



KILIKA
CAPITAL

Embracing complexity to capture Alpha

March 2026

Dear Investors,

Over the past decade, successive policy measures were undertaken to revive private corporate capital expenditure and accelerate economic growth. These included cleaning up overstretched corporate balance sheets, sharply reducing corporate tax rates, and significantly increasing public infrastructure spending with the objective of crowding in private investment. More recently, demand-side measures such as GST rate cuts were also deployed to stimulate consumption. Yet, despite these efforts, private capex and growth remained largely subdued and did not respond with the anticipated momentum.

The missing link or the real answer that was hiding in plain sight has been 'exports growth'. Historically, the most durable investment cycles, whether in the post World War II United States or in China over the past three decades have been anchored by expanding export markets that opened up new sources of demand. A sustained export impulse allows economies to scale manufacturing, justify large capital investments, generate employment, and ultimately create a virtuous cycle of domestic demand. In this context, a strengthening export engine, catalysed by the recently concluded trade agreements with the US, EU, and UK could well be the catalyst that finally unlocks India's long-awaited private capex cycle and, in turn, a high-growth era.

India's domestic macro picture is demonstrably strengthening. Real GDP growth for FY26 is estimated at 7.4%, with FY27 projected in the 6.8–7.2% range, anchored by resilient private consumption, a broadening pickup in domestic demand, and government capex at ₹ 12.22 lakh crore (~4.4% of GDP). Headline inflation remains benign at 2.75% on the new CPI base, well within the MPC's tolerance band. High-frequency indicators are constructive - services and manufacturing are firing on all cylinders, with Composite PMI at 58.9 and IIP growth led by infrastructure and construction goods. Corporate balance sheets are healthy, leverage remains low, and the Q3 earnings season points to a gradual, if uneven pickup in topline growth. Liquidity is abundant, fiscal consolidation is on track at 4.3% of GDP, and the external position remains manageable. Collectively, the macro setup for FY27 appears conducive for a gradual re-rating in equities.

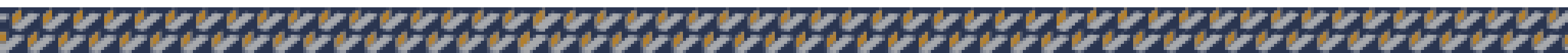
That said, two significant risks temper the near-term outlook. First, the ongoing US-Israel-Iran war and the effective closure of the Strait of Hormuz represent a direct threat to India's external balance and cost structure. With Brent surging from ~67 to \$82–84/bbl, the rupee at record lows near ₹ 92, and over 60% of India's crude imports and more than half its LNG sourced through Gulf routes, a prolonged disruption could widen the current account deficit, reignite imported inflation, and erode the very cost competitiveness that underpins the export-led growth thesis, stalling the capex cycle before it gains traction. The shock is already visible with the Nifty correcting over 1,100 points in three sessions, breaching 24,400. Although I do not see this war lasting for a prolonged period of time, the risk is certainly real. Second, India's limited exposure to the global AI-led investment theme continues to weigh on its positioning within international capital allocation frameworks. Unlike markets with scalable, listed AI-native platforms that are attracting outsized foreign portfolio flows, India's equity market lacks a comparable AI monetisation narrative, making it structurally underweight in global portfolios benchmarked to AI-driven growth. This has contributed to persistent FPI outflows and, combined with periodic private equity exits, kept the rupee under pressure, dampening USD-denominated returns and acting as a further deterrent to fresh equity inflows at a time when the domestic macro story otherwise merits deeper allocation.

This edition of our Investment Strategy Report seeks to frame these dynamics clearly - separating cyclical noise from structural signals, and to translate a complex macro environment into actionable portfolio insights. Periods like this reward patience, discipline, and a willingness to look beyond consensus narratives.

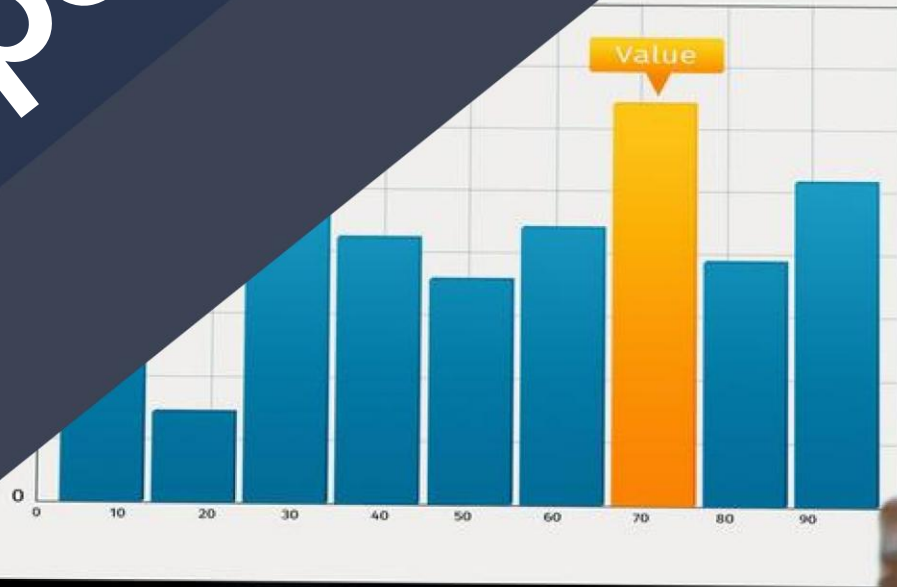
We thank you for your continued trust and partnership.

Best regards,

Siddharth Jadeja



Investment Strategy Report





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KILIKA CAPITAL





WHO WE ARE?



ABOUT US

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

OUR MISSION

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

MEET OUR LEADERSHIP TEAM – THE DREAM TEAM!

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

Siddharth Jadeja, CFA – The Strategist

Our managing partner, Siddharth Jadeja, is the calm, analytical anchor of Kilika Capital. A CFA charterholder and an MBA in finance, Siddharth comes with over 15 years of experience in a variety of roles ranging from credit risk, equity research, corporate banking, structured finance, and fund management at giants like HDFC Bank, Edelweiss Capital and Nuvama to name a few. He's been the brains behind countless deals, with the kind of market insights you'd bet on any day. Whether it's breaking down complex businesses or analysing sectors or structuring assets, Siddharth's expertise in credit and risk ensures our ship sails smoothly. Investors trust him, and so do we—his knack for turning numbers into actionable results 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.

Smitha Iyer – The Operational Hawk

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

Piyush Sharma – The Creative Wizard

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

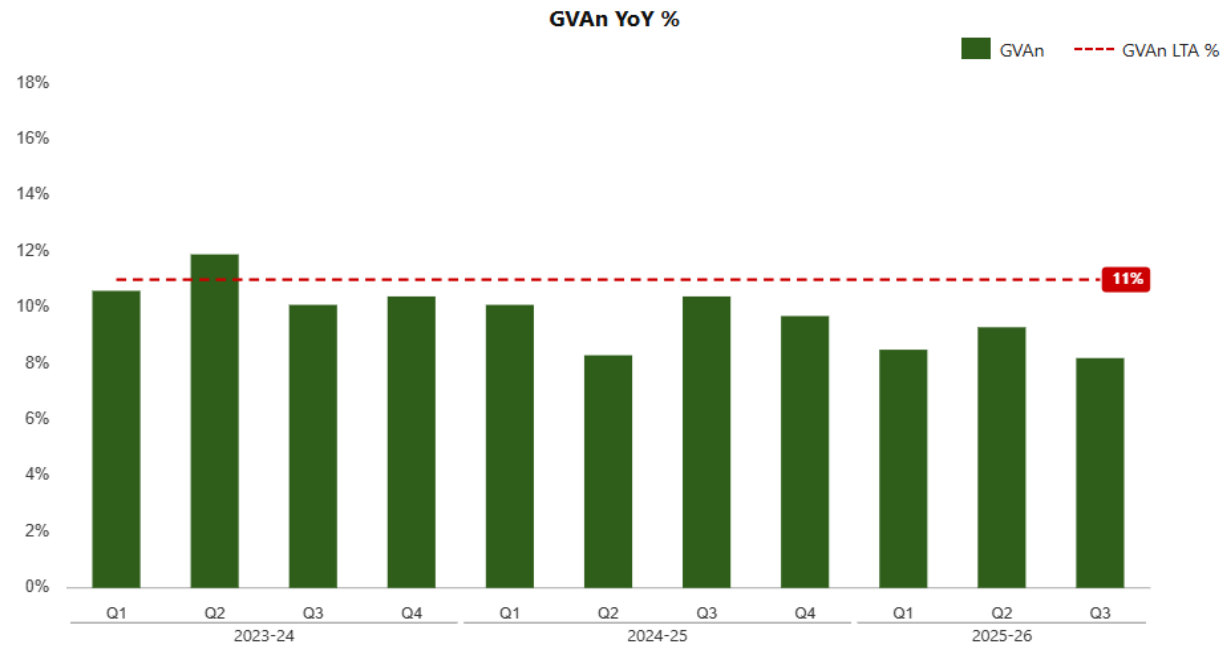
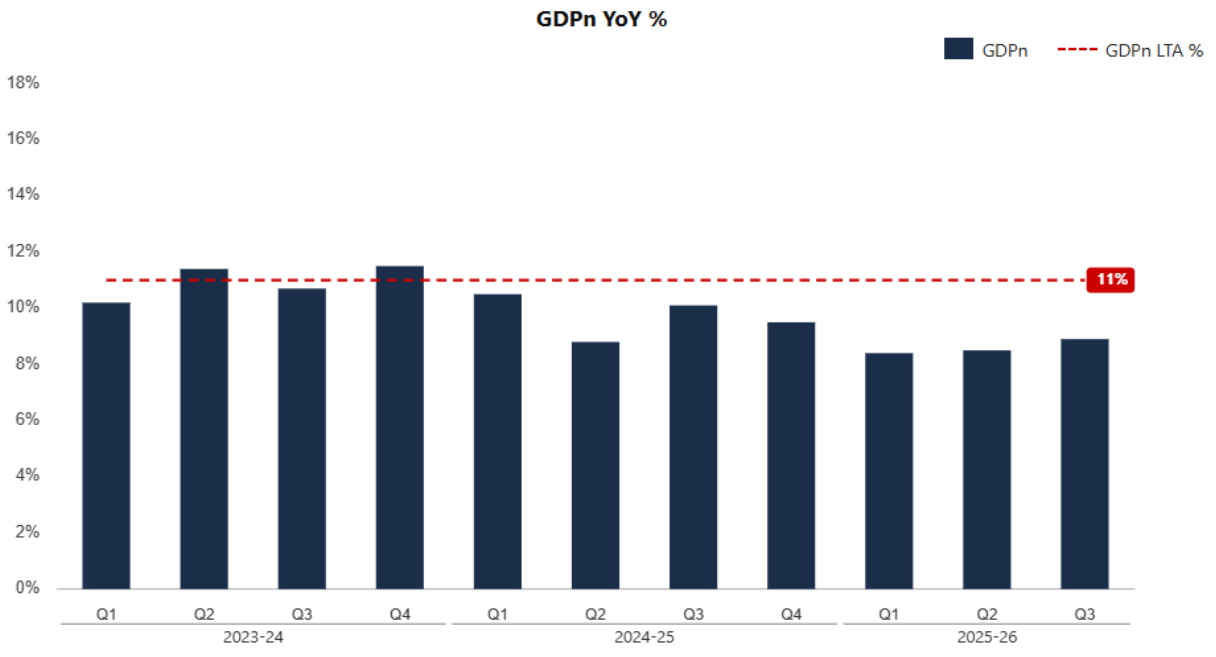
Together, we're not just a team; we're partners in your financial journey. We bring experience, attention to detail, and a touch of creative flair to everything we do. Whether it's operations, research, or strategy, rest assured—we've got your back. After all, when we win, you win. And we're in it for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

Macro-Economic Outlook





1. GDP (Gross Domestic Product)



India GDP Q3 FY2025–26: Quarterly Deep Dive



The Headline Print: Reading 7.8% Correctly

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

Demand-Side Drivers

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

The Base Year Overhaul – What Changed, Why It Matters

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

Why 2022–23?

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

The Revision Impact: Old Series vs New Series

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



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

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

What This Means for Key Ratios

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

Sectoral Performance – The Full Picture

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

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



Manufacturing: The Story of This Cycle

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

Agriculture: Quiet Outperformer

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

Services: Mixed, but Net Positive

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

Policy Implications – RBI, Fiscal & Beyond

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

India vs The World – The Alpha Story

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



Strategic Outlook – What to Watch in the next 3 Quarters

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

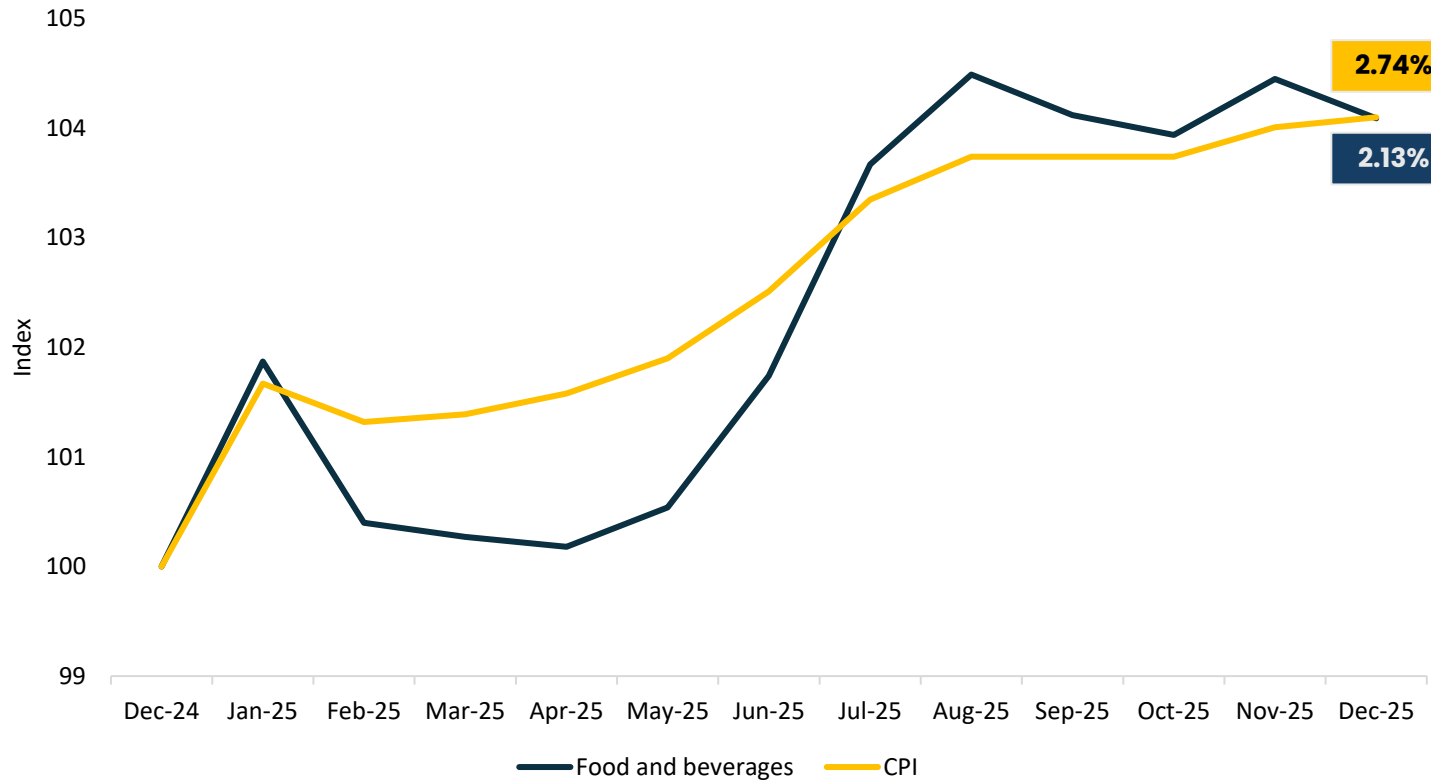
Our 12-Month View: Constructive with Eyes Open

India enters FY2026-27 with genuine momentum. The manufacturing cycle is at an inflection point. Rural consumption recovery is at a mature phase. The RBI has operational headroom and the political will to infuse liquidity. The base year upgrade removes a structural data-credibility overhang. Our base case is 7.4–7.8% real GDP for FY2026-27, with upside if: (a) global risk sentiment stabilises, with an agreement on the US/Israel-Iran war and global trade agreements thus giving a fillip to exports and in-turn a capex up-cycle (b) monsoon is normal or above-normal, and (c) the government's interim and full budgets stay on the public capex track. Downside scenario of 6.8–7.0% materialises if US tariff escalation broadens to include Indian electronics and pharmaceuticals, or if crude oil spikes above \$90/bbl for a sustained period, due to supply constraints, reviving inflation anxieties.

2. Inflation

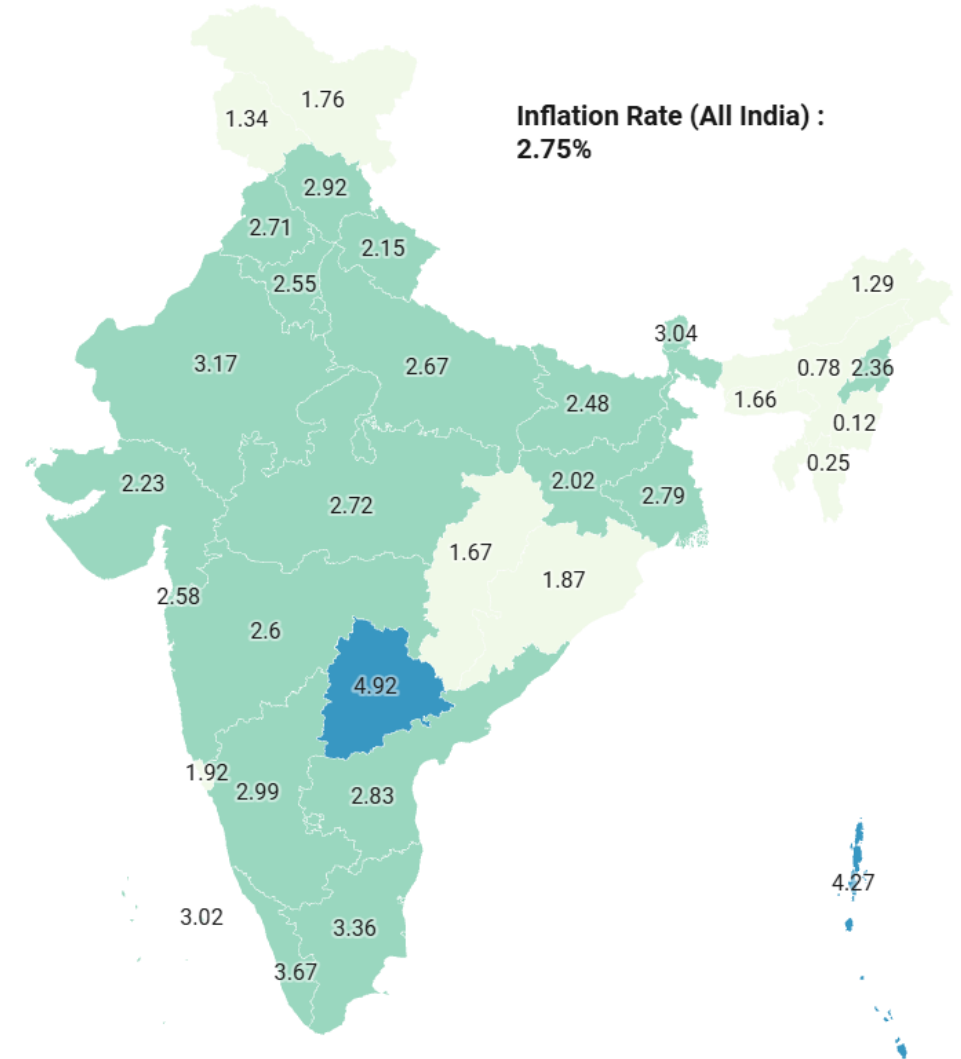


CPI (Headline Inflation) & CFPI (Food and Beverages Inflation)



Inflation Rate

- < 2
- 2-4
- 4-6
- ≥ 6



Source: Internal assessment based on RBI DBIE data

Inflation Update – January 2026 & Forward Outlook



Key Takeaways: January 2026 marks the debut of India’s revamped CPI series (base year 2024=100). Headline inflation printed at 2.75%, comfortably within the RBI’s 2–6% tolerance band. The new series reduces food weight from ~46% to ~37%, expands the basket to 358 items, and structurally reshapes how we read inflation going forward. The RBI held the repo rate at 5.25% and projects inflation rising to ~4.0–4.2% in H1 FY27 on base effects.

Headline Inflation

- **India’s CPI inflation for January 2026 was provisionally reported at 2.75% YoY** — the first official data point under the newly launched CPI series with base year 2024=100. This replaced the previous 2012–base series, under which December 2025 inflation had printed at 1.33%.
- While the headline number appears to show a sharp jump from December, the two readings are not directly comparable due to significant methodological and compositional changes. The new series expands the item basket from 299 to 358, realigns category weights based on the 2023–24 Household Consumption Expenditure Survey (HCES), and adopts the international COICOP 2018 classification framework with 12 consumption divisions (versus the earlier 6–group structure).
- The January print was broadly in line with Bloomberg consensus of 2.77% and slightly above the market expectation of ~2.4–2.5% that had been built under the old series assumptions. MoSPI has provided a linking factor for backward compatibility, but analysts note that historical comparisons will remain challenging for the next several quarters.

Indicator	Jan 2026 (New Series)
Headline CPI (YoY)	2.75%
Food Inflation (CFPI, YoY)	2.13%
Housing Inflation	2.05%
Personal Care & Misc. Goods	19.02%
Health	2.19%
Clothing & Footwear	2.98%
Transport	0.09%
CPI MoM (Jan over Dec)	+0.35%

The New CPI Series – What Changed

The transition to the 2024–base CPI is the most significant methodological overhaul in over a decade. Key changes that should be note:

- **Food & Beverages weight reduced from 45.86% to 36.75%.** This is the single most consequential shift. With food prices having been in deflation for much of late 2025, the lower weight means food deflation will have a smaller dampening effect on headline CPI going forward. Conversely, when food prices spike, the headline will be less volatile.



- **Housing weight nearly doubled from 10.07% to 17.67%**, now including water, electricity, gas, other fuels, and for the first time, rural house rent. This makes the CPI more representative of actual household expenditure but introduces greater sensitivity to administered energy price changes.
- **Core categories gain weight.** Transport, health, education, and personal care together carry a larger share, making core inflation a more influential driver of the headline print. SBI Research estimates the recalibration could raise reported inflation by 20–30 bps when food inflation is elevated.
- **Item count expanded from 299 to 358**, with additions reflecting modern consumption – OTT subscriptions, smartphones, e-commerce, CNG/PNG, fitness equipment – while removing obsolete items like VCRs and tape recorders.

Core Inflation

- Core CPI (excluding food & beverages, and electricity, gas & fuels) printed at a muted **3.4% in January 2026** under the new series. Under the old series, core inflation (excluding food, fuel & light, and petrol/diesel) had surged to a 28-month high of 4.8% in December 2025, **driven primarily by the precious metals rally.**
- The **standout driver remains precious metals. Gold has rallied over 70% and silver over 200% in the past year, feeding into the “personal care, social protection and miscellaneous” category, which recorded an outlier 19.02% inflation in January. Excluding gold and silver, core CPI remained anchored at approximately 2.4–2.6%, indicating that underlying demand-side price pressures remain subdued.**
- This bifurcation is critical: the headline core number appears elevated, but **the breadth of inflationary pressure remains narrow. Eleven of the twelve CPI divisions registered benign inflation between 0.1% and 3.4%. The RBI has acknowledged that the precious metals effect added an estimated 60–70 bps to core inflation and factored this into its revised FY26 CPI estimate of 2.1%** (up 10 bps from December’s projection of 2.0%).

Food Inflation

- **Consumer Food Price Index (CFPI) inflation came in at 2.13% YoY in January 2026** under the new series. This **marks a significant turnaround from the persistent food deflation that characterised the second half of 2025** – under the old series, food inflation was -2.71% in December 2025, having remained in negative territory for seven consecutive months.
- The deflation in food prices through mid-to-late 2025 was **driven by a combination of bumper kharif output, comfortable buffer stocks of food grains, and benign vegetable prices following favourable weather. The reversal to positive territory in January partly reflects the waning of these favourable base effects and a normalisation in perishable prices.**
- **Looking ahead, the RBI has flagged that food supply prospects remain bright on the back of healthy kharif production, sufficient buffer stocks, favourable rabi sowing, and adequate reservoir levels. However, we expect food inflation (on a WPI basis) to harden further as unfavourable base effects intensify through Q4 FY26 and into Q1 FY27. Vegetable and pulses price volatility remains a wildcard, though the lower CFPI weight in the new series should temper the headline impact of any spikes.**

Rural vs Urban Divergence



The January 2026 data reveals a remarkably narrow rural-urban inflation gap:

Measure	Rural	Urban
Headline CPI	2.73%	2.77%
Food Inflation (CFPI)	1.96%	2.44%

- The **4 bps headline gap (rural 2.73% vs. urban 2.77%)** is notably tight and reflects convergence driven by several structural factors. The new CPI series itself plays a role – by introducing rural house rent for the first time and expanding rural market coverage to 1,465 villages across 686 districts (up from 1,181 villages in 582 districts), the new framework captures rural cost-of-living pressures more comprehensively.
- On the food front, **rural food inflation (1.96%)** trailed urban food inflation (2.44%) by 48 bps, consistent with the proximity-to-production advantage that rural households enjoy during periods of adequate agricultural supply. The healthy kharif harvest and strong rabi sowing have kept farm-gate food prices subdued, benefiting rural consumers disproportionately.
- The convergence in headline numbers despite divergence in food inflation suggests that non-food categories – particularly services, personal care, and precious metals – are exerting relatively more pressure in rural areas than historically observed. This is consistent with rising rural demand for gold/silver jewellery, improved healthcare access, and the broader penetration of digital and services consumption into rural India.

Outlook

RBI's inflation trajectory: The MPC has projected FY26 CPI inflation at 2.1% (revised up 10 bps), with Q4 FY26 at 3.2%. For FY27, the RBI expects inflation to normalise toward its 4% target, with projections of 4.0% for Q1 FY27 and 4.2% for Q2 FY27. **The rise is largely technical – driven by unfavourable base effects from the sharp price declines in Q4 FY25 and H1 FY26 – rather than by fresh demand-pull pressures.**

Monetary policy stance: The MPC **unanimously held the repo rate at 5.25% in February 2026 with a “Neutral” stance.** We expect the RBI to remain on hold through at least Q2 FY27 as it assesses the implications of the new CPI and GDP series. The cumulative 125 bps of rate cuts since February 2025 has already transmitted approximately 105 bps to lending rates.

Key upside risks to inflation: **Unfavourable base effects from Q4 FY26 onward** will mechanically push YoY prints higher. **Geopolitical uncertainty** and **volatile energy prices** remain tail risks. The **INR/USD depreciation** in recent months could feed into imported inflation with a lag. **Precious metals**, if the rally sustains, will continue to inflate the core print. The new CPI's **higher weight on core categories means any services-led price pressures** will register more prominently.

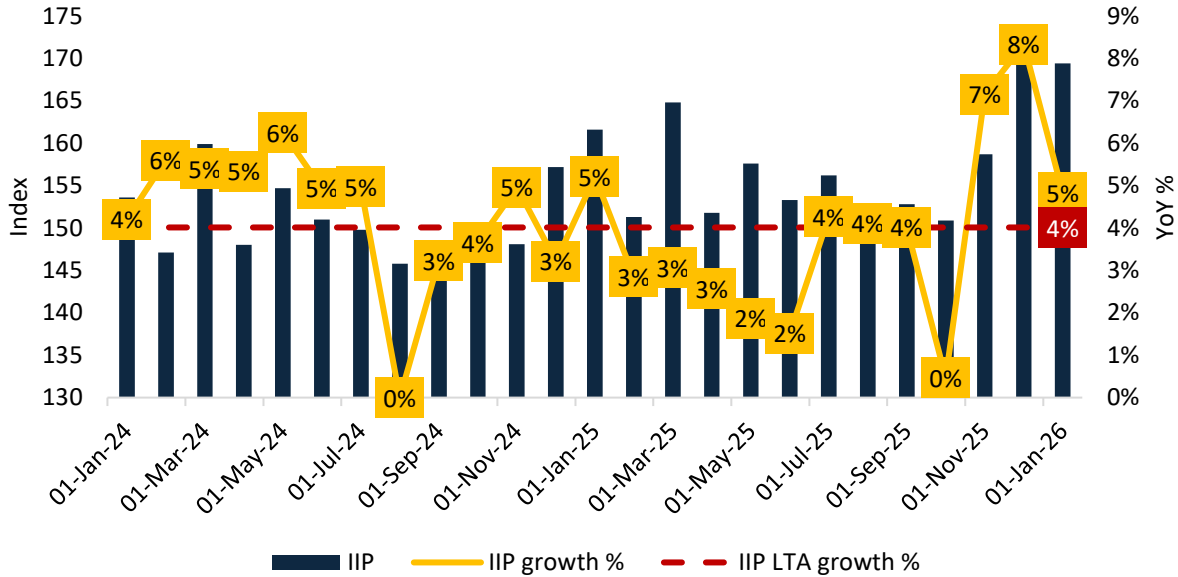
Key downside factors: **Food supply conditions remain favourable** with **healthy rabi prospects** and **comfortable government buffer stocks.** The **September 2025 GST rationalisation continues to exert a disinflationary impulse on approximately 11.4% of the CPI basket.** **Fuel and power remains in deflation** on a WPI basis (tenth consecutive month at -4.0% in January). **Global commodity prices**, while firming in metals, remain mixed overall. **A prolonged war in the Middle East is a clear risk.**

Net assessment: We see **headline inflation climbing toward 3.0–3.5% in Q4 FY26 and 4.0–4.5% in H1 FY27, largely on base effects and the structural impact of the new CPI weights.** Excluding precious metals, underlying inflation remains **benign and well-anchored.** The RBI is likely to remain in wait-and-watch mode through the first half of FY27, with further rate action contingent on clearer visibility on food price trajectories, external demand conditions, and calibration of the new statistical series.

