KILIKA CAPITAL

Embracing complexity to capture Alpha

April 2026

Dear Investors,

The world changed on 28 February 2026. Operation Epic Fury - the coordinated US-Israeli strikes on Iran set in motion the most consequential geopolitical shock to India's external sector since the 2022 Russia-Ukraine conflict. Six weeks in, the Strait of Hormuz remains effectively closed. Brent, which opened the year at USD 66-67 per barrel, briefly touched USD 126 before settling into a volatile USD 100-110 range. For India, which imports over 85% of its crude and sources more than half its LNG from Brent-indexed Gulf contracts, the transmission has been immediate and multi-dimensional, a record low rupee approaching 94, FPI outflows running at their highest monthly pace of the year, a Nifty that has corrected sharply from recent peaks, and an RBI caught between its easing instincts and the inflationary reality of triple-digit crude.

And yet, it would be a mistake to let the noise of the crisis obscure the signal of the underlying economy.

India entered FY27 with arguably the strongest domestic macro foundation it has had in a decade. Real GDP grew 7.8% in Q3 FY26, broad-based across manufacturing, construction, and services. The new national accounts base year reveals an economy that is more industrial and more formally structured than previously measured. Headline inflation stood at just 3.2% in February, with core subdued. Bank credit is growing at 14.5% YoY. Capacity utilisation has crossed above its long-term average, historically the trigger for a broad-based private capex cycle. Trade agreements with the US, EU, and UK have been concluded or are materially advanced. Corporate balance sheets are lean, liquid, and profitable. The RBI has delivered 125 basis points of rate cuts since February 2025. These are not marginal positives. They are the preconditions for a sustained growth re-rating, and they have not gone away.

What has changed is the near-term risk calculus, and it hinges almost entirely on a single variable: how long does the Hormuz closure last?

The base case, and the one we assign higher probability, is that the conflict de-escalates meaningfully by end-April or early May. Ceasefire talks are active. The US, Iran, and regional mediators were reportedly discussing a 45-day pause framework as recently as 6 April. If the Strait reopens near-term, oil corrects toward USD 80-90 per barrel, the rupee partially recovers, the RBI resumes its easing cycle in H2 FY27, and the Nifty, deeply oversold, with F&O long positioning at multi-year lows, stages a sharp recovery. FY27 GDP absorbs a 30-50 basis point hit and rebounds. The private capex upcycle, delayed but not derailed, picks up where it left off. In this scenario, the current dislocation represents a compelling entry point for investors with a long term horizon.

The tail risk is a prolonged blockade extending into Q2 FY27. The IEA has warned that April supply conditions will be worse than March as pre-war inventory buffers are exhausted. At sustained crude above USD 110-120 per barrel, India's current account deficit widens to 2.0-2.5% of GDP, CPI risks breaching the RBI's 6% upper tolerance band, India Inc margins compress, the MPC faces a stagflationary bind, and the private capex upcycle stalls before it has properly begun. In this scenario, the macroeconomic consequences are structural rather than transient, and portfolio positioning would need to reflect a more sustained adjustment.

This edition of the Kilika Capital Investment Strategy Report is written at this inflection point - between two very different FY27s. Our task, as it always is, is to separate cyclical noise from structural signal, and to translate complexity into clarity. The domestic story is intact. The external shock is real but exogenous. The next two to four weeks are pivotal.

We remain cautiously optimistic, with the emphasis, for now, firmly on caution.

We thank you for your continued trust and partnership.

Best regards,

Siddharth Jadeja

Investment Strategy Report

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KILIKA CAPITAL

WHO WE ARE?

ABOUT US

Kilika Capital is a research-driven investment firm specializing in **deep research** and analysis to identify high-quality financial products for sophisticated investors.

OUR MISSION

At Kilika Capital, our sole mission is to **generate Alpha** for our investors.

MEET OUR LEADERSHIP TEAM – THE DREAM TEAM!

At Kilika Capital, we believe that great businesses are built by exceptional people. Our team brings a mix of experience, precision, and creativity that sets us apart, but what truly defines us is our shared passion for delivering results.

Siddharth Jadeja, CFA – The Strategist

Our managing partner, Siddharth Jadeja, is the calm, analytical anchor of Kilika Capital. A CFA charterholder and an MBA in finance, Siddharth comes with over 15 years of experience in a variety of roles ranging from credit risk, equity research, corporate banking, structured finance, and fund management at giants like HDFC Bank, Edelweiss Capital and Nuvama to name a few. He's been the brains behind countless deals, with the kind of market insights you'd bet on any day. Whether it's breaking down complex businesses or analysing sectors or structuring assets, Siddharth's expertise in credit and risk ensures our ship sails smoothly. Investors trust him, and so do we—his knack for turning numbers into actionable results thought rigorous analysis is *nothing short of magic*. Siddharth, a passionate sports enthusiast who has played cricket at the state level, brings the same unwavering discipline and never-give-up attitude to Kilika Capital.

Smitha Iyer – The Operational Hawk

If you ever wonder who keeps our house in perfect order, meet Smitha Iyer, the head of operations and our very own perfectionist-in-chief. Chemical Engineer, an alumna of Welingkar Institute Of Business Management, Smitha is an MBA in finance with over 8 years of experience in giants like ICICI Prudential and Future Generali. She took a short break to embrace motherhood (shoutout to her little champ, Devamsh!) And returned with twice the tenacity. She hounds the AMCs, dots every *i*, and crosses every *t*—no document or process escapes her eagle eye. Sure, her insistence on perfection might leave you a little exasperated, but when you realize that clean operations mean safety, you'll be grateful she's on your side.

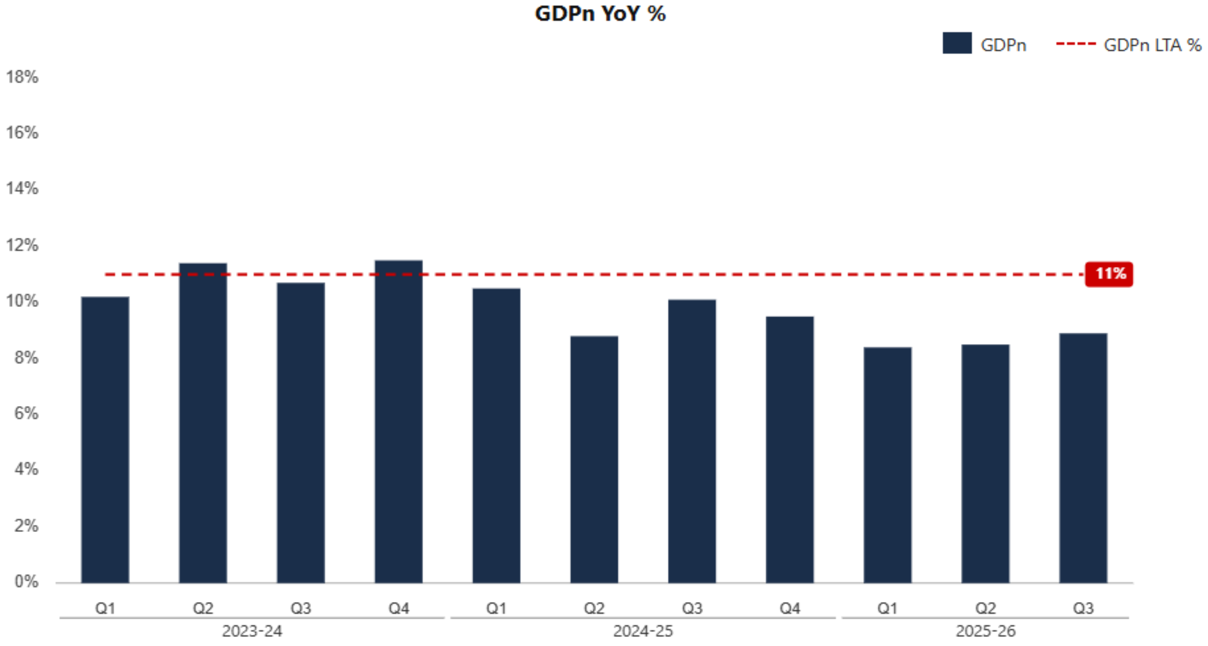
Piyush Sharma – The Creative Wizard

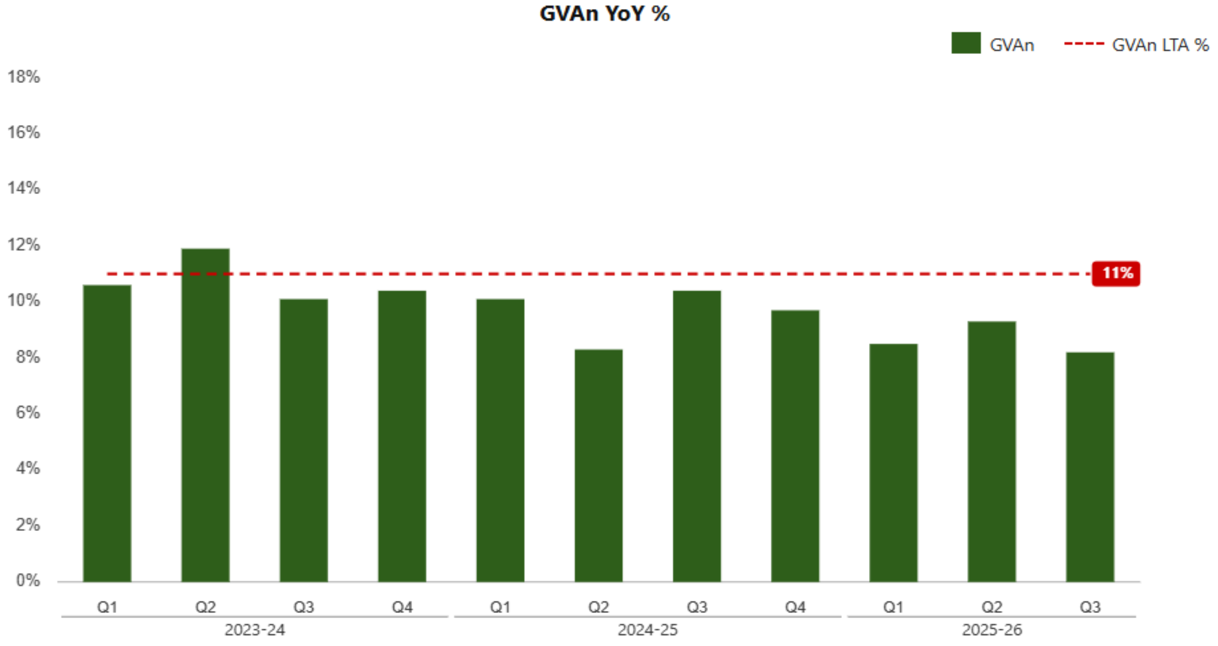
Meet Piyush Sharma, our research lead and the youngest brain in the room—but don't let that fool you. Armed with an MBA and a flair for creativity, Piyush lives and breathes financial models. Whether it's running a Monte Carlo simulation, dissecting a mutual fund, creating a portfolio company DCF model, or rethinking how investor portfolios are structured, he's always cooking up something extraordinary. Watching Piyush and Siddharth brainstorm together is like watching a symphony of numbers—a mix of youthful enthusiasm and seasoned experience. For Piyush, Kilika Capital isn't just a job; it's a playground for pushing the boundaries of quantitative finance, a platform to challenge conventions, explore new paradigms, and redefine what's possible in a financial model. Who says spreadsheets can't be fun!?

Together, we're not just a team; we're partners in your financial journey. We bring experience, attention to detail, and a touch of creative flair to everything we do. Whether it's operations, research, or strategy, rest assured—we've got your back. After all, when we win, you win. And we're in it for the long run.

Macro-Economic Outlook

1. GDP (Gross Domestic Product)





Source: Internal assessment based on RBI DBIE data

India GDP Q3 FY2025-26: Quarterly Deep Dive

The Headline Print: Reading 7.8% Correctly

- **India's real GDP grew at 7.8% YoY in Q3 FY2025-26**, the October–December 2025 quarter, marking a sharp acceleration from the 6.2% recorded in Q2 (July–September 2025). The print comfortably exceeds the Long-Term Average (LTA) of approximately 6.8–7.0% and firmly cements India as the fastest-growing major economy globally for a third consecutive year.
- However, context is everything. The Q3 print benefits from a moderately favourable base, Q3 FY2024-25 had printed at 6.2% under the old series (a multi-quarter low). Under the new base year series, that comparable has been slightly adjusted, but the directional story holds. The acceleration is **real and broad-based**, not a statistical artefact.

Demand-Side Drivers

- **Private Final Consumption Expenditure (PFCE) is growing at 7.6% YoY, the strongest pace in three years**. Rural India has meaningfully recovered, aided by a bumper Kharif harvest, moderating food inflation, and robust MGNREGS disbursements in H1. Urban consumption, while still healthy, is showing signs of the post-pandemic revenge-spending cycle normalising.
- **Gross Fixed Capital Formation (GFCF)** continues to punch above its weight at **7.1% growth**, **sustained almost entirely by government capital expenditure**. The Union Budget FY2025-26 maintained capex at 3.4% of GDP and the Q3 data confirms that this is transmitting into real economic activity through the construction and manufacturing supply chains.
- **Exports grew at 8.3% YoY in Q3**, the best quarterly performance in FY26. **Services exports - primarily IT, BPO, and GCC activity held up despite a decelerating global IT spend environment**. **Merchandise exports benefited from electronics and auto-component shipments under PLI-supported capacity**.

The Base Year Overhaul - What Changed, Why It Matters

- On 27 February 2026, the Ministry of Statistics and Programme Implementation (MoSPI) released India's rebased national accounts - shifting from **FY2011-12 to FY2022-23** as the new reference year. This is not a routine update. It is the most comprehensive methodological overhaul of India's national accounts in 14 years, and its implications for historical comparisons, debt-to-GDP ratios, capex intensity metrics, and sector allocations are material.

Why 2022-23?

- The old 2011-12 base had become a 14-year-old benchmark anchored to a pre-GST, pre-digital payments, pre-formalization era. FY2022-23 was selected as the first clean post-COVID 'normal' year with comprehensive data across the formal and informal sectors. The new series incorporates:
- Double deflation in Agriculture & Manufacturing - separate deflators for output and inputs, replacing the old single-deflator approach. This is methodologically superior and closer to international best practice.
- Proportional Denton method for quarterly benchmarking, ensuring more accurate quarterly-to-annual alignment of data.
- Expanded price indices covering 500–600 items (vs ~180 previously), better reflecting the consumption basket of a modern Indian economy.
- Administrative data integration - GST, PFMS (government financial data), MCA21 (corporate accounts), and e-Vahan (vehicle registrations) now feed directly into sectoral estimates, dramatically improving coverage of the formal economy.

The Revision Impact: Old Series vs New Series

- The table below summarises the key headline revision across fiscal years. Investors should note that the back-series to FY2012-13 is expected only by December 2026. Until then, longer-horizon trend comparisons remain provisional.

Metric	Old Series (Base 2011-12)	New Series (Base 2022-23)	Δ Revision
FY2023-24 Real GDP Growth	8.2%	7.2%	−1.0 pp
FY2024-25 Real GDP Growth	6.5%	7.1%	+0.6 pp
FY2025-26 est (Real GDP)	7.4%	7.6%	+0.2 pp
FY2023-24 Nominal GDP	9.6%	11.0%	+ 1.4 pp
FY2024-25 Nominal GDP	9.8%	9.7%	~flat

The key narrative: **manufacturing and the secondary sector have been revised upward**, reflecting better capture of formal manufacturing activity through GST data. **Services, particularly informal services, have been revised downward,** the new methodology is more conservative on imputed output. For equity investors, this is a sectoral realignment story: India is more industrial than the old series suggested, and less dependent on informal services activity.

What This Means for Key Ratios

- GDP Deflator: The new series implies a lower GDP deflator for FY24, which means nominal GDP in that year was higher as a share of the new nominal base. Watch for revised debt/GDP and capex/GDP ratios from the government - they will shift.
- Per-Capita Income: Revised nominal GDP changes the absolute per-capita income figure. India is closer to the US$3,000 per-capita threshold under the new series than previously measured.
- Sectoral Weights in Indices: Brokers and quants will need to recalibrate sector-weight models for portfolio construction if they were anchored to old-series GDP shares.

Sectoral Performance - The Full Picture

- The breadth of Q3's growth is arguably its most important characteristic. **Seven of eight sectors recorded accelerating or stable growth**. The sole laggard - Mining & Quarrying is a structural constraint (regulatory delays in mine allocation) rather than a cyclical one.

Sector	Q1 FY26	Q2 FY26	Q3 FY26*	Trend	Assessment
Manufacturing	9.8%	10.2%	**11.4%**	↑ Accelerating	Star performer; PLI dividends accruing
Construction	8.1%	8.6%	**9.2%**	↑ Strong	CapEx multiplier at work
Financial, RE & Prof. Svcs	7.0%	6.8%	**7.5%**	↑ Recovering	Credit expansion + FDI inflows
Trade, Hotels, Transport	6.1%	6.4%	**7.2%**	↑ Momentum	Festive season + tourism revival
Public Admin & Defence	9.5%	8.8%	**9.0%**	→ Stable	Govt capex front-loaded
Agriculture & Allied	3.8%	4.1%	**4.5%**	↑ Improving	Rabi outlook positive
Electricity & Utilities	7.2%	7.5%	**8.1%**	↑ Solid	Renewable capacity additions
Mining & Quarrying	2.1%	1.8%	**2.4%**	→ Muted	Coal stable; metals subdued

Manufacturing: The Story of This Cycle

- At **11.4% YoY in Q3**, manufacturing has now printed double-digit growth for six of the last eight quarters. **This is the PLI scheme delivering** - electronics (mobile phones, components), auto and auto-ancillaries, pharmaceuticals, and food processing are the primary drivers. The new base year's double-deflation methodology may actually be slightly understating manufacturing output, since input cost deflation (lower commodity prices in Q3) was significant; under double-deflation, lower input costs boost value-added measurement.

Agriculture: Quiet Outperformer

- Agriculture at **4.5% in Q3** is at a multi-year high for the sector, **aided by a normal Southwest Monsoon in 2025, better Kharif output, and improved reservoir levels** heading into the Rabi season. The rural economy's recovery is not yet fully priced in - rural FMCG volumes, two-wheeler sales, and Kisan Credit Card disbursements all corroborate the on-ground turnaround.

Services: Mixed, but Net Positive

- The **trade, hotels, and transport cluster** - the bellwether for urban and tourism-driven services accelerated to **7.2% in Q3**, its best print of FY26, **driven squarely by the festive season (Dussehra–Diwali–Christmas) and strong inbound tourism**. The **financial services complex recovered to 7.5%** after a brief deceleration in Q2, with **credit growth running at 13–14% and insurance premium growth back above 10%**.

Policy Implications - RBI, Fiscal & Beyond

- **Reserve Bank of India: The Green Light**
- **A 7.8% Q3 real GDP print with a 1.1% implied GDP deflator - the narrowest nominal-real wedge** in eight quarters gives the RBI substantial operational room. The more interesting debate is whether the RBI will signal a reduction in the Cash Reserve Ratio (CRR) to inject durable liquidity, particularly relevant if FPI outflows create transient tightness. But the key theme here is **operation flexibility**.
- **Fiscal Policy: Consolidation Without Contraction**
- The government's **capex-first, revenue-consolidation-second** approach is clearly paying off in the Q3 numbers. Construction at 9.2%, manufacturing multipliers firing, public administration steady - this is exactly what the fiscal arithmetic was designed to deliver. The challenge entering FY2026-27 is maintaining capex intensity at 3.4% of (higher, revised) GDP while also compressing the fiscal deficit toward 4.4% of GDP. Our read: **the new higher nominal GDP base actually makes fiscal consolidation optically easier - the deficit-to-GDP ratio improves even at the same absolute deficit level, thus crowding-in atleast public investments**.

India vs The World - The Alpha Story

- **7.6% real GDP growth for FY2025-26 in an environment where the US is expanding at ~2.5%, the Eurozone is stagnating at 0.8–1.2%, China is adefending a 4.5–5.0% floor, and Japan is struggling to break 1% - India is not merely an outlier. It is the only major economy with both accelerating growth AND an improving structural data quality story. The new base year upgrade actually matters for global institutional allocators: it removes a longstanding credibility discount that sophisticated investors applied to Indian GDP data.**
- **For fixed income global investors: India's inclusion in global bond indices (JPMorgan, Bloomberg) means GDP revisions directly impact sovereign spread models. A higher nominal GDP base implies a lower debt/GDP ratio — this is incrementally positive for India's sovereign credit narrative and should support further yield compression at the long end of the curve.**
- **For equity investors: The sectoral story of 'more industrial, less informal services' under the new series aligns with where equity markets have already been migrating — manufacturing, capex, infrastructure, and formal consumption. The data has caught up with the market's instinct in our view.**

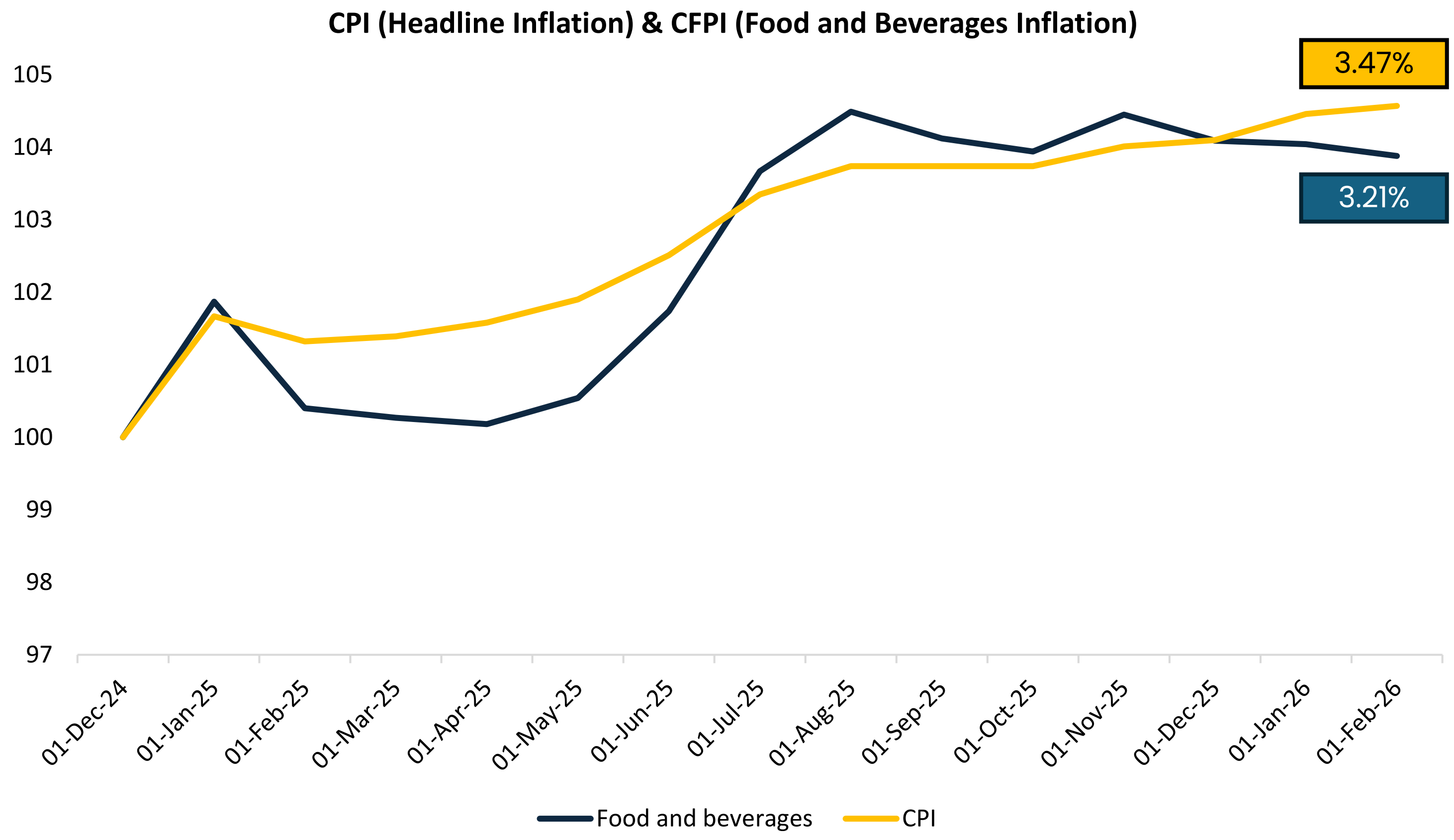
Strategic Outlook – What to Watch in the next 3 Quarters

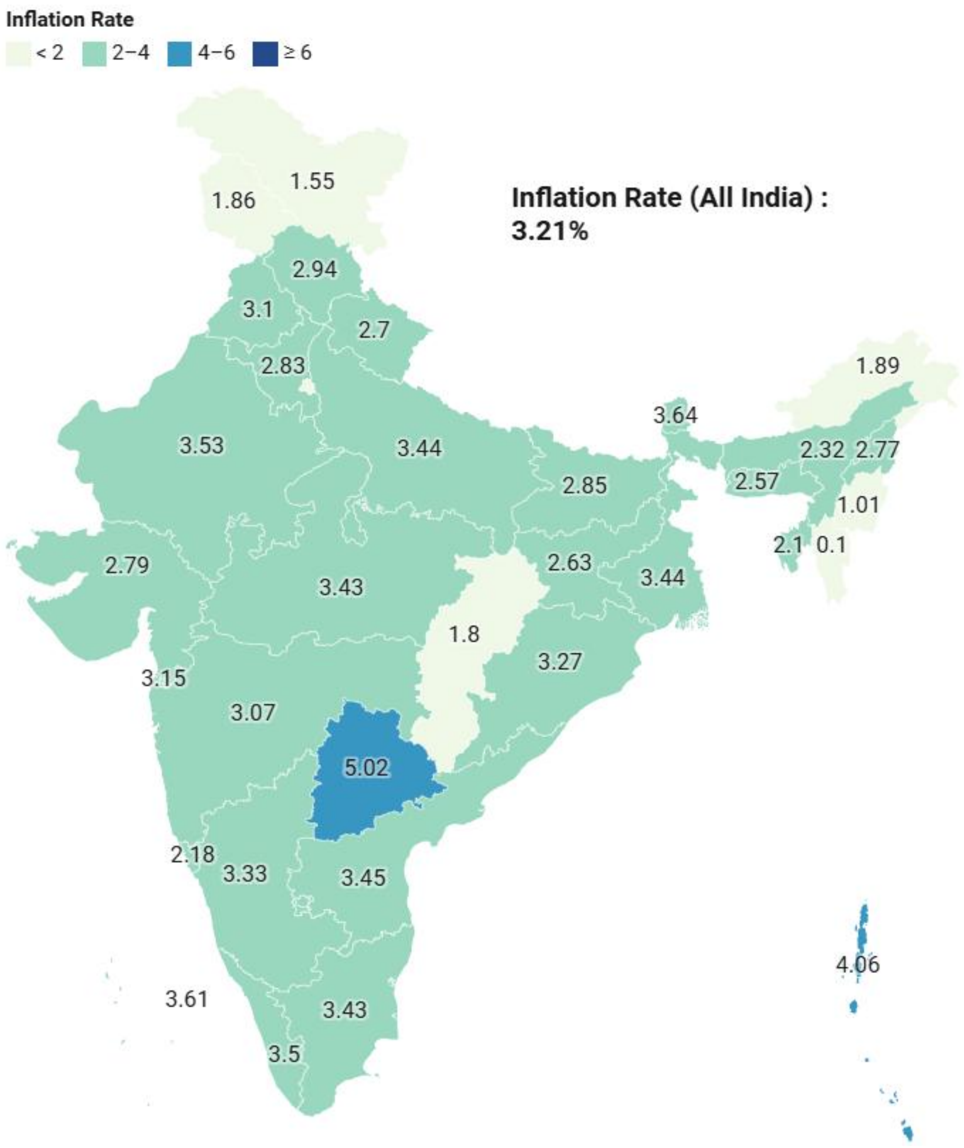
Signal	Theme	Implication for Portfolios
POSITIVE	Manufacturing & CapEx	PLI scheme payoffs continuing. Double-digit manufacturing growth expected into Q4 FY26. Government capex, if maintained at 3.4% of GDP in FY27 Budget, keeps the construction multiplier firing.
WATCH	Services Sector Revision	Under the new base year, services growth has been revised downward. IT/ITES sector faces global headwinds. The full back-series reconciliation (expected Dec 2026) may cause further narrative revision.
WATCH	GDP Deflator Trajectory	The current narrow 1.1pp nominal-real wedge suggests benign inflation. If crude/metals re-accelerate, the deflator widens - this changes the real rate calculus for RBI faster than markets expect.
RISK	US Tariff Escalation & a prolonged US/Israel-Iran War	Export-oriented manufacturing (electronics, auto components) exposed to any fresh US tariff actions. Oil prices could shoot up, negatively impacting India macros Also, global risk-off reducing FDI/FPI flows could dampen GFCF growth.
RISK	Monsoon & Base Effects	A below-normal monsoon (low probability currently) reverses the rural consumption recovery visible in Q3. Additionally, the Q3 FY26 base will be a high-bar comparator for Q3 FY27.

Our 12-Month View: Constructive turned Cautious

India enters FY2026-27 with genuine momentum. The manufacturing cycle is at an inflection point. Rural consumption recovery is at a mature phase. The RBI has operational headroom and the political will to infuse liquidity. The base year upgrade removes a structural data-credibility overhang. However, the twin shocks of the US-Israel-Iran war since February 2026 which has effectively shut the Strait of Hormuz and pushed Brent crude above $120/bbl have fundamentally altered the risk calculus. India imports ~85% of its crude oil, and the energy shock is transmitting through a weaker rupee, widening current account deficit, and reviving inflation anxieties, compressing the RBI's room to stay accommodative. We revise our base case to 6.5–7.0% real GDP for FY2026-27 (down from 7.4–7.8%), with upside if: (a) a de-escalation in the Iran war is reached and the Strait of Hormuz reopens by April end, allowing oil to normalise toward $80/bbl, (b) monsoon is normal or above-normal, and (c) the government's interim and full budgets stay on the public capex track. Downside scenario of 5.8–6.2% materialises if (a) the Hormuz closure extends beyond April 2026, crude sustains above $110/bbl for another quarter, and/or (b) US tariff escalation broadens to include Indian electronics and pharmaceuticals.

