



**January 2026**

## Executive Summary

**Global Backdrop:** 2025 was a strong year for global markets, with global equities and Emerging Markets fixed income outperforming Indian assets. Despite tariff-related uncertainties, global growth held up, supported by loose fiscal policies and AI-driven investments in the US. Trade tensions eased, though the India-US trade deal remains pending. Looking ahead, US growth ex-AI appears modest, Europe is fiscally expansionary, but China remains export-dependent, limiting global growth impulses for 2026. Inflation worries persist in the US, while elsewhere deflationary impulses from Chinese exports are strong. Yet for now, most central banks appear to be in final legs of easing unless growth falters meaningfully. EM economies may benefit from softer dollar and supportive liquidity.

**India's growth:** Real GDP averaged 8% y-o-y in 1H FY26, but nominal growth was soft at 8.8%. FY26 nominal GDP likely ~8.5%, while real growth could appear statistically elevated at 7.5%. Nominal GDP expected to improve to ~11% in FY27, with real GDP statistically moderating to ~7.2%. FY27 growth will be domestically driven, led by consumption and credit revival. Exports remain the weakest link, while inflation stays benign and policy supportive. Structural reforms and premiumization trends reinforce a constructive medium-term outlook. Global slowdown and geopolitical remain the key risk.

**Policy Pivot:** RBI cut repo by 125 bps in 2025 and infused liquidity (~INR 15.7 trillion since Dec'24), signaling a shift to growth orientation. Fiscal stance eased, and reforms accelerated—tax cuts, GST rationalization, labour code, 100% FDI in insurance, private nuclear investment, and revamped employment schemes. 2025 can be classified as the year of reforms which create a medium to long term structural positives for India.

**Credit Revival:** Bank credit rose from 9% in May to 11.4% by Nov'25; aggregate credit likely grew by 10.5–11% in FY26. Bank credit growth is projected at 13–14% in FY27; household credit likely to outpace corporate. Segments reliant on credit-driven demand and premiumization trends should outperform.

**Capex:** Corporate capex to stay healthy (early-teens), led by power, gas transmission, capital goods, and cement; central capex likely in line with nominal GDP as fiscal consolidation moderates.

**Inflation & Policy:** Inflation to average ~4% in FY27, still benign. Monetary policy likely on extended pause; liquidity support to continue.

**Fiscal & Bonds supply:** Centre's deficit to ease to 4.2% in FY27; state deficits remain elevated. Government bond supply could rise to Rs. 29 trillion (vs. an estimated Rs. 27.2 trillion in FY26), keeping demand-supply tight.

**Currency:** INR depreciation expected to slow to ~2% in FY27 (~₹92/USD), aided by potential global bond index inclusion, resumption of FPI equity inflow, contained CAD and trade deal optimism. REER has depreciated significantly in 2025

**Equity Outlook:** We expect the trends of 2025 to continue into 2026. EM equities and hard assets, including industrial commodities, should stay supported after years of underperformance on the back of improving global growth. India having moderated on valuations premium to EMs should receive its fair share of flows. Policy support should help growth which should help equities inch higher. However, equity supply puts a lid on the markets. Expect measured up move for large caps. Performance down the market cap spectrum may stay muted as market polarization increases on the back of valuation normalization. Rising polarization amidst moderate market returns should mean staying selective and focusing on bottom-up should help.

**Fixed Income Outlook:** Given the overall macro and demand dynamics in the current phase of the rate cycle, it is time to prioritise stability and accrual over a directional duration strategy. A moderate duration stance, with core accrual built around high-grade short tenor AAA bonds and selective exposure down the curve (consistent with fund risk mandates) is warranted in portfolios. Duration remains tactical in the current environment.

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## Section 1: Global Economy

### 2025 Market Review: Global strength vs. Indian underperformance

2025 has been a relatively strong year for global asset classes, marked by a broad-based recovery. Positive momentum was seen across gold, equities in both emerging and developed markets, and emerging market fixed income assets. Overall, global equities and global fixed income significantly outperformed Indian markets during the year (Exhibit 1).

#### Exhibit 1:

Precious metals and EM equities outperform in 2025; Strong returns in gold for two years in succession

2021	2022	2023	2024	2025
Industrial metals and mining(73%)	Brent (10%)	BSE Small Cap(48%)	Gold (30%)	Precious Metals (154%)
BSE Small Cap(63%)	CRB Food(9%)	BSE MidCap(46%)	BSE Small Cap (29%)	Gold (63%)
Brent (50%)	DXY index (8%)	MSCI DM Equity (22%)	BSE MidCap (26%)	Industrial metals and mining (39%)
BSE MidCap(39%)	India NIFTY(4%)	Industrial metals and mining(21%)	MSCI DM Equity (17%)	MSCI EM Equity (31%)
CRB Food(35%)	Industrial metals and mining(3%)	MSCI India (20%)	FTSE Global Equity (16%)	FTSE Global Equity (21%)
CRB Commodity(30%)	MSCI India (2%)	India NIFTY(20%)	MSCI India (14%)	MSCI DM Equity (19%)
MSCI India (27%)	BSE MidCap(1%)	FTSE Global Equity(20%)	CRB Food (14%)	EM Aggregate Total Return Index (11%)
India NIFTY(24%)	Nifty 10 yr Benchmark G-Sec (0.4%)	Gold (13%)	Nifty 10 yr Benchmark G-Sec (10%)	India NIFTY (11%)
MSCI DM Equity (20%)	Gold (0.4%)	EM Aggregate Total Return Index (9%)	India NIFTY (9%)	Barclays Global aggregate Index (8%)
FTSE Global Equity (17%)	BSE Small Cap(-2%)	Nifty 10 yr Benchmark G-Sec (8%)	Precious Metals (7%)	MSCI India (8%)
DXY index (6%)	CRB Commodity(-4%)	MSCI EM Equity (7%)	EM Aggregate Total Return Index (7%)	Nifty 10 yr Benchmark G-Sec (7%)
Nifty 10 yr Benchmark G-Sec (1%)	Precious Metals(-11%)	Barclays Global aggregate Index (6%)	DXY index (7%)	BSE MidCap (1%)
EM Aggregate Total Return Index (-2%)	EM Aggregate Total Return Index (-15%)	Precious Metals(2%)	CRB Commodity (5%)	CRB Commodity(1%)
Gold (-4%)	Barclays Global aggregate Index (-16%)	DXY index (-2%)	MSCI EM Equity (5%)	BSE Small Cap (-7%)
MSCI EM Equity (-5%)	MSCI DM Equity (-19%)	CRB Commodity(-8%)	Barclays Global aggregate Index (-2%)	DXY index (-9%)
Barclays Global aggregate Index (-5%)	FTSE Global Equity(-20%)	Brent (-10%)	Brent (-3%)	CRB Food (-10%)
Precious Metals(-9%)	MSCI EM Equity (-22%)	CRB Food(-13%)	Industrial metals and mining(-18%)	Brent (-18%)

Source: Bloomberg, SBIFM Research



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### Global growth persists in 2025 despite tariffs

The US and global economies have delivered a surprisingly decent performance this year, despite ongoing protectionist trade policies and the fact that the Federal Reserve has only recently resumed rate cuts (Exhibit 2). Loose fiscal policies across most key economies (US, Europe, and China) and AI investment in the US have cushioned the impact of tariffs. To add, intensity of tariff has also watered down during the year. For all the noise, global trade performed rather well, with exports running at record levels in much of the region (Exhibit 3).

#### Exhibit 2:

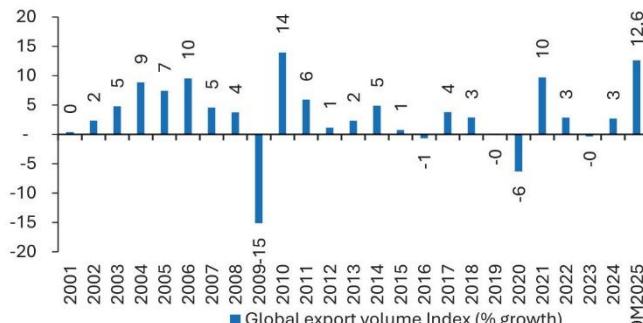
2025 growth expectation sees upward revision for most economies

Bloomberg estimates	2025 Real GDP expectation as on (%)			2026 Real GDP expectation (%)
	Jan-25	Apr-25	Dec-25	
US	2.1	1.4	2.0	2.0
Eurozone	1.0	0.8	1.4	1.1
UK	1.4	0.9	1.4	1.1
Canada	1.8	1.2	1.2	1.2
China	4.5	4.2	4.9	4.5
India	6.7	6.5	7.3	7.2
South Korea	1.8	1.3	1.0	2.0
Indonesia	5.0	5.0	5.0	5.0
Taiwan	2.8	2.8	7.0	3.6
Thailand	3.0	2.5	2.1	1.8
Malaysia	4.7	4.6	4.7	4.3
Philippines	6.0	5.9	4.9	5.3
Russia	1.5	1.6	0.8	1.0
South Africa	1.7	1.5	1.3	1.6
Brazil	2.0	1.9	2.2	1.7
Mexico	1.2	0.2	0.5	1.3
Colombia	2.5	2.4	2.6	2.8
Chile	2.2	2.2	2.4	2.2

Source: Bloomberg, SBIFM Research; NB: Taiwan and Philippines have seen material revision in their 2025 growth outlook; India data for FY26 is RBI's projection on financial year basis; FY27 is SBIFM estimate

## Exhibit 3:

So much for trade war: One of the best years in exports



Source: Bloomberg, SBIFM Research

## US' trade war de-escalates with China and lopsided deals with most other nations

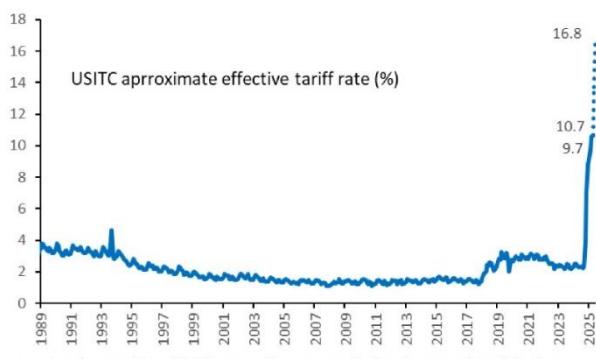
The US de-escalated its trade war with China in May 2025 and has been more lenient toward Chinese re-exports than initially expected. Most countries have entered into asymmetric trade deals with the US; however, these remain deals rather than formal agreements, raising questions about whether the current structure represents a sustainable equilibrium. Surprisingly, the India-US trade deal has taken longer to materialize than anticipated.

## Collection based effective tariffs at ~10-11% vs. 2% a year ago

Back on Liberation Day, the effective tariff was projected to rise from around 2% to 28%. According to Yale Budget Lab's study, the current effective tariff rate stands at 17–18%. Yet, based on actual collections, tariffs appear closer to 10–11%, likely due to transshipment practices (Exhibit 4). This indicates that tariff intensity has significantly diluted over the course of the year.

## Exhibit 4:

US tariffs at 11% based on collection – much less than feared



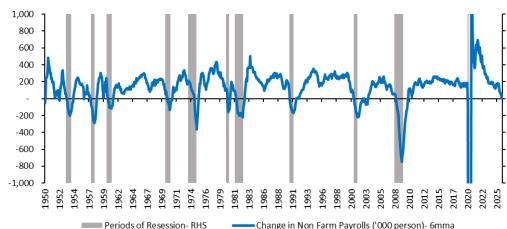
Source: Yale Budget Lab, Bloomberg, SBIFM Research

## AI capex and fiscal support drive US growth amidst labour market and credit stress concerns

Looking ahead, we are in an unusual scenario in the US with strong capex but weak labour market. Current employment levels are historically associated with sharp declines and potential recessions (Exhibit 5). There are emerging signs of credit stress in U.S. consumer segments, particularly in student loans, mortgages, and credit cards (Exhibit 6).

## Exhibit 5:

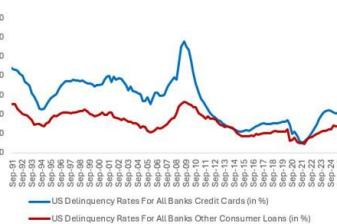
US NFP additions have weakened to levels associated with sharp growth declines in past



Source: Bloomberg, SBIFM Research

## Exhibit 6:

Gradual rise in US consumer loan delinquencies



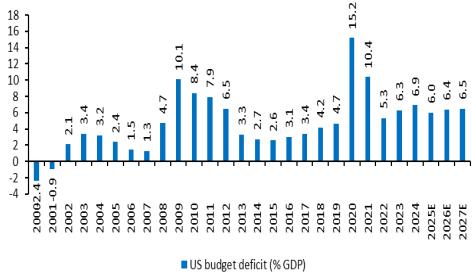
Source: Bloomberg, SBIFM Research

On the other hand, the passage of One Big Beautiful Act has kept the fiscal thrust in US intact. US fiscal deficit is expected to stay above 6% in the medium term (Exhibit 7). There is a high possibility that US fiscal stimulative provisions may remain supportive towards consumer spending and allay meaningful credit concerns.

Further, substantial investments in artificial intelligence and data centres continue to drive economic growth expectations in the US. Excluding AI-related spending, underlying U.S. growth is closer to 1%, pointing to a more modest outlook. Given corporate capex commitments, AI-related investments are likely to continue 2026, even if overall spending falls short of hyperscale projections.

## Exhibit 7:

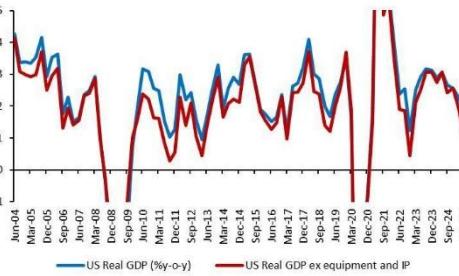
US fiscal policy is expected to stay loose over next two years



Source: Bloomberg, SBIFM Research, Forecasts are Bloomberg estimates

## Exhibit 8:

AI related capex accounts for half of US growth

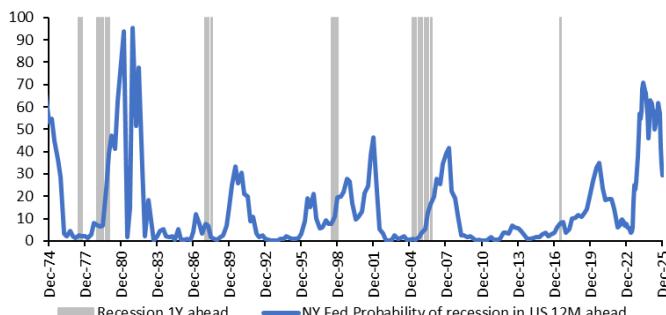


Source: Bloomberg, SBIFM Research; NB: Data above reports y-o-y GDP instead of usually referred to q-o-q SAAR

Even as investment in the US now seems almost entirely AI related and we are seeing the word 'bubble' being used quite frequently in reference to artificial intelligence space, the recession fears have subsided meaningfully and the discussion on any type of landing (hard/soft) has also ebbed (Exhibit 9). It remains to be seen whether weakening US labour demand will finally cause the US economy to cool off meaningfully in 2026 or not.

## Exhibit 9:

Recession probabilities have cooled off significantly since the liberation day



Source: Bloomberg, SBIFM Research

The analyst fraternity has been proven consistently wrong in calling out for recession in the US. The current cycle is very different in the sense that historical lead indicators of recession have failed to work in the current cycle (such as PMI, Non-Farm payrolls, yield curve inversion). **So, for now, we work with an assumption that US and the overall global growth would stay supported in 2026. Risks emanate from further weakness in job creation and any potential fractures in the AI space.**

## Europe Fiscal policy turns modestly expansionary

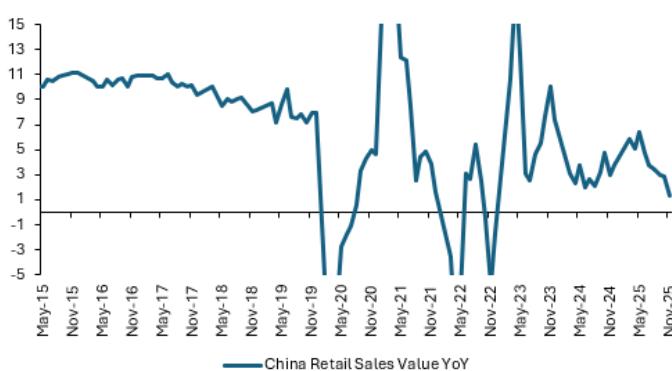
In Europe, fiscal policy has turned modestly expansionary, led by Germany's Euro 1 trillion infrastructure and defence initiative, marking the end of a decade of austerity. Finally, trade tensions with the US have subsided following a new trade agreement, removing a major source of uncertainty.

