Turbulence globally but drivers remain local

December 10, 2024

While current global growth forecasts show stability, possible policy shifts in the US starting 20-Jan cloud visibility. Uncertainty in global trade and financial markets may remain elevated; we also expect higher global rates and USDINR volatility. However, the growth rebound we expect for India, with an above-consensus forecast of 7% in FY26, is primarily dependent on local policies. The 1HFY25 slowdown was driven by unintended fiscal and credit tightening: fiscal spending is already rising, and the CRR cut should ease growth headwinds due to shortage of money. Tailwinds from back-ended fiscal spending in FY25 and some further macro-prudential easing to help credit growth should help.

Exhibit 1 - FY26E: India growth accelerates to 7%; inflation moderates to 4.5%

Key macro indicators	FY22	FY23	FY24	FY25E	FY26E
GDP growth (%)	9.7	7.0	8.2	6.6	7.0
Average CPI inflation (%)	5.5	6.7	5.4	4.8	4.5
Current account deficit % of GDP	1.2	2.0	0.7	0.8	1.1
Fiscal deficit (Gen. Govt.) % of GDP	8.7	8.8	8.0	7.3	7.0
Repo rate year-end	4.0	6.5	6.5	6.5	6.5
USD/INR year-end	75.81	82.22	83.37	85.5	86.5
10Y G-sec yield year-end	6.9	7.3	7.1	6.6	6.5

Source: Bloomberg, Axis Bank Research

Turbulent global economic environment; domestic political stability

Global growth in CY25e is currently projected to be unchanged from CY24 at 3.2%, ~30-40 bps below pre-Covid levels. Under the new US President, with a mandate to course-correct (or disrupt) on trade, taxes, regulations, immigration and energy among others, possible policy pronouncements after 20-Jan-25 cloud visibility, as outcomes remain uncertain. Trade tariffs may be ineffective in isolation (fiscal deficits, FX, industrial policy matter too), but can disrupt, as nearly all trade growth post-2016 has been US (imports) & China driven (exports). In India, a nearly empty state-election calendar provides a window to push reforms.

Financial uncertainty, higher rates, USDINR volatility

Neutral rates have risen by 1pp+ across developed economies and may remain well above those seen last decade (more US tax cuts likely; rising supply of longer-term paper). In India, we do not see inflation easing quickly: over the longer term, core and food price indices move by similar quanta. Food relative to core and vegetables relative to food are both at cyclical highs currently, but the supply response may remain deficient given a demand boost from income-transfer schemes. GSec demand-supply should help reduce yields. We expect USDINR volatility to rise, though it would be unwise to expect USD strength to last the year.

Cyclical rebound to push growth back to trend

The 1H FY24 loss in momentum for the Indian economy, in our view, is cyclical, and due to unintended fiscal and monetary tightening; the latter due to a focus on macro stability risks which hurt credit growth. Fiscal spending is already rising and the CRR cut should ease growth headwinds due to shortage of money. We maintain that potential growth is 7%, with capital formation boosted by the restart of the capex cycle. We forecast an above-consensus 7% growth in FY26, with the tailwinds from back-ended fiscal spending in FY25, and some further macro-prudential easing to help re-accelerate credit growth.

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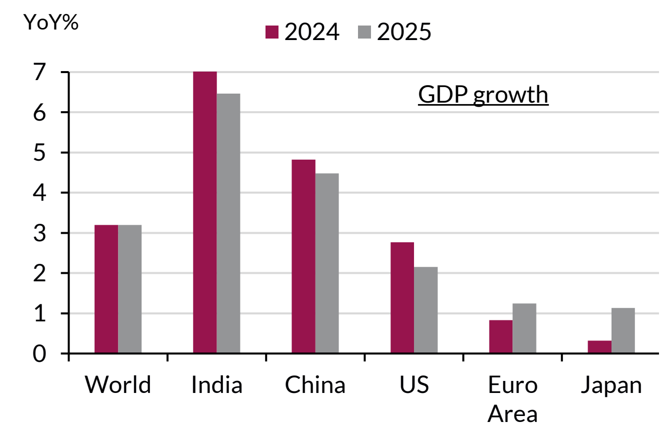
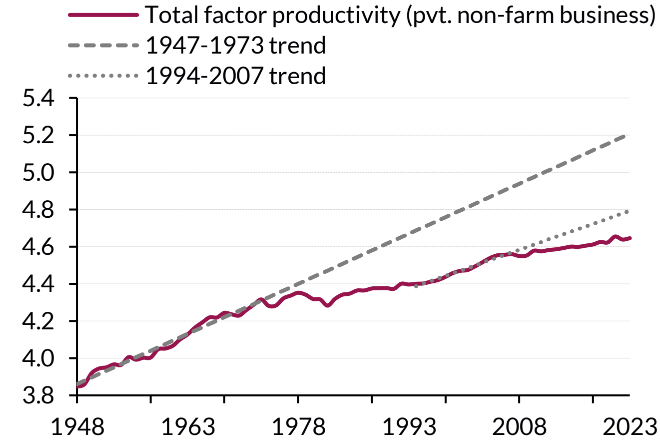


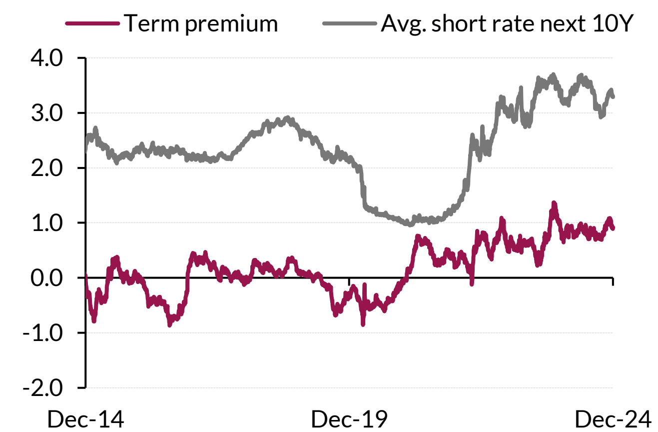
Source: IMF WEO Oct 2024, Axis Bank Research

Exhibit 3 - An upside surprise in US productivity growth?



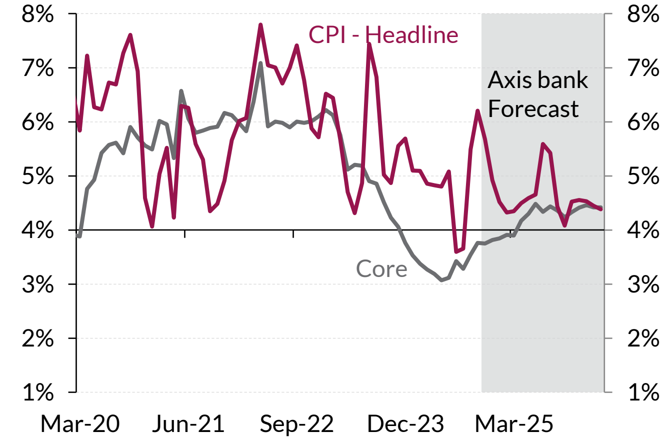
Source: BEA, Axis Bank Research

Exhibit 4 - US rates up, may rise further



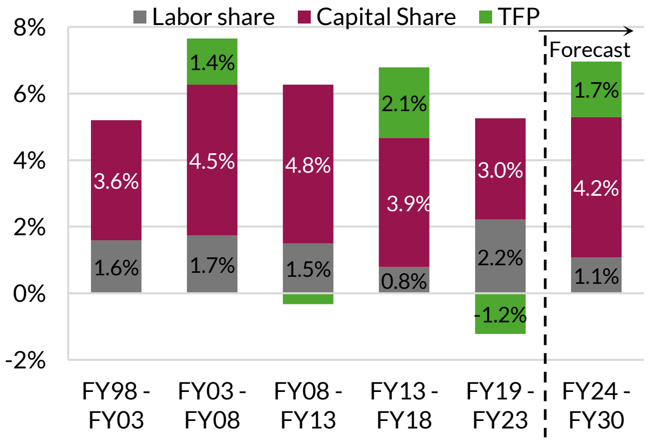
Source: Bloomberg, Axis Bank Research

Exhibit 5 - Headline inflation to average 4.5% in FY26



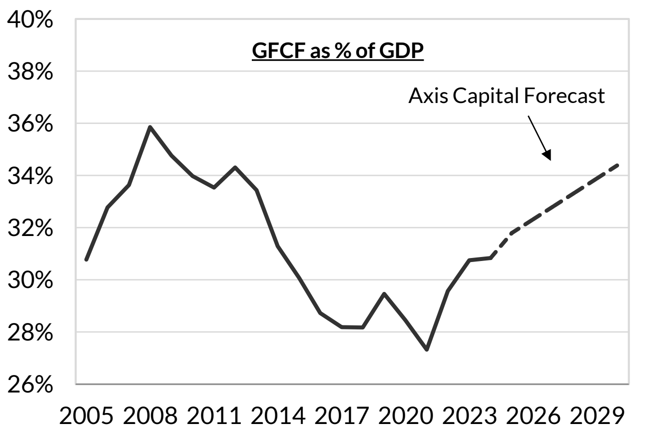
Source: Bloomberg, Axis Bank Research

Exhibit 6 - 7% growth realistic



Source: RBI, Axis Bank Research

Exhibit 7 - We expect GFCF/GDP ratio to rebound further



Source: MOSPI, Axis Capital Estimates

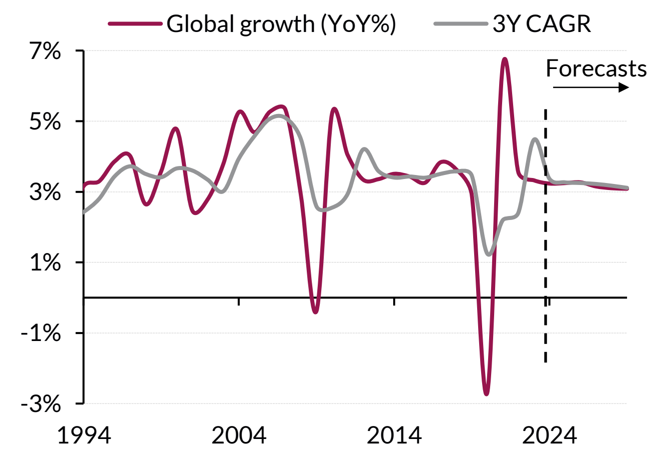
Turbulent global environment; domestic political stability

Global growth in CY25e is currently projected to be unchanged from CY24 at 3.2%, ~30-40 bps below pre-Covid levels. Under the new US President, with a mandate to course-correct or disrupt on trade, taxes, regulations, immigration and energy among others, possible policy pronouncements after 20-Jan-25 cloud visibility, even if outcomes are uncertain. Trade tariffs may be ineffective in isolation (fiscal deficits, FX, industrial policy matter too), but can disrupt, as nearly all trade growth post-2016 has been US (imports) & China driven (exports). In India, a nearly empty state-election calendar provides a window to push reforms.

Global growth expected to remain flattish in 2025E, with a slight change in mix

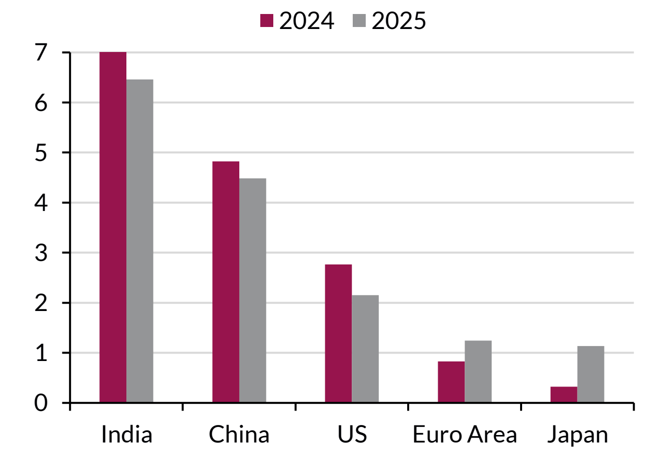
IMF forecasts, which generally represent consensus, project the global economy to grow at 3.2% YoY in CY25E, unchanged from CY24, and keeping the three-year CAGR at ~30-40 bps below the pre-Covid level (Exhibit 8 -). The mix of growth among major economies though would be slightly different, with slower growth in India, China, and the US offset by stronger growth in the Eurozone and Japan (Exhibit 9 -). Our growth forecasts on India are stronger, though dependent on further policy easing in the coming months.

Exhibit 8 - Global growth slow, unlikely to accelerate



Source: IMF WEO Oct 2024, Axis Bank Research

Exhibit 9 - YoY growth in CY24/25



Source: IMF WEO Oct 2024, Axis Bank Research

The US's growth has exceeded expectations (including ours) for the past two years, and it remains the only major economy above its pre-pandemic path. It has been boosted by a boost to labour supply due to a surge in acceleration, and the absence of a meaningful fiscal consolidation. Persistently high fiscal deficits have also contributed to the pick-up in growth in labour productivity (1.7% since late 2019, vs pre-pandemic trend of 1.3%).

A steady growth slowdown in China over the medium term is now the consensus view, with demographics slowing labour input, limits emerging on capital formation (overbuilt real estate and excess industrial capacity), falling total-factor productivity, and the nature of growth in the past few decades constraining consumption. Global trade disruptions and the US's policies can disrupt momentum, but we believe the Chinese government has the balance sheet and political control to keep any sharp growth slowdown short-lived.

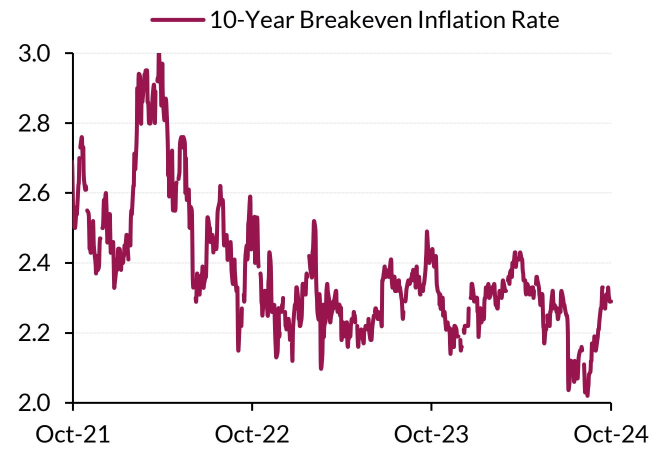
Structural issues in Europe like weak demographics (and now emerging resistance to immigration), overbearing regulation, and lack of fiscal cohesion have been compounded by disruptions energy supply and fiscal constraints due to the Russia-Ukraine war. An early end to the war can be a positive catalyst to the economy, even if the terms of peace may appear to be negative over the long term. In both Europe and China, the state of real estate cycle has weighed negatively on growth as well.

Positives on global growth: weaker inflation permits economies like Europe and China's monetary space to stimulate growth, and real-income growth improves.

Will the new Trump administration's initial salvos hurt or help growth?

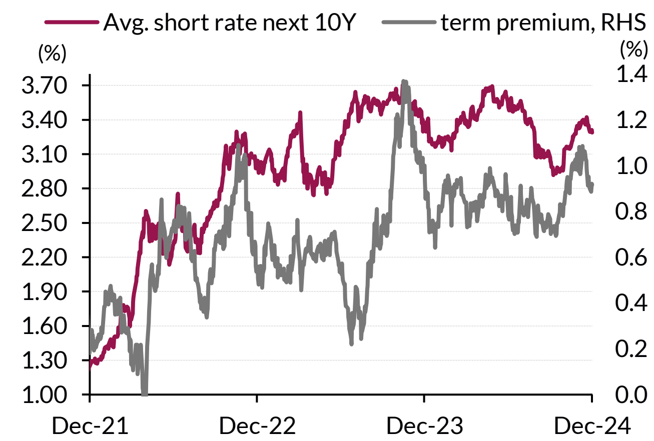
The intent of policy formulation under the new Trump administration is clear (reduce trade deficits, cut taxes and regulations, slow if not reverse immigration, bring down energy costs), though outcomes in most cases are uncertain and likely to take time. The uncertainty should ease partly after 20 Jan'25, though likely second and third-order effects may only emerge over time.

Exhibit 10 - Inflation expectations up sharply since Sep'24



Source: Bloomberg, Axis Bank Research

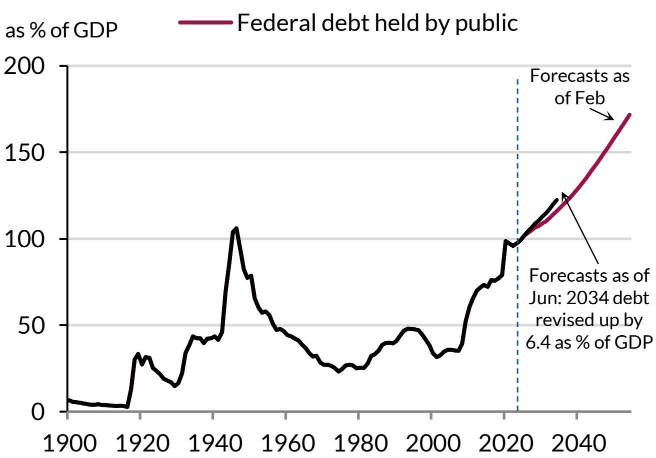
Exhibit 11 - Term premia rising due to fiscal reasons



Source: Bloomberg, Axis Bank Research

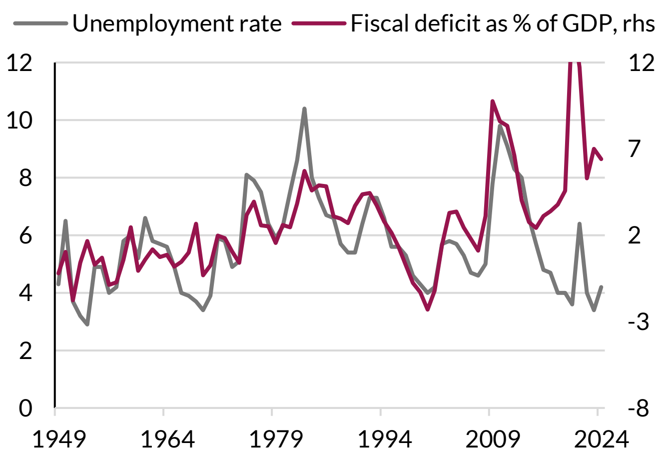
The easiest to implement would be fiscal measures like extending tax cuts. Given that inflation expectations have risen from 2% to 2.3% since early Sep (Exhibit 10 -), the ten-year bond yields have risen with the term premium (Exhibit 11 -), and both were correlated with the rising probability of Trump's victory, are such measures priced in? We believe not. There are other explanations: over this period, inflation surprised and concerns on growth receded.

