ECOINSIGHT

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COUNTRY RISK PROFILE: INDIA

Johanna Melka – November 2026

- Over the past two years, India has demonstrated remarkable resilience in the face of external shocks, while its macroeconomic fundamentals have remained solid.
- India's economic growth is one of the highest among emerging countries and medium-term forecasts are favourable. However, structural constraints on India's development are significant. Its industrial base remains too small to absorb its vast labour force. The country needs to accelerate reforms to address two key structural challenges: i) adapting the services sector to AI, ii) accelerating industrial development.
- India has multiplied Free Trade Agreements to improve its integration in global trade, increase its attractiveness and develop its industrial sector.
- Risk profile: the banking sector has strengthened significantly over the past five years and is supporting economic activity. External accounts are solid with a low external debt and large FX reserves. A major weakness is the government's limited fiscal room for manoeuvre resulting from the very narrow fiscal base and heavy debt interest payments.

Key Indicators

Fiscal year from April 1 of year n-1 to March 31 of year n		2022/23	2023/24	2024/25	2025/26	2026/27f	2027/28f
External solvency	External debt / GDP (%)	19.6	19.1	20.1	20.2	20.9	21.3
	Ext. debt service / G & S exports (%)	80.0	85.7	88.8	88.1	86.5	85.8
External liquidity	Forex reserves (USD bn)	509.7	570.9	567.6	552.3	578.0	608.0
	In months of G & S imports	7.1	7.8	7.6	6.7	6.2	6.4
Financial	Short-term debt / FX reserves (%)	25.8	23.1	24.6	27.0	28.0	27.8
Vulnerability	Short-term external liabilities* / forex reserves (%)	52.5	50.0	49.3	47.7	NA	NA
Activity	Real GDP growth (%)	7.6	7.3	7.2	7.8	7.1	6.9
Imbalances	Inflation (CPI, average, %)	6.6	5.4	4.6	2.1	5.1	4.9
	Budget balance / GDP (%)	-8.7	-8.7	-8.6	-7.8	-7.6	-7.5
	Government debt / GDP (%)	85.1	85.1	84.4	84.6	83.7	83.1
	Current account balance / GDP (%)	-2.1	-0.7	-0.6	-0.7	-1.6	-1.4

Sources: IMF, RBI, BNP Paribas. * Include short-term external debt and the stock of foreign portfolio equity investments.

Level of Development

	2026	Real growth rate (FY22/FY26)
GDP (USD billion)	3908	7.9
GDP / cap (USD)	2670	7.0
Population (million)	1.4	0.9

FC sovereign ratings

S&P	Moody's	Fitch
BBB	Baa3	BBB-

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STRONG RESILIENCE TO EXTERNAL SHOCKS, SOLID MACROECONOMIC FUNDAMENTALS

- Over the past two years, India has demonstrated remarkable resilience in the face of external shocks, while its macroeconomic fundamentals have remained solid.
- In FY2025/2026 (ended in March 2026), India was hit by a sharp rise in US tariffs. However, thanks to supportive fiscal and monetary policies, real GDP grew by 7.8% in FY2026, placing India among the fastest-growing Asian economies.
- For the current fiscal year, the Indian economy is facing rising energy prices (due to the conflict in the Middle East and increased food prices because of an unfavourable monsoon) as well as monetary tightening. Nevertheless, despite these new challenges, real GDP growth is expected to exceed 7%.
- India is currently in a stronger position than it was in 2022 to cope with the new energy shock. The fiscal leeway to support the economy has increased with the decline in the fiscal deficit, and inflation is more contained.
- Although rising energy prices have put pressure on external accounts, FX reserves remain sufficient to cover the country's short-term external financing needs. Yet, downward pressures on the rupee have been significant and could persist in the short term.

  In H1 2026, India's external accounts withstood the rise in energy prices fairly well, notably thanks to the sharp increase in workers' remittances. The widening of the trade deficit was primarily due to the substantial increase in machinery and equipment imports while the oil trade deficit increased only moderately, as the rise in energy prices was offset by a decline in import volumes. However, in H2 2026, the oil trade deficit is expected to widen significantly.