## Export is a lone source of growth in China

Economic activity looked a bit better in China for a while in 2025, but then turned, with the real estate market, consumption, and investment cooling again during 2H 2025 (Exhibit 10).

## Exhibit 10:

China's economic activity cools in 2H 2025



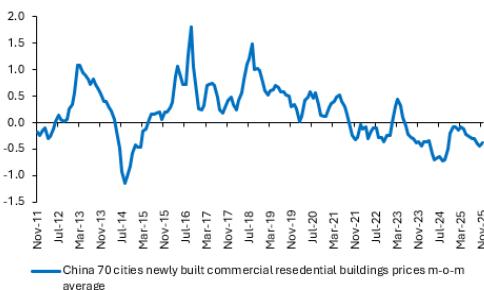
Source: Bloomberg, SBIFM Research

Beijing's newly released 15th Five-Year Plan reiterates the goal of increasing the household-consumption share in the economy meaningfully, which on the surface is a positive sign. Achieving this, however, will require deep structural reforms including income redistribution and a material expansion of social-welfare spending. This could be a more of medium-term goal. And until then, exports remain the lone source of growth in China.

With housing comprising roughly 60% of household assets, property-market swings remain the dominant driver of household wealth effects, sentiment, and consumption. So far, the policy narratives in China are against any massive stimulus to the housing sector and home prices in China keep falling thereby weighing on the sentiment (Exhibit 10 and 11).

### Exhibit 11:

China's residential market continues to fall in prices



Source: Bloomberg, SBIFM Research

### Exhibit 12:

Consumer sentiment stays weak despite a few fiscal measures



Source: Bloomberg, SBIFM Research

**The bottom line for investors is that China will not contribute to a significant pickup in global economic activity next year. This underscores that the US will likely be the most important driver for the global economy in 2026, and the economic backdrop in the US is getting increasingly complex and unclear. AI Investment led growth in the US appear precarious and there are risks to US growth outlook in 2026.**

**Assuming no recession, inflation likely to remain above the 2% target in the US...**

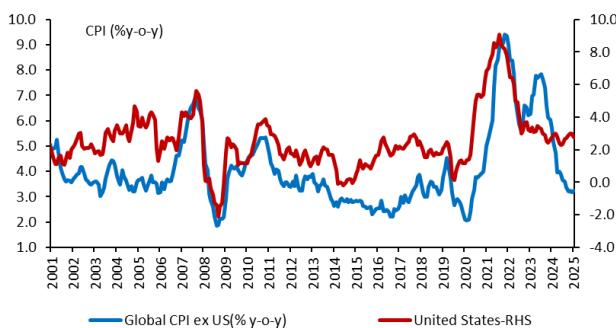
A Harvard study concludes that most tariff-related costs have been absorbed by U.S. importers and consumers, which remains incrementally negative for U.S. growth. Tariffs have added about 0.7% to U.S. CPI. Without tariffs, inflation would have been closer to 2.3% instead of 3%. As the effects of both the One Big Beautiful bill and Tariffs stabilize, US CPI could stay above the desired 2% even into 2026.

**... but China's export thrust precludes any significant inflation fear outside the US**

Outside of the US, inflation does not appear to be a major threat (Exhibit 13). Inflation is close to 2% in the euro area. We are in the camp to believe that while US struggles with sticky inflation a bigger problem for rest of the world is exported deflation from China.

### Exhibit 13:

Inflation stays sticky in the U.S., soft elsewhere



Source: Bloomberg, SBIFM Research

## 2026: last few cuts then extended pause (assuming no recession)

Tariff-driven inflation may slow the Fed's pace of policy easing in the coming year, assuming a low likelihood of US recession. US Fed has guided for one more rate cut in 2026 while market expects two.

Most central bankers, except for Latin American economies, appear to be in final leg of monetary easing though we do acknowledge that there is a buffer space to ease further, especially amongst the emerging market economies, should the global growth falter (Exhibit 14). Inflation amongst the EM economies appear largely stuck to the floor.

Loose fiscal and monetary policy has contributed to the steeping of bond yields in developed markets. 2026 appears to be yet another unexciting year for developed market global bonds unless growth softens significantly.

### Exhibit 14:

Most central banks expected to either pause or deliver last 1-2 rate cuts (ex-Russia & LATAM)

Annual Policy Rate (in %)	2023	2024	2025	2026E	Hike/cut in 2026E
US	5.50	4.50	3.75	3.25	-50
Eurozone	4.50	3.15	2.15	2.00	-15
UK	5.25	4.75	3.75	3.25	-50
Japan	-0.10	0.25	0.75	1.00	25
Canada	5.00	3.25	2.25	2.25	0
India	6.50	6.50	5.25	5.00	-25
South Korea	3.50	3.00	2.50	2.50	0
Indonesia	6.00	6.00	4.75	4.25	-50
Thailand	2.50	2.25	1.25	1.00	-25
Malaysia	3.00	3.00	2.75	2.75	0
Philippines	6.50	5.75	4.50	4.25	-25
Russia	16.00	21.00	16.00	12.75	-325
South Africa	8.25	7.75	6.75	6.25	-50
Brazil	11.75	12.25	15.00	12.25	-275
Mexico	11.25	10.00	7.00	6.50	-50
Colombia	13.00	9.50	9.25	8.25	-100
Chile	8.25	5.00	4.50	4.23	-27

Source: Bloomberg, SBIFM Research; NB: Red denotes rate hike and green denotes rate cut

## Section 2: Outlook on USD

### Dollar to remain on a softening bias in 2026

#### Dollar sees a strong start in 2025, weakens in Q2, and then stabilizes July onwards

2025 began with a strong USD, supported by the Trump administration's election promises. However, this strength started to fade following the German elections in March 2025 and the prospect of significant fiscal policy changes in the Europe. A major turning point came around Liberation Day when the USD weakened sharply in response to tariffs (Exhibit 15).



#### Exhibit 15:

DXY moves through 2025



Source: Bloomberg, SBIFM

#### Exhibit 16:

The DXY has converged to its weighted rate differential



Source: Bloomberg, SBIFM Research; NB: Interest rate differential is the US vs. the economies that make up DXY index, German Bund is taken as a proxy for Euro



#### Dollar's Q2 2025 slump sparks regime-shift debate...

The abrupt dollar declines in Q2 2025 sparked arguments for a potential structural regime shift—de-risking from the U.S., de-dollarization, fiscal concerns, and increased FX hedging—making an ongoing fall appear inevitable. While currency debasement has also been cited as a reason for higher gold prices, what remains perplexing is that if the risk of a structural dollar decline were truly meaningful, it should have triggered a severe deterioration in U.S. bond markets—something that has yet to materialize.

#### ...but USD returns to fundamentals as trade deal jitters ease

As hasty trade deals were pieced together, U.S. policy uncertainty began to recede, allowing the traditional drivers of dollars to regain importance. This is evident in the chart mapping DXY against its weighted interest rate differential (Exhibit 16). Early in the year, the DXY traded much stronger than its yield composition implied. Later, this reversed, with the USD being far weaker than rate differentials through Q2 2025 and part of Q3 2025. As of now, it's largely in line with the US interest rate differential with other currencies in DXY.

Since July 2025, DXY has stabilized around 98 levels. This makes us question whether USD's decline is over and whether its next move will be higher. We believe there is still modest room for further weakness.

## US rate cuts outside of recession have coincided with weaker dollar

Historically, Fed rate cuts outside of recessionary periods, as is the case now, have mostly coincided with dollar weakness with the exception of 1995–96 (Exhibit 17). It is also striking how closely the USD's trajectory this year mirrors that of 2017 during Trump's first year in office (Exhibit 18). The eventual bottoming of the USD will also depend on global growth slowing—if that occurs in the coming quarters, it will lend support to the dollar. So far, against initial expectations, global growth has held up despite heightened U.S. trade frictions, and momentum outside the U.S. appears stronger (Exhibit 19). Finally, the magnitude of Fed rate cuts and the choice of the next Fed Chair will also influence the dollar's path.

### Exhibit 17:

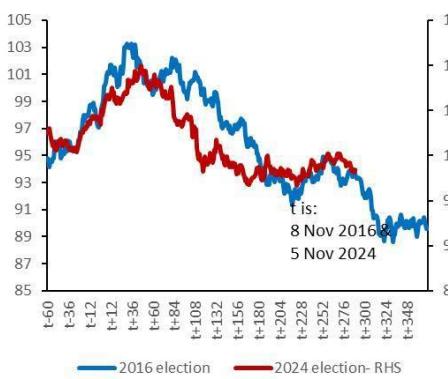
Historically, Fed interest rate reduction without a recession has driven dollar weakness

Start of rate cut	End of Rate cut	Starting Fed Funds rate	Ending Fed Funds Rate	Quantum of Cut	% fall in DXY	US in recession
Feb-71	Dec-71	4.00	3.50	50	-8	No
Jul-74	Apr-75	13.00	5.25	775	-5	Yes
Dec-79	Jun-80	15.50	9.50	600	-2	Yes
Jan-81	Dec-81	18.00	12.00	600	16	Yes
Apr-82	Dec-82	15.00	8.50	650	2	Yes
Oct-84	Aug-86	11.75	5.88	587	-28	No
Oct-87	Feb-88	7.25	6.50	75	-8	No
Jun-89	Sep-92	9.75	3.00	675	-21	Yes
Jul-95	Jan-96	5.75	5.25	50	7	No
Sep-98	Nov-98	5.50	4.75	75	-4	No
Jan-01	Dec-01	6.50	1.75	475	7	Yes
Nov-02	Jun-03	1.75	1.00	75	-11	No
Sep-07	Dec-08	5.25	0.25	500	-4	Yes
Jul-19	Oct-19	2.50	0.25	225	0	No
Mar-20	Mar-20	1.75	0.25	150	1	Yes
Nov-24	Dec-25	5.00	3.75	125	-6	No

Source: Bloomberg, SBIFM Research; NB: Cells highlighted depict depreciation in DXY when Fed cut interest rates outside of the US recession

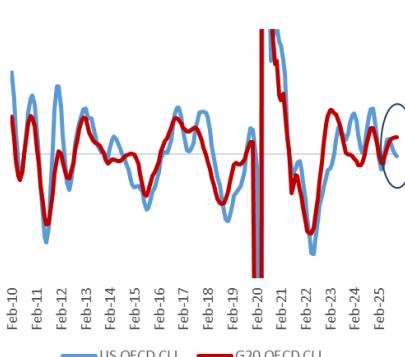
### Exhibit 18:

DXY moves during Trump's first and second presidency



### Exhibit 19:

Global growth indicators are firmer than the US



Thus, provided global growth does not suddenly falter, the Fed remains on an easing or a pause mode, and U.S. financial conditions stay loose, the USD is likely to remain soft-creating a supportive backdrop for Emerging market currencies.

## Section 3: Indian Macro

India's 1H FY26 real GDP growth has averaged at 8% y-o-y while the nominal GDP growth has been extremely soft at 8.8% y-o-y.

### India's economic activity had been soft in 1H FY26

Real GDP strength is at odds with modest growth in several high-frequency indicators, including corporate data. We maintain that Nominal GDP is the clearer indicator of India's economic pulse especially during times when WPI is extremely low. Nominal growth, presently, is much weaker than desired 11-12% (at the very least).

### High frequency indicators suggest a pick-up in activity during November 2025

Looking beyond Q2, high-frequency indicators for November show encouraging signs: a pickup in bank credit, healthy services exports, freight activity (likely aided by GST rate cuts and festive demand), strong steel consumption, and resilient auto sales especially for tractors, and passenger vehicles. Tax collections have also improved in September and October 2025 (Exhibit 20).

#### Exhibit 20:

##### High Frequency Indicators

%y-o-y		FY23	FY24	FY25	1HFY26	Oct-25	Nov-25
Overall Macro Indicators	GST collections (Rs. Billion)	21.4	11.7	9.4	9.8	4.6	-4.0
	Bank Credit (Rs. Tn)	14.4	19.2	13.4	9.9	12.5	11.4
	Petroleum Consumption (000 MT)	10.6	5.0	2.1	1.1	-0.4	3.0
	Electricity generation (bn KWh)	8.9	7.1	5.2	1.0	-6.9	-0.2
Logistics and Movements of Goods	Air Traffic: Passengers handled (mn passengers)	73.3	15.0	9.5	2.6	4.7	7.0
	Air Traffic: Cargo handled ('000 tonnes)	0.2	7.0	10.5	4.7	-2.5	15.6
	National Electronic Toll Collection (mn numbers)	39.2	10.9	11.7	15.6	17.5	17.3
	Total E-way bills (mn numbers)	23.8	16.1	17.3	21.8	8.2	27.6
	HSD Consumption (000 MT)	12.1	4.3	2.0	2.9	-0.3	4.7
Consumer	Total Port traffic (mn tonnes)	8.8	7.6	3.4	4.3	3.0	12.3
	Digital Payments (Value INR tn)	45.1	36.9	26.3	15.1	10.1	16.6
	Nauki Job Speak Index (Jul 2008=1000)	14.0	-9.4	1.4	6.6	-9.3	23.5
	MGNREGA (work demanded by persons)	-17.5	0.3	-7.7	-8.5	-35.7	-32.0
	Rural Wage (Rs./ day)	5.4	6.3	5.8	5.5	na	na
	Domestic Passenger vehicle sales ('000 units)	24.1	25.7	1.9	-1.5	17.2	18.7
	Domestic two wheeler sales ('000 units)	17.7	13.4	9.1	0.7	2.1	21.2
	Urban consumer sentiment index	74	97	104	109	107	113
	Rural consumer sentiment index	80	102	113	117	117	118
	IIP: Consumer durables (2011-12=100)	0.6	3.6	8.0	4.8	-1.3	10.3
Business	IIP: Consumer non- durables (2011-12=100)	0.7	4.1	-1.5	-1.8	-5.2	7.3
	Manufacturing PMI	56	57	57	58	59	57
	Services PMI	57	60	59	60	59	60
	Coal (mn tonnes)	14.9	11.8	5.1	-0.8	-8.5	2.1
	Fertilizers(mn tonnes)	11.3	3.7	2.9	-0.4	7.4	5.6
	Steel(mn tonnes)	9.8	12.5	6.9	10.7	5.9	6.1
Government	Cement(mn tonnes)	8.7	8.9	6.3	7.7	5.2	14.5
	Import of Capital Goods (US\$ mn)	15.5	7.6	9.5	15.9	14.5	15.3
	Centre Revex ex Interest Payment (Rs. Tn)	5.3	-3.7	2.3	-3.1	-17.3	18.8
	Centre Capital expenditure (Rs. Tn)	24.4	28.8	10.9	40.0	-28.3	-13.8
	State Revex ex interest payment (Rs. Tn)	22.1	8.3	10.7	8.0	-16.2	na
Trade	State Capex (Rs. Tn)	11.9	27.2	6.7	10.3	1.2	na
	Tax collection (Rs. Tn)	16.4	12.7	9.2	4.4	12.2	na
	Exports of Goods (US\$ bn)	6.9	-3.1	0.1	3.0	-11.9	19.3
	Imports of Goods (US\$ bn)	16.8	-5.3	6.2	4.6	16.9	-2.0
Prices	Non oil and non gold imports (US\$ bn)	16.0	-3.8	5.2	8.1	7.3	15.2
	Exports of Services (US\$ bn)	27.8	4.8	13.6	9.4	2.2	11.7
Prices	CPI (2011-12=100)	6.7	5.4	4.6	2.2	0.3	0.7
	WPI (2011-12=100)	9.4	-0.7	2.3	0.2	-1.2	-0.3

Source: CMIE, RBI, SBIFM Research; NB: Dark green denotes positive and higher than previous month, light green positive but moderation, light red is negative but improvement, red is negative and deterioration

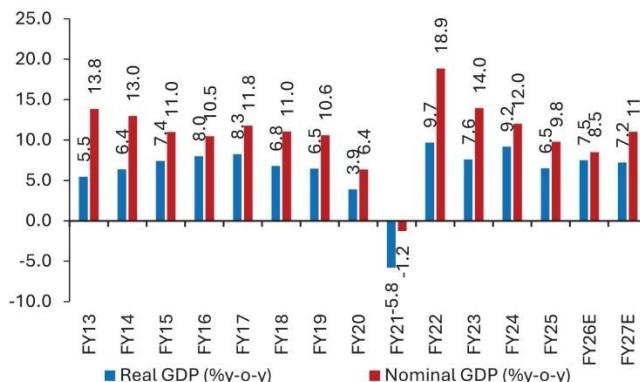
### Statistical anomalies could distort the GDP prints in FY26 and FY27, but...

