

India: Here comes the sun, here comes the rain

Frequently asked questions

- ◆ Amid falling oil prices but rising El Niño risks, we forecast a slightly improved growth-inflation mix, but challenges remain
- ◆ The FX package will likely push the BoP into surplus, supporting the INR, and easing domestic financial conditions
- ◆ We forecast rate hikes, but expect a shallow cycle; and some fiscal slippage, but not a one-for-one rise in borrowing

How resilient has activity been to the energy shock? Growth has slowed since the year began, but sectors diverge. Manufacturing and exports remained resilient as firms front-loaded production. Lower US tariffs created a window to boost exports ahead of possible Section 301 tariffs, while energy uncertainty drove inventory builds. In contrast, trade, transport and construction weakened amid higher energy costs.

Which sectors will be resilient, which not? Falling oil prices and easier financial conditions (led by the RBI's FX package) should lift FY27 GDP growth to 6.3% (6% earlier). Risks remain from El Niño-driven heatwaves hurting food output. The informal sector may suffer most, while the formal sector stays relatively resilient, supported by liquidity and personal loan growth – a split reminiscent of the post-pandemic years.

Will the RBI's FX package swing the BoP? The "all-in" FX package to attract inflows and the fall in oil prices have flipped the BoP outlook. We now forecast FY27 oil at USD85/b (USD95/b earlier), a narrower c/a deficit (of 1.7% of GDP), and a cUSD25bn BoP surplus (after two years in deficit), likely stabilising the INR. The FX package inflows are repayable; eventually 'permanent' FDI inflows will be needed.

Will the fiscal slippage be disruptive? Fiscal costs have risen. But there are offsets too (stabilisation fund, windfall taxes, and disinvestment). The central government fiscal deficit could be 0.4% of GDP (INR1.5trn) higher than budgeted, but may not lead to higher 1-1 borrowing, given other funding options. Markets will watch for OMO sales to drain liquidity. States are near the 3% cap; spending may shift from capex to current.

How high could inflation rise? Pass-through from WPI to PPI has been stronger for consumer goods, while pass-through to CPI is incomplete. Historically, firms pass through c70% of costs over 3-4 months, so core CPI should firm soon. An El Niño could lift food inflation, keeping FY27 inflation at 5.1%. Inflation could average just under 6% for two quarters from October, before settling back at 4% in 2HFY28.

Will the RBI react to growth or inflation? Expect a shallow RBI hiking cycle: two 25bp hikes in 4Q 2026, taking the repo rate to 5.75%. Inflation sitting near the top of the 2-6% band for about six months is hard to ignore. But the cycle should be shallow because inflation is forecast to fall back to 4% in 2HFY28 and growth is likely to weaken from the September quarter.

Before we'd even had time to celebrate the latest drop in oil prices, fears of a 'very strong El Niño' took centre stage. With multiple shocks hitting at once, we tackle the key questions for the economy and set out our latest forecasts.

Q1. How resilient has activity been to the energy shock?

Our **100 indicators of growth database** shows that growth momentum has been gradually easing since the start of the year (see exhibit 1).

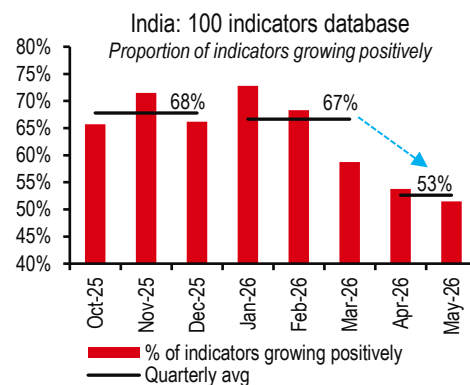
These headline numbers, however, hide some important nuances.

We find that **manufacturing and exports have been remarkably resilient** (see exhibit 2).

