

India's Economic Activity Remains Resilient; Inflation and Rupee Pressures Raise the Risk of Faster RBI Policy Tightening



- Global monetary tightening is likely to continue despite the US Fed's and BOJ's October pauses, as resilient economic activity, above-target inflation, and energy-related supply risks support further rate hikes.
- India's economic activity remained broadly resilient, although pockets of weakness emerged. Industrial production growth remained firm in Q2 despite a September moderation, while manufacturing and services PMIs recovered during the month. Agricultural risks persist following deficient and uneven monsoon rainfall.
- We retain our FY27 real GDP growth forecast at 7.2%, with growth expected to moderate following the robust Q1 expansion. Renewed geopolitical tensions and elevated crude oil prices continue to pose headwinds to the outlook.
- Consumption indicators held up through September, although early festive sales were mixed. Labour market developments were uneven in September: lower participation drove the unemployment rate down, while the sectoral and occupational employment mix improved.
- Investment indicators remained firm in Q2. However, new project announcements slowed sharply during the quarter and remained concentrated in a few sectors. An expected moderation in central government capex growth over the remainder of FY27, along with geopolitical uncertainty, could weigh on investment momentum.
- Lower excise-duty collections and higher subsidies are narrowing fiscal flexibility, despite support from disinvestment and asset monetisation. We expect the FY27 fiscal deficit to reach 4.5–4.6% of GDP, above the 4.3% target, with expenditure rationalisation likely as the government seeks to contain slippage.
- Merchandise exports grew strongly in September, but the trade deficit widened sequentially. We retain our FY27 current account deficit forecast at 1.4% of GDP, with elevated energy prices posing upside risks. FX reserves remain comfortable, although they have declined sharply from their early-September record high amid FX intervention and valuation changes.
- CPI inflation rose to 5.5% in September, with price pressures broadening. We retain our FY27 CPI inflation forecast at 5.1%, with inflation expected to exceed 6% during Q3 before easing. Agricultural supply risks, elevated energy costs and rising inflation expectations could delay inflation moderation.
- In October, the RBI announced targeted FX measures that supported a rupee recovery, while liquidity-absorption operations, seasonal currency demand and tax outflows sharply narrowed the banking-system liquidity surplus. Higher crude oil prices and foreign portfolio outflows have limited rupee gains. Further action remains possible, while sustained currency stability depends on crude oil prices, foreign capital flows and geopolitical developments.
- At its October meeting, the RBI raised the repo rate by 25-bps to 5.50% and shifted its policy stance to "Calibrated Tightening", consistent with our baseline expectation of 75-bps of cumulative rate hikes. We expect a 25–50 bps repo rate hike in December, with a larger move more likely if crude oil prices remain elevated and inflation and/or rupee pressures intensify. Alternatively, the RBI could pair a 25-bps repo rate hike with a larger Marginal Standing Facility (MSF) rate hike, while limiting banks' access to repo liquidity under the Liquidity Adjustment Facility (LAF).

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Tighter Monetary Policy & Elevated Yields Remain the Baseline

Both the US Federal Reserve and the Bank of Japan (BOJ) held their respective policy interest rates steady in October. Importantly, however, their October pauses do not signal a shift away from a generalised global tack toward somewhat tighter monetary policy. Broad global macroeconomic fundamentals remain consistent with tighter monetary policy. Resilient economic activity, labour markets at or near full employment in many large economies, and inflation advancing at an above-target pace characterise macro conditions in much of the global economy. Accordingly, many of the world's largest central banks are likely to continue to tighten monetary policy in the period ahead, as officials seek to curb upside inflation risks and/or prevent financial instability owing to too high inflation (e.g. skyrocketing bond yields, and outsized currency depreciation).

As outlined in last month's report, monetary tightening has shifted from idiosyncratic to more broadly based, now encompassing major advanced economy central banks – the Fed, BOJ, European Central Bank (ECB) – and emerging economy ones such as the Reserve Bank of India (RBI). The details underpinning policymakers' tightening decisions differ somewhat across economies / central banks but are united by a common thread of constraining upside inflation risks. Elevated energy prices and ongoing uncertainty with respect to potential further disruptions to energy supply – and in turn more upward price pressure – remain an upside threat to the inflation outlook for advanced and emerging central banks alike.

Importantly, following a steady climb higher that took benchmark bond yields in many advanced economies to among their highest levels in the past quarter century, signs of stability have begun to emerge. Not in all markets – indeed, yields still are rising in some large emerging economies and in places such as France. But in the world's largest and most liquid and, arguably, most important for broad cross-border financial stability – the United States and Japan – conditions have stabilised.

This stabilisation is encouraging on two fronts. First, it suggests that the forward-looking signalling effects of recent monetary tightening are having the desired effect. A growing concern among bond market investors this year has been that insufficiently tight policy would push up further inflation risks and, by extension, term premia and longer-dated yields. The stabilisation in US Treasury and Japanese Government Bond (JGB) yields, as the Fed and BOJ have signalled a tighter policy stance through their actions, underscores the potent role of monetary policy in shaping expectations. Second, stabilising US Treasury and JGB

yields bodes well for the durability of the expansion – not just in the US and Japan but globally. Treasuries are the primary collateral of the global financial system, and JGBs (and Japan's financial system more broadly) play a key role in cross-border financial transactions. The smooth functioning of these markets is critical to financing global economic activity.