Purely for deflator reasons, FY26 real GDP could clock a growth of 7.5% y-o-y while nominal could be low at 8.5%. For FY27, we are getting incrementally positive on India's growth outlook. As the low inflation tailwinds will be behind us, real GDP growth could appear to be moderating to 7.2% but we expect nominal growth to improve to ~11% in FY27 (Exhibit 21). It is important to note that Ministry of Statistics is planning to release a new GDP CPI and IIP series which will see a base revision and some methodological changes which might require us to revisit the statistical prints.



## Exhibit 21:

India's Nominal and Real GDP outlook



Source: CMIE, SBIFM Research

**...more importantly, directionally, we are positive on growth in FY27 backed by policy thrust**

One of the most important reasons for us to get positive is the change in policy outlook. Both fiscal and monetary policy were growth restrictive in 2024, with monetary policy fixated on inflation and regulatory tightening while fiscal policy focused on tax buoyancy and consolidation. This has meaningfully reversed in 2025.

**Monetary policy has shifted from risk aversion to growth orientation in 2025**

For banks, the regulatory stance has shifted from risk aversion to growth orientation. Throughout 2025, there has been tacit relaxation in credit-to-deposit ratio norms, liquidity coverage ratio requirements, and provisioning for unsecured loans. Repo rate has been reduced by 125bps in 2025, and RBI has taken direct liquidity infusion measures totaling to INR 15.7 trillion via OMO purchases, CRR reduction and FX swaps and LCR relaxation since December 2024. Even as liquidity had stayed lower than desired despite these measures, the intent is quite clear- which is to keep liquidity supportive.

## Exhibit 22:

Liquidity support by RBI since Dec'2024

Liquidity management measures by RBI since Dec-24	INR tn
Repo rate cut by 125bps cumulatively	
Reduction in risk weights to lending towards SME & MFI	
Easing in earlier proposed stringent LCR Norms	
Relaxation of priority sector lending norms	
CRR cut by 150bps (50bps in Dec'24 & 100bps from Sep-Nov'25)	3.7
OMO purchases	8.5
Buy sell swaps	3.5
<b>Total</b>	<b>15.7</b>

Source: RBI, SBIFM Research

**From tax cuts to labour code: India's reform surge in 2025**

Further, the absence of a trade deal and the resurgence of the current government's popularity in multiple state elections post-June 2025 appear to have catalyzed a series of meaningful reforms during the year. The year began with a reduction in personal income tax, followed by GST rate rationalization, removal of quality control orders in select sectors, implementation of the labour code, 100% FDI in the insurance sector, permission for private investment in the nuclear sector, and a revamp of the employment guarantee scheme to enhance efficiency. Overall, 2025 was a power-packed year for reforms. It is also understood that several states have become increasingly proactive in easing regulatory bottlenecks to attract FDI, with Tamil Nadu setting a notable example. While many of these reforms are difficult to quantify in terms of their immediate growth impact they undoubtedly contribute to a more constructive outlook for India's medium-term economic story.

## India's Export Outlook: Waiting for Clarity Amid Trade Deal Uncertainty

We remain hopeful that the India-US trade deal will materialize in 2025, while India continues to sign free trade agreements with other nations (Exhibit 23). However, any export-related boost from such an agreement is not factored into our current growth model, even though it would likely improve sentiment around dollar inflows and the rupee. At the same time, we are mindful of rising competition from China, which continues to capture a larger share of global trade, leaving India's market share stalled under 2% of GDP (Exhibit 24,25,26). For now, we assume healthy services exports but a subdued performance in goods exports. Interestingly, November 2025 merchandise export data was surprisingly strong, suggesting that India's export dynamics have remained resilient despite the 50% tariff imposed by the US. Still, it would be prudent to wait for a few more months before establishing a trend. It is too early to conclude whether a trade deal would significantly boost exports or, conversely, whether the absence of one would lead to a meaningful decline. Given that US growth – excluding AI-driven sectors – appears modest, and both China and Europe lack significant momentum, we maintain an unexciting outlook for India's exports in 2026–27.

### Exhibit 23:

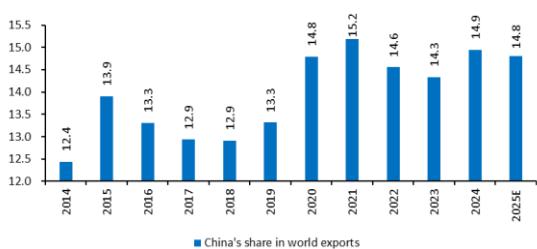
Bilateral Trade Agreements post COVID

#	Details	Partner nation	Year Concluded
1	India Oman CEPA	Oman	Dec-25
2	India- UK CETA	UK	Jul-25
3	India EFTA TEPA	Iceland, Liechtenstein, Norway, and Switzerland	Mar-24
4	India Australia ECTA	Australia	Jun-22
5	India UAE CEPA	UAE	Mar-22
6	India Mauritius CECPA	Mauritius	Apr-21

Source: <https://www.commerce.gov.in/international-trade/trade-agreements/>

### Exhibit 24:

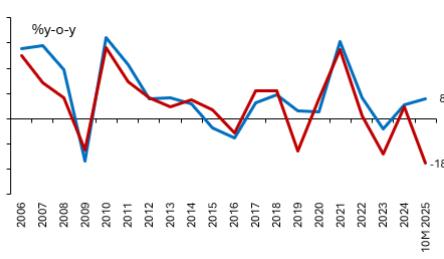
China continues to grab global trade share



Source: Bloomberg, SBIFM Research

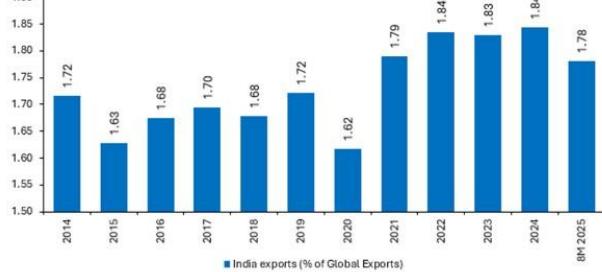
### Exhibit 25:

China's exports ex of US surges



### Exhibit 26:

India's global trade share has fallen in 2025



Source: Bloomberg, SBIFM Research

Hence, growth will clearly be shaped by domestic forces.

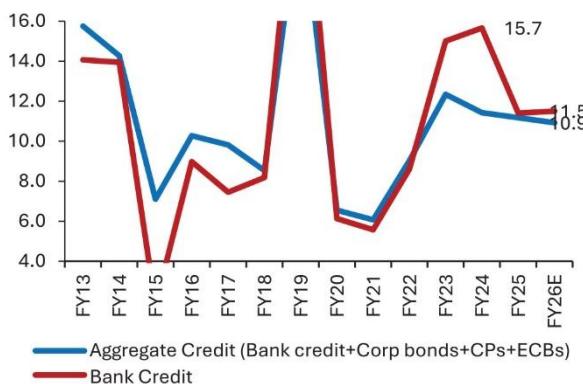
## Credit led growth recovery in cards

A true yardstick for success stories of government reforms would be measured in the form of bank credit, improvement in India's manufacturing share to GDP, formalization of labour force and increased FDI in India. One of them has already started to improve.

Bank credit which has improved from 9% in May 2025 to 11.5% by end November 2025 (Exhibit 27). We expect it to further improve to 13-14% in FY27. Adding up the other avenues of credit (NCDs, CPs and ECBs), aggregate credit could improve to 12% in FY27 compared to a likely 10.5-11% in FY26 and 11% during FY24 and FY25. This should at least drive a nominal GDP growth higher to 10-11% in FY27. As the profit accruals of corporates stay strong, household credit growth could likely outpace the corporate credit growth.

### Exhibit 27:

Bank credit growth and aggregate credit growth



Source: CMIE, RBI, SBIFM Research

### Exhibit 28:

Break-up of bank credit

% CAGR	FY20-22	FY23-24	FY25 (y-o-y)	FY26 (y-o-y)(Till Oct)
Bank Credit	7	18	11	12
Non-Food Credit	7	18	11	12
Agriculture and allied activities	10	18	10	9
Industry	4	7	9	11
Micro & small	15	14	10	27
Medium	33	13	19	19
Large	0	5	8	6
Services	10	21	11	12
Personal Loans	15	24	12	14
Consumer durables	37	15	-2	0
Housing (Including PSL)	14	25	11	11
Advances against fixed deposits(FCNR(Banks), NRI Non-Repatriable deposits etc.)	-1	22	13	18
Advances to individuals against share, bonds, etc.	2	12	19	10
Credit card outstanding	21	29	11	8
Education	3	19	15	15
Vehicle loans	12	21	6	10
Loans against gold jewellery	45	17	101	119
Other personal loans	18	24	11	13

Source: CMIE, SBIFM Research

**A pick-up in credit, contained inflation, government supportive measures along with a decent income backdrop should aid consumption recovery.**

## Constructive outlook on FY27 consumption; Segments thriving on credit-led demand could outperform

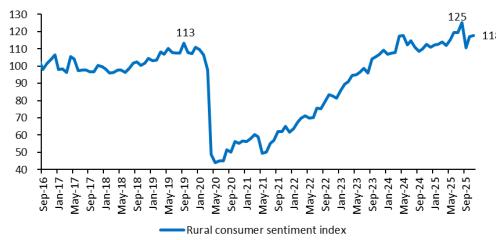
We remain optimistic about consumption demand in FY27, supported by stronger credit flows, contained inflation, and the sustained impact of multiple government initiatives. While personal loan growth was robust in FY23 and FY24 (21% and 28%, respectively), consumption remained muted as credit was largely used to offset COVID-induced income stress. This time, with a healthier income backdrop, improved credit availability is expected to translate into stronger consumption. Segments that thrive on credit-driven demand could perform particularly well in FY27.

## Rural spending outlook positive as welfare measures and low inflation mitigate kharif income setback

Further, state welfare schemes, combined with easing inflation and improving wage growth, have boosted rural consumer sentiment (Exhibit 29 to 32). The welfare schemes primarily target women, farmers, senior citizens, and the unemployed, with free or subsidized electricity and LPG are also becoming widespread. 14 states are offering unconditional cash transfers to women in FY26. While it is often argued that these schemes merely reallocate revenue expenditure and hence are not truly income supportive. However, we think that they represent direct cash transfers and carry significant political visibility, making non-implementation difficult. Hence, even as there has been a mere rejuggling of revenue expenditure, this is more direct in nature and enables better cash inflow to low-income households (Exhibit 33 to 35).

### Exhibit 29:

CMIE Rural consumer sentiment index is healthy



Source: CMIE, SBIFM Research

### Exhibit 30:

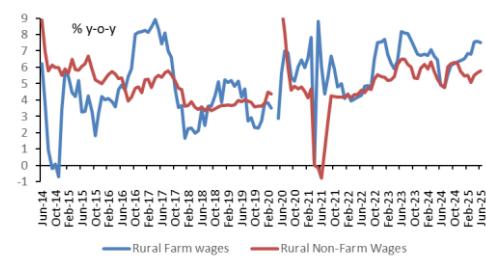
Rural CPI inflation is at an all-time low



Source: CMIE, SBIFM Research

### Exhibit 31:

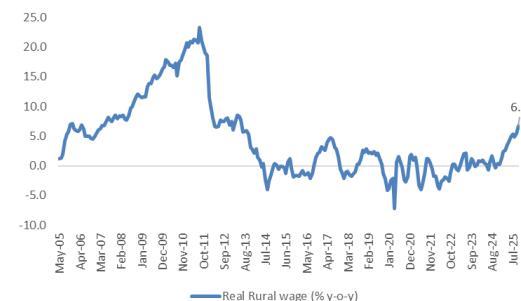
Rural wage growth sees modest improvement



Source: CMIE, SBIFM Research

### Exhibit 32:

Wage growth in real terms is at the highest level since 2013



Source: CMIE, SBIFM Research

## Exhibit 33:

Welfare schemes account for 11% of expenditure and 13.5% of receipts across states; High welfare outlay in Andhra Pradesh, Karnataka, Maharashtra, Tamil Nadu, Telangana, West Bengal

#	States	Announced	Under Active implementation	Implemnted (as % of announced)	Cost of Schemes (Rs. Bn)	# of schemes for which cost available	% for which cost available	State GDP FY26Est (Rs. Bn)	State Receipts FY26BE (Rs. Bn)	State Revenue FY22 BE(Rs. Bn)	State Expenditure FY26 BE (Rs. Bn)	Scheme Cost (as % of GDP )	Scheme Cost (as % of Receipts)	Scheme Cost (as % of state Revenue)	% of State's Total Expenditure	State FY26 Budgeted Fiscal Deficit (% GDP)
1	Andhra Pradesh	12	8	67	532	8	67	18,250	2,180	2,512	2,979	2.9	24	21	18	4.4
2	Assam	8	7	88	109	7	88	7,416	1,172	1,172	1,471	1.5	9	9	7	3.7
3	Bihar	9	9	100	238	5	56	10,970	2,608	2,520	2,941	2.2	9	9	8	3.0
4	Chhattisgarh	10	8	80	340	8	80	6,359	1,410	1,382	1,650	5.3	24	25	21	3.8
5	Delhi	9	8	89	58	5	56	13,244	817	719	954	0.4	7	8	6	1.0
6	Gujarat	7	6	86	146	5	71	29,820	2,516	2,319	3,322	0.5	6	6	4	2.0
7	Haryana	12	11	92	189	8	67	13,475	1,278	1,484	1,692	1.4	15	13	11	2.7
8	Himachal Pradesh	7	7	100	17	5	71	2,556	424	487	527	0.7	4	3	3	4.0
9	Jharkhand	6	6	100	232	5	83	5,563	1,252	1,106	1,367	4.2	19	21	17	2.0
10	Karnataka	9	9	100	808	6	67	30,701	2,925	3,117	3,831	2.6	28	26	21	2.9
11	Kerala	6	2	33	197	5	83	14,271	1,524	1,795	1,986	1.4	13	11	10	3.2
12	Madhya Pradesh	10	10	100	329	10	100	16,945	2,909	2,903	3,753	1.9	11	11	9	4.7
13	Maharashtra	10	10	100	701	9	90	49,394	5,610	6,069	7,000	1.4	12	12	10	2.8
14	Odisha	6	5	83	149	4	67	10,630	2,320	2,002	2,668	1.4	6	7	6	3.2
15	Punjab	6	5	83	75	3	50	8,913	1,117	1,357	1,466	0.8	7	6	5	3.8
16	Rajasthan	5	4	80	20	3	60	19,890	2,945	3,255	3,796	0.1	1	1	1	4.3
17	Tamil Nadu	10	10	100	398	9	90	31,160	3,316	3,732	4,393	1.3	12	11	9	3.4
18	Telangana	10	7	70	608	8	80	18,003	2,297	2,270	2,848	3.4	26	27	21	3.0
19	Uttarakhand	2	2	100	0	1	50	4,293	626	600	752	0.0	0	0	0	2.9
20	West Bengal	7	7	100	502	6	86	20,318	2,661	3,014	3,415	2.5	19	17	15	3.6
		161	141	88	5,648	120	75	3,32,172	41,904	43,814	52,810	1.7	13.5	12.9	10.7	4.6

Source: State budget documents, media resources, CMIE, SBIFM Research

## Exhibit 34:

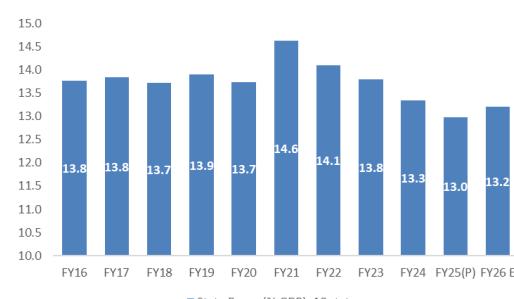
14 States have monthly income transfer schemes for women ranging from Rs. 1000-2500 per month; entails an annual cost of Rs. 1.6 trillion