Frontloading seems to be supporting growth on two fronts:

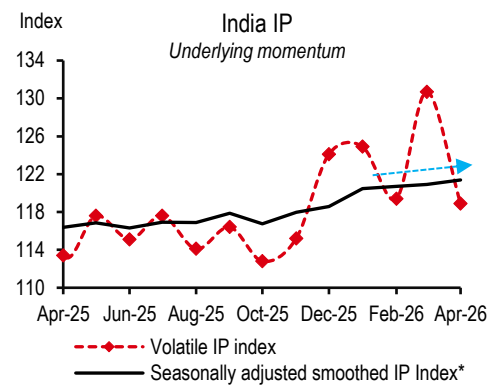
One, the fall in US tariff rates on Indian exports in early 2026 (from 50% to 18%, and then to 10% when the IEEPA tariffs were struck down), and fears that they may be raised again (when new tariffs from Section 301 potentially kick in), has created a window to bunch up exports (see exhibit 3).

1. Growth momentum has been gradually easing...



Source: S&P Global PMI, CEIC, HSBC

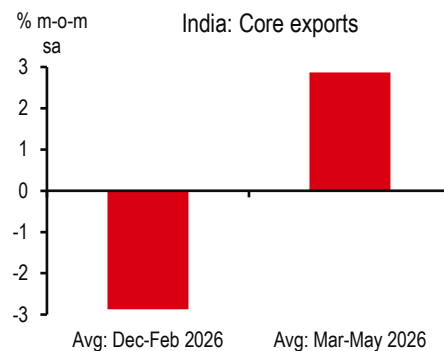
2. ... but manufacturing has been remarkably resilient



Source: CEIC, HSBC

* The original IP is very volatile. To read through the noise, we first seasonally adjusted the series and then take 3-month moving average

3. Core exports picked up after the US Supreme court struck down US tariffs



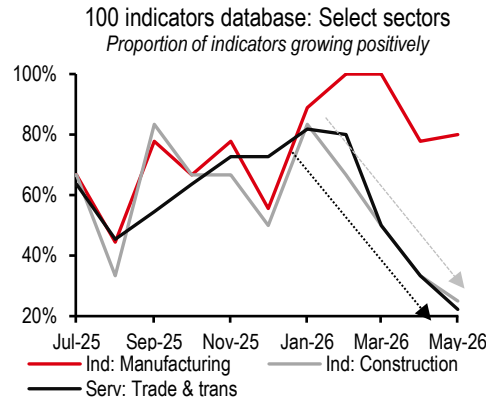
Source: CEIC, HSBC. The Supreme court struck down US reciprocal tariffs under the International Emergency Economic Powers Act (IEEPA) on 20 February 2026

4. Stocks of finished goods have risen



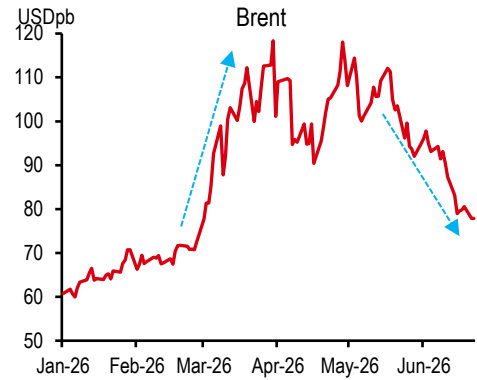
Source: S&P Global PMI, HSBC

5. Construction and trade & transport have slowed



Source: S&P Global PMI, CEIC, HSBC

6. Oil prices have tumbled



Source: Bloomberg, HSBC

Two, firms with access to energy have been front-loading manufacturing, given fears of energy sources drying up (see exhibit 4). This has raised output growth and urban jobs over the last few months. The June flash PMI showed a rise in the order-to-inventory ratio, led by strong domestic orders, which is likely to contribute to resilient manufacturing activity over the next few months.

On the other hand, trade and transport as well as construction activity have fallen most, likely because of higher energy prices and unavailability of industrial feed (see exhibit 5). As these make up a larger share of economic activity, the latter has gradually slowed.

