SUERF Policy Note
No 395, February 2026

India’s great transformation

Alessia Berardi | Amundi Investment Institute
Ruchit Mehta | SBI Mutual Fund India
Monica Defend | Amundi Investment Institute
Namrata Mittal | SBI Mutual Fund India

Keywords: India, Make in India[1], portfolio diversification, monetary policy, geopolitics, manufacturing, infrastructure

JEL codes: G11, F40

Abstract

This paper examines the multi-faceted transformation of India’s economy and financial markets and the implications for global investors. We explore the key structural drivers supporting growth and ongoing policy measures to simplify regulatory frameworks and improve market access. The medium-term macroeconomic outlook is supportive but risks remain, including economic volatility in growth and inflation, FX and liquidity volatility, and sector-specific valuation pressures.

Disclaimer: This policy note is based on Amundi Thematic Paper. The views expressed are those of the authors and not necessarily those of the institutions the authors are affiliated with.

[1] https://www.dpiit.gov.in/ministry/about-us/details/Title=Make-in-India-(MII)-ITMwETMtQWa

India’s long-term transformational growth drivers

Scaling up domestic manufacturing

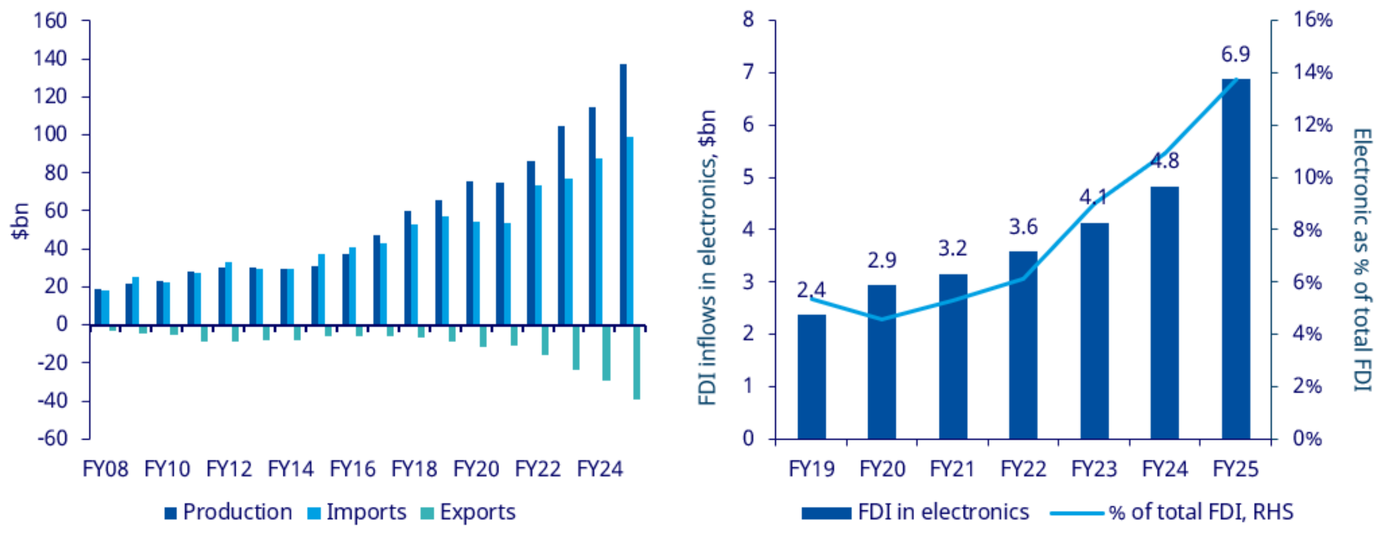
Make in India – a policy framework encouraging domestic manufacturing – was launched in 2014. The programme intends to incentivise domestic manufacturing to meet internal demand and exports. In principle, the programme goals were premised on sound economic logic: India had – and still has – a large, growing consumption demand for a range of goods and services, as the middle class and its disposable income grew, which was being met primarily through imports. Historically, India’s manufacturing was more industrial in nature, focused on sectors such as petroleum products, chemicals, metals, and metal products.