Still, nominal interest rates across the term structure will likely remain elevated around prevailing ranges in the period ahead. Nominal income growth in many economies is running above the pace that prevailed from the GFC to the onset of COVID. Nominal bond yields generally align with nominal economic growth. In this context, interest rates are not “high” vis-à-vis fundamentals; they are higher relative to the recent past (so-called recency bias).

India's Economic Activity Remains Resilient, but Inflation and External Pressures Point to Slower Growth Ahead

Economic activity remained broadly resilient through September, although pockets of weakness emerged and headline CPI inflation moved closer to the RBI's 6% upper tolerance limit. Industrial production growth remained firm in Q2 despite moderating in September. Manufacturing and Services PMIs recovered in September, although softer earlier readings kept their Q2 averages subdued. Consumption indicators held up broadly, though consumer-durables output growth moderated in September and early festive sales were mixed. New investment project announcements grew strongly in H1 but slowed sharply in Q2 and remained concentrated in a few sectors. Central government capex growth is likely to moderate after front-loaded spending, with revenue and subsidy pressures constraining fiscal flexibility. Despite strong exports, the merchandise trade deficit widened sequentially in September as higher energy costs added to the import bill. 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 economic outlook.

We retain our FY27 real GDP growth forecast at 7.2%, with growth expected to be around 7% in Q2 and Q3 before moderating to slightly below 7% in Q4, following a robust expansion in Q1. Less favourable base effects, moderating fiscal support and a drag from net exports are likely to slow growth. Deficient and uneven monsoon rainfall poses risks to agricultural output and rural incomes, while inflation could constrain purchasing power and discretionary spending. Domestic demand should nevertheless sustain growth resilience, with the extent of moderation depending on energy prices, agricultural outcomes and inflation persistence. Resilient activity provides room for the RBI to

respond to rising inflation risks, with crude oil prices and renewed rupee pressures likely to shape the pace and extent of further rate hikes.

RBI Signals Calibrated Tightening; Higher Crude Oil Prices and Renewed Rupee Pressures Raise the Risk of a Larger Rate Hike in December

Higher energy prices, Middle East supply disruptions and El Niño-related food price risks have complicated monetary-policy decisions. Resilient growth has allowed several central banks to tighten policy or signal a tightening bias to prevent inflation from becoming entrenched. For energy-importing economies such as India, currency depreciation can amplify the initial supply shock by further raising import costs, while disorderly exchange-rate movements can also pose financial-stability risks. Central banks must therefore assess both the duration of supply disruptions and the risk that their effects become embedded in domestic inflation, while also addressing the risk of instability in currency markets.

In this context, the Monetary Policy Committee (MPC) unanimously voted to raise the policy repo rate by 25-bps to 5.50% at the October meeting, in line with our expectations. The policy stance was also changed from “Neutral” to “Calibrated Tightening”, signalling that, while this stance remains in place, the near-term policy choice is between a pause and further rate hikes. The Governor clarified that “calibrated” signals a “milder form of tightening”, with decisions measured against evolving macroeconomic conditions. The October communication therefore pointed to a measured tightening cycle, with subsequent decisions dependent on the growth–inflation outlook.

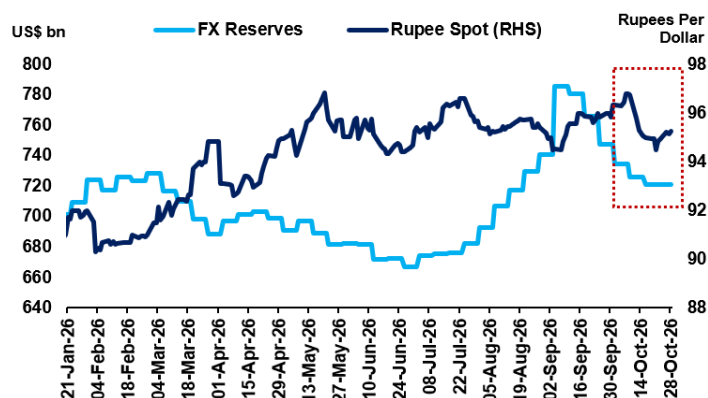
The combination of stronger growth and a less favourable inflation outlook supports further tightening. The RBI raised its FY27 real GDP growth projection by 40-bps to 7.1% and its CPI inflation forecast by 20-bps to 5.2%. The policy stance and inflation projections remain broadly consistent with our baseline expectation of 75-bps of cumulative repo rate hikes, including October’s rate increase, implying a further 50-bps of increases and a terminal repo rate of 6.00%. This view is primarily based on an inflation trajectory that remains elevated in the near term but moderates as supply pressures ease. The RBI’s medium-term projections provide some support for this assessment. Its FY28 CPI projection of 5.0% in the Monetary Policy Report, alongside 5.6% in Q1, implies inflation averaging ~4.8% during Q2–Q4 FY28. This projected moderation assumes a normal monsoon and no major additional shocks in FY28, making the duration of energy disruptions and the extent of second-round effects important to the terminal policy repo rate outlook.

Developments since the October policy meeting have, however, increased the risk of a stronger near-term response. Crude oil prices have risen, the risk of further escalation in the Middle East has increased, and pressure on the rupee has started to re-emerge. These developments could both worsen the inflation outlook and increase financial-stability concerns, particularly if disorderly currency depreciation reinforces imported inflation and disrupts financial-market conditions.

