ECONOMIC OUTLOOK AND MACRO TRENDS

India's GDP growth projected to ease to 7.0% in Q2 FY2026, while remaining robust

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Abbreviations

AE: Advance Estimates
ATF: Aviation Turbine Fuel
AUM: Assets under Management
BAI: Business Assessment Index
BoP: Balance of Payments
BU: Billing Unit
CAD: Current Account Deficit
CCS: Consumer Confidence Survey
CGA: Controller General of Accounts
CGST: Central Goods and Services Tax
CIL: Coal India Limited
CNY: Chinese Yuan
CP: Commercial Paper
CPD: Cut and Polished Diamond
CPI: Consumer Price Index
CSI: Current Situation Index
CTD: Central Tax Devolution
CV: Commercial Vehicle
DAP: Di-ammonium phosphate
DIPAM: Department of Investment and Public Asset Management
ECB: External Commercial Borrowing
F&B: Food and Beverages
FAO: Food and Agriculture Organization
FAR: Fully Accessible Route
FCI: Food Corporation of India
FCNR: Foreign Currency Non-Resident
FDI: Foreign Direct Investment
FMCG: Fast Moving Consumer Goods
FOMC: Federal Open Market Committee
FPI: Foreign Portfolio Investors
FRL: Full Reservoir Level
FRP: Financial, Real Estate and Professional Services
GCC: Global Capability Centre
GDP: Gross Domestic Product
GFCE: Government Final Consumption Expenditure
GFCF: Gross Fixed Capital Formation
G-Sec: Government Securities
GVA: Gross Value Added
HFC: Housing Finance Companies
HSD: High Speed Diesel
IGST: Integrated Goods and Services Tax
IIP: Index of Industrial Production
IMD: Indian Meteorological Department
IMF: International Monetary Fund
IOS: Industrial Outlook Survey
IPO: Initial Public Offering
JPC: Joint Plant Committee
KMS: Kharif Marketing Season
LAF: Liquidity Adjustment Facility
LIC: Life Insurance Corporation
LPA: Long Period Average
LPG: Liquefied Petroleum Gas
M&HCV: Medium and Heavy Commercial Vehicle
MGNREGS: Mahatma Gandhi National Rural Employment Guarantee Scheme
MICE: Meetings, Incentives, Conferences, Exhibitions
MoM: Month-on-month
MoRTH: Ministry of Road Transport and Highways
MoSPI: Ministry of Statistics and Program Implementation
MPC: Monetary Policy Committee
MSF: Marginal Standing Facility
MSP: Minimum Support Price
MTD: Merchandise Trade Deficit
NBFC: Non-Banking Finance Companies
NBS: Nutrient Based Subsidy
NHAI: National Highway Authority of India
NR(E)RA: Non-Resident (External) Rupee Account
NRI: Non-Resident Indians
NRO: Non-Resident Ordinary
NSO: National Statistical Office
OMC: Oil Marketing Companies
PADOS: Public Administration, Defence and Other Services
PFCE: Private Final Consumption Expenditure
PLF: Plant Load Factor
PLI: Production Linked Incentive
PPF: Public Provident Fund
POL: Petroleum Oil and Lubricants
PV: Passenger Vehicle
REER: Real Effective Exchange Rate
SDF: Standing Deposit Facility
SDR: Special Drawing Rights
SIOS: Services and Infrastructure Outlook Survey
THTCS: Trade, Hotels, Transport, Communication and Services related to broadcasting
UPI: Unified Payments Interface
VRR: Voluntary Retention Route
WPI: Wholesale Price Index
WTO: World Trade Organisation

OVERVIEW

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EXHIBIT: GDP growth trends

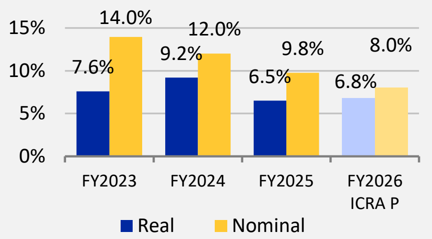
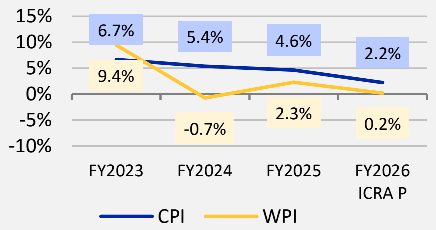


EXHIBIT: CPI inflation trends



P: Projected; Source: NSO; Ministry of Commerce and Industry; ICRA Research

Initial estimates of the NSO had pegged India's GDP growth for Q1 FY2026 at 7.8%, materially exceeding expectations. When Q2 FY2026 had commenced, it seemed as if a large deceleration was on the anvil, with a slowdown in growth of Government capex and uncertainty related to US tariffs. However, the benefits of the GST rationalisation pushed up volumes in September 2025, and we now project GDP growth for that quarter at 7.0%. Looking ahead, unless the GoI's capex allocation is enhanced and tariff-related uncertainties ebb, the GDP growth appears set to ease below 7.0% in H2 FY2026, resulting in a full-year expansion of 6.8%. While the well-timed GST rationalisation may result in a steady boost in volumes of consumer non-durables, consumer durables may see a trend of premiumisation instead of a sustenance of the spike in volumes that was seen during the festive season.