  Additionally, large portfolio outflows have exacerbated downward pressure on the rupee, necessitating interventions by the central bank in foreign exchange markets and the adoption of regulatory measures to support the currency. Although these measures have led to a rebound in the rupee (at least temporarily), inflationary pressures, volatile portfolio investments, and low net foreign direct investments are expected to continue to put pressure on the currency.
- Downward pressures on the rupee and rising bond yields will reduce the government's already limited fiscal capacity to increase public investment and support economic development. However, this will not undermine its ability to refinance its debt, given its safe structure.
- The banking sector is sufficiently robust to cope with the expected rise in credit risks.

STRONG ECONOMIC GROWTH DESPITE STRUCTURAL CONSTRAINTS

- In October 2026, the IMF revised upward India's medium-term growth forecast from 6.5% to 6.8% per year. Nonetheless, to achieve such strong growth performance, India will have to adapt to the challenges posed by artificial intelligence (AI), while its infrastructure and education system are not prepared for it.
- Moreover, India's development remains highly uneven. The middle class is still modest. This is explained by a large informal economy, heavy concentration of employment in low value-added sectors such as agriculture, low participation rates among women and youth, and limited industrial development. All this, in turn, reflects India's weak integration into global value chains.
- India faces two key structural challenges: i) adapting the services sector to AI and ii) accelerating industrial development. Even with progress in sectors such as smartphones and pharmaceuticals, India's industrial base remains too small to absorb its vast labour force. Labour market rigidities and the mismatch between training and business needs are holding back both the creation of quality jobs and industrial development.
- Low net foreign direct investment is a major obstacle. While India attracts new FDI, retention is weak: despite improvements in logistics, governance issues and regulatory barriers have led disinvestments to triple over the past five years.
- India may fail in completing its transition to a higher-value, more industrialised and inclusive economy if reforms do not accelerate significantly. Structural changes could lag behind pressures from its rapidly growing population and fast global technological advances.

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INDIA'S COMPLEX POSITION IN INTERNATIONAL TRADE

Low attractiveness due to unfavourable business environment and limited integration in global value chains

- Despite very strong growth, India's attractiveness is low relative to the size of its economy. The stock of foreign direct investment stood at only 15% of GDP in Q2 2026 compared to 52% of GDP in Vietnam and around 67% of GDP in Thailand and Malaysia.
- This lack of appeal can be attributed to India's still unfavourable business environment and its limited integration into global value chains. India's global market share remains low (1.9% of total world exports of goods), especially in comparison with that of China (16.1% of total exports).
- India has not benefited from the AI boom, since its exports of AI-related goods remain modest (0.5% of its total exports). However, it has benefited from the "China +1" strategy adopted by international companies seeking to diversify their production sources. Smartphone exports by India have increased 6.3-fold over the past five years and accounted for almost 6% of global exports in 2025 compared to less than 1% five years earlier.

To increase its attractiveness and develop its industrial sector, India has multiplied Free Trade Agreements

- Over the past 18 months, India has signed a growing number of free trade agreements – with the European Free Trade Association in October 2025, the United Kingdom in July 2025, Oman in December 2025, and the European Union in January 2026. This should help to develop the industrial base and demonstrates the Modi government's commitment to accelerating India's integration into global trade.

  The sectors most likely to benefit from the recent trade agreement with the EU are electronics and semiconductors, pharmaceuticals and chemicals, textile and renewable energy technologies. But expanding trade agreements without deep domestic improvements in the business environment, governance, education, and infrastructure will be ineffective. India will continue to struggle with investment retention.
- The US-India bilateral trade agreement has not yet been concluded. The two sides reached a framework for an interim Agreement in February 2026, under which the US would apply an 18% reciprocal tariff on Indian goods, with further reductions subject to the successful conclusion of the agreement. As of early October, negotiations are stalled. Key sticking points include market access, particularly in India's sensitive agricultural sector.

COUNTRY RISK PROFILE

Non transfer risk

India's external accounts are solid with a low external debt, moderate current account deficit and large FX reserves. India's net debtor position reached only 5.9% of GDP in Q2 2026. In the short term, external accounts are expected to deteriorate given the rise in energy prices while downward pressures on the rupee should remain high.