Over the past years, the policy environment has evolved to meet the challenges of scaling up domestic manufacturing. First, India worked strenuously to get the many basics in place, such as reducing logistics costs, ensuring sufficient quality electricity supply, easing land acquisition for industrial use through government land banks, and renewing the tax system (e.g. GST). In addition, various initiatives have been launched to get the machinery humming, such as production-linked incentive schemes, tax incentives for new manufacturing units, and the setting up of industrial parks. While not always directly consequential, these measures have provided the necessary base support to kick-start the manufacturing journey.

India has also made significant progress in cutting red tape for business, which has facilitated the transformation of the manufacturing sector. These include reforms in areas such as starting a business, dealing with construction permits, registering property, and enforcing contracts. These reforms have helped create a more conducive environment for businesses, boosting investor confidence, and encouraging both domestic and foreign investment. Indeed, they have also helped attract FDI into the manufacturing sector and reduce red tape.

Current efforts to scale up manufacturing focus on a few key areas, including **electronics** – specifically **semiconductors** – and **defence procurement**. All these areas are strategic in nature from a political and geopolitical standpoint as India lacked significant domestic supply capabilities in all of them, both technical and manufacturing-wise. In **electronics manufacturing**, if we look at mobile handsets, the government focused on two aspects: first, setting up a production-linked incentive programme, which provided production-linked subsidies to bring local manufacturing costs to parity (compared with production located in China and Vietnam); second, encouraging global manufacturers to set up assembly and manufacturing facilities in India. In 2014-15, about 75% of India’s mobile handset demand was met through imports; by 2024-25, this is close to zero. In addition to meeting domestic demand, exports have scaled up materially. **From a manufacturing standpoint this is a start of a long journey**. Currently India is primarily assembling components, but, eventually, it is likely that a larger share of components will be made domestically as economies of scale kick in and technological capabilities are built.

FIGURE 1: Domestic electronics production, imports, exports, and FDI



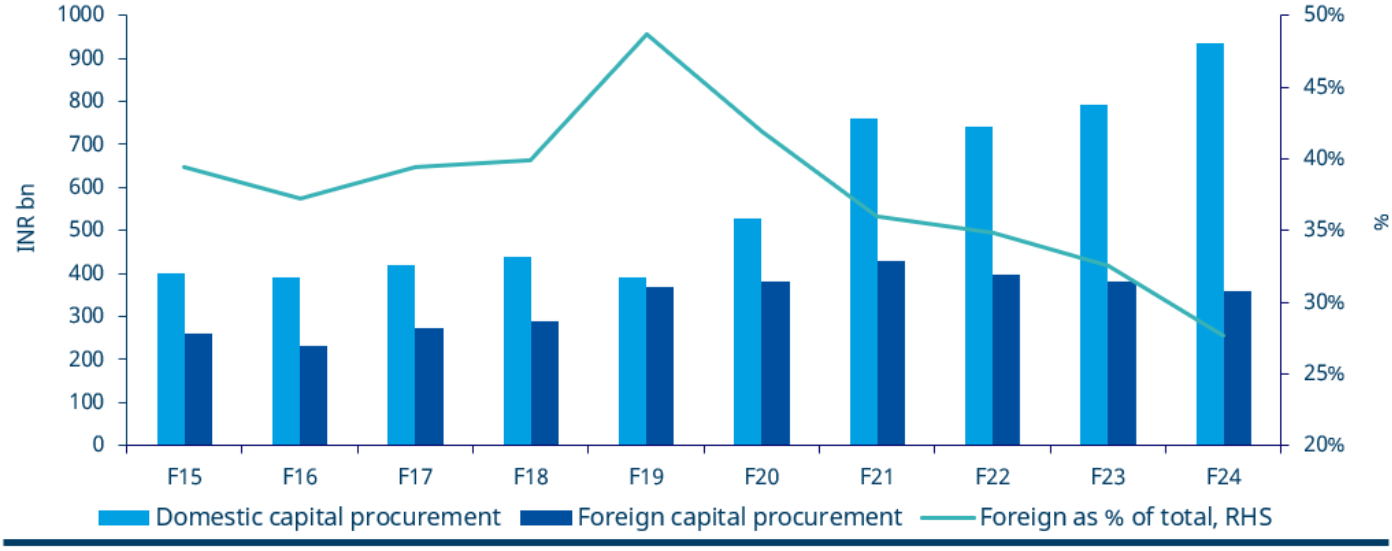
Source: SBI MF, MeitY, GoI, CLSA. Data is as of 7 October 2025.