2. Inflation





Source: Internal assessment based on RBI DBIE data

Inflation's Grip Persists: CPI Print Disrupts the Disinflation Story

Headline Inflation: Uptick Continues, But Within Comfort Zone

- **India's headline Consumer Price Index (CPI) inflation accelerated to 3.21% year-on-year in February 2026, up from a revised 2.74% in January 2026**. This marks the fourth consecutive month of rising inflation after the all-time low of 0.25% recorded in October 2025 under the old CPI series. The 47 basis point sequential increase was broadly in line with market expectations. The CPI index itself rose to 104.57 in February from 104.45 in January, reflecting continued upward pressure across multiple consumption categories.
- Importantly, headline inflation remains well within the Reserve Bank of India's 2–6% tolerance band and continues to print below the 4% medium-term target midpoint. This provides considerable comfort from a monetary policy standpoint, though the directional trend warrants close monitoring. The February print is the second reading under the newly revised CPI series with base year 2024=100, making direct comparison with historical data under the old 2012-base series methodologically complex. On a month-on-month basis, the CPI was up by a modest 0.11%, suggesting that while annual comparisons are firming, sequential momentum remains relatively contained.

Core Inflation: Range-Bound But Gold-Driven Noise Persists

- **Core inflation, which strips out volatile food and fuel components remained broadly stable at approximately 3.4% in February 2026**. This suggests that underlying demand-side price pressures remain moderate and the economy is not exhibiting signs of overheating. However, a **significant source of distortion continues to emanate from the precious metals category**. Silver jewellery prices surged 160.84% year-on-year, while gold, diamond, and platinum jewellery prices rose 48.16%, **reflecting the extraordinary rally in bullion markets over the past year where gold has appreciated over 70% and silver by more than 200%**.
- The RBI itself has acknowledged this anomaly, estimating that **precious metals alone are contributing 60–70 basis points to the headline CPI number**. This creates significant "noise" in the core inflation reading and masks what are otherwise benign underlying price dynamics. If one were to exclude precious metals, the core inflation trajectory would appear substantially lower and more consistent with the narrative of contained demand-side pressures. This distinction is analytically critical for policymakers and market participants attempting to assess genuine inflationary momentum versus statistical artefacts driven by asset price inflation in a single commodity class.

Food Inflation: Sharp Rebound from Deflationary Territory

- **Food inflation, measured by the Consumer Food Price Index (CFPI), accelerated sharply to 3.47% in February from 2.13% in January**. This represents a meaningful 134 basis point increase and signals that the extended period of food price deflation which persisted through much of H1 FY26 with food inflation touching -5.02% in October 2025 has decisively reversed. Rural food inflation stood at 3.46% while urban food inflation came in marginally higher at 3.48%, indicating relatively uniform food price pressures across geographies.
- Within the food basket, price dynamics were mixed. Among the highest inflation items were coconut copra at 46.16%, tomato at 45.29%, and cauliflower at 43.77%. However, on a month-on-month basis, the index for tomato, peas, and cauliflower declined by more than 10% between January and February, suggesting that seasonal correction in perishable vegetable prices is underway. Milk and dairy products, which carry the largest weight within the food sub-division at 7.28% under the new series, recorded inflation of approximately 3.1%. **The food inflation trajectory in the coming months will be critical, particularly as favourable base effects from the sharp food price deflation in H2 FY26 begin to wane. We expect food inflation to ease marginally to around 3.4% in March 2026, though upside risks from LPG price hikes and global supply disruptions persist**.

Rural vs. Urban Inflation Dynamics

- A noteworthy feature of the February data is the persistent rural-urban inflation divergence. **Rural CPI inflation stood at 3.37%, considerably higher than urban inflation at 3.02% a gap of 35 basis points**. This divergence has widened from January, when the gap was a negligible 4 basis points (rural: 2.73%, urban: 2.77%).
- The widening rural-urban gap is analytically significant for several reasons. First, it suggests that **rural households are bearing a disproportionate share of the food price rebound, given the higher effective weight of food in rural consumption baskets**. Second, it indicates that the **benefits of moderating services inflation which tend to be more concentrated in urban centres** are not uniformly distributed. Third, **for monetary policy transmission, the divergence implies that rate cuts may be more effective in stimulating urban demand while rural consumption conditions remain somewhat constrained by persistent price pressures**. It is noteworthy that the new CPI series narrows the structural rural-urban gap by updating consumption baskets, reflecting that rural India's consumption patterns have converged towards urban norms due to lifestyle changes but the February data nonetheless reveals meaningful cyclical divergence that deserves policy attention.

Housing Inflation: Stable but Structurally more Important, however Supply Side Disruptions likely going forward

- **In the new CPI series, housing, electricity, and fuels have been consolidated into a single index with a weight of 17.6%. On an annual basis, this combined category rose by 1.5% in February**, while monthly momentum moderated slightly to 0.07% from 0.13% in January. Within the housing segment, repair and maintenance services remained firm, increasing by 0.2% month-on-month, while rental payments by tenants also recorded a 0.2% MoM rise. On the fuel side, LPG cylinders and piped natural gas prices declined marginally by 0.1% MoM, whereas liquid fuel prices edged up slightly by 0.01% MoM. This is likely to increase in the coming months due to the ongoing war in the Middle East leading to supply side disruptions. Among other components, coal prices saw a modest increase of 0.1% MoM, while firewood prices recorded a marginal decline of 0.02% MoM.

State-Wise Inflation: Regional Dispersion

- The regional distribution of inflation reveals significant heterogeneity across states. Among states with populations exceeding 50 lakh, **Telangana recorded the highest inflation at 5.02% the only major state breaching the RBI's 4% target midpoint**. Rajasthan followed at 3.53%, with Kerala at 3.50%, Andhra Pradesh at 3.45%, and West Bengal at 3.44%. The persistence of Telangana at the top of the inflation league table warrants deeper investigation into state-specific supply-side constraints and local demand conditions.

Rank	State	Inflation (%)	Category	vs RBI Target
1	**Telangana**	5.02%	Highest	Above 4%
2	**Rajasthan**	3.53%	High	Below 4%
3	**Kerala**	3.50%	High	Below 4%
4	**Andhra Pradesh**	3.45%	High	Below 4%
5	**West Bengal**	3.44%	High	Below 4%

- The dispersion across states underscores the importance of granular, sub-national inflation monitoring. While the all-India headline number remains benign, individual states may face materially different price environments, affecting local consumption, fiscal planning, and targeted policy interventions. **The fact that southern states feature prominently in the high-inflation cohort may reflect regional food supply dynamics, differing fuel price pass-through mechanisms, and demand push inflation**.

CPI Base Revision: New Series (2024) vs. Old Series (2012)

Inflation Rate Comparison: Feb 2025 (Old Series) vs. Feb 2026 (New Series)

- To appreciate the impact of the base revision on inflation measurement, it is instructive to compare the February inflation print across the two series. The table below presents the old series February 2025 inflation rates (Base 2012=100) alongside the new series February 2026 rates (Base 2024=100). While the two prints are separated by a year and cannot be directly compared on a like-for-like basis, the juxtaposition is analytically useful in illustrating how structural weight shifts and methodological changes alter the inflation narrative.

Indicator	Feb 2025 (Old: Base 2012)	Feb 2026 (New: Base 2024)	Difference (bps)	Remarks
Headline CPI (Combined)	**3.61%**	**3.21%**	**-40 bps**	**Lower under new series**
Rural CPI	3.69%	3.37%	-32 bps	**Food weight effect**
Urban CPI	3.48%	3.02%	-46 bps	**Services moderating**
Food Inflation (CFPI)	3.75%	3.47%	-28 bps	**Lower food weight**
Rural Food Inflation	4.06%	3.46%	-60 bps	**Significant decline**
Urban Food Inflation	3.20%	3.48%	+28 bps	**Urban food pressures**
Housing Inflation	2.91%	2.12%	-79 bps	**Methodology shift**
Fuel & Light / Energy	-1.33%	N/A	—	**Category restructured**
Education Inflation	3.83%	N/A	—	**Category restructured**
Health Inflation	4.26%	1.90%	-236 bps	**Lower in new series**
Clothing & Footwear	2.76%	2.81%	+5 bps	**Broadly stable**

- The comparison reveals several important patterns. Headline CPI under the new series (3.21%) is 40 basis points lower than the old series February 2025 print (3.61%), **partly reflecting the reduced weight of food in the new basket**. Food inflation under the new series (3.47%) is also lower than the old series reading of 3.75%, consistent with the 9 percentage point reduction in food weight. **Most strikingly, health inflation has declined from 4.26% to 1.90% and housing inflation from 2.91% to 2.12%, reflecting both methodological changes and genuine price dynamics**. The restructuring of fuel and light, education, and other categories under the new COICOP framework means that several old series line items are no longer directly comparable, necessitating a fundamentally new analytical approach to inflation monitoring.

Divisional Weight Comparison: Old Series vs. New Series

- The revision is anchored in the Household Consumption Expenditure Survey (HCES) 2023–24 and **adopts the COICOP 2018 international classification framework, expanding the basket from 299 to 358 items across 12 divisions (up from the earlier 6-group structure). Price collection now spans 1,465 rural and 1,407 urban markets (up from 1,181 and 1,114 respectively), including 12 online retail platforms for the first time**. The table below presents a side-by-side comparison of the key divisional weights under both series.

CPI Division	Old Series (Base 2012)	New Series (Base 2024)	Change	Dir.
Food & Beverages	45.86%	36.75%	-9.11 pp	↓
Housing, Water, Electricity, Gas & Fuels	16.91%*	17.67%	+0.76 pp	↑
Clothing & Footwear	6.53%	2.38%	-4.15 pp	↓
Transport	8.59%**	8.80%	+0.21 pp	↑
Health	5.89%**	6.10%	+0.21 pp	↑
Information & Communication	—	3.61%	New	★
Education Services	4.46%**	3.33%	-1.13 pp	↓
Recreation, Sport & Culture	—	2.47%	New	★
Restaurants & Accommodation	—	3.35%	New	★
Personal Care, Social Protection & Misc.	—	5.54%	New	★
Pan, Tobacco & Intoxicants	2.38%	2.99%	+0.61 pp	↑
Furnishings, HH Equipment & Maintenance	—	4.47%	New	★

- **The most consequential shift is the reduction of food and beverages weight from 45.86% to 36.75%, a decline of over 9 percentage points. This structurally dampens the sensitivity of headline CPI to food price shocks, which have historically been the dominant driver of inflation volatility in India. Conversely, services-oriented categories such as transport, health, information and communication, and restaurants and accommodation now carry higher weights, making headline inflation more responsive to demand-side and sticky services price dynamics. The inclusion of new-age consumption items such as OTT subscriptions, e-commerce prices, smartphones, air purifiers, and digital storage devices further modernises the index while the removal of obsolete items like VCRs and audio cassettes reflects evolving consumption realities**.

Services Inflation: Mixed Signals Across Categories

- **Services inflation presented a mixed trend in February, coming in at 2.9% YoY, unchanged from January levels.** Clothing and footwear inflation eased to 2.81% from 2.98% in January, while restaurants and accommodation services softened to 2.73% from 2.87%. Health inflation also moderated to 1.90% from 2.19%, a positive development given the increased weight of health in the new series at 6.10%. However, information and communication services inflation edged up to 0.25% from 0.16%, and transport inflation turned marginally negative at -0.05% amid the pullback in wholesale oil and gas costs during the reference period though this is likely to reverse sharply in coming months given the subsequent surge in global crude prices.
- **The personal care, social protection and miscellaneous goods and services category continues to be an outlier, driven entirely by the extraordinary rally in precious metal prices. This category recorded an estimated 19.0% inflation in January and likely remained elevated in Februar**y. The pan, tobacco and intoxicants category registered inflation of 3.49%. **Excluding the precious metals-driven noise, the services inflation landscape remains broadly benign and consistent with an economy operating close to potential without overheating pressures**. The persistence of low and stable core inflation strengthens household purchasing power and corporate debt-servicing capacity.

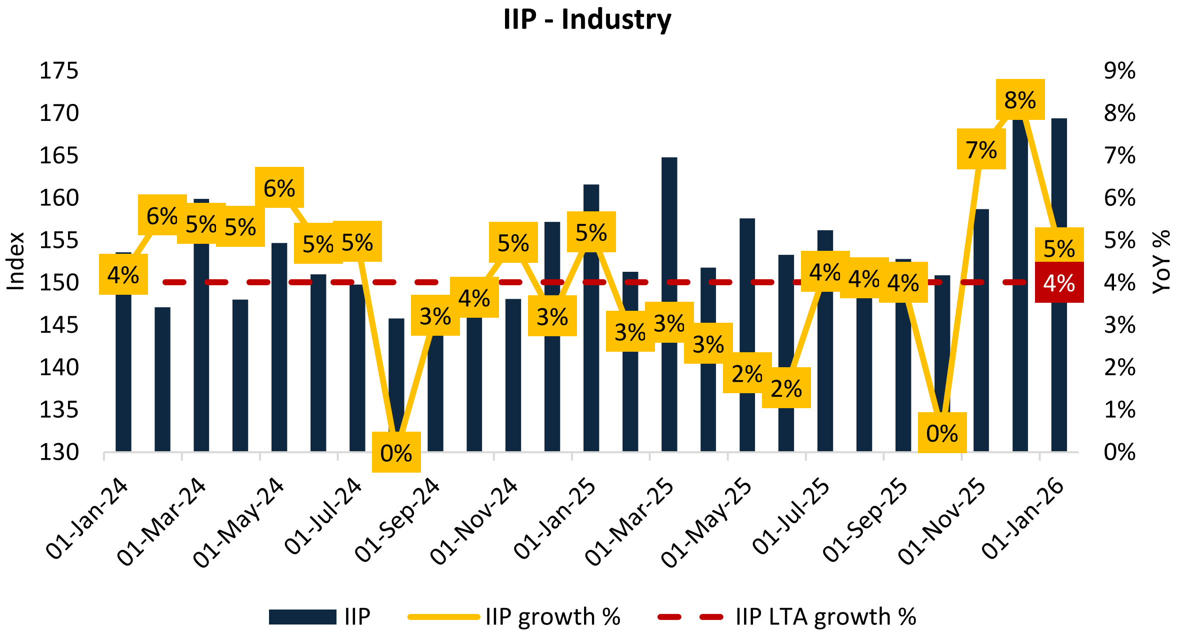
Crude Oil Shock: The Elephant in the Room

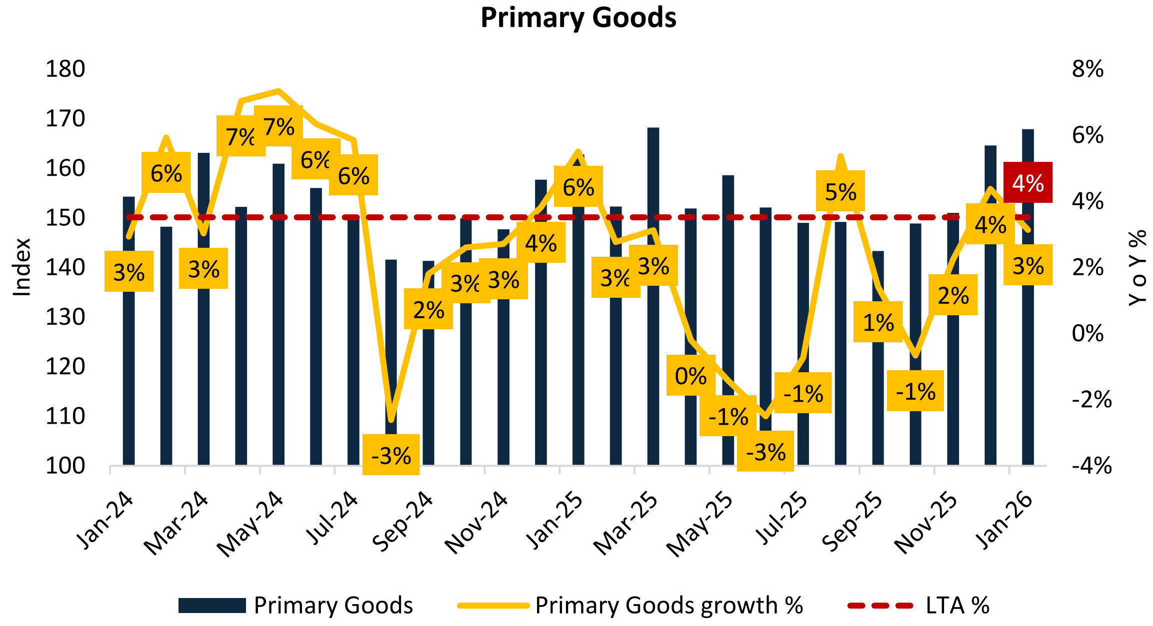
- **Perhaps the most significant risk to the benign inflation trajectory comes from the global crude oil market. The February CPI data predates the severe disruption caused by the escalation of the U.S.–Israel conflict in Iran, which has sent Brent crude surging to $100 per barrel and briefly touching $119.50 in early March. The effective stalling of tanker traffic through the Strait of Hormuz through which roughly one-fifth of global oil and gas supplies transit, represents the most significant supply disruption in recent history.**
- **For India, which imports approximately 85% of its crude oil requirements, the macroeconomic implications are substantial. Economists estimate, a 10% increase in crude oil prices, assuming full pass-through to domestic fuel prices, could raise inflation by approximately 40-60 basis points and reduce GDP growth by 15 basis points, though the actual pass-through coefficient remains low given that oil marketing companies and the government absorb a significant share of the burden which in turn would affect Fiscal Deficit. While OMCs have thus far held retail petrol and diesel prices steady, the hike in LPG cylinder prices in early March 2026 is an early signal that energy cost pass-through has commenced. The sustainability of the current fuel price freeze remains a critical variable for the inflation outlook.**

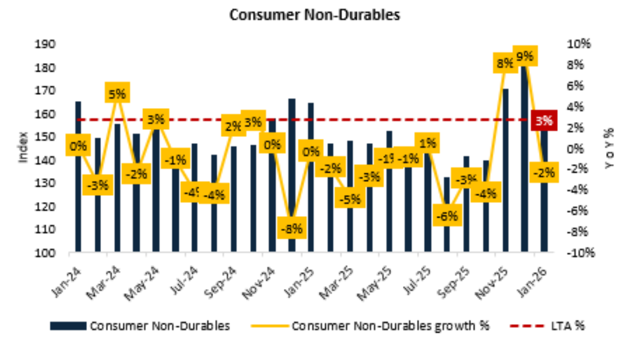
Inflation Outlook: Cautious Optimism Amid Significant Tail Risks

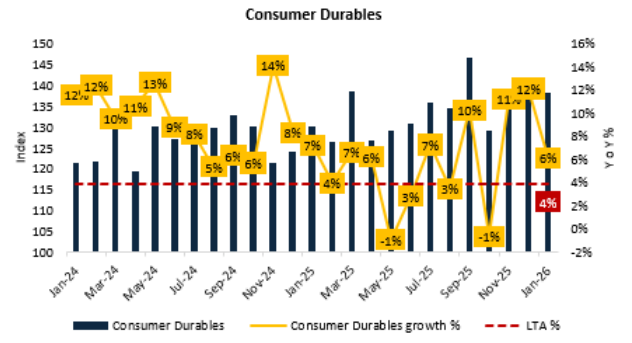
- The RBI, in its February 2026 monetary policy statement, projected CPI inflation for FY26 at 2.1%, with **Q4 FY26 estimated at 3.2%. For FY27, the central bank guided for inflation at 4.0% in Q1 and 4.2% in Q2, reflecting the anticipated impact of unfavourable base effects and the structural implications of the new CPI series**. The **MPC unanimously held the repo rate at 5.25% and maintained a neutral stance, signalling that the current policy rate is appropriate given the growth-inflation balance**. The **near-term food supply outlook remains constructive, supported by healthy kharif production, favourable rabi sowing, adequate reservoir levels, and sufficient buffer stocks of foodgrains. Core inflation, barring potential volatility induced by precious metals, is expected to remain range-bound**.
- **India's narrative of strong growth and low inflation continues under the new data series but is increasingly challenged by elevated crude oil prices and energy supply disruptions. We expect a policy rate hold from the RBI going forward. We observed that the next few months' prints will be keenly watched to factor in any impact of the West Asia crisis, and does not expect an immediate inflation impact but cautions that a prolonged disruption could have knock-on effects**. Our estimate - **March 2026 CPI inflation at 3.7%, driven by continued food price firmness and higher petroleum product costs, and tracks FY27 inflation at 4.0–4.1% under a base case of crude oil coming back to $70 per barrel**.
- In summation, **while the February 2026 CPI print remains comfortably within the RBI's tolerance band and underlying inflation pressures appear contained, the confluence of unfavourable base effects, rising crude oil prices, and geopolitical uncertainty tilts the risk balance decidedly to the upside in the near-to-medium term. The eventual balance sheet, fiscal and inflationary impact will critically depend on how the burden is distributed among oil marketing companies, the government through duty cuts and subsidies, and end-consumers through price hikes. The RBI is expected to remain in a "watchful pause" mode, with the April 2026 policy meeting the first to incorporate full-year CPI and GDP projections under the new series likely to be a pivotal moment for the monetary policy trajectory in FY27**.

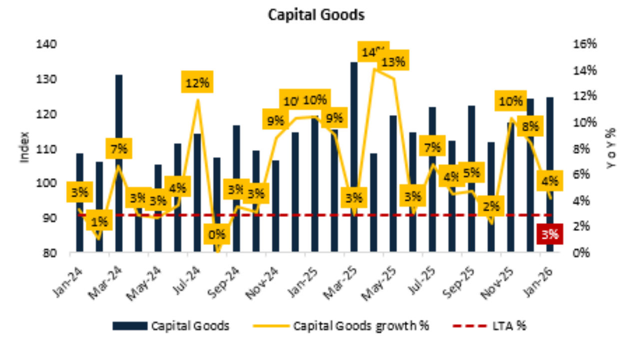
3. IIP (Index of Industrial Production)

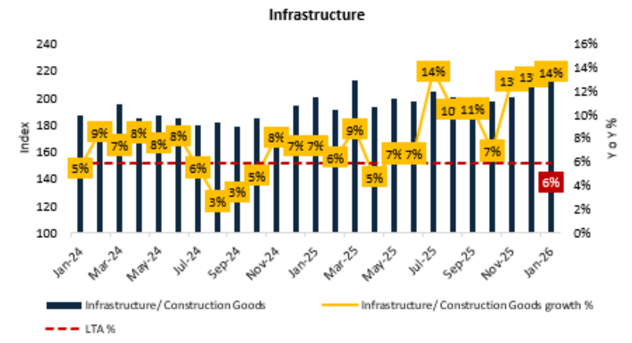




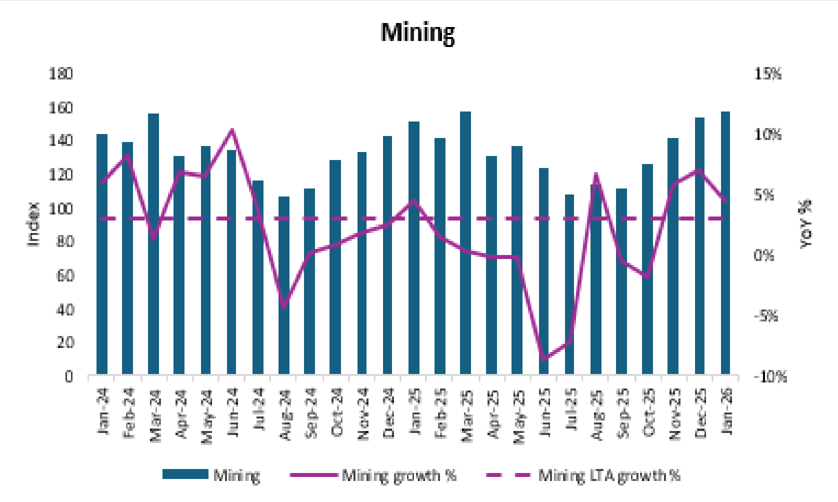


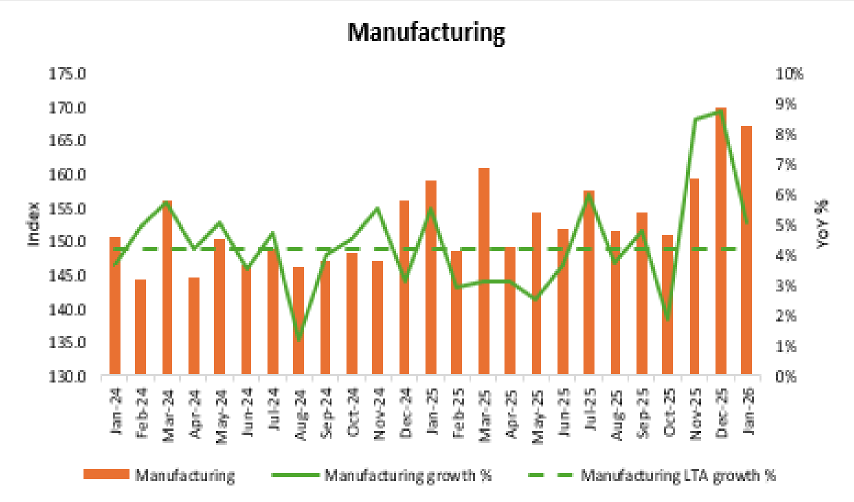


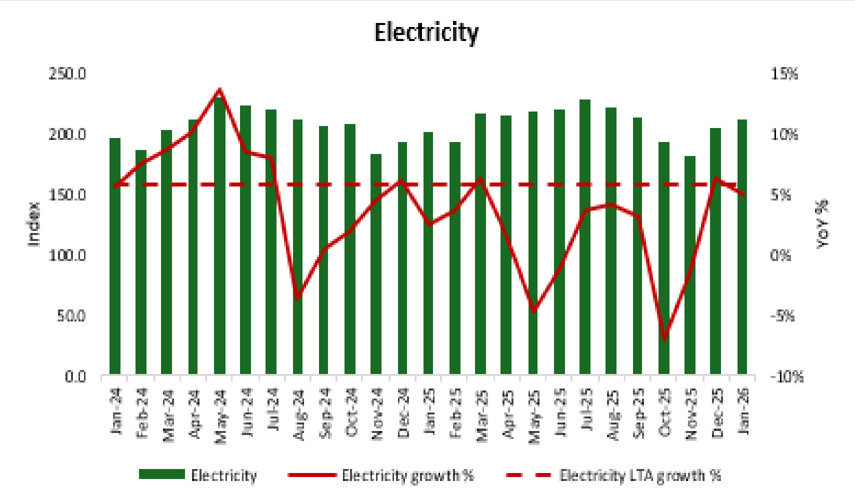




Source: Internal assessment based on RBI DBIE data







Index of Industrial Production (IIP)

<u>Headline Data Snapshot</u>

- India's IIP registered 5.2% YoY growth in February 2026, significantly above the 2.7% recorded in the year-ago month. The General Index at 159.0 (vs 151.1 in Feb-25) confirms the industrial cycle is in a solid expansionary phase. Manufacturing led at 6.0% YoY (vs 2.8%), mining improved to 3.1% (vs 1.6%), while electricity moderated to 2.3% (vs 3.6%) – the latter partly reflecting emerging constraints from the Middle East energy supply disruption on thermal fuel availability. The cumulative April–February FY26 IIP growth stands at 4.1%, flat versus the corresponding FY25 period, indicating a steady rather than accelerating full-year trajectory despite the monthly improvement.

Parameter	Feb 2026	Jan 2026 (R)	Feb 2025
IIP Overall Growth (% YoY)	**5.2%**	**5.1%**	**2.7%**
General Index	159.0	169.4	151.1
Mining Growth	3.1%	4.3%	1.6%
Manufacturing Growth	6.0%	4.8%	2.8%
Electricity Growth	2.3%	5.1%	3.6%

Source: Internal assessment based on RBI DBIE data

Sectoral Decomposition

- **Manufacturing (77.6% weight) grew 6.0% YoY in February 2026**, more than double the 2.8% recorded a year ago. The breadth of expansion remained stable with 14 of 23 NIC 2-digit industry groups in positive territory. The top three contributors were: motor vehicles, trailers and semi-trailers (+14.9% YoY), led by auto components, commercial vehicles, and agricultural tractors; basic metals (+13.2%), driven by alloy steel products, MS slabs, and pipes; and machinery & equipment (+10.2%), supported by industrial engines and tractors. The strength in motor vehicles and basic metals is consistent with the twin pillars of infrastructure-led investment and logistics demand driving the current manufacturing cycle. However, 9 of 23 groups remained in negative or flat territory – export-oriented and consumer-facing sub-sectors continue to face headwinds, now compounded by Hormuz-related freight disruptions and elevated input costs.
- **Mining (14.4% weight) grew 3.1% YoY**, nearly doubling from 1.6% a year ago, but the sector remains structurally constrained by declining crude oil production (-5.2% YoY) and natural gas output (-5.0% YoY), both in persistent contraction. Coal grew 2.3%, supported by thermal power generation needs, though cumulative FY26 coal growth remains marginal at -0.1%.
- **Electricity (8.0% weight) grew 2.3% YoY** versus 3.6% a year ago – the deceleration is partly base-driven, but the emerging energy supply disruption from the Middle East conflict poses a material risk for thermal generation dependent on imported gas and LNG, where the Strait of Hormuz closure has constrained availability and pushed spot prices sharply higher.

Use-Based Classification & Core Sector Analysis

- The use-based data reveals the sharpest K-shaped divergence of FY26. **Capital goods surged 12.5% YoY** – the strongest print in nine months – signalling a genuine pick-up in private investment activity alongside the sustained public capex push. **Infrastructure/construction goods grew 11.2%**, with the index at 213.2 (the highest across all use-based segments), directly reflecting the Rs 12.2 lakh crore budgetary allocation. **Intermediate goods grew a healthy 7.7%** and **Consumer durables rose 7.3%**, indicating resilience in discretionary spending. **Primary goods grew a modest 1.8%**. The critical concern is **Consumer non-durables at -0.6% YoY** – everyday items like food products, beverages, textiles, and personal care goods consumed by mass-market households. This contraction, following January's -2.7%, raises legitimate questions about the durability of the rural and lower-income consumption recovery. An industrial cycle where capital goods grow at +12.5% while everyday consumption goods contract is structurally lopsided.
- The Index of Eight Core Industries (ICI), constituting 40.27% of IIP weight, grew 2.3% YoY in February. Cumulative April–February FY26 growth stands at 2.9% versus 4.5% in the prior year – a clear moderation in the core infrastructure pipeline. The internal divergence is stark: cement (+9.3%) and steel (+7.2%) outperformed handsomely, with cumulative FY26 growth of 9.2% and 9.7% respectively, underscoring the robustness of the infrastructure build-out. Energy extraction, however, contracted across the board – crude oil -5.2%, natural gas -5.0%, and refinery products -1.0%. Natural gas has now declined for approximately 20 consecutive months, a structural challenge with direct implications for fertilizer production costs, city gas distribution, and industrial energy pricing that will be further amplified by the Hormuz supply disruption.

