29 September 2026

India's Economic Growth Remains Resilient; Broadening Inflation Pressures Bring RBI Policy Tightening Forward

- Global monetary tightening is becoming more broad-based, with the US Fed, ECB, and BoJ all raising policy rates as inflation remains above target in several countries. Further policy tightening is likely, which should help contain upside inflation risks and support greater stability in key global bond markets.
- India's economic growth momentum remains largely resilient despite the external energy shock. Q1 FY27 real GDP growth surprised on the upside at 7.8% YoY, and high-frequency indicators remained broadly firm through July-August.
- We now expect FY27 real GDP growth at 7.2%, with some moderation likely later in the year as fiscal support eases, monsoon-related headwinds to agricultural output persist, net exports turn into a drag on growth, base effects turn less favourable, and higher price pressures raise the GDP deflator.
- Industrial activity remained robust, while services momentum strengthened. PMIs were mixed in August, with weaker manufacturing activity, but September flash PMIs point to renewed momentum across both manufacturing and services.
- Risks to the agriculture sector persist as deficient and uneven southwest monsoon rainfall, lower kharif acreage and below-average reservoir levels continue to pose risks to agricultural output, rural incomes and food inflation.
- Private consumption indicators showed resilience through August, although the outlook remains exposed to headwinds from rising inflation and risks to rural incomes from deficient monsoon rainfall. The labour market registered a sharp employment gain in August, but the gains were concentrated in rural areas and relatively informal jobs.
- The Centre's fiscal deficit remains contained so far, but higher crude oil prices have increased full-year slippage risks. The fiscal deficit is likely to reach around 4.5–4.6% of GDP, above the 4.3% BE, and the government will likely need to rationalise expenditure to meet the budget deficit target.
- Merchandise exports grew strongly in August, and the trade deficit narrowed. We expect the FY27 CAD to widen to 1.4% of GDP from 0.7% in FY26, reflecting, among other factors, elevated crude oil prices. Large FX reserves of ~US$766 billion provide ~11 months of merchandise import cover.
- CPI inflation rose to a 20-month high of 4.8% in August, with food, core and item-level inflation diffusion all firming. We retain our FY27 CPI forecast at 5.1%, with inflation expected to exceed 6% during Q3 FY27 and risks tilted upward.
- Broadening inflation pressures, persistent supply disruptions, higher crude oil prices, and tighter global monetary conditions have brought forward our expected start of the policy rate-hiking cycle to October.
- At the RBI's October policy meeting, we expect a 25-bps repo-rate hike, a shift in stance from neutral to withdrawal of accommodation, and liquidity-absorption measures, while retaining our call for cumulative repo-rate hikes of 50–75 bps.
- The large liquidity surplus remains the key complication for the October MPC. Foreign-currency inflows under the RBI's special swap facilities pushed banking-system liquidity sharply into surplus, although recent tax outflows and RBI operations have reduced the excess. We expect the RBI to continue using VRRRs, OMO sales, sell-buy FX swaps and, if needed, other liquidity-absorption tools to keep the WACR closer to the repo rate and improve transmission.

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Global Monetary Tightening Broadens as Major Central Banks Respond to Persistent High Inflation

Following recent rate increases by the Federal Reserve, European Central Bank (ECB) and Bank of Japan (BoJ), monetary tightening is shifting from idiosyncratic to more broadly based. This mid-cycle tightening campaign now underway is necessary, in our judgment, to curtail upside inflation risks in some of the world's largest economies and to help to stabilise key global bond markets such as the US Treasury and Japanese Government Bond markets. Both these developments are essential in maximising the duration of the current global economic expansion.

More tightening by these central banks – and, increasingly, their peers around the world – lies ahead. Inflation in many countries – particularly advanced economies – continues to run at an above-target pace. With many economies at or close to full employment, a return of core inflation to target – or close to it – on its own will be very difficult to achieve. A reversal of some or part of the geopolitical-induced surge in energy prices would be welcome. But the prevailing inflation rates are due to price pressures that extend beyond energy, requiring a tighter monetary backdrop to maintain macroeconomic stability.

This month's BoJ interest rate hike was particularly notable. The quarter-percentage-point rate increase lifted the BoJ's policy interest rate to its highest level since April 1995. Moreover, Governor Ueda's hawkish comments in the post-meeting press conference indicated that the BoJ likely is accelerating its pace of tightening from once every six months to once every three months. Given Japan's deflationary history and the extraordinary macro policy measures that ultimately were put in place to propel the economy out of deflation plus the Takaichi government's desire for as a low-as-possible policy interest rate, the seemingly now every quarter pace of monetary tightening is a significant development / break from historical caution.

Monetary tightening in the United States has also begun. Like Japan, the US economy has strengthened in recent quarters in the face of higher energy costs and has an inflation rate that is above target. Chairman Warsh's statement that the Fed "removed a dose of accommodation" with its 25-bps rate hike is aligned with our assessment that the policy setting in the US is not restrictive. Such language breaks from the policy setting characterization of the Powell Fed and – more importantly – points toward additional policy tightening ahead. The Fed likely will boost its policy rate by another half percentage point between now and yearend.