Developing semiconductor manufacturing is another key focus area for the government. This has the dual objective of creating a source of chips for domestic electronic manufacturing and building strategic capabilities for defence and computing applications. While home-grown talent for chip design is well established, the domestic production has room to evolve further. Low initial demand and high capital costs deterred local manufacturing. With current demand rapidly increasing, the government has provided large and generous subsidy programmes to address the high capital costs. Once again, the government's intention to create domestic capabilities in semiconductor manufacturing for its own requirements first, and eventually to export.

The third big pivot has been the **increased sourcing of defence equipment and consumables from domestic vendors**. India has traditionally had strong local manufacturing capabilities in the industrial-machinery, tools, and equipment space, including for export orders. India needs to leverage these capabilities to meet its own new strategic requirements.

The government initiated a series of reforms aimed at encouraging domestic companies to invest into local defence technologies and to ensure off-setting clauses requiring domestic sourcing or technology-transfer conditions for defence contracts awarded to foreign firms. These included changing regulation to enable the participation of private-sector entities in the design, development, and supply of defence equipment and mandating a "procure from India" clause in many defence contracts. This has resulted in a spurt of domestic firms focusing on capital goods for defence tech.

FIGURE 2: Domestic defence capital-goods procurement



Source: Ministry of Defence, Company data, Morgan Stanley. Data is as of 7 October 2025.

Shifts in consumption patterns

The India consumption story is undergoing an interesting transformation. The journey is shaped along two main paths: India consumption moving from **being basics-heavy to being more discretionary and a further move towards more premium categories of consumption**, particularly within the higher-income bracket.

On the first, the transition is similar to what has happened in most EMs. As incomes rise, the pattern of consumption moves away from basics towards more discretionary products. This is driving significant demand across a larger range of products and services, from household durables such as air conditioners and kitchen appliances to an increased propensity for travel and tourism. If we look at kitchen appliances, there is a high penetration of basics like refrigerators, but incrementally there is greater demand for lifestyle products such as dishwashers. Where households previously had one air conditioner (typically in the bedroom), rising affordability and more reliable electricity supply have increased the number of air conditioners per home. These changes are most visible in larger cities but are beginning to percolate in smaller towns as well.

There is also an **aspirational element** to the changes in consumption patterns. The proliferation of smartphones, cheap internet, e-commerce, and digital payment systems is enabling notable change. **Social media has amplified aspirational consumption**. Consumers are no longer happy to wait for products to be available in stores or to travel to a larger town to purchase them. They want products delivered to their doorstep as soon as they become available in larger cities.

While the Indian middle class is spending on newer, aspirational areas of consumption, the higher-income segments are upscaling their spending. One of the most visible aspects of this shift is **the category movement in automotive vehicles.** Entry-level vehicles accounted for around 70% of volumes in FY2014 but are down to 31% in FY2025. Within each segment, the share of feature-rich vehicles has been rising. Another example of the scaling up is the **steady rise in international tourism**. Indian nationals travelling abroad hit an all-time high of 30.9 million in 2024. The aspirational Indian consumer is likely to continue expanding their consumption basket into newer categories, which should open new, longer-term growth avenues.

Due to the importance of the domestic economy to underpin economic growth, the government currently favours initiatives to support consumption among lower-income households. Over the last year, the government has introduced measures to increase disposable income, such as tax reduction and the GST reform (see box below).

Box 1: Simplification of GST to spur growth potential

One of the most consequential developments in India's recent policy landscape has been the rationalisation of the Goods and Services Tax (GST) structure. This reform marks a pivotal moment in India's fiscal architecture, aiming to simplify a system that had grown increasingly complex. India introduced GST in 2017 to unify its indirect tax regime into a single, streamlined framework. While the reform was transformative, the proliferation of multiple tax brackets introduced complications. Businesses often found themselves navigating a maze of classifications, where even minor changes in product definitions could shift items into higher tax brackets, triggering litigation and uncertainty. Consumers were also affected by inconsistent and often high tax rates on essential goods. Moreover, the rise of digital platforms, gig workers, and e-commerce businesses exposed structural gaps in the GST framework.

The reform seeks to address these issues. The most notable change is the simplification of the tax structure, reducing the existing five brackets to three: 5% for essential goods and services, 18% for standard items, and 40% for sin and luxury goods. This move should reduce compliance costs for businesses and eliminate ambiguity in pricing.

