

INDIAN ECONOMY

Crisil Insights

August 2026

Through the monthly Crisil Insights Indian Economy series, we delve into the country's growth dynamics over the past few years, as well as developments in the opening months of this fiscal.

On hold, not an all-clear

Amid the continuing conflict in West Asia and weather-related uncertainties, the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) kept interest rates on hold and maintained its neutral stance.

The MPC's decision comes at a time when the balance between growth and inflation is becoming increasingly delicate. Headline consumer inflation rose to 4.5% in July. That said, core inflation remains relatively benign and does not yet point to a broad-based generalization of price pressures. This gave the RBI room to lower its headline inflation forecast for the current fiscal by 10 basis points to 5.0%.

Inflation risks, however, warrant close monitoring, as reflected in the MPC minutes. With the conflict in West Asia showing no signs of resolution, crude oil prices are likely to remain elevated.

Weather-related risks also persist amid prevailing El Nino conditions. Cumulative rainfall was 13% below the long-period average as of August 18.

Interestingly, the RBI raised its growth forecast for the current fiscal to 6.7% from 6.6%, citing better-than-expected performance across a range of high-frequency indicators.

The theme article examines India's growth dynamics over the past few years, as well as developments in the opening months of the current fiscal.

The exceptional gross domestic product (GDP) growth of 7.7% in the last fiscal was aided by favorable external conditions, including lower oil prices and normal monsoons. In addition, accommodative monetary policy and fiscal support through direct and indirect tax cuts, along with spending via direct benefit transfers, helped underpin growth.

Healthy industrial activity, robust consumption, and sustained government investment were the key drivers of growth in the first quarter of the current fiscal. Particularly noteworthy was the strong performance of the automobile sector. Read on for more details.

As the economy moves deeper into fiscal 2026-27, growth is projected to moderate to 6.6% from 7.7% last fiscal, while inflation is expected to rise to 5.1% from 2.0%. This less favorable growth-inflation mix reflects a weakening external environment, including disruptions stemming from the West Asia conflict, unresolved tariff issues with the United States (US), and weather-related uncertainties.

In short, India's economy remains resilient, but the road ahead is likely to be less forgiving than the one traversed in recent years. The challenge now is to sustain growth amid a more complex and uncertain macroeconomic landscape.

Money and banking

Calm at the helm

Industrial production

At a 22-month high

Inflation

The heat beneath the headline

Money and banking

- The MPC announced the repo rate would remain unchanged at 5.25%, the standing deposit facility rate at 5.00%, and the marginal standing facility rate at 5.50%. The committee retained its neutral stance, signaling a data-dependent approach
- It lowered the inflation forecast 10 bps to 5% for the fiscal and increased the GDP growth forecast 10 bps to 6.7% on resilient macro signals. However, it highlighted risks from deficient rains, El Niño, West Asia conflict and potential supply chain disruptions
- Systemic liquidity surplus rose in July, with the RBI net-absorbing Rs 1.07 lakh crore (0.4% of net demand and time liabilities), against Rs 0.78 lakh crore (0.3%) in June. A higher credit-deposit ratio and government cash balances were key drags on liquidity
- Rates on six-month certificates of deposit and commercial paper eased. The one-year marginal cost of funds-based lending rate rose 10 bps to 8.60%. Bank credit growth rose to 19.3% on-year in July from 18.6%. The weighted average call rate was stable
- The MPC's decision to maintain the status quo was in line with our expectations. While Consumer Price Index (CPI)-linked inflation exceeded the 4% target in June, core inflation was contained, suggesting inflationary pressures were not yet broad-based
- However, the monsoon, advancing under the shadow of El Niño, remains a key monitorable. The situation in West Asia also remains unpredictable. The MPC's approach to policy rates is likely to remain flexible, with close monitoring of inflation risks

Industrial production

- Industrial growth, as tracked by the Index of Industrial Production (IIP), accelerated to a 22-month high of 7.3% in June from 5.0% in May. IIP growth for the quarter ended June rose to 5.7% from 3.9% in the quarter ended March
- Manufacturing growth strengthened during the quarter, led by capital goods and consumer-oriented sectors. Primary goods growth rose to a nine-month high. Electricity generation remained a key driver, supported by higher power demand
- Sectorally, the rise in IIP was broad-based. As per the use-based classification, growth rose in intermediate, infrastructure and construction goods, consumer non-durables and primary goods. Growth softened in consumer durables and capital goods
- Slowing global growth is impacting export demand, while elevated input costs and price pass-throughs are expected to somewhat squeeze producer margins and temper consumption demand, leading to moderation in industrial output growth
- An erratic and sub-normal monsoon could further weigh on growth by curbing agricultural incomes and raise the cost of farm-based industrial inputs. Uncertainties pertaining to the West Asia conflict has heightened risks to growth and inflation
- Manufacturing and construction are particularly exposed to higher costs of critical imported inputs, especially energy. Core input sectors such as land transport, mining, chemicals and rubber and plastic products are most vulnerable to an energy shock
- Against this backdrop, we expect India's gross domestic product growth to moderate to 6.6% this fiscal from 7.7% last fiscal.

