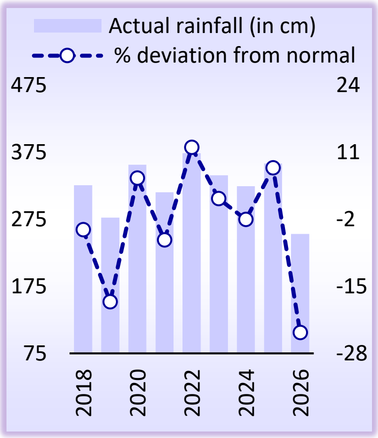
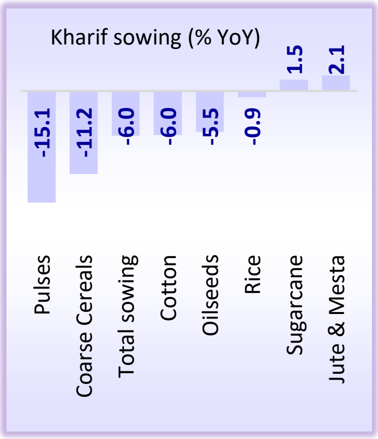
Economy | Macro-Cap

Rural demand: Down, but not out

All-India rainfall is 24% below normal as of 19th July, 2026 (vs. 8% above normal in 2025)

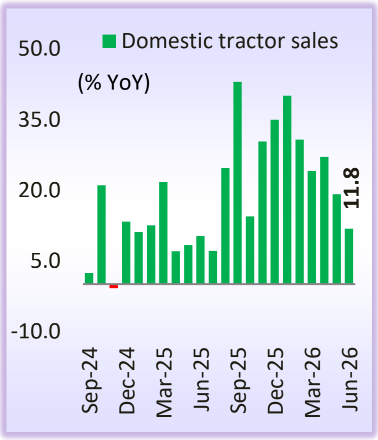


Kharif sowing down by 6% as of 17th Jul'26



Data as of 17th July for all years

Tractor sales grew 11.8% in Jun'26



- **Channel checks:** Our interactions with corporates and farmers across Karnataka, Maharashtra, Telangana, Rajasthan, and Madhya Pradesh indicate that the weak monsoon has not yet translated into a sharp deterioration in rural activity. Tractor demand remains more resilient than expected, while farmers report that sowing activity has accelerated following the revival in July rainfall. Management commentary from NBFCs indicates cautious optimism so far. Reservoir levels are adequate, though not abundant, and rainfall over the coming weeks will remain critical for crop development and rural demand. At this stage, channel checks suggest that rural conditions have softened but are not showing the signs of distress that were feared at the start of the monsoon season.
- **Rainfall has improved, but monsoon remains significantly below normal:** Cumulative rainfall remains 24% below the long-period average (LPA) as of 19th Jul'26 (vs. 40% in Jun'26), with 23 of 36 meteorological sub-divisions still reporting deficient rainfall. Weakness remains concentrated across the Eastern, Southern, and several key agricultural states.
- **Of the 111 districts identified by the government as most vulnerable to El Niño due to low irrigation coverage, 69 are already facing deficient rainfall.** This strengthens our view that food inflation risks remain tilted to the upside, particularly for rain-fed crops such as pulses and oilseeds.
- **Total kharif sowing contracted 6% YoY (as of 17th Jul'26),** with the sharpest declines in pulses (-15.1%), coarse cereals (-11.2%), cotton (-6.0%), and oilseeds (-5.5%). Rice sowing (-0.9%) has proved relatively resilient because of extensive irrigation coverage and favorable rainfall across key Eastern states.
- Live storage across major reservoirs has improved to 34% of capacity as of 16th Jul'26 from 26% at the beginning of July, reflecting stronger rainfall over recent weeks. However, storage remains well below last year's levels (57%), with Southern and Eastern India continuing to experience significant water stress.
- **The spatial extent of drought has continued to increase despite the improvement in rainfall during July.** As of 15th Jul'26, 35.5% of the country's geographical area was classified under abnormally dry (D0) or worse conditions, up from 30.7% a week earlier. Of this, 16.1% of the area was under moderate drought (D1+), 6.0% under severe drought (D2+), and 1.1% under extreme drought (D3).
- **Rural CPI inflation accelerated to 4.7% YoY in June, compared with 3.9% in urban India, reflecting the higher weight of food in rural consumption baskets.** We maintain our FY27 CPI inflation forecast of 5.2%, relative to RBI's 5.1%, taking into account El Niño risks and energy-led price increases
- **RBI likely to remain on hold through CY26**: The RBI has identified the weak monsoon as one of the principal macroeconomic risks for FY27 but continues to view weather-related food inflation as a temporary supply-side shock. With average CPI inflation at 3.9% in 1QFY27, below the RBI's 4.2% forecast, the MPC has room to remain patient while assessing the persistence of food inflation. We, therefore, expect the policy rate to remain unchanged through CY26, with any potential rate hike deferred to 2027, contingent on sustained food inflation, monsoon outcomes, and evidence of second-round inflationary pressures.