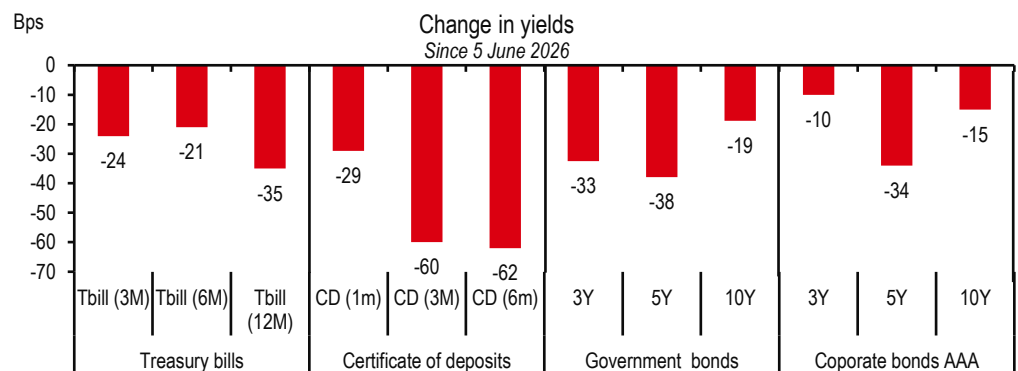
Q2. Which sectors will be resilient, which not?

Until a month ago, there were three concerns around India's macroeconomy – high oil prices, tight domestic financial conditions, and the likelihood of a 'very strong El Niño'.

The first two concerns have eased. Oil prices have fallen (see exhibit 6). We expect the FX package announced by the RBI to attract foreign inflows (deposits from non-resident Indians, ECBs, and foreign bank borrowing) which will have to be invested domestically. Even before the inflows have begun, interest rates across a host of financial instruments are falling in anticipation (see exhibit 7). Financial conditions don't look as tight as a month ago.

On the back of this, we have **raised our FY27 GDP forecast from 6% to 6.3%**.

7. Financial conditions have begun to ease



Source: CEIC, Bloomberg, HSBC. Data as of 24 June 2026 close.

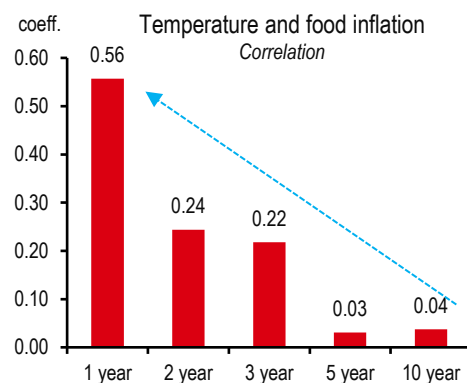
Alas, concerns around the El Niño hurting growth remain strong. Our analysis shows that rising temperatures and heatwaves are far more disruptive for food production and inflation than insufficient rains¹. We find that the temperature spikes in El Niño years are rising with time, and are now crossing important thresholds, where they not only impact perishable crops such as fruits and vegetables, but also hardy ones like rice, wheat, pulses, edible oils, poultry, and dairy (see exhibit 8). An El Niño could shave off 0.3ppt from growth, going by previous experience (see exhibit 9).

On sectoral splits, we believe the informal sector, comprising rural workers and urban informal workers, is impacted most during supply shocks. Heatwaves will impact farmers directly, and the consequent high inflation will likely impact urban informal workers, who tend to be price sensitive. Together, this group makes up two-thirds of India's consumption pie (see exhibit 10).

In contrast, the formal sector might be relatively better protected. Already we are seeing two-wheeler sales (proxy of rural and informal demand) begin to slow compared to passenger vehicle sales (proxy of urban formal sector demand, see exhibit 11). This group is not as sensitive to inflation and may benefit from improved domestic liquidity and rising personal loan growth.

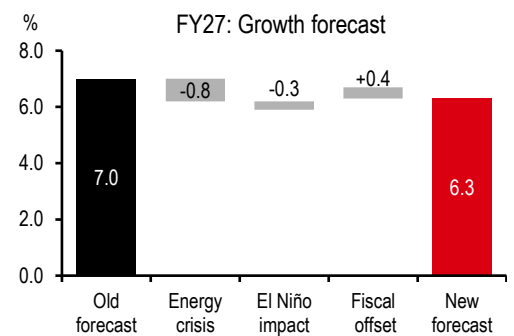
Indeed, corporates had resorted to domestic borrowing over foreign borrowing when the INR was weakening. As the INR stabilises and the RBI's FX package incentivises foreign borrowing again, bank lending may pivot away from corporates towards personal loans.