PMI Cross-Read: Forward-Looking Signals

- **The HSBC India Manufacturing PMI at 56.9 in February 2026 had marked a four-month high**, with output, new orders, and employment all expanding at the fastest pace in four months. Importantly, the breadth of improvement was notable – consumer goods recorded the strongest operating conditions, followed by intermediate goods, while capital goods lagged, suggesting inventory building ahead of the geopolitical shock. Input purchases and inventories expanded, reflecting precautionary stock-building as firms anticipated supply disruptions.
- The **March final PMI, however, collapsed to 53.9 – the weakest expansion since August 2022 (a 45-month low)** – as the Middle East war's effects transmitted rapidly through the economy. Domestic new orders slowed to a 3-year low amid escalating uncertainty, even as export orders surged to a record high (global buyers front-loading purchases to hedge against further disruptions – likely transient). Input costs surged at the steepest rate in 45 months across aluminium, chemicals, and fuels, while firms absorbed much of the pressure – selling charges rose at the weakest pace in two years, pointing directly to margin compression that will show up in Q4 FY26 corporate earnings. The **Composite PMI also fell to 56.5 from 58.9, with services moderating alongside manufacturing. The 56.9-to-53.9 single-month deterioration confirms the Hormuz crisis has moved from a risk premium in market pricing to a tangible drag on activity**.

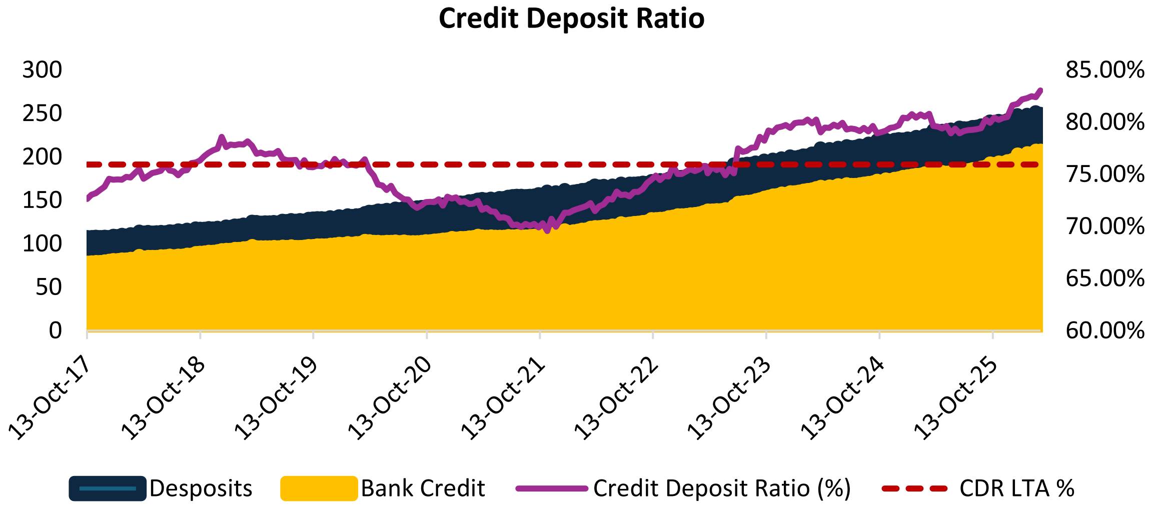
Key Structural Themes

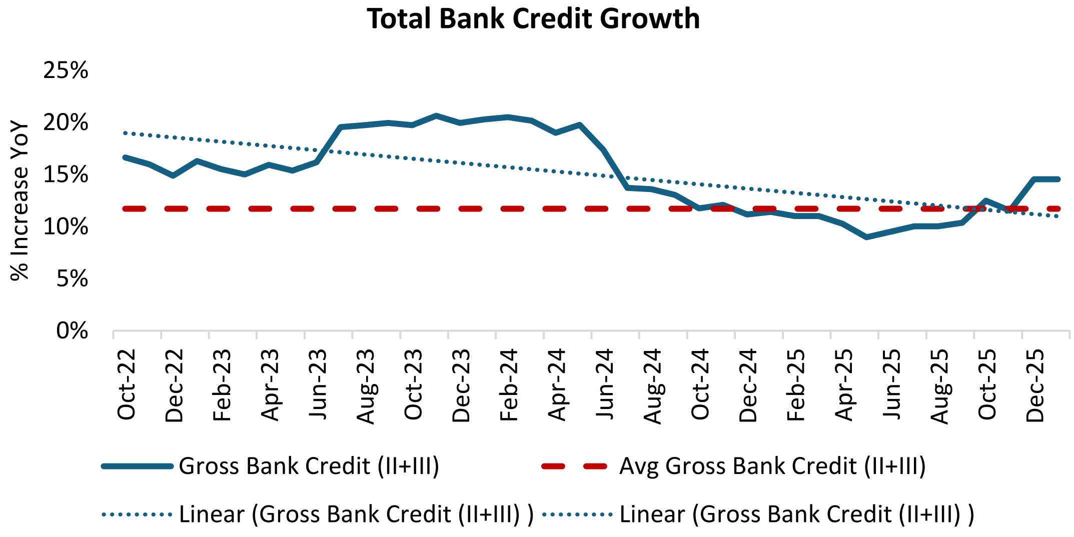
- **The Consumption Gap**: The most consequential theme emerging from the February IIP is not the headline number but what lies beneath it. The industrial cycle is running on one engine – government and private investment – while the mass-market consumption engine remains stalled. Until rural and semi-urban spending recovers meaningfully, the cycle remains vulnerable to any shock that weakens the investment pillar. GST rationalisation, income tax cuts, and cumulative 125 bps of RBI rate easing (repo at 5.25%) are the right policy levers, but the transmission lag to ground-level demand is the key monitorable. The risk is that the energy shock, by raising input costs and compressing margins across the FMCG and textile value chain, could delay this consumption recovery further.
- **Bank Credit-IIP Divergence**: Bank credit to industry continues to significantly outpace IIP growth, suggesting a substantial portion of credit flow is supporting working capital needs, infrastructure projects with longer gestation periods, or sectors not immediately captured in the IIP basket. This likely indicates a pipeline of investment activity that will reflect in future output, but warrants monitoring for credit misallocation – particularly as the energy shock raises working capital requirements across import-dependent manufacturers and could strain smaller firms' balance sheets.
- **IIP Base Year Revision**: The IIP base year update to 2022-23, scheduled for MoSPI release on 28th May 2026, will reassign weights to manufacturing and electricity, and should help reconcile the divergence between IIP growth (~4.1% cumulative) and manufacturing GDP growth (11.5% under the new national accounts). The revision will also provide better coverage of newer manufacturing segments – electronics, EVs, defence production – that are underrepresented in the current 2011-12 base. Investors should prepare for discontinuities in historical trend analysis and recalibrate sectoral models accordingly.

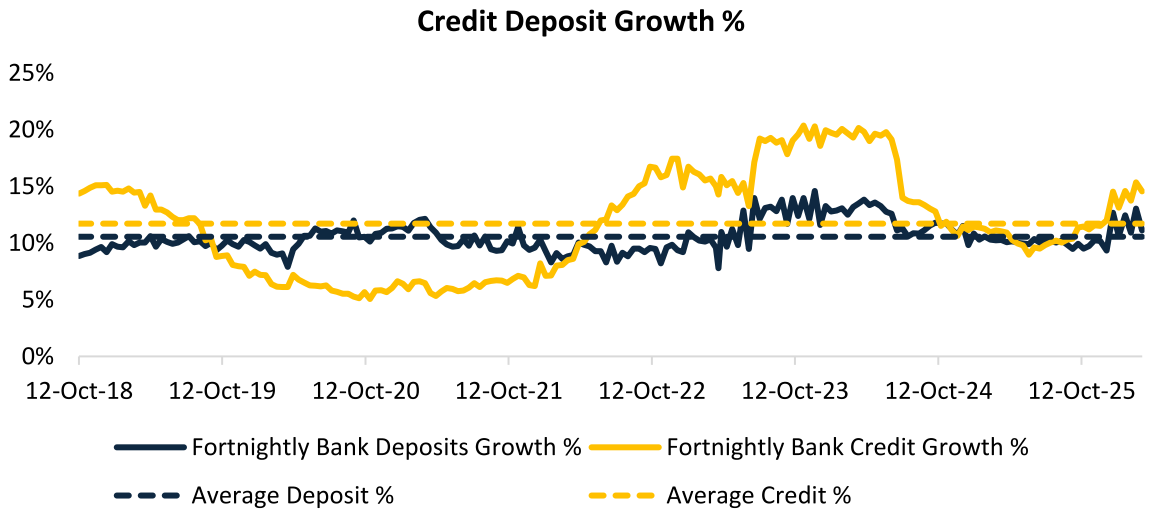
Outlook

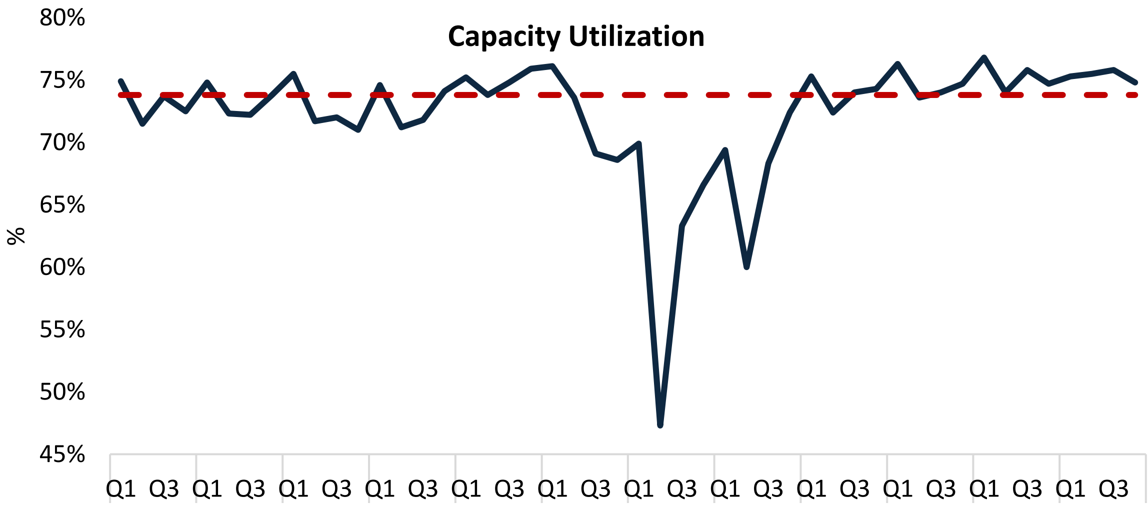
- **Here's the thing about this February print – it's arguably the last "clean" IIP reading we'll get for a while. The US-Israel-Iran conflict kicked off on 28 February, which means the February IIP data captures industrial activity almost entirely before the war began. Whatever disruption the Hormuz closure, the oil spike, and the freight chaos are causing – none of that shows up here. This 5.2% number reflects an economy that was genuinely building momentum: capital goods at a 9-month high of 12.5%, infrastructure goods at 11.2%, manufacturing breadth holding at 14 of 23 groups positive. The investment engine was firing, trade deals with the US and EU were done, the RBI was in easing mode at 5.25%, and the Rs 12.2 lakh crore capex allocation was translating into real activity on the ground. Full-year FY26 IIP will likely close around 4.0–4.2%.**
- **March is where the picture changes – and we need to be honest that we don't yet know the full extent. The war started on the last day of February, but the Hormuz shutdown, the oil surge to $120+, the rupee cracking past 95, the freight rerouting – all of this hit in March. The flash PMI has already given us a preview: 53.9, a 45-month low, with input costs at the steepest since August 2022 and domestic new orders at a 3-year low. That's survey data collected mid-March. The actual March IIP (due 28 April) will be the first hard data point that captures the war's impact on factory output. Our expectation is a meaningful step-down – probably into the 2–3.5% range – driven by energy-intensive sectors taking the first hit (refining, chemicals, fertilizers, cement kilns running on imported fuel), followed by broader margin compression squeezing discretionary production decisions. But frankly, the range of outcomes is unusually wide. If Hormuz reopens by mid-April, the disruption could be a one-quarter blip. If it drags into Q2 FY27, we're looking at something structurally different.**
- **The deeper concern isn't the headline IIP number – it's the consumption side that was already missing before the war. Consumer non-durables contracting at -0.6% in February, with capital goods at +12.5%, tells you this cycle was running on one leg. An economy doesn't sustain 7%+ GDP growth on government capex alone; the private consumption multiplier has to kick in. The GST rationalisation and income tax cuts were supposed to catalyse that – but now the energy shock risks pushing FMCG and textile input costs higher, compressing rural purchasing power further, and delaying precisely the recovery that the IIP data has been waiting for. Every $10/bbl on crude adds ~$13–14 billion to the import bill. Goldman has already cut CY2026 GDP to 5.9% from 7.0%. Morgan Stanley is talking stagflation. Moody's warns of up to 3% GDP loss in a prolonged scenario.**
- **For FY2026-27, we're working with a 3.5–5.5% IIP range, skewed to the lower end until there's clarity on Hormuz. The variables that matter most, in order: (1) duration of the Strait closure and crude's path back toward $80, (2) the monsoon – any El Nino shortfall compounds the supply shock through food prices and kills whatever rural momentum was building, and (3) whether the government can maintain its capex run-rate or gets forced into fiscal consolidation to fund fuel subsidies.**
- **What was shaping up as a breakout year has become a stress test. The investment engine has earned its credibility; whether it can carry the full weight alone while crude stays triple digits – that's the question the next two quarters will answer.**

4. Capex



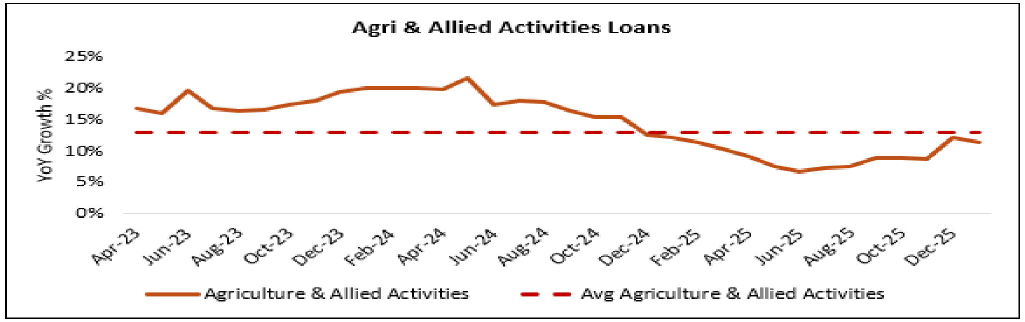




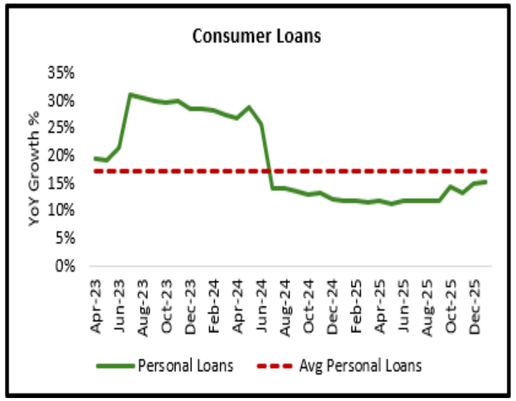


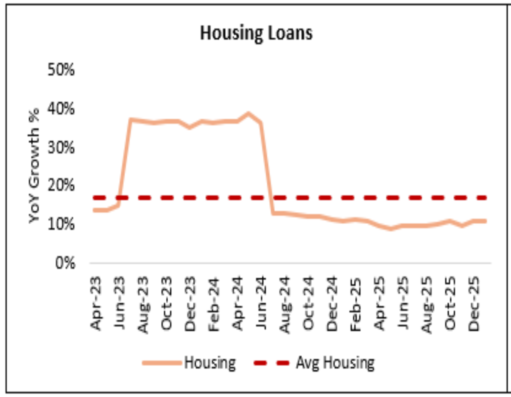
Source: Internal assessment based on RBI DBIE data

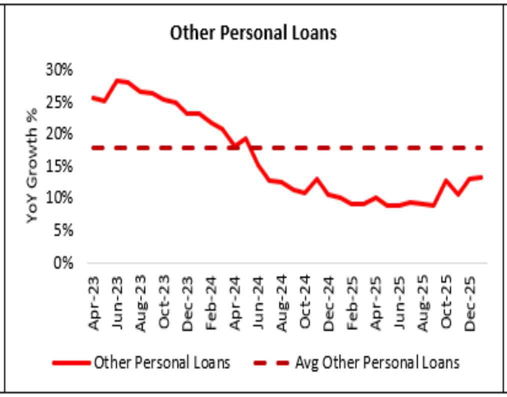
Credit to Agri

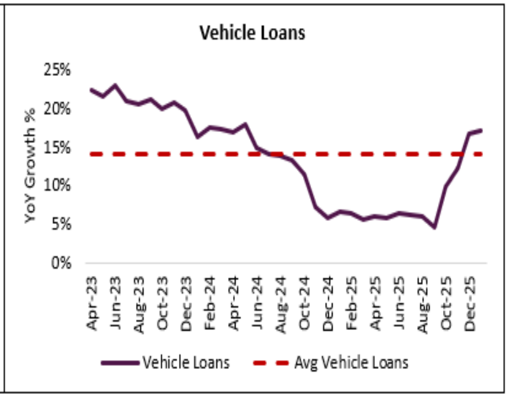


Credit to Consumer

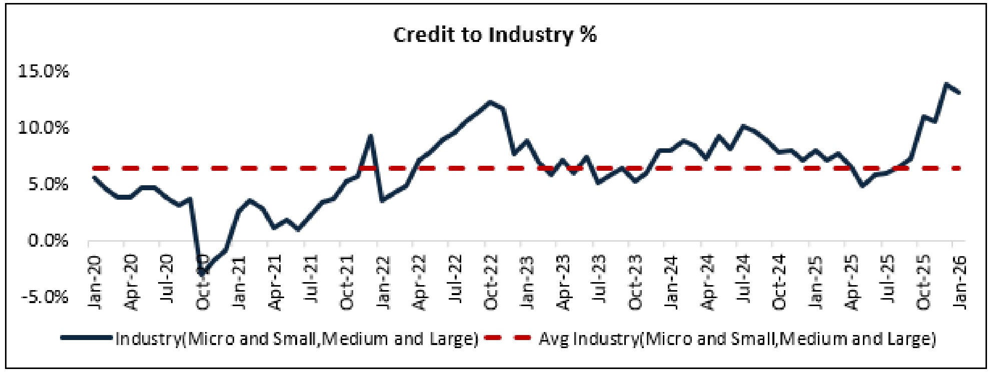


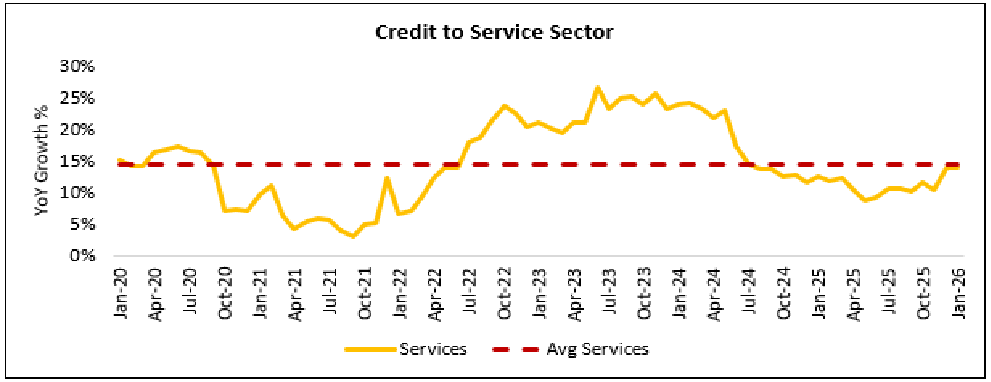


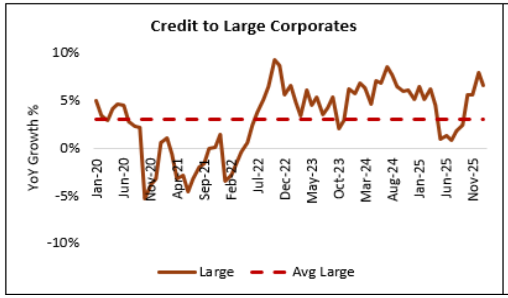


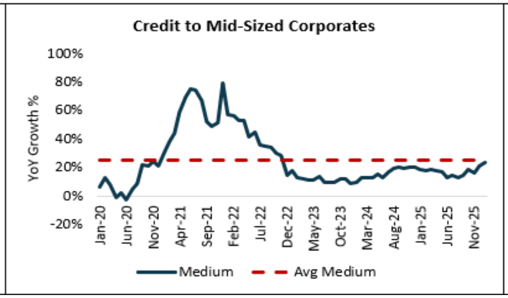


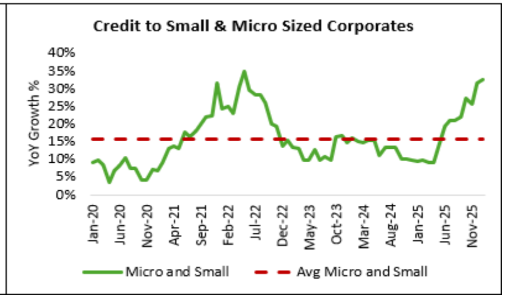
Credit to Industry











Source: Internal assessment based on RBI DBIE data

Bank Credit Dynamics: A Broad-Based Uptick
Aggregate Credit Flows: Acceleration Sustaining into Q4 FY26

- **Total non-food bank credit grew 14.4% YoY as of the sectoral deployment data for January 2026** (vs approximately 14% in December), indicating sustained credit momentum. In the fortnightly data, credit growth hit 14.6% YoY for the fortnight ending January 31, 2026, before settling at 14.5% YoY for the fortnight ending February 28, 2026. **The breadth of this acceleration is the critical signal: all major sectors, agriculture, industry, services, and personal loans, are contributing simultaneously, a pattern historically associated with an economy operating near its productive capacity and entering a cyclical recovery mode**.
- The Economic Survey 2025-26 confirmed that credit growth accelerated to 14.5% YoY by December 2025, reflecting improved demand conditions and effective policy transmission. **The primary drivers of incremental flow remain non-food bank credit and corporate bond issuances by non-financial entities**. This dual-channel expansion suggests that **financial intermediation is broadening structurally rather than merely cycling through a single channel**.

Sectoral Decomposition: Where the Growth Is Coming From
Credit to Agriculture
- Agricultural credit growth stood at approximately **11.4% YoY as of the January 2026 sectoral data**, a partial recovery from the sharper deceleration seen in November 2025 (when it stood at 8.7%). **The earlier deceleration was largely a high-base effect, as FY24 saw exceptionally robust farm lending compounded by healthy rabi output that eased distress-driven borrowing needs. In structural terms, agricultural credit expansion has returned closer to its long-run trend, supported by continued government subsidised loan schemes, crop insurance programmes, and stable rural demand**. State-run banks remain the dominant providers of farm finance. **The normalisation of agri credit is not a concern, it reflects a healthier underlying agricultural economy rather than a contraction in access**.

Credit to Industry: Signal vs Noise
- Industry credit growth has **accelerated meaningfully to 12.1% YoY in January 2026**, up from 9.6% in November 2025 and 8.3% a year ago, marking the third successive quarter of sequential acceleration and comfortably above the sector's structural long-run trend of 5-6%. This **acceleration is broad-based, driven by infrastructure, engineering, textiles, and petroleum/nuclear fuels**.
- Critically, **lending to Micro, Small and Medium Enterprises (MSMEs) continues to expand at extraordinary rates**. As per the January 2026 sectoral data, **micro and small enterprises grew 31.2% YoY and medium enterprises grew 22.3% YoY, while large industry credit remained relatively modest at 5.5% YoY**. This signals that **credit transmission is reaching the productive economy in its broadest sense, not just large corporates or NBFCs**. The persistent MSME credit growth since the formalisation wave post-GST and the RBI's MSME Priority Sector incentives has been one of the most structurally significant developments of this credit cycle.
- **Engineering goods credit remains the single most important capex signal in the data**. This category, which serves as a leading indicator for equipment purchases, capacity expansions, and manufacturing investment decisions, has been surging at over 25% YoY through Q3 and Q4 FY26. A surge of this magnitude is structurally significant and typically precedes IIP capital goods acceleration by two to three quarters. **The one area of relative caution within industry credit is at the large-industry level (5.5% YoY), where some segments have shown muted growth, likely weighed down by elevated bond yields in earlier quarters and cautious corporate greenfield spending. As monetary transmission progresses and trade deal certainty improves, these segments are positioned for a catch-up**.

Credit to Services: The Structural Growth Engine

- Services sector credit expanded approximately **15.5% YoY by January 2026** (up from 11.7% in November 2025), making it the **fastest-growing broad credit category**. **NBFCs at 17.8% YoY and commercial real estate at 16.2% YoY remain the dominant drivers**, with trade finance and IT/software services also contributing. **Services credit is a proxy for the broader formalisation and financialisation of the Indian economy**, as the **rapid growth of NBFCs in particular reflects deepening credit penetration in Tier 2/3 cities and among self-employed and semi-formal business segments that were previously underserved**.
- The **one area that has shown modest credit uptake is exporters and travel/hospitality, a reflection of uneven global demand, though the government's focus on travel and hospitality in the recent budget is expected to catalyse demand going forward**. **While AI will likely act as a headwind to IT services growth, the magnitude of the slowdown may be less severe than initially feared, largely because GCCs are absorbing displaced work rather than eliminating it entirely, and traditional IT/ITeS firms are actively reinventing their revenue models to adapt**. **Although this is likely to play out over a much longer period of time**, and the effect will not be seen in the short or even medium term.

Credit to Consumers: Healthy but Shifting Composition

- The **retail/personal loans segment** grew approximately **14.9% YoY by January 2026** (per RBI sectoral deployment data), an acceleration from 12.8% in November 2025. Within this, **housing loans at 11.1% YoY, vehicle loans at 17.1% YoY, and loans against gold jewellery (continuing their extraordinary surge) all represent secured asset expansion**, while **credit card outstanding growth has softened sharply to just 1.5% YoY**. **This compositional shift is significant and fully consistent with RBI's deliberate policy to check unsecured retail lending risk**. It also reflects rational consumer behaviour: with benign inflation and steady incomes, **borrowers are channelling credit demand toward productive and secured assets (vehicles for work, gold as collateral) rather than unsecured consumption**. **The sharp moderation in credit card outstanding specifically suggests improved household financial discipline post-pandemic**.

Credit-Deposit Ratio & Liquidity: Structural Tightening, Policy Response

The Deposit Mix Shift: Structural Migration Underway

- Within the deposit base, **time deposits have decelerated** as customers **shift into demand deposits for operational liquidity**, **a natural consequence of the business activity pickup**. This shift carries two implications. First, it **reduces the stable funding base of banks** (demand deposits are more volatile than term deposits). Second, **it reflects an economy where businesses and households hold more liquid balances, consistent with elevated economic activity and business confidence**. The **term deposit growth deceleration partly reflects the pass-through of RBI's rate cuts**: weighted average domestic term deposit rates on fresh deposits have been declining steadily since the rate-cutting cycle began. **As deposit rates moderate, some savers are migrating to mutual funds, market-linked instruments, and equities, a structural deepening of capital market participation that is positive for long-term financial intermediation even if it temporarily constrains bank deposit growth**.

The CDR Dynamic: Credit Outpacing Deposits

- The credit-deposit (CD) ratio has been holding at a **record high of 82.5% for four consecutive fortnights through February 15, 2026**, a level that merits careful monitoring because it **indicates credit is expanding materially faster than deposits**. As of February 15, credit was growing 13.7% YoY while deposits grew only 10.9% YoY, a gap of 281 basis points. By the fortnight ending February 28, credit growth strengthened to approximately 14.5% YoY and deposit growth to nearly 12% YoY. **This structural gap, credit expanding faster than deposits, is the defining tension in India's banking system today**. On the risk side, **if deposit growth does not accelerate, banks will face increasing reliance on certificates of deposit and wholesale funding for incremental lending, which compresses margins and introduces funding volatility**. **RBI's liquidity operations, including open market operations, CRR cuts, and forex swaps, are explicitly designed to bridge this gap and ensure credit growth is not supply-constrained**. The Economic Survey 2025-26 detailed these measures as central to the monetary transmission framework. We have spoken about them in our previous editions as well.

Private Capex: From Wait-and-Watch to Early Signs of Inflection

The Paradox of Muted Capex in a Strong Macro Environment

- India's private sector capital expenditure paradox remains one of the defining puzzles of the current economic cycle. Growth is stable, inflation is at multi-year lows (averaging 1.7% CPI for April-December FY26 per Economic Survey), corporate balance sheets are lean in debt and flush with profits, real GDP growth is estimated at 7.4% for FY26, and yet fresh greenfield capex announcements by private companies fell for two consecutive quarters (Q2 and Q3 FY26). As per Projects Today data, **fresh private-sector capex plans fell 4.6% sequentially in Q3 FY26** even as government infrastructure project announcements rebounded strongly.
- The NSO's Forward-Looking Survey on Private Sector Capex Investment Intentions (conducted October-December 2025, released March 23, 2026) tells a more nuanced story. The survey showed a **high realisation ratio of 96.3%** for the previous year's investment plans, indicating that companies largely follow through on committed spending. **Forward capex intentions for FY27 also remain robust (NSO notes such estimates are typically conservative). Internal accruals remain the dominant funding source, followed by domestic debt, while equity and external sources account for a smaller share. The majority of enterprises are focusing capex on core asset creation and value addition to existing assets**. This confirms the **ability to invest is unambiguously present, but the willingness to commit to large greenfield capex remains cautious**. This is as much a corporate psychology problem as a financial one, and understanding its drivers is essential to forecasting when the inflection will come.