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Rainfall Deficit	Kharif Sowing	Reservoir levels
-24%	**-6% YoY**	**34%**
As of 19th Jul'26	As of 17th Jul'26	Lower than last year and decadal avg.
CPI Inflation FY27E	**Crude Oil FY27E**	**Real GDP Growth FY27E**
5.2%	**USD 85/barrel**	**6.6% YoY**
vs. RBI's estimate of 5.1%	Decreased from USD 95/barrel post-ceasefire	Similar to RBI's estimate

Channel checks suggest rural conditions are softer, but not alarming yet

- **Our channel checks indicate that the impact of the weak monsoon on rural activity remains manageable at this stage, although risks warrant close monitoring.** Discussions with corporates focusing on rural markets suggest that rural demand has remained resilient despite weather concerns. According to management, reservoir levels are adequate, though not abundant, and improving non-farm income opportunities are providing an additional cushion to rural demand.
- Our interactions with farmers across Karnataka, Maharashtra, Telangana, Rajasthan, and Madhya Pradesh also point to improving ground conditions following the revival in July rainfall. Farmers indicated that sowing activity has accelerated materially over the past week, with nearly 50% of planting completed (13th Jul'26), compared with significantly weaker progress at the end of June. However, reservoir levels remain relatively low, and farmers continue to emphasize that consistent rainfall over the coming weeks will be critical, as prolonged dry spells could damage recently sown crops and adversely affect yields.
- **Management Commentary:** L&T Finance (1QFY27 results, 13th Jul'26):
  - Management remains constructive on the overall macro environment, supported by healthy urban and rural demand despite delayed monsoon. Healthy reservoir levels reduce the risk from a potential El Niño impact.
  - The microfinance industry has deleveraged meaningfully over the past year, reducing the probability of another severe credit cycle.
  - Around 70% of the country received normal-to-above-normal rainfall during July, while the cumulative monsoon deficit narrowed to 14%, below the LPA. Rural demand continues to remain healthy, aided by government spending and a sustained policy focus on the rural economy.

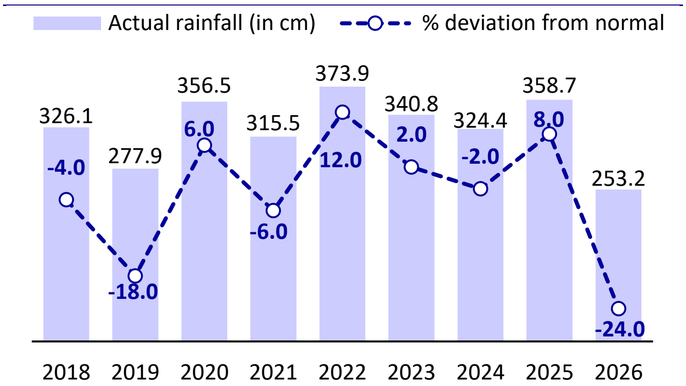
Rainfall deficit remains broad-based despite improvement in July

- The Southwest monsoon has recovered from its exceptionally weak start but continues to remain significantly below normal, with rainfall deficits persisting across most parts of the country. **As of 19th Jul'26, cumulative rainfall stood 24% below the long-period average, improving considerably from the 42% deficit recorded in late June but remaining substantially weaker than the 8% surplus witnessed during the corresponding period last year.** The improvement reflects a revival in monsoon activity during early July following a prolonged dry spell in June. However, the recovery has been insufficient to eliminate the large cumulative rainfall deficit accumulated during the critical sowing period.

