KILIKA CAPITAL

# *Embracing complexity to capture Alpha*

June 2026

Dear Investors,

Last month we wrote to you from an inflection point, between two very different versions of FY27, with the entire calculus hinging on a single question: how long does the Strait of Hormuz stay shut. A month on, that question has begun to answer itself, though not yet with finality.

The near-term path has bent toward de-escalation. The United States lifted its naval blockade of Iranian ports on 29 May, after roughly six weeks in force. Washington and Tehran are reported to have broadly agreed a 60-day memorandum of understanding to pause hostilities. Crude has responded sharply. Brent, which touched roughly USD 128 per barrel at the peak of the crisis, fell almost 19% through May, its worst month since the pandemic, and now trades in a USD 92 to 96 range. For an economy that imports over 85% of its crude, a USD 30-plus retreat from the highs is the single most important relief valve available, and it has started to open.

We would caution against reading too much into it. As we write, the framework looks fragile. The talks are being described as faltering, the Strait itself remains effectively closed with traffic running at a small fraction of pre-conflict levels, and physical (spot) cargoes are still pricing a premium that the futures curve does not fully capture. Restoring flows to normal will take months even after a durable settlement, given stranded tankers, damaged Gulf infrastructure, and the risk premium shippers will continue to demand. The direction of travel is constructive; the journey is not complete.

Crucially, the domestic story we described last month has not merely held, it has been reaffirmed. Q3 FY26 real GDP grew 7.8%, broad-based and led by manufacturing. April CPI printed at 3.48%, still below the RBI's 4% target, with the fuel pass-through deliberately absorbed by the Centre. The IIP rose 4.9% in April under the new series, with capital goods up 16%, the clearest signal that the investment cycle is firing. Bank credit is growing close to 16%, capacity utilisation has climbed to 75.6%, and corporate balance sheets remain lean and liquid. These are the preconditions for a sustained re-rating, and the external shock has not taken them away.

At its review concluded last morning, the RBI held the repo rate at 5.25% and retained its neutral stance, exactly as we anticipated. The Governor trimmed the FY27 real GDP projection to 6.6% (from 6.9%), acknowledged that the Committee has turned more cautious on geopolitics, and noted that the pass-through of the energy shock to domestic prices has so far been limited. The central bank also announced a set of measures aimed at attracting foreign capital and easing access for global investors. We read the policy as a confirmation of the wait-and-watch posture we expected: the easing door is not shut, but it will not reopen until crude and the rupee cooperate.

Markets reflect this balance. The Nifty sits near 23,370 and the Sensex near 74,240, having corrected from their February peaks, which on our own read leaves large caps in undervalued territory. Foreign portfolio investors remain net sellers, with CY2026 outflows now the heaviest on record, but domestic flows have absorbed the selling almost entirely. SIP inflows of roughly ₹24,000 crore a month and steady institutional buying have made DIIs the dominant owners of Indian equities for the first time, ahead of FPIs. The rupee, near ₹95 to the dollar, stays under pressure, though it firmed intraday on the RBI's announcements. This is a market that has already priced in a great deal of bad news.

The risk calculus has therefore improved, but it has not resolved. A month ago the emphasis was firmly on caution. Today we are willing to let it shift, modestly, back toward the constructive: the tail risk of a prolonged blockade is receding, valuations are more reasonable, and the domestic engine is intact. We stop short of committing fully, because a single headline from the Gulf can reverse the oil move, and with it the rupee, inflation, and the RBI's room to ease. Our positioning accordingly remains neutral across equity and gold, with a measured, staggered deployment that keeps powder dry for the dislocations a fragile peace tends to throw up.

The domestic story is intact. The external shock is real, but for the first time in three months it is easing rather than worsening. We remain cautiously optimistic, with the emphasis now resting a little less heavily on caution than it did.

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 charter holder 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.

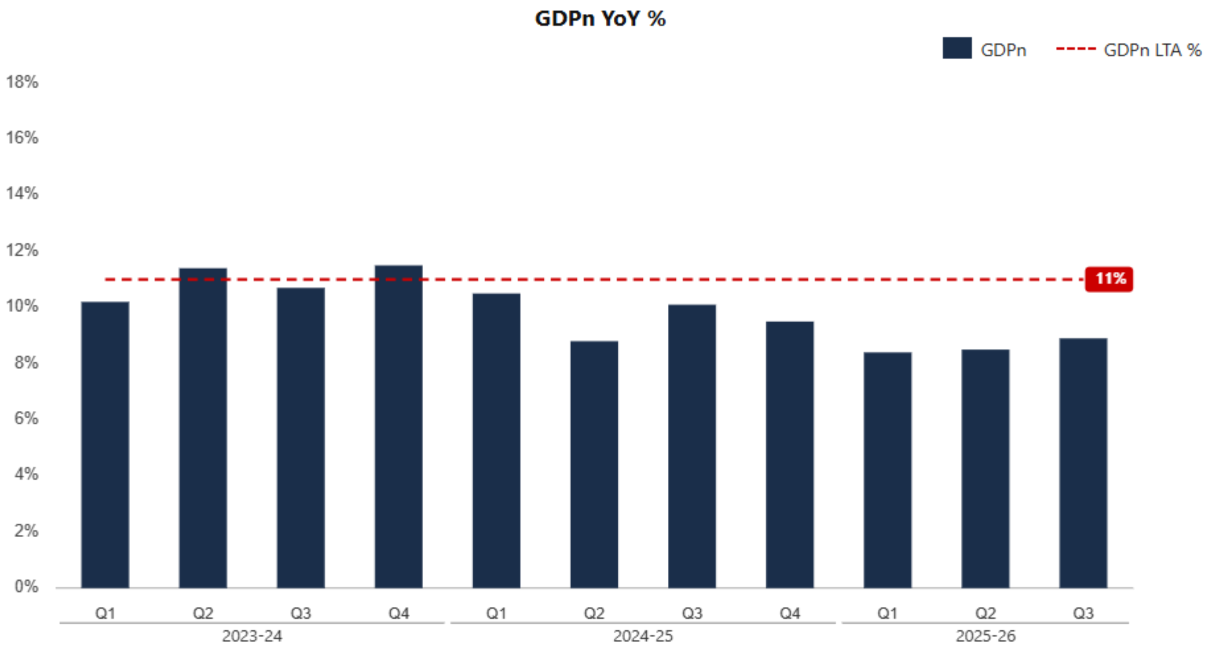
**Piyush Sharma – The Creative Wizard**
Meet Piyush Sharma, our research lead and the youngest brain in the room—but don't let that fool you. Armed with an MBA and a flair for creativity, Piyush lives and breathes financial models. Whether it's running a Monte Carlo simulation, dissecting a mutual fund, 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?

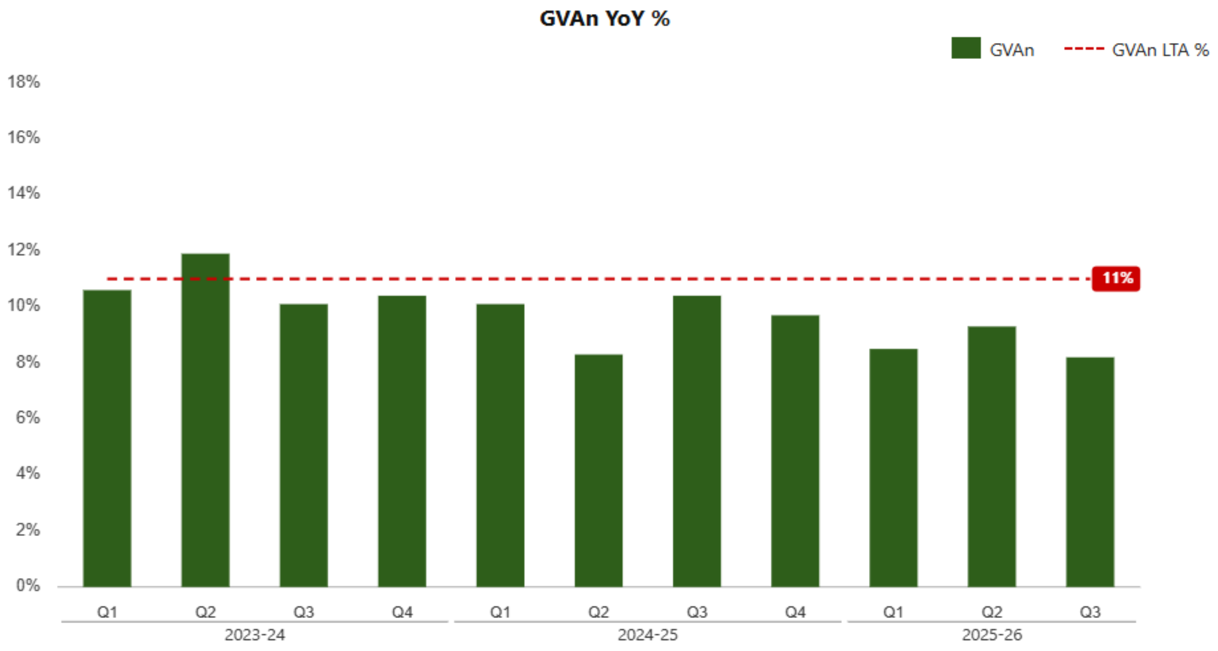
**Harris Lunis - The Fundamentals Detective**
Harris Lunis is a research-driven finance professional with a sharp eye for fundamentals and a curiosity that extends well beyond the balance sheet. Armed with a Master's in Finance, he specializes in deep-dive sector research, financial modelling, and valuation frameworks - turning complex data into clear, investment-ready insights. Backed by a strong academic record and CA Inter, Harris brings structure, rigor, and consistency to financial statement analysis, forecasting, and valuation. He keeps a close watch on global markets, macro indicators, and geopolitics, with a particular interest in how U.S. policy decisions ripple through the global economic system. When he's not dissecting companies or tracking indices, Harris is likely on the field playing cricket or football, a discipline that mirrors his approach to investing: patient, precise, and long-term oriented. His analytical mindset and fundamentals-first thinking fit seamlessly with our firm's long-term investment philosophy.

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 defending 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

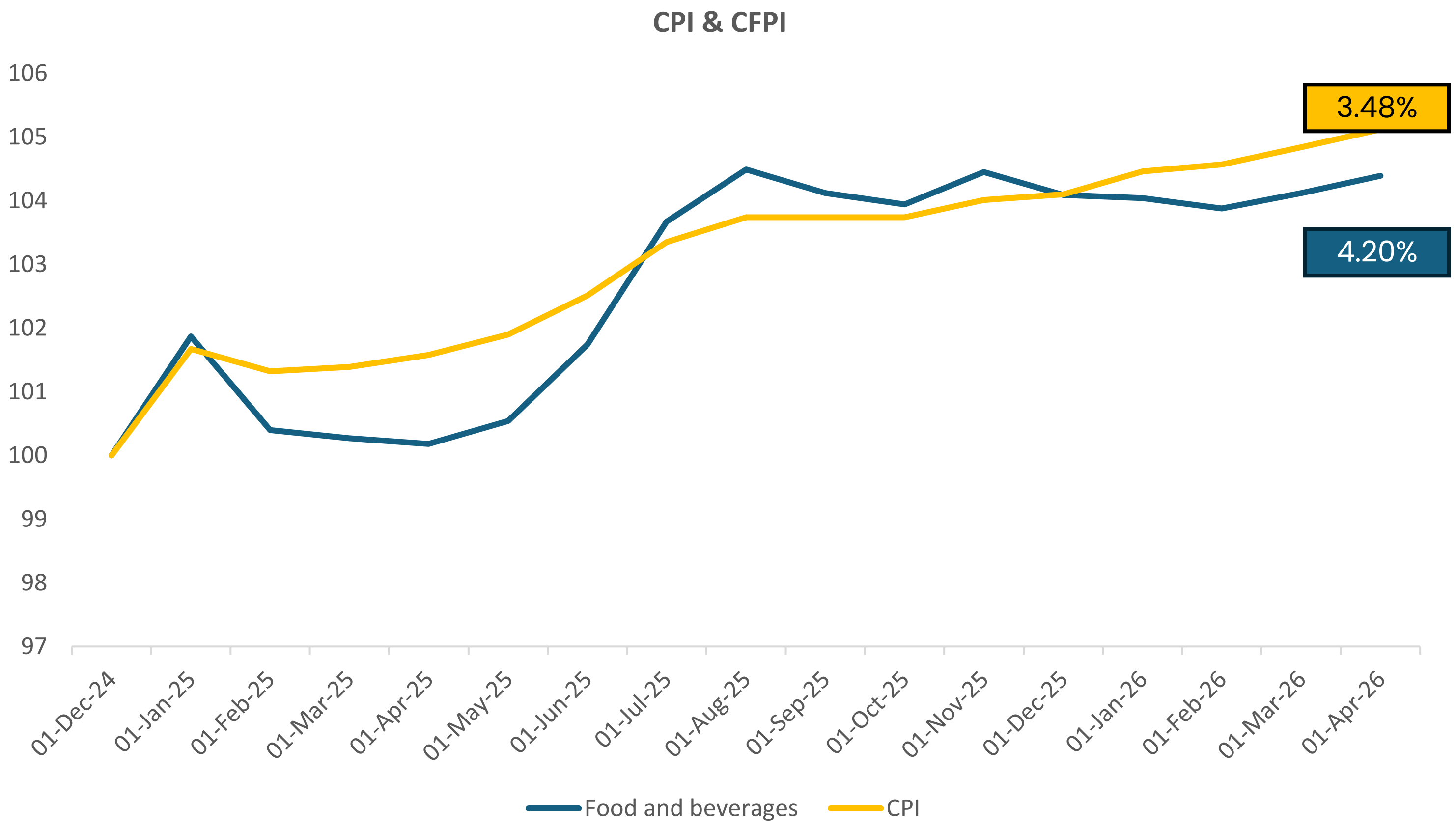
| Signal | Theme | Implication for Portfolios |
|---|---|---|
| POSITIVE | Manufacturing & CapEx | PLI scheme payoffs continuing. Double-digit manufacturing growth expected into Q4 FY26. Government capex, if maintained at 3.4% of GDP in FY27 Budget, keeps the construction multiplier firing. |
| WATCH | 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.<br>Oil prices could shoot up, negatively impacting India macros<br>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. |

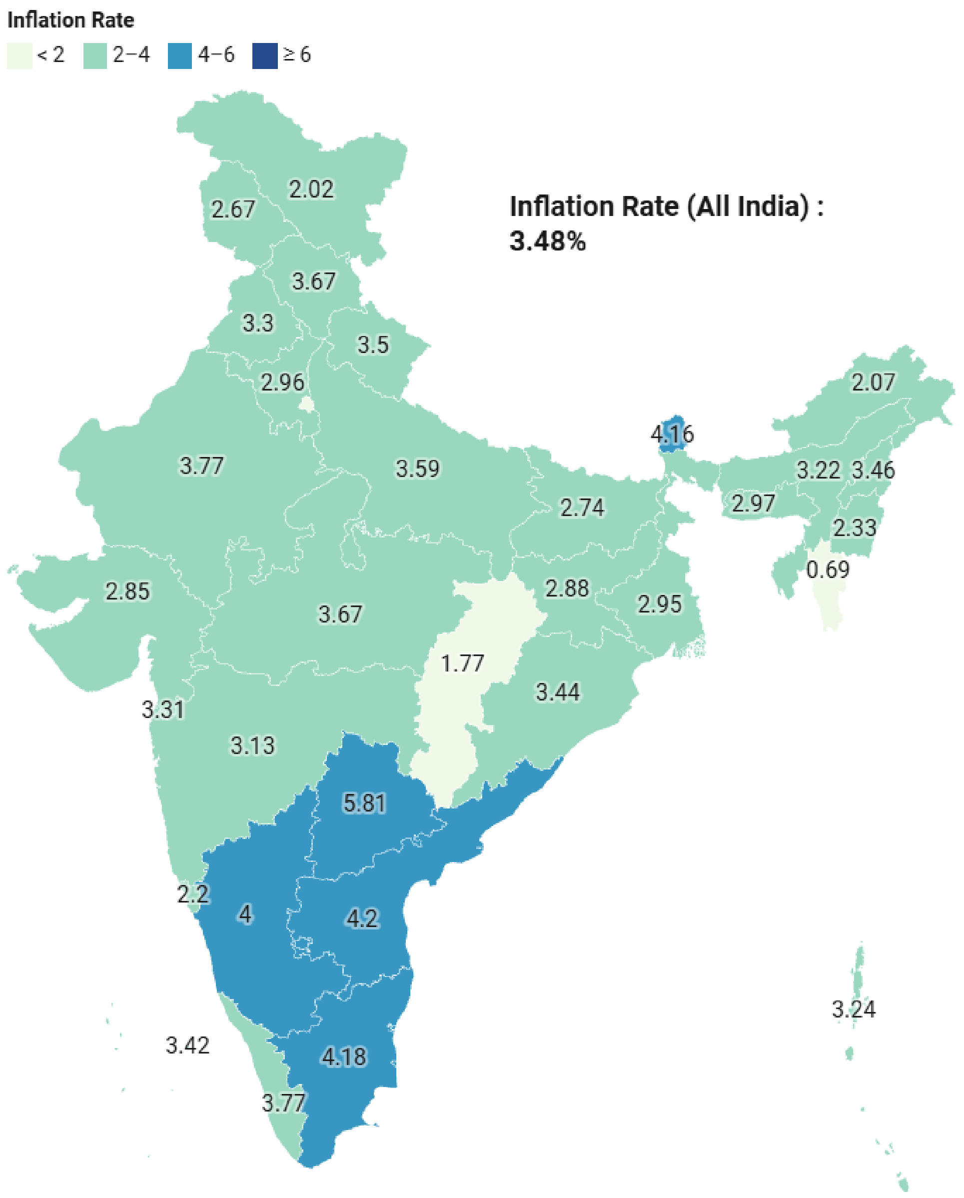
## Our 12-Month View: Constructive turned Cautious

**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 $110/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 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 June 2026, crude sustains above $110/bbl for another quarter, and/or (b) US tariff escalation broadens to include Indian electronics and pharmaceuticals.**

*Based on Q3 GDP data. Q4 GDP data released post writing this report, hence not covered in this edition*

# 2. Inflation




Source: Internal assessment based on RBI DBIE data

# The Calm Before the Storm? Decoding India's April 2026 CPI Print

- India's headline **CPI inflation for April 2026 edged up to 3.48% YoY** from 3.40% in March, marking the **sixth consecutive month of sequential acceleration** and a 13-month high under the back-series data of the revised CPI series (base year 2024=100). At first glance, the number looks comfortable, sitting well below the RBI's 4% medium-term target and significantly undershooting the market consensus of 3.80% (Reuters poll). But beneath this seemingly benign print lies a narrative of **gradually broadening price pressures**, a **government absorbing shocks** on behalf of consumers, and a **geopolitical tinderbox** that threatens to upend the entire inflation arithmetic in the quarters ahead.
- This is the fourth reading under the updated CPI series, which recalibrated the consumption basket using the Household Consumption Expenditure Survey, shifting greater weight toward non-food items. The month-on-month increase of 0.27% may seem marginal, but for those tracking the trajectory, the pattern is unmistakable. From 2.74% in January to 3.21% in February, 3.40% in March, and now 3.48% in April, **the inflation curve has been quietly but relentlessly climbing. The question is no longer whether inflation is rising, but how quickly it will breach the 4% mark**.

## The Kitchen Is Getting Expensive Again

- Food inflation, measured by the Consumer Food Price Index (CFPI), accelerated to **4.20% YoY in April** from 3.87% in March. This is significant because food and beverages carry the largest weight in India's CPI basket at 45.86%, and any sustained move here tends to anchor household inflation expectations, something the RBI watches very closely.
- The vegetable basket told a story of extreme divergence. On one end, coconut prices surged 44.55%, tomatoes jumped 35.28%, cauliflower rose 25.58%, green chillies climbed 22.66%, cabbage was up 22.13%, grapes soared 22.12%, raisins advanced 23.97%, and brinjal increased 21.09%. On the other end, potatoes saw sharp deflation of -23.69% and onions declined -17.67%, providing a meaningful offset. Without these two deflationary anchors, the headline food inflation number would have been materially higher.
- The **waning of a favourable base effect** from last year is a key factor to watch going forward. In April 2025, food inflation had printed at just 2.1% with vegetable prices in deep deflation at -11.0% YoY. **As this low base rolls off, the upcoming months are likely to see a mechanical uplift in food inflation numbers, even without any fresh price shocks**.
- **Rural food inflation at 4.26% ran ahead of its urban counterpart at 4.10%, underscoring the structural vulnerability of rural households where food constitutes a disproportionately large share of the consumption basket**.

## Core Tells a Different Story

- Core inflation, which strips out the volatile food and fuel components, **remained anchored at approximately 3.7% YoY for the fourth consecutive month**. This stability is remarkable given the external headwinds, and it suggests that demand-side price pressures in the broader economy are not yet broad-based. **The pass-through from elevated wholesale energy prices to final consumer goods pricing has been limited so far, largely because the government has refrained from raising retail fuel prices despite Brent crude trading above $100 a barrel for 29 consecutive days during April**.
- However, the core print comes with an important caveat. **The personal care and miscellaneous category witnessed inflation of 17.66%, driven almost entirely by the precious metals complex. Silver jewellery inflation stood at an extraordinary 144.34%, while gold and platinum jewellery prices surged 40.72%**. These items, while not reflecting everyday purchasing patterns, do carry weight in the CPI basket and have been distorting the headline core number**. If one strips out precious metals from the core calculation, the underlying price momentum appears even more subdued, closer to the 1.9% estimate that some economists have flagged**.

- Clothing and footwear inflation remained steady at 2.80%, health inflation held at 4.01%, and education services recorded a 3.15% increase. These are the kinds of slow-moving, sticky components that rarely make headlines but collectively shape the consumer's lived experience of inflation.

### The Rural-Urban Divide Widens

- The rural-urban inflation gap continued to persist in April. **Rural CPI rose to 3.74% from 3.63% in March, touching a 15-month high, while urban CPI edged up modestly to 3.16% from 3.11%. The 58-basis-point gap between rural and urban inflation is not merely a statistical artefact. It reflects deeper structural realities, namely, the higher weight of food in rural consumption baskets, weaker supply-chain infrastructure in hinterland markets, and limited access to competitive retail formats that help moderate prices in cities**.
- **For rural households, food inflation running at 4.26% versus an urban equivalent of 4.10% translates into meaningful erosion of purchasing power, particularly at a time when rural wage growth has remained tepid. This divergence has implications for rural demand, FMCG volumes, and ultimately for the broader consumption recovery that policymakers are counting on to sustain GDP growth**.

### Housing Holds Steady, but Watch the Margins

- Housing inflation in April was estimated at 2.15% YoY, inching up slightly from 2.11% in March. Rural housing inflation stood at 2.65% while urban housing printed lower at 1.96%. These are among the stickiest components in the CPI basket, moving glacially over time. **The current readings suggest that rental markets remain relatively stable, with no evidence of a sharp re-pricing cycle**.
- That said, **housing inflation tends to lag the broader cycle. If the input cost pressures from elevated commodity and energy prices eventually feed into construction costs and lease renewals, the housing component could become an incremental headwind for headline CPI later in FY27**.

### States Paint a Varied Picture

- The state-level inflation data reveals significant regional heterogeneity that gets masked in the national aggregate. Among states with populations exceeding 50 lakh, **Telangana recorded the highest combined inflation at 5.81% in April, maintaining its position at the top for several months**. **Puducherry, Tamil Nadu, and Andhra Pradesh also reported elevated readings**. On the other end, **Delhi printed a relatively benign 1.96%** and Chhattisgarh was among the lowest at 1.77%.
- The regional dispersion is noteworthy for two reasons. First, imported inflation pressures, which carry a weight of 21.84% in the CPI basket, showed uneven transmission across states. **Telangana recorded imported inflation close to 12%, while states like Rajasthan, Sikkim, and Andhra Pradesh reported levels around 8%**. Second, this divergence complicates the monetary policy transmission mechanism, as a single repo rate must serve vastly different inflation realities across the country.