Why Private Capex Has Been Held Back Until Now

- The **escalating West Asia conflict in March 2026**, with crude oil crossing $100/bbl and fears over Strait of Hormuz disruption, has compounded existing **trade tensions with the US**. **FPI outflows from Indian equities** in March alone have been the highest monthly outflow recorded in 2026, further dampening corporate confidence and tightening financial conditions. **The rupee has weakened meaningfully**, adding currency volatility for import-heavy capital goods sectors. Beyond the geopolitical shock, **the structural cost of capital for greenfield projects remains elevated** despite cumulative RBI rate cuts bringing the repo rate to 5.25%. Greenfield investment requires long-tenor debt, land, environmental clearances, and grid connectivity, all of which remain elevated relative to the returns available from brownfield/maintenance capex. **Companies have rationally preferred asset-sweat strategies: refreshing and optimising existing capacity rather than building new**.
- Land acquisition remains complex, power grid connectivity timelines are long, logistics costs (while improving) remain a factor, and regulatory approvals add meaningful execution risk and cost to greenfield projects. **Much of corporate spending in FY26 has accordingly been confined to maintenance capex, technology upgrades, and asset replacement, spending that does not meaningfully expand productive capacity but sustains operational efficiency**. The NSO survey confirms a majority of enterprises focused capex on core assets or value addition to existing assets rather than new capacity creation.

The Turning Point: Why the Outlook is Materially Improving

- Against the headwinds above, several powerful tailwinds are building simultaneously. The **India-EU Free Trade Agreement, signed January 27, 2026, is a pivotal development**. The EU is India's largest trading partner, and this deal directly reduces export uncertainty for pharmaceutical, textile, auto component, and engineering goods manufacturers, sectors where capex decisions have been most constrained. **US-India trade deal negotiations remain active at a much lower rate now**. Total funds raised for capex via ECBs, IPOs, and bank/FI sanctions in April-December FY26 remained higher than in any comparable period since FY20, indicating that the corporate sector is evidently accessing long-term finance in anticipation of deployment, even if actual deployment has been cautious.
- **Monetary transmission is now working meaningfully**. Per the Economic Survey, WALR on fresh rupee loans declined by 59 bps and WALR on outstanding loans declined by 69 bps between February and November 2025. With residual WALR reduction still to come as deposits reprice, the financing cost advantage is still building. **Union Budget 2026-27 introduced a suite of targeted capex catalysts, the MSME Growth Fund, India Semiconductor Mission 2.0, dedicated Chemical Parks, new Freight Corridors, and the Infrastructure Risk Guarantee Fund. PLI schemes across 14 sectors have attracted significant actual investment and generated meaningful employment**. These are precision instruments targeting the sectors where private capex has been most inhibited by structural constraints and financing risk.

Capacity Utilisation & Investment Readiness: At the Threshold

The OBICUS Survey: The Most Reliable Real-Time Investment Barometer

- The RBI's quarterly Order Books, Inventories, and Capacity Utilisation Survey (OBICUS) provides the most granular real-time reading of the manufacturing sector's investment readiness. The latest publicly available reading shows **seasonally-adjusted manufacturing CU at 75.4% for the October-December 2024 quarter (Q3 FY25), above the long-term average of approximately 74%**. This is analytically critical because **CU crossing and sustaining above 75% has historically been the inflection point that triggers broad-based greenfield investment announcements**. The Economic Survey 2025-26 independently confirms that capacity utilisation remained above long-term averages through the first half of FY26, supporting fresh investment activity. When existing capacity is fully employed, the only way to sustain output growth is to create new capacity. The economic logic is simple, what has delayed its translation into investment decisions this cycle is the global demand uncertainty and geopolitical risk discussed above.
- **Order backlogs in infrastructure-heavy industries (power transmission, roads, metro rail) and technology manufacturing (electronics, automobiles) are strong** and businesses report better forward sentiment in surveys. The **HSBC India Manufacturing PMI stood at 56.9 in February 2026** (a four-month high supported by strong domestic demand and rising new orders), though **the March 2026 flash reading dropped sharply to 53.8**, the weakest since September 2021, **as the West Asia conflict weighs on near-term sentiment and input costs jump to a 45-month high**. The **composition of capacity tightness matters. CU is highest in consumer goods (auto, electronics, consumer durables) and infrastructure-linked sectors (cement, steel, power equipment), precisely the sectors where private sector capex announcements, when they come, will have the largest multiplier effect on jobs, bank credit, and GDP growth**.

Sector-Level Readiness: Power, Roads, Engineering, Autos Lead

- **Renewable energy capacity addition remains the single largest investment pipeline in the economy**. Bank credit to the power sector is growing in double digits, and the sector's capex guidance has been revised upward by leading transmission utilities, reflecting sustained confidence in long-term demand.
- **Cement production growth has been accelerating**, one of the most reliable physical proxies for construction intensity, and NHAI's active project pipeline together with state government capex recovery in FY26 are sustaining demand on the roads and construction front.
- The **sustained credit surge in engineering goods and capital equipment** is indicative of robust order-flow and equipment financing, encompassing machine tools, industrial machinery, and process equipment, the physical building blocks of capacity expansion.
- IIP for December 2025 showed 7.9% YoY growth overall with manufacturing at 8.1% YoY, though January 2026 IIP moderated to 4.8% YoY.
- **PLI-linked investment in EV manufacturing, semiconductor assembly, and mobile device production continues on schedule, with multiple major semiconductor units set to begin commercial production in 2026**.
- **CU in the auto sector is high, order books are full**, and both domestic demand and export ambitions are driving investment planning.

Forward Outlook: Credit & Investment Cycle Through FY2026-27

Bank Credit Trajectory: Above Structural Trend into FY27

- **Credit growth is expected to remain above its structural 10-11% trend and sustain at 12-14% through most of FY27**, supported by four structural tailwinds: the **RBI's continuing focus on transmission of earlier rate cuts** into broader lending rates, **ample systemic liquidity from RBI's open market and forex swap operations**, **industry credit and MSME credit remaining above long-term average growth rates as the construction and manufacturing cycle deepens**, and **services sector credit expansion being supported by the strong NBFC and IT/GCC growth vector**. SBI has revised its FY26 credit growth guidance upward to 13-15% from 12-14%. The **primary risk to this outlook, besides a War driven Oil supply constraint leading to elevated Crude Oil prices, is a CDR-driven funding constraint**: if deposit growth does not accelerate, either through interest rate differentials attracting savers back to term deposits or through broader measures to increase household savings capture, banks may face margin pressure and have to moderate credit growth. RBI's liquidity operations mitigate but do not eliminate this structural tension.

Monetary Policy: Holding at 5.25%, Focus Shifts to Transmission

- With 125bps of cuts already delivered since February 2025 and inflation well below target, **RBI held the policy repo rate at 5.25% in February 2026**. The policy focus has definitively shifted from delivering additional rate cuts to **ensuring full transmission of existing cuts into lending rates, deposit rates, and ultimately credit creation**. The gap between cumulative policy cuts (125bps) and actual WALR reduction (59-69bps) represents the remaining transmission pipeline, as term deposits mature and reprice at lower rates, this gap will close, providing an additional lending rate reduction without any further policy action. **Subdued core inflation and rising capacity utilisation allow for an accommodative-for-now stance without sacrificing the inflation credibility that RBI has rebuilt**. The key risks that could force a pivot are **INR depreciation beyond comfort levels from the West Asia conflict pushing crude further above $100/bbl**, or a **widening fiscal deficit that crowds out private bond issuances and pushes term yields higher**. Both risks are manageable in the current environment but require monitoring.

Private Capex: Gradual Revival in FY27, Supercycle Potential in FY28

- **Our base case** is a **gradual private capex revival beginning in Q2-Q3 FY27**, as the **war situation in the Middle-East deescalates**, **trade deal blueprints are finalised**, **CU pressures intensify**, and **rate transmission is complete**. Under this scenario, **GFCF grows 7-9% in FY26-27** (vs 7.8% in the FY26 First Advance Estimates per Economic Survey) and the **investment-to-GDP ratio stabilises in the 30-31% range**. Sectoral beneficiaries are well-diversified: **construction materials (cement, steel), power equipment manufacturers, engineering companies, logistics infrastructure, and NBFCs that finance MSME capex**.
- **A bull case, a capex supercycle scenario with GFCF at 10-12%, becomes credible if the US-India trade deal is signed,** the **war situation in the Middle-East deescalates, CU crosses 76-77% for two or more consecutive quarters, and at least two quarters of rising greenfield announcements materialise.** This scenario would trigger a **significant rotation into capital goods, construction, and financial intermediaries serving MSME capex**.
- **A bear case, GFCF falling to 4-5%, requires a global demand shock, trade deal collapse, sustained crude above $110/bbl from the West Asia conflict, and sustained FPI outflows constraining financial conditions. We assign this a 5-10% probability, elevated from our previous assessment given the West Asia escalation and March FPI outflows**.

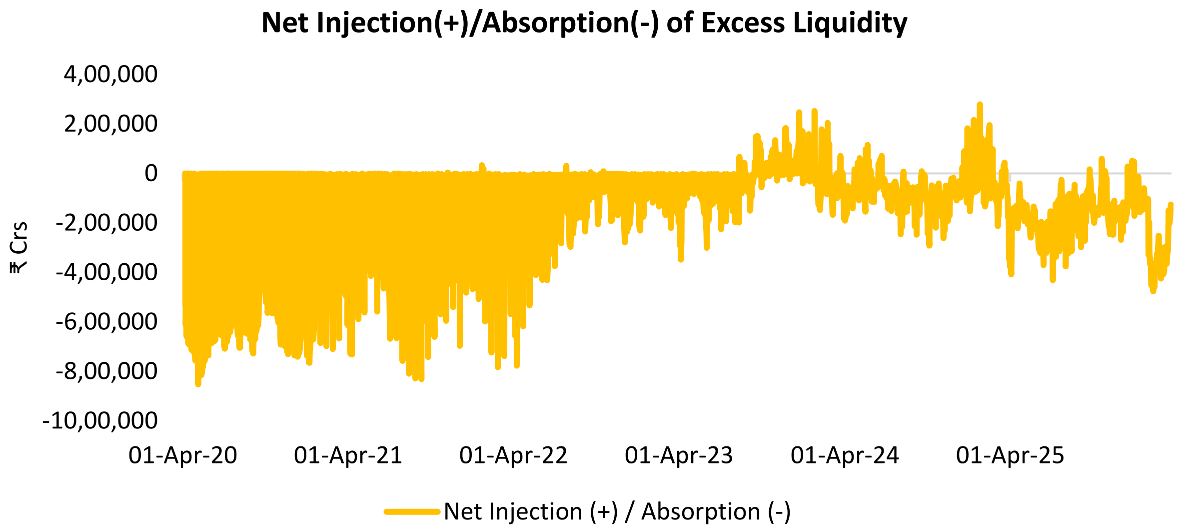
What Would Signal Full Investment Confirmation?

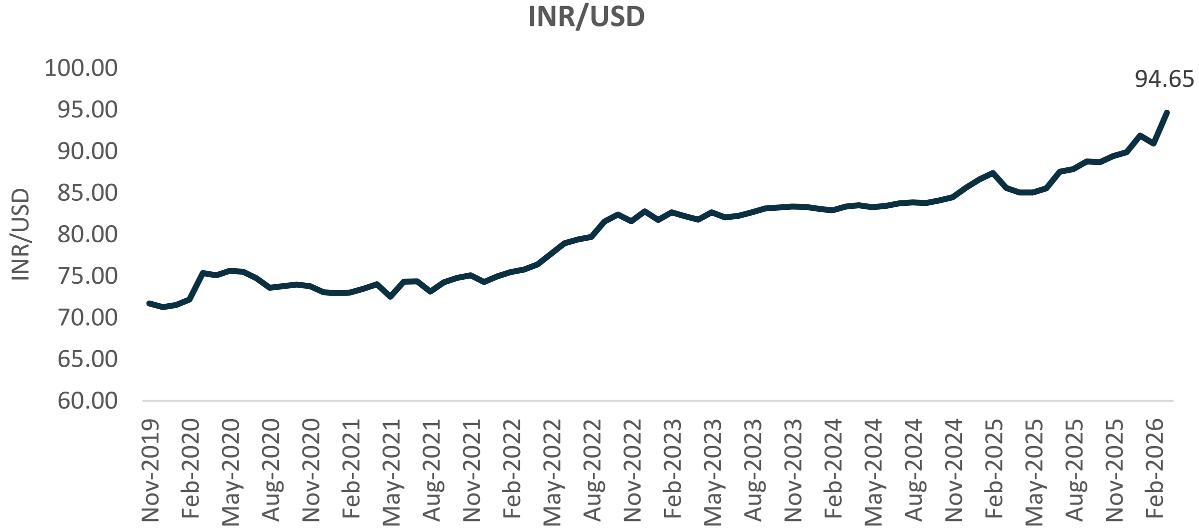
- Three consecutive signals would confirm that the private capex cycle has moved from inflection to expansion:
- **CU sustaining above 75-76% for two or more quarters** (one quarter could be seasonal noise, two quarters is a trend),
- **greenfield investment announcements returning to growth on a YoY basis** (currently negative for two quarters per Projects Today data, watching the Q4 FY26 data keenly), and
- **IIP Capital Goods growth averaging 10%+ over a rolling three-month period** (currently showing improvement but not yet consistently above this threshold, with January 2026 IIP moderating to 4.8% YoY).

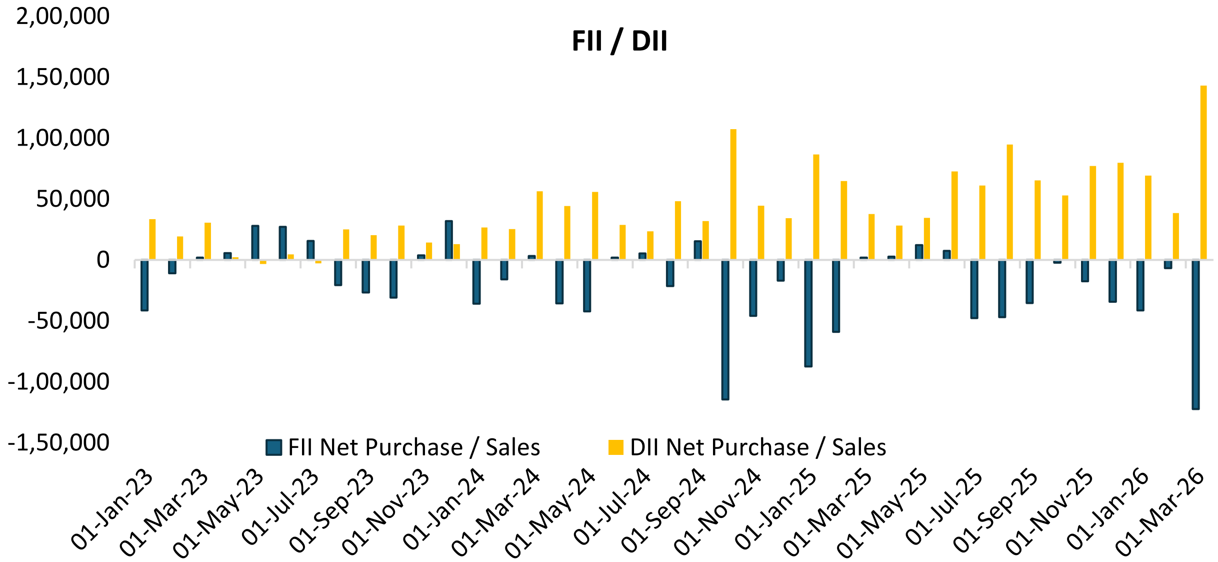
Bottom Line: Positioned for Convergence, With Elevated Near-Term Risks

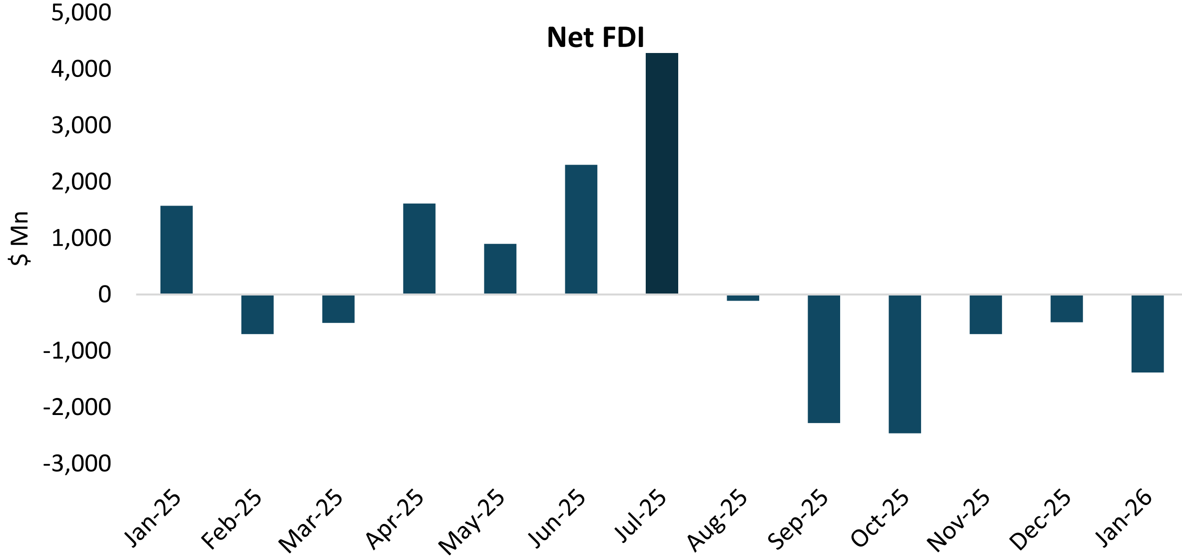
- India's credit and investment landscape in March 2026 presents a more complex picture than a month ago. The underlying macro setup remains one of the most compelling for investors in over a decade. **Bank credit is growing at 14.5% YoY, capacity utilisation has crossed above its long-term average, monetary policy has delivered substantial rate cuts with more transmission still to come, GFCF has grown 7.8% to sustain a 30% share of GDP, and the Economic Survey confirms GDP growth of 7.4% for FY26**.
- However, the **near-term risk environment has deteriorated materially**. **The West Asia conflict escalation** has pushed crude above $100/bbl, triggered massive FPI equity outflows in March (the highest monthly outflow in 2026 per NSDL data), weakened the rupee significantly, and dragged the Manufacturing PMI to its weakest flash reading since September 2021. This introduces a genuine tension between the strong structural setup and the challenging near-term external environment.
- The **private capex revival has not yet arrived in its full form but its preconditions are assembling**. The sustained engineering goods credit surge is the single most important leading signal to track. The India-EU FTA is the first decisive geopolitical catalyst. CU above long-term averages is approaching the historical trigger zone. The MSME finance ecosystem is the deepest it has ever been. And the NSO survey shows near-complete execution on committed capex plans, demonstrating that corporate India is following through on investment commitments even while remaining cautious on new greenfield projects.
- **The convergence of public infrastructure and private investment, when it comes, will define India's growth trajectory for the remainder of the decade. Investors positioned ahead of this convergence, in construction materials, engineering, capital goods, power, and financial intermediaries serving MSME capex, stand to benefit from what could be the most powerful broad-based investment cycle India has seen since the infrastructure boom of 2004-2008. The key variable to watch in the immediate near-term is whether the West Asia conflict de-escalates or intensifies, this single factor will likely determine whether the capex inflection accelerates on schedule or is delayed by another one to two quarters**.

5. Liquidity

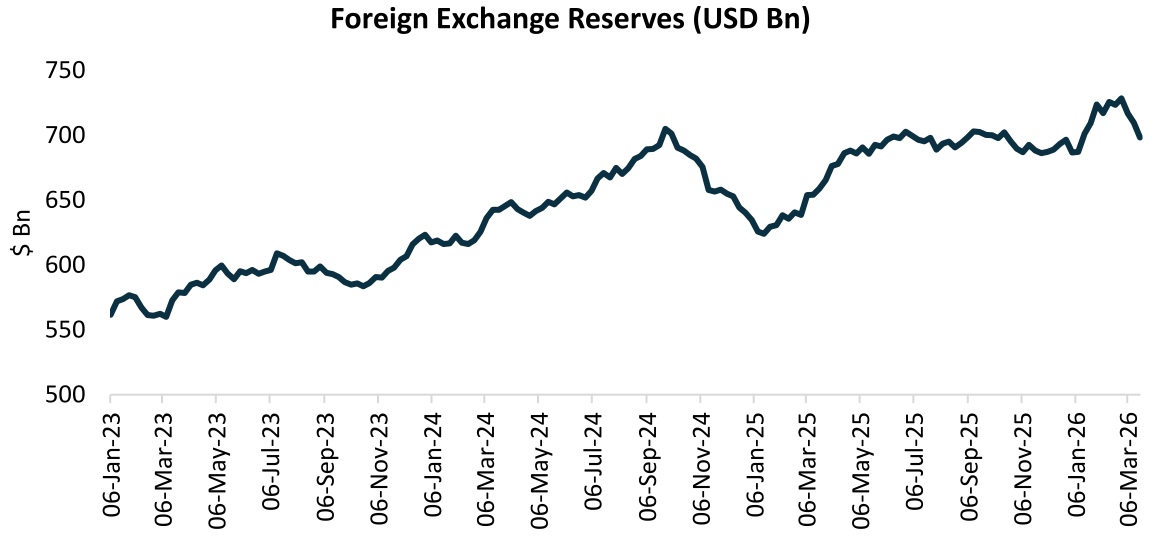


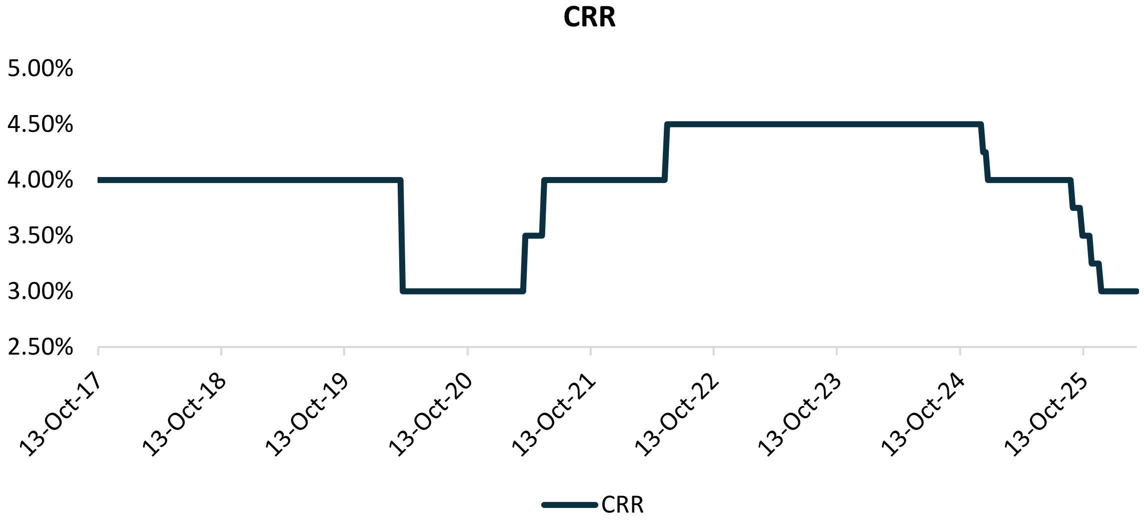


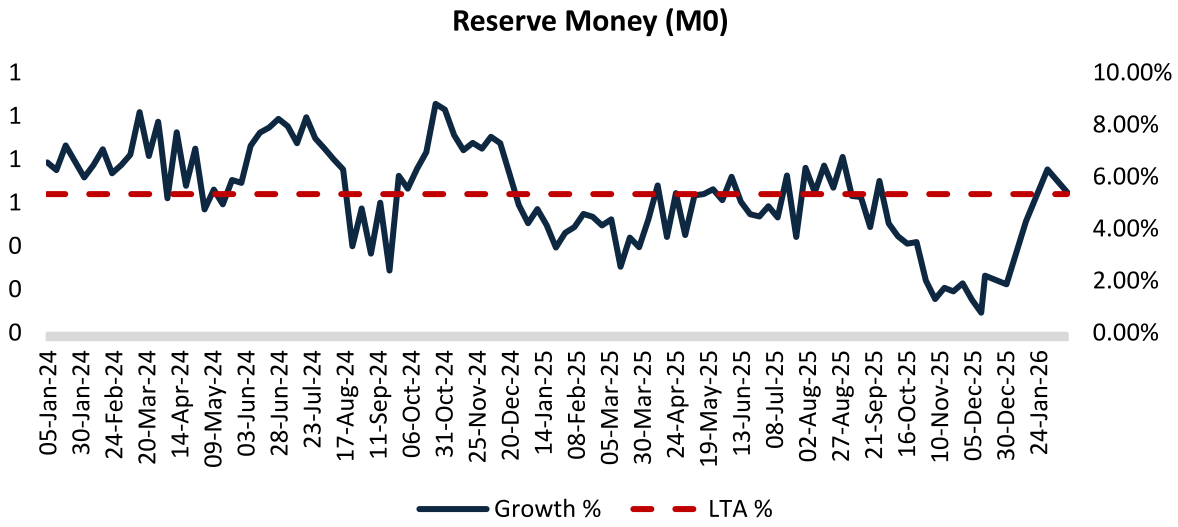


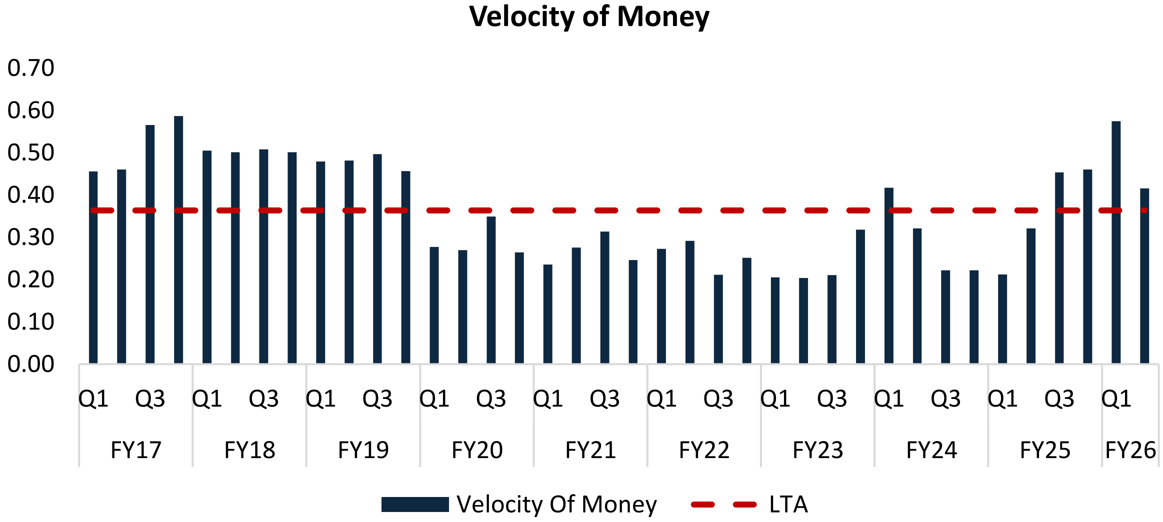


Source: Internal assessment based on RBI DBIE data









Source: Internal assessment based on RBI DBIE data

From Surplus to Squeeze: ₹3 Lakh Crore Vanished in One Week

- **System liquidity flipped to a deficit of ₹65,395 crore on March 23**, the first deficit since January 21, reversing a daily average surplus of ₹2.50 lakh crore that had prevailed since early February. The immediate **trigger was the simultaneous hit of advance tax outflows (~₹2 lakh crore) and GST payments (~₹1 lakh crore)**. But the popular narrative misses a critical amplifier, **RBI's FX intervention. Every dollar the central bank sells in the spot market to defend the rupee absorbs an equivalent quantum of rupees from the banking system**. With net dollar sales running at unprecedented levels through March (calendar 2025 total: $51.7 billion, nearly 4x the $12.4 billion sold in 2024), the **FX drain compounded the tax drain, producing a swing that was sharper than what seasonal patterns alone would explain**.
- The LAF corridor (SDF 5.00%, repo 5.25%, MSF 5.50%) tells the story through rate movements. **The WACR (overnight unsecured interbank rate) averaged 5.11% through mid-March, deep in the lower half of the corridor, indicating banks had more cash than they needed. Post March 16 it jumped to 5.34%, compressing to within 9 bps of the repo rate, the clearest real-time signal that surplus liquidity had evaporated**. The SORR (secured overnight rate, collateralised lending against government securities) moved correspondingly. MSF usage stayed low, confirming the tightness was system-wide, not institution-specific.
- The **RBI's response, a ₹1 lakh crore overnight VRR (variable rate repo auction) on March 23**, drawing bids of ₹79,256 crore at 5.26%. A 3-day VRR for another ₹1 lakh crore was announced for Tuesday. These are transient tools. On the durable side, the RBI has already infused ₹3.50 lakh crore through OMO bond purchases since January, plus ~₹90,000 crore via the $10 billion USD/INR swap in February. **Core liquidity (stripping frictional flows) remains at ~₹5 lakh crore. Government expenditure in early April will push ₹1.5-2 lakh crore back into bank reserves**. The deficit is seasonal and self-correcting.
- But the money market is sending a forward-looking signal worth noting while overnight rates and T-bill yields remained stable (no counterparty stress), **CD rates hardened 11 bps as banks built term funding buffers against year-end uncertainty. This divergence between overnight calm and term-rate stiffness suggests banks are not confident the surplus will hold beyond quarter-end, particularly with FX intervention continuing to drain rupee liquidity in the background. There is a strong case for the RBI to front-load another ₹50,000-1,00,000 crore of OMOs or offer longer-tenor VRRs if the deficit extends past March**.