State	Scheme Name	Monthly Transfer (in Rs.)	Announcement Date	Budgetary allocation in FY26 (in Rs. bn)
Andhra Pradesh	Mahashakti Scheme	1,500	Apr-24	Not available
Assam	Orunodoi Scheme	1,250	Mar-20	50
Delhi	Mukhyamantri Mahila Samman Nidhi	2,500	Mar-25	51
Haryana	Deen Dayal Lado (Lado Lakshmi) Yojana	2,100	Mar-25	50
Himachal Pradesh	Indira Gandhi Pyari Behna Sukh Samman Nidhi Yojana	1,500	Feb-24	8
Jharkhand	Mukhyamantri Maiya Samman Yojana (JMMSY)	2,500	Jul-24	134
Karnataka	Gruha Lakshmi	2,000	Jun-23	286
Kerala	Women's Safety Scheme	1,000	Oct-25	38
Madhya Pradesh	Ladli Behena Yojana	1,500	Jan-23	187
Maharashtra	Mukhyamantri Majhi Ladki Bahin Yojna	1,500	Jun-24	360
Punjab	Cash transfer to women	1,000	Mar-22	Not applicable
Tamil Nadu	Kalaignar Magalir Urimai Thogai	1,000	Mar-23	138
Telangana	Mahalakshmi	2,500	Nov-23	50
West Bengal	Lakshmir Bhandar	1,000	Feb-24	260
14 States	Total Cost			1,612

Source: State budget documents, media resources, SBIFM Research

## Exhibit 35:

States rejig revenue expenses to accommodate the welfare expenses

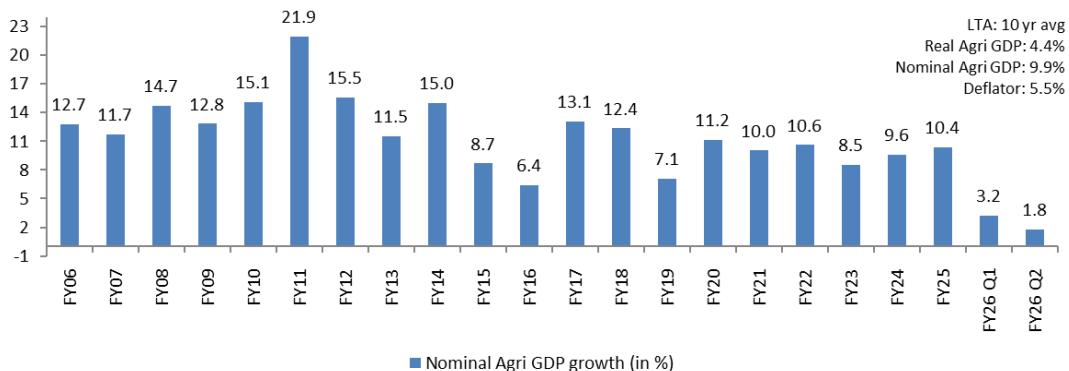


Source: CMIE, SBIFM Research

Yet, one adverse development stands out: Kharif income has weakened this season due to unseasonal rains affecting yields, especially for oilseeds and pulses. Despite strong inventories, prices have fallen below MSPs for most food grains, even compared to last year's MSP levels (Exhibit 36,37,38). While farmers may withstand one weak season after two bumper years, sectors reliant on farm income—such as two-wheelers, fertilizers, and tractors—could face headwinds. Encouragingly, Rabi sowing is progressing well.

## Exhibit 36:

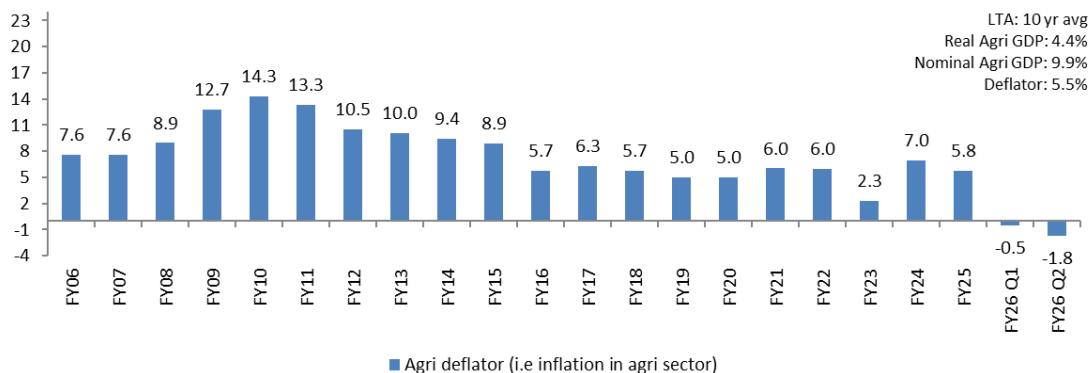
Agri and allied income growth one of the lowest since FY06.



Source: CMIE, SBIFM Research

## Exhibit 37:

Sharp decline in agri prices in FY25-26



Source: CMIE, SBIFM Research

## Exhibit 38:

Prices of all the crops are trading below their MSP. For Kharif crops, their current prices are even below 2024 MSP

Rs/quintal	MSP:2024-25	MSP: 2025-26	Current Market Price Nov 2025	Market price less MSP	% diff in Market price vs. MSP
<b>Kharif</b>					
Paddy (Common)	2,300	2,369	2,297	(72.2)	(3.0)
Jowar (Hybrid)	3,371	3,699	2,983	(716.2)	(19.4)
Bajra	2,625	2,775	2,322	(452.8)	(16.3)
Maize	2,225	2,400	1,886	(513.6)	(21.4)
Ragi	4,290	4,886	3,884	(1,002.2)	(20.5)
Arhar (Tur)	7,550	8,000	6,558	(1,442.3)	(18.0)
Moong	8,682	8,768	6,479	(2,289.3)	(26.1)
Urad	7,400	7,800	6,393	(1,406.6)	(18.0)
Cotton (Medium Staple)	7,121	7,710	7,000	(710.0)	(9.2)
Groundnut in shell	6,783	7,263	5,738	(1,525.3)	(21.0)
Sunflower seed	7,280	7,721	5,407	(2,314.3)	(30.0)
Soyabean (Yellow)	4,892	5,328	4,270	(1,058.3)	(19.9)
Sesamum	9,267	9,846	10,187	340.8	3.5
Nigerseed	8,717	9,537	6,850	(2,687.0)	(28.2)
<b>Rabi</b>					
Wheat	2,425	2,585	2,531	(54.0)	(2.1)
Barley	1,980	2,150	2,266	116.2	5.4
Gram	5,650	5,875	5,687	(187.7)	(3.2)
Masur (Lentil)	6,700	7,000	6,962	(37.7)	(0.5)
Rapeseed/mustard	5,950	6,200	6,557	356.8	5.8
Safflower	5,940	6,540	7,680	1,140.3	17.4

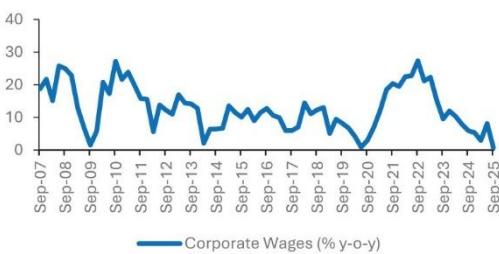
Source: CMIE, SBIFM Research

## Urban consumption outlook: cautious but improving

Urban households have faced headwinds from moderating corporate wages and reduced hiring in banks and IT since FY25. However, if overall economic growth strengthens, hiring activity should pick up, improving the outlook for urban consumption demand.

### Exhibit 39:

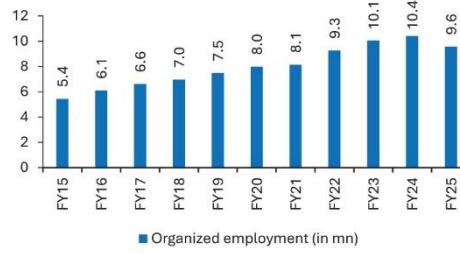
#### Corporate wage growth



Source: CMIE, SBIFM Research

### Exhibit 40:

#### Hiring falls in financial sector and IT



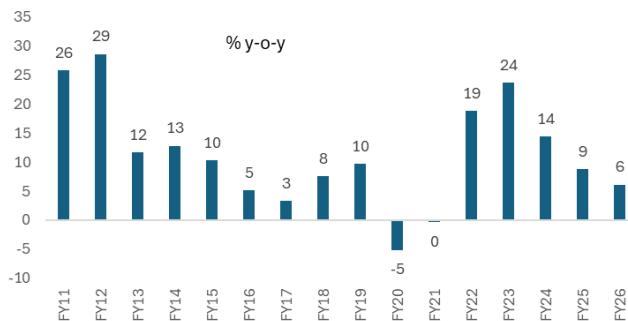
Source: Ace Equity, Capitaline, SBIFM Research

## Premiumization: a structural consumption theme

While we often bucket consumption trends into rural and urban segments, one theme stands out as a structural play—premiumization. Rising middle-class incomes, demographic dividends, a large population base, and growth outpacing most global peers have provided a strong backdrop for this trend. Premiumization of the consumption basket is likely to remain a key driver in the medium to long term.

## Exhibit 41:

Consumption spending has been moderating since FY25



Based on 128 listed companies that we track as a representative of consumption spending in India

Source: Ace Equity, SBIFM Research

Consumption spending has been moderating since FY25 (Exhibit 41). However, we find that segments associated with premium consumption have depicted much stronger growth (Exhibit 42).

## Exhibit 42:

Stronger sales in Jewellery, E-commerce, QSR, Retail and telecom relative to other sectors

Net Sales (% y-o-y)	FY22	FY23	FY24	FY25	1H FY26
Alcoholic Beverages	24	18	12	9	13
Automobile	16	29	21	5	-2
Building Materials	27	17	1	0	3
Consumer Durables	21	19	10	16	-3
Jewellery	28	38	27	31	25
E-commerce	97	49	45	47	83
FMCG	22	17	6	10	11
Footwear	28	9	3	0	-2
Paints	31	17	4	0	2
Printing & Stationery	44	58	9	10	9
Quick Service Restaurant	51	31	13	26	13
Readymade Garments/ Apparels	40	13	2	7	7
Retail	57	61	30	29	20
Telecomm-Service	9	17	6	13	22
Tobacco Products	22	17	1	7	9
<b>Consumer Spending</b>	<b>19</b>	<b>24</b>	<b>14</b>	<b>9</b>	<b>6</b>

Source: Ace Equity, SBIFM Research: NB: Based on 128 listed companies that we track as a representative of consumption spending in India

## Corporate capex has been healthy

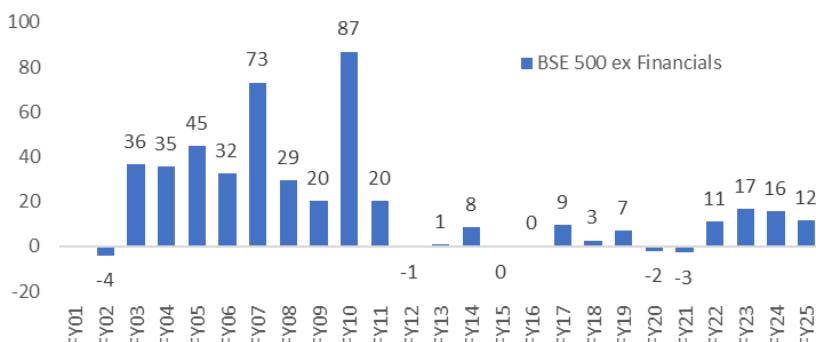
BSE 500 ex financials capex has expanded by 12% in FY25 vs. 16% in FY24 (Exhibit 43). Two third of the capex comes from power and gas sectors. As per our assessment, the capex growth has likely continued to be in mid-teens in FY26 and will further expand by 10-12% in FY27. We believe the real estate and power-generation cycles remain in good health.

The capex outlook is also positive for renewables, data centre, and cement sector in India. There is a vision to increase data centre capacity from current 1-1.2GW to 3GW over the next four years which would entail a capex outgo of Rs. 1-1.2 trillion over the period. A healthy growth in the urban India housing (which accounts for 12-15% of cement demand) compared to an extremely muted real estate activity for most part of last decade, is the key factor driving a pick-up on cement demand and thereby capacity utilization while other segments of demand continue to hold a

healthy pace. While auto and textile sector companies have retained the capex guidance, if the India US trade deal stays stuck even in 2026, it could pose some downside risks to the capacity addition in these sectors. On the other hand, capex outlook for Oil & Gas, Chemicals and Sugar sector appears weak owing to heavy capex activity in the oil & Gas sector in recent years, the overhang of Chinese dumping in the chemicals sector and completion of sufficient ethanol plant addition in the sugar sector.

#### Exhibit 43:

BSE 500: Capex activity shows double digit growth since FY22



Based on Purchase of fixed assets data

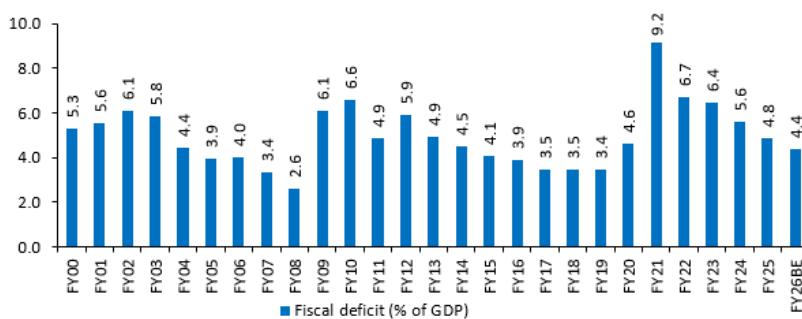
Source: Ace Equity, SBIFM Research

#### Central government capex commitment is likely to be in line with Nominal GDP growth as the pace of fiscal consolidation likely moderates

Over the past three years, the central government has reduced its fiscal deficit by 2 percentage points—from 6.4% in FY23 to a likely 4.4% by FY26 (Exhibit 44).

#### Exhibit 44:

Centre's fiscal deficit



Source: CMIE, SBIFM Research

Consequently, after a near tripling of capex outgo from Rs. 3.3 trillion in FY20 to Rs. 9.5 trillion by FY24 (partly due to the absorption of off-balance-sheet capex into the main budget), the strong infrastructure push led by the central government has since cooled. We are given to understand that more than the funding constraints, execution challenges have been at the front foot of moderating infrastructure activities in India over last three years.

Looking ahead in FY27, we do not expect any material change in infrastructure outlook. On a positive note, the pace of consolidation will likely come down to 20bps in FY27. Better growth should drive an improvement in tax buoyancy in FY27. We estimate Centre's capex commitment to be in line with Nominal GDP growth.

## State capital outlay has been intact at 2.4-2.5% of GDP

While it is true that implementation of state welfare schemes and lack of revenue buoyancy in states' finances has led to widening of state deficit from 2.5% of GDP (FY18–FY20) to 3.2–3.5% in FY25–FY26, state capital outlay has largely remained stable, ranging between 2.2% and 2.4% of GDP from FY15 to FY25 (Exhibit 45).

This resilience is partly due to the 50-year interest-free capex loans offered under the Scheme for Special Assistance to States for Capital Investment (SASCI) since FY21. These loans, outside the normal borrowing limit, have grown from Rs. 120 billion in FY21 to an estimated Rs. 1,500 billion in FY26, financing 19% of states' capital outlay in FY25 compared to 2.9% in FY21. While states' own capital spending effort (excluding SASCI loans) has remained relatively stable, central assistance has given a boost to capital expenditure. In 2024-25, several states have estimated to finance more than 25% of capital outlay through these loans.

### Exhibit 45:

State capex remains intact despite welfare spending



Source: CMIE, SBIFM Research

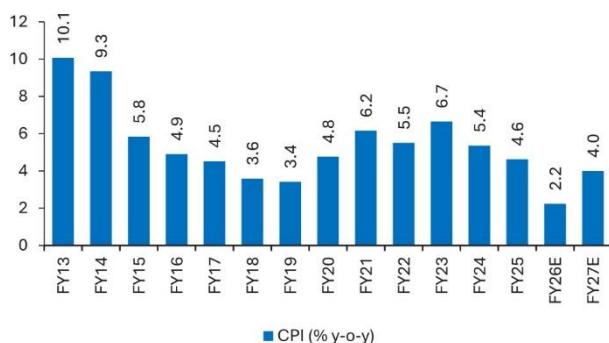
To sum it all, consumption demand appears to be the key driver of improved growth in FY27 while the growth momentum in corporate capex and infrastructure activity could be similar to FY26. We are least constructive on exports. Impact of any trade deal remains unclear for now as competition from China is fierce and risks to global growth and geopolitics continues to be a key downside risk for FY27 too.