Exhibit 12 - US debt set to become more unsustainable



Source: CBO, Axis Bank Research

Exhibit 13 - Pro-cyclical fiscal policies are dangerous



Source: CBO, Axis Bank Research

Bond markets may limit Trump's expansionary fiscal agenda, but higher-for-longer likely

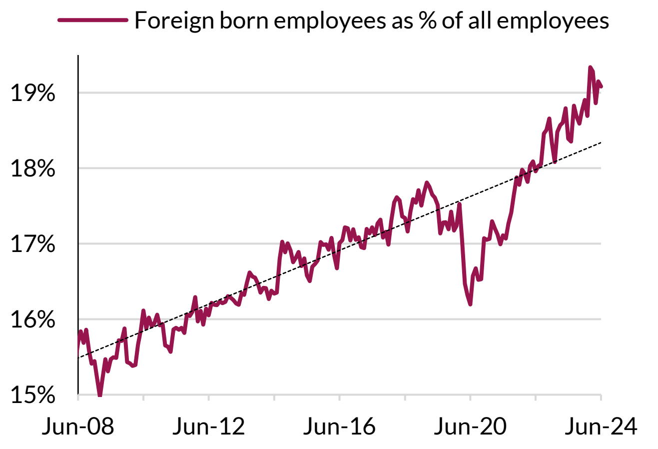
If Trump's proposed plans – estimated to increase debt by USD 7.8 tn between 2026E and 2035E (Exhibit 12 -) – fructify, yields must rise further to attract buyers. Tricks to finance the deficit no longer work: term premiums are rising as deficit financing shifts away from T-bills (link), and ending QT may only help temporarily. In our view, higher yields would force the Treasury to jettison many proposals, and the debt may only rise USD 3-4 tn (link). We are now firmly in the era of higher-for-longer rates (link), with implications for growth ex-US too.

The nominated Treasury Secretary's '3 by 3' target of 3% fiscal deficit, 3% GDP growth, and an additional 3 mn barrels per day was stated before his nomination. Achieving the first two may be challenging given the pro-cyclical deficits the US has been running (Exhibit 13 -).

Restricted immigration can impact growth

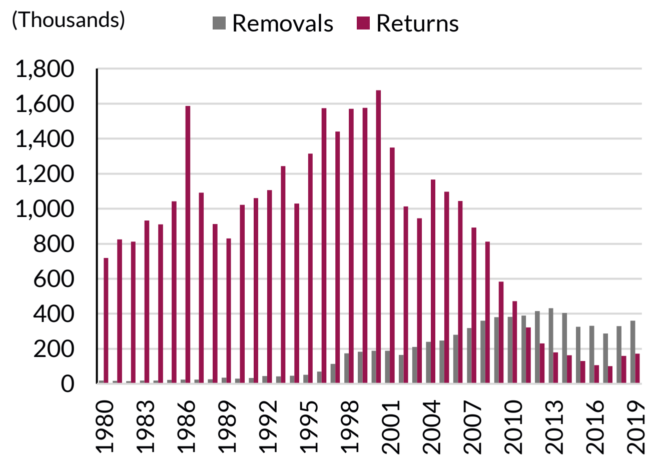
Mass deportation is likely to be challenging, as the US has never deported more than 0.5 mn people in a year (Exhibit 15 -). The administration should be able to slow down immigration though, which would hurt growth, as the spurt in immigration contributed to the growth surprise in the past few years (Exhibit 14 -). Legal quotas may be raised, but these take time. With the labour market less tight now than just before the pandemic (link), direct impact on inflation may be insignificant, as a recent Dallas Fed study shows.

Exhibit 14 - Higher immigration aided growth



Source: ICE, BEA, Axis Bank Research

Exhibit 15 - US has never deported >0.5 mn/year

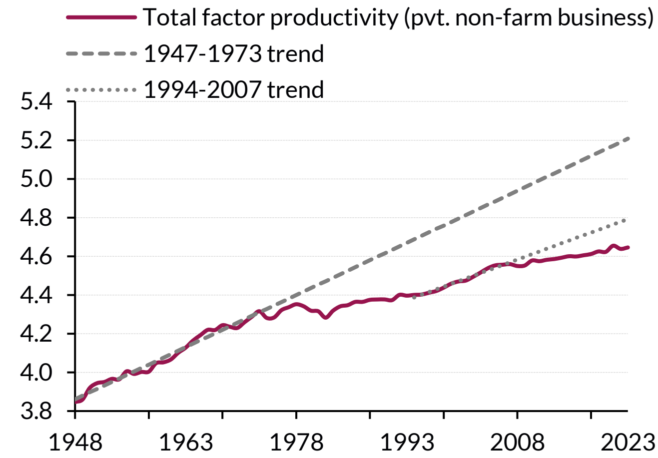


Source: ICE, BEA, Axis Bank Research

Productivity can rebound with deregulation and the impact of AI

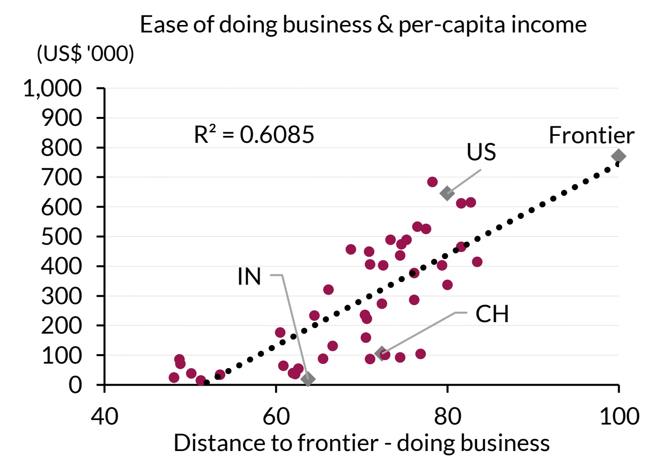
Between 2000 and 2019, the US's growth has been half of the rate between 1950 and 2000. Some ascribe the weak growth in total factor productivity (TFP: Exhibit 16 -) to a lack of innovation, some to secular stagnation that warrants negative real rates, and some to excessive regulation, with the US slipping to 34th in 2019 in the OECD Product Market Regulation Index from fifth in 2003, with compliance costs rising 2x the rate of GDP. Excessive regulation is estimated to have cost 0.8% of GDP growth annually since 1980 (link, Exhibit 17 -).

Exhibit 16 - Can productivity growth pick up in the US?



Source: BEA, Axis Bank Research

Exhibit 17 - Not just AI: Deregulation expected to boost TFP

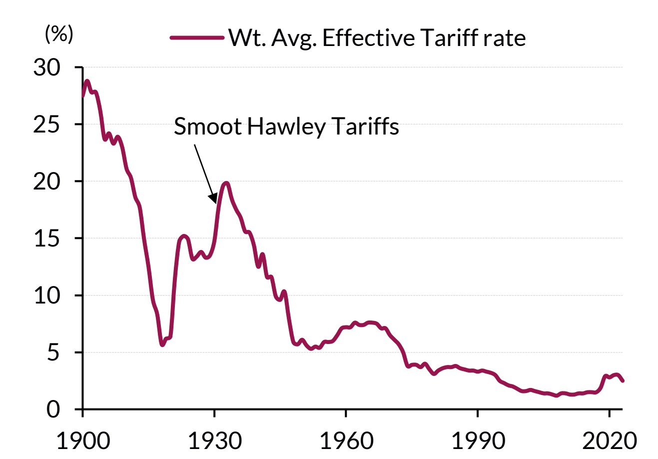


Source: World Bank, IMF, Axis Bank Research

Tariffs may rise, but can that meaningfully impact trade balances?

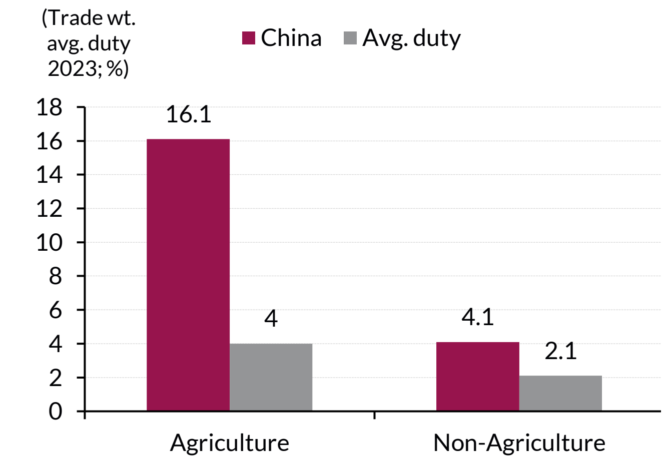
As President, Donald Trump will have more leeway to pursue foreign policy as opposed to his domestic agenda. The intended use of tariffs to address priorities beyond trade, from raising revenues, managing migrant/drug flows, to tackling de-dollarization, makes them a negotiation tool, and a real threat. The risk could materialize through global growth and trade channels. Compared to history (Exhibit 18 -), despite the 2018 hikes against China, weighted-average tariffs are still low.

Exhibit 18 - US import tariffs well below pre-1975 levels



Source: US ITC, Axis Bank Research

Exhibit 19 - For China they are already up sharply

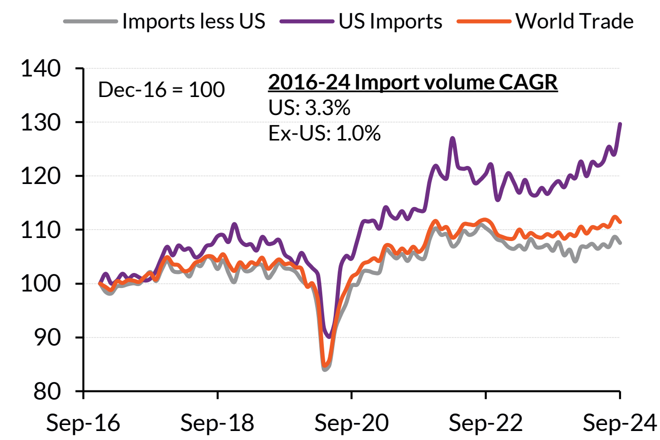


Source: WTO, Axis Bank Research

US China dominance in global trade points to the risk of tariffs misfiring

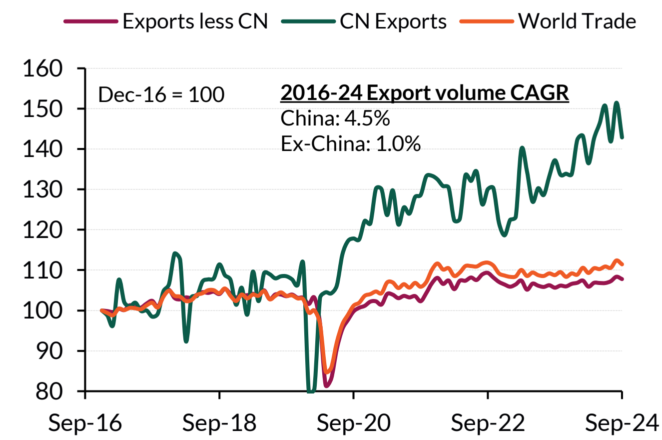
Despite the first salvo in the trade war in 2018, after which tariffs have remained high, much of global trade growth still comes from the rise in US imports (Exhibit 20 -). Similarly, despite the increase in tariffs against China in the US (Exhibit 19 -), and the widespread attempt to find 'China + 1' supply, global export growth has been tepid ex. China (Exhibit 21 -).

Exhibit 20 - US driving most of global import growth



Source: CPB, Axis Bank Research

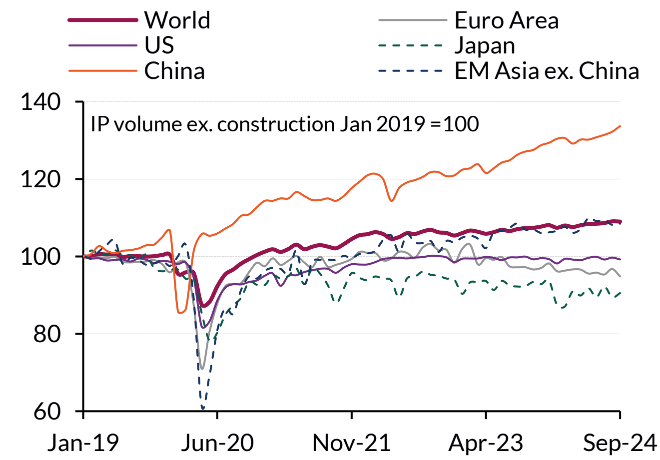
Exhibit 21 - Exports ex. China have stagnated



Source: CPB, Axis Bank Research

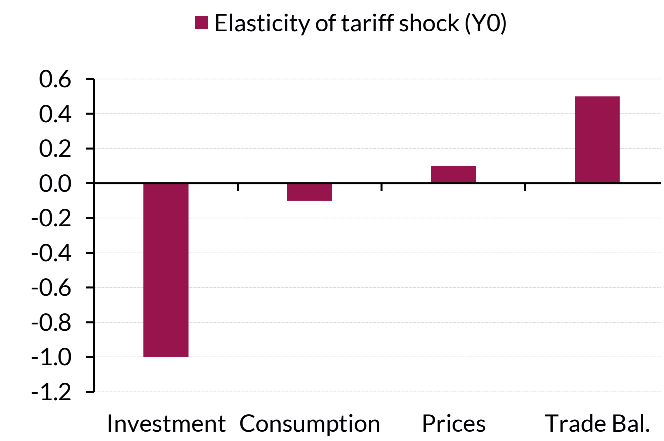
This is because tariffs are not the only drivers of trade flows. High fiscal deficits and a strong dollar counteract the impact of tariffs on import demand in the US. Similarly, capacity expansion at China's scale hampers prospects of capital formation in other countries. China's share of global manufacturing has continued to grow (Exhibit 22 -.Exhibit 22 - On the other hand, tariff shocks and trade uncertainty can hurt investments (Exhibit 23 -Exhibit 24 -). A large across-the-board tariff hike would likely hit growth hard in the near term, with increase in prices hurting demand and impact on investment or near-shoring showing up with a lag.

Exhibit 22 - Despite tariffs, CN share of global mfg. rising



Source: CPB, Axis Bank Research

Exhibit 23 - High uncertainty could hurt investments

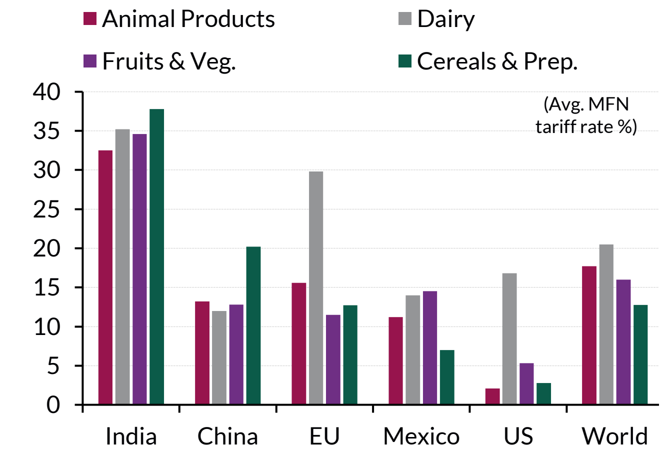


Source: IMF Working Papers 2024, 013, Axis Bank Research

India is exposed to the risk of reciprocal tariffs

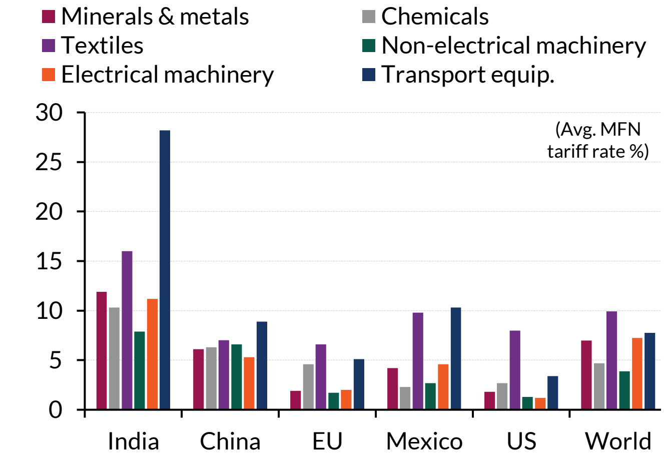
Among the major economies today, India has the highest tariffs across categories (Exhibit 24 -Exhibit 25 -). Should the Trump administration choose to impose a reciprocal tariff policy, assuming full pass-through immediately, the export shock could be USD 7.4 bn (9% of 2023 exports to the US, 1.8% of total goods exports; 0.2% of GDP). Among agricultural commodities, tariffs on fish and fish products, and oilseeds could be meaningful. Among non-agri goods, iron and steel, chemicals, textiles, and electrical machinery are the most exposed.

Exhibit 24 - India's agri tariffs are 2x-40x that of US



Source: WTO, Axis Bank Research

Exhibit 25 - Non-agri sector tariffs could rise 6x on avg.



Source: WTO, Axis Bank Research

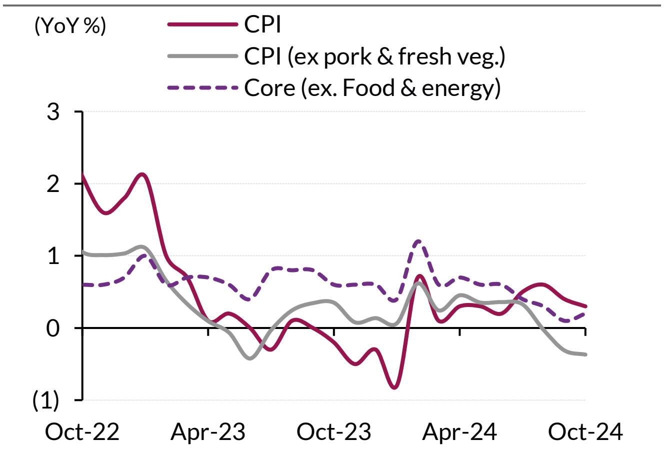
China: More measures could help the economy find a floor

China's fiscal support measures announced so far are not in the 'stimulus' category, as no direct support for consumption has been granted, though the revival in property sales, especially in Tier-1 cities, is a stabilizing force. The default preference is to play the long game, aligned with 'high-quality' growth (better quality investments) and overcoming structural depressants to domestic demand such as falling population and a low GDP share of household income. A need to pre-empt/respond to economic shocks from the incoming US administration could also prompt policy action. More measures are likely, in our view.