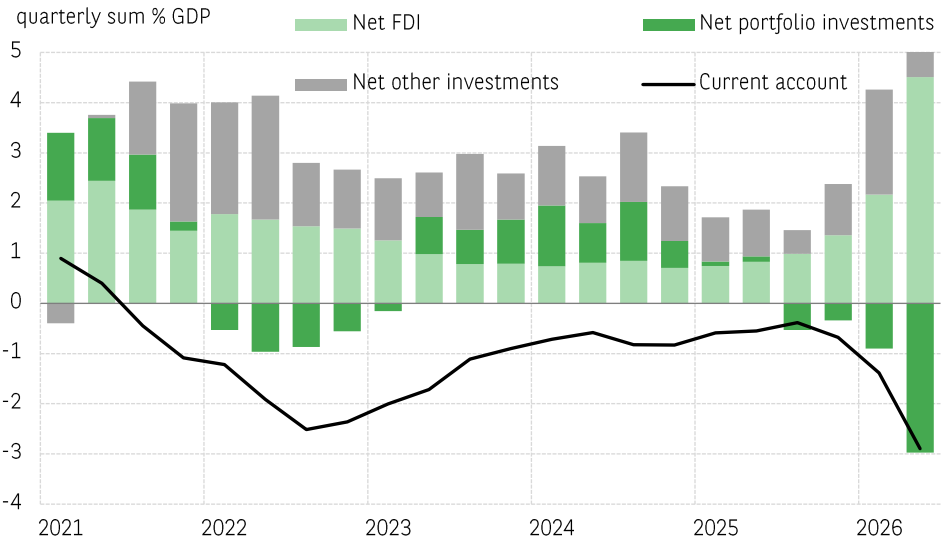
- **External accounts have remained solid despite recent adverse shocks.** In 2025, external accounts remained solid despite the significant increase in US tariffs. In H1 2026, they held up well against rising energy prices. Although the current account deficit is expected to widen for the current fiscal year as a whole, it should remain contained, and foreign exchange reserves should be more than sufficient to cover the country's short-term financing needs. The major causes for concern are the structurally low level of foreign direct investment (although it is rising) and the increased reliance on portfolio investment, which exposes the currency to greater volatility.
- **Structural vulnerability to energy price shock**. India is structurally vulnerable to an energy price shock as its oil and gas trade deficit is relatively high (2.8% of GDP in 2025). However, in H1 2026, the current account withstood fairly well the rise in energy prices especially thanks to the sharp increase in workers' remittances (+0.7 pp to 3.7% of GDP). The trade deficit widened significantly but principally because of the strong increase in machinery and equipment imports rather

than to the rise in the oil bill. The energy trade deficit increased moderately as the rise in energy prices was offset by the decline in imported volumes.

However, the trade deficit is expected to widen further during the rest of the year with the significant rise in oil prices, and the current account deficit is projected to increase to 1.6% of GDP for FY 2026/2027, compared to 0.7% of GDP for FY 2025/2026. This is still modest and slightly lower than during the previous energy shock in 2022.

- **Low net FDIs.** Although rising in H1 2026 (+0.2 point of GDP), net FDI inflows remained low at only 0.5% of GDP and did do not cover the entire current account deficit. In fact, the country's reliance on portfolio investment inflows to meet its external financing needs has gradually increased over the past five years.
- **FX reserves remain very comfortable and represent a solid buffer protecting against external shocks.** Officially, they reached USD591 bn at end-October, covering 6.5 months of imports. However, adjusted for the net short-term forward position (–USD200 bn, ~50% from RBI's dollar swaps for non-resident deposits), "usable" reserves covered only 4.6 months of imports, a historic low. Nonetheless, this constraint is future-oriented, as much of the non-resident deposit dollars are due for repayment in 3–5 years. Additionally, FX reserves still exceed external debt service (estimated at USD 63 bn by the central bank).
- **External debt is low (20.8% of GDP and 87.1% of total exports in Q2 2026).** Banks accounted for the largest share of external debt (30.9% of total), followed by non-financial corporations (29.8% of total). The general government's share reached 22.3%.
- **Currency risk: India is vulnerable to capital outflows and is very exposed to change in US monetary policy.** Its performance will continue to depend on energy prices and the spread between India's and the US government bond yields.

