ICRA

35 Years of Unwavering Credibility

ECONOMIC OUTLOOK AND MACRO TRENDS

FY2027 GDP growth set to ease below 6.5% amid elevated energy prices, sub-par monsoon

June 2026

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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
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
ECB: External Commercial Borrowing
ESF: Economic Stabilisation Fund
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
FPI: Foreign Portfolio Investors
FRL: Full Reservoir Level
FRP: Financial, Real Estate and Professional Services
GCC: Global Capability Centre
GCF: Gross Capital Formation
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
JPC: Joint Plant Committee
KMS: Kharif Marketing Season
LAF: Liquidity Adjustment Facility
LPA: Long Period Average
LPG: Liquefied Petroleum Gas
LRF: Long Range Forecast
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
PE: Provisional Estimate
PFCE: Private Final Consumption Expenditure
PIT: Personal Income Tax
PLF: Plant Load Factor
PLI: Production Linked Incentive
PPF: Public Provident Fund
POL: Petroleum Oil and Lubricants
PSU: Public Sector Undertaking
PV: Passenger Vehicle
REER: Real Effective Exchange Rate
RCCS: Rural Consumer Confidence Survey
RMS: Rabi Marketing Season
SAE: Second Advance Estimate
SDF: Standing Deposit Facility
SDR: Special Drawing Rights
SIOS: Services and Infrastructure Outlook Survey
STT: Security Transaction Tax
SW: Southwest
THTCS: Trade, Hotels, Transport, Communication and Services related to broadcasting
UCCS: Urban Consumer Confidence Survey
UPI: Unified Payments Interface
VRR: Voluntary Retention Route
WPI: Wholesale Price Index
WTO: World Trade Organisation

OVERVIEW

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EXHIBIT: YoY GDP growth trends (2022-23 prices)

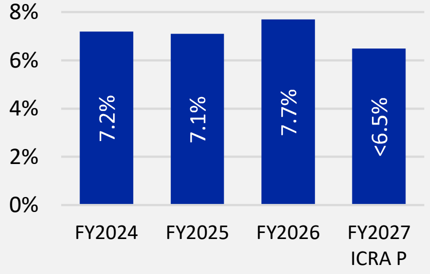
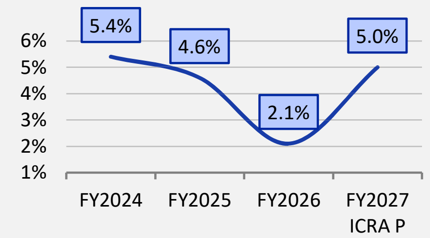


*EXHIBIT: YoY CPI inflation trends**



**CPI inflation data for FY2024-2026 is as per the 2011-12 series, while for FY2027 is as per 2022-23 series; P: Projected; Source: NSO; ICRA Research*

Given the uncertainty around the duration of the ongoing West Asia crisis, elevated energy prices for an extended period poses a key downside risk to growth in the near term, including muted prospects for investment demand, negative impact on corporate profitability and dampening consumer sentiments. Besides, the IMD's forecast of deficient rainfall in the ongoing Southwest Monsoon season and potential development of strong El Nino conditions have dulled the agricultural outlook and rural demand prospects for H2 FY2027. ICRA currently assumes crude oil prices to average at ~$95/bbl in FY2027, amid the ongoing stickiness in prices amid the stalemate in West Asia. This presumes that oil prices will remain elevated in H1 FY2027 before moderating to around $80/bbl in H2 FY2027. Consequently, ICRA expects the GDP growth (at constant 2022-23 prices) to slip below 6.5% in FY2027 from the 7.7% seen in FY2026 PE.

On the inflation front, risks remain tilted to the upside owing to the below-normal monsoon forecast triggered by El Nino and elevated energy prices. ICRA expects the CPI inflation to average at 5.0% in FY2027, similar to the MPC's forecast (+5.1% YoY). While the next move on policy rates is likely to be a hike, its timing would depend on how geopolitical and macro developments, including the severity of the El Nino, transmit to a generalisation of inflationary pressures. ICRA believes that the October and December 2026 policy meetings could be live for potential rate hike(s), after there is some clarity on the monsoon impact. Additionally, ICRA expects the current account deficit (CAD) to more than double to 1.7% of GDP in FY2027 from 0.6% of GDP in FY2026, owing to likely surge in net oil import bill and higher commodity prices, amidst the West Asia conflict. On the fiscal front, the West Asia crisis is likely to necessitate the Government of India (GoI) to make additional allocations for fertiliser and LPG subsidy, while excise duty cut on auto fuels and some hit to direct taxes may dampen its revenues. Overall, ICRA estimates the FY2027 fiscal deficit to print at 4.7% of GDP, ~40 bps higher than the budgeted target.

