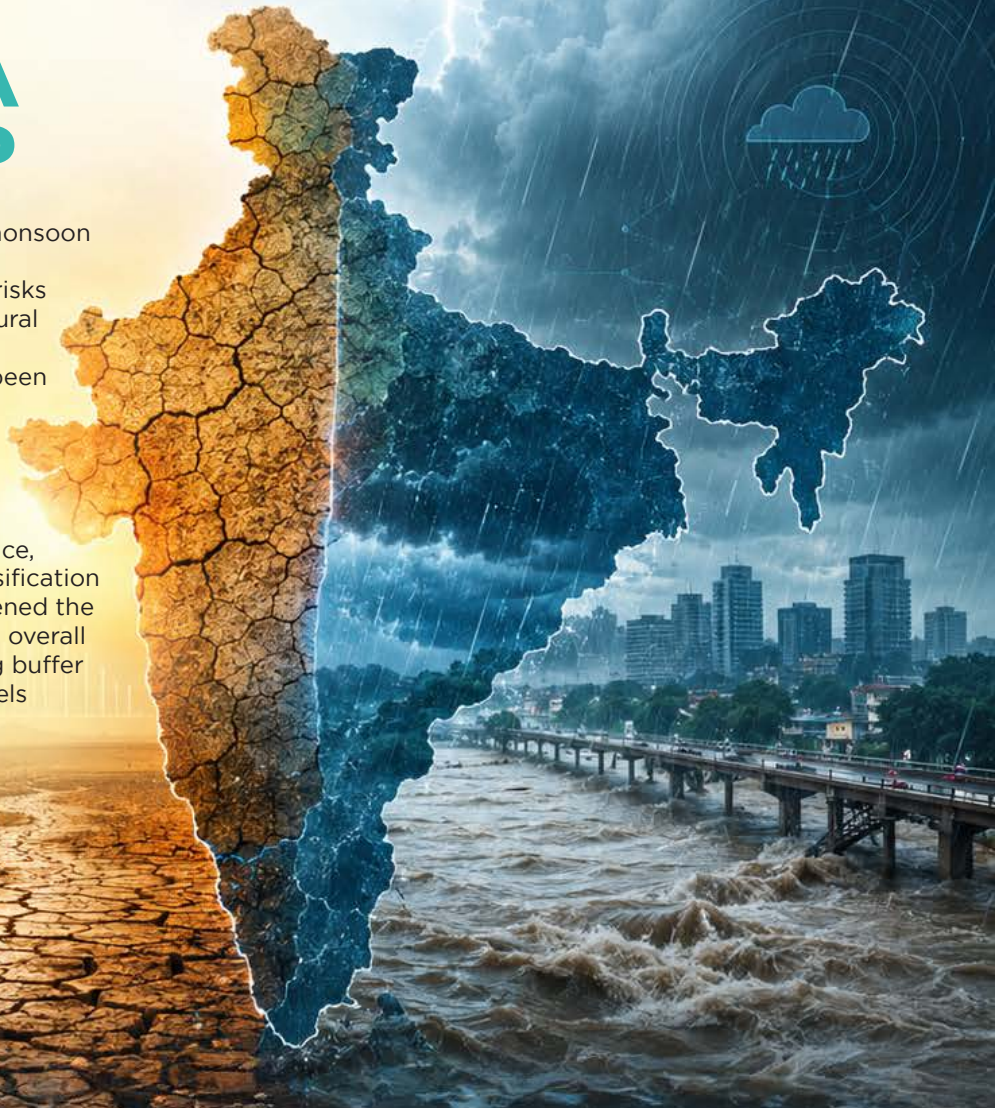


EL NIÑO 2026 - IS INDIA READY?

The projected below-normal monsoon and high likelihood of El Niño conditions in 2026 pose clear risks to India's agricultural output, rural incomes, and food prices. Historically, such events have been associated with weaker agricultural growth and sporadic spikes in inflation. However, structural changes in the economy—particularly reduced agricultural dependence, expanded irrigation, and diversification within agriculture—have weakened the direct link between rainfall and overall economic performance. Strong buffer stocks and better reservoir levels further enhance resilience.



FORESIGHTS

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June 2026



MERC's ToD Change: Peak Power Costlier, Solar Cheaper



Fertiliser Sector: West Asia Crisis Impact



Indian Banks Well Positioned to Implement ECL Norms

NOTE FROM SACHIN GUPTA

Chief Rating Officer & Executive Director



From Shock to Strategy: India's Policy Response to External Volatility

Recent developments in West Asia, while showing early signs of stabilisation, have already stress-tested India's macroeconomic resilience. The episode exposed the economy's continued sensitivity to external shocks, particularly through energy prices, capital flows, and currency pressures.

The rupee had been under pressure due to declining Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). This vulnerability has been further compounded by the West Asian crisis, a surge in crude oil prices, and severe supply chain disruptions affecting natural gas and fertilisers. The resulting pressure on the current account deficit (CAD) and the balance of payments has forced the government and the Reserve Bank of India (RBI) to intervene actively to stem dollar outflows and attract fresh capital inflows. While the immediate trigger may be easing, the policy response offers deeper insight: India is not merely reacting to episodic disruptions but actively strengthening its external-sector defences against recurring global volatility.

Tactical Moves and Structural Interventions

Initial tactical measures, including higher import duties on gold and export taxes on petroleum products, provided little relief. Recognising the need for deeper structural reforms, the government and the RBI launched a coordinated strategy to attract foreign capital directly.

Key initiatives include:

- Incentivising Foreign Currency Non-Resident (FCNR) deposits to attract stable diaspora capital. The RBI will provide a concessional hedge to commercial banks for mobilising fresh deposits, up to September 30, 2026, with a tenor of 3-5 years, effectively absorbing principal hedge cost for these deposits. RBI has

also exempted FCNR(B) deposits from SLR and CRR. This will result in efficiency of up to 4%, and most banks have passed on part of these benefits to depositors by increasing the rates on such deposits by up to 200 bps. RBI has also allowed leverage against these eligible deposits.

- Providing a hedge to Public Sector Undertakings (PSUs) and commercial banks for ECB (with maturity between 3-5 years) at a concessional rate of 1.5%.
- Eliminating withholding and capital gains taxes on Government Securities (G-Secs) to boost global investor participation.

These measures are likely to attract inflows of more than USD 50 bn.

The Inflationary Paradox and Domestic Headwinds

The primary challenge of this strategy lies in a classic macroeconomic paradox: attracting large dollar inflows requires the central bank to release corresponding rupee liquidity, thereby risking the fuelling of domestic inflation.