### Inflation outlook: benign but rising in FY27

We expect inflation to average around 4% in FY27, up from sub-2% levels likely in FY26—marking two consecutive years below or at RBI's 4% target. Inflation is expected to move above 4% only by October next year, largely due to base effects (Exhibit 46).

### Exhibit 46:

CPI outlook benign for FY27

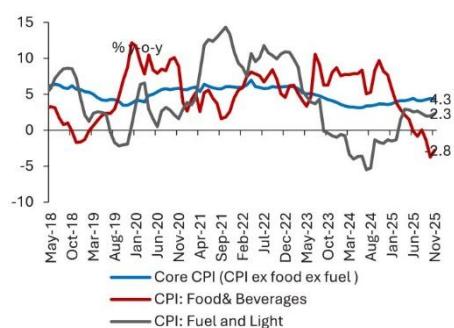


Source: CMIE, SBIFM Research

Cyclically, this benign inflation environment reflects several factors: capped food inflation from continued positive supply shocks, low commodity input costs, moderating wage growth, and further transmission of GST cuts to prices from October. Structurally, efficiency and productivity gains from infrastructure investment and increased digital transactions have also played a role. Additionally, anchored inflation expectations under the inflation-targeting regime, proactive government supply-side measures, and heightened competition from Chinese imports have contributed to this trend (Exhibit 47 to 50).

## Exhibit 47:

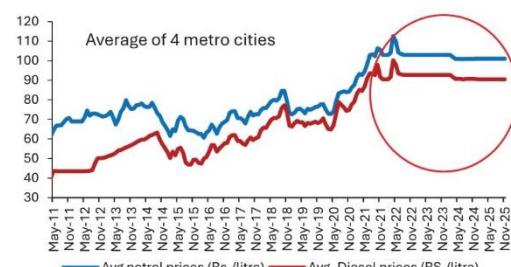
### Food inflation to likely mean revert in FY27



Source: CMIE, SBIFM Research

## Exhibit 48:

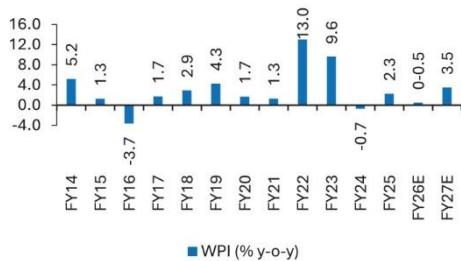
### Transportation cost unchanged in last 42 months



Source: CMIE, SBIFM Research

## Exhibit 49:

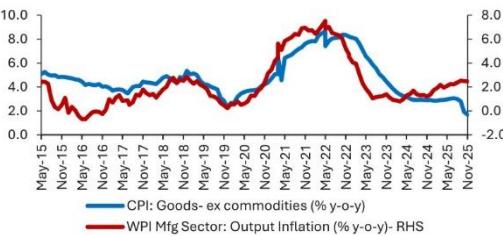
### Annual WPI inflation



Source: CMIE, SBIFM Research

## Exhibit 50:

### WPI inflation and CPI goods inflation correlated



Source: CMIE, SBIFM Research

## Monetary policy to stay supportive – liquidity actions at the fore

While we would not rule out one more rate cut in 2026, monetary policy in India is likely headed for a long pause (unless global growth outlook deteriorates). Liquidity, however, would continue to stay supportive and we expect continued liquidity infusion into the early parts of 2026

## Centre on the path of modest fiscal consolidation; state fiscal has deteriorated

We expect Centre to stick to 4.4% of fiscal deficit target in FY26. Direct tax collections improved in October'25 (42% y-o-y) while indirect taxes declined -5.7% y-o-y. Despite this, total 7M gross tax collection has grown by 4% y-o-y. It is required to grow by 22% in remaining 5 months to meet the budgeted targets (Exhibit 51). Indirect taxes could stay weak as GST effect also creeps in 2H FY26. We estimate that overall tax revenue could miss the budgeted target by Rs. 1.5 trillion. A part of this will be offset by improved dividend collection. Overall receipt shortfall is estimated at 0.2% of GDP which is manageable by minor expenditure adjustment. We expect a modest consolidation to 4.2% of GDP in FY27 implying a gross and net G-sec supply of Rs. 15.5 trillion and 11.5 trillion, respectively.

## Exhibit 51:

Gross tax collection likely to fall short of the required 22% in remaining 5M FY26 to meet budgeted targets

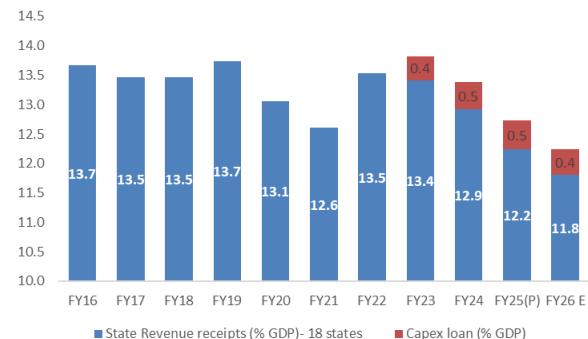
Cumulative Apr-Oct FY26	Budgeted growth based on FY25		Required in remaining months
	% y-o-y	actuals	
Net Tax Revenue	-2.4	13.5	30.9
Gross Tax Revenue	4.0	12.5	22.3
Income Tax	6.9	13.1	24.1
Corporate Tax	5.2	13.0	14.0
Custom	-2.5	5.8	10.3
Excise duties	7.9	5.0	3.2
GST	1.2	11.6	32.2
Total Direct Tax	6.1	13.1	19.3
Total Indirect Tax	1.5	9.4	23.0

Source: CMIE, SBIFM Research

On the other hand, state finances have been deteriorating. State fiscal deficits have risen—from 2.5% of GDP (FY18–FY20) to 3.2–3.5% in FY25–FY26—amid falling receipts and higher welfare spending (Exhibit 52, 53, 54). The RBI (2024) cautioned that rising expenditure on subsidies and cash transfers to farmers, youth, and women could strain state finances, recommending rationalization to preserve space for productive spending. Given that these schemes carry significant political visibility, non-implementation would be increasingly difficult. Further, there are impending problems with multiple state DISCOMS too which must be addressed sooner than later.

## Exhibit 52:

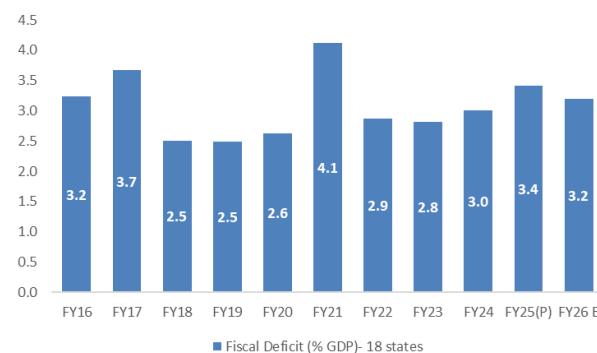
Despite capex loan, the flow of receipts to states has moderated during FY24-26



Source: CMIE, SBIFM Research

## Exhibit 53:

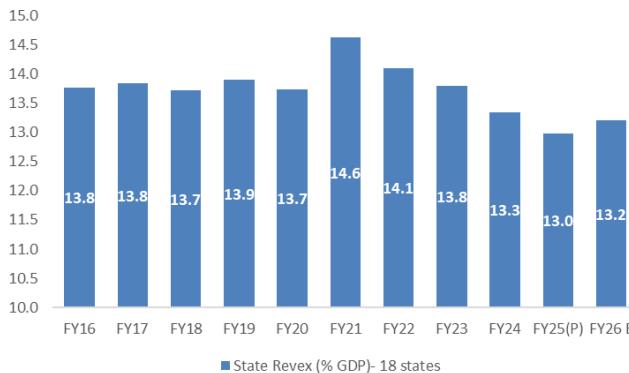
Reduced receipts and welfare measures have driven state deficit to 3.2-3.4% of GDP during FY25-FY26 from 2.8% during FY22-23 and 2.5% during FY18-19.



Source: CMIE, SBIFM Research

## Exhibit 54:

So far, states are rejigging their revenue expenses to accommodate the welfare expenses



Source: CMIE, SBIFM Research

## Regulations and capex loan keep state borrowing under check

Even as state fiscal deficits are rising, a part of this is getting funded by Centre's capex loan. Further, regulatory limits on states' borrowing have also helped to keep overall state fiscal deficit in check and forced states to rejiggle their expenses and accommodate the rise in scheme-based expenditure.

## Government bonds supply could rise to Rs. 29 trillion in FY27 (vs. Rs. 27.2 trillion in FY26)

In FY26, budgeted gross SDL had jumped by 16% to Rs. 12.4 trillion (most likely will go through). In FY27, we expect net and gross SDL borrowing to rise to Rs. 9.5 trillion (vs. Rs. 8.7 trillion in FY26) and gross supply to rise to Rs. 13.5 trillion. To sum, the overall supply of government securities is estimated to rise to Rs. 29 trillion in FY27 against an estimated Rs. 27.2 trillion in FY26.

## Government bonds' demand supply dynamics continues to stay in a tight spot in FY27

Even as a likely inclusion of India in Bloomberg Aggregate Index and resumption of NPS buying in FY27 appears to be a positive thrust, the demand supply equation for government bond stays in a tight spot. Improving credit growth in the banking system amid elevated credit to deposit ratio would keep banks' SLR investment under check. Further, RBI has conducted Rs. 3.7 trillion of OMO purchase between Apr-Dec 2025 and more could be in the offing in Q4 FY26. We are not sure if liquidity dynamics would necessitate a similar OMO action in FY27 (Exhibit 55).

## Exhibit 55:

Government bond demand supply

Incremental Gsec and SDL in Rs. Bn	FY21	FY22	FY23	1HFY24	2HFY24	1H FY25	2HFY25	1H FY26
Total Demand	17,633	14,234	16,356	9,704	8,414	7,945	8,611	8,163
Commercial Banks	4,275	3,899	6,216	4,871	2,826	2,923	2,130	1,749
NonBank PDs	-106	23	363	222	47	175	53	-110
Insurance Companies	4,372	3,641	3,644	2,710	1,693	1,692	1,099	2,085
Mutual Funds	1,653	334	382	429	199	385	-324	458
Cooperative Banks	385	364	51	60	56	-27	7	186
Financial Institutions	1,108	75	292	-440	76	149	136	231
Corporates	375	1,057	492	-327	369	365	91	-232
Foreign Portfolio Investors	-154	-96	-18	360	871	627	485	-46
Provident Funds	1,610	1,166	1,945	753	1,630	974	1,645	1,258
RBI	2,853	1,859	-418	-193	-340	-643	2,298	1,558
Others (incl State government)	1,258	-2,991	2,109	499	397	500	380	667
Pension Funds	NA	NA	1,320	764	569	814	605	414

Source: RBI, SBIFM Research

## Rupee has been the focal point in 2025- depreciating nearly 5% in 2025

The Indian rupee witnessed significant depreciation in November, marking its sharpest pace of decline since 2022 (Exhibit 56 and 57). Interestingly, this weakness has unfolded despite the

U.S. dollar index (DXY) showing an 8% decline and most emerging market currencies, except Indonesia and Türkiye, appreciating against the dollar. Typically, India's lower inflation relative to the U.S., stable crude prices, fiscal discipline, and Current account deficit under 1% of GDP support Indian assets and the rupee.

## Exhibit 56:

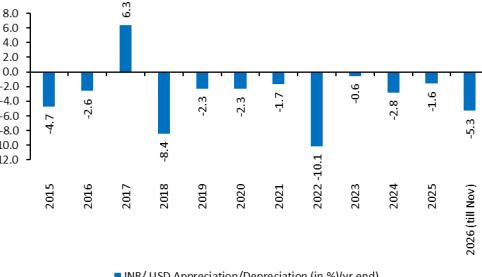
Rupee moves in 2025



Source: Bloomberg, SBIFM Research

## Exhibit 57:

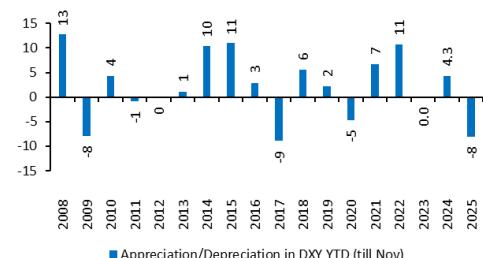
Sharpest depreciation in rupee since 2022



Source: Bloomberg, SBIFM Research

## Exhibit 58:

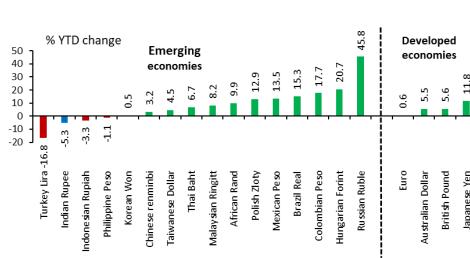
Dollar on a weakening bias



Source: Bloomberg, SBIFM Research

## Exhibit 59:

Rupee underperforms relative to EM peers



Source: Bloomberg, SBIFM Research

## No trade deal at the helm of this mayhem

While India's overall GDP growth appears to be largely cushioned and minimally impacted by reduced exports to the US, it is clearly impacting the external account and hence sentiment around Rupee. Weak trade dynamics and earnings downgrades are weighing on rupee sentiment. Indian exports are up 4% y-o-y FYTD, while global exports rise. FPI flows remain muted, owing to the combination of earnings downgrades, lack of AI plays and no positive developments around trade deal (Exhibit 60). India's MSCI weight has slipped to third place after nearly overtaking China last year. Thus, India's external account struggle has been more on the capital inflow side which has not been even enough to cover up for this muted CAD.

## Exhibit 60:

FII outflow should see a turnaround in FY27



Source: Bloomberg, SBIFM Research

## From Forward to Spot: Hedging Rush and Rising Premiums

Weakening sentiment around rupee triggered panic among importers, prompting a rush to hedge future dollar liabilities. This surge in hedging demand has pushed up forward premiums in India. The 3-month dollar forwards premium now stands at 2.6%, up from 1.4% six months ago (Exhibit 61). Consequently, 3M INR implied yield (i.e., selling rupee and investing in dollar adjusted for the hedging cost) offer an annualized return of roughly 6.70 %, (vs. 6% six months ago) compared to Indian PSU CDs yielding 6.05% for similar tenors (CDs have been at similar levels since Jun'25). This 90bps differential effectively caps downward adjustment in onshore short end rupee assets (Exhibit 62). To add, relaxation in RBI rules are also leading exporters to delay in repatriating their dollar earnings back to India.

### Exhibit 61:

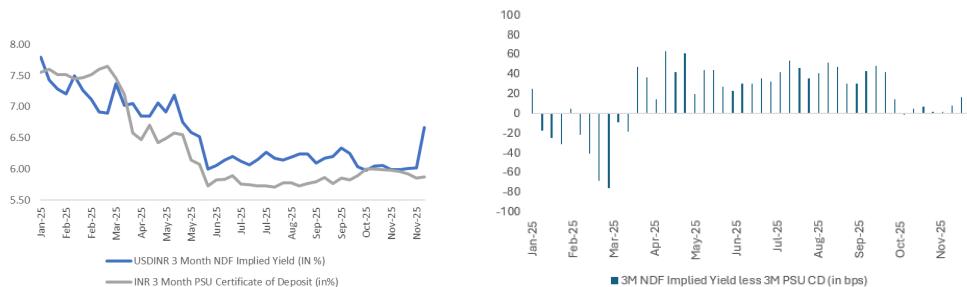
Dollar forward premia jumps



Source: Bloomberg, SBIFM Research

### Exhibit 62:

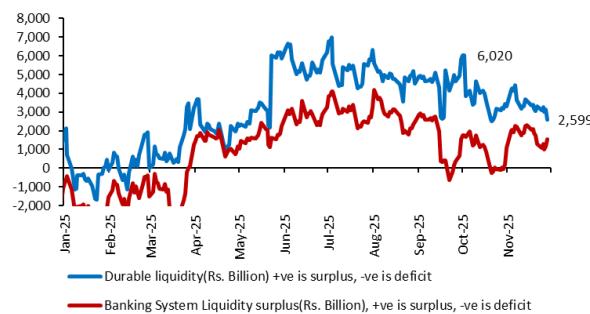
Sharp arbitrage opportunity between Indian CD's and NDF Implied yield



Source: Bloomberg, SBIFM Research

### Exhibit 63:

Banking System liquidity falls substantially due to dollar capital outflow



Source: Bloomberg, SBIFM Research

## Impact on Domestic Markets

The dollar squeeze has led to increased selloffs in Indian assets, reduced INR liquidity in the system, and a rise in buy-sell swaps by private players. Forward market stress is spilling over into spot rates because of arbitrage opportunities. Despite a 100bps CRR cut during September to Nov'25, durable banking system liquidity has fallen from 5-6 trillion during July'25 to 2.6 trillion by end November (Exhibit 63).