Earlier measures to attract foreign-currency inflows augmented FX reserves, while the RBI’s October FX measures provided some support to the rupee. These included a special dollar window for public-sector OMCs, the Foreign Exchange Risk Reserve (FERR) and tighter FX-derivative restrictions. The OMC window redirects eligible dollar demand away from the regular spot market, while the derivative measures seek to curb speculative activity. However, their ability to sustain a rupee recovery is constrained when elevated crude oil prices and weak capital flows maintain underlying pressure on the currency. Please refer to our [report](#) for more details.

India’s FX reserves rose to a record US\$785.7 billion on 4 September, supported by large FCNR(B) inflows. However, FX reserves subsequently declined by around US\$64.7 billion to US\$721.0 billion on 16 October, reflecting a combination of FX intervention-related flows and valuation changes. Despite the decline, reserves as of 16 October remained comfortable, covering 10.6 months of goods imports and equalling 92.7% of outstanding external debt at end-June 2026. The sizeable reserve buffer provides scope to manage currency volatility, but the sharp decline highlights the challenge of containing rupee pressures during a prolonged period of elevated energy prices and foreign capital outflows.

Rupee Recovered Following RBI’s October Measures but Subsequently Pared Gains; FX Reserves Declined Sharply



Source: CMIE, Bloomberg. Note: INR data through 28 October 2026; FX reserves through 16 October 2026

Against this backdrop, the Governor's recent media comments suggest that persistent currency pressure could also influence interest-rate decisions. He reaffirmed the RBI's commitment to ensuring orderly currency-market conditions and reiterated the usual separation between monetary policy, which addresses price stability, and regulatory and macroprudential tools, which address financial-stability risks. Importantly, however, he acknowledged that the two cannot be fully separated. In our view, this leaves room for a stronger interest-rate response if disorderly currency depreciation compounds imported inflation, poses risks to financial stability, or impairs monetary transmission.

We therefore expect a 25–50 bps repo-rate increase in December. A 25-bps hike would remain consistent with the measured approach signalled in October, while a 50-bps increase would become more likely if geopolitical conditions deteriorate, crude oil prices remain elevated or rise further, and inflation and/or currency pressures intensify. A larger move would let the RBI respond faster to a worsening inflation outlook and ongoing currency pressures.

An alternative would be to combine a 25-bps repo-rate increase with temporary operational tightening, drawing on the approach used during the 2013 taper tantrum. The RBI could raise the LAF corridor's upper bound by widening the MSF rate's spread over the repo rate beyond the current 25-bps, while restricting banks' access to RBI repo liquidity under the LAF. In 2013, a wider MSF–repo spread and limits on LAF borrowing pushed money-market rates toward the MSF rate; these exceptional measures were subsequently unwound as currency-market conditions stabilised. Such a combination could raise short-term funding costs and increase the cost of speculation, potentially reducing the additional repo-rate tightening needed specifically to address currency market pressures. It would also allow the operational measures to be reversed as conditions stabilise, while the repo-rate path remains guided by the inflation outlook.

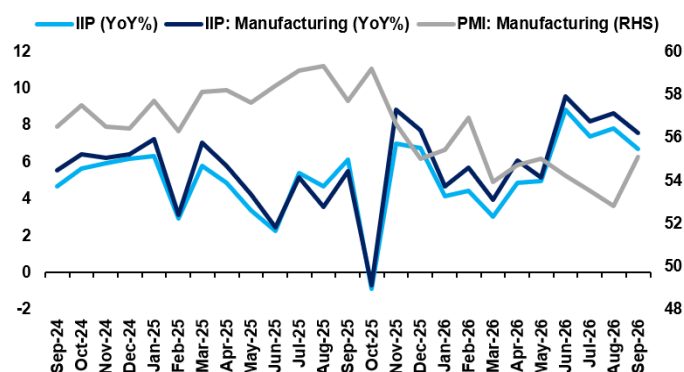
A 50-bps December hike would bring cumulative tightening to 75-bps and the repo rate to 6.00%, and chances are good that would not mark the end of the cycle. Whether the RBI raises rates further in February 2027 would depend on crude oil prices, geopolitical developments, inflation persistence and rupee conditions at that time. Continued pressure on these fronts could require cumulative tightening beyond our baseline expectations. Conversely, geopolitical de-escalation, lower crude oil prices, stabilising inflation expectations, and easing rupee pressures could strengthen the case for a pause.

Industrial Growth Moderated in September but Strengthened in Q2; Inventory Accumulation and Higher Energy Costs Pose Risks

India's industrial output growth moderated to 6.7% YoY in Sep-26 from a revised 7.8% in Aug-26, reflecting slower growth in manufacturing, electricity & gas supply, water supply, sewerage & waste management, alongside a deeper mining contraction. Nevertheless, IIP growth averaged 7.3% in Q2 FY27, up from 6.2% in Q1. Manufacturing growth accelerated to 8.1% in Q2 from 6.9% in Q1, while electricity & gas supply growth rose to 10.7% from 8.8%, more than offsetting a sharper mining contraction. The quarterly improvement points to resilient industrial momentum despite September's moderation, ongoing supply disruptions, and elevated energy prices.