Additionally, the CPI inflation is projected to average at a benign ~2.2% in FY2026 (+4.6% in FY2025), led by a sharp dip in food inflation, along with the positive impact of GST rate cuts on the H2 readings, even as core-CPI inflation is likely to print above the 4.0%-mark in the fiscal. ICRA believes that the dovish tone of the October 2025 MPC document and a paring of inflation projections would support a 25-bps rate cut in the December 2025 policy, unless Q2 FY2026 GDP growth surprises on the upside. India's CAD is expected to widen to 1.2% of GDP in FY2026 from 0.6% of GDP in FY2025, owing to the adverse impact of the US tariffs and penalties, as well as the recent surge in imports of gold. On the fiscal front, the estimated shortfall in net tax revenues and potential additional allocation for fertiliser subsidy, etc. is likely to be offset by the upside to the non-tax revenues as well as expenditure savings, which would prevent the fiscal deficit from exceeding the budgeted 4.4% of GDP in FY2026.

Macroeconomic Variables	FY2025	FY2026 ICRA Projections
GDP Growth (at constant 2011-12 prices)	+6.5%	+6.8%
GDP Growth (at current prices)	+9.8%	+8.0%
CPI Inflation	+4.6%	+2.2%
Current Account Balance	Deficit of $23.3 billion; -0.6% of GDP	Deficit of ~$49-51 billion; -1.2% of GDP
GoI's Fiscal Deficit	4.8% of GDP	Likely to meet the budgeted 4.4% of GDP
G-sec Yields	10-year G-sec yield (6.33% GS 2035) to range between 6.40-6.55% in the near term	
Policy Repo Rate	Close call, slightly titled towards a final rate cut of 25 bps in December 2025	

EXECUTIVE SUMMARY

India's GDP growth to ease to 7.0% in Q2 FY2026 from 7.8% in Q1, while remaining healthy, aided by GST rate rejig

- While a lower YoY rise in Government spending is likely to weigh on the pace of the GDP and GVA growth in Q2 FY2026, inventory stocking related to the early onset of the festive season, enhanced by the GST rate cuts, and upfronting of exports to the US ahead of the tariffs, are expected to boost the performance of the manufacturing sector, and help industrial GVA growth outpace that of the services sector.
- The GVA growth is expected to ease to 7.1% in Q2 FY2026 from 7.6% in Q1. Additionally, with net indirect taxes estimated to contract in Q2, the GDP-GVA growth wedge is expected to turn negative. Consequently, the GDP growth is projected to ease to 7.0% in Q2 FY2026 from 7.8% in Q1.

GDP growth projected at 6.8% in FY2026, amid headwinds posed by uncertain trade policies and slowdown in GoI capex

- 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.
- At present, ICRA forecasts GDP growth to print at 6.8% in FY2026 (+6.5% in FY2025), up from our earlier estimate of 6.5% for the fiscal, in light of the GST cut-led boost across some sectors.

CPI inflation expected to average at 2.2% in FY2026, dampened by GST rate rationalisation, low food prices

- After touching a series-low of 0.3% in October 2025, the CPI inflation is expected to rise thereafter, likely crossing 4% in Q1 FY2027, as the base turns adverse. Overall, we expect the CPI inflation to average at ~2.2% in FY2026, against our earlier projection of 2.4%, likely led by a sharp dip in the food and beverages segment, along with the positive impact of the GST rate cuts, even as core-CPI inflation is likely to average slightly above the 4.0%-mark.
- ICRA believes that the dovish tone of the October 2025 MPC document and the expectation of a downward revision in the MPC's CPI inflation projection from the current 2.6%, would support a 25-bps rate cut in the December 2025 policy review, unless Q2 FY2026 GDP growth surprises on the upside.

India's CAD to enlarge to 1.2% of GDP in FY2026; tariff and visa-related policy changes pose key risks

- Amid persisting uncertainity related to global trade and tariff policies, ICRA currently expects India's merchandise exports in FY2026 to print largely at par with FY2025, with risks tilted to the downside. However, merchandise imports are expected to grow by 5-6% in FY2026, given the surge in gold imports. Based on this, the merchandise trade deficit is expected to widen to ~$330 billion in FY2026, from $287 billion in FY2025.
- India's CAD is projected to nearly double to 1.2% of GDP in FY2026 from 0.6% of GDP in FY2025. Nevertheless, any negative developments on the tariff deal front and/or policy changes around H-1B visas and HIRE Act further pose a key downside risk to the outlook.

GoI to meet its fiscal deficit target of 4.4% of GDP in FY2026

- ICRA currently expects that the higher-than-budgeted non-tax revenues (+Rs. 0.5 trillion over FY2026 BE) would absorb a significant part of the shortfall on the taxes front (-Rs. 0.6-0.8 trillion in net tax revenues). On the expenditure side, while there could be some additional allocation towards the fertiliser subsidy, and any supplementary demand for grants, if announced, this would be offset by the expenditure savings of various ministries/departments, in line with the typical trend seen during the fiscal.
- Overall, we expect the GoI's FY2026 fiscal deficit target of 4.4% of GDP to be achieved.

ICRA

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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