### Services Are Quietly Heating Up

- **One of the more instructive shifts in the April data was the behaviour of services inflation. Restaurants and accommodation services saw inflation surge to 4.20% from 2.88% in March. This is a sharp move for a services category and reflects the cascading impact of rising commercial LPG prices and higher operational costs for hospitality and food-service businesses. When input costs rise for restaurants, they tend to reprice menus with a lag, and this pass-through appears to have accelerated in April**.
- Education services inflation at 3.15% remained moderate but bears watching, as fee revisions typically cluster in the April-June window for the new academic year. **Transport inflation stayed essentially flat at -0.01% YoY, a testament to the government's deliberate decision to hold domestic fuel prices steady despite the global crude price surge. This is perhaps the single biggest reason why headline inflation has not already breached the 4% mark, however this is likely to change if the war persists and the energy supply remains constrained.**

## The Elephant in the Room. Crude, Hormuz, and the Geopolitical Gamble

- The April CPI print cannot be read in isolation from the geopolitical conflagration unfolding in West Asia. This is the second full month of data since the conflict erupted, and the limited pass-through of crude oil prices to the consumer is as much a policy choice as it is an economic outcome.
- Brent crude surged nearly 40% between late February and early May, staying above $100 a barrel for 29 consecutive days in April. As of mid-May, it trades around $106-110 per barrel, up roughly 64% from a year ago. Iran's grip on the Strait of Hormuz has throttled global energy flows, with the IEA reporting that crude and fuel flows through the strait declined by nearly 6 million barrels per day in Q1 2026. Saudi Arabia has informed OPEC that its output fell to the lowest level since 1990. The IEA has warned that the global oil market will likely remain severely undersupplied until October, even if the conflict ends next month.
- For India, which imports nearly 85% of its crude oil requirements, this is an existential vulnerability. Yet the April CPI data shows a remarkable disconnect. Transport inflation is flat, fuel and light inflation remains contained, and the headline number sits comfortably below 4%. How?
- The answer lies in the government's fiscal buffer. Retail fuel prices for petrol and diesel have been held steady, with only a marginal hike in cooking gas. The subsidy absorption and the calibrated use of fuel taxation have shielded consumers thus far. But this is a finite strategy. Every month of sustained crude above $100 widens the fiscal exposure, strains the oil marketing companies, and builds a reservoir of deferred price hikes that will eventually have to be released.
- A study by Bank of Baroda using data from January 1991 to March 2026 offers a useful framework here. The research finds that Brent crude prices show a positive correlation with wholesale inflation (WPI-Fuel correlation of 0.69 during volatile periods) but virtually no relationship with CPI in normal times. This is because the fuel component weight in CPI is lower than in WPI, and government intervention through administered pricing absorbs much of the first-round shock. However, the study also finds that oil price transmission operates with an optimal lag of five quarters, implying that the real impact of the current crude surge may not fully manifest in CPI until late FY27 or early FY28.
- The second-round effects, rising input costs for manufacturers, higher logistics expenses, and increased raw material costs, are where the true risk lies. These tend to percolate through the supply chain with a delay and show up in core inflation well after the initial shock.

## What Lies Ahead - The Balancing Act Gets Tougher

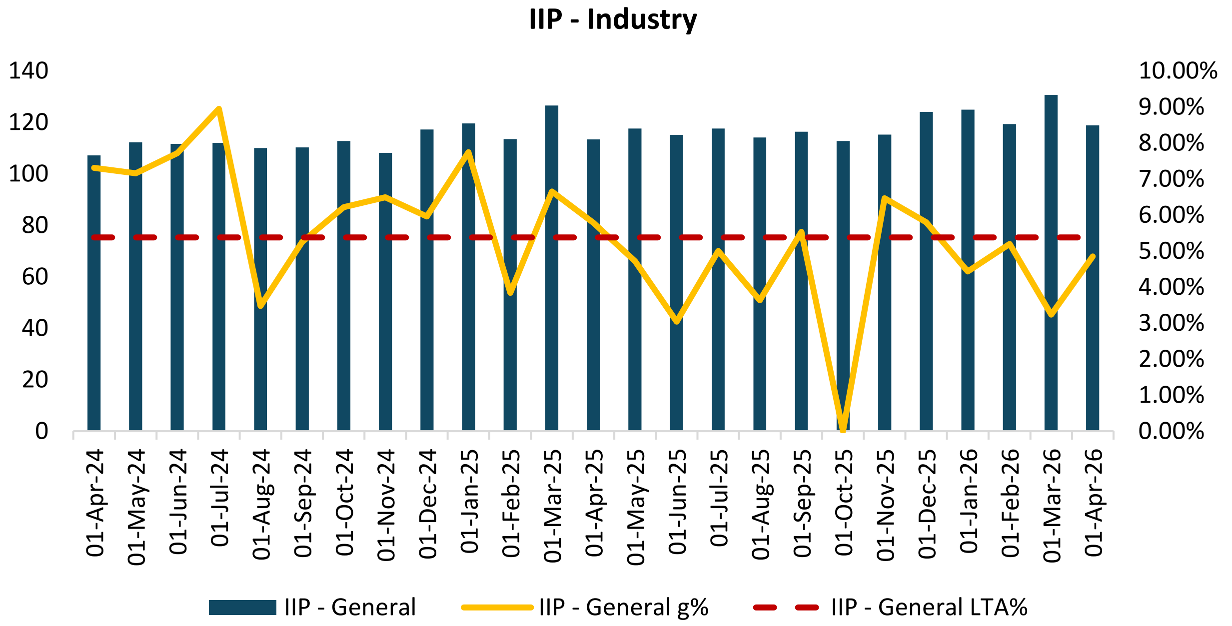
**The RBI, in its April 2026 monetary policy assessment, projected CPI inflation at 4.0% for Q1 FY27, rising to 4.4% in Q2, peaking at 5.2% in Q3, and moderating to 4.7% in Q4, with a full-year FY27 estimate of 4.6%. SBI Research has retained its FY27 CPI forecast at 4.5%, while CRISIL projects a higher average of 5.1%. ICRA expects headline inflation to harden to approximately 4.1% as early as May 2026.**

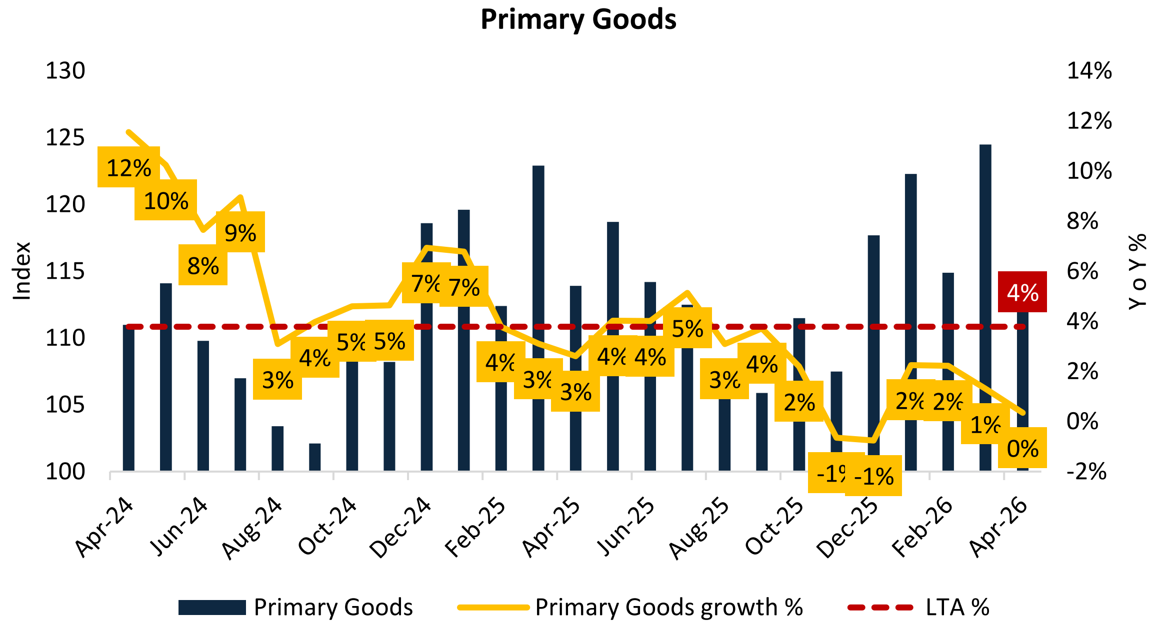
**Several factors will determine whether the inflation trajectory tracks the RBI's baseline or breaks higher.**

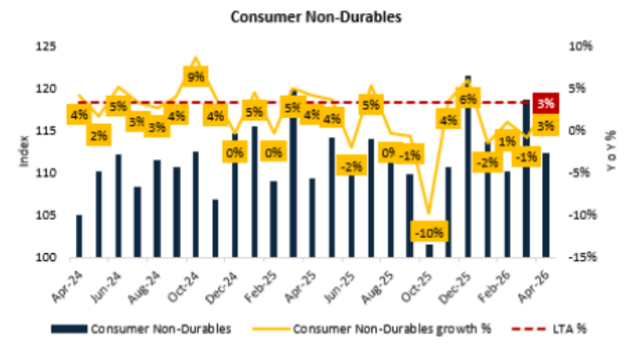
- **First, the monsoon.** The India Meteorological Department (IMD) has flagged the possibility of El Niño conditions, which could weaken southwest monsoon rainfall and disrupt agricultural output. Any shortfall in kharif production would directly amplify food inflation in the second half of FY27.
- **Second, fuel price repricing.** The government cannot indefinitely absorb the crude oil shock. Any decision to pass through even a fraction of the accumulated cost to consumers would cause a step-change in headline CPI, particularly through transport and cooking fuel categories.
- **Third, the rupee.** A depreciating currency, pressured by a widening current account deficit and elevated energy imports, amplifies imported inflation. As the chief economist at Bank of Baroda has noted, a weaker rupee has already added to the cost of precious metals like gold and silver, and this imported inflation channel is likely to intensify.
- **Fourth, the base effect.** The favourable base from H1 FY26, when headline inflation averaged well below 3%, will roll off progressively. Mechanically, even with flat sequential prices, the YoY numbers will rise.

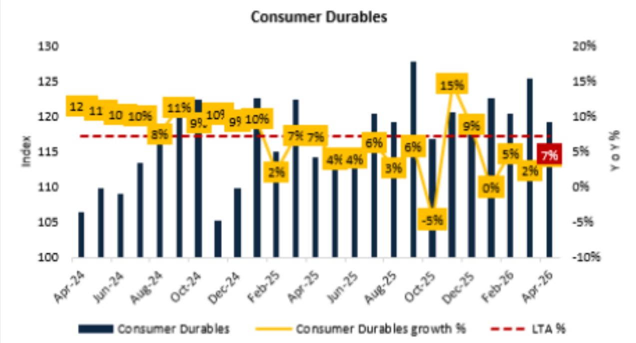
**The MPC's June 2026 review will be pivotal. With inflation still below target but rising, and growth facing headwinds from the geopolitical disruption, the committee is likely to hold rates and adopt a wait-and-watch posture. Former RBI Governor Duvvuri Subbarao captured the central dilemma best when he warned that if inflation persists long enough, expectations harden, and what begins as a supply shock can morph into a demand shock, and that is what should concern the RBI the most. The April print of 3.48% is not a cause for alarm in isolation. But it is the slope, not the level, that matters at this juncture. The inflation curve is ascending, the external risks are intensifying, and the policy buffers are being depleted. The calm in the data may well be the calm before the storm.**

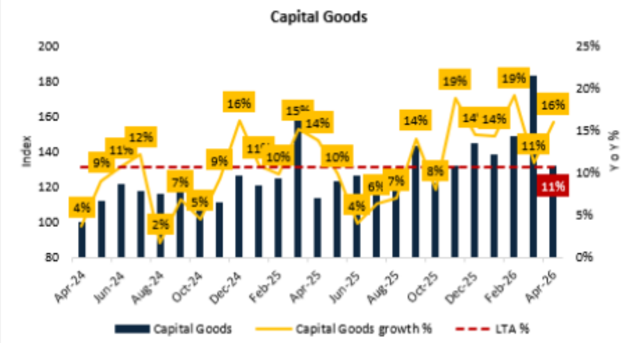
# 3. IIP (Index of Industrial Production)

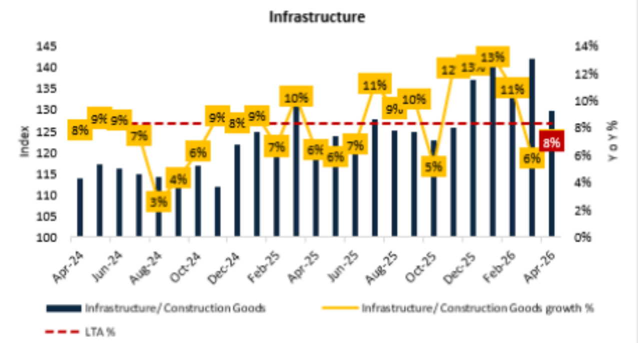


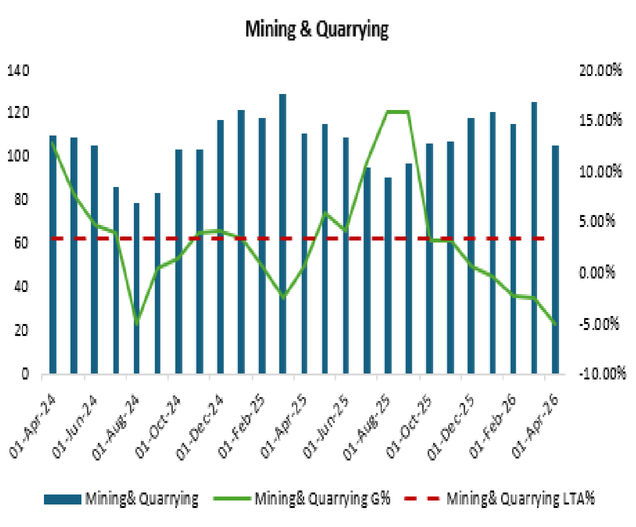



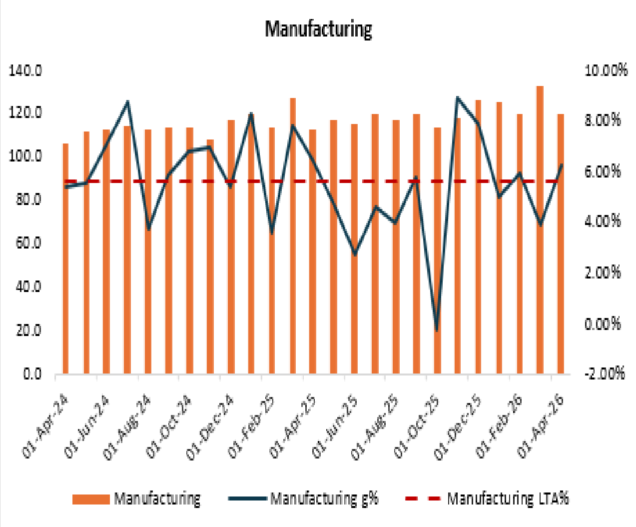



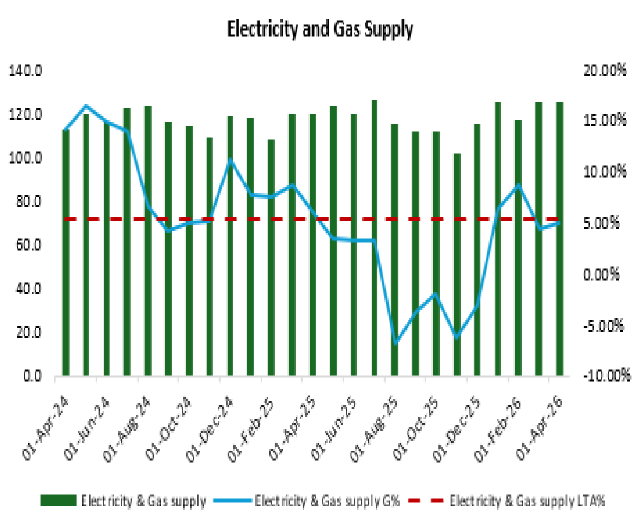



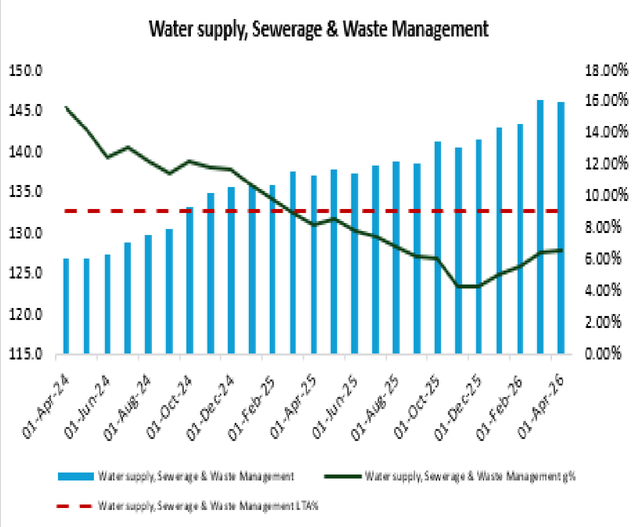




*Source: Internal assessment based on RBI DBIE data*




# India IIP. April 2026 - Capital Goods Surge 16%, Manufacturing Broadens to 17 of 23 Sectors, but Five Core Industries Contract as the West Asia Energy Shock Splits India's Factory Floor in Two

## New Lens, Same Recovery. 4.9% Opens a Fresh Chapter in India's Industrial Statistics

Industrial production grew **4.9% YoY in April 2026**, the first reading under the revamped IIP series with **2022-23 as the new base year**. The General IIP index stood at 118.9 against 113.1 a year ago. Under the old 2011-12 series, March 2026 had recorded 4.1%. **The base revision**, prepared under a Technical Advisory Committee report submitted May 25, 2026, adds sectors like rare earth minerals, gas supply, aircraft components, vaccines, and medical devices while dropping kerosene, fluorescent tubes, and sewing machines. Water supply, sewerage, and waste management now form a fourth sectoral pillar alongside mining, manufacturing, and electricity. The product basket is aligned with NIC-2025, and data sources have expanded to 16 agencies. Old and new series numbers are not directly comparable.

## FY26 context under the old series

**Full-year growth came in at roughly 4.8%, recovering from FY25's 4.0%** (weakest in four years). The trajectory was sharply back-loaded. Q1 FY26 averaged just 2.0%, weighed down by mining contractions and election aftereffects. H2 surged, with November at 7.2% and December at 8.0% as government capex front-loading (52% of BE by October), 125 bps of cumulative rate cuts, and festive demand converged. Q4 moderated to 4-5% as the West Asia conflict began inflating energy costs. April 2026's 4.9% under the new series confirms momentum survived the initial war shock.

*Source: Internal assessment based on RBI DBIE data*

## Dissecting the Machine - Where Every Percentage Point Came From

### The Split Screen. Who Is Growing, Who Is Bleeding

| By Sector | Apr-26 (New) | Mar-26 (Old) | FY26 (Old) | Signal |
|---|---|---|---|---|
| **Manufacturing (76%+ weight)** | **6.2%** | 4.3% | ~5.0% | **Strong** |
| **Mining & Quarrying** | -5.1% | 5.5% | ~1.5% | Weak |
| **Electricity & Gas** | 4.9% | 0.8% | ~2.0% | Recovering |
| **Water, Sewerage & Waste (New)** | 6.6% | N/A | N/A | New Pillar |
| **By Use-Based Classification** | **Apr-26 (New)** | **Apr-25 (Old)** | **FY26 Avg** | **Signal** |
| **Capital Goods** | **16.0%** | 20.3% | ~8.5% | **Very Strong** |
| **Infra / Construction Goods** | 7.1% | 4.0% | ~6.0% | Healthy |
| **Intermediate Goods** | 7.7% | 4.1% | ~5.0% | Healthy |
| **Consumer Durables** | 4.3% | 6.4% | ~4.5% | Steady |
| **Consumer Non-Durables (FMCG)** | Negative | -1.7% | Weak | Pain Point |

*Source: MoSPI Quick Estimates (June 1, 2026); RBI Bulletin May 2026*

- **Manufacturing at 6.2%** is the anchor. 17 of 23 industry groups posted positive output, a structurally healthier breadth than the 13-16 groups typical of FY25. Top contributors were motor vehicles (12.7%), electrical equipment (19.2%), and machinery (12.9%), **all directly reflecting the capex cycle's demand pull from infrastructure, real estate, and the EV transition. Auto components, switchgears, and small transformers were the sub-drivers.**
- **Capital goods at 16.0% is the single most important investment signal**. These are machines that build other things. **A 16% surge means the credit flowing to industry (up 15.0% YoY, MSMEs at 33.1%) is translating into real productive capacity on the ground.** Under the old series, capital goods IIP had already been strong through FY26, accelerating from 6.8% in July to 14.6% in March. Capital goods imports also grew double-digit in April, providing independent corroboration. **This is the transmission mechanism between the banking system and the real economy, and it is firing.**
- **Mining at -5.1% is the persistent drag** and the most **direct casualty of the West Asia conflict**. Coal production fell 8.7% in April, crude oil declined 3.9% (a secular structural decline as mature fields deplete), and natural gas dropped 4.3%. Mining contracted in multiple months through FY26 (April, June at -8.7%, October at -10.6%) and remains the weakest sectoral link. Environmental clearances and land acquisition issues create a secular headwind that geopolitics is now compounding.
- **Electricity at 4.9% recovered sharply from March's 0.8%,** driven by **above-normal summer temperatures pushing cooling demand**. Renewable generation remains volatile month-to-month. The new series adds water supply and waste management at 6.6%, capturing Smart Cities and Swachh Bharat-driven urban infrastructure investment.
- **Consumer non-durables remain the weak link**. Near-zero or negative growth has persisted since mid-FY25. **Rural income stress, food inflation's dampening effect on FMCG volumes, and the absence of a meaningful early monsoon-driven rural recovery explain the sustained softness. This is the one segment where the investment cycle's strength has not yet trickled down to mass consumption.**

### The Foundation Cracks - Eight Core Industries Tell Two Different Stories

| Sector | IIP Wt % | Apr-26 | FY26 Cum. | Driver | Signal |
|---|---|---|---|---|---|
| **Cement** | 5.37% | **+9.4%** | +8.7% | Govt Capex | Strong |
| **Steel** | 6.68% | +6.2% | +9.5% | Infra + Auto | Strong |
| **Electricity** | 19.85% | +4.1% | +3.5% | Summer | Steady |
| **Coal** | 10.33% | **-8.7%** | +3.0% | West Asia | Weak |
| **Fertilizers** | 2.63% | -8.6% | -0.1% | Gas Costs | Weak |
| **Natural Gas** | 1.71% | -4.3% | +4.8% | Structural | Weak |
| **Crude Oil** | 3.22% | -3.9% | -1.0% | Field Depletion | Structural |
| **Refinery Products** | 5.94% | -0.5% | +1.8% | Margin Squeeze | Neutral |
| **Combined ICI** | **40.27%** | **+1.7%** | **+2.7%** | **Bifurcated** | **Mixed** |

*Source: Office of Economic Adviser, DPIIT; Ministry of Commerce & Industry (May 20, 2026)*

**The combined ICI grew just 1.7% in April** (March revised. 1.2%, FY26 cumulative. 2.7%). The split is stark. **Three construction-infra sectors are thriving. Cement at 9.4%** reflects the Rs.12.20 lakh crore **FY27 government capex programme. Steel at 6.2% is pulled by both road construction and auto-sector demand. Electricity at 4.1% tracks summer** cooling load.

**Five energy-linked sectors contracted**, all **bearing West Asia's fingerprints**. **Coal's 8.7% decline reflects dispatch disruptions and base effects. Fertilizer's 8.6% drop** is concerning for the **Kharif season**, driven by **elevated natural gas feedstock costs. Crude oil and natural gas declines are secular (mature field depletion) compounded by conflict-driven supply chain stress**. Refiners at -0.5% are adjusting throughput to manage crude price volatility and margin compression.