Additional monetary tightening in the months and/or quarters ahead is unlikely to restore the US, Japanese, European, or similar economies' underlying rate of inflation back to its target rate. The resilience of economic activity in these (and other) economies suggests that while higher rates over time will have the desired directional effect, they are unlikely to be sufficient to push inflation back down to target on their own. Ultimately, an economic contraction probably will be necessary for inflation to return to target or lower on a realised basis.

Nonetheless, this monetary tightening has the capacity to truncate upside inflation risks. Even if inflation is going to remain above target for the remainder of the business cycle, reducing the upside risks to inflation / nudging the underlying rate lower as soon as possible has immense benefits for the current expansion.

For one, tighter monetary policy in time should help to stabilise key bond markets. Such development is extremely important from a financial stability perspective. Despite the nascent shift in central bank posture, select bond markets continue to remain under pressure – yields higher, bond prices lower – as highlighted by recent price action. Rapid, outsized spikes in benchmark bond yields historically often have produced collateral damage to interest rate sensitive economic sectors and/or the financial system so containing that risk is critical. For another, tightening now and reaping some rewards – even modest ones – on the inflation front likely reduces the amount of future monetary tightening and the risk of prematurely short circuiting the expansion. Finally, some relief on inflation would enhance households' real purchasing power.

India's Economic Growth Remained Resilient; Robust Activity Gives the RBI Greater Policy Space to Focus on Controlling Inflation

The Indian economy weathered the global energy-supply shock better than initially feared, with real GDP growth surprising on the upside at 7.8% YoY in Q1 FY27, although it moderated from 8.6% in Q4 FY26. Growth was supported by a favourable base, resilient private consumption, a pickup in investment, including front-loaded central government capital expenditure, and a higher contribution from net exports. On the supply side, growth was supported by stronger manufacturing and electricity & other utilities activity and sustained double-digit growth in services, partly offset by moderation in agriculture and construction and continued weakness in mining. (Please refer to our Q1 GDP report for more details, link).

Economic resilience was also supported by the lagged impact of earlier policy support, including tax relief and monetary easing, and by FY27 measures to limit the pass-through of higher global energy prices to domestic retail prices. The longer-term decline in energy intensity and greater diversification of energy sourcing since the onset of the Middle East conflict also appear to have helped cushion

the shock, alongside the economy's favourable underlying fundamentals.

High-frequency data point to continued momentum in economic activity through August, even as inflationary pressures broadened and geopolitical developments, along with associated crude oil-price volatility, remained key risks. We expect economic activity to remain resilient through the rest of FY27, although real GDP growth is likely to normalise due to less favourable base effects, expected moderation in fiscal support, a drag from net exports as import volumes rise, and the potential impact of deficient and uneven monsoon rainfall on agricultural output and rural incomes. A higher GDP deflator, reflecting the pass-through of input-cost pressures to output prices, could mechanically lower reported real GDP growth relative to nominal growth, while the underlying rise in price pressures could weigh on household purchasing power.

Following the Q1 FY27 real GDP release, we had indicated that full-year growth could exceed 7%, given resilient economic activity and robust growth momentum. We now forecast FY27 real GDP growth at 7.2%, with growth expected to remain around 7% in Q2 and Q3 before moderating to slightly below 7% in Q4. Renewed geopolitical tensions, disruptions to energy shipments through the Strait of Hormuz and the resulting rise in crude oil prices continue to pose headwinds to the outlook.

RBI October Policy Preview: Case for Earlier Tightening Strengthens as Inflation Risks Broaden, Supply Disruptions Persist, and Global Rates Rise

At the time of our last monthly report (link), we expected the RBI's policy tightening cycle to begin in December 2026 or February 2027, while acknowledging the possibility of rate action as early as October. Developments since then have strengthened the case for starting the tightening cycle earlier, and we now expect the RBI to begin raising the policy rate in October. Our cumulative policy-rate hike call remains unchanged at 50–75 bps.

Four developments underpin our call for an earlier start to the monetary policy tightening cycle. First, price pressures have continued to build, with headline CPI inflation rising to a 20-month high of 4.8% in August 2026, Food & Beverages inflation accelerating further, and core inflation rising above 4%. Meanwhile, WPI inflation remained elevated, pointing to continued upstream price pressures. Firmer food inflation, potentially wider pass-through of input-cost pressures to retail prices, and potential second-round effects from the fuel and supply shock could add to inflationary pressures in the coming months.

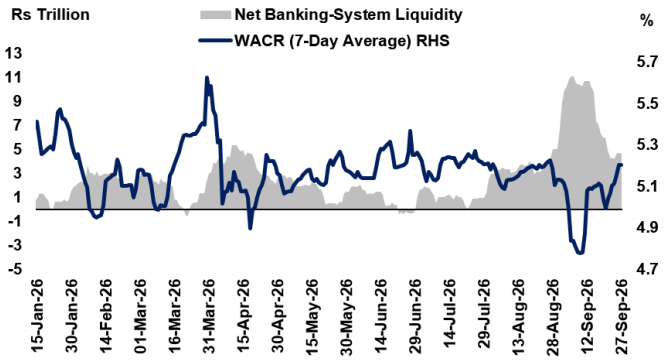
We retain our FY27 CPI inflation forecast of 5.1%, with upside risks from higher crude oil prices, disruptions to energy supply routes and deficient and uneven monsoon rainfall. We expect CPI inflation to exceed 6% during Q3 FY27 before easing to around the mid-5% range in Q4. The prospective inflation trajectory also implies a relatively weak real policy rate cushion. As highlighted in our August policy review (link), the RBI's own projections showed headline CPI inflation remaining above 5% for three consecutive quarters from Q3 FY27 to Q1 FY28. At an FY27 average CPI inflation rate of around 5%, the real policy rate is only marginally positive on average, while it is likely to turn negative during part of the projected high-inflation phase. In our view, resilient economic growth, a negative ex-ante real policy rate during part of the forecast horizon, and persistent upside inflation risks strengthen the case for policy normalisation rather than an extended pause.

