

Macro Review | Q2 FY2026

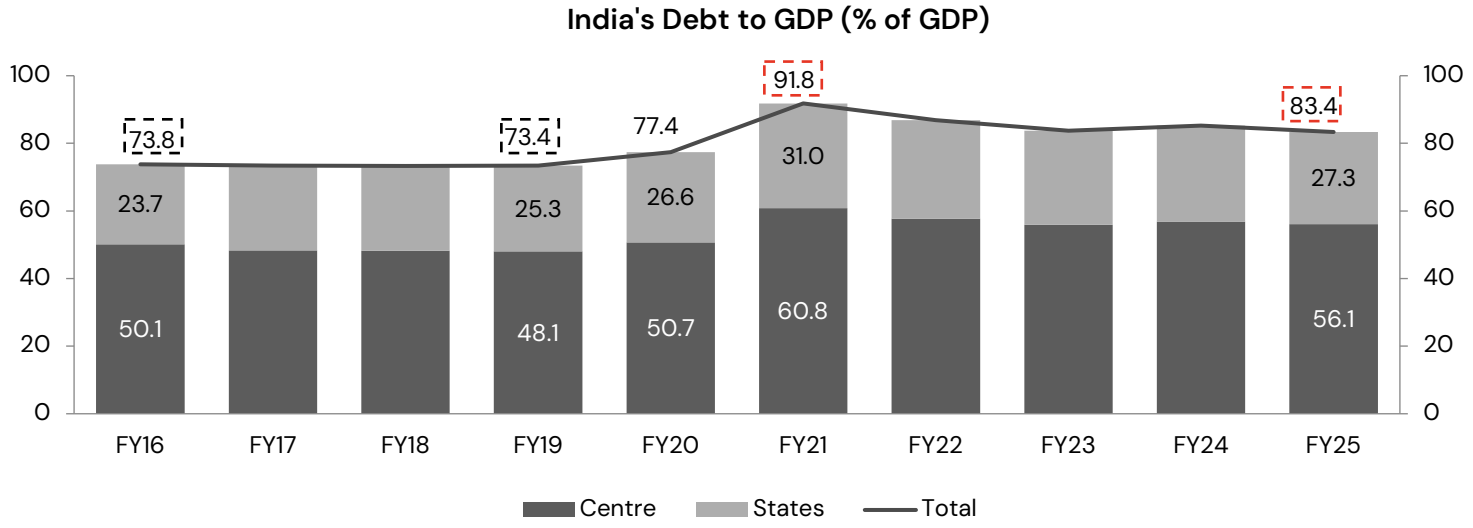
Acknowledging Context

The macro environment shapes the contours in which individual companies operate. It influences the opportunity set, the cost of capital, and the durability of earnings. It determines which pockets of the market offer genuine value, and where optimism runs ahead of fundamentals. In periods when macros shift meaningfully, it is essential as managers of risk to articulate the context.

As we step into the final quarters of FY26, India's macroeconomic backdrop has changed in ways that matter for portfolio construction, driving the context for growth and value. Portfolio composition is a response to the environment and an indication of why we are positioned the way we are, and how it aligns with both risk and opportunity in the current cycle.

India, State of the Economy

Limited Fiscal Room | Over the past few years, India's public debt (Central and State) has risen meaningfully. The Centre's debt-to-GDP ratio now sits above 56%, and State debt has followed a similar upward trajectory at 27%, bringing the combined public debt to 83.4% of GDP; or 10% above the pre-COVID levels (FY19) (Source: Ministry of Finance). While the numbers remain manageable, they close the option of significant discretionary fiscal expansion. The government cannot materially outspend its current trajectory without compromising on fiscal discipline. This constraint is essential because public expenditure has been a dominant driver of growth over the last decade.