Persistent weakness in consumption makes deflation the most acute policy challenge

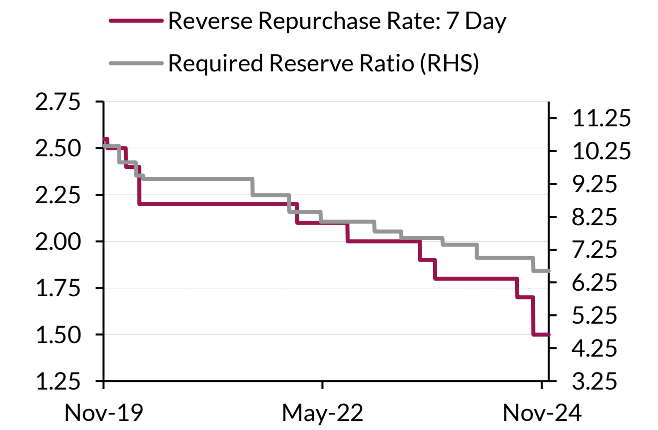
China is grappling with the risk of prolonged deflation. Excluding pork and fresh vegetables, headline CPI inflation has been negative (deflation) since Aug'24 (Exhibit 26 -), and as pork and vegetable prices normalize, headline inflation could be in deflation in two quarters. So far, policymakers have relied on monetary measures to ward off deflation (Exhibit 27 -). But with the money multiplier falling, liquidity is not really the constraint.

Exhibit 26 - Barring pork/fresh veggies, CPI is negative



Source: CEIC, Axis Bank Research

Exhibit 27 - Monetary easing ongoing since 2021

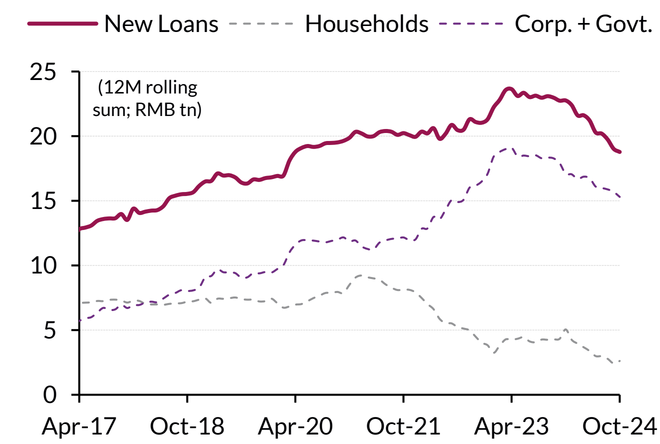


Source: PBoC, Axis Bank Research

Credit growth continues to slow; both households and corporates cannot borrow more

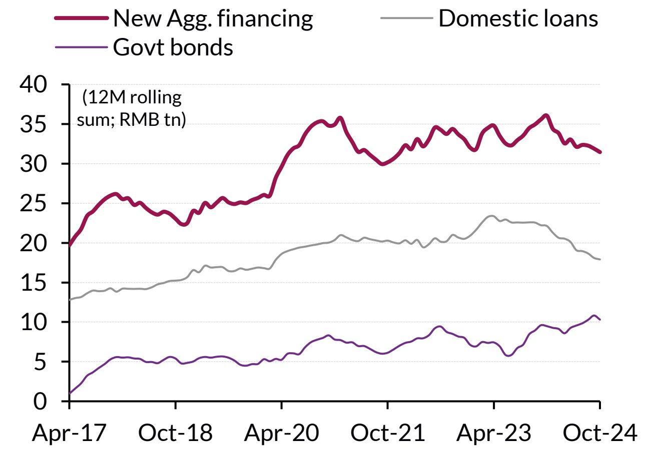
Credit growth has been falling as households, which mostly borrow to finance home purchases, have not been doing so since 2021 (Exhibit 28 -). For a while, industry stepped into the vacuum, but starting 2023, saddled with excess capacity, it also seems to have reached its limit to absorb new credit. In such a scenario, bond-financed government spending is the only meaningful way to generate new credit in the economy. This has been happening (Exhibit 29 -), but much of this new debt issued is being used to clean up old 'hidden debt' at the local level. Unless there is a fundamental shift in use of fiscal force to stimulate the economy, high growth is likely to remain elusive.

Exhibit 28 - New loan demand has been weak



Source: CEIC, Axis Bank Research

Exhibit 29 - Govt. bonds driving new credit growth

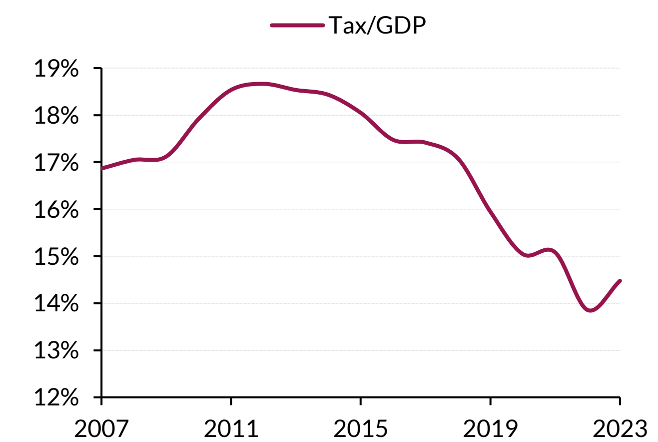


Source: CEIC, Axis Bank Research

Fiscal measures are politically messy, and thus have not been forthcoming

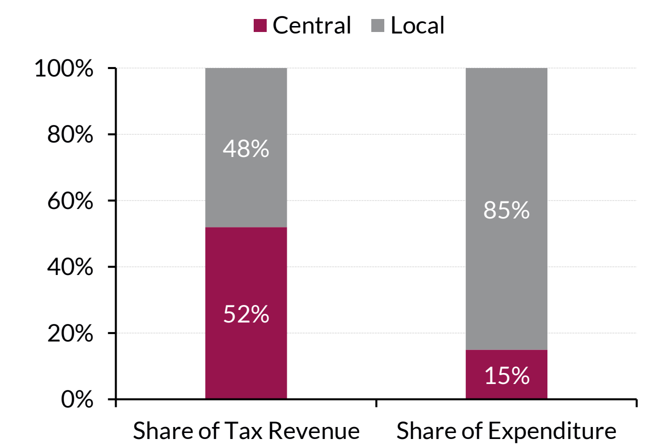
Fiscal room available to the government has narrowed over the past decade with the steady decline in the tax-to-GDP ratio (Exhibit 30 -). Also, there is a structural resource-responsibility mismatch between the centre and local governments, which drives the latter to seek alternative sources of revenue, including land sales and LGFV debt (Exhibit 31 -). The recently announced local-level debt cleanup package just removes a fiscal fudge, without solving the underlying problems. Further, LGFV debt continues to rise, and the RMB 10 tn refinancing only accounts for two years of incremental loans.

Exhibit 30 - Fiscal space is more constrained than before



Source: CEIC, Axis Bank Research

Exhibit 31 - Resource and responsibility mismatch

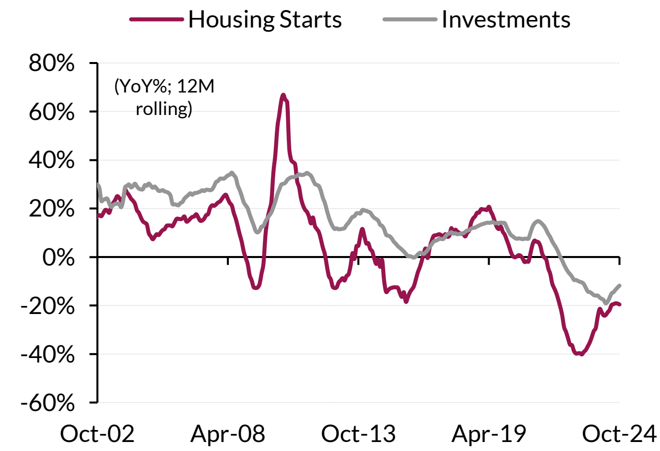


Source: ADB, Axis Bank Research

Real estate crisis not over: volumes have stabilized, but home prices to fall further

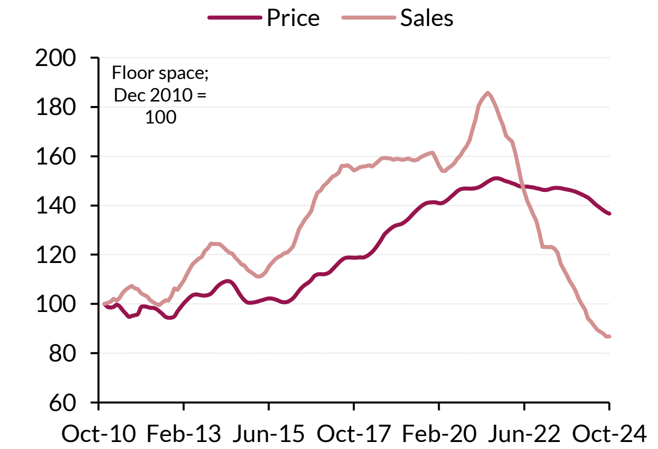
At the peak in 2021, property developers in China were pre-selling twice the level of residential floor space completed annually. Since then, pre-sales have fallen 62% and are now below completions, i.e. there should be no further additions to the backlog of 'pre-paid, and yet to be delivered' homes. But the sector has yet to find a floor. Specifically, a mere 10% fall in prices from peak levels in 2021 is inconsistent with the depth of the crisis: sales are down 53% from peak (Exhibit 32 -). Prices may need to correct further from here to get to an equilibrium, which could further hurt consumer sentiment. Continuing declines in new starts and investments (Exhibit 33 -), given the ample idle inventory waiting to be sold, is also likely to be a drag on growth.

Exhibit 32 - Investments/housing starts still falling...



Source: CEIC, Axis Bank Research

Exhibit 33 - ...but price fall so far < sales slump



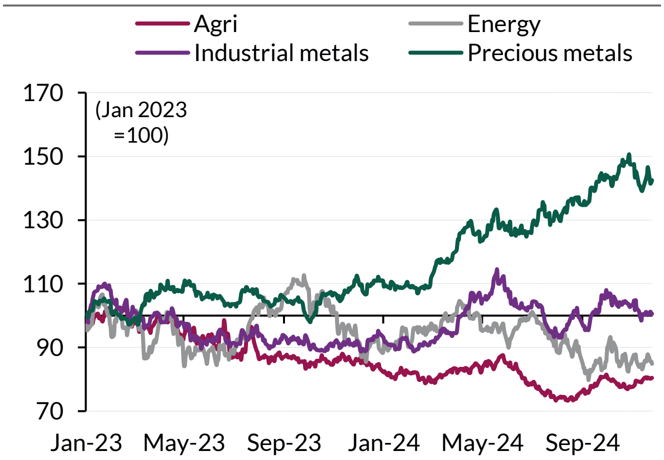
Source: CEIC, Axis Bank Research

Global commodities: Events-driven price breakouts possible

Commodity prices have stayed weak or range-bound over the past two years, except for precious metals (Exhibit 34 -). Energy prices have been buffeted by multiple forces, ferrous metals await substantive news out of China, and agriculture prices have corrected with improving harvests (though edible oils are up) and steady demand.

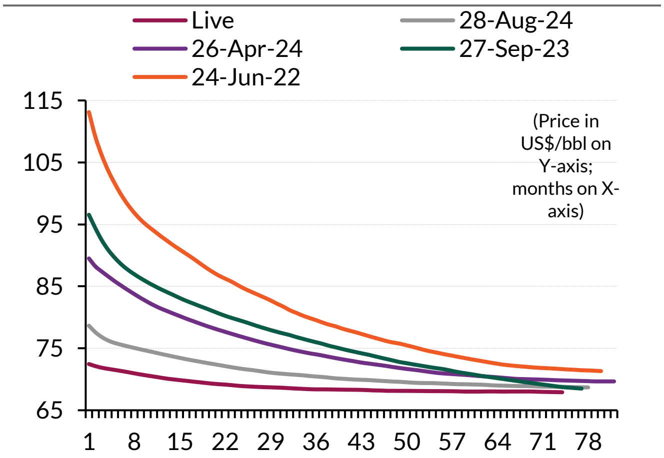
With correlations with TIPS yields/ETF flows seemingly broken, gold prices appear to be behaving less as a financial asset and more geopolitically driven, with demand from central banks taking up the slack, especially following the US elections.

Exhibit 34 - Industrials & agri flat, precious metals higher



Source: Bloomberg, Axis Bank Research

Exhibit 35 - Geopolitics priced out of crude oil futures

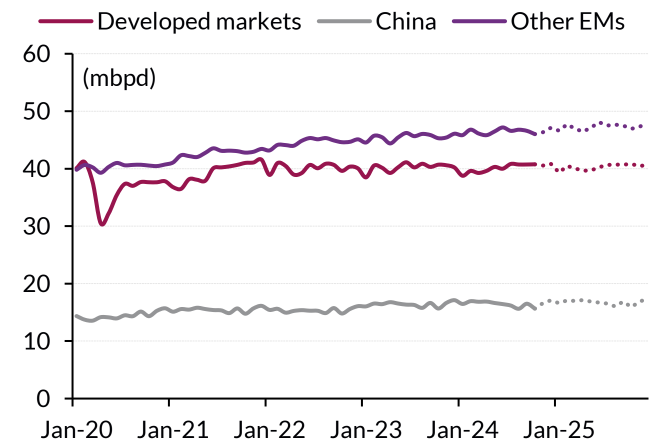


Source: Bloomberg, Axis Bank Research

Crude oil – ignoring the geopolitical noise so far; what of US energy policy?

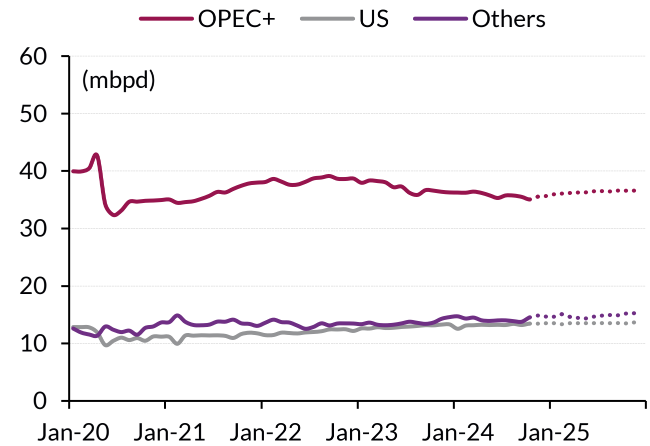
Despite geopolitical flashpoints in Ukraine and West Asia, the backwardation in crude oil prices became less steep, indicating that the geopolitical risk premium is priced out (Exhibit 35 -). This has also contributed to prices staying largely range-bound over the past two years, with limited growth in demand (Exhibit 36 -) and expectations of higher output by OPEC+ members (Exhibit 37 -). The nominated Treasury Secretary, in statements made before his nomination, had recommended an increase in output of 3 mn barrels/day, a ~30% increase.

Exhibit 36 - Crude oil and liquids demand stagnant



Source: EIA, Axis Bank Research

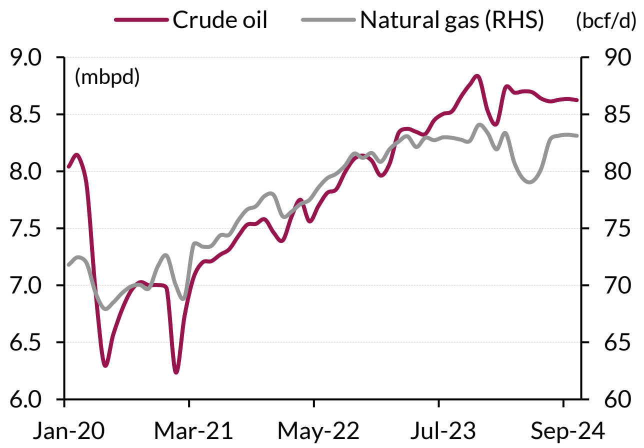
Exhibit 37 - OPEC+ could support global oil supply



Source: EIA, Axis Bank Research

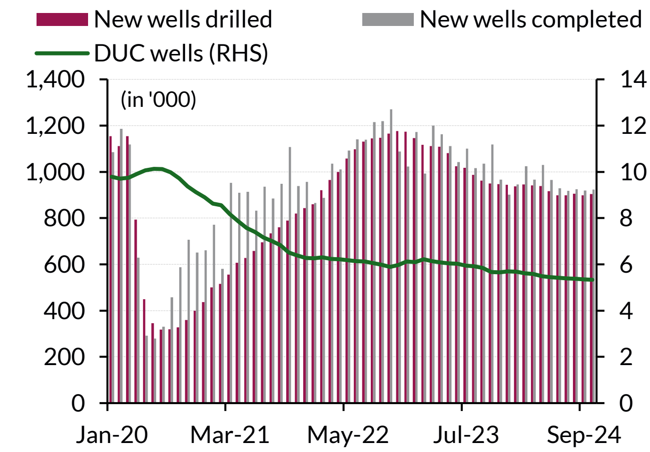
Even with fresh well drilling discouraged under the outgoing US administration, shale oil and natural gas outputs have rebounded to pre-pandemic levels (Exhibit 38 -), drawing on previously drilled but unfinished wells (Exhibit 39 -). At the current breakeven for shale (USD 65-70 per barrel), this can go on. For shale drilling to pick up again, prices must rise, possibly from disruptions in West Asia which can take supply out of the market meaningfully.