Second, the Middle East conflict has persisted longer than initially anticipated, with no clear path to resolution, prolonging risks from energy-supply disruptions, elevated crude oil prices and higher input costs. The RBI had earlier indicated that it would monitor whether supply-side shocks generated broader second-round effects; the recent broadening in core and item-level inflation therefore assumes greater policy significance.

Third, domestic economic growth in Q1 FY27 proved more resilient than initially anticipated, and high-frequency indicators through July-August point to continued momentum. This gives the RBI greater policy space to focus on controlling inflation.

Finally, the external monetary-policy environment has become less supportive. Major advanced-economy central banks have moved towards tighter monetary policy, with the US Fed, ECB and BoJ raising policy rates in September, while global sovereign bond yields have moved higher. This does not mechanically determine RBI policy, but it tightens external financial conditions and reduces the room for a relatively accommodative domestic real policy-rate setting when domestic inflation is also rising.

Absorption of Excess Banking-System Liquidity Required to Align WACR with the Policy Repo Rate



Source: CMIE. Note: WACR stands for Weighted Average Call Money Rate.

The principal complication for the October meeting is the unusually large surplus in banking-system liquidity. Substantial foreign-currency mobilisation under the RBI's special FCNR(B), ECB and OFCB swap facilities injected large amounts of rupee liquidity into the banking system. The average liquidity surplus rose to around Rs 8.1 trillion during September (through 27 September), compared with Rs 3.7 trillion in August and around Rs 1.1 trillion in July. The surplus has since moderated sharply, with the latest reading at around Rs 4.6 trillion, reflecting a combination of tax outflows and RBI liquidity-absorption operations, including OMO sales and VRRR operations, alongside a reported sell-buy FX swap. The decline is significant, but liquidity remains comfortably in surplus (~1.5% of NDTL), and part of the tax-related drain could reverse as government spending subsequently returns liquidity to the banking system. Moreover, the WACR has traded below the repo rate for much of September, indicating that effective overnight monetary conditions have remained easier than the policy rate would suggest.

This creates an important sequencing challenge for the MPC. Raising the policy repo rate while the WACR remains below it would dilute the immediate transmission of policy tightening. The RBI therefore needs to continue withdrawing surplus liquidity alongside any rate action, with the objective of bringing the WACR closer to the policy repo rate.

The RBI has several instruments available. VRRR operations can absorb short-term liquidity, while additional OMO sales would provide more durable absorption. Sell-buy FX swaps can also drain rupee liquidity, while securities issued under the Market Stabilisation Scheme and separate Cash Management Bills offer further sterilisation options if the surplus remains persistent. Festive-season currency demand and tax payments could further drain liquidity, while RBI spot dollar sales could absorb further rupee liquidity. We do not rule out the use of reserve-requirement measures if surplus liquidity remains persistently large.

Overall, continued robust economic activity should give the RBI greater policy space to address rising inflationary pressures. The August MPC minutes had already indicated a shift in the balance of risks. Some members noted that a pause preserved flexibility rather than necessarily implying an extended hold, while the Governor and Deputy Governor highlighted conditions under which policy recalibration or a rate hike could become appropriate as the inflation trajectory evolved. Since then, stronger-than-expected economic growth, broader inflation pressures, prolonged geopolitical and energy risks and tighter global financial conditions have moved the balance further towards earlier policy tightening.

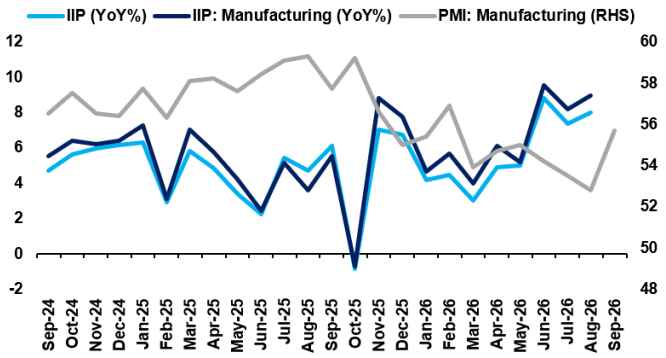
Our base case is for a 25-bps policy repo-rate hike in October, alongside a shift in the policy stance from neutral to withdrawal of accommodation and continued liquidity absorption, followed by further tightening that takes cumulative rate hikes to 50–75 bps. However, the October decision remains finely balanced. We do not rule out the possibility of the RBI deferring the initial rate hike to December, allowing more time to absorb excess liquidity and bring the WACR closer to the policy repo rate to support effective transmission.