Inflation

- After crossing 4% in June, CPI-based inflation rose to 4.45% in July from 4.38% in June. The rise in food inflation was slower; non-food inflation was steady. A favourable base effect from high vegetable and edible oil prices capped the upside to food inflation
- Fuel-related inflation rose a tad, led by continued hardening in cooking fuel prices. Inflation in transportation fuels eased slightly, though remaining elevated, given the hikes in retail petrol and diesel prices since the start of the West Asia conflict
- Core inflation, which excludes fuel for personal transport but includes gold and silver, was indicating a slow pass-through of higher input costs. It was flat at 3.9% for the third month. Inflation based on the Wholesale Price Index remained elevated
- Retail inflation is expected to rise in the coming months, led by an adverse base effect for food inflation, higher edible oil prices, the fading impact of goods and services tax rate rationalisation and a pass-through of input costs, particularly transportation
- Although retail fuel prices have risen moderately, transportation cost for producers has increased sharply. Transport-related inflation in wholesale prices rose to ~42% during April-July, part of which is likely to be gradually passed through to retail prices
- Uneven rainfall continues to cloud the outlook on food inflation, and its spread will need monitoring. Given these pressures, we expect CPI-based inflation to average 5.1% this fiscal against 2.0% last fiscal. Risks remain tilted to the upside

Interest rate

Caught in crosscurrents

Rupee

Dollar looms large

Trade

Exports slip on oil

- With domestic liquidity improving and crude prices easing, the yield on the new benchmark 10-year paper (6.94% GS 2036) fell 12 bps to average 6.77% in July, after declining by a similar magnitude in June. On-year, however, the yield remained 45 bps higher
- Risk aversion stemming from geopolitical tensions and the narrowing spread between the 10-year Indian government security (G-sec) and US Treasury yields moderated foreign poinflows into debt despite regulatory easing from the government and the RBI
- This, combined with a significant hardening in US Treasury yields and higher government borrowings, limited the fall in yield
- Yields hardened on-year across tenures except the 91-day Treasury bill, with longer tenure yields recording a sharper rise
- We expect the benchmark 10-year G-sec yield to harden to 7% by March 2027 from 6.7% in March 2026 due to higher crude prices, government borrowing and global yields and volatile finances amid tensions. Rising inflation has curbed monetary policy flexibility
- In addition, a reduction in excise duty on fuel and an expected increase in the fertilizer subsidy bill are likely to put pressure on government finances this fiscal. Global crude oil prices are expected to remain elevated on-year
- While the measures announced by the government and RBI in June have provided an impetus to FPI inflows into the debt segment, global risk-off sentiment and elevated yields in the US and other advanced economies could cap further gains

Interest rate

- The rupee averaged 95.8 against the dollar in July as against 95.0 in June. The currency came under pressure from a stronger dollar, rising crude oil prices and a widening trade deficit
- The US Dollar Index, which measures the greenback against a basket of six major currencies, averaged 100.9 in July, up from 100.3 in June, indicating continued dollar strength as safe-haven demand increased
- Foreign currency non-resident (B) dollar inflows are being absorbed by the RBI rather than entering the spot market, limiting immediate support for the rupee. Net foreign investor inflows surged to \$4.2 billion in July, the highest since September 2024
- Amid broad dollar strength, most major advanced and emerging market currencies weakened against the greenback. Among emerging markets, the Russian rouble, Turkish lira and Thai baht recorded the sharpest depreciation
- We expect the rupee to average 93.5 per dollar by March 2027, compared with 92.8 in March 2026. A widening current account deficit and volatile capital flows are likely to keep pressure on the rupee. We expect some recovery by fiscal year-end
- Gradual easing of the peak effects of the West Asia conflict and stronger capital inflows driven by recent RBI policy measures will support the rupee. This outlook is consistent with historical patterns in currency markets

Rupee

- Merchandise exports accelerated 19.6% on-year in July to \$44.2 billion from 15.5% growth in June. The increase was driven by a sharp rise in petroleum exports (68.0% vs 8.9%), reflecting elevated global crude oil prices and prolonged uncertainty in West Asia
- However, gems and jewellery exports declined 2.7% on-year (versus 34.6% growth in June) while growth in core exports moderated marginally to 14.9% (versus 15.3% previously)
- Exports to the US rebounded, rising 12.8% on-year compared with a 1.2% decline in June, while growth in shipments to the United Arab Emirates strengthened to 10.2% from 3.6% previously, indicating some normalization of trade amid the West Asia conflict
- Merchandise imports grew at a healthy 17.5% on-year to \$76.2 billion, although this was lower than June's 31.0% growth. Oil imports and core imports moderated, while gems and jewellery imports recorded a shallower decline (-2.2% versus -7.9%)
- The merchandise trade deficit widened to \$32.0 billion in July from \$30.4 billion in June and \$27.9 billion a year earlier. Preliminary estimates suggest services trade remained resilient, with the surplus widening to \$17.0 billion from \$16.4 billion a year earlier
- We expect the current account deficit to widen to 1.5% of gross domestic product in fiscal 2027 from 0.6% in fiscal 2026. Higher crude oil prices will remain the key driver of the goods trade deficit
- Global trade disruptions may weigh on merchandise exports, though robust services exports should provide some support

Trade

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