The Money Engine: Reserve Money at 10.3%, M3 at 11.5%, and What the Transmission Gap Reveals

- **Reserve money (M0) growth, adjusted for CRR changes, stood at 10.3% y-o-y at end-February, easing from 10.9%**. M0 is the foundation layer, currency in circulation plus bankers' deposits with the RBI, the raw material the banking system multiplies through lending. Within M0, currency in circulation (roughly 75-80% of the aggregate) grew at 10.6% y-o-y. This is not purely seasonal. **The festive cycle ended in November, yet currency demand has sustained at elevated levels through February, pointing to a structural reality, rural and semi-urban India transacts heavily in cash even as urban digital payments grow 20-25% in volume. Both economies are running simultaneously**. The CRR at 3.00% (down from 4.00% a year ago) has mechanically reduced the bankers' deposits component by releasing ~₹1.16 lakh crore of reserves back to banks, expanding lendable resources.
- **M3 (broad money, capturing currency with public, demand deposits, time deposits, and other bank liabilities) held at 11.5% y-o-y, outpacing nominal GDP growth of ~10-10.5%. This confirms accommodative monetary conditions, more money is being created than what the economy produces in nominal terms. This is intentional during an easing cycle, it keeps cost of money low and availability ample for investment and consumption. The money multiplier (M3/M0) is operating at elevated levels with CRR at historic lows and SLR at 18.00%, meaning the banking system is efficiently converting base money into broad liquidity**.
- **The monetary transmission picture is where the nuance lies**, and it deserves a precise read. Since February 2025, the RBI has cut the repo rate by a cumulative 125 bps. The WALR (weighted average lending rate) on outstanding loans has declined 83 bps, while on fresh loans it has fallen only 66 bps. This inversion seems counterintuitive but has a clear mechanical explanation, a large and growing share of outstanding loans are linked to external benchmarks (primarily the repo rate) through the EBLR framework, meaning they reset automatically every quarter without bank discretion. Fresh loans, however, include a mix of EBLR-linked and MCLR-linked products. The median 1-year MCLR (marginal cost of funds-based lending rate, set by banks based on their internal cost structure) has declined only 60 bps because banks' deposit costs have not fallen proportionately. On deposits, the WADTDR (weighted average term deposit rate) on fresh deposits fell 96 bps, nearly full pass-through, but on outstanding deposits only 45 bps because legacy fixed deposits at higher rates have not yet matured and repriced.

- **This asymmetry is the critical signal, bank assets are repricing faster than liabilities, compressing net interest margins. NIM at 3.3% is still healthy, but private banks have passed through 88 bps on outstanding WALR versus just 54 bps for PSBs, and if the easing cycle deepens further with another 25-50 bps of cuts, margin pressure will intensify, particularly for PSBs where deposit franchises are stickier. Watch this space closely through FY27, it will drive bank earnings revisions**.

The Great Wall of DII: ₹90,000 Crore of FPI Selling in March, Absorbed Without a Crash

- **FPI flows have turned decisively negative in FY26, with cumulative net outflows of ~₹1,19,000 crore through March 18, driven by equity withdrawals. March alone accounts for ~₹90,000 crore**. What distinguishes this episode from previous selloffs is that debt outflows of ~₹7,566 crore accompanied equity selling in the first nine trading days, signalling country-level de-risking, not asset class rotation within India.
- The causal chain is tightly linked. **Brent above $105-111/bbl after Middle East infrastructure attacks and Strait of Hormuz threats is not merely a commodity story for India, it is a macro repricing event. Every $10/bbl adds ~$15 billion to the annual import bill, ~30-40 bps to CPI inflation with a 2-3 quarter lag, and ~30-40 bps to the CAD/GDP ratio. For dollar-denominated FPIs, this compounds viciously the wider CAD pressures the rupee, the weaker rupee erodes local currency returns in dollar terms, and elevated US Treasury yields raise the opportunity cost of EM exposure. Add a strengthening DXY on safe-haven demand, and the incentive structure is unambiguous sell India, buy dollars, buy Treasuries**.
- The daily data confirms this is sustained reallocation, not event-driven volatility. March 5: ₹11,141 crore outflow. March 10: ₹7,960 crore. March 11: ₹7,984 crore. March 12: ₹8,406 crore. March 13: ₹7,492 crore. Net selling on virtually every session. **The BSE Sensex corrected sharply and the India VIX spiked 66.5% to 22.8 by March 20**.
- The structural counterweight is the story. **DII ownership in NSE-listed equities reached 18.3% by Q2 FY26, surpassing FPI ownership at 16.7% (a 13-year low). Combined domestic holdings (DII + retail + HNI) hit an all-time high of 27.8%. SIP inflows at ₹24,000-26,000 crore/month, insurance and pension fund deployments, and growing direct retail participation have created a domestic absorption capacity that is fundamentally different from 2013 (taper tantrum), 2018 (IL&FS), or 2022 (Russia-Ukraine)**. On March 2, FPIs sold ₹3,230 crore, DIIs bought ₹7,941 crore. On March 4, FPIs sold ₹8,700 crore, DIIs absorbed ₹12,000+ crore. Ratio consistently at 2-3x absorption.
- **The correction has been orderly, no liquidity cascade, no forced margin selling spiral, no credit event. India's equity beta to global risk-off events has structurally declined. The remaining vulnerability is through the currency and current account channel, not the equity market channel**.

$79 Billion In, $1.7 Billion Net: The FDI Gap That's Quietly Bleeding the Capital Account

- **Gross FDI during April 2025 to January 2026 was $79.3 billion, up 14.6% y-o-y, with manufacturing leading equity inflows followed by computer services, electricity, and financial services (together >60% of flows). The US tripled its Q1 FY26 contribution to $5.61 billion, reflecting GCC build-out and China-plus-one diversification. The composition is productive and employment-generating, which is the right kind of FDI**.
- **But the number that matters for external stability is net FDI: $1.7 billion for April-January, down from $2.2 billion, negative for five consecutive months. The gap between gross and net is driven by elevated profit repatriation from the maturing stock of foreign investments made during 2015-2020 (now generating returns), and a surge in outward FDI by Indian corporates expanding into the US, Singapore, UK, and UAE (~75% of outflows)**. Outward FDI absorbed 57% of fresh inflows in some months.
- **This has direct capital account consequences. The CAD rose to $13.2 billion (1.3% of GDP) in Q3 FY26, up from $11.3 billion (1.1%). With net FDI covering a negligible fraction, and FPIs running at negative ₹1.2 lakh crore for the year, the financing burden falls on ECBs (registrations down 30% y-o-y to $32.9 billion), NRI deposits, and RBI reserve drawdowns. The $24.4 billion BoP-basis reserve depletion in Q3 reflects this gap. If crude sustains above $100 and pushes FY27 CAD, the financing structure becomes genuinely fragile, and that is when the rupee faces disruptive, not managed, depreciation pressure**.

Past 93 and Counting: Oil, Outflows, and a Resurgent Dollar Are Breaking the Rupee

- **The rupee hit an intraday all-time low of 93.59/$ on March 20, its worst weekly decline in four years, depreciating ~3% since the Middle East escalation in end-February and ~9% y-o-y**. The INR breached 91 on December 16, took less than 15 sessions to cross 91, and the pace has accelerated since. **The speed creates a negative feedback loop, importers rush to hedge near-term payables, adding to dollar demand, which weakens the rupee further, which triggers more hedging demand**.
- Three reinforcing pressures, all external. **First, crude: Brent at $105-111/bbl after Strait of Hormuz threats directly inflates the import bill for an 80% import-dependent economy. Every $10/bbl adds ~$15 billion annually to imports and ~30-40 bps to CPI with lag. Second, capital outflows: FPIs withdrew ~₹66,000 crore from equities in March, converting rupee proceeds to dollars for repatriation. Third, DXY strengthened on safe-haven demand, compressing EM currencies broadly, but INR underperformed Asian peers given its outsized oil sensitivity**.
- **RBI intervention has been the most aggressive in institutional memor**y. CY2025 net dollar sales: $51.7 billion. Net forward sales across onshore/offshore: approaching $100 billion. **The intervention has prevented disorderly depreciation but cannot reverse the trend given the magnitude of external pressures. Critically, every dollar sold also drains rupee liquidity (connecting back to Section 1), creating a secondary tightening effect**.
- **Reserves at $709.8 billion cover 11.2 months of imports and ~95% of external debt. REER (40-currency basket) fell to 94.1 in February, down 0.8% m-o-m, with India's lower inflation (CPI 3.2% vs trading partners) partially supporting real competitiveness**. The **key monitorable: if crude sustains above $100 for more than one quarter, the pass-through to inflation forces the RBI to pause or reverse easing, the CAD widens materially, and the rupee could test 95-96, at which point the intervention cost in terms of reserve depletion and liquidity drain becomes substantially more expensive**.

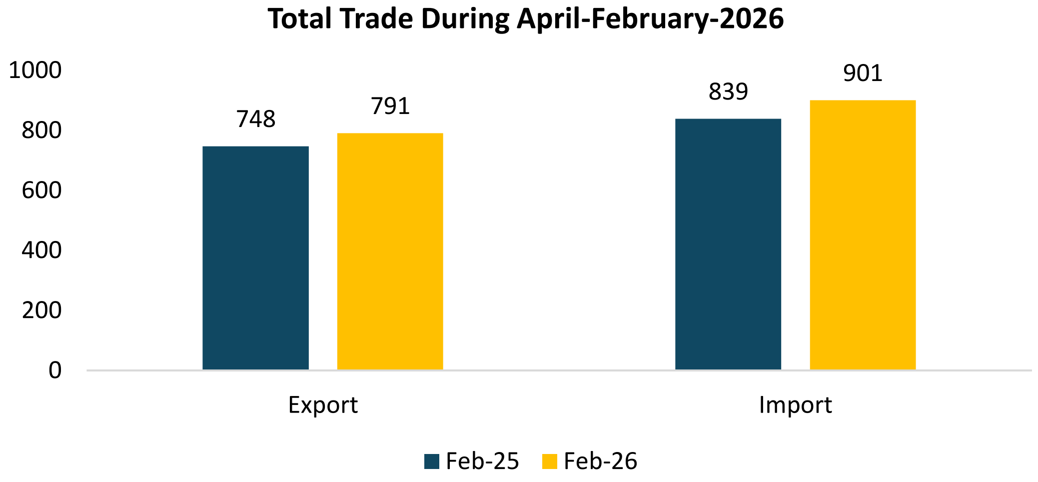
More Money, Same GDP? The Velocity Puzzle Decoded

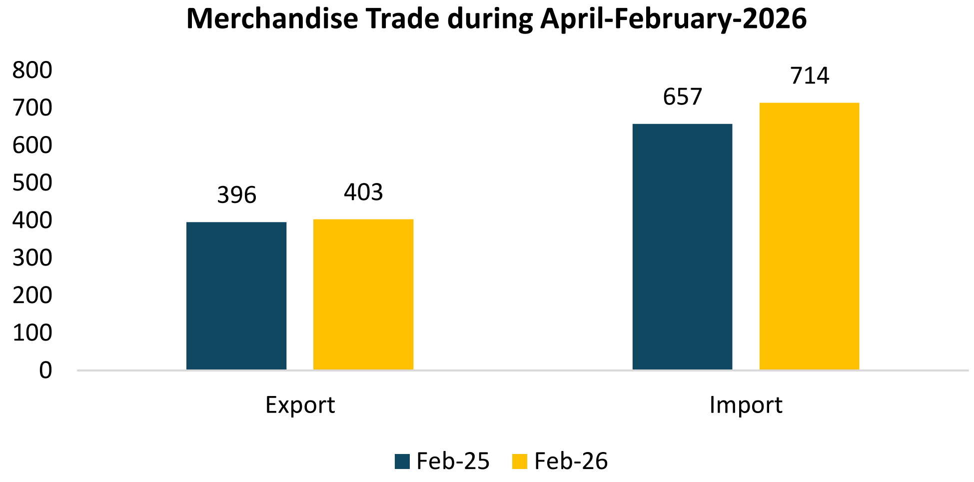
- **The velocity of money (nominal GDP / money supply) has been declining gradually through FY26**. M3 at 11.5% outpaces real GDP growth at 7.6%, and even adjusting for the deflator, narrow money velocity (M1: currency with public + demand deposits) is moderating. This is not a warning sign but requires careful interpretation for what it reveals about the economy's evolving structure.
- **Three forces compress velocity simultaneously. First, financialization: household savings increasingly flow into mutual funds (₹24,000-26,000 crore monthly SIPs), insurance, and NPS, expanding M3 aggregates but with a deployment lag before the money reaches the real economy as productive investment. Second, the credit multiplier: bank credit at 14.5% creates deposits on the other side of every loan (expanding M3), but the output from that credit, an infrastructure project, a factory, a housing complex, takes 12-24 months to generate GDP. Third, digital payments at 20-30% volume growth enable faster settlement but also facilitate financialization, netting out the velocity effect**.
- **Q3 GDP at 7.8% was driven by private consumption at 8.7% and GFCF at 7.8%. The output elasticity of credit has improved in FY26, particularly in manufacturing and infrastructure where PLI schemes and public capex are maturing. Declining aggregate velocity alongside improving credit-to-output efficiency is the hallmark of a deepening financial system building long-gestation capacity, not a system where money is being wasted**.

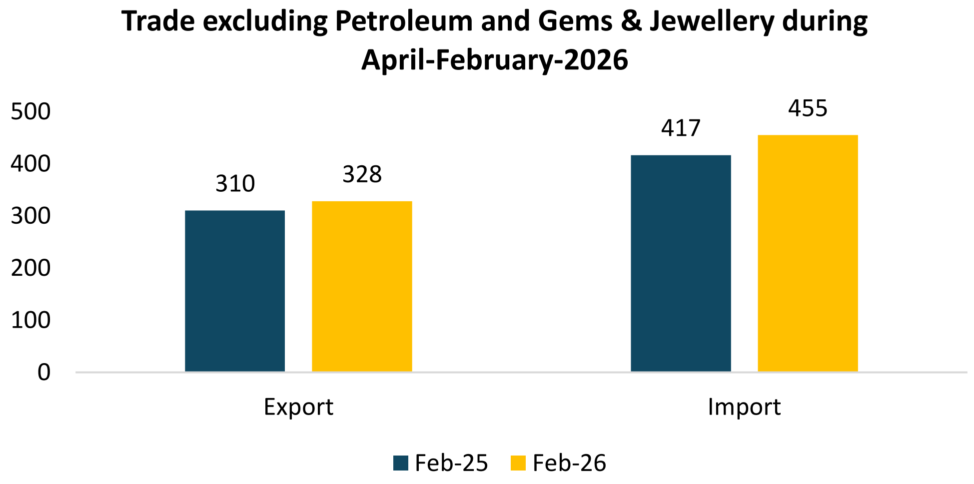
Outlook: Strong Foundations - Stormy Skies

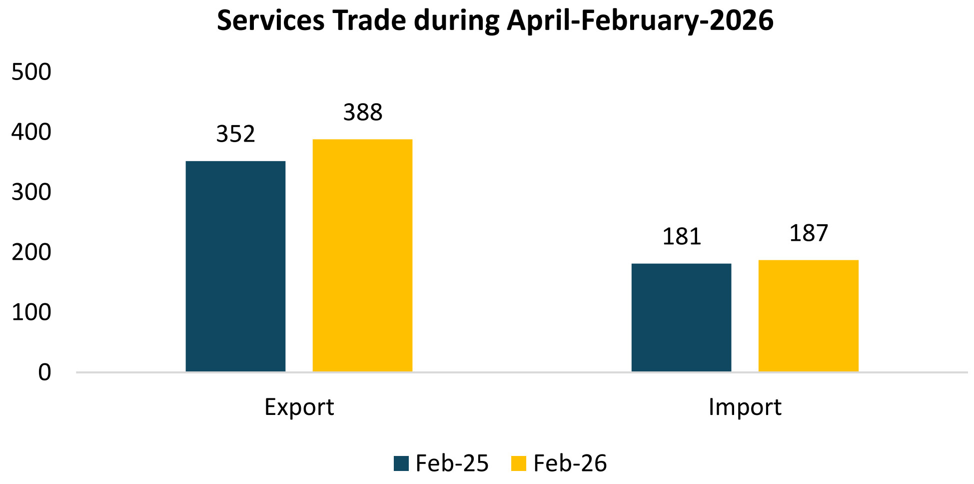
- The RBI will likely hold rates at 5.25% through at least H1 FY27, that much is clear from Governor Malhotra's February guidance. But the policy lever that matters from here is not the repo rate, it is liquidity. Expect another ₹1-1.5 lakh crore of OMO purchases in April-May to restore the surplus to 1.25-1.75% of NDTL, the range the RBI is implicitly targeting. The March deficit reverses on its own once government spending resumes. The central bank will manage through quantity while the price stays frozen, keeping overnight rates near repo, letting EBLR transmission do its work, and giving banks enough durable liquidity to sustain 14%+ credit growth. On the rupee, the RBI will likely smooth but not defend a level, if crude sustains above $100, a drift to 94-95 by June is the base case. The real wildcard is whether the government steps in with fiscal measures (excise cuts, SPR release, the proposed Economic Stabilisation Fund) to absorb the oil shock before it reaches CPI. That fiscal response, or its absence, determines whether the RBI can stay on hold or is eventually forced into a hawkish pivot nobody is pricing.
- The easing cycle is paused, not dead. India's domestic macro, 7.6% GDP, 1.9% core inflation, GNPA at a two-decade low, the deepest domestic capital market the country has ever had, is not the problem. The external shock from oil and geopolitics is real and could persist, but it is exactly that, an external shock, not a domestic structural weakness. The RBI will navigate this through liquidity management and FX intervention rather than rate action, and when crude normalizes and FPI flows stabilize, the easing cycle resumes. The domestic foundations are strong enough to hold.

6. Trade









Source: RBI, PIB

India’s Trade Story

- India’s **total exports of goods and services during April 2025–February 2026 reached USD 790.86 billion, registering 5.79% growth** over the corresponding period of FY25 (USD 747.58 billion). **Total imports during the period stood at USD 900.51 billion, growing 7.37% year-on-year**. The differential growth rate between imports and exports has widened the overall trade deficit.
- The headline growth, however, masks two divergent narratives. **On the merchandise side, exports grew a tepid 1.84% to USD 402.93 billion, while imports surged 8.53% to USD 713.53 billion**, **widening the goods trade deficit to USD 310.60 billion** (versus USD 261.80 billion in the comparable FY25 period). **On the services side, exports expanded robustly to USD 387.93 billion (+10.23% YoY), generating a trade surplus of USD 200.96 billion**, a substantial increase from USD 170.69 billion a year earlier. **Services continue to serve as the economy’s structural counterweight to a deteriorating merchandise balance**.
- **The outlook is dominated by the West Asia crisis that began on 28 February 2026 with coordinated US-Israeli strikes on Iran. The Indian crude oil basket has surged from approximately USD 63/bbl in January to USD 146–156/bbl in mid-March, the Strait of Hormuz faces disruption, and the India–US interim trade deal has been delayed pending a new US tariff architecture under Section 301. We expect these factors to widen the current account deficit meaningfully in FY27**.

Exhibit 1: India’s External Sector — April–February Cumulative Comparison

Indicator	FY26 YTD	FY25 YTD	YoY Change
Total Exports (G+S)	790.86	747.58	+5.79%
Total Imports (G+S)	900.51	838.69	+7.37%
Merchandise Exports	402.93	395.66	+1.84%
Merchandise Imports	713.53	657.46	+8.53%
Merchandise Trade Deficit	310.60	261.80	+18.64%
Services Exports	387.93	351.93	+10.23%
Services Imports	186.98	181.23	+3.17%
Services Trade Surplus	200.96	170.69	+17.73%
Overall Trade Deficit (G+S)	109.64	91.11	+20.34%

1. Merchandise Trade

1.1 Exports: Modest Growth, Fragile Breadth

- **Merchandise exports during April–February FY26 reached USD 402.93 billion, a marginal 1.84% increase** over the USD 395.66 billion recorded in the corresponding FY25 period. **Non-petroleum exports performed somewhat better, rising 5.03%** to USD 354.12 billion from USD 337.17 billion, **suggesting that the drag came primarily from petroleum product exports, where lower global refining margins compressed shipment values**.

- The most recent monthly data point, February 2026 showed a 0.81% YoY contraction in merchandise exports to USD 36.61 billion from USD 36.91 billion. This was the first negative year-on-year print in four months. The **core exports measure (non-petroleum, non-gems and jewellery, or NPNGJ) came in at USD 30.55 billion in February, up from USD 28.66 billion a year earlier, indicating some underlying resilience in value-added export categories**.
- **Key sectoral drivers (February 2026 YoY):** Engineering goods (+12.9%), electronic goods (continued strong cumulative run, with April–February YTD at approximately USD 43–44 billion versus USD 34 billion a year earlier), coffee (+31.9%), marine products (+13.3%), and meat, dairy & poultry (+22.7%) all registered positive growth. Pharmaceutical exports and chemicals also contributed positively.
- **Areas of weakness (February 2026 MoM):** Petroleum product exports contracted sharply on a cumulative basis due to weaker global refining margins. Ready-made garment textiles remained under pressure. On a monthly MoM basis, several agricultural sub-categories showed volatility, while coffee and rice posted strong sequential rebounds, tea, oilseeds, and marine products declined.

Exhibit 2: Merchandise Exports — February 2026 Snapshot

Indicator	Feb 2026	Feb 2025	YoY
Total Merchandise Exports	36.61	36.91	−0.81%
Non-Petroleum Exports	33.18	—	—
NPNGJ Exports (Core)	30.55	28.66	+6.6%

1.2 Imports: Price-Driven Surge, Structural Dependencies

- **Merchandise imports during April–February FY26 rose to USD 713.53 billion from USD 657.46 billion, an increase of 8.53% YoY**. The February 2026 monthly figure of USD 63.71 billion represented a 24.1% YoY surge from USD 51.33 billion, **driven overwhelmingly by precious metals and elevated commodity prices**.
- **Gold and silver - the price-volume disconnect:** Gold and silver imports combined reached an all-time high of approximately USD 68 billion in calendar year 2025. Critically, **the gold import bill is being inflated almost entirely by prices rather than volumes**: gold prices rose approximately 73–76% in calendar 2025, while import volumes actually declined. **Silver imports are being driven by both higher prices (silver tripled in 2025) and structurally higher industrial demand, particularly from solar energy and electronics manufacturing**. The **combined gold and silver import bill accounted for roughly 9% of India's total import bill in CY2025**.
- **Electronics - a growing structural dependency:** Electronics imports have emerged as a **major import category, rivalling petroleum in scale**. Cumulative electronics imports during April–February are estimated to have continued their strong trajectory, **reflecting India's deepening reliance on imported semiconductor components, smartphone kits, and finished electronics**. **This has implications for the pace and efficacy of import substitution under the PLI scheme**.
- **Petroleum - a volume story becoming a price story:** While petroleum and crude import volumes showed some moderation through much of FY26, the February data and the March crude price surge are set to sharply reverse this trend. **The Indian crude oil basket averaged USD 69 per barrel in February, but had already surged to an average of approximately USD 111–119 per barrel in March following the West Asia escalation, with daily peaks reaching USD 146–156 per barrel**.

Exhibit 3: Merchandise Imports — April–February Cumulative

Category	FY26 YTD	FY25 YTD	YoY
Total Merchandise Imports	713.53	657.46	+8.53%
NONG Imports (excl. Oil/Gold/Silver)	454.82	416.59	+9.18%
Merchandise Trade Deficit	310.60	261.80	+18.64%

2. Services Trade: The Structural Buffer

India's services sector has been the standout performer in FY26's external accounts. **Services exports** during April–February reached USD 387.93 billion, up from USD 351.93 billion in the prior year **(+10.23% YoY)**. **Services imports** rose more modestly to USD 186.98 billion from USD 181.23 billion **(+3.17%)**. **The resulting services trade surplus of USD 200.96 billion represents a 17.73% increase from USD 170.69 billion and provides a critical offset to the merchandise deficit**.

2.1 Services Export Drivers

- The primary engine remains the **IT, business process, and professional services complex**. India continues **to benefit from the structural shift toward offshore delivery models, the GCC (Global Capability Centre) build-out by multinational corporations, and rising demand for digital transformation services globally**. The February 2026 monthly reading was particularly strong: services exports reached USD 39.53 billion, up 24.9% YoY from USD 31.65 billion, accelerating from the 9.8% YoY growth recorded in January.
- The RBI's Q3 FY26 balance of payments data corroborates this trend, showing net services receipts increasing 12.3% YoY to USD 57.5 billion in the October–December quarter alone.

2.2 The Offset Ratio

- **The services surplus as a proportion of the merchandise deficit, what we term the "offset ratio" has improved to approximately 64.7% on a cumulative April–February basis (USD 200.96 billion surplus against USD 310.60 billion deficit), up from roughly 65.2% in FY25**. However, the marginal improvement is modest, and **the critical question is whether services growth can keep pace if the merchandise deficit widens sharply in Q4 FY26 and into FY27 due to the oil shock**.
- *The services surplus of USD 200.96 billion for April–February is the largest on record and has offset nearly two-thirds of the merchandise deficit. This structural shift is one of the most significant positive developments in India's external sector over the past decade.*

Exhibit 4: Services Trade — April–February Cumulative

Indicator	FY26 YTD	FY25 YTD	YoY
Services Exports	387.93	351.93	+10.23%
Services Imports	186.98	181.23	+3.17%
Services Trade Surplus	200.96	170.69	+17.73%
Feb 2026 Services Exports	39.53	31.65	+24.9%
Feb 2026 Services Imports	16.38	14.51	+12.9%

3. Trading Partners and Bilateral Dynamics

3.1 United States

- **The United States remains India's largest trading partner**. **Cumulative exports to the US during April–February FY26 grew, driven largely by electronic goods (which are exempted from US tariffs and constitute approximately 30% of India's total exports to the US). However, the bilateral trade relationship is undergoing significant structural change**.
- **On 6 February 2026**, the US and India announced a framework for an Interim Trade Agreement. Key terms included**: the US lowered reciprocal tariffs on Indian goods from 50% to 18%**; India committed to eliminating or reducing tariffs on all US industrial goods; India pledged to purchase USD 500 billion of US energy, aircraft, technology, and other products over five years; and India agreed to address non-tariff barriers across agricultural products, medical devices, and ICT goods.
- However, this framework has been significantly complicated by subsequent events. **On 20 February 2026, the US Supreme Court struck down the legal basis for reciprocal tariffs** under IEEPA. **The administration immediately imposed a uniform 10% tariff** under Section 122 of the Trade Act of 1974 as a temporary measure. On **11 March 2026, the USTR launched Section 301 investigations against 16 economies including India**, targeting excess capacity in sectors such as solar modules, petrochemicals, steel, textiles, and automotive products. **The India–US interim trade deal has effectively been put on hold pending clarity on the new US tariff architecture**.

The Section 122 tariffs expire in July 2026. The USTR's goal is to replace them with Section 301-based measures before that deadline. Until the new framework is established, India's export outlook to the US remains highly uncertain.

3.2 China

- **India's trade deficit with China remains the single largest bilateral imbalance.** During April–November FY26 alone, India's goods exports to China stood at approximately USD 12.2 billion, against imports of USD 84.2 billion, yielding a deficit of roughly USD 72 billion for just eight months. **For the full April–February period, the deficit is estimated at approximately USD 102 billion. China's dominance as a supplier of intermediate and electronic goods, particularly in categories like smartphones, semiconductor components, and industrial chemicals, continues to drive this structural imbalance**. Despite policy efforts to diversify supply chains, import substitution in these categories has been limited.

3.3 Gulf Cooperation Council (GCC)

- The **UAE and Saudi Arabia are India's second and third largest export markets after the US, and serve as gateways to the wider West Asian and North African markets**. **The GCC is also a critical source of energy imports, LPG, LNG, and remittance inflows. The escalation of the West Asia conflict has placed all three channels - trade, energy, and remittances, under stress simultaneously**. Approximately 400,000 metric tonnes of Indian basmati rice were reported stranded at ports or in transit in early March due to shipping disruptions. **India's exposure to the Strait of Hormuz rose back to approximately 52% of crude imports in early 2026**.

3.4 European Union

- **India and the EU have concluded long-running free trade negotiations, with India agreeing to reduce car tariffs to 40% from levels as high as 110%. Once ratified, the agreement is expected to expand bilateral trade and provide Indian exporters with an alternative market, partially offsetting US tariff uncertainty. The deal is expected to boost Indian textiles, gems and jewellery, and services exports to the EU**.

4. The West Asia Crisis: Energy, Logistics, and Transmission Channels

On 28 February 2026, the United States and Israel launched coordinated strikes on Iran ("Operation Epic Fury"), killing Iran's Supreme Leader and sparking Iranian retaliatory attacks across the region. Iran declared the Strait of Hormuz closed. The crisis represents the most significant geopolitical shock to India's external sector since the 2022 Russia-Ukraine conflict.

4.1 Crude Oil: From USD 63 to USD 156 in Seven Weeks

- **The Indian crude oil basket, a weighted mix of Oman-Dubai sour and Brent Dated grades in a 78.71:21.29 ratio, averaged approximately USD 63 per barrel in January 2026. By mid-March, it had surged to USD 146–156 per barrel, the highest on record**. **The March average through 23 March stood at approximately USD 111–119 per barrel, following a brief easing after President Trump announced a five-day pause in strikes on 23 March**. Brent crude itself traded around USD 96–112 per barrel, but the Indian basket has traded at a significant premium due to India's heavy reliance on Gulf-sourced sour grades.
- **India imports approximately 85–90% of its crude requirements. Estimates suggest that every USD 10 per barrel rise in crude adds approximately USD 14–16 billion annually to the import bill. At sustained prices of USD 120–140 per barrel, the incremental annual cost versus the pre-crisis USD 63–70 baseline could be USD 70–100 billion, a direct hit to the current account of 1.5–2.5% of GDP**.

4.2 LNG and LPG: A Compounding Energy Crisis

- **The crisis extends well beyond crude oil. Qatar, which supplies approximately 47% of India's LNG imports, has seen its export capacity severely disrupted after attacks damaged LNG infrastructure. Qatar's LNG exports plummeted from 1.7 million metric tonnes to 0.06 million metric tonnes in the immediate aftermath. India has invoked the Essential Commodities Act to prioritise LPG supply for domestic households and natural gas for fertiliser plants. India is sourcing emergency LPG cargoes from the US, with 13 tankers carrying approximately 350,000 tonnes en route, but transit times are significantly longer than Gulf sourcing**.

4.3 Shipping and Freight

- **Global shipping capacities to Europe and the US have reportedly dropped to 30–35% of normal levels as vessels reroute away from the Hormuz chokepoint. War-risk insurance premiums have spiked. The Federation of Indian Export Organisations (FIEO) has confirmed that rerouting is already increasing costs for exporters. The Commerce Secretary has flagged March as particularly challenging due to this logistics bottleneck. India's crude oil import volumes collapsed in early March as Saudi, Iraqi, and UAE supply routes were disrupted**.

The Indian crude oil basket at USD 146–156 per barrel is approximately 2.3x the January average of USD 63. If sustained, this would be the most severe terms-of-trade shock India has experienced since the 2008 commodity supercycle.

5. Current Account Deficit and Macro Outlook

5.1 FY26: Manageable, with a Sting in the Tail

- The current account deficit in H1 FY26 was 0.8% of GDP, an improvement from 1.3% in H1 FY25, supported by strong services exports and contained oil prices. The Q3 FY26 CAD edged up to USD 13.2 billion (1.3% of GDP), with the merchandise trade deficit widening 18% YoY to USD 93.6 billion for the quarter, partially offset by a 12.3% increase in net services receipts to USD 57.5 billion.
- **Analysts projects the full-year FY26 CAD at 0.9% of GDP, factoring in the February trade data and initial oil price impact. However, these estimates largely predate the March crude surge. Under stress assumptions where the oil shock persists into Q4, the second-half CAD could widen to 2.5–2.7% of GDP, pushing the full-year figure closer to 1.5–2.0%**.