### When Hard Data Meets Soft Data. PMI Says the Same Thing

The S&P Global **Manufacturing PMI stood at 54.7 in April 2026** (above 50 = expansion), sustaining in positive territory though moderating from the 55-59 range of mid-FY26. **Export orders moderated to 56.3 amid West Asia disruptions.** The **forward-looking future output sub-index at 65.5 signals strong manufacturer confidence about the next 12 months despite geopolitical noise**. The PMI trajectory through FY26 peaked at 59.3 in August, dipped to 53.9 in March (the West Asia shock month, consistent with the IIP step-down from 5.2% in February to 4.1% in March), and recovered in April. The convergence between PMI and IIP confirms the same story. **Indian manufacturing is in a moderate but broadening expansion with investment-linked segments leading, consumer segments holding steady, and energy costs creating a margin headwind without derailing output growth. The March dip was a temporary speed bump, not a cyclical inflection.**

## Follow the Money. How Credit, Capacity, and Policy Are Wiring the Factory Floor

The IIP data does not exist in isolation. It sits at the intersection of four converging forces. **First, bank credit to industry is growing 15.0% YoY** (MSMEs at 33.1%, large industry at 8.9%), meaning money is flowing to the manufacturing sector. **Second, the RBI's OBICUS survey shows manufacturing capacity utilization at 75.6% in Q3 FY26, approaching the ~76-77% threshold that historically triggers private greenfield investment. Third, the government's capex execution has been robust, with Rs.9.3 lakh crore deployed through February 2026** (79.7% of revised estimate) and FY27 budgeted at Rs.12.20 lakh crore. **Fourth, the RBI has executed a textbook tighten-then-ease regulatory cycle, cutting rates by 125 bps, easing project finance provisioning from 5% to 1.0-1.25%, and moderating the LCR digital-deposit run-off to 2.5%, unlocking an estimated Rs.2.7-3 lakh crore of lending capacity.**

**The capital goods IIP at 16.0% is where all four forces converge into physical output. Credit availability + regulatory easing + government demand + rising CU** = more machines being produced. The **question is whether this investment-led expansion becomes self-sustaining through a broad-based private capex cycle, or remains dependent on government spending.** At 75.6% CU, we are at the door but not yet through it. The transition requires CU to sustain above 76-77% for two consecutive quarters, clear of the **West Asia supply shock that is dampening global demand and creating uncertainty for corporate investment committees.**

## What Comes Next. Factories at a Crossroads Between Capex Boom and Energy Shock

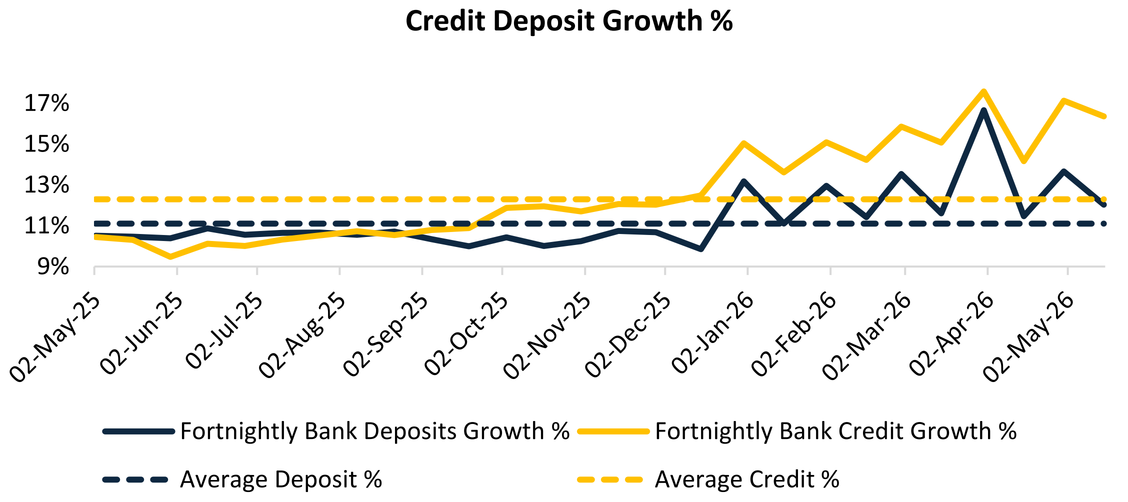
**We expect FY27 headline IIP growth to average 5.5-6.0% under the new series. Manufacturing should sustain 6.0-6.5% as capital goods orders stay strong and PLI schemes (electronics, semiconductors, textiles) deliver volumes. Mining will remain flat to marginally positive given the structural constraints on domestic crude and coal logistics. Electricity should grow 4.0-4.5% on summer demand and renewable capacity additions.**

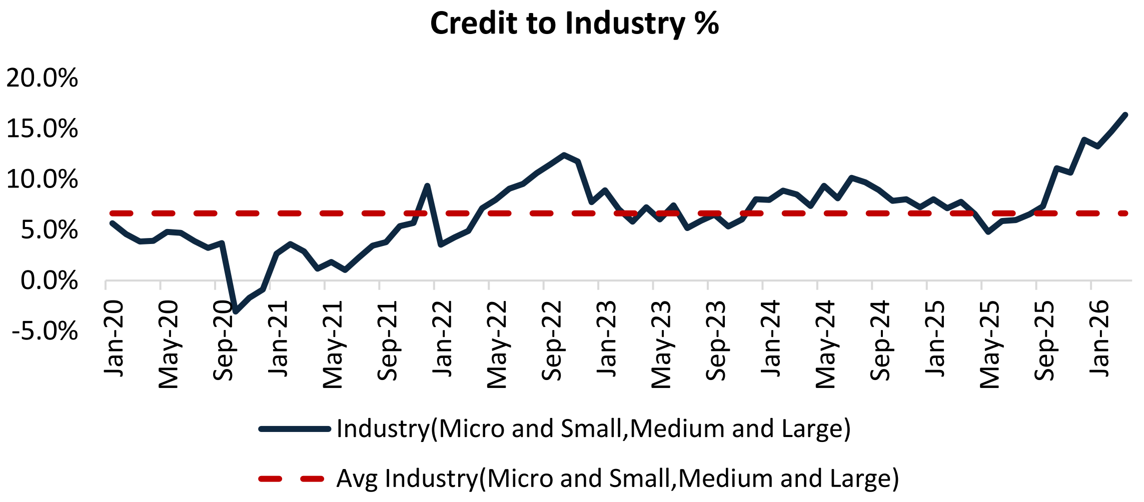
**Upside risk**. If capacity utilization crosses 77% in Q4 FY26 and Q1 FY27 (data pending), private sector greenfield investment kicks in and the capital goods cycle gets a second wind. Corporate balance sheets are ready. Leverage is low, cash buffers are large, and interest coverage ratios are comfortable. The financing channel is open. The missing ingredient is conviction, and a sustained CU above 77% would provide it.

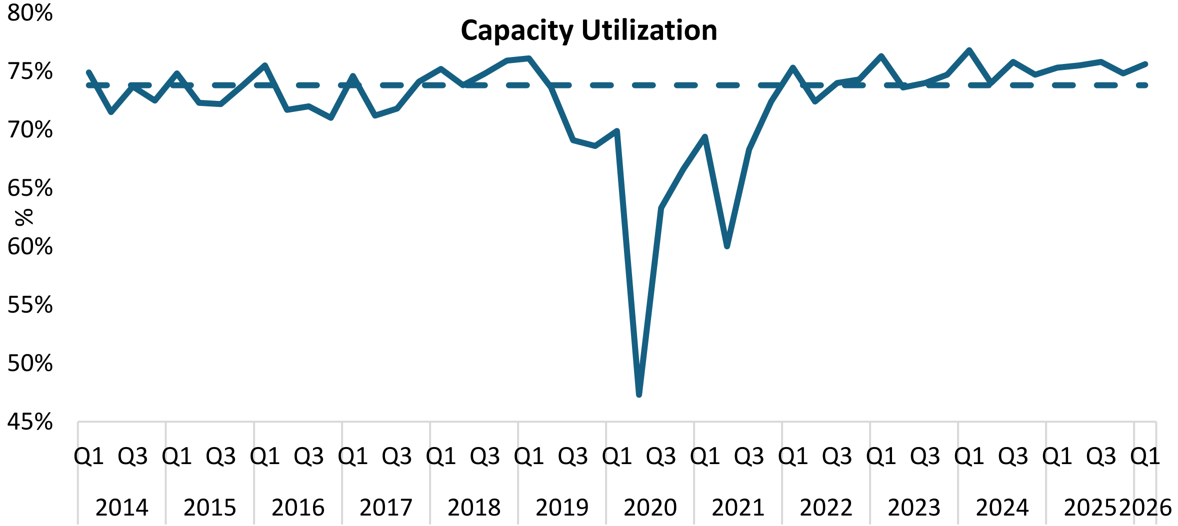
**Downside risk**. A sustained escalation of the West Asia conflict pushing crude above $100-110/barrel for an extended period. This would compress margins across energy-intensive industries, force production curtailments, inflate fertilizer costs ahead of Kharif, and add 40-60 bps to headline CPI, constraining the RBI's ability to cut further. Five of eight core industries are already contracting. A prolonged energy shock would widen that crack.

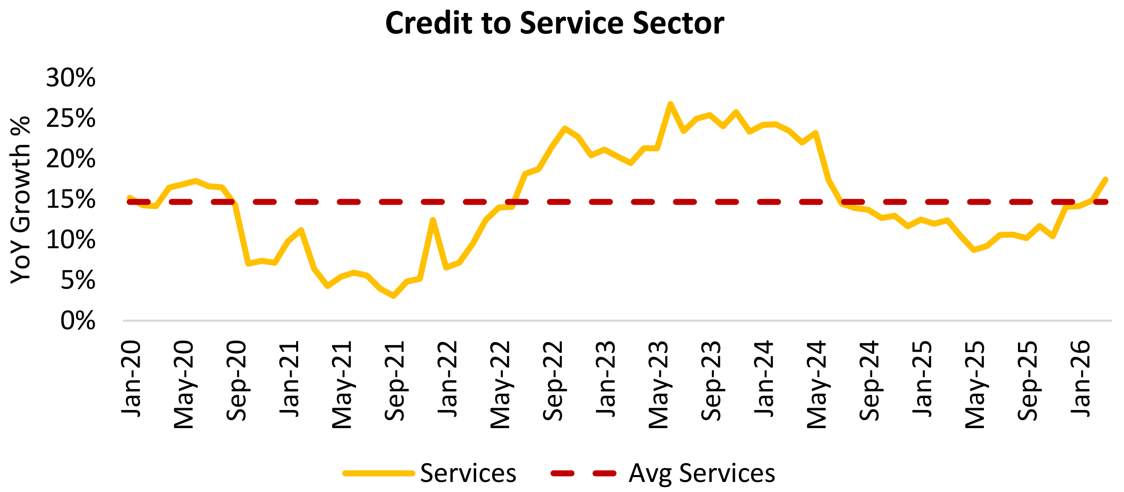
**The MPC at 5.25% will likely stay on hold through June 2026, with one additional 25 bps cut possible in H2 FY27 if crude stabilises below $100 and the monsoon delivers normally. The real GDP projection of 6.9% and CPI at 4.6% for FY27 carry asymmetric risks. The 125 bps of transmission machinery is built and ready. When CU crosses the trigger and private capex joins the government's sprint, the industrial cycle will shift from recovery to expansion. The IIP data says we are closer to that moment than at any point since FY24.**

# 4. Capex




*Source: Internal assessment based on RBI DBIE data*

## The Funding Machine. Credit Surges Ahead, Deposits Struggle to Keep Pace

- India's banking system closed FY26 with its most aggressive credit expansion in over a decade. **Non-food bank credit outstanding rose to Rs.21.29 lakh crore as on March 31, 2026, registering 15.9% YoY growth**, a sharp acceleration from 10.9% at end-March 2025. The total outstanding credit to the commercial sector expanded 15.0% YoY in FY26, with non-food bank credit alone contributing Rs.29.19 lakh crore in incremental flows during the year, compared to Rs.18.08 lakh crore in FY25.
- The re-acceleration has been unmistakable. **As on April 30, 2026, non-food bank credit stood at 15.8% YoY growth**, compared to just 9.8% a year earlier. This credit cycle has been engineered by **125 bps of cumulative repo rate cuts, 100 bps of CRR reduction releasing roughly Rs.2.5 lakh crore of primary liquidity, and a deliberate easing of project finance and risk-weight norms by the RBI**.
- **Deposit growth, however, has not matched this pace. Aggregate deposits grew 13.5% YoY to Rs.262.30 trillion at end-March 2026**, a meaningful improvement from FY25's 10.28%, but still 200-300 bps behind credit growth on a sustained basis. The April 2026 data makes the divergence even starker. **Deposit growth decelerated to 12.3% YoY as on April 30, 2026**, while credit held firm at 16.0%, widening the gap that had been building since mid-FY26.
- **The structural shift in household savings behaviour is at the heart of this divergence. Banks' share of household financial assets has fallen from 53% in 2020 to 43% in FY25, with mutual fund inflows nearly doubling to Rs.4.7 lakh crore in CY2025. Savings deposit growth is drifting back toward its pre-Covid 40% level, with the CASA ratio settling near 41.4% in mid-April, down from a post-Covid peak near 45%. This is not a temporary aberration; it is a medium-term challenge for banks' liability franchises and very much a structural shift in our opinion**.
- The **system-wide credit-deposit ratio (CDR) stood at 81.4% at end-March 2026**, easing marginally from the intra-year peak near 83.04% observed on March 15, 2026, which was the highest reading since 1962. While the year-end normalization brought some relief, the CDR remains well above the **historical median of 74.4%** and the RBI's informal comfort zone of 75-78%.

### Credit-Deposit Ratio Trajectory:

| Metric | FY25 | Q2 FY26 | Q3 FY26 | Mar 2026 |
|---|---|---|---|---|
| **Credit-Deposit Ratio** | 80.4% | 82.4% | 80.8% | **81.4%** |
| **Incremental CDR** | 82.1% | 96.1% | 86.1% | **85.4%** |
| **Investment-Deposit Ratio** | 29.5% | 27.6% | 29.7% | **26.5%** |

*Source: RBI Bulletin, May 2026; Select Economic Indicators (Table No.1)*

- The **incremental CDR has been running above 85%** for most of FY26, peaking near 96.1% in Q2 FY26, meaning banks lent roughly Rs.103.90 for every Rs.100 of fresh deposits raised in mid-March. Private banks and small finance banks have been running incremental CDRs above 92-94% and 105% respectively, forcing aggressive reliance on wholesale funding. FY26 certificate of deposit issuances hit Rs.14 trillion, roughly 30% above FY25, reflecting this funding squeeze.
- The implication is clear. **The banking system has the willingness to lend but faces a structural constraint on the ability to fund that lending at competitive rates. Marginal funding costs remain elevated, and the pass-through of the 125 bps repo cut to deposit rates has been limited at 55 bps on fresh deposits and 47 bps on outstanding deposits, compared to a more complete 93 bps pass-through on fresh lending rates. This asymmetry will continue to compress net interest margins through FY27**.

## Under the Hood of Personal Credit. Gold Gleams, Credit Cards Fade

Personal loans, the largest sectoral category at Rs.69.41 lakh crore outstanding in March 2026, grew **16.2% YoY** in FY26. But the aggregate masks dramatic divergences underneath, each segment telling a distinct story about regulatory intent, collateral dynamics, and consumer behaviour.

### Personal Loan Sub-Segment Growth (YoY%, March 2026):

| Segment | Outstanding (Rs. Cr) | FY26 Growth | FY25 Growth |
|---|---|---|---|
| **Housing** | 33,55,980 | 11.5% | 13.4% |
| **Vehicle Loans** | 7,38,680 | 18.6% | 14.1% |
| **Gold Jewellery Loans** | 4,60,313 | **123.1%** | 30.2% |
| **Education** | 1,55,850 | 13.4% | 17.6% |
| **Credit Card Outstanding** | 2,94,461 | 3.5% | 17.8% |
| **Consumer Durables** | 21,962 | -5.3% | -2.1% |
| **Advances against Fixed Deposits** | 1,69,107 | 19.2% | 11.5% |
| **Other Personal Loans** | 17,34,440 | 13.0% | 12.8% |
| **Total Personal Loans** | **69,41,339** | **16.2%** | **14.8%** |

*Source: RBI Bulletin, May 2026; Deployment of Gross Bank Credit by Major Sectors*

- **Housing credit at Rs.33.56 lakh crore grew 11.5% YoY in March 2026**, moderating from the post-Covid highs near 15-17% but remaining healthy. **The moderation is partly base-effect driven and partly a reflection of the repo-linked EMI transmission that has kept affordability intact despite elevated property prices**. With 125 bps of cumulative rate cuts flowing through EBLR-linked home loans, EMI relief has supported sustained disbursements even as ticket sizes rise. Housing remains the single largest anchor of the personal loan book at 48.3% share.

- **Vehicle loans surged 18.6% YoY, reflecting festive demand spillover, new model launch cycles, and double-digit growth in automobile production across passenger vehicles, two-wheelers, and three-wheelers in FY26**. The financing channel for the auto sector is firmly open, with capital goods imports also growing double-digit in April 2026, signalling sustained momentum in the industrial vehicle segment.
- The standout outlier is **gold jewellery loans, which surged 123.1% YoY to Rs.4.60 lakh crore in March 2026. This extraordinary growth is not purely organic demand. Domestic gold prices rose approximately 80% over the past year, peaking at Rs.1.79 lakh per 10g in January 2026 before moderating to around Rs.1.53 lakh by mid-April. Higher collateral values mechanically increase eligible loan amounts under the same LTV norms. Additionally, one large bank reclassified an agriculture sub-category into gold loans in May 2024, inflating the YoY comparison**. The RBI issued comprehensive Master Directions on gold lending in June 2025, with full compliance effective April 1, 2026, introducing a tiered LTV structure (85% for loans up to Rs.2.5 lakh, 80% for Rs.2.5-5 lakh, and 75% above Rs.5 lakh) and capping bullet repayments at 12 months.
- **Credit card outstandings decelerated sharply to just 3.5% YoY, a fraction of the 17-20% historical norm. This is almost entirely a regulatory artefact. The November 2023 risk-weight hike to 150% on credit card receivables made unsecured revolving credit prohibitively expensive for banks on a risk-adjusted return basis, precisely as intended by the RBI to throttle the unsecured retail boom it had flagged as a systemic concern.**
- **Education loans grew 13.4% YoY, supported by rising overseas enrolments and steady repo-linked EMI transmission.**
- **The broader retail credit footprint has nearly doubled from 10.1% of GDP in FY16 to 18.1% of GDP in FY25, a structural shift reflecting both financial deepening and a regulatory arbitrage towards secured products post-November 2023.**

## The Credit Composition Signal. Where the Money Is Actually Flowing

The sectoral credit mix in March 2026 offers a far healthier picture than the headline number alone suggests. **The rebalancing from unsecured consumer credit towards productive, investment-linked lending is one of the most significant structural shifts in this credit cycle.**

### Sectoral Credit Growth (YoY%, March 2026):

| Sector | FY26 Growth (%) | FY25 Growth (%) |
|---|---|---|
| **Agriculture & Allied Activities** | 15.7% | 15.4% |
| **Industry (Micro, Small, Medium & Large)** | 15.0% | 8.1% |
| Micro & Small | 33.1% | 18.1% |
| Medium | 21.7% | 14.5% |
| Large | 8.9% | 3.2% |
| **Services** | 19.0% | 14.8% |
| NBFCs | 26.3% | 15.2% |
| Commercial Real Estate | 19.9% | 14.2% |
| Trade | 16.2% | 13.8% |
| **Personal Loans** | 16.2% | 14.8% |
| **Non-Food Bank Credit** | **15.9%** | **10.9%** |

*Source: RBI Bulletin, May 2026; Deployment of Gross Bank Credit by Major Sectors*

- **Industry credit nearly doubled its growth rate to 15.0% in FY26 from 8.1% a year ago, with infrastructure, engineering, chemicals, and textiles as lead drivers.** Within industry, the MSME segment has been the standout performer. **Micro and small enterprise credit grew 33.1% YoY and medium enterprises grew 21.7%, reflecting both PLI-related disbursements and working capital demand from an expanding manufacturing base. Large industry credit, at 8.9%, while more modest, has accelerated meaningfully from just 3.2% in FY25.**
- **Services credit accelerated to 19.0% YoY, powered by bank lending to NBFCs (26.3%), commercial real estate (19.9%), and trade (16.2%).** The NBFC channel is particularly important because it acts as a transmission mechanism for credit to reach segments that direct bank lending may not efficiently serve, including micro-LAP, used vehicle financing, and small-ticket retail.

## Agriculture credit held steady at 15.7%, broadly in line with the prior year.

The key takeaway from the sectoral composition is that this credit cycle is **investment-led rather than consumption-led. Industry and services together account for the bulk of the acceleration, while the unsecured consumer segments (credit cards, consumer durables) have been deliberately restrained. This is a healthier credit mix from a systemic risk perspective and a more productive one from a GDP multiplier standpoint.**

## The Factory Floor. Capacity at 75.6% and Warming, but Not Yet Overheating

The RBI's OBICUS survey for Q3 FY26 (October-December 2025) reported manufacturing **capacity utilization (CU) at 75.6%, up from 74.3% in Q2 FY26**. The trajectory has been gradually ascending. In seasonally adjusted terms, CU has been trending upward from the 73-74% range that prevailed through much of FY25, but it remains tantalisingly close to, yet still below, the **~75% threshold** that the RBI has consistently flagged as the trigger for fresh capacity creation.

### Manufacturing Capacity Utilization Trajectory:

| Q2 FY25 | Q3 FY25 | Q4 FY25 | Q1 FY26 | Q2 FY26 | Q3 FY26 |
|---|---|---|---|---|---|
| 74.2% | 75.4% | 76.8% | 74.1% | 74.3% | **75.6%** |

- The order-book detail paints a cautiously optimistic picture. **New orders rose 6.5% QoQ in Q2 FY26** (the latest available order data), reversing Q1's 4.6% decline, but pending orders fell, suggesting backlog-clearing rather than fresh structural demand. Finished-goods inventory grew as production outpaced absorption, and the **output gap remains around -5.2% in Q2 FY26**, indicating considerable slack still exists in the system.
- The April 2026 Monetary Policy Report cites improving manufacturing capacity utilization as a growth tailwind but stops short of declaring a positive output gap. The **Manufacturing PMI rose marginally in April 2026**, with new orders and output sustaining slow but positive momentum despite cost pressures from the West Asia conflict. The index of eight core industries witnessed an uptick in April, supported by cement, steel, and electricity production. Capital goods imports grew double-digit in April, signalling sustained capex momentum at the industrial level.
- The implication for the investment cycle is nuanced. At 75.6%, capacity utilization is at the door of the trigger zone but has not yet sustained above it for the two consecutive quarters that typically precede broad-based greenfield capacity additions. The current CU level supports **brownfield expansions and debottlenecking investments** rather than large-scale new plant construction. The transition from selective to broad-based private capex will require CU to sustain above 76-77% for at least two quarters, which, given the West Asia supply shock and its dampening effect on global demand, is unlikely before H2 FY27 at the earliest.

## The Capex Relay. Government Sprints, the Private Sector Jogs

- The Centre has been the primary engine of India's investment cycle over the past three years. **Real GFCF grew 7.8% in FY26** (as per the Second Advance Estimates), with the new GDP series placing **nominal GFCF at roughly 31.7% of GDP, the highest in over a decade**. Government capex is the visible driver behind this achievement.
- The Union Budget FY26 allocated Rs.11.21 lakh crore (3.1% of GDP) in direct capital expenditure, up over 10% from the previous fiscal year. CGA actuals through February 2026 show **Rs.9.3 lakh crore deployed, representing 79.7% of the revised estimate** and a 15% YoY increase over the April-February FY25 period. The execution was front-loaded in H1 FY26, with capex reaching 52% of Budget Estimates by October, a marked improvement from H1 FY25 when general elections had suppressed spending to barely 37% of BE.
- Roads (63% of BE absorbed in H1) and Railways (57%) led execution. **The FY27 Budget has raised the bar to Rs.12.20 lakh crore**, an 11.5% increase over the FY26 revised estimate of Rs.10.9 lakh crore, maintaining 3.1% of GDP. Effective capital expenditure, including grants for capital asset creation to states, is budgeted at Rs.17.15 lakh crore (4.4% of GDP) for FY27.