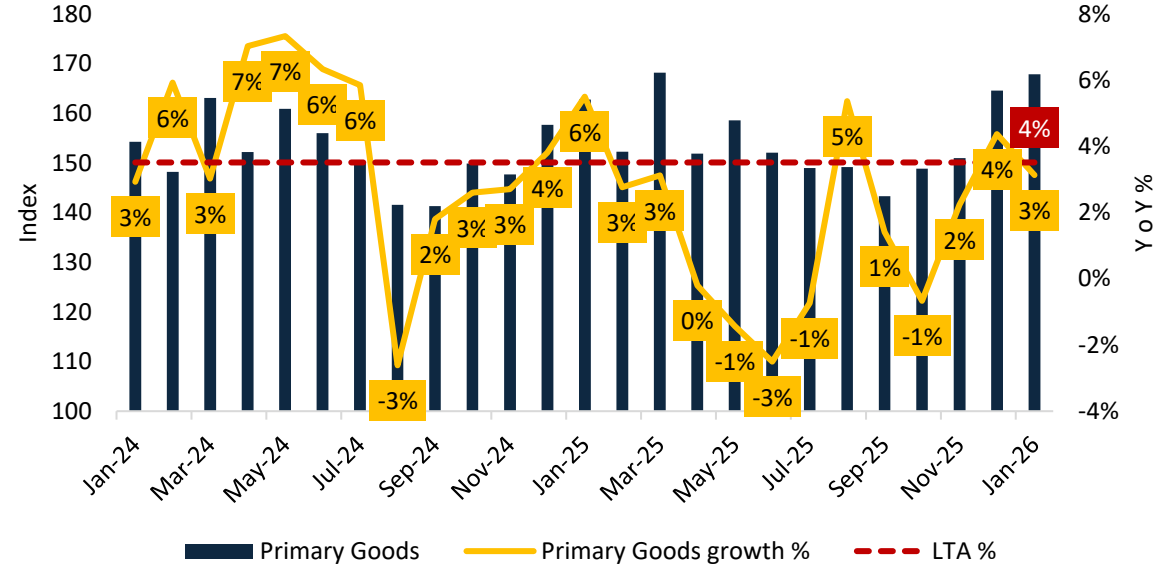


3. IIP (Index of Industrial Production)

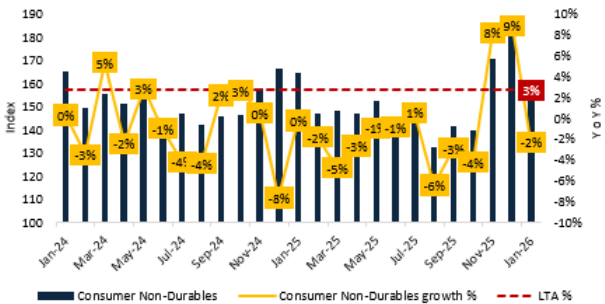
IIP - Industry



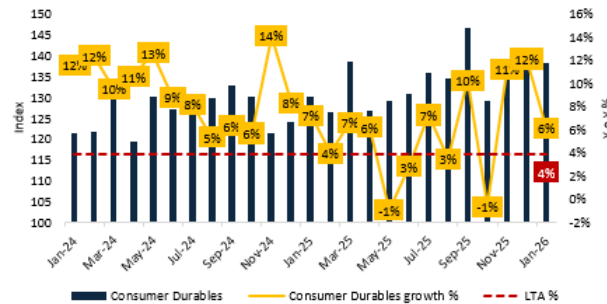
Primary Goods



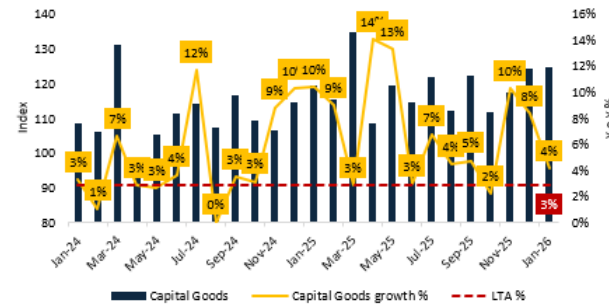
Consumer Non-Durables



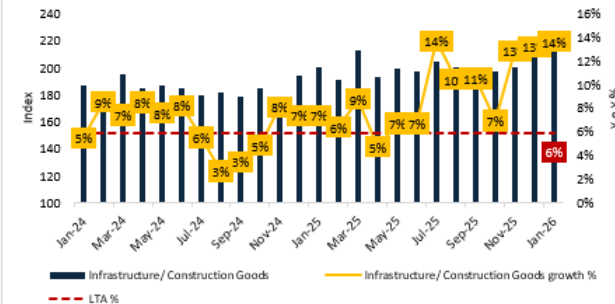
Consumer Durables

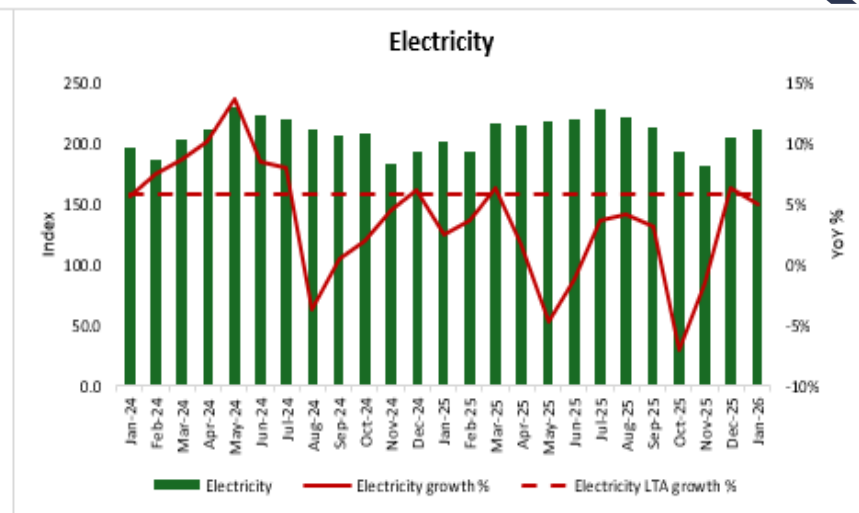
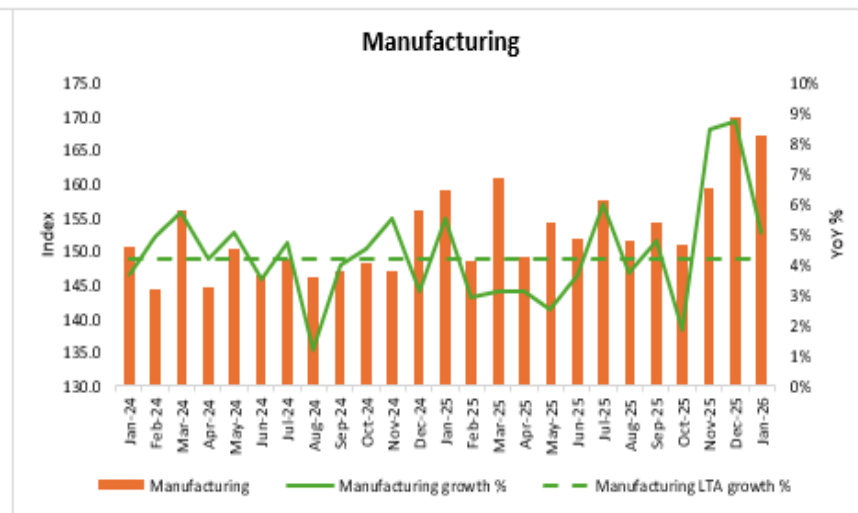
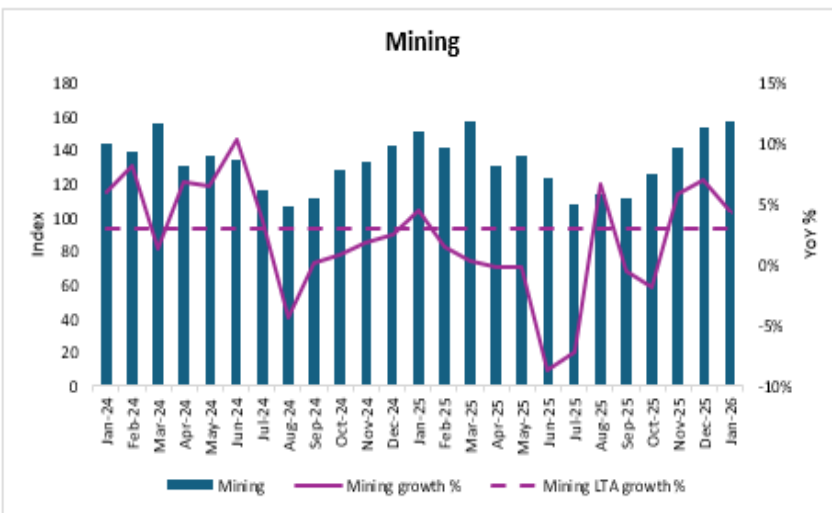


Capital Goods



Infrastructure





Index of Industrial Production (IIP)

Headline Data Snapshot

- India's Index of Industrial Production (IIP) registered a year-on-year growth of 4.8% in January 2026, moderating from a revised 8.0% (upwardly revised from the initial estimate of 7.8%) recorded in December 2025. The General Index stood at 169.4 in January 2026, compared to 161.6 in January 2025, indicating that **while the pace of expansion has decelerated, the absolute level of industrial output remains firmly in expansionary territory.**
- The moderation was broad-based, spanning mining, manufacturing, and electricity, though the deceleration was most pronounced in manufacturing which carries the dominant weight in the IIP basket. Importantly, **the January reading follows two consecutive months of exceptionally strong growth (7.2% in November and 8.0% in December), and a degree of normalisation was both expected and structurally consistent with the post-festive demand correction cycle.**

Parameter	Jan 2026	Dec 2025 (R)	Jan 2025
IIP Overall Growth (% YoY)	4.8%	8.0%	5.2%
General Index	169.4	170.7	161.6
Mining Growth	4.3%	-	4.4%
Manufacturing Growth	4.8%	8.1%	5.8%
Electricity Growth	5.1%	-	2.4%

Source: Internal assessment based on RBI DBIE data



Sectoral Decomposition

Manufacturing (Weight: 77.6% in IIP)

- The manufacturing sector recorded a **4.8% YoY growth in January 2026**, a notable deceleration from the 8.1% growth in December 2025. However, the **breadth of expansion remained reasonably healthy, with 14 out of 23 industry groups at the NIC 2-digit level recording positive growth**. This implies that **approximately 61% of the manufacturing sub-sectors continued to expand**, even as headline momentum softened.
- **The top three positive contributors were: Manufacture of basic metals (+13.2% YoY), driven by alloy steel flat products, MS slabs, and hot-rolled mild steel coils and sheets; Manufacture of motor vehicles, trailers and semi-trailers (+10.9% YoY), led by auto components, commercial vehicles, and bus/minibus chassis; and Manufacture of other non-metallic mineral products (+9.9% YoY), benefiting from robust cement and clinker output.**
- The **strength in basic metals and non-metallic mineral products is consistent with the infrastructure-led growth thesis** and aligns with the **9.9% and 10.7% growth in steel and cement** recorded in the Index of Eight Core Industries (ICI) for January. The **auto sector's performance, particularly in commercial vehicles, further reinforces the view that investment-linked and logistics demand rather than purely discretionary consumption, is driving the manufacturing cycle.**
- However, the **moderation from December's 16 out of 23 groups in positive territory to 14 in January warrants monitoring. The contraction or stagnation in select export-oriented and consumer-facing sub-sectors may reflect global headwinds and subdued mass-market demand, respectively.**

Mining (Weight: 14.4% in IIP)

- Mining output grew **4.3% YoY in January 2026**, marginally lower than the 4.4% recorded in January 2025. While **growth remains in positive territory, the sector continues to face structural headwinds from declining crude oil production (-5.8% YoY) and natural gas output (-5.0% YoY)**, both of which have been in negative territory for multiple consecutive months. **Coal production grew 3.1%, supported by thermal power generation needs**, though its cumulative growth for April-January FY26 remains marginally negative at -0.3%.

Electricity (Weight: 8.0% in IIP)

- Electricity generation recorded a **5.1% YoY growth in January 2026**, a significant improvement from the 2.4% expansion in January 2025. This is a particularly encouraging data point, as **electricity output is widely considered a lead indicator of broader economic and industrial activity. The improvement suggests that operational activity in manufacturing, infrastructure, and services sectors remained healthy** during the month, and that the underlying demand environment is stronger than what the headline IIP deceleration might suggest.

Use-Based Classification: Demand Structure Analysis

Infrastructure/Construction Goods: The Growth Anchor

- **The 13.7% YoY growth** in infrastructure and construction goods is the standout data point in this release and the highest among all use-based categories. This category **captures output of materials directly linked to roads, railways, housing, urban infrastructure, and public works. The strength here is directly attributable to the sustained government capital expenditure push, with the Union Budget 2026-27 allocating Rs 12.2 lakh crore towards public capital expenditure focused on efficiency and connectivity projects.** This category's index at 227.7 the highest across all use-based segments, underscores the structural shift towards investment-led industrial expansion.



Category	Growth (%)	Index (Jan-26)	Assessment
Infrastructure/Construction Goods	13.7%	227.7	Very Strong
Consumer Durables	6.3%	138.2	Healthy
Intermediate Goods	6.0%	182.8	Healthy
Capital Goods	4.3%	124.4	Moderate
Primary Goods	3.1%	167.9	Moderate
Consumer Non-Durables	-2.7%	160.7	Contraction

Core Industry	Weight in IIP (%)	Jan 2026 Growth	Trend
Cement	5.37%	+10.7%	Strong
Steel	17.92%	+9.9%	Strong
Electricity	19.85%	+3.8%	Steady
Fertilizers	2.63%	+3.7%	Steady
Coal	10.33%	+3.1%	Moderate
Refinery Products	28.04%	0.0%	Flat
Crude Oil	8.98%	-5.8%	Contracting
Natural Gas	6.88%	-5.0%	Contracting (19th consecutive month)

Consumer Non-Durables: The Persistent Concern

- The **2.7% YoY contraction** in consumer non-durables is perhaps the most critical data point for the broader macro narrative. This category includes everyday items such as food products, beverages, textiles, and personal care goods, essentially products consumed by the mass market, particularly lower and middle-income households. The contraction follows an unusually strong 8.5% growth in December (a 26-month high), suggesting that festive demand front-loaded consumption, leaving January with a payback effect.
- However, the trend is not merely a one-month aberration. **Consumer non-durable performance has been inconsistent through FY26, and the contraction raises legitimate questions about the durability of the rural and mass-market consumption recovery. If consumption does not accelerate meaningfully, it could cap the pace of manufacturing expansion in the coming quarters and present asymmetric risks to the growth trajectory.**

Capital Goods: Investment Cycle in Low Gear

- Capital goods grew at a moderate **4.3% YoY in January 2026**, which while positive, suggests that the **private investment cycle has not yet shifted into a higher gear**. The capital goods index at 124.4 remains the lowest among all use-based segments, indicating that despite favourable conditions - healthy corporate balance sheets, accommodative monetary policy, and supportive fiscal incentives, **private sector capex is yet to achieve escape velocity**. The RBI's **capacity utilisation data** and **forward-looking business confidence surveys** will be critical in assessing when this transition occurs.

Core Sector (ICI) Corroboration

- **The Index of Eight Core Industries (ICI), which constitutes 40.27% of the IIP weight, registered a 4.0% YoY growth in January 2026**, moderating from a revised 4.7% YoY in December 2025 and below the 5.1% recorded in January 2025. The cumulative growth for April-January FY26 stands at 2.8%, compared to 4.5% in the corresponding period of the prior year, reflecting a clear deceleration in the core infrastructure pipeline.
- The divergence within the core sector is stark: infrastructure-linked sectors (cement and steel) are outperforming handsomely, while energy extraction sectors (crude oil and natural gas) remain in contraction. We have noted that the strong performance in steel and cement is reflective of robust investment in infrastructure led by the central government, with states also contributing, alongside stable housing activity in the economy. Natural gas output has now declined for 19 consecutive months, representing a structural challenge in India's energy production landscape that has implications for fertilizer production, city gas distribution, and industrial energy costs.



PMI Cross-Read: Forward-Looking Indicators

- The HSBC India **Manufacturing PMI rose to 55.4 in January 2026 from 55.0 in December (revised down from the flash estimate of 56.8), signalling continued solid expansion in manufacturing activity.** The PMI print above 55 for three consecutive months suggests that the underlying manufacturing cycle remains robust, even as the IIP captures some post-festive normalisation.
- Key PMI sub-indices presented a mixed picture: output and new orders grew at a faster pace, driven by strong domestic demand, with exports recording modest growth. Employment increased at the quickest rate in three months, indicating that firms are expanding workforce in response to higher workloads. Input costs increased at a four-month high, though remained moderate in historical context. Output prices edged up only marginally, limited by competitive pressures and efficiency gains.
- **The critical divergence, however, lies in business confidence. Business sentiment weakened sharply to a three-and-a-half-year low, with only 15% of firms expecting higher output over the coming year. This disconnect between current activity (robust) and forward expectations (weak) is a key signal for clients: it suggests that firms are fulfilling current order backlogs but remain cautious about capital allocation decisions and medium-term demand visibility, likely influenced by geopolitical uncertainty in the Middle East and evolving global trade dynamics.**

Key Structural Themes

Capex-Led vs. Consumption-Led Growth: The Structural Skew

- The January IIP data reinforces what has been the defining feature of India's industrial cycle in FY26: growth is overwhelmingly anchored by government-led infrastructure spending rather than broad-based private consumption. Infrastructure and construction goods growing at 13.7% while consumer non-durables contract by 2.7% encapsulates this divergence. The sustainability of the current growth trajectory critically depends on the private consumption engine accelerating to complement the public capex-led momentum. The GST rate rationalisation and recent income tax cuts in the Union Budget should provide tailwinds, but the transmission to rural and semi-urban demand remains the key monitorable.

Bank Credit-IIP Divergence

- Bank credit to industry grew at 12.1% in January 2026, significantly outpacing the 4.8% IIP growth. This divergence suggests that part of the credit flow is supporting working capital needs, infrastructure projects, or sectors with longer gestation periods rather than translating into immediate production expansion. This is not necessarily concerning, it may indicate a pipeline of investment activity that will reflect in future output, but it does warrant monitoring for early signs of credit misallocation or sector-specific stress.

IIP Base Year Revision: An Upcoming Structural Shift

- The new base year for IIP will be updated to 2022-23, with the revised series scheduled for official release by MoSPI on 28th May 2026. This revision is expected to assign higher weights to manufacturing and electricity segments, potentially altering the growth narrative and historical comparisons.



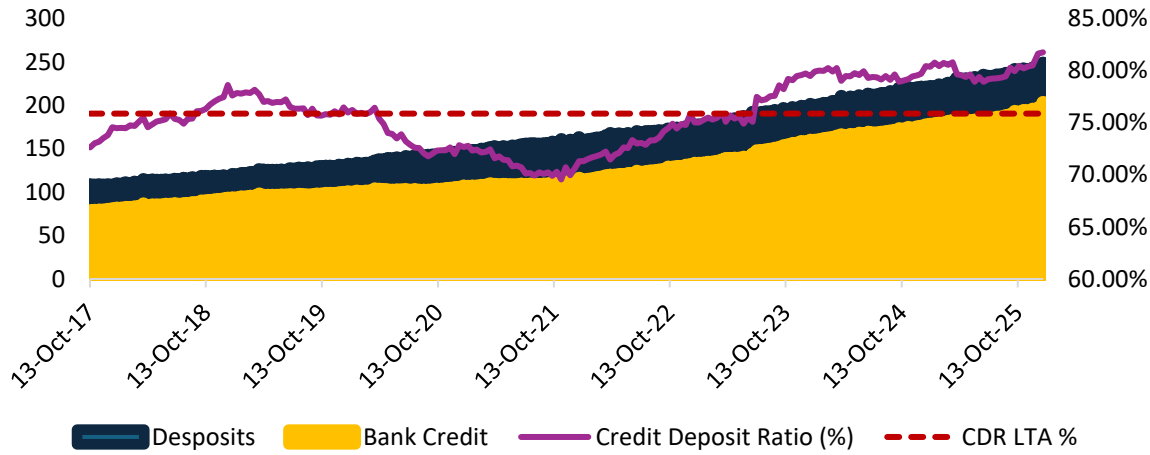
Outlook

- **Going forward, the industrial cycle appears poised for continued expansion, though the pace of growth has expectedly moderated from December's elevated levels. The festive and year-end demand boost has waned, and base effects will become less favourable in the coming months. We expect IIP growth to settle in the 4–5% range for the remainder of FY26, with full-year growth likely around 4.5%. Still, the underlying macro fundamentals remain supportive – government capex continues at a strong clip with Rs 12.2 lakh crore allocated in the Union Budget 2026–27, monetary policy remains accommodative with the repo rate at 5.25% after cumulative 125 bps cuts, and the recently concluded trade deals with the US (tariffs reduced from 25% to 18%) and the EU should provide an additional fillip to exports and investment inflows. Rural demand indicators remain positive on the back of a good monsoon harvest, and GST rationalisation measures should support consumption in the near term.**
- **Nonetheless, several risks could slow the industrial upturn. Externally, escalating geopolitical tensions in the Middle East pose a direct threat to energy costs and supply chains, while a renewed global slowdown or intensification of trade conflicts could hurt exports and capex sentiment – business confidence on the PMI survey has already fallen to a three-and-a-half-year low. On the domestic front, the 2.7% contraction in consumer non-durables remains a concern; consumer spending may not sustain unless rural wages and farm incomes improve meaningfully, particularly with the probability of an El Niño event in 2026 posing risks to agriculture and the inflation trajectory. The divergence between IIP growth (~4.5%) and manufacturing GDP growth (11.5% under the new national accounts series) also needs reconciliation – the upcoming IIP base year revision to 2022–23, scheduled for May 2026, should address this, but investors should be prepared for potential discontinuities in historical trend analysis. Finally, any significant pullback in government infrastructure spending (after front-loading capex earlier in the year) could dampen the infrastructure goods sector, which has been the primary growth driver.**
- **The elephant in the room is the energy shock risk now dominating the near-term macro outlook. The Middle East escalation has pushed oil prices sharply higher and disrupted the Strait of Hormuz, which matters acutely for India's import-dependent economy – input costs, working-capital stress, margin compression, and potential financial tightening loom if inflation expectations shift. Weaker global demand is also showing up in export orders (slowest pace in over a year), meaning the discretionary industrial segments cannot rely on external tailwinds. Our baseline remains expansionary (4–6% IIP for FY2025–26, broadening into FY2026–27), but the distribution of risks has clearly shifted: energy normalisation and trade-deal execution are now the necessary conditions for the capex engine to translate into sustained economy-wide growth rather than sufficient conditions on their own.**

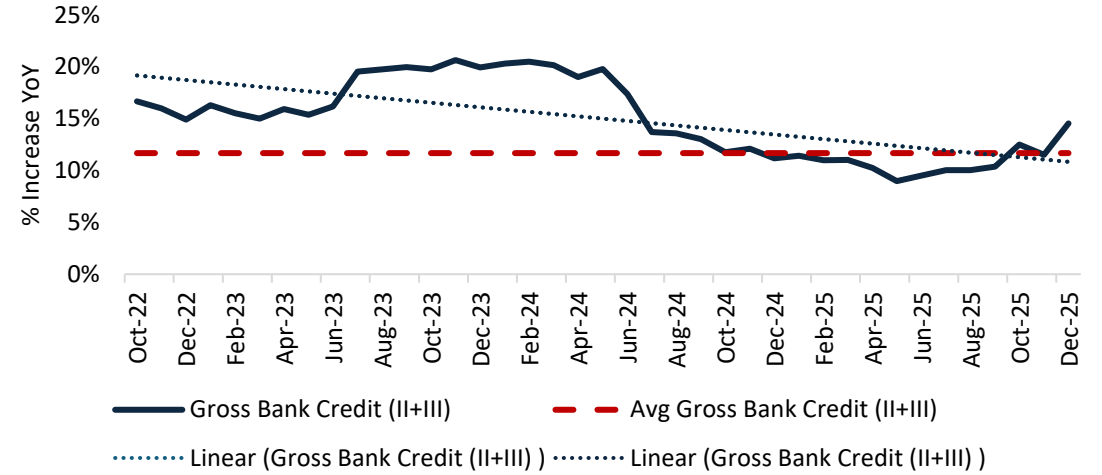
4. Capex



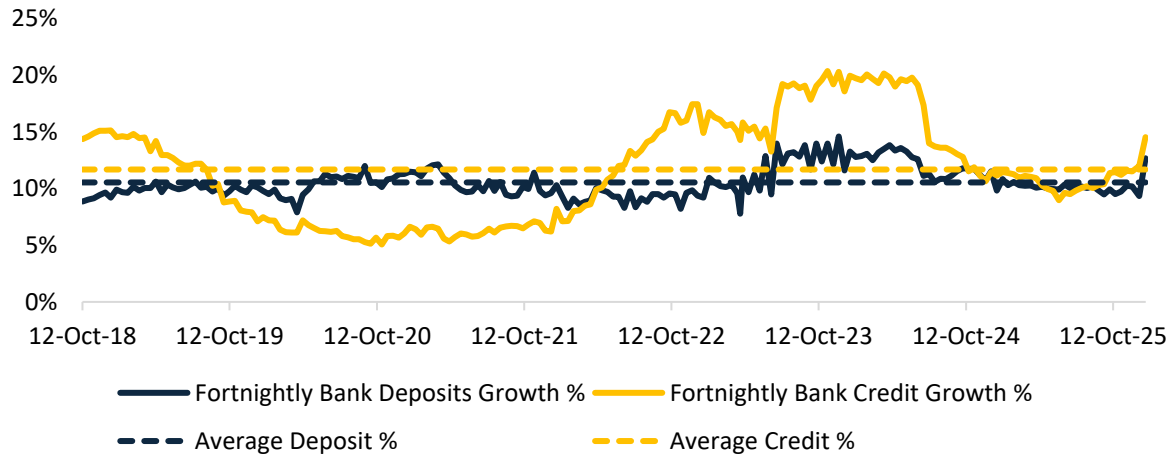
Credit Deposit Ratio



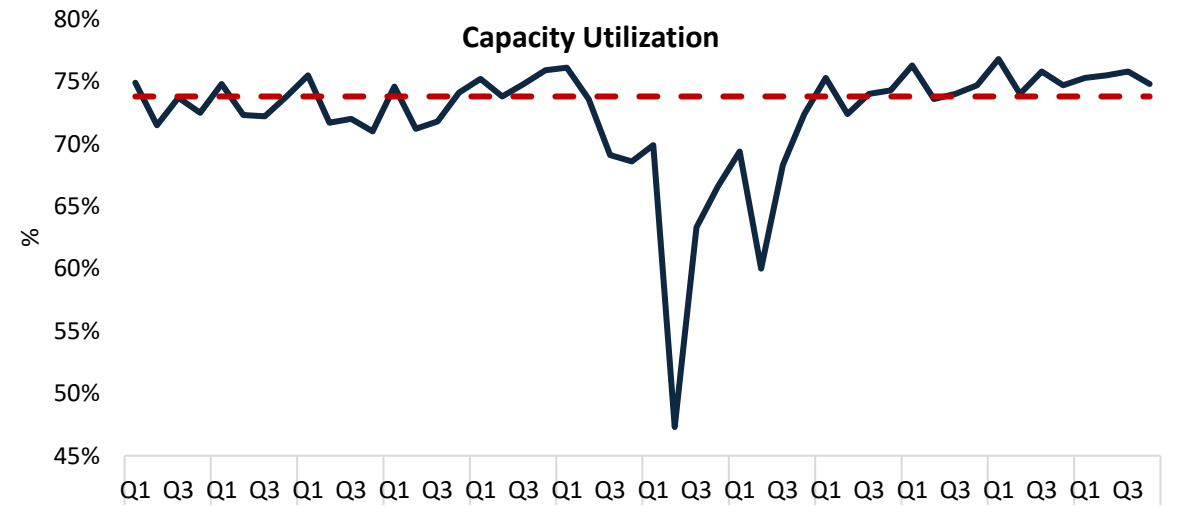
Total Bank Credit Growth



Credit Deposit Growth %

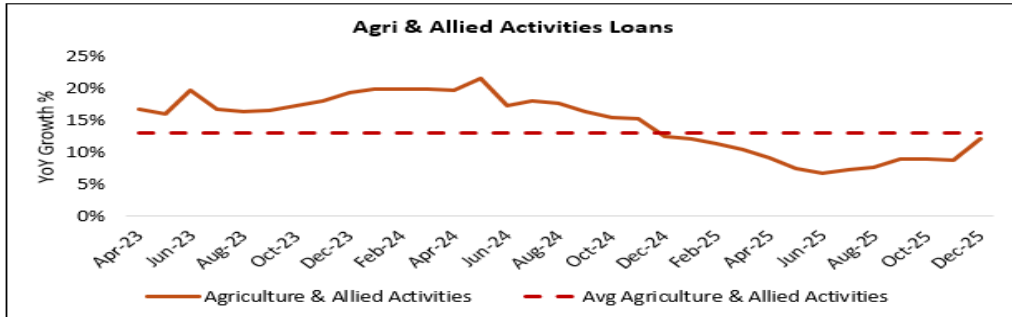


Capacity Utilization

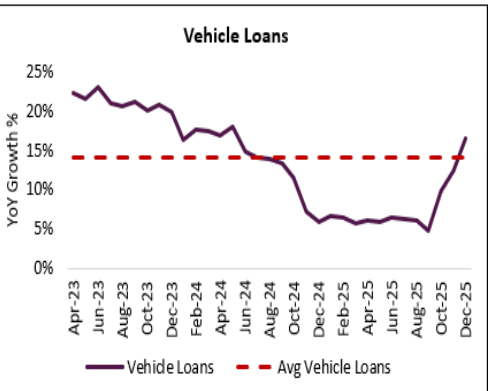
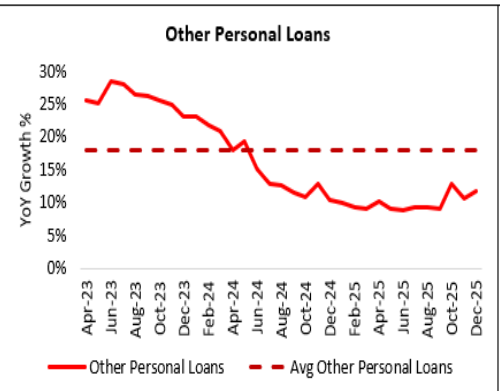
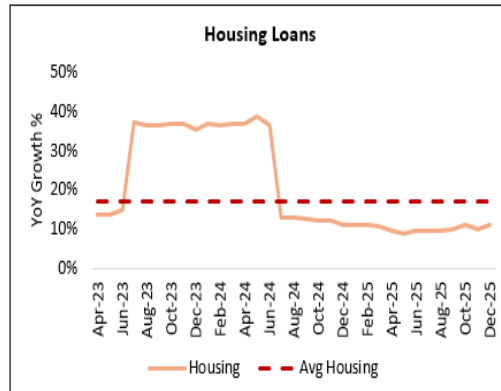
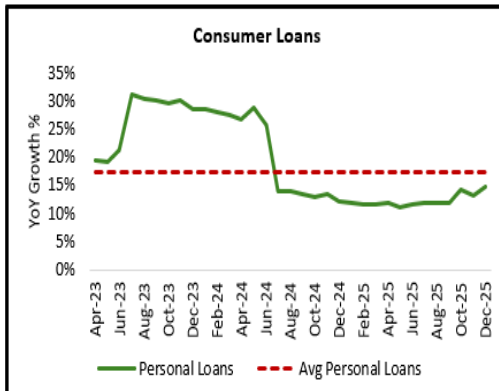




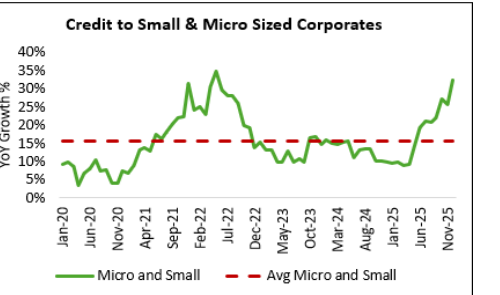
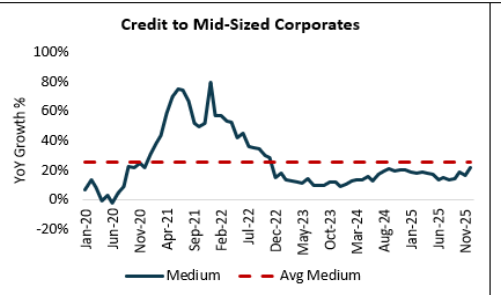
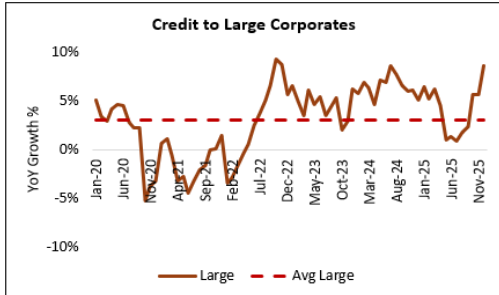
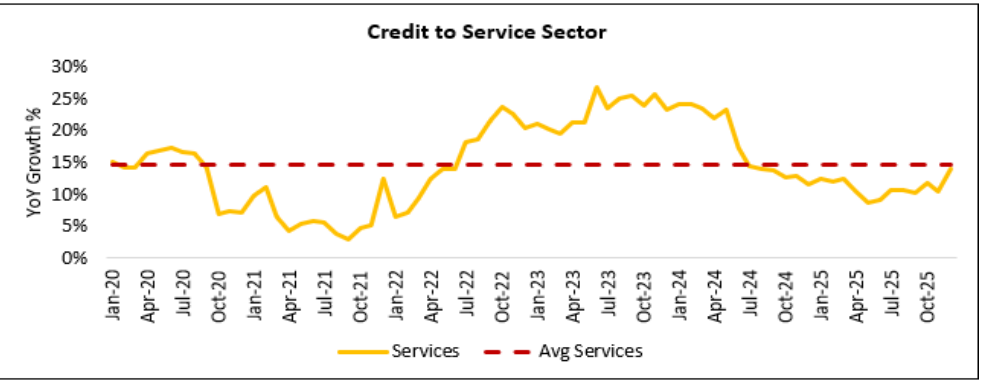
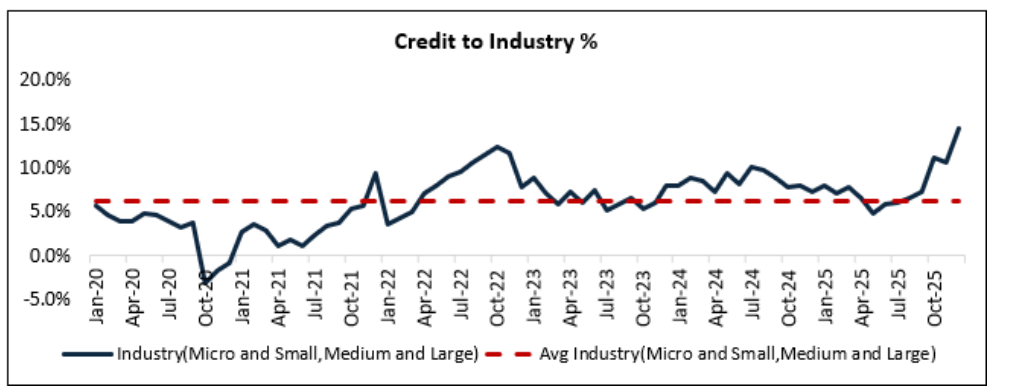
Credit to Agri



Credit to Consumer



Credit to Industry



Source: Internal assessment based on RBI DBIE data



Bank Credit Dynamics: A Broad-Based Uptick

Aggregate Credit Flows: Fastest Expansion in Two Years

- Total non-food bank credit grew **13.1% year-on-year as of January 15, 2026, its fastest pace in nearly two years** and a significant acceleration from 11.5% recorded in the same period of the prior year. The breadth of this growth is particularly significant: all major sectors — agriculture, industry, services, and personal loans — are contributing simultaneously, a pattern that has historically been associated with an **economy operating near its productive capacity rather than in cyclical recovery mode**.
- The aggregate resource flow from both bank and non-bank sources to the commercial sector rose to **₹29.6 lakh crore in FY26 year-to-date**, up from ₹23.3 lakh crore in the comparable prior-year period. **The primary drivers of this ₹6.3 lakh crore incremental flow were non-food bank credit (₹5.04 lakh crore) and corporate bond issuances by non-financial entities (₹1.4 lakh crore)**. This dual-channel expansion suggests that financial intermediation is deepening and that the corporate bond market is maturing as a complementary, rather than competing, source of capital.

Sectoral Decomposition: Where the Growth Is Coming From

Credit to Agriculture

- Agricultural credit growth moderated to approximately **8.7% YoY as of the fortnight ending November 28, 2025**, from 15.3% a year earlier. This deceleration is largely a high-base effect — FY24 saw exceptionally robust farm lending — compounded by healthy rabi output that eased distress-driven borrowing needs. **In structural terms, agricultural credit expansion has returned to its long-run trend**, supported by **continued government subsidised loan schemes, crop insurance programmes, and stable rural demand**. State-run banks remain the dominant providers of farm finance. **The normalisation of agri credit is not a concern; it reflects a healthier underlying agricultural economy rather than a contraction in access**.

Credit to Industry: Signal vs Noise

- Industry credit growth has **picked up meaningfully**. Outstanding bank credit to industry grew approximately **9.6% YoY in November 2025**, up from 8.3% a year ago, the second successive quarter of sequential acceleration and, importantly, comfortably above the sector's structural long-run trend of 5–6%. This **acceleration is broad-based, driven by infrastructure, engineering, textiles, and petroleum/nuclear fuels**.
- Critically, **lending to Micro, Small and Medium Enterprises (MSMEs) continues to expand at double-digit rates**. MSME credit growth has been a persistent positive since the formalisation wave post-GST and the RBI's MSME Priority Sector incentives, it signals that **credit transmission is reaching the productive economy, not just large corporates or NBFCs**. At the sectoral level:
 - **Engineering Goods: +30.4% YoY (Dec 2025)** — The single most **important capex signal** in the data. Engineering goods credit is a **leading indicator for equipment purchases, capacity expansions, and manufacturing investment decisions**. A **30% surge of this magnitude in this category is structurally significant and typically precedes IIP capital goods acceleration by two to three quarters**.
 - **Base Metals: +14.2% YoY** — Consistent with **strong order flows from road, rail, and power sector construction activity**. Steel and aluminium credit flows mirror the **infrastructure pipeline**.
 - **Chemicals: +14.8% YoY** — Reflects a **combination of PLI-driven capacity additions in specialty chemicals and the government's Chemical Parks announcement** in Union Budget 2026–27.
 - **Textiles: +11.8% YoY** — Supported by **PLI textile scheme uptake and export-linked capacity investment, likely to accelerate further post-EU FTA implementation**.
- The one area of **relative caution within industry credit is chemicals and capital goods, where some large-industry segments have shown more muted growth, likely weighed down by elevated bond yields in earlier quarters and cautious corporate greenfield spending**. As monetary transmission progresses and trade deal certainty improves, these segments are positioned for a catch-up.