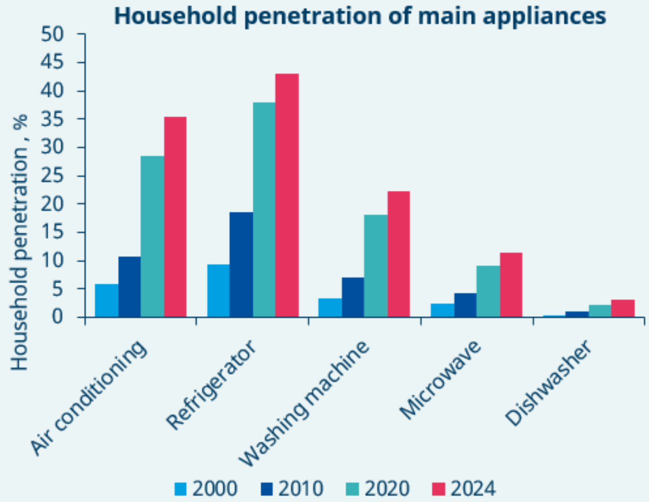
In addition, for consumers, the reform promises tangible relief. Many mass-market and aspirational goods will now fall under the 5% tax bracket. This shift should reduce the cost of living and boost consumption. Additionally, the reform attempts to correct inverted-duty structures in certain sectors. Aligning input and output tax rates will support domestic value addition and improve sectoral efficiency. The reform also introduces technological upgrades to the GST system, including real-time tracking, e-invoicing, and AI-powered reconciliation tools.

The timing of the GST reform aligns with broader counter-cyclical measures designed to support domestic growth amid global uncertainties and is expected to **buoy household consumption over the next quarters**. The fiscal cost of the reform is estimated at INR 1.4tn, or 0.4% of GDP, which is manageable for FY2025–26, given the buoyancy in non-tax revenue for the central government. Importantly, GST cuts are likely to have a higher multiplier effect than income or corporate tax reductions, as they directly influence private consumption at the point of purchase.

Lower GST rates should also have a disinflationary impact by easing inflationary pressures and increasing the likelihood of further monetary easing. **In conclusion, the GST reform is a timely and necessary intervention, not just to simplify the tax system, but to stimulate domestic demand.** While its immediate impact on spending may be modest, the long-term benefits should unfold gradually, reinforcing India's growth trajectory through improved competitiveness, demand, and fiscal resilience.

Changing consumption patterns

As incomes rise, the pattern of consumption moves away from basics towards more discretionary products.



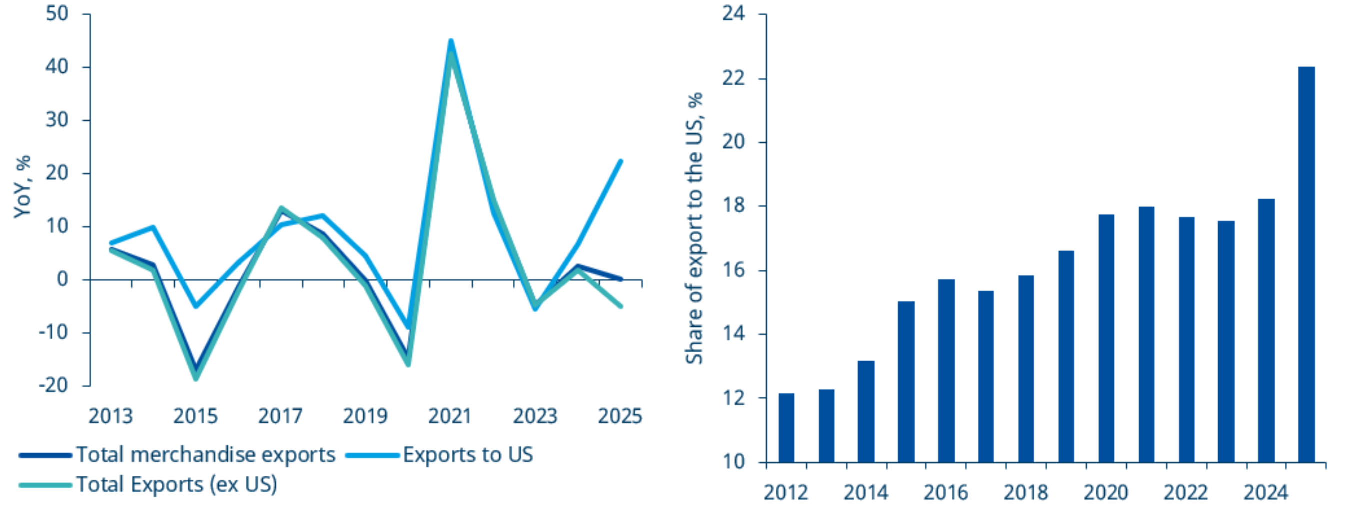
Source: SBI MF, CMIE, Motilal Oswal, EuroMonitor, Morgan Stanley. Data is as of 8 October 2025.