Industrial Activity Remained Robust and Services Regained Momentum; Headwinds to the Agricultural Outlook Persist

Industrial activity remained robust in August, with high-frequency indicators pointing to healthy manufacturing momentum.

India's industrial output growth accelerated to 8% in August 2026, as compared to a revised 7.4% in July. Manufacturing and Electricity & Gas Supply continued to drive industrial growth, while growth in Water Supply, Sewerage & Waste Management softened but remained healthy; conversely, mining contracted for the second consecutive month. Within manufacturing, breadth remained healthy, with 18 of 23 industry groups recording growth.

Industrial Activity Remained Robust in August; September Flash PMI Signals Further Rebound



Source: CMIE; S&P Global. Note: September 2026 data reflect Flash PMI estimates.

Cumulatively, IIP growth during April–August FY27 stood at 6.8% YoY, supported by strong investment-linked production, particularly capital and infrastructure goods, broad-based manufacturing strength and steady durable-goods output. Export demand and possible precautionary stocking amid uncertainty over the duration of energy-supply disruptions may have provided additional support to production.

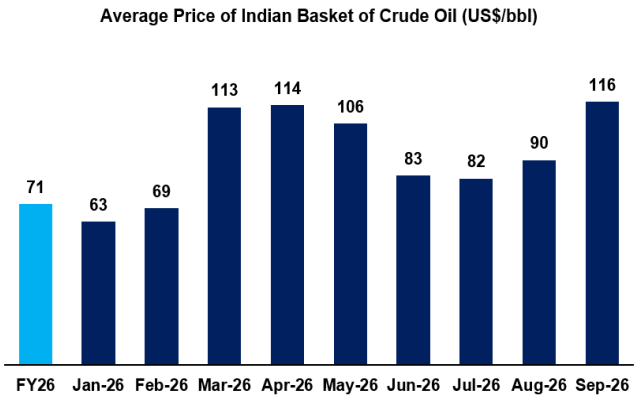
Survey indicators, on the other hand, pointed to softer manufacturing momentum in August, as the Manufacturing PMI declined to 52.8 from 53.5 in July, indicating the weakest improvement in sector conditions in five years. Output and new orders grew at their softest rates since August 2021. Softer demand was also reflected in a second consecutive month of finished-goods inventory

accumulation. However, September's flash Manufacturing PMI rose to 55.7, signalling a renewed pickup in manufacturing activity, led by faster growth in output and new orders.

Going ahead, renewed Middle East-related supply disruptions and elevated input costs, particularly higher crude oil prices, could weigh on industrial activity. Any payback from earlier precautionary stocking could also temper industrial momentum in the coming months, although festive-season demand could provide some near-term support.

Renewed geopolitical tensions and disruptions to energy shipments through the Strait of Hormuz have pushed India's crude oil basket price sharply higher. The September-to-date average has risen to around US$116/bbl, close to levels seen during March–April 2026, following US$90/bbl in August and a brief easing to US$82–83/bbl during June–July after the US–Iran interim agreement. These developments pose upside risks to our FY27 average crude oil price assumption of US$85/bbl and could add to input-cost pressures across energy-intensive industries.

Geopolitical Re-Escalation and Hormuz Disruptions Push Crude Oil Prices Higher



Source: PPAC. Note: September 2026 average is through 25 September.

Fuel consumption data for August showed resilient transport fuel demand, though growth moderated from July as peak-monsoon seasonality weighed on road freight activity. Petrol and diesel consumption continued to expand, albeit at a slower pace, while domestic LPG consumption contracted by ~17% YoY, marking its sixth consecutive month of double-digit decline. Import diversification provided an important cushion to domestic energy supplies, with Russia supplying around 45% of crude oil imports, while the US accounted for around one-third of LNG and around half of LPG imports in August. This helped partially cushion domestic supplies against disruptions through the Strait of Hormuz.

Services Activity Regains Momentum in August; September Flash PMI Signals Continued Strength

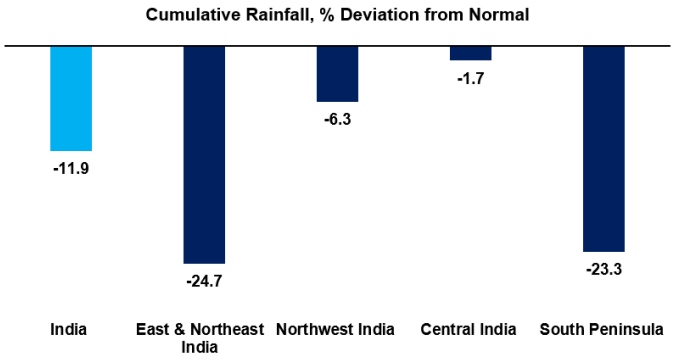
Indicators (YoY%)	Q4FY26	Q1FY27	Apr-26	May-26	Jun-26	Jul-26	Aug-26
PMI Services	58.0	58.7	58.8	59.8	57.4	53.3	54.1
International Passenger Traffic	-2.8	-10.0	-16.1	-9.1	-4.6	-4.6	-3.4
Port Cargo Traffic	4.4	6.1	2.4	6.6	9.2	8.8	8.4
GST E-way Bills	15.8	12.4	11.8	10.9	14.5	6.0	7.7
Services Exports	8.9	9.6	12.7	2.8	13.3	13.4	24.6
Banking Non-Food Credit	15.9	18.3	15.8	17.4	18.3	19.1	18.8

Source: CMIE and RBI. Banking non-food credit for August 2026 is provisional as per the RBI Bulletin. FY26 and quarterly numbers are based on monthly averages. Credit growth numbers are as of the end of the period.