Exhibit 38 - Shale output rose under Democrats too



Source: EIA, Axis Bank Research

Exhibit 39 - Drilled but incomplete wells drew down

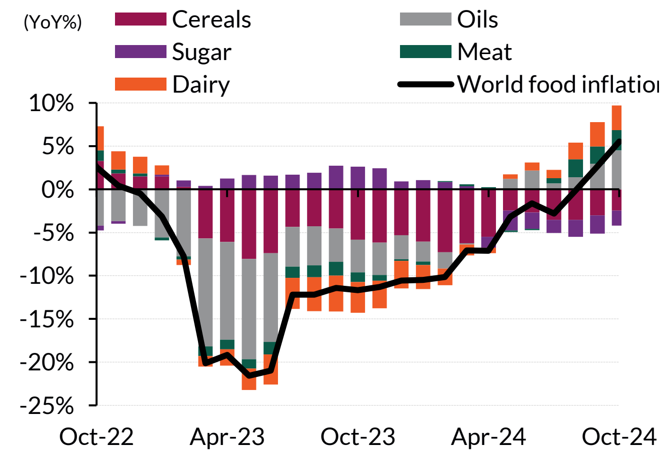


Source: EIA, Axis Bank Research

Agri-commodities: Grain output exposed to La-Nina, palm oil output lower

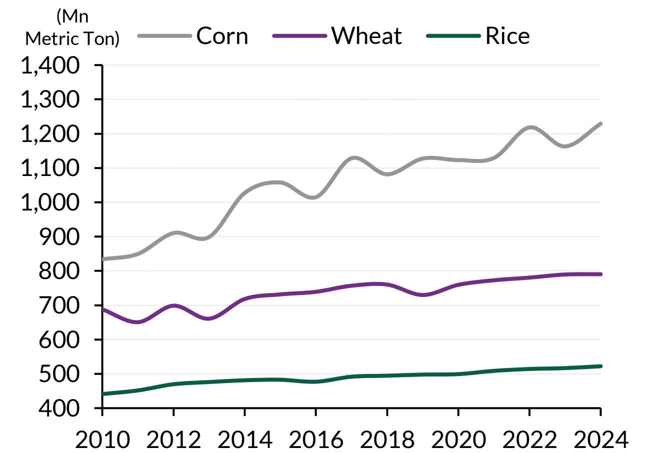
Agri prices currently look soft globally, but this masks the sequential gains after Sep'24, and the highest prices since Apr'23 (Exhibit 40 -). Edible oil prices are higher, in line with weaker expectations of Malaysian palm oil output, an increase in biofuel blending in Indonesia, and prospects of subdued sunflower and rapeseed oil in Europe. Notably, edible oil prices have a strong pass-through to India prices, compounded by the increase in domestic tariffs of late. The upward pressure on prices of cereals due to adverse conditions for winter sowing in Eurasia and the US, ongoing tensions around Ukraine, and dry conditions in South America (La-Nina) has, so far, been offset by expectations of higher output globally for the current year (Exhibit 41 -). Dairy prices are higher on limited EU supply, and sugar prices are up on concerns around Brazilian output (La-Nina), partly offset by a weaker BRL.

Exhibit 40 - Global food inflation now rising on edible oil



Source: FAO, Axis Bank Research

Exhibit 41 - Good cereals output cap price rise for now



Source: Bloomberg, Axis Bank Research

Financial uncertainty, higher rates, USDINR volatility

Neutral rates have risen by 1pp+ across developed economies and may remain well above those seen last decade (more US tax cuts likely; rising supply of longer-term paper). In India, we do not see inflation easing quickly: over the longer term, core and food price indices move by similar quanta. Food relative to core and vegetables relative to food are both at cyclical highs currently, but the supply response may remain deficient given a demand boost from income-transfer schemes. GSec demand-supply should help reduce yields. We expect USDINR volatility to rise, though it would be unwise to expect USD strength to last the year.

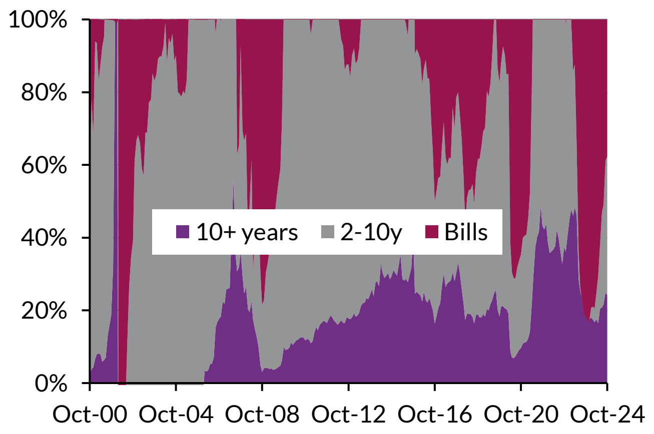
Global interest rates likely to be well above that seen past decade

As discussed in the previous section, market-implied inflation expectations have shifted higher since Sep (Exhibit 10 - on Page 5), and if higher fiscal deficits do manifest, these are likely to rise further. Even without this potential negative surprise, and from well before the recent US elections, neutral rates between 3.5% and 3.75% are 1 pp above the 2011-19 levels, as seen in the US 1y OIS-implied rates 4y ahead (Exhibit 42 -). A break-up of US inflation shows services inflation anchored even over the 2010s, with deflation in goods.

Exhibit 42 - Neutral rates are now 1p p above 2011-19

Source: Bloomberg, Axis Bank Research

Exhibit 43 - Issuance of long-term paper to rise further



Source: Bloomberg, Axis Bank Research

US Treasury's over-dependence on T-bills to finance its high deficits is also not sustainable. Incremental net issuance of term securities taking the place of T-bills (Exhibit 43 -) in an environment of rising fiscal deficits is likely to push up UST 10y yields above 10 OIS rates.

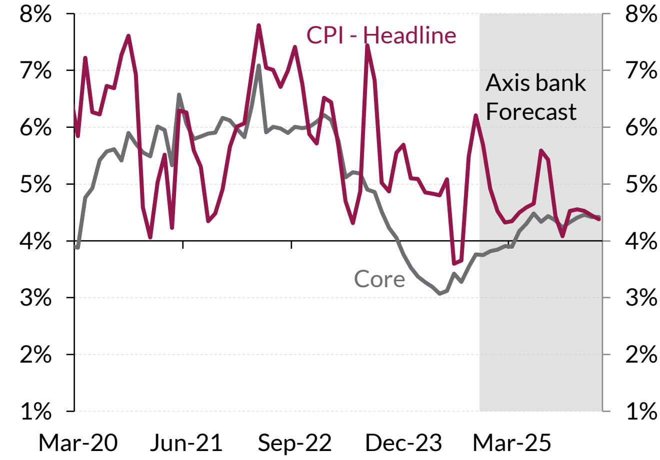
India inflation driven by food; limited respite visible in the near term

We expect inflation to average 4.5% in FY26E, coming close to 4% only for a short period

In Dec'24, the Monetary Policy Committee has pushed inflation projections the next two quarters higher by 30 bps each. The MPC's expectation that inflation will hit 4% in Q2FY26E and remain anchored is, in our view, dependent on favourable weather conditions and a strong supply response to meet the demand deficit (Exhibit 45 -). In addition, imports of several commodities would need to be relaxed.

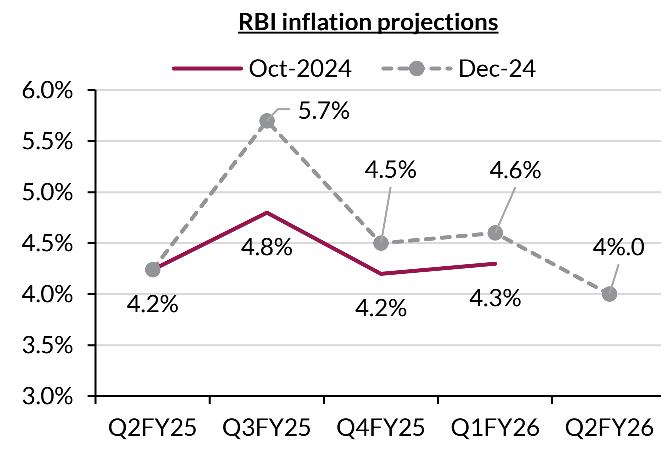
We expect headline inflation to remain high, averaging at 4.5% in FY26E (Exhibit 44 -). Due to base effects, it is likely to get close to 4% in Oct but otherwise stay above the mid-point of the target range, limiting the room to cut rates.

Exhibit 44 - Headline inflation has run faster than core



Source: Bloomberg, Axis Bank Research

Exhibit 45 - RBI in the Dec MPC raised inflation projections

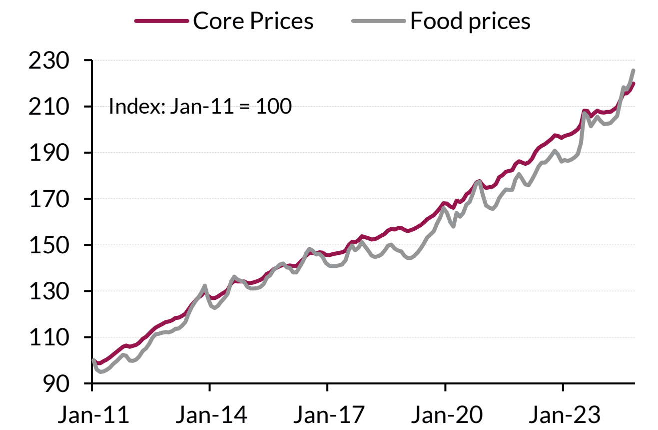


Source: Bloomberg, RBI, Axis Bank Research

Headline and core prices tend to move together over time

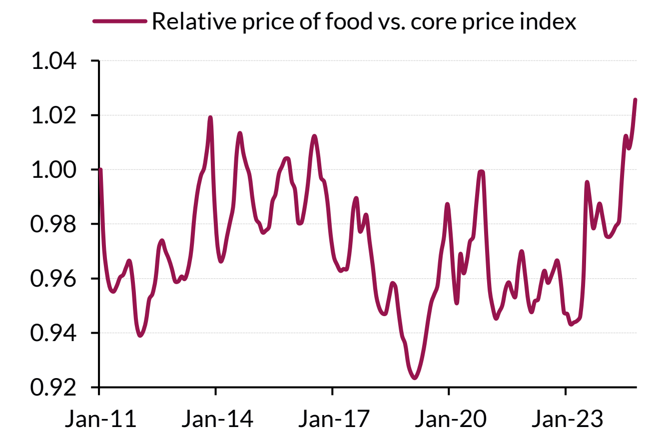
The significant and persistent divergence between food and core inflation in the past two years has brought back the debate on whether the MPC's target of headline inflation is appropriate. Until the law changes, the debate is inconsequential. However, we note that while core and food inflation trends may diverge over short time periods, of say a few quarters, over longer periods, like a few years, they move together (Exhibit 46 -6). Between 2011 and 2024, for example, food and core indices rose 125% and 120% respectively, with annualized inflation rates of 6.08% and 5.90%, a difference of just 17bps. Given that relative weights in the consumption basket can shift over time, this understandable.

Exhibit 46 - Food and core prices tend to converge over time



Source: Bloomberg, Axis Bank Research

Exhibit 47 - Cyclical high in relative prices of food

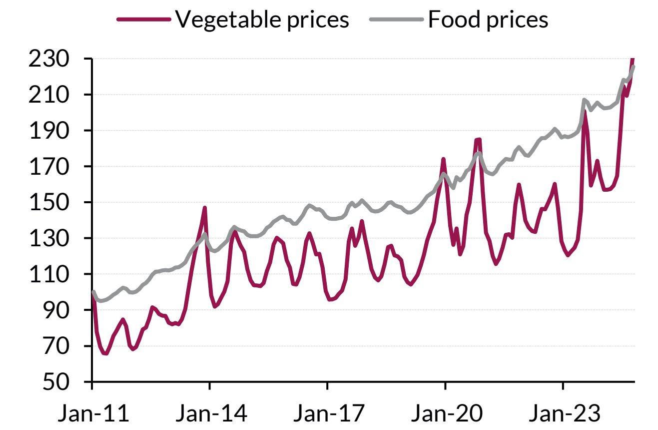


Source: Bloomberg, Axis Bank Research

Core inflation is driven primarily by services, the most linked to wages, where price increases are relatively stable, with volatility caused by telecom tariff hikes. Food prices relative to core have risen from a cyclical low of 0.94 in February 2023 to an all-time high of 1.03 (Exhibit 47 -7) – this suggests that if prior patterns repeat, food relative to core should fall. The question for inflation forecasters is whether food falls to core or core rises higher.

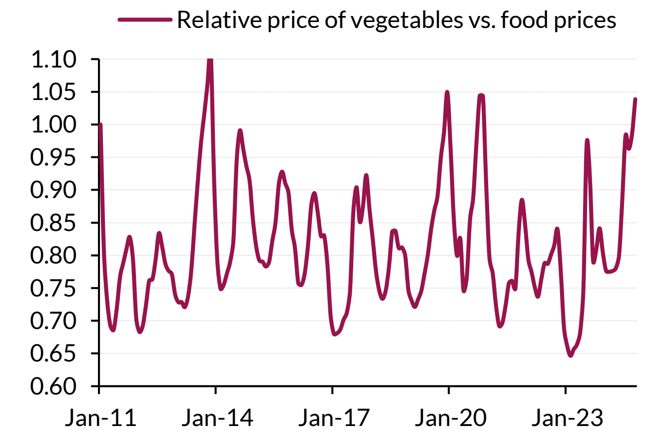
We focus below on why food prices are volatile. A major driver of food price volatility are vegetables: while over a long period of time the vegetable price index moves in-line with overall food prices, there are significant seasonal variations in vegetable prices (Exhibit 48 -). Relative to food, vegetable prices are at a cyclical high (Exhibit 49 -9), indicating that either other food prices rise going forward, or vegetable prices are likely to fall. This volatility is primarily due to inflexibility in supply – it is harder for farmers to shift acreage in the absence of sufficient market access unless prices remain high for an extended period.

Exhibit 48 - Vegetable prices volatile but converge broadly



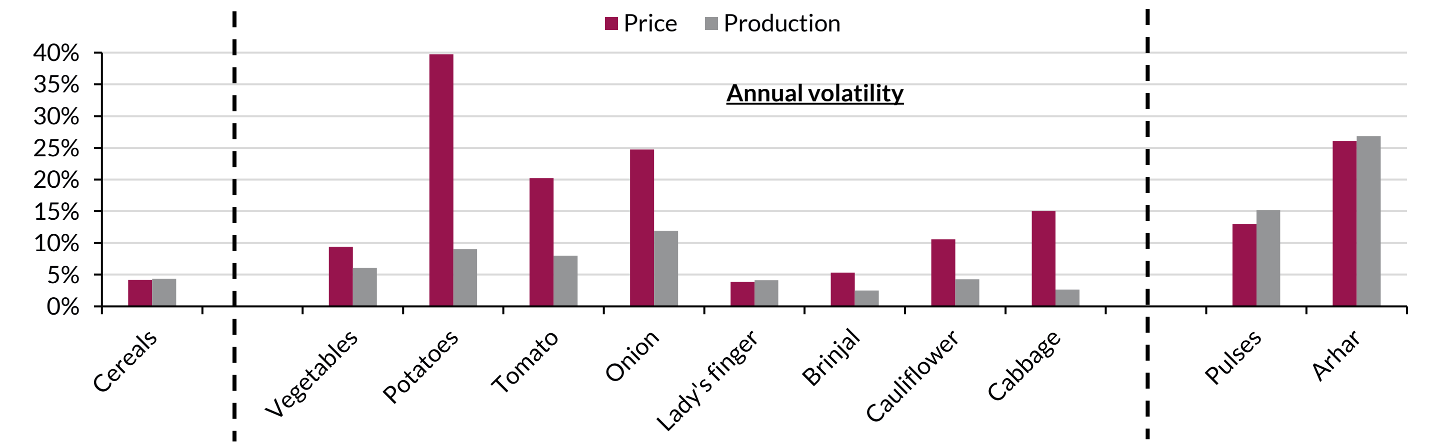
Source: Bloomberg, Axis Bank Research

Exhibit 49 - Vegetable prices relative to food also at a high



Source: Bloomberg, Axis Bank Research

Exhibit 50 - Price volatility much higher than production volatility for vegetables



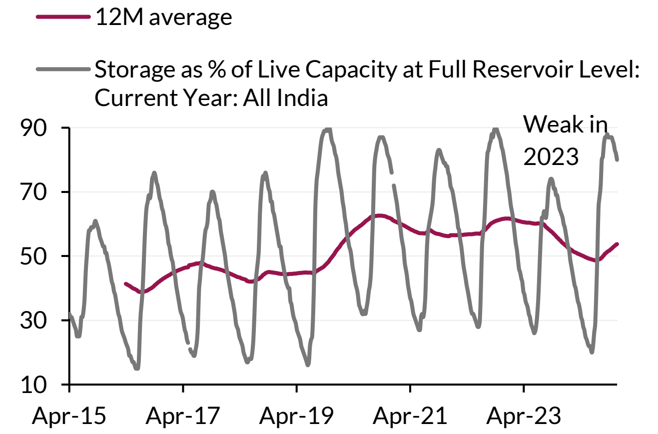
Source: Company

Among major food items, cereals have the lowest volatility in production volumes and prices (Exhibit 50 -50). Due to the Minimum Support Prices (MSPs) being enforced via government procurement, acreage allocation does not change much, and output volatility is mainly due to weather affecting yields. As India has a significant surplus in cereals, and they are distributed through the Public Distribution System (PDS), price volatility is also contained.

Volatility of output is much higher in pulses, as sown area under pulses is often not irrigated, and therefore more dependent on rainfall. Over the past several years price volatility has been contained by an increase in warehousing by the government and supply diversification (earlier ex-India supplies were limited to Madagascar and Myanmar, which are also affected by the south-west monsoon; now pulses also come from Canada and Australia).

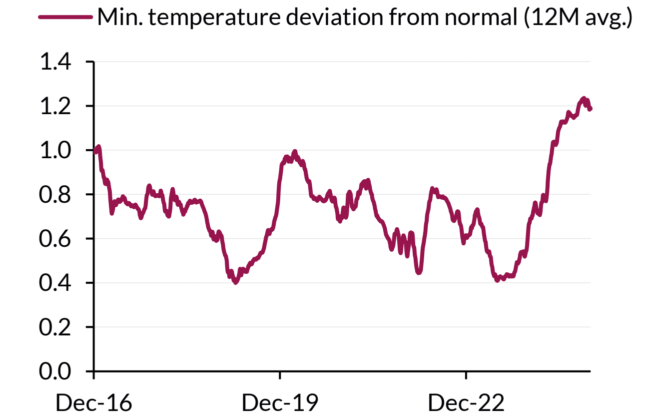
Output volatility is relatively low for vegetables overall, and in most of the green vegetables despite minimal government intervention. It is slightly higher for onions, potatoes and tomatoes, given crop-specific factors, and some dependence on water availability (Exhibit 51 -) and temperature variations (Exhibit 52 -). However, the price volatility is significantly higher, given low price elasticity of demand – to reduce demand by a few percentage points, prices need to rise substantially – and limited storage.

