative at -1.2% YoY in March, marking the weakest performance in two years. Meanwhile, banking sector non-food credit growth remained resilient, supported by year-end demand, ongoing monetary policy transmission, and a partial shift in corporate borrowing from the bond market to banks amid elevated yields. However, the Services PMI moderated to a 14-month low of 57.5 in March from 58.1 in February, though remaining well above its long-run average. New business growth softened to its weakest pace since January 2025, with the Middle East conflict weighing on demand conditions, market sentiment, and tourism, even as international demand showed some improvement.

### Services Sector Activity Slows in March '26

Indicators (YoY%)	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Feb-26	Mar-26
PMI Services	58.7	58.8	60.4	60.5	62.9	60.9	58.9	59.8	58.0	58.5	58.1	57.5
International Passenger Traffic	13.0	5.0	3.4	5.5	7.7	7.3	9.7	7.5	6.0	7.1	3.0	-17.8
Port Cargo Traffic	7.0	4.3	5.6	4.0	2.5	11.5	11.9	14.5	12.8	7.6	5.1	0.7
GST E-way Bills	23.4	18.9	19.3	25.8	22.4	21.0	8.2	27.6	23.5	15.8	18.8	12.9
Services Exports	8.9	9.6	12.0	10.3	2.8	12.5	2.2	6.7	13.0	9.8	9.7	-1.2
Banking Non-Food Credit	10.2	8.8	9.3	9.9	9.9	10.2	11.1	11.4	14.4	14.4	14.3	15.9

Source: CMIE. Banking Non-Food Credit for March 2026 is provisional as per the RBI Bulletin.

The agricultural outlook faces emerging headwinds in FY27 from higher input and fuel costs, disruptions to fertiliser production, and the risk of a weaker monsoon. The IMD has projected below-normal rainfall for the south-west monsoon at 92% of the long period average of 87 cm, with El Niño conditions expected to develop during the monsoon season. The risk of deficient rainfall could weigh on agricultural output and rural demand, while posing upside risks to food inflation.

### Private Consumption Holding; Investment Plans Slowing; External Trade Impacted

Private consumption has broadly held up so far, supported in part by government measures aimed at insulating households from higher energy prices. Auto registrations remained robust in March, with two-wheelers accelerating further while light passenger vehicles moderated marginally but continued to grow at a healthy pace, supported by GST-driven price adjustments and new model launches, reflecting sustained rural demand and recovering urban demand. However, domestic air passenger traffic softened during the month. The RBI's March 2026 consumer confidence survey pointed to deterioration in both urban and rural sentiment across current perceptions and the one-year-ahead expectations.

Labour market indicators presented a mixed picture. PMI employment indices for manufacturing and services signalled a pickup in hiring activity in March, while formal sector hiring activity remained healthy in March per the Naukri JobSpeak Index, albeit moderating from the stronger pace in February. As per CMIE data, the unemployment rate edged lower in March, driven by a decline in urban unemployment; however, this was partly due to decline in the labour force participation rate. Employment declined in the industrial and services sectors in March, suggesting early signs of the conflict's spillover to the labour market; if sustained, this could weigh on the ongoing recovery in private consumption.