- The weakness in the monsoon continues to be broad-based across all four meteorological regions, although the intensity of rainfall deficiency varies considerably. East and Northeast India remain the weakest-performing region, with cumulative rainfall 35% below normal, followed by the Southern Peninsula (-27%), Northwest India (-23%), and Central India (-14%). The improvement in Central India is encouraging, given that the region had recorded one of the sharpest rainfall deficits during June and accounts for a significant share of India's soybean, cotton, and pulse production.
- **Rainfall deficiency has become significantly more widespread this year.** As of 19th Jul'26, 23 of India's 36 meteorological sub-divisions reported deficient rainfall, compared with 8 during the same period last year and 12 in 2024. At the same time, none of the sub-divisions recorded excess or large excess rainfall, versus 10 in 2025.
- **State-level rainfall data further highlight that the current monsoon weakness remains concentrated across several major agricultural states.** Large rainfall deficits continue to persist across Bihar (-44%), Punjab (-41%), Jharkhand (-41%), Goa (-38%), Kerala (-34%), Gujarat (-33%), Assam (-31%), Telangana (-31%), Andhra Pradesh (-30%), Karnataka (-28%), Rajasthan (-28%), Uttar Pradesh (-27%), Haryana (-24%), and Chhattisgarh (-22%). Although rainfall has improved materially in Madhya Pradesh (-16%) and Maharashtra (-14%), both states continue to remain below normal after recording exceptionally weak rainfall during June. In contrast, only a handful of states have received normal or excess rainfall, including Odisha (+14%), Sikkim (+11%), West Bengal (normal), and Tamil Nadu (-1%).
- The geographical distribution of rainfall deficiency is also becoming increasingly concerning. The Center had earlier identified 111 districts with less than 25% irrigation coverage as highly vulnerable to El Niño-related agricultural stress. According to recent assessments, 69 of these priority districts are already reporting deficient rainfall, indicating that rainfall weakness is becoming concentrated in some of India's most rain-fed farming regions. Since these districts rely heavily on monsoon rainfall, a prolonged dry spell could disproportionately affect pulse, oilseed, and coarse cereal production, reinforcing upside risks to food inflation during 2HFY27.
- **The agricultural implications of the current rainfall pattern depend not only on the magnitude of rainfall deficits but also on irrigation coverage across producing states.** The outlook for rice production appears relatively resilient despite below-normal rainfall in several major producing states. Punjab, Haryana, Telangana, and Andhra Pradesh together account for more than one-fourth of India's rice output and have irrigation coverage exceeding 95%, significantly reducing their dependence on monsoon rainfall. Similarly, Uttar Pradesh irrigates over 86% of its rice acreage. Moreover, the two largest Eastern rice-producing states—West Bengal, which contributes 13.4% of national rice production, and Odisha, accounting for 7%—have received normal and above-normal rainfall, respectively. **Thus, aggregate rice production remains relatively well protected owing to extensive irrigation infrastructure and favorable rainfall across parts of Eastern India** *(Exhibit 6).*
- **In contrast, the outlook for pulses remains considerably more vulnerable because production is concentrated in states with relatively poor irrigation**

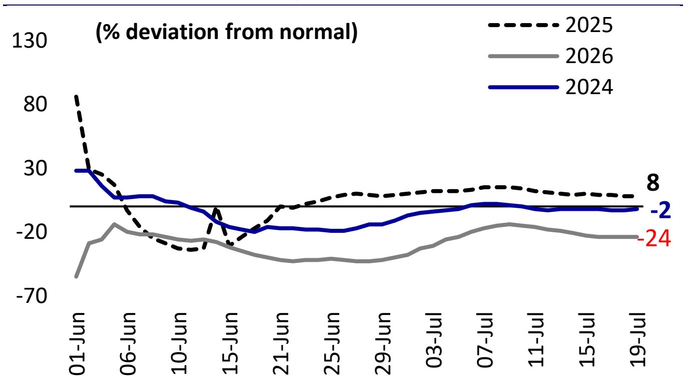
coverage and persistent rainfall deficits. Madhya Pradesh and Maharashtra together account for over 40% of India's pulse production, followed by Rajasthan, Gujarat, Uttar Pradesh, and Karnataka. Irrigation coverage remains particularly low in Maharashtra (12.5%), Karnataka (10.8%), Jharkhand (11.8%), and Rajasthan (22.2%), making pulse cultivation highly dependent on monsoon rainfall. Most of these states continue to report rainfall deficits ranging between 14% and 41%, increasing the risk of lower yields if rainfall does not improve during the remainder of the season *(Exhibit 7).*

Exhibit 1: All-India rainfall is 24% below normal as of 19th Jul'26 (vs. 8% above normal in 2025)



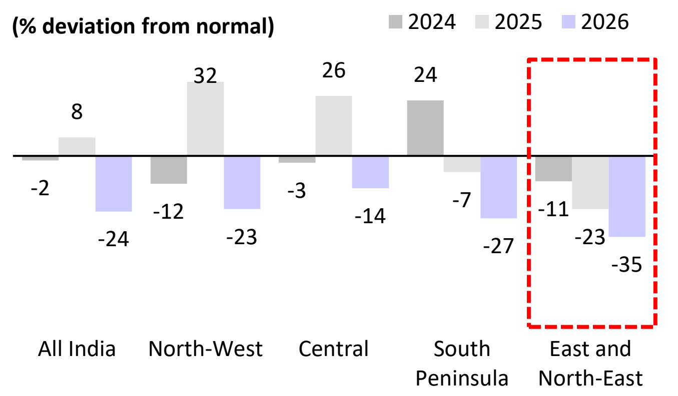
Data as of 19th July for all years

Exhibit 2: This is much lower than 2024 levels; -24% now vs. -2% in 2024 (last El Niño episode)