Where does India stand on its long-term journey?

Short-term macroeconomic outlook

We have recently upgraded our India GDP forecasts for the current fiscal year (6.6% in FY2026) and they remain substantially unchanged for next year (6.3% YoY). Growth in the second half of 2025 appears solid despite recently imposed tariffs. The US’s 50% face-value tariff rate on Indian exports places India at a relative disadvantage, since peer economies like Vietnam and Indonesia have secured more favourable terms, but negotiations between the two countries are ongoing. Goods exports from India to the US have risen further in the first five months of 2025 to 22-23% as a share of total exports. While **India’s overall merchandise exports have seen a marginal decline over the same period**, exports to the US have risen by 25% YoY.

FIGURE 3: Indian economic activity supported by exports to the United States



Source: SBIFM Research, CMIE. Data is as of 17 September 2025.

Having said that, it is worth remembering that India is an economy mostly driven by domestic demand. In the short term, looking at consumption and investment, household demand perspectives seem more supported by the recently introduced fiscal relief (lower income taxes) and reform (GST), as well as the planned 8th Pay Commission expected by January 2026 that will see a rise in civil servants' pay. As far as private investments are concerned, the recovery is more uneven and, recently, mostly disappointing amid the elevated uncertainty impacting business confidence. Indeed, the downside risk stems from the external environment, and it mostly concerns mostly investments and exports. Without any fiscal support, the growth impact would drag GDP growth **below 6% in FY2026, compared to our baseline expectations of 6.3%.**

We expect India's **headline inflation** to average around 2.4% in FY2026 and stay well anchored within the target band, at 4.0-5.0% in FY2027. A favourable monsoon season and global food dynamics are conducive to a **benign food inflation outlook**. Subdued global energy prices and political compulsions have kept utilities inflation anchored, with transportation costs mostly unchanged since 2022, which has had a significant bearing on core goods and services prices. In addition, as per the Reserve Bank of India's (RBI) latest monetary policy report, the GST reform could lead to a tax reduction of 11.4% in the CPI basket by weight. Eventually, the actual impact on CPI inflation will depend on the extent of the pass-through, but it will certainly be disinflationary.

Our expectations factor in the assumption of continuing favourable weather conditions and contained global food and energy prices, alongside a gradual pick-up in consumer demand aided by the policy stimulus. The introduction of a new rebased CPI series next calendar year aims to improve the accuracy in reporting the inflation data based on changes in consumption habits and a more inclusive consideration of urban India as well as rural India that is absent in some sub-components.

Monetary policy outlook

As the growth risks remains tilted to the downside, the RBI will be watching closely the trade developments, which potentially add uncertainty to the baseline. At its latest monetary policy meeting in October 2025, the RBI recognised the tariffs and trade headwinds as important risks. Nevertheless, the baseline for the Indian growth outlook appeared sanguine, forecast at 6.8% for FY2026. We are more cautious on growth prospects and believe that the actual growth dynamics in India are running softer than that recently portrayed by real GDP prints.

At its October meeting, the RBI confirmed its neutral stance, highlighted in June and August, which somehow overlooks the historical low level of inflation that makes real rates rather high. By anticipating higher inflation dynamics -- though not running above the CB target range – **we believe there are enough reasons for the RBI to depart from its recent neutral guidance and deliver an additional 25/50bp cut over the course of FY2026-27**.