8. Correlation between India's average temperature and food inflation has risen



Source: CEIC, HSBC. Note: Both variables are in % m-o-m sa terms

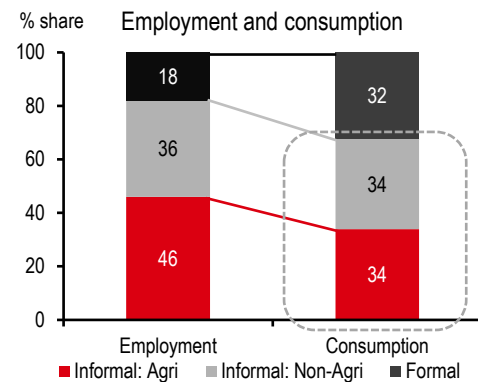
9. India's growth forecast for FY27



Source: HSBC estimates

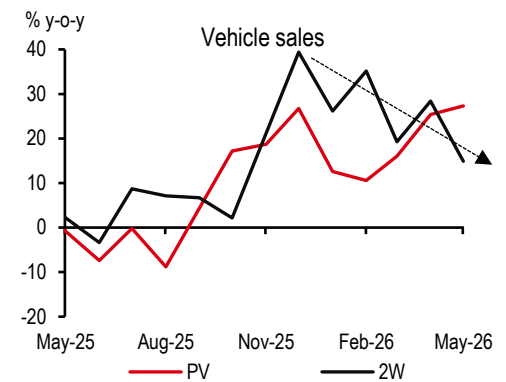
¹ The spread of irrigation facilities has helped in the management of drought-like situations. But there is no magic wand for dealing with heatwaves.

10. The informal sector is likely to be impacted most



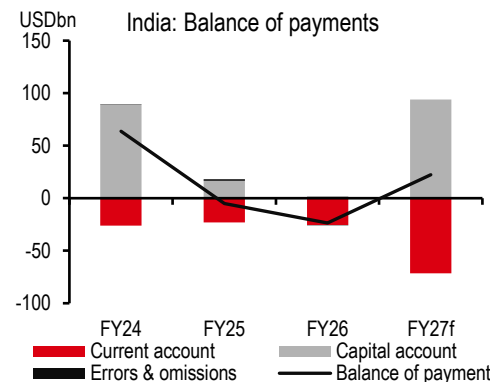
Source: PLFS, HCES survey of 2023-24, HSBC calculations

11. Two-wheeler sales have slowed compared to passenger vehicle sales



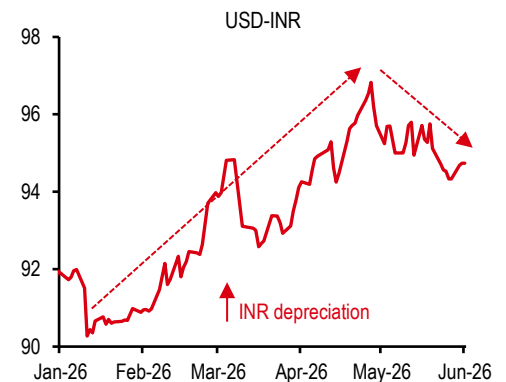
Source: CEIC, HSBC

12. We forecast a BoP surplus in FY27 after two years of deficit



Source: CEIC, HSBC

13. The INR has strengthened against the USD in June



Source: Bloomberg, HSBC

Q3. Will the RBI's FX package swing the BoP?

Going into the June 5 policy meeting, there were hopes that some kind of FX package which attracts foreign inflows would be announced. After all, oil prices were on the boil, it was turning out to be a third year of BoP deficit, and the INR was falling against the USD.

Many options were on the table. Eventually the authorities opted for them all, in an "all-in" FX package. Soon thereafter, oil prices began to fall too.

