

Embracing complexity to capture Alpha

Dear Investors,

Last month we wrote that the risk had moved from growth to prices. In September it moved again, from the price of goods to the price of money.

The ECB, the Federal Reserve and the Bank of Japan all raised rates between 10 and 18 September, the Fed for the first time since 2023, and the US 10-year reached its highest yield since 2007. At home the 10-year gilt touched 7.2%, its highest since April 2024, and the rupee trades near 96. We expect the MPC to raise the repo rate by 25 basis points to 5.50% on 7 October, as do eight of the ten economists Business Standard polled. The barrel did its part: Brent reached about USD 108 after drone attacks shut Saudi Arabia's pipeline around Hormuz and sits near USD 102, while the Indian basket averaged USD 114.6 in September.

We also owe you a correction. Last month we wrote that flows had turned, on foreign purchases of Rs 20,200 crore in July and Rs 30,919 crore in August. Those were depository figures, which count primary-market allocations. On exchange data, where prices are set, foreign investors sold in both months and have now sold for fifteen consecutive months, the longest run in over a decade. September removed the ambiguity: Rs 33,864 crore of selling, taking 2026 to Rs 3.92 lakh crore, already more than all of 2025. We read the ledger that flattered the thesis. We will read both from here.

What has needed no correction is the business. Industrial output grew 8.0% in August, the second-fastest pace in 29 months, and it is not the base: stacked over two years, July and August both grew about 13% against 11% for June. Capital goods rose 16.9%, and the manufacturing PMI climbed to 55.1 in September from 52.8, with hiring at its fastest since May. Credit to industry is growing 20.0%, to engineering 36.2%, and the private capex already scheduled for FY27 stands 24% ahead of where FY26 began. That matters more than it did a month ago: central capex, at 41.7% of its Rs 12.22 trillion target, has seen its lead over last year narrow from six points to about three. The private cycle is now carrying its own weight.

Of last month's two optics calls, one has been confirmed and one has eased. The fiscal comfort was transfer timing: the April-August deficit is 41.9% of budget against 38.1% a year ago, with net tax revenue up only about 3%. GST, though, has firmed, with domestic refunds down 13.5% in September, net collections up 18.1% and domestic gross up 10.1%, the joint best of the year, even if domestic growth is still only 6.1% year to date.

Now the parts we would not put in a brochure.

The spread that paid foreigners to own Indian bonds is nearly gone. Our 10-year yields about 7.2% against roughly 5.27% on the US 10-year, under 200 basis points against a long-run 350 to 450, and a rupee down 13% since March 2025 has more than consumed that carry. That arithmetic is part of why foreign money keeps leaving, and part of why the RBI cannot sit still. We expect 25 basis points now and a repo rate of 6.00% by April 2027, 75 basis points in all.

Prices have stopped asking for the benefit of the doubt. August CPI rose to 4.82%, an eighth consecutive increase, the highest print of the rebased series and already above the RBI's 4.7% projection for the quarter. Restaurants moved from 7.72% to 8.38%. Last month we called menu repricing the point where a supply shock stops being transitory; restaurant inflation has now risen in every month of the series. Rural inflation at 5.23% runs 92 basis points above urban, the widest gap yet, wholesale inflation is 9.92% with fuel at 22.9%, and El Niño carries an 80 to 98% probability of persisting through March. We expect headline CPI through 5% in Q3 FY27.

The deposit recovery is real on the screen and borrowed underneath. Deposit growth reached 17.8% at end-August, the fastest in fifteen years, and the gap to credit growth has closed from 5.3 points to 0.8. But USD 133 billion of FCNR(B) deposits arrived between June and August, about Rs 12.6 lakh crore, or three-quarters of all deposits added this year, and those dollars mature over one to five years. The surplus they created pushed the overnight call rate to 4.92% on 18 September, below the RBI's own floor, so for much of the month the market ran policy about 25 basis points looser than the MPC had set, while inflation rose. A hike now is partly a correction of that.

Trade flatters in the same way. August exports rose 26.11%, electronics 89.82% and US-bound shipments 21.83% under a 10% duty, and the monthly goods deficit narrowed year-on-year for the first time this cycle. That was gold, whose imports fell 57.75% under the new duty, delivering USD 2.55 billion of relief against USD 1.41 billion of core deterioration and USD 0.78 billion of extra oil drag. The five-month goods gap is USD 147.09 billion against USD 123.88 billion, and at USD 100-plus crude the current account tracks the top of its 1.8 to 2.3% band, arguably beyond.

One last thing we would rather you heard from us. Small-cap funds took Rs 7,973 crore of August's Rs 29,329 crore of equity inflows, more than any other category, into the one segment trading 25% above its long-run multiple. Domestic money is going where the value is not.

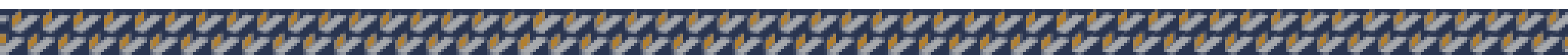
So we hold our Aggressive stance. The market has done the opposite of the business: the Nifty is down 13.7% this year while output, credit and the capex pipeline have accelerated. Large Caps trade at 19.7 times against a 23.7 times long-run average, a 17% discount against 14% a month ago, while Small Caps sit 25% above theirs. We are buying the discount fastest, with large caps fully deployed within three months and mid and small caps over six and ten. New debt money stays in money markets until the rate path is clear.

We opened by correcting ourselves on flows. Foreigners have sold for fifteen months and domestic institutions have bought in every one of them. Since last month's report the benchmark gave back 4.2% and the portfolio 2.8%, and that asymmetry is what lets us wait for price to catch up with value.

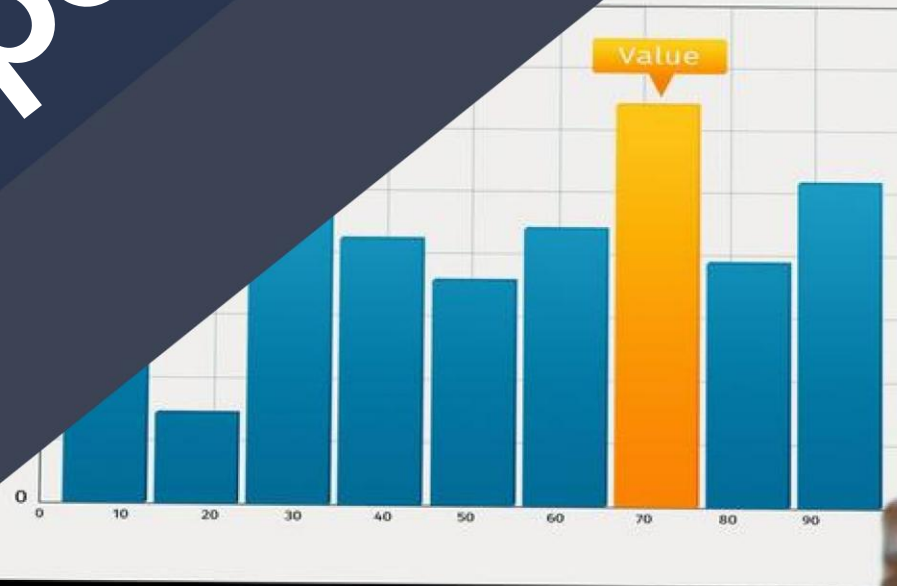
With thanks, as always, for your trust and partnership.

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 through 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.



Bhavya Bundela– The Crunch Time Queen

Bhavya Bundela doesn't just crunch numbers, she commands them. With over six years of steering high-stakes financial reporting and corporate finance projects across global giants like KPMG and Danone, she's been the secret sauce behind IPO-prep DRHPs, seamless Ind AS/IFRS transitions, and multi-industry makeovers. From decoding financials of companies to leading XBRL missions like a boss, Bhavya brings spreadsheet sorcery, project precision, and presentation prowess all rolled into one. Whether it's wrangling audits, forecasting like a finance oracle, or managing teams with flair, she gets it done, and makes it look easy. Fluent in balance sheets, budgets, and good vibes.

WHO WE ARE?



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

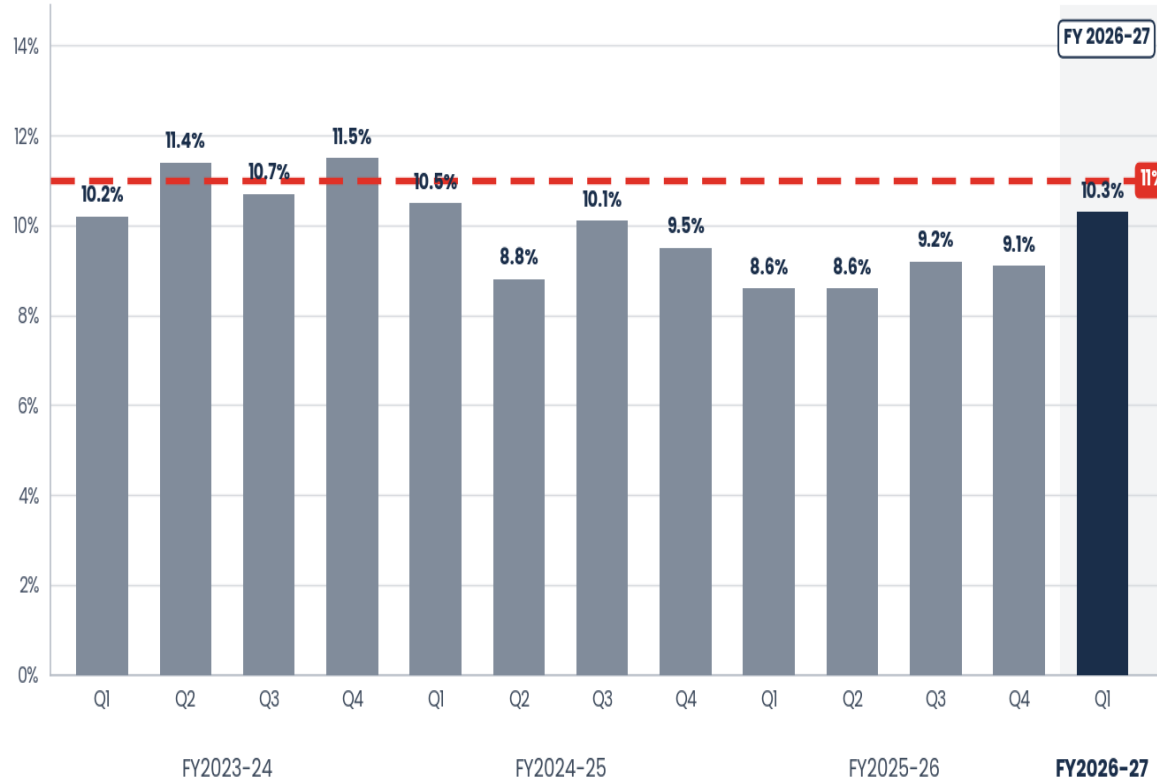


1. GDP (Gross Domestic Product)

Start with nominal, because nominal is the part nobody disputes. **Q1 nominal GDP grew 10.3% and nominal GVA 11.5%, against long-run averages near 11% for both. The economy is compounding roughly in line with its own history.** Everything being argued about this quarter, the 7.8% real print, the deflator, the rebasing, is an argument about how to split that nominal number into price and volume.

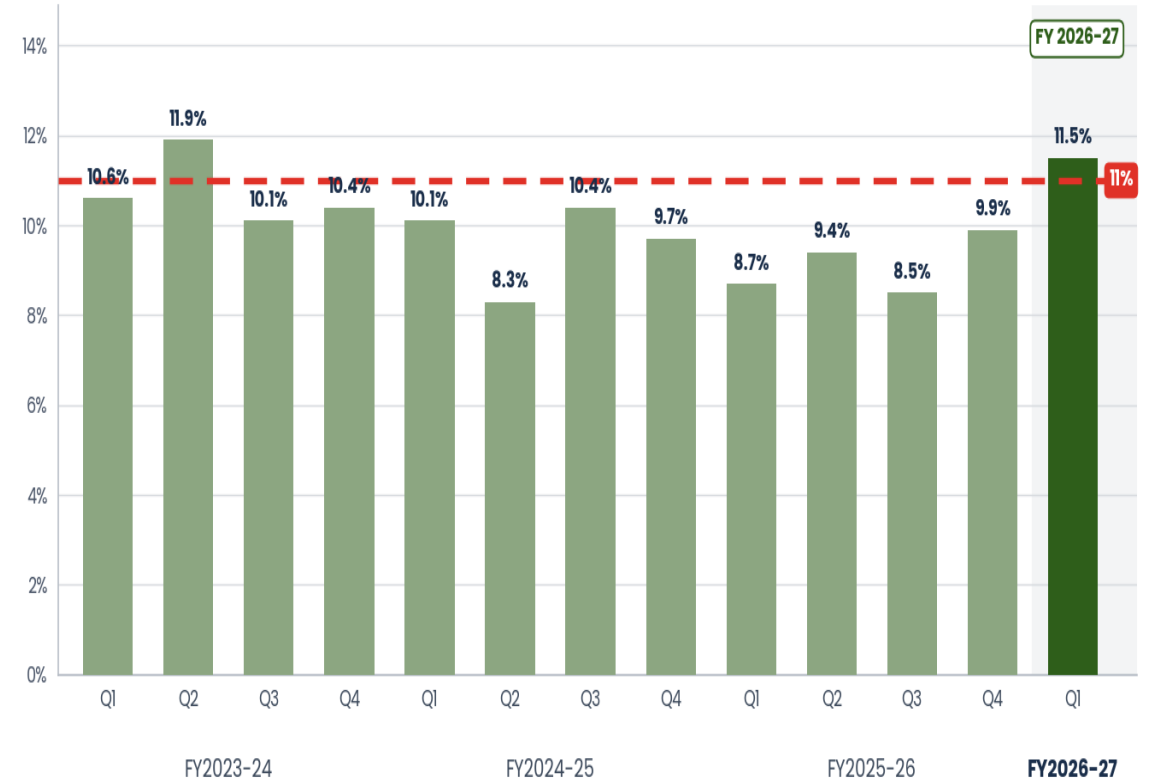
GDPn YoY % | FY2023-24 to FY2026-27

■ GDPn ■ GDPn LTA %



GVA n YoY % | FY2023-24 to FY2026-27

■ GVA n ■ GVA n LTA %





The Headline

- **India's economy grew 7.8% in real terms in the April–June 2026 quarter, against 6.9% a year earlier and a long-run average of roughly 6.8–7.0%. Nominal growth, the actual rupee value of what was produced, was 10.3%.** Real GDP was Rs 81.36 lakh crore and nominal GDP Rs 88.27 lakh crore. **Real GVA, which strips out taxes and subsidies and is the better read on production, grew 8.2% against nominal GVA of 11.5%.**
- These are the first quarterly estimates for FY2026–27, released by MoSPI on 31 August 2026 alongside a full revision of the back series. On the revised numbers Q4 FY2025–26 now reads 8.6% against the 7.8% first reported, so Q1 is a step down from a stronger base rather than a fresh acceleration.
- Note one detail that explains a lot. At the GVA level, nominal ran well ahead of real, as it normally does. At the GDP level the gap narrowed to 2.5 percentage points. The difference between the two lines is **net taxes, where real growth was 3.9% but nominal fell 0.4%, because the fertiliser subsidy rose 57.6% and Union excise fell 22.4%. Subsidies are subtracted in the GDP build, so a subsidy surge mechanically drags nominal GDP below nominal GVA.**

Where the Demand Came From

- **Investment did the heavy lifting. Gross fixed capital formation grew 11.9%,** the first double-digit investment print of the new series and more than double last year's 5.8%, **lifting investment to 34.3% of GDP from 31.4%.** Two independent checks agree with it: **machinery and equipment imports rose 51.5% and capital goods IIP 15.2%.** Those are physical things, ordered and shipped.
- **Household consumption grew 7.1%, up from 6.8%, and still holds 55.6% of nominal GDP.** It remains the largest block of demand but is no longer the fastest-growing one.
- **Exports grew 12.0% in real terms, the best quarter in three years, while real imports fell 1.1% even as nominal imports rose 30.9%. That divergence is price, not volume: the same barrels and components simply cost far more.** Net exports therefore added about 3.0pp to headline growth and statistical discrepancies subtracted about 3.2pp, almost exactly offsetting. Domestic final demand, at roughly 8.4pp, is the cleaner read.

Where the Output Came From

- **Services led at 10.0%. The largest single block, financial, real estate, IT and professional services at 27% of nominal GVA, grew 12.1%, the strongest print in the series. Industry grew 8.6%, while the primary sector slowed to 2.9% as mining contracted 2.4%. Electricity swung to 8.9% from minus 1.8%, construction reached 7.7% and public administration 7.5%. Seven of eight sectors expanded.**

The One Number That Needs Explaining

- **Manufacturing real GVA grew 9.2% while nominal manufacturing GVA grew only 7.7%, an implicit deflator of about minus 1.5%.** Manufacturing prices did not fall. This is what a change in measurement method looks like when input costs run ahead of output prices, and it is the source of most of the argument about this print. We take it apart overleaf.



Metric	Q1 FY2025-26	Q1 FY2026-27	Δ Change
Real GDP Growth	6.9%	7.8%	+0.9 pp
Nominal GDP Growth	8.1%	10.3%	+2.2 pp
Real GVA Growth	7.0%	8.2%	+1.2 pp
Real GDP (₹ lakh cr)	75.46	81.36	+7.8%
Nominal GDP (₹ lakh cr)	80.00	88.27	+10.3%

The two tables say the same thing in different ways: growth accelerated, and it accelerated in the right places.

Three Ratios Carry the Message

- **Investment intensity.** GFCF is 34.3% of GDP against 31.4%, with nominal GFCF up 20.4%. This is the strongest single argument in the release for capex-gearred sectors and the construction multiplier.
- **Consumption share.** Households held 55.6% of nominal GDP against 55.8%, growing 9.9% in nominal terms. Still the largest demand block, no longer the fastest – the composition of this cycle is investment, not consumption.
- **The deflator.** Nominal 10.3% against real 7.8% implies an economy-wide deflator of about 2.5%, against roughly 1.2pp for FY26 as a whole. Read one way, that is producer-price inflation returning through the energy channel. Read another, it is a low number when CPI averaged 3.9% and producer prices around 9%. Both readings have serious advocates; we deal with the dispute overleaf.

And One Line in the Sector Table

- **Manufacturing volumes are firming while its deflator is negative. Strong output, compressed value.** That combination is the quarter in miniature.

Sector	Q1 FY25	Q1 FY26	Q1 FY27	Trend	Assessment
Manufacturing	9.9%	8.3%	9.2%	↑ Firming	Volumes strong; deflator negative
Construction	8.1%	5.2%	7.7%	↑ Firm	CapEx multiplier intact
Financial, RE & Prof. Svcs	8.5%	8.8%	12.1%	↑ Strong	Credit + real-estate strength
Trade, Hotels, Transport	8.1%	9.8%	8.5%	→ Steady	Travel normalising off base
Public Admin & Defence	6.9%	4.6%	7.5%	↑ Firming	Govt spending steps up
Agriculture & Allied	2.6%	4.4%	3.6%	↓ Moderating	High base; wheat near flat
Electricity & Utilities	9.8%	-1.8%	8.9%	↑ Rebounding	Demand plus base effect
Mining & Quarrying	15.7%	12.4%	-2.4%	↓ Contracting	Fuel minerals and gas weak



Two Questions Behind the Number: Rebasing and Double Deflation

What Rebasing Actually Does

- A base year is the reference point against which real growth is measured. India moved from a 2011-12 base to 2022-23, adopted on 27 February 2026, with the fully revised back series published on 31 August 2026. Rebasing does not recalculate growth; it re-measures the level of the economy using current weights and better data — ASUSE and PLFS survey data replacing proxy estimates, expanded GST records, e-Vahan for vehicle consumption, PFMS for government spending, and Supply-and-Use Tables that force total supply to equal total use. Roughly 500-600 price indicators now do the deflating, against about 180 before.
- One fact is widely missed: rebasing lowered India's nominal GDP by about 3-4%. That pushed the FY26 fiscal deficit from 4.4% to 4.5% of GDP and central debt from 56.2% to 58.1%. A revision engineered to flatter would have enlarged the denominator, not shrunk it.

What Double Deflation Actually Does

- Real output is nominal output divided by a price index. Under single deflation, one output price index is applied to value added as a whole. Under double deflation – the international standard, now used in India for manufacturing and agriculture – output and inputs are deflated separately, and real value added is real output minus real intermediate consumption.
- The two methods diverge whenever input and output prices move apart. When input prices fall faster than output prices, single deflation flatters real growth; that is what inflated India's manufacturing numbers during the 2014-16 oil crash. When input prices rise faster, as now, double deflation can produce a negative implicit deflator: nominal value added is squeezed by the input bill while real value added tracks volumes. Crude and gas producer prices rose 58.0% against manufactured output prices of 10.7%. Manufacturing real 9.2% against nominal 7.7% is the arithmetic signature of that, not evidence of falling prices.



Signal	Theme	Implication for Portfolios
POSITIVE	Investment & CapEx Cycle	GFCF surged 11.9% in Q1 with machinery imports +51.5% and IIP capital goods +15.2%; investment at 34.3% of GDP supports construction, capital goods and financiers through FY27.
POSITIVE	Services Leadership	Financial, real estate and professional services (12.1%) drove a 10.0% tertiary block; credit-linked, real-estate and IT-services names remain well-placed.
WATCH	Manufacturing Margin Squeeze	Real manufacturing GVA of 9.2% against nominal 7.7% implies a negative deflator. Watch whether input-cost pass-through restores pricing power or compresses FY27 margins further.
WATCH	Energy & Terms of Trade	Crude and natural gas PPI rose 58.0% and the nominal import bill 30.9%. With India importing over 85% of its crude needs, any renewed escalation feeds straight into inflation, the rupee and the current account deficit.
RISK	Data Composition & Base Effects	Net exports added ~3.0pp while discrepancies subtracted ~3.2pp, so the expenditure side does not independently confirm the production side. The 2.5% deflator is the live dispute. Domestic final demand at ~8.4pp is the cleaner read.