Services activity improved in August after a mixed performance in July. Freight activity remained firm in August, with port cargo traffic maintaining momentum, while GST E-way bill growth inched up. Services export growth surged to its highest rate in 42 months, based on preliminary data. Banking-sector non-food credit growth remained strong, while deposit growth accelerated. International passenger traffic remained weak amid Middle East-related disruptions, higher fuel costs and capacity rationalisation.

Survey indicators also pointed to continued momentum. The Services PMI rose to 54.1 from 53.3 in July, as growth in both business activity and new orders strengthened. The improvement extended into September, with the flash Services PMI rising to 55.8.

Cumulative Rainfall Deficit Persists, Posing Risks to Agricultural Output



Source: CMIE. Data through 27 September 2026.

The withdrawal of the southwest monsoon has commenced. Cumulative rainfall during the southwest monsoon season remained 12% below normal as of 27 September, with substantial regional variation.

Deficient and uneven rainfall weighed on kharif sowing. Kharif sowing has almost concluded, with total acreage 1.2% lower YoY as of 25 September. Rice recorded the steepest decline in sowing, partly due to a high base, although its acreage remained well above the normal level.

Deficient rainfall has also kept reservoir levels below their long-term average, with storage at around 71% of full capacity as of 24 September, compared with the 10-year average of around 80%. Beyond the potential impact on kharif crops, below-normal rainfall and weaker reservoir storage levels could also weigh on rabi crops prospects by reducing soil-moisture availability and irrigation buffers. These conditions pose downside risks to agricultural output and rural incomes, and upside risks to food inflation.

Private Consumption Indicators Held Up in August; Festive Demand to Provide Near-Term Support

Private consumption indicators showed resilience through August, although the outlook remains exposed to headwinds from rising inflation, potential erosion of household purchasing power and risks to rural incomes from deficient and uneven southwest monsoon rainfall.

Urban and rural demand indicators held up in August, although growth moderated from July levels. Retail passenger vehicle sales, a proxy for urban demand, continued to record double-digit growth of 16.1% YoY, while retail two-wheeler sales, a proxy for rural demand, remained robust at 19.7% YoY. Going ahead, festive-season demand should remain supportive; however, a higher base from October onwards is likely to weigh mechanically on YoY growth.

Other high-frequency consumption indicators were mixed but broadly supportive. Banking-sector retail credit growth accelerated to 16.2% YoY in July. Consumer durable goods production growth remained elevated in August while non-durable consumer goods output growth improved from a mild contraction in the previous month. Meanwhile, domestic air passenger traffic contracted further in August, reflecting capacity rationalisation, higher aviation fuel costs and weather-related disruptions, although festive-season travel could provide some near-term support.

Labour-market conditions rebounded sharply in August, though gains remained heavily skewed towards rural areas and relatively informal employment. According to CMIE data, employment rose by 13.3 million in August, marking the largest monthly employment gain since April 2025. However, as the expansion in the labour force outpaced employment gains, the headline unemployment rate edged up slightly to 6.1% in August from 6.0% in July. Employment gains were largely rural-driven and concentrated in agriculture and real estate and construction. By occupational category, gains were dominated by small traders and wage labourers, accounting for around 90% of the overall increase in employment, while salaried employment declined.

Formal-sector hiring strengthened sharply on a YoY basis, with the Naukri JobSpeak Index rising 13.7% YoY in August from 5.0% in July, although the headline acceleration was amplified by a favourable base and the index contracted sequentially after expanding in the previous two months. Going ahead, sustained improvement in labour-market conditions, including employment quality and wage/salary growth, will be key to supporting durable consumption growth, while rising inflation and monsoon-related risks to rural incomes remain near-term constraints.

Private Consumption Indicators Showed Resilience in August, but Rising Inflation Poses Risks

Indicators (YoY%)	Q4FY26	Q1FY27	Apr-26	May-26	Jun-26	Jul-26	Aug-26
Passenger Vehicle Sales	18.3	23.3	18.1	23.2	28.6	19.1	16.1
Two-wheeler Sales	24.8	15.3	17.2	7.5	21.2	28.3	19.7
IIP- Consumer Durables	2.1	8.0	5.6	8.0	10.3	12.0	11.1
IIP- Consumer Non-durables	-0.1	1.8	0.2	-0.4	5.6	-0.8	2.1
Retail Credit Growth	16.2	15.8	16.0	15.4	15.8	16.2	
Domestic Air Passenger Traffic	0.6	1.2	-2.9	7.7	-1.2	-4.7	-6.0
Unemployment Rate (%)	6.7	6.8	6.7	7.0	6.6	6.0	6.1
Rural	6.2	6.5	6.7	6.4	6.4	6.1	6.2
Urban	7.5	7.3	6.7	8.0	7.1	5.9	6.0
Naukri JobSpeak Index	8.1	4.3	5.8	1.0	6.1	5.0	13.7

Source: CMIE and RBI. Numbers shown are YoY changes (%) except unemployment rates, which are reported as levels (%). FY26 and quarterly numbers are based on monthly averages. Credit growth numbers are as of end-period.

