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- *The IMD projected below normal rainfall, amidst expectations of a strong El Niño occurrence.*
- *Past trends suggest that only a significant shortfall in rainfall materially impacts output.*
- *The increasing share of irrigated land serves as a key mitigating factor.*
- *Other counterbalancing factors by way of excess foodgrain stocks, reservoir levels, fertilisers and administrative steps will help prevent a price spiral.*
- *Passthrough to rain-sensitive crops, nonetheless, pose upside risks to our inflation forecast.*
- *Implications for forecasts: The RBI policy committee is unlikely to act in a hurry on supply-side shocks.*

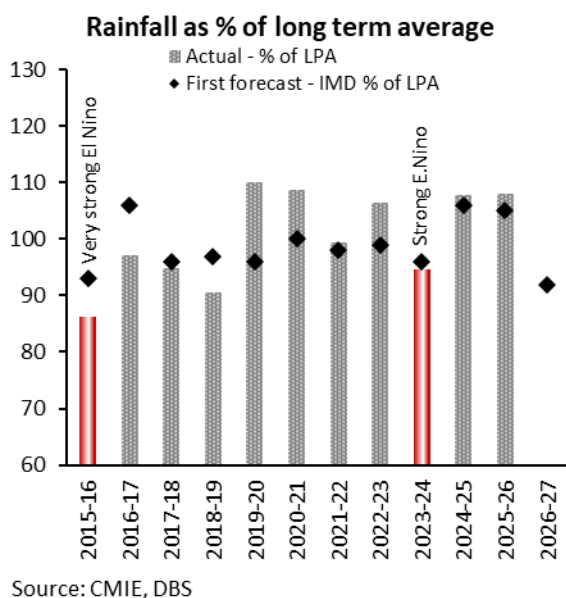
El Niño and monsoon – some but not all

The NOAA ([press release](#)) highlighted a growing 61% chance that El Niño might emerge around mid-year and persist through at least the end of 2026. Observers have also cited the likelihood that this year's build up might be the strongest in over three decades. Typically, in the Asia Pacific, this development weakens monsoon and can lead to drought in some parts, also raising the risk of wildfires. Besides El Niño, the Indian Ocean Dipole (IOD) will also influence rain patterns, with officials expecting a positive IOD condition to partly mitigate the El Niño impact.

The Indian Meteorological agency IMD has projected a below normal monsoon for 2026, in midst of expectations of a strong El Niño occurrence. Seasonal rainfall over the country is seen at 8% below the Long Period Average (LPA), with a 66% probability of monsoon being below normal or deficient. Risk of heatwaves was also highlighted as a risk for the Apr-Jun quarter. Private agency Skymet projected rainfall at 94% of LPA, with second half of the peak period (June to September) to experience shortfalls. **The IMD's next updated forecast is due in the last week of May.**

In India, recent El Niño occurrences have coincided with below normal rainfall though not necessarily drought-like conditions – see chart. In 2015-2016, IMD's first forecast was 93% of LPA, which was revised to 88% later and actual was closer to 86%. In the past three

years, FY24 was the weaker end of normal range after experiencing a relatively strong El Niño phase ([link](#)), followed by two successive years of above normal rains at 108% in FY25 and FY26. The crucial southwest monsoon accounts for ~70% of the annual rainfall, concentrated during June to September.



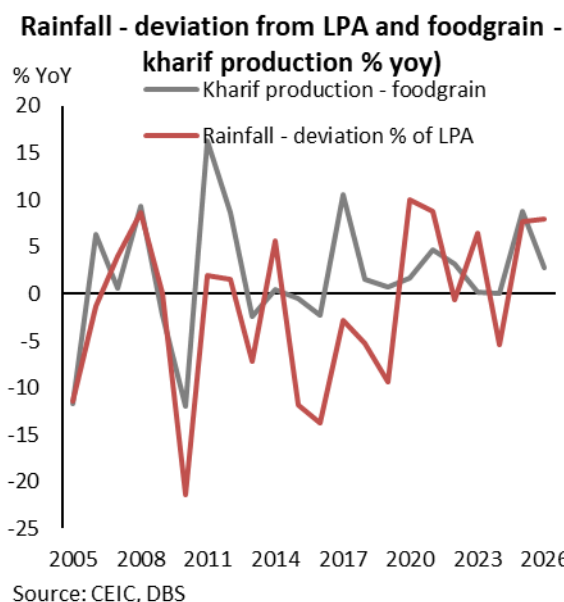
Economic watch factors

Output

The extent of the economic impact will depend on the severity, intensity, and length of the El Niño occurrence. At the same time, not only the strength of aggregate rainfall, but also its distribution can impact output.