Credit to Services: The Structural Growth Engine

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

Credit to Consumers: Healthy but Shifting Composition

- The **personal loans segment** (housing, vehicles, gold, credit cards, etc.) grew approximately **12.8% YoY by late November 2025**, a moderation from 13.4% a year ago. Within this, **housing loans, vehicle loans, financial asset loans, and gold loans (all secured) continued robust expansion**, while **unsecured personal loans, and credit card outstanding growth has softened**. This compositional shift is significant and **fully consistent with RBI's deliberate policy to check unsecured retail lending risk**. It also reflects rational consumer behaviour: with benign inflation and steady incomes, **borrowers are channelling credit demand toward productive and secured assets (vehicles for work, gold as collateral) rather than unsecured consumption**. The decline in credit card outstanding growth specifically suggests improved household financial discipline post-pandemic.

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

The Deposit Mix Shift: CASA Rises, Term Deposits Decelerate

- Within the deposit base, **time deposits have decelerated**, while **CASA (Current Account and Savings Account) deposits have risen strongly at 15–20%**, as customers shift into demand deposits for operational liquidity, **a natural consequence of the business activity pickup**. This shift has two implications. First, it reduces the stable funding base of banks (CASA is more volatile than term deposits), potentially compressing net interest margins if lending rates decline faster. Second, **it reflects an economy where businesses and households hold more liquid balances, consistent with elevated economic activity and business confidence**.
- The **term deposit growth deceleration partly reflects the pass-through of RBI's rate cuts**: weighted average domestic term deposit rates (WADTDR) on fresh deposits declined by 95 basis points between February and December 2025. As deposit rates moderate, some savers are migrating to mutual funds, market-linked instruments, and equities – a structural deepening of capital market participation that is positive for long-term financial intermediation even if it temporarily constrains bank deposit growth.

The CDR Dynamic: Credit Outpacing Deposits

- The credit-deposit (CD) ratio of the Indian banking system has inched up into the **low 80% range**, a level that merits careful monitoring. As of November 28, 2025, aggregate bank deposits stood at approximately **₹242.6 lakh crore, growing 10.2% YoY**, down from 11.1% a year ago. In contrast, non-food credit was growing at approximately 11.4% YoY over the same period. **This structural gap – credit expanding faster than deposits, is the defining tension in India's banking system today.**



Private Capex: From Wait-and-Watch to the Edge of an Inflection

The Paradox of Muted Capex in a Strong Macro Environment

- India's private sector capital expenditure paradox is one of the defining puzzles of the current economic cycle. Growth is stable, inflation is well-contained, corporate balance sheets are lean in debt and flush with profits — **listed private manufacturing companies reported 8.3% operating profit growth in Q3 FY26** versus just 2.7% in Q3 FY25, and yet fresh greenfield capex announcements by private companies fell for two consecutive quarters (Q2 and Q3 FY26) even as government infrastructure project announcements surged 40%.
- The private sector's share of new infrastructure proposals fell to under half of total announcements in Q3 FY26. Projects Today data confirms this: the **ability to invest is unambiguously present, but the willingness to commit to large greenfield capex remains weak**. This is a corporate psychology problem as much as a financial one, and understanding its drivers is essential to forecasting when the inflection will come.

Why Private Capex has been held back until now

- **Global Demand Uncertainty:** Trade tensions with the US, geopolitical risks, and a weakening export outlook have created legitimate concerns that new capacity commissioned today may not find buyers once it comes online in 18-24 months. Companies are not willing to bet on export demand recovery without trade deal certainty.
- **High Cost of Capital (Structural):** Despite 125bps of RBI cuts, the structural cost of capital for greenfield projects – which requires long-tenor debt, land, environmental clearances, and grid connectivity – remains elevated relative to the returns available from brownfield/maintenance capex. Companies have rationally preferred asset-sweat strategies: refreshing and optimising existing capacity rather than building new.
- **Manufacturing Bottlenecks:** Land acquisition remains complex, power grid connectivity timelines are long, logistics costs, while improving, remain above pre-2019 levels in some corridors, and regulatory approvals (environmental clearances, industrial licensing) add meaningful execution risk and cost to greenfield projects.
- **Replacement over Creation:** Much of corporate spending in FY26 has been confined to maintenance capex, technology upgrades, and asset replacement, spending that does not meaningfully expand productive capacity but sustains operational efficiency.
- **FPI Outflows and Currency Pressure:** FPI equity outflows of \$7.5 billion in FY26 year-to-date (April to February 3) tightened domestic financial conditions at the margin and added currency volatility, compounding project cost uncertainty for import-heavy capital goods sectors.

The Turning Point: Why the Outlook is materially improving

Against the headwinds above, several powerful tailwinds are building simultaneously:

- **Capacity Utilisation Above Long-Term Average:** This is the single most important fundamental trigger for a capex cycle. RBI's OBICUS survey shows manufacturing CU at 74.8% (SA) in Q2 FY26, above the long-term average of 73.9%. Historically, CU crossing and sustaining above 75% has been the inflection point that triggers broad-based greenfield investment announcements. We are at the threshold.
- **Trade Deal Pipeline Materialising:** The India-EU Free Trade Agreement, signed January 27, 2026, is a pivotal development. The EU is India's largest trading partner, and this deal directly reduces export uncertainty for pharmaceutical, textile, auto component, and engineering goods manufacturers – sectors where capex decisions have been most constrained. US-India trade deal negotiations remain active and at a much lower rate now (15%). Once the "final blueprints" of these deals are available, the RBI Governor's own assessment is that "credit growth is expected to rise considerably." Hence with the geo-political trade uncertainty now seemingly behind us, we can expect this to be a major tailwind going forward.



- **Investment Finance Already at Multi-Year Highs:** Total funds raised for capex via ECBs, IPOs, and bank/FI sanctions in April–December FY26 remained higher than in any comparable period since FY20. Capex projects sanctioned by select banks and financial institutions in Q3 FY26 reached ₹96,554 crore, above the post-COVID quarterly average of ₹72,982 crore. The corporate sector is evidently accessing long-term finance in anticipation of deployment, even if deployment has been cautious.
- **Monetary Transmission Now Working:** The 105bps decline in WALR (fresh loans) out of 125bps of cuts, combined with ample liquidity, is lowering the financial hurdle rate for investment projects. With 15–20bps of residual WALR reduction still to come as deposits reprice, the financing cost advantage is still building.
- **Policy Architecture Supporting Capex-Intensive Sectors:** Union Budget 2026–27 introduced a suite of targeted capex catalysts – the MSME Growth Fund, India Semiconductor Mission 2.0, dedicated Chemical Parks, new Freight Corridors, and the Infrastructure Risk Guarantee Fund. These are not generic fiscal measures; they are precision instruments targeting the sectors where private capex has been most inhibited by structural constraints and financing risk.

Capacity Utilisation & Investment Readiness: At the Threshold

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

- The RBI's quarterly Order Books, Inventories, and Capacity Utilisation Survey (OBICUS) provides the most granular real-time reading of the manufacturing sector's investment readiness. The **Q2 FY26 reading of 74.8% seasonally-adjusted manufacturing CU**, above the long-term average (LTA) of 73.9% carries significant analytical weight for three reasons.
- First, **CU above LTA has historically been the necessary (though not sufficient) condition for a broad capex cycle to begin.** When existing capacity is fully employed, the only way to sustain output growth is to create new capacity. The economic logic is simple; what has delayed its translation into investment decisions this cycle is the **global demand uncertainty** discussed above.
- Second, the **Economic Survey independently corroborates this reading**, noting that capacity utilisation is "above long-term averages," supporting further investment. Order backlogs in infrastructure-heavy industries (power transmission, roads, metro rail) and technology manufacturing (electronics, automobiles) are strong and **businesses report better forward sentiment in surveys.** The **PMI Manufacturing Future Output index reached 65.1** in November 2025 – among the highest readings in several years and a strong leading signal for production (and therefore capacity) expansion.
- Third, the composition of capacity tightness matters. CU is highest in consumer goods (auto, electronics, consumer durables) and infrastructure-linked sectors (cement, steel, power equipment) – precisely the sectors where private sector capex announcements, when they come, will have the largest multiplier effect on jobs, bank credit, and GDP growth.

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

- **Power & Electricity:** Bank credit to the sector growing 14.2% YoY and IIP electricity sub-index showing double-digit expansion. Renewable energy capacity addition remains the single largest investment pipeline in the economy.
- **Roads & Construction:** Cement production growth accelerated to 11.1% in Q3 FY26 – one of the most reliable physical proxies for construction intensity. NHA's active project pipeline and state government capex recovery in FY26 are sustaining demand.
- **Engineering Goods & Capital Equipment:** The 30.4% YoY credit surge is indicative of robust order-flow and equipment financing. This category includes machine tools, industrial machinery, and process equipment – the physical building blocks of capacity expansion.
- **Automobiles & Electronics:** PLI-linked investment in EV manufacturing, semiconductor assembly, and mobile device production continues on schedule. CU in auto sector is high, order books are full, and both domestic demand and export ambitions are driving investment planning.



What Would Signal Full Investment Confirmation?

Three consecutive signals would confirm that the private capex cycle has moved from 'inflection' to 'expansion':

- CU sustaining above 75–76% for two or more quarters (one quarter could be seasonal noise; two quarters is a trend)
- Greenfield investment announcements returning to growth on a YoY basis (currently negative for two quarters; watching the Q4 FY26 data keenly)
- IIP Capital Goods growth averaging 10%+ over a rolling three-month period (currently showing improvement but not yet consistently above this threshold)

Forward Outlook: Credit & Investment Cycle Through FY2026–27

Bank Credit Trajectory: Above Structural Trend into FY27

- **Credit growth is expected to remain above its structural 10–11% trend and sustain at 12–14% YoY through most of FY27**, supported by four structural tailwinds: (a) the RBI's continuing focus on transmission of the 125bps of earlier rate cuts into broader lending rates; (b) ample systemic liquidity from RBI's OMO and forex swap operations; (c) industry credit and MSME credit remaining above LTA growth rates as the construction and manufacturing cycle deepens; and (d) services sector credit expansion being supported by the strong NBFC and IT growth vector.
- The **primary risk to this outlook is a CDR-driven funding constraint**: if deposit growth does not accelerate, either through interest rate differentials attracting savers back to term deposits or through broader measures to increase household savings capture, banks may face margin pressure and have to moderate credit growth. RBI's liquidity operations mitigate but do not eliminate this structural tension.

Monetary Policy: Holding at 6.25%, Focus Shifts to Transmission

- With 125bps of cuts already delivered since early 2025 and inflation well below target, **RBI is expected to hold the policy repo rate at 6.25% through at least the near term**. The policy focus has definitively shifted from delivering additional rate cuts to **ensuring full transmission of existing cuts into lending rates, deposit rates, and ultimately credit creation**. The 20bps gap between WALR reduction (105bps) and policy cuts (125bps) represents the remaining transmission pipeline, as term deposits mature and reprice at lower rates, this gap will close, providing an additional lending rate reduction without any further policy action.
- **Subdued core inflation and rising capacity utilisation allow for an "accommodative for now" stance without sacrificing the inflation credibility that RBI has rebuilt.**
- **The key risk that could force a pivot is: (a) INR depreciation beyond comfort levels from FPI outflows or commodity price shocks; or (b) a widening fiscal deficit that crowds out private bond issuances and pushes term yields higher. Both risks are manageable in the current environment but require monitoring.**

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

- Our base case is a **gradual private capex revival beginning in Q2–Q3 FY27**, as trade deal blueprints are finalised, CU pressures intensify, and rate transmission is complete. Under this scenario, **GFCF grows 7–9% in FY26–27** (vs 7.8% in the NSO First Advance Estimates for FY26) and the **investment-to-GDP ratio stabilises in the 32–33% range**. Sectoral beneficiaries in this scenario are well-diversified: construction materials (cement, steel), power equipment manufacturers, engineering companies, logistics infrastructure, and NBFCs that finance MSME capex.
- **A bull case – a capex supercycle scenario with GFCF at 10–12% becomes credible if the US-India trade deal is signed, CU crosses 76–77%, and at least two quarters of rising greenfield announcements materialise. This scenario would trigger a significant rotation into capital goods, construction, and industrial companies. A bear case – GFCF falling to 4–5% requires a global demand shock, trade deal collapse, and sustained FPI outflows constraining financial conditions. We assign this 15% probability given current macro conditions.**



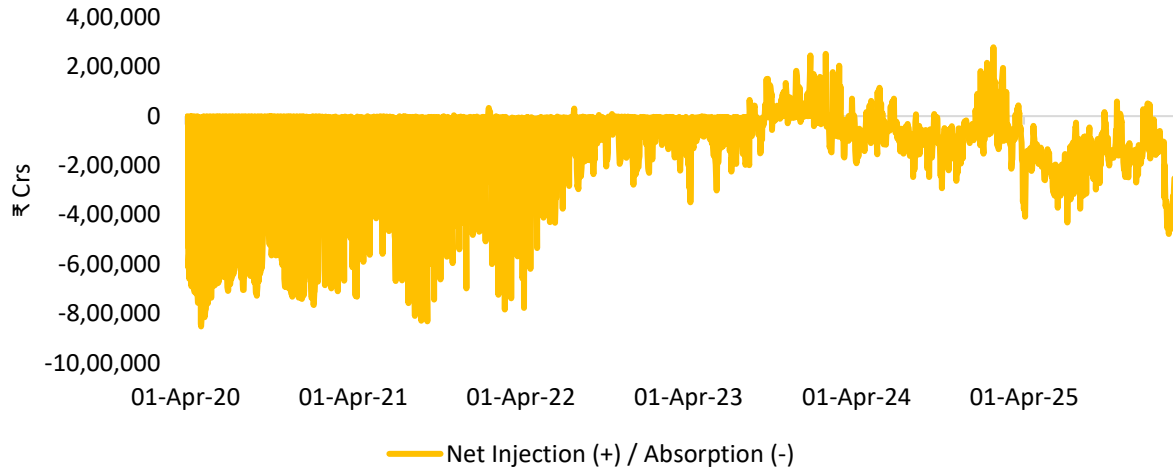
Bottom Line: Positioned for Convergence

- India's credit and investment landscape in February 2026 presents one of the most compelling macro setups for investors in over a decade. **Bank credit is growing at its fastest pace in two years, capacity utilisation has crossed above its long-term average for the first time since the pre-COVID cycle, monetary policy has delivered 125bps of cuts with more transmission still to come, and the fiscal architecture has been maintained without sacrificing the structural infrastructure investment that anchors the cycle.**
- The **private capex revival has not yet arrived in its full form but its preconditions are now assembling**. The engineering goods credit surge of +30.4% is the single most important leading signal to track. The India-EU FTA is the first decisive geopolitical catalyst followed by the India-US trade deal at a competitive 15-18%. CU at 74.8% is one step from the historical trigger zone. And the MSME finance ecosystem is the deepest it has ever been.
- The convergence of public infrastructure and private investment, when it comes, will define India's growth trajectory for the remainder of the decade. Investors positioned ahead of this convergence, in construction materials, engineering, capital goods, power, and financial intermediaries serving MSME capex, stand to benefit from what could be the **most powerful broad-based investment cycle India has seen since the infrastructure boom of 2004-2008.**

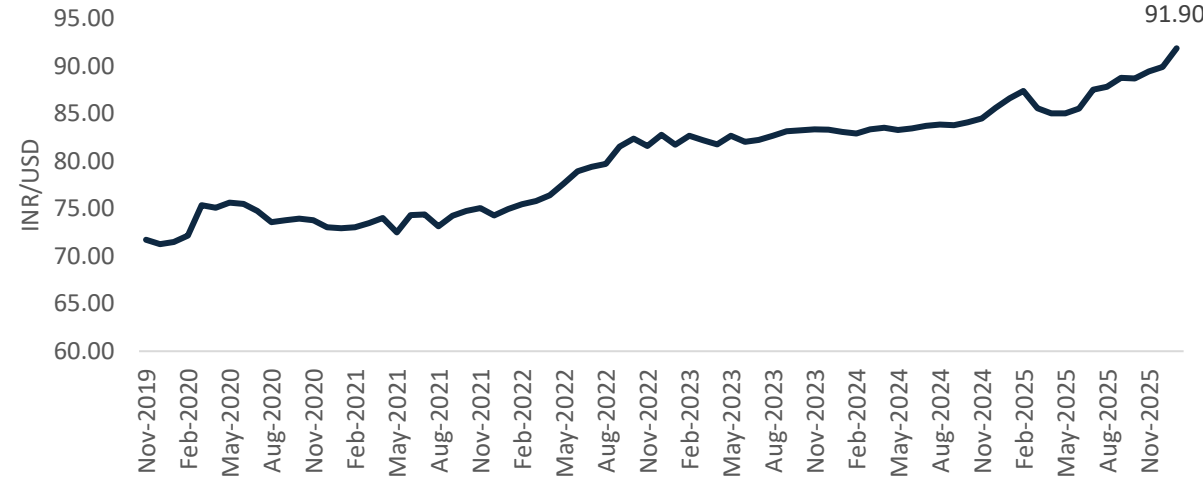
5. Liquidity



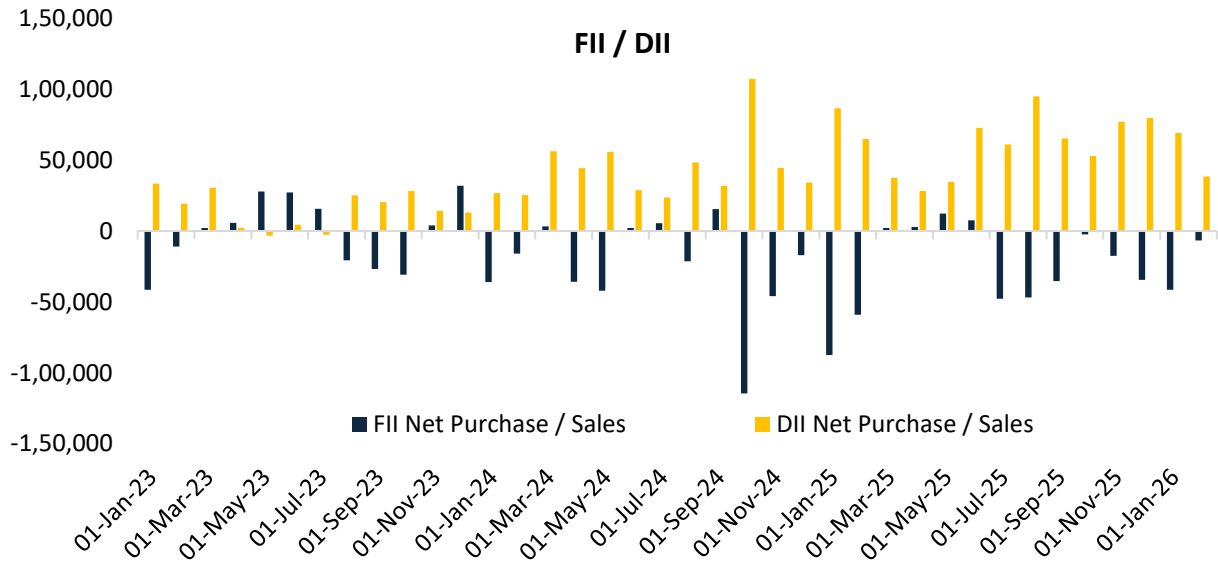
Net Injection(+)/Absorption(-) of Excess Liquidity



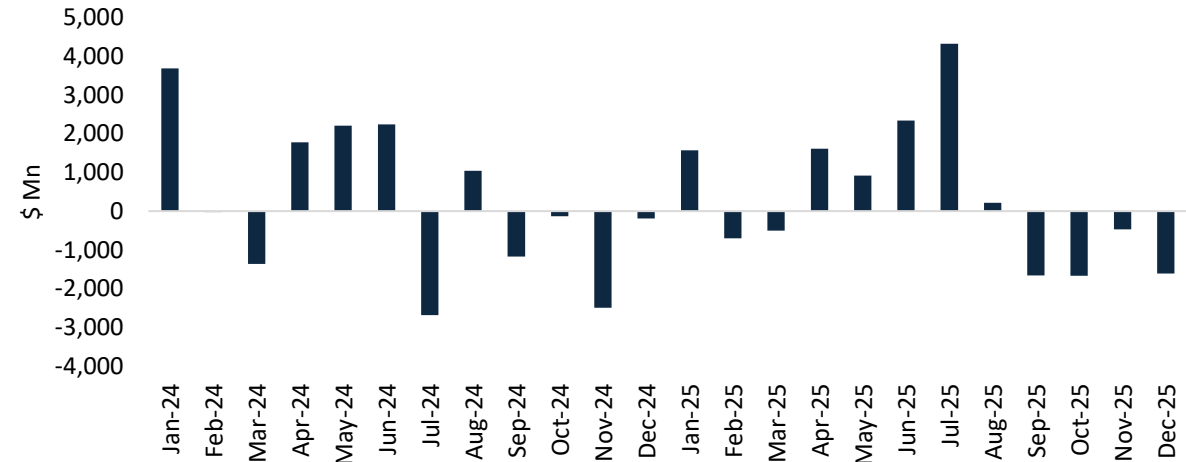
INR/USD



FII / DII

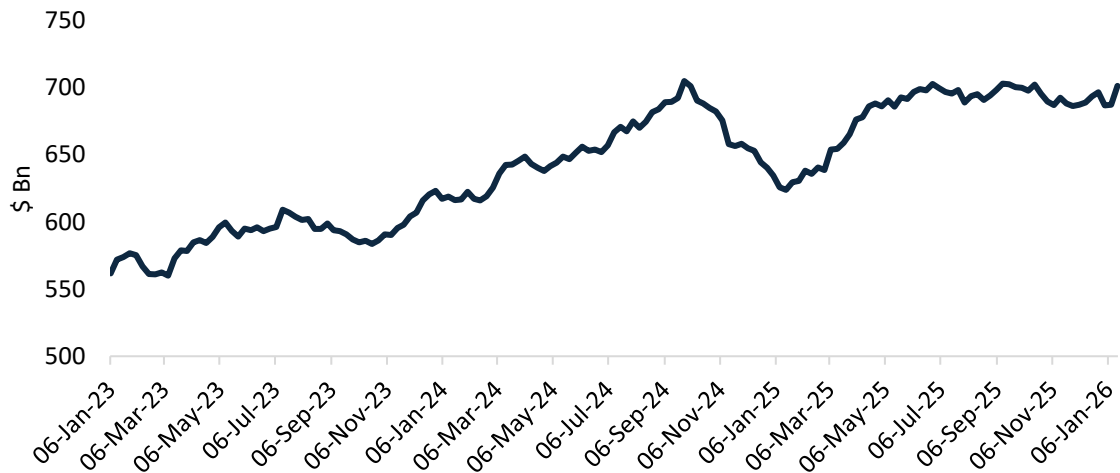


Net FDI

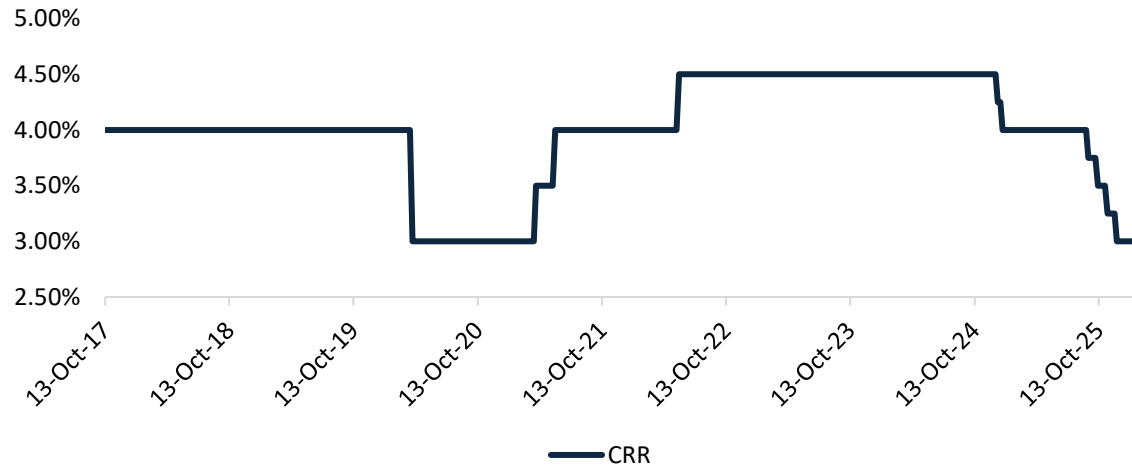




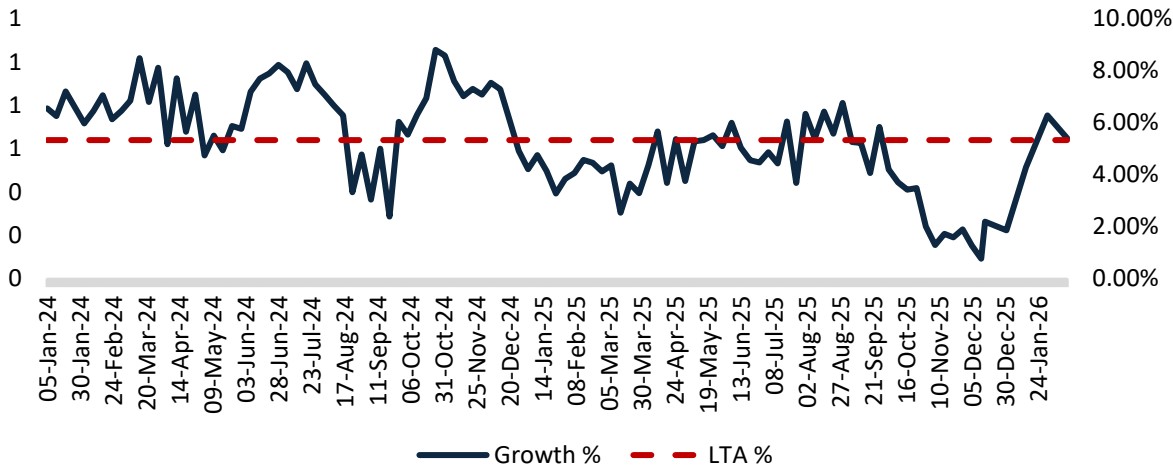
Foreign Exchange Reserves (USD Bn)



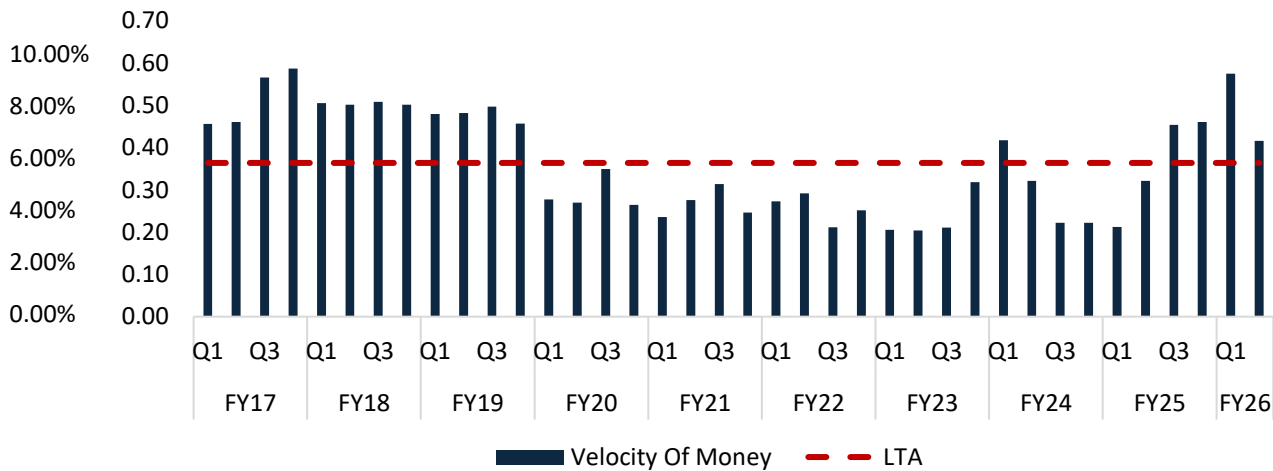
CRR



Reserve Money (M0)



Velocity of Money





India: System Liquidity – Architecture, Transmission & Investment Implications

The Structural Liquidity Regime: From Deficit to Engineered Surplus

- To understand the significance of India's current liquidity situation, one must first appreciate where the system came from. Through the second half of FY2024-25, India's banking system operated in a structural liquidity deficit – the net LAF position averaged a daily absorption deficit of ₹1.8 lakh crore in February 2025 and ₹0.9 lakh crore in March 2025. Banks were routinely borrowing from the RBI's standing facilities, overnight money market rates were elevated and occasionally breached the upper bound of the policy corridor, and the transmission of rate cuts into actual lending rates was sluggish precisely because the system was funding-constrained.
- This deficit was not accidental. It was partly by design: the RBI had been allowing structural liquidity to tighten through Q3-Q4 FY25 as it fought residual inflation pressures and sought to maintain financial stability during a period of elevated FPI outflows. The forex intervention – selling dollars to defend the rupee was itself a liquidity-absorbing operation, withdrawing rupee liquidity from the system each time the RBI sold reserves in the spot market.

The Inflection: Why the RBI Decided to Shift

- By late Q3 FY25, the macroeconomic calculus changed decisively. Headline CPI inflation had fallen below the 4% target for the first time in years, with food inflation moderating sharply. GDP growth, while resilient, showed signs of consumption softening in the middle segments. The private capex cycle remained stubbornly muted despite strong public infrastructure spending. And critically, the banking system's credit-deposit gap, with credit growing 2-3 percentage points faster than deposits was creating a structural funding tension that threatened to choke off credit growth even as the RBI was cutting rates.
- The RBI's response was multi-dimensional and sequenced with precision. First came the CRR cuts – a total reduction of 100 basis points from 4% to 3% across FY25, releasing approximately ₹2.2 lakh crore of trapped reserves into lendable funds. This was the structural measure: permanent, balance-sheet positive for banks, and unambiguously bullish for credit availability. It was followed by the OMO programme – open market operations to buy government securities, injecting durable rupee liquidity. And then the forex dimension: long-term USD/INR buy/sell swap auctions that provided dollar-rupee liquidity for periods of three years, simultaneously supporting rupee stability and injecting domestic currency.

Monthly LAF Trajectory: The Anatomy of a Regime Shift

- The monthly evolution of the LAF position tells the complete story of this regime shift. In October 2025, the average daily net absorption under the LAF was ₹0.9 lakh crore – a modest surplus, barely above breakeven. November saw this jump to ₹1.9 lakh crore as early OMO tranches took effect. December and January then paradoxically fell back to ₹0.8 lakh crore, not because liquidity withdrew, but because GST outflows, currency-in-circulation expansion (which accelerated to 11.1% YoY by January 31, 2026), and year-end liquidity seasonal pressures temporarily absorbed the injected liquidity. The RBI diagnosed this correctly as transient and continued injecting. By February 4, 2026, daily average absorption had already jumped to ₹1.8 lakh crore, and the full period average of January 16 – February 17 landed at ₹1.89 lakh crore, confirming the successful completion of the liquidity regime transition.
- The composition of this surplus is analytically important. The Standing Deposit Facility (SDF), where banks park overnight excess liquidity averaged ₹2.88 lakh crore in the January 16 – February 17 period, sharply up from ₹1.29 lakh crore in the preceding month. Meanwhile, Marginal Standing Facility (MSF) borrowings a measure of day-to-day liquidity stress in the system averaged only ₹0.01 lakh crore, declining from ₹0.02 lakh crore. This combination – high SDF, near-zero MSF is the textbook signature of a well-lubricated, surplus-liquidity banking system with no funding stress at the individual bank level.



The Money Market: Rate Architecture & Corridor Dynamics

- A surplus liquidity environment does not automatically translate into lower borrowing costs across the entire yield curve – this is perhaps the most important conceptual point for investors to internalise. The RBI's policy corridor operates as follows: the repo rate (currently 6.25% post-February 2026 hold) sets the upper bound for overnight borrowing costs; the SDF rate (6.00%) sets the lower bound for parking excess funds. In a surplus system, overnight money market rates (WACR) should theoretically trade within this corridor, closer to the SDF floor.
- The February 2026 data confirms this: the WACR averaged 5.21% during January 16 – February 17, 2026 – 104 basis points below the repo rate and 21 basis points below even the SDF rate. This is technically below the stated corridor floor, indicating that liquidity surplus was sufficiently large, hence banks were willing to lend overnight at below-SDF rates in the uncollateralised call money market.

The January Spike: Transient Pressure vs Structural Change

- January 2026 presented an important diagnostic test for the liquidity framework. During the first half of January, the WACR moved into the upper half of the policy corridor, breaching 5.5–5.7% as GST outflows, advance tax outflows, and a seasonal surge in currency in circulation (CiC grew at 11.1% YoY by month-end) temporarily absorbed system liquidity. Simultaneously, the commercial paper (CP) market and certificate of deposit (CD) market experienced sharp rate increases: 3-month CP issued by NBFCs hardened by 73 basis points and 3-month CDs hardened by 81 basis points in the January 16 – February 17 period relative to December 16 – January 15.
- These money market dislocations were accompanied by a widening of the CP-T-bill spread: the risk premium between 3-month CP (NBFC) and the 91-day treasury bill expanded to 195 basis points during January 16 – February 17, from 125 basis points in the preceding period. This 70 basis-point spread widening was threefold in origin: (i) seasonal year-end funding needs concentrated in January, (ii) a bunching of CP and CD redemptions in the same period, and (iii) the temporary moderation in surplus liquidity described above. Critically, RBI diagnosed the episode correctly as transient and responded with VRR auctions and the second OMO tranche – by February, WACR had moved below the repo rate.