The Manufacturing PMI rose to a seven-month high of 55.1 in Sep-26 from 52.8 in Aug-26. Stronger domestic and external demand lifted new-order growth to a seven-month high and production growth to a four-month high. However, the Q2 FY27 average of 53.8 was the lowest quarterly average since Q2 FY22, showing that the September recovery followed a relatively soft start to the quarter. October's flash survey points to broadly sustained manufacturing momentum: the output index edged up, although slower hiring contributed to a marginal decline in the headline Manufacturing PMI to 54.9 from 55.1.

Industrial Activity Strengthened in Q2 FY27 Despite Geopolitical Headwinds



Source: CMIE; S&P Global

Festive demand should support near-term production, but rising inventories make it more important for sales to meet firms' expectations. October's flash Manufacturing PMI survey showed that finished-goods inventories increased at the fastest pace on record. Separately, the Federation of Automobile Dealers Associations (FADA) reported passenger-vehicle inventories of 43–45 days at end-September, around twice its recommended 21-day benchmark.

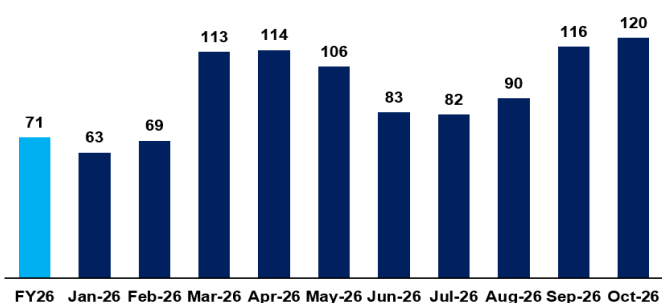
Early festive auto sales reinforce the need to monitor inventory clearance. FADA reported a 6.5% YoY decline in

Navratri vehicle retail sales, though a shorter selling window and a high base after last year's GST-related demand surge skewed the comparison. Sales nevertheless remained healthy relative to Navratri 2024, rising 26.8% over that period's level. Elevated passenger-vehicle inventories could still prompt production adjustments if demand during the remaining festive season falls short of expectations.

Higher energy costs pose an additional challenge, particularly for energy-intensive industries. The Indian crude oil basket price rose further from an average of US\$116.1/bbl in September to an average of around US\$120.2/bbl in October through 28 October. Sustained increases in energy and transport costs are likely to squeeze margins where firms have limited pricing power, while greater pass-through to consumers could weaken demand.

Geopolitical Re-Escalation and Risk of Renewed Supply Disruptions Push Crude Oil Prices Higher

Average Price of Indian Basket of Crude Oil (US\$/bbl)



Source: PPAC. Note: October 2026 average is through 28 October.

Services Activity Remained Resilient, Despite Pockets of Weakness in External Demand

Services sector activity broadly maintained its momentum in September, although performance remained uneven across segments. Freight activity remained strong, with port cargo traffic growth accelerating to 12.7% YoY, its fastest expansion since December 2025, while e-way bill generation reached an all-time high. Retail commercial-vehicle sales growth also accelerated sharply, consistent with firm freight and infrastructure activity. Financial services indicators remained supportive: bank non-food credit growth increased to 19.1% YoY at end-September, while deposit growth held steady at 17.8%. Bank lending to the services sector remained buoyant, led by credit to NBFCs, trade and commercial real estate.

Survey indicators also improved, with the Services PMI rising to a three-month high of 55.2 in Sep-26 from 54.1 in Aug-26. Nevertheless, the Q2 FY27 average was the weakest since Q4 FY22, reflecting softer conditions earlier in the quarter. September's new-order growth accelerated to a three-month high, primarily supported by domestic demand. October's flash Services PMI rose further to 56.2

from 55.2 in September, suggesting that the recovery in activity extended into the current quarter.

External demand was less supportive. Services PMI export orders increased in September, but at their slowest pace in nearly three years. International passenger traffic remained weak in September amid Middle East-related disruptions, higher fuel costs and capacity rationalisation. The Commerce Ministry's preliminary estimates showed services exports contracting by 0.9% YoY in September, subject to revision when the RBI releases its September services trade data. Together, these indicators suggest that domestic demand remains the principal support to services activity.

Services Sector Activity Broadly Maintained Its Momentum in September

Indicators (YoY%)	FY26	Q4FY26	Q1FY27	Apr-26	May-26	Jun-26	Jul-26	Aug-26	Sep-26
PMI Services	59.4	58.0	58.7	58.8	59.8	57.4	53.3	54.1	55.2
International Passengers Flown	4.1	-10.1	-26.0	-39.1	-24.2	-14.6	-13.4	-12.5	-11.2
Port Cargo Traffic	7.3	4.4	6.1	2.4	6.6	9.2	8.8	8.4	12.7
GST-e-way Bills	19.8	15.8	12.4	11.8	10.9	14.5	6.0	7.7	7.2
Services Exports	8.7	8.9	9.1	12.2	2.3	12.7	13.4	13.7	-0.9
Banking Non-Food Credit	15.9	15.9	18.3	15.8	17.4	18.3	19.1	18.8	19.1

Source: CMIE, DGCA, and RBI. Banking non-food credit for September 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. Colour coding based on FY26 average/level.