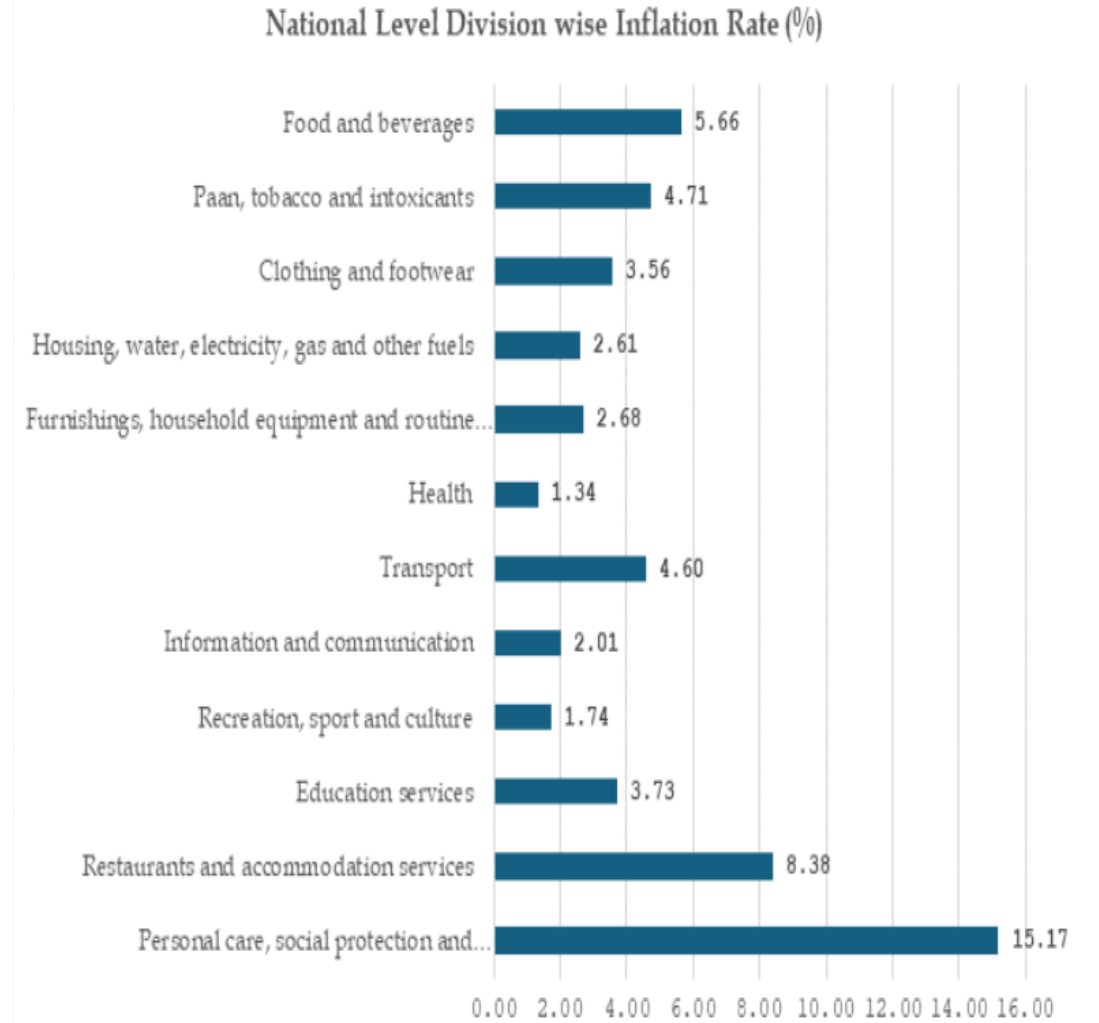
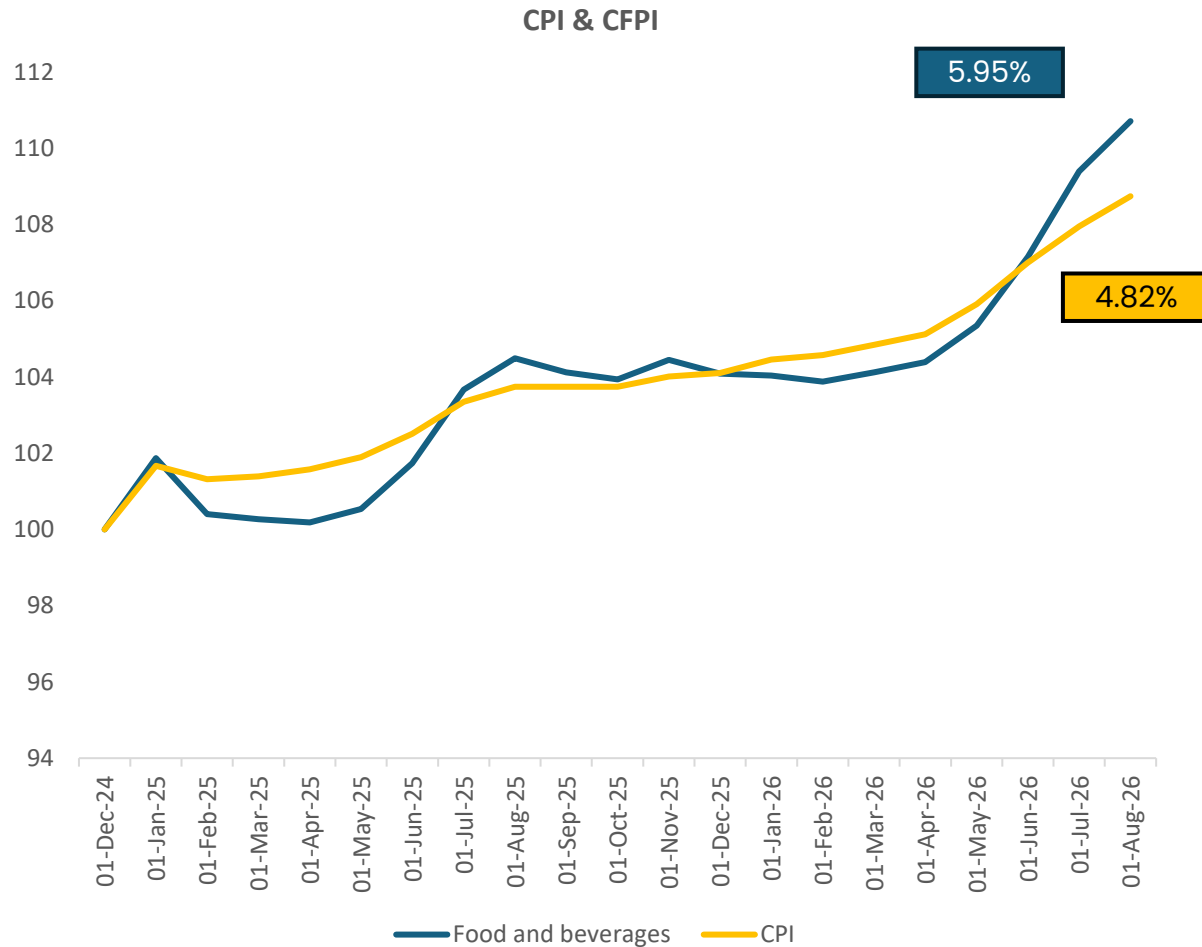
Our 12-Month View: Constructive, With Price Risk Replacing Growth Risk

Strip away the methodology argument and the investment case is unchanged. Whether real growth is 7.8% or the 5.0–5.5% the sceptics prefer, the nominal economy is compounding at 10.3%, and nominal is the currency in which earnings, tax collections and debt ratios are actually settled. The composition is not in dispute: investment at 34.3% of GDP, machinery imports up 51.5%, capital goods output up 15.2%, industry credit at 19.2%. Those are counts, not deflated estimates.

The risk has migrated from growth to prices and the external account. Crude and gas producer prices up 58.0%, a nominal import bill up 30.9% and a negative manufacturing deflator point to imported inflation working through corporate margins for another two to three quarters, already visible in roughly 20% revenue growth against 15% profit growth. A deficient and uneven monsoon is likely to keep food-inflation risks elevated, with weaker Kharif yields and limited soil moisture raising concerns over Rabi sowing and wheat, pulses and oilseed output.

We hold FY27 GDP growth at 7.0–7.5%, below the headline run rate and above the sceptics, and we would own the capex chain over the consumption chain on the strength of the composition rather than the level.

2. Inflation





A Bigger Step on a Broader Base: CPI at 4.82% as Food, Fuel and Services Turn

Headline

- **Headline CPI inflation accelerated to 4.82% in August 2026 from 4.45% in July 2026, an eighth consecutive monthly rise and the highest print of the rebased series.** The 37 basis point step is more than five times the 7 basis point move in July, and the sequence now reads 2.74%, 3.21%, 3.40%, 3.48%, 3.93%, 4.38%, 4.45% and 4.82%. The index rose 0.73% over the month against a 0.38% rise a year earlier, so **this acceleration is a genuine sequential move and not a base effect.**
- **We said last month that the headline was a poor guide to the pressure underneath it, and August 2026 removes the ambiguity.** The composition we warned about has now surfaced in the headline itself, with food, fuel and services firming together and the metals division firming with them rather than unwinding. **This has stopped being a distortion story and become a broadening one.** We read the print as confirmation that the cycle has turned.

Food

- **Food inflation accelerated to 5.95% in August 2026 from 5.52% in July 2026, with the food and beverages division at 5.66% against 5.24%.** The vegetable rotation continued. Tomato deepened to minus 31.09% from minus 4.60% and potato stayed in deflation at minus 13.14%, but onion more than doubled to 48.27% from 22.54%, garlic firmed to 43.60% from 35.36% and ginger, while easing to 73.82% from 83.57%, is still the second highest item in the index. **The deflating items are getting cheaper while the inflating ones get dearer faster, and the net effect is now clearly upward.**
- **Rural food inflation at 6.13% runs well ahead of urban at 5.64%, and both accelerated from 5.79% and 5.05% in July.** The pressure has also spread west out of the southern belt, with food inflation at 8.10% in Maharashtra, 8.07% in Andhra Pradesh, 7.96% in Tamil Nadu, 7.58% in Karnataka and 7.33% in Telangana. **Food remains the primary upside risk into the second half of FY27, and it is no longer a regional story.**

Core and Underlying Pressures

- **The metals distortion did not fade, and that is the single biggest change from July.** The personal care, social protection and miscellaneous goods division firmed to 15.17% from 14.77%, with the other personal effects group at 44.56%. Silver jewellery eased only to 107.11% from 109.89%, while gold, diamond and platinum jewellery accelerated to 35.53% from 32.98%. **We expected this contribution to shrink from here, and instead it grew.**
- **Strip metals out and the underlying trend is hardening faster than the headline shows.** Transport firmed to 4.60% from 4.43%, with operation of personal transport equipment at 7.40% and transport services for goods at 14.64% against 7.77%, while electricity, gas and other fuels jumped to 3.09% from 2.02% and restaurants accelerated again, as discussed overleaf. **Freight and utility costs of this order feed every other price in the index with a lag.**

The Rural-Urban Divergence

- The national figure continues to mask a widening gap. **Rural CPI was 5.23% in August 2026 against urban CPI at 4.31%, a 92 basis point spread that has widened from 88 basis points in July 2026 and is again the widest of the rebased series.** Rural households carry a higher food and fuel weight and fewer substitution options, and rural food inflation now sits almost 50 basis points above the urban rate.
- We flag this again because **the monsoon has not delivered in the second half as the rural economy needed. With rural prices accelerating into a deficient season, the headline understates what the rural consumer actually pays, and the policy read is harder than a 4.82% print suggests.**



Housing Is No Longer Insulated

- **Housing and utilities inflation firmed to 2.61% in August 2026 from 2.16% in July 2026, with rural at 3.27% and urban at 2.22%.** Actual rentals rose 2.27% and maintenance and repair of dwellings 3.77%, but the move came from electricity, gas and other fuels at 3.09% against 2.02%, with the rural sub index at 3.59%. The one division we described last month as insulated from the crude and currency channel is no longer insulated, and we now expect it to drift higher rather than stay range bound.

State Dispersion

- **Regional dispersion widened further.** Thirteen of 36 states and union territories printed above the national rate in August 2026, up from eleven in July. Telangana again led at 6.27%, followed by Tamil Nadu at 5.92%, Madhya Pradesh at 5.55%, Andhra Pradesh at 5.53% and Odisha at 5.52%. Mizoram was lowest at 2.35%, with Delhi at 2.61% and Meghalaya at 2.74%. **The gap between the highest and lowest state is now close to 400 basis points, and the leaders are all food led.**

Services

- **Services inflation deteriorated again. Restaurants and accommodation accelerated to 8.38% in August 2026 from 7.72% in July 2026, with food and beverage serving services at 8.41%.** Education services firmed to 3.73% on the academic year reset, with urban at 4.29%, while health at 1.34% and information and communication at 2.01% stayed benign.
- This is the mechanism we have been watching for, and it is now running. **Restaurant inflation has crossed 8% and has risen in every month of the rebased series, which is the signature of menu repricing rather than input pass through.** Serving prices do not reverse when vegetable prices fall, so the transitory reading of these pressures is no longer available to us.

Crude and the Import Channel

- **The August print is where the July crude spike landed, and it is visible.** The transport division firmed to 4.60% from 4.43% and purchase of vehicles stayed deflationary at minus 4.38%, but operation of personal transport equipment held at 7.40% and goods freight nearly doubled to 14.64%. Petrol, diesel and LPG are captured on the 15th of each month, and Brent averaged 91 dollars per barrel in August against 84 dollars in July. **The pass through is no longer confined to fuel line items, it is now in freight.**
- September has been worse. **Brent has traded up to roughly 108 dollars per barrel, a four month high, after the Saudi East-West pipeline was shut following drone attacks and talks on a temporary Hormuz shipping corridor were postponed. With India importing over 85% of its crude and the rupee back near 95 to 96 per dollar against a record low close to 97, the crude and currency channel remains the dominant upside risk, and it lands in the September and October prints.**

Monsoon and the Kharif Swing

- **The monsoon failed to build on its July recovery.** After a June roughly 40% below normal and a July at 103% of the long period average, the cumulative season deficit was still 13% on 19 August against about 11% in early August. El Nino conditions were confirmed over the central Pacific in July and are now assigned an 80% to 98% probability of remaining the dominant phase through March 2027. Sowing distribution is still the problem, with acreage down 26% in Karnataka, 12% in Odisha and 8% in Maharashtra. **We expect cumulative kharif acreage to finish 1% to 2% below last year, which keeps food inflation elevated into Q4 FY27.**



What Lies Ahead – The Step Is Bigger and the Base Is Broader

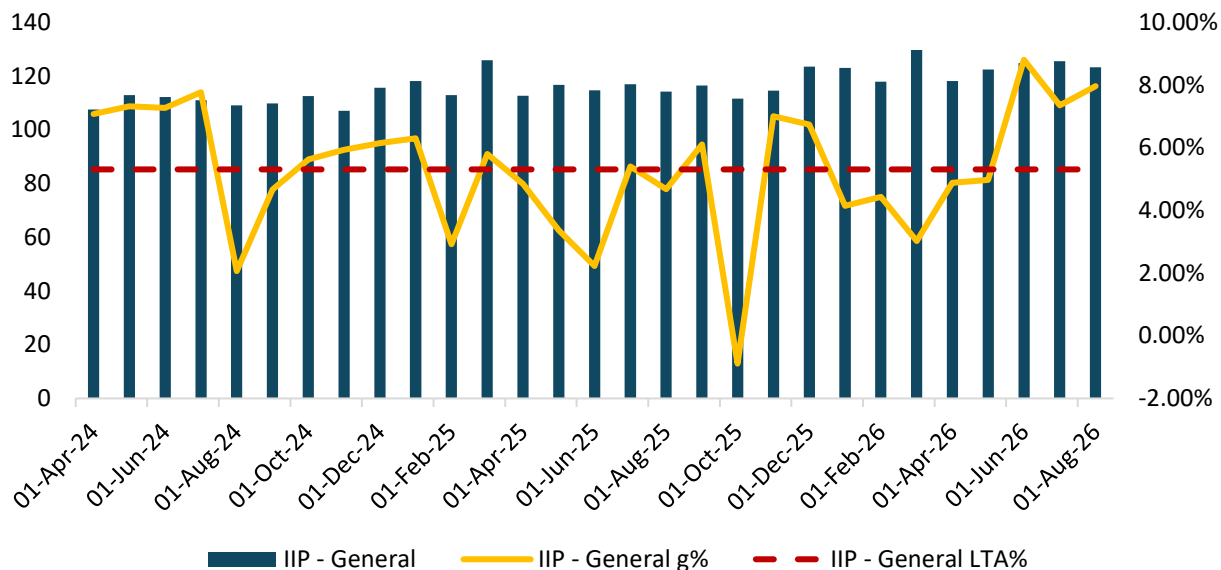
Several factors will determine whether the inflation trajectory tracks the RBI's baseline or breaks higher.

- **The RBI held the repo rate at 5.25% at its August 2026 meeting on a unanimous vote and retained the neutral stance, raised its FY27 GDP growth projection to 6.7% from 6.6% and trimmed its FY27 CPI projection to 5.0% from 5.1%, with the quarterly path at 4.7% in Q2, 5.9% in Q3 and 5.5% in Q4 FY27.** August at 4.82% is already running above that Q2 path, and the next review is on 5 to 7 October 2026.
- **The August print undercuts the case for that downgrade. It leaned on the metals unwind and the monsoon recovery, and neither has held, while food, services and the crude channel have all accelerated together. We expect the headline to move through 5% during Q3 FY27 and to test the upper end of the RBI's 5.9% Q3 projection as the September crude spike and menu repricing transmit.**
- **We continue to view the easing cycle as complete, and within a neutral stance the balance of risk has now shifted towards tightening rather than away from it. With food broadening, services embedding and crude back above 100 dollars per barrel, October becomes the first genuine test of whether the committee is prepared to act on a path it has so far described as food and fuel led.**

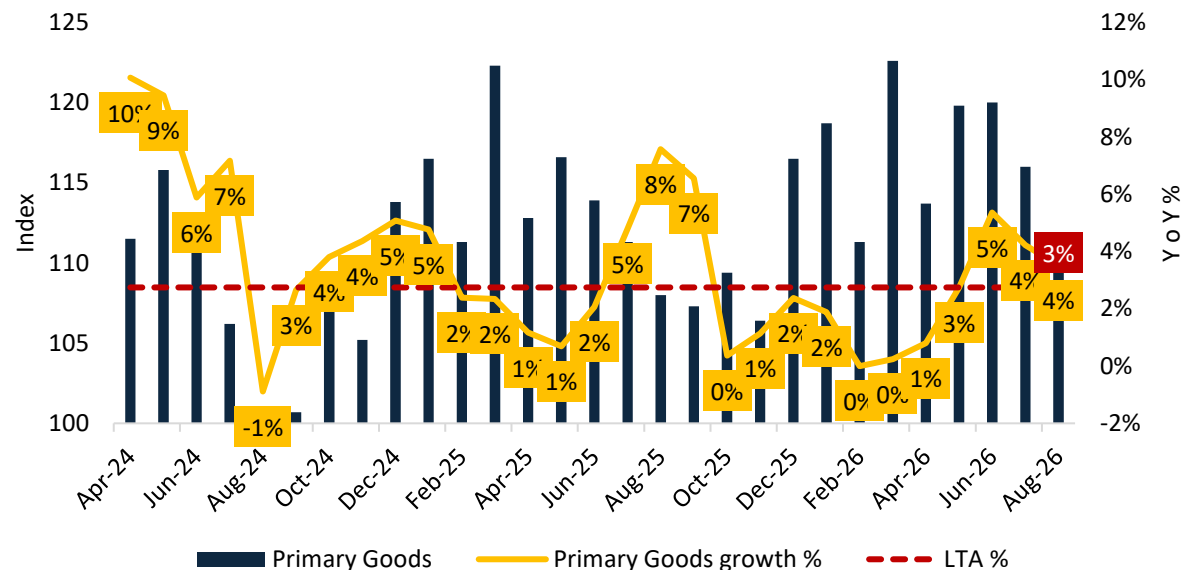
3. IIP



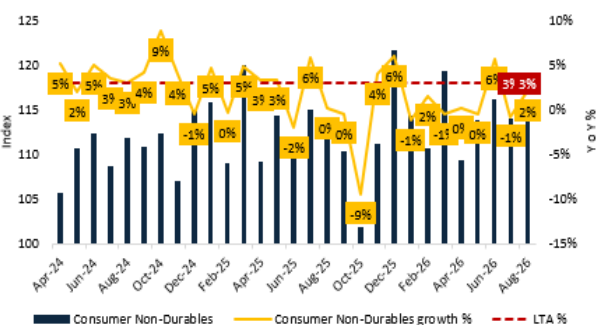
IIP - Industry



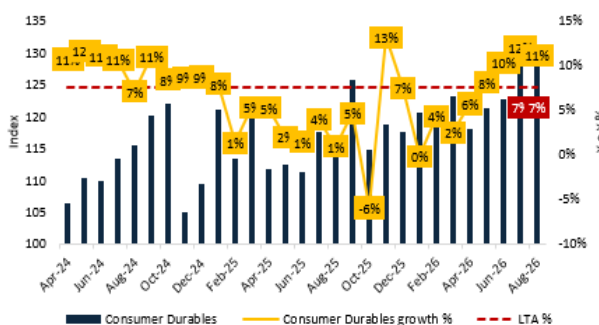
Primary Goods



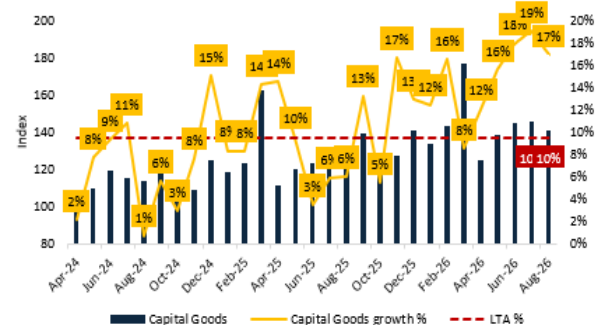
Consumer Non-Durables



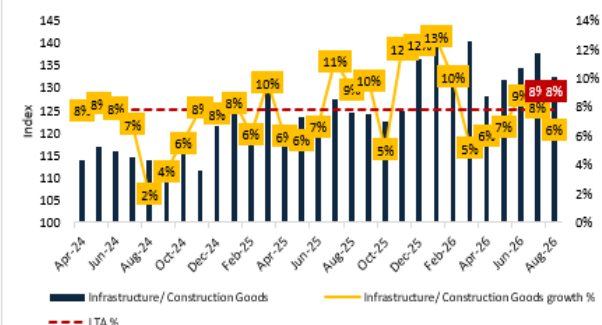
Consumer Durables

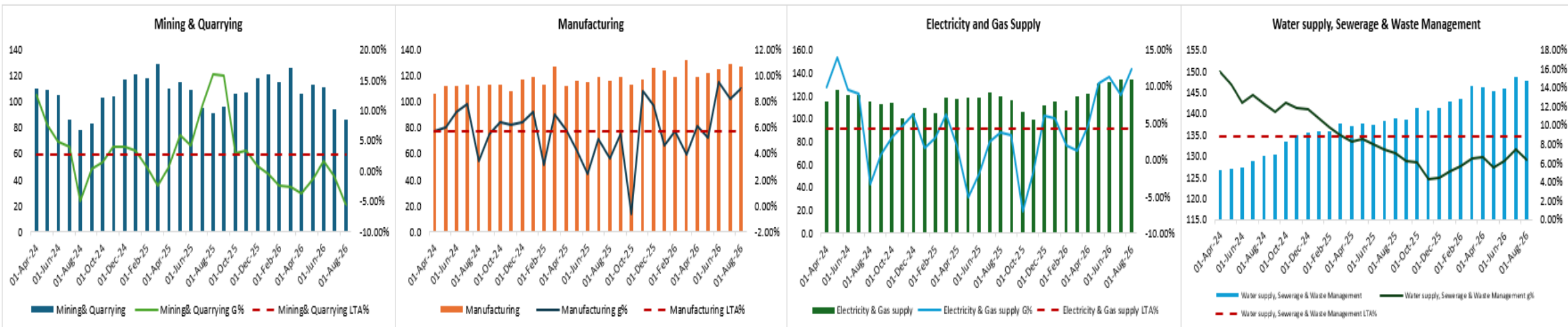


Capital Goods



Infrastructure





Factories Shift Into Top Gear While Mines and Staples Stall

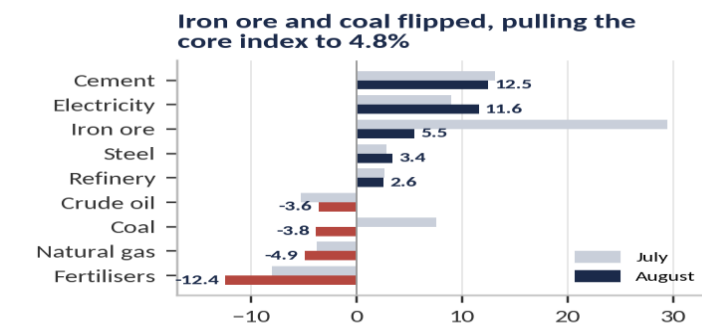
Output Grows 8.0%, and This Time It Is Not Just the Base

India's Index of Industrial Production (IIP), which tracks the physical volume of goods made by factories, mines and power plants, **grew 8.0% in August**, up from a revised 7.4% in July (first reported at 6.7%) and 4.7% a year ago. It is the second-fastest reading in 29 months, behind June's 8.8%. **Growth averaged 7.7% in July and August against 6.2% in Q1**, and 6.7% for April to August against 4.2% a year earlier.

The obvious question is how much of this is the base effect, that is, strong growth simply because last year's number was weak. We tested it by stacking two years of growth together, which strips out the base. June's 8.8% came on a weak 2.2% base, so its two-year growth was only about 11.2%. July and August both come to about 13.1% to 13.2%. In other words, June was flattered by the base, but **July and August reflect a genuine step-up in output, not arithmetic**.



Source: MoSPI, RBI Bulletin Sep 2026 (July revised)



Source: Office of Economic Adviser, % y-o-y

Source: Internal assessment based on RBI DBIE data



The Core Is Cooling Even as the Factory Floor Heats Up

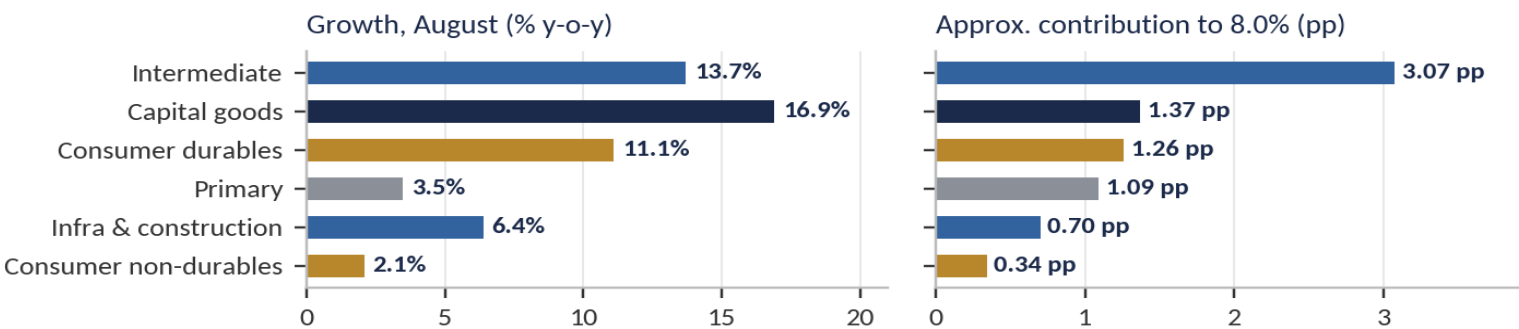
- **The Index of Eight Core Industries, now nine industries with iron ore included**, covers basic inputs such as coal, steel, cement and power and makes up about a third of the IIP. **It eased to 4.8% in August from a revised 5.0%**, a four-month low, and the index fell 1.3% from July. **Two swings did the damage. Iron ore growth collapsed to 5.5% from 29.5%, and coal turned from +7.6% to -3.8%, as monsoon rains disrupted mining. The energy block stayed under water, with crude oil at -3.6%, natural gas -4.9% and fertilisers -12.4%, the last two reflecting gas supply constraints from the West Asia conflict. Construction inputs held up, with cement at 12.5% and electricity at 11.6%, though steel slowed to 3.4%.**
- **The gap between the two indices is itself a signal. If the core, at roughly a third of the IIP, grew 4.8%, the rest of the index must have grown about 9.6% to produce an 8.0% headline. Growth is coming from what factories make out of basic inputs, not from the inputs themselves.**

Manufacturing Carries the Index, Power Surges, Mines Slip

- **Manufacturing (+9.0%), about 89% of the growth.** It has **now grown 8% or more for three straight months, with 18 of 23 industry groups expanding.** The leaders are **all capex or discretionary-linked.** Electrical equipment rose 30.9%, other transport equipment 25.3%, motor vehicles 25.2%, rubber and plastics 21.4% and computers and electronics 19.3%. Beverages grew 18.3%, helped by a hot August. **The five laggards tell their own story.** Apparel (-7.4%) mirrors the 2.7% fall in garment exports, while refined petroleum (-0.6%) and chemicals (-0.5%) **reflect costly crude and feedstock. Part of the jump also comes from a favourable base, as firms cut inventory in August 2025 ahead of the GST rate cuts.**
- Electricity and gas (+12.3%), the fastest in over two years. August 2026 was the second-hottest August since 1901 and rainfall ran 16% below normal, so both cooling and irrigation pumping drove demand up 12.8%. Renewable generation grew 15.4% and conventional 12.3%, but gas supply fell 2.4%, again pointing to West Asia.
- **Mining (-5.6%), a weather and base story. Non-metallic minerals fell 12.8% and fuel minerals 5.7%, while metallic minerals grew 5.0%. Last August mining grew 15.8%, so the base is punishing. We read this as seasonal rather than a structural slowdown.**

Investment and Inputs Lead, Staples Lag Behind

Intermediate goods did the heavy lifting, while staples barely moved



Source: MoSPI. Contribution = growth x base-year weight, Kilika Capital calculation.