At equilibrium, returns on rupee assets equal returns on dollar assets plus hedging cost. Currently, rupee returns are lower than this benchmark, creating persistent pressure. To restore balance, one of the following must occur: U.S. Treasury yields decline, hedging costs fall, or Indian fixed-income yields rise.

This is partially happening. Despite a 25bps repo rate cut and a Rs.1.45 trillion-rupee liquidity injection announced in December MPC meet, Indian yields have firmed. 10-year G-sec is up 10–12bps and three-month CDs up 15–16bps. Thus, monetary easing since June has not led to similar transmission in market rates (despite an ultra-low inflation). Position unwinding by FPI's (reducing EM risk) leading to rise in offshore NDOIS spilling over to onshore swaps have led to up move in domestic yields, particularly since November. At the same time, the market continues to grapple with Rupee dynamics, alongside weak demand for sovereign assets due to regulatory and taxation changes.

A durable solution requires either a meaningful shift in rupee sentiment or RBI intervention via continued OMO purchases. Our assessment suggests RBI may need to inject an additional Rs. 2 trillion rupees over the next three months to maintain LAF near 1% of NDTL. Now the currency woes suggest that these liquidity actions could come increasingly in the form of buy sell swap rather than OMO purchases. This has been another reason to lead to some adverse movement in G-sec yields in past one week.

## We are not meaningfully worried on Rupee

The INR's recent weakness despite low inflation has brought the REER to competitive levels. We do not see an unduly stressed Balance-of-Payments. The impact of the surge in investor demand for gold, which is keeping import volumes high despite 50% higher prices is offset by weak oil prices. A higher non-oil/gold deficit due to a recovering economy and Chinese competition in export markets can be paid for by the continuing double-digit growth in net services exports. We expect the current account deficit to stay contained under 1% of GDP in FY26 and FY27. More importantly, we expect capital inflow to improve in FY27 on the hopes of India's inclusion in another global bond indices. Further overall FPI inflows in equity has reached to a level where one can expect some resumption in equity purchases by the foreigners. To sum, after ~5% depreciation in 2025 and ~4% depreciation FYTD, we expect rupee to depreciate by a mere 2% in FY27 (i.e., 92/US\$). In case of a trade deal, we would not be surprised if Rupee appreciates around the deal announcement (Exhibit 64 to 70).

## Exhibit 64:

### BoP Outlook

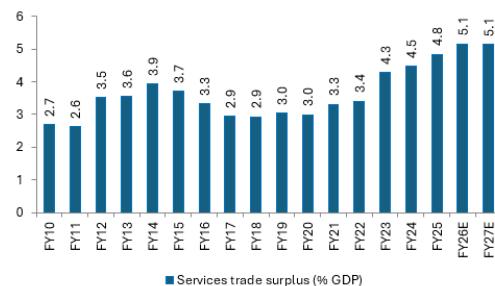
Balance of Payment (US\$ bn)	FY21	FY22	FY23	FY24	FY25	FY26E	No trade deal	US India trade deal
							FY27E	FY27E
CURRENT ACCOUNT								
Exports (RBI)	296	429	456	441	442	443	480	493
% y-o-y	-7.5	44.8	6.3	-3.2	0.1	0.2	8.5	11.3
Imports (RBI)	398	619	721	686	729	762	807	814
% y-o-y	-16.6	55.3	16.6	-4.9	6.2	4.5	5.9	6.9
1. Trade Balance (RBI)	-102	-189	-265	-245	-287	-319	-327	-321
% GDP	-3.8	-6.0	-7.9	-6.7	-7.3	-7.8	-7.4	-7.2
2. Services Balance	89	108	143	163	189	209	228	228
% GDP	3.3	3.4	4.3	4.5	4.8	5.1	5.1	5.1
3. Primary Income	-36	-37	-46	-50	-48	-50	-53	-53
4. Secondary Income (Transfers)	74	81	101	106	124	131	130	130
A. Current A/c Balance (1+2+3+4)	24	-39	-67	-26	-23	-29	-22	-16
% GDP	0.9	-1.2	-2.0	-0.7	-0.6	-0.7	-0.5	-0.4
CAPITAL ACCOUNT								
5. FDI (Net)	43.8	38.9	28.0	10.1	1.0	12.7	20.0	20.0
6. FPI (Net)	36.1	-16.8	-5.2	44.1	3.6	-4.1	30.0	30.0
7. Loans	6.8	33.8	8.3	1.6	29.3	16.9	14.0	14.0
8. Banking Capital	-21.1	6.7	21.0	40.5	-9.8	9.3	-10.0	-10.0
B. Capital Account Balance (5+6+7+8+9+10)	63	88	59	87	17	35	54	54
% GDP	2.4	2.8	1.8	2.4	0.4	0.9	1.2	1.2
C. Error and Omissions	-0.2	-0.1	-1.0	0.5	1.4	0.0	0.0	0.0
D. Overall Balance (A+B+C)	87	48	-9	64	-5	6	32	38
% GDP	3.3	1.5	-0.3	1.8	-0.1	0.1	0.7	0.9
Increase in Reserves due to BoP	87	48	-9	64	-5	6	32	38
Rupee vs. US\$ (average)	74	75	80	83	85	88	89	89

Source: RBI, SBIFM Research

## Exhibit 65:

## Exhibit 66:

Trade deal has had a significant impact on India's exports; Outlook for services exports stay healthy

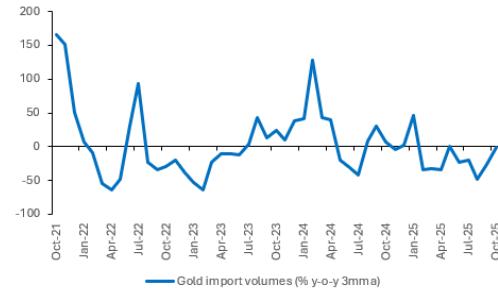


Source: CMIE Economic Outlook, SBIFM Research

## Exhibit 67:

## Exhibit 68:

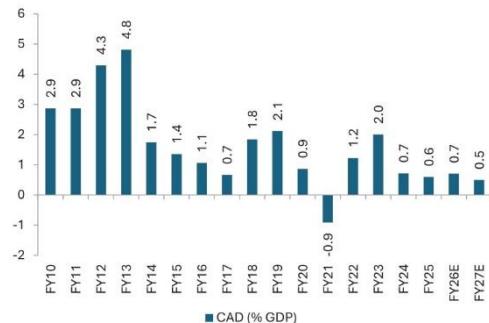
Gold prices rose sharply leading to gold import volumes being subdued



Source: CMIE Economic Outlook, SBIFM Research

## Exhibit 69:

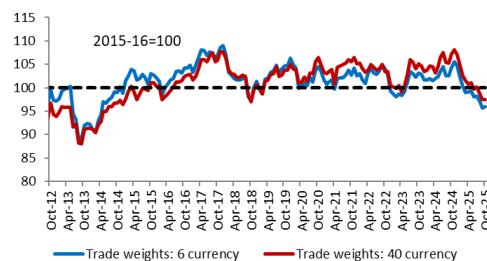
CAD to remain contained at under 1% of GDP for FY26 and FY27



Source: RBI, CMIE Economic Outlook, SBIFM Research

## Exhibit 70:

INR REER is 5% below the fair value



Source: CMIE, SBIFM Research

## Section 4: Equity Strategy

CY25 was marred by key macro challenges – systemic liquidity stress, elevated household leverage, slowing hiring and salary growth, pressures on consumption and fiscal pressure. Add to this an optimistic earnings growth expectations and elevated valuation multiples, we were largely negative (1<sup>st</sup> half of 2024) to neutral (2<sup>nd</sup> half of 2025) equities in CY25. As expected, year 2025 was marked by modest returns, sectoral divergence, and a challenging global backdrop. Market returned ~12% YTD, but broader markets had a much tougher time with Midcap and Small caps returning ~6% and ~-5% respectively.

Yet, the groundwork laid by policy actions, monetary easing, a resilient domestic investor base and bottoming out of corporate earnings sets the stage for a more constructive year ahead.

### State of Fundamental Corporate Affairs

Over the last couple of years, we have seen moderation of trends that were exacerbated by COVID induced abnormalities in financial statements. The post-COVID trend of expanding margins and therefore bottom-line has now eased. CY 25 saw convergence in topline, operating level and bottom-line growth posing a big challenge to corporate fundamental performance.

The starker drop has been in bottom line, with PAT growth coming in lowest over the last 10 years, excluding COVID-impacted FY20. This deterioration has been across the board but relatively speaking Midcap universe had a good 12 months with 19.3% bottom line growth. However, topline challenge is most pronounced in midcaps with just 4.1% expansion in sales in FY25.

### Exhibit 71:

#### Summary of Corporate Fundamentals

	No of Co	TTM				FY25			
		Revenue	YoY %	PAT	YoY %	Revenue	YoY %	PAT	YoY %
Nifty 50	50	63,834	0.3	8,632	3.07	63,640	6.1	8,375	4.93
BSE 500	500	1,44,806	8.3	16,482	4.88	1,33,650	5.0	15,715	4.85

Sales Growth												
In Billions	No of Co	Last 10 FYs Sales, EBITDA & PAT growth (%)										
		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
<b>Nifty 50</b>	50	5.0	-5.1	15.3	11.4	22.0	0.2	-1.3	29.2	22.0	8.3	6.1
<b>BSE 500</b>	500	2.2	-6.4	11.6	14.8	21.6	0.6	-1.0	31.1	23.9	7.0	5.0
<b>Eq Coverage</b>	428	2.3	-5.5	12.1	15.7	20.5	0.5	-1.6	30.7	23.5	6.9	5.4
<b>Large Cap</b>	100	2.2	-7.4	12.5	13.8	21.4	-0.3	-3.2	32.6	25.3	6.2	4.2
<b>Mid Cap</b>	156	0.8	-2.0	7.9	16.2	22.0	3.0	7.4	27.4	19.8	9.1	2.8
<b>Small Cap</b>	380	6.4	-5.4	13.2	17.2	19.4	2.8	-1.2	29.2	22.5	7.3	17.3

Legends	Highest	Lowest
---------	---------	--------

PAT Growth												
In Billions	No of Co	Last 10 FYs Sales, EBITDA & PAT growth (%)										
		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
<b>Nifty 50</b>	50	-0.3	5.1	5.1	9.9	3.5	-5.3	22.5	58.5	9.4	25.2	4.9
<b>BSE 500</b>	500	-4.8	-1.7	23.5	0.1	10.5	-14.9	53.8	51.4	9.1	29.6	4.8
<b>Eq Coverage</b>	428	-3.8	-1.4	25.1	7.0	5.9	-11.6	41.1	47.0	6.4	30.7	4.4
<b>Large Cap</b>	100	-7.5	2.6	19.0	7.8	3.4	-12.8	45.0	53.6	7.6	33.1	3.8
<b>Mid Cap</b>	156	0.5	-31.4	52.7	-25.8	3.6	-17.5	186.4	37.2	8.3	29.9	12.8
<b>Small Cap</b>	380	15.1	15.9	25.2	-15.4	76.7	-22.0	5.6	60.2	22.1	5.8	4.1

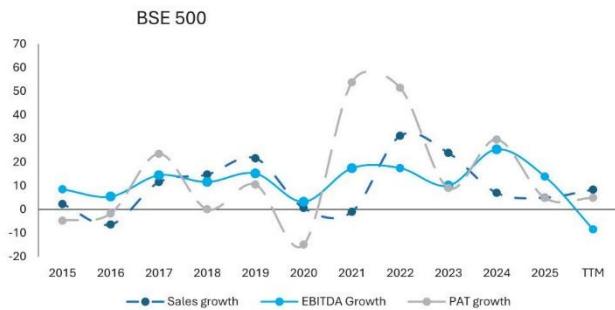
Legends	Highest	Lowest
---------	---------	--------



**Pradeep Kesavan**  
CFA – Equity Strategist

## Exhibit 72:

Sales growth and PAT growth have converged



## Number of high growth sectors declining

Across sectors highest PAT growth was seen in FY22, following which there has been a steady decline in the number of sectors (as defined by AMFI) with high growth (>15%). Compared to FY24, FY25 saw a decline in high growth sectors and increase in sectors that saw profit contraction, this trend exacerbated further over the last twelve months.

## Exhibit 73:

High growth sectors are decreasing

BSE500		PAT Growth	Sales/EBITDA/PAT Growth YoY%											
Sectors	No of Co		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	TTM
Oil, Gas & Consumable Fuels	18	-15.5	23.8	32.5	3.7	12.3	-35.4	73.3	34.9	-15.3	64.6	-30.5	12.7	
Power	15	4.0	16.0	-12.0	24.6	22.0	-4.2	25.1	27.3	16.9	24.3	-6.4	7.5	
Capital Goods	59	-72.4	376.0	47.3	-7.0	46.3	-49.2	49.5	54.0	27.6	35.7	21.4	16.1	
Financial Services	92	13.7	-37.4	10.2	-29.8	30.4	27.5	110.7	39.7	52.4	28.9	10.8	9.3	
Information Technology	28	6.9	8.4	9.6	3.4	14.4	4.2	8.3	20.7	6.6	5.3	8.4	6.5	
Fast Moving Consumer Goods	29	10.7	0.6	17.7	-4.9	47.6	31.6	-15.2	15.2	13.2	10.7	34.3	34.7	
Healthcare	48	17.5	20.2	6.9	-33.8	24.3	15.8	33.6	2.3	9.8	24.2	35.7	5.1	
Consumer Services	24	-19.9	-33.1	-352.9	355.3	-142.5	283.3	-70.2	-1217.0	-79.9	242.1	26.8	0.4	
Automobile and Auto Components	35	1.8	16.8	-1.6	15.2	-75.6	78.3	-23.6	61.6	112.6	90.8	-8.4	-14.7	
Construction	15	0.9	9.8	24.6	28.8	19.6	-1.2	-38.6	57.2	22.1	25.6	24.4	37.4	
Construction Materials	13	0.7	9.3	24.4	0.0	2.6	67.3	10.9	28.0	-19.5	24.9	-30.9	27.6	
Telecommunication Services	9	54.1	39.5	-52.2	-201.4	-165.7	-1200.6	-42.4	-180.5	-9.3	-5.0	213.6	134.7	
Metals & Mining	17	-82.9	-294.1	-303.3	139.0	-17.7	-64.2	273.0	134.9	-55.6	-19.3	41.8	29.8	
Chemicals	32	38.5	18.2	43.6	18.5	0.6	34.6	21.5	47.8	12.6	-43.4	23.5	50.2	
Consumer Durables	25	14.1	45.0	-3.3	14.9	8.6	16.2	-1.2	24.6	18.6	22.8	-1.4	8.0	
Textiles	7	6.7	-226.1	-66.9	2138.4	-125.7	-15.1	-193.1	-228.1	-50.9	12.7	19.1	7.6	
Realty	10	10.1	2.0	3.5	128.2	-31.2	-67.8	161.5	28.1	42.6	35.2	41.6	22.4	
Forest Materials	1	469.5	-713.3	-230.4	125.6	78.7	-24.3	-104.0	-1123.0	109.3	-5.5	-152.9	-318.3	
Media, Entertainment & Publication	4	-61.8	202.7	58.5	-16.6	17.5	-33.8	6.2	43.8	-47.2	10.1	-76.5	-43.1	
Diversified	4	21.4	-18.7	118.6	22.2	42.3	-23.1	-31.0	88.0	25.3	-18.7	27.4	51.3	

>25% >15% Negative

## Steady margins despite topline challenge, but are we hitting a wall here?

Despite challenging topline environment, margins, both EBITDA margin and PAT margin have been healthy and higher than pre-covid years. This trend is visible across narrow market, broader market, and our coverage universe. Over the last twelve months, however, there has been a marginal dip in PAT margin. The key question is about sustainability of these margins, especially if demand challenges persist. **Over the coming year, we would want to bet on companies that can protect margins.**

### Exhibit 74:

Margins for BSE 500 companies have held up



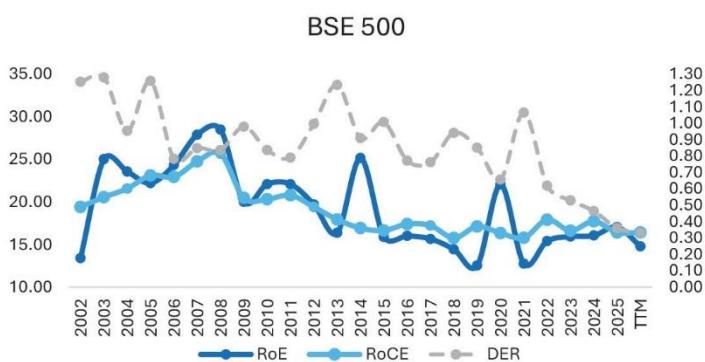
## Return focused approach has paid off, but are we running out of levers?