Deficient Monsoon and Low Reservoir Storage Pose Risks to Agricultural Output

The agriculture sector continues to face risks to crop yields from deficient and uneven monsoon rainfall. Rainfall during the June–September southwest monsoon season was 12.6% below the long-period average, with uneven distribution across regions and over time. However, the impact on sowing acreage was relatively contained. By the end of the sowing season, the kharif sown area was about 1% below the previous year's level. The main concern, therefore, is how rainfall deficits affect crop yields, even where the sown area has held up.

Deficient rainfall has also kept reservoir storage below its long-term average, weakening the buffers for the ongoing rabi season. As of 22 October, storage across the 178 reservoirs monitored by the Central Water Commission stood at 67% of full capacity, below both the normal storage average of 82% and the previous year's 91%. Lower soil moisture and weaker irrigation buffers could weigh on rabi sowing and yields, extending agricultural risks beyond the kharif season.

Against the backdrop of El Niño-related concerns and drought conditions in several districts, the Centre has set the

2026–27 crop-year foodgrain production target at 373.93 million tonnes, 2.63 million tonnes below the previous year's output of 376.56 million tonnes (third advance estimates). A further strengthening of El Niño conditions could compound water constraints, increasing downside risks to agricultural output and rural incomes and upside risks to food inflation.

Private Consumption Indicators Held Up in September, but Early Festive Sales Were Less Encouraging

Consumption indicators pointed to resilient but uneven demand through September 2026, with slower growth in consumer-durables output and mixed early festive sales. Higher inflation and monsoon-related risks to rural incomes remain the main headwinds to household purchasing power and discretionary spending in the near term.

Passenger-vehicle sales grew strongly in September, while consumer-durables production growth moderated to 6.0% YoY from 10.5% in August. Nevertheless, consumer-durables output growth averaged 9.4% in Q2 FY27, up from 8.0% in Q1, indicating resilient quarterly momentum despite September's slowdown. Two-wheeler retail sales growth hit an 11-month high in September, supporting the rural consumption assessment. Consumer non-durables output returned to growth at 1.4% YoY in September after two months of contraction, although its Q2 average remained marginally negative, suggesting a less sustained recovery in essential-goods demand. Bank retail credit growth strengthened to 16.9% YoY in August, with gains across major sub-segments led by secured loans. However, domestic air passenger traffic contracted further in September amid capacity rationalisation and higher aviation fuel costs, showing continued weakness in this segment despite the prospect of a festive travel pickup.

Private Consumption Indicators Remained Resilient but Uneven; Rising Inflation Poses Risks

Indicators (YoY%)	FY26	Q4FY26	Q1FY27	Apr-26	May-26	Jun-26	Jul-26	Aug-26	Sep-26
Passenger Vehicle Sales	10.6	18.3	23.3	18.1	23.2	28.6	19.1	16.1	32.1
Two-wheeler Sales	12.8	24.8	15.3	17.2	7.5	21.2	28.3	19.7	33.1
IIP- Consumer Durables	3.2	2.1	8.0	5.6	8.0	10.3	12.0	10.5	6.0
IIP- Consumer Non-durables	0.9	-0.1	1.8	0.2	-0.4	5.6	-0.8	-1.1	1.4
Retail Credit Growth	16.2	16.2	15.8	16.0	15.4	15.8	16.2	16.9	
Domestic Air Passenger Flow	1.1	0.7	1.7	-3.5	9.5	-1.0	-4.8	-6.2	-6.5
Unemployment Rate (%)	6.8	6.7	6.8	6.7	7.0	6.6	6.0	6.1	4.0
Rural	6.4	6.2	6.5	6.7	6.4	6.4	6.1	6.2	3.4
Urban	7.6	7.5	7.3	6.7	8.0	7.1	5.9	6.0	5.2
Naukri JobSpeak Index	7.7	8.1	4.3	5.8	1.0	6.1	5.0	13.7	1.7

Source: CMIE and RBI. Numbers shown are YoY changes (%) except unemployment rates, which are reported as levels (%). FY26 and quarterly figures are monthly averages, except credit growth, which is reported at end-period. Colour coding based on FY26 average/level.

Early festive season sales have been less encouraging. According to FADA, retail auto sales declined 6.5% YoY during Navratri, with sales falling in both the two-wheeler and passenger-vehicle segments, partly reflecting last year's high base and an 11-day Navratri festival selling window

versus 10 days this year. Media reports also indicated a mixed start to festive sales, with higher prices and limited discounts weighing on electronics demand against a strong year-earlier base, even as selected home-appliance categories and apparel showed resilience. Sales could strengthen closer to Diwali, but early readings suggest a measured start to festive-season spending.

Labour market developments presented a mixed picture. Formal-sector hiring activity showed limited momentum in September, with the Naukri JobSpeak Index rising by just 1.7% YoY in Sep-26, sharply lower than 13.7% in Aug-26, when a favourable base had amplified annual growth. Sequentially, the index edged up only 0.8% MoM after falling 6.2% in August.

According to CMIE data, employment fell sequentially by 1.1 million in Sep-26, reversing only a small part of August's substantial increase. The unemployment rate fell to 4.0%, its lowest level in nearly nine years, from 6.1% in August, as the labour force contracted much more sharply than employment, particularly in rural areas. The decline in unemployment thus reflected lower participation rather than gains in employment.

