

INDIA

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AN ECONOMY BETTER EQUIPPED THAN IN 2022 TO FACE THE ENERGY SHOCK

India is currently in a stronger position than it was in 2022 to cope with the new energy shock. The fiscal capacity to support the economy has increased, and inflation is more contained. Although a slowdown is anticipated (from 7.7% for FY 2025/2026 to 6.7% for the current year), economic growth is expected to remain robust. However, the government's subsidy policy is likely to delay the consolidation of public finances. Despite the expected reduction in energy subsidies — supported by lower oil prices — food subsidies could rise due to a poor monsoon.

GROWTH REVISED DOWNWARDS FOR FY2026/2027

Indian economic growth reached 7.7% in FY 2025/2026 (up from 7.1% the previous year), marking one of Asia's most dynamic rates. For the current year, and despite stronger than expected growth in the last quarter of FY 2025/2026 (+7.8% y/y), the central bank has revised its growth forecast downwards by 0.3pp to 6.6% due to the sharp rise in energy prices and the risks associated with an unfavourable monsoon, which will weigh on rural household incomes. Household consumption still accounts for 55.7% of Indian growth (with investment at 34.3%, and government spending at 7.1%).

India has been particularly exposed to the energy shock and the closure of the Strait of Hormuz. It imports nearly 88% of its oil (approximately 50% from the Middle East), 62% of its liquefied petroleum gas (LPG; 90% from the Middle East), and 50% of its liquefied natural gas (LNG; 55% from the Middle East). LPG is used by households at a rate of 87%, while LNG is primarily used by industry (particularly for electricity generation) and fertiliser production. India is highly dependent on fertilisers, as 41.5% of the population works in agriculture.

RISING INFLATIONARY RISKS

In June 2026, consumer price growth was contained at +4.4% y/y, remaining below the 4% ± 2pp target set by monetary authorities (Chart 1). However, inflationary risks have increased due to higher domestic energy prices, with petrol prices rising by 7.9% in May, and producer prices climbing by 9.9% y/y in June, exacerbated by the rupee's depreciation against the dollar. Additionally, while the increase in food prices is still moderate at +5.3% y/y, risks are skewed upwards as the Indian Meteorological Department (IMD) forecasts a below-normal monsoon.

The central bank, the Reserve Bank of India (RBI), has revised its inflation forecast for the current fiscal year to 5.1%, compared to 2.1% for 2025/2026. Since late February, it has kept its policy rates unchanged at 5.25%. The recent drop in energy prices and reduced downwards pressure on the rupee have reduced the likelihood of a rate hike at the upcoming Monetary Policy Committee meeting in August.

EXTERNAL ACCOUNTS UNDER PRESSURE

India's external accounts have been affected by the Middle East conflict through two channels: i) higher commodity prices (oil, gas) and ii) capital outflows.

India's energy trade deficit, encompassing oil and gas, is relatively high at 2.8% of GDP in 2025.

Assuming oil prices stabilise around USD 80 per barrel for the rest of the year, the current account deficit could reach 1.9% of GDP for FY 2026/2027, compared to 0.7% of GDP for FY 2025/2026.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, % (1)	7.6	7.2	7.1	7.7	6.7	6.8
Inflation, CPI, year average, % (1)	6.7	5.4	4.6	2.1	5.1	4.3
General gov. balance / GDP, % (1)	-9.1	-8.3	-8.1	-7.4	-7.6	-7.5
General gov. debt / GDP, % (1)	85.3	85.4	84.3	84.4	83.3	82.6
Current account balance / GDP, % (1)	-2.0	-0.7	-0.6	-0.7	-1.9	-1.6
External debt / GDP, % (1)	18.6	16.8	19.8	20.1	20.0	19.8
Forex reserves (excl. gold), USD bn	498	552	552	560	536	545
Forex reserves, in months of imports	6.7	7.5	6.8	6.7	6.2	6.3

TABLE 1

(1) Fiscal year from April 1st of year N to March 31st of year N+1
e: ESTIMATES & FORECASTS

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Inflationary pressures below 2022 level

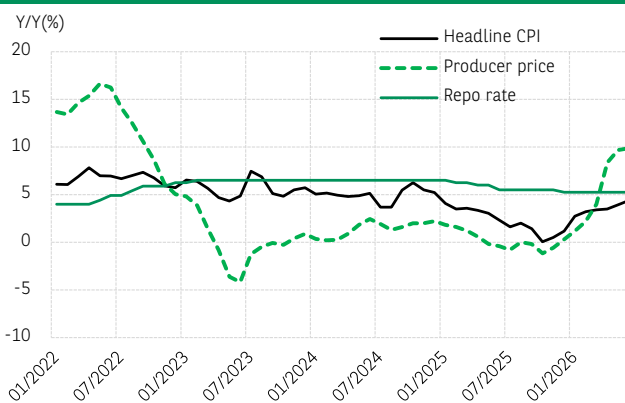


CHART 1

SOURCE: RBI, BNP PARIBAS

Although still modest and slightly lower than during the previous energy shock, the current account deficit will not be covered by foreign direct investment (FDI), thereby increasing the need to attract portfolio investments. Over the past five years, net FDI inflows have averaged just 0.5% of GDP annually, while the current account deficit stood at 1.2% of GDP. The country's reliance on portfolio investments to meet its external financing needs has gradually increased. However, in a climate of uncertainty, the appeal of emerging markets is fundamentally diminished. Since the start of the Middle East conflict, portfolio investment outflows from India have reached



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levels not seen since the pandemic, amounting to 2.4% of GDP on an annualised basis between March and May 2026, thereby intensifying downwards pressure on the rupee. The central bank's efforts to mitigate currency depreciation resulted in a USD 32 billion reduction in foreign exchange reserves between March and June 2026, marking a 5.6% drop, the most significant among Asian emerging markets.