- The use-based split, which groups goods by who buys them, shows where demand sits. Intermediate goods, the parts and materials firms buy to make other products, accelerated to 13.7% from 10.4% and contributed nearly 40% of the growth. That usually signals firms stocking up ahead of festive production. Capital goods, the machinery firms buy to expand capacity, grew 16.9%, slower than July's 19.0% but still the fastest category, backed by capital goods imports up 23.7% and bank credit to industry up 20%. Infrastructure and construction goods slowed to 6.4% from 8.0%, as monsoon months usually slow building sites.
- On the consumer side, the split is stark. **Consumer durables, such as vehicles, phones and appliances, grew 11.1%, while consumer non-durables, everyday staples such as food, soaps and tobacco, grew just 2.1%** after contracting 0.8% in July. Non-durables carry a bigger weight in the index (16.2% against 11.3%), so their weakness costs the headline more than it seems.

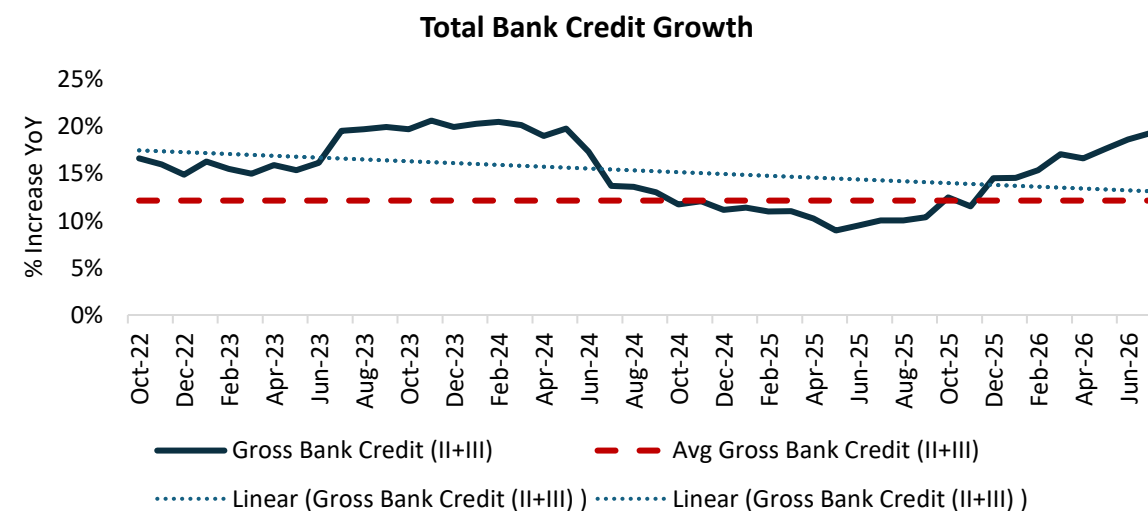
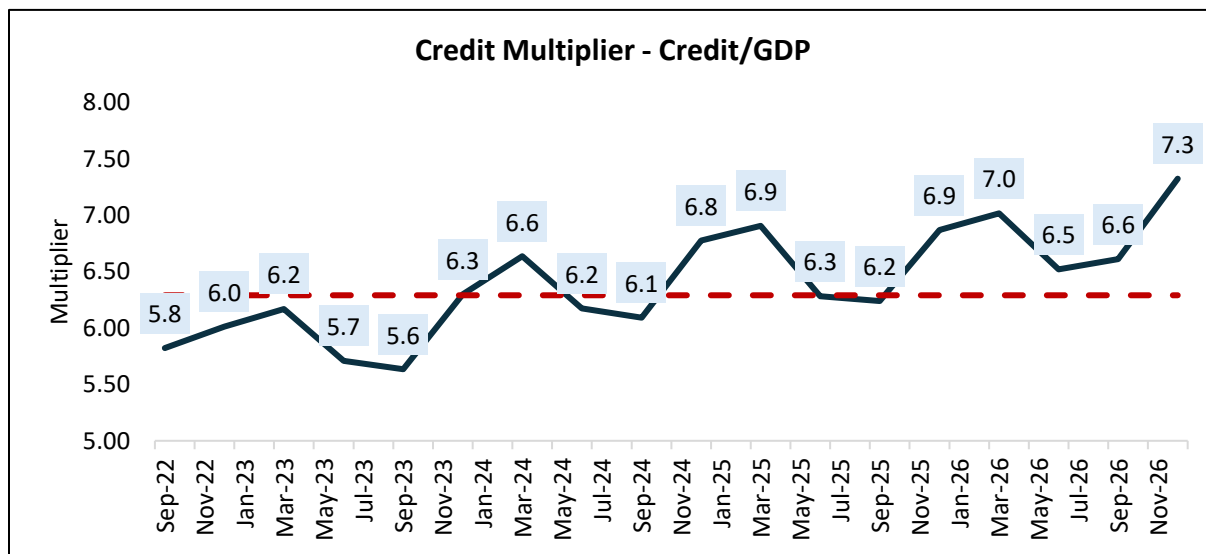
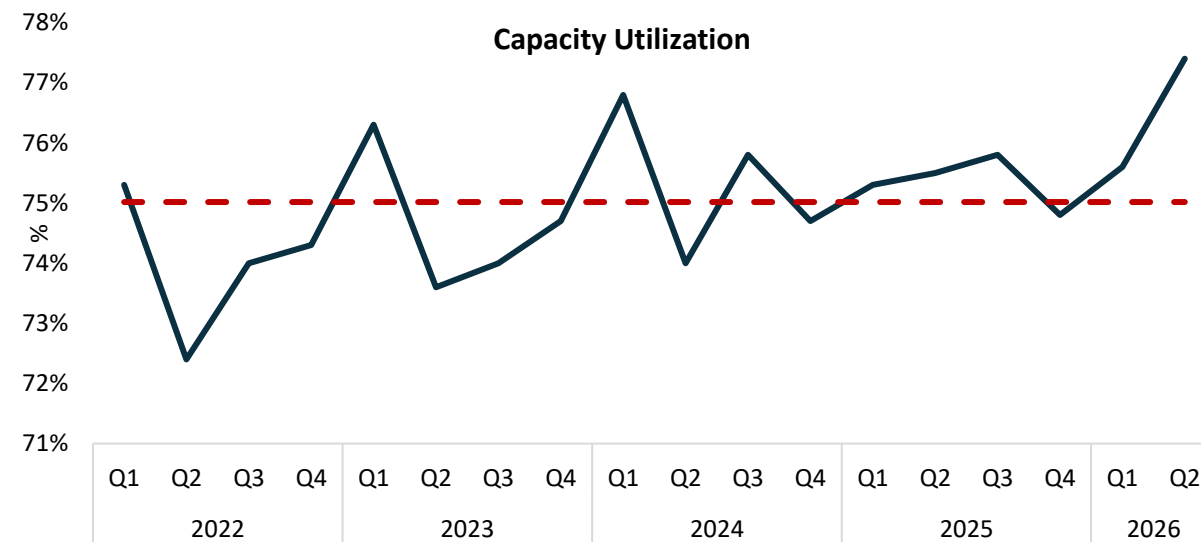
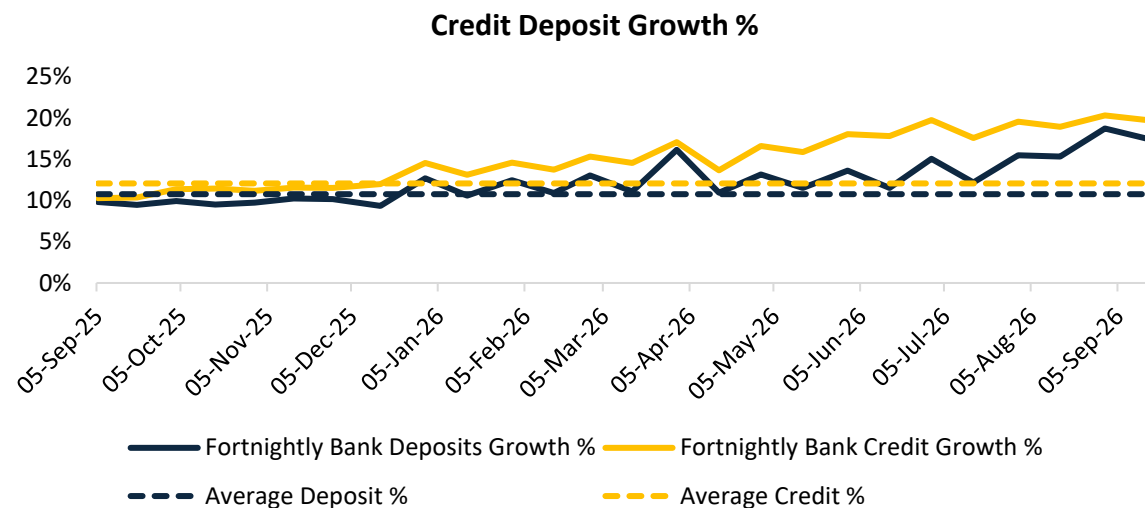
Three Things the Headline Does Not Show

- **A two-speed consumer.** Durables are selling on credit, with vehicle loans up 18.8% and record auto retail, while staples depend on everyday incomes that food inflation of 5.7% is eating into. In our view, higher prices and weak purchasing power are holding back staples output. Until rural incomes recover, the consumer engine runs on the discretionary side only.
- **Volume is strong, value may not be.** The IIP measures quantities, not profits. **With WPI inflation at 9.9% and input costs high, firms are producing more but earning thinner margins. We expect strong volumes to partly offset this margin squeeze in Q2 GDP, but manufacturing GVA, which is value-based, is likely to grow more slowly than the IIP suggests.**
- **Domestic demand is carrying export weakness.** The September flash PMI shows export orders growing at their weakest pace in almost three years, and apparel output is shrinking. Today's manufacturing boom is being driven by Indian buyers, which makes it more sensitive to domestic interest rates.

We See Momentum Holding, With the Festive Calendar Setting the Rhythm

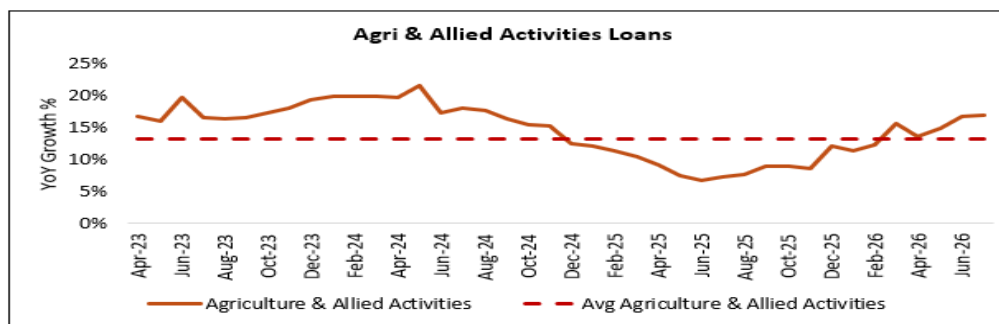
- **The festive calendar will set the rhythm.** We expect growth to cool in September as the base from last year turns tougher. October should then look unusually strong, because Diwali fell in October last year and cut factory working days, while this year it falls in November. The holiday drag therefore shifts into November, which is likely to look soft. Investors should read October and November together rather than react to either month alone.
- **Our view for the year.** We expect industrial momentum to hold through FY27, led by manufacturing, capital goods and power, though at a slightly gentler pace than the summer months. Factory orders are rising, the private capex pipeline is strong, and the RBI's own assessment describes industrial activity as resilient despite the West Asia conflict.
- **What the market is weighing.** On the supportive side, markets are pricing in festive demand, a steady investment cycle and strong credit flow to industry. On the risk side, they are weighing a possible rate hike at the October policy, which would raise borrowing costs for the credit-financed durables and machinery now leading growth. They are also watching crude oil and gas supply from West Asia, which keep the energy and fertiliser blocks weak and squeeze factory margins, and a weak end to the monsoon, which puts rural demand for everyday staples at further risk. The signals we will track are consumer non-durables, whether the build-up in intermediate goods turns into final sales, and whether mining recovers once the rains end.

4. Capex

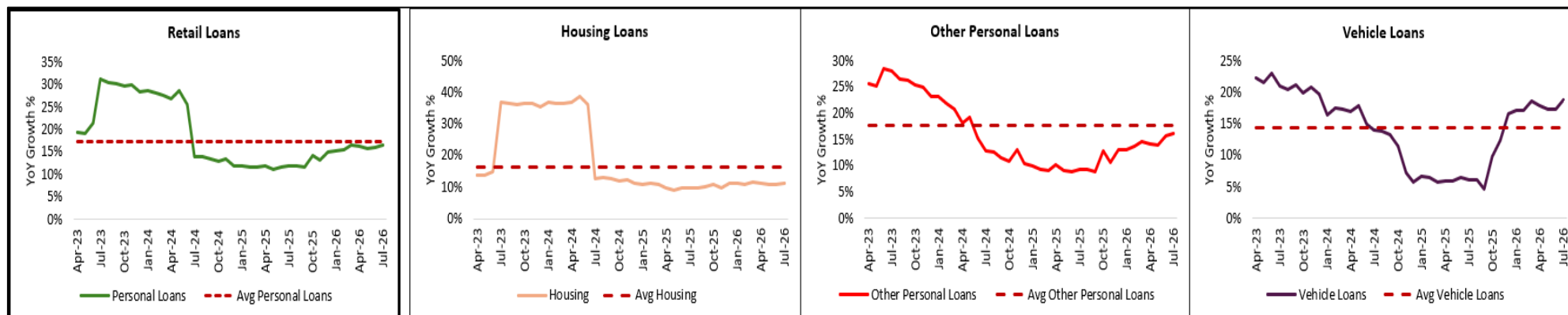




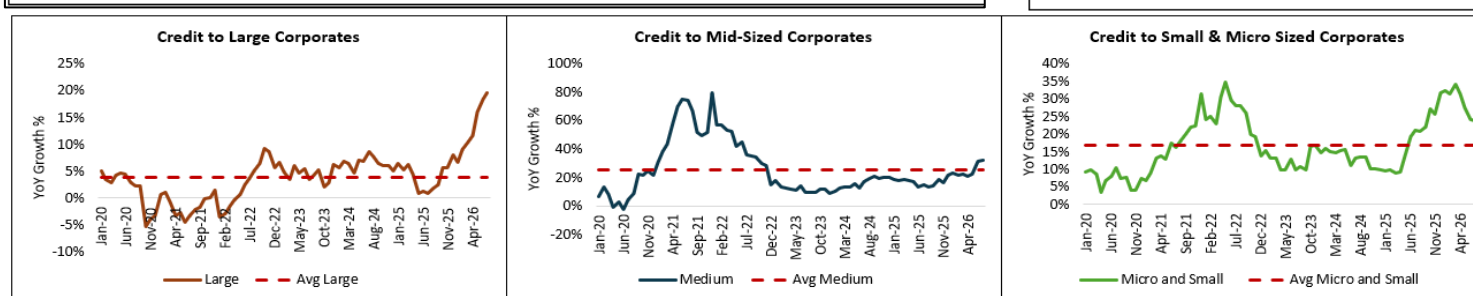
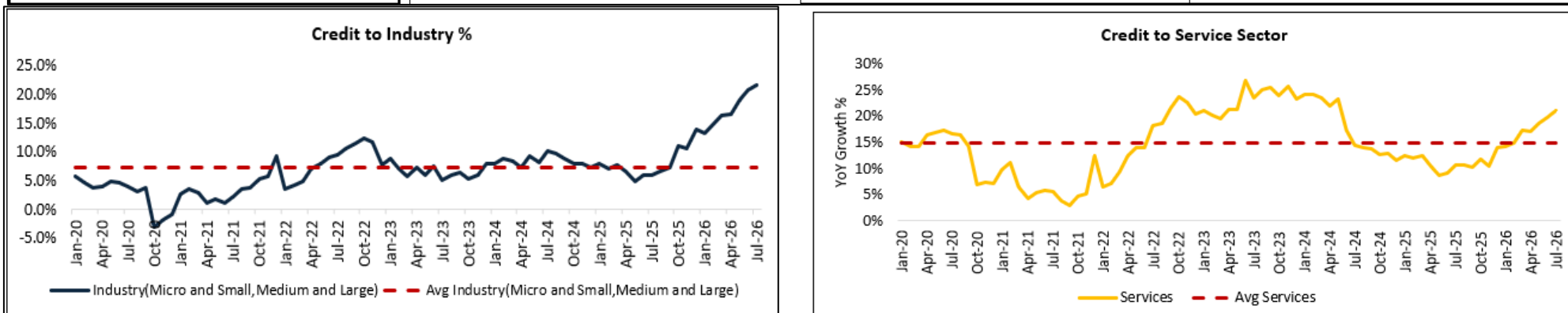
Credit to Agri



Credit to Consumer



Credit to Industry





Capex Is Firing on Both Engines, but the Deposit Catch-Up Needs a Second Look

India's investment cycle is in its strongest phase in over a decade. The government is spending faster than its budget plan, private firms have a record pipeline of projects, and banks are lending to capex-heavy industries at 20% to 35% growth. What changed this quarter is the funding side. For three years, bank credit grew far faster than deposits, and the market worried that banks would run out of money to lend. That gap has now almost closed. Our analysis shows it closed mainly because of a one-time surge of foreign currency deposits, not because Indian savers suddenly deposited more, and that distinction shapes our outlook.

The Government Built the Base, and the Investment Numbers Show It Is Still Building

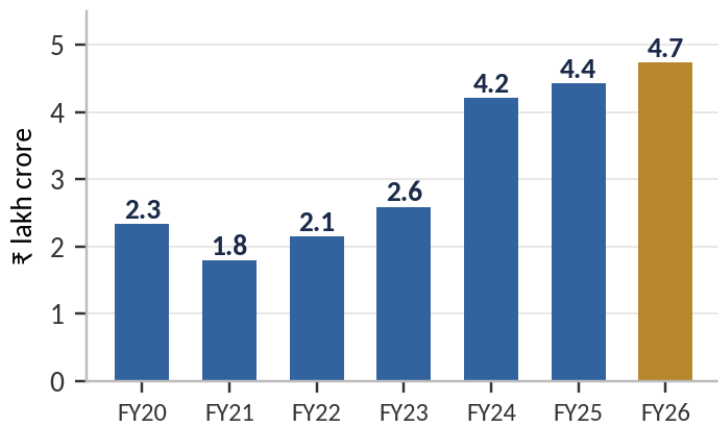
- **Gross fixed capital formation (GFCF), the national accounts measure of money spent on new factories, roads, machinery and buildings, grew 11.9% in real terms in Q1 FY27, its highest in the new GDP series and up from 7.2% a year ago. Its share in GDP stood at 33.2% in FY26. At current prices, GFCF grew 20.4%. The public sector is still the anchor. Union government capex grew 29.9% in April to July, and the Centre has already spent 36.9% of its full-year capex budget against 30.9% by the same point last year. States, too, have spent 16.8% of their capex budget, slightly ahead of last year, while cutting their revenue deficits.**

Private Capex Plans Are at a Record, and FY27's Pipeline Is Already 24% Ahead

- The **RBI's annual study of private investment tracks projects funded by bank or FI loans, by ECBs raised abroad, or by IPOs.** It gives three different numbers, and they are easy to mix up because a big project is not paid for in one year. Think of buying a house on instalments. The price of the house is one number, and the instalment you pay each year is another.
- Total project cost, the price of the house. In FY26, banks and FIs approved loans for 1,032 new projects with a combined cost of a record ₹4.35 lakh crore, up from ₹3.68 lakh crore in FY25. Including ECB and IPO funded projects, the **total is 1,839 projects worth ₹5.64 lakh crore.** This money is spent over several years. Of the ₹4.35 lakh crore, firms planned to spend 43% in FY26, 35% in FY27 and the remaining 22% later.
- Spending in a year, the instalment. Adding up the FY26 instalments of all projects, old and new, private firms planned to spend ₹4.73 lakh crore during FY26, 6.9% more than in FY25.
- The pipeline, instalments already fixed for the coming year. Projects approved in FY26 or earlier have already scheduled ₹3.2 lakh crore of spending for FY27. To compare like with like, the projects approved up to FY25 had scheduled ₹2.6 lakh crore of spending for FY26. So FY27 starts 24% ahead of where FY26 started, before any project approved during FY27 is added. That is why the FY27 figure looks smaller than FY26's ₹4.73 lakh crore today. It will rise as new projects are approved through the year.
- The **RBI's own statistical test finds that a 1% rise in planned capex lifts actual private corporate GFCF by about 0.33% over time. On that relationship, a 24% stronger pipeline points to roughly 8 percentage points of support to private investment growth.**

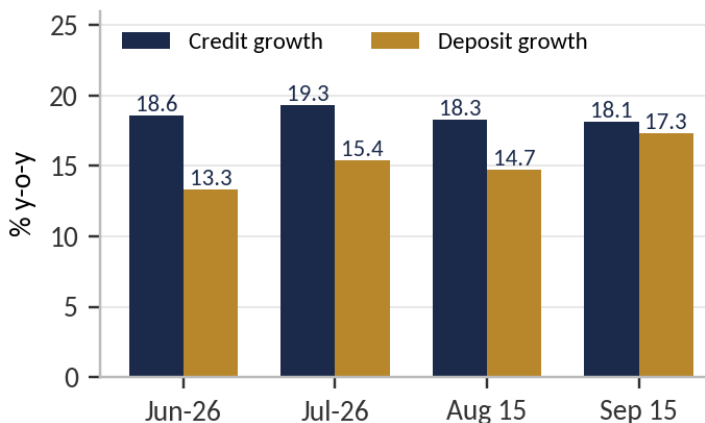


Planned private capex spend has more than doubled since FY22



Source: RBI Bulletin Sep 2026, Table A4 (banks, FIs, ECBs, IPOs)

The credit-deposit gap shrank from 5.3 to 0.8 percentage points in three months



Source: RBI Bulletin Sep 2026, SCBs (Section 42 returns)

- Where the money is going. Infrastructure takes 54.2% of project cost, led by power (39.6%) and roads and bridges (8.5%), followed by construction (11.2%), chemicals (5.9%), metals (4.8%) and cement (4.0%). **Greenfield projects, meaning brand new capacity rather than upgrades, make up 89.2%, and large projects of ₹1,000 to 5,000 crore now account for 51.3% of cost.** Maharashtra (20.2%), Gujarat (17.9%) and Rajasthan (11.1%) lead the states, and the top six hold 67.1% of project cost.
- How it is being paid for. **Funding is moving beyond banks. 509 companies raised ₹1.05 lakh crore through ECBs for capex, while IPO-funded capex fell to ₹23,809 crore. ECB registrations in April to July jumped to US\$ 22.3 billion from US\$ 12.5 billion, with about 31% earmarked for capex.**

Factories Are Busy but Not Full, So the Greenfield Wave Is Mostly Power and Infrastructure

- Capacity utilisation (CU) tells us how much of existing factory capacity is actually being used. The latest RBI survey reading we have, for Q3 FY26, was 75.6% (75.5% seasonally adjusted). History suggests firms start building new factories in a broad way only when CU sustains near 78% to 80%. Below that, they sweat existing plants first. This explains a puzzle in the data. Greenfield projects are 89% of sanctioned cost, yet manufacturing CU is not at the trigger level. The answer is that **most greenfield money is going into power and infrastructure, which are driven by demand and policy rather than by full factories.** That said, the hard data on machinery is strong. IIP capital goods grew 15.2% in Q1 and 16.1% in July, capital goods imports rose 25.7% in Q1 and 23.7% in August, cement output grew 12.5% in August, and bank term loans, the loans that fund long-term assets, grew 15.4% in June against 8.3% a year earlier. **Utilisation is climbing towards the trigger zone, not away from it.**

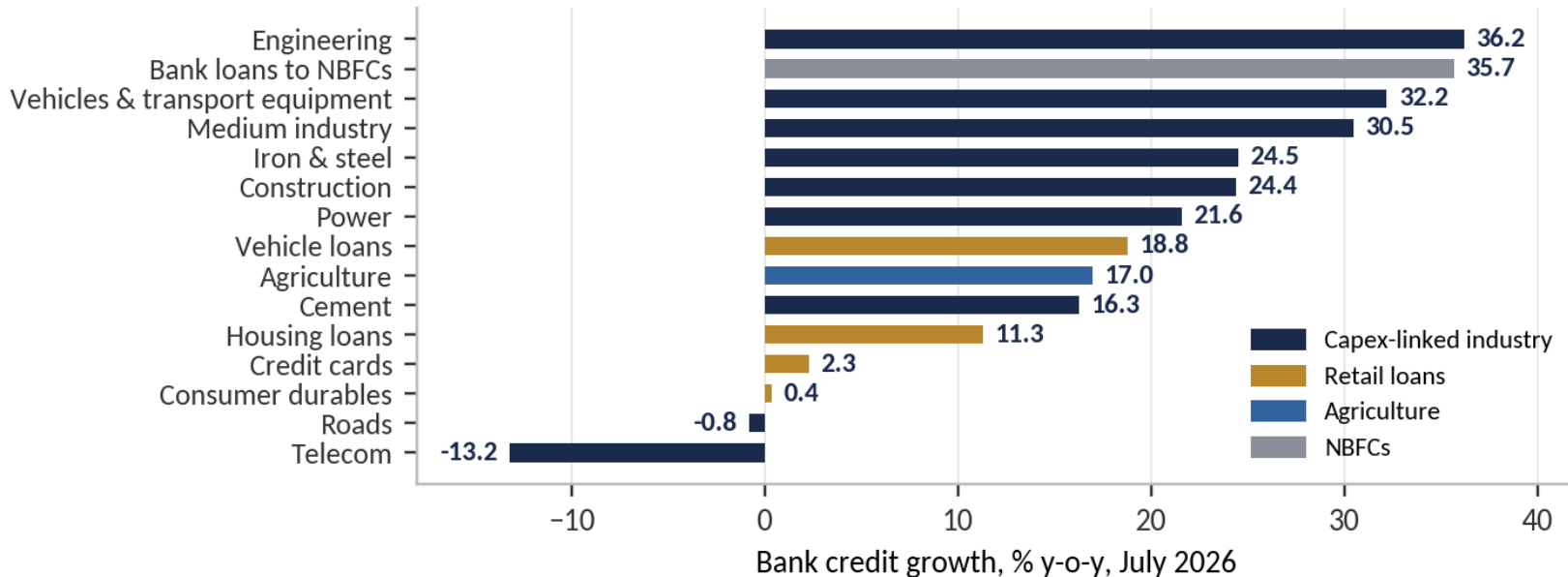
Deposits Have Caught Up With Credit, but Mostly on Borrowed Dollars

- **Bank credit growth stood at 18.1% on September 15, while deposit growth jumped to 17.3%, having touched 17.8% on August 31, its fastest in 15 years. The gap between the two has narrowed from 5.3 percentage points in June to 0.8.** The incremental credit-deposit ratio, which measures how much of each new ₹100 of deposits is lent out, fell to 84.1% from about 114% in May, when banks were lending more than every new rupee they raised.