Investment Activity Strength Likely Extended into Q2, though a Broader Private Capex Revival Remains Contingent on Geopolitical and Energy-Supply Risks

India's real GDP growth in Q1 FY27 was supported by strong investment activity, underpinned by robust central government capex and likely resilience in private investment. High-frequency investment indicators suggest this momentum carried into early Q2, with IIP capital goods output expanding by an average of ~18% YoY and infrastructure and construction goods output growing by an average of 7.2% YoY during July-August. Central government capex also surged by ~54% YoY in July, following strong front-loading during Q1 FY27.

However, central government capex growth is expected to moderate over the remainder of FY27 after early front-loading, which could moderate the pace of overall investment growth. Private capex appears to have held up despite the adverse external environment, but near-term caution could persist amid renewed geopolitical uncertainty and elevated energy prices. A sustained easing of these risks would be important to support corporate confidence, protect margins, and facilitate broader strengthening in private investment.

Centre's Fiscal Deficit Remains Contained in 4MFY27, but Higher Oil Prices Raise Full-Year Slippage Risks

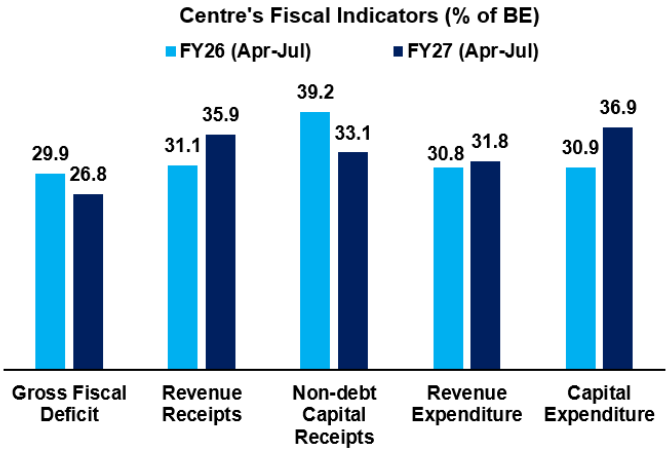
The central government's fiscal position remained comfortable during the first four months of FY27 (April–July),

with the fiscal deficit at 26.8% of the BE compared with 29.9% in the corresponding period last year.

The Centre's total expenditure expanded by 12.7% YoY during April–July, driven by a strong 29.9% increase in capital expenditure, while revenue expenditure grew at a measured pace as a sharp uptick in major subsidies, up 35.1% YoY, was partly offset by a 4.5% decline in interest payments.

On the revenue front, tax receipts during April–July were supported by corporation tax, income tax and customs duties. Notably, net tax revenue surged 27.6% YoY during April–July FY27, partly reflecting the timing of tax devolution to states, as an additional instalment was released earlier last year. This timing effect should become less pronounced from August, when the Centre released an additional devolution instalment alongside the regular monthly transfer. Non-tax revenue growth remained muted, as strong growth in dividends & profits and interest receipts was partly offset by a contraction in other non-tax revenue. More recent data indicate that non-debt capital receipts remained strong, with disinvestment and asset-monetisation proceeds reaching 78% of the full-year target by end-August.

Centre's Fiscal Deficit Remains Contained Compared with Last Year



Source: CMIE. Note: Percentages represent actuals for the stated period as a share of the full-year Budget Estimate.

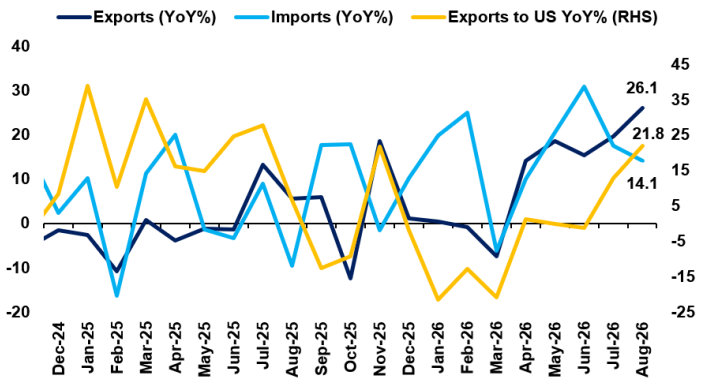
Looking ahead, lower excise revenue following the March 2026 duty cuts on petrol and diesel, potentially lower OMC dividends and higher fertiliser subsidies pose fiscal-slippage risks, amplified by the resurgence in crude oil prices. Higher export duties on petroleum products, higher customs revenue from gold and silver imports, stronger disinvestment and asset-monetisation receipts, available budgetary flexibility under the Economic Stabilisation Fund, and the decline in fertiliser prices from their post-Middle East conflict peaks could help contain these pressures. We expect the FY27 fiscal deficit to reach 4.5–4.6% of GDP, above the budgeted 4.3%. The government is nevertheless likely to seek to adhere to the budgeted fiscal-deficit target, potentially through some expenditure rationalisation later in the year. However, if crude oil prices remain elevated, the risk of fiscal slippage would increase.