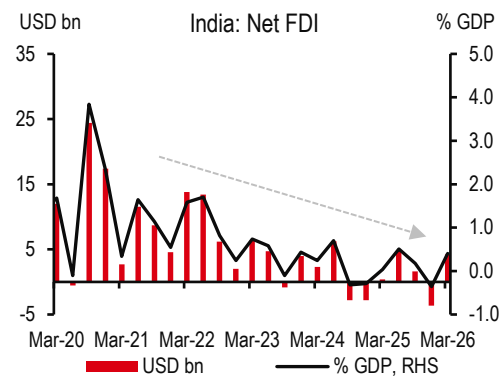
With these two back-to-back developments, BoP dynamics seem much altered. We now forecast oil to average USD85/b in FY27, down from USD95/b just a month ago. On the back of lower oil and other industrial feed prices, and steps to lower gold imports, we forecast a narrower current account deficit of 1.7% of GDP vs 2.3% forecasted earlier.

Furthermore, we forecast the capital account to be higher by USD65bn than previously forecasted, leading to a BoP surplus of about USD25bn, which is broadly in line with the 10-year average (see exhibit 12). No surprise that the INR has strengthened against the USD in June (see exhibit 13).

Having said that it must be remembered that the FX package points to one-time inflows which need to be repaid over time. From that perspective, the economy has bought time, in which it can undertake important reforms, which attract more permanent inflows, like FDI (see exhibit 14).

How the INR eventually behaves will also depend on central bank behaviour. If it buys dollars to build up FX reserves (given its short forward book), the INR may not strengthen. Yet, substantial inflows may keep it from weakening rapidly.

14. Net FDI will be tracked to ascertain if India is able to attract permanent inflows



Source: CEIC, HSBC

15. Central government fiscal math: Drags and offsets

	% GDP
Drags	1.0
Excise duty cut	0.4
Fertiliser bill	0.2
Under-recoveries	0.2
Others	0.2
Offsets	0.6
Windfall profits	0.1
Economic stabilisation fund	0.1
Higher disinvestment	0.1
Expenditure rationalisation	0.3
Net fiscal slippage	0.4

Source: CEIC, HSBC

Q4. Will the fiscal slippage be disruptive?

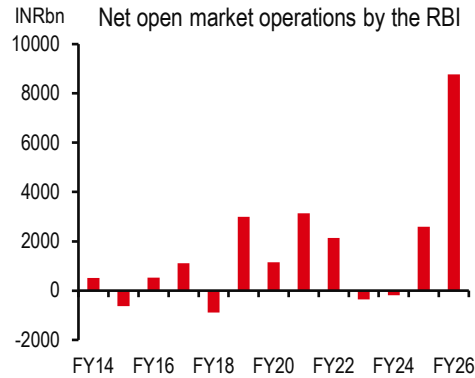
Since the start of the energy crisis, the government has sought to cushion households and small firms through a mix of tax cuts and subsidies like oil excise duty reductions and higher fertiliser subsidies, alongside measures such as the credit guarantee scheme. Taken together, these steps are likely to create a fiscal drag of around 1% of GDP.

Some of this impact should be offset by receipts and savings, including the economic stabilisation fund, windfall profit tax on petroleum related exports, higher disinvestment proceeds, and expenditure rationalisation². These offsets should help contain the net fiscal slippage to roughly 0.4% of GDP (INR1.5tr, see exhibit 15 for details).

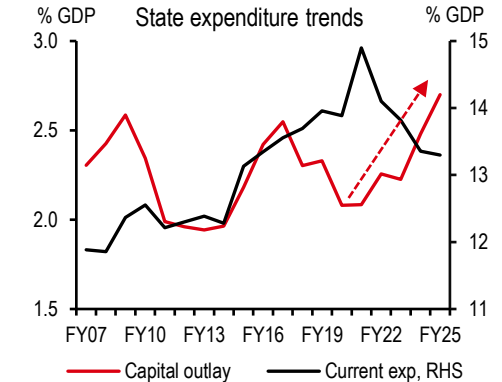
We therefore expect the Centre’s fiscal deficit to widen to 4.7% of GDP versus the budgeted 4.3%. Bond markets are likely to scrutinise government finances more closely in 2HFY27 when the fiscal consolidation narrative comes back into sharper focus. Even so, we don’t expect a slippage of INR1.5trn to translate into higher market borrowing one-for-one, given alternative funding channels such as the small savings fund and higher T-bill issuances. The attention, instead, may move to the role of the RBI, and whether it will do OMO purchases following the large purchases last year (see exhibit 16), or pivot to OMO sales, to take out some of the excess liquidity following the FX package-induced inflows

At the state level, the fiscal deficit (excluding the centre’s capex loans) has already reached the 3% ceiling in FY26, leaving limited room for further slippage. That said, the composition of spending could shift, with a tilt towards current expenditure at the expense of capex (see exhibit 17).