- We would not call this a structural fix. **The trigger was the FCNR(B) scheme, which brought in US\$ 133 billion of foreign currency deposits between June 8 and August 31.** At about ₹95 to the dollar, that is roughly ₹12.6 lakh crore, equivalent to about three-quarters of the ₹16.5 lakh crore of deposits the banking system added this year to August. The RBI's own balance sheet data confirm it, with the banking system's net foreign assets up ₹9.4 lakh crore this year, nearly matching the ₹10.3 lakh crore rise in credit. **Strip out the dollar inflow, and domestic deposit growth is still running well behind credit.**
- Does that matter? It matters less than the market thinks. Banks create a deposit every time they make a loan, so deposits are not a fixed pool that must exist before lending. The study shows how banks funded the credit-deposit gap between September 2021 and March 2026. For every ₹100 of new deposits, banks gave ₹102.2 of loans and bought only ₹24.7 of investments, drawing the difference from ₹15.5 of new capital and ₹13.6 of borrowings. The credit-deposit ratio rose from 68.6% to 82.2% over this period, but bank health improved at the same time. Gross NPAs are at 1.8%, the capital adequacy ratio is 17.7%, and the liquidity coverage ratio is 124.2%, well above requirements. We agree that a high ratio is not a warning sign on its own. Our caution is narrower. **Part of today's comfort is temporary, and the dollar deposits will start leaving as they mature over the next one to five years.**
- **The bond market is also pushing firms back to banks. Corporate bond issuance by non-financial firms fell to just ₹34,910 crore in April to July from ₹1.53 lakh crore a year ago, as bond yields rose. Commercial paper raised ₹1.23 lakh crore. Total funds flowing to the commercial sector rose to ₹17.46 lakh crore this year to August, from ₹11.24 lakh crore, with bank credit (₹9.84 lakh crore) and FDI (₹2.49 lakh crore) doing most of the work.**

The Loan Book Tells the Same Story, Capex Credit Is Booming and Unsecured Retail Is Cooling

Capex-linked industries lead bank credit, while unsecured retail has almost stalled





- Industry (+20.0%). The capex signal is clearest here. Engineering (+36.2%), vehicles and transport equipment (+32.2%), iron and steel (+24.5%), construction (+24.4%) and power (+21.6%) are all growing strongly. Medium-sized firms (+30.5%) and small firms (+22.6%) are outpacing large ones (+17.7%). Within infrastructure (+10.2%), roads (-0.8%) and telecom (-13.2%) are shrinking as those firms repay debt or tap bond markets.
- Services (+22.9%). Bank loans to NBFCs grew 35.7%, as NBFCs increasingly act as the channel through which bank money reaches smaller borrowers. Commercial real estate grew 21.5%.
- Agriculture (+17.0%). Farm credit is growing steadily, supported by strong procurement and comfortable food stocks, even with a weak monsoon.
- Personal loans (+16.2%). The mix is shifting towards secured loans. Vehicle loans grew 18.8%, in line with 2-wheeler and car sales up 20% to 26% in Q1, and housing loans a steadier 11.3%. Credit cards (+2.3%) and consumer durables (+0.4%) have nearly stalled, reflecting tighter lending norms on unsecured credit. Gold loans rose 88.1%, but this is inflated by a bank reclassifying farm loans and by record gold prices.

We See Capex Staying Strong in FY27, but a Rate Hike and Costly Oil Will Slow Its Pace

The RBI study expects the investment outlook to remain healthy, though global uncertainties are likely to temper sentiment. It stresses that actual capital formation depends on projects being executed on time and on how the external environment evolves. It also notes that corporates have strengthened their balance sheets through debt reduction and strong internal cash flows, and that banks have strong capital and liquidity buffers.

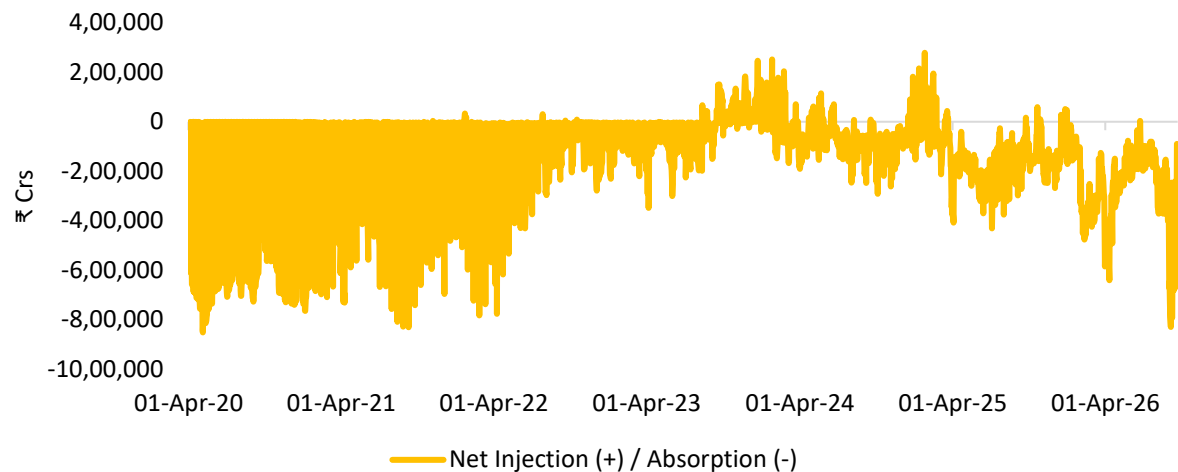
Our view. We expect the capex cycle to hold its momentum through FY27, with private planned spending of at least ₹3.2 lakh crore already locked in from the pipeline. We expect real GFCF growth to moderate from 11.9% in Q1 to about 9% to 10% for the full year. The Centre has less room to accelerate after front-loading 37% of its budget by July, and three headwinds will slow private execution. First, we expect a 25 bps repo rate hike in October, and banks cut rates on fresh loans by only 81 bps during the 125 bps easing cycle, so a hike will raise borrowing costs quickly. Second, Indian crude above US\$ 110 and WPI inflation near 10% squeeze the margins that fund internal capex. Third, with 10-year G-sec yields near 7.2%, firms will lean further on bank loans, keeping pressure on bank funding once FCNR(B) inflows fade.

What would change our view. On the upside, a sustained move in capacity utilisation above 78% would signal that manufacturing, not just power and roads, has joined the cycle. On the downside, a slowdown in industrial term loans or a fresh widening of the credit-deposit gap as dollar deposits mature would tell us funding, not demand, has become the constraint. We will track IIP capital goods, capacity utilisation and the incremental credit-deposit ratio.

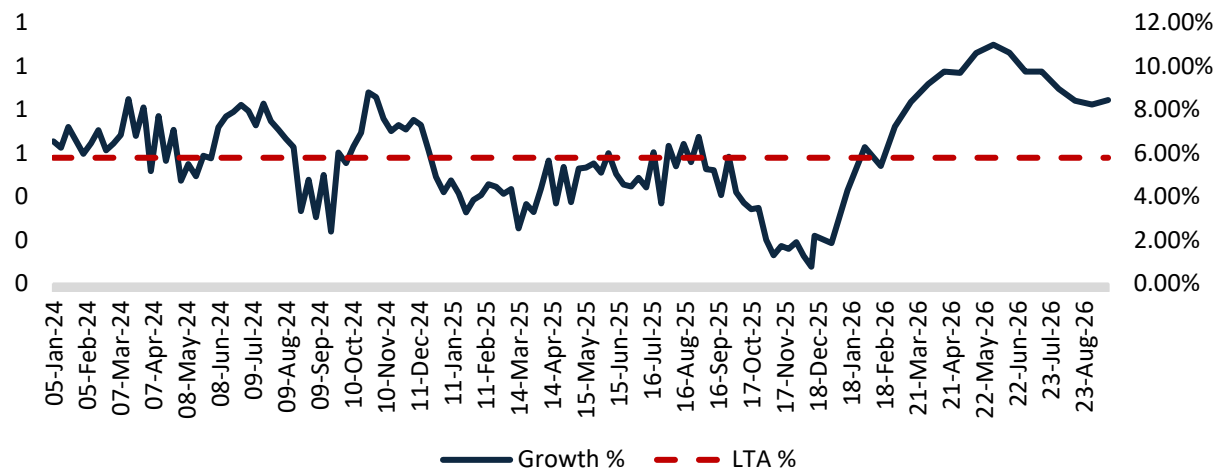
5. Liquidity



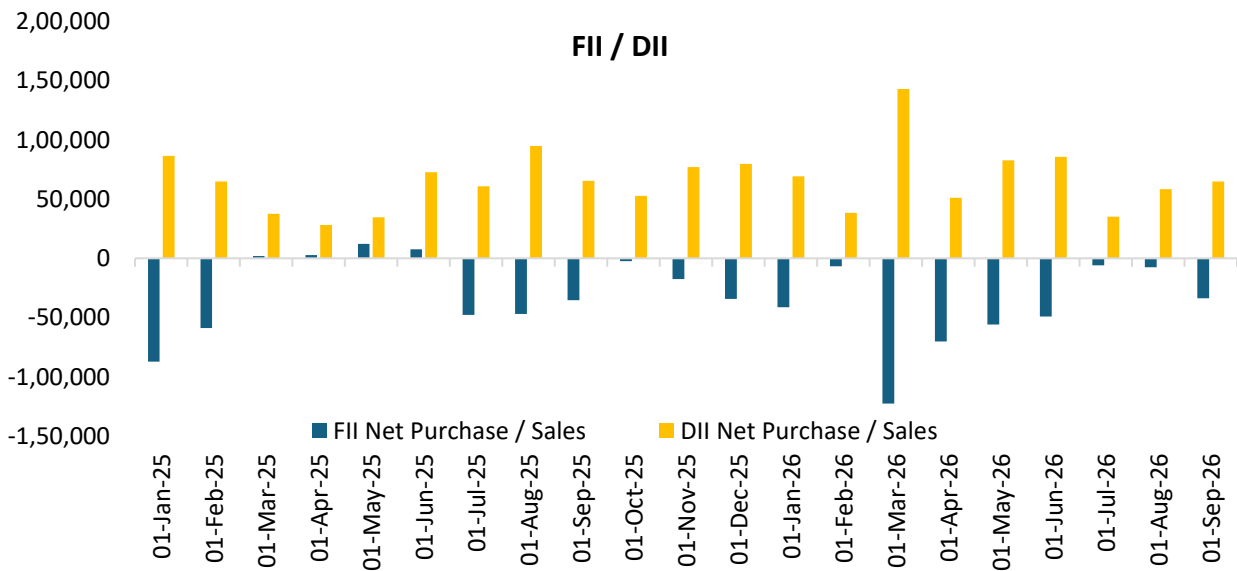
Net Injection(+)/Absorption(-) of Excess Liquidity



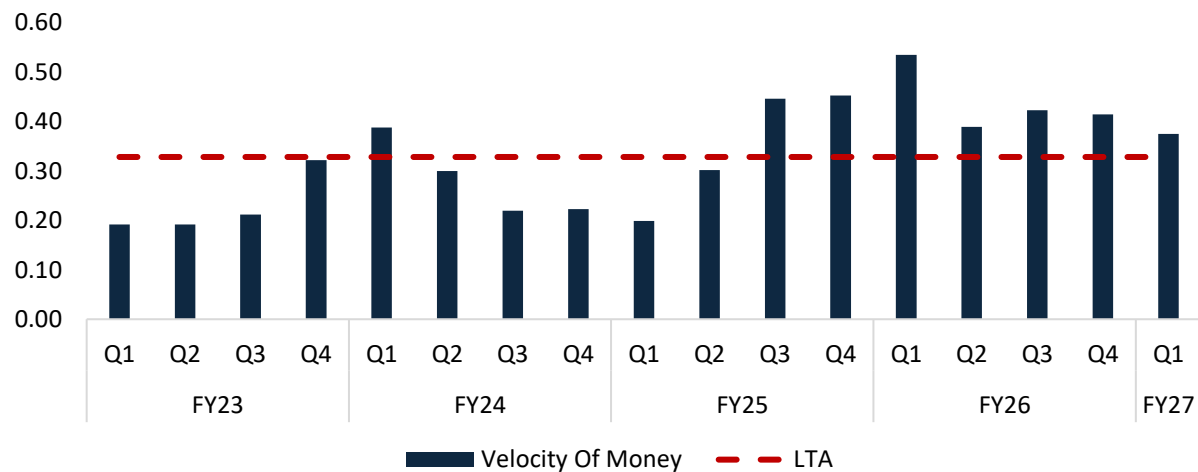
Reserve Money (M0)



FII / DII



Velocity of Money



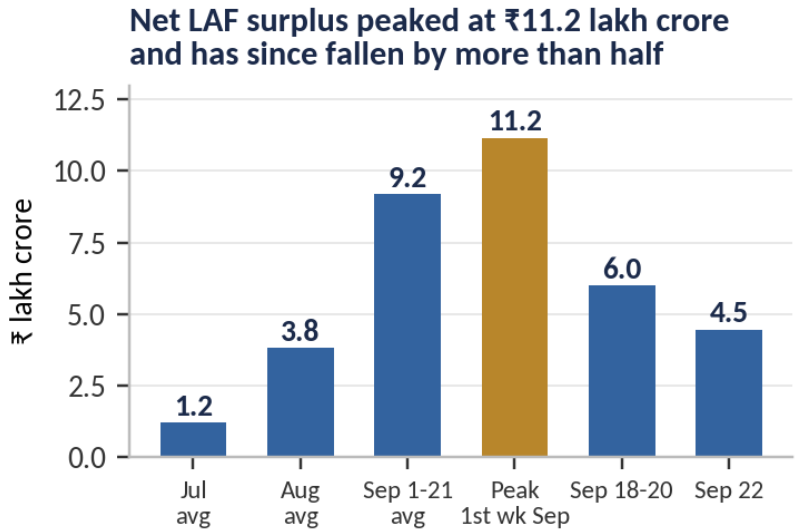
The Flood Is Receding on the Screen, Not Yet in the System



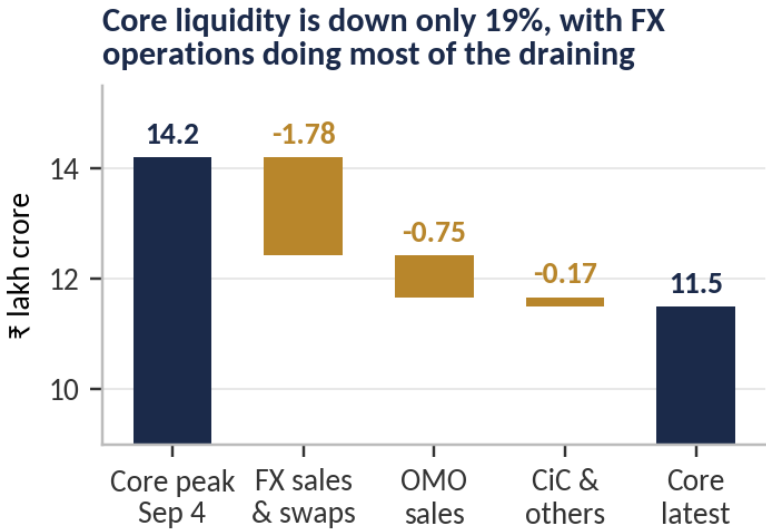
September was the month the RBI stopped hosting the liquidity party and started clearing the room. Its concessional dollar swap window pulled in more than US\$ 140 billion, well above official expectations, and every dollar the RBI took in via that swap created rupees inside the banking system. The result was a record surplus that pushed the overnight call rate below the RBI's own floor. The drain that followed has been fast on the headline number and slow underneath it, and that gap is the core of our analysis.

The Surplus Has Halved on the Screen, but Only a Fifth of It Has Actually Left

- **System liquidity**, measured as the average daily net absorption under the Liquidity Adjustment Facility (LAF), which is the cash banks park with the RBI because they have nowhere better to lend it, **rose from ₹1.2 lakh crore in July to ₹3.8 lakh crore in August and ₹9.2 lakh crore in September (till 21st), peaking at a record ₹11.16 lakh crore in the first week of the month. The trigger was the FCNR(B) swap facility, under which banks mobilised US\$ 133.0 billion of FCNR(B) deposits between June 8 and August 31, alongside US\$ 5.3 billion each via ECBs and overseas foreign currency borrowings.**
- **By September 22, the surplus had shrunk to ₹4.45 lakh crore. We would not read this as genuine tightening.** A large part of the fall came from mid-month advance tax and GST outflows, which simply move cash from bank accounts into the government's account at the RBI. That money is parked, not destroyed, and it flows back as the government spends. The cleaner gauge is **core liquidity, which adds government cash balances back to the LAF number. Core liquidity has fallen only 19%, from ₹14.2 lakh crore on September 4 to ₹11.5 lakh crore, and the durable surplus is still estimated at about ₹13 lakh crore.** Without the RBI's intervention, the peak would have been closer to ₹15.5 lakh crore.



Source: RBI Bulletin Sep 2026, RBI daily data, market reports



Source: IDFC FIRST Bank estimates, Kilika Capital calculations (₹96/\$)



The RBI Is Draining With Bonds and Dollars, Not With the CRR

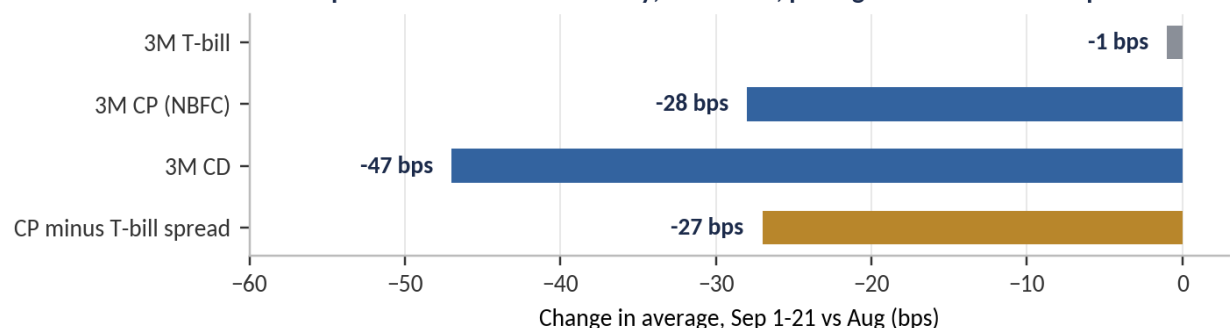
- The RBI is running a layered toolkit, matching each instrument to the shelf life of the surplus it is targeting.
- Temporary surplus, via reverse repos. Between August and September 21, the RBI ran 40 fine-tuning variable rate reverse repo (VRRR) auctions of overnight to 7-day tenor at an average bid-to-offer ratio of 0.68, plus three term VRRRs of over 14 days that drew only 0.24. The weak appetite for term VRRRs is telling. Banks are unwilling to lock cash for two weeks at near-repo rates while a rate hike debate is live, and prefer the flexibility of the standing deposit facility (SDF), where average balances rose to ₹2.17 lakh crore.
- Durable surplus, via bond sales. The RBI announced open market operation (OMO) sales of ₹1 lakh crore in three tranches, ₹50,000 crore on September 17 and ₹25,000 crore each on September 21 and 28. Demand has been strong, with the first two tranches covered 2.36 times on average and the September 21 tranche drawing ₹84,942 crore of bids against ₹25,000 crore on offer. The appetite is rational. **A 10-year G-sec at 7.05% offers banks roughly 200 bps more carry than parking cash at the SDF rate of 5.00%. Net bond sales this year are now the largest in over a decade.**
- Durable surplus, via the dollar. This has been the heavier lever. Through sell-buy swaps of at least US\$ 10 billion (one to six months) and spot dollar sales, the RBI has made net dollar sales of about US\$ 18.5 billion, draining roughly ₹1.8 lakh crore, more than double the OMO drain so far. Swaps absorb rupees without adding to bond supply, but the cost shows up elsewhere. The one-year dollar-rupee forward premium has risen about 50 bps this month, raising hedging costs for importers and borrowers of foreign currency debt.
- What the RBI has not used is the CRR. The cash reserve ratio (CRR) is the share of deposits banks must keep with the RBI at zero interest. Raising it would lock up cash instantly, but it hurts bank profits because that money earns nothing. Governor Malhotra has said the RBI has several ways to drain liquidity, and it has exempted FCNR(B) deposits from CRR, which tells us a broad CRR hike is not its first choice. We agree. OMOs and swaps also remove cash, but at a market price, so banks still earn a return on the money taken out.
- **Part of the surplus will reverse on its own, but slowly. When banks brought in FCNR(B) dollars, the RBI bought those dollars and promised to sell them back when the deposits mature, in one to five years.** On each maturity, banks pay rupees to the RBI to get their dollars back, and those rupees leave the system. These promised future dollar sales stood at US\$ 136.8 billion at end-July, up from US\$ 103.3 billion at end-June, and US\$ 91.5 billion of them fall due after more than a year. So this self-correcting drain is real but spread over years. The short sell-buy swaps work the other way round. Today the RBI sells dollars and takes rupees out, and on maturity it buys the dollars back and returns the rupees. About US\$ 10 to 15 billion of these mature before March 2027, so part of September's drain will flow back into the system in the January to March quarter, when banks usually need extra cash for year-end.

Overnight Rates Are Back at Repo, and Term Rates Have Stopped Falling

- The policy corridor runs from the SDF rate of 5.00% (floor) through the repo rate of 5.25% to the marginal standing facility (MSF) rate of 5.50% (ceiling). The weighted average call rate (WACR), the RBI's operating target, averaged 5.15% in August and 5.03% in September (till 21st), and dipped to 4.92% on September 18, below the floor. How can a rate fall below the floor? The SDF floor only works for those who can use it. Banks with SDF access will not lend below 5.00%, since they can earn that risk-free at the RBI. But some call market lenders, mainly smaller co-operative banks, cannot park money at the SDF. With the system this flush, almost no one needed to borrow, so these lenders accepted whatever rate they could get rather than leave cash idle, and that pulled the average below the floor. In effect, the market was running policy about 25 bps looser than the MPC had set, with CPI inflation at 4.8% and WPI at 9.9%. OMO sales and tax outflows restored the anchor, with the WACR settling at 5.24% on September 21 and the overnight VRRR clearing at the same rate. Borrowing under the MSF, a sign of stress, fell to ₹976 crore a day.