This liquidity risk is compounded by severe supply-side vulnerabilities. An emerging El Niño threat looms over the monsoon season, heightening the risk of food inflation. Furthermore, the retail economy has yet to absorb the impact of global energy prices fully. State-run oil marketing companies are currently holding back an estimated Rs 15-20 per-litre pump price hike. As the government inevitably transitions towards gradual price corrections, broader inflationary pressures will intensify. Consequently, the RBI is unlikely to ease policy interest rates anytime soon. This domestic stance mirrors global realities, with the U.S. 10-year Treasury yield remaining high at above 4.5%, driven by fiscal expansion and sticky inflation in the world's largest economy.

Resilience Amidst Uncertainty

Despite a flat immediate outlook, India's core economic indicators show remarkable resilience. Corporate profitability is rebounding across key sectors. Bellwether industries like Automotive and Banking are reporting material improvements, defying tariff overhangs and global trade friction. This corporate strength is anchored by a sturdy Q4 GDP growth rate of 7.8%.

Ultimately, India is entering a transient phase with risks of wider fiscal deficits, elevated inflation, and restrained government spending. However, because this crisis is strictly event-driven rather than structural, a resolution to the West Asian conflict could brighten India's economic horizon just as quickly as it darkened.



NOTE FROM RAJANI SINHA

Chief Economist

India's GDP Growth: A Positive Surprise!

India's GDP growth for Q4 FY26 at 7.8% has come as a positive surprise in midst of the lingering West Asia crisis. The West Asia crisis started in March and hence there has not been much adverse impact of the crisis on this quarter's growth numbers. While all segments of the economy have recorded healthy growth, it is specifically worth highlighting the sustained strong growth in services sector. The services sector has recorded strong growth of 9.9% in Q4 FY26. From the expenditure side, there has been a sharp jump in investment growth to 10.8%. It is interesting to note that this jump in investment growth has been achieved, despite weak capital expenditure by Centre in the fourth quarter. Hence, this could reflect pick up in capex by private sector or household sector (through dwellings).

The full impact of the West Asia crisis will be felt in FY27. There are also concerns around projection of poor monsoon this year. However, it is to be noted that the adverse impact of weak monsoon on India's economy has relatively reduced over the last decade. RBI has lowered India's GDP growth projection for FY27 to 6.6% and increased the average inflation projection to 5.1%, broadly in line with our projections. Given the fluid global environment, the Central Bank opted to maintain a status quo on policy interest rate, which was very much in line with market expectations. The inflationary pressure in the economy is currently due to supply side factors and hence the Central Bank can see through it. However, going forward, depending on the growth and inflation dynamics a policy rate hike towards the end of the year cannot be ruled out.

Despite positive developments around the West Asia crisis, the elevated energy prices would still lead to slippage in the current account deficit to 2.1% of GDP in FY27. However, it will still be relatively better compared with some of the previous episodes of stress. For instance, during the 'taper-tantrum and Fragile five episode', India's CAD averaged 3.6% of GDP (FY12-14).



The weak capital flows into the economy are concerning. Since the beginning the crisis, we have seen FII outflows of around USD 29 billion. Moreover, the net FDI flows have also been relatively feeble. Measures like expansion of FAR securities and removal of taxes on capital gains and interest for foreign investors in government securities should help increase FII inflows into the debt market. Overall, measures announced by the government and Central Bank to attract capital flows into the economy are steps in the right direction. This should also help ease pressure on Indian rupee. We expect Indian currency in the range of 92-94, assuming global crude oil prices move in the range of USD 90-100/bbl during the year.



EL NIÑO 2026 – IS INDIA READY?

The India Meteorological Department (IMD) has projected that rainfall during the June–September 2026 southwest monsoon season will stand at 90% of the Long Period Average (LPA), indicating a below-normal monsoon. This marks a downward revision from an earlier estimate of 92% and is accompanied by a probability distribution strongly skewed toward deficient rainfall. Concurrently, oceanic indicators suggest the development of El Niño conditions during the monsoon period, with a very high likelihood of a “moderate” or stronger El Niño episode materialising during the monsoon months.

Historically, El Niño has been associated with weaker monsoons in India, though this relationship is not deterministic. Out of 25 El Niño episodes since

1951-52, most coincided with below-normal rainfall, especially when the event was moderate or stronger (Exhibit 1). Specifically, 12 of 16 moderate-to-strong events resulted in deficient or below-normal rainfall.

Rainfall and Output: An Important but Weakening Linkage

Deficient rainfall has had a direct bearing on agricultural output and overall economic growth. Of the 23 years since 1951-52 in which agricultural gross value added (GVA) declined, 13 occurred during El Niño years, accounting for nearly 57% of such contractions. Overall, GVA growth was also lower in El Niño years than in Non-El Niño years.

However, a key finding is that the relationship between rainfall variability and economic growth has weakened over time. 20-year rolling regressions show a declining sensitivity of both agricultural and overall GVA growth to rainfall deviations. Several structural factors explain this shift. Agriculture’s contribution to GVA has declined significantly from 53% in FY1951 to 17% in

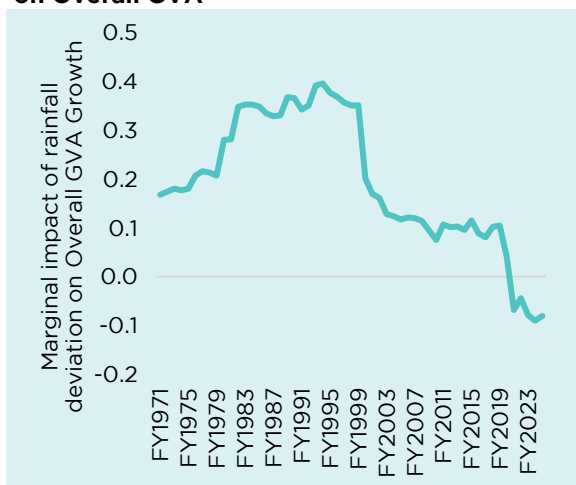
Average Annual GDP Growth and Agri Production During El Niño and Non-El Niño Years

1951-52 to 2024-25	No. of years	Rainfall Deviation from LPA (%)	Average Agriculture GVA growth	Average Overall GVA growth
Weak El Niño Years	9	-4.6	1.1	4.3
Moderate El Niño Years	9	-5.5	1.0	5.2
Strong El Niño Years	4	-13.2	-5.6	-0.9
Very Strong El Niño Years	3	-7.0	-0.7	5.1
Total El Niño Years	25	-7.6	-1.1	3.4
Non-El Niño Years	49	1.5	4.7	5.6