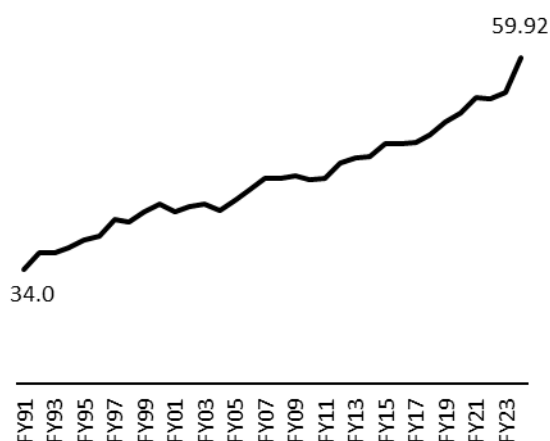
The share of agriculture in India’s growth mix is modest at 16-17% of GDP but has accounted for a little less than half of overall employment in recent years. **The correlation of the crops sub-component under GVA (gross value added), which makes up half of overall agriculture forestry and fishing (AFF), and foodgrain output is high.**

For kharif foodgrain, we observe that in the past three decades, more than 10-11% shortfall in the rainfall vs the LPA causes material impact on the foodgrain output. For instance, 2014-2016, monsoon was an average 12-13% below the LPA (see chart), resulting in a fall in the summer foodgrain output. This was partly responsible for the -0.2% yoy fall in GVA-agri and allied services in FY15 and a modest 0.6% growth in FY16. Hence, assuming a stark double-digit shortfall in the monsoon vs LPA pushes the GVA-AFF growth rate from 3.5% to 2% in the coming year, this could result in 20-30bp reduction in overall headline growth.



As a mitigating factor, the share of gross irrigated area as a percentage of overall gross cropped area has continued to increase, suggesting a reduction in directly rain-fed acreage. Yet, key rain-fed summer crops, which are largely grown during the Kharif season, are heavily dependent on the Southwest monsoon, with major production including rice, soybeans, cotton, maize, and pulses, as well as few horticulture plants.

Gross irrigated area as % of gross cropped area



Source: CMIE, DBS

Inflation impact

The temporal and geographical distribution of rainfall will determine the eventual impact.

We tracked movements in India’s food CPI inflation against the last two El Niño periods (of which 2015-2016 was more severe), which showed that swings were moderate, even if not non-trivial. A key offset for inflation during the adverse El Niño spell in 2015-2016 was lower commodity prices including energy, which helped to keep a lid on non-food pressures. By contrast, energy commodity prices are elevated at this juncture, suggesting price pressures could stem from other quarters as well.

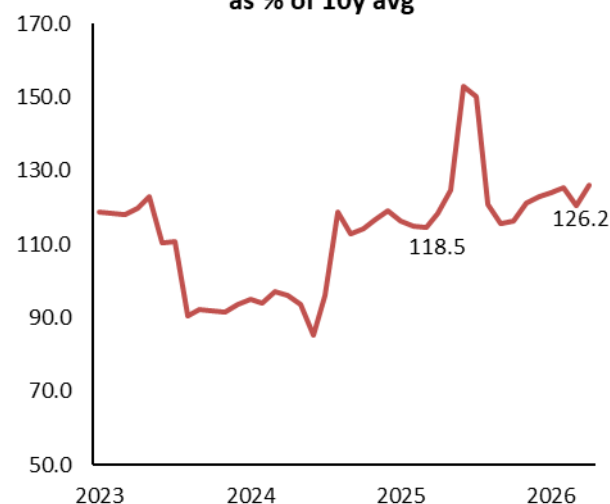
Encouragingly, price pressures can be partly mitigated by current foodgrain inventories and potential supply countermeasures. The country has ample official foodgrain stocks. As of May26, total foodgrain stocks in the central pool (managed by Food Corporation of India) jumped to over 60.mn metric tonnes (LMT), which is nearly three times the required buffer norms – comprising of 38.6mn LMT of rice and

21.8mn LMT of wheat. Shortages can be met by these inventories to keep prices stable. Nonetheless, certain other crop groups where maintaining inventories is a challenge (perishables like vegetables) and where stocks are generally inadequate (oilseeds, pulses) could face price pressure. On the latter, imports have been stepped up in the past instances to cap the scale of price hikes.