The G-Sec Market: Where Liquidity Meets Fiscal Reality

- While overnight money market rates have normalised decisively below the repo rate, the government securities (G-sec) market has told a more complicated story. The benchmark 10-year G-sec yield has hardened over the past eight months, reaching 6.65–6.66% by mid-February 2026 – up from 6.51% in December 2025 and broadly elevated relative to where it should theoretically be given five cumulative rate cuts. The 10-year yield spiked sharply to 6.77% on February 2, 2026 – its sharpest intraday rise since late August 2025 – following the Budget announcement of gross market borrowings of ₹17.20 lakh crore for FY2026–27.
- This dynamic is the textbook articulation of fiscal crowding at the long end: the RBI is successfully managing overnight and short-term liquidity (evidenced by WACR at 5.21%), but the 10-year segment is being influenced by the enormous supply of government paper that needs to be absorbed by the market. The duration mismatch between RBI's OMO operations (which provide short-to-medium term liquidity) and the 20–30 year fiscal supply pipeline means that long-end yields are being set more by fiscal expectations than by monetary policy stance.

Corporate Bond Market: Yield Hardening Amid Volume Strength

- The corporate bond market has exhibited an interesting bifurcation in FY26. On the volume dimension, the market has seen strong issuance activity – new corporate bond issuances reached ₹0.74 lakh crore in December 2025 (up from ₹0.59 lakh crore in November), and FY26 cumulative issuances through December stood at ₹6.83 lakh crore. However, on the pricing dimension, yields have hardened across the rating spectrum: AAA 1-year corporate bond yields rose 41 basis points to 7.53% in January 16 – February 17, and AAA 3-year yields rose 11 basis points to 7.31%.
- Corporate bond spreads over equivalent G-secs have widened modestly: the 1-year AAA spread over G-sec increased by 30 basis points to 181 basis points, while the 3-year AAA spread held flat at 122 basis points. The spread widening at the 1-year end reflects the money market tightening discussed above – CP and CD rate hardening spilled over into short-dated corporate bonds. The more important read is that investment-grade credit spreads remain well-contained in medium tenors, suggesting no systemic credit concern despite the rate volatility. The BBB-3 year spread at 582 basis points is elevated but stable, reflecting ongoing caution on lower-rated issuers.



Monetary Policy Transmission: Efficiency, Lags, and Gaps

The quality of monetary policy transmission — how effectively the RBI's 125 basis-point cumulative repo rate cut (February–December 2025) flows through to actual borrowing costs in the economy — is the central question for investors assessing whether RBI's easing cycle is actually working. The data, properly dissected, shows a transmission that is broadly efficient by historical standards, but with important pockets of incompleteness that have significant sector-level implications.

The Transmission Scorecard: Where Cuts Have and Have Not Passed Through

Rate/Instrument	Tightening (May 22–Jan 25, bps)	Easing (Feb–Dec 25, bps)	Efficiency (%)	Assessment
Repo Rate (Policy)	+250	-125	50%	Policy anchor
EBLR (Ext. Benchmark Lending Rate)	+250	-125	100%	Perfect — mechanically linked
WALR — Fresh Loans	+182	-105	84%	Strong — 16bps lag remains
WALR — Outstanding Loans	+191	-81	42%	Lagged — portfolio repricing incomplete
1-Year MCLR (Median)	+175	-55	31%	Weak — MCLR structurally sticky
WADTDR — Fresh Term Deposits	+259	-95	37%	Moderate — competitive pressures slow
WADTDR — Outstanding Deposits	+206	-41	20%	Very slow — term deposit duration lock-in

The transmission table reveals a tale of three markets. The EBLR segment — covering loans directly benchmarked to the repo rate (primarily home loans, auto loans, and MSME loans taken by floating-rate borrowers) — has delivered perfect, instantaneous 125 basis-point transmission to approximately 52% of outstanding bank credit. This is the structural benefit of the EBLR regime introduced in 2019: it creates a hard mechanical link that forces immediate rate cuts to flow through, removing the discretion banks previously exercised.

The WALR on fresh loans at 84% efficiency (105 basis points out of 125) is healthy and confirms that new borrowers are receiving most of the policy cut benefit in their loan pricing. The gap of 20 basis points reflects residual risk-based pricing adjustments and the fact that the MCLR system — which still governs a significant portion of corporate credit — has only transmitted 55 basis points despite the 125 basis-point policy move. MCLR's structural stickiness is a known feature: it is linked to the bank's marginal cost of funds, and as long as outstanding deposit rates are falling slowly (outstanding deposit rates down only 41 bps), MCLR decline will also be constrained.

The Public vs Private Bank Divergence

Disaggregating transmission by bank group reveals a systematic pattern: private sector banks have transmitted more aggressively on lending rates (WALR on fresh loans: -107bps for private vs -85bps for public sector banks), while public sector banks have been more proactive on deposit rate reduction (WADTDR on fresh deposits: -101bps for PSBs vs -74bps for private banks). This divergence reflects structural differences in funding mix, risk appetite, and competitive strategy. Private banks, with higher reliance on wholesale funding and variable-rate deposits, can reprice their lending books more nimbly. Public sector banks, with sticky legacy deposit books and stronger deposit franchises, have more headroom to cut deposit rates without losing depositors — but their lending rates are dragged down by the slower institutional decision-making cycle and their higher exposure to MCLR-linked loans. For investors, this bifurcation has direct sector implications. Private banks' superior lending rate transmission, combined with their faster deposit repricing, means their NIMs will experience sharper compression in the easing cycle — but their loan growth is also likelier to accelerate faster as new borrowers find private bank rates more competitive. Public sector banks, with slower transmission and more stable NIMs in the short run, offer relative stability on earnings but may lose market share in the EBLR-linked retail segment over time.



Reserve Money & M3: The Monetary Aggregates Perspective

- Behind the rate transmission picture lies the broader monetary aggregates story. Reserve money growth (adjusted for CRR) accelerated to 10.9% YoY as of January 31, 2026, from 9.4% in December 2025, a sharp uptick driven by the liquidity injection programme and accelerating currency in circulation (CiC). Currency with the public grew at 11.1% YoY by end-January, reflecting genuine economic activity and a seasonal pickup in retail transactions. Money supply (M3) growth moderated marginally to 12.0% YoY from 12.1%, broadly stable and supportive of a 7–7.5% nominal GDP growth environment without inflationary concern.
- The total flow of financial resources to the commercial sector is the most comprehensive measure of monetary accommodation. In the April–January FY26 period, total flows reached ₹34.5 lakh crore, a 35% increase over ₹25.5 lakh crore in the same period last year. Non-food bank credit contributed ₹21.8 lakh crore (up from ₹14.0 lakh crore), while non-bank sources, FDI and corporate bond issuances, added ₹12.7 lakh crore. The outstanding credit to the commercial sector now stands at ₹300.9 lakh crore (+14.7% YoY), confirming that monetary easing is translating into real credit availability.

Structural Liquidity Drivers: The Three Withdrawal Forces

A sophisticated understanding of India's liquidity framework requires mapping the structural forces that permanently drain or inject rupee liquidity from the banking system, independent of monetary policy. These are the underlying plumbing that the RBI must continuously manage, and they explain why the liquidity injection programme is not optional discretion but rather a structural necessity given current macroeconomic conditions.

Forex Intervention: The Dominant Structural Drain

- When the RBI sells US dollars in the spot forex market to prevent excessive rupee depreciation, it does so by receiving rupees and delivering dollars, the rupees effectively leave the banking system and are parked in RBI's balance sheet. This is a powerful, immediate, and often under-appreciated liquidity drain. In FY26, India's forex reserves declined from their peak of approximately \$704 billion in late September 2024 to \$623.9 billion by end-January 2026 (including the ₹723.8 billion as of January 30, 2026 as reported in the bulletin), with the RBI actively selling reserves to manage INR depreciation pressures. Each dollar sold absorbs approximately ₹85–87 of rupee liquidity from the banking system.
- The scale is staggering: if the RBI sold even \$30–40 billion of reserves in the FY26 defense of the rupee (a plausible estimate given the observed trajectory), the rupee liquidity withdrawal would approximate ₹2.5–3.5 lakh crore. This is precisely why the forex swap programme was deployed alongside OMOs, the buy/sell swap structure allows the RBI to simultaneously support the rupee in the spot market while providing rupee liquidity through the forward leg of the swap, partially sterilising the liquidity drain. The USD 25.1 billion 3-year swap programme is, in effect, a structured response to the structural drain created by spot forex intervention.

Currency in Circulation: The Seasonal and Structural Component

- Currency in circulation (CiC) represents rupee notes and coins held by the public outside the banking system — when individuals hold cash, that cash is drained from bank reserves and hence from the system's lendable liquidity pool. CiC has been growing at an accelerating pace: 7.2% YoY in October 2025, 10.2% in December, and 11.1% by end-January 2026. This rapid acceleration coincided with the festive season and post-harvest agricultural settlements, creating a genuine seasonal drain.
- The structural concern is that if CiC growth remains above 10%, the liquidity drain is approximately ₹0.8–1.0 lakh crore per percentage point of CiC growth relative to the previous year — implying that the move from ~8% to 11% structural CiC growth has created a permanent additional drain of roughly ₹2.5–3.0 lakh crore that must be offset by other RBI measures. This partly explains why the RBI's liquidity injection programme needs to be so large: it is not just offsetting transient seasonal pressures, it is compensating for a structural acceleration in currency demand.



Government Cash Balances: The Budgetary Cycle Effect

- When the central government collects taxes but has not yet spent the proceeds, those funds sit in its account with the RBI – effectively draining banking system liquidity. Conversely, large government expenditures (particularly capital expenditure releases) inject liquidity into the banking system as government payments flow from the Treasury to contractors, employees, and vendors who hold accounts with commercial banks. This creates a highly seasonal and often volatile liquidity pattern: Q3 of each fiscal year (October–December) typically sees large tax outflows (advance tax, GST) creating liquidity pressure, while Q4 (January–March) sees a large spending surge as the government races to utilise budget allocations – creating a powerful liquidity injection into the system.

Financial Conditions Index & Market Integration

- The RBI's Financial Conditions Index (FCI) – a composite metric integrating government securities, corporate bond markets, equity markets, and the foreign exchange market into a single standardised measure – has been trending toward 'easier conditions' through H2 FY26, though with periodic setbacks reflecting global risk-off episodes. The FCI below zero (its historical average baseline) through much of the October 2025 – February 2026 period confirms that financial conditions in India are accommodative by historical standards – a necessary condition (though not sufficient) for private capex revival.

Equity Markets: The External Demand Drag vs Domestic Resilience

- Indian equity markets declined in January 2026 amid dual pressures: uncertainty over US import tariffs and the Russia-Ukraine ceasefire negotiations introducing geopolitical risk premia, alongside renewed US-Iran tensions. The BSE Sensex fell to approximately 76,000–77,000 levels before recovering to 83,451 in February as the India-EU trade deal optimism and strong Q3 FY26 corporate earnings results (particularly in IT, banking, and auto) provided upward momentum. FPI equity outflows of USD 7.5 billion in April–February 3, FY26 created persistent rupee and equity market pressure, which the RBI partially offset through its forex and liquidity operations.
- The domestic institutional investor (DII) community – mutual funds, insurance companies, pension funds – has been a critical stabilising force, absorbing FPI selling and preventing a more disorderly market correction. This structural shift in India's equity market microstructure (domestic ownership now rivalling foreign ownership in many blue-chip stocks) means that FPI outflows, while significant, are no longer the systemic liquidity event they would have been five years ago. The market's resilience in the face of sustained FPI selling is itself a testament to the deepening of India's financial markets.

The Rupee: Managed Float Under Active Management

- The Indian rupee depreciated meaningfully through FY26, moving from approximately ₹83–84/USD at the start of the year toward ₹86–87 range by February 2026 – a depreciation of approximately 3–4% in nominal terms. The RBI managed this depreciation actively, intervening in both spot and forward markets to prevent disorderly moves, while allowing a gradual adjustment that reflects India's slightly elevated inflation differential versus the United States.
- The forex reserve position remains formidable: at \$723.8 billion as of January 30, 2026, India has over 11 months of import cover – one of the most comfortable reserve adequacy ratios in emerging markets. The external debt-to-GDP ratio rose only marginally to 19.2% at end-September 2025 from 19.1%, and the net international investment position (Net IIP) improved to -7.2% of GDP from -8.6% – confirming that external balance sheet vulnerabilities are well-managed. This reserve buffer gives the RBI significant capacity to continue managing the exchange rate without triggering a balance of payments crisis, even in the event of sustained FPI outflows.



BULLISH: Why India's Liquidity Framework Is Sound

Forex reserves at \$723.8bn = 11+ months import cover. External debt/GDP at 19.2% among lowest in EM. Net IIP improving. LAF surplus at ₹1.89L cr daily avg confirms banking system not stressed. CRR at 3% means RBI has 50-150bps of CRR firepower for future easing. OMO programme successful – 2x bid coverage on recent swaps confirms strong market demand. WACR below repo = monetary transmission working as intended.

RISK WATCH: Vulnerabilities Requiring Monitoring

10-year G-sec yield hardening (6.66%) despite 125bps of cuts – fiscal supply dominating long end. CP/CD spread widening to 195bps from 125bps = NBFC funding cost pressure. FPI equity outflows (\$7.5bn YTD) creating persistent rupee pressure requiring ongoing intervention. CiC acceleration to 11.1% YoY is a structural drain requiring continued OMO offset. ₹17.2L cr gross borrowing in FY27 is the largest single risk to the long-end G-sec yield trajectory.

The Liquidity–Capex Nexus: Investment Implications

The ultimate purpose of this liquidity analysis is not academic – it is to identify how the structural liquidity shift in the Indian banking system translates into investable opportunities and risks across asset classes. The connections are both direct (lower funding costs benefiting banks and NBFCs) and indirect (accelerating monetary transmission enabling lower corporate borrowing costs, supporting the private capex trigger).

Banking Sector: The NIM Compression vs Volume Growth Trade-off

- Net interest margins (NIMs) across the Indian banking sector face a structural squeeze in the current easing cycle. NIMs peaked in FY24 when the deposit repricing lag meant banks were collecting high lending rates while still paying low legacy deposit rates; that tailwind has reversed. System-level NIMs declined from 3.52% in September 2024 to 3.26% in September 2025 – a 26 basis-point compression – and will likely continue to fall by another 15-25 basis points through FY26-27 as the 41 basis-point lag on outstanding deposit repricing progressively catches up.
- However, the offsetting force is volume: credit growth at 14.6% YoY (January 31, 2026 data) is running strongly above the 10-11% range that the market has historically used to compensate for NIM compression. Banks with high EBLR exposure (retail-focused private banks) will see the fastest NIM compression but also the strongest loan growth, as their rates become the most competitive in the market. Banks with high MCLR exposure (large PSBs with corporate loan books) will see slower NIM compression but also slower new loan origination as their rates remain relatively elevated.
 - Large private banks (HDFC Bank, ICICI Bank, Axis Bank): Best positioned – fast EBLR transmission drives retail loan growth, strong fee income, digital cost efficiency offsets NIM headwinds.
 - Mid-size private banks: Mixed – EBLR benefits on retail, but MCLR stickiness on SME books; watch asset quality in unsecured segments.
 - PSBs (SBI, Bank of Baroda, Canara): Stable NIMs near-term, dividend yield plays, but medium-term risk of market share loss as private bank rates become increasingly competitive in retail.
 - Small Finance Banks: Most exposed to funding cost pressure (high CD/CP dependence) – the January CP spike directly compressed spreads; watch NIM trajectory closely.



NBFC Sector: Funding Cost Relief vs Spread Compression

- NBFCs are the most direct beneficiaries of a normalised liquidity environment after being the most visible victims of liquidity stress. The January 2026 CP spike – which pushed 3-month CP (NBFC) rates to 7.23% – is a reminder of how quickly NBFC funding costs can spike in a tightening liquidity environment. The current surplus, combined with the RBI's explicit forward guidance on proactive liquidity management, provides a more stable operating environment for NBFC borrowing programmes.
- Large, well-rated NBFCs that had termed out their liabilities (3-5 year borrowings) during the high-rate FY24 period are now sitting on relatively expensive funding costs relative to market rates – but as these mature and are refinanced, they will benefit from a significant funding cost decline that could expand spreads and improve ROA. NBFCs focused on retail auto finance, gold loans, and affordable housing (secured, granular loans) are better positioned than those with concentrated wholesale book exposures.

Government Securities & Duration: Navigating the Yield Curve

- The steep yield curve – approximately 75 basis points between the 2-year and 10-year G-secs – creates a classic carry trade opportunity in the banking book. Banks that hold long-duration G-secs (acquired at higher yields in FY24) are sitting on mark-to-market losses as long yields have hardened, but they earn superior coupon income. The RBI's OMO purchases are a direct price support for the G-sec market – each OMO auction removes duration supply from the market, capping the extent of long-end yield rise.
- The investment implication for institutional fixed-income investors is nuanced. The short end (up to 2-3 years) is well anchored by the LAF corridor and offers attractive risk-adjusted returns – 91-day T-bills at 6.41% with essentially zero duration risk. The 5-year segment at approximately 6.41% is also attractive given the likely further rate cuts (50-75 basis points expected by most consensus forecasts through FY27). The 10-year presents the most risk: the fiscal supply of ₹17.2 lakh crore in FY27 is the single largest overhang on the G-sec market, and unless RBI continues heavy OMOs, the 10-year could test 6.75-7.00% – a negative mark-to-market outcome for holders of existing bonds.

The Monetary Policy Outlook: Further Cuts in the Pipeline

- With WACR already below the repo rate and headline CPI at 2.8% in January 2026 (new CPI 2024 series) – comfortably below the 4% target – the RBI has significant room for additional rate cuts in FY27. The February 2026 MPC meeting held the repo rate at 6.25% with a neutral stance, signalling patience rather than a pause in the easing cycle. The outlook for Q1 FY27 and Q2 FY27 CPI inflation is projected at 4.0% and 4.2% respectively – benign enough to allow at least 50 basis points of further cuts if growth momentum warrants support.
- The transmission arithmetic suggests that each additional 25 basis-point cut will transmit approximately 21 basis points to WALR on fresh loans (84% efficiency) with a 1-2 quarter lag, and approximately 10-11 basis points to WALR on outstanding loans over a 4-6 quarter window. This means that even after the February hold, the full effect of the 125 basis points already delivered will continue to flow through the outstanding loan book for 2-3 more quarters – providing a sustained tailwind to corporate profitability and investment return calculations without any further policy action required.



Outlook

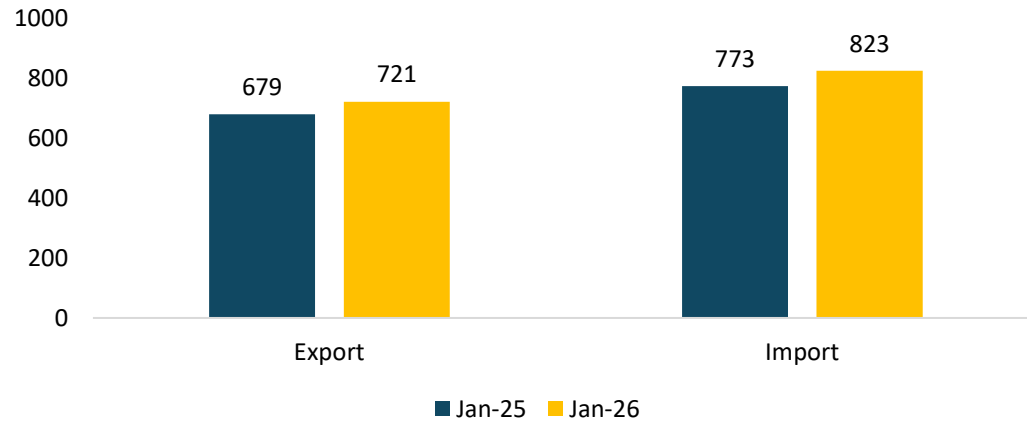
- **India's liquidity framework in February 2026 represents the most accommodative monetary environment since the post-COVID stimulus period — but delivered with far greater structural precision. The ₹4.5 lakh crore OMO programme, USD 25.1 billion in forex swaps, and CRR reduction to 3% have collectively engineered a transition from a ₹1.8 lakh crore daily deficit to a ₹1.89 lakh crore daily surplus — a swing of over ₹3.7 lakh crore in under twelve months.**
- **The transmission is working: WACR at 5.21% below the repo rate of 6.25%, WALR on fresh loans down 105 basis points, total commercial sector credit flows 35% above last year at ₹34.5 lakh crore. The 10-year G-sec yield premium over short rates is elevated but manageable, and the RBI's forward guidance on proactive liquidity management provides institutional investors with confidence that overnight and short-term rates will remain well-behaved.**
- **The key residual risk is the long end of the yield curve: ₹17.2 lakh crore of FY27 gross borrowings hanging over the G-sec market is a genuine supply overhang that the RBI must actively manage through continued OMOs. The base case is that it does — the bid coverage on recent OMO and swap auctions (2x oversubscribed) confirms market confidence in the RBI's monetary management framework. But investors in long-duration assets should price this risk explicitly rather than assuming it away.**

Bottom line: India's liquidity architecture is purpose-built to support a credit and investment expansion cycle. The monetary plumbing is in place. The transmission is working. The remaining catalyst is the demand-side confidence that trade deals and sustained capacity utilisation pressure will provide — and that is the capex story playing out in real time.

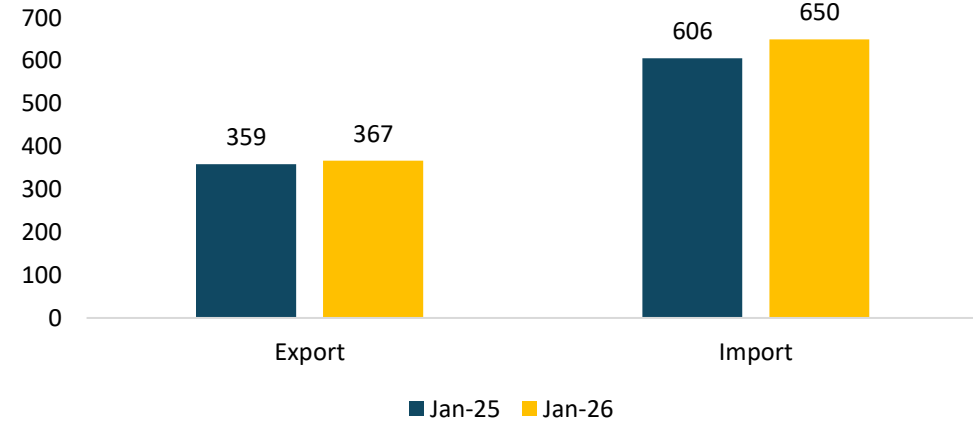
6. Trade



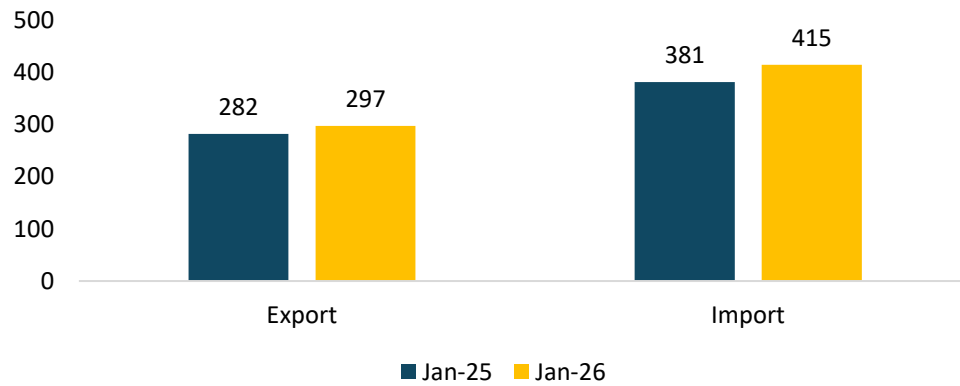
Total Trade During April-January-2026



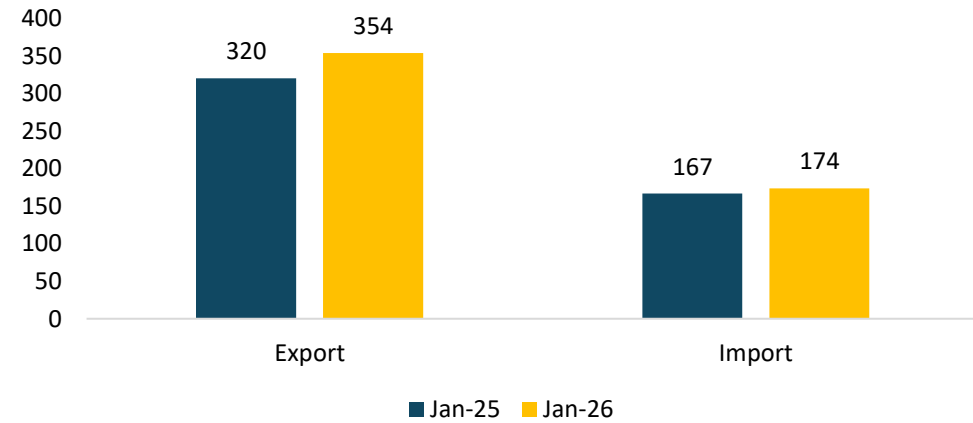
Merchandise Trade during April-January-2026



Trade excluding Petroleum and Gems & Jewellery during April-January-2026



Services Trade during April-January-2026



India External Sector Review – Trade, Balance Of Payments & Capital Flows Analysis



Key Highlights

- India's external sector in FY26 (April 2025 – January 2026) has been shaped by three defining forces: **the US tariff shock and subsequent trade deal, a landmark EU FTA, and persistent structural pressure from gold and energy imports.**
- The period has tested the resilience of India's trade architecture, with **merchandise exports largely flat but services exports providing a robust cushion.** The February 2026 **US-India interim trade deal, which slashed US tariffs from 50% to 18%, represents a material de-escalation that should support exports in the near term,** even as the full implementation details remain under negotiation.
- The cumulative **merchandise trade deficit for Apr–Jan FY26 stands at USD 283.2 billion,** up from USD 247.4 billion in the same period last year. However, a **services trade surplus of USD 180.6 billion** has partially offset this, resulting in an overall trade deficit of USD 102.7 billion.
- Goldman Sachs has revised India's 2026 GDP forecast upward to 6.9% following the trade deal, citing reduced uncertainty as a key catalyst for private investment recovery.**

Key Metrics Snapshot: April–January FY26

Metric	Apr–Jan FY26 (USD bn)	Apr–Jan FY25 (USD bn)	% Change
Total Exports (Goods + Services)	720.8	679.0	6.2%
Total Imports (Goods + Services)	823.4	772.9	6.5%
Merchandise Exports	366.6	358.8	2.2%
Merchandise Imports	649.9	606.1	7.2%
Merchandise Trade Deficit	283.2	247.4	14.5%
Services exports	354.1	320.3	10.6%
Services imports	173.6	166.7	4.1%
Services Trade Surplus	180.6	153.6	17.6%
Overall Trade Deficit	102.7	93.9	9.4%

Source: Ministry of Commerce & Industry, Government of India; RBI data. Services data for January 2026 is provisional.

Merchandise Trade: Resilience Amid Headwinds

- The Tariff Timeline and Its Impact: The US tariff escalation was the dominant macro event for Indian trade in FY26.** The timeline unfolded as follows: in April 2025, the US announced reciprocal tariffs with a 25% rate on Indian goods. By August 2025, an additional 25% punitive tariff was imposed (effective 27 August) for India's continued purchase of Russian oil, taking the effective rate to 50% on most Indian exports – the highest levied on any major US trading partner. **This affected over 55% of India's approximately USD 87 billion in annual exports to the US,** while exempting critical sectors such as pharmaceuticals, semiconductors, and energy.



The front-loading effect was clearly visible in the data. Exports to the US surged 17.9% YoY during the first five months of FY26 (April–August), as Indian exporters accelerated shipments ahead of anticipated tariff hikes. The strong headline export numbers masked underlying weakness, with low base effects and frontloading inflating the figures. Once the full 50% tariffs took effect, exports to the US contracted 10.2% YoY during September–October 2025, with October seeing an 8.6% decline. Labour-intensive sectors such as textiles, leather, and gems & jewellery were disproportionately affected, with some exporters reporting up to 50% declines in turnover.

Electronics exports, however, proved a notable bright spot, growing 122% during April–November FY26, benefiting from their zero-tariff exemption. Similarly, pharmaceuticals (up 12%) continued to grow given the US's structural dependence on Indian generics. These two categories, combined with petroleum products, accounted for over 40% of India's total exports to the US at zero duty, providing an important buffer against the tariff shock.

January 2026 Trade Data: A Mixed Picture:

The latest data for **January 2026** presents a nuanced picture. **Merchandise exports stood at USD 36.56 billion, essentially flat (+0.6% YoY) compared to USD 36.34 billion in January 2025.** However, **merchandise imports surged 19.2% to USD 71.24 billion, driven primarily by elevated gold and silver purchases.** The resulting **merchandise trade deficit of USD 34.68 billion** was the widest since October's record USD 41.68 billion and significantly exceeded market expectations of USD 26 billion.

Key export drivers in January included engineering goods (+10.4%), iron ore (+31.5%), marine products (+13.3%), and meat & dairy (+17.9%). Imports of coal, crude petroleum, iron & steel, and chemicals actually contracted, suggesting **the import bill was skewed heavily by precious metals rather than reflecting broad-based demand pressures.**

The October 2025 Anomaly: Gold Import Surge:

October 2025 deserves special mention as it produced the highest-ever monthly merchandise trade deficit of USD 41.68 billion. **Gold imports alone trebled to USD 14.72 billion (up ~200% YoY), while silver imports surged 529% to USD 2.71 billion.** This was fuelled by a confluence of festive-season demand, pent-up purchasing following GST rationalisation in September 2025, and safe-haven buying amid tariff uncertainty. Simultaneously, **merchandise exports contracted 11.8% on a high base and tariff-related headwinds.** We had flagged earlier that while gold imports would normalise post-festival season, the episode underscored India's structural vulnerability to precious metals in the trade balance.

The Emerging Trade Deal Architecture

India–US Interim Trade Deal (February 2026):

Announced on 2 February 2026, the India–US interim trade framework represents a significant de-escalation. The key terms, as outlined in the White House joint statement of 6 February 2026, include the **reduction of US reciprocal tariffs on Indian goods from 50% to 18%, with further elimination of tariffs on pharmaceuticals, gems & diamonds, and aircraft parts contingent on successful conclusion of the Interim Agreement by March 2026.** The additional 25% punitive tariff linked to Russian oil purchases has been fully rescinded.

In return, India has committed to eliminating or reducing tariffs on all US industrial goods and a wide range of agricultural products including DDGs, sorghum, tree nuts, fruits, and soybean oil. Critically, **dairy, poultry, rice, wheat, and spices remain protected** – a key negotiating victory for New Delhi. **India has also committed to purchasing over USD 500 billion in US energy products, aircraft, precious metals, technology products (including GPUs), and coking coal over five years.**



India has already been ramping up imports from the US, with January 2026 inward shipments rising nearly 24% YoY to USD 4.49 billion, contributing to a narrowing of the bilateral trade surplus from a high of USD 5 billion in May to USD 2.1 billion in January. This calibrated increase is a diplomatic signal addressing Washington's deficit concerns. The **India–US bilateral trade surplus narrowed to approximately USD 35–36 billion for the FY26 period thus far, compared to USD 41 billion in FY25, however this data might be skewed due to the previous tariff rates which have now been rescinded.**

From an investment perspective, **Goldman Sachs has revised India's 2026 GDP growth forecast to 6.9%, citing the deal's potential to lower trade uncertainty** and, together with **easier financial conditions, gradually unlock a private investment cycle**. Export-oriented sectors such as engineering goods, electronics, textiles, leather, and marine products are likely to see the most immediate margin relief. **The deal could restore India's attractiveness as a manufacturing destination vis-à-vis China for global supply chain diversification.**

India–EU FTA: 'The Mother of All Deals:

Just weeks before the US deal, India concluded negotiations for a **landmark Free Trade Agreement with the European Union on 27 January 2026 – the largest FTA ever signed by either side**. The **deal creates a free trade zone covering two billion people and nearly 25% of global GDP**. India secured market access for more than 99% of its exports by trade value. For labour-intensive sectors such as textiles, apparel, leather, footwear, marine products, gems & jewellery, and engineering goods, tariffs of up to 10% will be eliminated upon entry into force, covering approximately USD 33 billion worth of exports.

The agreement also includes commercially meaningful services access across 144 EU service subsectors, a mobility framework for skilled Indian professionals, and provisions on digital trade and regulatory cooperation. Importantly, India safeguarded sensitive agricultural and dairy sectors. The EU's CBAM mechanism remains in effect, though Brussels has pledged USD 590 million to assist India's emission reduction efforts.

The EU is India's largest trading partner, accounting for approximately EUR 120 billion in bilateral goods trade in 2024. The EU Commission estimates the FTA could potentially double EU goods exports to India by 2032. For Indian exporters already constrained by US tariffs at 50% (prior to the deal), the EU FTA provided a critical diversification avenue. It is noteworthy that the timing of both deals – the EU FTA concluded just days before the US deal – reflects India's deliberate strategy of leveraging multiple trade partnerships to reduce external vulnerability.

Broader FTA Network:

Since 2014, **India has signed or concluded trade agreements with Mauritius, Australia, UAE, EFTA (implemented October 2025), UK (signed July 2025), Oman (signed December 2025), and New Zealand (talks concluded December 2025)**. The **India–EU deal, combined with the UK and EFTA pacts, effectively opens up the entire European market for Indian businesses**. This diversification is strategically significant: with FTA partners now representing a substantial share of global GDP, India is **reducing its over-reliance on any single market**. From the perspective of a global enterprise evaluating sourcing or manufacturing bases, India's expanding FTA network materially improves the tariff predictability and market access calculus relative to competitors such as Vietnam and Bangladesh.

Services Trade: The Structural Pillar

Services exports remain **India's most reliable external sector strength**. During April–January FY26, **services exports are estimated at USD 354.1 billion, registering 10.6% YoY growth**, while services imports stood at USD 173.6 billion (+4.1% YoY). The resulting **services trade surplus of USD 180.6 billion has been the critical buffer against the merchandise trade deficit**.