Source: IMD, NOAA, MoSPI, CMIE CareEdge

FY2026, while services have expanded from about 36% to 55%. Therefore, a lower share of GVA is now directly at risk of rainfall variability. The irrigated area has also expanded. As a percentage of gross sown area, gross irrigated area has increased from 17% in FY1951 to 60% in FY2024. Finally, the government’s efforts to promote sustainable farming and crops that require less water, such as millets and pulses, may also be helping reduce the dependence of output growth on rainfall. While the linkages between rainfall variability

Evolving Trend in Effect of Rainfall Deviation on Overall GVA



Source: CareEdge analysis based on data from IMD and MoSPI, CMIE;
Note - Marginal impact of rainfall deviation is measured by the coefficient estimated using 20 year rolling regressions of rainfall deviation on GVA and agriculture GVA, respectively.

and agricultural and overall growth have been weakening, the disruptions in the sector can still cause marked distress. The agricultural sector still absorbs the largest, albeit declining, share of India’s workforce. As per the Periodic Labour Force Survey 2025, agriculture employs 43% of the total working population, down from 46% in 2022. Similarly, while it is noteworthy that the share of households’ income in the agricultural sector derived from crop production declined from 63% in FY2012 to 53% in FY2024, it remains substantial.

Rainfall and Inflation

The second major channel through which El Niño and lower rainfall affect the economy is food inflation. The relationship between deficient rainfall and inflation, however, is more nuanced than that between deficient rainfall and output.

Historical evidence shows that while some episodes of deficient rainfall have coincided with higher wholesale price index (WPI) food inflation, this has not been consistent. For instance, despite a very strong El Niño in 2015-16 and deficient rainfall, food inflation remained subdued due to strong buffer stocks, supply-side measures, and stable global commodity prices. Nonetheless, several risks remain.

El Niño conditions are often linked to heatwaves and erratic weather, which can heighten inflationary pressures in perishables such as fruits and vegetables. Tomatoes, onions and potatoes—key drivers of seasonal spikes in retail food and headline inflation—may be particularly exposed. Pulses are also vulnerable, as El Niño years have historically weighed on acreage and yields. A NITI Aayog report notes that 15 such episodes since 1951 were associated with declines in pulse acreage and productivity. Imported food inflation is another channel to watch, especially for commodities sourced from El Niño-affected countries. India’s palm oil imports, largely from Malaysia and Indonesia, remain exposed to weather disruptions in these markets, which could lift domestic prices.

Preparedness and Mitigating Factors

India is currently better prepared to handle El Niño-related disruptions compared to previous episodes. As of May 2026, reservoir storage stood at 30.4% of full capacity, higher than the 25.1% average observed in recent El Niño years. This enhances irrigation capacity and reduces dependence on rainfall.

In addition, foodgrain buffer stocks—especially wheat and rice—are at record highs, which can help stabilise prices even if production declines. Government contingency planning and early interventions further strengthen resilience at the macro level. These factors suggest that while risks remain, especially at localised levels, the overall economic impact of El Niño is likely to be manageable.

State-wise Poor Monsoon Resilience Index (SPMRI)

While national-level indicators show improved resilience, vulnerability varies significantly across states. To capture this heterogeneity, we have constructed the State-wise Poor Monsoon Resilience Index

¹<https://niti.gov.in/sites/default/files/2025-09/Strategies-and-Pathways-for-Accelerating-Growth-in-Pulses-towards-the-Goal-of-Atmanirbharta.pdf>

(SPMRI), a composite measure based on six parameters: (i) Irrigation coverage, (ii) Share of agriculture in overall GVA; (iii) Share of non-crop activities in agricultural GVA; (iv) Share of water-intensive crops (rice and sugarcane) in kharif output; (v) Average historical rainfall deviation from LPA; and (vi) Regional reservoir levels. Each state is assigned a score from 0 to 100 using min-max normalisation, with higher scores indicating greater resilience. The index incorporates weighted contributions from all parameters to generate a composite measure.

Patterns of State-Level Vulnerability and Resilience

The SPMRI reveals considerable variation across states. Odisha, Chhattisgarh, Madhya Pradesh, and Uttar Pradesh emerge as relatively more vulnerable to an El Niño shock. Odisha and Chhattisgarh face low irrigation coverage (31% and 32%, respectively, compared to the national average of 60%) and a high dependence on water-intensive kharif crops, increasing their exposure to rainfall deficits. Madhya Pradesh shows limited diversification into allied agricultural activities, heightening reliance on crop output. At the same time, Uttar Pradesh, despite better irrigation coverage, remains vulnerable due to its heavy skew toward water-intensive crops and a lower share of non-crop agricultural activities.

In contrast, Gujarat, Telangana, Haryana, and Rajasthan are the major states that appear better positioned to handle such disruptions. Gujarat benefits from a lower dependence on agriculture, stronger reservoir levels, and historically favourable rainfall patterns. Haryana and Telangana are supported by well-developed irrigation and significant diversification into livestock, leading to a higher share of non-crop GVA within agricultural GVA, thereby reducing vulnerability to rainfall shocks. Haryana is a leading producer of milk and dairy products,

while Telangana is a leading producer of eggs and meat.

Rajasthan stands out as the most resilient state due to its minimal reliance on water-intensive crops, a high share of non-crop agricultural activities, and a relatively small role of agriculture in its economy. Interestingly, Punjab, despite strong irrigation and reservoir levels, ranks lower in resilience due to its continued dependence on water-intensive crops.

Conclusion and Outlook

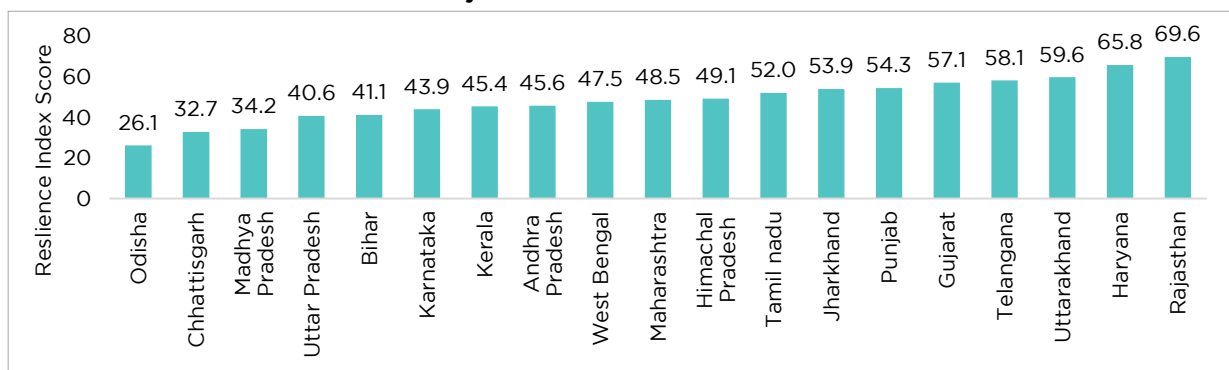
The projected below-normal monsoon and high likelihood of El Niño conditions in 2026 pose clear risks to India’s agricultural output, rural incomes, and food prices. Historically, such events have been associated with weaker agricultural growth and sporadic spikes in inflation.