² This includes delays in BSNL’s capital infusion and lower than budget spending on some richly funded centrally sponsored schemes like Housing and National Rural Drinking Water Mission.

16. RBI's OMO purchases touched c9trn in FY26


Source: RBI, CEIC, HSBC

17. State capex had picked up in the recent years, aided by centre's capex loans


Source: RBI, HSBC

Q5. How high could inflation rise?

India's inflation landscape has received a meaningful data upgrade with the rebasing of the CPI and WPI series, alongside the introduction of an output PPI.

The 9%+ inflation for both PPI and WPI in May points to elevated price pressures at the producer and wholesale levels, driven largely by higher fuel costs (see exhibit 18). Interestingly, the pass-through from WPI to PPI thus far, has been led more by consumer goods like electronics, furniture and apparel (see exhibit 19).

CPI inflation, by contrast, remains benign and close to the RBI's 4% target in May, suggesting that pass-through from producers to consumers is still incomplete. The PMI price indices tell a similar story, highlighting a clear wedge between rising input costs and more subdued output price increases (see exhibit 20).

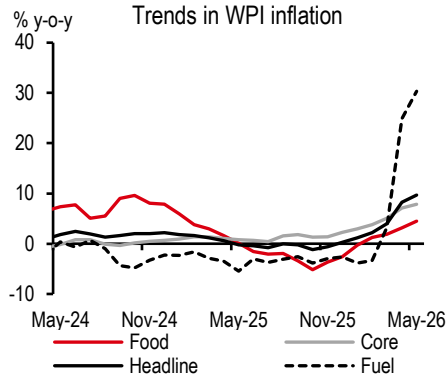
Our statistical work suggests corporates typically pass through around 60-70% of cost increases to consumers over roughly 3-4 months. We therefore expect core CPI inflation to firm over the next few months as second-round effects from the energy shock begin to feed through. But the inflation story doesn't stop there.

The likelihood of a 'very strong El Niño' will result in warmer temperatures, less rains and higher food inflation. Our research shows that an El Niño can be a lot more hurtful now than in the past as its impact is no longer confined to perishable crops like vegetables and fruits but increasingly extends to more durable staples like cereals, pulses, and oilseeds, and even livestock (impacting dairy, poultry and fishery products).

At the start of the year, our inflation forecast for FY27 was 4%. The two shocks can raise it to 5.1% (see exhibit 21). We also believe that some of the El Niño pressure could be felt in the winter crop, keeping inflation elevated in the first half of FY28.

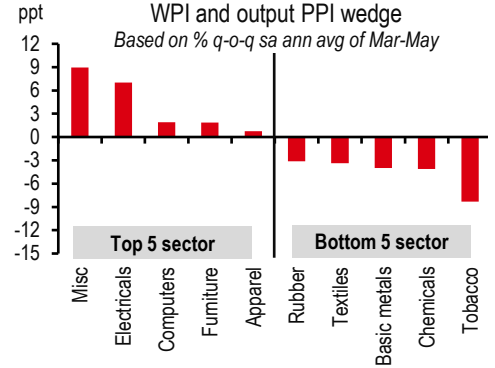
We forecast CPI inflation to average just below 6% for two quarters starting October. Thereafter, we forecast inflation to average 4% in 2HFY28 (see exhibit 22).