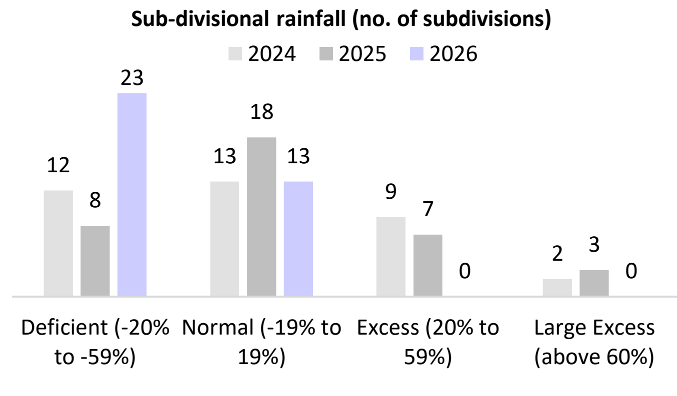
Source: IMD, CEIC, MOFSL

Exhibit 3: East and Northeast India remain the weakest-performing regions



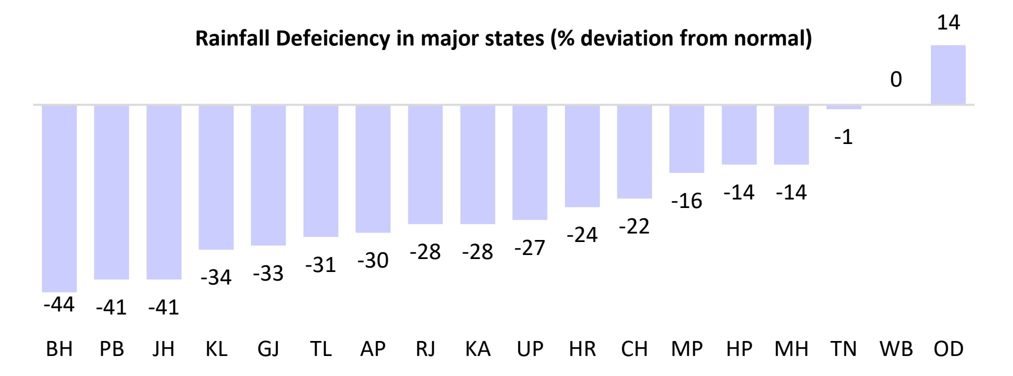
Data as of 19th July for all years

Exhibit 4: 23 sub-divisions received deficient rainfall (as of 19th Jul'26), while 13 received normal rainfall



Source: IMD, CEIC, MOFSL

Exhibit 5: Rainfall deficiency persists across majority of the agrarian states



Data as of 19th July for all years

Exhibit 6: Major rice-producing states

States	% share in rice production	Area under irrigation (%)	% deviation from normal rainfall	
			2025	2026
Bihar	5.3	64.6	-43	-44
Punjab	9.9	99.7	4	-41
Telangana	6.3	98.5	-23	-31
Assam	4.2	15.1	-43	-31
Andhra Pradesh	7.3	96.7	-24	-30
Uttar Pradesh	13.1	86.2	5	-27
Haryana	4.1	99.9	33	-24
Chhattisgarh	5.7	36.3	4	-22
Madhya Pradesh	4.0	39.4	67	-16
Tamil Nadu	6.0	91.6	-6	-1
West Bengal	13.4	51.1	5	0
Odisha	7.0	30.9	18	14

Data as of 19th July for all years

Exhibit 7: Major pulses-producing states

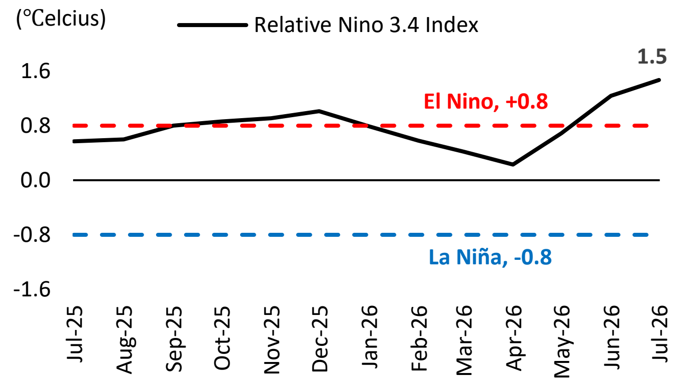
States	% share in pulses production	Area under irrigation (%)	% deviation from normal rainfall	
			2025	2026
Jharkhand	3.2	11.8	65	-41
Gujarat	9.7	41.1	48	-33
Andhra Pradesh	3.9	2.5	-24	-30
Rajasthan	14.5	22.2	124	-28
Karnataka	7.1	10.8	8	-28
Uttar Pradesh	9.3	33.8	5	-27
Madhya Pradesh	21.8	43.8	67	-16
Maharashtra	18.8	12.5	0	-14