However, structural changes in the economy—particularly reduced agricultural dependence, expanded irrigation, and diversification within agriculture—have weakened the direct link between rainfall and overall economic performance. Strong buffer stocks and better reservoir levels further enhance resilience.

At the same time, vulnerabilities persist at the state level, as evidenced by the SPMRI. States with low irrigation, high crop dependence, and limited diversification remain particularly exposed to rainfall shocks.

Overall, while the aggregate macroeconomic impact of El Niño is likely to be manageable, localised disruptions—especially in agriculture and food prices—cannot be ruled out. Continuous monitoring of monsoon progress, inflation trends, and region-specific stress points will remain critical in navigating the evolving situation.

State-wise Poor Monsoon Vulnerability Index



Source: CareEdge analysis based on data from IMD, Dept of Agriculture and Farmers Welfare, CWC and MoSPI; Note: A lower score implies the state is relatively more vulnerable; a higher score implies the state is relatively more resilient.



STRUCTURAL SHIFTS IN DEBT MARKET: EMERGING THEMES

The world economy is increasingly surrounded by a fresh set of macro-financial risks marked by elevated geopolitical tensions, fragmented trade linkages, volatile capital flows, and weakening fiscal flexibility across major economies. At the same time, total global debt (general government + non-financial corporations + households) remains at historically elevated levels, around 246% of global GDP by Q3 2025. The challenge is no longer limited to debt accumulation alone. The renewed risk of global financial tightening is intensifying concerns around debt affordability, with likely spillover effects on broader financial markets. Addressing the CareEdge Conversation 'Debt Market Summit' in Mumbai, Mr Tuhin Kanta Pandey, Chairman, SEBI, said that the corporate debt market is central to India's journey for sustained economic growth.

According to the CareEdge Rating's report 'Structural Shifts in Debt Market: Emerging Themes', India's bond market is largely dominated by government securities, with the general government debt securities market accounting for 55.4% of the country's GDP. While this is broadly comparable with some other Asian economies, such as the Philippines (52.1%) and Indonesia (33.6%), it is lower than that of some advanced economies, such as Japan (191.9%), the US (107.5%) and the UK (90.7%).

Limited rollover risks, a well-diversified G-sec maturity profile, and evolving

investor participation by insurance companies and provident and pension funds are some positives for India's government securities market. Despite these developments, several gaps persist, including limited retail and foreign investor participation, lower secondary-market trading volumes, and limited development of sub-sovereign debt securities markets. These gaps will need to be bridged to strengthen the government securities market and align it with global best practices.

Aligning with this view Mr Tuhin Kanta Pandey noted that a growing economy needs patient debt capital for infrastructure, capacity expansion, refinancing, and long-gestation projects. It also requires wider price discovery and broader access to global capital providers. He emphasised that the corporate bond market is the economy's second engine of growth, helping reduce over-reliance on banks. He added that a deep bond market can finance infrastructure, productive capacity, urbanisation, energy transition, housing, and digital infrastructure. India's outstanding corporate bonds have grown from about Rs 17.5 lakh crore at the end of FY16 to over Rs 59 lakh crore today, reflecting a CAGR of around 12%. In FY26, debt issuers mobilised about Rs 9.1 trillion — nearly twice the amount raised through equity issuances. Though, he highlighted that around 6000 companies are listed on NSE and BSE. But only 776 have listed debt.

He also said that while retail investors have widely embraced equities and mutual funds, corporate bonds remain unfamiliar to most households. Citing a SEBI investor survey, he noted that awareness of corporate bonds stands at just 10%, with household penetration below 1%. He emphasised the need for simpler access, better disclosures, stronger fixed-income liquidity, and investor-friendly communication around bonds. He added that SEBI is working with market participants, the Reserve Bank of India (RBI), and the Ministry of

Finance on a market-making framework announced in the Union Budget. SEBI is also exploring a separate regulatory classification for debt brokers to reduce costs and encourage dedicated debt market intermediaries.

He noted that the municipal debt framework is also under review to support pooled financing for multiple municipal bodies and increase retail participation in municipal bonds. Concluding, he said the future of India’s bond market lies in a broad network of reforms spanning market-making, municipal bonds, securitisation, bond indices and derivatives, tokenisation, and investor education. The Debt Market Report has mentioned that as India advances towards becoming a ‘Viksit Bharat’ by 2047, it is critical to have a strong, well-developed financial ecosystem capable of large-scale mobilisation of capital at competitive prices. CareEdge Ratings calls for strengthening the accessibility and depth of the bond market in India, as a deep and robust bond market is paramount for India becoming a ‘Viksit Bharat’ by 2047. It notes that continued reforms will be necessary to enhance market accessibility for both issuers and investors.

Mr Ashishkumar Chauhan, MD & CEO, National Stock Exchange, said that India’s ambition of Viksit Bharat by 2047 would require investments to rise from around 30% of GDP to more than 35%. Bank credit alone cannot carry that burden, and therefore, corporate bonds must play a much larger role. He noted that India’s bond market size stands at 17.1% of GDP, compared with 75.7% in South Korea, 54.7% in Malaysia, and 38.2% in the United States. Corporate bonds currently represent 13.5% of India’s overall domestic debt market – meaningful, but not yet transformational. He noted that the average daily trading volume in corporate bonds reached Rs 9,168 crore in FY26, nearly three times that of Rs 3,180 crore recorded in FY25.