Though not as high as pre GFC levels, corporate ROEs have jumped up to very healthy levels post COVID, compared to low ROE period of 2010-2020. This period also saw a sharp decline in balance sheet leverage, to the extent that currently ROEs have converged with ROCEs (most pronounced in our coverage).

The key question is, **"is corporate India now without levers to further expand ROEs?"** Given slowing topline and lack of leverage, it appears so. If preserving such higher levels of ROEs is important, then Corporate India will look to re-lever itself as a way to do so.

### Exhibit 75:

ROE has sustained but are we lacking levers?



In our view, the key missing ingredient in corporate performance is topline growth. A recovery in economic activity aided by recent government support in the form of GST rationalisation, I-T concessions, and the upcoming pay commission, along with a conducive monetary environment will pave the way for corporate topline led recovery in CY26.

## CY26 – A more constructive year ahead for the markets

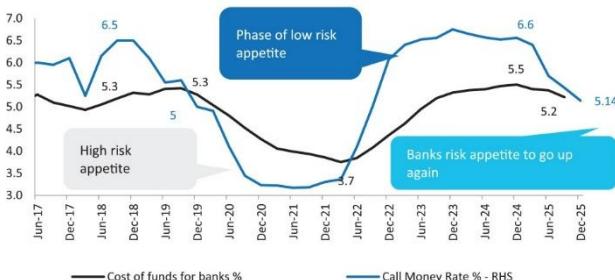
In CY26, we expect (i) Bank credit growth to expand, (ii) FPI and FDI flows to return, (iii) Monetary transmission to percolate supportively, (iv) Consumption to improve on the back of (a) improving Household finances and (b) some recovery in urban incomes

## (i) Bank credit to expand in CY26

Over the last few months, the overnight yields have fallen below the average cost of funds of banks. This, combined with increase in liquidity, will prod banks to ramp up credit and hence we expect growth to improve

### Exhibit 76:

Call money rates are collapsing; likely to improve risk appetite of banks

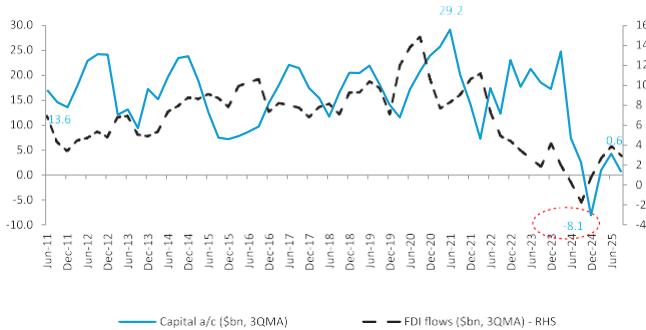


## (ii) FPI and FDI flows to improve

FPIs were net sellers, with equity outflows of **US\$18 billion in CY25**. This was driven by global risk aversion, better opportunities elsewhere, and the lack of an AI-driven theme in Indian equities. This along with this, the net FDI flows too dragged in CY25, putting pressure on rupee.

### Exhibit 77:

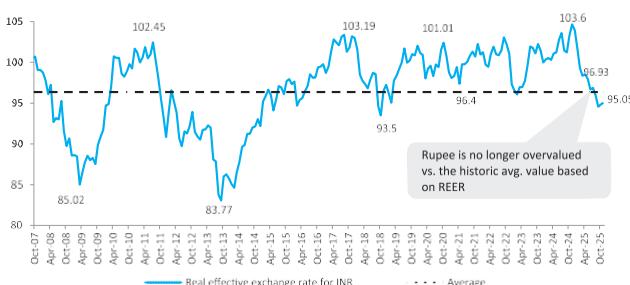
Both portfolio and capital flows are likely to improve



Rupee stands out among the major currencies to have depreciated vs USD in 2025 in an environment where USD weakened across all major currencies. We expect this trend to reverse in CY26. Announcement of US-India trade deal will be a key catalyst in this direction, in our view. A weakening USD has traditionally been good for EM flows and CY26 will likely see return of FPIs into EM and India.

### Exhibit 78:

Rupee looks undervalued



### (iii) Monetary transmission to percolate

Over the last year RBI has infused ~ INR 11 trillion in liquidity and has cut repo rates by 125 bps. Experience from past easing cycles shows that transmissions can take up to 12 months, in which case CY26 should see the real impact of these measures

#### Exhibit 79:

Recent liquidity infusion by RBI to help



### (iv) Consumption to improve

Overall household leverage that reached a peak of 6.2% of GDP in FY24, eased off from there and hit 4.7%. This, in our view, should provide elbow room for consumers to lever up at a time when credit appetite for banks also improves. A combination of these two is should be consumption supportive.

#### Exhibit 80:

HH liabilities are easing, scope for levered consumption



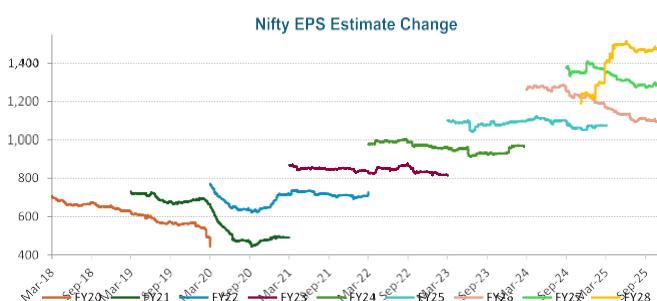
While hiring and salary growth has been lagging over a period of time, 1HFY26 saw a marginal recovery in salary growth of I-T salaries. Additionally, ~INR 1 trillion support from Income Tax relief and ~INR 1.3 trillion impetus from GST rationalisation, along with the impending 8th pay commission will all be consumption supportive in CY26.

### Early signs in terms of bottoming of earnings cuts

FY26 earnings saw the steepest cuts seen in recent years. However, FY27 numbers are stabilising due to a combination of factors that we covered above. We might be seeing the bottoming out of earnings cuts portending better earnings prospects going into CY26.

#### Exhibit 81:

We are likely seeing bottoming of earnings cuts



## Section 5: Equity Outlook

### Beginning of normalization of excesses

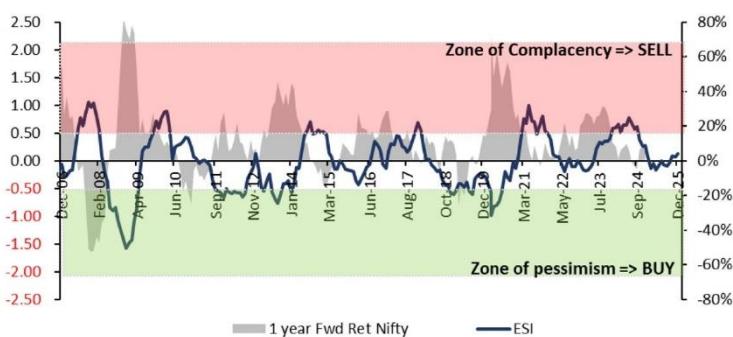
2025 was a year of normalization of market excesses for Indian equities. Entering the year, valuations were expensive and market sentiment was euphoric. The months of January and February saw big drops for the frontline indices and more brutal cuts for the broader markets. The correction in the early part of the year erased excesses on market sentiment as our proprietary market sentiment index moved back to neutral from readings denoting euphoria earlier. With the correction, valuations also normalized for large caps. On our valuation measures, which track equity valuations as a spread to government bond yields, correction in equity indexes as well as drop in bond yields led to valuations moving back towards historical medians. This combination led to our asset allocation framework moving to 60% equity allocation on a scale of 0-100% versus 20% entering CY25 suggesting a move to neutral versus a significant underweight stance. Going into 2026, that allocation stays unchanged.



**Gaurav Mehta**  
CFA, Head – SIF,  
Equity

### Exhibit 82:

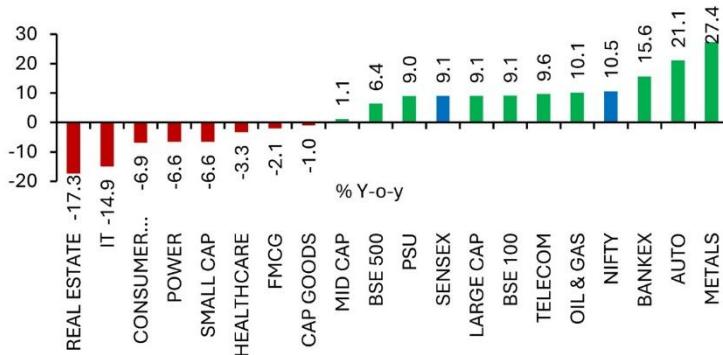
#### Equity market sentiment subsided from euphoric levels in 2024 to neutral in 2025



Source: Bloomberg, FactSet, SBIFM Research, ESI stands for Equity Sentiment Index, our proprietary equity sentiment measure

### Exhibit 83:

While Nifty has delivered double-digit gains this year, performance across sectors and market capitalizations have been mixed



Source: Bloomberg, SBIFM Research

### Large caps over Mid and Small- Polarization to increase

However, in terms of relative valuations, broader markets stayed expensive versus large caps. Through the year this reflected in narrowing of market breadth with Nifty and Sensex delivering 12% and 10.5% returns for CY25 respectively but Nifty Midcap 150 index trailing at 6.2% and Nifty Smallcap 250 index declining 5.3%. Entering 2026, that relative picture hasn't changed much, and we expect leadership to stay with large caps and therefore polarization to increase.

## Exhibit 84:

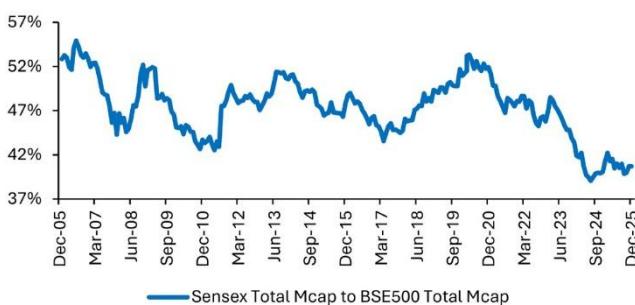
### Market breadth stays weak even as Nifty attempts fresh highs



Source: FactSet, SBIFM Research

## Exhibit 85:

### Polarization may continue to increase with large caps cheap on relative valuations



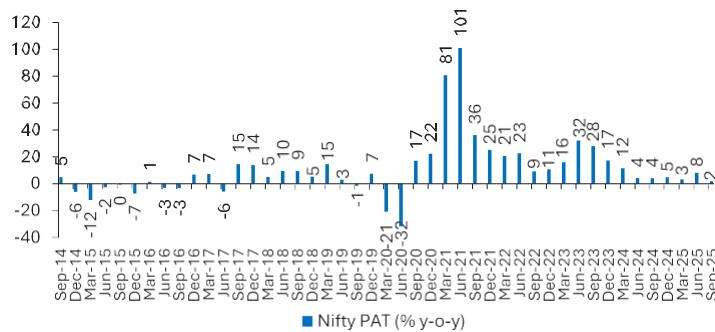
Source: Bloomberg, SBIFM Research

### Policy support amidst weak earnings

Amidst higher tariffs from the US and continued weak earnings growth from corporate India, the government announced a slew of measures to revive domestic economy including income tax cuts, cut in Goods and Services (GST) tax and simplifying the labour code. The RBI on its part was aggressive with triple easing across rates, liquidity, and regulation. While this hasn't yet reflected in improving the health of corporate India, pace of earnings downgrades has eased with upgrades and downgrades largely balancing each other now. This may reflect a troughing of earnings with gradual improvements going forward.

## Exhibit 86:

### India's earnings have been slowing down over the past many quarters



## Exhibit 87:

**Breadth of earnings revisions have improved and now point to a balance between upgrades and downgrades**



Source: FactSet, SBIFM Research

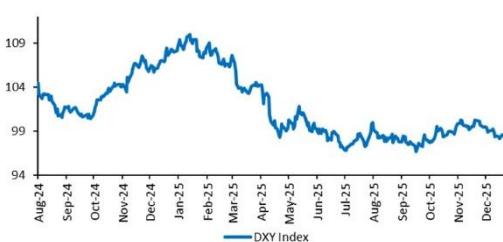
## EMs do well, India's premium has normalized

Emerging markets had a good year with MSCI EM index returning 34.3% dollar returns in 2025. This compared with 21.6% dollar returns for the MSCI World Equity Index. Sustained weakness in US dollar and moderation in policy uncertainty after the trade tariff related spike helped EMs to come back after decades of underperformance to US equities. The extent of long-term underperformance, however, suggests that this reversion has more course to run and EMs should continue to do well.

India was a significant underperformer within the EM basket and consequently the massive premium that India traded at versus EMs has now reverted closer to long run averages. This means that relative valuation picture is better now and continued flows into EM equities may see flows into India as well.

## Exhibit 88:

**DXY depreciated this year**



Source: Bloomberg, SBIFM Research

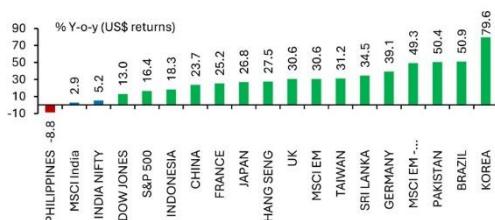
## Exhibit 89:

**DXY is still overvalued, more room for decline?**



## Exhibit 90:

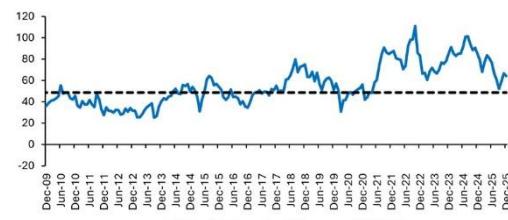
**India has stayed an underperformer this year amidst a surge in EM equities**



Source: Bloomberg, SBIFM Research

## Exhibit 91:

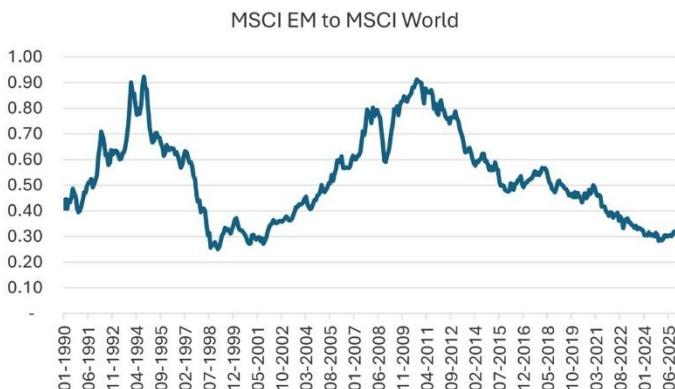
**India's valuation premium to EMs has moderated**



Source: Bloomberg, SBIFM Research

## Exhibit 92:

### EMs have a lot of room to revert after years of underperformance



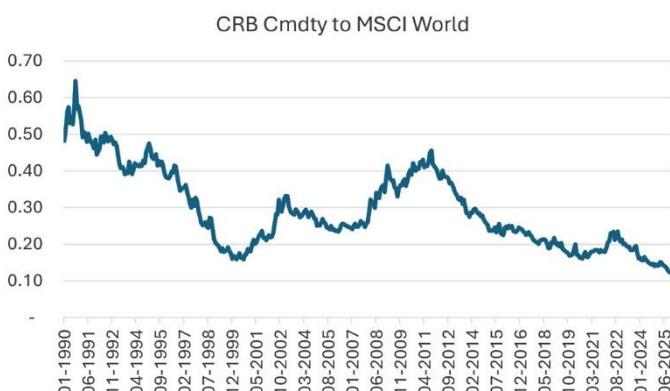
Source: Bloomberg, SBIFM Research

### Commodities stage a comeback

Like EMs, Commodities also woke up from a multi-year slumber to stage a strong comeback in 2025. While precious metals led the charge as investors looked to diversify away from dollar assets. Base metals started to see uptick in latter part of the year as global economic headwinds began to recede as world moved past the tariff related turbulence. Like EMs, the long-term underperformance is so stark that the reversion trade may have a longer course to run. Factors such as reindustrialization, defense spending, data centre, and electrification capex in several parts of the world are supportive factors that may continue to fuel the demand for commodities, especially base metals. Decline in tariff uncertainty and receding headwinds from Chinese growth should aide. As confidence in the global economy increases, we believe leadership may move from precious metals to industrial commodities.