## Central Government Capital Expenditure Trajectory

| | FY24A | FY25 RE | FY26 BE | FY27 BE |
|---|---|---|---|---|
| **Centre Capex (Rs. Lakh Cr)** | 10.0 | 10.18 | 11.21 | **12.20** |
| **YoY Growth (%)** | 28.2% | 1.8% | 10.1% | **11.5%** |
| **Capex as % of GDP** | 3.2% | 3.0% | 3.1% | **3.1%** |
| **Fiscal Deficit (% of GDP)** | 5.6% | 4.8% | 4.4% | **4.3%** |

## Private Capex. Intentions Rising, Conversion Lagging

- **Private corporate investment intentions are improving but remain modest by historical standards. Bank-sanctioned projects** stood at **Rs.3.91 lakh crore in FY24**, the highest since FY15, with projected deployment of roughly **Rs.2.67 lakh crore in FY26 versus Rs.2.2 lakh crore in FY25. Infrastructure dominates at 50.6% of sanctioned projects, with Power and Roads leading.**
- However, at **0.8% of GDP, envisaged capex remains a fraction of pre-2013 magnitudes of 3-6%.** The financing channel has improved, with bank credit to industry growing 15.0% YoY and infrastructure and engineering as lead segments. **Capital-goods IIP grew 8.1% YoY in December 2025, capital-goods imports rose 9.2% in Q2 FY26**, and the **April 2026 Manufacturing PMI at 55.9** noted that firms explicitly cited capacity expansion and technology investment. **Corporate balance sheets are ready. Leverage has declined, cash buffers are sizeable, and interest coverage ratios are comfortable.**
- The constraint is not financial; it is conviction. **At 75.6% CU, most manufacturers can meet incremental demand through existing capacity optimization rather than greenfield investment. The announcement-to-execution pipeline requires CU to sustain above 76-77% for at least two consecutive quarters, clear order-book signals of durable demand, and resolution of the West Asia supply uncertainty**. State-level capex has also lagged, with only 38.3% of the combined annual budgeted capex of Rs.9.64 trillion utilized in the first eight months of FY26.

## The Regulatory Cycle. Tighten, Then Ease. Timing the Turn

The RBI has executed a textbook tightening-then-easing cycle over FY24-FY26, and understanding its sequencing is critical to assessing where the capex cycle stands.

- **The November 2023 risk-weight hikes (125% on unsecured personal loans, 150% on credit cards, 25 ppt add-on for bank-to-NBFC lending) successfully throttled the unsecured boom.**
- **The February 2025 rollbacks then restored the NBFC add-on and cut microfinance risk weights.**
- **The June 2025 Project Finance Directions replaced the punitive 5% construction-phase provisioning with 1.0-1.25%, removing a major friction from infrastructure lending.**
- **The April 2026 LCR norms replaced the originally proposed 5% digital-deposit run-off with 2.5%, unlocking an estimated Rs.2.7-3 lakh crore of lending capacity.**

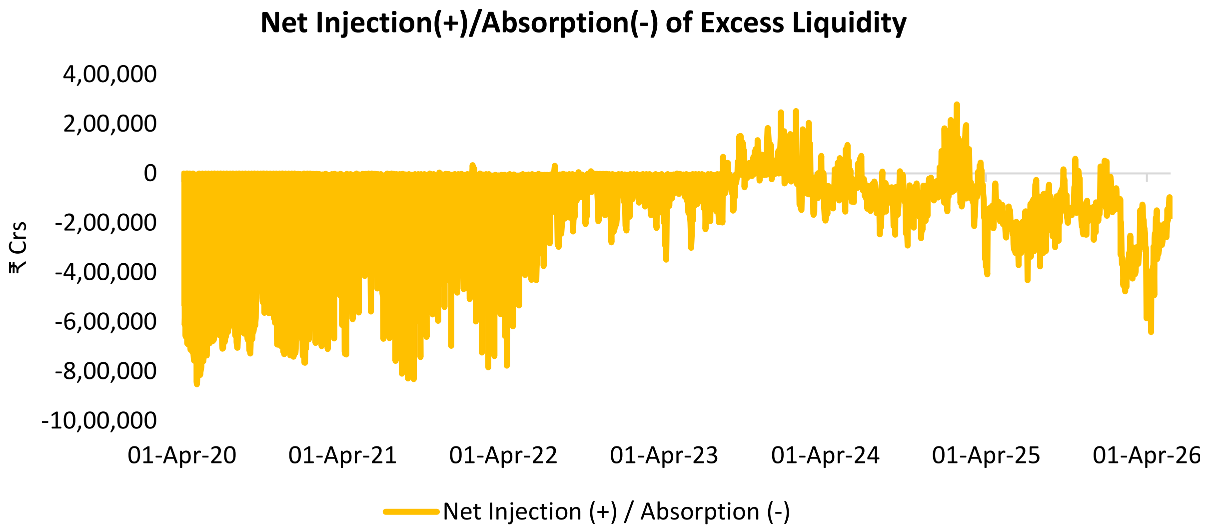
Asset quality provides the comfort for this easing. **System GNPA at 2.1-2.2% (September 2025) is a multi-decadal low and Net NPA at 0.5% is a record**. But the tail is concentrated. 53.1% of retail loan slippages originate in unsecured products, 76% of slippages at private banks come from unsecured exposure, and bank-NBFC interconnectedness is elevated with 80% of acquired pools sourced from a small set of originators. **Household debt at 41.3% of GDP sits above its five-year average. These are not imminent risks, but they define the boundary of how far the easing cycle can run**.

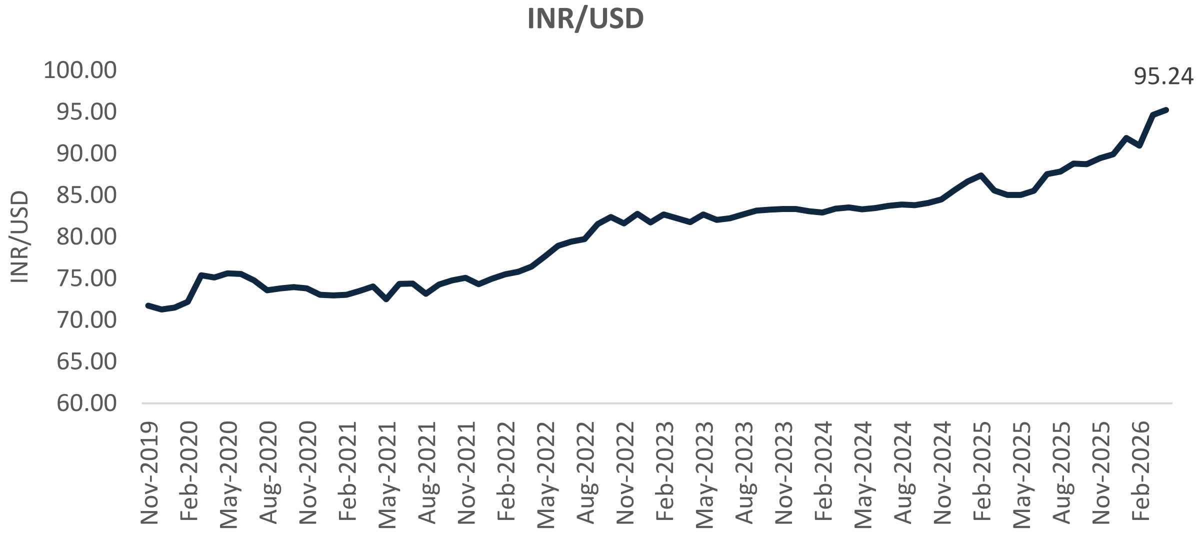
**The transmission of 125 bps of rate cuts has been robust on the lending side. EBLR has passed through the full 125 bps,** the 1-year median MCLR has declined 60 bps, and the WALR on fresh rupee loans has fallen 93 bps (80 bps on outstanding loans). The pass-through to deposit rates, at 55 bps on fresh and 47 bps on outstanding, remains less complete and is likely to stay so as bulk deposit rates firm up. The spread between the 3-month commercial paper and 91-day Treasury bill widened from 158 bps in April to 205 bps in May 2026, signalling rising funding pressure.

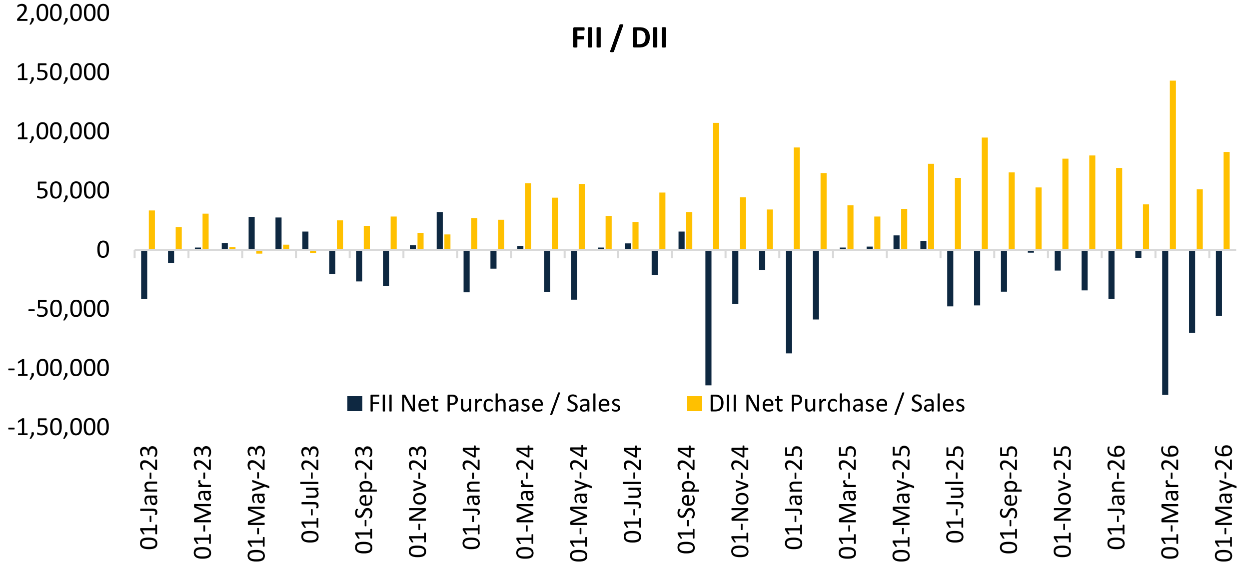
## Where This Is All Heading. The Capex Puzzle Comes Together in H2 FY27

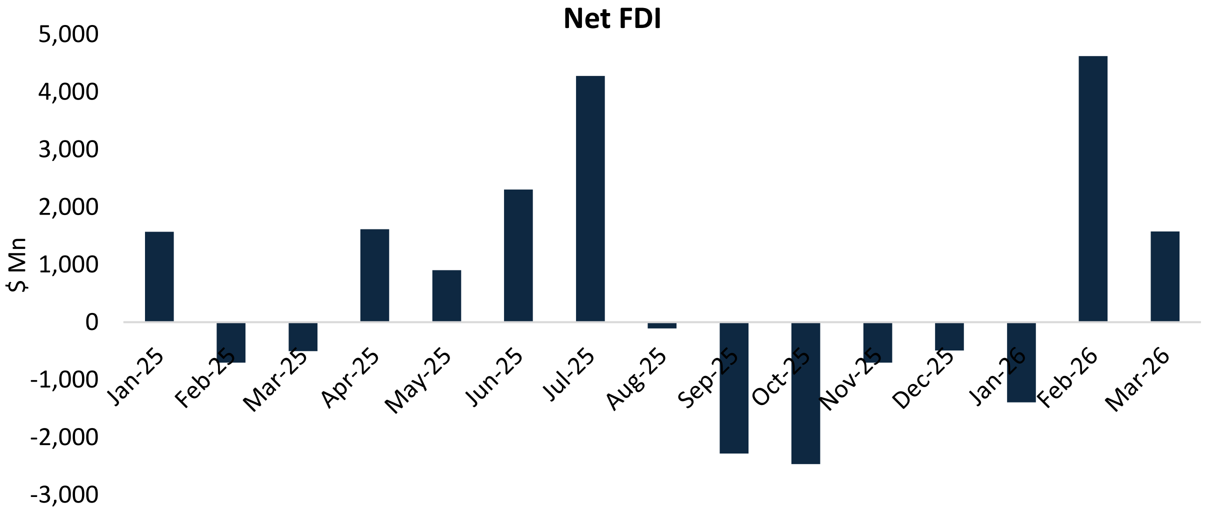
- **The Indian economy's investment cycle is in a healthy early-expansion phase, but it is not yet a self-sustaining private capex boom. The pieces are assembling. Credit supply is abundant and flowing to the right sectors. The regulatory architecture has shifted from tightening to selective easing. Government capex execution is on track. Corporate balance sheets are strong. But the binding constraint is not credit supply; it is credit demand from a private sector still waiting for capacity utilization to cross the trigger threshold.**

# 5. Liquidity

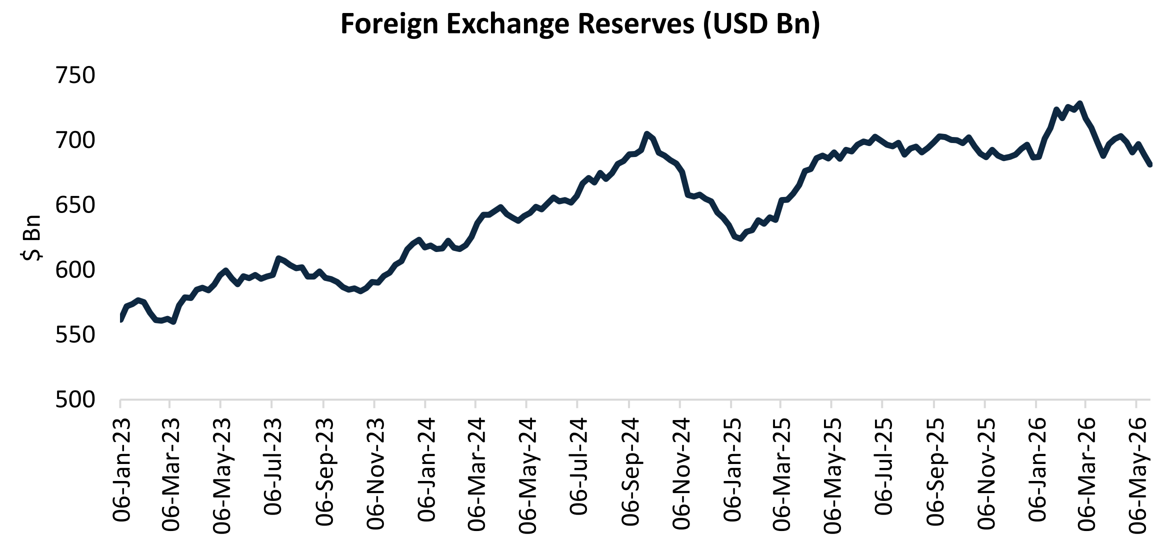


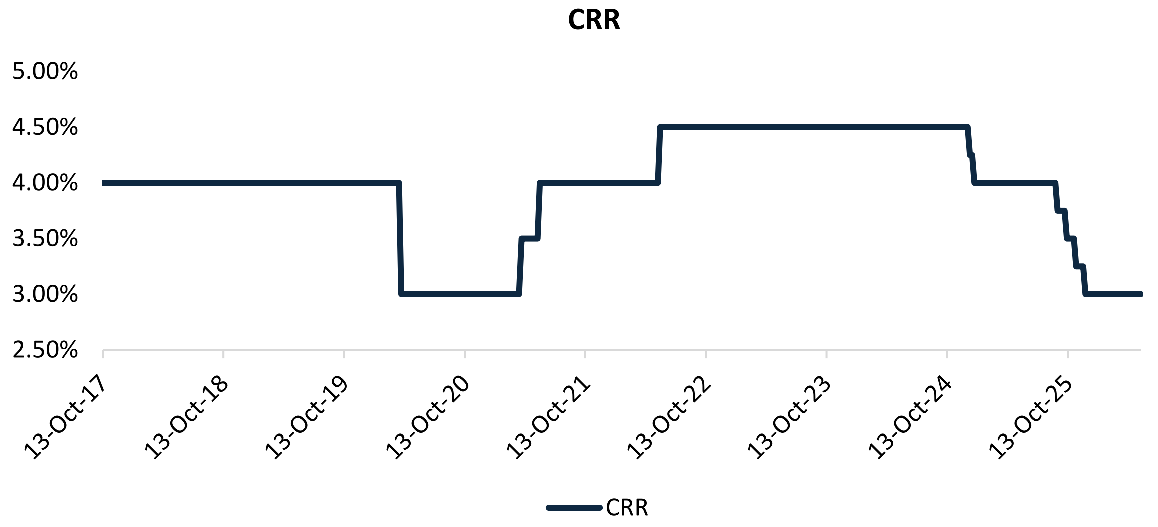



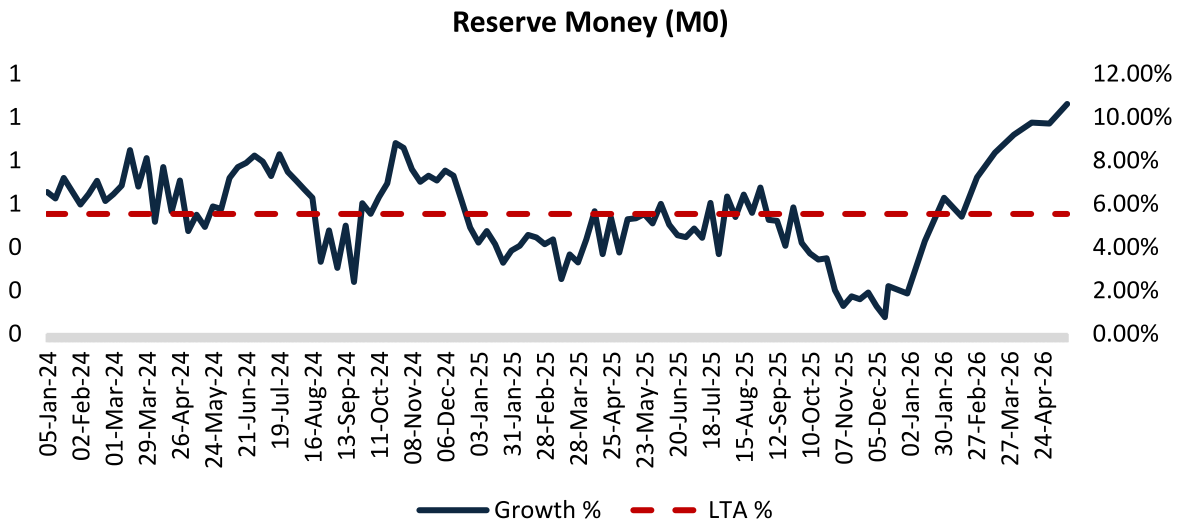



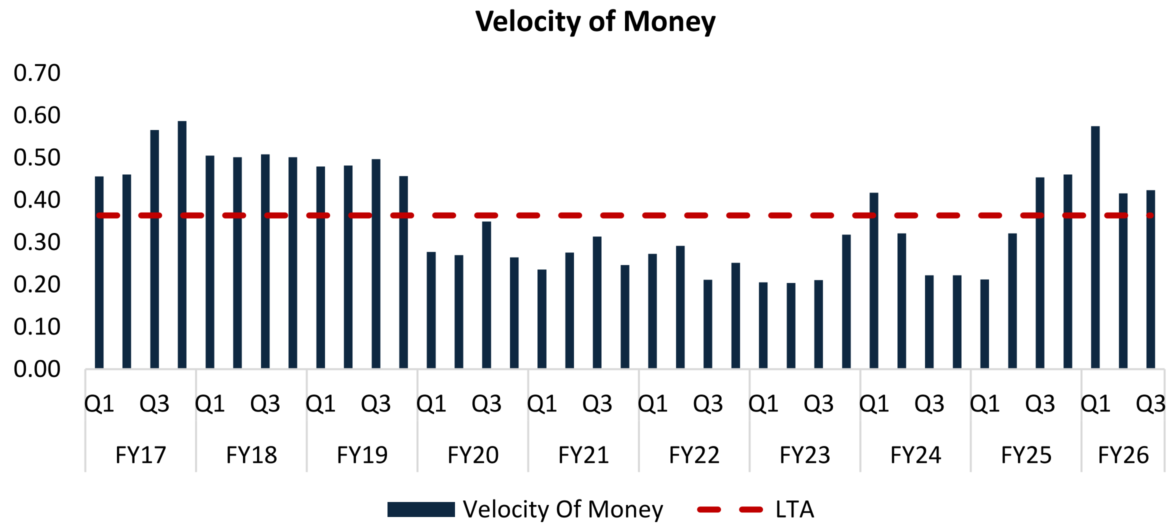




*Source: Internal assessment based on RBI DBIE data*




*Source: Internal assessment based on RBI DBIE data*

## Liquidity, Capital Flows & External Sector

125 bps of Cuts Delivered, but Transmission Hits Friction as FPI Exodus Meets Rupee Defence. The RBI Is Running Two Engines in Opposite Directions.

### Liquidity & External Sector Dashboard

| Indicator | Latest | Prior Period | Trend |
|---|---|---|---|
| **Net LAF Absorption** | **Rs.2.11 L Cr (May 21)** | Rs.3.94 L Cr (Apr) | Tightening |
| **WACR** | **5.21% (May avg)** | 5.13% (Apr avg) | Above Repo |
| **INR/USD** | **~95.24 (May avg)** | ~94.65 (Apr avg) | Depreciating |
| **Forex Reserves** | **$681.4 Bn (May 22)** | $688.9 Bn (May 15) | Declining |
| **Net FDI (FY26)** | **$7.7 Bn (FY26)** | $1.0 Bn (FY25) | Sharp Recovery |
| **FPI Equity Flows (CY26 YTD)** | **-Rs.2.25 L Cr** | -Rs.1.66 L Cr (CY25) | Record Outflow |
| **DII Ownership** | **18.9%** | FPI at 14.7% | DII > FPI (1st) |
| **Reserve Money (CRR-adj, YoY)** | **11.2% (Apr 30)** | 10.9% (Mar 30) | Expanding |
| **Money Supply M3 (YoY)** | **12.0% (Apr 30)** | 13.0% (Mar 31) | Moderating |
| **CP-Tbill Spread (3M)** | **205 bps (May)** | 158 bps (Apr) | Widening |

### The Plumbing. System Liquidity Tightens as the Credit Engine Outpaces Deposits

- Surplus system liquidity moderated sharply in May. **Daily average net LAF absorption fell to Rs.2.11 lakh crore (up to May 21) from Rs.3.94 lakh crore in April, as currency in circulation picked up (+11.6% YoY, double-digit since December 2025)** and government spending stabilised. Standing deposit facility balances declined to Rs.2.25 lakh crore from Rs.3.77 lakh crore. The RBI conducted six fine-tuning VRR auctions in May, cumulatively injecting Rs.1.57 lakh crore against a notified Rs.6.0 lakh crore, the tepid bid-cover highlighting that the system's liquidity needs are real but unevenly distributed.
- The friction is now visible in money market rates. **WACR averaged 5.21% in May versus 5.13% in April, breaching the policy repo rate on May 11 and May 21** for the first time since the easing cycle began. **The 3-month CP-Tbill spread widened from 158 bps to 205 bps, the sharpest move in FY27, signalling rising funding stress among non-bank borrowers**. CD issuances, already at record Rs.14 trillion in FY26, are accelerating further. The RBI announced a **$5 billion USD/INR 3-year buy/sell swap on May 26 to inject durable rupee liquidity**, a creative tool that adds to domestic liquidity without depleting dollar reserves. The signal is clear. **125 bps of rate cuts have been delivered, but the transmission machinery is encountering friction as the credit-deposit gap (16.0% versus 12.3%) forces banks into expensive wholesale funding**.

### The External Account. Reserves Draw Down, the Rupee Bends, but the Balance of Payments Holds

- **Forex reserves fell to $681.4 billion as of May 22, 2026** (weekly decline of $7.5 billion), driven by a $4.5 billion drop in gold valuations and a $2.9 billion drawdown in foreign currency assets from active RBI intervention. Reserves are down from the $704.9 billion all-time high of September 2024, but the composition is strengthening. **Gold reserves rose to 880.52 metric tonnes, with gold's share at 16.7% of total reserves (up from 13.9% in September 2025) and 77% stored domestically**. Import cover remains comfortable at 10+ months. The RBI's FY26 forex transaction gains jumped 52% YoY to Rs.1.69 trillion, reflecting the scale of currency market intervention required to smooth rupee volatility.
- **The rupee depreciated in May, pressured by elevated crude ($100+ Brent), persistent FPI outflows, and a firming dollar**. The RBI has been managing the descent rather than resisting it, allowing gradual depreciation to preserve reserve adequacy while preventing disorderly moves. On the capital account, **gross FDI inflows surged to $94.5 billion in FY26 from $80.6 billion in FY25, with net FDI recovering to $7.7 billion from just $1.0 billion**. Net FDI remained positive in March for the second consecutive month, supported by lower repatriation and reduced outward FDI. **The improvement in net FDI provides a structural counterbalance to portfolio outflows and supports the overall balance of payments**.