Despite the marginal decline in total employment, the sectoral mix improved, with employment falling in agriculture and real estate & construction and rising in manufacturing and services. The occupational mix also improved, with salaried and business-owner employment rising. This composition is more favourable than in August, although the unusually large shifts across consecutive months warrant caution when interpreting the improvement as a sustained change in employment quality.

Festive spending should provide near-term support, but durable consumption growth will depend on sustained employment gains and stronger wage and salary growth. Lasting improvements in job quality and stability, and real incomes would strengthen households' ability to absorb higher living costs and sustain discretionary spending.

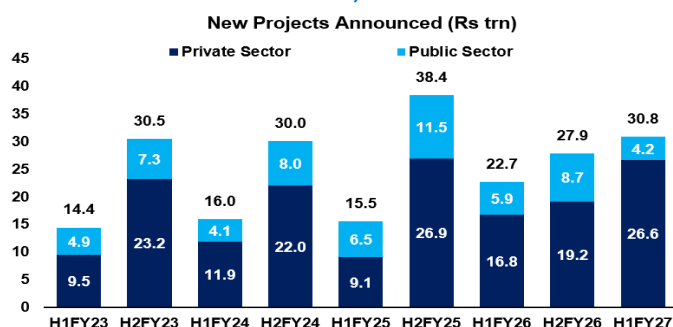
Investment Indicators Remained Firm, but Slower New Project Announcements, Fiscal Constraints and Geopolitical Risks Weigh on the Outlook

High-frequency investment indicators suggest that investment activity remained firm in Q2 FY27, despite moderating in September. Capital goods output growth eased to 10.4% YoY in September from 15.9% in August, while infrastructure and construction goods output growth slowed to 7.2% from 8.0%. Nevertheless, capital goods output growth averaged 14.9% in Q2, relatively steady compared to 15.2% in Q1, while infrastructure and construction goods output growth strengthened to 7.7% from 7.2%, indicating sustained quarterly investment momentum.

Manufacturing capacity utilisation rose 110-bps QoQ to 76.3% on a seasonally adjusted basis in Q1 FY27, indicating firmer use of existing capacity. Manufacturers also recorded stronger new-order growth alongside higher inventory-to-sales ratios for both finished goods and raw materials. Stronger orders and capacity use support the case for investment, but order-to-sales conversion, sustained domestic demand, and evolving geopolitical risks are likely to influence the timing of capacity expansion.

As per CMIE data, new project announcements, a forward-looking indicator of investment intentions, strengthened in H1 FY27 but remained concentrated and slowed sharply in Q2. Overall announcements increased 36% YoY in H1 FY27. Electricity, supported by large nuclear-power proposals, and non-financial services, particularly ITES and data-centre projects, led the increase. Their combined share rose to 68% from 48% a year earlier, while manufacturing's share declined to ~28% from 46.5%, highlighting the dependence on a few sectors and large projects.

Investment Announcements Strengthened in H1 FY27, but Remained Concentrated; Q2 Momentum Moderated



Source: CMIE

Private-sector new project announcements rose by 59% YoY in H1 FY27. However, proposals were front-loaded in Q1, with Q2 announcements declining by 49% QoQ and remaining broadly flat YoY. Private investment intentions therefore remained strong over H1, but the Q2 slowdown and sectoral concentration suggest that a broad-based revival has yet to take hold.

Meanwhile, central government capex contracted by ~30% YoY in August following strong spending earlier in the fiscal year. Cumulative growth nevertheless remained robust at 18.2% during April–August, above the ~14% full-year growth implied by the Budget allocation relative to FY26 actual expenditure. Adherence to the full-year Budget allocation would therefore imply slower capex growth over September–March, while revenue pressures and a higher subsidy burden could further constrain spending flexibility. The Centre's expenditure support to investment is consequently likely to moderate during the remainder of FY27.

Sustained investment expansion will depend on execution of the announced project pipeline, broader sectoral

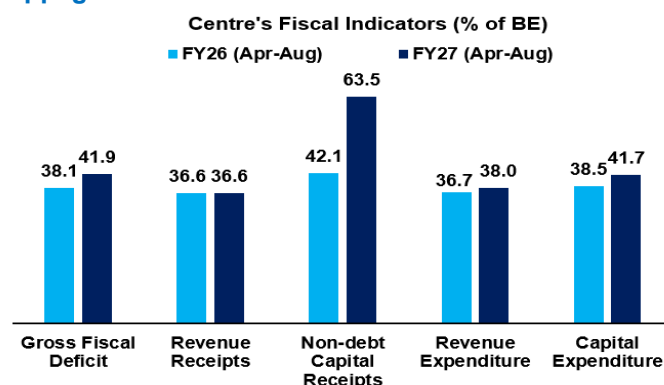
participation, and continued public investment support. Higher energy costs could compress margins and reduce expected project returns, while geopolitical uncertainty could push firms to defer commitments until demand and cost conditions are clearer. Easing these pressures is likely to support both implementation of announced projects and a broader recovery in private investment.

Fiscal Slippage Risks Persist as Higher Crude Oil Prices Add to Tax and Subsidy Pressures

The Centre's fiscal space is narrowing as lower excise-duty collections and higher subsidies continue to put pressure on the fiscal position. The Central Government's fiscal deficit reached 41.9% of the full-year target during Apr–Aug 2026, up from 38.1% of the Budget Estimate (BE) in the corresponding period last year, as expenditure growth outpaced receipts.