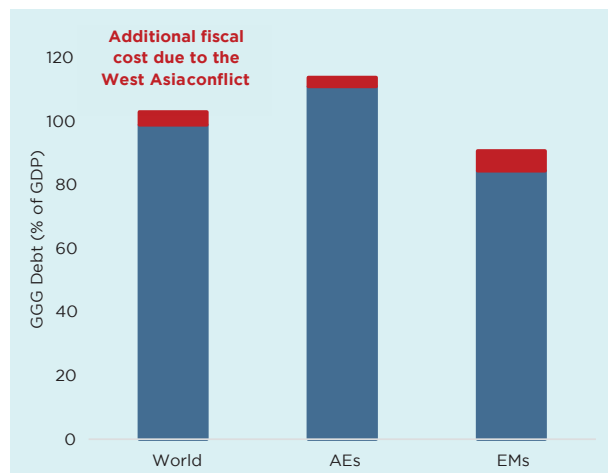
India’s corporate bond market has expanded steadily over the years. However, it remains undersized given the commercial sector’s heavy dependence on bank credit for resource mobilisation. Several efforts have been made to improve India’s bond market; however, it remains relatively small compared with that of the US and China, which dominate the global bond market. Furthermore, the rising appetite for equity capital among Indian investors has also constrained resource mobilisation through debt markets. Preference for private placements, limited foreign participation,

poor liquidity, regulatory restrictions, less competitive tax regime, etc., are some of the challenges faced by the Indian corporate bond market. Several measures aimed at simplifying the regulatory architecture, providing support during periods of financial stress, and developing the credit default swap (CDS) market have been undertaken to strengthen the Indian corporate bond market.

Mehul Pandya, MD & Group CEO, CareEdge, said, “A nation of 1.4 billion people, the fastest growing major economy in the world, a vision of becoming a USD 30 trillion economy by 2047, that is the acceleration of Viksit Bharat. And standing within that ambition and its realisation is a single critical question: how does India finance its future? The answer lies in large part right here in the debt market.”

“As India moves towards its aspiration of becoming a ‘Viksit Bharat’ and achieving a USD 30 trillion economy by 2047, the country will require a deep, resilient, and diversified financial system capable of supporting large-scale long-term investments. In this journey, capital markets—and particularly the bond market—will assume a pivotal role. Their importance becomes even more pronounced at a time when rising geopolitical fragmentation is disrupting global supply chains and increasing vulnerabilities in the external sector,” Pandya further added.

Fiscal Cost Projected to Rise Due to the West Asia Conflict



Source: IMF, Haver Analytics, CareEdge;
Note: Debt numbers are average of IMF projections for 2026-28; additional fiscal cost considers a prolonged West Asia conflict



MERC'S TOD CHANGE: PEAK POWER COSTLIER, SOLAR CHEAPER

What MERC changed in March 2026?

MERC issued a fresh order in March 2026 that, in substance, reinstates several elements of the earlier June 2025 framework. These have been mentioned below -

- The banking window for solar projects was effectively reduced to ~8 hours/day (against ~17 hours earlier)
- The unutilised banked energy would lapse every month, which is in line with green energy open access (GEOA) rules
- Banking is aligned with Time of Day (ToD) principles (drawl allowed only within the same or lower tariff time blocks)

CareEdge Ratings understands that, for the

that peak-hour tariffs for eligible C&I categories be materially higher than base tariffs, while solar-hour tariffs offer meaningful rebates to encourage demand-shifting to hours of abundant renewable generation. Accordingly, the revised ToD tariff structure (charges/rebates) for eligible consumer categories in its final order, as outlined below: -

Impact on C&I Projects

The revised framework has materially altered the economics of open access procurement:

Higher risk of energy lapse weaker cash-flow resilience: Projects structured with oversized solar capacities under the earlier banking framework are likely to face increased risks under the revised regime,

Banking Provisions: Then Vs Now

ToD Slabs	Energy banked during	Earlier Provision regarding banking adjustment		Amended Provision	
		Same ToD Slot	Another ToD Slot	Same ToD Slot	Another ToD Slot
Solar Hours	09:00 hrs to 17:00 hrs	Yes	Yes, except peak hours	Yes	No
Peak Hours	17:00 hrs to 24:00 hrs	Yes	Yes, all other slots	Yes	Yes, all other slots
-	00:00 hrs to 06:00 hrs 06:00 hrs to 09:00 hrs	Yes	Yes, during solar hours	Yes	Yes, during solar hours

Source: MERC order dated March 2026

time being, APTEL has stayed the retrospective implementation of the revised banking provisions; however, settlements from April 2026 onwards are being carried out in accordance with the revised norms. In line with the original MYT order in March 2025, MERC revised the ToD framework, mandating

as restrictions on cross-time-slot banking raise the likelihood of energy lapses and weaken cash-flow resilience. Consequently, credit metrics such as DSCRs may come under pressure, particularly for banking-dependent projects. To mitigate the impact, developers are evaluating multiple strategies. In the third option- BESS Deployment- While the nameplate

tariffs would increase, in CareEdge Ratings’ opinion, the landed tariff during the peak period is likely to be competitive considering that recent bids for 4-hour BESS-linked projects have discovered tariffs in the range of Rs 6-6.5 per unit and the energy charges during the peak period in Maharashtra are likely to be ~Rs 12 per unit.

To limit the potential impact on revenue and cash

continued decline in solar tariffs amid abundant market supply has intensified pricing pressures on existing projects. With banking restrictions limiting the ability to utilise solar power during peak-demand periods, off-takers may seek tariff renegotiations to align with current market rates, potentially impacting project returns and investment viability.

Surplus Power Management: Opportunities and Challenges Across Alternatives

S. No	Alternatives	Pros	Cons
Option 1	Existing off-taker absorbs excess energy	✓ Leverages existing customer relationships and reduces off-take risks	X Tariff renegotiation risk X Likely amendments to existing PPAs
Option 2	Onboarding a new off-taker for surplus energy	✓ Enables monetisation of surplus energy	X Tariff renegotiation risk X Contractual risks as supplementary PPAs required X Regulatory approvals for captive compliance (51% off-take requirement)
Option 3	BESS Deployment	✓ Shifts excess generation to peak hours ✓ Enhances renewable utilisation and grid flexibility	X Higher Tariff X Capacity augmentation X Contractual risks as supplementary PPAs required X Regulatory approvals X Captive compliance requirements

flow arising from the revised banking provisions, developers are likely to adopt a combination of the mitigation measures discussed above, depending on commercial feasibility and stakeholder negotiations. Therefore, developers may need to pursue a mix of contractual restructuring, new bilateral arrangements, and storage deployment to manage the extent of losses and maintain project viability.

Reduced Competitiveness of PPAs: Even for projects that do not rely on banking provisions, the revised framework poses challenges, as ToD-linked rebates during solar hours lower effective grid tariffs, making them more competitive than existing long-term PPAs and potentially shifting C&I consumers toward shorter-term and more flexible procurement strategies. According to CareEdge Ratings’ assessment, the revised ToD regime is likely to compress margins of safety across renewable open-access projects, with group captive projects moderating to 20-30% from 30-40%. In contrast, third-party open-access projects may see margins decline to low single digits, affecting their long-term competitiveness and viability.