## The Ownership Shift. FPIs Exit, DIIs Step In, and the Market Structure Changes Permanently

- **FPIs remained net sellers for the third consecutive month in May, pulling out Rs.32,963 crore from equities** (April. Rs.60,847 crore, March. Rs.1,17,775 crore). Total CY2026 equity outflows have reached approximately Rs.2.25 lakh crore, the worst calendar year since foreign portfolio investing was permitted in 1993. West Asia tensions, Brent above $100, global risk-off rotation towards AI-linked US equities, and elevated US Treasury yields are the primary drivers. **FPI ownership in Indian listed stocks has fallen to a 14-year low of 14.7%**, dropping below DII ownership (18.9%) for the first time in recent history.
- The domestic institutional counterweight has been decisive. Mutual fund SIP inflows averaging Rs.24,000+ crore per month and insurance company deployments have absorbed the FPI selling, preventing a sharper market correction. The Sensex rebounded from ~73,000 in late March to ~80,000+ by late April before settling near 75,000-76,000 in May. This structural shift from FPI-dominated to DII-anchored market microstructure is arguably the most significant development in India's capital markets in the past decade, reducing external vulnerability and lowering the volatility transmission from global risk events.

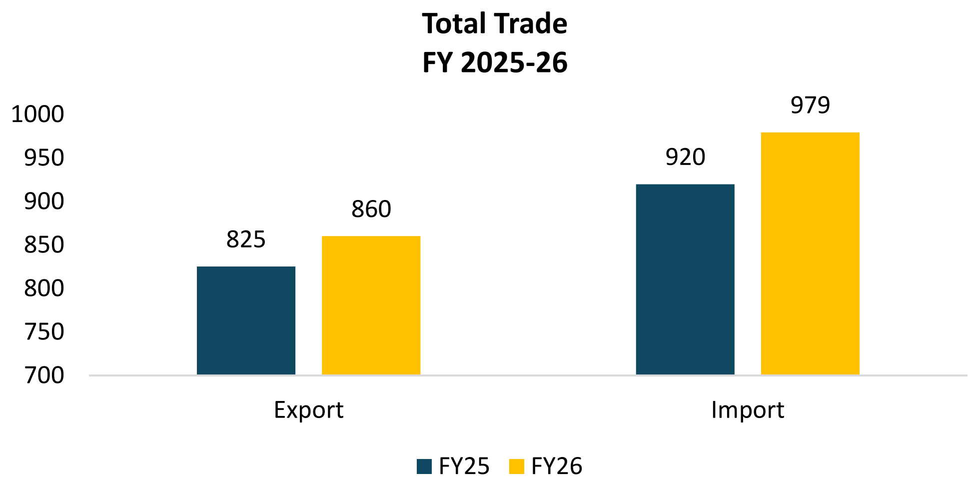
## Base Money. The Liquidity Pipeline Is Full, but the Multiplier Is Constrained

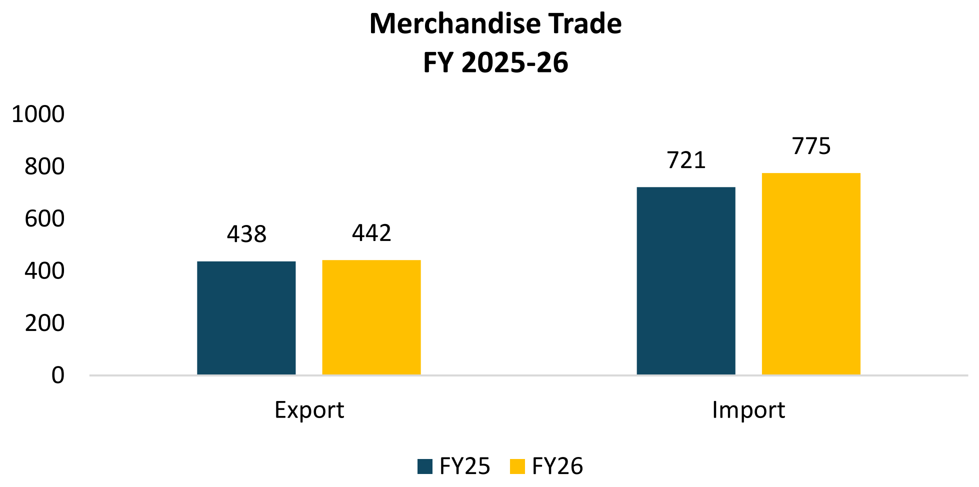
- **Reserve money (CRR-adjusted) grew 11.2% YoY as of April 30, 2026** (up from 10.9% at end-March), with currency in circulation at 11.6% YoY, sustaining double-digit expansion since December 2025. Factors driving elevated CiC include higher rural cash withdrawals linked to welfare disbursements and rising precious metal prices, alongside the run-up to assembly elections in five states. **Money supply (M3) grew 12.0% YoY as of April 30**, moderating from 13.0% at end-March. The reserve money expansion confirms that the RBI's cumulative liquidity injection (125 bps CRR cut releasing Rs.2.5 lakh crore, OMO purchases, VRR auctions, and now the $5 billion swap) is feeding through to base money growth. However, the money multiplier remains constrained by the banking system's funding squeeze, with the **credit-deposit ratio at 81.4% limiting banks' ability to expand credit without proportionate deposit mobilisation.**

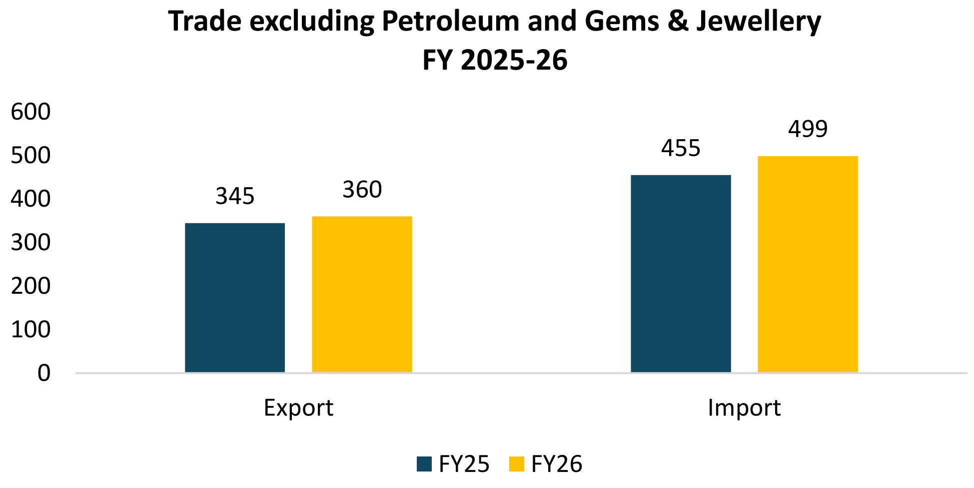
## What Comes Next. The RBI's Tightrope Walk Continues

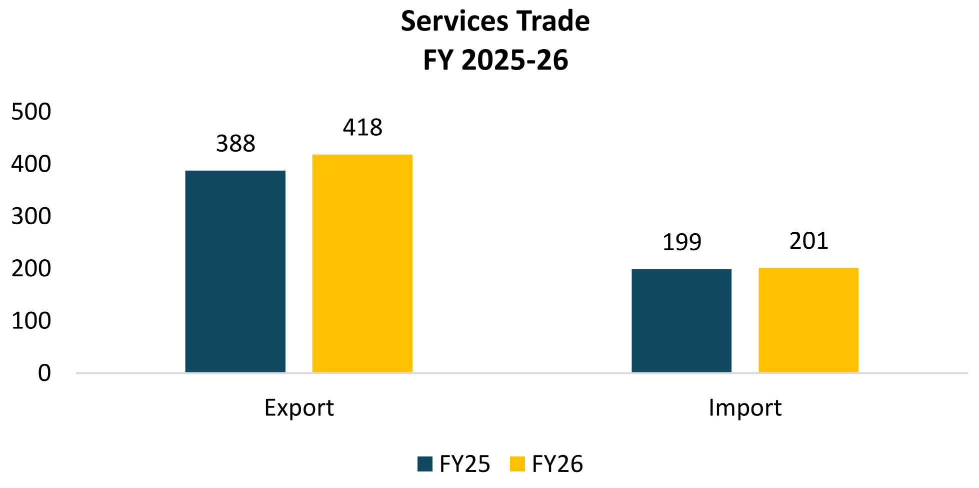
- The RBI faces its most complex policy trade-off since the pandemic. On one side, it needs to keep liquidity supportive to ensure the 125 bps of rate cuts transmit fully into lending rates and credit growth. On the other, rupee defence against FPI outflows and crude-driven current account pressure is draining reserves and tightening short-end rates. The $5 billion swap is a creative solution that injects rupee liquidity without selling dollars, but it is a bridge, not a permanent fix.
- **We expect the MPC to hold at 5.25% through at least June 2026, with one additional 25 bps cut possible in H2 FY27 if crude stabilises below $100 and the monsoon delivers normally. The CDR at 81.4% and widening CP-Tbill spreads suggest that the quantity of liquidity is adequate but its distribution is becoming increasingly uneven, with private banks and small finance banks running significantly tighter than public sector banks. FPI outflows are likely to moderate in H2 as valuations correct (Nifty trailing PE has fallen from 23x to ~19x) and India's growth premium versus emerging markets reasserts itself. The Rs.12 lakh income-tax exemption and a potential crude correction post-ceasefire could trigger a sentiment reversal. DII flows remain the structural anchor, and the FPI-to-DII ownership transition is now irreversible in any near-term scenario.**

# 6. Trade




Source: RBI, PIB

## USD 80.80 Billion and Counting — But at What Cost?

- **India opened FY27 with a statement. Overall exports surged 13.6% YoY to USD 80.80 billion in April 2026, with merchandise and services both printing double-digit growth. The overall trade deficit narrowed sharply to USD 7.81 billion from USD 11.16 billion a year ago. But the merchandise gap tells a different story — it widened to a three-month high of USD 28.38 billion, as imports climbed 10% YoY to a six-month peak of USD 71.94 billion. We read this as a tale of two currents: strong export momentum, and a gold-and-oil import surge that has forced the government into emergency tariff action**.

## Exports Hit a Four-Year Monthly High — Electronics and Petroleum Lead the Charge

- **Merchandise exports rose 13.8% YoY to USD 43.56 billion in April**, a four-year monthly high. This is the strongest opening month for any fiscal year since April 2022, and a sharp improvement from March 2026's USD 38.92 billion. **Two sectors drove roughly half the incremental gain: petroleum products and electronic goods**.
- Petroleum product exports jumped 34.7% YoY to USD 9.59 billion, up from USD 7.12 billion in April 2025. The increase was driven by **elevated global product cracks and higher refining throughput**, **even as crude import volumes declined**. Our read is that Indian refiners — running at near-peak utilisation — are capturing a favourable spread between discounted crude procurement and elevated global product prices, a dynamic amplified by the West Asia supply squeeze.
- Electronic goods exports surged 40.3% YoY to USD 5.18 billion, up from USD 3.69 billion. This is the clearest validation yet of the **PLI-driven manufacturing buildout**. Mobile phones, consumer electronics, and smart devices are scaling rapidly, with exports now reaching markets across Asia, Africa, and Europe**. Electronics has moved from the 7th-largest export category in FY22 to the 3rd-largest, and is on track to overtake gems and jewellery as the second-largest export vertical behind petroleum within the next two years**.
- Engineering goods exports rose to USD 10.35 billion from USD 9.52 billion, posting steady 8.7% YoY growth. This category — machinery, auto components, industrial equipment — remains the ballast of India's export base. We also note strong performances in meat, dairy, and poultry products (up 48% YoY), marine products, and handicrafts, signalling broadening **diversification in the export basket**.
- **Non-petroleum merchandise exports grew 9.0% YoY in April, confirming that the headline number is not merely a commodity-price artefact. The breadth of this growth — spanning electronics, engineering, agriculture, and processed food — is the most encouraging aspect of the print**.

## Imports Surge on Gold and Electronics — Crude Declines, but the Bill Stays Elevated

- **Merchandise imports climbed 10.0% YoY to USD 71.94 billion, the highest reading for any April on record and a six-month peak. The composition, however, is uneven. Gold and electronics drove the bulk of the increase, while crude oil imports actually declined in volume terms**.
- Gold imports surged 81.7% YoY to USD 5.63 billion, up from USD 3.10 billion in April 2025. Silver imports more than doubled to USD 411 million. We stress that this is **predominantly a price story rather than a volume story**. International gold prices rose roughly 50% through FY26, and physical demand in quantity terms actually declined. The unit value of gold imports has risen from approximately USD 76,600 per kg to nearly USD 99,800 per kg. Nonetheless, the pace of the inflow clearly alarmed policymakers — the government hiked the effective import duty on gold and silver from 6% to 15% on 13 May, a sharp reversal of the July 2024 reduction.
- **Electronic goods imports rose 38% YoY to USD 12.78 billion, up from USD 9.25 billion. This is the flip side of the electronics export story: India is assembling and exporting smartphones and consumer electronics at scale, but components and sub-assemblies are imported almost entirely from China. Until a domestic component supply chain materialises, growth in electronics exports will be accompanied by parallel growth in electronics imports. The net electronics trade balance remains deeply negative**.
- Petroleum, crude, and products imports declined approximately 10% YoY to USD 18.63 billion, likely reflecting lower LPG imports and some substitution effects. However, elevated crude prices — the Indian basket was averaging above USD 100 per barrel in March — mean the per-unit cost remains punishing. The Strait of Hormuz blockade has complicated procurement logistics, even if headline volumes have moderated.
- Non-petroleum, non-gems and jewellery imports rose 19.3% YoY, reaching approximately USD 45 billion. Within this, coal and coke imports edged up 2.4% to USD 2.8 billion, vegetable oil imports stood at USD 1.7 billion, and chemical material imports declined 35%. The broad-based rise in non-commodity imports suggests genuine demand-side strength in the domestic economy.

## Geography of Trade: Singapore Triples, UAE Crumbles, China Keeps Climbing

- **The US remained India's largest export destination in April, with exports at USD 8.48 billion** — up marginally from USD 8.38 billion a year earlier. The near-flat trajectory reflects the overhang of the temporary 10% tariff imposed in late February 2026 alongside standard MFN rates. Imports from the US fell 4.7% to USD 5.27 billion, leaving India with a bilateral surplus of USD 3.21 billion.
- **The most striking country-level datapoint is Singapore. Exports nearly trebled to USD 3.20 billion from USD 1.14 billion in April 2025, a 179% YoY surge. We believe this partly reflects rerouting dynamics as supply chains recalibrate around the Hormuz disruption, and partly genuine trade diversification toward ASEAN markets**. Exports to Sri Lanka surged 214%, to Tanzania 157%, and to Bangladesh 64%, underscoring a structural eastward and southward pivot in India's export geography.
- **China remained India's largest source of imports, with inbound shipments rising 20.9% YoY to USD 11.97 billion. Merchandise exports to China rose 27% to USD 1.77 billion. The bilateral deficit with China continues to widen** — we estimate it at approximately USD 10.2 billion for April alone. For full-year FY26, India's trade deficit with China hit a record USD 112.16 billion, with bilateral trade reaching USD 151.1 billion. **China displaced the US as India's largest trade partner in FY26 for the first time in four years.**
- **Trade with the UAE came under severe pressure. Both exports and imports declined by more than 30% YoY in April, a direct consequence of the Strait of Hormuz blockade**. Exports to the UAE fell to USD 2.19 billion from USD 3.43 billion. This is the clearest trade-flow casualty of the ongoing West Asia conflict, and given that the UAE is India's second-largest export market in normal times, the sustained disruption is a material headwind.

## Services Continue to Anchor the External Account

- **Services exports are estimated at USD 37.24 billion in April, up 13.4% YoY from USD 32.85 billion. Services imports edged lower to USD 16.66 billion from USD 16.91 billion, yielding a services trade surplus of USD 20.58 billion. This surplus offset 72% of the merchandise trade deficit in April, and continues to be the single most important structural buffer in India's external account**.
- The services surplus is **dominated by IT and IT-enabled services, consulting, and financial services** — sectors that benefit from the accelerating global demand for technology-driven solutions and digital transformation. We note that services exports at USD 418.31 billion in FY26 have now reached 94.7% of merchandise exports at USD 441.78 billion. That ratio, approaching parity, is reshaping how India's external balance is understood. India is no longer simply a merchandise-trade-deficit economy; the services surplus is structural, recurring, and growing.
- Final services trade data for April will be released by the Reserve Bank later this month. The numbers above are Commerce Ministry estimates.

## The Gold Tariff Reset: Necessary, but Insufficient

- **The government's decision on 13 May to hike the effective import duty on gold and silver from 6% to 15% is the most consequential trade-policy action of the month. It follows the Prime Minister's public appeal to citizens to avoid purchasing gold for a year — a rare step that underscores the severity of the external-balance pressure.** In FY26, India imported gold worth approximately USD 72 billion, more than double the import bill in FY23.
- We are sceptical that the tariff increase alone will materially curb gold demand. Indian gold consumption is driven by deep-rooted social, cultural, religious, and economic factors that are unlikely to shift because of a duty change. On the investment side, gold is viewed as a store of value and an inflation hedge, and pure investment demand has been rising — ETF demand for gold surged from approximately 7 tonnes in Q1 CY2025 to 20 tonnes in Q1 CY2026. Some investment demand may be tempered by the expectation that the duty hike could be reversed once conditions improve, which would erode the value of holdings at the higher tariff.
- **The more important concern is the structural one. Higher duties encourage smuggling.** Revenue intelligence agencies reported a considerable decline in gold seizures in FY25 after the government reduced duty in July 2024; the reverse can now be expected. Additionally, under the India–UAE Comprehensive Economic Partnership Agreement, India is committed to gradually reducing silver import duty to zero over a ten-year period, and gold can be imported at a tariff one percentage point below the MFN rate. The share of the UAE in India's gold imports more than doubled between FY23 and FY25, and more imports are likely to be routed through this preferential channel.

- In our view, gold imports must be treated as a structural factor in India's external account, not a cyclical one amenable to tariff fixes. The sovereign gold bond programme did not succeed in materially shifting demand. A more fundamental approach — reducing financial repression, allowing market-determined interest rates, and deepening financial inclusion — could help divert investment demand away from gold over time. Banks are currently mandated to invest in government bonds under the statutory liquidity ratio, which artificially suppresses market interest rates. Better real returns on financial savings would be a more durable solution than tariff escalation.

## Hormuz and the West Asia Overhang: FY27's Defining Risk

- **The Strait of Hormuz disruption is the single largest exogenous risk to India's trade trajectory in FY27. Approximately one quarter of global seaborne oil trade passes through the Strait, along with significant LNG and fertiliser volumes. Military escalation has disrupted shipping flows, raised insurance premiums, and extended transit times. India's trade with the UAE — both exports and imports — has already contracted by over 30% YoY, and crude oil procurement logistics remain strained even where headline import volumes have moderated**.
- **For FY26 as a whole, the war arrived too late — in the final month — to significantly impact the full-year numbers**. The provisional FY26 data shows total exports at a record USD 860.09 billion (up 4.2% YoY) and total imports at USD 979.40 billion (up 6.5%). The merchandise trade deficit widened to USD 333.19 billion from USD 283.50 billion in FY25, but the services surplus of USD 213.89 billion (up 13.3% YoY) offset 64% of this. **The full impact of the conflict on shipping costs, crude prices, and trade route recalibration will be an FY27 story**.
- **Indian exporters are already responding. The sharp increase in exports to Singapore, Sri Lanka, Bangladesh, Vietnam, Hong Kong, and Malaysia signals a deliberate diversification away from Gulf-dependent corridors. The Commerce Secretary has indicated that the government will work with exporters to deliver 10–15% export growth this year, leveraging recently concluded trade agreements and the Export Promotion Mission. In the uncertain global environment, we expect India's share of recalibrating global supply chains to rise — the question is whether this offsets the Hormuz drag**.

## FY26 in Retrospect: A Record Year, but the Cracks Are Widening

- The full-year FY26 numbers provide important context. Total trade (merchandise and services) reached a record USD 863.1 billion in exports and approximately USD 979 billion in imports. Merchandise exports grew a modest 0.93% to USD 441.78 billion, while services exports rose 7.94% to USD 418.31 billion. **Services are now doing the heavy lifting: the services-to-merchandise export ratio is at an all-time high**.
- Within merchandise, the FY26 story was one of structural shifts rather than headline growth. Petroleum product exports fell 15.0% YoY, reflecting lower global crude prices through most of the year depressing per-unit realisations. Electronics rose 24.4% and is now the fastest-growing large export category. Pharma and chemicals were broadly stable. Gems and jewellery and textiles faced headwinds from US tariffs and weak European demand. On the import side, gold imports rose 24.1% to USD 71.98 billion on prices (quantity fell from 757 tonnes to 721 tonnes), while electronic goods imports rose 17.8% to USD 116.2 billion alongside the export buildout. Petroleum imports fell 6.4% to USD 174 billion, benefiting from discounted Russian crude through most of the year.
- China emerged as India's largest trade partner in FY26, displacing the US after a four-year gap. Bilateral trade with China reached USD 151.1 billion versus USD 140.2 billion with the US. The trade deficit with China hit a record USD 112.16 billion. This is the most structurally significant development in the trading-partner data, and it reflects the deep electronics-component dependency that will take years to unwind.

## Outlook: Momentum Is Real, but the Path to USD 1 Trillion Is Not Straight

- The government's target of USD 1 trillion in total exports for FY27 is ambitious but not implausible from an April base rate of USD 80.80 billion per month. However, the path is far from straight. On the positive side, electronics exports are scaling rapidly and will likely cross USD 60 billion this fiscal year. Services growth remains robust and globally competitive. The diversification of export markets toward Southeast Asia, South Asia, and Africa provides resilience against Gulf disruptions. The weak rupee, while inflationary, provides a competitive tailwind for exporters.
- On the risk side, the Hormuz disruption remains the single biggest wild card. If the blockade persists or escalates, crude prices above USD 100 per barrel will compress refining margins, raise the import bill, and erode the current account position. Gold imports may moderate following the duty hike, but we do not expect a dramatic decline given the structural nature of demand. The US tariff overhang on Indian goods adds further uncertainty. The rupee has come under pressure, and the Reserve Bank's intervention capacity, while substantial, is not unlimited.
- For our clients, the key variables to monitor over the next quarter are: the crude oil trajectory (the Indian basket above USD 100 per barrel is the stress threshold), progress on Hormuz normalisation, the pace of electronics import substitution, the gold import response to the duty hike, and the Reserve Bank's forex intervention posture. The Commerce Secretary's preliminary comment that May trends are encouraging is a positive signal, but one month does not make a trend. We maintain a cautiously constructive view on India's FY27 trade trajectory, with the strong services surplus and export diversification providing structural support against near-term geopolitical headwinds.

# 7. Fiscal Situation

**India Fiscal Pulse. FY26 Closes Clean, but FY27 Faces a Rs.1.3 Trillion War Bill** - The Centre Hit Its 4.4% Target Through Expenditure Compression and a GDP Rebasing Tailwind. Now the West Asia Conflict Threatens a 40 bps Slippage to ~4.7% in FY27, Unless Buffers Hold.