The surplus flowed into term money, not T-bills, pulling CD rates down 47 bps in a month



Source: RBI Bulletin Sep 2026 (State of the Economy)

- Why overnight rates matter for three-month rates. The overnight rate is the base on which all short-term borrowing is priced. A 3-month certificate of deposit (CD), which is how banks borrow, or a 3-month commercial paper (CP), which is how NBFCs and companies borrow, is priced as the expected overnight rate plus a premium for time and credit risk. When the system is flooded, two things happen at once. Banks have so much cash that they stop issuing CDs, so CD supply dries up and rates fall. Banks and money market funds with surplus cash then compete to buy CPs, which pushes CP rates down too. The 3-month T-bill barely moved because it is government paper, sold in fixed auction sizes and anchored to where the repo rate is expected to be, so it does not reflect how much surplus cash is floating around. This is exactly what the data show. **CD rates fell 47 bps and NBFC CP rates 28 bps, while the 3-month T-bill moved just 1 bp. The CP to T-bill spread, the extra cost a private borrower pays over the government, narrowed to 145 bps from 172 bps. In plain terms, surplus liquidity cut funding costs for companies and NBFCs without the MPC ever cutting rates.**

The Bond Market Is Paying the Price for the Drain

- The 10-year G-sec yield has climbed from 6.84% at end-July to 6.95% at end-August and 7.05% on September 21, trading near 7.2% since, its highest since April 2024. The pressure is on supply. Net issuance of central and state government bonds is estimated at ₹12.5 lakh crore in H2 FY27 against ₹9.2 lakh crore in H1, with a demand shortfall of about ₹4 lakh crore for the year, and every OMO sale adds to that pile. FPI debt outflows, a Fed rate hike and US 10-year yields above 5.2% compound it.** Corporate bonds have repriced too, with 3-year AAA yields up 20 bps to 7.79%. On the external side, the swap inflows lifted forex reserves to a record US\$ 765.9 billion (11.2 months of import cover), yet the rupee sits near ₹96 per dollar with the Indian crude basket above US\$ 110.

Metric	August 2026	September 2026*
Avg daily net LAF absorption (₹ lakh crore)	3.8	9.2
SDF avg balance (₹ lakh crore)	2.13	2.17
MSF avg borrowing (₹ crore)	1,298	976
WACR avg (%), corridor 5.00% to 5.50%	5.15	5.03
3M CP minus 3M T-bill spread (bps)	172	145
10-year G-sec, period end (%)	6.95	7.05
Currency in circulation growth, y-o-y (%)	12.4	13.2
Forex reserves (US\$ bn)	740.8	765.9



- **Foreign and domestic investors are pulling in opposite directions. FIIs have been net sellers in the cash market for 15 straight months since July 2025, the longest selling streak in over a decade. Their selling has totalled ₹3.92 lakh crore in calendar 2026 so far, including a record ₹1.23 lakh crore in March alone.** After slowing to about ₹6,000 to 7,500 crore a month in July and August, it picked up again to ₹33,864 crore in September as West Asia tensions returned and US yields climbed. Domestic institutions have more than absorbed it, buying ₹6.28 lakh crore in 2026 and ₹64,759 crore in September, nearly twice the FII outflow. DIIs have not had a single month of net selling since July 2023. Long-term foreign money is far steadier. **Net FDI reached US\$ 7.3 billion in July, its highest monthly level in five years, taking April to July net FDI to US\$ 13.4 billion against US\$ 9.7 billion a year ago.** Still, the rupee has weakened to about ₹96 per dollar, down 13% since March 2025. Every rupee an FII sells is converted into dollars and taken out of the country, and costly crude adds to the demand for dollars, so the FCNR(B) inflows lifted the rupee only briefly in early September. This matters for liquidity, because each dollar the RBI sells to steady the rupee removes rupees from the banking system. Deputy Governor Poonam Gupta calls the fall an overcorrection and sees room for the rupee to stabilise or even strengthen.

We See a 25 bps Repo Hike in October, With the Liquidity Drain Running Alongside

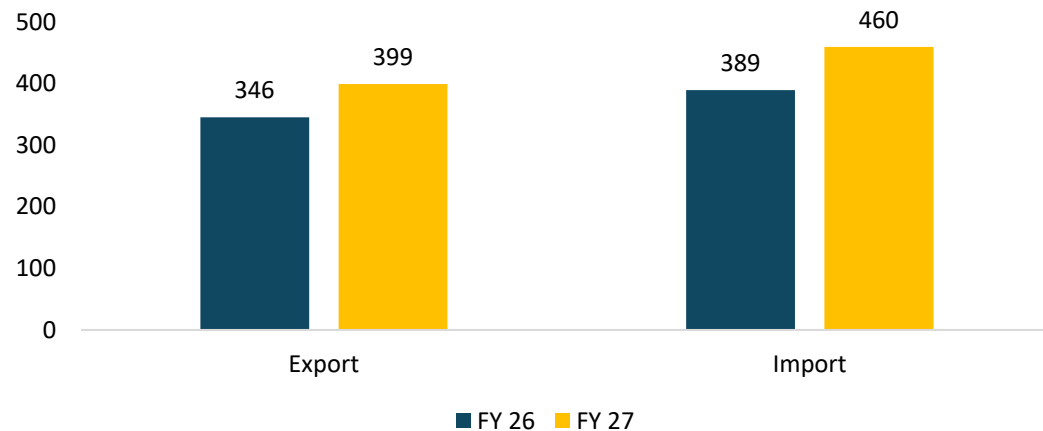
- **Liquidity path – The final ₹25,000 crore OMO tranche settled on September 28, and bank treasuries expect another ₹1 lakh crore of OMO sales over the coming months, with a further ₹1.5 lakh crore estimated to come out through bonds and sell-buy swaps. Festive season currency demand (currency in circulation is already growing at 13.2%, a five-year high) and rising required reserves will add natural drains. Against this, tax money returns as the government spends in October, and short swaps mature in Q4. We therefore expect the LAF surplus to swing within ₹3 to 6 lakh crore through the December quarter rather than fall steadily, with the durable surplus unlikely to be fully absorbed before Q2 FY28.**
- **Policy call – We see a real case for a 25 bps hike in the repo rate to 5.50% at the October 7 MPC, which would move the SDF floor to 5.25% and the MSF ceiling to 5.75%. The RBI's own data make the argument. Headline CPI has risen for four straight months, from 3.5% in April to 4.8% in August, and the September Bulletin describes the uptick as broad-based, with 10 of 12 CPI divisions accelerating. Core inflation has climbed to 4.2%, and even excluding precious metals it has risen from what the RBI calls ultra-low levels. Pipeline pressure is heavier still, with WPI at 9.9% and WPI fuel at 22.9%. The Indian crude basket averaged US\$ 114.6 in September and the rupee near ₹96 per dollar makes every barrel costlier, so imported inflation is still building. Abroad, the Fed, ECB and BoJ all hiked in September and US 10-year yields are above 5.2%, narrowing the interest rate gap that keeps foreign money in Indian bonds just as FPIs have pulled out US\$ 4.9 billion this year. With GDP growing at 7.8%, growth gives the MPC room to act. Finally, the surplus itself has been doing the opposite of policy, running money market rates below the floor. A hike would align rate policy with the drain the RBI is already running. The risk to our call is a hold with a shift in stance to withdrawal of accommodation, which becomes more likely if crude eases below US\$ 100 before the meeting, given that CPI is still inside the 2% to 6% band and the RBI sees scope for the rupee to stabilise.**
- **Market implications – After a hike, we expect the WACR to settle within 5.40% to 5.55%, term CD and CP rates to rise 40 to 60 bps from their September lows as the higher floor and a thinner surplus work together, and the 10-year G-sec to trade in a 7.15% to 7.40% band, with the short end rising faster and the curve flattening. Forward premia should stay elevated while swaps remain the RBI's preferred tool. The signals we will watch are OMO bid cover, the core liquidity print, one-year forward premia, and the liquidity guidance in the October 7 policy statement.**



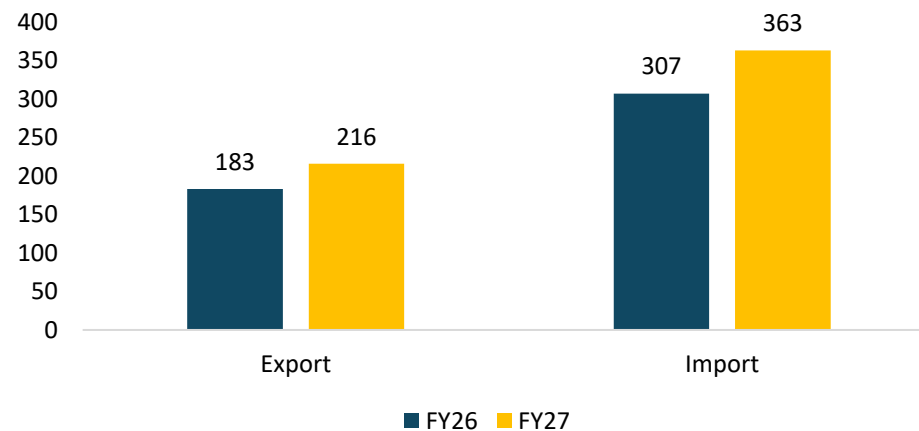
6. Trade



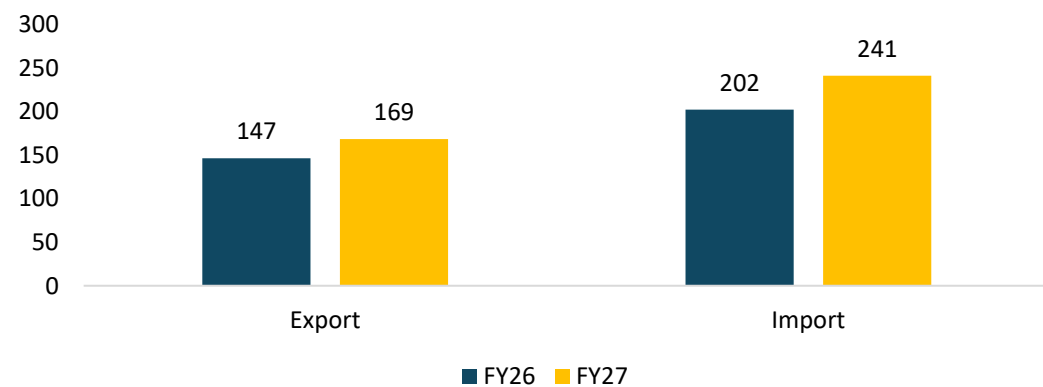
Total Trade During April-August 2027



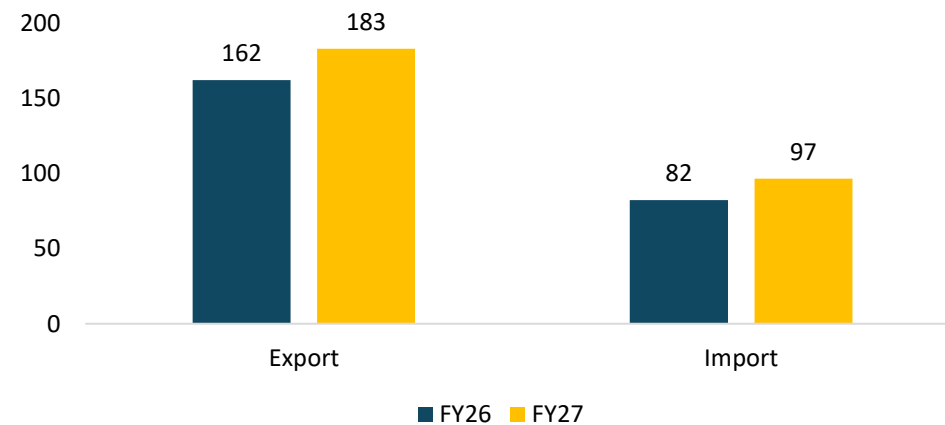
Merchandise Trade during April-August 2027



Trade excluding Petroleum and Gems & Jewellery during April-August 2027



Services Trade during April-August 2027





The Deficit Narrows, but Gold Did All the Work

- **India's merchandise exports rose 26.11% YoY to USD 43.81 billion in August 2026** against USD 34.74 billion in August 2025, **the strongest monthly growth rate of this cycle. Merchandise imports rose 14.06% YoY to USD 70.67 billion**, so the export line outgrew the import line by twelve points against two points in July. **The monthly goods trade deficit actually narrowed, to USD 26.86 billion from USD 27.22 billion a year earlier, the first year-on-year improvement in the merchandise gap we have recorded this cycle.** After four months of writing that the direction of travel had improved while the level had not, the level has finally moved.
- **The combined goods-and-services deficit narrowed sharply to USD 9.41 billion in August 2026 from USD 11.62 billion in August 2025.** Cumulatively, April-August FY27 total exports reached USD 399.27 billion (+15.55% YoY) and imports USD 459.65 billion (+18.01% YoY), leaving a five-month overall deficit of USD 60.38 billion against USD 43.94 billion a year earlier, with the merchandise gap now USD 147.09 billion against USD 123.88 billion, an 18.7% widening. **We would not yet call August the turn, because the entire monthly improvement is a gold effect and the cumulative arithmetic is still deteriorating.**

Export Drivers – Electronics Doubles and the Base Broadens

- **Electronic goods took the front of the export book, up 89.82% YoY to USD 5.55 billion from USD 2.93 billion, and petroleum products rose 63.27% YoY to USD 6.81 billion from USD 4.17 billion.** Engineering goods, our preferred read on the manufacturing cycle, rose 24.86% YoY to USD 12.32 billion and remain the largest category by absolute size, organic and inorganic chemicals rose 16.38% YoY to USD 2.80 billion, and cotton yarn, fabrics, made-ups and handloom products 13.79% YoY to USD 1.12 billion. **Electronics and petroleum together contribute roughly fifteen points of August's 26.11% headline export growth, and only one of the two is a price story.**
- **Non-petroleum exports rose 21.03% YoY to USD 37.00 billion and non-petroleum, non-gems-and-jewellery exports 22.72% YoY to USD 34.68 billion, so the non-commodity core accelerated rather than merely carried.** The second tier was broad, with Iron Ore (+126.3% YoY) the fastest line of the month, followed by Meat, Dairy & Poultry (+37.08% YoY), Handicrafts (+29.63% YoY), Marine Products (+27.76% YoY), Plastic & Linoleum (+18.92% YoY), Coffee (+17.08% YoY) and Man-Made Yarn (+9.92% YoY). **Drugs and pharmaceuticals grew just 3.84% YoY and gems and jewellery 0.69% YoY, so India's two most US-exposed export books remain the laggards even as US-bound exports accelerated to 21.83% YoY.**

Imports Composition – Gold Masks a Still-Widening Core

- **Non-petroleum imports rose only 10.87% YoY to USD 53.98 billion while non-petroleum, non-gems-and-jewellery imports rose 18.92% YoY to USD 49.22 billion, and the gap between those two numbers is the whole story of this print.** The **petroleum import bill**, on our calculation, rose to roughly USD 16.69 billion from USD 13.27 billion, **a 25.8% increase that is entirely price. Gems and jewellery imports collapsed to roughly USD 4.76 billion from USD 7.30 billion, a 34.8% fall, and that single line is what turned the monthly deficit.**
- **The decomposition is unambiguous. The gold collapse delivered USD 2.55 billion of deficit relief, against USD 1.41 billion of further core deterioration and USD 0.78 billion of additional net oil drag, which nets to the USD 0.36 billion improvement in the headline gap.** Gold imports fell 57.75% YoY, with Pulp & Waste Paper (–13.83% YoY), Iron & Steel (–11.69% YoY), Newsprint (–10.85% YoY), Textile Yarn & Fabric (–8.12% YoY) and Medicinal & Pharmaceutical Products (–7.9% YoY) also declining. **Strip gold out and the merchandise deficit widened again, so the import-intensity problem we have flagged since April is still compounding.**



Trading Partner Geography – Europe Joins the Rotation

- **The export-destination data widened beyond the Asian corridor. In August 2026, exports to Tanzania rose 214.52% YoY, Spain 196.47% YoY, Singapore 160.96% YoY, China 52.35% YoY and the United States 21.83% YoY by change in value.** The cumulative April-August FY27 picture is led by Tanzania (+129% YoY), Singapore (+96.56% YoY), Malaysia (+75.4% YoY), China (+38.71% YoY) and the United States (+6.17% YoY). **Spain entering the monthly top five at +196.47% YoY is the first hard evidence of European demand rotation, and US-bound exports accelerating to 21.83% YoY from 12.85% in July says the 10% duty layer is being absorbed rather than destroying volume.**
- **On the import side, the energy-diversification trade remains the base case rather than a hedge.** In August 2026, imports from Oman rose 157.45% YoY, Taiwan 108.31% YoY, the United States 65.78% YoY, Russia 43.82% YoY and China 17.07% YoY. The cumulative April-August FY27 import-source picture is starker still, with Oman up 190.63% YoY, Brazil up 159.83% YoY, Russia up 56.69% YoY, the United States up 29.6% YoY and China up 27.01% YoY. **With the Strait still effectively closed, the Oman, Brazil and Russia barrels are the default sourcing map, and the Taiwan print is the semiconductor and component supply chain feeding the same electronics export book that grew 89.82% in August.**

Services – The Cushion Widens, but on an Estimate

- **The services cushion widened sharply. Services exports grew 24.62% YoY to USD 38.87 billion and services imports grew 37.40% YoY to USD 21.42 billion, taking the monthly net surplus to USD 17.45 billion against USD 15.60 billion in August 2025.** That is the strongest monthly services print of this cycle. **With the goods deficit at USD 26.86 billion, the services surplus now offsets about 65% of the merchandise gap against roughly 57% a year earlier, the first month of this cycle in which the cushion grew faster than the hole it fills.**
- One caveat carries real weight. The release notes that the latest services data is for July 2026 and that the August figure is an estimate, so the entire narrowing of the combined deficit rests on a number that will be revised. The cumulative position is the sterner read: the April-August FY27 services surplus is USD 86.71 billion against USD 79.94 billion a year earlier, on services exports of USD 183.36 billion, which the release puts at 12.95% growth, while services imports at USD 96.65 billion against USD 82.40 billion are running well ahead at 17.29% YoY. **We continue to treat the services surplus as the binding variable for the current account.**

Gold and Silver Duty – The Compression Finally Reaches the Cumulative Line

- **The fourth clean month of data is the one that matters, because the compression has spread from silver to gold. Gold imports fell 57.75% YoY in August and total gems and jewellery imports fell to roughly USD 4.76 billion from USD 7.30 billion.** Cumulatively the picture has now inverted the other way: April-August FY27 gems and jewellery imports work out to about USD 26.19 billion against USD 26.68 billion a year earlier, a 1.8% decline, against the 10.6% cumulative increase we reported a month ago. **The precious-metals channel is delivering net import relief at the cumulative level for the first time this fiscal year.**
- **We are revising our read, not our critique.** The design objection stands, since a duty of this kind has a poor historical record on revenue and a reliable one on driving unofficial channels, and a 57.75% single-month collapse in the gold line is more consistent with deferral and channel-shifting than with genuine demand destruction. **We would still not build structural deficit improvement off this measure, and we expect the gold line to normalise into the festive quarter, which would remove most of August's headline improvement.**



West Asia – Hormuz Stays Shut and the Price Floor Moves Up

- **The Strait of Hormuz remains effectively closed and the conflict has escalated since our July note.** Brent averaged USD 91 per barrel in August against USD 84 in July, and September has been worse, with prices running to roughly USD 108, a four-month high, after the destruction of Iranian tankers, strikes on Saudi facilities and the shutdown of the Saudi East-West pipeline, while talks on a temporary shipping corridor have been postponed. **We wrote last month that we would not underwrite USD 84 to 90 as the floor, and the floor has since moved up by roughly twenty dollars.**
- **August's data again vindicates the hedge thesis we have run since Q4 FY26.** Imports from Oman are up 157.45% YoY in the month and 190.63% cumulatively, Russia 43.82% and 56.69%, and Brazil 159.83% cumulatively, so refiners are sourcing structurally outside the Gulf chokepoint. **The offset is narrowing, though. Petroleum exports of USD 6.81 billion against a petroleum import bill of roughly USD 16.69 billion leave a net oil drag of USD 9.88 billion, USD 0.78 billion wider than a year earlier, and the September price lands in the next print.**

Trade Policy – The 10% Layer Holds and the Excess-Capacity Case Is Live

- **The August sequel we flagged has arrived without a shock. The 10% Section 301 band on India is unchanged and US-bound exports accelerated to 21.83% YoY in the month, the strongest US print since the duty layer came in.** The effective rate remains MFN plus 10% on an open-ended legal basis, with steel and autos still under Section 232 duties and bilateral talks continuing. **A 21.83% US export print under a 10% duty layer is the strongest evidence yet that the tariff is being absorbed in margin and freight rather than in volume.**
- **The excess-capacity proceeding is now the live risk.** It remains the binary event for engineering, electronics and metals, which are precisely the lines carrying this print. The offset remains the FTA calendar. The India-UK CETA has been in force since 15 July, removing UK duties on 99% of Indian tariff lines, the India-New Zealand FTA signed in April 2026, which gives duty-free access to 100% of Indian export lines, is expected to enter into force in October 2026, and the India-EU agreement is on track for early 2027. **August is the first full month with CETA in force, and marine products (+27.76% YoY), handicrafts (+29.63% YoY) and cotton yarn and made-ups (+13.79% YoY) are exactly the lines where we expected it to show first.**

Outlook

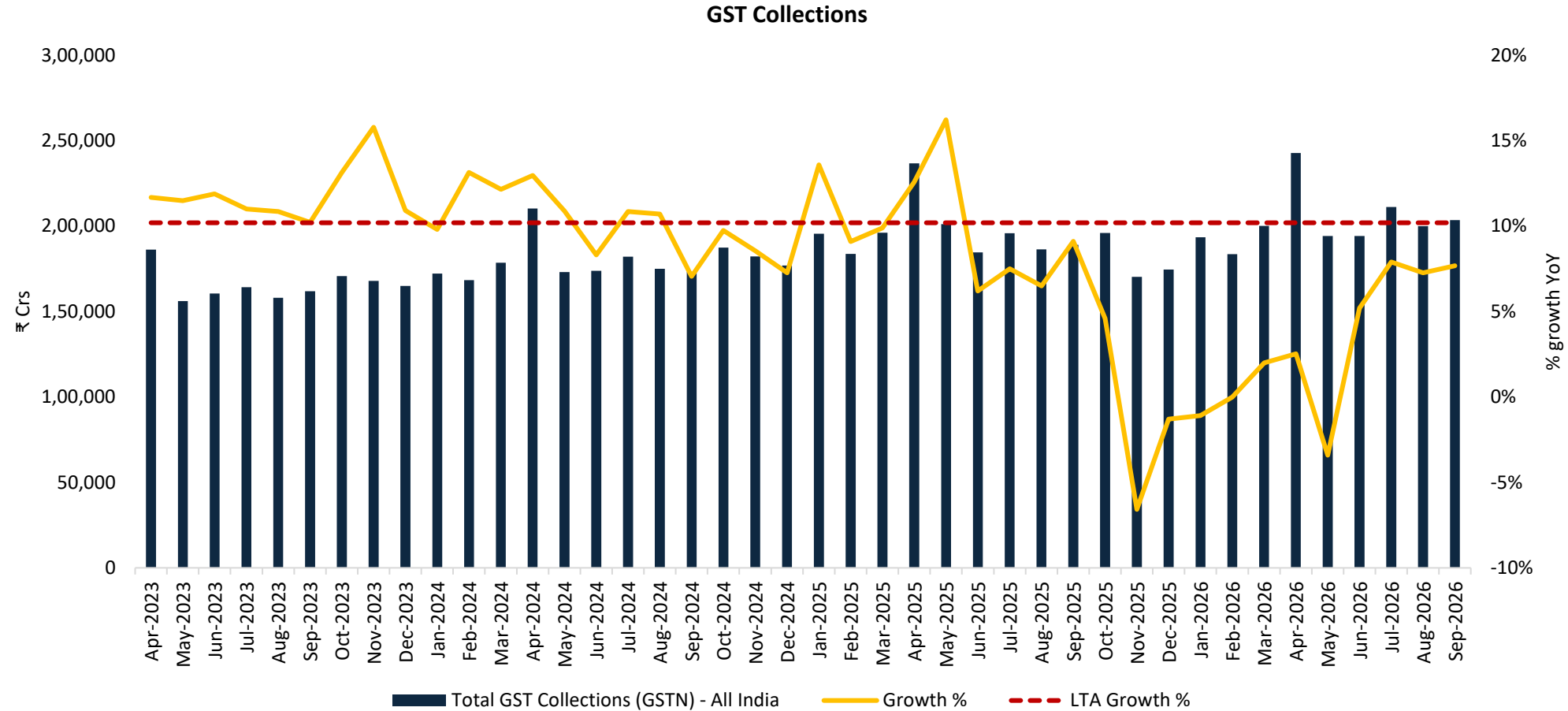
- **August is the strongest export print of this cycle on every measure.** Merchandise exports of USD 43.81 billion (+26.11% YoY) grew twelve points faster than imports, the combined deficit narrowed to USD 9.41 billion from USD 11.62 billion, and cumulative April-August exports are running 15.55% ahead. **The USD 147.09 billion cumulative goods gap, not the export line, remains the constraint.**
- **The monthly improvement is Gold, not structure. The 57.75% fall in gold imports delivered USD 2.55 billion of relief against USD 1.41 billion of further core deterioration and USD 0.78 billion of extra net oil drag, and cumulatively the core accounts for 72% of the USD 23.21 billion widening in the merchandise gap. Strip gold out and nothing has turned.**
- **Energy risk has got worse, not better. With the Strait shut, Brent near USD 108 after an August average of USD 91 and normalisation not expected before early 2027, the crude bill, current account and imported inflation stay exposed; the diversified barrel and a 63.27% petroleum export print cushion the net, not the gross.**
- **Tariff risk is contained for now.** The 10% Section 301 band is holding and US-bound exports grew 21.83% YoY in August, but the excess-capacity proceeding remains the open binary and we would not add export beta into it.
- **We hold our FY27 current-account band and stay overweight domestic engineering, electronics and CETA-advantaged export manufacturing against a marginal underweight in import-intensive consumer discretionary. The net view stays cautiously constructive, with a gold-flattered monthly print, a thinning cumulative invisibles offset and crude back above USD 100 the risks to size around.**



- India's current account deficit is expected to widen materially in FY27, with published estimates still clustering in a 1.8% to 2.3% of GDP range against FY26's actual 0.6% of GDP (–USD 25.2 billion), and the spread across those estimates is almost entirely a function of the crude assumption, which at a September Brent near USD 108 now sits above the USD 85 to USD 95 band on which those forecasts were built. The April–August data supports the wider half of that band and arguably beyond it: the merchandise gap has already reached USD 147.09 billion against USD 123.88 billion a year earlier, and the overall goods-and-services deficit USD 60.38 billion against USD 43.94 billion, a run rate that is difficult to reconcile with the sub-2% forecasts still on the table. August's monthly narrowing, to a combined deficit of USD 9.41 billion from USD 11.62 billion, is real but almost entirely a gold effect, and we would not extrapolate it. The offsets remain real but thinning, with the April–August services surplus at USD 86.71 billion against USD 79.94 billion, but services imports growing 17.29% against 12.95% services export growth, so the invisibles cushion is expanding more slowly than the goods gap and now covers ~57% of the merchandise deficit against 65% a year earlier.
- Key risks to the outlook are a prolonged Hormuz closure keeping crude above USD 100, a structurally wider merchandise deficit that some forecasters do not see narrowing at all through FY27, a normalisation of the gold import line into the festive quarter, and moderating services and remittance growth off FY26's high base, partly offset by the India–UK CETA now in force and the India–EU agreement due in early 2027. As we have argued since April, financing risk rather than the current account itself is the bigger swing factor, and the central bank's measures on FCNR(B) hedging support and concessional forex swaps for PSU overseas borrowing are explicitly aimed at holding the balance of payments in surplus even if the current account gap widens, though a sustained USD 108 crude makes the roughly USD 15 billion BoP surplus still embedded in published estimates look optimistic.