Data as of 19th July for all years

El Niño strengthens further, while IOD remains unsupportive

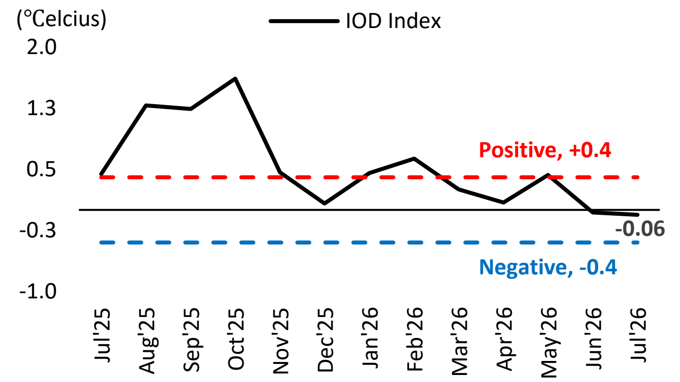
- Global weather conditions remain unfavorable for the Southwest monsoon, with El Niño strengthening further during July. The Niño 3.4 index rose to 1.47 as of 12th Jul'26, up from 1.11 in late June, signaling an intensifying warming phase that is typically associated with weaker monsoon rainfall over India and higher risks of rainfall deficiency across key agricultural regions *(Exhibit 8).*
- At the same time, the Indian Ocean Dipole (IOD) remained slightly negative at -0.06 (as of 12th Jul'26), compared with -0.01 in late June, providing little support to offset the adverse influence of El Niño. The absence of a positive IOD has limited moisture transport towards the Indian subcontinent, contributing to uneven rainfall distribution despite some improvement in monsoon activity during July *(Exhibit 9).*

Exhibit 8: Relative Niño index stood at 1.5 (higher than 0.8) as of 12th Jul'26



Data as of 12th July

Exhibit 9: IOD index remained neutral, providing little support

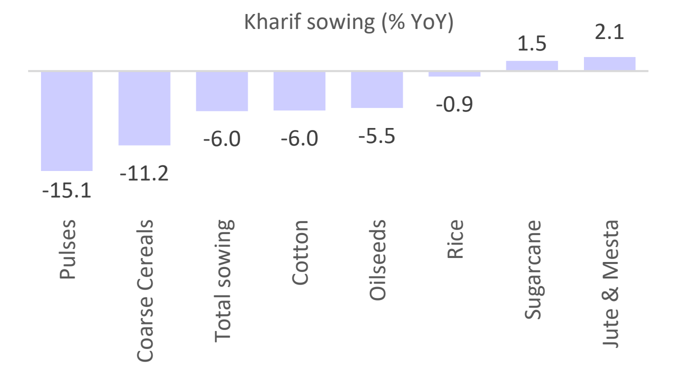


Source: Australian Bureau of Meteorology, IMD, CEIC, MOFSL

Rain-fed crops bear the brunt of weak monsoon

- **As of 17th Jul'26, total kharif sowing was 6.0% lower YoY, compared to the 3.0% growth recorded a year ago.** Although rainfall improved during early July, it has not been sufficient to offset weak soil moisture conditions during the critical sowing period, leading farmers in several rain-fed regions to delay planting.
- **The decline in acreage has been driven largely by rain-fed crops, while relatively irrigated crops have remained more resilient.** Pulse sowing declined the most (-15.1% YoY), followed by coarse cereals (-11.2%), cotton (-6.0%), and oilseeds (-5.5%), reflecting persistent rainfall deficits across Central and Western India. In contrast, rice sowing was only 0.9% lower YoY, supported by high irrigation coverage in major producing states such as Punjab, Haryana, Andhra Pradesh, Telangana, and Uttar Pradesh, along with favorable rainfall in West Bengal and Odisha *(Exhibits 10 and 11).*
- **From a macro perspective, pulses and oilseeds remain the biggest concern.** Production is concentrated in states such as Madhya Pradesh, Maharashtra, Rajasthan, Karnataka, and Gujarat, where rainfall remains below normal (as of 19th Jul'26) and irrigation coverage is relatively low. **Any sustained reduction in acreage could tighten domestic supplies and keep pulse and edible oil inflation elevated during 2HFY27, unlike cereals, where comfortable buffer stocks provide greater policy flexibility.**
- Cotton sowing has also declined by 6.0% YoY, reflecting delayed rainfall across Maharashtra, Gujarat, and Telangana. While improved rainfall over the coming weeks could support late sowing, prolonged delays may shorten the crop cycle, lower yields, and keep domestic cotton prices firm.

Exhibit 10: Kharif sowing down by 6% as of 17th Jul'26



Data as of 17th July for all years

Exhibit 11: Cotton, oilseeds, pulses, and coarse cereals were the major contributors to lower sowing

% YoY	17-Jul-24	17-Jul-25	17-Jul-26
Rice	1.0	6.8	-0.9
Coarse Cereals	-12.8	14.0	-11.2
Pulses	14.2	1.7	-15.1
Jute & Mesta	-6.3	9.6	2.1
Sugarcane	-3.8	3.4	1.5
Oilseeds	7.9	-4.4	-5.5
Cotton	-3.4	-3.6	-6.0
Total	0.0	3.0	-6.0