During April–August, the Central Government's total expenditure grew by 10.5% YoY, above the 9.0% full-year growth implied by the Budget allocation relative to FY26 actual expenditure. Revenue expenditure rose 8.2%, with major subsidies up about 24%, while capex expanded 18.2%. To stay within their respective Budget allocations, capital and revenue expenditure would need to grow by 11.7% and 7.2%, respectively, during September 2026–March 2027, implying slower expenditure growth in the remainder of FY27 than in April–August. Higher subsidy expenditure and slower revenue growth could further limit spending on other priorities, including capital expenditure.

Fiscal Deficit Widened During April to August Period; Higher Crude Oil Prices and Subsidy Bill Increase Fiscal Slippage Risk



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

Meanwhile, total receipts rose by 6.6% YoY during April–August, with gross tax revenue growth of 6.5% trailing the budgeted full-year growth of 9.4%. Excise-duty collections contracted by 22.6%, while CGST and customs revenue rose 15.4% and 28.2%, respectively. The decline in excise-duty collections partly offset the increase in CGST and customs receipts. Direct tax collection growth also remained below the rate budgeted for the full year.

Non-debt capital receipts remained strong, supported by disinvestment and asset monetisation. Receipts from these sources have reached Rs 62,124 crore so far in FY27, around 78% of the Rs 80,000 crore full-year target. If the IDBI Bank divestment transaction is completed and the Government receives its share of the sale proceeds during FY27, combined receipts could reach around Rs 88,700 crore, about Rs 8,700 crore above the Budget target. This could provide a modest offset to the fiscal impact of lower tax collections and higher subsidies.

Looking ahead, lower excise revenue, potentially lower OMC dividends and higher fertiliser subsidies pose fiscal-slippage risks, particularly if crude oil prices remain elevated. Petroleum-product export duties, higher customs revenue from precious metals, stronger disinvestment proceeds, and easing fertiliser prices could partially offset these risks. Available resources under the Economic Stabilisation Fund could also cushion unforeseen expenditure pressures.

We expect the FY27 fiscal deficit to reach around 4.5–4.6% of GDP, above the 4.3% target. The government will nevertheless likely prioritise adherence to the target, increasing the prospect of later-year expenditure rationalisation. Persistently elevated crude oil prices would make the required adjustment more challenging, raising the risk of fiscal slippage or deeper expenditure cuts that could weaken support for growth.

Merchandise Exports Remained Robust, but Elevated Crude Oil Prices Pose External-Sector Risks

Merchandise exports continued to grow strongly, rising 23.0% YoY in September, driven by double-digit growth in engineering goods, petroleum products and electronic goods. By destination, exports to the US rose 48% YoY, aided by a favourable base, while shipments to Singapore, Malaysia and China also recorded robust growth. Exports to West Asian markets were uneven, with shipments to the UAE, Saudi Arabia and Kuwait contracting, while Oman and Qatar recorded double-digit growth.

Merchandise import growth slowed to around 8% YoY in September, its weakest pace in six months. Higher imports of petroleum crude and products and non-petroleum, non-gems-and-jewellery goods were partly offset by lower precious-metals imports. Despite moderating annual import growth, India's merchandise trade deficit widened to US\$30.2 billion in September from US\$26.9 billion in August, as higher petroleum and other imports more than offset modest sequential export growth.

Meanwhile, the services surplus narrowed from the previous year. The Commerce Ministry's preliminary estimates showed services exports contracting marginally by 0.9% YoY to US\$36.4 billion in September. The services surplus

narrowed to US\$16.9 billion from US\$18.8 billion a year earlier, although it improved from around US\$16.5 billion in August. Services therefore continued to cushion the merchandise deficit but provided a smaller offset than a year earlier. These estimates remain subject to revision when the RBI releases its September services trade data.

India's current account deficit widened to US\$18.3 billion during April–August 2026 from US\$12.8 billion in the corresponding period last year, as the larger merchandise deficit outweighed improvements in the services surplus and net transfers. We maintain our FY27 current account deficit forecast at 1.4% of GDP, compared with 0.7% in FY26, based on revised GDP. Persistently elevated crude oil prices pose upside risks to this forecast.

External financing nevertheless remained strong through August. Capital inflows, particularly through FCNR(B) deposits, helped generate an overall balance-of-payments surplus of US\$58 billion during April–August. However, this financing support does not eliminate the external pressures associated with persistently elevated crude oil prices. Measures to attract foreign-currency inflows and regulate FX transactions can provide near-term relief to the rupee, while sustained stability depends on the underlying import bill and capital flows. As discussed in the monetary-policy section, persistent currency depreciation pressures could strengthen the case for further tightening by raising imported inflation and/or financial stability risks.