In January 2026 alone, services exports reached an estimated USD 43.9 billion (up from USD 34.75 billion a year earlier), generating a monthly surplus of USD 24.3 billion. This **robust performance is driven by continued strong growth in IT/BPM services, business process outsourcing, Global Capability Centre (GCC) revenues, and consulting services. The offset ratio – services surplus as a share of the goods deficit – improved to approximately 60.1% in FY26 YTD from 57.2% in FY25, a positive structural signal.**

Commerce Secretary Rajesh Agrawal has expressed confidence that **services exports will cross USD 410 billion** in FY26, with total exports (goods + services) expected to exceed USD 860 billion. Given the first 10 months' trajectory of USD 720.8 billion, this appears achievable, representing a new record. The India–EU FTA further strengthens the outlook by securing access to 144 EU service subsectors.

Current Account Deficit & Balance Of Payments

H1 FY26 CAD: Contained Thus Far:

RBI data shows the **CAD moderated to USD 15 billion (0.8% of GDP) in H1 FY26** (April–September), a marked improvement from USD 25.3 billion (1.3% of GDP) in H1 FY25. Q1 saw a deficit of just USD 2.5 billion (0.2% of GDP) – the lowest since 2021 – supported by a strong services surplus and rising remittances. Q2 widened to USD 12.3 billion (1.3% of GDP) but still comfortably undershot expectations. **Lower-than-expected goods deficit and stronger remittance flows were key contributors.**

However, **the H2 outlook is materially different. India's CAD widened significantly to around 2.8% of GDP in Q3 FY26 (October–December 2025), driven by the October gold import surge, the full impact of 50% US tariffs on exports, and elevated import bills.** The record October trade deficit of USD 41.68 billion alone likely contributed substantially to this deterioration. ICRA has projected the Q3 CAD at 2.4–2.5% of GDP.

Full-Year FY26 and FY27 Outlook:

For the full year FY26, estimates range between 1.1–1.2% of GDP (ICRA) on the assumption that the gold import surge normalises and the US trade deal provides some export relief in Q4.

The **IMF's November 2025 Article IV assessment projected real GDP growth of 6.6% for FY26 under a baseline of prolonged 50% US tariffs, noting that the CAD has been contained by resilient services exports. With the tariff reduction to 18% now in effect, the growth outlook has improved, though the IMF emphasised the need for greater exchange rate flexibility to absorb external shocks.**

Balance of Payments: H1 FY26 Snapshot

Component	H1 FY26	H1 FY25
Current Account Deficit	USD 15.0 bn	USD 25.3 bn
CAD as % of GDP	0.8%	1.3%
Services Surplus	~USD 99 bn	~USD 84 bn
Net FDI	USD 7.6 bn	USD 3.4 bn
Net FPI (Equity + Debt)	-USD 4.1 bn	+USD 20.8 bn
Forex Reserves Change (BoP)	-USD 6.4 bn	+USD 23.8 bn

Source: Reserve Bank of India, BoP preliminary data.



Capital Flows: FDI Recovery, FPI Retreat

Foreign Direct Investment:

- **FDI has shown encouraging signs of recovery in FY26. Net FDI more than doubled to USD 7.6 billion in H1 FY26** from USD 3.4 billion in H1 FY25, reversing the concerning trend from FY25 when full-year net FDI dropped to a mere USD 0.96 billion. Gross FDI inflows rose 16% YoY to approximately USD 50.4 billion in H1, **with FDI inflows surging 18% – led by services, computer software & hardware, and manufacturing. Key source countries remain Singapore, Mauritius, UAE, Luxembourg, and Qatar.**
- **That said, elevated repatriation and outbound FDI continue to compress net figures.** In September 2025, net FDI turned negative at USD 2.37 billion due to a surge in outward investments. **Soft net FDI flows remain a structural concern for India's BoP financing. The US trade deal and expanding FTA network should, over the medium term, improve India's positioning as a manufacturing destination, but the translation into sustained FDI acceleration is yet to materialise decisively.**

Foreign Portfolio Investment: Record Exodus and Early Stabilisation:

- **FPI flows have been the most visible source of capital market stress. In calendar year 2025, FPIs pulled out a net INR 1.66 lakh crore (~USD 18.9 billion) from Indian equities,** making it one of the worst periods for foreign flows. **The selloff was driven by elevated US bond yields, a strong US dollar, lofty Indian equity valuations (MSCI India PE at ~25.6x vs. EM average of 16.4x), trade deal uncertainty, and a weakening rupee that breached INR 91/USD.**
- January 2026 continued the trend with approximately **INR 36,000 crore (~USD 4 billion) in net equity outflows. However, early February 2026 has shown stabilisation, with FPIs turning net buyers of approximately INR 20,000 crore (~USD 2.2 billion),** aided by the US trade deal announcement and broader EM fund inflows. Business Standard reported that **most inflows are coming via GEM (Global Emerging Market) fund allocations rather than India-dedicated strategies – suggesting that the return is cyclical rather than conviction-driven.**
- Critically, **domestic institutional investors (DIIs) have been the anchor, pumping in over INR 7 lakh crore (~USD 81.5 billion) in 2025, more than offsetting FPI outflows.** SIP (Systematic Investment Plan) flows into mutual funds have provided structural demand. **For global allocators, the key message is that India's equity market dependency on FPI flows has structurally diminished, even as FPI sentiment remains a barometer of macro confidence.**

Rupee and Foreign Exchange Reserves:

- **The Indian rupee has depreciated to approximately INR 91/USD, reflecting the combination of a widening trade deficit, FPI outflows, and a globally strong dollar.** Foreign exchange reserves stood at over USD 630 billion as of early 2025, providing an import cover of more than 10 months, although on a BoP basis, reserves depleted by USD 6.4 billion in H1 FY26 (contrasting with a USD 23.8 billion accretion in H1 FY25). **The RBI has adopted a less aggressive intervention posture to provide relief to exporters, allowing a gradual depreciation rather than defending a specific level.** MUFG projects USD/INR rising to 90.80 by September 2026.



Analytical Assessment & Key Risks

- **Front-Loading: The Overhang Fades** : The front-loading effect in H1 FY26 artificially inflated export growth numbers and will create adverse base effects in FY27. Exports to the US surged 17.9% during April–August but contracted 10.2% in September–October once tariffs fully bit. This pattern of rush-to-ship followed by a sharp correction is common in tariff-escalation cycles and must be netted out when assessing underlying export momentum. For investors modelling export-linked corporate earnings, the H1 export surge should not be extrapolated; instead, the post-tariff trend of Q3 better reflects the steady-state under the prevailing (now revised) tariff regime.
- **The Trade Deal Premium: What Is Priced In?** Markets have responded positively to the US deal. FPIs turned net buyers in February. However, several caveats warrant attention. First, the 18% tariff, while a major reduction from 50%, is still a substantial levy that keeps India above pre-dispute rates and competitive disadvantage versus Vietnam (currently ~20%) and Bangladesh (19% under new deal). Second, the Interim Agreement is expected to be signed by March 2026, with a full BTA targeted for late 2026 or 2027; implementation delays or renegotiation risks persist. Third, India's commitment to purchase USD 500 billion in US goods over five years and curtail Russian oil imports introduces its own fiscal and energy-security trade-offs. Any re-escalation for example, if the US sanctions on Iran-trading countries are applied to India, could reopen tensions.
- **Structural Merchandise Weakness Persists** : The near-flat merchandise export growth of 2.2% YoY for April–January FY26 (vs. 10.6% growth in services) underscores a long-standing structural concern: India's manufacturing export engine has not kept pace with its services sector. Non-petroleum exports grew at a modestly better 4.9%, but this still lags global trade growth. The merchandise trade deficit of USD 283.2 billion is being financed primarily by services and remittance surpluses, a model that works at current levels but leaves limited margin for error if services exports face any cyclical slowdown, especially with AI being an impediment to India's domestic IT companies projected revenue models and terminal values.

Key Risks to Monitor:

- **Trade deal implementation risk:** The US-India Interim Agreement must be formalised by March 2026. Any slippage could reignite tariff uncertainty.
- **Gold import volatility:** Gold remains a structural drain on the trade balance. A repeat of the October 2025 episode in a rising gold price environment would pressure the CAD.
- **FPI flow reversal:** The early February stabilisation is fragile. Elevated US yields, equity valuation concerns (Buffett Ratio ~125% vs. 90% long-term average), and any delay in corporate earnings recovery could trigger renewed outflows.
- **Russian oil quid pro quo:** India sources ~35% of its crude from Russia. Replacing this with higher-cost US or Middle Eastern crude could widen the import bill and stoke input costs for refiners.
- **CBAM and EU compliance costs:** Indian steel and aluminium exporters face carbon border adjustment costs from 2026 under the EU FTA. The EUR 590 million pledged by Brussels may not fully offset the transition cost for heavy industry.



Investment Implications & Outlook

- **India's external sector is at an inflection point. The worst of the tariff shock appears to be behind, with the US deal reducing the effective tariff to 18% and the EU FTA opening a massive new market. Services exports continue to provide a robust structural surplus for now. The CAD, while likely to have widened in Q3 FY26 due to gold imports, is expected to moderate to a manageable 1.1–1.2% of GDP for the full year.**
- **For equity markets, the key catalyst is the potential unlocking of a private investment cycle as trade uncertainty dissipates. The GDP forecast of 6.9% for CY2026 reflects this expectation. Export-facing sectors like textiles, engineering goods, pharmaceuticals, electronics should benefit most directly from tariff relief. Manufacturing-linked stocks may see a re-rating as global firms reassess India as a China+1 sourcing destination under more favourable tariff terms.**
- **For fixed income, the RBI's cumulative 125bps of rate cuts in 2025, combined with liquidity injections of INR 6.3 trillion, have eased financial conditions. We see limited scope for further easing ceteris parabis. The rupee is likely to remain under mild depreciation pressure, which provides a natural hedge for export earnings but adds to the cost of servicing dollar-denominated liabilities.**
- **In summary, India's trade architecture has been fundamentally reshaped in a matter of weeks. The combination of the US deal, the EU FTA, and the broader FTA network positions India more favourably than at any point in the past decade for export diversification. However, the merchandise deficit remains structurally wide, gold imports introduce volatility, and the transition costs of India's commitments (Russian oil reduction, US procurement, CBAM compliance) are non-trivial. Investors should view the trade deals as necessary but not sufficient conditions for a sustained re-acceleration in India's external sector performance. Over the medium term, we expect growth to be driven by a revival in the private capex cycle, supported by a meaningful easing of geopolitical uncertainty—though the finer details still warrant close scrutiny. As capacity expansions gain momentum and companies enter new markets, incremental hiring should follow. This employment led income expansion would, in turn, reinforce domestic demand. In our view, this virtuous cycle - capex driving jobs, jobs driving consumption, and consumption supporting further investment - has the potential to meaningfully accelerate growth in the coming quarters.**

7. Fiscal Situation



INR BN	FY24-25	FY25-26	FY25-26	FY26-27	% YoY	
	Actual	BE	RE	BE	FY27BE/FY26RE	Comments
Revenue Receipts	30366	34204	33423	35332	5.7	
Tax Revenue (Net of State Share)	25000	28374	26747	28669	7.2	Reasonable on the back of nominal GDP growth of 10%
Non-Tax Revenue	5366	5830	6677	6662	-0.2	
Capital Receipts	16162	16449	16225	18142	11.8	
Recovery of Loans	246	290	302	384	27.2	
Other Receipts	172	470	338	800	136.4	Disinvestment target set at INR 800Bn; needs monitoring
Borrowing & Other Liabilities	15744	15689	15585	16958	8.8	
TOTAL Receipts	46529	50653	49648	53473	7.7	
Revenue account other than interest payment	24853	26679	25947	27215	4.9	
Interest Payment	11156	12763	12743	14040	10.2	
TOTAL Expenditure	46529	50653	49648	53473	7.7	
Total Revenue expenditure	36009	39443	38691	41255	6.6	Control over revenue expenditure
Of which grants for creation of capital assets	2727	4272	3082	4927	59.9	
Total capital expenditure	10520	11211	10958	12218	11.5	strong growth in capital expenditure
Effective capital expenditure	13246	15483	14039	17145	22.1	strong growth in effective capital expenditure
REVENUE DEFICIT	5643	5238	5268	5923	12.4	
% of GDP	1.7%	1.5%	1.5%	1.5%		
FISCAL DEFICIT	15744	15689	15585	16958	8.8	fiscal deficit remains under control; Budgeted to decline to 4.3% of GDP in FY27BE
% of GDP	4.9%	4.4%	4.4%	4.3%		
PRIMARY DEFICIT	4589	2926	2842	2918	2.7	
% of GDP	1.4%	0.8%	0.8%	0.7%		
Nominal GDP	324114	356979	357139	393004		
Growth (%)	-1.1%	10.1%	10.2%	10.1%		nominal GDP growth assumptions appear realistic
Effective capital expenditure as % of total exp	28.5%	30.6%	28.3%	32.1%		
revenue expenditure as % of GDP	11.11%	11.05%	10.83%	10.50%		
capital expenditure as % of GDP	3.25%	3.14%	3.07%	3.11%		



Revenue

INR BN	2025A	2026BE	2026RE	2027BE	Change (%) 2026RE/2025	Change (%) 2027BE/2026RE	Comments
Receipts							
1. Revenue receipts (2d + 3)	30,366	34,204	33,423	35,332	10.1	5.7	
2. Gross tax revenues (a + b)	37,964	42,702	40,778	44,041	7.4	8.0	Assumption appears realistic given nominal GDP growth of 10%
2.a. Direct taxes	22,359	25,351	24,365	27,250	9.0	11.8	
2.a.1. Corporation tax	9,868	10,820	11,090	12,310	12.4	11.0	Assumes improvement in corporate earnings
2.a.2. Income tax (incl. other taxes)	12,491	14,531	13,275	14,940	6.3	12.5	
2.a.2.1. Securities transaction tax (STT)	522	780	637	737	22.0	15.8	Growth on back of higher STT
2.b. Indirect taxes	15,605	17,351	16,413	16,791	5.2	2.3	
2.b.1. Goods and Services Tax	10,270	11,780	10,465	10,190	1.9	-2.6	
2.b.2. Customs duty	2,332	2,400	2,583	2,712	10.8	5.0	
2.b.3. Excise duty	3,003	3,170	3,366	3,889	12.1	15.6	Hike in excise duty on the back of higher tax of cigarettes
2.b.4. Service tax	-0	1	-	-	-	-	
2.c Devolution to states, UTs, etc.	12,963	14,328	14,031	15,372	8.2	9.6	Devolution to states retained at 41%
2.d Net tax revenues (2 - 2.c)	25,000	28,374	26,747	28,669	7.0	7.2	
3. Non-tax revenues	5,366	5,830	6,677	6,662	24.4	-0.2	
3.a. RBI's transfer of surplus	2,104	2,104	2,686	2,686	27.7	0.0	Assuming similar transfer of dividend by RBI in FY27E
3.b. Telecommunications	848	824	1,408	1,171	66.1	-16.9	
3.c. Others	2,414	2,902	2,582	2,806	7.0	8.7	
4. Non-debt capital receipts (a + b)	418	760	640	1,184	53.1	84.9	
4.a Recovery of loans	246	290	302	384	22.6	27.2	
4.b Other receipts (incl. disinvestments)	172	470	338	800	96.7	136.4	Higher budgeted disinvestment receipts need close monitoring
5. Total receipts (1 + 4)	30,784	34,964	34,064	36,515	10.7	7.2	

Expenditure

INR Bn	2025A	2026BE	2026RE	2027BE	Change (%) 2026RE/2025	Change (%) 2027BE/ 2026RE	Comments
Expenditure							
6. Revenue expenditure	36,009	39,443	38,691	41,255	7.4	6.6	
6.a. Interest payments	11,156	12,763	12,743	14,040	14.2	10.2	
6.b. Subsidies	3,850	3,834	4,297	4,105	11.6	-4.5	Subsidies lower than FY26RE
6.c. Pay, allowances and pensions	7,543	7,825	7,873	8,151	4.4	3.5	
6.d. Agriculture and farmers' welfare	1,299	1,272	1,230	1,305	-5.3	6.1	
6.g. Rural development	1,767	1,878	1,870	1,944	5.9	3.9	
6.h. Drinking water, sanitation, etc.	464	989	410	943	-11.7	130.2	
6.i. Transfers to states	1,333	1,574	1,815	1,678	36.2	-7.6	
6.j. Police (Central forces)	1,351	1,438	1,463	1,525	8.3	4.3	
6.h. Others	5,290	5,659	4,866	5,183	-8.0	6.5	
7. Capital expenditure	10,520	11,211	10,958	12,218	4.2	11.5	Tracking Nominal GDP growth
7. a. Defence	1,706	1,924	1,974	2,310	15.7	17.0	Growth in defence expenditure continues
7. b. Railways	2,519	2,520	2,520	2,778	0.0	10.3	
7. c. Roads and highways	2,853	2,722	2,721	2,942	-4.7	8.1	
7. d. Loans for capex to states	1,499	1,500	1,500	2,000	0.1	33.3	
7. e. Housing and urban affairs	316	376	330	348	4.3	5.5	
7. f. Others	1,625	2,168	1,913	1,840	17.7	-3.8	
8. Total expenditure (6 + 7)	46,529	50,653	49,648	53,473	6.7	7.7	Quality of expenditure continues to improve

Revenue receipts are projected to grow by ~7% in FY 2026–27, while total expenditure is budgeted to rise by ~8%, resulting in an estimated fiscal deficit of ~4.3% of GDP. The slightly faster pace of expenditure growth relative to revenue underscores the government's calibrated expansionary stance at this stage of the cycle. While revenue growth remains healthy, expenditure continues to be skewed toward priority areas such as capital outlay and growth-supportive spending. The resulting fiscal deficit of 4.3% of GDP reflects a conscious trade-off—supporting economic momentum without materially compromising medium-term fiscal consolidation. Importantly, the deficit remains on a declining glide path, suggesting that fiscal credibility is being preserved even as near-term growth is prioritised.



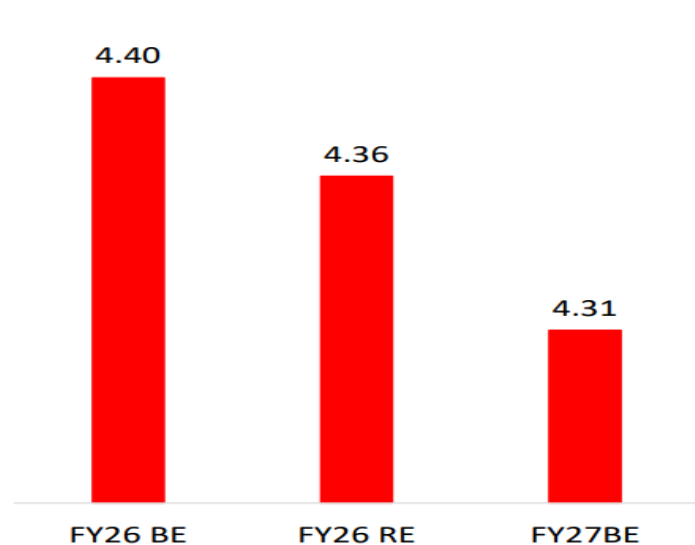
Fiscal Outlook and Consolidation

- The Union Budget FY2026-27 (FY27) continues on a path of gradual fiscal consolidation. The **gross fiscal deficit (GFD) is targeted at 4.3% of GDP, a modest improvement from 4.4% in the previous year**. This meets the government's medium-term fiscal roadmap, with an **aim to reduce debt-to-GDP to 55.6% in FY27 and around 50% by 2030-31**. The budget underscores a shift in fiscal anchor from one-year deficit figures to the debt ratio, emphasizing sustainable debt reduction over time. Importantly, **primary deficit (fiscal deficit net of interest payments) is contained near 0.7% of GDP, reflecting that much of the deficit is due to interest outgo**. By restraining revenue expenditure growth and sticking to deficit targets, the government signals commitment to prudence – a stance aimed at preserving market confidence and leaving credit space for the private sector (i.e. minimizing crowding-out).

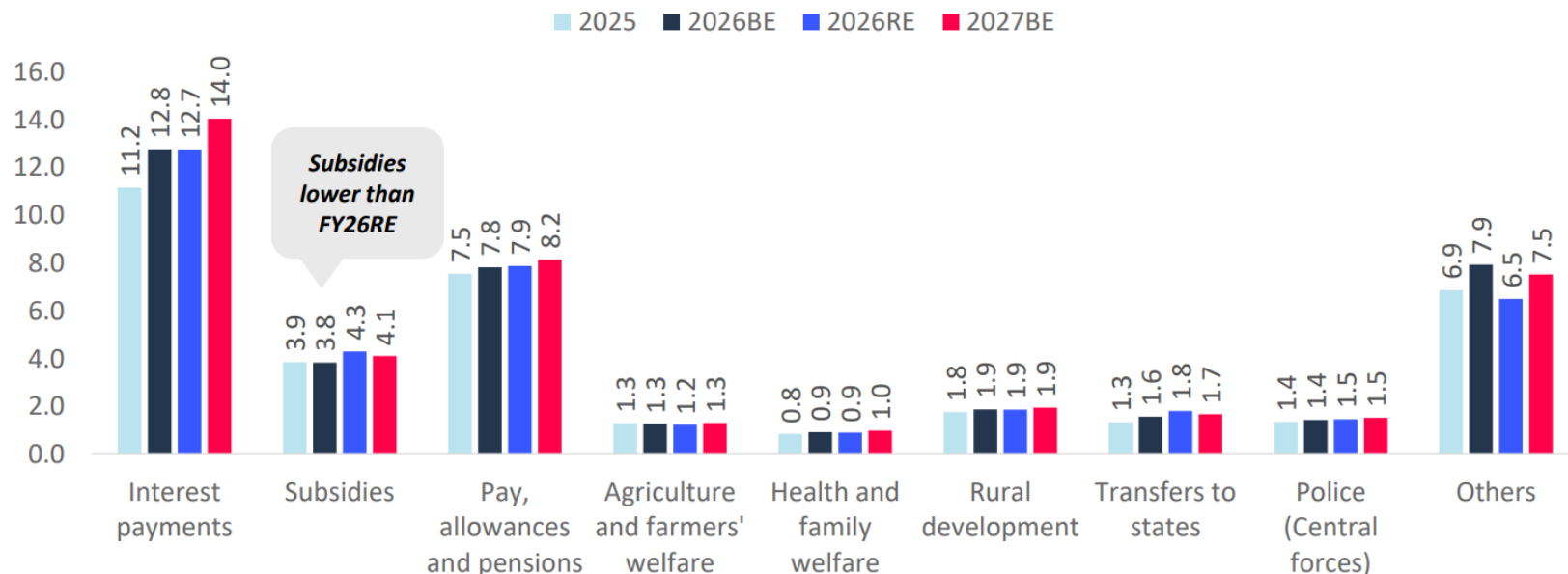
Revenue and Taxation Structure

- Revenue projections in Budget FY27 are cautiously optimistic. **Gross tax revenue is estimated at about ₹44.0 lakh crore, an ~8% increase over FY26 (RE)**. After devolving shares to states, the net tax revenue to the Centre is pegged around ₹28.6 lakh crore, up from ₹26.8 lakh crore in FY26. This assumes a **tax buoyancy under 1 (approximately 0.8) – reflecting subdued growth in collections due to last year's tax rate cuts**. **Direct taxes are forecasted to grow faster than nominal GDP (buoyancy >1), while indirect taxes (notably GST) lag behind (buoyancy ~0.3) after rate reductions**. Indeed, the **tax-to-GDP ratio is expected to dip slightly from 11.4% in FY26 (RE) to 11.2% in FY27**. Notably, **no changes in personal income tax slabs** were introduced, preserving the existing structure. Instead, the budget relies on stability and better compliance to raise revenue, alongside minor tweaks: for example, customs duties were streamlined (with some exemptions pruned) to encourage domestic value-addition. On the non-tax side, the **divestment target remains at a realistic ₹80,000 crore (similar to last year) to avoid overly ambitious revenue assumptions**. Overall, the tax structure signals continuity – providing a stable policy environment – while modestly higher collections are expected from an expanding tax base and economic growth.

Fiscal Deficit
(% Of GDP)



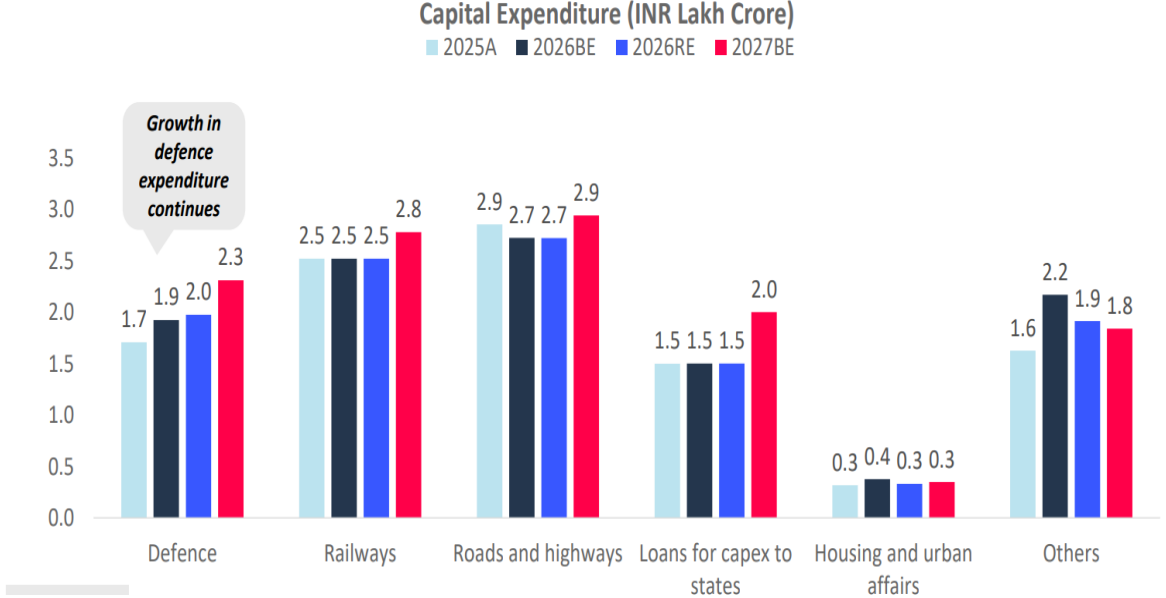
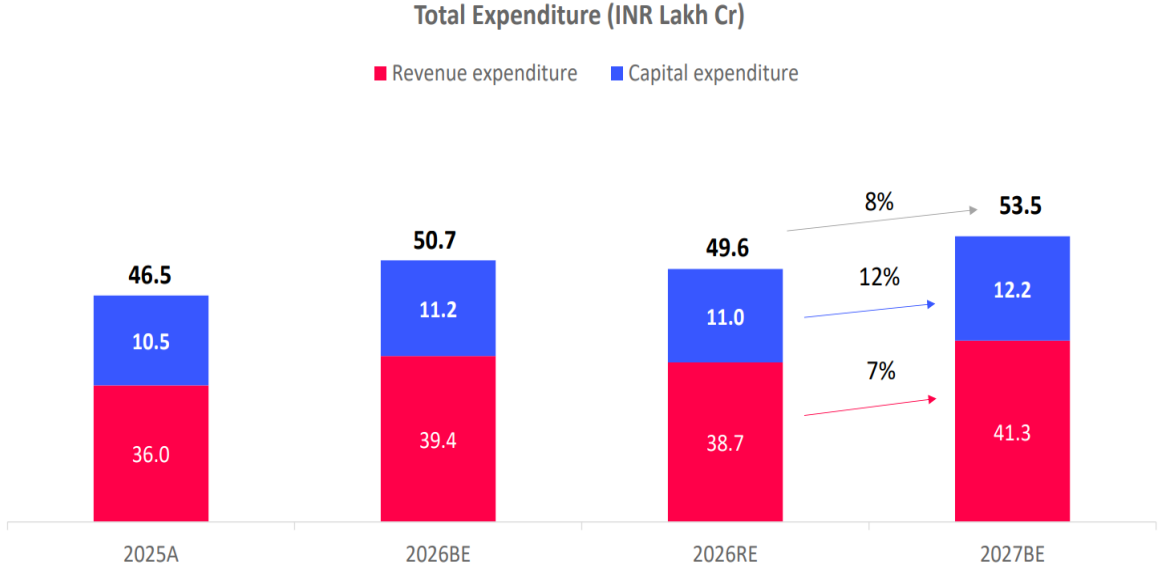
Revenue Expenditure (INR Lakh Crore)





Capital Expenditure and Infrastructure Push

A key highlight of Budget FY27 is the **record boost to capital expenditure (capex), underscoring an infrastructure-led growth strategy**. Budgeted capex outlay is ₹12.2 lakh crore, an 11.5% increase over the current year's revised figure. This amounts to 3.1% of GDP dedicated purely to capital investments in FY27 – the highest in decades. Including grants for asset creation (to states, etc.), the effective capital expenditure rises to ₹17.14 lakh crore, which is about 4.4% of GDP. In fact, effective capex now comprises nearly 32% of total budget outlay, marking a decisive shift towards building long-term assets. The Finance Minister highlighted that public capex has grown more than five-fold since FY15, reflecting sustained emphasis on infrastructure. Major investments span transportation (roads, railways, urban transit), logistics (new Dedicated Freight Corridors, national waterways, ports), energy infrastructure, and digital connectivity. For instance, the Indian Railways received a historic allocation (around ₹2.9 trillion) to expand and modernize rail infrastructure (a record high). Additionally, an Infrastructure Risk Guarantee Fund is being established to incentivize private developers by mitigating project risks. This capex thrust is expected to not only directly boost construction activity and jobs, but also enhance the economy's productive capacity and competitiveness in the medium term.



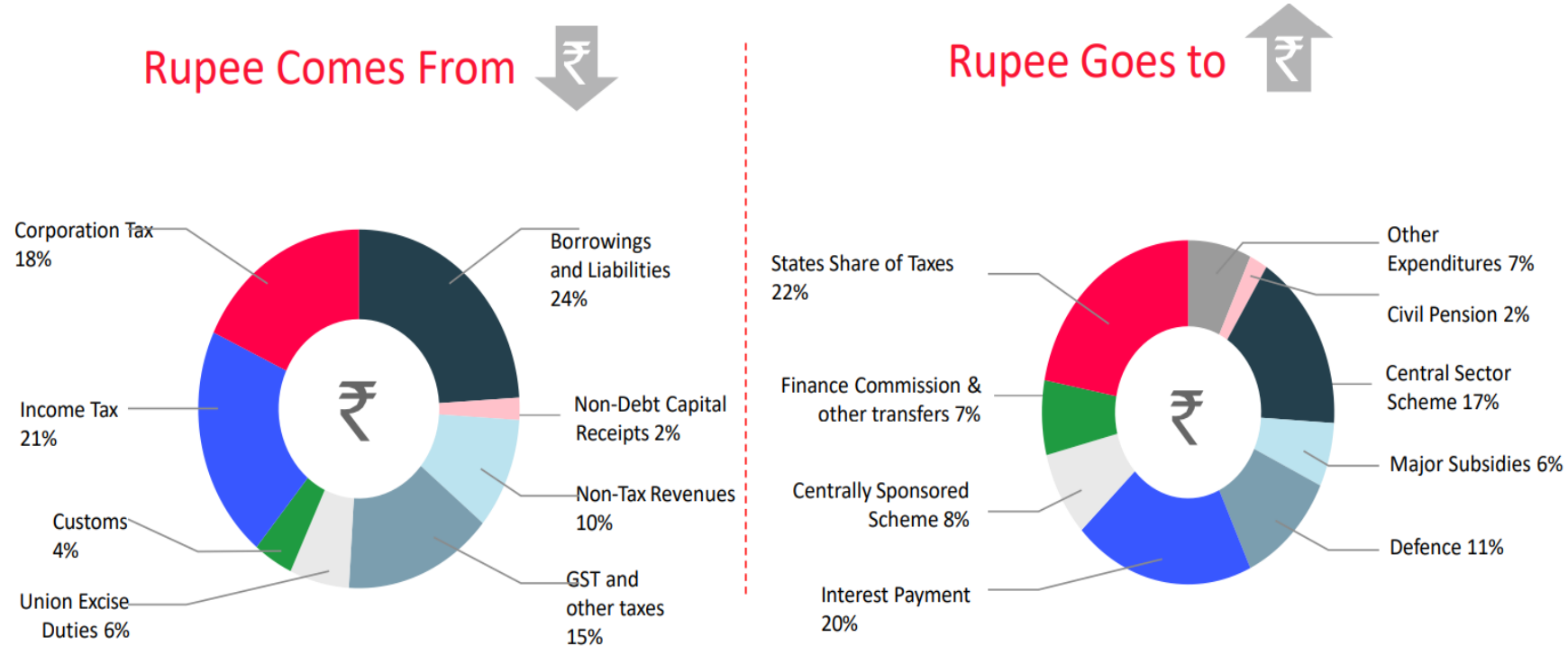
Budget Math: Deficit, Borrowing, and GDP Assumptions

The budget's macro-fiscal math is built on realistic if slightly optimistic assumptions. It projects nominal GDP growth of 10.1% in FY27, based on real GDP growth around 6.8–7.0% plus GDP deflator (inflation) of ~3%. This assumption is crucial: higher nominal growth boosts tax revenues and makes the fiscal deficit ratio easier to contain. At a 10% growth rate, the budget comfortably accommodates a total expenditure of ₹53.5 lakh crore (7.7% above last year) while lowering the deficit to GDP ratio. However, if growth were to slip (say to 9% nominal), the consolidation would require more belt-tightening in the future.

Source: Budget documents, KMFAMC, Internal assessment



- The FY27 fiscal deficit (GFD) of 4.3% of GDP translates to roughly ₹17.0 lakh crore of borrowing. Indeed, the government has announced a record market borrowing of ₹17.2 lakh crore (gross) for FY27, which is 17% higher than the current year's ₹14.6 lakh crore. After accounting for repayments, net borrowing is estimated at ₹11.73 lakh crore. This large supply of government bonds has raised concerns about upward pressure on yields; the benchmark 10-year yield spiked to around 6.8% post-budget on anticipation of heavy borrowing. The budget did not announce any immediate measures to expand demand for these bonds, meaning the RBI's support (OMOs or liquidity management) may be needed to prevent crowding out private credit.
- On the deficit composition, the revenue deficit is pegged at 1.5% of GDP, indicating that nearly two-thirds of the fiscal deficit is devoted to capital formation rather than operating expenses. In other words, borrowed funds are increasingly being used for investment (roads, rail, defense capital, etc.) rather than consumption. primary deficit (fiscal deficit net of interest payments) is contained near 0.7% of GDP, which indicates, interest payments, however, remain a significant burden – about 26% of total expenditure (taking up 40% of revenue receipts). This highlights why containing debt and interest costs is vital for fiscal health. The Budget Estimates (BE) vs Revised Estimates (RE) for the current year reveal that while the deficit target was met in FY26, it was achieved partly by curtailing expenditures in various ministries due to lower-than-projected tax receipts (tax revenue grew only ~6.7% in FY26 despite ~7.4% real GDP growth). For FY27, the government has set achievable targets – an 8% rise in tax revenue, 10% nominal GDP growth – leaving some buffer for slippage. The gross borrowing figure of ₹17.2 lakh crore, though high, is in line with market expectations (analysts had predicted ₹16–17.5 lakh cr). In sum, the budget math reflects a careful balancing act: gradually lower deficits without derailing growth spending, and bank on decent economic growth and efficient tax administration to make the numbers work.