How India is dealing with new protectionism and geopolitical shifts

Despite the recent tariff spat with the US, India is a beneficiary of the geopolitical changes towards multipolarity. As a middle power and an alternative to China, India stands to gain from Western diversification away from China, and Asian diversification efforts away from the West. India follows a multi-alignment strategy, which involves fostering relationship with various powers, evident in its participation in BRICS, while at the same time expanding military drills with the US. India's unique position in today's geopolitical power plays has become evident in recent months, as it sought to improve ties with China. Prime Minister Modi attended the Shanghai Cooperation Organisation (SCO) summit in Beijing despite long-standing tensions. **Both Xi and Modi will benefit from better ties, even if these mainly serve to improve negotiating positions with other countries**.

Wary of over-dependence, in recent years India has diversified its defence procurement towards other countries, such as the US, France, and Israel, and is actively seeking to improve ties with the US. While it does not want to cut off ties with Russia, it has offered the US more energy purchases to get a trade deal over the line. Interestingly, as the US is shifting its support more towards India – and its relationship with Pakistan remains volatile – China is the main provider of weapons to Pakistan, which is China's own geopolitical hedge and pressure point against India.

Better US-India ties are in the interest of both: the US does not want to push India closer to China, while India remains wary of China's intentions and wants to hedge geopolitically. Importantly, India is part of the QUAD, which also includes Australia, the US, and Japan and aims to support stability in the Indo Pacific region. Therefore, improved US-India ties are likely.

India's approach to improving relations with other countries is evident in its recent trade negotiations. The country has stepped up trade engagement for both geopolitical and economic reasons. Talks are progressing well with the EU, after signing a deal with EFTA (Switzerland, Norway, Liechtenstein, and Iceland) and the UK earlier this year. It is also aiming to expand an existing deal with Brazil to include Mercosur countries.

The macroeconomic impact of these agreements is multifaceted. **First, they should enhance India's export competitiveness by reducing tariff barriers and improving market access**. Second, **they support domestic manufacturing by facilitating the import of intermediate goods at a lower cost**. Finally, **they attract FDI by offering regulatory certainty and improved ease of doing business**. India's services sector has also benefited from these agreements, with services exports surpassing $375bn in 2024, from around $220bn in FY2018-19.

Looking ahead, India is actively negotiating trade deals with the US, New Zealand, and the EU. The India-US trade agreement has hit multiple roadblocks, though negotiations are ongoing. Meanwhile, the EU negotiations are targeted to be concluded by the year-end. India commenced trade talks with New Zealand in March 2025 and has successfully concluded two rounds of negotiations thus far.

In conclusion, **India's recent trade agreements are strategic instruments of economic transformation. By aligning trade policy with domestic reform, investment promotion, and global value-chain integration, India is laying the groundwork for sustained growth and enhanced global competitiveness. These reforms are not just about boosting exports, they are about reshaping India's economy and its role in the new geopolitical landscape**.

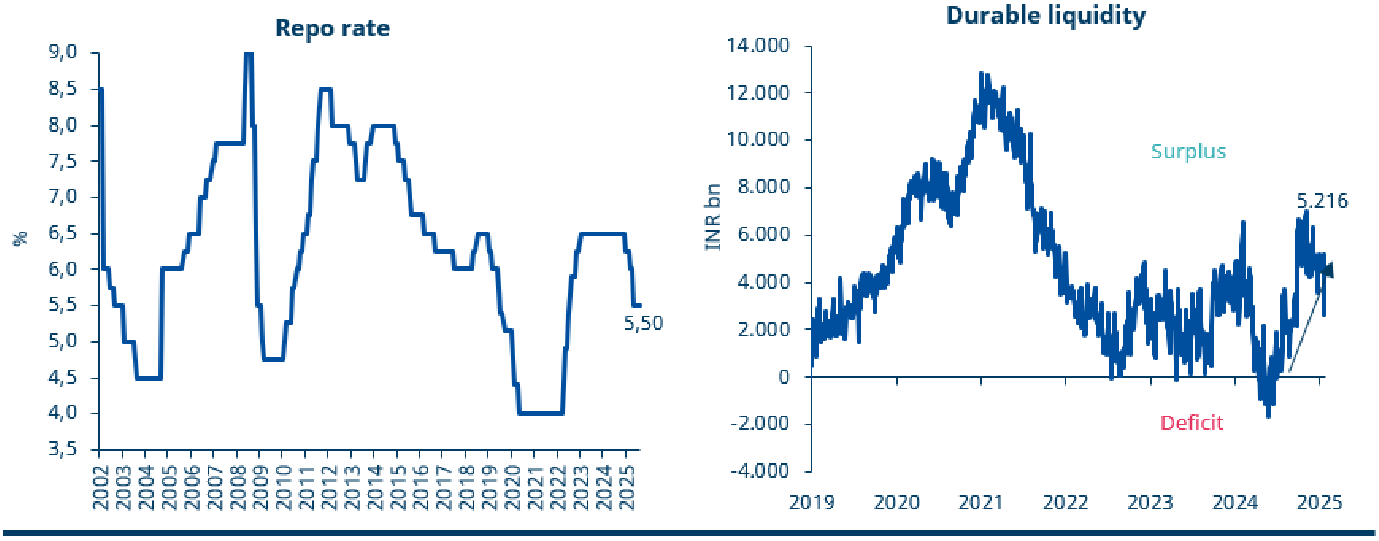
Regarding prospects ahead, **challenges in fundamentals persist in the near term**. India's nominal GDP growth has fallen into single digits and should stay at similar levels in the current fiscal year (see p. 15 for further details). **Slowing nominal growth rates are reflected in challenges to corporate top-line earnings growth**. Post-Covid-19, markets have been focused on bottom-line growth, which had bounced back strongly from Covid-19 lows. However, during the same period, top-line growth was lacklustre, implying cost-efficiency-driven improvements in corporate bottom lines. FY2025 saw this trend ease and bottom-line growth converged with top-line growth to single-digit levels. Regarding FY2026, there was a widespread expectation of improvement in corporate performance and growth in the 14-15% range in bottom line. This number has been revised down and is currently at 9.1%, which still points to decent earnings growth.