India's current account widened significantly



Source: RBI, BNP Paribas

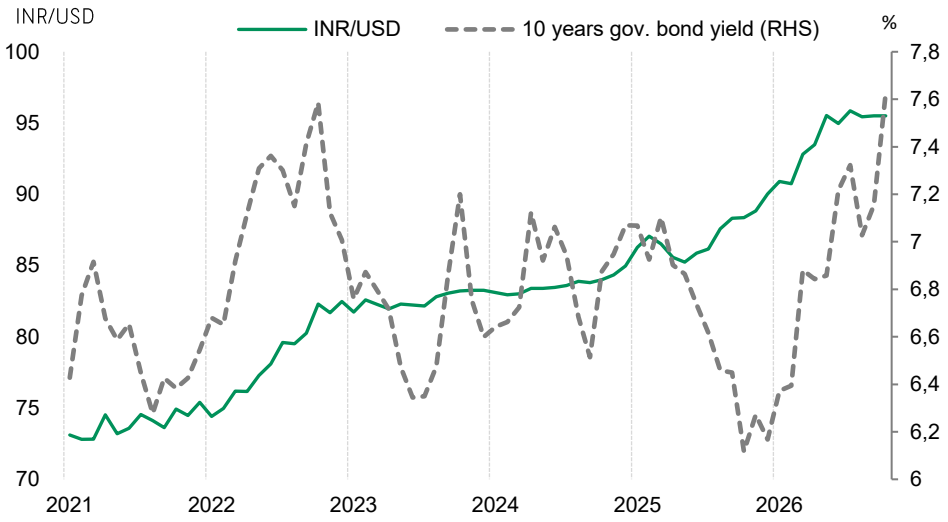
Sovereign risk

Public finances are structurally fragile and fiscal policy room is narrow, as India has one of the lowest tax bases in Asia and one of the highest debt interest burdens (second only to Pakistan). Nonetheless, the debt refinancing risk is limited given its sound profile (debt is denominated in domestic currency and held by domestic investors with a long maturity).

- **In FY2026 (ended in March 2026), public finances continued to improve.** The central government's fiscal deficit narrowed to 4.4% of GDP from 5% of GDP the previous year. However, this reduction stemmed primarily from a significant rise in dividends from the central bank. Government revenues remained low at 9.6% of GDP, with tax revenues stagnant at 7.6% of GDP. Besides, debt-servicing costs climbed to a peak of 3.6% of GDP, equivalent to 37.6% of total government revenues. The fiscal position is stronger than during the 2022 energy crisis, with the general government deficit estimated at 7.8% of GDP in FY2026, compared to 9.5% in FY2021/2022.
- For FY2027, the initial budget targets a slight reduction in the central government deficit, to 4.3% of GDP. This goal may however prove challenging due to rising subsidies amid the energy shock.

  To cushion households from the shock, the government initially kept petrol prices unchanged. Refining firms absorbed the financial burden, partially offset by lower excise duties on petroleum products. Only after regional elections in mid-May did the government allow a modest increase in pump prices to reflect higher international prices. The government has also increased subsidies to offset the impact of rising fertiliser prices on farmers. Revenue losses —driven by lower excise duties, reduced dividends from state-owned enterprises, and the economic slowdown— could reach 0.5% of GDP, while the cost of fertiliser subsidies could rise from 0.4% to 0.8% of GDP. To reduce the risk of fiscal slippage, the government has: i) raised taxes on fuel exports, ii) capped household diesel purchases; and iii) planned cuts to certain expenditures.
- **While the primary deficit reduction target may prove difficult to achieve, the surge in government bond yields is another source of severe concern.** Over the first ten months of 2026, 10-year bond yields rose by 80 basis points, and further increase is expected due to the central bank's monetary tightening. A 100-bp rise in interest rates could push debt servicing costs above 40% of fiscal revenue by 2029. This is expected to increase the debt-to-GDP ratio gradually.

