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INDIAN ECONOMY

Crisil Insights

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Through the monthly Crisil Insights Indian Economy series, we delve into how India's growth dynamics are expected to change in the fiscal. In this issue, we look at the channels through which the West Asia conflict can impact the Indian economy.

The fog of war

The turbulence triggered by higher tariffs levied by the United States last year did not significantly impact global macroeconomic conditions.

The West Asia conflict that began late February is proving to be different.

Forecasters are already revising growth projections downward and inflation estimates upward. This trend may persist if the conflict expands in scale and duration.

The disruption extends beyond oil and gas price spikes. Freight costs have risen, supply chains are curtailed, uncertainties have soared. The risks to oil and non-oil trade and fiscal balances have surged. Some 40% of remittances to India originate from West Asia, making it a key area.

The conflict, thus, has the potential to morph into a polycrisis.

Driven by rising demand, India's dependence on energy imports has grown over time. While there have been efforts to derisk supplies—Prime Minister Modi told Parliament on March 25, that crude is sourced from over 41 countries now—the volume of gas from West Asia has risen.

This heightens India's vulnerability to price increases and supply disruptions, resulting in lower energy availability at higher costs.

Compounding the issue, the price of the Indian crude basket (a mix of Oman and Dubai sour grade and Brent dated sweet grade crude) has risen much faster than Brent, and the Russian discount on oil has disappeared.

While consumers are somewhat protected at this juncture, thanks to prioritized domestic cooking gas supply and unchanged petrol and diesel prices, costs are ascending for all manner of industries.

Many petroleum products have prices that adjust in line with global rates and currency depreciation is further increasing the cost of imported inputs. If the crisis continues, these factors will impose fiscal burdens and negatively affect manufacturing.

Damaged energy infrastructure in the region will take a long time to recover, implying reduced supply for a while even if the conflict ends immediately. In the aftermath, energy-dependent countries are likely to intensify efforts to reduce import dependence by diversifying sources and maximizing use of domestic resources—coal, in India's case.

Our base case forecasts for India's growth in fiscal 2027 is 7.1% and 4.3% for retail inflation, assuming crude oil averages $75-80 per barrel for the year. But the risks today are tilted to the downside and are rising at this juncture.

The Monetary Policy Committee of the Reserve Bank of India is expected to hold policy rates steady and maintain its neutral stance during its review meeting in April.

Financial conditions	Industrial production	Inflation
Respite amid ructions	A three-way drag	Further up

Financial conditions

- For the first time in eight months, the Crisil Financial Conditions Index (FCI) showed a material improvement in financial conditions, rising sharply to touch the neutral, or 0 (akin to the long-period average) in February from -0.6 in January
- The main drivers of the FCI were foreign portfolio investors (FPIs) returning to India (net inflows up to a 17-month high of $4.2 billion), driven by optimism surrounding the India-US trade deal announcement and a largely stable rupee against the US dollar
- The factors included the systemic liquidity surplus increasing sharply to a six-month high, driven by FPI inflows, Reserve Bank of India (RBI) actions and a modest reduction in the government's cash balances. Bank credit growth remained strong at 14.5%
- However, the rising 10-year government security (G-sec) yield and increasing lending rates were the key drags as were mild losses in equity markets, rising commercial papers and certificate of deposit rates and higher crude oil prices
- In March, however, financial conditions weakened, with the West Asia conflict triggering FPI outflows, and the rupee and equity markets nosediving. Until March 16, FPIs net-sold $7.9 billion, the S&P BSE Sensex declined 6.5%, and the rupee depreciated 1.4%
- Risks from the West Asia conflict will need monitoring and could drive volatility. Elevated oil prices if sustained, can pressure yields. Further worsening of global uncertainty could divert foreign capital away from India and impact the rupee
- We expect the Monetary Policy Committee to hold policy rates steady this fiscal amid expectations of a pick-up in inflation

Industrial production

- Growth in the Index of Industrial Production decelerated to 4.8% on-year in January 2026 from a 26-month high of 8.0% in December 2025, with sectors such as mining, manufacturing and electricity softening
- However, the gauge grew faster in January compared with 4% average so far (April-January) this fiscal, as mining (4.3% in January vs 0.7% so far) and electricity (5.1% vs 0.9%) outpaced, while manufacturing (4.8% vs 4.9%) lagged a little
- According to use-based classification, growth decreased in the consumer sectors, and in all but one industrial and investment sector. Growth in consumer durables and non-durables was down; growth in capital, primary and intermediate goods softened
- Growth in automobile-related segments normalised after rising following the rationalisation of goods and services tax and festive demand. Export-oriented consumer sectors such as pharmaceuticals and wearing apparel logged a decline as exports softened
- The West Asia conflict has imposed downside risks to industrial output and the surge in energy prices is another key challenge. The favourable input cost environment of the past three fiscals is reversing though healthy domestic demand provides a buffer
- The Ministry of Finance's Monthly Economic Review notes supply-side activity has slowed but demand has remained resilient. The global uncertainty is casting a shadow over India's outlook; if extended, it can deter the recovery in private investment