7. Fiscal Situation



India's GST Collections. September 2026 at Rs.2.04 Lakh Crore (+14.7% YoY). Domestic Pick-up and Easing Refunds Lift Net Growth to 18.1% YoY

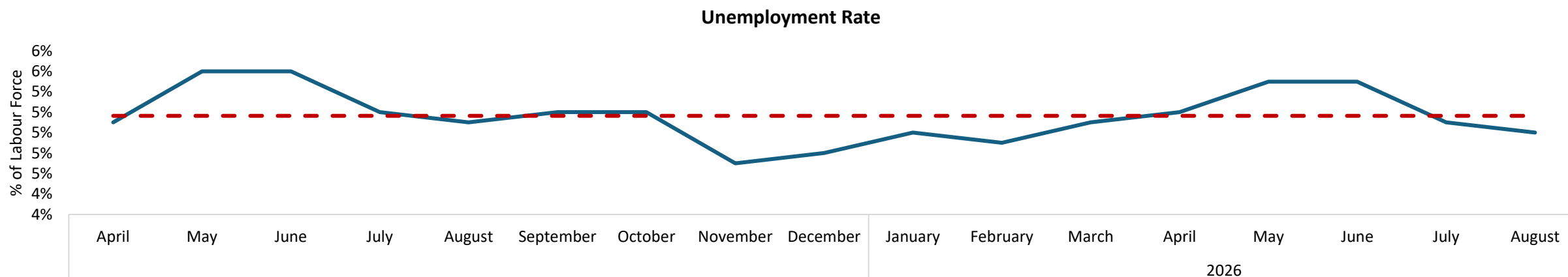
- India's GST collections in September 2026 stood at **gross revenue of Rs.2,03,521 crore (+14.7% YoY)**, broadly steady on August's +14.8% print and back above the Rs.2.00 lakh crore mark, against the Rs.1,77,365 crore September 2025 base. The import leg again carries the headline, but this month the domestic leg and the refund line both turned supportive. The component wise breakup stood at **CGST Rs.37,762 crore, SGST Rs.45,363 crore, IGST Rs.1,20,396 crore (of which imports contributed Rs.65,525 crore)**. **Import IGST rose 25.9% YoY**, the standout driver for a fourth consecutive month, though easing from August's 29.0% as the crude risk premium tied to the Strait of Hormuz escalation stays embedded. Domestic gross revenue grew **10.1% YoY to Rs.1,37,996 crore**, up from August's 9.3% and matching July's 10.1% as the joint best domestic print of FY27. The refund line has reversed last month's drag. **Gross refunds eased 3.0% YoY to Rs.27,001 crore**, with domestic refunds down 13.5% to Rs.13,504 crore more than offsetting export refunds up 10.2% to Rs.13,497 crore, which lifted **net GST revenue to Rs.1,76,520 crore (+18.1% YoY)** against August's +8.3%. **Cumulative FY27 gross collections through September reached Rs.12,46,278 crore (+11.6% YoY)**, with year to date net at Rs.10,66,116 crore (+10.4% YoY). State wise, **Uttar Pradesh (+18%), Telangana (+18%), Punjab (+18%), Gujarat (+17%), Karnataka (+16%) and Maharashtra (+15%)** led the industrial cluster, while Jammu and Kashmir (-29%), Uttarakhand (-23%), Himachal Pradesh (-21%), Meghalaya (-14%) and Tamil Nadu (-5%) contracted, with Assam's +88% a base distortion.
- The September print reaffirms our view that the structural floor for monthly GST has settled at Rs.2.00 lakh crore**, clearing that mark by Rs.3,521 crore, and the domestic catch up we flagged in July has resumed after August's stall. **We retain our FY27 gross collection estimate of Rs.24.5–25.0 lakh crore (+10–12% YoY)** against the FY26 base of Rs.22.27 lakh crore, with the six month run rate of Rs.2.08 lakh crore annualising to Rs.24.9 lakh crore, near the top of that range. **The key swing factor remains import IGST**, which has grown 27.1% YoY on a YTD basis to Rs.3,71,912 crore and now contributes 29.8% of gross versus 26.2% a year ago, rising to 32.2% in September alone. The line remains largely crude repricing, and a Hormuz resolution would compress it sharply. **Domestic gross growth at 6.1% YTD is the number to watch**, as it captures consumption without the crude and capex import overlay. On a net basis domestic revenue is up 4.3% YTD as domestic refund growth has cooled to 21.4% at Rs.1,04,357 crore, and September's 13.5% fall in domestic refunds is the first sign of the normalisation we called two months ago. The divergence between headline and domestic growth held at 550 bps in September, and we continue to expect convergence in Q3 as import base effects normalise. Compensation cess, phased out in January 2026, should now have washed out of the base fully.

Fiscal Deficit at 42% of Target as August Revenue Spending Surges

- The **April–August fiscal deficit at Rs 7.10 trillion, or 41.9% of the FY27 BE of Rs 16.96 trillion**, runs ahead of the 38.1% pace a year ago and, at roughly **19% higher YoY**, reverses the consolidation seen through July, with August alone adding Rs 2.55 trillion. **Total receipts of Rs 13.68 trillion covered 37.5% of BE against 36.7% a year ago**, with non-tax revenue at Rs 4.55 trillion or 68.2% of BE on the central bank dividend, while **net tax revenue at Rs 8.38 trillion tracked 29.2% of BE versus 28.6% a year ago**, up only about 3% YoY. **Net tax slipped from Rs 8.45 trillion at end-July, implying August devolution to states exceeded the Centre's gross tax intake**, so the July comfort from transfer timing has unwound as we flagged. Total expenditure of Rs 20.78 trillion was 38.9% of BE, and the **capex flow remains the standout at Rs 5.10 trillion, 41.7% of the FY27 target of Rs 12.22 trillion against roughly 39% a year ago, up close to 18% YoY**, reinforcing our capital goods stance despite a softer August. Revenue expenditure of Rs 15.68 trillion at 38.0% of BE carries interest of Rs 5.15 trillion, about two-fifths of revenue receipts, and major subsidies of Rs 1.87 trillion at 46% of BE, up 24% YoY and still front-loaded on urea at 66% of BE. **The primary deficit widened to Rs 1.95 trillion and the revenue deficit to Rs 2.76 trillion**, as August revenue spending of about Rs 2.57 trillion outran receipts. With **Brent averaging near \$91 in August against \$84 in July**, our binding constraint of Brent below \$85 is breached, and we retain our **15–20 bps slippage versus the 4.3% of GDP target for FY27, widening to 25 bps if crude holds above \$90 through Q3**. Net-net, the **fiscal impulse to industrial activity remains firmly positive**, and this is the single most important underpinning of our **5.0–6.0% FY27 IIP growth range**.



8. Employment



Unemployment — Headline UR Eases to 5.0% in August 2026; Rural Absorption Deepens as Urban Conditions Stay Stuck

- **Unemployment Rate (UR) eases further; Rural absorption deepens**, taking rural unemployment to its lowest level since January 2026. **India's headline unemployment rate (UR) declined to 5.0% in August 2026 from 5.1% in July (-10 bps MoM), just below the 5.1% recorded a year earlier.** The improvement was again entirely rural, with **rural UR falling 40 bps to 4.1% from 4.5%, the lowest reading since January 2026**, while **urban UR edged up for a second month to 6.8% from 6.7%**. On a year-on-year basis, rural UR improved by 20 bps from 4.3%, while male UR eased to 4.9% from 5.0% and female UR to 5.1% from 5.2%.
- **LFPR and WPR rise together for a second month**; the WPR is now at its highest since March 2026. **Labour Force Participation Rate (LFPR) rose 0.2 pp to 55.6% in August, above 55.0% a year earlier, while Worker Population Ratio (WPR) increased to 52.8% from 52.5%**. Rural LFPR climbed 0.2 pp to 58.2% and rural WPR 0.4 pp to 55.8%, up 1.2 pp and 1.3 pp respectively year-on-year, while urban LFPR held at 50.4% and urban WPR at 47.0%, both 0.5 pp below their year-earlier levels. Male WPR strengthened to 73.5% from 73.3%, led by rural males at 75.0%.
- Female labour market: **Rural women extend the gains for a second month, though urban female unemployment keeps rising. Female LFPR rose 0.4 pp to 34.8% in August** and stood 1.1 pp above its year-earlier level, led by rural women whose LFPR climbed to 39.4% — up 0.6 pp from 38.8% in July 2026 and 2.0 pp year-on-year, while urban female LFPR was broadly stable at 25.4% and remains 0.7 pp below August 2025. **Female WPR increased to 33.0% from 32.5%**, with rural female WPR up 0.6 pp to 37.8% and rural female UR down to 3.9% from 4.3%. On unemployment, however, the **urban female UR rose for a third consecutive month to 8.9% from 8.8%, so the entire female improvement is rural while urban women continue to face the tightest conditions in the survey.**

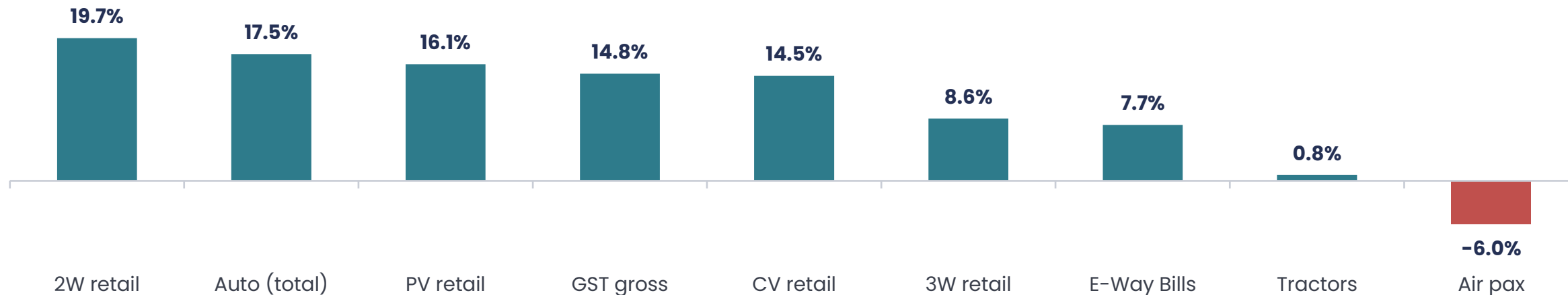
Overall Assessment

- **The August 2026 print extends July's improvement rather than broadening it, with the headline UR easing to 5.0%, the WPR rising to 52.8% and the LFPR to 55.6%, the strongest readings since March 2026.** The composition remains the concern: rural UR at 4.1% against urban UR at 6.8% is a 270 bps gap, the widest since January 2026, and urban LFPR and WPR are both 0.5 pp below year-earlier levels while their rural equivalents are 1.2 pp and 1.3 pp higher. Rural absorption held up through a 13% rainfall deficit, but with kharif acreage below last year we read it as sowing and weeding demand rather than durable job creation. We stay of the view that the improvement is rural and cyclical, with no sign yet of urban formal-sector hiring turning.



9. Demand Indicators

Consumer Demand Momentum



Select high-frequency indicators, August 2026. Auto retail sets an August record, but tractors stall as the monsoon falters.

Rural demand

Rural demand held up despite weak rains. Total vehicle retail hit a record August at 24.23 lakh units, up 17.5% YoY. Two-wheelers rose 19.7% to 17.15 lakh (rural 20.3% vs urban 19.1%), and passenger vehicles crossed 4 lakh units in an August for the first time at 4.02 lakh, up 16.1%, with rural at 25.0% against urban 10.9%. Tractors were the soft spot at just 0.8%, as August rainfall ran 16% below normal.

Urban demand

Urban demand is steady but slower. GST gross rose 14.8% to Rs 1.99 lakh crore, though import GST (+29%) did more of the lifting than domestic GST (+9.3%). E-Way Bills grew 7.7%, well below June's 14.5%. The fuel mix is shifting fast. CNG, hybrids and EVs together overtook petrol in car sales for the first time at 42%, and electric two-wheelers crossed a 10% share. Domestic air traffic fell 6.0% on capacity cuts and costlier jet fuel.

Demand outlook

The festive quarter starts on a strong base but with heavier stock. PV dealer inventory has climbed to 38 to 40 days against a recommended 21, which points to festive discounting. Headline CPI rose to 4.8% in August (rural 5.23%, urban 4.31%), and we see a 25 bps repo hike at the 7 October MPC, lifting EMIs just as buying peaks. A below-normal September monsoon forecast keeps rural demand under watch.

Source: Internal assessment based on data from Tijori Finance

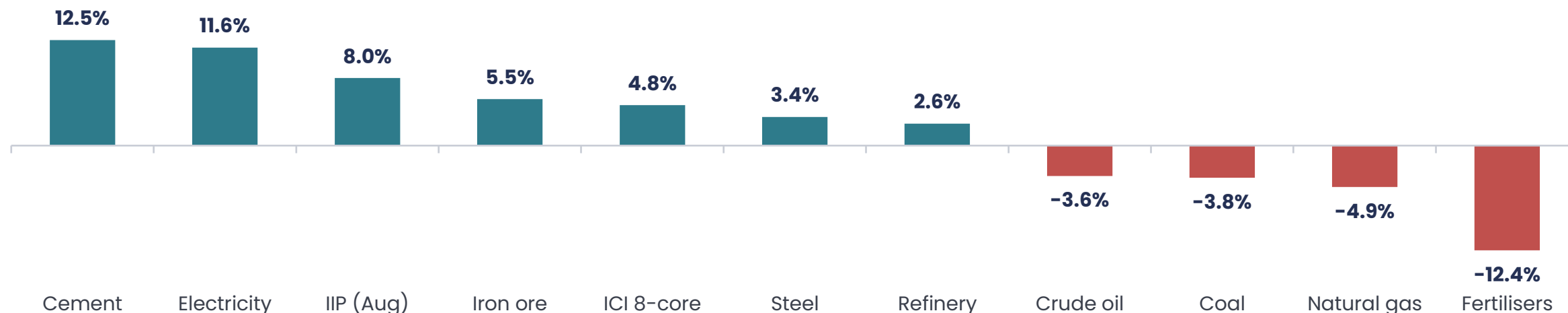
**55.1****MFG PMI (SEP FLASH)**

jumps from 52.8

55.8**SERVICES PMI (SEP FLASH)**

rises from 54.1

Industrial & Services Momentum



Industrial and services momentum, August and September 2026. Factory output accelerates, energy drags, flash PMIs rebound.

■ Industrial activity

IIP rose 8.0% YoY in August, its second-fastest pace in 29 months, with July revised up to 7.4%. Manufacturing grew 9.0% and electricity 12.3% on a hot August, while mining fell 5.6%. Capital goods led at 16.9% and intermediate goods at 13.7%. Core-sector output (ICI) eased to 4.8% from 5.0% as iron ore cooled to 5.5% from 29.5%. Cement (12.5%) and electricity (11.6%) stayed firm, while fertilisers fell 12.4%.

Source: Internal assessment based on data from Tijori Finance

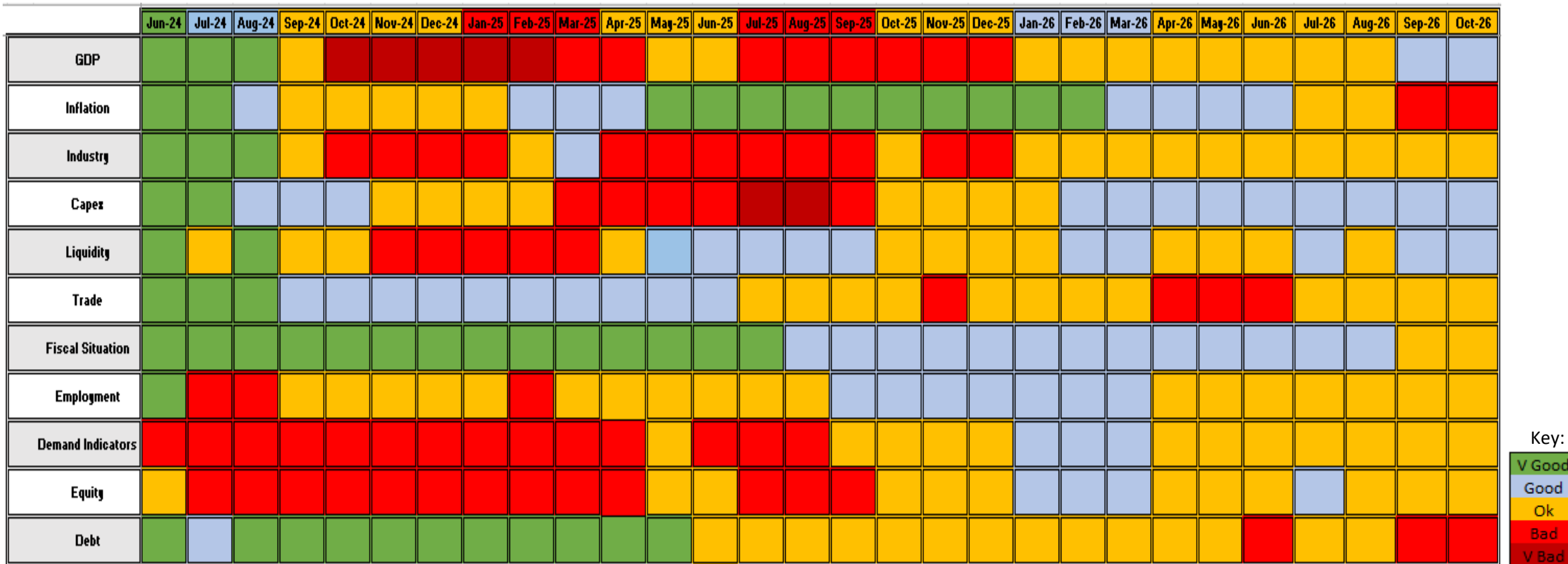
■ Services sector

The September PMIs show a clear rebound. Services PMI rose to 55.8 from 54.1, and Manufacturing PMI jumped to 55.1 from 52.8, with new factory orders at a seven-month high. The composite climbed to 56.5, a three-month high. The soft spots are export orders, growing at their weakest pace in nearly three years, and factory-gate prices, rising faster even as input-cost inflation eased to its lowest since January.

■ Industrial & services outlook

We expect industrial growth of 6% to 7% through the December quarter, lifted by festive production, capital goods and power demand, before the base effect fades. The 7.8% Q1 GDP print and a record capex pipeline support investment goods. Risks are crude above \$110, gas and fertiliser supply via Hormuz, and the 25 bps rate hike we see on 7 October. We watch consumer non-durables (2.1% in August) and export orders.

Economic Heatmap



Tailwinds Domestic, Headwinds Imported

October's column reads three Goods, six Oks and two Bads, and the Bads are unchanged: Inflation and Debt. Growth is not the problem. GDP, Capex and Liquidity read Good on 7.8% Q1 growth, 11.9% investment growth and industry credit at 20.0%. Industry stays Ok despite an 8.0% August IIP, as staples grew only 2.1%, and Fiscal has slipped to Ok with the April–August deficit at 41.9% of budget against 38.1% a year ago. What has deteriorated is the price of goods and the price of money, and both are imported: CPI at 4.82%, Brent near \$102, the rupee at ~96 and the US 10–year at its highest since 2007. The growth question has been answered and we hold FY27 at 7.0–7.5%; the price question has not, and that is what we size for.





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%	1%	2%	-1%	-6%				-13.6%
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 %	11.3%	14.1%	14.1%
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	2	1
No of Years	27	21	13

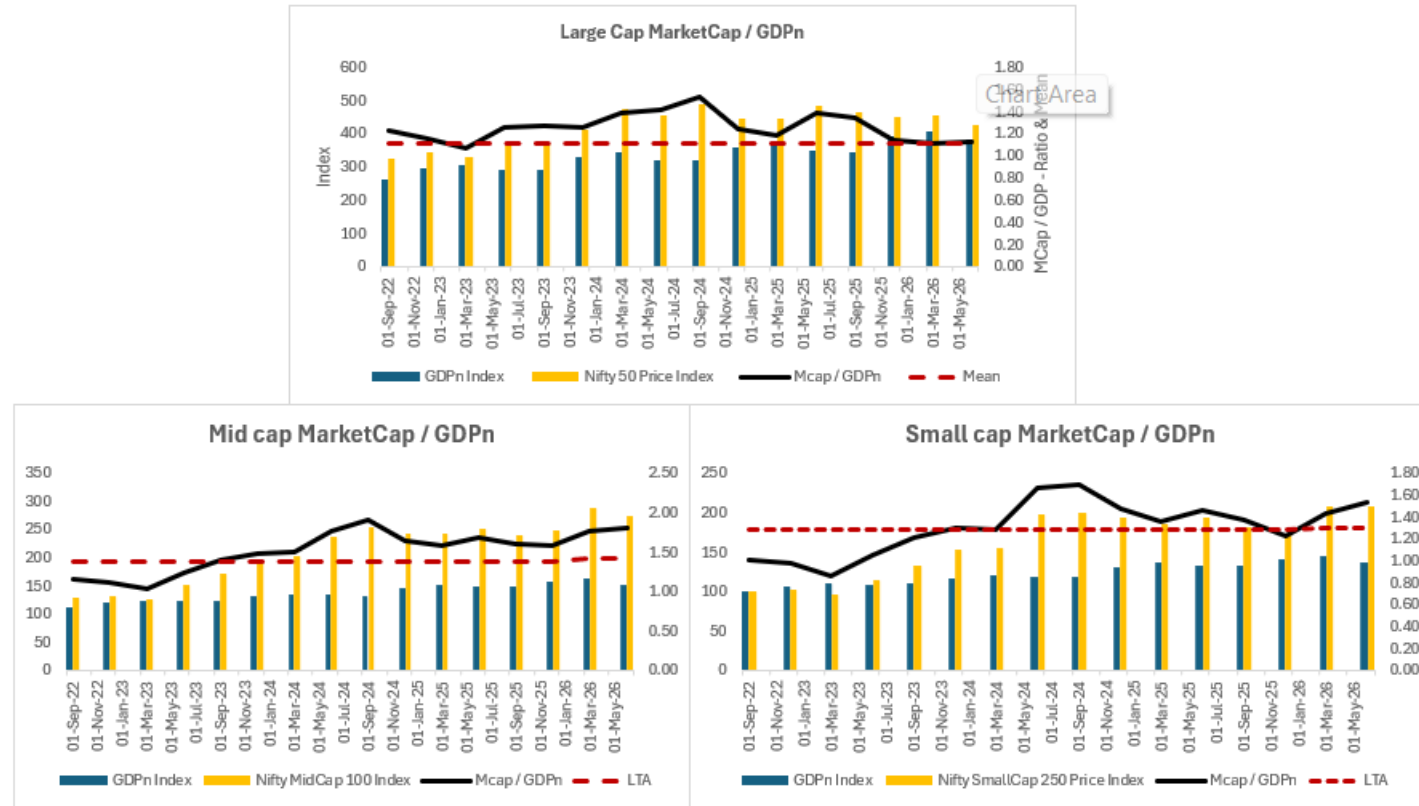
Ample Tailwinds

- The Nifty 50 is down 13.60% CYTD, with geopolitical tensions, elevated global yields, and oil-price volatility keeping near-term sentiment cautious. However, resilient domestic demand, and improving private capex are providing support to the Indian economy and corporate earnings. With earnings expected to strengthen through FY27, the medium-term outlook remains constructive, though global risks could keep volatility elevated in the short term.
- The Risk-Return Matrix highlights the higher return potential of Mid and Small Caps, albeit with correspondingly higher volatility relative to Large Caps.
- On valuations, Large Caps appear Undervalued, Mid Caps Fairly Valued, and Small Caps Overvalued, suggesting a more favourable risk-reward proposition in the large-cap and mid-cap segment at current levels**

Market Cap	Current PE	Long Term Average PE	Premium / (Discount)	Valuation
Large Cap	19.69	23.67	-17%	Undervalued
Mid Cap	30.07	32.29	-7%	Fairly Valued
Small Cap	33.97	27.16	25%	Over Valued



Buffett Indicator



Present valuations remain moderate to attractive as evidenced by the premiums exhibited in their MCap/GDP ratios, where Large Caps are currently trading at a premium of approximately 2%, Mid Caps at a premium of approximately 22%, and Small Caps at a premium of approximately 15% to their respective long-term averages (as per the Buffett Indicator), as on 30th September 2026.