Heightened risk of tariff renegotiation: The

CareEdge Ratings’ View

“The MERC order is expected to align tariffs with utilities procurement costs better and ease the financial burden on distribution companies through restrictions on flexible banking and revised ToD rebates. However, it could adversely affect open-access developers and may bind stakeholders to reassess PPAs, optimise consumption-linked procurement, and explore mitigation strategies. Other states could also adopt similar regulatory measures,” stated Jatin Arya, Director, CareEdge Ratings.

“This order is expected to increase peak-hour power procurement costs for off-takers and pressure the viability of renewable energy projects due to reduced banking benefits. While mitigation options are available, their implementation is likely to be gradual. In the interim, cash flows of affected projects may weaken. However, those with strong liquidity, limited banking exposure, and sponsor support are expected to remain relatively resilient,” stated Prachi Gupta, Associate Director, CareEdge Ratings.

RBI POLICY: STATUS QUO MAINTAINED AMID ELEVATED UNCERTAINTY



In line with CareEdge Ratings' expectations, the RBI's MPC kept the policy rate and stance unchanged, adopting a data-dependent approach amid an increasingly uncertain global environment. The decision reflects the RBI's wait-and-watch approach to assess the evolving impact of external developments and their implications for domestic growth and inflation before going for interest rate adjustments. Amid elevated energy prices, the risk of a below-normal monsoon, and persistent supply-side bottlenecks, the RBI has revised its FY27 GDP growth forecast downward to 6.6% from 6.9% earlier, with a more pronounced moderation expected in the second half of the fiscal year. On the inflation front, the RBI has projected CPI inflation to average at 5.1% for FY27, up from the earlier forecast of 4.6%, citing twin risks arising from expected below-normal monsoon amid El Niño conditions and elevated energy prices. Furthermore, it also emphasised the risks stemming from the second-round effects of higher WPI inflation. With this revision, RBI's growth and inflation projections for FY27 broadly align with our estimates.

Another key highlight of the MPC policy was the announcement of measures to attract foreign capital inflows, such as expanding the universe of securities eligible under the Fully Accessible Route for foreign investors, providing concessional forex swap facilities for PSUs raising ECBs, and absorbing hedging costs on FCNR(B) deposits. These measures should support forex inflows and the balance of payments position. Additionally, the government has also removed taxes on capital gains and interests for foreign

investors in government securities. While the current account deficit is expected to widen to 2.1% of GDP in FY27, it is better than levels seen during previous episodes of stress, such as the taper-tantrum episode, when it averaged 3.6% of GDP. The weakness in the rupee in the current context largely stems from the sustained foreign investment outflows. We expect foreign investment inflows at 0.5-0.6% of GDP in FY27, much lower than the average of 2% of GDP seen during the taper tantrum episode. The measures announced today by both the RBI and the government should ease pressure on the rupee. If global crude oil prices average around USD 90/bbl in FY27, we expect the rupee to average 92-93 against the US dollar.

Looking ahead, the situation remains fragile amid the ongoing conflict in West Asia, with intermittent flare-ups highlighting persistent geopolitical risks. Against this backdrop, the MPC's decision to adopt a wait-and-watch approach appears prudent, given the simultaneous pressures on both growth and inflation in an increasingly stagflationary environment. It is important to note that much of the inflation risk stems from supply-side shocks rather than from overheating domestic demand. The future trajectory of policy rates will largely depend on the MPC's assessment of evolving growth-inflation dynamics, which remain significantly influenced by external factors. Though there have been positive developments around the West Asia tensions, the situation remains fluid. If the external environment stabilises quickly, the MPC may choose to look through the near-term spike in inflation, particularly as projected growth in FY27 remains below the potential rate of around 7%. However, if inflationary pressures become entrenched in household expectations, the possibility of rate hikes toward the latter part of the year cannot be ruled out.



FERTILISER SECTOR: WEST ASIA CRISIS IMPACT

India's fertiliser value chain remains significantly import-dependent for key raw materials, including ammonia, phosphoric acid, rock phosphate, sulphur, and natural gas, as well as finished products, including Urea and Di-ammonium phosphate (DAP). India imports over 80% of its ammonia and sulphur requirements from Gulf countries, while Rock Phosphate and Phosphoric Acid are mainly procured from African countries. In FY26, 85% of the gas required by the fertiliser sector was met through imports, while domestic sources accounted for the balance. India remains heavily dependent on Gulf countries for meeting its gas requirements, which cumulatively account for 63% of our gas imports, with Qatar accounting for 45% of those imports.

Import dependency on West Asia for Urea remains high at 37%, with a major share from Oman (17%), followed by Qatar (8%). In contrast, for DAP, import dependency is estimated at ~68% for FY26, with Saudi Arabia contributing 40% of DAP imports in 10MFY26, followed by Morocco and China.

The fertiliser sector remains vulnerable to supply disruptions, amidst the West Asia conflict and the blockage of the Strait of Hormuz. While the Government of India has ensured comfortable fertiliser stock levels, the timing of shipments and product-specific availability shall remain crucial. Stocks as of

March 31, 2026, stood at ~40% of the estimated kharif season requirement of ~390 LMT, improving to ~49% in April 2026, versus a normal level of 33%. Higher stock levels should help soften the immediate risk of a supply squeeze.

Conflict and resultant supply disruptions have led to a sharp increase in prices. In April 2026, urea prices increased by ~85% MoM to \$950/tonne, while DAP rose by ~30% MoM to \$900/tonne. Ammonia prices have risen by ~60% and sulphur prices by ~50%, while spot prices for imported natural gas have risen from ~\$10/mmbtu to over ~\$15/mmbtu in April 2026, increasing production costs across the sector. Amid a rise in prices, the FY27 subsidy requirement is expected to exceed the budgeted allocation, potentially necessitating significant supplementary grants. The sector is entering this challenging phase from a stronger credit position, supported by timely subsidy releases in recent years.

"After a steady performance for three years ending FY26, the fertiliser sector is entering FY27 amid a challenging operating environment. Movements in global raw material prices, including gas prices, shall influence the profitability of fertiliser companies, especially NPK players," said Rabin Bihani, Associate Director, CareEdge Ratings.

"Timely subsidy releases in recent years have reduced receivable build-up and supported working capital management of fertiliser companies. Cost escalations and expectation of a below-normal monsoon in CY26 could keep the sector on edge and increase the subsidy budget requirement. Furthermore, elevated prices as well as any delay in subsidy release will also lead to increased borrowings by the sector for meeting its working capital requirements," said Hardik Shah, Director, CareEdge Ratings.