Moreover, this did not prevent the rupee from recording one of the worst performances in Asia. In mid-May, it neared INR 97 per USD 1 (compared to below INR 90 at the start of the year) before rebounding due to measures taken by Indian authorities and a reduction in oil prices. However, risks of renewed pressure on the rupee remain high as illustrated by tensions recorded mid-July and are closely linked to fluctuations in energy prices and US monetary policy.

To address the widening current account deficit and promote foreign investment inflows, the central bank and government have implemented several measures: i) increased taxes on gold and silver imports, ii) shortened the legal timeframe for repatriating foreign exchange earnings by Indian exporters, iii) eliminated or reduced specific taxes for foreign investors holding sovereign bonds, and iv) created a more favourable environment to attract foreign currency deposits from non-resident Indians by mitigating exchange rate risk.

The risk associated with foreign currency refinancing remains manageable. Although declining, foreign exchange reserves still cover 1.5 times the country's short-term external financing needs and 6.3 months of goods and services imports (Chart 2). At the end of 2025, external debt stood at just 20.2% of GDP, with debt servicing accounting for only 5.8% of goods and services export revenue. Furthermore, although government debt is high (84.4% of GDP), it is largely insulated from exchange rate risk, as only 4.4% is denominated in foreign currency. Additionally, since nearly 97% is held by residents, it is only slightly susceptible to fluctuations in foreign investor sentiment.

RISK OF FISCAL DEFICIT SLIPPAGE

Public finances are structurally fragile due to one of the lowest tax bases in Asia and one of the highest interest burdens (second only to Pakistan). Consequently, the government has limited fiscal leeway to mitigate the impact of the energy shock on the economy. Nevertheless, the government is in a more comfortable position than during the 2022 energy shock. In particular, budget deficits have been reduced. For FY2025/2026 (ended March 2026), the central government deficit was cut by 0.5pp to 4.4% of GDP (down from 6.7% in FY2021/2022), while the general government deficit is estimated at 7.4% of GDP (down from 9.5% in FY2021/2022).

To mitigate the shock's impact on households, the government initially kept petrol prices unchanged. Refining companies absorbed the financial loss, which was partially offset by lower excise duties on petroleum products. It was only in mid-May, after regional elections, that the government passed on a small percentage of the rise in international prices to prices at the pump. Additionally, to lessen the impact of higher fertiliser prices on farmers, the government raised subsidies.

Budget revenue losses attributed to i) lower excise duties, ii) reduced dividends from public enterprises, and iii) the economic slowdown could reach 0.5% of GDP. Meanwhile, fertiliser subsidy costs could rise from 0.4% to 0.8% of GDP.

FX reserves still comfortable

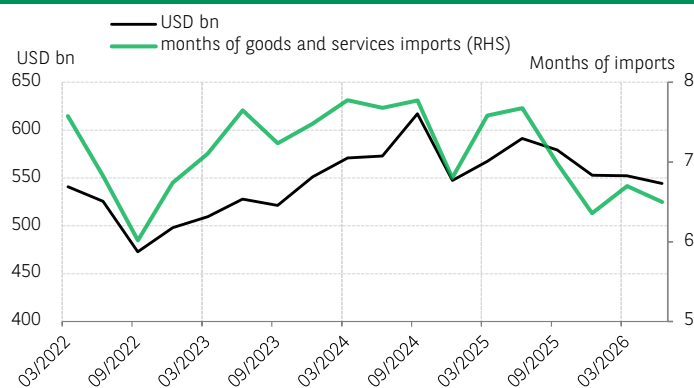


CHART 2

SOURCE: RBI, BNP PARIBAS

In an effort to mitigate the risk of fiscal slippage, the government has raised taxes on fuel exports and limited household diesel purchases. It is also expected to suspend some expenditures. However, these measures are unlikely to be adequate to achieve its 0.1pp deficit reduction target. The overall deficit is projected to rise by 0.2pp to 7.6% of GDP. The main concern regarding fiscal slippage is the potential increase in bond yields. Although still manageable (10-year yields rose by 45bps between January and mid-July), yields could climb further if inflationary pressures or downward pressures on the rupee force the central bank to hike rates. This would further increase debt interest payments (projected to reach 3.6% of GDP in FY2025/26, equivalent to 36.7% of budget revenue) and reduce the government's capacity to boost investment spending.

BETWEEN ENERGY DIVERSIFICATION AND RELIANCE ON THE GULF

The energy shock is expected to expedite India's ongoing shift towards i) speeding up solar and nuclear energy development to lessen oil dependency and ii) increase energy stockpiles, particularly by expanding domestic storage capacity in collaboration with the United Arab Emirates (UAE). However, despite India's efforts to diversify its oil sources, the Middle East will likely remain its primary supplier. Imports from Russia, Africa and Venezuela cannot fully replace Middle Eastern oil due to factors such as geographic proximity, lower transport costs, refineries designed to process Gulf crude, and strategic ties with the UAE.

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