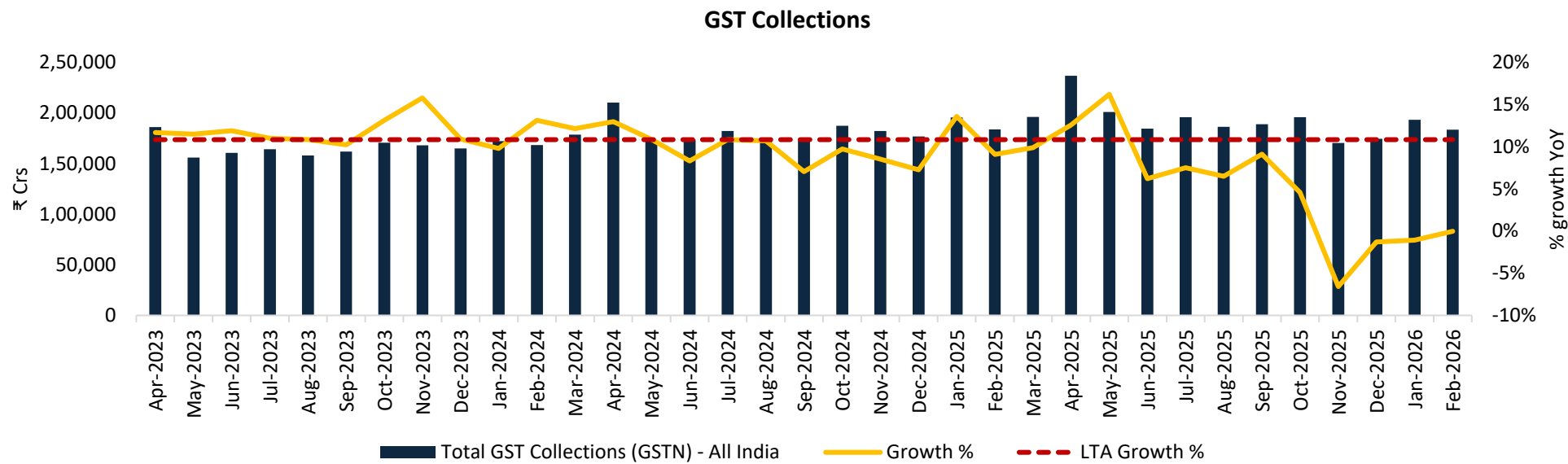
Implications for Private Investment and Crowding-In

- A central question for economists is whether high public spending will “crowd out” private investment or “crowd in” more private activity. The government’s stance in this budget is that high-quality public expenditure can crowd-in private investment by boosting overall demand and reducing infrastructure bottlenecks. With FY27’s capex push (in roads, railways, urban infrastructure, logistics, etc.), the state is effectively laying groundwork that lowers costs for businesses and can stimulate complementary private sector projects. Initiatives like the new Infrastructure Risk Guarantee Fund aim to de-risk private infrastructure investments, encouraging developers and financiers to partake in projects alongside government. As one expert noted, the focus has shifted to not just the scale of public spending but its ability to “crowd in private participation through better risk sharing” and diversifying beyond traditional sectors. Moreover, by maintaining fiscal discipline (deficit at 4.3%) the government tries to contain excessive rise in interest rates, thereby keeping credit available for businesses – an approach explicitly intended to avoid crowding-out.
- However, the actual impact on private investment will depend on broader economic conditions. Currently, private capital formation in India has been subdued – in fact, private companies’ share in gross capital formation dropped to a decade low in recent years. Factors such as tepid consumer demand, global uncertainties, and existing excess capacities have made firms cautious. The budget acknowledges this by not relying solely on the private sector to drive growth; instead, the public sector is taking the lead until private sentiment revives. The large government borrowing program, while necessary to fund infrastructure, does pose a risk of crowding-out if not managed – higher bond yields can raise borrowing costs for enterprises. The RBI’s role in yield management will be crucial in this regard. On the positive side, improved infrastructure and logistics (e.g. freight corridors, port upgrades, power supply) should eventually lower the cost of doing business, improving returns on private investment. The Production-Linked Incentive schemes and sectoral subsidies in the budget also aim to “pull in” private capital by sweetening the investment proposition in targeted industries.
- Overall, the crowding-in effect is expected in industries where public outlay directly enables new opportunities (such as manufacturing clusters, or digital infrastructure attracting data center investments), and where budget measures reduce risk (credit guarantees, project insurance). Indeed, the budget explicitly ties its capex strategy to unlocking private spending: effective capital expenditure is now almost as large as the fiscal deficit itself, suggesting that nearly all government borrowing is funneled into asset creation that could boost productivity and private sector confidence. If nominal GDP growth holds up and demand strengthens, we anticipate a virtuous cycle where private investment picks up – validating the government’s approach of using public investment as a catalyst. Conversely, if the external environment or domestic consumption falters, the private sector may continue to lag, leaving the public sector as the spender of last resort. In summary, Budget FY27 tilts decidedly toward the “crowd-in” thesis: it maintains fiscal discipline to avoid choking credit, while channeling spending into areas that generate multiplier effects and encourage businesses to invest alongside the state.



Key Positives and Negatives of Budget FY27

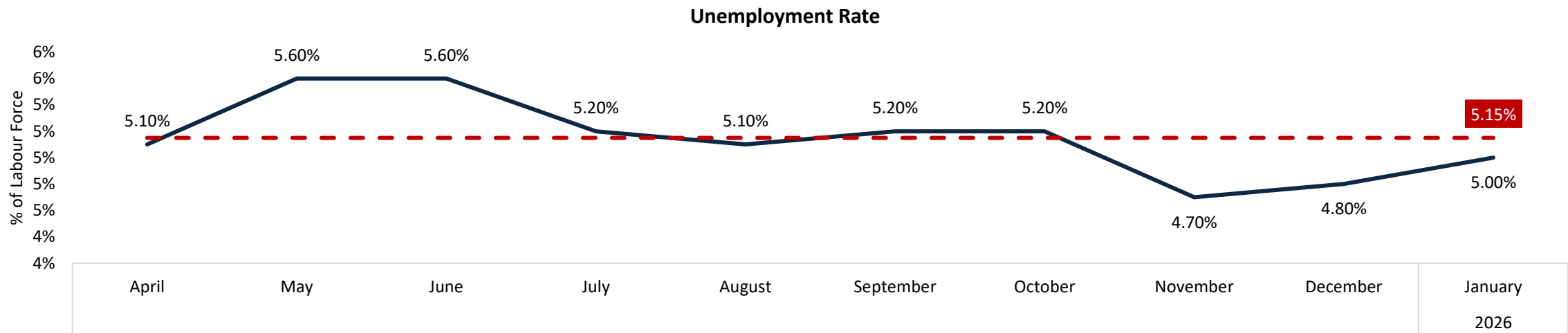
Positives (Strengths and Opportunities)	Negatives (Challenges and Concerns)
Prudent Fiscal Consolidation – Fiscal deficit lowered to 4.3% of GDP, signaling continued discipline and a sustainable debt trajectory. This restraint bolsters macro-stability and keeps India on course towards its medium-term debt target.	Slower Revenue Growth – Tax buoyancy is modest (overall tax-GDP slips to 11.2%). Previous tax cuts and conservative estimates mean limited fiscal headroom. Any growth shortfall or revenue shock could strain the deficit target and lead to crowding-out.
Record Infrastructure Spending – Capital expenditure raised to a historic ₹12.2 lakh crore (effective capex 4.4% of GDP), which should improve productivity, job creation, and crowd-in private investment in infrastructure and related sectors.	High Borrowing Requirement – Gross market borrowing of ₹17.2 lakh crore is the highest ever, potentially putting upward pressure on interest rates. Without measures to widen bond demand, there's risk of crowding-out private credit or increased debt servicing costs.
Boost to Manufacturing & Strategic Sectors – Targeted support for electronics, semiconductors, pharma, textiles, and rare earths (via PLI schemes and dedicated funds) is set to enhance domestic capacity and reduce import dependence. Over time this strengthens industrial growth and export competitiveness.	Limited Tax Reforms for Investors – No simplification or reduction in capital gains taxes, and a sharp STT hike on F&O trading. These may dampen investor sentiment in capital markets and were viewed as a missed opportunity to make markets more attractive amid foreign outflows.
MSME and Job Focus – Introduction of the ₹10,000 cr SME Growth Fund and expanded credit guarantees will ease financing for MSMEs. Support for labor-intensive industries (textile parks, cluster development) can boost employment and inclusive growth.	Cuts in Social & Welfare Outlays – In an effort to meet fiscal targets, certain social sectors saw relatively modest increases or spending curtailments. For example, FY26 spending in areas like education, health, and urban development fell short of initial allocations, which could slow progress in human capital development.
Investment-Friendly Moves – Longer tax holidays for data center operations and IFSC units, plus higher limits for NRI investment in equities, enhance India's appeal to global investors. Simplified customs tariffs and SEZ reforms should also lower costs for manufacturers and exporters.	Private Investment Still Weak – The onus of growth remains on government spending, as private capital expenditure is yet to rebound strongly. Until demand (domestic and international) improves significantly, there's a risk that the high public capex may not immediately translate into a proportional rise in private investment, tempering the crowd-in effect in the near term.



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

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

8. Employment



Unemployment – UR Edges Up to 5.0% in January; Seasonal Softening, Not a Structural Break

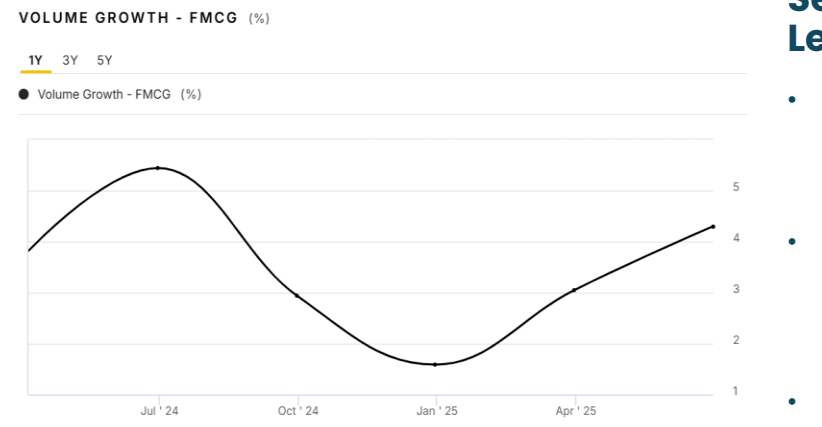
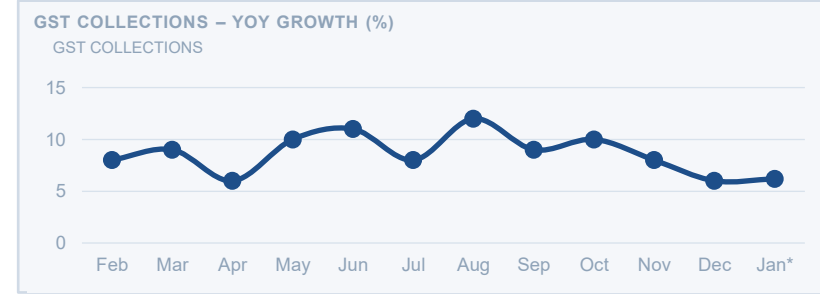
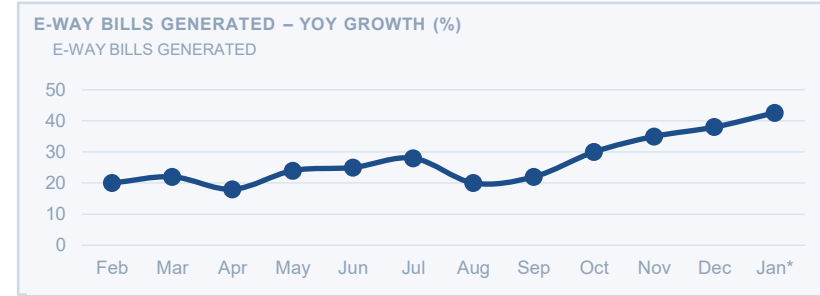
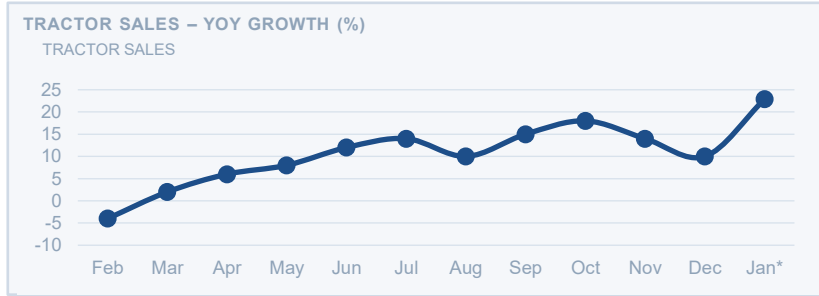
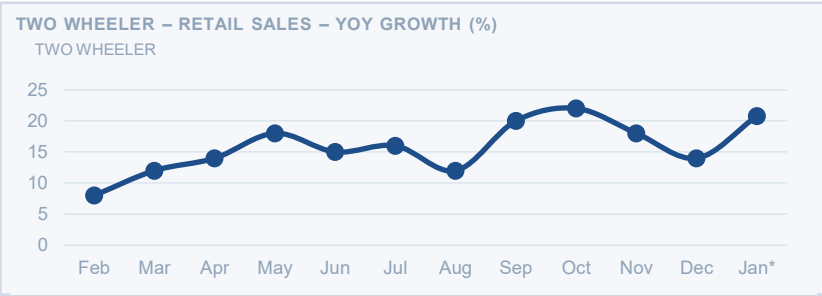
Dynamics:

- **Seasonal uptick in UR; underlying conditions remain stable:** India's unemployment rate rose to 5.0% in January 2026 from 4.8% in December 2025, a 3-month high, driven overwhelmingly by rural seasonal factors: post-harvest slack, winter slowdown in construction, agriculture-allied work, and small trade. The NSO explicitly attributed the move to seasonal and discouragement effects, with rural UR edging from 3.9% to 4.2%. Urban UR rose marginally from 6.7% to 7.0%, remaining stable in structural terms.
- **LFPR and WPR broadly steady; rural WPR high after strong H2 FY26 run:** The Labour Force Participation Rate (LFPR) dipped slightly to 55.9% (from 56.1% in December, a series high). Crucially, this follows a sustained six-month climb in rural Working Population Ratio (WPR) from June 2025 (53.3%) to December 2025 (56.7%). January's marginal decline in WPR to 56.2% reflects a normal mean-reversion after an exceptional Kharif-driven peak, not a structural deterioration. Urban WPR held stable at 46.8%.
- **Female UR uptick within observed range; male UR stable:** Male unemployment remained unchanged in January, while female UR edged higher – but NSO confirmed this remained within the April–December 2025 range, ruling out a new adverse trend. Rural female WPR (38.0%) and LFPR (39.7%) pulled back modestly after reaching multi-year highs, consistent with seasonal agricultural cycle dynamics.

Overall Assessment:

- **January 2026's 5.0% unemployment print is a seasonal blip, not a signal.** The NSO's own commentary anchors this firmly in post-harvest winter slowdown dynamics, with no evidence of broad-based demand destruction in the labour market. Urban employment conditions, the more structurally sensitive metric remained essentially flat month-on-month, and the LFPR decline is better read as a post-series-high normalisation than a genuine withdrawal from the workforce. The more important trend is the H2 FY26 arc: rural WPR rose for six consecutive months through December, MGNREGS demand stayed in contraction for the sixth month running (confirming rural labour market confidence), and the Naukri JobSpeak Index held firm in non-IT hiring – insurance, hospitality, and BPO. The employment backdrop heading into Q4 FY26 and FY27 remains constructive. The principal risk is GenAI-led headcount rationalisation in IT services narrowing formal white-collar hiring even as overall employment stays stable.

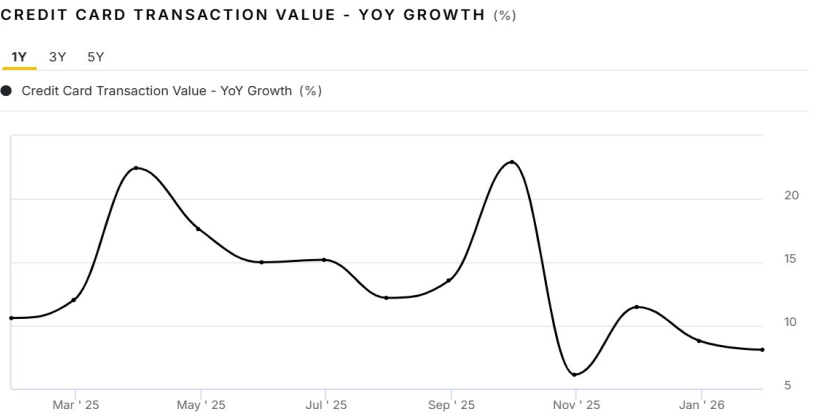
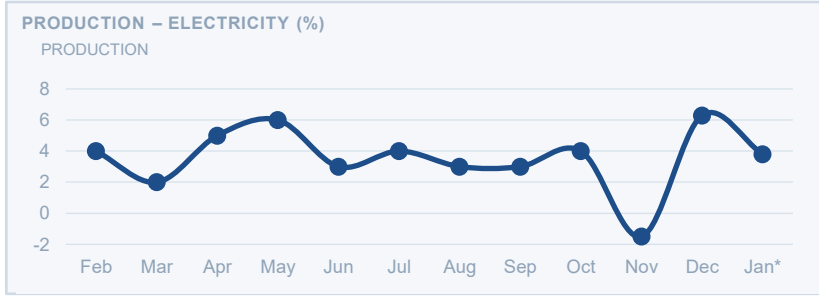
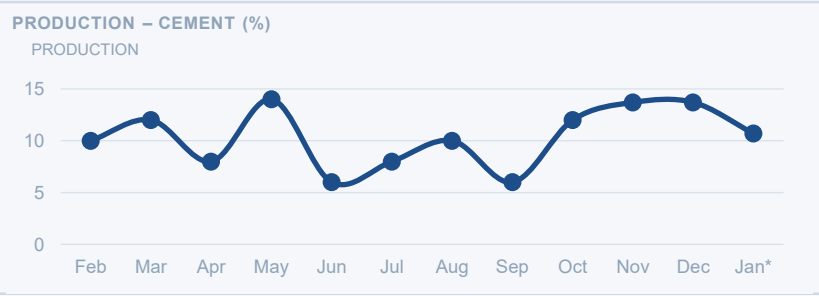
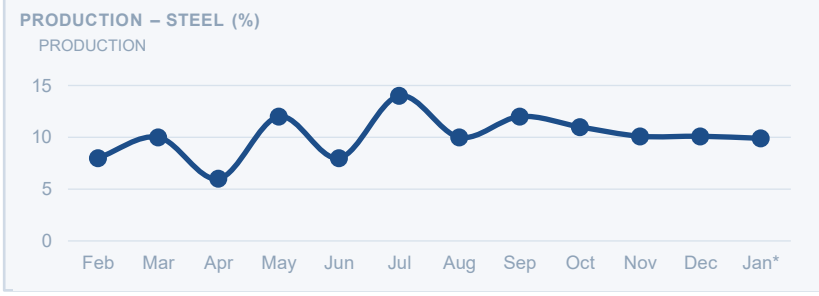
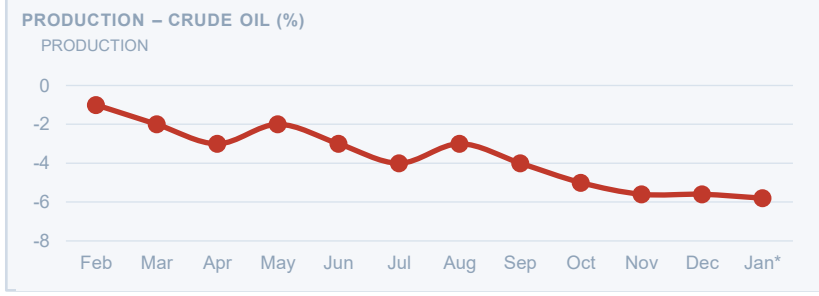
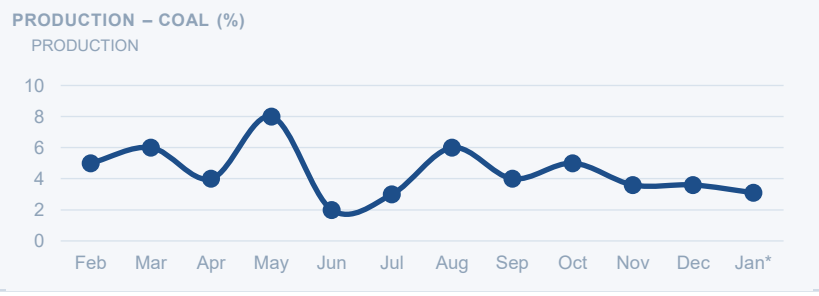
9. Demand Indicators



Select High-Frequency Indicators (January 2026) – Demand Momentum Firming; Rural Leads, Urban Recovering

- Rural Demand:** Two-wheeler retail surged +20.82% YoY to 18.53 lakh units, an all-time January high, with rural share anchored at ~56%, driven by post-harvest cash flows and Pongal/Sankranti demand. Tractor retail grew +22.89% YoY to 1.14 lakh units, the strongest January in this cycle, reinforcing a sustained farm-income expansion. MGNREGS demand stayed in contraction for the 7th consecutive month, rural labour has found better-paying employment; this is structurally positive.
- Urban Demand:** Passenger vehicle retail grew +7.22% YoY to 5.13 lakh units, with rural PV growth (+14.4%) sharply outpacing urban (+2.75%), confirming the structural pivot of PV demand into non-metro India. Domestic airline traffic rose +4.36% YoY (150+ lakh passengers), steady experience-led urban spending. GST collections at ₹1.93L Cr (2nd-highest ever) with E-Way Bills at a near-record 13.68 crore (+42.6% YoY) reflect broad-based goods movement momentum. The ₹12L income-tax exemption (effective April 2026) is an upcoming tailwind not yet in the January data.
- Demand Outlook:** January confirms consumption has graduated from a festive-led spike to a durable, normalised growth phase. Rural cushion is firm; urban recovery is underway but concentrated in premium segments. With CPI at 4.26%, RBI in a 50bps cut cycle, and Budget FY27 disposable income support, downside risks are well-contained. Key watch: whether the urban mass market broadens as income-tax benefits flow through from Q1 FY27.

Source: Internal assessment based on data from Tijori Finance



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

- Industrial Activity:** Core Sector (ICI) grew 4.0% YoY in January 2026. Cement (+10.7%) and Steel (+9.9%) delivered the strongest January readings of this cycle, consistent with government infrastructure capex that remains front-loaded and robust private construction activity. Electricity output recovered to +3.8% and Coal to +3.1%, both steady. The persistent drag: Crude Oil contracted -5.8% (5th consecutive month) and Natural Gas -5.0% (19th consecutive month), structural field-depletion issues at ONGC, not demand-side weakness. Commercial vehicles surged +15.07% YoY to 1.07 lakh units, driven by LCV freight recovery and M&HCV replacement cycle post-GST rationalisation to 18%.
- Services Sector:** HSBC Services PMI held at 58.5 in January (42nd consecutive month above 50) before accelerating to a 4-month high of 59.3 in February 2026. Composite PMI at 58.4 – one of the highest globally, confirms India's domestically-driven services economy is insulated from global deceleration. Financial services, insurance, hospitality, BPO and logistics are all in firm expansion. Manufacturing PMI recovered to 55.4 in January from 55.0 in December; new orders hit a 2-month high and export orders edged up modestly.
- Industrial & Services Outlook:** The January data points to an economy operating well above trend, with the capex-consumption virtuous cycle intact. Steel and cement double-digit growth alongside CV recovery confirms both public infra and private construction are simultaneously absorbing industrial output. RBI's rate-cut cycle, Budget FY27's ₹11.21L Cr capex outlay, and PLI-driven electronics/auto output are all incremental tailwinds. Sustained capex traction through Q1 FY27 will confirm whether this industrial cycle has another 6–9 months of runway.

Source: Internal assessment based on data from Tijori Finance



Consumer Demand Indicators:

2-Wheeler Retail +20.8% YoY 18.53L units – All-time Jan high	Tractor Sales +22.9% YoY 1.14L units – Rabi season driven	Passenger Cars +7.2% YoY 5.13L units – Rural leads +14.4%	GST Collections ₹1.93L Cr +8.2% YoY – 2nd highest ever	E-Way Bills +42.6% YoY 13.88Cr units – Near record	Airline Traffic +4.4% YoY 150L+ pax – Experience demand
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Industry Demand Indicators:

IIP Growth (Dec) 7.8% YoY 26-month high – Mfg +8.1%	Core Sector (ICI) 4.0% YoY Jan 2026 – Cement & Steel lead	Cement Production +10.7% Infra & real estate demand	Steel Production +9.9% Construction capex-led	Mfg PMI – Jan 55.4 Jan 2026 – New orders 2M high	Services PMI – Feb 59.3 4-month high – Composite 58.4
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Economic Heatmap



Key:
 V Good
 Good
 Ok
 Bad
 V Bad

Cautious optimism under a new shadow

India's macroeconomic backdrop enters FY27 on a resilient footing - real GDP growth for FY26 is estimated at 7.4%, anchored by healthy consumption, a nascent private capex revival, and government infrastructure spending at ₹12.22 lakh crore (~4.4% of GDP). Headline CPI on the new 2024-base printed at 2.75% in January 2026, well below the MPC's tolerance band, with Q1 FY27 projected at 4.0% and Q2 at 4.2% as base effects normalise. High-frequency indicators remain constructive - Manufacturing PMI rose to 56.9 in February, a four-month high, Composite PMI at 58.9 marks the fastest private-sector expansion in three months, and IIP grew 4.8% in January with infrastructure and construction goods surging 13.7%.





The fiscal deficit is targeted at 4.3% of GDP, though the GDP base revision may push the effective number closer to ~4.5%. System liquidity remains in surplus at ~₹1.89 lakh crore, supported by OMOs, CRR cuts, and FX swaps, while the 10Y G-Sec yield sits at ~6.68%, held in a tight range between a benign domestic rate backdrop and crude-driven risk repricing. On trade, the US-India interim accord lowered reciprocal tariffs to 18% with a \$500 billion US procurement commitment over five years - a meaningful tailwind, though the US Supreme Court's 20 February ruling striking down several tariffs and the subsequent imposition of a 10% global levy under Section 122 have injected fresh uncertainty, with the formal signing still pending.

The dominant near-term risk is the ongoing US-Israel-Iran war (Operation Epic Fury): the Strait of Hormuz has been effectively shut with tanker traffic at near-zero, Brent has surged to \$82-84/bbl from \$66-67 in January-February, and India faces the largest combined exposure - over 60% of oil imports and more than half of LNG imports are Gulf-linked and Brent-indexed. The shock is already visible: the Nifty has collapsed over 1,100 points in three sessions, breaching 24,400, the rupee has weakened to a record ~92/\$, FII remain net sellers for a third consecutive week, and institutional buying of nearly ₹560 billion over four sessions is providing a floor in the bond market. A sustained crude environment above \$85 would widen the CAD, accelerate imported inflation, compress OMC margins, and constrain the RBI's room to resume easing.

The broader macro architecture remains fundamentally sound, characterised by subdued core inflation, capex-led fiscal spending, early signs of a private sector capex upcycle, strong PMI momentum, improving trade architecture, adequate liquidity, and healthy GDP growth. However, the ongoing Middle East conflict introduces a meaningful first-order tail risk through the crude oil channel and potential disruptions around the Strait of Hormuz, which could impact inflation, external balances, the rupee, and ultimately private capex and growth. Accordingly, while the structural backdrop remains constructive, the appropriate stance at this juncture is one of cautious optimism, with the emphasis now firmly on caution until greater clarity emerges on crude prices, Hormuz shipping flows, and the broader geopolitical trajectory.



Equity Outlook





Market Cap Risk-Return Profile/ PE-Multiples

Year	Nifty 50 Return %												CY
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
2025	-3%	-2%											-4.9%
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%	0%	-2%	0%	-5%	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%	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 %	11.6%	14.6%	14.9%
Standard Deviation	21.5%	26.1%	30.0%
Avg Months with +ve return / yr	7	7	6
Avg Months with -ve return / yr	5	4	5
Avg Months with >6% decline / yr	1	1	1
No of Years	27	21	13

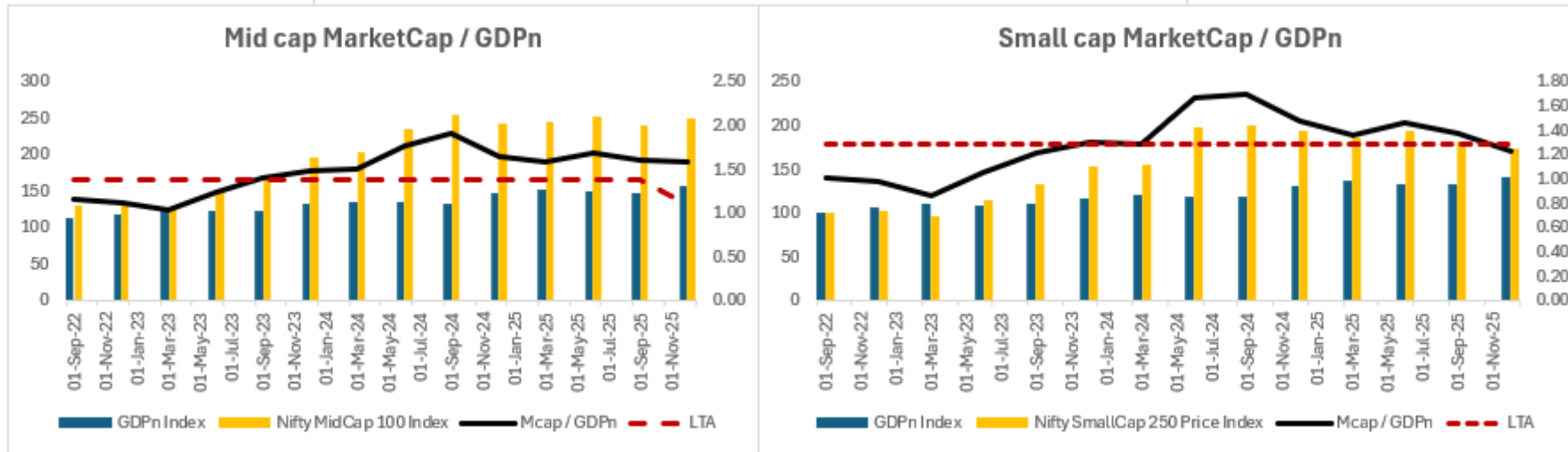
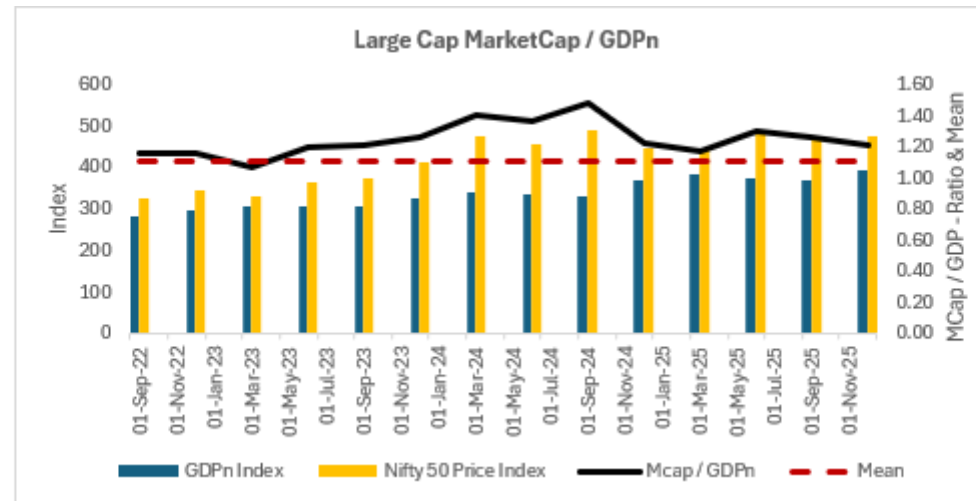
Ample Tailwinds

- In the last 2 months, the Nifty 50 Index has risen -4.9%. Historically, the Nifty 50 has given a CAGR of ~12% over the past ~27 years. Furthermore, advances and declines in a single month were at an average of 7 and 5 respectively in a single year for large caps, thus tending towards a CAGR of ~12% over a long-time horizon. Similarly Mid and Small Caps registered a CAGR of ~15% each over the past ~21 years and ~13 years respectively. We expect returns to improve going forward, supported by the ongoing uptick in domestic demand aided by recent tax rate reductions and the introduction of a simplified, lower GST regime, as well as trade deal announcements improving general market sentiments. The capex cycle, too, is beginning to show early signs of revival. However, geopolitics currently appears to be the primary driver behind the recent weakness in the broader market, and until the United States and Iran reach some form of de-escalation or settlement, markets are likely to remain under pressure with a downward bias and elevated volatility.
- The Risk-Return Matrix shows the tradeoff between risk and return for the 3 Market Cap indices, with increasingly higher returns at the cost of higher risk as we move down the Market Cap spectrum.
- As per TTM PE valuations, Large Cap, Mid Cap and Small Cap seem to be Fairly-valued.