Inflation

- Inflation based on the revised Consumer Price Index (CPI) series, with 2024 as the base year, rose to 3.2% in February from 2.7% in January as food inflation further normalised even as fuel inflation remained benign and core inflation was unchanged
- The rise in food inflation was driven by vegetables, readymade food and other food products. Core inflation was unchanged at 3.40% in February. Inflation based on the Wholesale Price Index (WPI) rose to 2.1% in February from 1.8% in January
- Against the backdrop of the West Asia conflict, fuel and transport inflation could be the first to face pressures from higher oil and gas prices and supply shocks. Rising global fuel prices could also put upward pressure on transportation, and precious metals inflation could rise
- In our base case we expect CPI inflation to increase to 4.3% on average in fiscal 2027. Food inflation is expected to continue to normalise from this fiscal's lows (with potential weather-related disruptions posing an upside risk).
- The expected heatwaves this summer, as well as the possibility of El Niño conditions coinciding with India's southwest monsoon season, also pose a risk to our base case of a normal monsoon and warrant monitoring

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Interest rate	Rupee	Trade
Inching up	Holding the line	Skidding on oil

Interest rate

- The benchmark 10-year government security (G-sec; 6.48% GS 2035) rose 5 basis points to 6.70% in February from 6.65% in January
- Yields rose on the back of higher gross market borrowing budgeted for fiscal 2027 (Rs 17.2 lakh crore from Rs 14.6 lakh crore) and high borrowing pressure from states (state development loan issuances surged to Rs 1.78 lakh crore, up 21.4% on-month)
- Other factors included higher crude oil prices, reduced open market purchases by the RBI (purchased G-secs worth Rs 0.6 lakh crore, down from Rs 2.2 lakh crore in January), and higher inflation which tempered expectations of further RBI rate cuts
- The increase in yields was limited by softening US treasury yields, increased FPI inflows and higher surplus liquidity, which surged to its highest since August 2025; the RBI net-absorbed 0.9% of net demand and time liabilities (NDTL) vs 0.2% in January
- The benchmark yield curve has steepened this fiscal, with short-term yields dropping and long-term yields rising. The 10-year G-sec term premium over the repo rate surged to 145 bps in February, up significantly from 33bps in April
- We expect the 10-year G-sec yield to moderate a tad to 6.6% by March 2027 from 6.7% in March 2026. The yield will remain sticky due to expected higher government borrowings, but fiscal consolidation and lower RBI rates can lend a mild downside
- State borrowings and the impact of geopolitical uncertainties on oil prices and foreign portfolio flows will be monitorable. The effect can be mitigated through policy but the yields will be an interplay of the duration of the conflict and the policy response

Rupee

- The rupee was stable against the US dollar in February, averaging 90.7 vs 90.8 in January, but ending the month with a 1% gain at 91 per dollar vs 91.9 at January-end. In early February, the rupee gained on news of progress in the India-US trade deal
- FPIs turned net-buyers at $4.2 billion in February (net outflow of $3.2 billion in January), giving support. After two months of outflows, net inflows rose to their highest since September 2024. A narrower trade deficit and weakening dollar also helped
- The equity segment's net inflows also rose to their highest level since September 2024 to hit $2.5 billion vs outflows of $4 billion in January. Debt market inflows rose to $2.1 billion, an 11-month high, compared with $0.7 billion
- But higher crude oil prices likely exerted downward pressure on the rupee. Brent crude oil surged 6.5% on-month to $71.1 per barrel. In March, intensifying conflict in the West Asia put pressure on the rupee, which exchanged at 92.5/dollar on March 17
- The US Dollar Index, which measures the greenback's performance against a basket of six major currencies, reached its lowest monthly average since February 2022. Key advanced and emerging market currencies gained against the dollar
- India's external vulnerability is low, and if the conflict does not prolong or spread, the rupee could stabilise closer to its longer-term trend though face high near-term volatility. Foreign investment is likely to fluctuate in sync with the uncertainty, hurting the rupee

Trade

- After remaining subdued for two months, the merchandise shipments slipped into negative territory, declining 0.8% on-year to $36.6 billion in February (vs 0.6% growth in January), the result of a steep on-year decline in petroleum products exports
- In contrast, export performance improved for both gems and jewellery (4.1% vs -23.0%) and the core segment (6.6% vs 2.0%). The former saw an on-year growth in exports after two successive months of decline
- Imports surged 24.1% on-year to $63.7 billion compared with 19.9% in January. Oil imports accelerated (9.1% on-year growth vs -0.2%). Core imports (14.0% vs 2.5%) also grew faster possibly reflecting strengthening domestic demand
- With growth in merchandise imports far outpacing that of exports, the merchandise trade deficit widened significantly to $27.1 billion in February from $14.4 billion a year ago. However, it was narrower than $34.7 billion in January
- Merchandise exports to the US declined 12.9% on-year in February while exports to the rest of the world rose by 2.5%
- Growth in services exports moderated to 9.8% on-year to $38.2 billion in January vs 13.0% in December
- Assuming exports benefit from US tariff relaxations and crude prices rise to $75-80/bb, we expect the current account deficit to widen to 1.5% of GDP in fiscal 2027 as against a projected 0.8% in fiscal 2026. However, this forecast is tilted to the upside

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About Crisil

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