

INDIAN ECONOMY

Crisil Insights

September 2026

Through the monthly Crisil Insights Indian Economy series, we delve into how the country's growth dynamics are expected to change in the fiscal. In this issue, we explore the forces driving the sharp rise in bond yields, particularly across advanced economies, and the implications for India.

A turn in monetary policy

September proved to be a particularly turbulent month in at least four ways:

- Global yields surged following a sell-off in sovereign debt in advanced economies
- Crude oil again breached \$100 per barrel amid the escalating conflict in West Asia
- The rainfall deficit widened in August and September after narrowing in July
- Consumer inflation gathered momentum in August and is likely to remain elevated

Yet, despite mounting risks and uncertainty, India's economy has continued to demonstrate remarkable resilience. Gross domestic product (GDP) growth of 7.8% in the April-June quarter once again surpassed expectations, extending a pattern seen over the past several quarters.

This sustained outperformance underscores the strength of India's domestic growth engines and the economy's ability to weather an increasingly uncertain global environment.

Reflecting the stronger-than-anticipated performance of the economy so far, we have revised our GDP growth forecast for the current fiscal upward to 7.0% from 6.6% earlier.

This month's theme article explores the forces driving the surge in bond yields, particularly in advanced economies, and the implications for India. Three broad messages emerge:

- Bond yields have risen more sharply in advanced economies than in India, reflecting high inflation and growing concerns over fiscal sustainability in those countries
- The spread between US and Indian 10-year government bond yields has narrowed to ~200 basis points (bps) from ~400 bps, lowering the attractiveness of Indian government bonds
- Central banks across advanced economies continue to tighten monetary policy. The US Federal Reserve joined this trend with a 25-basis-point rate hike in September

These developments are exerting some upward pressure on Indian monetary policy. However, they do not automatically warrant a corresponding response from the Reserve Bank of India (RBI). Domestic macros will remain the principal determinant of the RBI's policy stance.

Strong demand is enabling producers to pass on higher fuel and input costs to consumers. Early signs are visible in the 9.9% wholesale price inflation in August. Consumer prices are beginning to reflect these pressures as well, with core inflation edging higher. Taken together, these trends are steadily narrowing the room for monetary policy to remain on hold.

Against this backdrop, we expect the next phase of monetary tightening to begin soon. It is likely to be gradual and limited in magnitude though.

Financial conditions

Easing further

Industrial production

Staying pacy

Inflation

The bend in the road

Financial conditions

- Financial conditions eased significantly in August. The Crisil Financial Conditions Index rose to 0.8, its highest reading in nearly two years, from 0.2 in July and an average of -0.9 in the first quarter of this fiscal
- A surge in foreign currency non-resident (banks), or FCNR (B), deposits drove the easing, with banks mobilizing \$133.0 billion by end-August. The inflows supported the rupee and, more significantly, infused rupee liquidity into the banking system
- Systemic liquidity surplus rose as FCNR (B) inflows and government spending increased. The RBI net-absorbed Rs 3.67 lakh crore (1.3% of net demand and time liabilities), lowering the weighted average call rate 15 bps and easing other money market rates
- However, elevated crude oil prices, rising US Treasury yields and the West Asia conflict prevented conditions from easing further. The benchmark 10-year government security yield rose, while the Sensex and Nifty 50 declined on a month-end basis
- The rupee appreciated 0.4% on-month to average 95.5 per dollar, while bank credit growth remained strong at 19.1%. Foreign portfolio investors remained net buyers, though inflows moderated to \$2.7 billion as the debt segment recorded mild outflows
- Financial conditions are expected to remain volatile in the near term. Rising inflation could prompt an RBI rate increase, while slowing global growth, an unfavourable monsoon, El Niño, geopolitical risks and rising global yields could keep inflows uncertain

Industrial production

- Industrial growth, as tracked by the Index of Industrial Production (IIP), moderated to 6.7% in July from 8.8% in June, but remained above the previous fiscal's average of 4.3%. The IIP rose to 124.8 from 117 a year ago
- Consumer durables growth accelerated to an eight-month high, led by auto-related sectors. Capital goods recorded the strongest growth among use-based segments, while electricity generation remained robust, supported by record power demand
- Growth accelerated in consumer durables. Capital, intermediate and primary goods growth softened, but remained above the previous fiscal's average. Growth weakened in consumer non-durables and infrastructure and construction goods
- Healthy rural and urban automobile demand, double-digit growth in machinery and equipment and strong demand for cooling equipment supported activity. Lower crude also aided coke and refined petroleum products, which returned to positive growth
- Going forward, a below-normal monsoon could weigh on the rural economy, while the West Asia crisis poses risks from higher input costs and softer global growth. Manufacturing and construction remain exposed to cost pressures from imported inputs
- Against this backdrop, industrial growth is expected to moderate in the second half of this fiscal as the benefits of goods and services tax rationalisation fade. Monsoon weakness, geopolitical uncertainties and slowing global demand are key monitorables