### Private Consumption Indicators Showed Resilience

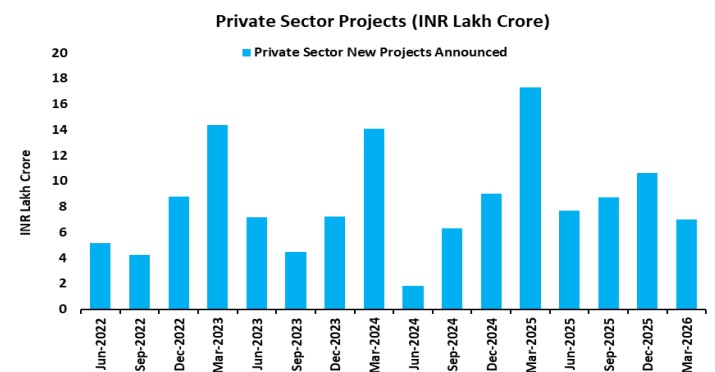
Indicators (YoY%)	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Feb-26	Mar-26
Vehicle Registrations	4.0	6.0	5.7	-3.6	3.8	6.5	41.7	2.9	15.6	18.4	26.7	25.4
Two-Wheeler Registrations	2.8	7.8	5.2	-6.1	2.7	7.3	52.7	-2.6	10.0	21.3	25.7	28.9
IIP- Consumer Durables	6.2	-0.9	2.8	7.3	3.5	10.0	-1.3	11.2	12.4	7.2	7.3	
IIP- Consumer Non-Durables	-2.7	-1.0	-0.9	0.5	-6.4	-0.3	-5.2	8.0	8.5	-2.3	-0.6	
Retail Credit Growth	11.9	11.1	12.1	11.9	11.8	11.7	14.0	12.8	14.4	14.9	15.2	
Domestic Air Passenger Traffic	9.7	2.6	3.7	-2.5	-0.5	-2.5	3.5	7.0	-4.9	3.1	-0.1	-1.5
Unemployment Rate (%)	7.7	6.7	7.1	7.1	6.3	6.3	7.5	6.5	6.9	6.9	6.7	6.6
Rural	7.5	5.8	6.7	6.8	6.3	5.0	7.6	6.1	7.0	6.0	6.3	6.4
Urban	8.1	8.3	7.7	7.8	6.4	8.5	7.3	7.2	6.8	8.3	7.3	6.9
Naukri JobSpeak Index	8.9	0.3	10.5	6.8	3.4	10.1	-9.3	23.5	13.2	3.4	11.9	9.2

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

Private sector new project announcements, a key forward-looking indicator of capital expenditure, slowed sharply in Q4 FY26, reversing the strong momentum seen in the first three

quarters of the year. Total private new project announcements declined 34% QoQ and 59% YoY in Q4, compared with growth of ~58% YoY during Q1-Q3 FY26, largely driven by the sharp escalation in geopolitical tensions in March, which weakened investor sentiment and led to a pullback in announcements. Capacity utilisation in the manufacturing sector rose 130 bps QoQ to 75.6% in Q3 FY26, remaining above its long-term average, indicating that underlying conditions continue to support fresh investment. However, elevated geopolitical risks and high energy prices pose meaningful headwinds to the nascent private investment recovery. We expect private investment momentum to moderate in the near term, with a gradual recovery contingent on resolution of the Middle East conflict.

### Private Sector New Project Announcements Slowed Sharply in Q4 After Robust Growth in Q1 to Q3 FY26



Source: CMIE

The external sector remains under pressure. Goods exports weakened further, contracting by 7.4% YoY in March, compared with -0.8% in February, partly reflecting an unfavourable base. The contraction in exports to the US deepened in March, marking a fourth consecutive monthly decline, although this partly reflects the front-loading of shipments in early 2025. Sequential momentum in US-bound exports improved, supported by the reduction in reciprocal tariffs.

Exports to the GCC region were significantly disrupted, with shipments to the UAE declining by 61.9% YoY and to Saudi Arabia by 45.7%. Total goods imports also contracted by 6.5% YoY in March, a seven-month low, led by a sharp decline in petroleum, crude and products imports at -35.9% YoY and gold imports at -31.6%, reflecting supply disruptions. A sequential increase in the services account surplus helped narrow the overall trade deficit to a 13-month low.

For FY26 as a whole, goods exports grew by just 0.9% YoY, compared with goods imports growth of 7.5%, resulting in a wider merchandise trade deficit, with the services account surplus continuing to provide a cushion. We expect the current account deficit at ~1.0% of GDP in FY26, widening to around 1.7% of GDP in FY27 (up from the previous

projection of 1.6% of GDP), driven by elevated energy prices and disruptions to GCC-linked exports, partly offset by a recovery in trade with the US and other regions including EU.

### Fiscal Outlook: Fiscal Consolidation on Track for FY26, Pressures Building for FY27

The central government's FY26 fiscal consolidation trajectory appears broadly on track through April-February FY26, with the deficit at 80.4% of the Revised Estimate, improving from 85.8% at the same stage last year, supported by stronger receipts growth alongside muted revenue expenditure growth. Based on the revised GDP series, the FY26 fiscal deficit is estimated at ~4.5% of GDP, marginally above the 4.4% Union Budget Estimate.