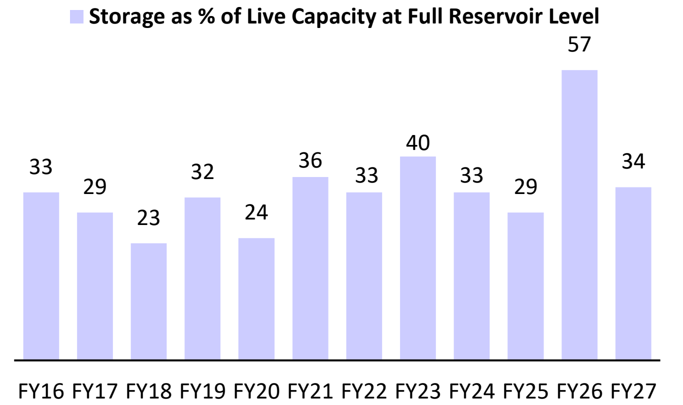
Source: IMD, CEIC, MOA&FW, MOFSL

Reservoir levels improve, but regional water stress persists

- The revival in monsoon activity during July has led to a sequential improvement in reservoir storage, although water availability continues to lag both last year's levels and the long-term average across several regions. **As of 16th Jul'26, live storage across 166 major reservoirs stood at 63.2 BCM, equivalent to 34% of total live storage capacity, improving from 26.0% at the beginning of July.** Despite this recovery, reservoir storage remains at only 61% of the level recorded during the corresponding period last year and is marginally below the long-term normal.

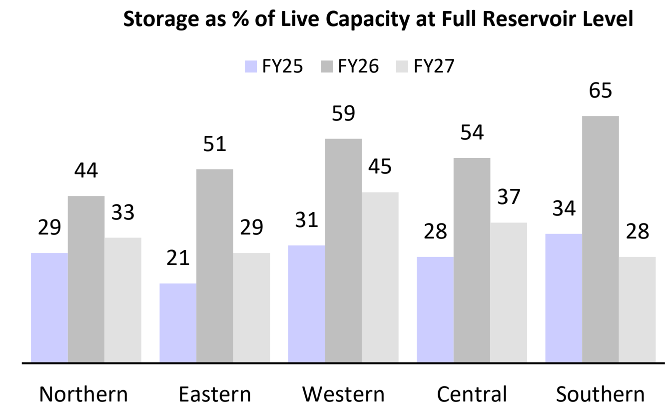
- **The recovery in reservoir storage remains highly uneven across regions.** Southern India has witnessed the sharpest deterioration, with reservoir levels at 28% as of 16th Jul'26, down from 65% a year ago, followed by the Eastern (29% vs 51%), Central (37% vs 54%), Western (45% vs 59%), and Northern (33% vs 44%) regions. While storage levels remain above FY25 across most regions, the Southern region is the only exception, where reservoir levels have fallen below FY25 (last El Niño episode), highlighting persistent water stress. West Bengal, Telangana, and Bihar remain among the weakest-performing states, reflecting the persistence of rainfall deficits.

Exhibit 12: Water reservoir levels at 34% of live storage capacity as of 16th Jul'26, lower than 57% last year