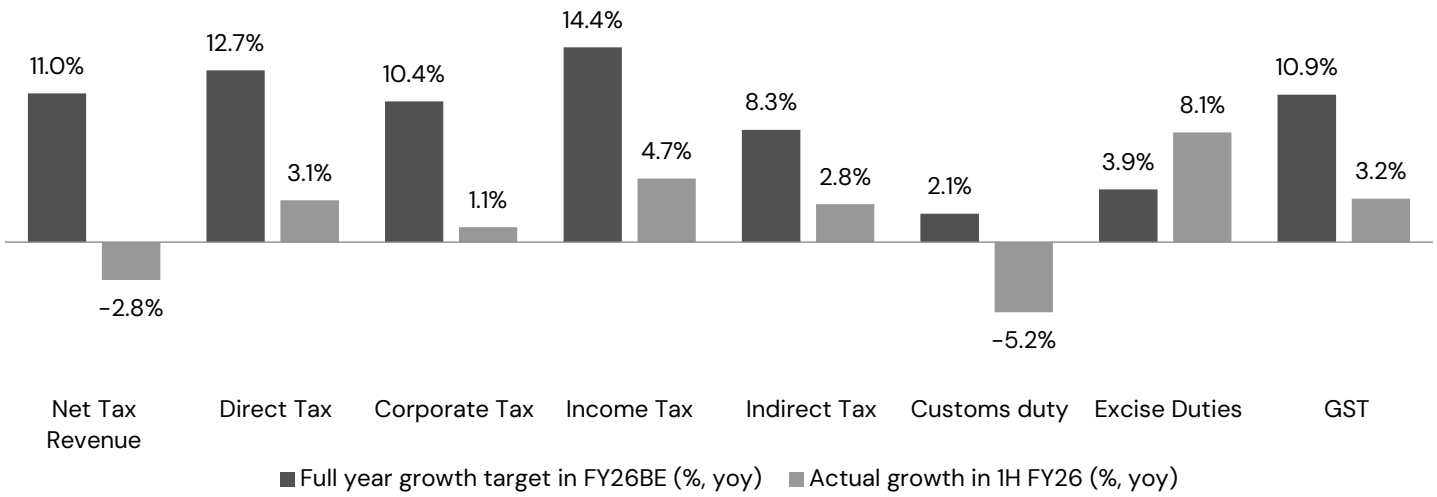
Source: Ministry of Finance

Over the past few years, much of India's growth impulse has come from the supply side: massive outlays on infrastructure, digital public goods, logistics corridors, energy transition, and manufacturing-linked incentives. Today, the budgeted share of public capex allocated to physical infrastructure (roads, railways, and metros) is set to decline to 50% in FY26 from an average of 54% between FY22-25, which could yield lower capex multipliers (Source: Ministry of Finance).

Tax Revenues Lose Steam | India's tax collections softened notably in the first half of FY26, reflecting a combination of weak corporate profitability, tepid consumption, and muted capital market activity. Direct tax revenues rose just 3.1% YoY, [Rs. 10.6tn], significantly below the 12.7% estimated in the Union Budget (Source: Ministry of Finance). Within this, personal income tax collections grew by 4.7%, while corporate tax collections grew by just 1%, dragging overall collections. (Source: Central Board of Direct Taxes)

Indirect taxes also disappointed, moving just 2.8% YoY. Within this, GST collections grew 3.2%, while Excise duty grew 8%. Custom duties continued to struggle, declining 5%, underscoring ongoing supply-chain normalization (Source: CBDT, CBIC, and Ministry of Finance).

Tax collections performace: Actuals vs. budgeted

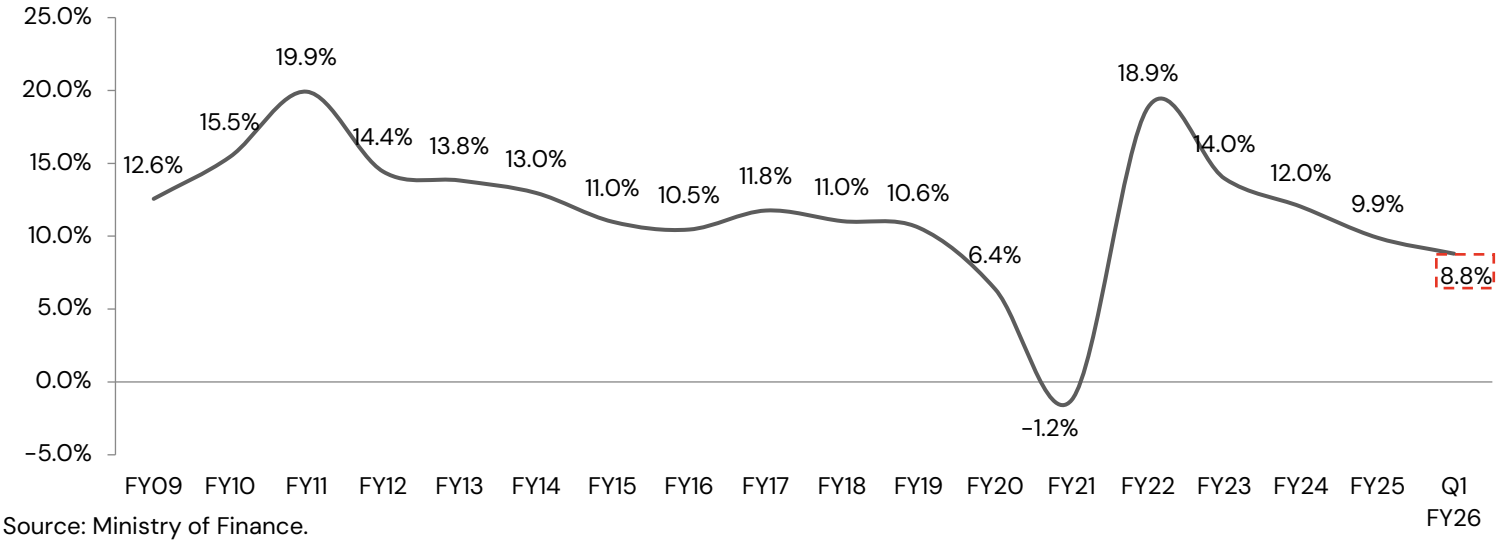


Source: Controller General of Accounts (Monthly Accounts), CBDT, CBIC, and Ministry of Finance.