Sectoral Performance and Outlook



Banking & Financial Services

Q1 FY27 Performance:

BFSI delivered strong profits on a subdued top line in Q1 FY27. Aggregate sector revenue, measured as net interest income plus other income, grew only about 10 percent year-on-year despite strong credit growth, as margins stayed under pressure from higher cost of funds, lower portfolio yields and intense competition. PAT, however, accelerated to roughly 22 percent as credit costs normalised, particularly in microfinance. NBFCs led with profit growth near 45 percent, PSU banks grew about 21 percent and private banks about 16 percent, while SMID banks posted a sharp turnaround against large-cap peers.

Outlook:

We expect margins to stabilise from Q2 FY27 as strong FCNR (B) inflows ease funding cost pressure, with NBFCs benefiting from improved system liquidity with a lag. Asset quality outcomes were resilient across most lenders, and the higher agri and rural slippages logged during the quarter appear seasonal rather than structural. The key monitorable is credit growth, which could taper in H2 FY27 as the low-base tailwind fades and the credit multiplier stays weak. FY27 estimates were upgraded for banks, and we prefer franchises with stronger deposit bases.

Information Technology

Q1 FY27 Performance:

IT delivered another quarter of stable execution in Q1 FY27, with rupee revenue up about 15 to 16 percent year-on-year and PAT accelerating into the mid-teens. Dollar revenue disappointed, but a weak rupee cushioned the shortfall and lifted reported earnings. Mid-cap companies again outgrew large caps, with revenue led by large deal ramp-ups, vendor consolidation and sustained AI demand, while discretionary spending remained selective. EBITDA margins expanded marginally by 0.2 percentage points. Deal bookings were healthy and FY27 guidance was maintained, though decision-making cycles stayed extended.

Outlook:

We expect growth momentum to improve in Q2 FY27, with FY27 estimates broadly stable and the sector among the few to escape downgrades this quarter. A weaker rupee and stabilising supply disruptions should continue to support reported earnings as enterprise AI adoption moves into scaled deployment. The principal risks are external rather than operational. Stocks are now reacting more to global AI and anti-AI trades than to fundamentals, and any sharp rupee appreciation against the dollar would compress reported growth. We stay constructive, favouring names with margin and cash flow improvement.



Pharmaceuticals & Healthcare

Q1 FY27 Performance:

Pharma posted a weak Q1 FY27 despite reasonable top line. Sector revenue grew about 14 to 15 percent year-on-year, but PAT declined roughly 6 to 8 percent and EBITDA margins contracted 2.1 percentage points, the second sharpest fall across sectors. US generics remained soft on price erosion and an absence of new launches, while semaglutide API issues and subdued generic demand weighed on GLP-1 sales in India. Domestic chronic therapies continued to grow healthily. Healthcare services were dragged lower within consumer services, where aggregate profits fell sharply.

Outlook:

We retain a selectively constructive view. Multiple US launches should help close the gRevlimid gap, capital allocation through M&A and R&D is delivering faster-than-expected synergies, and CDMOs benefit from the peptide opportunity and an improving project pipeline. For hospitals, capacity ramp-up, operating leverage and CGHS reimbursement rates should sustain ARPOB growth. Raw material pricing and supply chain vulnerability remain near-term challenges, while rising doctor costs, oncology drug pricing and regulatory price caps weigh on margins and returns. FY27 estimates were cut about 2 percent.

Automobiles & Auto Ancillaries

Q1 FY27 Performance:

Domestic autos delivered strong top line but decelerating profits in Q1 FY27. Revenue rose about 23 to 25 percent year-on-year, supported by GST rationalisation, better affordability and adequate finance availability, with passenger vehicle domestic sales up around 26 percent. PAT growth moderated to roughly 12 to 14 percent as EBITDA margins contracted 1.2 percentage points on commodity inflation and a lag in pass-through to customers. Export auto was materially weaker, with margins down 1.9 percentage points, though the segment is showing early signs of turning as the rupee depreciates.

Outlook:

We expect profits to stay subdued as the low-base and GST tailwinds fade. Managements across two-wheelers, passenger vehicles and commercial vehicles have flagged H2 FY27 as a key watch-out given the high base created by GST rate cuts. The domestic tractor outlook is subdued on a high base, below-normal rainfall and the discontinuance of some state-level subsidies. The global CY26 outlook is turning more favourable for commercial vehicle, tractor and construction equipment OEMs, which benefits export-oriented ancillaries. FY27 estimates saw among the sharpest cuts across our coverage.



Capital Goods

Q1 FY27 Performance:

Capital goods delivered a strong Q1 FY27, with industrials and infrastructure revenue up about 14 to 15 percent year-on-year and PAT rising roughly 20 to 28 percent, aided by 0.6 percentage points of margin expansion. Power electrical equipment across the high-voltage value chain, spanning transformers, switchgear and gensets, was the standout, benefiting from robust execution, all-time-high order books and multi-year high operating margins on better pricing, favourable mix and higher utilisation. Private capex green shoots emerged in inquiry pipelines despite West Asia cost pressures, and SMID industrials outperformed large caps on profits.

Outlook:

We turn more selective from here. The structural T&D cycle remains robust, underpinned by the new NEP 2027-36 and rising power demand from data centres, EVs and urbanisation, and FY27 estimates were revised up modestly. Valuations, however, have moved sharply higher, with MNC high-voltage players trading at roughly 35 to 40 times FY30 peak earnings, leaving limited room for execution delays, margin normalisation or any moderation in ordering momentum. Cost inflation from the West Asia crisis, higher freight and rupee volatility remain risks for players with fixed-price order books.

Infrastructure (EPC & Construction)

Q1 FY27 Performance:

Infrastructure had a mixed Q1 FY27. Revenue visibility improved across most companies and payments from Jal Jeevan Mission projects began to flow through, easing a long-standing receivable overhang. Margins, however, remained weak and the working capital cycle deteriorated further. Within the broader domestic investment basket, revenue grew about 13 percent and PAT about 14 percent, with industrials carrying the segment while cement and real estate lagged. Labour shortages persisted for EPC players and were exacerbated by the ongoing Middle East conflict, particularly for those carrying significant regional exposure.

Outlook:

We maintain a constructive medium-term stance while acknowledging near-term execution friction. Labour constraints are expected to ease in H2 FY27, paving the way for smoother execution, and transmission rollout has already improved marginally as right-of-way issues eased. Order books continue to provide multi-year revenue visibility, and improving government disbursements should support working capital. Prolonged West Asia tensions remain the key risk to both execution timelines and cost. We continue to prefer diversified players with transmission, water and railway exposure over those concentrated in road EPC.



Power & Renewable Energy

Q1 FY27 Performance:

Power demand remained strong in Q1 FY27, growing 8.9 percent year-on-year on an intense summer that pushed peak demand to about 270 GW in May 2026, up 17.2 percent, further supported by a delayed monsoon onset. Higher merchant prices and improved thermal PLFs followed, although curtailment pressures persisted for some renewable players. Sector top line growth was weak at about 5 to 9 percent, but EBITDA margins expanded 1.2 percentage points and PAT grew roughly 6 to 16 percent. Transmission rollout improved marginally as right-of-way issues eased during the quarter.

Outlook:

We remain directionally positive on generation growth over the next two to three years. Demand has stayed robust in year-to-date FY27 at about 9.3 percent, and renewable additions are gathering pace with roughly 45 to 50 GW expected in FY27. Battery storage gains for renewable plus storage players remain contingent on demand growth, with any slowdown weighing on merchant prices and realisations for open capacity. Market coupling remains a key overhang for power exchanges. We stay selective given company and segment specific risks, with FY27 estimates trimmed marginally.

Fast Moving Consumer Goods (FMCG)

Q1 FY27 Performance:

FMCG was again lacklustre in Q1 FY27. Revenue grew only about 6 to 8 percent year-on-year, remaining stuck in the range it has occupied for two years, and PAT declined roughly 1 to 5 percent, with EBITDA margins contracting 1.5 percentage points. The quarter did benefit from the carry forward of low-cost inventory, which supported gross margins and operating leverage, but input-cost inflation from crude derivatives and packaging limited margin expansion for most companies. Underlying demand held up, aided by rural recovery, premiumisation and distribution expansion.

Outlook:

We expect profits to remain weak through FY27 as the low-base tailwind fades and the consumption stimulus from GST cuts normalises by H2 FY27. Raw material inflation linked to crude oil derivatives and packaging remains the key monitorable, with pass-through likely to stay lagged. Weak household incomes and a subdued credit multiplier are structural constraints on volume recovery, and El Nino poses an additional risk to farm incomes. FY27 estimates were cut about 4 percent. We prefer companies with pricing power and premium portfolios over broad staples exposure.



Cement & Building Materials

Q1 FY27 Performance:

Cement was better than expected on volumes but weak on profits in Q1 FY27. Volumes grew about 8 percent year-on-year and realisations improved roughly 3 percent quarter-on-quarter, yet revenue growth decelerated to around 8 percent and PAT declined 6 to 8 percent, with EBITDA margins contracting 1.8 percentage points. Profitability remained under pressure from higher input costs, mainly power and fuel and packaging. Cement was among the weakest performers within domestic investment, and SMID players materially underperformed their large-cap peers on earnings during the quarter.

Outlook:

We expect input costs to peak in Q2 FY27 and ease from Q3 FY27, which should restore margin momentum alongside easing competitive intensity. The trajectory of input costs, the pace of demand recovery and infrastructure capex will remain the key drivers of the space in the near term. FY27 earnings estimates saw one of the sharpest cuts across sectors at about 5 percent, reflecting the weak start to the year. We stay positive into the second half, preferring players with cost efficiency and regional pricing discipline over volume-led expansion.

Metals & Mining (Steel)

Q1 FY27 Performance:

Metals delivered a fourth consecutive quarter of strong profits in Q1 FY27. Revenue grew about 25 percent year-on-year and PAT surged roughly 54 to 67 percent, driven by a combination of supply shock, a weak rupee, a low base and the global AI capex boom. Non-ferrous earnings expanded quarter-on-quarter primarily on higher commodity prices, while steel margins improved on better realisations, partially offset by higher raw material costs. Industrial metal prices in rupee terms rose sharply through the year and have plateaued at elevated levels entering Q2 FY27.

Outlook:

We turn cautious after a strong run. Top line growth should start to moderate in H2 FY27 as tailwinds fade and the base effect catches up, with supply-side dynamics critical in shaping the trajectory from here. The sector is currently operating close to the upper end of its ten-year margin range, creating risk of operating deleverage if volumes or prices slow. FY27 estimates already saw mild downgrades of about 4 percent. We prefer non-ferrous exposure over ferrous given tighter supply, and stay underweight on valuation and base effects.



Real Estate

Q1 FY27 Performance:

Real estate delivered reasonable reported earnings but a concerning leading indicator in Q1 FY27. Revenue grew about 9 to 11 percent year-on-year with PAT up roughly 13 to 20 percent, yet pre-sales growth for listed developers slipped into contraction on a four-quarter moving average basis after a strong FY26. Sustenance sales remained healthy and leverage and collections were steady during the quarter, but launches were weak. Reported revenue also came in well below expectations, making the sector among the larger misses versus estimates this quarter.

Outlook:

We expect a period of slower growth as the pre-sales cycle turns. Weak household incomes and a subdued credit multiplier, with households still the leveraging agent after a decade of rising leverage, constrain the affordability-led demand that drove the last upcycle. Recognised revenue should hold up near term given the existing sold book, but a sustained pre-sales contraction would feed through to earnings with a lag. FY27 estimates were cut about 2 percent. We prefer developers with strong collections, low leverage and a visible launch pipeline.

Consumer Durables & Electronics

Q1 FY27 Performance:

Durables delivered a strong headline quarter, with revenue up about 13 to 15 percent year-on-year and PAT rising sharply on a low base and price increases. Cables and wires continued to outperform, supported by elevated commodity prices that are largely passed through, though volume growth stayed subdued at low-to-mid single digits for a second consecutive quarter. Large appliances grew double digits on an extended summer and partial price hikes, while margins compressed under commodity costs and revised BEE norms. EMS revenue grew 24 to 26 percent with profits lagging materially.

Outlook:

We expect cables and wires to remain structurally well placed, driven by higher T&D capex, rising solar investment and growing demand for optical fibre cables amid data centre and AI infrastructure expansion. For EMS, profitability should stay pressured by raw material costs, wage inflation and currency depreciation given the lag in cost pass-through, with muted mobile demand and rising working capital requirements as near-term headwinds. Whether the durables base effect sustains beyond the current summer is the key question. FY27 estimates were revised up modestly.

Tailwinds

- **Macroeconomic resilience** with strong GDP growth and robust private/public capex, supported by adequate liquidity. The festive season has further boosted consumption, with healthy momentum visible across key high-frequency indicators.
- **Resilient earnings** with improving demand, operating leverage and healthy earnings growth. 20% YoY Revenue growth and 15% YoY PAT growth reported in Q1 FY 27.
- **Strong corporate balance sheets and private capex** supported by robust order books across infrastructure, power, manufacturing and industrials
- **Continued government focus on infrastructure, manufacturing, and defence**, reinforcing investment-led growth through public spending and PLI initiatives.
- **Supply-chain diversification toward and from India** supporting manufacturing, exports and global companies seeking resilient production bases (multiple FTAs).

Headwinds

- **Persistent geopolitical tensions and elevated crude-oil risks** could pressure inflation, corporate margins and India's external balances.
- **FPI flow volatility** may continue amid global risk aversion, US monetary-policy hawkishness, elevated DM yields, and currency movements.

Both the above are exogenous risks India cannot control but must absorb.

- **AI disruption and global technology spending** remain key headwinds for Indian IT and Indian equities at large, representing a significant endogenous risk. The AI cycle is a double headwind for India: it compresses pricing in the traditional IT services book faster than it creates offsetting revenue, while also redirecting global EM allocations toward markets that offer more direct exposure to the semiconductor buildout. As a result, India's weight in the MSCI EM index has declined, while Taiwan and Korea have absorbed a greater share. FII outflows of ~₹3.92 lakh crore in the ongoing CY26 have already exceeded the whole of 2025, cushioned only by domestic institutional buying.
- **Hawkish RBI stance** remains a key risk for equities, as elevated rates and tighter liquidity could pressure valuations, corporate borrowing costs and rate-sensitive sectors.

Outlook

- **Volatility may persist in the near term, but the market retains a positive medium-term bias, supported by strong domestic fundamentals, improving earnings visibility from Q2 FY 27, and a strengthening private investment cycle.**

Suggested Strategy

➤ Gradual Accumulation

Category	Stance
Large Cap	Optimistic
Mid Cap	Cautiously Optimistic
Small Cap	Risky



Debt Outlook

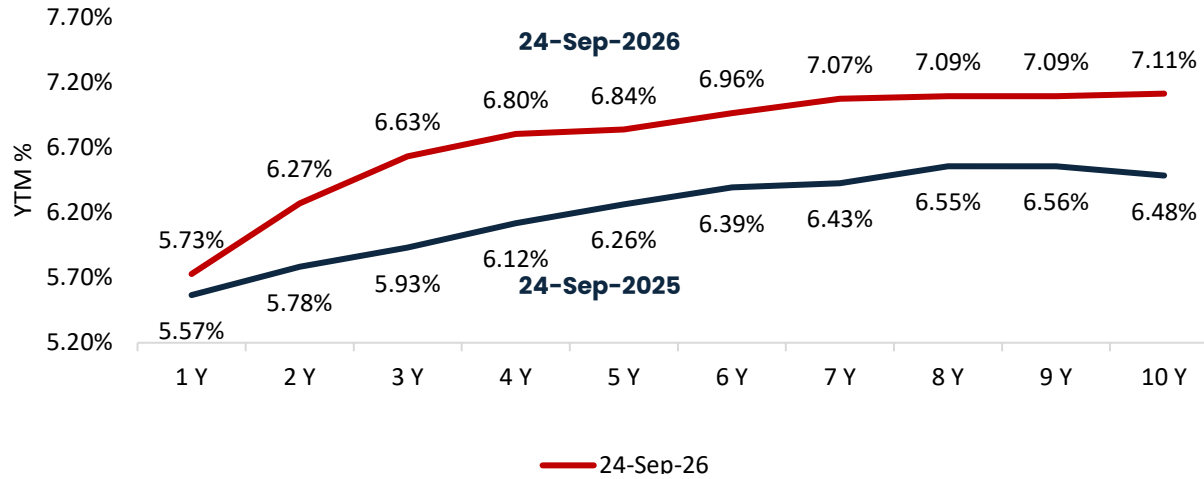




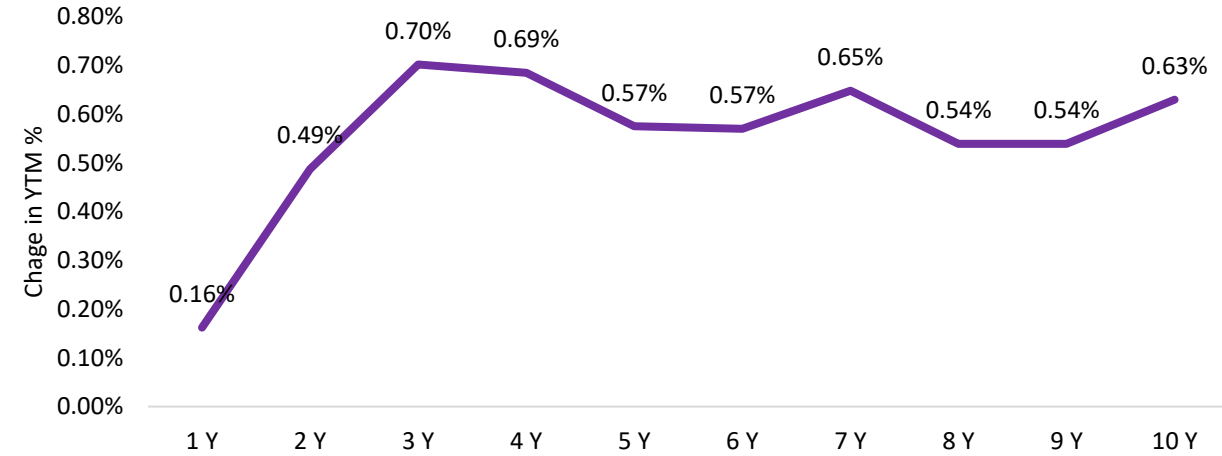
Yields Curve Dynamics



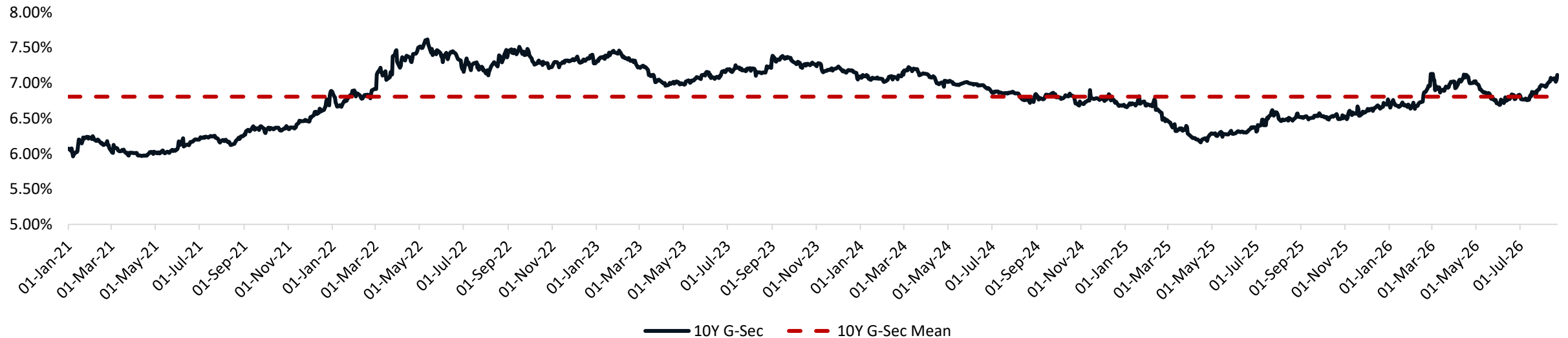
Change in Yield Curve



10Y GSec 1Y Delta - Bear Steepening



G-Sec YTM





Debt Market Outlook & Strategy



Rates Need to Rise – we see the repo rate at 5.5% in the coming MPC meet and stay cautious on duration

Key Takeaways

- Inflation risk is going up, not down. Prices are rising across commodities, and demand at home is strong.
- Interest rates around the world have moved higher. India cannot keep its rates far below the rest of the world.
- Indian banks are holding too much spare cash. This has pushed short-term market rates well below the policy rate.
- Our call. We expect the central bank to drain this cash and raise the repo rate (the rate at which it lends to banks) from 5.25% to 5.5% in the current meeting. We stay conservative on duration.

The story in one picture



Source: Kilika Capital Research

Inflation Risk Is Rising

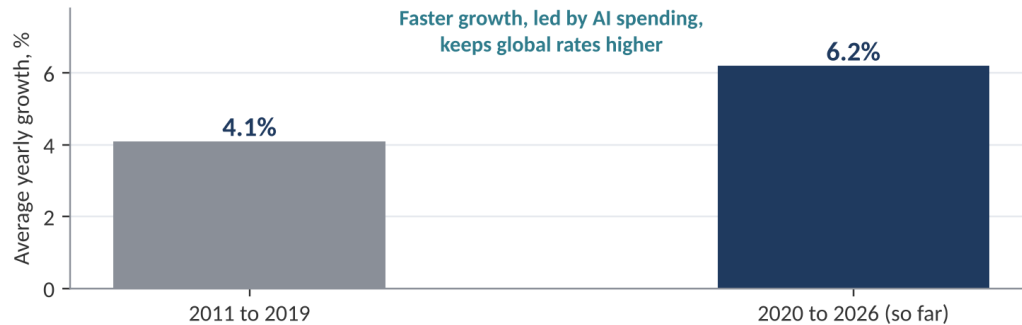
- **It is not just oil.** Food and farm prices are rising too. A broad commodity index is back at its March to April highs, **even though oil is cheaper now than it was then.**
- **Home-grown pressure.** Rains have been uneven, GDP growth is strong and bank credit is growing about 18%. All three push prices up.
- **Comfort is fading.** Inflation data so far looks fine, but we no longer rely on low core inflation (prices excluding food and fuel) to keep policy on hold. The minutes of the last policy meeting already sounded more hawkish.