Macroeconomic Variables	FY2026	FY2027 ICRA Projections
GDP Growth (at constant 2011-12 prices)	7.7%	<6.5%
CPI Inflation	2.1%	~5.0%
Current Account Balance (% of GDP)	-0.6% of GDP	-1.7% of GDP
GoI's Fiscal Deficit	4.4% of GDP	4.7% of GDP
G-sec Yields	10-year G-sec yield to range between 6.85-7.00% in the near term	
Policy Repo Rate	Expect back ended rate hike(s) in 2026, post monsoon clarity	
USD/INR	USD/INR pair to trade between 94.0 and 96.0 in the near term	

EXECUTIVE SUMMARY

ICRA expects GDP growth to slip below ~6.5% in FY2027, with downside risks emerging from sustenance of the West Asia crisis

- Given the uncertainty around the timeline of the resolution of the West Asia conflict, elevated energy prices for an extended period present a near term downside risk to growth, with potential consequences, including muted prospects for investment demand, negative impact on corporate profitability and subdued consumer sentiments.
- Besides, the likely development of El Nino conditions and weak monsoon forecast for 2026 have dulled the agricultural outlook and rural demand prospects for H2 FY2027, while rising inflation risks and expectations of a rate hike in late-2026 may weigh on urban consumption demand. Based on these factors and assuming an average crude oil price of $95/barrel, ICRA pegs the GDP growth to moderate to sub-6.5% in FY2027 from 7.7% in FY2026, entailing lower growth outcomes in H1.

CPI inflation expected to average at ~5% in FY2027; ICRA expects back-ended rate hike in 2026

- The YoY CPI inflation print is expected to cross the 4%-mark in May 2026, crossing the mid-point of the MPC's band for the first time in the new series, owing to the impact of the fuel price hike, rising commercial LPG prices, and higher import duty on precious metals. Overall, ICRA expects the CPI inflation to average at 5.0% in FY2027 (in line with the MPC's estimate: +5.1%), amid upside risks from a sub-par monsoon as well as elevated energy prices and prolonged supply disruptions owing to the West Asia conflict.
- Given the paring of MPC's growth projections, and with inflation forecasts remaining below the upper bound of the MPC's target range of 2-6%, ICRA believes that the next move on rates is likely to be a hike, as any premature policy easing would only hit near-term growth outcomes. We believe that the Oct and Dec 2026 policy meetings are live for potential rate hike(s), after there is some clarity on the monsoon turnout.

India's CAD to enlarge to ~1.7% of GDP in FY2027 from 0.6% of GDP in FY2026

- ICRA expects the value of merchandise exports to rise by 7-8% YoY to $478-480 billion in FY2027 ($446.1 billion in FY2026; on a BoP basis), aided by a low base as well as the jump in commodity prices owing to the West Asia crisis. Additionally, merchandise imports are projected to grow by a much sharper 12-13% YoY to $878-880 billion in FY2027 ($783.4 billion in FY2026).
- Consequently, the MTD is estimated to widen to ~$400 billion in FY2027 from $337 billion in FY2026 (on a BoP basis). This is likely to be only partly offset by a healthy growth in the service trade surplus (+7%; $231-233 billion in FY2027 vs. $217 billion in FY2026). Consequently, India's CAD is expected to widen to ~1.7% of GDP in FY2027 from 0.6% of GDP in FY2026. The recent measures by the GoI and the RBI to attract capital flows are likely to offer respite, and aid in financing the CAD to a large extent in FY2027, preventing a sharp drawdown of reserves in the fiscal.

GoI's fiscal deficit to exceed the target of 4.3% of GDP by ~40 bps in FY2027

- ICRA currently pegs the net impact of the West Asia conflict on the GoI's fisc at ~Rs. 1.3 trillion, with higher fuel and fertiliser subisides, and some hit to OMC dividends, excise and direct tax/GST collections. However, these would be partly offset by higher collections on account of customs duty hike on gold and silver and allocation towards the ESF. This is estimated to entail a fiscal slippage of ~30 bps, along with the ~10 bps estimated on account of a lower nominal GDP vis-à-vis that given at the time of the Union Budget FY2027 presentation. Accordingly, ICRA projects the fiscal deficit to print at ~4.7% of GDP in FY2027, as against the Budget Estimate (BE) of 4.3%.
- In ICRA's view, the recent measures by the GoI and the RBI to attract foreign capital flows could boost G-sec demand to some extent and help cool yields. ICRA now expects the 10-year G-sec yield to trade between 6.85-7.00% in the near term.

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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

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Our services are designed to

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- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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