This change in trend matters, as tax buoyancy is no longer at a level that can comfortably underwrite a wave of fresh government spending to stimulate demand.

External Stress | Compounding this dynamic is the external environment. Despite the 50% punitive tariffs imposed by the US, India has had limited room to diversify its export basket as the share of exports to the US has risen from 18% in FY23–25 to 20.5% in FY26YTD. A policy relaxation on this front will be a welcome relief, notwithstanding the depreciation of the INR. As a result, and amid other factors, India's nominal GDP growth has slowed sharply to 8.8% in Q1 FY26, the weakest pace in more than a decade, barring Covid. In Q2 of FY26, India grew at a higher-than-expected 8.2%, the fastest pace in six quarters, largely on the grounds of GST and tariff-led front-loading (Source: CBDT, CBIC, and Ministry of Finance).

Nominal GDP growth (%, yoy)



Source: Ministry of Finance.

Without a structural return to 11–12% nominal GDP growth, a broad-based pickup in corporate earnings is a challenge. Lower nominal growth also keeps government revenues under strain, limiting the fiscal space for higher spending while staying on the consolidation path.

Monetary Easing | Amid these constraints, monetary policy remains an area of constructive optionality. With inflation trending in a tolerable band [<2% YTD], the space for incremental monetary easing remains open. A well-timed reduction in policy rates will help lower costs across the system and revive the credit cycle in a balanced manner, especially to the MSME sector, which can absorb incremental capital. India's banks enter this phase with healthier balance sheets, stronger capital adequacy, and improved underwriting discipline, positioning them to transmit easing more effectively than in earlier cycles.

With limited fiscal space and a maturing tax base, the supply-side lever that has carried this cycle cannot be extrapolated. The next phase of growth will have to emerge from the demand side - from the capacity of households to consume and enterprises to invest, rather than from the state's ability to build. It is here, in the delicate interplay between private-sector confidence and household purchasing power, that the trajectory of India's expansion will now be determined.

Q2 FY 2026 Earnings Update

2H Recovery Setup

Q2FY26 results were steady but unspectacular, with headline numbers held back by a softer nominal growth environment. Nifty companies reported c.6% revenue and operating profit growth, but aggregate earnings were broadly flat for the quarter, reflecting both a strong base last year and continued pressure in select sectors. For the half-year, Nifty earnings grew 4% while the broader BSE-500 delivered healthier double-digit growth, though earnings upgrades remain rare and consensus estimates for FY26 and FY27 have inched lower (source: Bloomberg). Valuations across large, mid, and small-caps remain above their 5-year averages, suggesting the market is waiting for clearer earnings momentum before rewarding the broader basket.

NSE500	Adj PAT Cr		
Sector	**Q2 25**	**Q2 26**	**YoY %**
Automobiles	20,327	17,144	-15.7%
Banks-Private	51,338	50,023	-2.6%
Banks-PSU	47,655	48,865	2.5%
Capital Goods	11,215	14,582	30.0%
Consumer	15,596	16,175	3.7%
EMS/ Durables	1,941	2,823	45.5%
Healthcare	3,656	4,816	31.7%
Technology	32,691	35,367	8.2%
Utilities	25,148	23,230	-7.6%
Pharma	12,178	13,611	11.8%

Source: Internal Data

Across sectors, demand commentary was noticeably more positive than reported numbers. Banks and NBFCs continued to report stable asset quality, with disciplined growth, while rate-cut-led-NIM compression muted earnings. The festive season lifted sentiment in autos, jewellery, electronics, and select apparel, pointing to improving underlying consumption. EMS players continued to grow at high rates amid industry opportunities, while seasonal factors have muted domestic consumer electricals. The pharma segment is showing signs of recovery, driven by improved U.S. demand and a more stable pricing environment, while the domestic market remains resilient. The domestic healthcare space remains on a good footing, supported by incremental expansion and pricing. The chemical industry is undergoing a period of consolidation as it navigates an extended destocking phase, tariff-related pressures, and continued oversupply from China. The metals sector delivered strong performance, supported by firmer commodity prices, and improved sentiment driven by expectations around China's involution policy. IT services remained subdued amid global uncertainty. A significant observation was muted wage growth, especially in IT and financial services, constraining parts of urban discretionary demand.

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