Export Growth Gained Momentum in August; Current Account Deficit Widened, but Strong Capital Inflows Supported a BoP Surplus in 4M FY27

Merchandise export growth accelerated to a 50-month high of 26.1% YoY in August from 19.6% in July, marking the fifth consecutive month of double-digit expansion. Exports to the US strengthened further, alongside robust shipments to Singapore, China, Tanzania and South Africa; conversely, exports to GCC countries (ex-Bahrain) contracted amid continued Middle East-related trade disruptions. Goods import growth moderated, as a sharp contraction in gold imports helped contain the import bill despite higher oil imports and continued expansion in non-oil, non-gold and non-silver imports.

During April–August FY27, merchandise exports expanded by 17.8% YoY, while imports rose by 18.2% YoY. Export growth remained highly concentrated, with five export commodity categories — Engineering Goods, Petroleum Products, Electronic Goods, Chemicals, and Meat & Dairy Products — accounting for ~91% of the absolute YoY increase during April-August FY27, while Ceramic Products & Glassware and RMG of All Textiles recorded sharp declines over the same period. Similarly, five import categories — Petroleum Crude & Products, Electronic Goods, Machinery, Non-Ferrous Metals, and Fertilisers — accounted for ~84% of the absolute YoY increase in imports during the same period.

Export Growth Gained Momentum in August; Imports Moderated



Source: CMIE.

India's goods trade deficit narrowed to a five-month low of US$26.9 billion in August 2026, from US$32.0 billion in July, driven by a sharp sequential contraction in imports, particularly gold, which more than offset a sequential decline in exports. Preliminary estimates indicate that the services trade surplus remained broadly stable in August, continuing

to provide a significant cushion against the merchandise trade deficit.

India's current account deficit widened to US$11.2 billion during April–July FY27, from US$6.6 billion a year earlier, as a wider merchandise trade deficit offset gains in net services receipts and transfers. We maintain our FY27 current account deficit forecast at 1.4% of GDP, compared with 0.7% in FY26 (based on revised GDP).

In contrast, the overall balance of payments recorded a surplus of US$12.7 billion during April–July FY27, up from US$4.8 billion a year earlier, as net capital inflows more than doubled to US$23.9 billion. The improvement was driven by a US$20.8 billion BoP surplus in July, supported by strong NRI deposit inflows following the RBI's special forex swap facility, alongside higher net FDI inflows and short-term trade credit.

Foreign exchange reserves reached an all-time high of US$785.7 billion on 4 September before easing to around US$766 billion by 18 September, providing a robust buffer equivalent to around 11 months of merchandise import cover.

Inflation Pressures Broaden in August; Food, Energy and Core Prices Point to Further Near-Term Upside

Inflation pressures continued to rise and broaden in August. Headline CPI inflation rose to a 20-month high of 4.8% in August 2026 from 4.45% in July, remaining above the RBI's 4.0% target for a third consecutive month. Price pressures broadened further, with 10 of the 12 major CPI categories recording higher inflation than in July, led by Food & Beverages, Housing, Water & Electricity, Information & Communication, Restaurants & Accommodation, and Personal Care & Miscellaneous.

CPI Inflation Accelerated in August as Price Pressures Broadened Further

Inflation Basket	Weights	YoY%				
Base Year: 2024	%	Apr-26	May-26	Jun-26	Jul-26	Aug-26
Food and Beverages	36.8	4.0	4.5	5.1	5.2	5.7
Paan, Tobacco and Intoxicants	3.0	4.8	4.8	4.8	4.8	4.7
Clothing and Footwear	6.4	2.8	3.0	3.2	3.4	3.6
Housing, Water, Electricity	17.7	1.7	1.7	2.0	2.2	2.6
Furnishings and Maintenance	4.5	1.6	1.9	2.2	2.4	2.7
Health	6.1	1.6	1.5	1.4	1.34	1.33
Transport	8.8	0.0	1.8	4.3	4.4	4.6
Information and Communication	3.6	0.5	0.3	0.4	0.6	2.0
Recreation, Sport and Culture	1.5	2.1	2.0	1.7	1.6	1.7
Education Services	3.3	3.1	3.0	3.4	3.7	3.7
Restaurants and Accommodation	3.3	4.2	5.7	6.9	7.7	8.4
Personal Care and Misc.	5.0	17.7	18.5	16.7	14.8	15.2
Core CPI	**53.0**	**3.7**	**3.9**	**3.9**	**3.9**	**4.2**
Core (excl. Gold & Silver)	52.1	2.2	2.4	2.5	2.7	2.9
Headline CPI	**100.0**	**3.5**	**3.9**	**4.4**	**4.45**	**4.8**

Source: CMIE. Note: Core CPI excludes food and fuel from the CPI basket. Fuel comprises the group 'Electricity, gas and other fuels' and the class 'Fuels and lubricants for personal transport equipment', which includes diesel, petrol and other natural gas.