18. Elevated price pressures at wholesale level are driven by higher fuel costs



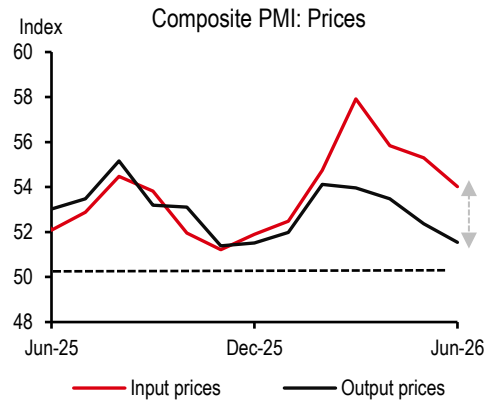
Source: CEIC, HSBC

19. Pass-through from WPI to PPI has been most for consumer goods



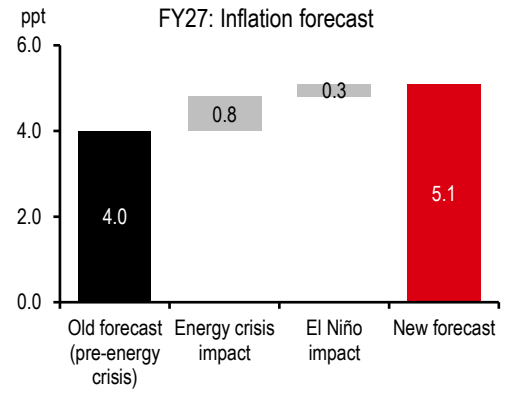
Source: CEIC, HSBC

20. The wedge between input and output prices has widened



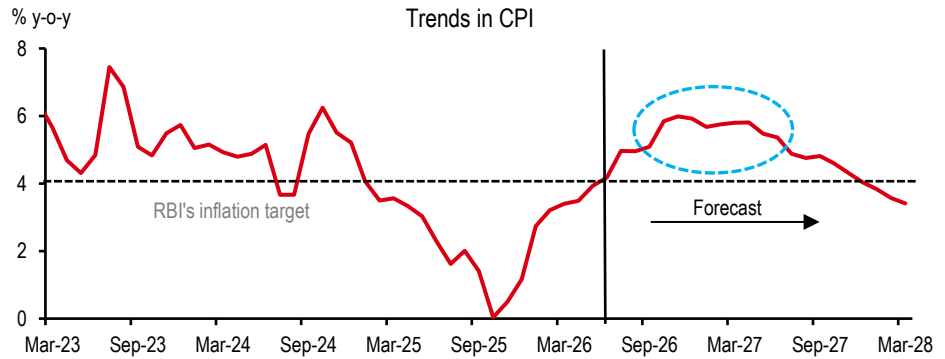
Source: S&P Global PMI, HSBC

21. The energy and El Niño shock can raise India's inflation to 5.1% in FY27



Source: HSBC estimates

22. CPI inflation to average just below 6% for two quarters starting October and ease to an average of 4% in 2HFY28



Source: CEIC, HSBC

Q6. Will the RBI react to growth or inflation?

Supply shocks are never easy. Eventually we believe this will be a shallow rate hiking cycle. We expect two rate hikes of 25bp each in 4Q 2026, taking the repo rate to 5.75%.

The reason for hikes is inflation as the RBI may not be able to look through CPI price increases which average close to the upper end of the 2-6% target range for around six months.

The reason for a shallow rate hiking cycle is also inflation, which could settle back closer to the 4% target range in 2HFY28. Alongside this, weak growth prints will also likely tie the central bank's hands. We expect a meaningful fall starting in the September quarter.

The central bank will also have to play a proactive role in liquidity management, taking out excesses induced by the FX package. There are several options available, ranging from temporary (VRRRs) to the more permanent (OMO sales, and even CRR hikes, if needed).

23. India: Key forecasts

	Unit	FY26 (Apr'25-Mar'26)	FY27f (Apr'26-Mar'27)
Real gross domestic product (GDP)	%y-o-y	7.7	6.3
Nominal gross domestic product (GDP)	%y-o-y	8.9	12.9
Consumer price index (CPI)	%y-o-y	2.0	5.1
Central government fiscal balance	% GDP	-4.4	-4.7
Current account balance (C/A balance)	% GDP	-0.7	-1.7
Repo rate	%, end-period	5.25	5.75

Source: HSBC estimates

Disclosure appendix

Important disclosures

Additional disclosures

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