Strong pressures on the rupee and government bond yields



Source: RBI, BNP Paribas

- **Despite the high public debt level (84.6% of GDP in FY2026), refinancing risks remain moderate.** The debt structure is relatively safe, and the government benefits from access to large domestic savings. In Q2 2026, 87.8% of central government debt was domestic, and 70.5% was market debt. It is almost entirely held by domestic financial institutions and denominated in local currency. Refinancing risks are limited as most debt is long term (the average maturity of central government debt is 13.8 years). T-bills (with a maturity of less than one year) account for only 4.2% of central government debt. Foreign investors held only 3.1% of Treasury securities in Q2 2026. Finally, borrowings in foreign currency accounted for only 3.0% of total general government debt in FY2025/2026 (*i.e.* 2.6% of GDP).

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Systemic credit risk

The banking sector has strengthened over the past five years, as illustrated by the improvement in asset quality and capital buffers. The main sources of credit risks are rising household debt, the rise in energy prices, the unfavourable monsoon and monetary tightening.

- **The quality of assets has improved significantly.** In Q1 2026, the banking sector's non-performing loan (NPL) ratio fell to a multi-decade low of 1.8%. For public banks (54.4% of total loans), the NPL ratio declined to 2.1%.
- **Capital buffers are strong.** While loan loss provisions remained modest at 75.6% of NPLs, capital buffers stayed strong. The Capital Adequacy Ratio (CAR) rose to 17.7% in Q1 2026, up from 17.4% a year earlier. From April 2027, Indian banks will adopt a new Expected Credit Loss (ECL) framework, requiring earlier provisioning for potential loan losses. In the short term, higher provisioning requirements could push up lending rates and tighten credit conditions while triggering capital raising or targeted government recapitalisation. In the medium term, the reform could strengthen banking sector resilience through earlier recognition of credit risks and more robust loss buffers.
- **Banks' liquidity is comfortable.** It deteriorated slightly in H1 2026 because credit growth outpaced deposit growth; the liquidity coverage ratio declined to a still solid 124% and the loan-to-deposit ratio increased to 83% in Q2 2026 from 79.1% a year earlier. RBI interventions to support the rupee also drained liquidity. Moreover, the deposit mix shifted from low-cost current and savings accounts (CASA) to higher-cost term deposits, pressuring net interest margins. However, since June 2026, liquidity has improved significantly due to RBI measures to attract foreign-currency non-resident (FCNR) deposits.
- **Profitability remains satisfactory.** It has declined since the start of the year, primarily due to narrowing net interest margins, but remains satisfactory. In Q2 2026, the return on assets (ROA) and return on equity (ROE) stood at 1.6% and 13.0%, respectively (IMF data).
- **Private-sector debt is moderate, but its increase needs to be monitored.** It stood at 105.1% of GDP in Q1 2026 (BIS data), compared to 100.1% five years earlier, which is lower than in other emerging Asian economies.

  Non-financial corporate debt was 56% of GDP in Q1 2026. Listed firms' financial positions continued to strengthen amid surging profits, improving their ability to service debt. In Q2 2026, the average interest coverage ratio (ICR) rose to 7.4, up from 6.1 a year earlier. However, the share of companies with an ICR below 1 (insufficient earnings to cover interest costs) increased to 18.5%. Stress remains concentrated in micro-enterprises, agriculture, and energy-intensive sectors (*e.g.*, power, steel, cement, aviation), which are the most exposed to oil-price shocks.

  Household leverage requires monitoring. Although still moderate, household debt increased to 49.1% of GDP in Q1 2026, up from 42.7% five years earlier, driven largely by non-housing retail loans (58.4% of total borrowing).
- **Monetary policy tightening.** Due to rising inflation (+5.5% year-on-year in September) and downward pressure on the rupee, the RBI raised its policy rate by 25 basis points to 5.5% in October 2026 under a "calibrated tightening" stance.
- **The banking sector should remain resilient despite rising risks in the short term.** Due to rising energy prices, a poor monsoon, and monetary tightening, asset quality is expected to deteriorate, particularly for low-income borrowers, micro, and small enterprises. Early warning signs are emerging, with some borrowers starting to miss payments. The stress is concentrated in unsecured retail loans (which account for over half of fresh retail slippages). This could lead to new NPLs over the coming quarters, especially as higher rates and inflation squeeze repayment capacity. Additionally, in the near term, capital inflows may remain weak, and liquidity and funding pressures could intensify.

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