LOW R&D SPEND TO HAMPER INDIA'S MANUFACTURING GROWTH

India lags its Asian peers in manufacturing-driven industrial expansion. India's manufacturing output increased from ~US\$328 billion in 2015 to ~US\$493 billion in 2024; however, its share of GDP declined from 16% to 13% as the services sector grew faster. China and South Korea have sustained a manufacturing share of ~25-27% while Vietnam and Bangladesh have expanded manufacturing through export-led and low-cost models.

R&D spending is concentrated primarily in a few sectors in India, with limited broader investment. R&D is not yet a strategic priority for Indian corporates. Low R&D investment limits advanced manufacturing in India, keeping the economy focused on low- to mid-tech production and making it harder to compete with innovation-driven exporters, including China, South Korea, and developed economies.

Innovation Ecosystem Gaps

- 1. Low Researcher Density and Patent Output:** India's research base per capita remains significantly lower than that of developed economies, leading to limited innovation output, a low patent share (~4% globally), and weak commercialisation. Talent outflow further reduces innovation capacity.
- 2. Limited Private Sector Participation:** In advanced economies, 60-80% of R&D is driven by the private sector. In India, the government accounts for over 60% of R&D spending. Corporate reluctance stems from long gestation periods, high capital risk and preference for imported technologies.

- 3. Structural Constraints:** Government spending is largely directed toward infrastructure, welfare programmes and defence, thereby limiting investment in deep tech and advanced manufacturing.

Way Forward

- 1. Strengthening Education and Industry Linkages:** Improving manufacturing requires significant investment in science, technology, engineering, and mathematics, as well as stronger Industry-Academia integration. Although education spending is ~4-4.6% of GDP, low per capita spending (~Rs 6,000) limits skill development, particularly in technical and vocational training.
- 2. Enabling Private Sector R&D:** Enhancing R&D requires tax incentives, improved access to risk capital, and performance-linked funding to encourage corporate innovation and commercialisation. Strong institutional support for startups and manufacturing firms is essential.
- 3. Building Integrated Industrial Ecosystems:** Sustained competitiveness requires moving beyond isolated projects to integrated clusters that combine suppliers, labour, infrastructure, and R&D. Countries such as China and South Korea have demonstrated how such ecosystems drive innovation and efficiency.

Conclusion

"India should target to increase its R&D spend to ~2% by 2035 in line with its Asian peers, to enhance the share of manufacturing in GDP, which will require greater private-sector participation, stronger innovation ecosystems and improved research-to-commercialisation pipelines," says Ranjan Sharma, Senior Director, CareEdge Ratings.

"India's manufacturing growth has been largely volume driven so far, but sustaining global competitiveness will require a decisive shift towards innovation and R&D led industrialisation," says Krunal Modi, Director, CareEdge Ratings.

INDIAN BANKS WELL POSITIONED TO IMPLEMENT ECL NORMS

The shift from the Income Recognition, Asset Classification and Provisioning (IRACP) framework to a more forward-looking Expected Credit Loss (ECL)- based provisioning regime establishes a more anticipatory and risk sensitive credit loss recognition mechanism. This shift places Indian banks on par with their global counterparts and aligns domestic prudential standards with internationally accepted financial reporting and Basel III norms.

ECL Framework

Under the ECL framework, banks would use a general approach consisting of three functions - probability of default, loss given default, and earnings at default that conforms to the instructions and principles outlined in these Directions. Under the ECL norms, banks will be required to assess at each reporting date whether the credit risk on a financial instrument has changed significantly since initial recognition. If so, the bank is required to make a loss allowance, estimated based on lifetime expected credit losses.

At the time of initial recognition, banks are required to classify their assets into three stages based on credit risk: Stage 1: Low Credit Risk; Stage 2: Significant Increase in Credit Risk (SICR); and Stage 3: Credit Impaired. Subsequently, at each reporting date, the bank must assess the credit risk on financial instruments for any significant increase in credit risk and would recognise the ECL accordingly. Banks may upgrade accounts based on their assessment of the sustainability of the rectification of defaults/stress in exposures. Further, in the case of multiple exposures to a single borrower, in the case of overdue exposures, the classification as Stage 2 shall be at the facility level, while the

Stage 3 classification shall be at the borrower level. While banks are required to determine ECL provisioning estimates at Stages 1 and 2 using their models, the ECL shall be subject to product-wise prudential floors as a regulatory backstop. For ECL computation, banks are required to have a minimum regulatory floor for 12-month PD.

The final guidelines have reduced the regulatory PD from 0.05% to 0.03%. Banks shall calculate their own LGD using historical data and macroeconomic projections. If the bank cannot obtain LGD estimates from its data, it may use regulatory backstops. While keeping the regulatory LGD at a similar level, the final guidelines have reduced the LGD on loans secured by eligible collateral from 45% to 30% to align with the Basel guidelines. Banks must estimate EAD for ECL, including expected drawdowns for commitments and guarantees. Credit risk mitigants aren't netted. If EAD can't be reliably estimated, banks may use regulatory CCFs under the Commercial Banks - Capital Charge for Credit Risk - Standardised Approach Directions, 2026.

CareEdge Ratings' View

Sanjay Agarwal, Senior Director, CareEdge Ratings, said, "Overall, transition to the ECL framework represents a structurally positive development for the Indian banking system, reinforcing transparency, risk sensitivity, and alignment with global prudential standards. The guidelines come at a time when Indian banks have robust capitalisation levels and good asset quality."

Aditya Acharekar, Associate Director, CareEdge Ratings, said, "The clarifications provided in the final Directions are expected to materially reduce uncertainty and smooth market expectations. The new regime may also influence strategic behaviour, particularly during periods of net interest margin compression. Under ECL norms, moving to higher-yield, riskier assets might lead to higher provisions, reducing margins and compressing returns."

RBI'S NEW CREDIT RISK FRAMEWORK TO UNLOCK Rs 580 Bn CAPITAL RELIEF

The Reserve Bank of India's (RBI) circular - Capital Charge for Credit Risk - Standardised Approach Directions, 2026 was published on April 27, 2026 (effective from April 01, 2027) for commercial banks, in line with the 'Basel III framework published in December 2017. Under the new framework, RBI has reduced risk weights for three of the six rating categories - AA, BBB and BB (forming 43% of the total live-rated debt). This is expected to reduce capital requirements for banks and may benefit borrowers with lower interest rates, better sanction terms, and enable banks to extend higher loan amounts or longer tenors. However, the extent of this benefit would be contingent upon CRA's compliance with the prescribed one year average Observed Default Rate requirements set by the RBI.