For FY27, pressures are likely to build around sustaining the capital expenditure push, budgeted to grow 11.5% over the FY26 revised estimate, and adhering to the fiscal consolidation path. Assuming nominal GDP growth of ~11% in FY27 on the revised base, the implied budget deficit stands at ~4.4% of GDP in FY27, modestly above the 4.31% Budget Estimate. Without significant efforts to boost revenue and/or rationalise expenditure, the central government fiscal deficit is likely to be around 4.8% of GDP in FY27, factoring in revenue losses from excise duty cuts on petrol and diesel, lower dividend transfers from OMCs, and higher fertiliser subsidies, partly offset by buffers available in the Economic Stabilisation Fund. With the conflict persisting and fiscal pressures mounting, a partial pass-through of elevated energy prices to end-users appears likely, expected to be implemented in a staggered manner over May-July. Concurrently, targeted support measures for MSMEs and exporters with GCC trade exposure, including a credit guarantee scheme along the lines of the ECLGS, are also likely to be announced in the coming weeks.

### Inflation: Pressures Contained in FY26; FY27 Upside Risks Rising

Inflation pressures have remained subdued through FY26, with CPI inflation averaging ~2.1% YoY, in line with our estimates. Headline CPI inflation edged up to a 12-month high of 3.40% YoY in March from 3.21% in February, as base effects turned unfavourable, driven by Food and Beverages, Paan, Tobacco and Intoxicants, and Fuel. Food and Beverages inflation rose to 3.7% from 3.4% in February, led by meat and vegetables & pulses. The gas sub-category (LPG and PNG, weight 1.98%) inflation accelerated from 1.6% in February to 5.3% in March, reflecting LPG cylinder price hikes and indicating only partial pass-through of higher global energy prices thus far. A mild uptick in restaurant and accommodation prices was also observed, though it remains contained.

Core inflation remained steady at 3.4%, indicating a benign underlying trend; core inflation excluding gold and silver has also remained stable over the past three months, suggesting that precious metals continue to account for most of the distortion in core readings rather than any broad-based price pressure.

### CPI Inflation Rises to a 12-month High in March; Core Inflation (ex-precious metals) Remains Subdued

Inflation Basket (Base=2024)	Weights (%)	CPI (% YoY)		
		Jan-26	Feb-26	Mar-26
Food and Beverages	36.8	2.1	3.4	3.7
Paan, Tobacco and Intoxicants	3.0	2.9	3.5	4.2
Clothing and Footwear	6.4	3.0	2.8	2.8
Housing, Water, Electricity	17.7	1.5	1.5	2.0
Electricity, Gas and Other Fuels	5.4	0.2	0.1	1.7
Furnishings and Maintenance	4.5	1.4	1.4	1.4
Health	6.1	2.2	1.9	1.8
Transport	8.8	0.1	0.0	0.0
Information and Communication	3.6	0.2	0.2	0.3
Recreation, Sport and Culture	1.5	2.3	2.2	2.3
Education Services	3.3	3.3	3.3	3.3
Restaurants and Accommodation	3.3	2.9	2.7	2.9
Personal Care and Misc.	5.0	19.1	19.7	18.6
<b>Core CPI</b>	<b>57.9</b>	<b>3.4</b>	<b>3.4</b>	<b>3.4</b>
Core (excl. Gold)	57.3	2.9	2.9	2.9
Core (excl. gold & silver)	56.9	1.9	1.9	1.9
<b>Headline CPI</b>	<b>100</b>	<b>2.7</b>	<b>3.2</b>	<b>3.4</b>

Source: CMIE

Looking ahead, we revise our FY27 CPI inflation forecast upward by 0.4 pps to 4.7% (vs. ~2.1% in FY26), reflecting our higher oil price assumption, the expected partial pass-through of elevated energy costs in the coming months, and the potential impact of a weaker monsoon.