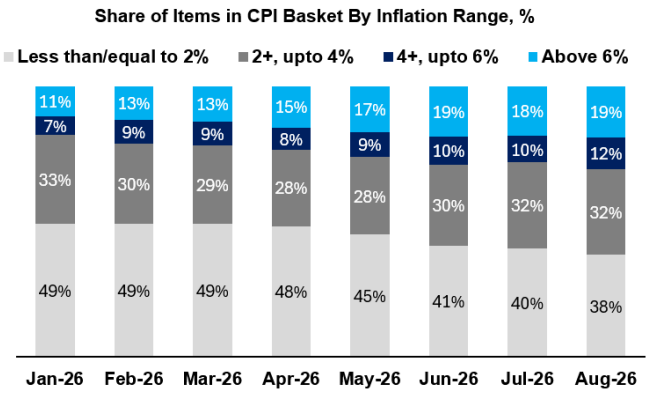
Food & Beverages inflation rose to 5.7% in August from 5.2% in July, with 9 of the 11 sub-categories recording higher inflation. The sharpest acceleration was seen in sugar, cereals, and fruits & nuts, while inflation moderated only in meat and oils & fats, although price pressures in these categories remained elevated. Near-term food-price risks remain tilted to the upside, particularly given deficient and uneven southwest monsoon rainfall and its potential impact on crop yields and food prices. More recent daily retail food-price data we track point to further acceleration in food inflation in September.

Core CPI inflation (excluding food & fuel) firmed to around 4.2% in August after remaining near 3.9% over the previous three months. Underlying inflation also strengthened beyond the impact of precious metals, with core inflation excluding gold & silver rising to 2.9% from 2.7% in July and 2.5% in June. This points to a gradual broadening of underlying price pressures and is consistent with potential pass-through from higher input, fuel and service-sector costs.

Our item-level analysis also points to a gradual broadening of inflation. Among 358 CPI items, the share recording inflation above 4% rose from 18% in January to 31% in August, while the share with inflation of 2% or below declined from around 49% during January–March to 38% by August. A similar pattern is visible within core CPI, where the share of items recording inflation above 4% nearly doubled from 10% in January to nearly 20% in August.

Wholesale price pressures remained elevated, with WPI inflation edging up to 9.9% in August from 9.8% in July. The sizeable gap between WPI and CPI inflation partly reflects a faster rise in wholesale crude oil and energy-related prices relative to retail prices, suggesting scope for additional pass-through to consumer prices if elevated input costs persist.

Inflation Broadens as Share of CPI Items Recording Inflation Above 4% Continues to Rise



Source: CMIE.

Overall, firmer food inflation, potentially wider pass-through of input-cost pressures to retail prices, and possible second-round effects from the energy-price and supply shock are

likely to keep inflation elevated in the coming months. This is particularly relevant given the RBI's earlier emphasis on monitoring whether supply-side disruptions generate broader second-round effects on inflation. We retain our FY27 CPI inflation forecast at 5.1%, with upside risks from higher crude oil prices, disruptions to energy supply routes, and deficient and uneven monsoon rainfall. We expect headline CPI inflation to rise above 5% in September and exceed 6% during Q3 FY27, partly reflecting an unfavourable base following last year's GST rate cuts, before easing thereafter.

Market Update

Bond market: India's 10-year G-Sec yield rose from 6.95% at end-August to ~7.18% by 28 September, amid renewed Middle East tensions, higher crude oil prices, rising US Treasury yields and foreign portfolio outflows. The relatively hawkish tone of the August MPC minutes also reinforced expectations of tighter domestic monetary policy. On the supply side, the Centre now plans FY27 gross dated market borrowing of Rs 15.99 trillion, compared with the Budget Estimate of Rs 17.2 trillion, with H2 FY27 issuance pegged at Rs 7.86 trillion. Switch transactions during H1 had already reduced the effective full-year gross borrowing requirement to around Rs 16.09 trillion, implying only a modest additional reduction relative to the previously indicated borrowing requirement.

Going forward, bond-market conditions are likely to remain sensitive to crude oil prices, global bond yields, foreign capital flows and evolving expectations of domestic monetary-policy tightening.

Equity market: Equity markets weakened further in September amid renewed geopolitical tensions and crude oil prices rising above US$100/bbl. After declining ~1.2% in August, the Nifty 50 Index fell further by ~5.4% through 28 September, with FPI flows reversing after two consecutive months of inflows. FPIs recorded net equity outflows of around US$2.2 billion in September (through 28 September), while continued DII buying provided some support. Near-term market sentiment is likely to remain sensitive to geopolitical developments, crude oil prices, foreign capital flows and global risk appetite.

Foreign-exchange market: The rupee's modest recovery in August reversed in September amid renewed geopolitical tensions, elevated crude oil prices and FPI outflows. After appreciating 0.2% MoM to Rs 95.17/US$ by end-August, the rupee depreciated 0.9% to ~Rs 95.99/US$ by 28 September. RBI intervention appears to have contained sharper volatility, but persistent external pressures, particularly elevated oil prices and foreign portfolio outflows, are likely to remain key near-term risks for the rupee. Large foreign exchange reserves of around US$765.9 billion as of 18 September, well above the pre-conflict level of US$728.5 billion in February 2026, continue to provide a substantial external buffer, although the headline reserve level should also be viewed alongside the RBI's sizeable forward dollar commitments.

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