5.2 FY27: The Year of Reckoning

- **FY27 is where the full impact of the West Asia crisis will be felt. Baseline scenarios project CAD at 1.1% of GDP (Brent averaging USD 65/bbl), widening to 1.5% if oil averages USD 75/bbl. However, these estimates appear conservative given that the Indian basket has already traded at 2–3 times the assumed Brent levels. Under a stress scenario of sustained USD 100+ crude, CAD could widen to 1.9–2.2% of GDP or beyond**.

5.3 The Denominator Trap

- **Most commentary on CAD/GDP focuses on the numerator. But elevated crude simultaneously erodes the denominator by suppressing GDP growth through compressed corporate margins, demand destruction, and reduced capital expenditure. Manufacturing and logistics firms face cost surges; downstream industries (chemicals, fertilisers, paints, aviation) absorb higher input costs. SMEs, operating on thinner margins without hedging capability, are particularly vulnerable. The CAD/GDP ratio thus faces pressure from both directions: a wider deficit divided by slower-growing output. Linear extrapolations based on oil price assumptions alone will understate the ratio deterioration**.

Exhibit 5: CAD/GDP Scenario Framework — FY27

Scenario	Brent Avg.	Indian Basket	CAD/GDP	Key Assumptions
Benign	$65–75	$70–85	1.0–1.3%	Conflict de-escalates Q2; Hormuz reopens; India–US deal signed
Base	$85–100	$95–120	1.5–1.8%	Intermittent Hormuz disruption; partial tariff rollback; LNG re-routing
Adverse	$100–120	$120–150	1.8–2.2%	Prolonged conflict; sustained Hormuz disruption; GCC demand weakens; US tariff escalation
Stress	>$120	>$150	>2.2%	Hormuz blockade; LNG/LPG shortage; remittance collapse; Section 301 tariffs imposed

5.4 Rupee and Capital Flows

- **The rupee has come under significant depreciation pressure, approaching the 94 mark against the dollar. A widening CAD, coupled with potentially lower capital flows (FPI outflows were near record levels in FY26), could push the rupee lower still. The RBI has intervened minimally, preserving reserves for growth priorities. Analysts expect capital flows to recover to approximately USD 33 billion in FY27 (versus an estimated USD 6 billion in FY26), but this is contingent on global financial conditions stabilising, an assumption that the West Asia crisis severely challenges**.

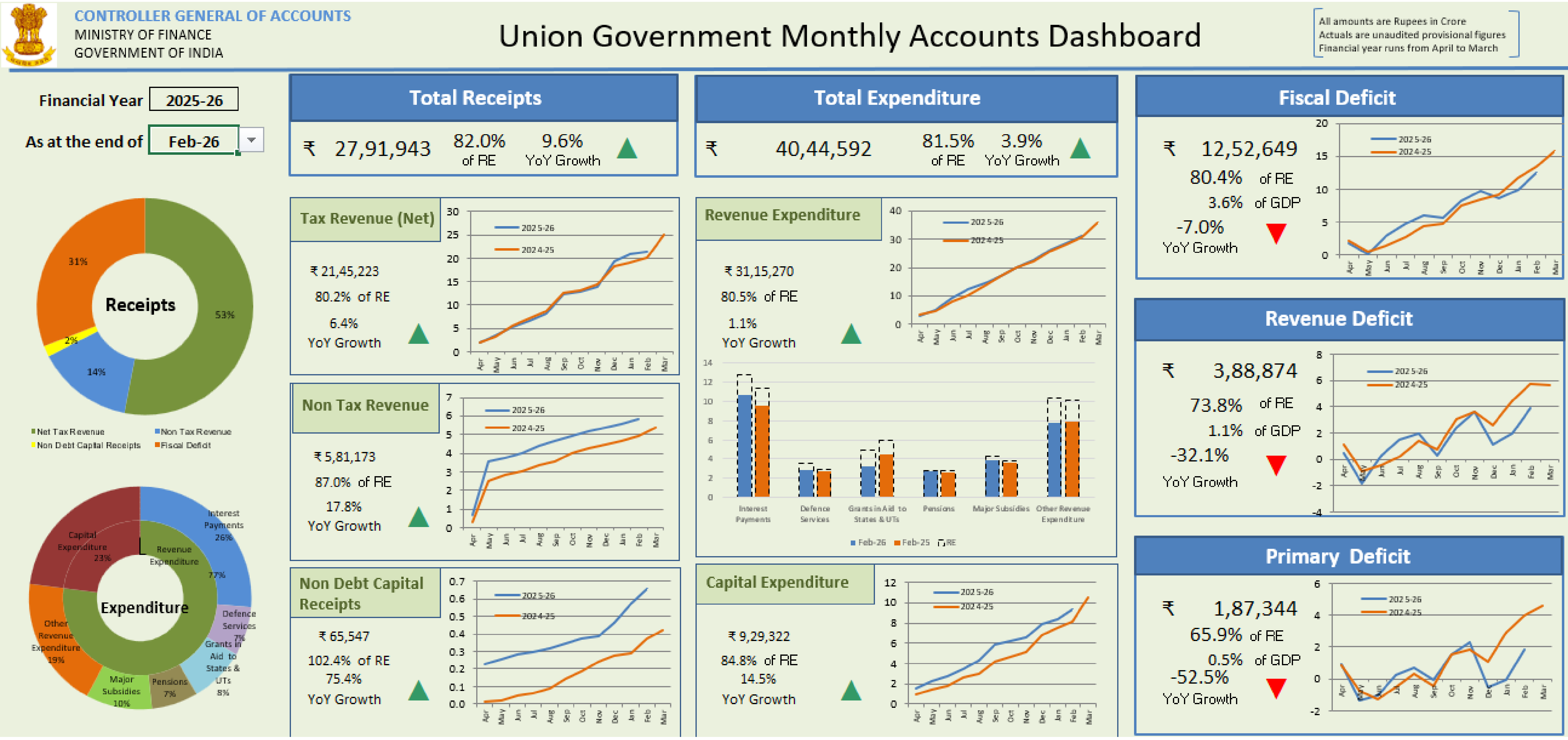
6. Monitoring Framework

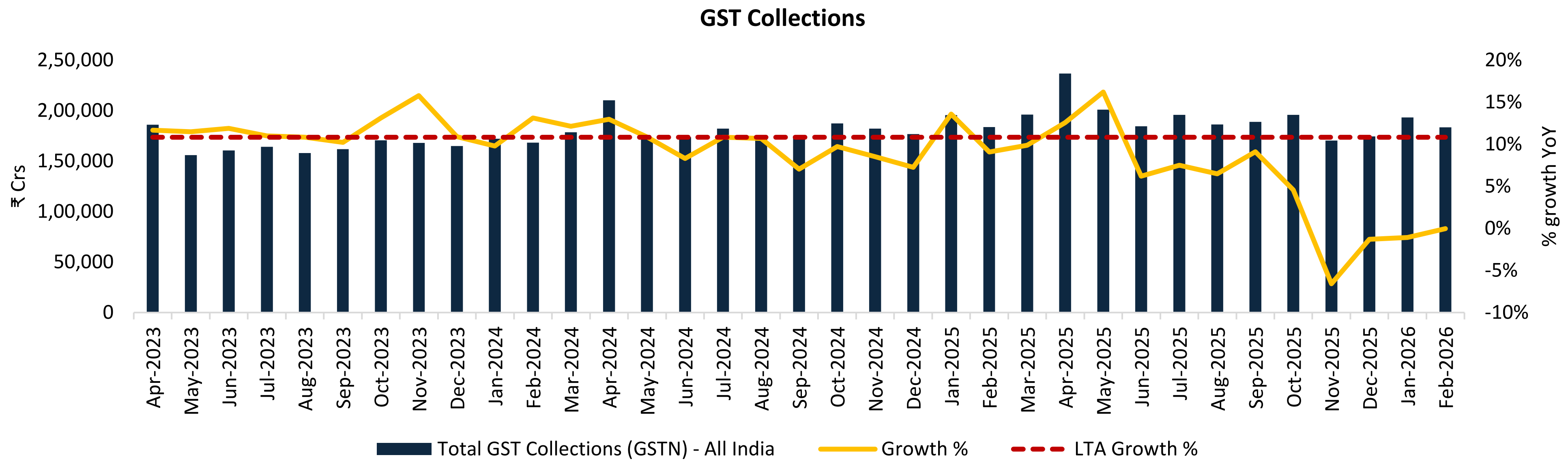
The forward-looking risk balance is unambiguously skewed to the downside. While the cumulative FY26 numbers show overall export growth of 5.79% and a record services surplus, the merchandise deficit has widened nearly 19% YoY, the oil shock has only begun transmitting through the data, and the US trade policy landscape has been upended.

Critical variables for the next 90 days:

- **(1) Crude oil prices - the Indian basket trajectory above USD 100/bbl is the critical threshold, with the Brent-Indian basket premium itself a key variable driven by Gulf supply dynamics.**
- **(2) Strait of Hormuz normalisation - daily transit data and war-risk premiums.**
- **(3) India–US trade deal signing and the Section 301 investigation timeline (hearings scheduled for May, new tariffs possible by July).**
- **(4) RBI's response to sustained rupee depreciation and its forex intervention posture.**
- **(5) LNG and LPG supply normalisation, particularly Qatar flows and alternative US cargo timelines.**
- **(6) Services export momentum - whether the 10%+ growth rate holds through the crisis.**
- *India's real GDP was estimated at 7.4% growth for FY26. However, the oil shock, if sustained, threatens to shave 50–100 basis points from GDP growth through demand destruction and margin compression, while simultaneously widening the CAD. This double effect makes the CAD/GDP ratio acutely sensitive to the duration and severity of the conflict.*

7. Fiscal Situation



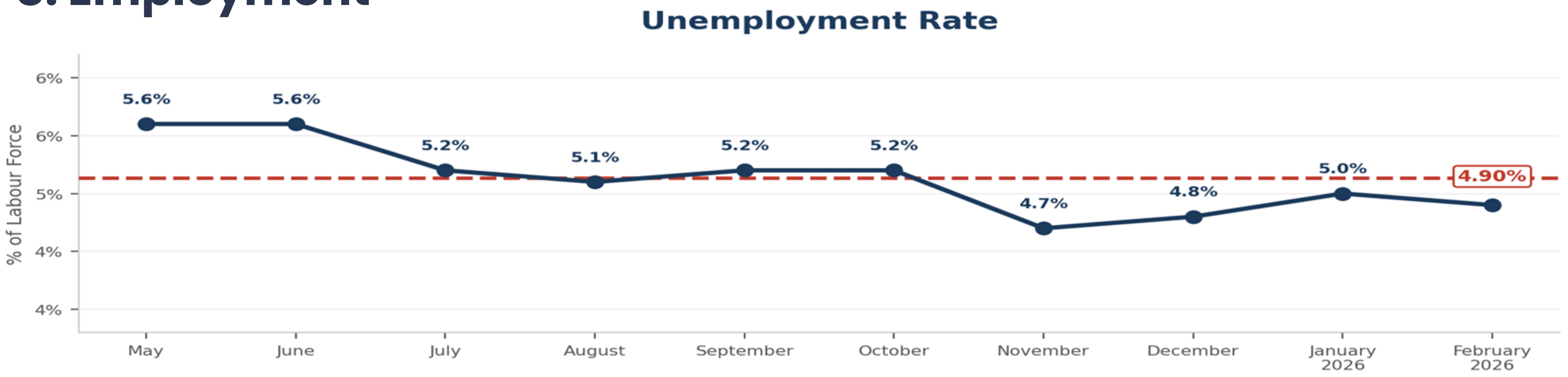


India's GST Collections up to Feb 2026: Steady Momentum Amid Rate Rationalisation

- India's GST collections in January–February 2026 **maintained solid momentum in absolute terms, though YoY growth remained moderate, largely reflecting the structural impact of GST 2.0 rate rationalisation on over 375 items in late 2025 rather than any underlying demand weakness**. Gross GST stood at ~₹1.93 lakh crore in January (+6.2% YoY) and ~₹1.84 lakh crore in February (+8.1% YoY), with February recovering sharply from January's sequential dip which was itself elevated by quarterly return filings. **Cumulative collections for Apr–Feb FY26 rose a healthy ~8.3% YoY to ~₹20.27 lakh crore**. The **moderation in domestic revenue growth (+4.8% in Jan, +5.3% in Feb) was offset by a strong surge in import GST (+10.1% and +17.2% respectively)**, reflecting resilient external trade flows and rupee pass-through effects. Compliance indicators, e-invoicing coverage, e-way bill volumes and registrations — remained robust. Notably, **compensation cess collections fell sharply** (₹5,768 crore in Jan vs. ₹13,009 crore a year ago) following its phase-out for most categories effective January 31, 2026, which also mechanically suppresses headline gross growth comparisons. Overall, the underlying consumption base remains firm, and with the cess distortion normalising from March onwards, **GST collections are expected to sustain ~8–9% YoY growth and remain comfortably above ₹1.8 lakh crore per month through Q4 FY26, broadly tracking nominal GDP growth**.

Source: Tijori and RBI DBIE

8. Employment



Unemployment – UR Eases to 4.9% in February; Urban Recovery Drives Improvement, Labour Market Stabilising

Dynamics:

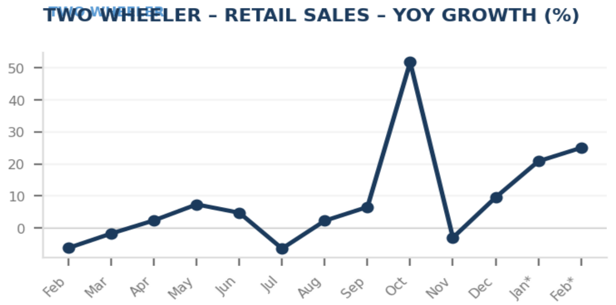
- **Marginal improvement in UR; urban conditions brighten:** India's **unemployment rate eased to 4.9% in February 2026** from 5.0% in January 2026, a marginal decline **driven overwhelmingly by urban improvement: post-winter hiring recovery, services-sector momentum, and renewed construction activity**. **Urban UR fell sharply from 7.0% to 6.6%,** dropping below the December 2025 level (6.7%), while rural UR held flat at 4.2%, remaining stable in structural terms.
- **LFPR and WPR broadly steady; female participation edges higher:** The **Labour Force Participation Rate (LFPR) held unchanged at 55.9%** (rural: 58.7%, urban: 50.4% up marginally from 50.3%). February's **stable LFPR alongside declining UR signals genuine absorption** rather than discouraged-worker exits. **Worker Population Ratio (WPR) rose marginally to 53.2%** (from 53.1%), with **urban WPR improving to 47.0% from 46.8%.** Urban WPR held stable at 47.0%.
- **Female UR decline notable; male UR stable: Female unemployment declined meaningfully from 5.6% to 5.1%,** with **urban female UR dropping sharply from 9.8% to 8.7%** and **rural female UR easing from 4.3% to 4.0%. Male UR remained unchanged at 4.8%. Female LFPR rose to 35.3% (from 35.1%)** and **female WPR improved to 33.4% (from 33.1%), extending the multi-month trend of rising female workforce engagement, particularly in rural areas where female LFPR reached 40.0%.**

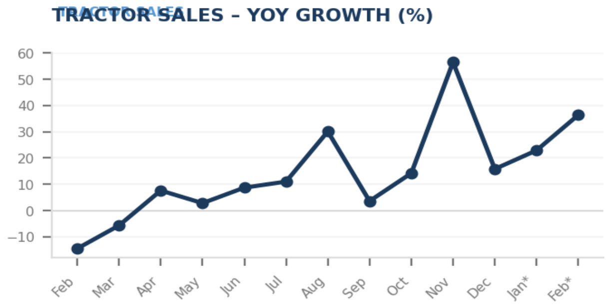
Overall Assessment:

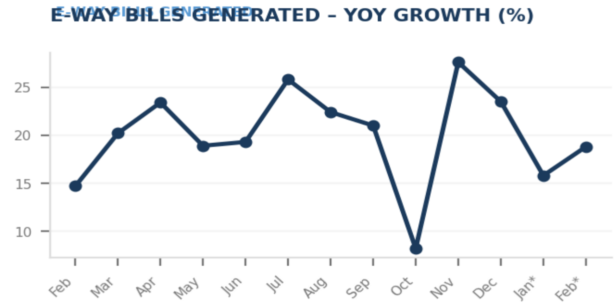
- **February 2026's 4.9% unemployment print confirms the January seasonal uptick was transient, not structural. The urban labour market recovery is the headline: UR at 6.6% is below the December level, WPR rose, and the improvement was broad-based across gender lines. LFPR stability at 55.9% alongside falling UR means the decline reflects genuine hiring, not labour force withdrawal. The more important trend remains the H2 FY26 arc: MGNREGS work demand fell for the eighth consecutive month (–14.1% y-o-y), confirming rural labour market confidence; PMI manufacturing employment hit a 4-month high (56.9), services PMI remained robust (58.1), and the Naukri JobSpeak Index surged 12% y-o-y to 3,233 points – the strongest February in recent years – led by IT recovery (+6% y-o-y, Indian MNCs +55%), insurance (+28%), BPO/ITES (+22%), and AI/ML roles (+40%). The employment backdrop heading into Q4 FY26 and FY27 is constructive. The principal risk remains GenAI-led headcount rationalisation in IT services narrowing formal white-collar hiring even as overall employment stays stable.**

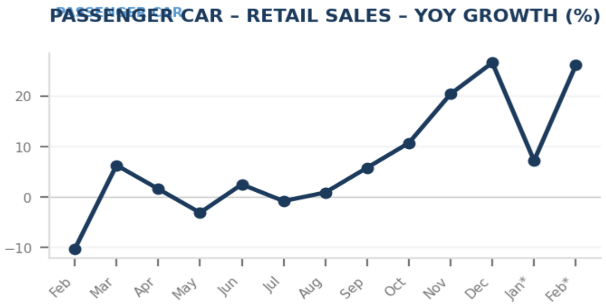
Source: RBI Bulletin and Internal assessment

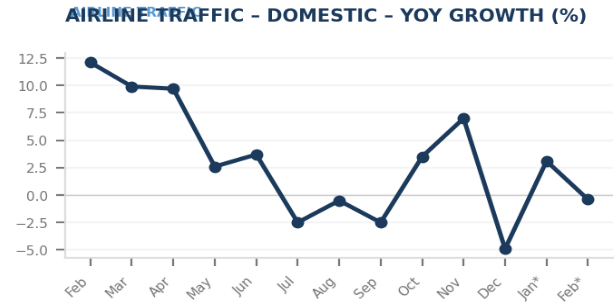
9. Demand Indicators

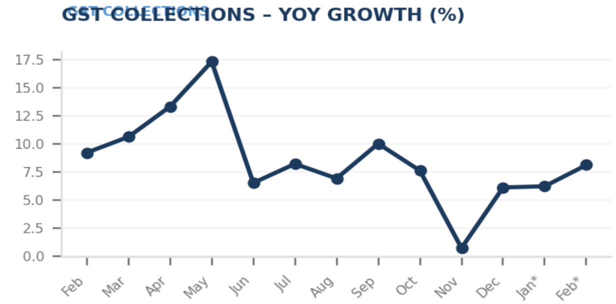












Select High-Frequency Indicators (February 2026) – Demand Momentum Broadening; Auto Sector Surges, GST Steady

Rural Demand: Two-wheeler retail surged +25.0% YoY in February, sustaining the rural consumption wave post-harvest. Tractor retail grew +36.4% YoY, the strongest print since October's 56.5% spike, confirming sustained farm-income expansion. MGNREGS work demand stayed in contraction for the 8th consecutive month (–14.1% y-o-y), signalling rural labour has found better-paying employment; this is structurally positive.

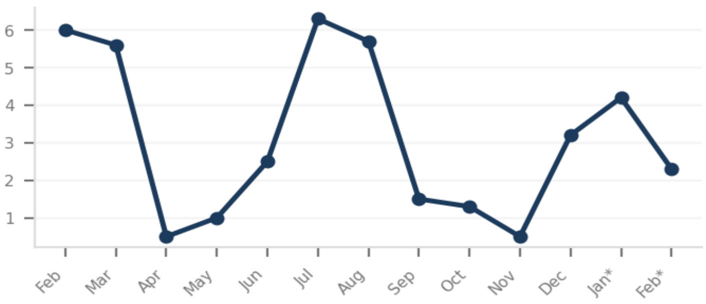
Urban Demand: Passenger vehicle retail grew +26.1% YoY, the second-strongest month this cycle after December's 26.6%, confirming the structural pivot of PV demand into non-metro India. Domestic airline traffic dipped –0.4% YoY on a high base post the festive season. GST collections at ₹1.84L Cr (+8.1% YoY) reflect steady broad-based goods movement. E-Way Bills grew +18.8% YoY to 132.6 million (3rd-highest ever), validating supply-chain momentum. The ₹12L income-tax exemption (effective April 2026) is an upcoming tailwind not yet in the February data.

Demand Outlook:

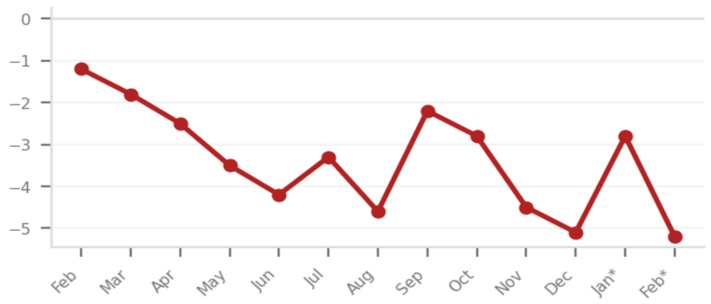
- **February confirms consumption has graduated from a festive-led spike to a durable, normalised growth phase. Rural cushion is firm; urban recovery is underway and broad-based. With CPI low, RBI in a 50bps cut cycle, and Budget FY27 disposable income support, downside risks are well-contained.**
- **Key Monitorables:**
- **Urban demand recovery and consumption broadening — Whether the income-tax relief announced in the Union Budget begins to translate into measurable consumption uplift in the urban mass market from Q1 FY27, and whether this narrows the relative outperformance rural demand has enjoyed — signalling a broader, more sustainable recovery in domestic consumption.**
- **Middle East conflict, crude, and macro spillovers — The duration and escalation path of the ongoing conflict remains the critical swing factor for oil prices; a prolonged or widening conflict risks keeping Brent elevated, feeding through to input costs, freight, and CPI. Should de-escalation materialise, the disinflationary impulse could give RBI room to ease further. Compounding this is the INR dimension — a weaker rupee in a high-oil environment amplifies imported inflation beyond what headline crude alone would suggest, widening the CAD and complicating the rate trajectory.**

Source: Internal assessment based on data from Tijori Finance

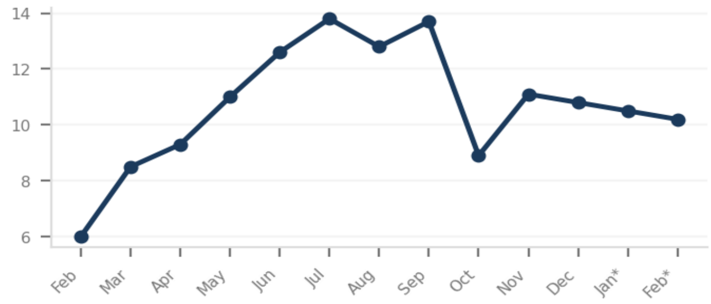
PRODUCTION – COAL (%)



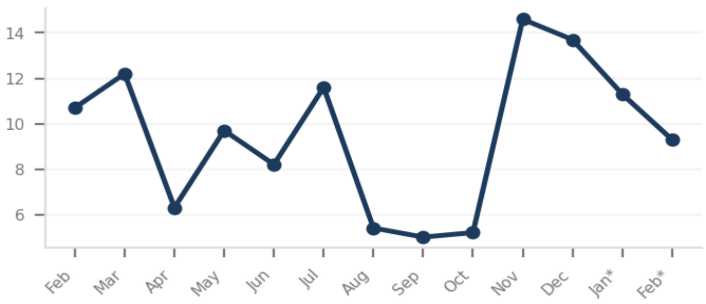
PRODUCTION – CRUDE OIL (%)



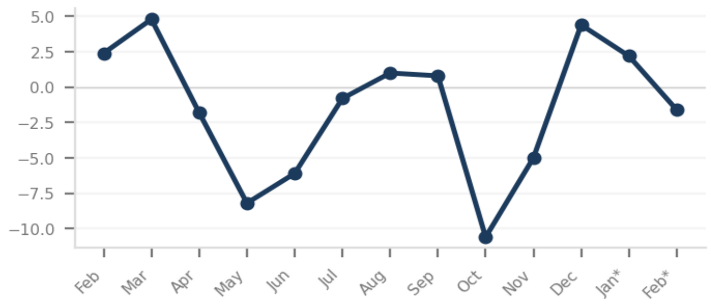
PRODUCTION – STEEL (%)



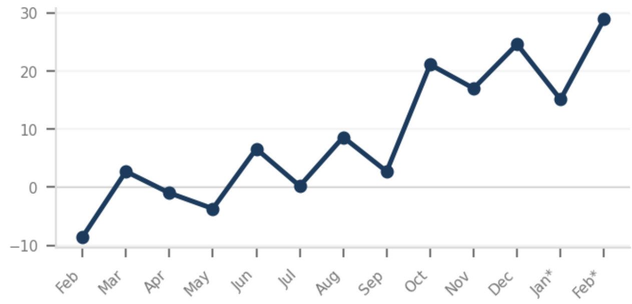
PRODUCTION – CEMENT (%)



PRODUCTION – ELECTRICITY (%)



COMMERCIAL VEHICLES – RETAIL SALES – YOY GROWTH (%)



Industrial & Services Momentum (February 2026) – Infrastructure Capex Sustaining; Energy Extraction Remains the Drag

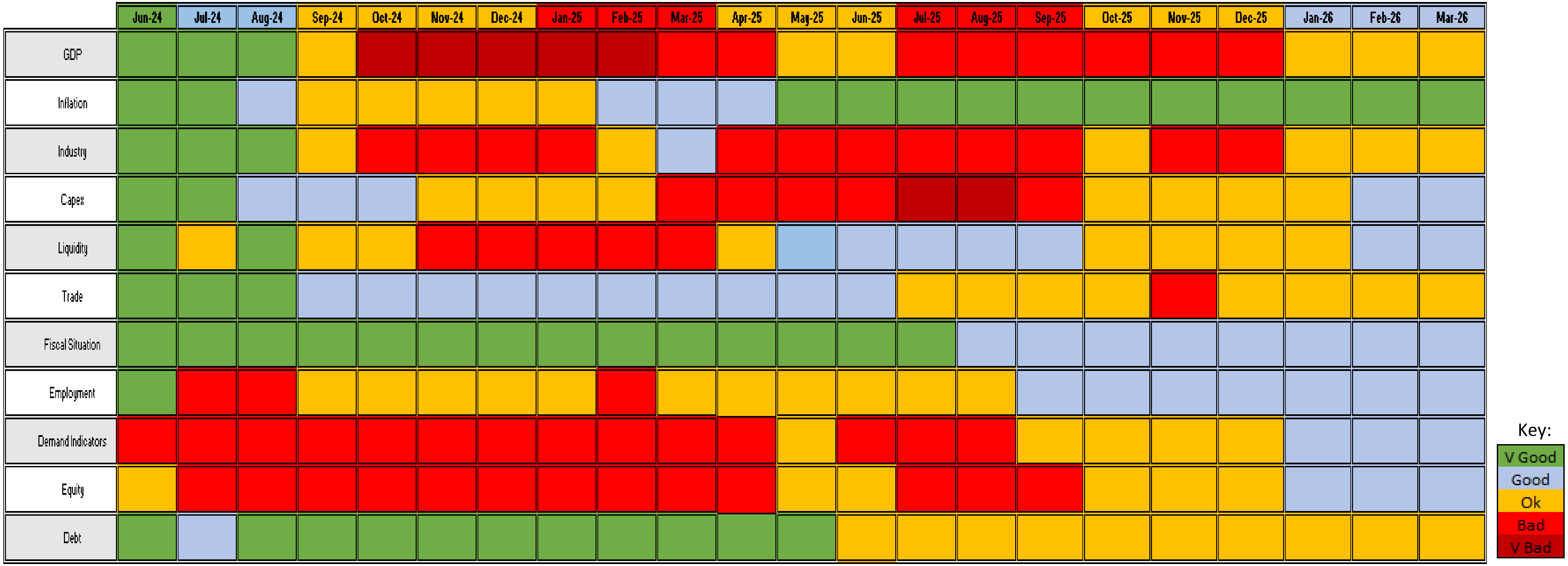
Industrial Activity: Core Sector (ICI) grew 2.3% YoY in February 2026, decelerating from January's revised 4.7%. Cement (+9.3%) and Steel (+7.2%) remained the standout performers, consistent with government infrastructure capex that remains front-loaded and robust private construction activity. Electricity output grew a modest +0.5%, partly weighed by milder-than-usual winter temperatures. The persistent drag: Crude Oil contracted –5.2% (6th consecutive month) and Natural Gas –5.0% (20th consecutive month), structural field-depletion issues, not demand-side weakness. Commercial vehicles surged +28.9% YoY – the fastest pace in over three years – driven by LCV freight recovery and M&HCV replacement cycle post-GST rationalisation.

Services Sector: HSBC Services PMI held at 58.1 in February (43rd consecutive month above 50), while Manufacturing PMI surged to 56.9 – a 4-month high. Composite PMI at 58.9 – one of the highest globally, confirms India's domestically-driven services economy is insulated from global deceleration. Employment in manufacturing rose at the fastest pace in four months. Financial services, insurance, hospitality, BPO and logistics are all in firm expansion.

Industrial & Services Outlook:
The February data points to an economy operating well above trend, with the capex-consumption virtuous cycle intact. Steel and cement double-digit growth alongside CV recovery confirms both public infra and private construction are simultaneously absorbing industrial output. RBI's rate-cut cycle, Budget FY27's ₹11.21L Cr capex outlay, and PLI-driven electronics/auto output are all incremental tailwinds. Sustained capex traction through Q1 FY27 will confirm whether this industrial cycle has another 6–9 months of runway. Key risk remains the Middle East conflict, crude, and macro spillovers

Source: Internal assessment based on data from Tijori Finance

Economic Heatmap



Cautious Optimism Under a Lengthening Shadow

India enters FY27 with a structurally sound domestic economy. What has changed sharply is the external environment. The US-Israel-Iran war (February 28, 2026) and Iran's effective blockade of the Strait of Hormuz has unleashed the most severe energy supply shock since the 1970s. Its impact on India is first order with the second and third order being even more severe. And the outcome hinges almost entirely on how quickly it ends.