Exhibit 51 - Low reservoir levels in 2023 affected output



Source: Bloomberg, Axis Bank Research

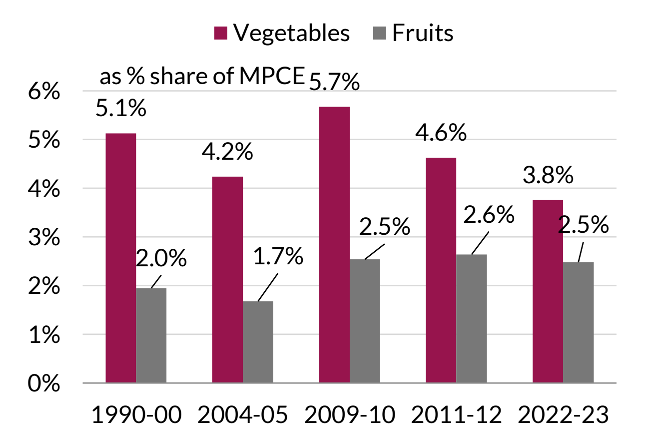
Exhibit 52 - Unexpected temperature variations hurt yields



Source: Bloomberg, Axis Bank Research

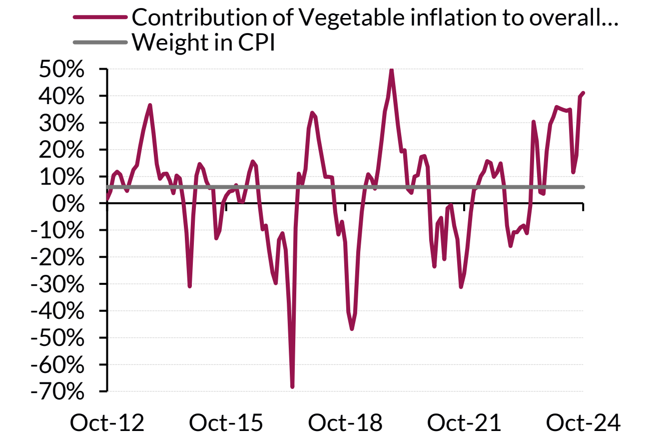
Consistent with vegetable prices over the long-term rising at the same pace as food prices overall, and the latter in turn keeping pace with overall consumer price inflation, the share of household expenditure on vegetables has remained in the 4-5% range since 1990, and had declined to 3.8% in the 2022-23 basket (Exhibit 53 -3), likely reflecting the cyclical low in vegetable prices relative to other food (Exhibit 49 -9). With the ~35% up-move since then, the ratio is likely above 4.5% now. For all practical purposes, the ~40% contribution to CPI coming from vegetables would normally define the near-term peak (Exhibit 54 -4).

Exhibit 53 - Share of basket: vegetable volatility price-driven



Source: HCES 2022-23, Axis Bank Research

Exhibit 54 - Vegetables currently 40% of CPI inflation



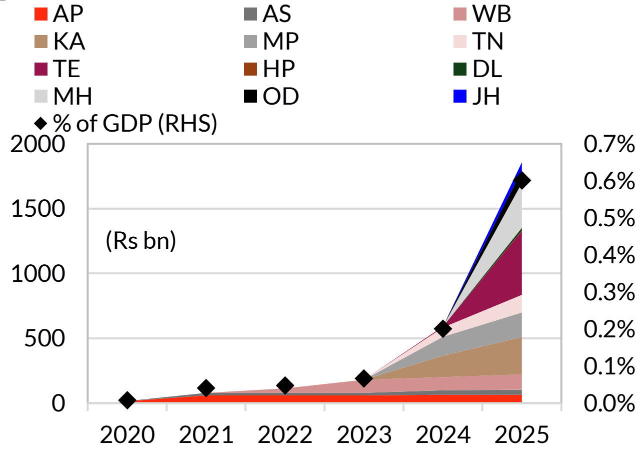
Source: CEIC, Axis Bank Research

Can income transfer scheme keep food inflation alive for longer?

Since July, when MH became the 10th state to start income transfer schemes (link), four more states have announced them, taking the count to 14 with an annualized spend of ~Rs 2trn (0.6% of GDP; Exhibit 55 -), benefitting 134mn women (20% of women and 34% of women in the 14 states). The fiscal space for this is mostly being created out of expenditure switching (link). Household spending data shows a 7-45% boost in the target segments, and a meaningful part of it is likely to be on food (link) in our view (Exhibit 56 -).

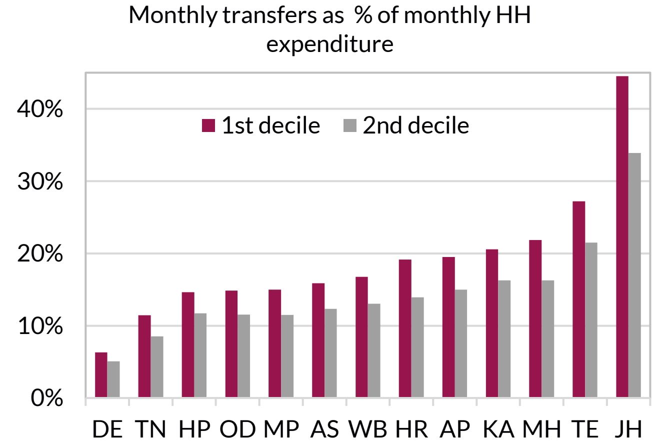
The volume of consumption of potatoes, onions, tomatoes, and pulses rises meaningfully as we move from the lowest deciles to the higher ones (Exhibit 57 -7). Food habits swing away from cereals: after Decile 6 the volume of per capita potato consumption begins to fall, but the increase in lower deciles is much steeper.

Exhibit 55 - Income transfer schemes in FY25: Rs1.9tn



Source: State Budget documents, Media articles, Axis Bank Research

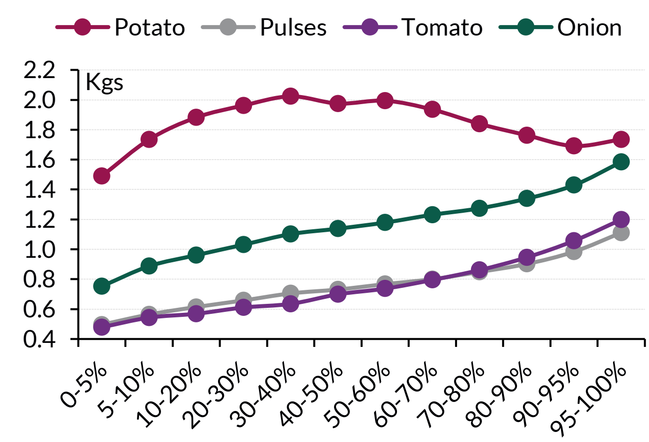
Exhibit 56 - 9-45% higher HH consumption in decile 1-2



Source: HCES 2022-23, Axis Bank Research

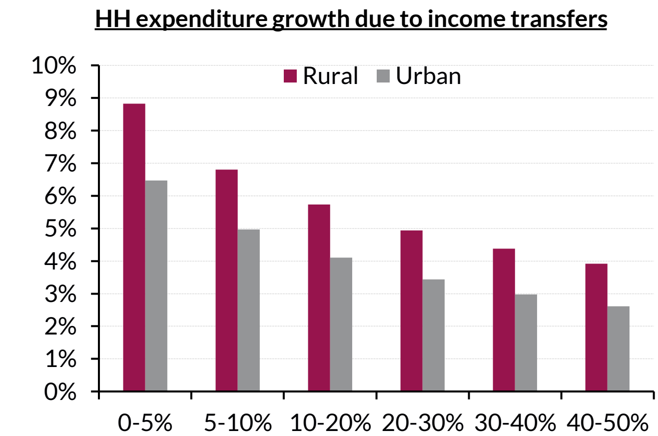
We calculate that the schemes announced thus far add about 1.5% to demand (Exhibit 58 -). As more states (say Bihar in 2025 and UP in 2026) launch such schemes, there could be a further boost. With around 3-4% annual increase over the past decade, this means nearly half a year worth of additional demand. It could take a few quarters for supply to respond adequately, limiting room for the MPC to cut rates.

Exhibit 57 - Rural per capita consumption (volumes)



Source: HCES 2022-23, Axis Bank Research

Exhibit 58 - 1.5% higher demand just due to income transfers

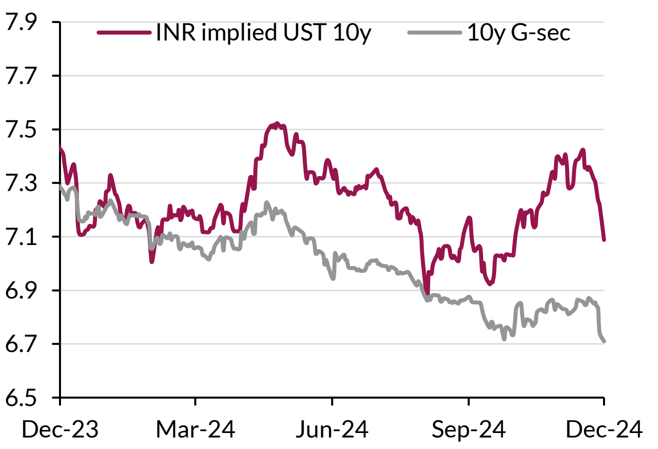


Source: HCES 2022-23, Axis Bank Research

India policy rates may not fall much, but fiscal health to help 10Y G-Sec yields

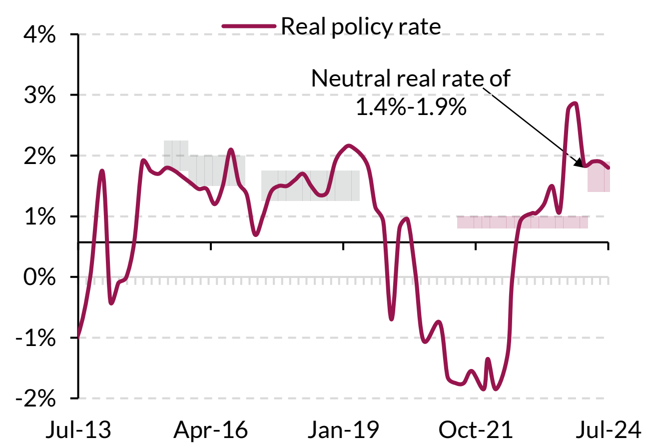
This reset in food prices in the last two months has raised the overall inflation trajectory (Exhibit 44 -). Current T-bill rates remain low, bringing real rates into the neutral range (Exhibit 60 -60), though given the recent weak data, this may not be undesirable. Onshore OIS rates now price in 75 bps of rate cuts over the year. This is not just at odds with expected recovery in conditions through reversal of the negative fiscal impulse, but also with likely elevated demand-side pressures on vegetables/food keeping headline inflation high.

Exhibit 59 - India 10y rates fell much more than UST yields



Source: MOSPI, Axis Bank Research

Exhibit 60 - Higher inflation means India real rates are lower



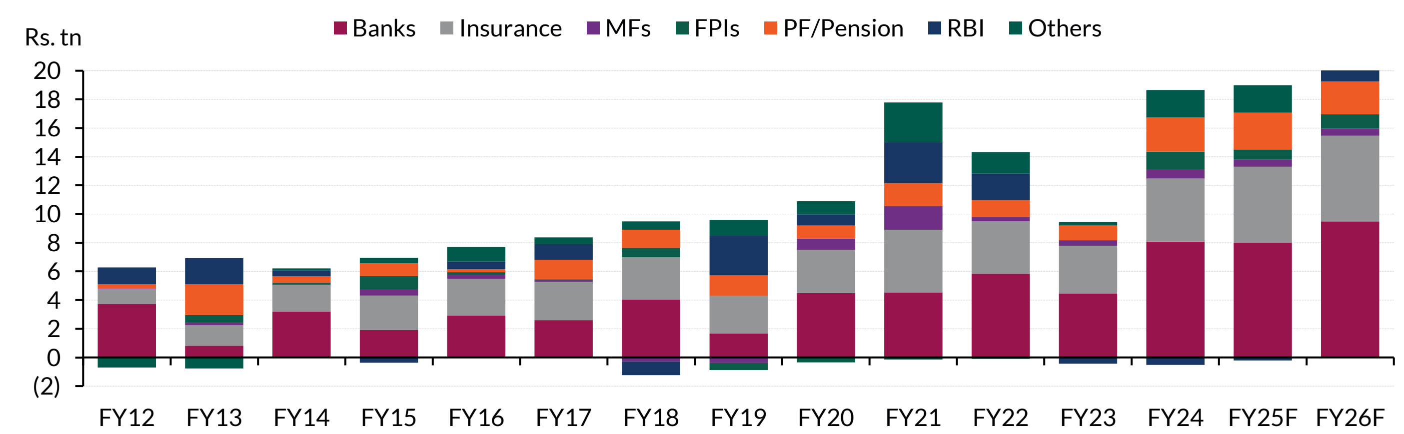
Source: RBI, Bloomberg, Axis Bank Research

Longer-term demand/supply mix remains favourable for GSecs

Tracking fully-hedged US treasuries in INR with movements in G-sec shows strong performance of domestic rates (Exhibit 59 -) – owing to limited upside in yields over the past two months despite the Trump trade, as well as weaker growth prints. This keeps the spread between India and INR-implied sovereign rates at high levels, where reversal is often seen.

However, longer term general government consolidation, combined with increased demand from banks (LCR requirements) as well as increased financialization provide positive demand/supply dynamics (Exhibit 61 -). These are also boosted by the potential for the RBI to infuse liquidity from OMO purchases, given drains from FX intervention. With these, we continue to expect yields to trend lower.

Exhibit 61 - Demand/supply for govt bonds are likely to remain balanced in FY26

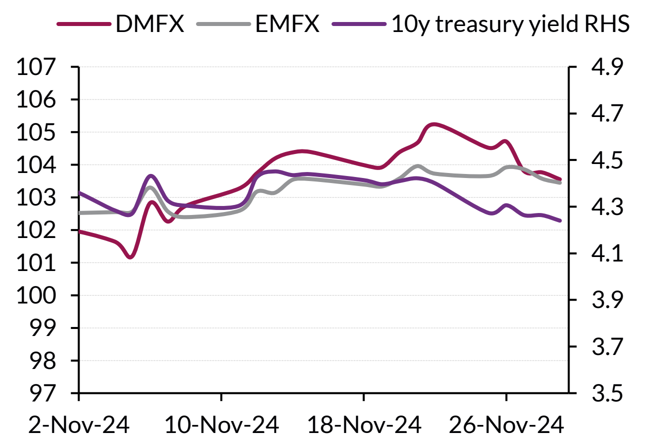


Source: RBI, EPFO, PFRDA, AMFI, Author's estimates; Axis Bank Research

FX Markets: front-loading of earlier expectations; higher USDINR volatility

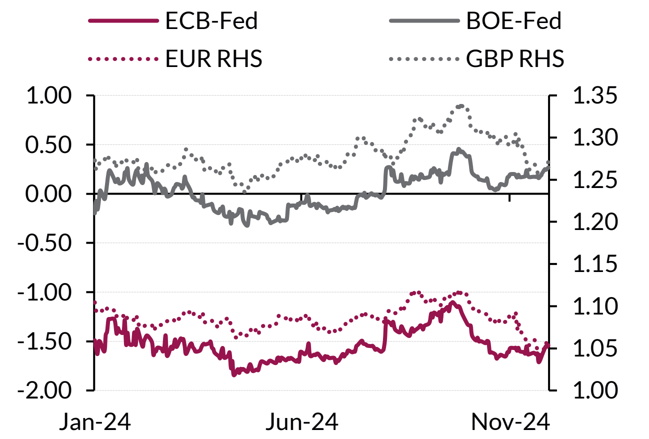
The sharp strengthening of the USD has been in line with expected evolution of US fiscal and trade policies as well as a compromised ECB. Already, squaring has helped the trade reverse, along with hawkish BOJ and BOE comments. The CNY has been held stable, with uncertainty around direction and speed, while the INR – renowned for its stability – will likely need to turn more volatile. The USD should give back some strength in a volatile year, in our view.

Exhibit 62 - US$ vs. DM & EMFX largely due to UST yields



Source: Bloomberg, Axis Bank Research

Exhibit 63 - EUR/GBP moving with rate expectations



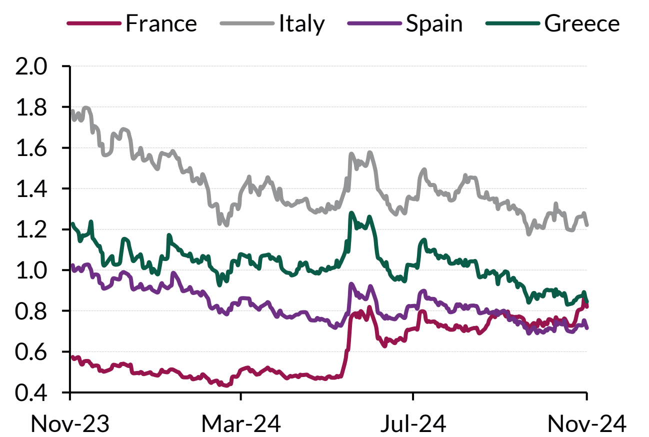
Source: Bloomberg, Axis Bank Research

Strong USD recently is a combination of Trump trade, compromised ECB

The USD measured both against DMFX (ICE Dollar Index) and EMFX (our proprietary complex) has been driven in large part by moves in treasury yields (Exhibit 62 -), as well as by a potentially compromised ECB (Exhibit 63 -). These developments have been seen in action, with the USD having risen to the 108.00 level in November following the US election, with some reversal of this after expected squaring of already heavy positioning.