Looking ahead, we expect some of the government initiatives to make the **second half of FY2026 better than the first half.** Such initiatives include the GST rationalisation, income tax benefits to a significant section of tax payers, and the impending revision of salaries to government employees, along with the usual demand uplift that we see during the festive season. **While there are near-term challenges, the long-term attractiveness of India's market fundamentals has not deteriorated**.

Bond market

The RBI has cumulatively cut policy rates by 100 bp this year. At the same time, the central bank has shifted its policy stance from accommodative to neutral since the June 2025 review. Such a neutral stance provides adequate flexibility to respond to evolving macroeconomic conditions. **From a growth-inflation perspective, there remains enough room to adjust policy rates lower in the current cycle**, which has seen an unprecedented liquidity infusion as the banking liquidity tightened on account of FX interventions, which impeded policy transmission. Apart from the core liquidity injection of INR 5.2 trillion through open market purchases, the RBI has also cut the cash reserve ratio (CRR) cumulatively by 150bp in this easing cycle. Over this cycle, a liquidity injection of INR 10.0 trillion has been conducted through open market operations (OMO), a CRR cut, and FX swaps, on top of multiple rounds of short-term liquidity infusions through variable rate repo auctions.

FIGURE 4: India's repo rate and durable liquidity



Source: SBI FM, Bloomberg. Data is as of 30 October 2025.

Alongside the rate cuts, the largest impact has been in system liquidity shifting from a deficit to a surplus with the core liquidity surplus currently under INR 4 trillion. The impact has been seen in the yield curve steepening over the past two years. **The yield curve steepness reflects near-term demand supply challenges more than any material concerns about the fiscal framework**. The fiscal deficit trajectory has shown a downward trend with the government budgeting FY2026 fixed deposits at 4.4% of GDP. In the FY2026 Union Budget, the central government has committed to anchoring the fiscal deficit over the coming five years such that the debt-to-GDP ratio is on a declining trend with a commitment to reduce the central government debt-to-GDP to 50% +/- 1% by March 2031.

A steeper yield curve has also been the result of demand-supply gaps and certain changes in investment patterns by long-term investors. Over the last fiscal year, the impact of large OMO purchases and index inclusion flows largely masked the emerging challenges. With the RBI OMO's winding down and the foreign portfolio investment (FPI) flows tapering off, these issues have come to the forefront. Changes in taxation norms as well as the investment pattern of pension funds have incrementally led to rising equity investments by these players. The tapering of long-end investor demand in sovereign bonds and higher duration supply by state governments in the State Development Loan (SDL) auctions has led to a widening tenor spread at the longer end of the sovereign curve. In response to these, the H2 borrowing calendar has been tweaked to reduce long-end supply. While some of the factors can adjust as the deposit rates in the banking sector stay lower, addressing the demand gap is crucial to enable a lowering of term spreads. At the same time, **real rates on sovereign bonds remain very compelling**.