The Domestic Backdrop: Intact

Growth: FY26 real GDP estimated at 7.6% (new 2022-23 base, MoSPI). Manufacturing PMI at a 4-month high of 56.9 in February; Services PMI 58.1. Flash PMI for March moderated sharply to 53.8, the first real-sector signal of the Hormuz shock. Government capex at Rs. 12.22 lakh crore (~4.4% of GDP) remains the structural anchor underpinning ~14% private credit growth, High frequency indicators collectively suggest the economy is still in an early stage expansion phase.
Inflation: Headline CPI 3.2% in February 2026 (new 2024-base series), with core inflation subdued. The MPC's 4% inflation target framework has been renewed for 2026-31.
Monetary Policy: Repo rate at 5.25% post 125 bps of cuts in 2025. April MPC (decision April 8) expected to hold unanimously. System liquidity is being managed efficiently by the RBI allowing transmission of rate cuts aiding economic growth.
Fiscal: FY27 fiscal deficit seems comfortable, and targeted at 4.3% of GDP (~4.5% on the revised GDP base).
Trade: US-India interim accord at 18% reciprocal tariff, USD 500 billion procurement commitment - positive, though formal signing remains pending.

The Shock: Hormuz And Crude

Brent, at USD 66-67/bbl in Jan-Feb, has surged 60%+ over March alone, the largest single-month move on record, touching USD 126/bbl at peak, and currently oscillating around USD 107-110/bbl. The IEA has described the crisis as the worst energy disruption in history, exceeding the 1970s oil shock, the Russian gas cut, and all prior conflicts combined. For India: 60%+ of crude imports and half of LNG are Gulf-linked and Brent-indexed. The rupee has weakened to a record 93+/USD, FIIs were net sellers for a third week in the first week of April.

The Fork: Two Scenarios

Resolution by April (Base Case): Ceasefire talks are live - the US, Iran and regional mediators are discussing a potential 45-day pause (Axios, April 6). If the Strait reopens near-term, oil corrects toward USD 80-90/bbl, the rupee recovers, and the Nifty - deeply oversold with F&O longs at just 15% stages a sharp recovery. FY27 growth absorbs a 30-50 bps hit and rebounds. The RBI resumes easing in H2. The Hormuz episode becomes a temporary glitch. Current market levels represent a compelling entry for 12-18 month investors.
Prolonged Conflict Beyond April (Tail Risk): The IEA warns April supply will be worse than March, as pre-war inventory flows are exhausted. TD Securities estimates ~1 billion barrels of oil and products lost by end-April. At USD 120-130/bbl, India's CAD widens to 2.5-3% of GDP, CPI breaches the 6% upper band, and the MPC faces a stagflationary bind. The private capex upcycle stalls. Global recession risk, already flagged by Paul Krugman, becomes the dominant scenario, with India's services export surplus, a critical external buffer, under pressure. This would not be a glitch; it would be a structural shift.

Conclusion

India's structural story is intact. The Hormuz shock is exogenous and, if short, manageable. If prolonged beyond April, it alters FY27 fundamentals materially. The stance: cautious optimism, with the emphasis on caution until greater clarity emerges on crude, the strait, and ceasefire trajectory. Trump's April 6 deadline has passed without resolution and the next 1/2 weeks are pivotal.

Equity Outlook

Market Cap Risk-Return Profile/ PE-Multiples

Year	Nifty 50 Return %												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	CY
2025	-3%	-1%	-11%	2%									-13.2%
2025	-1%	-6%	6%	3%	2%	3%	-3%	-1%	1%	4.51%	1.87%	-0.28%	10.5%
2024	0%	1%	2%	1%	-1%	7%	4%	1%	2%	-6%	0%	-2%	8.6%
2023	-2%	-2%	0%	4%	3%	4%	3%	-3%	2%	-3%	6%	8%	20.0%
2022	0%	-3%	4%	-2%	-3%	-5%	9%	4%	-4%	5%	4%	-3%	4.3%
2021	-2%	7%	1%	0%	7%	1%	0%	9%	3%	0%	-4%	2%	24.1%
2020	-2%	-6%	-23%	15%	-3%	8%	7%	3%	-1%	4%	11%	8%	14.9%
2019	0%	0%	8%	1%	1%	-1%	-6%	-1%	4%	4%	2%	1%	12.0%
2018	5%	-5%	-4%	6%	0%	0%	6%	3%	-6%	-5%	5%	0%	3.2%
2017	5%	4%	3%	1%	3%	-1%	6%	-2%	-1%	6%	-1%	3%	28.7%
2016	-5%	-8%	11%	1%	4%	2%	4%	2%	-2%	0%	-5%	0%	3.0%
2015	6%	1%	-5%	-4%	3%	-1%	2%	-7%	0%	1%	-2%	0%	-4.1%
2014	-3%	3%	7%	0%	8%	5%	1%	3%	0%	4%	3%	-4%	31.4%
2013	2%	-6%	0%	4%	1%	-2%	-2%	-5%	5%	10%	-2%	2%	6.8%
2012	12%	4%	-2%	-1%	-6%	7%	-1%	1%	8%	-1%	5%	0%	27.7%
2011	-10%	-3%	9%	-1%	-3%	2%	-3%	-9%	-1%	8%	-9%	-4%	-24.6%
2010	-6%	1%	7%	1%	-4%	4%	1%	1%	12%	0%	-3%	5%	18.0%
2009	-3%	-4%	9%	15%	28%	-4%	8%	1%	9%	-7%	7%	3%	75.8%
2008	-16%	2%	-9%	9%	-6%	-17%	7%	1%	-10%	-26%	-5%	7%	-51.8%
2007	3%	-8%	2%	7%	5%	1%	5%	-1%	12%	18%	-2%	7%	54.8%
2006	6%	2%	11%	5%	-14%	2%	0%	9%	5%	4%	6%	0%	39.8%
2005	-1%	2%	-3%	-7%	10%	6%	4%	3%	9%	-9%	12%	7%	36.3%
2004	-4%	-1%	-2%	1%	-17%	1%	8%	0%	7%	2%	10%	6%	10.7%
2003	-5%	2%	-8%	-5%	8%	13%	5%	14%	4%	10%	4%	16%	71.9%
2002	2%	6%	-1%	-4%	-5%	3%	-9%	5%	-5%	-1%	10%	4%	3.2%
2001	9%	-1%	-15%	-2%	4%	-5%	-3%	-2%	-13%	6%	10%	-1%	-16.2%
2000	4%	7%	-8%	-8%	-2%	7%	-9%	5%	-9%	-8%	8%	0%	-14.7%

Risk-return Measures	Nifty 50	Nifty Mid Cap 150	Nifty Small Cap 100
CAGR Return %	11.5%	14.5%	14.7%
Standard Deviation	21.5%	26.1%	30.0%
Avg Months with +ve return / yr	7	7	6
Avg Months with -ve return / yr	5	4	5
Avg Months with >6% decline / yr	1	1	1
No of Years	27	21	13

Ample Tailwinds

- **In the last 3 months, the Nifty 50 Index has fallen -15%. Historically, the Nifty 50 has given a CAGR of ~12% over the past ~27 years**. Furthermore, advances and declines in a single month were at an average of 7 and 5 respectively in a single year for large caps, thus tending towards a CAGR of ~12% over a long-time horizon. **Similarly Mid and Small Caps registered a CAGR of ~15% each over the past ~21 years and ~13 years respectively. We expect returns to improve going forward, supported by the ongoing uptick in domestic demand aided by recent tax rate reductions and the introduction of a simplified, lower GST regime, as well as trade deal announcements improving general market sentiments. The capex cycle, too, is beginning to show early signs of revival. However, geopolitics currently appears to be the primary driver behind the recent weakness in the broader market, and until the United States and Iran reach some form of de-escalation or settlement, markets are likely to remain under pressure with a downward bias and elevated volatility.**

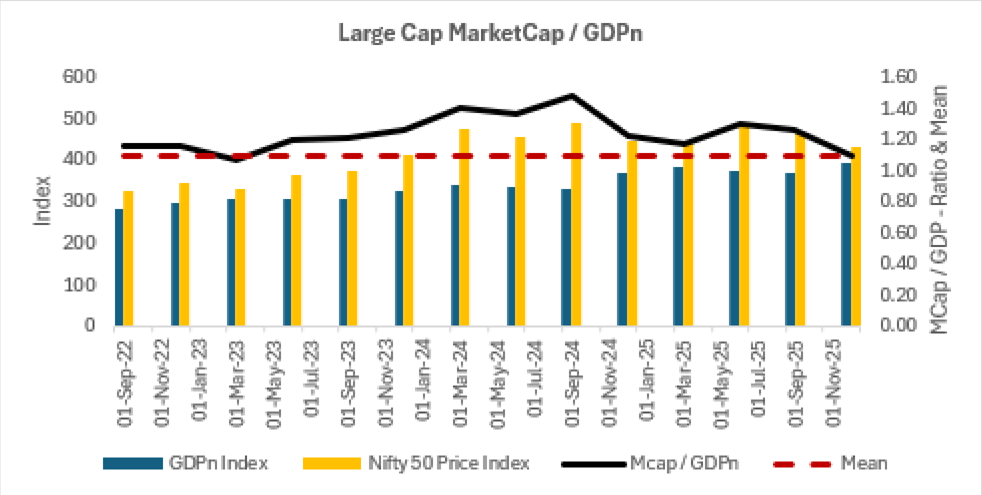
- The Risk-Return Matrix shows the tradeoff between risk and return for the 3 Market Cap indices, with increasingly higher returns at the cost of higher risk as we move down the Market Cap spectrum.

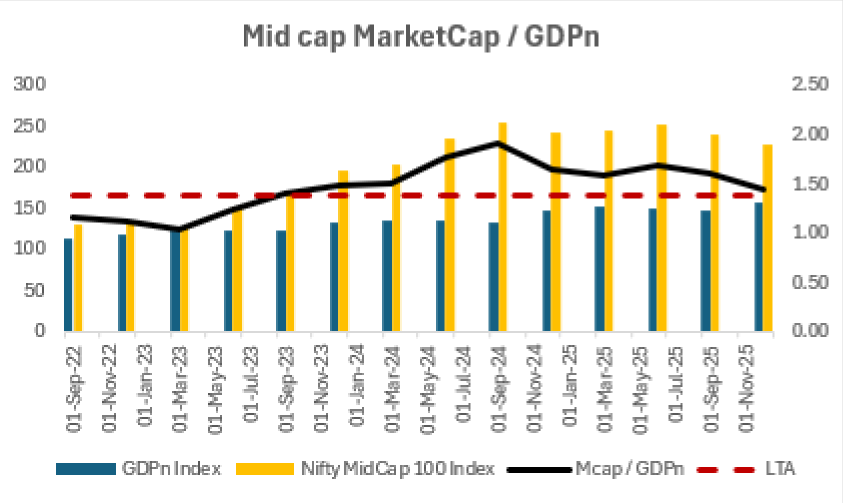
- **As per TTM PE valuations Large Cap to be Undervalued & Mid Cap and Small Cap seem to be Fairly-valued.**

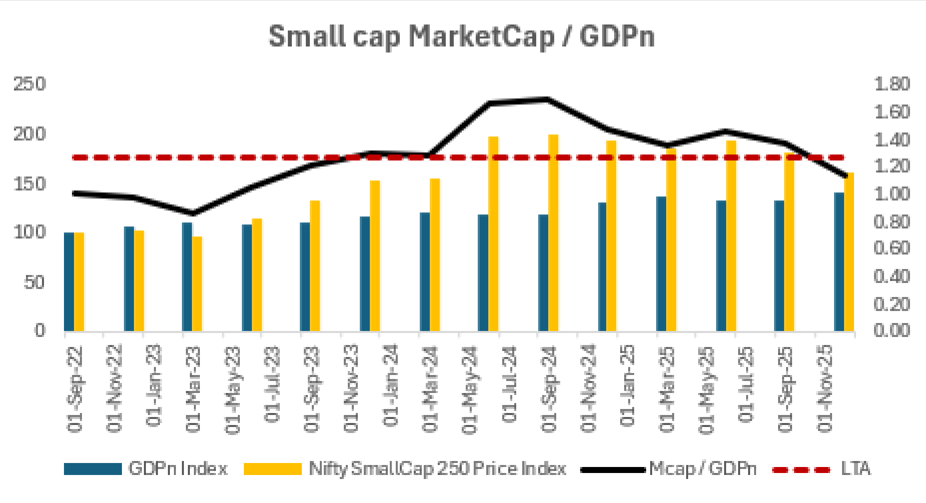
Market Cap	Current PE	Long Term Average PE	Premium / (Discount)	Valuation
Large Cap	19.46	23.78	-18%	Undervalued
Mid Cap	33.27	32.36	3%	Fairly Valued
Small Cap	26.69	26.41	1%	Fairly Valued

Source: NSE and Bloomberg

Buffett Indicator







The present valuations remain moderate to attractive as evidenced in the premiums exhibited in their Mcap/GDP ratios where Mid Caps are currently trading at a premium of approx 5%, whereas Large Caps & Small Caps are currently trading at discount of approx 1% & 12% respectively (as per Buffet Indicator), as on 31st Mar 2026.

Source: Internal assessment based on RBI DBIE data and NSE India and Bloomberg

Iran War: Sectoral Transmission Channels for Indian Industry

How the Shock Transmits: It's Not Just Oil

The Strait of Hormuz carries ~20 mnbpd of oil and oil products globally. For India, 54% of crude imports, 60% of LNG, and 90% of LPG transit through the Strait. Crude oil availability itself is manageable near-term – India has ~40 days of strategic reserves, the IEA has released 400 mn barrels, and Russian barrels are being redirected. The real stress points are oil products (LPG, naphtha, bitumen) and natural gas, where there are no spare global capacities and India's storage cover is critically thin: LNG at under 5 days, LPG at 15–20 days. Beyond hydrocarbons, the Gulf accounts for ~45% of global sulphur exports, ~30% of methanol production, ~30% of urea trade, and ~9% of aluminium output – each feeding directly into Indian industrial value chains. This is not a single-commodity shock but a multi-input, multi-sector supply squeeze with staggered inventory exhaustion timelines.

Oil & Gas: Upstream Gains, Downstream Pain

Upstream producers benefit directly – every $5/bbl adds ~11–12% to EBITDA. But downstream is ugly: oil marketing companies face negative marketing margins of ~Rs 30/litre on petrol/diesel with near-zero pass-through ability (four state elections this year). Every $1/bbl above the budgeted $70 costs the exchequer Rs 100 bn; at a sustained $90 average, the fiscal hit is Rs 2 trillion – forcing a trade-off between wider fiscal deficit and lower government capex. LPG under-recovery exceeds Rs 300/cylinder even after the Rs 60 hike. City gas distributors face 15–30% EBITDA compression on gas cost pass-through lag. Refining margins have spiked to >$25/bbl (vs normalised $8), benefiting complex refiners, but petchem feedstock diversion is already constraining downstream production.

Infrastructure & Cement: Government Capex at Risk

The Rs 12.2 lakh crore budgetary capex is now under fiscal pressure. If government absorbs the oil subsidy burden, capex becomes the adjustment variable. Infra companies with Middle East order books face execution slowdowns and deferred ordering. Unlike earlier oil spikes, higher prices are not boosting ME economies this time – lower export volumes offset price gains. Cement faces no direct ME supply chain exposure, but every 10% increase in international pet-coke and coal prices contracts EBITDA by ~8% (Rs 130/tonne), plus polypropylene-linked packaging costs add another Rs 80/tonne. Bitumen availability from ME is directly impacted, hitting the roads sector.

Fertilizers: Input-Cost Shock, Not Availability Crisis (Yet)

Near-term supplies are comfortable – lean demand period with kharif buying starting only from mid-May. But stress is building: urea plants are cutting utilisation due to gas shortages, DAP is the most exposed on import-chain vulnerability (Saudi supply Hormuz-locked, China has suspended fertilizer exports), and sulphur – 77% of India's imports sourced from ME – is seeing immediate price spikes. India needs ~18 mn tonnes of urea through August; even with a 20% production cut, the gap is ~2 mn tonnes requiring imports (Russia via Suez is the fallback). If disruption persists into kharif, subsidy bill balloons, landed costs surge, and food inflation follows.

Chemicals & Petrochemicals: Margin Squeeze with a Lag

Most chemical chains with crude-linked inputs pass through cost inflation with a quarter lag – Q4 FY26 may show inventory gains while Q1 FY27 faces the real margin test. Most exposed: methanol (Gulf controls 30–35% of global production), ammonia, and crude-linked petrochemicals (ethylene, propylene, benzene). With LPG prioritised for households, gas is being diverted from petchem feedstock, constraining domestic production. PE/PP prices are already elevated; if disruption extends beyond weeks, focus shifts from price hikes to sourcing risk and plant run-rates.

FMCG & Consumer: Packaging Cost Inflation
Crude-linked packaging inputs – PET chips, HDPE, liquid paraffin, flexible laminates – account for ~8–15% of operating costs. Margin pressure materialises only if crude stays elevated beyond 1–2 months (from Q1 FY27). Palm oil prices tend to follow crude, impacting soaps and detergents. A ~3% price hike needed at $85/bbl; ~5–6% at $100/bbl. Organised players can gain share as they're better positioned to pass through costs versus unorganised.

Automobiles: Urea Shortage Could Immobilise the Diesel Fleet
An underappreciated risk. India imports 50–60% of technical-grade urea from ME, used in diesel exhaust fluid (DEF) – mandatory for all BS-VI diesel trucks/buses with engine interlock. SIAM flags no visibility of supply beyond early April. A DEF shortage could immobilise a significant portion of the commercial diesel fleet, disrupting logistics nationwide. Crude derivatives constitute 40–45% of tyre RM costs; forging/casting companies dependent on gas-fired furnaces face direct production constraints.

Textiles & Home Improvement: Near-Term Gains, Medium-Term Risk
Polyester yarn prices up 15–20% on MEG/PTA supply disruption, creating inventory gains for producers holding 30–40 days of stock. Cotton yarn spreads widened, benefiting spinners. Persistently high crude would weigh on apparel demand. Tiles face 70–150 bps EBITDA margin risk on gas cost inflation (Morbi-based production especially vulnerable); wood panels see 30–60 bps margin pressure from resin and energy costs.

Airlines, Alcobev & RAC: Direct Cost Hits
ATF is 35–40% of airline costs; every 10% ATF hike hits EBITDA by ~15%, compounded by ME airspace shutdowns forcing costly rerouting. Alcobev's vulnerability is glass bottle costs – furnaces rely on natural gas, with only 1–2 months of inventory before cost inflation bites. RAC manufacturing disrupted by LPG shortages for heat exchangers during peak summer; EMS vendors more exposed than brands. Industry shifting to oxyacetylene/PNG alternatives at elevated costs.

Sugar: A Rare Beneficiary
Higher crude incentivises sugarcane-to-ethanol diversion in Brazil (season starts April), tightening global sugar supply. Domestic production revised down to <32 MT, potentially enabling 0.6–1 MT of Indian exports. Sustained high crude may prompt government to accelerate ethanol blending beyond 20%, supporting distillery utilisation.

Strategy

Tailwinds

- India's strong government finances reflect underlying structural resilience, with the twin deficits - both **fiscal and current account deficits remain well-contained and manageable for now.**
- **Inflation well under control** and well within the RBI's comfort level for now.
- **Uptick in Domestic Demand on account of tax rate cuts, a new lower GST regime.** This trend is visible is in various high frequency indicators.
- **Corporate India's healthy balance sheets and low leverage**, enabling them to benefit from an impending **cyclical recovery and capex upcycle, the early signs of which are visible. Q4 results will be an important indicator of this.**
- **Valuations now seem to be in the reasonable zone for many sectors.**
- **The newly announced trade deals** provide comfort to export oriented companies and market sentiment as well.

Headwinds

- **Limited exposure to AI-led growth themes** - Compared with other emerging markets, India has relatively fewer scalable, listed AI-centric platforms. This has reduced India's appeal within global AI-driven capital allocation, keeping incremental foreign portfolio flows directed toward markets with clearer AI monetisation stories.
- **INR depreciation amid persistent foreign outflows** - Continued FPI outflows, alongside periodic private equity exits have exerted pressure on the INR versus the USD. Currency weakness dampens USD-denominated returns for foreign investors, acting as a further deterrent to fresh equity inflows.
- **Geopolitical shock from the US-Israel-Iran war and Hormuz disruption** — The ongoing Operation Epic Fury, now in its second week, has effectively shut the Strait of Hormuz — the conduit for ~20% of global oil supply and over 60% of India's crude imports. Brent has surged from 66–67/bbl in January–February to $100+. For an economy that imports 85%+ of its crude and sources more than half its LNG from Brent-indexed Gulf contracts, this is a dual physical and financial shock - widening the CAD, stoking imported inflation, compressing OMC margins, and pressuring the rupee to record lows of +₹93. The conflict has already triggered a sharp correction in the Nifty from recent peaks, accelerated FPI outflows, and pushed the 10Y G-Sec yield higher to ~7.06% as markets reprice the inflation and external balance trajectory. A prolonged conflict would materially constrain the RBI's room to resume easing and risk derailing the nascent private capex recovery.

Outlook

- **Volatility to persist due to the current geopolitics, however with an Upward Bias in the medium term due to strong Macros and a high probability of de-escalation of the war.**

Suggested Strategy

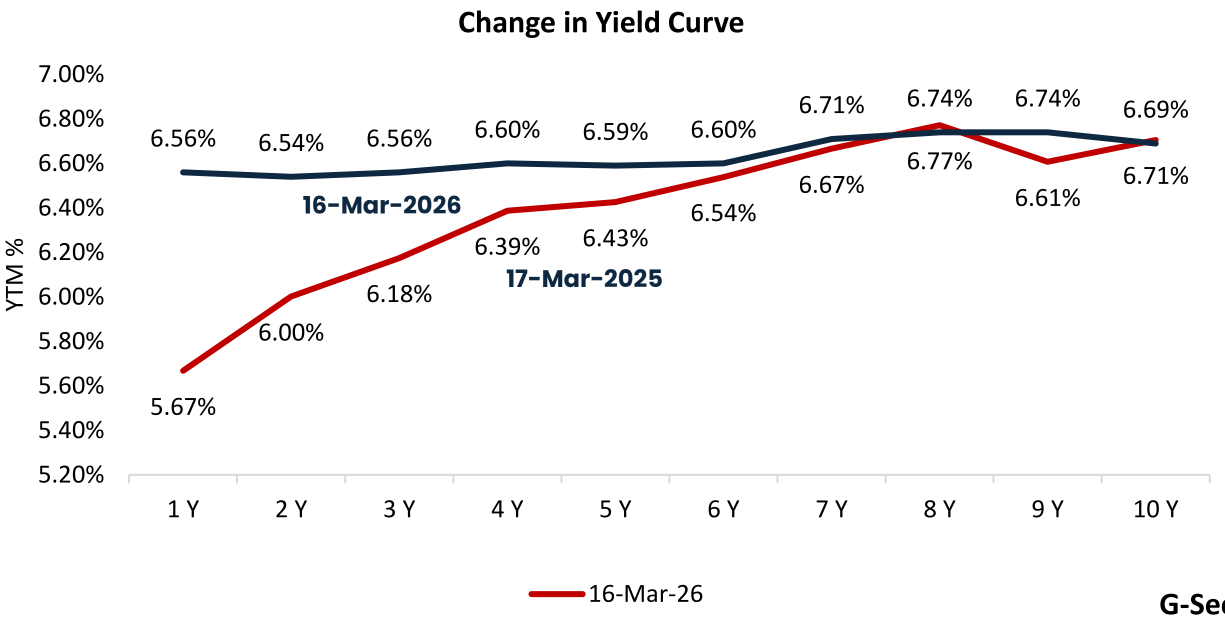
➢ **Neutral Equity**

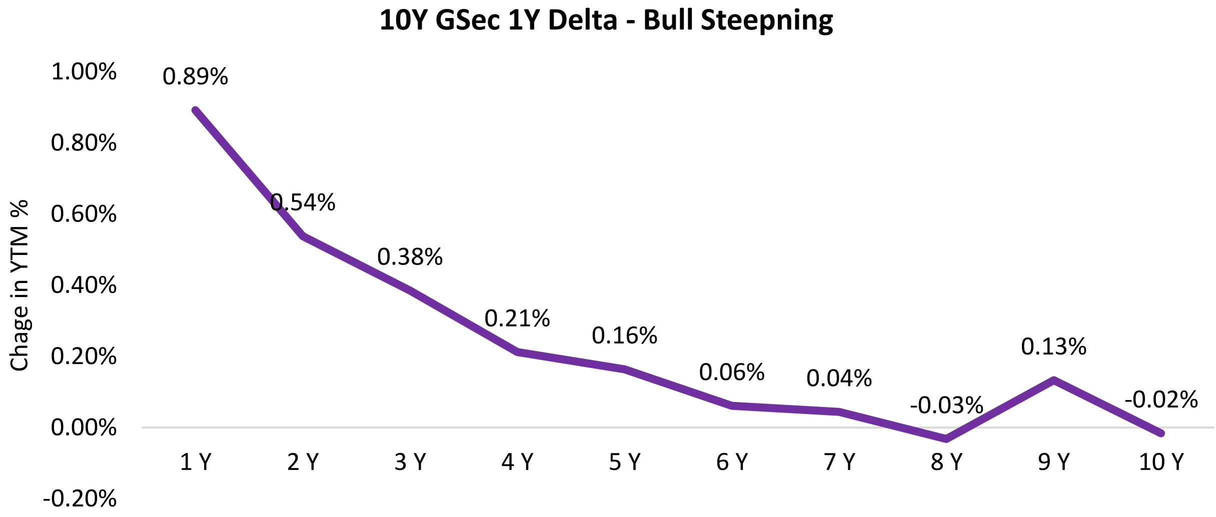
Category	***Stance***
Large Cap	*Neutral*
Mid Cap	*Neutral*
Small Cap	*Neutral*

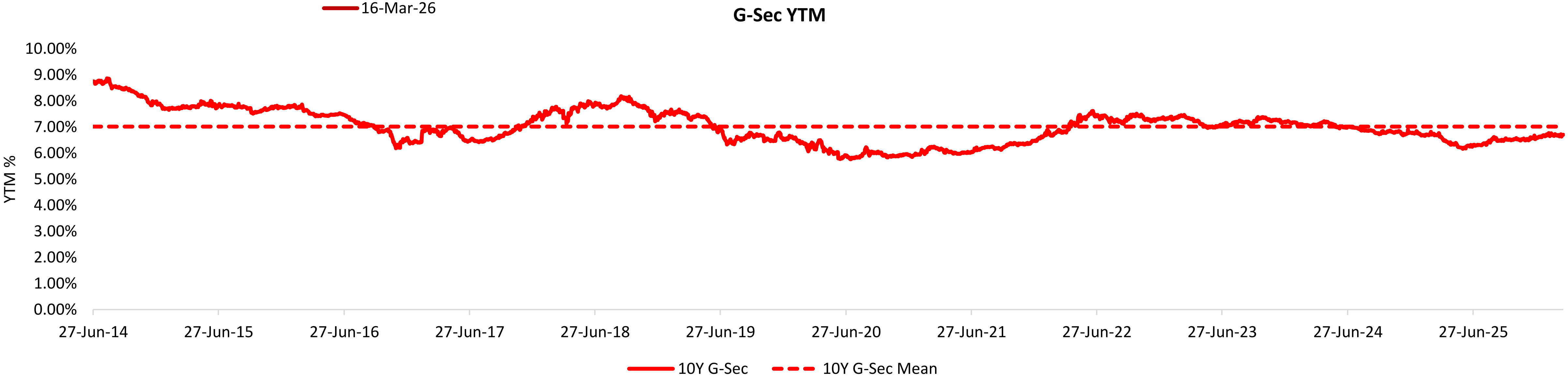
➢ **Neutral Gold**

Debt Outlook

Yields Curve Dynamics







Source: Internal assessment based on RBI DBIE data and data from Bloomberg

Debt Market Outlook & Strategy

Fault Lines & Fixed Income - Navigating Debt Markets Through a Geopolitical Storm

Where the World's Central Banks Stand: Why the Starting Point Matters

- The timing of this geopolitical shock is particularly relevant when viewed against the backdrop of global monetary policy cycles. Most major central banks are either at or approaching the lower end of their respective easing cycles. The prevailing narrative across several markets has shifted towards a prolonged pause in rate adjustments, following a period of cumulative easing.
- There are, of course, notable exceptions on either side of this spectrum. Some central banks, such as those in Australia and Japan, have either hiked or are in the process of tightening policy. Others, including the US Federal Reserve and the Bank of England, are still expected to deliver some additional easing. However, the overarching point is that central bank reaction functions are likely to differ materially depending on whether a fresh inflation shock arrives at a high point on the policy rate cycle versus when it arrives at the trough.
- **The degree of susceptibility to this shock, the available room for policy maneuvering, and crucially, the judgement as to whether this should be treated as a transient supply disruption with limited second-order pass-through or as something more persistent with the potential to alter inflation expectations. All of these considerations will have a material bearing on how individual central banks respond to the current developments**.

The American Conundrum: Sticky Prices, Split Opinions

- The United States presents a particularly complex picture. The Federal Reserve delivered 75 basis points of rate cuts since September 2025 in response to intermediate signs of labour market weakness, bringing the federal funds rate to the current target range of 3.50–3.75%. However, the incremental commentary from both FOMC members and market participants has become decidedly more mixed.
- On one hand, the labour market is yet to find firm footing, and there are credible arguments that potential disruptive effects from artificial intelligence on employment may necessitate further monetary support. On the other hand, core inflation remains stubbornly elevated. The core Personal Consumption Expenditures (PCE) price index stands at approximately 3.0% YoY as per the latest available data, which is meaningfully above the Federal Reserve's 2.0% target. Additionally, labour supply growth remains weak, and there is incremental fiscal easing in the pipeline.
- **The net market expectation had been for approximately 50 basis points of additional easing over the next six months. However, this expectation now faces the risk of unwinding, given the persistence of core inflation and recent evidence of some broad-basing in economic growth drivers. It is noteworthy that the initial market response to the geopolitical crisis has been a rise in bond yields, indicating that markets are prioritising the inflation implications over the traditional flight-to-safety dynamic. This is a significant signal and warrants close monitoring**.