As per CareEdge Ratings' analysis, for AA- and BBB-band-rated entities, the change in risk weight is expected to result in a capital release of more than Rs 58,000 crore for banks across exposures in the manufacturing, including trading, services, infrastructure, and NBFC sectors.

The framework also states that unrated corporate exposure of less than Rs 500 crore shall attract a 100% risk weight. In comparison, exposure exceeding Rs 500 crore shall attract a 150% risk weight, significantly increasing capital cost compared to earlier norms. This is likely to create a disincentive for entities with exposure below Rs 500 crore that could secure an investment-grade rating (since rated exposure would attract a lower risk weight), and for entities with exposure above

Rs 500 crore, as these would be subject to a higher risk weight. Also, once a borrower is classified as an issuer not cooperating, banks shall determine the applicable risk weight based on all other available ratings, subject to a floor of 100% that escalates to 150% if non-cooperation from any CRA continues beyond six months. This is likely to lead to faster resolution in more than 10% of the ~23,000 CRAs in the INC portfolio, either through cooperation or the withdrawal of ratings.

CareEdge Ratings' View

The RBI's adoption of the Standardised Approach marks a structural inflection point in India's credit ecosystem, embedding external credit ratings firmly into the core of bank capital determination and risk management. The framework not only enhances the systemic importance of CRAs but also strengthens credit discipline across borrowers through transparent, rule-based capital disincentives for unrated and non-cooperative exposures.

"We expect the revised framework to drive greater rating penetration, improved credit discipline among borrowers, and more risk-sensitive lending by banks. The reduction in risk weights for AA and BBB and release of regulatory capital, which is likely to support enhanced lending capacity, higher exposure and/or longer debt tenure, and it will provide cushion to the commercial banks upon implementation of ECL-based provisioning from April 1, 2027," said Kalpesh Patel, Director, CareEdge Ratings.

Capital efficiency improvements are expected to support credit growth, particularly in the BBB and BB segments. Moderately rated borrowers are likely to benefit through lower borrowing costs, favourable sanction terms, and increased acceptance, among other advantages," said Anuja Parikh, Associate Director, CareEdge Ratings.

HEAT MAP AND PROJECTION TABLE

		May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Feb-26	Mar-26	Apr-26	May-26
PMI-M	Unit	57.6	58.4	59.1	59.3	57.7	59.2	56.6	55.0	55.4	56.9	53.9	54.7	55.0
PMI-S	Unit	58.8	60.4	60.5	62.9	60.9	58.9	59.8	58.0	58.5	58.1	57.5	58.8	59.8
GST Collections	Rs lakh crore	2.0	1.8	2.0	1.9	1.9	2.0	1.8	1.8	2.0	1.9	2.0	2.4	1.9
E-Way Bill	Crore	12.3	11.9	13.2	12.9	13.2	12.7	13.0	13.8	13.7	13.3	14.1	13.3	13.6
Air Passenger Traffic	Crore	3.5	3.4	3.2	3.3	3.2	3.5	3.8	3.6	3.9	3.5	3.5	3.4	
PV Sales	Lakh	3.7	3.5	3.7	3.6	4.0	4.7	4.4	4.2	4.6	4.3	4.6	4.5	4.6
2-3-Wheeler Sales	Lakh	21.2	20.5	21.1	23.8	27.2	27.6	25.3	21.1	24.9	24.8	25.2	25.0	25.2
Tractor Sales	Lakh	1.0	1.2	0.7	0.7	1.5	1.7	1.0	0.8	1.0	0.9	1.1	1.1	1.2
IIP	y-o-y%	4.7	3.0	5.0	3.6	5.5	0.0	6.5	5.8	4.4	5.2	3.2	4.9	
Core Sector	y-o-y%	1.2	2.2	3.7	6.5	3.3	-0.1	2.1	4.7	4.7	2.8	1.2	1.7	
Power Consumption	y-o-y%	-4.9	-1.5	2.1	4.3	3.2	-6.0	-0.8	6.1	3.9	4.9	0.7	4.4	11.0
Petroleum Consumption	y-o-y%	1.1	0.5	-4.4	4.8	7.0	-1.5	0.6	4.5	0.3	4.5	3.2	-3.8	-6.5
Outstanding Bank Credit - Total	y-o-y%	9.0	9.5	10.0	10.0	10.4	11.3	11.5	14.5	14.6	14.5	17.1	16.6	
Capital Goods Import	y-o-y%	15.7	2.6	12.2	-1.3	10.1	8.7	13.1	13.2	5.2	17.0	11.7	21.6	18.0
Merchandise Exports	y-o-y%	-1.2	-1.3	13.3	5.7	6.0	-12.5	18.6	1.2	0.4	-0.8	-7.4	14.2	18.0

Indicator	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27 Forecast
Gross Domestic Product (y-o-y%)	6.5	3.9	-5.8	9.7	7.6	7.2	7.1	7.8	6.7
CPI Inflation (y-o-y%)	3.4	4.8	6.2	5.5	6.7	5.4	4.6	2.1	5.0
Fiscal Deficit (As % of GDP)	3.4	4.6	9.2	6.7	6.5	5.5	4.8	4.4	4.3
Current Account Balance (As % of GDP)*	-2.1	-0.9	0.9	-1.2	-2.0	-0.7	-0.6	-0.6	-2.1
Rupee (USD/INR) (Fiscal year-end)	69.2	75.4	73.5	75.8	82.2	83.4	85.6	94.7	92-93
10-Year G-Sec Yield (%) (Fiscal year-end)	7.5	6.9	6.3	6.9	7.3	7.1	6.6	7.0	6.8-6.9

##GDP data from FY24 is as per the new series *(-) Deficit / (+) Surplus; Fiscal deficit data for FY27 is budget estimate; FY27 forecasts are basis assumption of crude oil averaging at 90 USD/bbl during the year

About Us

CareEdge is a knowledge-based analytical group offering services in Credit Ratings, Analytics, Consulting and Sustainability. Established in 1993, the parent company CARE Ratings Ltd (CareEdge Ratings) is India's second-largest rating agency, with a credible track record of rating companies across diverse sectors and strong position across the segments. The wholly-owned subsidiaries of CareEdge Ratings are (I) CARE Analytics & Advisory Private Ltd, (II) CARE ESG Ratings Ltd, and (III) CareEdge Global IFSC Ltd. CareEdge Ratings' other international subsidiary entities include CARE Ratings (Africa) Private Ltd in Mauritius, CARE Ratings South Africa (Pty) Ltd, and CARE Ratings Nepal Ltd. For more information: www.careedge.in.

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