Inflation

- After a slower increase in the previous month, Consumer Price Index (CPI)-based inflation rose significantly to 4.82% in August from 4.45% in July. The rise was broad-based, with food, fuel and core inflation all strengthening
- Food inflation rose to 6.0% from 5.5%, led by cereals, pulses, onions and ready-made foods. Fuel-related inflation increased to 5.2% from 4.6%, driven by cooking fuels and an adverse base effect for electricity, gas and other fuels
- Inflation eased in meat, oils and fats, tomatoes and potatoes, while domestic airfare inflation moderated. Core inflation rose sharply to 4.2% from 3.9%, indicating a strengthening pass-through of input costs. Excluding gold and silver, it increased to 2.9%
- Inflation based on the Wholesale Price Index edged up to 9.9% from 9.8%, led by food, fuel and power. Non-food inflation was stable, while higher manufacturing output prices indicated that earlier input-cost pressures continued to be passed through
- Retail inflation is expected to rise in the coming months, led by an adverse base effect for food, fading benefits of goods and services tax rate rationalisation and a gradual pass-through of input costs, particularly transportation, to consumer prices
- A weak monsoon could pressure crop yields, while crude oil prices and persistent geopolitical risks could keep fuel prices high and lift core inflation. We expect CPI-based inflation to average 5.1% this fiscal against 2% in fiscal 2026, with risks on the upside

Interest rate

Yield uptick

Rupee

A wee increase

Trade

Exports slip on oil

- After a brief reprieve in June and July, the yield on the benchmark 10-year government security (6.94% GS 2036) rose 5 bps on-month to average 6.82% in August. On-year, the yield was 35 bps higher
 - Higher crude oil prices, rising US Treasury yields and renewed foreign portfolio investor outflows from debt drove the increase. The premature closure of the FCNR (B) swap scheme also dented investor sentiment
 - Improved systemic liquidity, lower central and state government borrowing, and rangebound retail inflation capped the rise. The Monetary Policy Committee's status quo on the rate and the RBI's downward revision to its inflation forecast supported sentiment
 - The yield curve steepened as improved liquidity primarily benefited shorter-tenure securities. The 91-day Treasury-bill yield eased, while three- and five-year yields rose less than the 10-year yield. The 10-year term premium increased to 157 bps
 - We expect the benchmark 10-year G-sec yield to rise to 7.0% by March 2027 from 6.7% in March 2026, owing to elevated crude oil prices, higher global yields, monetary tightening and high government borrowing
 - Rising inflation could constrain policy flexibility, while pressure from lower fuel excise duty and a higher fertilizer subsidy bill could cause mild fiscal slippage. Global risk aversion, elevated yields and the West Asia conflict could limit foreign inflows
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- The rupee appreciated to average 95.5 against the dollar in August from 95.8 in July. The currency was supported by a weaker dollar, a narrower trade deficit and foreign capital inflows, including sizeable FCNR(B) deposits
 - The US Dollar Index weakened as easing consumer and producer price inflation and weak labour market data in the United States lowered expectations of sharp rate hikes by the Federal Reserve. India's trade deficit narrowed to \$26.9 billion from \$32 billion
 - Higher crude oil prices limited the rupee's appreciation, with Brent crude rising to \$90.9 per barrel from \$83.4 amid renewed tensions in West Asia. Net foreign portfolio inflows also moderated to \$2.7 billion in August from \$4.2 billion in July
 - The US Dollar Index averaged 99.5 in August against 100.9 in July. Major advanced-economy currencies appreciated against the greenback, while emerging-market currencies were mixed. The Russian rouble, Turkish lira and Vietnamese dong depreciated
 - 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 continue exerting pressure on the domestic currency this fiscal
 - However, some recovery from current levels is expected fiscal-end, supported by a gradual easing of the peak effects of the West Asia conflict. This is consistent with historical patterns, where sharp rupee depreciation is followed by correction and recovery
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- Merchandise exports accelerated 19.6% on-year in July to \$44.2 billion from 15.5% growth in June, driven by a sharp rise in petroleum exports (68.0% vs 8.9%) amid 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 shipments to the United Arab Emirates strengthened to 10.2% from 3.6%, 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

Interest rate

Rupee

Trade

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