**FY26 Provisional Actuals vs. FY27 Budget. The Fiscal Scorecard**

| Metric | FY26 BE | FY26 RE | FY26 PA (CGA) | FY27 BE |
|---|---|---|---|---|
| **Fiscal Deficit (Rs. Trillion)** | 15.69 | 15.58 | **15.19** | 16.13 |
| **Fiscal Deficit (% of GDP)** | 4.4% | 4.4% | **4.4%** | 4.3% |
| **Net Tax Revenue (Rs. Trillion)** | 31.29 | — | **33.00** | 34.20 |
| **Total Expenditure (Rs. Trillion)** | 50.65 | 49.60 | **49.00** | 53.18 |
| **Capital Expenditure (Rs. Trillion)** | 11.21 | 10.90 | 10.18 | **12.20** |
| **Revenue Deficit (% of GDP)** | 1.5% | — | ~1.4% | 1.3% |
| **Our FY27 Estimate (% of GDP)** | | | | **~4.7%** |

*Source: CGA Provisional Actuals (June 1, 2026); Union Budget FY27; Kilika estimates*

## FY26 Closes Better than Expected but Read the Fine Print

- The CGA's provisional actuals released on June 1 confirm that the Centre closed FY26 with a **fiscal deficit of Rs.15.19 lakh crore, 4.4% of GDP, exactly in line with the revised estimate**. At 97.5% of RE, the outcome was Rs.0.4 trillion tighter than the RE target. This was achieved through **Rs.0.6 trillion of expenditure compression** versus RE, with total expenditure pared from the original BE of Rs.50.65 trillion all the way down to Rs.49.0 trillion through the year. On the revenue side, **net tax receipts reached Rs.33.0 trillion (up from Rs.30.87 trillion in FY25), a solid 7% YoY improvement**, though personal income tax collections fell short by Rs.0.6 trillion from budgeted levels.
- Two accounting items deserve attention. First, **fertiliser subsidy payouts overshot by Rs.0.2 trillion on large March transfers**. Second, **Rs.1.0 trillion was allocated to the Economic Stabilisation Fund (ESF), a new contingency reserve that provides a fiscal buffer for FY27**. Without the expenditure compression, the fiscal deficit ratio would have printed at 4.5%, breaching the target. **A downward revision in nominal GDP under the new 2022-23 GDP series provided an additional tailwind by mechanically lowering the denominator. The bottom line is that FY26 was a managed landing, not an organic one. The deficit target was met through deliberate spending cuts and favourable statistical revisions rather than revenue outperformance.**

## April FY27 Opens on a Sombre Note - The Deficit Has Already Doubled

- The first month of FY27 delivered a **fiscal deficit of 21.4% of the full-year budgeted target**, nearly double the April FY26 reading. The deterioration was driven by a YoY contraction in both tax and non-tax revenues combined with a **sharp front-loaded expansion in revenue and capital spending. Capital expenditure has been deliberately accelerated to offset any potential disruption from the West Asia conflict later in the year**, a strategy the government employed successfully in FY26 when it executed 52% of capex BE by October. While a single month's data should not be overread, the directional signal is clear. FY27's fiscal arithmetic starts on a weaker footing than FY26.

## The West Asia Invoice - Rs.1.3 Trillion of Fiscal Risk at $95 Crude

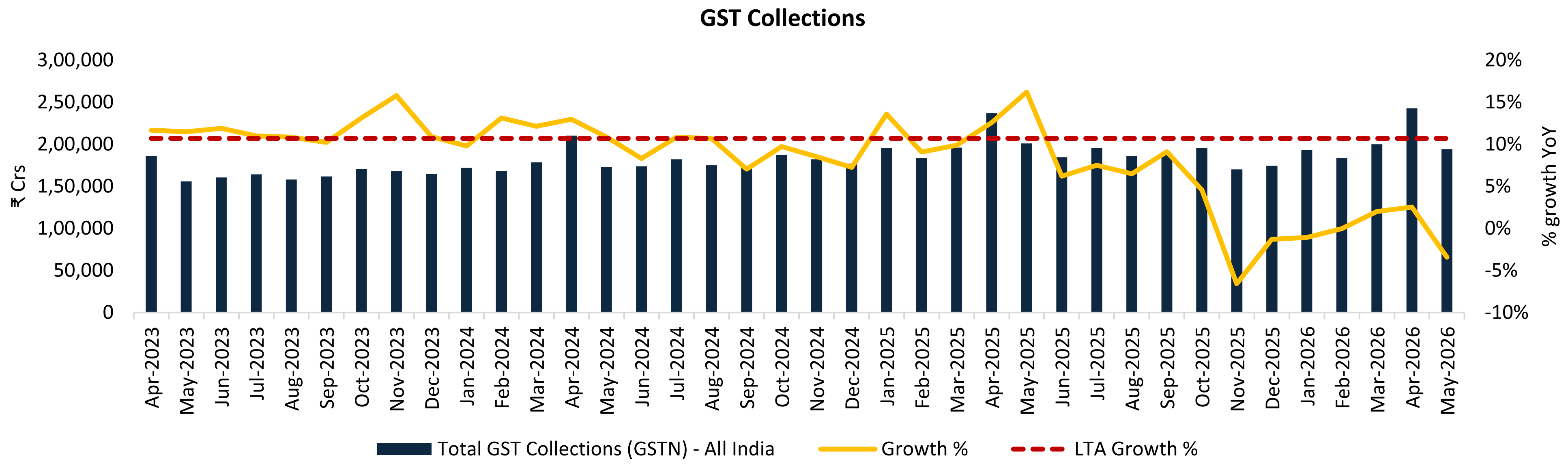
- The West Asia conflict has introduced multiple fiscal pressure points, each compounding the other. We estimate the net fiscal impact at **approximately Rs.1.3 trillion at an assumed average crude of $95/barrel in FY27 (declining to ~$80 in H2), translating to a fiscal slippage of ~30 bps. An additional ~10 bps of slippage arises from lower nominal GDP relative to the Budget assumption.** The pressure channels are as follows:
- **Excise duty erosion (Rs.1.1 trillion)** - The cumulative Rs.7.5/litre hike in petrol and diesel RSPs has been relatively modest. At sustained crude above $95, OMCs will continue to absorb losses, reducing their dividend and corporate tax payouts to the Centre. The FY26 shortfall in personal income tax (Rs.0.6 trillion) has steepened the embedded PIT growth target for FY27 to 17.7% (versus the 11.5% budgeted), a tall ask in a slowing nominal GDP environment. Corporate tax collections are also at risk as elevated input costs compress manufacturing margins.
- **Fertiliser subsidy overshoot (Rs. 0.5 trillion+)** - The revised NBS rates notified for Kharif FY27 remain inadequate given the surge in ammonia and sulphur prices. Unless the industry sharply raises retail prices (politically unlikely ahead of state elections) or subsidy rates are revised upward, profitability of fertiliser producers will deteriorate. Given the Centre's focus on ensuring fertiliser availability, additional allocations during the year appear inevitable.
- **LPG and energy subsidies**. Elevated energy prices will also necessitate budgetary support for LPG. While precise quantum is difficult to estimate, the direction is unambiguously upward and could add Rs.0.2-0.3 trillion to the subsidy bill depending on crude's trajectory.

## The Buffers. Gold Duty, the ESF, and the Small Savings Windfall

- The picture is not entirely bleak. Three identifiable buffers partially offset the war bill. First, the **sharp hike in customs duty on gold and silver is expected to boost collections by Rs.0.5 trillion in FY27**, a direct beneficiary of the domestic gold price surge (gold crossed Rs.1.79 lakh per 10g in January 2026). Second, the **Rs.1.0 trillion ESF created in March 2026** provides a sizeable contingency reserve to absorb the initial hit from tax shortfalls or subsidy overshoots. Third, FY26 provisional actuals reveal a **Rs.1.0 trillion overshoot in small savings inflows**, which increased the Centre's cash balances instead of the drawdown envisaged under the RE. This carry-forward of cash may prevent market borrowings from materially exceeding budgeted levels in FY27 despite the fiscal slippage, offering significant relief to the bond market.
- Additionally, the Centre has consistently generated expenditure savings across ministries and departments, a pattern that may repeat in FY27 if the West Asia conflict constrains discretionary spending. **The capex target of Rs.12.20 lakh crore may see a modest undershoot of Rs.0.3-0.5 trillion if execution slows in H2 due to input cost inflation and supply chain disruptions.**

## Where This Lands - ~4.7% of GDP, a Moderate Slippage, Not a Crisis

- **We expect the FY27 fiscal deficit to print at approximately 4.7% of GDP, versus the budgeted 4.3%. The ~40 bps slippage (30 bps from the conflict, 10 bps from lower nominal GDP) is material but moderate, especially when benchmarked against the 9.2% deficit during the pandemic year of FY21 when revenues had collapsed. The Centre retains multiple levers. The ESF and gold duty cushion together cover roughly Rs.1.5 trillion of the estimated Rs.1.3 trillion conflict impact. The small savings surplus insulates the bond market from incremental supply pressure. Expenditure savings and potential further RSP hikes provide additional optionality.**
- **The critical variable is crude. Every $10/barrel above our $95 baseline adds approximately Rs.0.3-0.4 trillion to the fiscal gap through the combined channels of lower excise collections, higher subsidies, and reduced OMC dividends. A sustained move to $110+ would push the deficit towards 5.0%, necessitating more aggressive expenditure cuts that could compromise the capex programme. Conversely, if the Strait of Hormuz normalises and crude retreats to $80-85 in H2, the fiscal slippage could narrow to 15-20 bps, bringing the deficit closer to 4.5%. The fiscal is under pressure, but the Centre has built enough buffers, including through the unprecedented ESF, to manage a moderate stress scenario without derailing the consolidation path.**

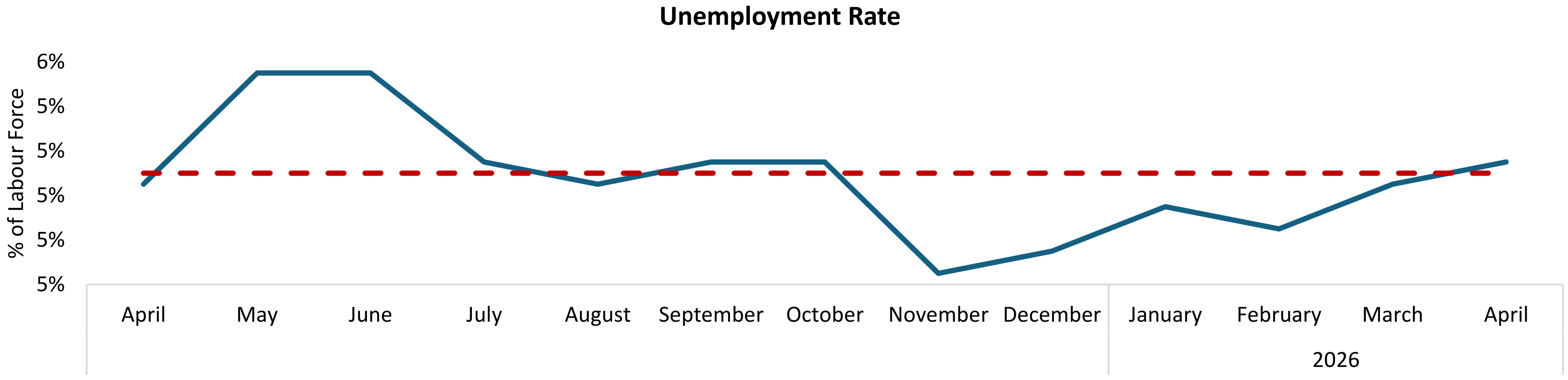



## India's GST Collections. May 2026 at Rs.1.94 Lakh Crore (+3.2% YoY). The Structural Floor Above Rs.1.85 Lakh Crore Holds Firm

- India's GST collections in May 2026 stood at **gross revenue of Rs.1,94,184 crore (+3.2% YoY)**, moderating from April's all-time record of Rs.2,42,702 crore. The MoM decline was entirely expected as April benefits from year-end reconciliations and annual filing surges. The component-wise breakup stood at **CGST Rs.37,397 crore, SGST Rs.45,143 crore, IGST (domestic) Rs.51,990 crore, IGST (imports) Rs.59,654 crore**. IGST on imports surged 19.1% YoY, signalling industrial capacity expansion and elevated commodity import values. Domestic CGST/SGST growth was softer at 3.3-3.7%, suggesting that headline growth was driven more by external trade than domestic consumption. GST refunds grew 2.6% to Rs.27,281 crore, with export-related refunds rising 16.6% YoY. **Net GST revenue stood at approximately Rs.1.67 lakh crore (+3.3% YoY)**. Cumulative Apr-May FY27 gross collections stand at Rs.4.37 lakh crore (+6.2% YoY). FY26 full-year gross collections hit Rs.22,27,096 crore (+8.3% YoY), with the **tax base now exceeding 1.5 crore registered taxpayers**. Compensation cess collections continue to normalise following the January 2026 phase-out for most categories, which mechanically suppresses headline growth comparisons.
- **The underlying consumption base remains firm, and with the cess distortion fully washing out from April onwards, GST collections should sustain 9-10% YoY growth through H1 FY27, comfortably holding above Rs.1.85 lakh crore per month**, broadly tracking nominal GDP growth and the structural uplift from GST 2.0 rate rationalisation. The near-term swing factor is crude-driven import IGST; if crude sustains above $100 via the West Asia conflict, import GST will continue to flatter the headline, but it also reflects genuine economic activity in the form of industrial capacity expansion.

*Source: Tijori and RBI DBIE*

# 8. Employment




## Unemployment — Urban UR Eases to 6.6% in April 2026; Urban Female Joblessness Hits One-Year Low, Labour Market Broadly Consolidates

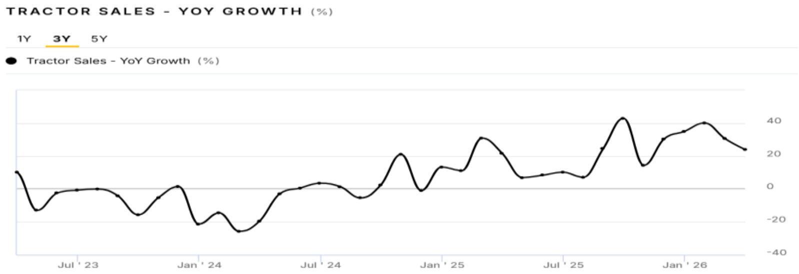
- **Labour market dynamics: Urban labour conditions improve, rural edges marginally higher**. India's headline unemployment rate (UR) for persons aged 15 years and above rose marginally to 5.2% in April 2026 from 5.1% in March 2026, remaining broadly stable on both a sequential and year-on-year basis — the latter also recorded at 5.1% in April 2025. Urban UR improved to 6.6% from 6.8% in March, marking the first sequential easing in two months and pointing to modest stabilisation in services-sector hiring and post-Holi construction activity. Rural UR rose to 4.6% from 4.3%, a move consistent with the seasonal agricultural transition gap that typically precedes the kharif sowing cycle. Taken together, the April print is in line with the Q4 FY26 trend average of approximately 5.0% and does not signal any directional deterioration in labour market conditions.
- **LFPR and WPR soften modestly; urban WPR anchors the reading**. The Labour Force Participation Rate (LFPR) eased to 55.0% in April 2026 from 55.4% in March, and now stands 60 basis points below the April 2025 level of 55.6%. Rural LFPR declined to 57.5% from 58.0%, while urban LFPR slipped marginally to 50.1% from 50.3%. The Worker Population Ratio (WPR) fell to 52.2% from 52.6%, with rural WPR declining to 54.9% from 55.5%. The critical stabilising signal in the April print is urban WPR, which held firm at 46.8% for the second consecutive month — indicating that employed persons as a share of the urban working-age population remained unchanged despite the modest headline softening. The sequential decline in LFPR and WPR is more consistent with seasonal workforce withdrawal than with any demand-side structural deterioration.
- **Female participation moderates; urban female UR records one-year low**. Female LFPR moderated to 33.9% in April 2026 from 34.4% in March, with the urban component registering a 70-basis-point year-on-year decline to 25.0%. Rural female LFPR held steady at 38.2%, unchanged from April 2025, reflecting structural stability in agricultural and allied-sector participation. The standout development in the April release is urban female UR, which declined sharply to 8.5% from 9.0% in March — its lowest reading since April 2025 — suggesting improving formal-sector absorption for women in urban labour markets. On a year-on-year basis, overall female UR rose 40 basis points to 5.4%, a trend that warrants continued monitoring given the persistent gender gap in formal employment outcomes.
- **Overall assessment**. The April 2026 labour market print represents a consolidation rather than a directional turn. The marginal headline uptick of 10 basis points masks a more constructive underlying picture: urban UR has eased, urban WPR has held flat for two successive months, and urban female unemployment has reached its best level in twelve months. Looking ahead into Q1 FY27, the April Manufacturing PMI recovery to 55.9 and sustained government capex disbursals are expected to support industrial and construction hiring. The principal near-term watch item on the rural side is kharif sowing progress and the spatial distribution of the southwest monsoon onset, both of which will be key determinants of rural labour demand through May–June 2026. On the formal sector, the structural concern remains GenAI-led headcount rationalisation in IT services, which continues to narrow white-collar hiring pipelines even as blue-collar and platform-gig employment stays relatively resilient. More broadly, LFPR at 55.0% — tracking 60 basis points below year-ago levels — suggests a latent participation constraint that a stable 5.2% headline UR alone does not fully capture, and which merits close attention as the FY27 employment cycle unfolds.

*Source: RBI Bulletin and Internal assessment*

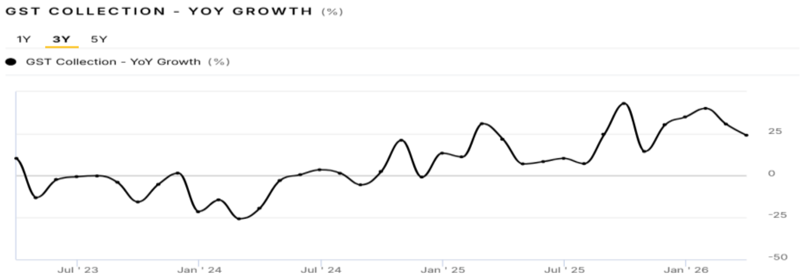
# 9. Demand Indicators

TWO WHEELER - RETAIL SALES - YOY GROWTH (%)


TRACTOR SALES - YOY GROWTH (%)

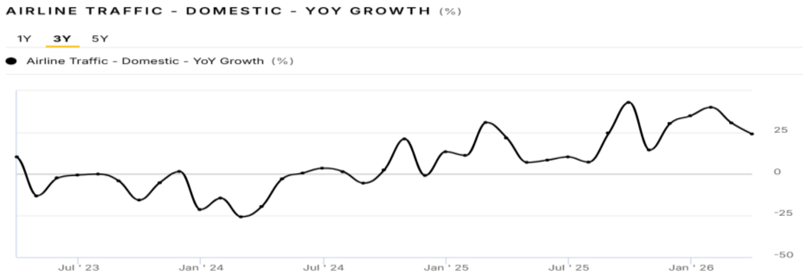



E-WAY BILLS / GST COLLECTION - YOY GROWTH (%)

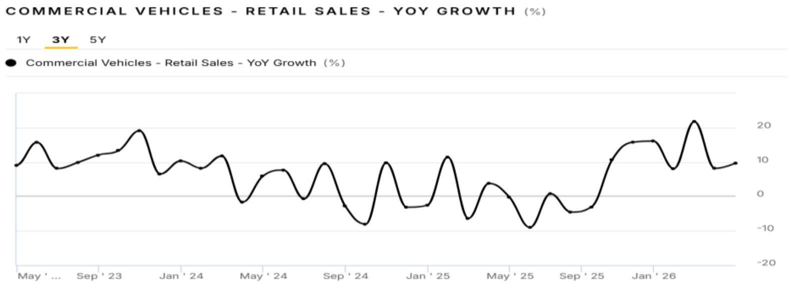



PASSENGER CAR - RETAIL SALES - YOY GROWTH (%)


AIRLINE TRAFFIC - DOMESTIC - YOY GROWTH (%)




COMMERCIAL VEHICLES - RETAIL SALES - YOY GROWTH (%)




## Select High-Frequency Indicators (April 2026) – West Asia Shock & the El Nino Effect Lingers, but Urban & Rural Consumption Hold Firm, for now

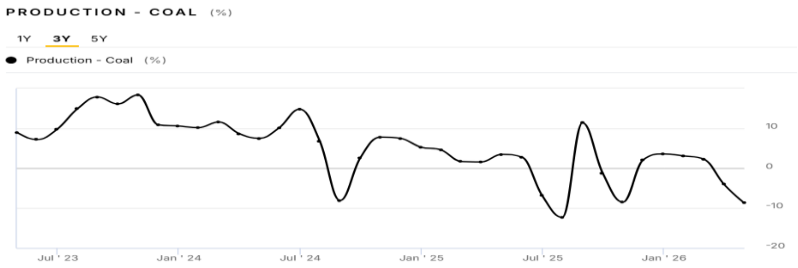
- **Rural Demand:** Two-wheeler retail surged +13.0% YoY in April 2026 (FADA data), marking the highest-ever April for the segment at 19.16 lakh units and affirming that rural consumption has structurally re-rated post-GST rationalisation. Scooters continued to outpace motorcycles, with Honda (+15.8%) and TVS (+18.7%) leading. Tractor retail surged +23.2% YoY to 75,109 units — the strongest April print on record — driven by Kharif season preparation and robust agri-cash flows. Sonalika (+35%) and Escorts Kubota (+35%) significantly outpaced the industry. Five of six vehicle categories set all-time April records. Rural RTOs grew +20.3% YoY vs. urban +10.2%, confirming the demand cycle is broadening geographically. GST E-Way Bills maintained double-digit growth, supported by GST rationalisation tailwinds and higher temperatures driving goods movement.
- **Urban Demand:** Passenger vehicle retail grew +12.2% YoY in April 2026 (FADA), delivering the best-ever April for PVs at record volumes, supported by the wedding-season carry-forward and stable inventory (stock days at ~28 days vs. 50+ a year ago). Three-wheelers rose +7.2% YoY. Domestic airline traffic remained subdued — West Asia-linked airspace disruptions, fuel surcharge levies, and the WestAsia crisis continue to weigh; system-wide domestic PAX growth is estimated at low-single digits for the next quarter. GST collections hit ₹2,42,702 crore in April 2026 (+8.7% YoY) — the highest-ever April, breaching ₹2.4 lakh crore for the first time. Import-related GST surged +25.8% YoY (₹57,580 crore), reflecting robust port activity and deepening trade integration. Commercial vehicles retail grew +15.0% YoY in April 2026 — also a best-ever April at 99,339 units — with rural CVs growing +20.3% YoY, confirming freight recovery and M&HCV replacement demand.

**Demand Outlook:**

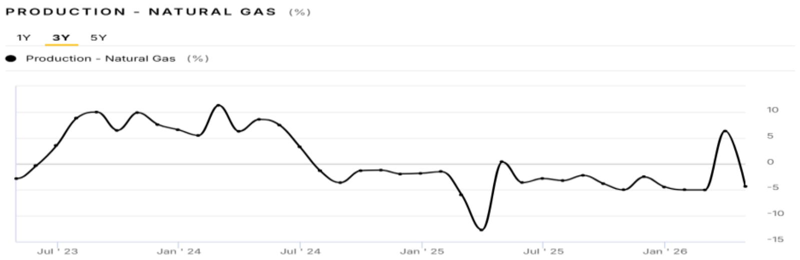
**April confirms that the consumption complex remains structurally resilient and has posted a healthy start to FY27 despite an elevated global uncertainty environment. The rural cushion is firm and broadening however a projected monsoon deficit threatens to derail the rural demand if the El Nino effect plays out; urban demand is recalibrating from the exceptional March high, not deteriorating. GST data sends a decisive fiscal buoyancy signal. With CPI at 3.34% (April 2026) and RBI in a 50bps cut cycle (paused at 6.00% repo), disposable income support remains intact. Key Monitorables: pace of Kharif credit disbursal; West Asia ceasefire trajectory and its pass-through to fuel prices and airline normalisation; and gold import duty revision impact on discretionary spending**.