SDL issuances have been broadly in line with expectations in the first half of the fiscal year, with a larger duration supply leading to higher term spreads on sovereign securities. Lower Q3 borrowing has been announced even as expectations remain for a higher calendar in Q4. **This is likely to keep SDL spreads high and provide reasonable investment opportunities, especially at the shorter end of the curve (10 year and below)**.

On **corporate bonds**, AAA bond spreads have remained elevated at the shorter end compared to recent history. **While spreads remain modest on a long-term comparison, the emerging supply outlook is relatively favourable**. Corporates benefit from better rates in the loan market, especially among the high-grade names and the supply has been fairly in line with demand. This trend may stay in the near term. Nuances on taxation-related demand shortfall has kept 3-year and below spreads elevated in an environment that has been traditionally spread supportive, e.g., excess liquidity and modest supply. The amendment to MF Debt taxation in 2023 has kept flows into bond funds muted.

Sustainable debt market

One area of India's bonds market which has experienced remarkable expansion in recent years is the **sustainable debt market**, including both bonds and loans, which was propelled by supportive government policies, rising climate-positive capital expenditure by corporates, and growing commitments from investors and financial institutions towards sustainable finance. **This momentum reflects a broader shift in India's financial ecosystem toward ESG-aligned instruments.**

According to data from the Climate Bonds Initiative, India raised a cumulative $55.9bn in GSS+ (Green, Social, Sustainability, and related) debt by end-2024, a 186% increase from 2021. A total of 76 Indian issuers executed 179 deals, contributing 1% to global volume. In 2024 alone, deals worth $12.5bn were priced, a 25% decline from the $16.7bn recorded in 2023, which had been boosted significantly by a $7bn green loan from ReNew Power. **Green bonds dominate, accounting for 83% of India's cumulative aligned volume**. The standout performer is the Indian sovereign green bond programme. Globally, India now ranks as the 18th-largest source of aligned GSS+ debt and the fourth-largest among EM, following China ($555.5bn), South Korea ($339.2bn), and Chile ($65.2bn).

Seven **social bonds** in 2024 added $5.5bn, lifting cumulative social-bond volume to $6.6bn. Non-Banking Financial Companies (NBFC) also raised $1.8bn in social loans during the year.

In June 2025, the Securities and Exchange Board of India introduced a comprehensive ESG Debt Securities Framework, expanding regulation beyond green bonds to include social bonds, sustainability bonds, and sustainability-linked bonds (SLB). This framework mandates enhanced disclosures, third-party verification, and alignment with global standards. Simultaneously, the RBI supports the market through its issuance calendar, which includes Sovereign Green Bonds (SGrB) across various tenures. **These regulatory developments aim to boost investor confidence, prevent greenwashing, and align India's sustainable finance ecosystem with international benchmarks**.

References

Data sources: Bloomberg, Cambridge Associates, Global Financial Data. Edhec Infra, MSCI and MSCI Burgiss.

About the author(s)

Alessia Berardi is the Head of Global Macroeconomics at Amundi Investment Institute. She is also responsible for Emerging Markets Strategy and a member of Amundi's Global Investment Committee. Alessia graduated in Econometrics and began her career in the investment industry in 1998.

Ruchit Mehta, CFA, is Head of Research at SBI Funds Management. He previously managed various SBI funds and also was a portfolio manager for 10 years. Ruchit holds a MSc in Finance and began his career in the financial industry in 2004.

Monica Defend is the Head of the Amundi Investment Institute and a member of Amundi's Executive Committee. Previously, Monica was Global Head of Research at Amundi and a member of its Global Investment Committee and Advisory Board. Monica holds master's degrees in Economics and Financial Economics. She started her career in the investment industry in 1997.

Namrata Mittal, CFA, is the Indian Economist for SBI Funds Management (SBIFM) since 2014. She previously was a consultant in Department Economic Affairs at India's Ministry of Finance. She holds a Masters' Degree in Economics and began her career in Economics research in 2010.

Designed by the Information Management and Services Division of the Oesterreichische Nationalbank (OeNB)

SUERF Secretariat
c/o OeNB, Otto-Wagner-Platz 3A-1090 Vienna, Austria
Phone: +43 1 40 420 7206
E-Mail: suerf@oenb.at
Website: https://www.suerf.org/