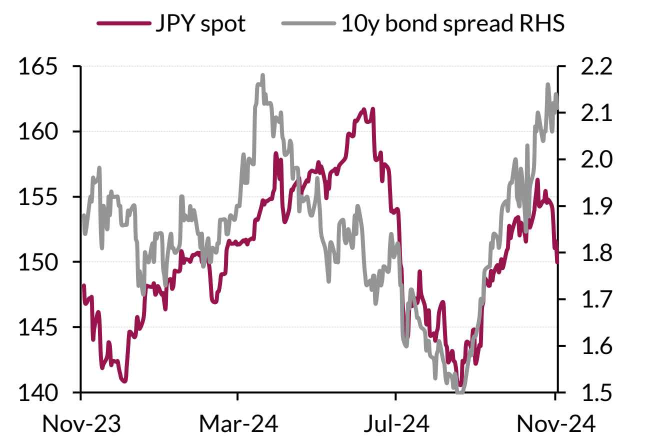
Given the likely nature of policy shifts, we expect some of these trends to persist early in the year, especially after President Trump's inauguration on 20 Jan. Even though spreads in the usual culprits Italy, Spain and Greece have narrowed, political deadlock in Germany and France provide headwinds to responsiveness on fiscal and trade policy, and only the ECB is left to handle the widening bond spreads (Exhibit 64 -).

Exhibit 64 - Widening of French bond spreads vs. Germany



Source: Bloomberg, Axis Bank Research

Exhibit 65 - Divergence between JPY and bond spreads



Source: Bloomberg, Axis Bank Research

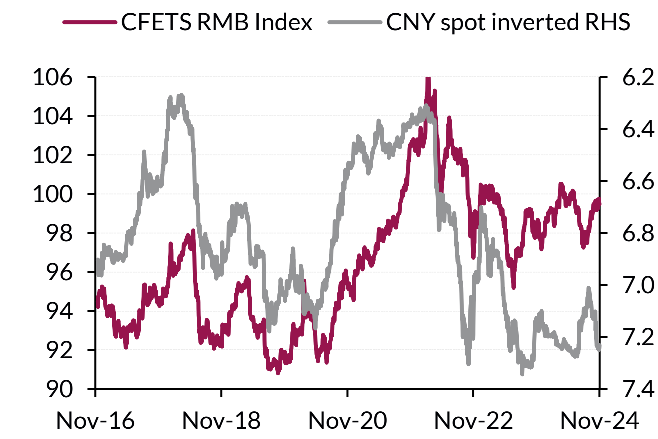
The BOJ and BOE are drivers pushing the USD back down

Owing to its position as a carry currency, the JPY often tracks spreads between US and Japanese interest rates, adjusted for potential policy action by the BOJ (Exhibit 65 -). The JPY weakened in mid-2024 after the BOJ failed to raise rates, and has now appreciated in the current month with expectations of a larger than usual (15 bps) rate cut being priced in. This is coupled with more cautious comments from the BOE, which has indicated an increase in upside risks to inflation from looser fiscal policy, brought after redefinition of fiscal rules in the latest budget. BoJ officials may be happy to have the USDJPY near 140, but there could be political pressure give the poor electoral showing of the new PM Ishiba, with potential replacements seen as advocating a more laissez-faire approach on the JPY.

CNY remains in focus given trade and other calculations

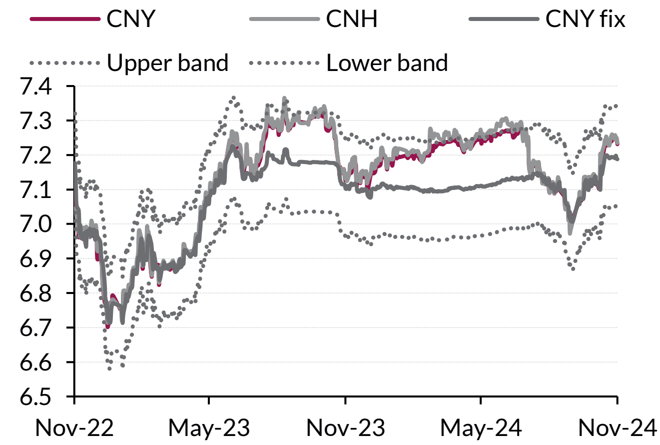
The Chinese authorities have shifted from managing the CNY through the CFETS RMB Index (its NEER measure) to managing the USD/CNY level (Exhibit 66 -), likely posturing before opening of trade/tariff negotiations with the US. In line with this, the authorities have been using countercyclical factors / market surprise factors to fix the spot CNY below 7.20 – indicating upper tolerance of around 7.35% as per the extant 2% band (Exhibit 67 -).

Exhibit 66 - Focus shifted from CFETS RMB index to USD/CNY spot over the past year



Source: Bloomberg, Axis Bank Research

Exhibit 67 - Fix lately below 7.20 signals upper tolerance on the CNY at 7.35



Source: Bloomberg, Axis Bank Research

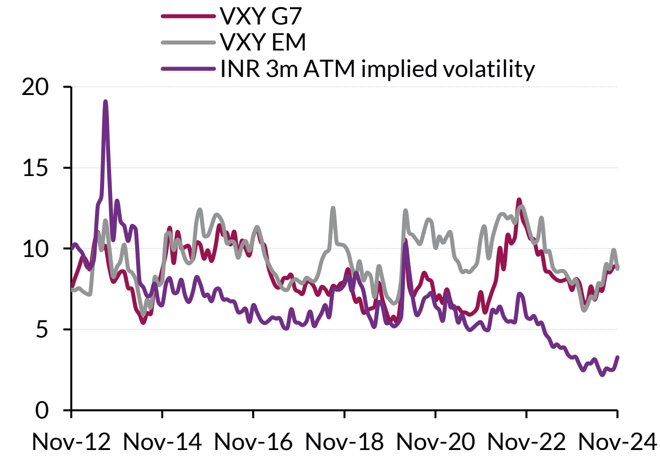
Future movements of the CNY given trade negotiations remain uncertain, given the use of depreciation to offset tariffs in the past. The fear of deflation, the explicit change of monetary stance to "moderately loose" from "prudent", and the permission to PBoC to monetize deficits are all indicators that the government is ready to let the CNY weaken.

Any significant moves are likely to be followed by several other currencies.

INR likely to see increased trading volatility

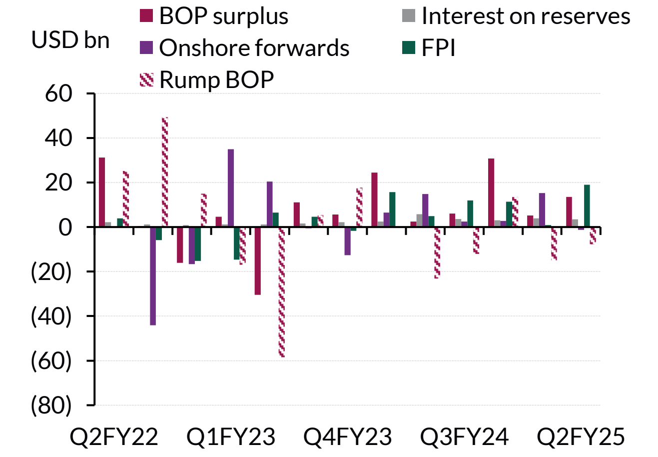
The INR was characterised by being extraordinarily stable through 2024, with implied volatility falling to record lows and breaking away from peer FX market volatilities (Exhibit 68 -). With significant volatility possible in the coming quarters, not just due to US policies but also second-order effects, say due to a bigger-than-expected move in the CNY, the INR is likely to become more volatile (see "A Steady increase in volatility seems likely", 2-Dec).

Exhibit 68 - INR volatility has been exceptionally low



Source: Bloomberg, Axis Bank Research

Exhibit 69 - BOP position can be volatile in coming quarters



Source: Bloomberg, Axis Bank Research

Expecting mild retracement of the USD in the coming year, though in volatile markets

It would be incorrect to assume incessant strength in the trade-weighted USD throughout the year. We continue to expect that momentum of ECB rate cuts will likely soon be behind, even if neutral rates below the 2% inflation target are actualised, while broader FX markets are likely to remain volatile in line with messaging from the incoming US political establishment. Some of the recent USD strength is also USD borrowers repaying their dollar loans (effectively covering their currency shorts) – a part of stealth de-dollarization. The possibility of a new Plaza accord-type mechanism can also keep the USD on the back foot.

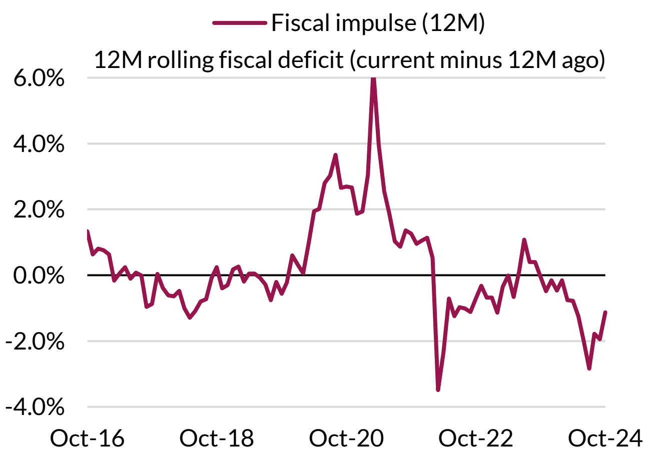
Cyclical rebound to push growth back to trend

The H1FY24 loss in momentum for the economy, in our view, is cyclical and due to unintended fiscal and monetary tightening, the latter due to a focus on macro stability risks which hurt credit growth. Fiscal spending is already rising and the CRR cut should ease growth headwinds due to a shortage of money. The current weakness has seen many reasserting that the potential growth rate for India is only 6.5%, but we maintain that the potential is 7%. The capex cycle has restarted, boosting capital formation; growth this cycle will be investment-led, in our view. We forecast an above-consensus 7% growth in FY26E, with the tailwinds from back-ended fiscal spending in FY25, and some further macro-prudential easing to help re-accelerate credit growth.

Weak credit impulse and unintended fiscal tightening hurt: H2 to be better

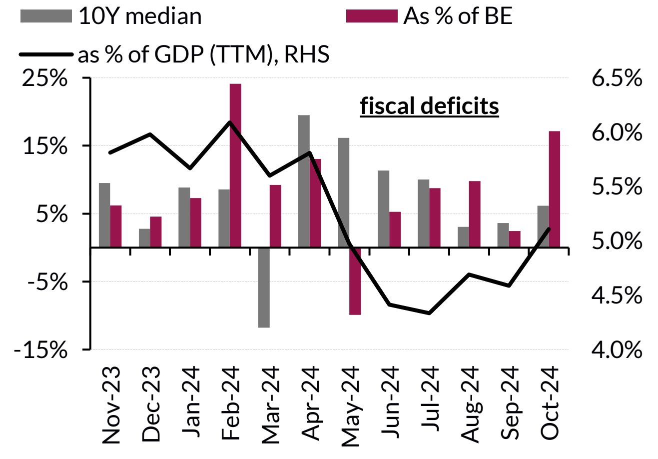
We believe the H1 slowdown was due to unintended fiscal and monetary tightening. Given front-loaded spending in FY24 and back-loaded spending in FY25 (file movement slows in central and state governments during elections), the fiscal drag was substantial (Exhibit 70 -). In H1FY25, the government incurred only 29% of its FY25 budgeted deficit, vs 62% median – a drag of 1.6% of GDP. This is now reversing, with Oct ahead of normal (Exhibit 71 -).

Exhibit 70 - Fiscal stimulus proxy shows drag on growth



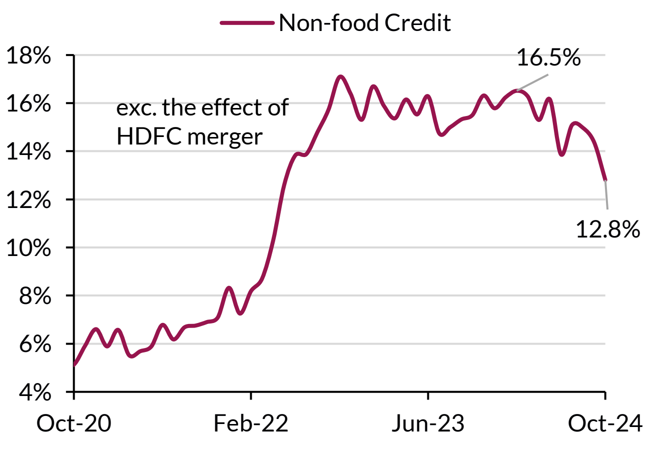
Source: RBI, Axis Bank Research

Exhibit 71 - Deficits below normal in May/Jun; Oct better



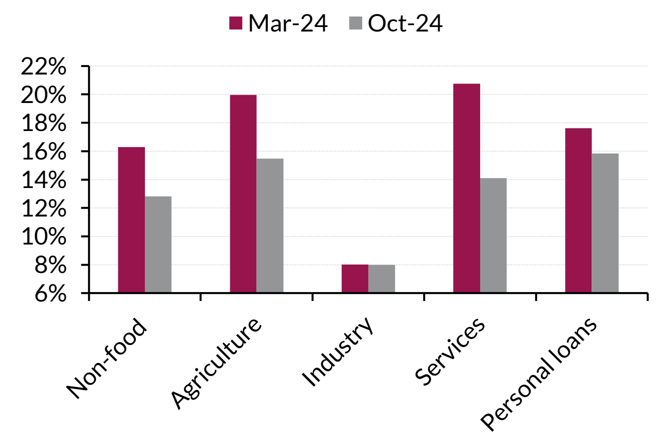
Source: RBI, Axis Bank Research

Exhibit 72 - Credit growth slowdown hurt activity too



Source: RBI, Axis Bank Research

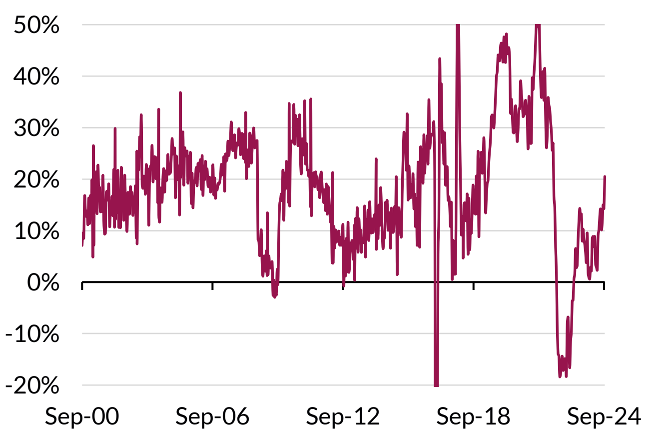
Exhibit 73 - Loan growth slowdown was broad-based



Source: RBI, Axis Bank Research

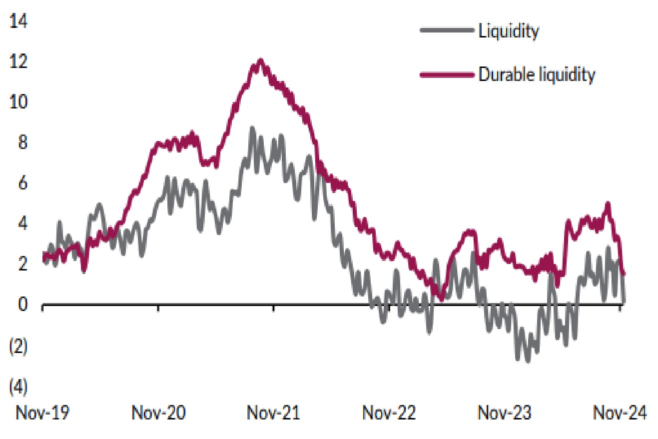
Non-food credit growth adjusted for the HDFC-HDFC Bank merger fell from 16.5% in Mar'24 to 12.8% in Oct (Exhibit 72 -) and to 11.2% in the fortnight ended 15 Nov. This sharp slowdown hurt was broad-based (Exhibit 73 -) too and was triggered by the regulator's concerns on high loan-deposit ratios (LDR) at some banks. As banks slowed credit growth, deposit creation by banks slowed too, compounding the weak money injection by the RBI.

Exhibit 74 - RBI's share of incremental M3 rising now



Source: RBI, Axis Bank Research

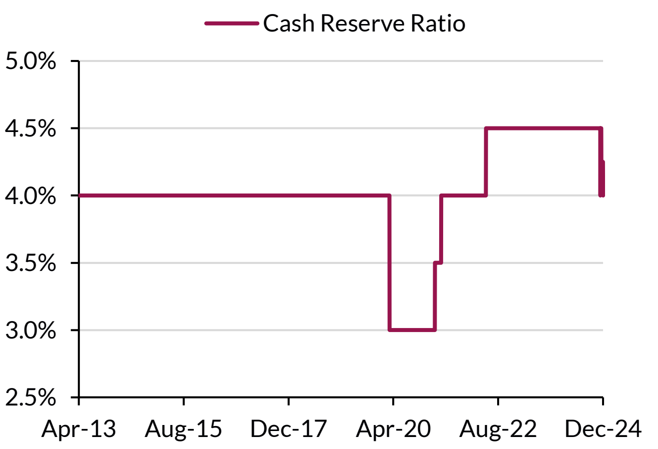
Exhibit 75 - Durable liquidity improvement needs to sustain



Source: RBI, Axis Bank Research

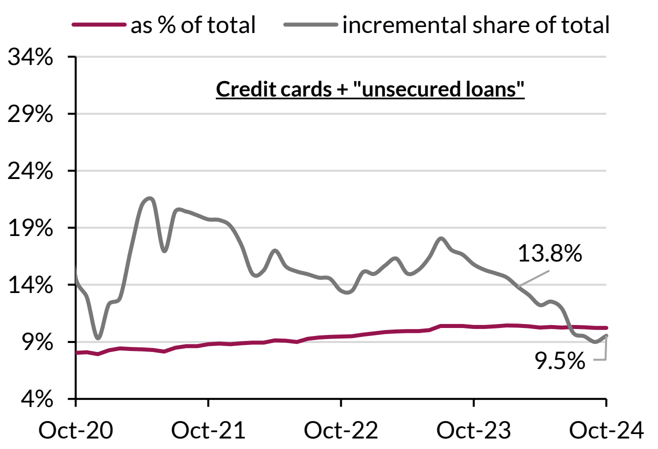
This began to shift in Jul as the RBI's share of incremental money creation rose from very low levels (Exhibit 74 -), after the rise in overnight and durable liquidity (Exhibit 75 -) signalled the end of India's quantitative tightening. USD sales by the central bank have drained durable liquidity in recent weeks, but the change in policy stance to neutral in Oct and the recent CRR cut (Exhibit 76 -) will help normalize the financial conditions. We believe the normalization of CRR should help the system respond better on money creation.