*Source: Internal assessment based on data from Tijori Finance*

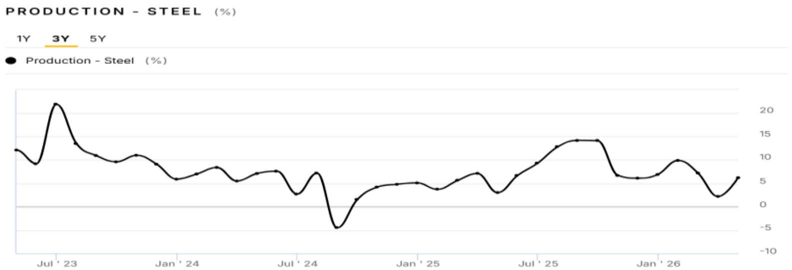
TWO WHEELER - RETAIL SALES - YOY GROWTH (%)



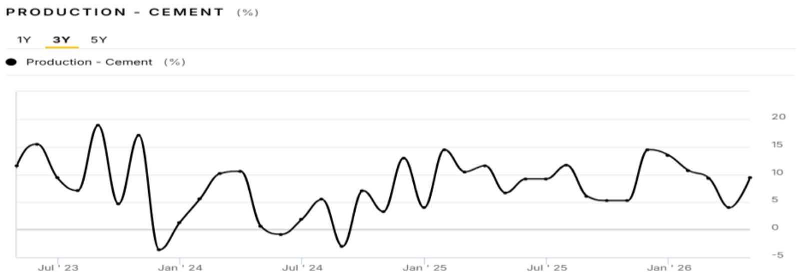

TRACTOR SALES - YOY GROWTH (%)



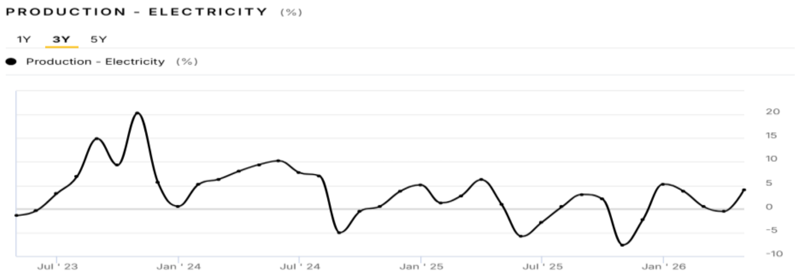

PRODUCTION - STEEL (%)



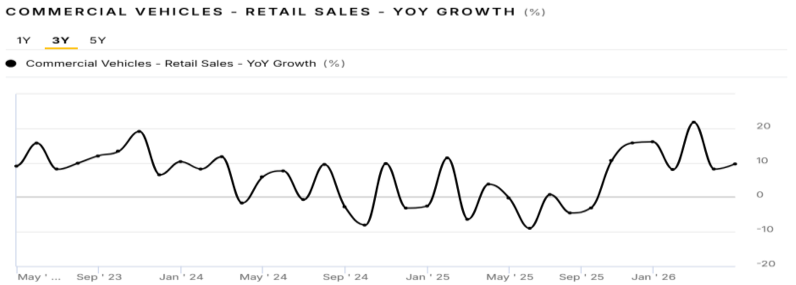

PRODUCTION - CEMENT (%)




AIRLINE TRAFFIC - DOMESTIC - YOY GROWTH (%)




COMMERCIAL VEHICLES - RETAIL SALES - YOY GROWTH (%)




## Industrial & Services Momentum (April 2026) – West Asia Delivers Continued Blow; Fertiliser Stress Eases, Steel & Cement Hold

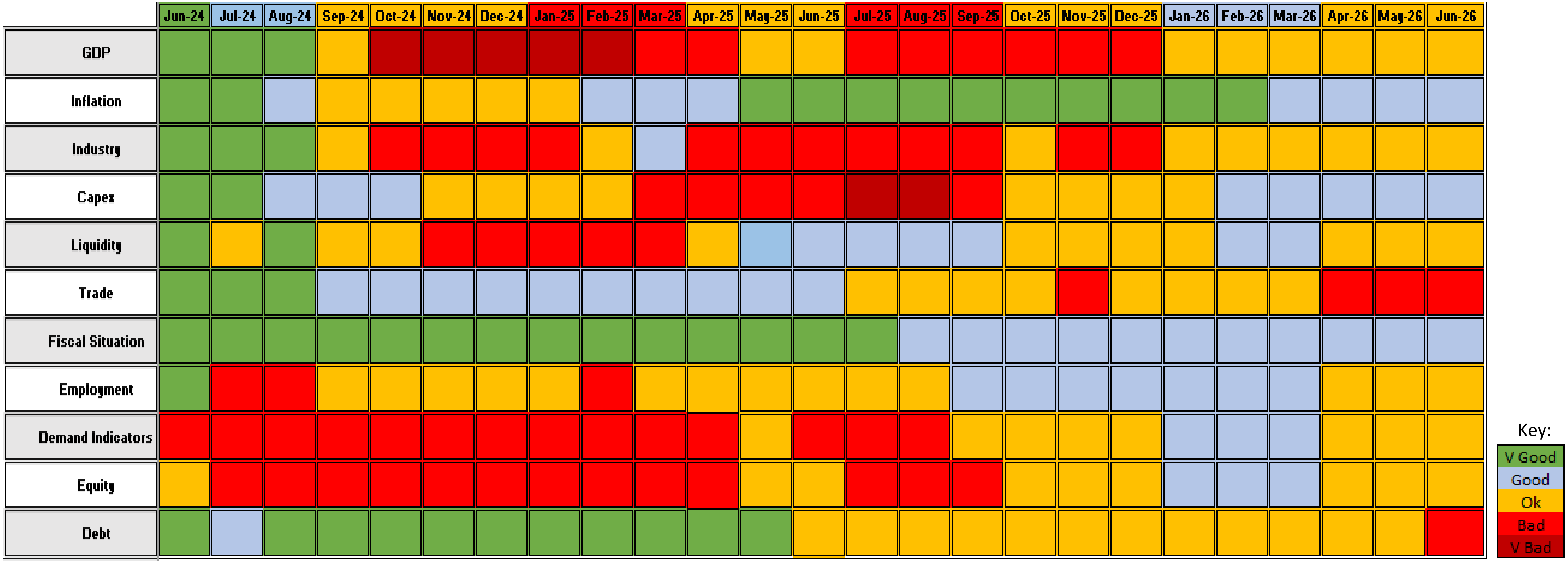
- **Industrial Activity:** Core Sector (ICI) grew +1.7% YoY in April 2026 — up from March's revised +1.2% but remaining deeply subdued, with five of eight sectors in contraction, marking the continued first-order impact of the West Asia conflict. Coal fell -8.7% (worsening from -4.0% in March; lower thermal demand as heat-wave load shifted to renewables, plus base effects). Crude Oil declined -3.9% (structural field-depletion, 7th consecutive month of contraction). Natural Gas fell -4.3% (downstream drag on chemicals, fertilisers and power). Fertiliser production contracted -8.6% — significantly moderating from March's historic -24.6% (worst in 13 years) — as Hormuz-linked raw material disruption partially normalised. Electricity generation rose sharply +4.1% driven by the extreme heat-wave demand surge. On the positive side: Cement surged +9.4% (strongest monthly print in 4 months; infrastructure and housing demand intact); Steel rose +6.2% (domestic consumption, CV-linked demand and construction activity). Electricity +4.1%. IIP for March 2026 printed at +4.1% YoY — a 5-month low but ahead of the 3.7% consensus — with Manufacturing at +4.3%, Mining at +5.5%, and Capital Goods at a robust +14.6% (confirming the capex cycle is intact beneath the energy-sector noise). Manufacturing PMI rebounded to 58.2 in April from 53.9 in March, with new orders at 10-month highs — the clearest early positive signal for Q1 FY27 output.
- **Services Sector:** HSBC Services PMI held at 58.7 in April 2026 (47th consecutive month above 50), as input cost pressures from crude and logistics moderated. Composite PMI remained robust. Commercial vehicle wholesale volumes grew +15.0% YoY in April (best-ever April; 99,339 units), with Tata Motors CV up +17% and VECV up +10%, reflecting LCV freight recovery and M&HCV replacement demand post-GST rationalisation.

**Industrial & Services Outlook:**

**The April data confirms that the West Asia conflict's supply-chain impact is moderating but not yet resolved. The fertiliser collapse is a direct supply casualty, not a demand issue, and will normalise once Hormuz import routes stabilise — the sharp moderation in April (-8.6% vs. -24.6%) is early evidence. Steel and cement holding positive growth, alongside record E-Way Bills, robust CV volumes, and a rebounding Manufacturing PMI, confirms that the capex-consumption virtuous cycle is intact beneath the energy-sector noise. IIP growth is expected to slow to ~1–2% in April 2026 (from 4.1% in March) on new base effects and energy-sector drag. If the Strait of Hormuz normalises and a ceasefire holds, industrial momentum should recover to 4–5% IIP growth by June 2026. Government capex at ₹12.20 lakh crore, PLI-driven electronics/auto output, and the RBI rate-cut transmission pipeline provide incremental tailwinds.**

*Source: Internal assessment based on data from Tijori Finance*

# Economic Heatmap




## Cautious Optimism Under a Lengthening Shadow

**India entered CY26 with a structurally sound domestic economy. What has changed sharply is the external environment, which is why you see a deterioration in the overall macros April 2026 onwards. The US-Israel-Iran war (starting 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.**

# 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 |
| 2026 | -3% | -1% | -11% | 7% | -2% | | | | | | | | -9.7% |
| 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% | 14.4% | 14.6% |
| 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 ~5%. 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 India's strong internal macros. 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.**

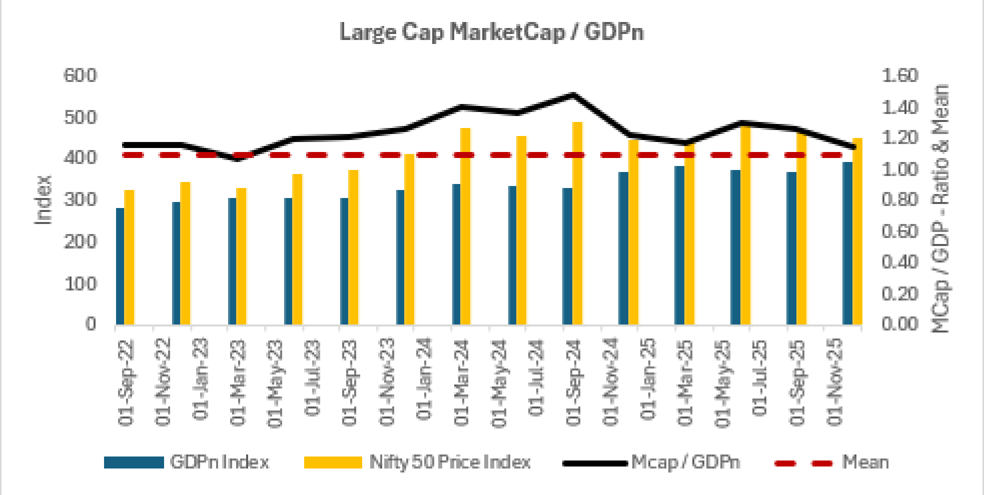
- The Risk-Return Matrix shows the tradeoff between risk and return for the 3 Market Cap indices, with increasingly higher returns at the cost of higher risk as we move down the Market Cap spectrum.

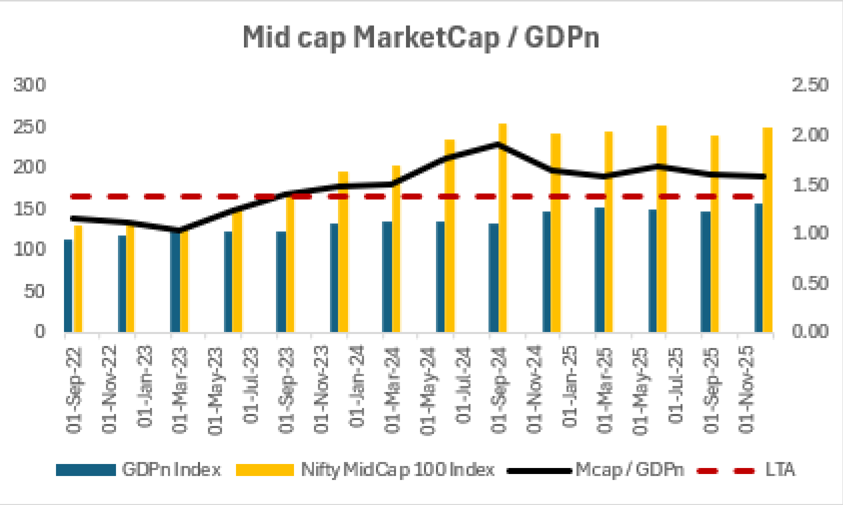
- **As per TTM PE valuations Large Cap appear to be Undervalued. Mid Cap seem to be Fairly-valued, and Small cap seem to be Overvalued**

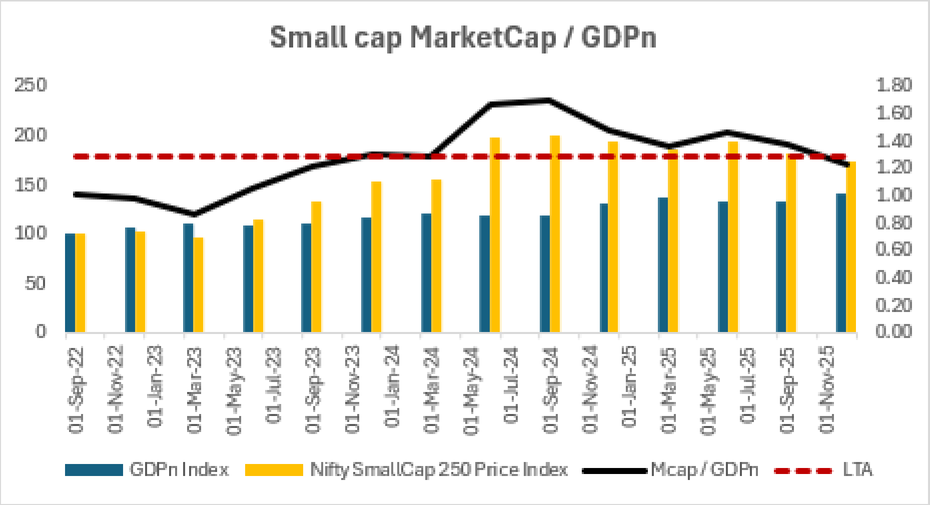
| Market Cap | Current PE | Long Term Average PE | Premium / (Discount) | Valuation |
|---|---|---|---|---|
| Large Cap | 20.16 | 23.76 | -15% | Undervalued |
| Mid Cap | 29.64 | 32.43 | -9% | Fairly Valued |
| Small Cap | 29.85 | 26.51 | 13% | Over Valued |

*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 13%, whereas Large Caps are trading at smaller premium of approx. 3% & Small Caps are currently trading at discount of approx. 4%** (as per Buffet Indicator), as on 31st May 2026.

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

# 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.
- **Geopolitical shock from the US-Israel-Iran war and Hormuz disruption** — The ongoing Operation Epic Fury, now in its second month, 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 $100+. For an economy that imports 85%+ of its crude and sources more than half its LNG from Brent-indexed Gulf contracts, this is a dual physical and financial shock - widening the CAD, stoking imported inflation, compressing OMC margins, and pressuring the rupee to record lows of +₹95. The conflict has already triggered a sharp correction in the Nifty from recent peaks, accelerated FPI outflows, and pushed the 10Y G-Sec yield higher to ~7.06% as markets reprice the inflation and external balance trajectory. A prolonged conflict would materially constrain the RBI's room to resume easing and risk derailing the nascent private capex recovery.
- **INR depreciation amid persistent foreign outflows** - Continued FPI outflows, alongside periodic private equity exits have exerted pressure on the INR versus the USD (~₹95/$). Currency weakness dampens USD-denominated returns for foreign investors, acting as a further deterrent to fresh equity inflows.

## 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

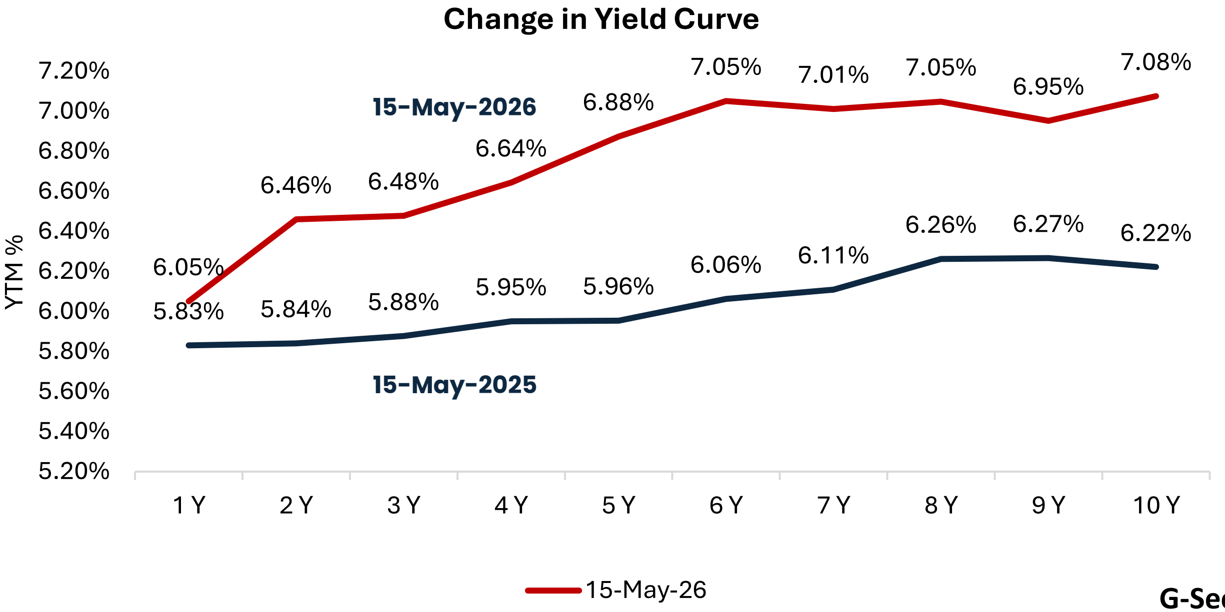
➢ **Neutral Equity**

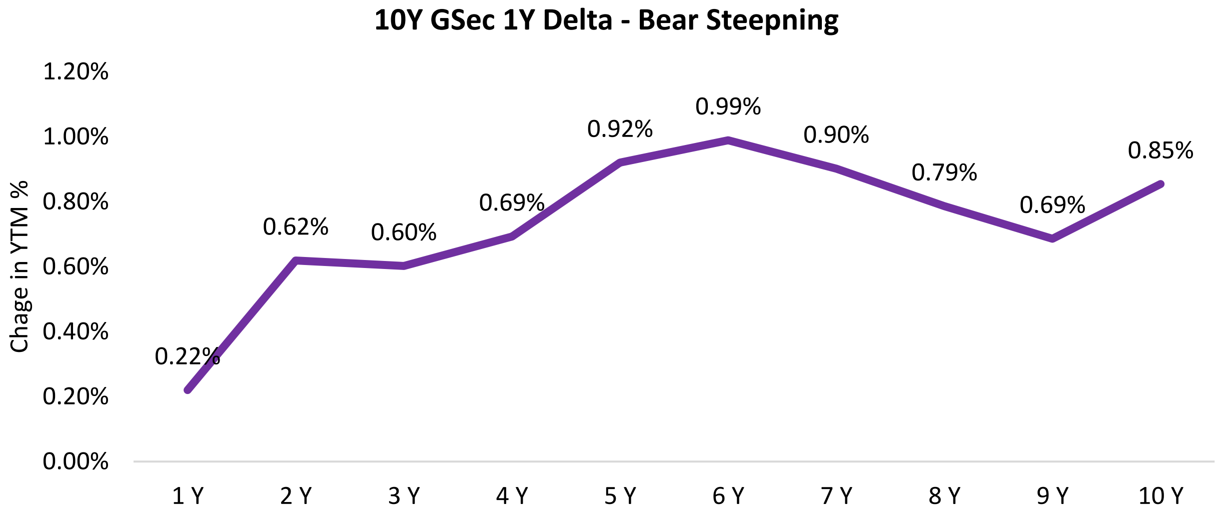
| *Category* | *Stance* |
|---|---|
| *Large Cap* | *Neutral* |
| *Mid Cap* | *Neutral* |
| *Small Cap* | *Neutral* |

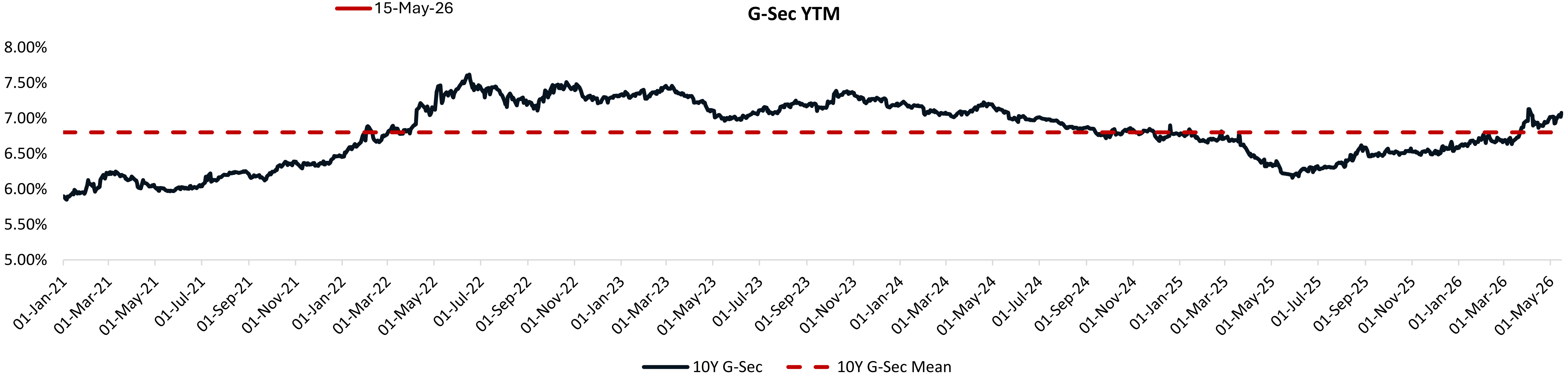
➢ **Neutral Gold**

# Debt Outlook

# Yields Curve Dynamics




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

# Debt Market Outlook & Strategy

## India Fixed Income: The Goldilocks Party Is Over

### The Story So Far

- Think of the last few years in Indian bonds as a long, comfortable summer. Inflation was falling, the RBI was cutting rates, global money was flowing in, and simply buying bonds and holding them was enough to earn strong returns. That was the Goldilocks phase — not too hot, not too cold. Investors were rewarded for doing very little.
- The data confirms this generosity. Over just the past twelve months, yields fell sharply across the curve — as much as 99 basis points in the middle of the curve and 85bps at the 10-year G-Sec, which now sits at roughly 7%. The bond market handed out strong capital gains on top of healthy coupons. But here is the critical point: a yield that has already fallen this far has already priced in most of the good news. The easy money has been made.

### What Has Changed — And Why It Matters

**The rate cuts are done.**

- The RBI's repo rate sits at 5.25%, and the cutting cycle is over. From here, the next move is more likely to be a long pause. That removes the single biggest tailwind the bond market enjoyed in recent years. You cannot keep earning capital gains when the driver of those gains has stopped.

**Inflation is no longer your friend.**

- CPI is around 3.8% today — comfortable. But the risks ahead are tilted upward, not downward. A bad monsoon, an oil shock from Middle East tensions, or sticky services prices could push inflation back above 5% quickly. When that happens, the RBI cannot cut, bond rallies reverse, and portfolios built for a falling-rate world get hurt.

**The rupee and global money flows are adding noise.**

- Foreign money has been leaving India steadily, weakening the rupee. The RBI has been intervening in currency markets to slow the fall — but every time it sells dollars, it pulls rupees out of the banking system, creating sudden tightness in domestic liquidity. That liquidity crunch feeds directly into short-term rate spikes, making the fixed income market choppier and harder to navigate than it was.

**Globally, interest rates have reset higher — permanently.**

- Post-COVID, the world's neutral rate — the level where rates are neither stimulating nor restricting growth — has moved up. The AI productivity boom, high government deficits in the US and Europe, and reduced globalisation all point to a structurally higher rate floor. What this means for India is simple: the 5.25% repo rate, which used to look restrictive, may actually be close to neutral now. The bond market cannot bank on rates returning to 4–5% anytime soon.

## Where We Go From Here — The Three Scenarios

**Most likely: Rates stay in a range, volatility stays elevated.**

- The 10-year G-Sec is most likely to oscillate between 6.50% and 7% over the next year. There is no clear catalyst to push it decisively lower, and equally, strong domestic demand from insurers, pension funds, and banks should prevent a sharp rise. In this world, you earn your return from the coupon — not from price appreciation. Carry is king.