Data around 16th July for all years

Exhibit 13: Broad-based weakness across all regions

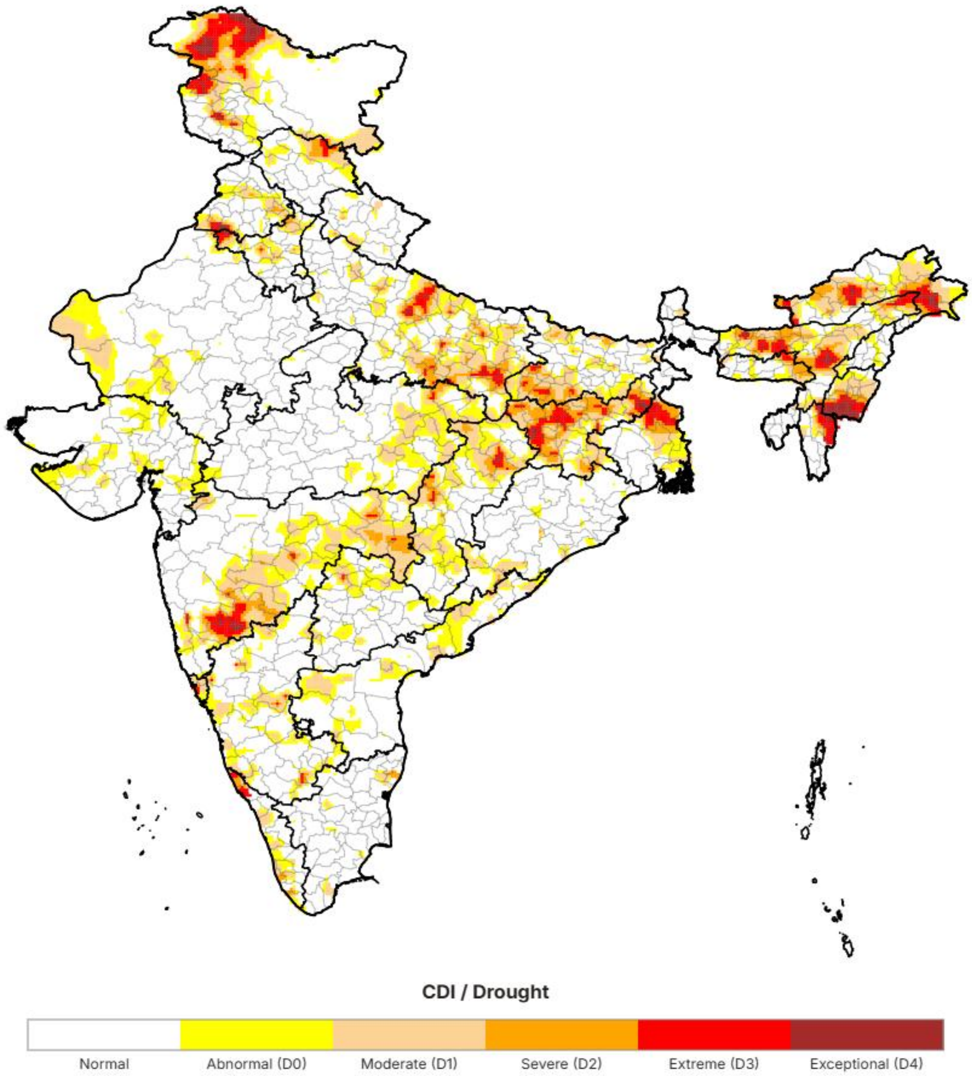


Source: CEIC, MOFSL

Drought conditions continue to expand despite the revival in monsoon

- **The spatial extent of drought has continued to increase despite the improvement in rainfall during July. As of 15th Jul'26, 35.5% of the country's geographical area was classified under abnormally dry (D0) or worse conditions, up from 30.7% a week earlier.** Of this, 16.1% of the area was under moderate drought (D1+), 6.0% under severe drought (D2+), and 1.1% under extreme drought (D3), highlighting that moisture stress remains widespread despite the recent recovery in monsoon activity *(Exhibit 14).*
- Drought conditions remain concentrated across Eastern, Northeastern, and Western India, broadly mirroring the regions that have recorded the largest rainfall deficits. States such as Goa (96.4%), Manipur (92.9%), Jharkhand (83.1%), Assam (71.2%), and Arunachal Pradesh (68.1%) have the largest share of area under drought conditions. The persistence of drought across several rain-fed agricultural regions suggests that even if rainfall improves further, soil moisture and crop conditions may take time to recover, keeping risks to kharif output and food inflation elevated during 2HFY27.

Exhibit 14: Current drought conditions (15th Jul'26)



Source: India Drought Monitor, MOFSL

Rural auto demand remains resilient despite monsoon concerns

- Rural auto demand remains resilient despite monsoon concerns: High-frequency rural demand indicators continue to remain supportive, although momentum has moderated. Domestic two-wheeler sales grew 22.9% YoY in Jun'26, extending the strong recovery seen over recent months, while tractor sales increased 11.8% YoY, marking the 24th consecutive month of positive growth. The moderation in tractor growth from 19.1% in May to 11.8% in June likely reflects the delayed onset of the monsoon, although demand remains well above historical trends. *(Exhibits 15 and 16).*
- The resilience in tractor and two-wheeler sales suggests that rural demand has softened but not weakened materially. Together with our channel checks, these data indicate that the revival in July rainfall has prevented a sharp deterioration in rural sentiment.

Exhibit 15: Tractor sales grew 11.8% in Jun'26

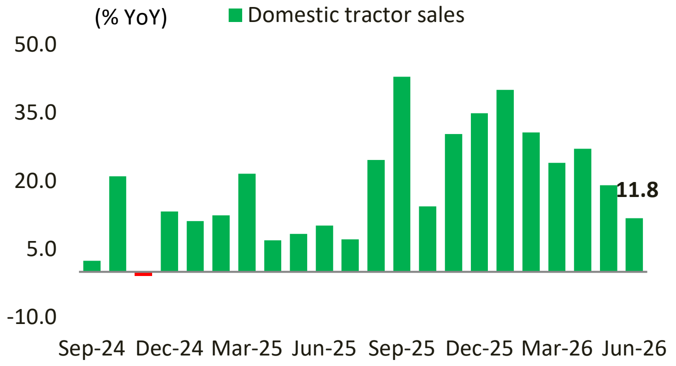
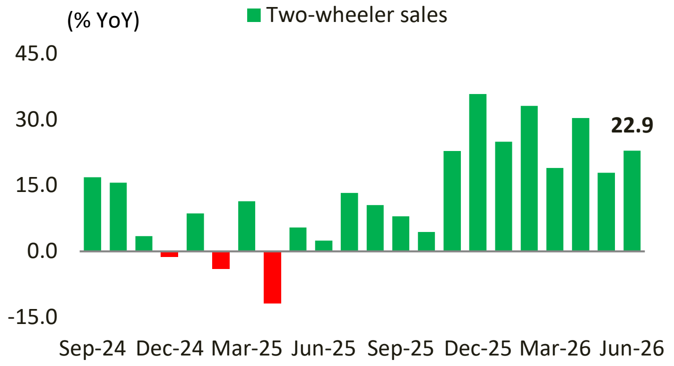