Exhibit 76 - CRR normalization to pre-Covid levels to help



Source: RBI, Axis Bank Research

Exhibit 77 - RBI justifiably wanted to slow unsecured credit

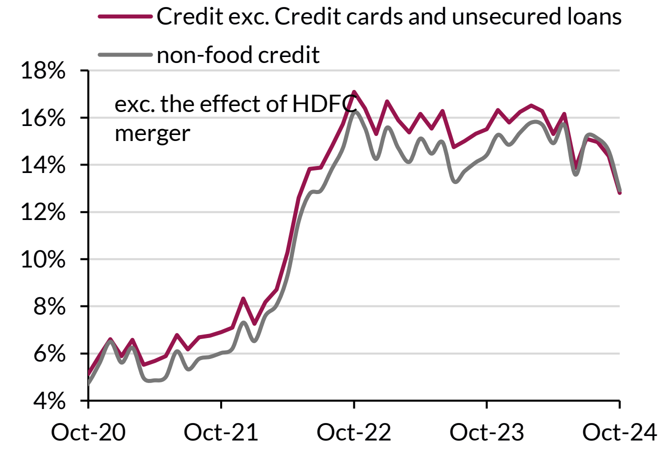


Source: RBI, Axis Bank Research

Some macro-prudential easing may still be necessary

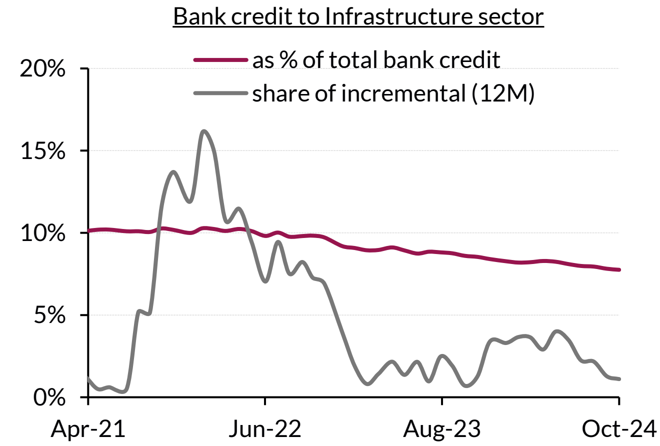
The regulator is also worried about the strong growth in unsecured personal loans, credit card debt, and growth in the micro-finance sector. It has taken several measures to slow down growth in these categories and has largely been successful (Exhibit 77 -). However, the tools used have been so broad-based that loans excluding these categories have slowed too (Exhibit 78 -), and growth in credit to infrastructure is now close to zero (Exhibit 79 -). This broad-based slowdown in credit growth has hurt both consumption and investment.

Exhibit 78 - However, nearly every loan segment has slowed



Source: RBI, Axis Bank Research

Exhibit 79 - Growth in credit to infrastructure is nearly zero



Source: RBI, Axis Bank Research

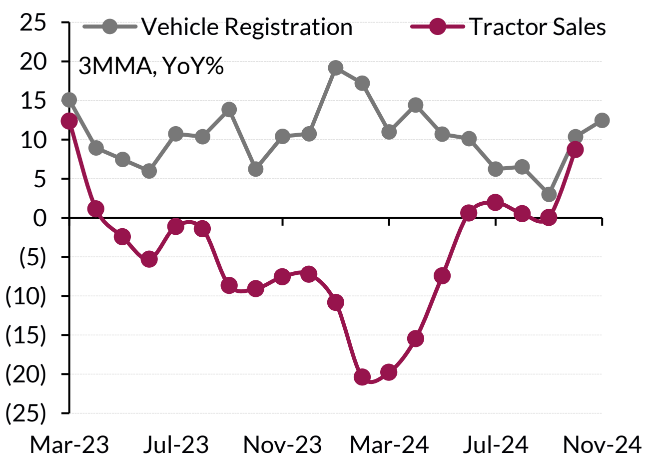
We believe persistent tight overnight liquidity for several quarters, compounded by much-above-normal government cash balances, and a higher-than-normal CRR ratio slowed the money creation engine in the economy. This too is easing, with government cash balances expected to normalize and the CRR not only improving overnight liquidity (Rs 1.16 tn improvement, but this being high-powered money, the eventual growth in money supply can be Rs 5-6 tn), but also signalling to the financial system that the RBI wants the condition to ease. A recent BIS paper (link) showed *a tightening in RR reduces the amplitude of the credit cycle.*

We believe further macroprudential easing may be necessary to fully normalize the credit impulse, but credit growth is likely to improve from here, boosting the economic rebound.

We expect high-frequency indicators to start turning from Mar/Apr

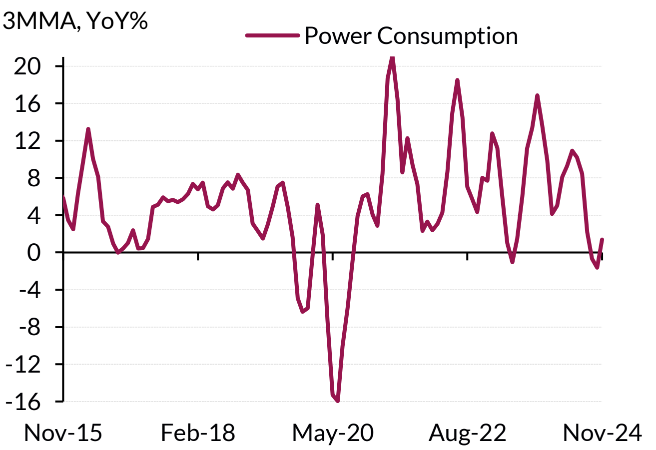
The economy likely bottomed out in Oct, and growth in demand for motor fuel, power (Exhibit 81 -), and retail auto sales (Exhibit 80 -) have already picked up. The front-loaded and excessive tightening in H1FY25 implies an effective stimulus in H2, which should boost high-frequency indicators.

Exhibit 80 - Vehicle registration and tractor sales rising again



Source: CEIC, Axis Bank Research

Exhibit 81 - Power demand grew 4.2% YoY in Nov'24

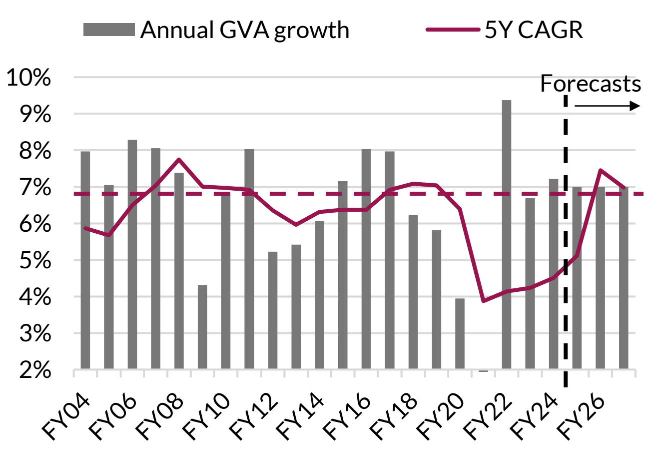


Source: CEIC, Axis Bank Research

Structural growth drivers intact: Recovery in capital formation to drive growth

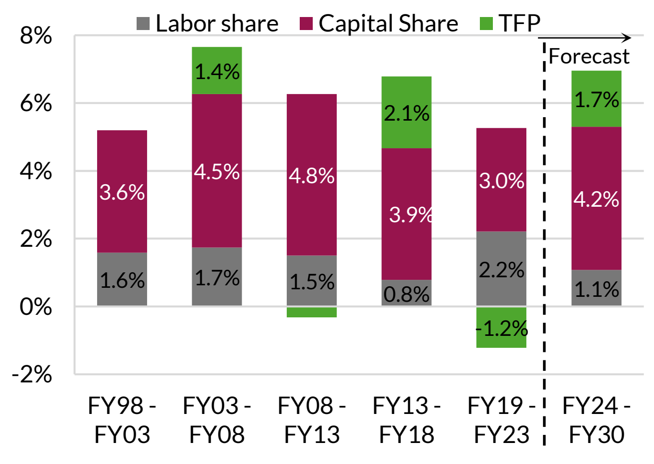
Over the past three decades, trend growth (seen as five-year average) through varying external environments, fiscal stance, and under different governments has been 6-7% (Exhibit 82 -). The five-year CAGR came close to 8% only in the FY03-08 period, when the workforce was expanding rapidly (Exhibit 83 -), and up-cycles in power generation, real estate, and global growth boosted capital formation. Over the next three to five years, labor growth is likely to be slower than in that period, as is global demand. In aggregate, we expect labor to add only ~1 pp annually to GDP growth for the next five years.

Exhibit 82 - Trend growth has been between 6-7% for 25Y



Source: RBI, Axis Bank Research

Exhibit 83 - 7% growth realistic



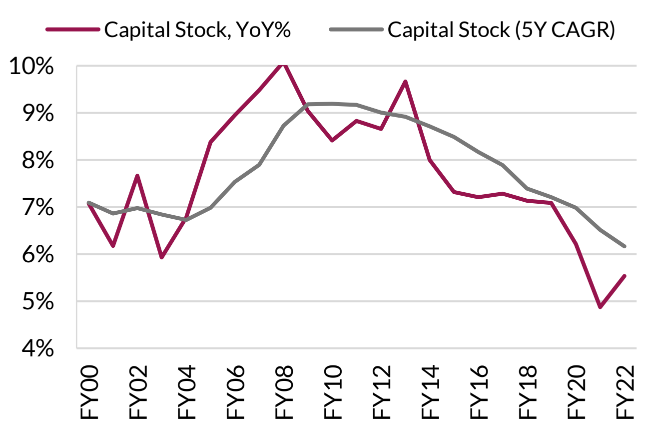
Source: RBI, Axis Bank Research

Total Factor Productivity (TFP) growth likely to be sustained at 1.5-2% annually

A shift in the government's mindset towards greater reliance on market forces has given some control to the private sector, as reflected in their rising share of capital stock (Exhibit 85 -). Additionally, (1) an expanded presence of foreign firms in India has helped with diffusion of global best practices and technology; and (2) there has been continued improvement in macro-infrastructure (roads, railways, highways, telecom, digital) and in micro-infrastructure (piped water to homes, cooking gas). Hence, we expect TFP to grow 1.5-2% annually for the next five years, adding ~1.7 pp to the growth.

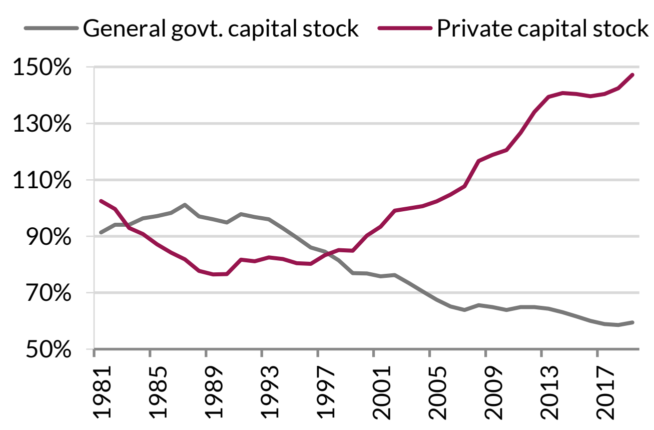
Total factor productivity (TFP) was also strong during the FY03-08 period, at 1.4%. Since then, it saw a deceleration during FY08-13 but has improved steadily thereafter; growth has increased to nearly 2% YoY in the past 10Y

Exhibit 84 - Capital stock (% of GDP) stagnated since 2011



Source: RBI, Axis Bank Research

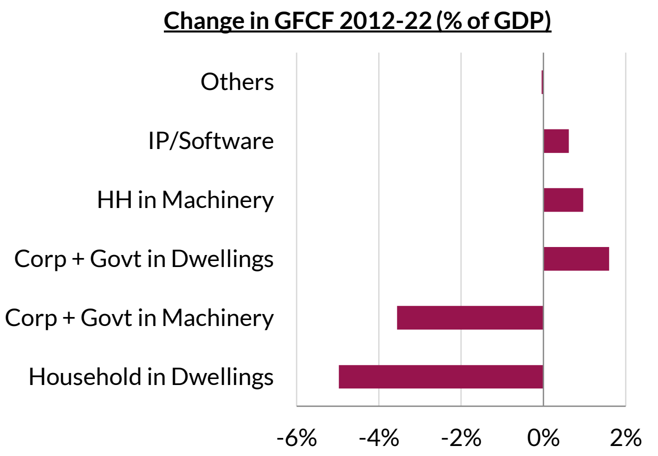
Exhibit 85 - India's capital stock dominated by private



Source: RBI, Axis Bank Research

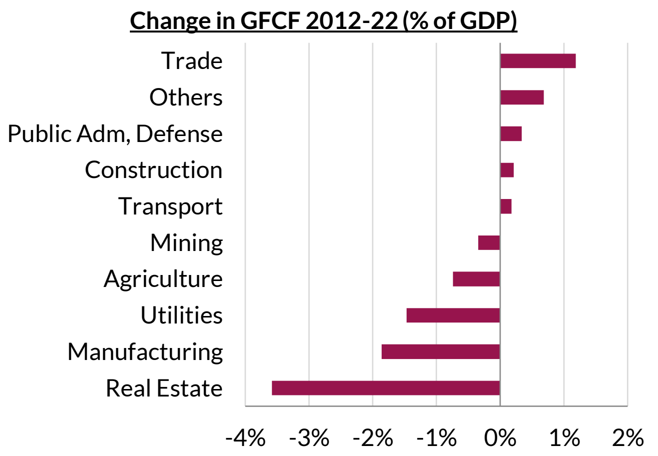
2012-21 investment slowdown driven by real estate, power generation, and mfg.
India's investment-to-GDP ratio fell sharply from 34% in 2012 to 27% in 2021, driven by a slowdown in households' spending on real estate, and corporate capex on machinery for utilities and manufacturing (Exhibit 86 -). Manufacturing capex by corporates (Exhibit 87 -) as a share of GDP fell the most in sectors like cement and steel, affected by real estate.

Exhibit 86 - HH in dwellings led the 2012-22 capex slowdown



Source: Axis Capital Capex Report

Exhibit 87 - Within sectors: RE, utilities, and manufacturing

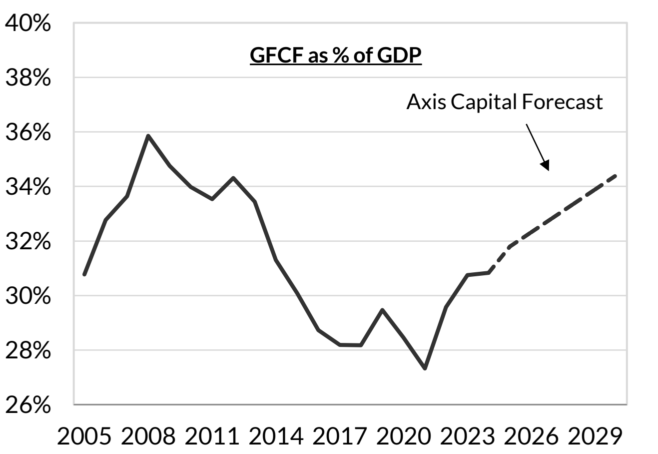


Source: Axis Capital Capex Report

Bottom-up sectoral trends support a pickup in capital formation

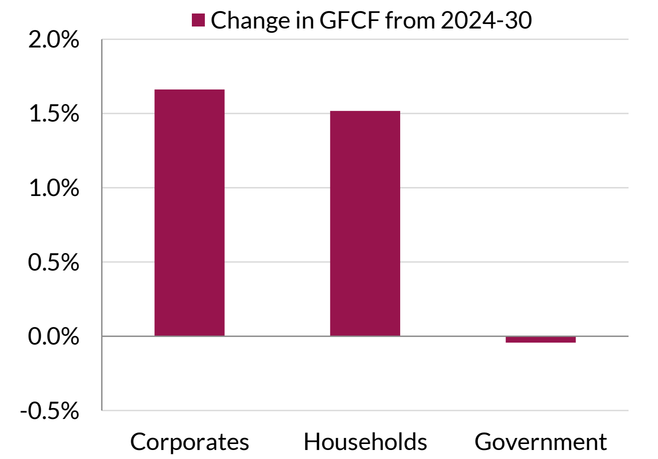
We expect the rebound in investment-to-GDP ratio to continue over the next few years, reaching 34% by 2029-30E (Exhibit 88 -). The improvement is likely to be split nearly equally between corporates and households, as government capital spending as a percent of GDP is unlikely to expand from here (Exhibit 89 -).

Exhibit 88 - We expect GFCF to GDP ratio to rebound further



Source: MOSPI, Axis Capital estimates

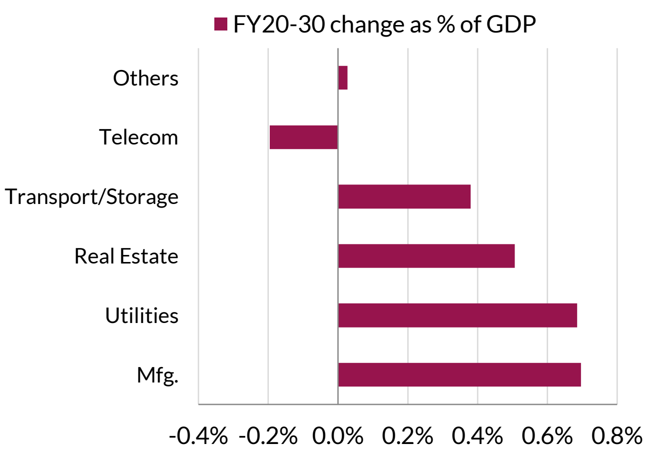
Exhibit 89 - 1.5 pp of GDP for households, 1.7 pp for corp.