Global Rates Have Moved Higher

- The US is growing faster. **Heavy spending on AI has lifted average nominal growth to 6.2% since 2020, against 4.1% in 2011 to 2019.** This spending is not slowed much by higher rates.
- **Investors want a higher real return.** Bond yields are rising mainly because investors demand more return after inflation (real yield). Heavy borrowing to fund **AI is also adding to bond supply.**
- The US central bank is firmly focused on inflation. **Markets expect another 0.75% to 1% of US rate hikes**, and the dollar is strengthening again.
- Why this matters for India. **We import energy and run a current account deficit, so we compete for the same foreign money. Our rates must keep pace with the world. This is normal policy tightening, not a defence of the rupee.**

The US economy is growing faster than before 2020



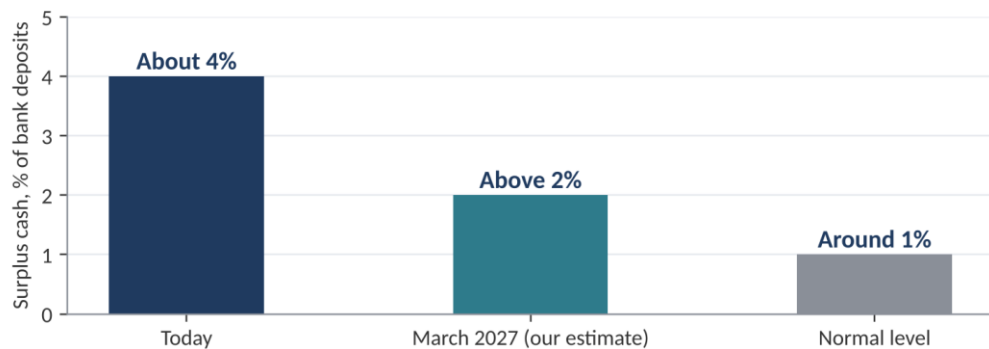
Source: Kilika Capital Research. US nominal GDP growth, average

Too Much Cash in Indian Banks

- **Where the cash came from.** Foreign currency deposits from overseas Indians (**FCNR**) have reached USD 127 bn, with total inflows at USD 136 bn. Once converted into rupees, this money has flooded the banks.
- **How big the surplus is. Spare cash in the system (core liquidity) is about 4% of NDTL**, roughly banks' deposit base, against a normal level near 1%. **Even by March 2027, we expect it to stay above 2%.**
- **What it has done to rates.** Overnight rates have fallen to 4 to 4.5%, below even the 5% floor of the policy band, and short-term money-market yields are below 6%. The central bank's short-term cash absorption (**VRRR**) has not been enough. **In practice, money is cheaper than the 5.25% repo rate suggests.**



Banks hold far more spare cash than normal



Source. Kilika Capital Research estimates. Core liquidity as % of NDTL

Market rates have fallen well below the policy rate



Source. Kilika Capital Research. Indicative range for collateralised overnight rates

What We Expect From Here

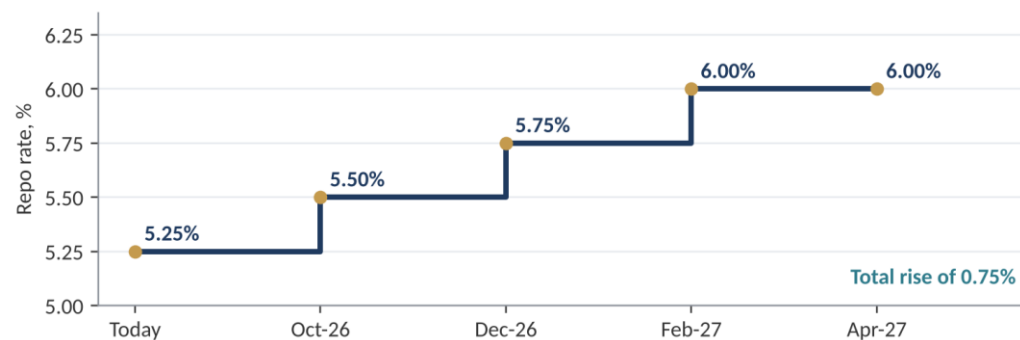
We see the central bank acting in three steps, and soon. The longer it waits, the bigger the adjustment needed.

Step 1, pull overnight rates back up to the repo rate.

Step 2, remove the extra cash for good. Likely tools are FX swaps, MSS bonds (special bonds issued to soak up cash), OMO sales (selling government bonds to banks) and possibly a CRR hike (making banks park more cash with the central bank). A CRR hike is the least likely, as it sends the strongest tightening signal.

Step 3, raise the repo rate to 6% by April 2027, a total rise of 0.75%. This is higher than we expected earlier.

Our expected path for the repo rate



Source. Kilika Capital Research estimates. Timing of each step is indicative



How We Are Positioned

- Short-term yields should rise as overnight rates move back up to the repo rate.
- Long-term bonds have little support while global yields keep climbing.
- **So we stay conservatively to very conservatively positioned on duration across our fixed income funds. This reflects our current view and may change at any time**

Our time frame, the 3 to 6 month segment

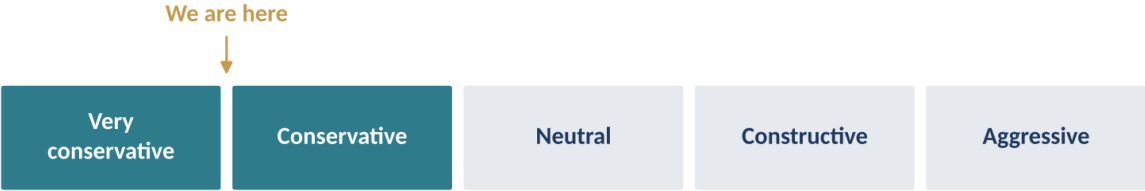
Near term, cash stays plentiful. The banking system is in surplus by about ₹4.67 lakh crore (25 September 2026). As government spending returns advance tax money to banks, overnight rates such as TREPS may soften further and stay below the repo rate before the October policy meeting.

This is the window we are focused on. The **money market portfolio, the 3 to 6 month segment**, with papers maturing between December 2026 and February 2027. **CDs** over T-bills. Within this window we are overweight Certificates of Deposit (short-term papers issued by banks) and underweight Treasury bills (short-term government papers).

Why this window works. **This part of the curve is steeper, so it offers good carry (the interest we earn) and roll-down (a price gain as the paper moves closer to maturity)**. Our duration call stays low, with a modified duration of 132 days as on 30 September 2026, which limits the impact of a possible October rate hike.

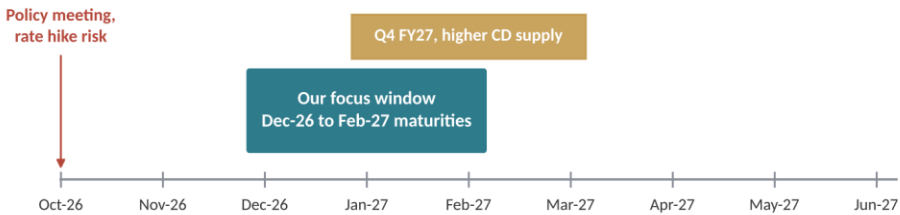
A cushion for January to March. **Credit demand usually picks up in Q4 FY27 and banks raise more money through CDs, which can push CD yields up. Staying in this window keeps us defensive through that period, until supply and market conditions settle.**

Our stance on duration (interest rate risk)



Source. Kilika Capital Research

Our time frame, the 3 to 6 month segment



Source. Kilika Capital Research

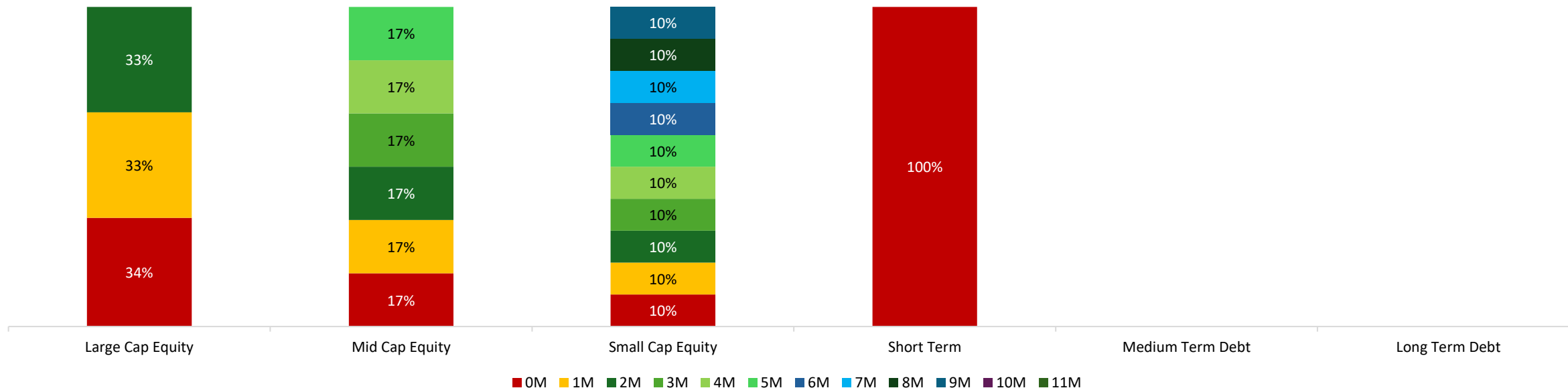
Deployment Strategy



Deployment



Stages of Deployment



Indicators:

Indicators to track for caution –

- FII flows remain negative, with global interest rate hikes and geopolitical risks continuing to influence market sentiment.
- India VIX at ~13.49 – Volatility has risen from subdued levels, reflecting increased market caution, while geopolitical tensions, elevated crude prices and global macro risks could drive further spikes.
- Mid- and small-cap valuations remain above long-term averages despite the recent correction, leaving limited room for disappointment if earnings recovery is slower than expected in the coming quarters.

Indicators signaling turnaround and optimism –

- DIIs remain strong net buyers, providing stability amid sustained selling pressure from FIIs.
- Private capex and infrastructure spending continue to support the investment cycle.
- Large-cap valuations remain relatively attractive.

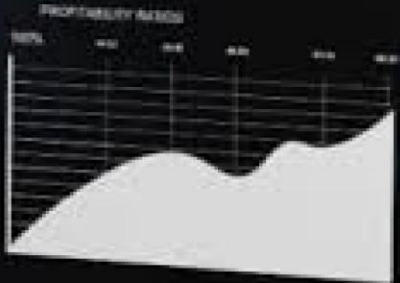
Deployment Strategy:

Staggered Deployment over the next 12 months –

- Large Cap – 34% immediate deployment and 33% in each month in the next 2 months
- Mid Cap – 16.67% immediate deployment and 16.67% in each month in the next 5 months
- Small Cap – 10% immediate deployment and 10% in each month in the next 9 months
- Debt – 100% immediate deployment. Money Market for parking until we have more clarity to form a view on interest rates – India and DMs.

Optimus Prime Model Portfolio

Aggressive Strategy

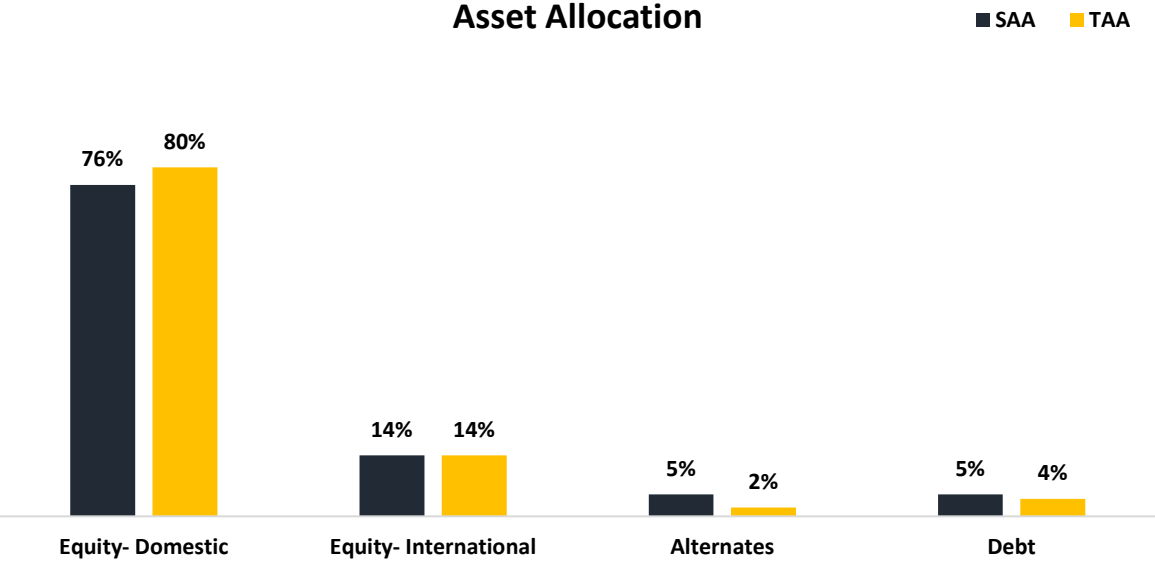


100%
9.12%
18.25%

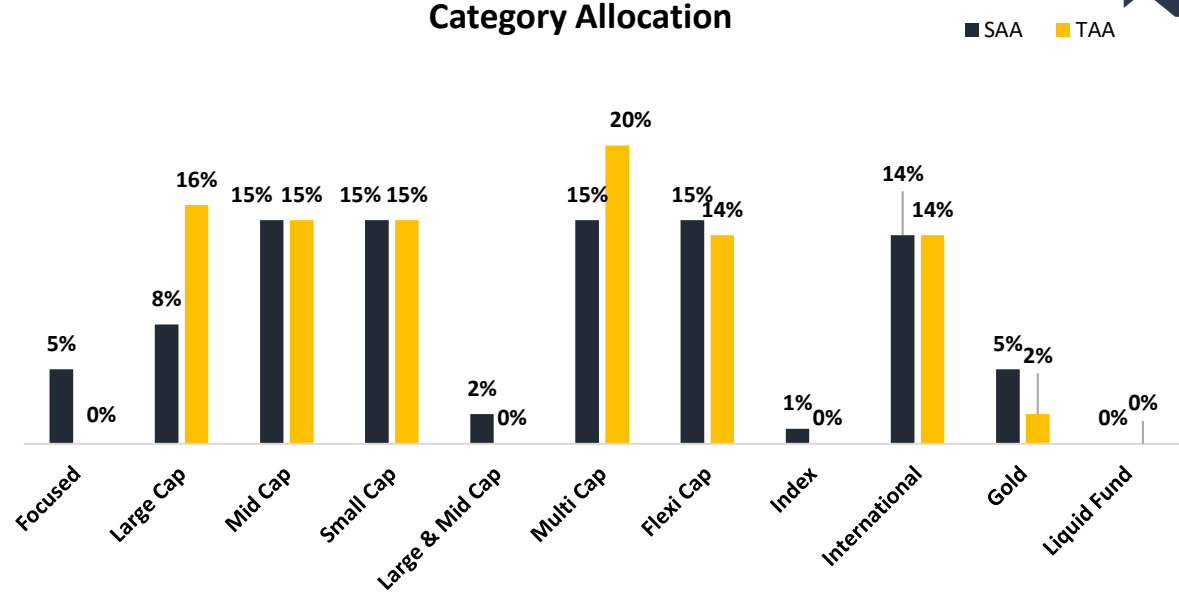




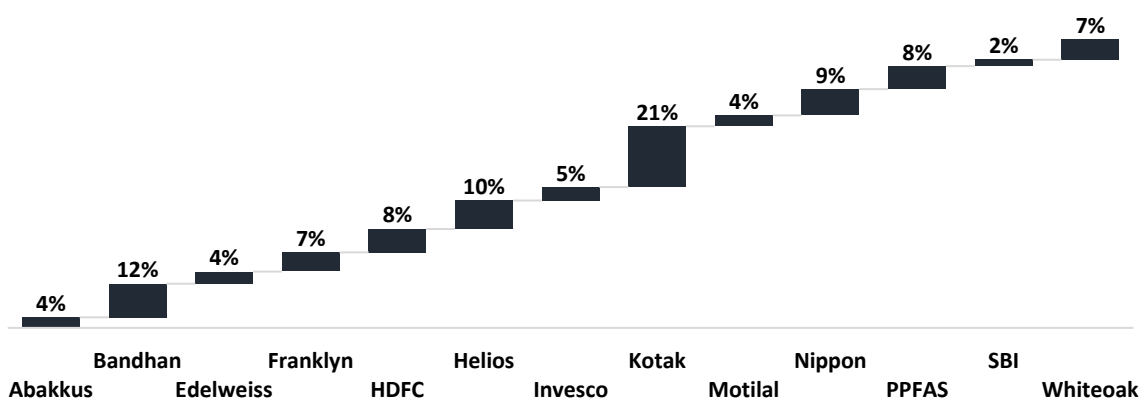
Asset Allocation



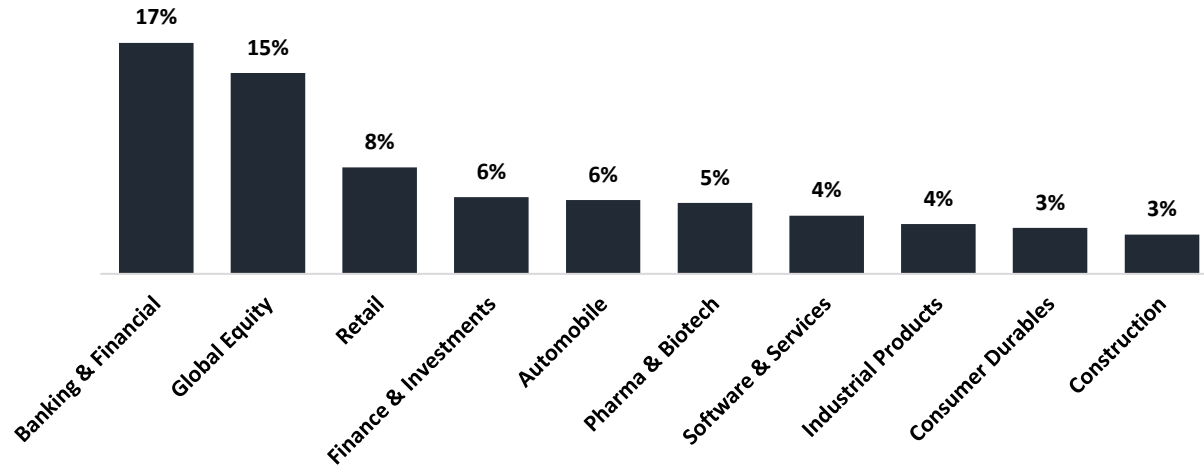
Category Allocation



Fund House Allocation



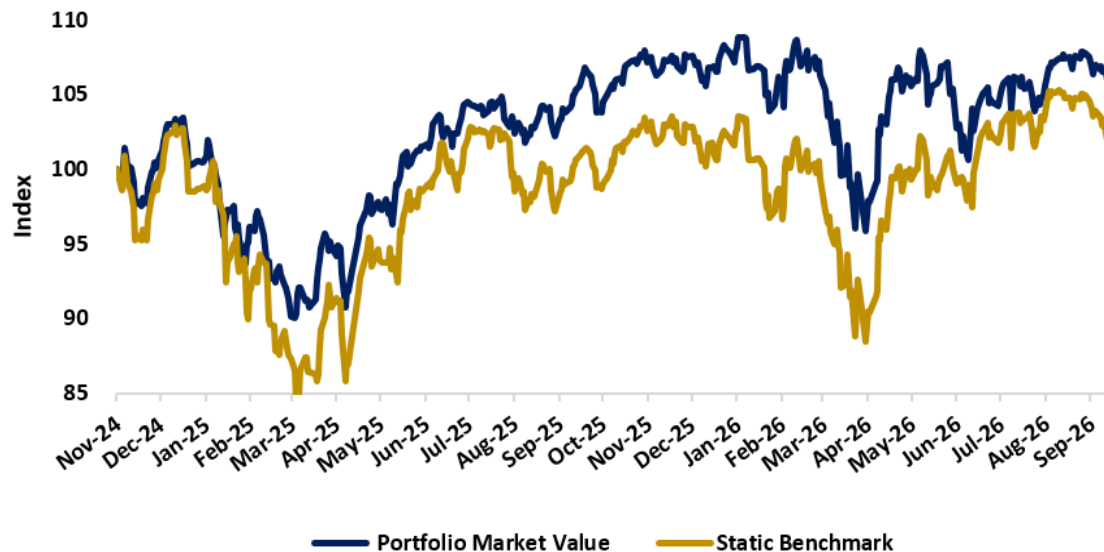
Sectoral Allocation (Top 10)



***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 Sep 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 Small cap 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.

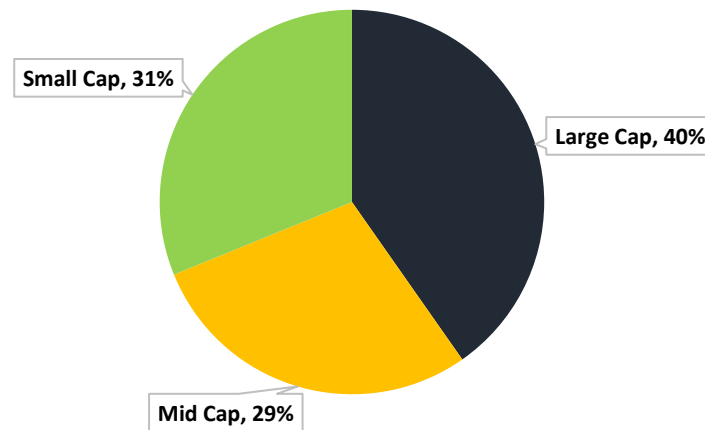


Portfolio vs Benchmark



2.12% Alpha

Portfolio Market Cap Mix



Portfolio Performance Analytics

Analytics	Portfolio	Benchmark
Abs / CAGR Return	4.44% / 2.35%	0.43% / 0.23%
Standard Deviation (annualized)	12.22%	15.13%
Beta	0.49	
Alpha (Abs / CAGR)	4.01% / 2.12%	
Information Ratio	5.17	
Downside Capture	72.82	

Debt Portfolio Analytics

Debt Measures	Sep-26
Average MoD	4.64
Average Maturity	5.57 yrs
Average Coupon	NA
Average YTM	7.17 %
Average Credit Rating	Sep-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 Sep 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 Small cap 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: **Aggressive**



Positioning & Portfolio Update

Our Investment Committee has retained the Aggressive stance adopted in July 2026. We stay constructive on Large and Mid Caps, bottom-up in selection and heavily skewed towards Quality.

We hold it with one of our three exit triggers tripped, and would rather report that than redraw the line. Brent closed above \$101 on 9 September, its highest since May, reached about \$108 after drone attacks shut Saudi Arabia's East-West pipeline, and sits near \$102; the Indian basket, the barrel we actually pay for, averaged \$114.6 in September. We count it as tripped. The stance survives because the two pillars carrying it strengthened again. Industrial output grew 8.0% in August with capital goods at 16.9%, the manufacturing PMI rose to 55.1, credit to industry compounds at 20.0%, and private capex already scheduled for FY27 is 24% ahead of where FY26 began. Price has moved further our way: the Nifty is down 13.7% for the year, and Large Caps trade at 19.7x against a 23.7x long-run average, a 17% discount against 14% a month ago; Mid Caps sit 7% below theirs and Small Caps 25% above. Foreign investors have sold in the cash market for fifteen consecutive months, Rs 3.92 lakh crore in 2026 alone, and domestic institutions have absorbed it 1.6 times over. What has changed is where the risk sits: it has moved from the price of goods to the price of money. August CPI at 4.82% was an eighth consecutive rise and restaurants are at 8.38%; the Fed, ECB and Bank of Japan all hiked in September, and our 10-year pays under 200 basis points over the US with the rupee near 96. We expect 25 basis points on 7 October and a repo rate of 6.00% by April 2027, and size for that rather than forecast past it.

The allocation expresses the view conservatively. Tactically we hold domestic equity at 80% against a 76% strategic weight, a 4% overweight funded by a 3% underweight in Alternates and 1% in Debt, International unchanged at 14%. On a look-through basis this leaves roughly a 7% overweight in Large Caps, 5% underweight in Mid and 2% underweight in Small, with Banking & Financial the largest sector exposure at 17.4%. Deployment is staggered by valuation: Large Caps complete within three months, Mid Caps over six and Small Caps over ten.

The positioning has been paid for. Since inception the portfolio has returned 4.44% absolute against 0.43% for the benchmark, an Alpha of 4.01% (2.12% annualised), on a Beta of 0.49, standard deviation of 12.22% against 15.13%, an Information Ratio of 5.17 and a Downside Capture of 72.82%.

What takes us to Neutral, now reported rather than restated. Crude: Brent sustained above \$100, tripped. Rates: a cycle beyond 75 basis points, a repo above 6.00%; our base case sits on that line, not over it. Earnings: a Q2 FY27 season, opening with TCS on 8 October, that spreads downgrades beyond the crude-cost sectors into Financials, Capital Goods and IT, where FY27 estimates have so far held or risen. One is live. Any second and we reduce





Key Monitorable:

Crude & Geopolitics

HIGH

Brent is back near \$100, due to the US–Iran stalemate and collapsing Hormuz transits. The diversified barrel — Oman +201%, Brazil +167% YTD, caps the damage, not the price. Above \$90 through Q3 costs 25 bps of fiscal slippage and a CAD near 2.3%.

Inflation Trajectory

HIGH

August CPI at 4.82% was the eighth straight rise, but food (5.95%) is doing the work. The 19 August minutes moved the question from whether to when; 5–7 October hike is now live.

Q2 FY27 Results & Valuations

MEDIUM

The Nifty closed 1 October at ~22,422, down ~14% CYTD. Large Caps trade at 19.69x against a 23.67x long-run average, a ~17% discount. October's Q2 print tests margins against crude costs and a fading GST base.

US & DM Yields

HIGH

Japan's 10Y hit 3.10%, a first since 1996; Bunds 3.47% (2011 high), gilts 5.41% (2008 high), UST 10Y 5.29%. Our 10Y at 7.21% pays only 192 bps over the US against 350–450 historically, and at 96.3 the rupee no longer covers it.

The Anti-AI Trade

MEDIUM

India's absence from the AI complex has flipped from penalty to hedge. Taiwan and Korea passed us on market cap in May on the chip trade. The structural cost is that Indian IT now trades on the global AI tape, not its own order book.

FPI Flows

MEDIUM

CY26 net selling of ₹3.92 trn.

Source: Internal assessment based on data from MoSPI, RBI, NSDL, US Federal Reserve (H.15), NSE and Bloomberg. Market levels as on 2–3 September 2026.

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