Market Cap	Current PE	Long Term Average PE	Premium / (Discount)	Valuation
Large Cap	21.56	23.81	-9%	Fairly Valued
Mid Cap	32.89	32.38	2%	Fairly Valued
Small Cap	26.13	26.44	-1%	Fairly Valued



Buffett Indicator



Nifty 50 Index EPS estimates for FY26/FY27 had seen the steepest cuts in the past 6 years, barring the Covid phase. The **present valuations remain high as evidenced in the premiums exhibited in their MCap/GDP ratios where Large Caps and Mid Caps are currently trading at premiums of approx 9% & 13%, whereas Small Caps are currently trading at discount of approx 4%** (as per Buffett Indicator), as on 27th Feb 2026.



Sectoral Performance and Outlook

Banking & Financial Services

Q3 FY26 Performance:

The Indian banking sector delivered a largely stable performance in Q3 FY26, with systemic credit growth remaining robust – private sector banks reported year-on-year loan growth of approximately 11%, while public sector banks posted growth exceeding 12%. Net interest margins for most private sector lenders remained flat to marginally higher, supported by disciplined repricing and stronger CASA franchises, even as state-owned banks witnessed a marginal NIM compression of 3–6 basis points as they transmitted rate cuts more swiftly. Asset quality broadly held its ground, with gross NPA ratios continuing to moderate and provision coverage ratios remaining at elevated levels, particularly among PSU banks. However, deposit mobilisation remained a persistent challenge with the system loan-to-deposit ratio hovering at an uncomfortable ~82%, a level the RBI has flagged historically as a zone requiring monitoring. Slippages in the microfinance and unsecured retail segments remained an area of caution, though overall stress was contained. The quarter also witnessed an acceleration in digital payment volumes, while credit card transactions continued their upward trajectory. On the profitability front, operating efficiency metrics held steady with the industry cost-to-income ratio stable at approximately 48%, and public sector banks continued to narrow the gap with their private counterparts on digital adoption and return metrics.

Outlook:

The banking sector's medium-term outlook remains constructive, underpinned by the RBI's cumulative repo rate cuts of 125 basis points since February 2025 and improving monetary transmission. Credit demand is expected to remain healthy across retail, MSME, and corporate segments, supported by GST rationalisation and continued infrastructure spending. NIMs, however, face near-term compression risk as lending yields reset on variable-rate loans while deposit repricing lags – large banks with stronger CASA franchises are better positioned to weather this dynamic. Asset quality is expected to remain broadly stable though microfinance and small-ticket unsecured segments will require vigilance. NBFCs are emerging as a bright spot within the broader financials universe – earnings growth has been driven by strong credit demand, declining cost of funds, and healthy AUM expansion. The gold loan segment in particular has seen a 91% year-on-year surge in sourcing value, according to Experian data. With structural tailwinds from housing demand revival, rural market robustness, and LCR relaxation measures, the sector is well-positioned for mid-teens earnings growth in FY27, though selective stock picking will be critical given valuation divergence between large and mid-tier lenders.

Information Technology

Q3 FY26 Performance:

India's IT services sector navigated a mixed Q3 FY26, with topline resilience masking pronounced profitability pressure. Revenue growth for Tier 1 companies was muted at 0.2%–1.7% qoq in US dollar terms, while Tier 2 players outperformed with stronger deal ramp-ups in select verticals. The quarter was characterised by steady deal wins, TCS reported a total contract value of \$9.3 billion for the period, with annualised AI services revenue reaching \$1.8 billion, up over 17% qoq in constant currency. However, profitability took a significant hit due to the operationalisation of India's Labour Code, which imposed one-time compliance expenses across large people-intensive employers. The aggregate effect of these costs weighed on net profit margins even as operating profit margins held in the 22.5%–23.0% range, supported by improved utilisation, sub-contracting optimisation, and moderation in wage hike costs. The demand environment, though improving incrementally, remained cautious in verticals such as BFSI and Telecom. Mid-tier firms displayed superior agility, benefiting from their concentrated exposure to high-momentum verticals and faster deal conversion cycles.

Outlook:

India's IT sector is expected to grow 6.1% to \$315 billion in revenue in FY26, per Nasscom's latest strategic update, with AI-led services revenue anticipated in the \$10–12 billion range – a clear indication that enterprise clients are moving from AI pilots to scaled deployments. Operating profit margins are expected to remain stable at 22.5–23.0% over the next three to four quarters, supported by cost efficiency and productivity improvements tied to GenAI adoption. Deal pipelines across large and mid-tier firms remain healthy, and management commentary across TCS, Infosys, and HCLTech indicates an improving demand outlook for FY27, driven by discretionary technology spend recovery, stronger BFSI and manufacturing verticals, and an expanded role for Global Capability Centres (GCCs) – which already contribute 42% of total gross leasing absorption. Hiring is expected to remain selective in the near term, with firms prioritising specialist roles in AI, cloud, and cybersecurity. The key monitorable for investors is the normalisation of Labour Code-related costs and the pace at which deal wins and AI adoption translate into recognisable revenues – factors that will ultimately determine whether FY27 can deliver meaningful earnings acceleration beyond topline growth.



Pharmaceuticals & Healthcare

Q3 FY26 Performance:

The Indian pharmaceutical sector delivered a steady Q3 FY26 with domestic formulations emerging as the primary engine of growth. Sector-wide revenue growth of approximately 12.3% year-on-year was primarily driven by the domestic market, which grew 12%, supported by sustained strength in chronic therapies – cardiology, diabetes, oncology, and CNS segments continued to outperform non-chronic categories. Emerging market revenues also posted double-digit growth, supplementing domestic gains and providing useful diversification from US generics pricing pressure. The US generic market remained a drag on bottom lines, with persistent price erosion limiting margin expansion for generic-focused exporters. API price indices for the top 15 China-sourced inputs remained broadly flat quarter-on-quarter, providing some stability to gross margins even as elevated R&D spending weighed on net profitability. Specialty product portfolios – particularly in injectables, complex generics, and biologics – showed stronger traction. The quarter was also notable for the early positioning around semaglutide (GLP-1) generics ahead of patent expiry, and CDMO segments continued to witness steady order inflows from European and US innovators. Operating leverage partially offset higher employee costs stemming from Labour Code provisioning at several companies during the quarter.

Outlook:

The structural outlook for the Indian pharma sector remains strongly positive, anchored by ageing demographics, rising chronic disease prevalence, increasing healthcare penetration in Tier 2 and Tier 3 markets, and India's expanding position as a global CDMO hub. The domestic formulations market is expected to maintain its growth trajectory at 10–12% on a sustained basis, driven by specialty and super-specialty therapy launches, prescription growth in oncology, and the imminent GLP-1 generic wave which will unlock a large and underserved obesity and diabetes treatment market in India. On the US front, while pricing headwinds persist, complex injectables, peptides, and biosimilars offer superior margin profiles compared to commodity generics. Companies diversifying into CDMO, specialty hospital generics, and branded emerging markets are better positioned for earnings re-rating. Regulatory approvals from the USFDA remain an important catalyst for export-oriented players. The recent EU-India FTA, if finalised, could offer meaningful export advantages for Indian pharmaceutical manufacturers. Our universe suggest stable-to-improving EBITDA margins in the 18–22% range through FY27, with earnings acceleration likely for innovator-aligned and specialty-heavy portfolios.

Automobiles & Auto Ancillaries

Q3 FY26 Performance:

Q3 FY26 emerged as one of the strongest quarters for the Indian automobile sector in recent memory, with aggregate revenues for listed auto OEMs (excluding Tata Motors) expected to surge approximately 22% year-on-year. Passenger vehicle volumes hit an all-time quarterly high of 1.27 million units, up 20.6% year-on-year, supported by festive demand, GST rationalisation on select vehicle categories, and a premium product mix driving higher average selling prices. Two-wheeler volumes recorded their highest-ever Q3 performance at 5.70 million units – a 16.9% year-on-year increase – crossing the 5-million quarterly milestone for the first time, reflecting a broad-based mass-market recovery underpinned by improved rural affordability and easing interest rates. Commercial vehicles delivered high single-digit growth while the tractor segment surged approximately 16% year-on-year, supported by a favourable monsoon base and state government subsidy schemes. SIAM data confirmed that five states – Maharashtra, Uttar Pradesh, Gujarat, Karnataka, and Tamil Nadu – consistently dominated national automotive demand across all categories. Exports also scaled new highs, with PV shipments rising 11.7% year-on-year to 2.25 lakh units, backed by sustained demand across the Middle East, Africa, and Latin America. The EPC impact of higher precious metal costs was partially offset by cooling steel prices and operating leverage benefits.

Outlook:

The structural growth trajectory for Indian automobiles remains intact for FY27, although growth normalisation is anticipated after the exceptionally strong Q3 base. Analysts projects passenger vehicle wholesale volumes to grow 5–7% in FY26 overall, with two-wheelers on track for 6–9% full-year growth. Tractor volume expansion may moderate to approximately 2% in FY27 following the anticipated expiry of Maharashtra state subsidies and a high base effect. The sector's long-term story is increasingly defined by the electric vehicle transition – India sold over 20 lakh EVs in FY25 and EV penetration is accelerating across two-wheelers, three-wheelers, and passenger vehicles, backed by PM E-DRIVE, PLI incentives, and aggressive investment by OEMs. The entry of VinFast's ₹16,000 crore plant in Tamil Nadu and expanding domestic EV lineups from Tata Motors, Mahindra & Mahindra, and JSW MG Motor are set to deepen the product ecosystem. For FY27, CAFE emission norms and mandatory safety feature compliance may push up entry-level pricing, posing near-term volume constraints in the sub-compact segment. Nevertheless, a richer product mix, steady EV ramp-up, rural income improvement, and ongoing export market expansion are expected to keep the broader sector on a 6–8% volume growth path through FY27.



Capital Goods

Q3 FY26 Performance:

Q3 FY26 presented a differentiated picture for the capital goods sector, with revenues broadly holding up even as aggregate order inflows for major players (excluding Larsen & Toubro) contracted year-on-year. Total cumulative orders for the segment stood at approximately ₹32,400 crore, with a 12% rise in pure capital goods orders offset by a 50% YoY decline in defence inflows – the latter largely attributable to a high base effect following HAL's ₹13,500 crore order in Q3 FY25. Revenue performance was stronger, with expectations of low double-digit growth across the sector, aided by strong execution in power transmission and distribution (T&D), EPC projects, and consumer electricals. The T&D segment remained a standout performer, driven by India's ambitious grid upgrade, renewable energy evacuation infrastructure, and data centre power demand – Hitachi Energy India's Q3 order book grew 73.7% year-on-year (excluding base effect), with data centres and renewables as dominant contributors. Cables and wires emerged as another bright spot, driven by construction activity and elevated copper prices driving revenue uplift. However, the long-awaited revival in private sector capex remained subdued, with most EPC companies flagging ongoing caution from discretionary industrial spenders amid elevated global uncertainty and below-target capacity utilisation across metals and cement.

Outlook:

The medium-term outlook for capital goods is selectively positive and policy-anchored. Central government capex, while having moderated to 11% YoY growth in FY25, is expected to maintain a constructive trajectory in FY27, with the Union Budget allocating enhanced infrastructure spend. Defence capex is budgeted at approximately 25–30% of the defence allocation, with potential for 8–9% growth, creating multi-year order visibility for defence-linked manufacturers. The energy transition super-cycle – encompassing solar and wind capacity addition, grid modernisation, battery storage, and green hydrogen infrastructure – is expected to sustain elevated T&D and equipment demand well into the decade. Data centres are an emerging high-value demand vertical for transformers and switchgear. Private capex recovery, when it materialises, is likely to lead with electronics manufacturing, EV supply chains, and renewable energy equipment rather than traditional metals or chemicals. Analysts note that if consumption strengthens in H2 FY26, private capex could pick up meaningfully in H2 FY27. Raw material cost pressures – particularly copper, aluminium, and zinc – remain a near-term margin monitorable for the sector.

Infrastructure (EPC & Construction)

Q3 FY26 Performance:

The broader infrastructure sector faced meaningful headwinds in Q3 FY26, with the aggregate top-line of the top-14 listed infrastructure companies contracting approximately 4% year-on-year. The weakness was attributed to a convergence of adverse factors – an eroding executable order book stemming from prior period order intake gaps, payment delays from government agencies, the extended lingering of monsoon conditions into October, and construction bans imposed in the National Capital Region (NCR) related to pollution control measures. Road EPC companies were among the hardest hit, with their top line declining approximately 7% year-on-year. Railway wagon manufacturers also faced sharp pressure, reporting a 16% revenue decline year-on-year and 3% sequentially due to the resurfacing of wheelset availability constraints. Average EBITDA margins contracted approximately 40 basis points year-on-year to 10.1%, while adjusted PAT margins fell to approximately 5.2%. Most EPC companies have consequently revised their FY26 revenue and margin guidance downward, reflecting ongoing execution challenges. Building construction companies and NBCC provided partial offsets, maintaining relatively healthier execution momentum supported by urban development projects and housing schemes. Order inflow quality, however, showed improvement towards the end of the quarter, providing some optimism for H2 FY26 execution.

Outlook:

Despite the weak Q3 print, the medium-term structural case for Indian infrastructure remains intact and is underpinned by significant policy tailwinds. The Union Budget for FY27 has promised a 12% increase in total infrastructure capital expenditure over FY26 revised estimates and a 10% increase over budgeted estimates, with elevated allocations for roads, railways, and urban infrastructure. India's National Highway network expanded to 1,46,342 km in FY25, with greenfield corridors and expressway projects continuing to attract investments. The PM Awas Yojana targets 2 crore additional housing units, supporting sustained building construction demand. While we maintain a cautious near-term stance due to persistent execution challenges, the risk-reward is increasingly favourable as order inflows normalise, payment cycles improve with government budget disbursements, and construction ban periods conclude. Analysts expect Q4 FY26 to mark a meaningful recovery quarter, with a stronger demand uptick expected in FY27. Players with diversified exposure across buildings, roads, metro, and T&D are better positioned, while companies with concentrated road EPC exposure face a longer recovery path. Working capital management and receivable collection efficiency remain critical performance differentiators.



Power & Renewable Energy

Q3 FY26 Performance:

India's power and renewable energy sector delivered an exceptional Q3 FY26, marked by record-breaking capacity additions and robust operational performance across the value chain. According to the Ministry of New and Renewable Energy, India added 52,537 MW of total generation capacity in the April 2025 to January 2026 period – the highest-ever capacity addition in a single year – of which 75% or 39,657 MW was from renewable sources (34,955 MW solar, 4,613 MW wind). Total installed capacity reached 520 GW as of January 2026, comprising 263 GW from renewables and 248 GW from fossil fuel sources – marking a landmark milestone where non-fossil fuel capacity has surpassed conventional generation. India achieved another historic milestone in June 2025 when renewables met 51.5% of the country's 203 GW electricity demand. At the company level, Tata Power reported strong Q3 execution, including a record 1.3 GW of renewable project execution, a 372 MWp rooftop solar capacity addition (up 242% YoY), and expansion of its distribution customer base to over 13 million. Hitachi Energy India reported a 73.7% YoY increase in Q3 orders (ex-base effect), with data centres and renewable energy as dominant demand drivers. Power deficit has been virtually eliminated – the energy gap declined from 0.5% in FY23 to near-zero in FY26.

Outlook:

The structural growth trajectory for India's power and renewables sector is among the most compelling in the economy. India is firmly on track to achieve 500 GW of non-fossil fuel capacity by 2030, having already crossed the 50% non-fossil milestone ahead of schedule. Solar module prices remain near historic lows at 8–9 US cents per watt, making new project economics highly attractive. The FY27 Union Budget's increased allocations for grid modernisation and transmission infrastructure, combined with SECI's and NTPC's robust tendering pipelines, support continued execution momentum. The T&D sector is entering a multi-year upcycle as renewable energy evacuation corridors, pump storage projects, and smart metering infrastructure require significant capital deployment – Power Grid's capex opportunity is estimated at ₹2,00,000 crore over the coming decade, per Motilal Oswal. Green hydrogen is emerging as a credible adjacent opportunity, with L&T Energy GreenTech announcing India's largest green hydrogen plant at IOCL Panipat. Motilal Oswal estimates the overall power sector investment opportunity at ₹40,00,000 crore over the next decade. Peak demand is projected to reach 277 GW in FY26 with energy demand growing at 6–6.5% annually over the next five years, suggesting that supply expansion will need to continue at pace to maintain the near-zero deficit achieved in FY26.

Fast Moving Consumer Goods (FMCG)

Q3 FY26 Performance:

The FMCG sector delivered a healthy Q3 FY26 performance, with broader sector revenue growth of approximately 9% year-on-year supported by volume expansion of around 6%, according to market data cited in sector analyses. Rural demand remained the primary growth engine – rural volumes expanded 7.7% in Q3, sustaining the seventh consecutive quarter of rural outperformance over urban markets. Urban volumes grew at a more modest 4.6%, reflecting the gradual normalisation of consumption patterns following a period of food inflation-induced urban demand suppression. Premiumisation remained the dominant structural theme, with branded and higher-value offerings – especially in personal care, packaged foods, and home care – growing faster than mass-market counterparts. The quarter witnessed some disruption in the first half due to GST 2.0 implementation, causing temporary trade destocking and re-labelling adjustments; by November, channel inventory had normalised. Operating profitability remained broadly stable at around 20–21%, supported by improving palm oil prices (down ~12.6% YoY) and partial pass-through of food commodity cost increases. E-commerce's share in metro FMCG sales continued to expand, crossing the modern trade share in Delhi-NCR and Kolkata, while quick commerce is increasingly becoming a critical urban distribution channel.

Outlook:

FMCG sector revenue is projected to grow 6–8% in FY26, per Crisil Ratings' analysis of 82 FMCG companies, reflecting a 100–200 basis point rebound from FY25 levels. The revival is expected to be driven by a combination of volume recovery and modest realisation improvement as FMCG companies partially pass on input cost inflation in categories such as tea, coffee, edible oils, and personal care. Rural India's structural consumption upgrade is a multi-year theme – average rural basket sizes have grown from 5.8 items in 2022 to 9.3 items in 2024, and rural's share in affordable premium consumption has surpassed 51%, per NielsenIQ. GST rate rationalisation and Union Budget tax relief are expected to provide an incremental consumption boost in urban markets through FY26-end. Quick commerce, now commanding 15% of metro FMCG sales and growing rapidly, is reshaping distribution economics and creating cost pressures for traditional trade, even as companies adapt their go-to-market strategies. Looking ahead, input cost volatility – particularly in palm oil, coffee, and wheat – alongside intensifying competition from regional and D2C brands, will constrain margin expansion. Companies with strong rural distribution networks, diversified category presence, and digital-first innovation pipelines are best placed for sustained growth through FY27.



Cement & Building Materials

Q3 FY26 Performance:

The Indian cement sector presented a mixed but ultimately resilient Q3 FY26. Industry demand grew approximately 7–8% year-on-year, supported by infrastructure and housing projects which together account for over 85% of consumption. However, the quarter was characterised by pricing pressure – non-trade cement prices corrected by ₹15/bag and trade prices by ₹5–7/bag, driven by large players aggressively ramping up newly acquired capacity and pushing volumes, alongside weak demand conditions in October amid extended rains and festival-related construction pauses. Demand firmed up meaningfully in December with a recovery in infrastructure project activity. Despite lower realisations, average NSR declined approximately 3% quarter-on-quarter – EBITDA per tonne increased 9% year-on-year to ₹869, supported by savings in power, fuel, and logistics costs. Aggregate operating profit for the top coverage universe (representing 75% of industry capacity) grew 26% year-on-year. The sector's cost efficiency drive – encompassing alternative fuel adoption, lead distance optimisation, and green energy sourcing, is increasingly evident in the operating leverage profile. Capacity expansion by major players remains on track, with UltraTech expecting to add 8–9 million tonnes in Q4 FY26 and 12 million tonnes in FY27, integrating the Kesoram and India Cements acquisitions ahead of schedule.

Outlook:

The near-term outlook for the cement sector has been revised modestly lower given Q3 pricing disappointments, but the medium-term trajectory remains positive and is aligned with India's infrastructure investment cycle. Cement prices recovered by ₹10–20 per bag in January 2026 across regions, supporting an anticipated improvement in Q4 FY26 earnings. Analysts forecasts healthy demand in FY27, aided by a 12% increase in total infrastructure capex in the FY27 Union Budget. Crisil's coverage universe expects average unit EBITDA to expand approximately ₹170/MT in FY26 and ₹120/MT in FY27, with realisation stability improving as consolidation reduces fragmented price competition. Industry volumes for FY26 are expected to settle at approximately 5–7% growth. However, rising petcoke prices, driven by global energy commodity inflation and rupee depreciation, represent a near-term cost headwind that may pressure power and fuel costs in Q1 FY27. The sector's longer-term capacity expansion of 80–85 million tonnes planned through FY31 will require sustained demand growth to prevent margin dilution. Green building materials and blended cement are emerging as high-growth adjacent categories, aligned with the government's sustainability mandates.

Metals & Mining (Steel)

Q3 FY26 Performance:

The domestic steel sector delivered a resilient volume performance in Q3 FY26, even as price realisation remained under pressure. Aggregate steel volumes for the coverage universe grew approximately 12% year-on-year, with Tata Steel's domestic volumes up 14%, SAIL up 18% (aided by NMDC Steel traded sales), and JSW Steel delivering 12% growth. Crucially, Q3 FY26 marked India's transition to a net steel exporter, a structural shift from being a net importer through FY24 and H1 FY26, aided by the government's 12% safeguard duty on flat steel imports which curtailed Chinese inflows. However, domestic HRC prices corrected 4.5% quarter-on-quarter and 1% year-on-year, while rebar prices declined a further 1.6% QoQ after a 13% QoQ fall in Q2. Margins were further compressed by higher coking coal costs, rising approximately \$3–5 per tonne quarter-on-quarter. EBITDA for the coverage universe is estimated to decline approximately 6% sequentially on a per-tonne basis despite strong volume growth. The quarter thus exhibited the classic volume-margin trade-off for the sector. Positively, steel prices began recovering in December 2025, with HRC up ₹2,200/MT and rebar up ₹2,700/MT in the month, and prices are tracking approximately 10–14% above Q3 averages in mid-January 2026.

Outlook:

The medium-term outlook for Indian steel is constructive, supported by a combination of strong domestic demand fundamentals, policy protection, and the ongoing price recovery. Analysts projects domestic steel demand to grow approximately 8% in FY26, normalising to a sustained 6–7% growth trajectory thereafter, driven by infrastructure, automotive, and capital goods end-markets. The 12% safeguard duty, effective in curtailing Chinese import aggression, has restored India's net exporter status and provides a meaningful floor for domestic pricing. With HRC prices already tracking well above Q3 averages as of January 2026, and rebar following a similar recovery path, the outlook for Q4 FY26 profitability is meaningfully better than Q3. We maintain a constructive stance on Indian metals, citing supportive global macro factors and potential for valuation re-rating as institutional ownership is currently under-represented. Risks include: potential rollback of safeguard duties post the sunset period, the ambitious 80–85 million tonne capacity expansion plan over FY26–FY31 which could pressure margins if demand growth undershoots, and Chinese steel export volumes (88 million tonnes in the first 9 months of CY25) which continue to exert structural downward pressure on global prices. Green steel is a long-horizon growth opportunity, with ICRA projecting its share to grow from ~2% in FY30 to ~40% of India's steel demand by FY2050.



Real Estate

Q3 FY26 Performance:

India's residential real estate sector maintained its multi-year upcycle momentum in Q3 FY26, even as overall unit sales volumes showed signs of moderating from the exceptional FY24 peak. The premium and luxury segments continued to outperform, with high-ticket homes (₹1 crore+) recording 6% year-on-year growth in unit sales despite an 11% overall market volume decline, per JLL's Residential Dynamics Report Q4 2025. This premiumisation reflects sustained demand from high-income urban households, NRI buyers, and a growing cohort of upgrade-seeking middle-income consumers. Pre-sales for listed developers remained strong, supported by aggressive new launches in Bengaluru, Mumbai Metropolitan Region, NCR, and Hyderabad. Office space leasing continued its strong momentum – gross Grade A leasing in India surpassed 62.98 million sq ft for the year, a 26.4% increase, with GCC leasing growing 24% YoY to 31.8 million sq ft, representing 42% of total office absorption. Institutional investment in real estate reached record levels: Q3 2025 recorded a historic 42 transactions worth ₹25,375 crore, the highest quarterly deal value on record. Average home prices, having risen 13–15% in FY25, are expected to climb an additional 3–5% in FY26, indicating sustained pricing power among developers with quality land banks.

Outlook:

The FY27 outlook for Indian real estate is one of moderated but sustainable growth, transitioning from the rapid demand-led expansion phase toward a more execution-driven consolidation. Crisil and Grant Thornton project the sector to maintain a stable demand environment anchored by urbanisation, income growth, and improving affordability enabled by mortgage rate reductions – seven banks have already cut home loan rates following RBI's repo rate cuts. The National Real Estate Policy 2025's unified single-window clearance system is expected to reduce project approval timelines by up to 40%, improving execution velocity for larger developers. The commercial real estate segment will remain a high-conviction growth area, with India on track to become the world's fourth-largest office market by late 2025 and GCC expansion continuing to drive Grade A leasing demand. REITs and the emergence of SM-REITs are expected to further institutionalise the sector and improve capital efficiency. Blackstone's planned additional investment of ₹1.7 lakh crore in Indian real estate by 2030 underscores the depth of global institutional confidence. Key near-term risks include supply overhang in certain luxury micro-markets, approval delays that can disrupt launch timelines, and affordability fatigue in the mid-income segment should price appreciation continue to outpace income growth. Overall, the sector is well-positioned for 10–15% value growth in residential presales for leading listed developers through FY27.

Consumer Durables & Electronics

Q3 FY26 Performance:

Q3 FY26 was a strong quarter for the consumer durables and electronics sector, driven by the festive season tailwind, new product launches, and a surge in electronics manufacturing under PLI schemes. Revenue growth across the consumer electricals and electronics category is estimated at mid-teens year-on-year, with cables and wires, air conditioners, and consumer electronics leading the charge. The cables and wires segment emerged as a standout performer, driven by construction sector demand, electrification infrastructure, and elevated copper prices driving average selling price uplift. The electronics manufacturing segment, particularly EMS players, delivered exceptional growth, underpinned by PLI scheme benefits and import substitution momentum in mobile devices and IT hardware. The room air conditioner category witnessed moderate sequential recovery in Q3 after the seasonally weak Q2, with premium models gaining share. Home appliances demand was supported by the wedding season and rural recovery, though the mass-market urban segment remained somewhat subdued. Consumer confidence metrics improved quarter-on-quarter, aided by income tax relief and moderation in food price inflation. Input cost dynamics were mixed – rising copper and aluminium prices created headwinds on raw material costs, which companies partially managed through operating leverage benefits and selective price increases.

Outlook:

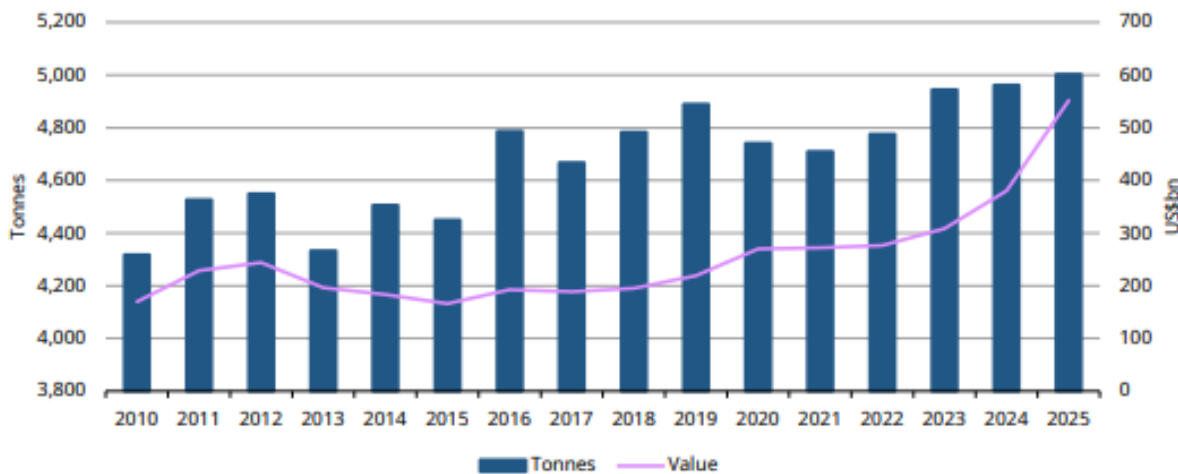
The consumer durables and electronics sector is expected to sustain its growth momentum through FY27, driven by structural demand drivers including India's large replacement cycle opportunity, rising household income, and the accelerating electrification of the economy. The PLI scheme for IT Hardware, electronics components, and white goods is expected to drive further domestic manufacturing capacity creation, reducing import dependency and improving cost competitiveness. EMS companies are poised to benefit from the global supply chain reconfiguration away from China, with India increasingly positioned as a manufacturing and export hub for consumer electronics. Air conditioning penetration in India remains low at sub-10% of households, offering a multi-decade runway for growth even as the annual replacement cycle accelerates. Premium and super-premium categories – smart home devices, energy-efficient appliances, and connected electronics, are growing significantly faster than the overall market, driven by India's expanding aspirational middle class. Quick commerce is reshaping demand patterns for select small appliance categories. Risks include commodity price volatility, INR depreciation pressures on import-dependent inputs, and the intensifying presence of Chinese brands at competitive price points in some segments.

Glittering Gold in India

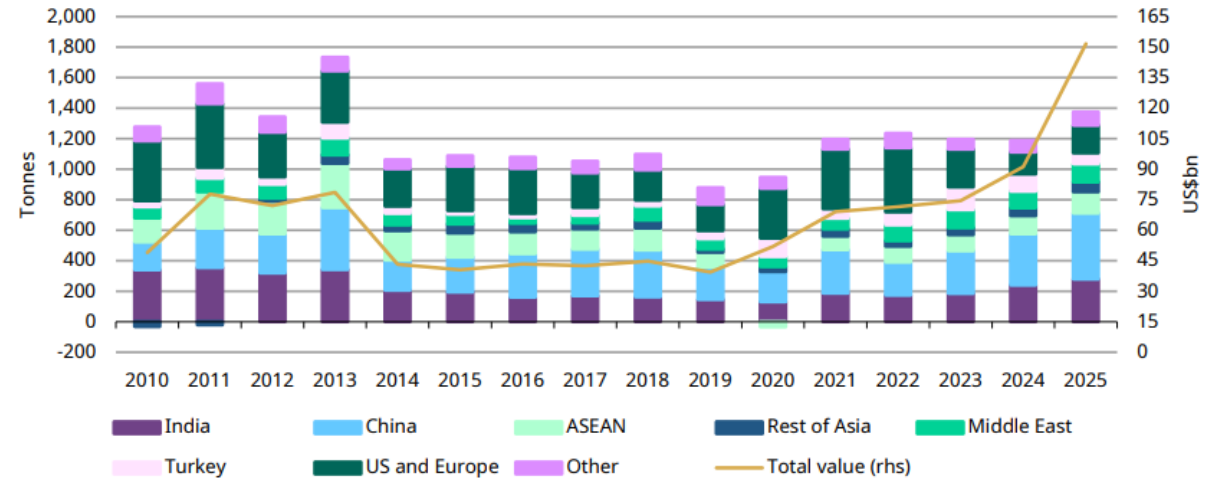
Gold’s 2025 run was not a “normal commodity rally” for India, it looked more like a macro-led repricing of the reserve asset. Globally, total gold demand (including OTC) crossed 5,000 tonnes for the first time, and the value of demand jumped to US\$555bn (+45% YoY) as the market logged 53 new all-time highs through the year. The price move was extraordinary: the LBMA (PM) gold price averaged US\$3,431/oz in 2025 (+44% YoY) and Q4 averaged US\$4,135/oz (+55% YoY). For an Indian investor, this matters because domestic gold behaviour is less about “buy/sell” and more about re-allocating within gold when prices surge - jewellery, coins/bars, and financial products respond very differently.

In India, the headline was a classic volume–value divergence in jewellery. Wedding/festival buying supported sequential momentum, but year-on-year volumes fell because affordability got hit by the record price environment. Yet value demand didn’t weaken - Q4 jewellery spend hit a record US\$19bn and full-year jewellery spend reached US\$49bn (record). The mechanism is simple and easy to see in real life: **most households operate with fixed budgets, so when gold prices rise sharply, they buy fewer grams, not “no gold.” Demand was pulled forward in October when prices dipped, then moderated as prices resumed their climb - exactly the sort of “buy-on-dips” behaviour that becomes visible in high-volatility gold years.**

Annual gold demand in tonnes and US\$bn*



Annual bar and coin demand by region, tonnes and US\$ value*





The more important structural shift for India in 2025 was financialisation and “pure investment” demand. Globally, bar-and-coin investment hit a 12-year high, and we can note that more than half of the record annual bar-and-coin value (US\$154bn) came from India and China combined. India-specific commentary reinforces that investment intensity was unusually strong, with two consecutive quarters of >90 tonnes for the first time since 2013, and record investment value of US\$32bn. In plain terms: when prices are ripping and uncertainty is high, Indian buyers prefer formats with lower “leakage” (making charges) and higher liquidity – bars, coins, and financial wrappers, because the intent is capital preservation and optionality, not consumption.

This is also why ETFs and digital gold started to matter more in the India story. A report of World Gold Council highlights a “phenomenal rise” in ETF buying, new product listings, and even notes digital gold transaction values rising sharply – signs that the buyer base is widening beyond traditional jewellery-driven households. A meaningful policy kicker is that India’s pensions regulator has permitted National Pension Systems funds to invest in gold and silver ETFs, which can steadily expand institutional participation over time. This matters because it changes the marginal buyer: institutional and systematic flows tend to be “stickier” than event-based retail buying, and can support prices even when jewellery volumes are constrained.

Another India-specific stabiliser is the monetisation channel, which reduces the need for outright selling even at record prices. We note that jewellery exchange remains strong, and that the growing practice of pledging gold as collateral has kept scrap supply relatively muted; by end-November, retail loans backed by gold jewellery with Indian banks stood at INR 3.6tn (US\$40bn), up 125% y/y. This is a key behavioural insight: in India, households often prefer to borrow against gold rather than liquidate it, which dampens recycling response and supports “hold gold” behaviour. Consistent with that, emerging markets such as India saw weaker recycling volumes even as global prices rose. In portfolio terms, this creates a feedback loop – gold remains both an asset and a liquidity backstop.