### RBI Holds Policy Repo Rate at 5.25%; Wait-and-Watch Approach with Focus on Second-Round Effects

As expected, the RBI's MPC unanimously kept the policy repo rate unchanged at 5.25%, maintaining a neutral stance in its policy meeting in April. The RBI published its first full-year FY27 projections assuming average crude oil price at ~\$85/bbl, projecting real GDP growth at 6.9% with downside risks and CPI inflation at 4.6%, peaking at 5.2% in Q3, with upside risks. Core inflation is projected at 4.4%; excluding precious metals, it is assessed to be lower, indicating underlying inflationary pressures are expected to remain relatively contained. The MPC noted that the initial supply shock could potentially evolve into a demand shock if supply chain normalisation is delayed but assessed that India's macro fundamentals remain stronger than in previous crisis episodes. Confronted with a supply shock and elevated uncertainty, the MPC judged it prudent to adopt a wait-and-watch approach.

The minutes of the meeting and recent commentary from the RBI Governor and Deputy Governor indicate that the RBI will look through first-order energy price effects and focus instead on second-round impacts, which appears appropriate given the elevated uncertainty and the fact that supply-side shocks are more effectively addressed through

targeted supply-side measures and fiscal policy. Based on our expected economic growth and inflation dynamics, and under the assumption of a US-Iran peace agreement in coming weeks and the onset of normalisation from May-June, we expect the RBI to maintain a hold on policy rates through FY27. However, a further delay in Middle East resolution, a re-escalation of the conflict, and/or a more severe monsoon shortfall could bring monetary policy tightening into consideration toward the end of FY27.

### Markets Update

**Equity Market:** Equity markets came under sharp pressure in March amid escalating Middle East tensions. The Nifty 50 Index declined 11.3% MoM in March, reversing the nascent stabilisation in sentiment seen in February, which had been supported by optimism around the US-India interim trade framework and strong corporate earnings. Sentiment deteriorated as crude oil prices surged, heightening concerns around inflation and broader macro risks. FPIs, after briefly turning net buyers in February, reversed course with net outflows of USD 12.7 billion, with additional pressure from concerns around AI-led disruption to India's IT sector outlook.

Sentiment improved in early April, with Nifty 50 Index rising 3.8% on April 8 following the ceasefire announcement. Volatility resurfaced, however, as US-Iran negotiations faltered, pushing Brent crude prices back toward USD 100/bbl. FPIs remained net sellers in April, recording USD 4.7 billion in outflows through April 24, though DII support helped cushion the downside. The Nifty 50 Index has rebounded ~7% in April (till 24<sup>th</sup>) from end-March levels, supported by partial easing of tensions and a moderation in near-term risks. Market direction is likely to remain closely tied to geopolitical developments and crude oil price movements.

**Foreign Exchange Market:** The Indian rupee weakened sharply by 4.2% MoM in March amid escalating Middle East tensions, large FPI outflows, and surging oil prices, closing a record level of ~Rs 94.83/USD by March end. The ceasefire announcement, along with the RBI measures to curb speculative arbitrage between onshore and offshore markets, provided support to the currency in early April. However, the subsequent resurgence in crude oil prices tempered the extent of the recovery. Through April 24, the rupee has appreciated modestly by ~0.6% from end-March level to ~Rs 94.26/USD.

Forex reserves declined to ~USD 703 billion as of April 17 from USD 728 billion at end-February, reflecting active RBI intervention to manage currency volatility. The rupee is likely to remain sensitive to crude oil price movements; sustained elevation in oil prices could keep depreciation pressures

intact, while durable geopolitical de-escalation may enable a sharp recovery.

**Bond Market:** Banking system liquidity tightened in March, with the average surplus declining to Rs 1.6 lakh crore from ~Rs 2.55 lakh crore in February, driven by advance tax and GST outflows alongside RBI FX intervention, with brief episodes of deficit. Liquidity rebounded sharply in April, with the surplus averaging Rs 4.3 lakh crore through April 23, supported by government spending and G-Sec redemptions. Reflecting this, WACR eased to ~5.02% through April 23, close to the SDF rate of 5.00%, prompting the RBI to conduct a VRRR operation to absorb surplus liquidity.

The 10-year G-Sec yield rose to a high of 7.13% in early April amid macro-fiscal concerns and elevated crude prices, before easing to 6.94% as of April 24 following the ceasefire extension. The G-Sec yield curve has shifted upward relative to pre-conflict levels, led by sharper increases at the short end, indicating a repricing of near-term rate expectations and inflation risks. Near-term yield direction will be driven by RBI liquidity operations, the trajectory of crude oil prices, and FPI flows into the debt market.

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