

The Tyranny of Surface Stability

Dear Investors,

India today sits at an interesting intersection. On one hand, it is widely accepted as a long-term growth market. On the other, the path to that growth is becoming increasingly volatile. The difference between these two statements is where most investment mistakes are made.

The current environment forces us to confront a simple but uncomfortable truth: growth alone does not generate returns—*the path of growth does*.

The Shock Beneath the Surface

The trigger this time is energy. But this is not a typical oil cycle. What is unfolding is a supply-side disruption with second-order effects that are only beginning to surface.

India's dependence on imported energy—especially LPG and natural gas—means that constraints in availability matter as much as price. Current estimates suggest a ~25% shortfall in natural gas availability, which alone could shave off ~25 basis points from GDP growth if sustained for a quarter.

At a broader level, macro sensitivities remain significant: a 10% increase in oil prices can reduce growth by ~15 basis points and increase inflation by ~30 basis points.

At first glance, however, the economy appears stable. Fuel prices have not meaningfully adjusted. Inflation remains within tolerance. This stability is not organic—it is engineered.

The burden of higher energy costs is currently being absorbed largely by the public sector.

Why This Cannot Last

This brings us to the most important framework for understanding the present situation: who ultimately bears the cost of a shock?

There are only three candidates—government, corporates, and consumers. And over time, the burden always moves.

Right now:

- The government and public sector are absorbing a large share of the shock
- Corporates are partially absorbing it through margins
- Consumers remain relatively insulated

But this configuration is temporary.

Empirical evidence suggests that corporates typically split cost increases roughly 40:60 between margin compression and price pass-through. When combined with direct fuel costs, consumers ultimately bear close to 70% of the total burden.

This is where the nature of the shock evolves.

What begins as a growth shock gradually becomes an inflation and demand shock as prices adjust and purchasing power declines.

The External Constraint

India's position as an oil importer adds another layer of complexity.

Higher energy prices directly affect the external balance. Under moderate scenarios:

- The current account deficit can widen by ~0.3% of GDP for every 10% rise in oil prices
- At higher oil levels, the deficit could expand by ~0.6–1.5% of GDP

India has already been running a balance of payments deficit, and foreign exchange reserves have seen drawdowns (around USD 19 billion in a fortnight during March).

This creates a feedback loop:

- Higher oil → wider external deficit
- Wider deficit → currency pressure
- Currency pressure → imported inflation

Each stage tightens financial conditions in a different way.

The Global Context

This is not an isolated episode.

Globally, energy shocks are pushing inflation higher while slowing growth. Forecasts indicate:

- Global growth moderating to ~2.5% in 2026
- India's growth expected to slow to ~6.3% (from ~7.5% prior)

At the same time, inflation pressures are broadening across regions, and central banks are likely to remain on hold for now, balancing inflation risks with growth concerns.

This creates an environment where policy clarity is limited and market volatility remains elevated.

Why This Matters for Portfolios

It is tempting to think of India as a single story. It is not.

Different parts of the market respond very differently to the same macro shock:

- Energy and industrial sectors react to input cost volatility
- Consumer sectors face demand compression as inflation passes through
- Financials respond to interest rates and liquidity
- Export-oriented sectors are influenced by currency movements

Recent investment perspectives highlight that energy-driven volatility is increasing dispersion across sectors, reinforcing the need for diversification across drivers, not just assets.

This divergence is not theoretical—it is already visible in earnings expectations, sector performance, and capital flows.

The One Principle That Matters

If there is one idea worth holding onto, it is this:

Supply shocks do not impact the economy all at once—they move through it in stages.

First, production is affected.

Then margins.

Then prices.

Then demand.

And finally, valuations.

Most investment errors do not come from misunderstanding the shock itself, but from misunderstanding where we are in this sequence.

Closing Thought

India will likely continue to grow. Even under stress scenarios, growth remains meaningfully higher than most large economies. But growth will not arrive in a straight line, and it will not reward all capital equally.

The key question, therefore, is not whether to invest—but how to think.

In environments like this, clarity comes not from stronger conviction, but from better structure—an understanding of how shocks move, how risks shift, and how different parts of the market respond.

Because in the end, investing is not about predicting outcomes. It is about understanding consequences.

Sincerely,

Ashish Mundada

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