Looking ahead, the base case stays supportive for investment demand, while jewellery tonnage remains capped if prices stay elevated. WGC outlook explicitly expects another year of strong gold ETF inflows and robust bar-and-coin demand, while jewellery demand remains weak in a persistently high-price environment. For India, that translates into a market where the “why” of owning gold becomes more important than the “how”: if uncertainty persists, investment formats and ETFs should keep gaining share; if prices consolidate, jewellery grams can recover but likely with continued preference for organised retail and exchange-driven purchases.

The key watchpoints for India are (1) the path of global rates and risk sentiment (2) Central bank gold buying programs as part of their reserve currencies (3) the pace of ETF/digital adoption, and (4) whether gold loans/monetisation keep reducing the incentive to scrap-sell (5) Geopolitical uncertainty – because these four determine whether gold behaves like a tactical trade or a structural allocation in Indian portfolios.

Tailwinds

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

Headwinds

- **Limited exposure to AI-led growth themes** – Compared with other emerging markets, India has relatively fewer scalable, listed AI-centric platforms. This has reduced India's appeal within global AI-driven capital allocation, keeping incremental foreign portfolio flows directed toward markets with clearer AI monetisation stories.
- **INR depreciation amid persistent foreign outflows** – Continued FPI outflows, alongside periodic private equity exits have exerted pressure on the INR versus the USD. Currency weakness dampens USD-denominated returns for foreign investors, acting as a further deterrent to fresh equity inflows.
- **Geopolitical shock from the US-Israel-Iran war and Hormuz disruption** – The ongoing Operation Epic Fury, now in its second week, has effectively shut the Strait of Hormuz – the conduit for ~20% of global oil supply and over 60% of India's crude imports. Brent has surged from 66–67/bbl in January–February to \$82–84, with analysts warning of \$100+ if disruptions persist beyond weeks. For an economy that imports 85%+ of its crude and sources more than half its LNG from Brent-indexed Gulf contracts, this is a dual physical and financial shock – widening the CAD, stoking imported inflation, compressing OMC margins, and pressuring the rupee to record lows near ₹92. The conflict has already triggered a ~7% correction in the Nifty from recent peaks, accelerated FPI outflows, and pushed the 10Y G-Sec yield higher to ~6.68% as markets reprice the inflation and external balance trajectory. A prolonged conflict would materially constrain the RBI's room to resume easing and risk derailing the nascent private capex recovery.

Outlook

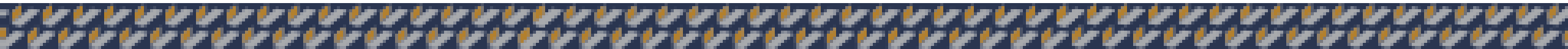
- **Volatility to persist due to the current geopolitics, however with an Upward Bias in the medium term due to strong Macros**

Suggested Strategy

➤ Neutral Equity

Category	Stance
Large Cap	Neutral
Mid Cap	Neutral
Small Cap	Neutral

➤ Neutral Gold





Debt Outlook

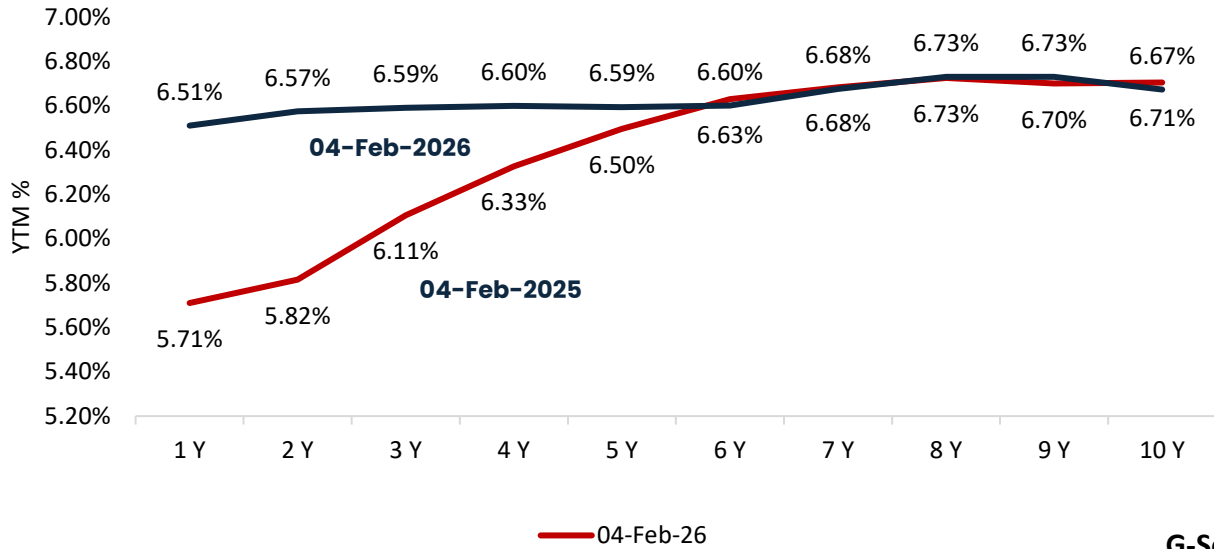




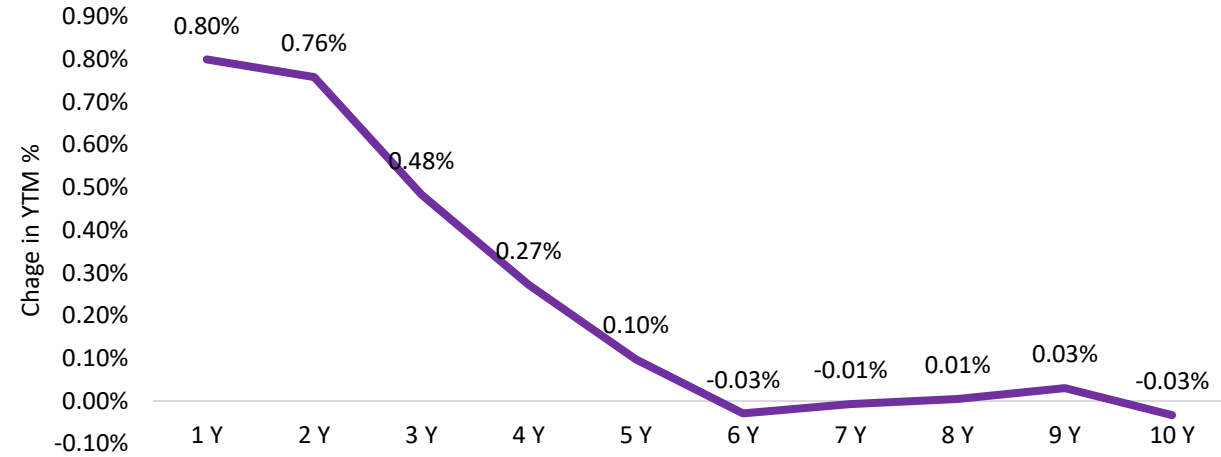
Yields Curve Dynamics



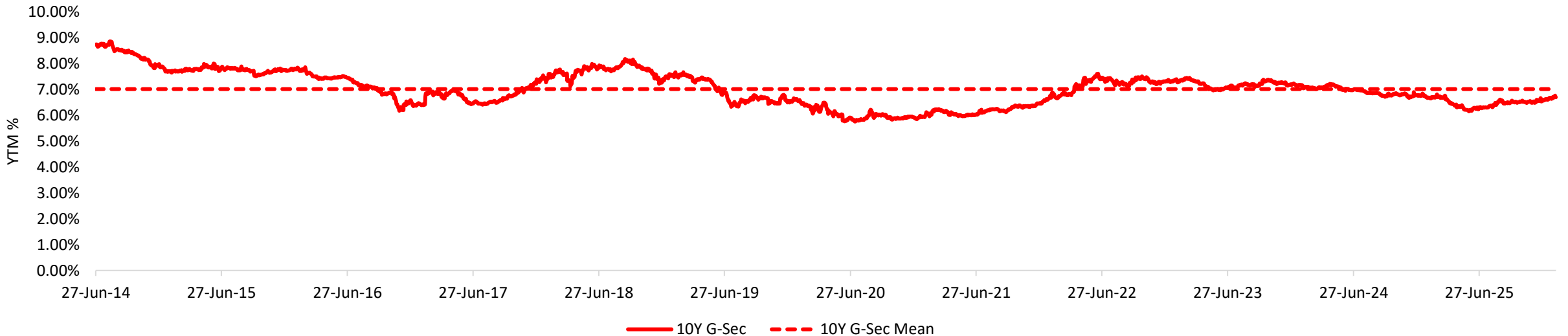
Change in Yield Curve



10Y GSec 1Y Delta



G-Sec YTM





Debt Market Outlook & Strategy

Steady as it Goes: RBI Holds Course Amid Liquidity Surplus

RBI Liquidity Actions and Guidance

The RBI's latest policy review **kept the repo rate at 5.25% with a neutral stance**, as expected. Despite substantial liquidity infusions since December (leading to a comfortable surplus), many market participants still hoped for fresh liquidity measures. Those hopes were largely unmet - no new actions were announced, though **the Governor strengthened guidance by emphasizing a proactive approach**: "Liquidity management would be pre-emptive with sufficient allowance for unanticipated fluctuations in government balances, changes in currency in circulation, forex intervention, etc.". In short, the RBI signaled it will actively manage liquidity, but without committing to new tools beyond what's already underway.

Over-Delivering Versus Expectations

To tell you the truth, we have been surprised by the market's persistent expectations of more from the RBI. The **central bank has arguably over-delivered on liquidity support since December**. Consider the measures from 1 Dec 2025 to 5 Feb 2026: roughly ₹4.00 trillion via open-market bond purchases (OMOs), ₹2.30 trillion through USD/INR buy-sell swaps, and ₹1.37 trillion via 90-day variable-rate repos (VRRs). These sum to **about ₹7.65 trillion of liquidity operations in just a few months**. (Notably, we exclude the 90-day VRR repos from "core" liquidity since they are temporary.) **Despite this massive infusion, bond yields remain elevated - underscoring that the RBI has already done a lot, even if the market expected everything and more.**

Core Liquidity: Changes and Drivers

Thanks to RBI's actions, core system liquidity (excluding transient factors) is on solid footing. Our estimates put **core liquidity surplus at around ₹3.44 lakh crore as of mid-January 2026. By end-March 2026, this surplus could swell to roughly ₹5.0 lakh crore**, given the RBI's scheduled OMOs (~₹1.50 lakh cr) and FX swaps (~₹0.91 lakh cr) injections. These add durable liquidity, offsetting outflows from rising cash in circulation (~₹1.60 lakh cr) and banks' higher cash reserve requirements (~₹0.15 lakh cr) due to deposit growth. In other words, with RBI's interventions, core liquidity by FY26-end would be far higher than the scenario without such support (~₹4.10 lakh cr). The **banking system's liquidity base is comfortable now and set to improve further**, barring unforeseen swings.

Debating Market Expectations - Three Themes

Investors and traders had coalesced around three main expectations from the RBI. Below we discuss each, along with our perspective:

1. **OMOs to Cap Bond Yields**: Some argue that **stubbornly high bond yields (despite rate cuts) warrant more OMOs to force yields down. We respectfully disagree with this notion**. For one, the RBI's OMOs so far have been aimed at liquidity injection, yet they have still **amounted to almost 75% of net government bond issuance since Jan 2025 - making RBI the largest buyer. This scale of intervention is not sustainable long-term. If yields remain elevated even after such support, it suggests other factors (e.g. global yield trends) are at play**. Moreover, pushing OMOs beyond core liquidity needs could slip into de-facto debt monetization. India, with twin deficits and a non-reserve currency, cannot indulge in endless bond-buying except in extreme crises. Finally, **the fact that credit growth is now relatively robust implies that the "price of money" (interest rates) isn't choking off borrowing or economic activity. Yields eventually will need to find a market-clearing level without constant RBI bidding.**



1. **Further Liquidity Infusion (Headline Liquidity):** Another expectation was for more proactive liquidity infusion to keep the headline banking liquidity in surplus at all times. The concern stems from fluctuations in government cash balances that cause swings in daily liquidity, plus banks needing a buffer (some funds parked at SDF window) especially with longer operating hours. We find merit in this argument. The RBI appears to acknowledge it as well – evidenced by the stepped-up operations since December and the Governor’s emphatic assurance of sufficient liquidity going forward. **Essentially, the RBI is already doing more to smooth out liquidity volatility, and it stands ready to pre-emptively inject funds as needed to maintain comfort.**
2. **Easing Banks’ Resource Pressures:** A third expectation was direct relief for banks facing high credit-to-deposit ratios (i.e. loan growth outpacing deposits). Ideas floated included early implementation of looser LCR (Liquidity Coverage Ratio) rules or a temporary CRR cut/CRR exclusion from LCR to free up resources. The policy **did not deliver on these** – no such reliefs were announced. The RBI’s stance seems to be that seasonal year-end funding pressures are normal and can be managed through existing liquidity tools, while banks adjust their own funding mix. We have no strong view in this debate, except to observe that money-market rates will likely stay somewhat elevated until the fiscal year-end “busy season” passes in March. In absence of special measures, **banks may continue bidding up deposit and money-market rates to meet credit demand in the short term.**

Global Backdrop and Evolving Macro Outlook

- External and domestic macro conditions have shifted subtly since the December policy. **Globally, growth prospects look a touch better.** U.S. economic data surprises have tilted to the positive side (barring some softer employment readings), and industrial metal prices have been firming (despite a recent pullback). **The RBI now notes that global growth in 2026 could be marginally stronger than previously projected, which feeds into India’s outlook.**
- Domestically, **India’s growth-inflation mix remains favorable.** Economic activity has been resilient, with **high-frequency indicators in early 2026 showing solid momentum.** The **RBI even revised up its GDP growth forecasts** for early FY27 – for example, Q1 FY27 growth was raised from **6.7% to 6.9%**, and Q2 from **6.8% to 7.0%**. On inflation, the picture is still benign. Underlying **core inflation is expected to stay range-bound this year**, with recent CPI upticks driven largely by a smaller decline in food prices and a spike in precious metals prices. The RBI did make a slight upward tweak to its inflation outlook compared to December: FY26 CPI is now seen around **2.1% (vs 2.0% earlier)** and Q1 FY27 at **4.0% (vs 3.9% earlier)**. These are tiny changes – essentially, **inflation is projected to hover near the target band even into 2026-27.** In sum, the RBI’s February review reinforced that growth is a bit stronger and inflation a tad higher than thought in December, but **overall macro stability persists.**

Portfolio Strategy and Positioning

With the RBI **on hold and liquidity ample**, we are positioning our fixed income portfolios **defensively yet opportunistically.** We believe **we are at (or very near) the bottom of this rate cycle, and that market yields will increasingly take cues from global trends and the heavy bond supply coming in FY27. Given a somewhat tougher global narrative and the potential for higher bond-market volatility ahead, we have become more value-sensitive and cautious. This means preferring segments of the bond market that offer better yield value and keeping flexibility to adjust as conditions evolve. Notably, front-end rates have risen appreciably, making short-term instruments attractive. In contrast, long-term government bonds have already been propped up by RBI buying and look less compelling at current yields.**



Portfolio Stance –

- **Underweight Duration:** We are running shorter maturity profiles (underweight long-duration bonds) given limited room for further rate declines and the likelihood of yields eventually drifting up.
- **Prefer Short-Term Credit:** We favor **bank CDs and front-end corporate bonds (up to 3-year tenor)**, which currently offer relatively high yields and good risk-reward. These should perform well once the March-quarter funding squeeze abates and liquidity pressures ease.
- **Maintain Liquidity Buffers:** We keep extra cash or **quasi-cash on hand for flexibility**. This **dry powder lets us deploy into opportunities if yields jump to more enticing levels**.
- **Outlook – “Long Pause”:** We anticipate an **extended pause in RBI policy rates through most of 2026, aligning with the Governor’s guidance that rates will stay low for a long time**. We are monitoring incoming data closely – especially the Q1 FY27 inflation trajectory – for any sign that could trigger a policy rethink. Barring an inflation shock or growth downturn, **the backdrop of stable 4% inflation and improving growth and credit offtake, suggests the repo rate can remain at 5.25% for an extended period**.

The **RBI has reinforced liquidity and confidence, but is also signaling the market must stand on its own feet in determining yields**. Our debt strategy is to navigate this phase by **staying light on duration, leveraging pockets of value in short-term credits, and remaining vigilant to macro shifts (global or domestic)**. This balanced, flexible stance should help us safeguard returns while being ready to seize opportunities as the next chapter in the rate cycle unfolds.



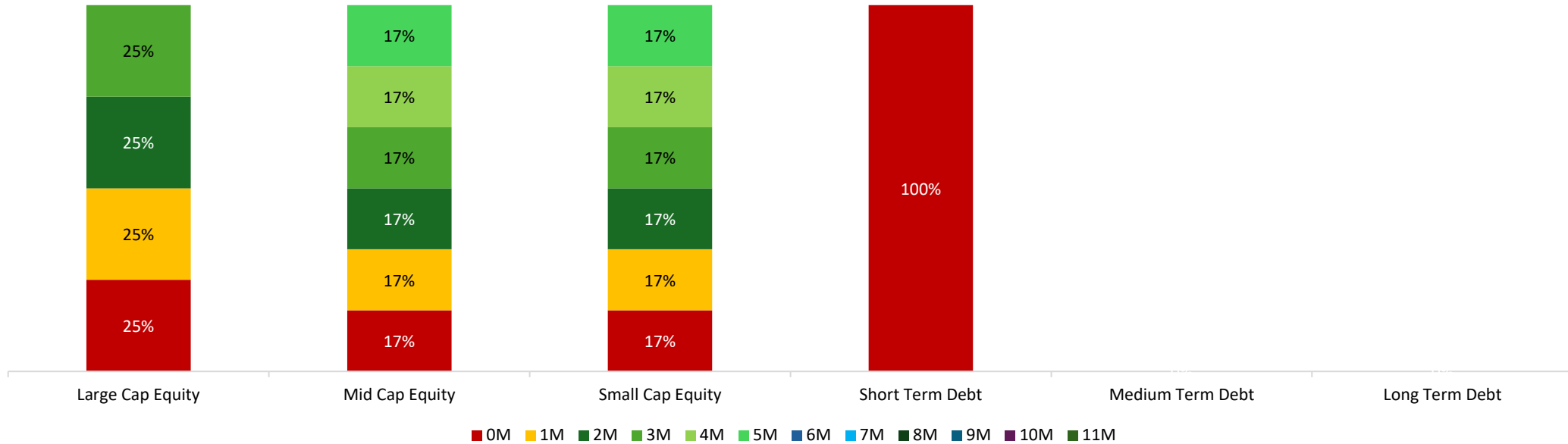
Deployment Strategy



Deployment



Stages of Deployment



Indicators:

Indicators signaling over heated market conditions –

- Market Cap/GDP for Large, Mid, and Small Cap Indices above their LTA's signaling lofty valuations
- FII's been net sellers
- VIX at 21.14 levels

Indicators signaling fair valuation –

- DII's have been net buyers
- Liquidity surplus
- Exports and Imports data are signaling a possible pickup in domestic demand
- Revival of Pvt Capex & Industrial Production & PMI
- TTM PE for all Indices indicate fair valuation

Deployment Strategy:

Staggered Deployment over the next 12 months –

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



Optimus Prime Model Portfolio

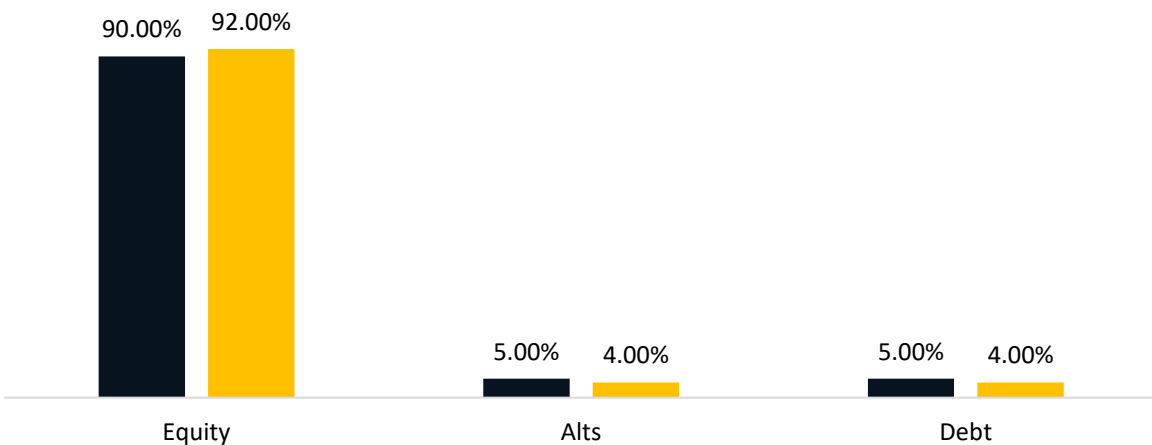
Aggressive Strategy





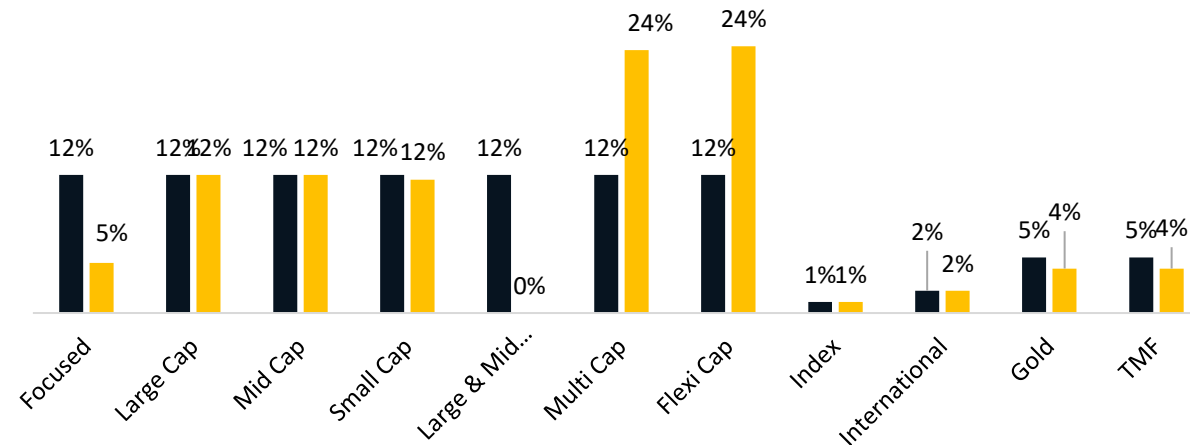
Asset Allocation

■ SAA ■ TAA

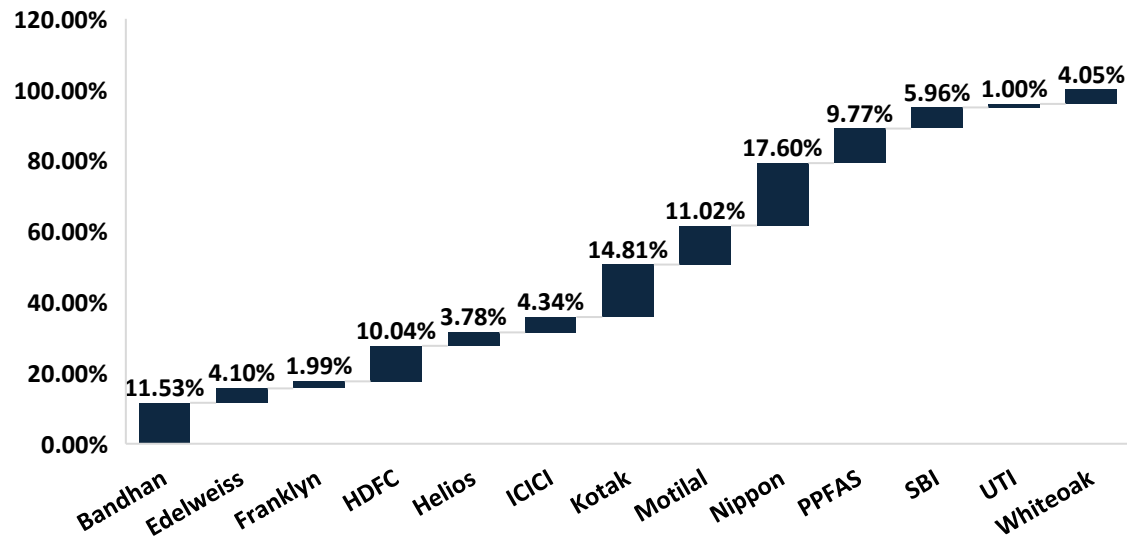


Category Allocation

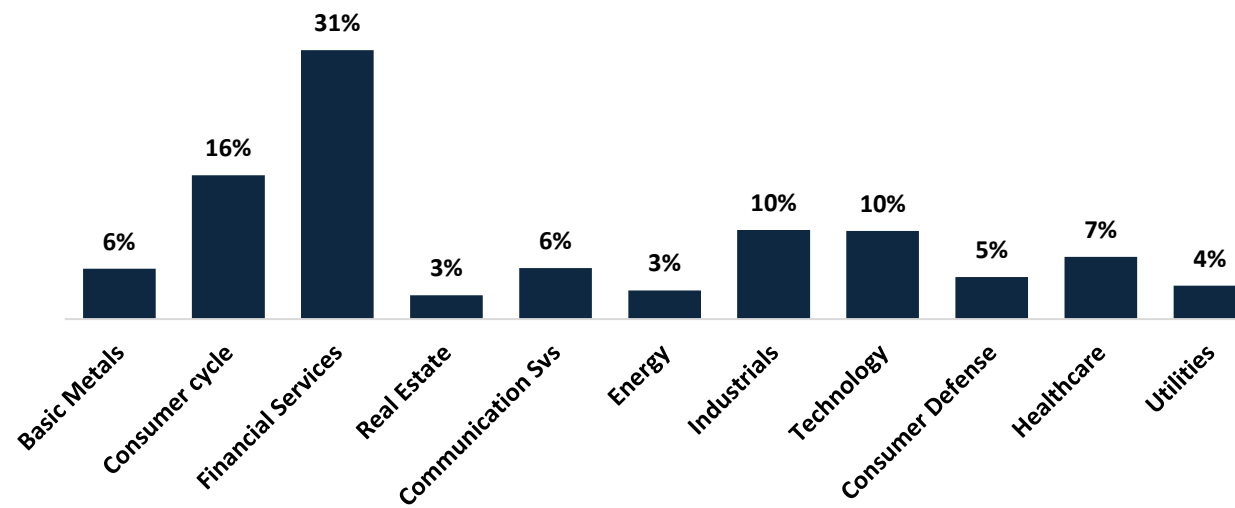
■ SAA ■ TAA



Fund House Allocation



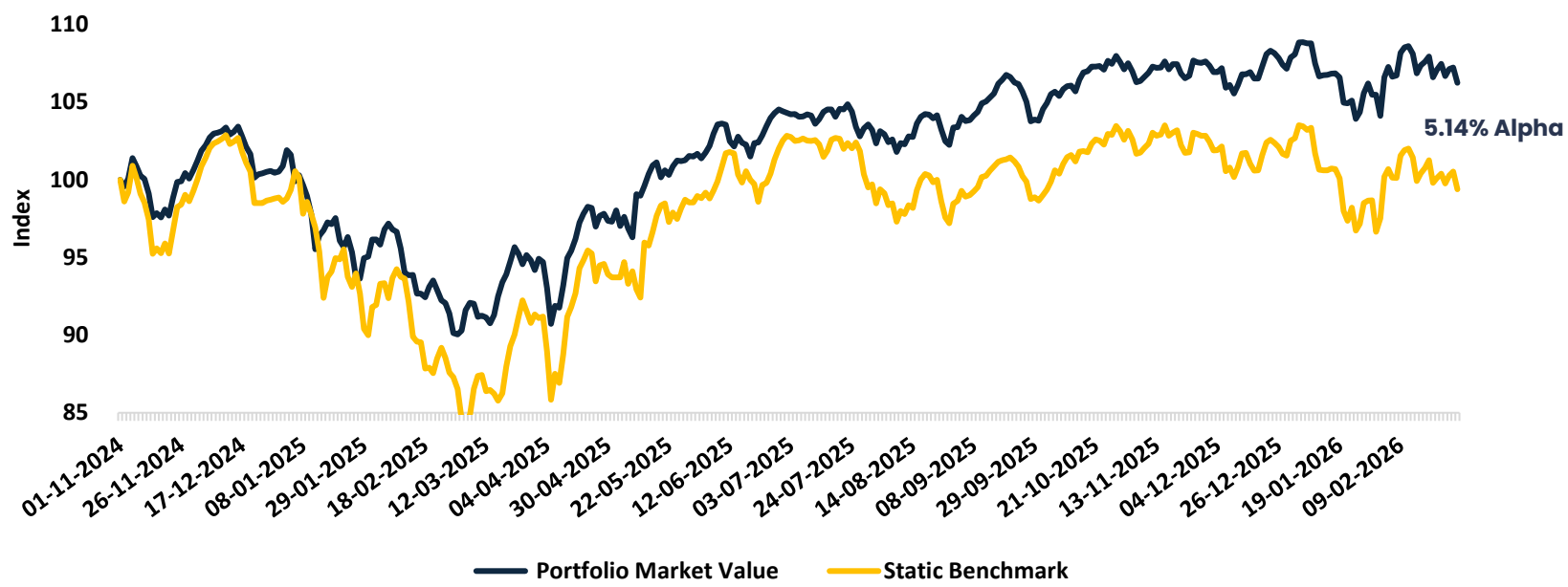
Sectoral Allocation



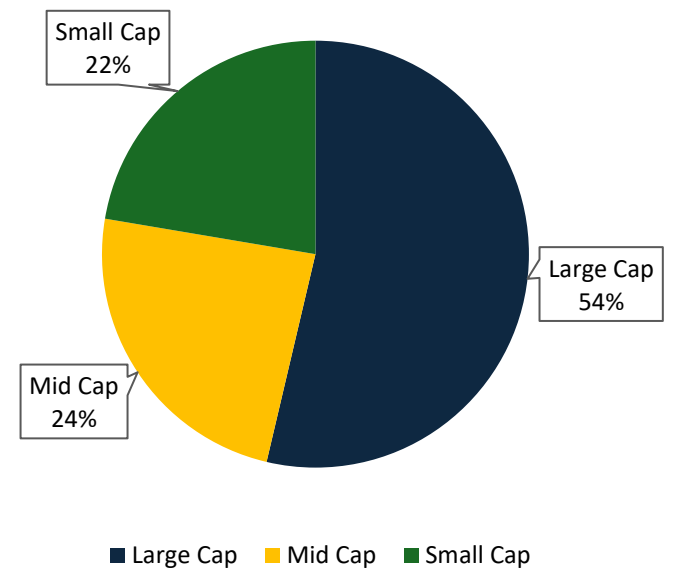
***SAA - Strategic Asset Allocation & TAA - Tactical Asset Allocation.** International Allocation considered as Equity Allocation, Arbitrage Funds & Liquid Funds Allocation, if present are considered as Debt Allocation, and is temporarily parked for the short term and will be deployed opportunistically,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



Portfolio vs Benchmark



Portfolio Market Cap Mix



Portfolio Performance Analytics

Analytics	Portfolio	Benchmark
CAGR Return %	4.68%	0.61%
Standard Deviation (annualized)	10.70%	14.31%
Beta	0.36	
Alpha	5.14%	
Information Ratio	8.22	
Downside Capture	66.87	

Asset Allocation Alpha	Product Selection Alpha	Timing	Total Alpha
0.05%	3.84%	1.25%	5.14%

Debt Portfolio Analytics

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

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

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



Current Investment Portfolio Stance: **Neutral**

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

The strong Neutral stance is grounded in a demonstrably **strengthening domestic macro picture**. **Real GDP growth for FY26 is estimated at 7.4%, with FY27 projected in the 6.8–7.2% range**, anchored by resilient private consumption, a visible **pickup in domestic demand**, and **government capex at ₹12.22 lakh crore (~4.4% of GDP)**. Headline **inflation remains benign at 2.75%** on the new CPI base, well within the MPC's tolerance band. **High-frequency indicators are constructive** – Manufacturing PMI at a four-month high of 56.9, Composite PMI at 58.9, and **IIP growth led by infrastructure and construction goods**. Corporate balance sheets are healthy, leverage remains low, and the Q3 earnings season points to a gradual if uneven **pickup in topline growth**. The **landmark trade agreements** with the US (18% reciprocal tariff accord), the EU, and the UK are expected to catalyse **the early stages of a private capex upcycle**, which should act as an important growth driver over the medium term. **Liquidity remains abundant, fiscal consolidation is on track** with the deficit targeted at 4.3% of GDP, and the external position is manageable – **collectively, the macro setup for FY27 appears conducive for a gradual re-rating in equities**.

However, the committee notes that the **ongoing US-Israel-Iran conflict** – Operation Epic Fury, now in its second week and introduces a material near-term risk that prevents a more decisive shift toward a pro-risk stance. The effective closure of the Strait of Hormuz has disrupted ~20% of global oil supply, with Brent surging from ~67 to \$82–84/bbl in a matter of days. India, which imports over 85% of its crude and sources more than half its LNG from Brent-indexed Gulf contracts, faces the largest combined exposure among major economies. The shock is already visible: the Nifty has corrected ~7% from recent peaks, the rupee has weakened to record lows near ₹92, FPI outflows have accelerated for a third consecutive week, and the 10Y G-Sec yield has edged up to ~6.68% as markets reprice the inflation and external balance trajectory. A prolonged disruption could widen the current account deficit, reignite imported inflation, compress margins across companies, and materially constrain the RBI's room to resume monetary easing.

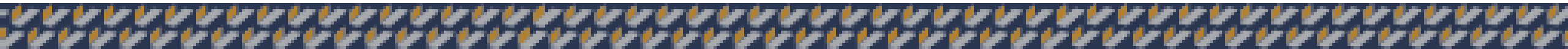
Absent the war, the domestic macro constellation – low inflation, strong PMI/IIP momentum, capex-super cycle, improving trade architecture, and healthy corporate balance sheets – would warrant a more aggressive tilt toward equities. **It is precisely this live and evolving geopolitical risk that underpins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

Despite the prevailing volatility, our current positioning has delivered favorable results. The portfolio generated a strong **Alpha of 5.14%**, driven primarily by **Product Selection Alpha**. Importantly, the portfolio has maintained a **low Beta of 0.36**, and an **Information Ratio of 8.22, highlighting strong risk-adjusted performance**. With a **Downside Capture of approximately 66.87%**, **the portfolio displays effective downside protection** relative to the benchmark in a volatile market.



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

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





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**THANK
YOU**

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