PRESS RELEASE

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GDP growth projected at a robust 7.0% in Q2 FY2026, albeit lower than Q1 print: ICRA

Rating agency ICRA has projected the year-on-year (YoY) **GDP expansion** to ease to 7.0% in Q2 FY2026 from 7.8% in Q1 FY2026. Further, it projects the growth in the **gross value added** (GVA) to record a narrower dip to 7.1% from 7.6%, respectively. Lower expansion in the services sector (to +7.4% in Q2 FY2026 from +9.3% in Q1 FY2026), and agriculture (to +3.5% from +3.7%), is likely to outweigh a pick-up in the performance of the industrial sector (to a five-quarter high +7.8% from +6.3%).

ICRA estimates net indirect taxes (in nominal terms) to contract on a YoY basis in Q2 FY2026, after having risen by 9.5% in Q1 FY2026, aided by the decline in indirect taxes of the Government of India (GoI; to -5.2% from +11.3% in Q1 FY2026), amidst the shallower contraction in its subsidies (to -4.6% from -7.3%). Accordingly, the gap between the GDP and the GVA growth is expected to revert to the negative territory at ~10 bps in Q2 FY2026, after being positive (18 bps) in the previous quarter.

Aditi Nayar, Chief Economist, Head-Research & Outreach, ICRA said: *"A lower YoY rise in Government spending is likely to weigh on the pace of the GDP and GVA growth in Q2 FY2026 compared to Q1 FY2026. However, inventory stocking related to the early onset of the festive season, enhanced by the GST-rationalisation induced volume pick-up, and upfronting of exports to the US ahead of the tariffs, are expected to boost the performance of the manufacturing sector, and help industry GVA growth outpace that of the services after a gap of four quarters."*

"Unless the GoI's capex allocation is enhanced and the tariff-related uncertainties ebb, the GDP growth appears set to ease below 7.0% in H2 FY2026. While the well-timed GST rationalisation may result in a steady boost in volumes of consumer non-durables going ahead, consumer durables may see a trend of premiumisation instead of a sustenance of the spike in volumes that was seen during the festive season."

On an enlarged base, the growth rate of the Government of India's (GoI's) gross capital expenditure moderated to 30.7% in Q2 FY2026 (+10.3% in Q2 FY2025) from 52.0% in Q1 FY2026 (-35.0% in Q1 FY2025). Simultaneously, in absolute terms, the monthly average capex rose to Rs. 1,019 billion in Q2 from Rs. 917 billion in Q1, despite the above-normal monsoons. Based on the available data for 22 state governments*, their aggregate capital outlay and net lending contracted by 4.6% YoY in Q2 FY2026 (+7.3% in Q2 FY2025), after the ~23% expansion in Q1 FY2026 (-19.1% in Q1 FY2025), mainly reflecting the unfavourable base effect. On an average, the monthly capex rose to Rs. 544 billion in Q2 FY2026 from Rs. 378 billion in Q1 FY2026, while being around half of the GoI's level.

Further, the GoI's non-interest revenue expenditure contracted by a sharp 11.2% YoY in Q2 FY2026, against the 6.9% uptick seen Q1 FY2026. Besides, the YoY growth in the combined non-interest revenue expenditure of the aforementioned 22 state governments halved to 5.3% in Q2 FY2026 from 10.9% in Q1 FY2026.

EXHIBIT: Trends in expenditure of the GoI and 22 state governments

	Rs. Trillion				YoY (%)	
	Q1 FY2025	Q2 FY2025	Q1 FY2026	Q2 FY2026	Q1 FY2026	Q2 FY2026
Non-interest revenue expenditure						
GoI	5.2	6.6	5.6	5.8	6.9%	-11.2%
States*	7.1	8.0	7.9	8.5	10.9%	5.3%

Capital expenditure						
GoI	1.8	2.3	2.8	3.1	52.0%	30.7%
States*	0.9	1.7	1.1	1.6	23.2%	-4.6%

**Available data is compiled for 22 state governments excluding Arunachal Pradesh, Bihar, Goa, Himachal Pradesh, Manipur, and Nagaland; Source: Controller General of Accounts (CGA), Comptroller and Auditor General of India (CAG), GoI, ICRA Research*

The YoY expansion in India's services exports eased to 8.7% in Q2 FY2026 (absolute: $101.6 billion) from 10.1% in Q1 FY2026 ($97.4 billion), the slowest pace of growth in six quarters. Overall, ICRA estimates the YoY growth in the services GVA to moderate to 7.4% in Q2 FY2026 from the eight-quarter high of 9.3% in Q1 FY2026, dampened by the lower expansion in Government spending and services exports.

Although the early onset of the monsoons and abundant rains supported kharif sowing, episodes of flooding in some parts of the country in August-September 2025 and untimely rains in October 2025 may have damaged the standing crops and/or delayed harvesting. While kharif sowing exceeded last year's acreage, the adverse base is anticipated to keep the agri-GVA expansion at around 3.5% in Q2 FY2026 (+4.1% in Q2 FY2025), similar to 3.7% in Q1 FY2026 (+1.5% in Q1 FY2025).

ICRA pegs the **industrial GVA growth** to record a broad-based improvement to a five-quarter high of 7.8% in Q2 FY2026 from 6.3% in Q1 FY2026, supporting the overall GVA expansion in that quarter. As per the data released on the Index of Industrial Production (IIP), the YoY growth in manufacturing output jumped to a seven-quarter high of 4.9% in Q2 FY2026 from 3.3% in Q1 FY2026, aided by inventory stocking ahead of the festive season as well as the GST cuts. India's merchandise exports increased by 8.9% YoY to $108.5 billion in Q2 FY2026 from $99.6 billion in Q2 FY2025, despite sizeable tariffs and penalties by the US. This was driven by a growth in both petroleum (+8.1% YoY) and non-oil (+9.0%) exports in Q2 FY2026. Within non-oil exports, electronic goods (+34.3%; exempted from tariffs) saw a sharp uptick in Q2 FY2026, followed by a relatively lower increase in gems and jewellery (+13.0%), agricultural products (+12.6%), drugs and pharmaceuticals (+7.8%), and engineering goods (+7.1%). These trends, along with a favourable base, are expected to boost the manufacturing GVA growth to a six-quarter high of 9.0% in Q2 FY2026 (+2.2% in Q2 FY2025) from 7.7% in Q1 FY2026 (+7.6% in Q1 FY2025).

Besides, construction activity appears to have held up in Q2 FY2026, as evinced in the improvement in the construction/infrastructure goods' output and the absolute increase in Government capex, notwithstanding the seasonal disruptions. ICRA projects the construction GVA growth to rise slightly to 8.0% in Q2 FY2026 from 7.6% in Q1 FY2026. While the mining and electricity sectors are also expected to show an improvement in their YoY GVA performance in the quarter, owing to the favourable bases, growth trends are expected to remain tepid.

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