Inflation Pressures Intensified and Broadened, Raising Risks of Further Cost Pass-Through

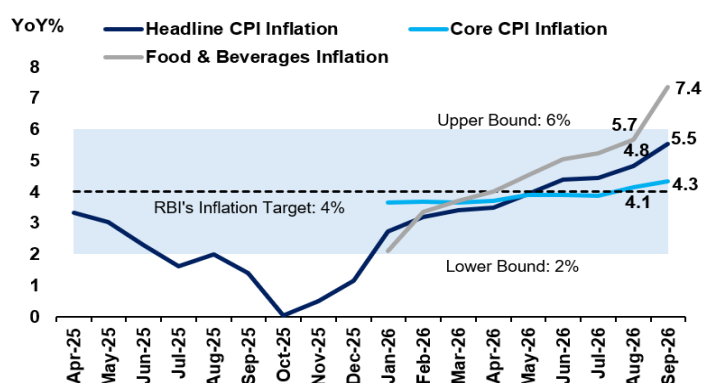
Inflation rose further in September, with food driving the increase and price pressures spreading more widely. Headline CPI inflation rose to 5.5% in September from 4.8% in August, moving closer to the RBI's 6% upper tolerance limit. Inflation increased across all major categories except for personal care, social protection and miscellaneous goods and services. Q2 FY27 CPI inflation averaged 4.9%, broadly in line with the RBI's projection and slightly above our estimate of around 4.8%.

Food & Beverages inflation rose sharply to 7.4% in September from 5.7% in August. Deficient monsoon rainfall and below-normal reservoir storage pose further upside risks to food prices by potentially reducing kharif yields and irrigation availability during the ongoing rabi season.

Core CPI inflation, excluding food and fuel, rose to 4.3% in September from 4.1% in August. Core inflation excluding gold and silver reached 3.2% in September, up from 2.2% in April, indicating that underlying inflation has firmed beyond the effect of precious metals, although its level remains relatively contained.

The weighted share of CPI items with inflation above 4% rose to around 46% in September from 37% in August, while the share in the 2–4% band fell to 29% from 37%. This shift indicates that inflation pressures are becoming more generalised. In core CPI, the weighted share of items with inflation above 4% rose to 28.4% in September from 20.8% in August, showing the broadening extended beyond food. Household inflation perceptions and expectations also rose across horizons, adding to the risk of second-round effects through higher wage demands and firms' pricing decisions.

CPI Inflation Moved Closer to the RBI's 6% Upper Tolerance Limit; Near-Term Risks Persist



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

WPI inflation rose to 11.4% in September from 9.9% in August, with increases across fuel, manufactured products and food. The broad-based rise points to sustained upstream cost pressures.

We expect CPI inflation to average ~5.1% in FY27, with upside risks. Inflation is expected to exceed 6% during Q3 before easing. However, elevated energy costs and agricultural supply risks could delay this moderation. Continued input-cost pass-through, alongside rising inflation expectations, could also keep price pressures persistent, strengthening the case for further monetary tightening.

Market Update

Bond Market Update: The banking-system liquidity surplus narrowed sharply in October, falling from around Rs 5.4tn at the start of the month to Rs 2.3tn by mid-month, and declining further thereafter to average around Rs 0.5tn during 19–28 October. This compares with a peak of approximately Rs 11tn in early September and September's monthly average of Rs 7.8tn. RBI OMO sales, FX interventions, alongside seasonal currency demand and tax outflows, drove the decline. The higher daily CRR maintenance requirement of 99%, effective 16 October, further reduced banks' flexibility in managing reserves within the reporting fortnight, without changing the overall CRR.

As surplus liquidity narrowed, the weighted average call rate (WACR) moved from the lower half of the LAF corridor during September and early October into the upper half after mid-October. The RBI injected temporary liquidity through variable-rate repo (VRR) operations to ease funding pressures and contain overnight-rate volatility, alongside its broader liquidity absorption programme. Further fine-tuning operations are likely as festive currency demand, FX intervention and stricter daily CRR maintenance keep funding conditions tight. Government spending should provide an offset, although strong bank credit growth could sustain funding pressures.

India's G-Sec yield curve shifted higher across maturities following the October RBI policy meeting. India's 10-year G-Sec yield rose to 7.44% on 28 October, amid elevated crude oil prices, renewed Middle East tensions, high US Treasury yields and expectations of further RBI tightening. Between 6 and 28 October, India's 5-year and 10-year G-Sec yields increased by 27 bps and 25 bps to 7.20% and 7.44%, respectively, reflecting a broader repricing of inflation and interest-rate risks. The bond market is likely to remain sensitive to crude oil prices, global bond markets, foreign capital flows, the domestic inflation outlook and expectations about the pace and extent of RBI policy tightening.

Foreign Exchange Market Update: The INR depreciated through September and came under sharper pressure in early October, reaching 96.79 per US\$ on 8 October amid elevated crude oil prices, higher US Treasury yields and FPI outflows. FX measures announced by the RBI during 10–12 October, along with IPO-related foreign inflows, helped the rupee recover to 94.47 per US\$ on 21 October. The rupee subsequently surrendered some gains as crude oil prices rose, closing at 95.23 per US\$ on 28 October.

The announced FX measures eased immediate pressure on the rupee but mainly affected the timing and channels of dollar demand. A sustained rupee recovery will depend on improved underlying external conditions, particularly crude oil prices and capital flows.

Equity Market Update: Indian equities remained volatile in October following the Nifty 50 index's 6.1% decline in September. Elevated crude oil prices and geopolitical uncertainty weighed on sentiment, while earnings-related buying and speculation about capital-gains tax relief in the next Budget supported intermittent recoveries. The Nifty 50 Index rose 0.3% in October through 28 October.

Equity FPI outflows reached approximately US\$3.7bn in October through 28 October, following around US\$3.8bn in September, while domestic institutional investors provided support through sustained net purchases. Near-term market performance will remain sensitive to earnings results, crude oil prices and global financial conditions.

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