**The optimistic case: Global disinflation rides to the rescue.**

- If China continues flooding the world with cheap goods, if oil prices fall as Middle East tensions ease, and if the US Federal Reserve begins cutting meaningfully, Indian bonds could rally further — the 10-year could reach 6.00–6.20%. This scenario is possible but not probable. It requires a lot of things to go right simultaneously. Treat it as an opportunity to trade into, not as a base case to position for.

**The risk case: Inflation returns and capital exits.**

- A weather-driven food price surge, an energy shock, or a fresh wave of foreign outflows could push yields sharply higher. This is the scenario where long-duration portfolios suffer. It is not the most likely outcome, but it is likely enough to warrant keeping portfolios liquid and avoiding overconcentration at the long end of the curve.

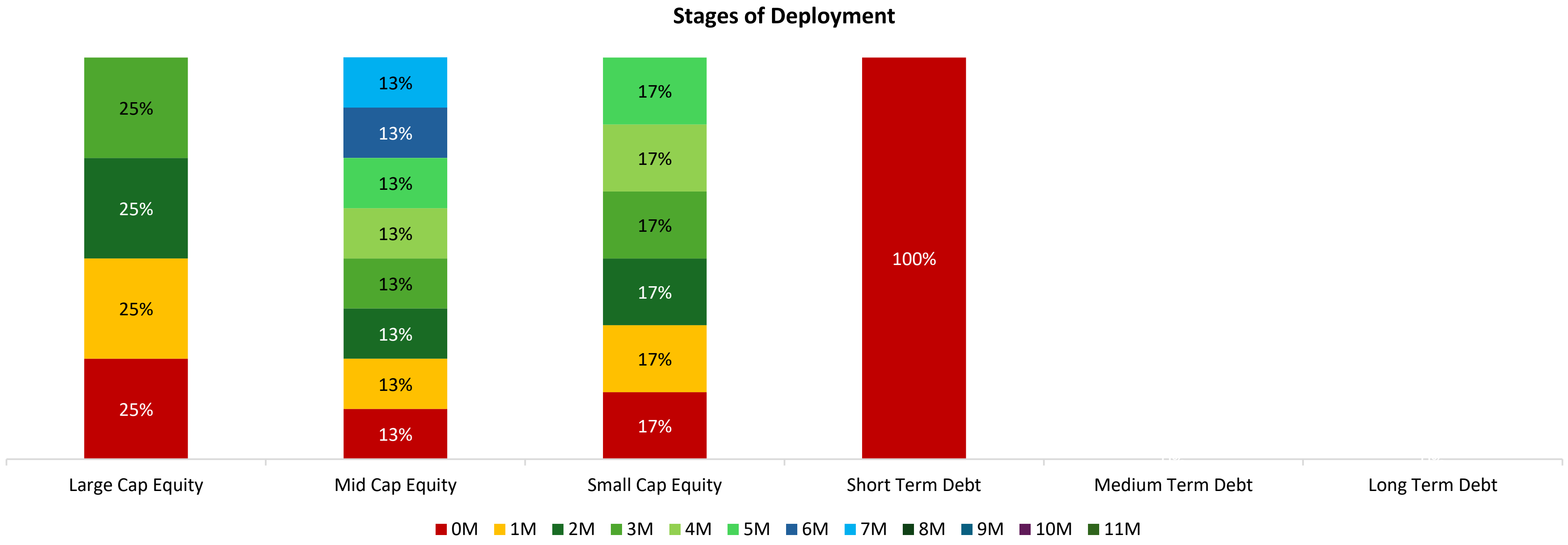
## What To Do — The Playbook For The New Regime

- The old strategy — buy long bonds, wait for yields to fall, collect capital gains — will not work reliably in this environment. The new playbook looks very different.
- Earn carry in the short-to-mid part of the curve. The 1–5 year segment offers yields of 6.5–7% with far less duration risk than the 10-year end. In a volatile, range-bound market, this is the sweet spot: you get paid meaningfully while not taking excessive interest rate risk. This is where the bulk of institutional allocation should sit.
- Trade the curve rather than making big directional bets. The curve is steepening — the front-end is anchored near the repo rate while the long-end moves more freely. Smart positioning exploits this: being long shorter tenors and cautious on the 10-year-plus end. When the market overshoots in either direction — too bullish or too pessimistic — actively repositioning to fade that extreme is where alpha is generated.
- Keep portfolios liquid. In a choppy market, the ability to move quickly is itself valuable. Portfolios locked into illiquid assets cannot take advantage of sudden dislocations. Maintaining a meaningful buffer in Treasury Bills and short end of G-Secs is not defensive — it is strategic.
- Hedge against inflation risk. A selective allocation to floating-rate bonds or inflation-linked instruments acts as insurance. If CPI surprises to the upside, these positions protect the portfolio while the rest of the market reprices. The sizing should be modest — enough to provide a hedge, not enough to drag returns in the base case.

**The bottom line: Indian fixed income is still a good place to invest — but the rules of the game have changed. The Goldilocks era rewarded patience and holding bonds. The new era rewards active management, disciplined carry, and the flexibility to move when markets shift. Investors who adapt will continue to generate strong real returns. Those who keep playing by the old rules will find the results increasingly disappointing.**

# Deployment Strategy

# Deployment




## Indicators:

### Indicators signaling over heated market conditions –

- FII's been net sellers
- VIX at ~18.5 levels
- Market Cap/GDP for Mid Cap Index above its LTA's signaling lofty valuations

### Indicators signaling fair valuation –

- DII's have been net buyers
- Market Cap/GDP for Large and 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

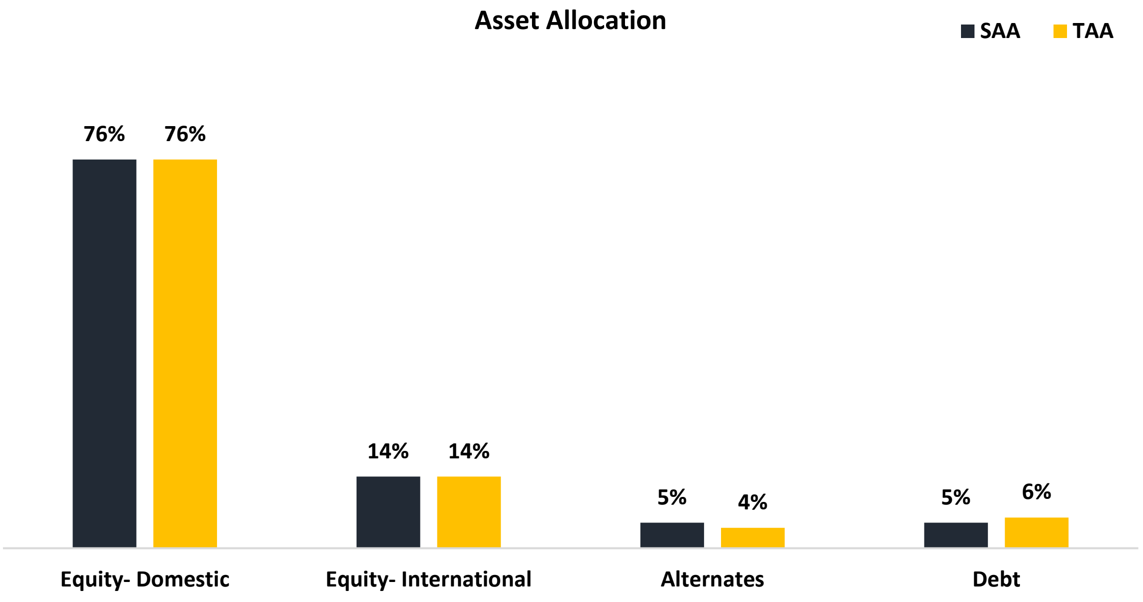
## Deployment Strategy:

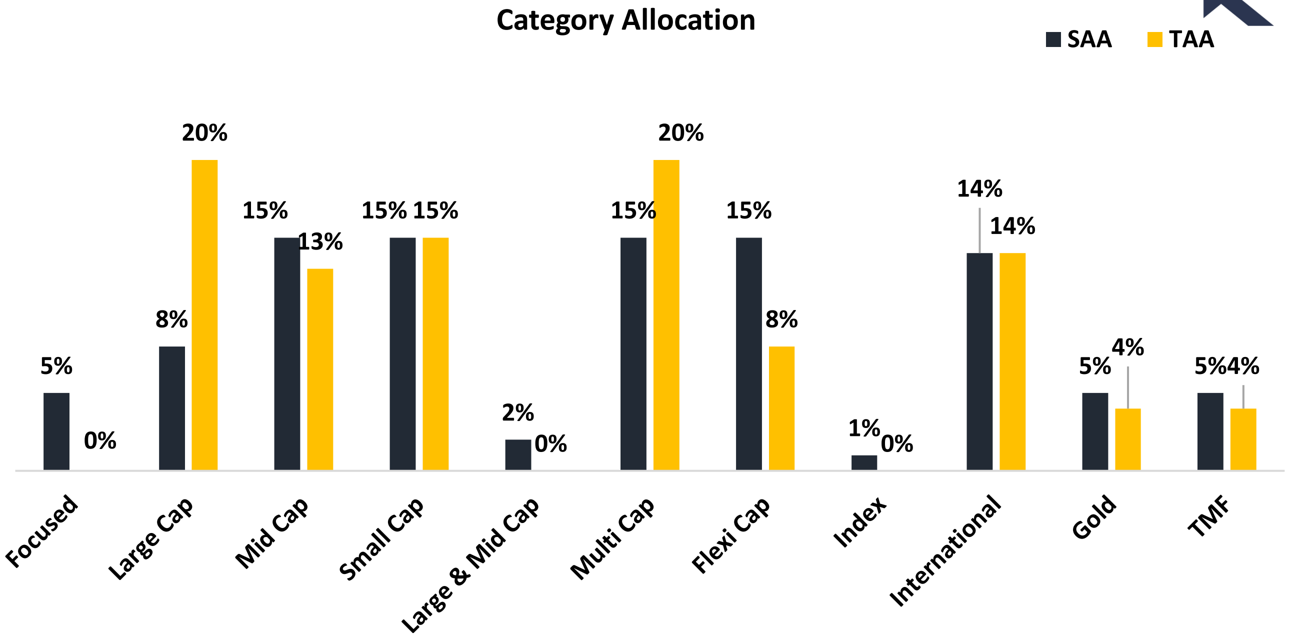
### Staggered Deployment over the next 12 months –

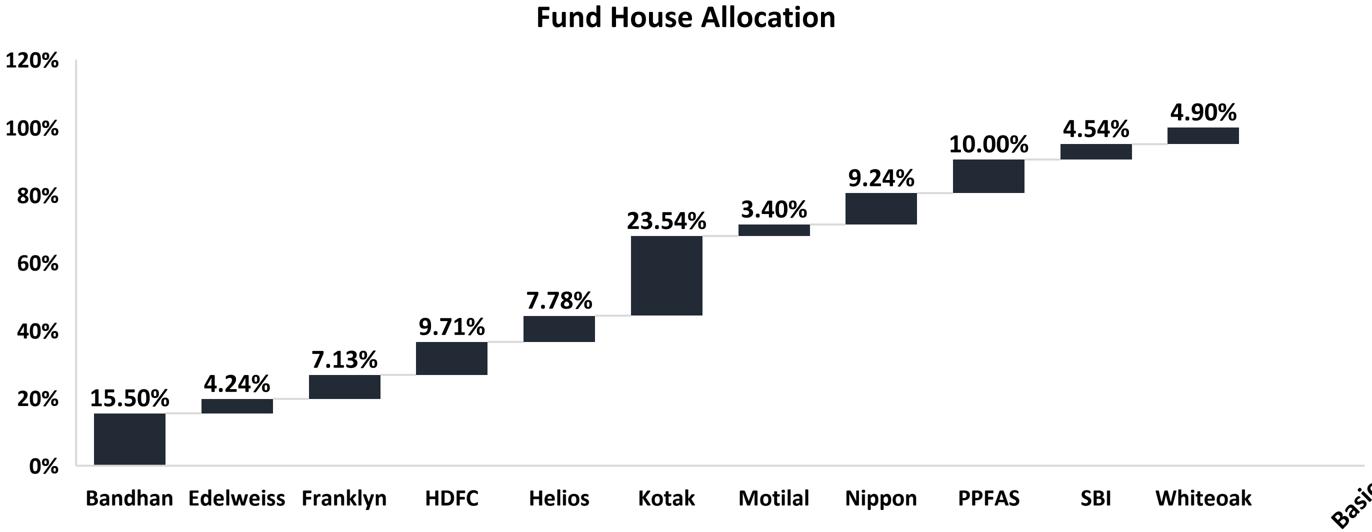
- Large Cap – 25% immediate deployment and 25% in each month in the next 3 months
- Mid Cap – 12.5% immediate deployment and 12.5% in each month in the next 7 months
- Small Cap – 12.5% immediate deployment and 12.5% in each month in the next 7 months
- Debt - 100% immediate deployment (bullet strategy at the short end (0-3 yrs) of the yield curve or Arbitrage Funds.

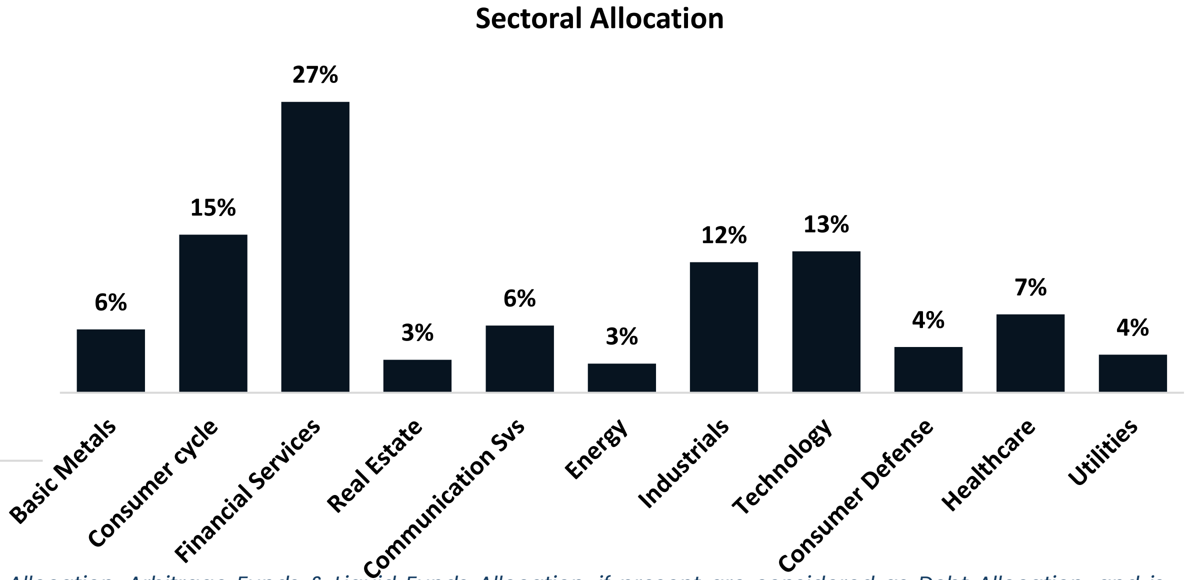
# Optimus Prime Model Portfolio

Aggressive Strategy

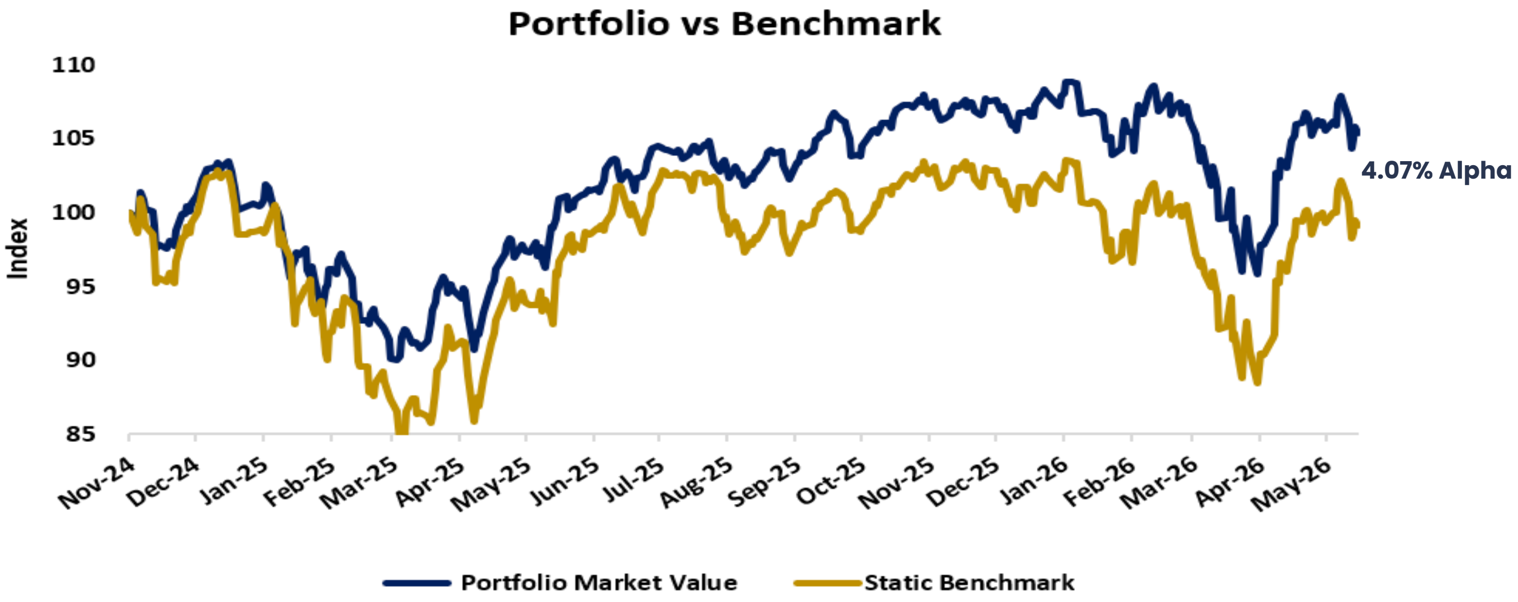


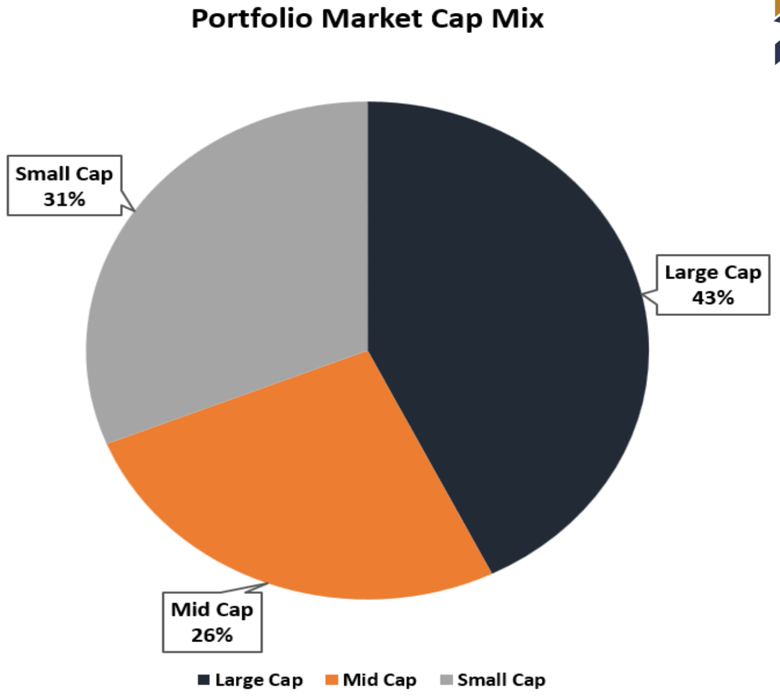




******SAA – Strategic Asset Allocation*** & ***TAA – Tactical Asset Allocation.*** *International Allocation considered as Equity Allocation, Arbitrage Funds & Liquid Funds Allocation, if present are considered as Debt Allocation, and is temporarily parked for the short term and will be deployed opportunistically, Portfolio Inception date - 1st November 2024, Portfolio values are as on 15th May 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 % | **3.49%** | -0.58% |
| Standard Deviation (annualized) | **12.47%** | 15.93% |
| Beta | **0.50** | |
| Alpha | **4.07%** | |
| Information Ratio | **8.00** | |
| Downside Capture | **72.76** | |

| Asset Allocation Alpha | Product Selection Alpha | Timing | Total Alpha |
|---|---|---|---|
| **0.04%** | **3.04%** | **0.99%** | **4.07%** |

## Debt Portfolio Analytics

| Debt Measures | Mar-26 |
|---|---|
| **Average MoD** | **5.87** |
| Average Maturity | 4.85 yrs |
| Average Coupon | NA |
| **Average YTM** | **7.53 %** |

| Average Credit Rating | Mar-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 May 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

## Positioning & Portfolio Update

At our most recent Investment Advisory Committee meeting, the Committee unanimously resolved to maintain a **Neutral investment stance**.

This reflects a deliberate and considered response to the current environment, one characterised by **elevated geopolitical risk, oil-driven inflationary pressure, and meaningfully compressed visibility on near-term earnings trajectories. Additional weight was given to emerging stress in the IT sector driven by concerns around India's AI positioning relative to competing South and South-East Asian economies.**

**However, looking inward, crucially, the domestic story we described last month has not merely held, it has been reaffirmed. Q3 FY26 real GDP grew 7.8%, broad-based and led by manufacturing. April CPI printed at 3.48%, still below the RBI's 4% target, with the fuel pass-through deliberately absorbed by the Centre. The IIP rose 4.9% in April under the new series, with capital goods up 16%, the clearest signal that the investment cycle is firing. Bank credit is growing close to 16%, capacity utilisation has climbed to 75.6%, and corporate balance sheets remain lean and liquid. These are the preconditions for a sustained re-rating, and the external shock has not taken them away**.

Our equity allocation is accordingly neutral in our aggressive portfolio. Within equities, we carry an approximately 7% underweight in Mid Caps and a 3% underweight in Small Caps, consistent with our risk-controlled framework and our preference for capital preservation over beta-seeking in conditions of heightened uncertainty.

Despite prevailing volatility, portfolio positioning has delivered strong results. We generated an **Alpha of 4.07%, driven primarily by Product Selection Alpha. The portfolio maintained a Beta of 0.50, an Information Ratio of 8.00, and a Downside Capture of approximately 72.76% - collectively reflecting disciplined risk management and effective downside protection relative to the benchmark**.

# Key Monitorables:

## Hormuz reopening

HIGH

The single most important variable. Each week of disruption adds ~0.1–0.2% to the FY27 CPI trajectory. A durable ceasefire and restoration of flows to 70% of pre-conflict levels would materially reduce risk.

## Crude price trajectory

HIGH

Brent at ~$95/bbl today; EIA forecasts Q2 2026 peak of ~$115/bbl before gradual normalisation. Watch the ceasefire expiry and Iran-US talks closely.

## April CPI (12 May)

HIGH

April 3.48% is likely not the peak. Energy and food pass-through effects expected to push the print higher.

## US Trade Deal

MEDIUM

India's commerce minister Piyush Goyal declared the deal "about 99 per cent" complete, with the USTR delegation visiting New Delhi June 1-4 to finalise the interim agreement, covering goods, non-tariff measures, customs facilitation, and economic security alignment; signing is expected within weeks, though the final 1% involves sensitive sticking points on dairy and agriculture.

## Q4 FY26 earnings & FY27 guidance

MEDIUM

Management commentary across banks, industrials, and consumer names through Q1 will drive the FY27 earnings revision cycle. Modest downgrades appear mostly priced in. Capex spends (pvt + govt) along with volumes and margins will a key monitorable to tack for the next 2 quarters.

## FII flows, INR, & the anti-AI trade

HIGH

With Rupee at ~₹95/USD; forex reserves at ~$690bn provide a buffer. FII reversal likely requires crude stabilisation + West Asia de-escalation and India’s gradual participation in the AI ecosystem, the former being a short-term risk and the latter longer-term. INR trajectory compounds inflation risk.

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# THANK YOU

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