Secondly, risk of shortages will be addressed via pre-emptive supply side price management steps including redistribution of inter-state supplies, stepping up imports or export bans to boost domestic stocks, supporting better crop yields, containing hoarders, amongst others.

Add to this, adequate reservoir and groundwater levels from the past should also provide some extent of offset until the winter crop but build up for the subsequent cropping seasons will fall short if the shortfall in monsoon is significant. Current storage levels are higher than comparable period last year – see chart.

Reservoir: Current live storage as % of 10y avg

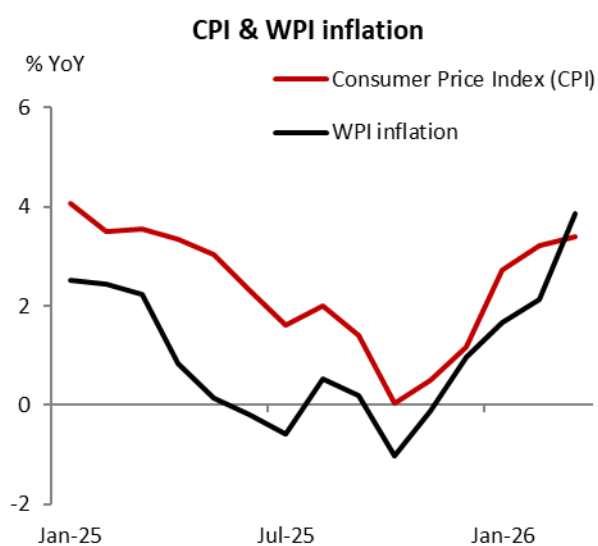


Source: CMIE, DBS

Confluence of forces. At an aggregate level, inflation faces a confluence of pressures – energy prices, second derivative impact via logistics and transport costs, higher input costs for businesses, jump in global fertiliser prices which will result in higher subsidy outlay and vulnerable perishables. Factoring in a modest scale of pump price hike and pipeline monsoon risks, we revise our annual inflation forecast to 4.9% yoy (risks of further upside) for FY27, before easing to 4% next year.

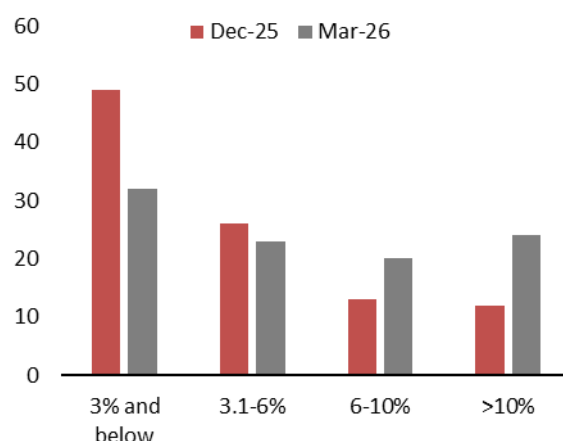
Compared to retail inflation, the wholesale index is more sensitive to commodity and imported price pressures and is expected to rise further due to base effects and external factors.

WPI inflation outpaced CPI gauge in the month (see chart), signalling pipeline risks. This is reinforced by the sharp rise in PMI input price gauge as well as IIMA Business Inflation Expectations Survey (BIES) for March 2026, which cumulatively point to firms facing strong cost-push factors, which are still be passed on down the value chain to the consumers.



Source: CEIC, DBS

How to current unit costs compare to last year?



Source: BIES Survey, IIM Ahmedabad

Policy implications.

The RBI monetary policy committee (MPC) is unlikely to exhibit urgency in tightening policy in response to supply-side - energy and food - pressures. The risk of further rate hikes will increase if there are signs of a sharp rise in inflation expectations and a sustained spillover of elevated headline inflation into core inflation readings. **Our baseline view is for the MPC to keep the benchmark rate to keep rates unchanged during 2026.**

Other non-policy measures have been undertaken to stabilize the rupee as discussed [here](#) and [here](#). Measures to draw in more dollar flows are reportedly under consideration, including a plan for state-owned banks to sell foreign currency bonds, or introduce a special non-resident deposit scheme. At this juncture, any underlying swap arrangements will need to factor in higher prevailing US rates vs past cycles (including 2013 taper tantrum), which in turn implies higher subsidy support from the RBI. The quantum of issuance will also need to at least partially commensurate with current funding requirements.

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