## Exhibit 93:

### Commodities waking up from a year's long slumber



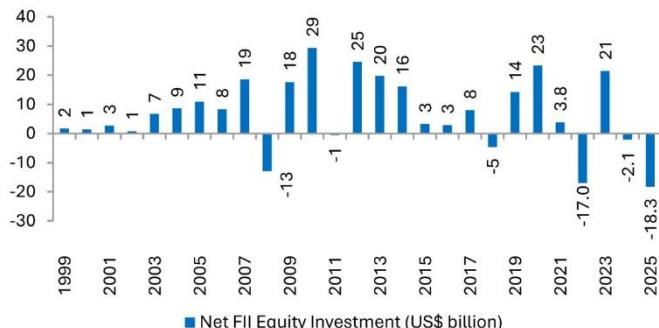
Source: Bloomberg, SBIFM Research

### Record FPI outflows, resilient domestic flows, and deluge of IPOs

Record FPI outflows, resilient domestic flows, and persistent supply of paper through primary issuance and secondary sales marked the flow picture for Indian equities. FPIs sold US\$ 18 billion in Indian equities while DIIIs bought US\$ 57 billion. The second half also saw a resurgence in supply of paper with IPOs surging along with secondary equity sales and acted to put a lid on the markets, in our view.

## Exhibit 94:

FPIs have been persistent sellers this year



Source: Bloomberg, SBIFM Research

## Exhibit 95:

DII flows stay resilient



Source: Bloomberg, SBIFM Research

## Exhibit 96:

Continued surge in primary market issuances have acted as lid on market upmoves



Source: Bloomberg, SBIFM Research

## 2026: More of the same?

We expect the trends of 2025 to continue into 2026. EM equities and hard assets, including industrial commodities, should stay supported after years of underperformance on the back of improving global growth. India having moderated on valuations premium to EMs should receive its fair share of flows. Policy support should help growth which should help equities inch higher. However, equity supply puts a lid on the markets. Expect measured upmove for large caps. Performance down the market cap spectrum may stay muted as market polarization increases on the back of valuation normalization. Rising polarization amidst moderate market returns should mean staying selective and focusing on bottom-up should help.

## Section 6: Fixed Income Outlook

### The Monetary cycle

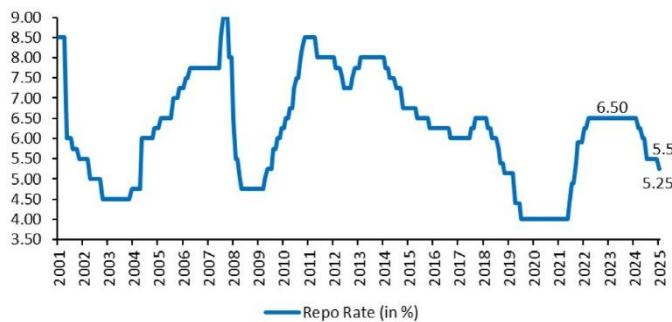
The RBI has cumulatively reduced policy rates by 125 bps in the current easing cycle that commenced in Feb 25 (Exhibit 97). At the same time, the central bank has shifted the policy stance from accommodative to neutral since the June 25 review. It must also be emphasized that the current cycle has also seen an unprecedented liquidity infusion as the banking liquidity tightness on account of FX interventions had impeded policy transmission. Apart from the core liquidity injection of Rs 7.0 trillion through Open market purchases in CY25, the RBI has also cut the CRR cumulatively by 150 bps in this easing cycle. Over this cycle, liquidity injection of Rs 15.7 trillion has been conducted through OMO, CRR cut and FX swaps. This is apart from multiple rounds of short-term liquidity infusion through Variable Rate Repo auctions.



**Rajeev Radhakrishnan**  
CFA, CIO – Fixed Income

### Exhibit 97:

RBI has cut rates by 125bps since Feb'25



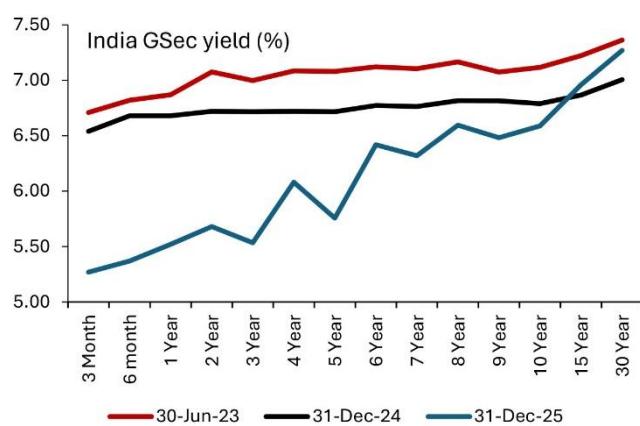
Source: RBI, SBIFM Research

### Impact

Alongside the rate cuts, the biggest impact has been in system liquidity shifting from deficit in Jan 2025 to surplus by March 2025. The impact has been seen in the yield curve steepening over the last 2 years (Exhibit 98,99).

### Exhibit 98:

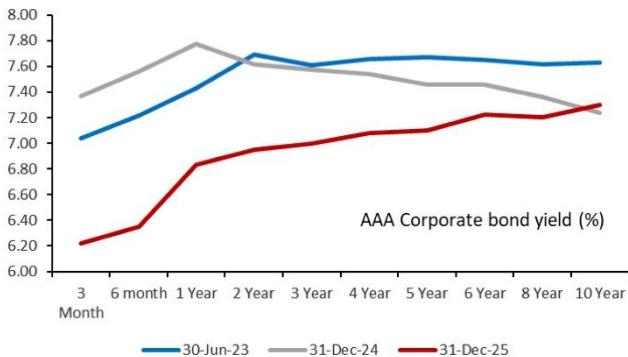
Yield Curve has steepened in 2025



Source: Bloomberg, SBIFM Research

## Exhibit 99:

Corporate bond yield curve has steepened too



Source: Bloomberg, SBIFM Research

The steepness in the yield curve reflects near term demand supply challenges more than any material concerns on the fiscal framework. The fiscal deficit trajectory in India has shown a downward trend with the government budgeting FY26 FD at 4.4% of GDP. In the FY26 Union Budget, the central government has committed to anchor the fiscal deficit over the coming 5 years such that the Debt/GDP is on declining trend with a commitment to reduce central government debt/ GDP to 50%+- 1% by March 2031.

## Emerging Issues/ Expectations in CY26:

### Global policy actions

While CY 25 saw a broadly easing bias across most large DMs as other jurisdictions, over the year diverging signals have emerged. Even as the FED faces increasing political interference and a leadership change in the coming year, macro data especially on inflation would constrain material reduction from the current levels on the Funds rate. Profound monetary policy changes are underway in Japan with the Bank of Japan normalising policy further with material impact on global financial markets as the risk-free rates inch higher even as the currency faces weakening pressures. Overall global monetary policy is likely to be less rates supportive in CY26.

### RBI Policy Stance

The current policy stance of the RBI being neutral provides the central bank with adequate flexibility to respond to evolving macroeconomic data.

We expect India's retail inflation to average around 2% in FY26 and stay anchored at sub-4% during the early months of FY27, before rising towards 5% during latter half of FY27. Cumulatively average inflation is likely to stay closely aligned to the 4% target over the near term even in FY27. Real GDP growth, while being resilient in FY26 on a relative basis largely on account of deflator adjustments due to low WPI, is anticipated to be lower on a forward basis as compared to potential estimates. The trade related uncertainties as well as still moderate domestic demand are additional headwinds. Slowdown in nominal growth to below 9% effectively indicates the challenges on growth, even as on a relative basis economic growth prospect in India are better.

Lower than potential growth, with visible challenges to the same and CPI being anchored closer to target provides some headroom for RBI policy to remain growth supportive in the near term, likely through most of CY26. There remains very little worry about any abrupt reversal of the policy cycle soon. At the same time, from a policy rate angle RBI seems to have done sufficiently in the current cycle. Incremental cuts are unlikely to make much of an impact even as the focus should move on to transmission of cuts.

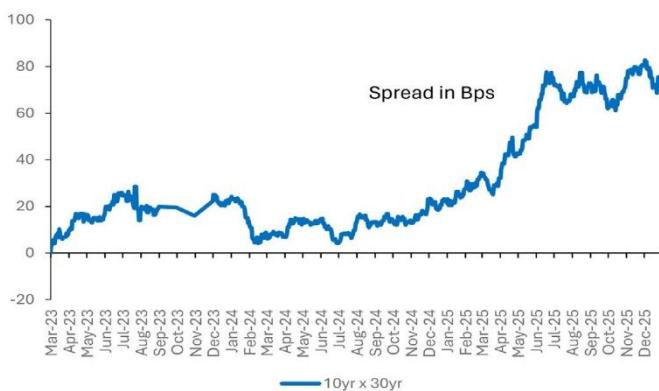
## Challenges In Transmission - Demand Supply gap

A steeper yield curve has been the result of demand-supply gaps and certain changes in investment pattern by long-term investors. In FY25, the impact of large OMO purchases and index inclusion flows largely masked the emerging challenges. In FY26, with the RBI OMO's winding down in June 2025 and the FPI flows tapering off, these issues have come to the forefront. Changes in taxation norms as well as investment pattern of pension funds have incrementally led to more of equity investment by these players.

Banking system credit – deposit growth gap and investment norm changes have also led to lesser SLR purchases on an incremental basis. The tapering of long end investor demand in sovereign bonds and higher duration supply by state governments in the SDL auctions has led to widening tenor spread on the longer end of the sovereign curve (Exhibit 100). In response to these, the H2 borrowing calendar has been tweaked to reduce long end supply. Resumption of large-scale OMO purchases and liquidity infusion by RBI since December 2025 have led to little impact so far on market yields, given the existing landscape of weak core and trader demand, pressure on INR and muted trading volumes on year end.

### Exhibit 100:

Steepness in the yield curve persisted through 2025



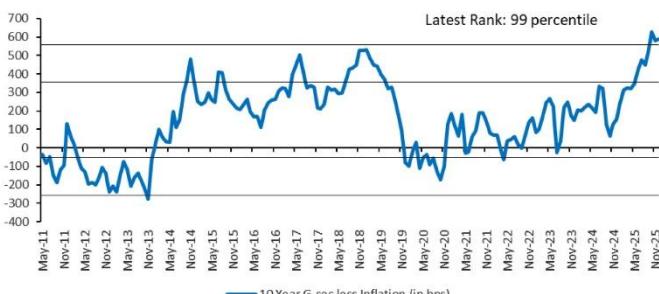
Source: Bloomberg, SBIFM Research

### Attractive real rates

Real rates on sovereign bonds remain very compelling and are likely to remain so in the near future (Exhibit 101). Even as the fiscal headwinds are largely over, there remains no worry with respect to any unanchoring of fiscal consolidation over the coming year.

### Exhibit 101:

Real rates on sovereign bonds are attractive



Source: Bloomberg, SBIFM Research

While most valuation metrics may remain supportive, addressing demand side challenges remain important for any durable easing in market yields and effective transmission of policy signals. While core demand from Pension and insurance should normalise with respect to CY25 trends, the overall duration supply from states and centre remain significant seen in the context of likely overall demand. RBI OMO purchases cannot remain the default choice for financing of fiscal deficits. As the rate cycle turns or liquidity infusion instrument moves to the Forex channel at some time, the lack of buying depth would hurt the broader economy even more. The rectification of a lacklustre demand environment is a fiscal policy necessity which cannot be postponed given the ground realities and the requirement to enable a favourable financing environment for the sovereign and corporate sector.

## Opportunities in bond markets- CY26

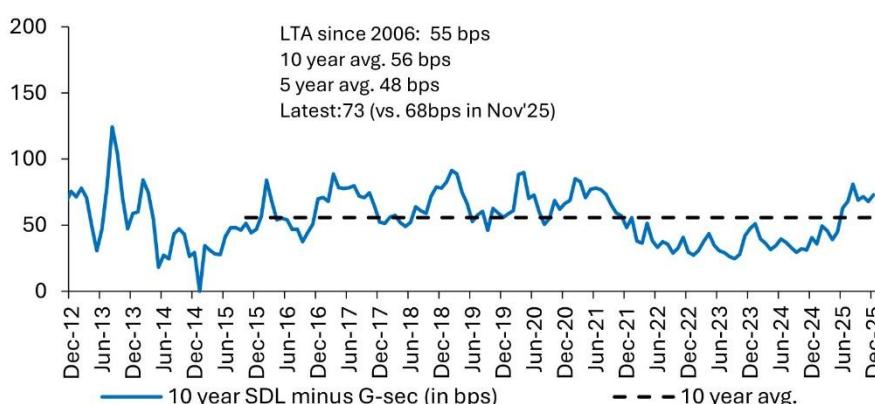
SDL's, short end bonds, and money market instruments remain near-term investment opportunities, more so over the last quarter of the financial year.

SDL issuances in the first half of the fiscal year have broadly been in line with the indicative calendar, with larger duration supply leading to higher term spreads on sovereign securities. Q3 FY26 borrowing has been announced lower even as the expectations remain on a higher calendar for Q4 FY26. This is likely to keep SDL spreads elevated and providing reasonable investment opportunities, especially at the shorter end of the curve (10y and below) – Exhibit 102.

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### Exhibit 102:

SDL spreads have widened in 2025

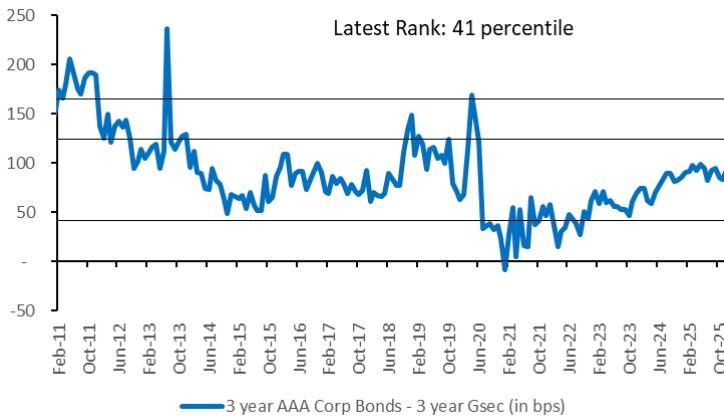


Source: Bloomberg, SBIFM Research

AAA bond spreads have remained elevated at the shorter end vs the recent history. While spreads remain modest on long term comparison, the emerging supply outlook is relatively favourable. Corporates continue to benefit from better rates in the loan market, especially at the high-grade names and the supply has been fairly in line with demand. This trend may sustain for the near term (Exhibit 103). Nuances on taxation related demand shortfall have kept 3y and below spreads elevated in an environment that has been traditionally spread supportive. i.e., excess liquidity and modest supply. The amendment to Mutual Fund Debt taxation in 2023 has kept flows into bond funds muted.

## Exhibit 103:

### Corporate Bond Spreads



Source: Bloomberg, SBIFM Research

Emerging trends in weak deposit growth and incremental credit demand have kept CD rates elevated. Supply pressure remains unlikely to abate even as RBI infuses core liquidity through swaps and OMO.

Given the overall macro and demand dynamics in the current phase of the rate cycle, it is time to prioritise stability and accrual over a directional duration strategy. A moderate duration stance, with core accrual built around high-grade short tenor AAA bonds and selective exposure down the curve (consistent with fund risk mandates) is warranted in portfolios. Duration remains tactical in the current environment.

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