Exhibit 16: Two-wheeler sales grew 22.9% in Jun'26



Source: CEIC, MOFSL

Rural inflation remains higher than urban inflation

- **Recent inflation trends indicate that rural households are already facing greater price pressures than urban households.** In Jun'26, rural CPI inflation accelerated to 4.7% YoY, compared with 3.9% in urban areas, with the gap widening from 72bp as food prices gathered pace. The divergence reflects the higher weight of food in the rural CPI basket (~42% versus ~30% for urban households), making rural inflation significantly more sensitive to monsoon-related supply shocks. Consequently, any further increase in prices of cereals, pulses, and vegetables is likely to erode rural real wages and purchasing power more sharply, weighing on discretionary consumption and delaying the recovery in rural demand.
- We continue to believe that the impact of a weak monsoon will be higher food inflation rather than a sharp decline in agricultural output. Lower sowing of pulses, oilseeds, and coarse cereals, coupled with uneven rainfall across key producing states, is likely to tighten supplies of weather-sensitive crops during 2HFY27. While comfortable cereal buffer stocks and higher irrigation coverage should limit the downside to rice and wheat production, structurally tight inventories of pulses and edible oils leave food prices vulnerable to further weather disruptions. Accordingly, we continue to expect average CPI inflation at 5.2% in FY27, even as real GDP growth moderates to 6.6%.

Exhibit 17: Inflation increased to 4.4% in Jun'26 from 3.9% in May'26

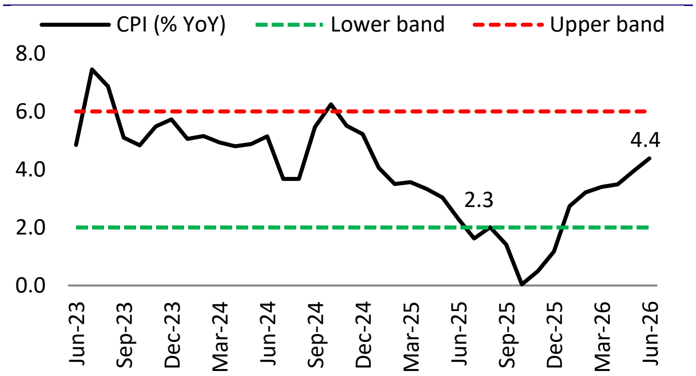
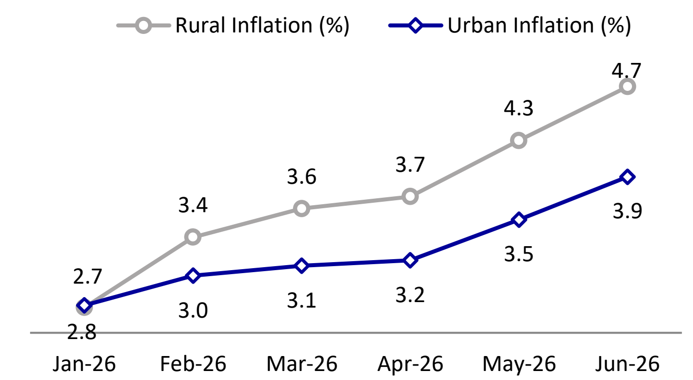


Exhibit 18: Rural inflation rose to 4.7% in Jun'26, compared with 3.9% in urban areas



Source: CEIC, MOSPI, MOFSL

RBI flags monsoon as a key macro risk

- The RBI has also identified the weak monsoon as one of the principal macroeconomic risks for FY27. **Governor Sanjay Malhotra recently (17th Jul'26) highlighted that, alongside geopolitical tensions in West Asia, below-normal rainfall could disrupt agricultural output, elevate food inflation, and weigh on growth.** While the RBI expects supply-side shocks to be transitory and has adopted a wait-and-watch approach, the evolving monsoon remains a key determinant of the inflation and policy outlook.
- The RBI is unlikely to respond to a temporary monsoon-led increase in food inflation with immediate policy tightening. Headline CPI inflation averaged 3.9% YoY during Apr–Jun FY27, 30bp lower than the RBI's FY27 forecast of 4.2%, providing the MPC with a comfortable starting point. Governor Sanjay Malhotra has reiterated that while the monsoon remains a key risk to the inflation outlook, the RBI's response will depend on whether food price pressures prove persistent and spill over into broader inflation. Premature policy tightening in response to a supply-side shock could unnecessarily weigh on growth.
- We, therefore, expect the MPC to remain on hold through CY26, with the next policy rate hike more likely in 2027, contingent on the persistence of food inflation, monsoon outcomes, and evidence of second-round inflationary effects. We forecast average CPI inflation at 5.2% in FY27, marginally above the RBI's forecast of 5.1%.

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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