Metals, Manufacturing, and the Whisper of Reflation

- Industrial metal prices have been on an upward trajectory since late 2025. While much of the market commentary has attributed this to supply-side disruptions, the price action may also be reflecting improved demand dynamics and a nascent 'reflation' trade. This thesis finds additional support from the fact that global manufacturing Purchasing Managers' Indices (PMIs) have been generally on an upswing since the middle of 2025.
- Industrial capital expenditure has been gaining momentum, supported by AI-related investments in the United States and increased defence and infrastructure spending in Europe. With improving fiscal support and a recent broad-basing in manufacturing activity, the pressure on central banks to provide additional growth support had already been diminishing even before this geopolitical shock.
- That said, a counterargument exists: if the geopolitical shock persists, it could also dampen the appetite for continued manufacturing expansion. **The ultimate trajectory will depend on the intensity and duration of the disruption and, critically, whether it meaningfully pushes inflation expectations highe**r.

India's Capital Flow Deficit: The Silent Pressure Building Beneath

- India has experienced net capital outflows for close to two years now. While this observation is well-known and widely discussed, it bears repeating as a macroeconomic consideration that sits near the top of the risk register for the Indian economy. **The underlying macro narrative for India remains strong; however, the competitive landscape for global capital allocation has changed materially**.
- Developed market bond yields are substantially higher than they were a few years ago, and the **global AI investment narrative has created attractive alternative avenues for international capital**. The new **geopolitical escalation adds a further layer of volatility to global capital allocation decisions**. In this environment, **attracting a fair share of global capital will require a combination of a robust macroeconomic narrative and reasonably attractive asset market valuations**, this is increasingly becoming a hygiene factor rather than a differentiator.
- **The implications for monetary policy are clear: the degrees of freedom available to the Reserve Bank of India may be somewhat constrained in this environment, particularly if external account pressures intensify**.

How the Shock Travels: Transmission Channels for Indian Bonds

Should the commodity price effects and associated disruptions persist beyond a very short period, several transmission channels become relevant for Indian fixed income markets. Importantly, for this episode to be truly classified as a transient supply shock with no second-order effects, one needs not merely for prices to stop rising but for them to fall back meaningfully, and for transportation costs and supply chain re-routings to normalise.

1. **The Rupee Paradox: When Currency Weakness Masquerades as Bond Strength**
    - **The first and most direct channel of transmission runs through the currency and the external account. Interestingly, this channel has recently been perceived as a bullish factor for government bonds, operating through the following logic: weaker capital flows lead to greater rupee depreciation, which in turn triggers more RBI intervention in the currency market, which necessitates more bond purchases by the central bank to sterilize the liquidity impact of the FX intervention, thereby creating better demand for government securities**.
    - This dynamic has, if anything, strengthened in recent months, with secondary market government bond purchases by the central bank reportedly being scaled up. **The RBI appears to be delivering on its commitment to forward-looking and proactive liquidity infusions by pairing currency interventions with bond purchases**. This is occurring despite durable system liquidity on a spot basis being more than adequately comfortable, with surplus liquidity reported at approximately INR 5.6 lakh crores as of mid-February 2026.
    - An alternate interpretation, that the central bank is engaging in yield management has also gained traction. If true, this is a delicate strategy to sustain for several reasons. First, the economy is no longer in a pandemic-shock scenario where yield-level control might be justifiable. Second, growth is not faltering, and the marginal utility of a 15–20 basis point change in bond yields in terms of its contribution to economic growth is not obvious. Third, sustained intervention risks creating a moral hazard problem where commercial demand for bonds is increasingly predicated on the expectation of the RBI as the buyer of last resort.
    - **At some juncture, continued weakness in the currency and capital flows will risk flipping from a bond-positive to a bond-negative factor**. Our earlier constructive view on Indian duration was anchored in the compression of India's current account deficit, driven by a sustained rise in the services trade surplus. However, there is growing risk to this compression, as software services and remittances face potential headwinds from AI displacement and, more recently, from geopolitical tensions. Further, given the many alternative avenues now competing for global capital, one may need to reassess what constitutes a sustainable current account deficit for India.
    - **The external account has thus transitioned from being a bullish tailwind for bonds to an area of caution. Additionally, continued currency pressures carry an inflation pass-through that may need to be reckoned with sooner or later**.

2. <u>**The Expectations Trap: When Dovishness Meets a Supply Shock**</u>
    - The second critical channel operates through **changes in forward-looking inflation and policy rate expectation**s. While we are cautious about drawing direct parallels, one instructive lesson from the 2022–23 period is that commodity shocks, particularly when accompanied by conducive underlying conditions, can rapidly alter forward-looking policy rate expectations.
    - The current starting conditions are worth noting: there have been recent tailwinds to global growth; many central banks are at relatively **accommodative monetary policy** settings; there is net **new fiscal easing in major developed markets**; and now we have a commodity price shock superimposed on this backdrop. **While the longevity of this shock is yet to be ascertained, one cannot rule out a shift in market rate expectations even ahead of actual inflation data turning**.
    - In the case of India, the RBI has recently introduced what can be described as 'dovish uncertainty' through two mechanisms. First, it has suspended Variable Rate Reverse Repo (VRRR) operations for some time, allowing collateralised overnight rates to drift below 5.0%. Second, it appears to be actively purchasing bonds in the secondary market, thereby setting a market expectation of a central bank backstop. Consequently, **should the RBI's forward-looking inflation assessment turn less favourable, the potential for a significant market expectation shock is amplified**.
3. <u>**The Subsidy Overhang: A Fiscal Wildcard**</u>
    - There is potentially a **fiscal transmission channel as well, primarily through a higher subsidy bill in the event of sustained commodity price increases**. However, the government retains flexibility to deploy other levers, including adjustments in excise duties and other compensating mechanisms to offset any subsidy expansion. We therefore do not dwell on this channel at length at this stage, but it **remains a factor to monitor**.

<u>**A Tale of Two Bond Markets: Washington Sells, Mumbai Holds**</u>

- **An interesting divergence has emerged in the initial market response. In the United States, inflation concerns have thus far trumped traditional safe-haven demand, resulting in a net rise in bond yields since the onset of the crisis. In contrast, Indian government bond yields have exhibited remarkably little net movement, despite the fact that the direct economic impact on India is materially larger given its status as a significant net importer of energy.**
- **This muted response in Indian yields is likely attributable to the RBI's active presence in the bond market. To the extent that this represents a proactive liquidity management approach, it is understandable. However, having relied heavily on bond purchases over the past 14 months, it may be prudent for the central bank to diversify its liquidity intervention toolkit going forward. This could include greater utilisation of short-maturity treasury bill purchases and other instruments. Such diversification would allow market forces to be more fully expressed in the bond market and help address the moral hazard problem that is already beginning to build**.

Fixed Income Positioning: Playing It Safe, Earning Smart

We are keeping our bond portfolios deliberately short and conservative. Here is what that means in practice and why.

Where we are not going:

- The government bond market presents a genuine dilemma right now. Long-term bonds offer reasonable yields in absolute terms, but we are not convinced the worst is over from a price perspective. If market expectations around RBI rate cuts begin to shift, even modestly, long-term bond prices could fall further, generating mark-to-market losses. We do not think that risk is adequately compensated at current yield levels.
- Short-term government bonds are not attractive either. Yields at the front end are simply too low relative to where policy rates could realistically settle over the next few months.

Where we are finding value:

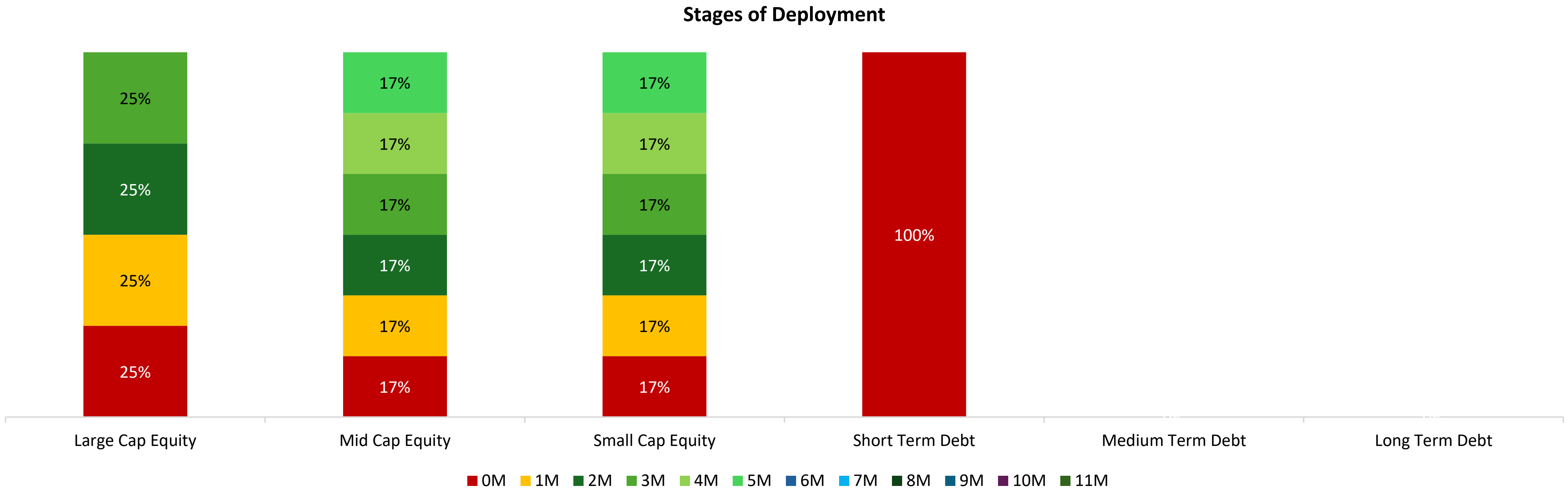
- The better opportunity right now lies in high-quality non-government bonds - corporate bonds, PSU issuances, and similar instruments, in the one-to-three year maturity range. This segment offers meaningfully better carry than equivalent government bonds, without requiring us to take on significant duration risk.

Why this is not just a trading call

- Our caution is not driven by short-term technical factors like demand and supply in the bond market. It reflects a more fundamental view: that this is a period where adding interest rate risk to portfolios is inconsistent with a conservative, return-protective stance.
- In simple terms, we would rather earn steady income from well-priced credit than bet on the direction of interest rates at a time when the picture remains unclear.

Deployment Strategy

Deployment



Indicators:

Indicators signaling over heated market conditions –

- FII's been net sellers
- VIX at 25.01 levels

Indicators signaling fair valuation –

- DII's have been net buyers
- Market Cap/GDP for Large & Small Cap Indices below their LTA's signaling Fair valuations
- Liquidity management by RBI
- Exports and Imports data are signaling a possible pickup in domestic demand
- Revival of Pvt Capex & Industrial Production & PMI
- TTM PE for all Indices indicate fair valuation

Deployment Strategy:

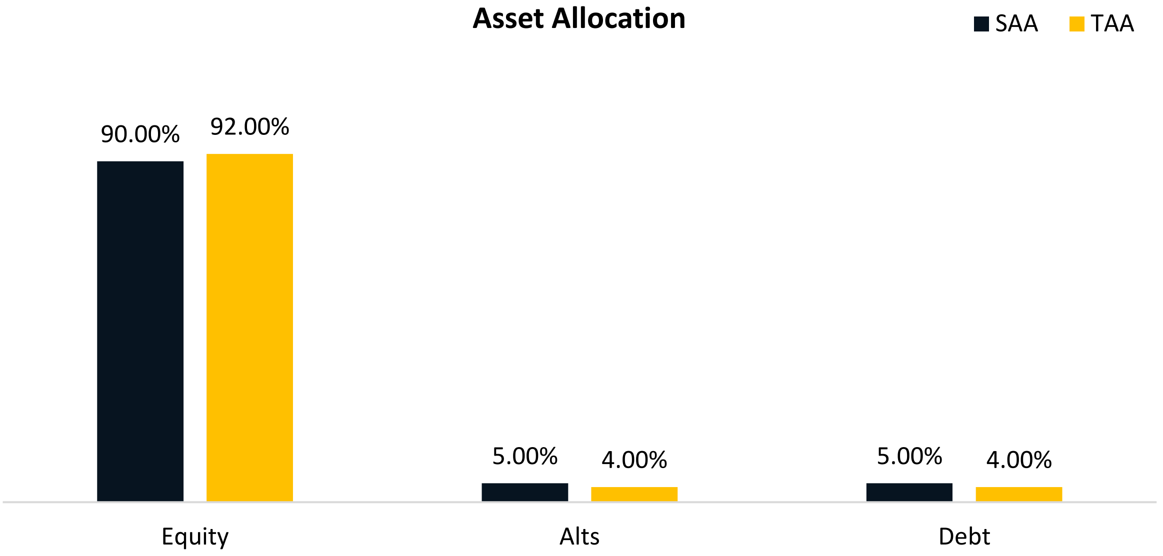
Staggered Deployment over the next 12 months –

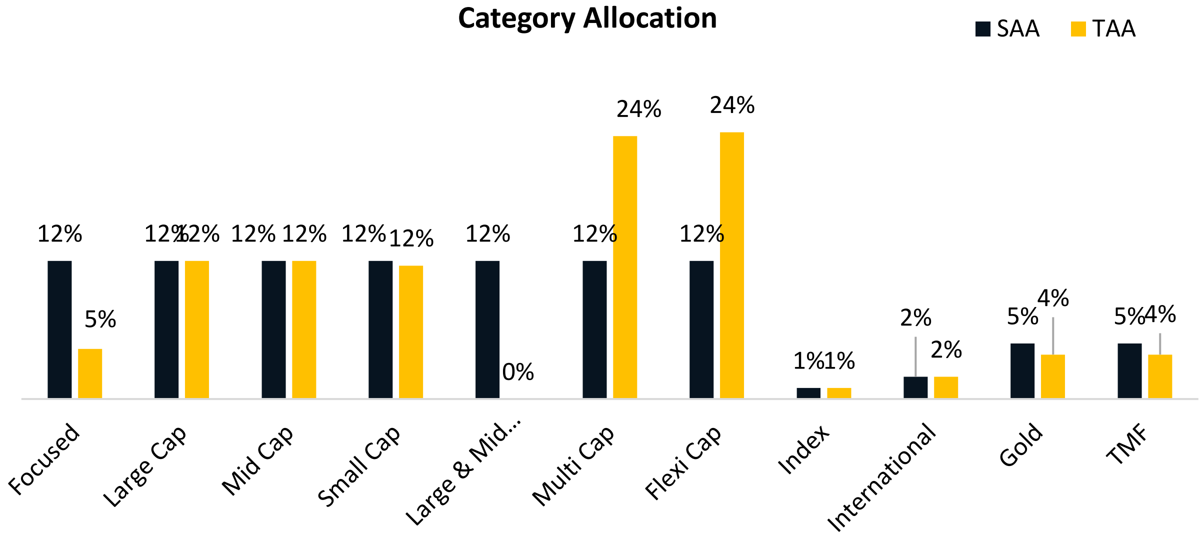
- Large Cap – 25% immediate deployment and 25% in each month in the next 3 months
- Mid Cap – 16.66% immediate deployment and 16.66% in each month in the next 5 months
- Small Cap – 16.66% immediate deployment and 16.66% in each month in the next 5 months
- Debt - 100% immediate deployment (bullet strategy at the short end (0-3 yrs) of the yield curve.

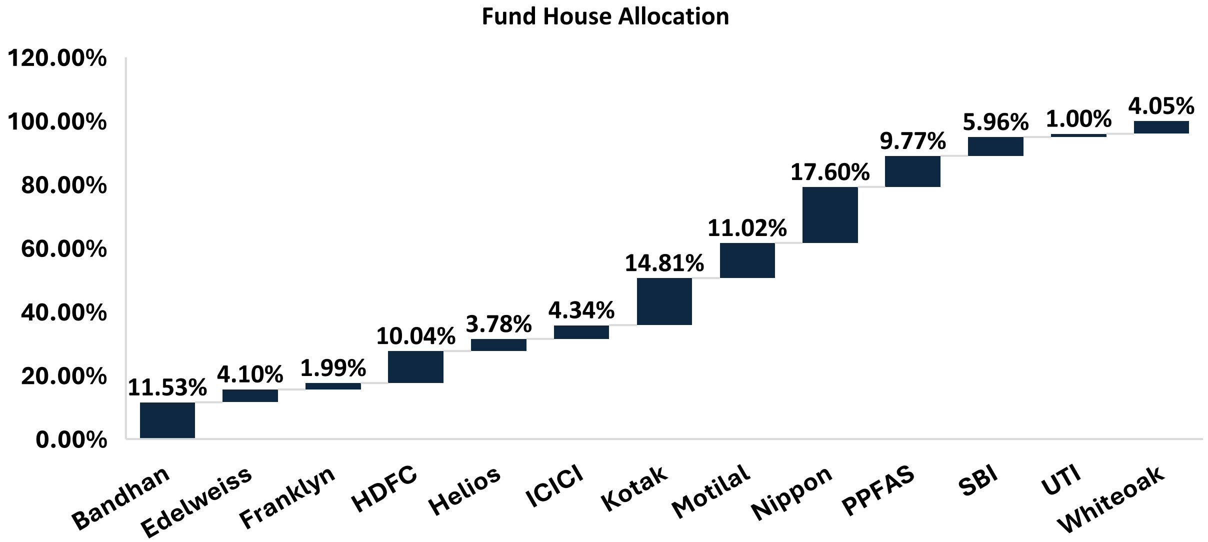
Optimus Prime

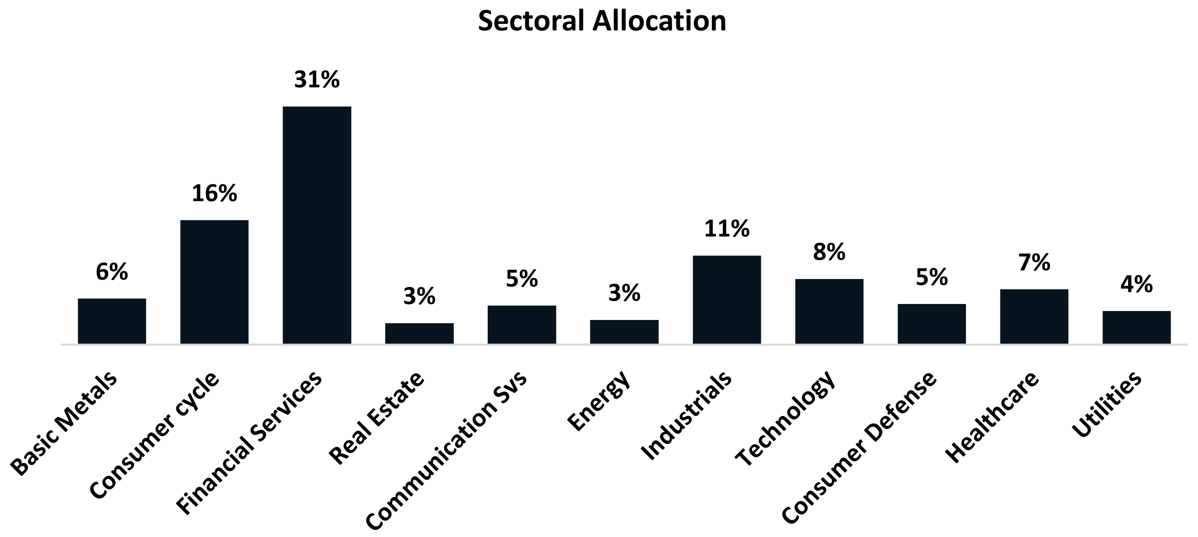
Model Portfolio

Aggressive Strategy

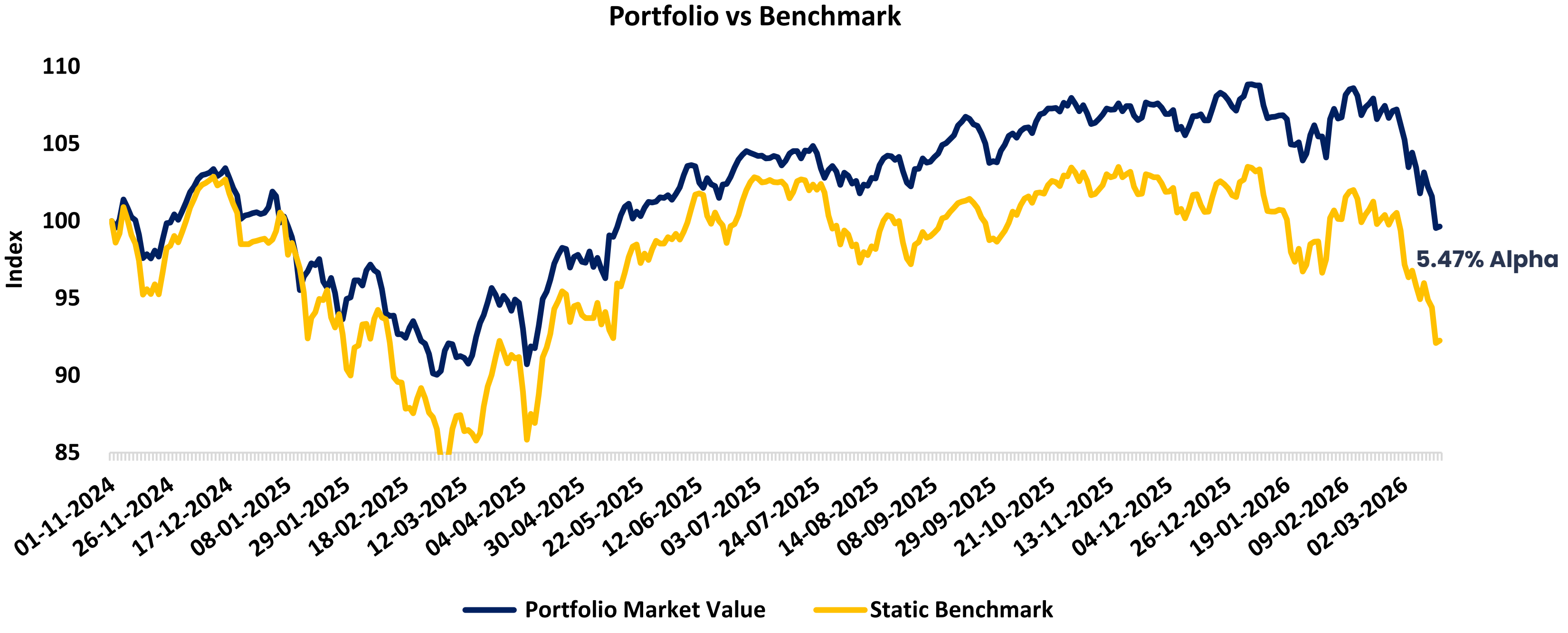


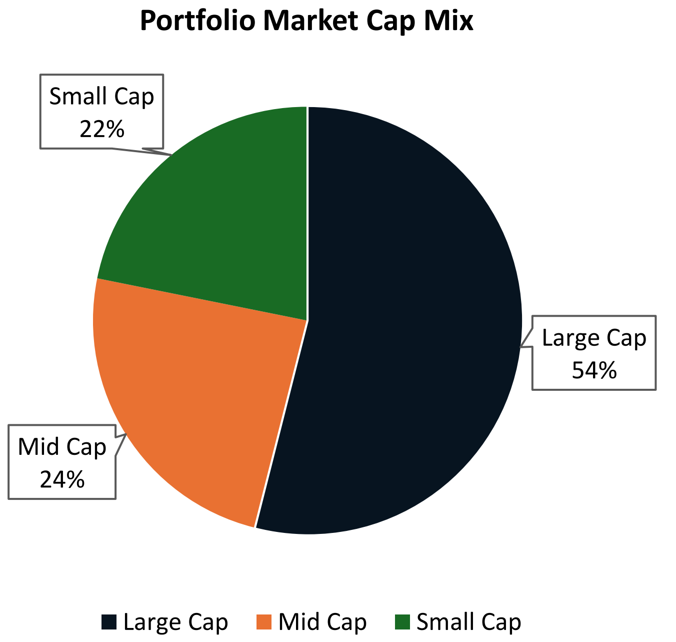






***SAA - Strategic Asset Allocation** *&* **TAA - Tactical Asset Allocation.** *International Allocation considered as Equity Allocation, Arbitrage Funds & Liquid Funds Allocation, if present are considered as Debt Allocation, and is temporarily parked for the short term and will be deployed opportunistically, Portfolio Inception date - 1st November 2024, Portfolio values are as on 15th February 2026, Returns under 1 year are absolute and returns over 1 year are annualized. The benchmark indices for each fund are carefully selected to align with their respective investment objectives for the Attribution Analysis. The benchmark weights remain static as per the SAA. The constituent benchmarks for all other calculations are: NSE 500 India TR INR – 5.00%, NSE 100 India TR INR – 30.00%, NSE Midcap 150 TR INR – 30.00%, NSE Smallcap 250 TR INR – 30.00%, NIFTY 11-15 YR G-SEC INDEX – 5.00%. All returns are pre-tax unless specifically mentioned. Optimus Prime Model Portfolio is an Aggressive portfolio strategy with a timeframe over 10 years.*





Portfolio Performance Analytics

Analytics	Portfolio	Benchmark
CAGR Return %	**-0.25%**	-5.72%
Standard Deviation (annualized)	**11.06%**	14.72%
Beta	**0.39**	
Alpha	**5.47%**	
Information Ratio	**8.95**	
Downside Capture	**66.55**	

Asset Allocation Alpha	Product Selection Alpha	Timing	Total Alpha
-0.43%	**1.00%**	**4.89%**	**5.47%**

Debt Portfolio Analytics

Debt Measures	Feb-26
Average MoD	**6.25**
Average Maturity	5.02 yrs
Average Coupon	NA
Average YTM	**6.89 %**

Average Credit Rating	Feb-26
AAA	**100%**
AA	0%
A	0%

**SAA - Strategic Asset Allocation & TAA - Tactical Asset Allocation.* *International Allocation considered as Equity Allocation, Arbitrage Funds & Liquid Funds Allocation, if present are considered as Debt Allocation, and is temporarily parked for the short term and will be deployed opportunistically, Portfolio Inception date - 1st November 2024, Portfolio values are as on 15th March 2026, Returns under 1 year are absolute and returns over 1 year are annualized. The benchmark indices for each fund are carefully selected to align with their respective investment objectives for the Attribution Analysis. The benchmark weights remain static as per the SAA. The constituent benchmarks for all other calculations are: NSE 500 India TR INR – 5.00%, NSE 100 India TR INR – 30.00%, NSE Midcap 150 TR INR – 30.00%, NSE Smallcap 250 TR INR – 30.00%, NIFTY 11-15 YR G-SEC INDEX – 5.00%. All returns are pre-tax unless specifically mentioned. Optimus Prime Model Portfolio is an Aggressive portfolio strategy with a timeframe over 10 years.*

Current Investment Portfolio Stance: Neutral

At the most recent Investment Advisory Committee meeting, it was unanimously agreed to **maintain a Neutral investment stance**. The portfolio's equity allocation is accordingly neutral, with a ~9% underweight in Mid Caps and a ~11% underweight in Small Caps, consistent with our risk-controlled framework.

The strong Neutral stance is grounded in a demonstrably **strengthening domestic macro picture**. **Real GDP growth for FY26 is estimated at +7.4%, with FY27 projected in the 6.5-7% range**, anchored by resilient private consumption, a visible **pickup in domestic demand**, and **government capex at ₹12.22 lakh crore (~4.4% of GDP)**. Headline **inflation remains benign at 3.2%** on the new CPI base, well within the MPC's tolerance band. **High-frequency indicators are constructive** - Manufacturing PMI at a four-month high of 56.9, Composite PMI at 58.9, and **IIP growth led by infrastructure and construction goods**. Corporate balance sheets are healthy, leverage remains low, and the Q3 earnings season points to a gradual if uneven **pickup in topline growth**. The **landmark trade agreements** with the US, EU, and UK are expected to catalyse **the early stages of a private capex upcycle**, which should act as an important growth driver over the medium term. **Liquidity management remains proactive**, **fiscal consolidation is on track** with the deficit targeted at 4.3% of GDP, and the external position is manageable — **collectively, the macro setup for FY27 appears conducive for a gradual re-rating in equities**.

However, the committee notes that the **ongoing US-Israel-Iran conflict** - Operation Epic Fury, now in its sixth week and introduces a material near-term risk that prevents a more decisive shift toward a pro-risk stance. The effective closure of the Strait of Hormuz has disrupted ~20% of global oil supply, with Brent surging from ~67 to +$100 in a matter of days. India, which imports over 85% of its crude and sources more than half its LNG from Brent-indexed Gulf contracts, faces the largest combined exposure among major economies. The shock is already visible: the Nifty has corrected from recent peaks, the rupee has weakened to record lows near ₹93, FPI outflows have accelerated, and the 10Y G-Sec yield has edged up to ~7% as markets reprice the inflation and external balance trajectory. A prolonged disruption could widen the current account as well as fiscal deficits, reignite imported inflation, compress margins across companies, and materially constrain the RBI's room to resume monetary easing.

Absent the war, the domestic macro constellation — low inflation, strong PMI/IIP momentum, capex-super cycle, improving trade architecture, and healthy corporate balance sheets - would warrant a more aggressive tilt toward equities**. It is precisely this live and evolving geopolitical risk that underpins the committee's decision to hold at Neutral rather than shift to an outright pro-risk or Aggressive stance**, ensuring the portfolio retains the flexibility to capitalise on opportunities as they emerge while **remaining adequately hedged against a tail-risk scenario that remains fluid. India's medium- to long-term outlook remains constructive, and the current dislocation, if contained may well present the entry points that disciplined, long-horizon portfolios are built to capture**.

Despite the prevailing volatility, our current positioning has delivered favorable results. The portfolio generated a strong **Alpha of 5.47%**, driven primarily by **Product Selection Alpha**. Importantly, the portfolio has maintained a **low Beta of 0.39**, and an **Information Ratio of 8.95, highlighting strong risk-adjusted performance**. With a **Downside Capture of approximately 66.55%, the portfolio displays effective downside protection** relative to the benchmark in a volatile market.

Going forward, the committee will maintain a **flexible approach to Tactical Asset Allocation**, guided by the **pace of recovery in domestic demand, the trajectory of the capex cycle, and evolving geopolitical developments, particularly the US–Iran conflict**.. Asset allocation will be reviewed and realigned as necessary, in response to evolving macroeconomic trends and market dynamics.

Our near-term priority remains firmly on **capital preservation** and the **generation of consistent Alpha**, amidst what continues to be a volatile investment environment.

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THANK YOU

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