Source: MOSPI, Axis Capital estimates

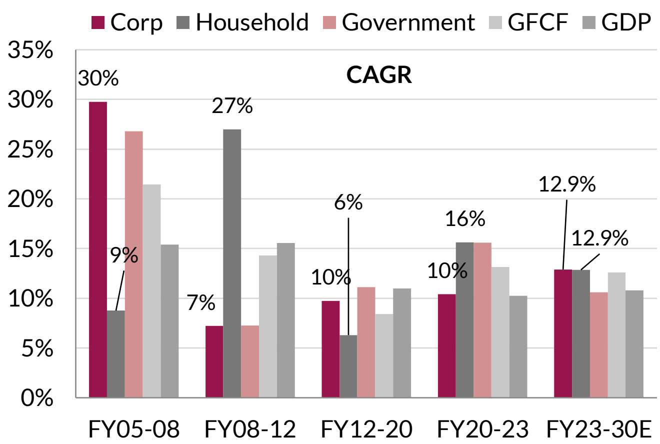
In corporates, we expect the recovery to be in manufacturing (sectors like steel, cement, machinery, etc. that are, among other things, supported by real estate demand), utilities, and transport/storage (Exhibit 90 -), and overall investment should grow faster than GDP over the next several years (Exhibit 91 -).

Exhibit 90 - In corporates, manufacturing and utilities are set to drive the pickup in investment



Source: MOSPI, Axis Capital estimates

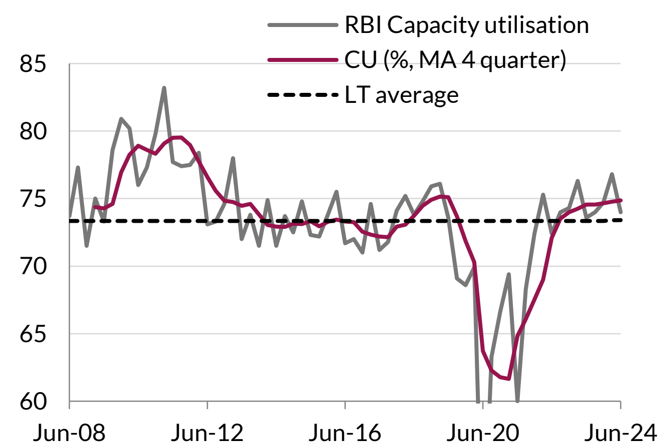
Exhibit 91 - GFCF projected to see 13% CAGR over FY22-30E, led by corporates and households



Source: MOSPI, Axis Capital estimates

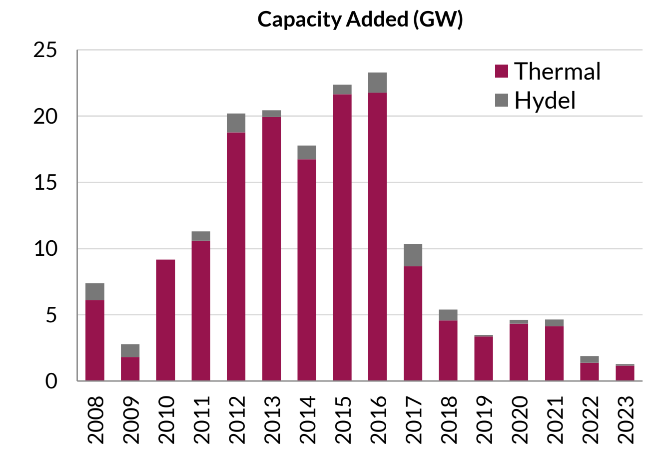
Industrial utilization now warrants new capex; power generation needs more capacity
Industrial capacity utilization has reached pre-Covid levels (Exhibit 92 -), and the surge in order backlog for capital goods companies shows that going forward, investment activity is likely to grow rapidly. For example, in utilities, excessive capacity addition necessitated a drop in capex between 2012 and 2016, as India completed 20-25 GW of power generation capacity every year, much more than the growth in demand (Exhibit 93 -). Most of this additional capacity was thermal. With barely any addition in capacity for the past seven years, the industry needs more capacity, and we expect strong corporate capex in the energy ecosystem, with Rs 19 tn of power generation capex over FY24-30E, including Rs 10 tn on renewables (ex. hydro). If power demand growth is faster than the 6% annual growth that we have estimated (based on a 7% GDP growth), capacity growth is likely to be faster. Power transmission capex should also grow, given the 5% CAGR expansion in the transmission line network and 10% CAGR growth in substation capacity.

Exhibit 92 - Industry capacity utilization > long-term avg.



Source: RBI, Axis Bank Research

Exhibit 93 - Thermal power generation capacity addition fell



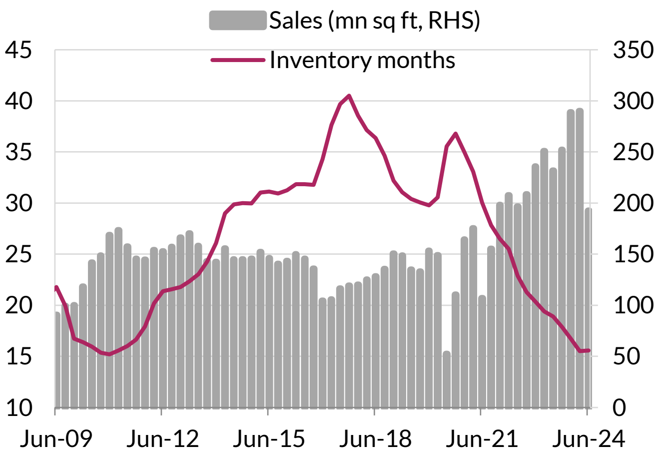
Source: CMIE, Axis Bank Research

We expect new investment areas like green hydrogen, defense, solar modules, robotics, data centers, and energy storage to add an additional 60-80 bps to India's investment ratio.

Real estate investment cycle: low inventory necessitates increase in construction
We also expect dwelling construction to see strong growth, supported by continuing steady expansion of commercial real estate and structural demand drivers such as a growing population, shrinking household size, rising urbanization, higher built-up area per capita, and improving construction quality. Housing inventories in the Top 8 cities, when seen as the number of months of sales, are now down to levels seen 15 years back. This was the point in the earlier cycle where we saw the pace of construction pick up. In the Top 8 cities, quarterly sales volumes, which had stagnated at ~150 mn sq ft, reached ~300 mn sq ft in the Mar'24 quarter. Volumes have slowed in the Jun and Sep quarters, but primarily due to the overall macro slowdown discussed earlier in this section and is likely to recover.

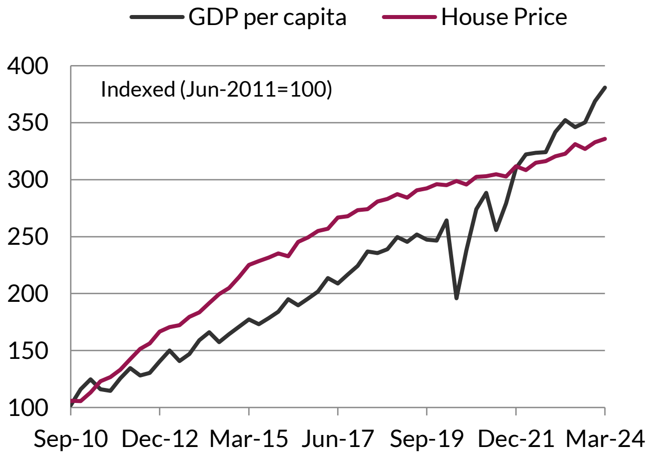
Cycles form only in urban real estate: there are no inventory cycles in rural areas, as most households own the land on which their houses are built; large-scale development of residential real estate is primarily an urban phenomenon

Exhibit 94 - Inventory in Top 8 cities at cyclical lows



Source: PropEquity, Axis Bank Research

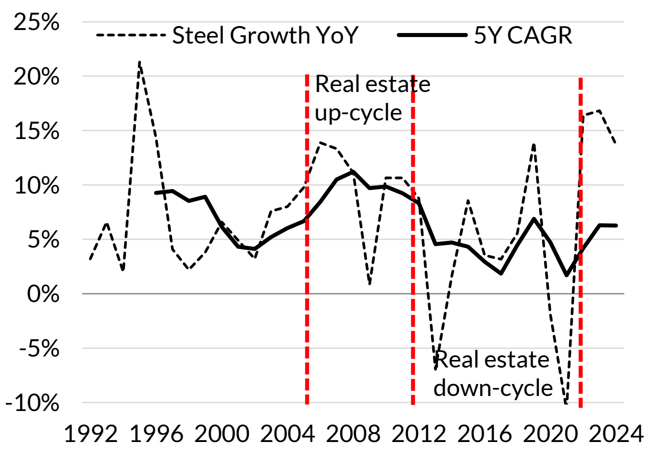
Exhibit 95 - Income growth now faster than real-estate prices



Source: RBI, CMIE, Axis Bank Research

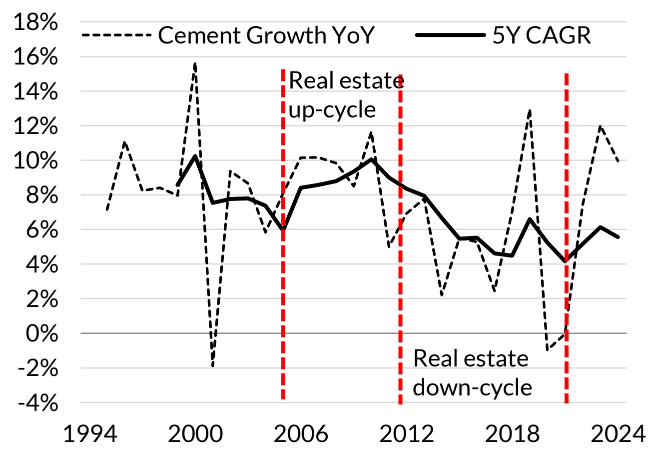
We expect the improvement in real estate construction to also boost demand for construction materials, implying a strong corporate capex in steel and cement. In prior real estate up-cycles, their demand growth was 4-5 pp faster annually than in down cycles. This is already visible in the expansion plans of major steel and cement companies.

Exhibit 96 - Steel consumption correlates strongly with RE



Source: Ministry of Steel, Axis Bank Research

Exhibit 97 - Similar trend for cement growth



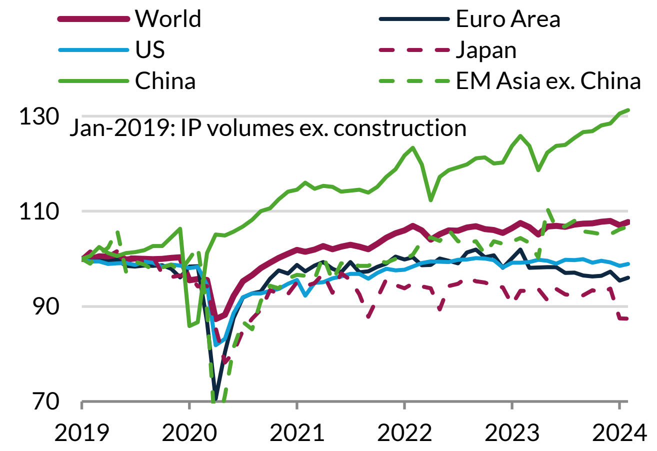
Source: CMIE, Axis Bank Research

External demand and external financing are likely to remain constrained

China's own capacity expansion (Exhibit 98 -) limits some avenues for India. However, as a share of GDP, India's core goods deficit (excluding oil and gold) has been falling since Apr'23, though it is still above the pre-pandemic level (Exhibit 99 -). The underlying momentum has improved in recent months: unlike last year, both exports and imports are now growing, with exports growing faster than imports. India has so far been unable to take substantial advantage of the 'China + 1' trend, but there are early signs that foreign firms are widening their footprint in a growing number of sectors – not just in the upstream supply chains in electronics, but also in more traditional sectors like footwear. The US election results and the turmoil in Bangladesh have also provided a new impetus to these trends.

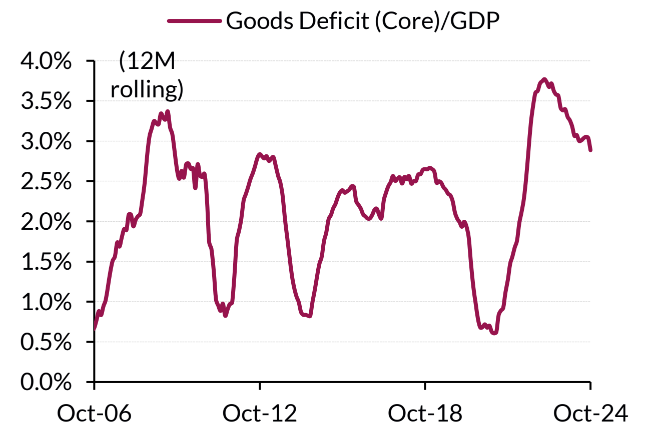
China's pivot from real estate to industrial capacity (link) is a major headwind, limiting Indian goods exports despite the "China+1" trend. However, improving competitive metrics, like in infra and value-chain development, are likely to help India gain share of global goods exports.

Exhibit 98 - China's capacity expansion limits room for others



Source: CPB, Axis Bank Research

Exhibit 99 - Core goods (ex. oil and gold) deficit to fall further

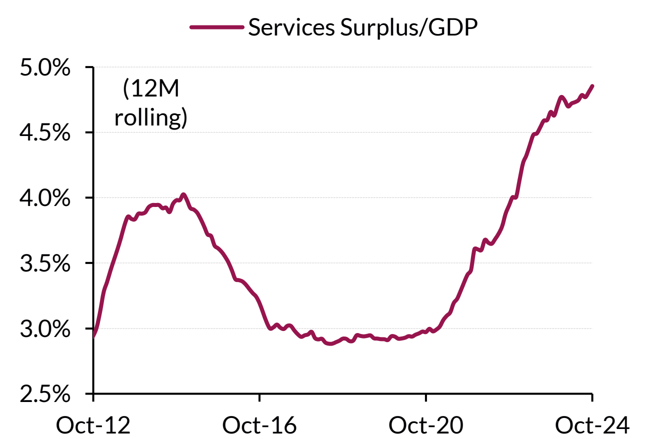


Source: CEIC, Axis Bank Research

We expect continuing expansion in India's services surplus as a share of GDP, which hit a new high in Oct'24 (Exhibit 100 -), remaining a key source of external strength to India's economy. As explained in our note (link) on the structural drivers of India's share gains in global services exports, the disaggregation of global services value-chains, rapid increase in global cross-border telecom bandwidth, and surge in remote-working are adding to the demographic trends supporting growth in India's services exports to developed markets. India's services exports are less susceptible to tariff actions. On the other hand, persistent high rates in the US are likely to keep net foreign flows well below past levels (Exhibit 101 -).

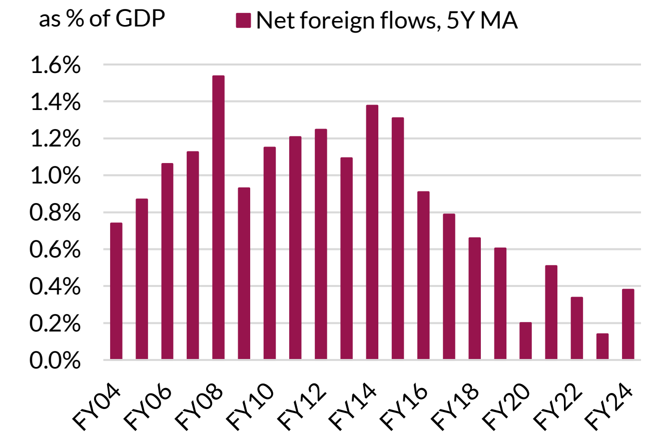
As global financial integration increases, the link between foreign flows and domestic investment weakens. The negative effect is mainly via TFP.

Exhibit 100 - Global growth est. weaker by ~1.5% vs pre-GFC



Source: CEIC, Axis Bank Research

Exhibit 101 - Net flows (FPI+FDI) >0.6% of GDP lower

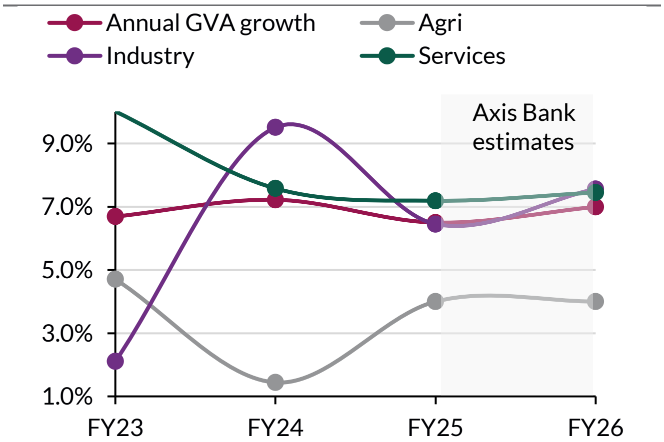


Source: Bloomberg, Axis Bank Research

FY26 outlook: Growth likely to rebound to 7%

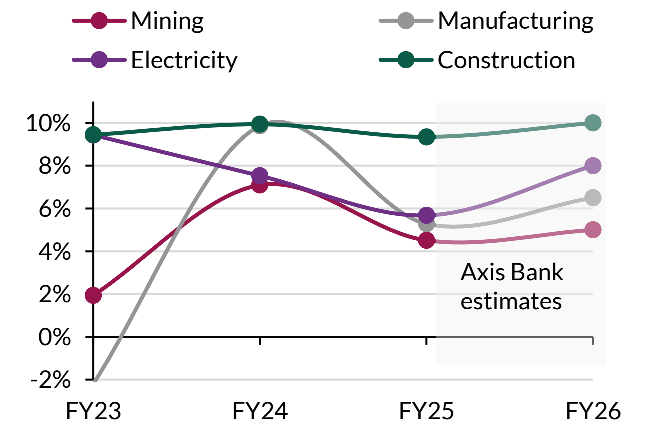
We expect the central government to stick to its target of FY26 fiscal deficit ratio of 4.5%, implying some more headwinds to growth next year, though likely to be only 30-40 bps of GDP. With the tailwinds from the reversal of QT and the excessive fiscal tightening of H1FY25, we expect a 7% growth in GVA in FY26E, up from 6.6% in FY25. We expect much of the improvement to come from industry GVA, with construction likely to grow in double-digits, aided by the real estate upcycle. Assuming a normal monsoon, agriculture is expected to grow at similar pace as in FY25, with some supply response to continued high food prices easing inflation woes. Public administration may grow marginally lower over a high base.

Exhibit 102 - Rebound in industry GVA primary driver of growth acceleration in FY26; services growth slightly up



Source: RBI, Axis Bank Research

Exhibit 103 - Both electricity and construction to register strong growth in FY26E



Source: RBI, Axis Bank Research

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