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BUILDING INDIA'S FINANCIAL RESILIENCE IN AN ERA OF WAR AND UNCERTAINTY

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ABSTRACT

The global order in 2025–2026 is defined by unprecedented levels of armed conflict, supply chain fragmentation, energy market volatility, and the weaponization of trade. India, the world's most populous nation and fifth-largest economy, stands at a pivotal crossroads. Unlike many nations pulled into alliance-based financial commitments, India has charted a distinct path — one of strategic autonomy, domestic resilience, and calibrated global engagement. This paper examines India's financial route map during this wartime crisis: its fiscal architecture, defense investment trends, monetary policy adjustments, trade recalibrations, and the structural reforms that will determine whether India emerges from global turbulence as a stronger economic power or falls prey to the vulnerabilities that have ensnared other emerging markets.

Key words: FDI, Financial Resilience, Fiscal policy, Monetary Policy Trade Recalibration,

1. Introduction: A World at War and India's Place in It

The years 2024–2026 have witnessed a dramatic deterioration of global peace. The Russia–Ukraine war continues to disrupt energy flows and grain markets. The Middle East conflict — centered on Gaza and increasingly involving Iran and regional proxies — has threatened shipping through the Strait of Hormuz, one of the world's most critical chokepoints for oil and gas. Simultaneously, India–Pakistan military tensions escalated sharply in May 2025, testing the subcontinent's fragile stability. Meanwhile, US–China rivalry has intensified, reshaping investment flows, semiconductor supply chains, and global financial architecture.

For India, this multipolar conflict environment is simultaneously a threat and an opportunity. As a net energy importer, India is highly sensitive to oil price spikes triggered by Middle Eastern instability. Yet as a democracy with deep ties to both the West and the Global South, India is uniquely positioned to benefit from supply chain diversification away from China, attract foreign direct investment, and negotiate landmark bilateral trade deals.

2. MACROECONOMIC FOUNDATIONS: RESILIENCE AMID GLOBAL SHOCK

2.1 Growth Trajectory

Despite the turbulent global environment, India's economic growth has remained remarkably robust. India's Economic Survey (2026) projects real GDP growth for FY2026–27 at between **6.8% and 7.2%**, placing India among the world's fastest-growing major economies. S&P Global, in its March 2026 report, projects growth at **7.1%** for FY27, while the IMF estimates **6.4%** and the World Bank **6.5%** — all converging on the view that India's domestic demand engine remains powerful enough to withstand external headwinds.

Agency / Report	Projected Growth Rate
Economic Survey (2026)	6.8% - 7.2%
S&P Global (March 2026)	7.1%
World Bank	6.5%
International Monetary Fund (IMF)	6.4

This growth is primarily driven by:

- **Private consumption** — a young, expanding middle class sustaining retail, digital, and services demand
- **Government capital expenditure** — infrastructure and defense modernization serving as fiscal multipliers
- **Services exports** — IT, business process outsourcing, and digital services continuing to generate foreign exchange
- **Manufacturing push** — the Production-Linked Incentive (PLI) schemes encouraging domestic and foreign manufacturing investment

A landmark development in August 2025 underscored India's improved financial standing: S&P upgraded India's sovereign credit rating from BBB (Better Business Bureau),

the first such upgrade in 18 years. This signals greater credibility in global capital markets at precisely the moment when external financing conditions are tightening.

2.2 Inflation and Monetary Policy

Inflation management has been central to India's financial stability. The Reserve Bank of India (RBI) has maintained an accommodative-to-neutral monetary stance, with policy rate cuts gradually feeding into the broader credit market. Inflation is projected to moderate to approximately **4.3%** in FY27, within the RBI's target range, even as global energy price volatility — driven by the Middle East crisis — poses persistent upside risks.

However, economists caution about the poor transmission of policy rate cuts to actual credit growth, a structural challenge that limits the effectiveness of monetary easing. The RBI faces a delicate balancing act: support growth through lower rates while guarding against imported inflation from higher oil prices and a weakening rupee.

3. THE DEFENSE-FINANCE NEXUS: SECURITY SPENDING AS ECONOMIC POLICY

3.1 The Escalating Defense Budget

One of the most significant financial decisions India has made in this era of global conflict is the dramatic increase in defense expenditure. In the Union Budget for FY2026–27, Finance Minister Nirmala Sitharaman allocated an **all-time high of ₹7.85 lakh crore (approximately \$87 billion)** — a **15.2% increase** over the previous year. Defense now constitutes **2% of GDP** and **14.7% of total central government expenditure**, the highest allocation among all central ministries.

Metric	Value
Total Defense Allocation	₹7.85 lakh crore (\$87 Billion)
Percentage of GDP	2.0%
Share of Total Central Govt. Expenditure	14.7%
Aircraft & Aero Engines Procurement	₹637 Billion
Naval Fleet Modernization	₹250 Billion

This acceleration is not accidental. It reflects the government's response to the security shocks of 2025, particularly the India–Pakistan military standoff of May 2025 and the broader imperative of military modernization. The capital outlay for defense services grew by nearly 22% year-on-year, with specific allocations including:

- **₹637 billion** for aircraft and aero engines (including Rafale expansion and Sukhoi-57 procurement)
- **₹250 billion** for naval fleet modernization
- Investment in unmanned aerial systems, drones, and next-generation weaponry

3.2 Defense Spending as a Fiscal Trade-Off

The surge in defense spending creates real fiscal tension. India's fiscal consolidation path requires reducing the fiscal deficit from current levels toward the government's medium-term target. Elevated defense expenditure — though necessary for security — crowds out resources that could alternatively fund health, education, or rural infrastructure.

The historical trend reveals a consistent upward march: from ₹2.49 lakh crore in FY2016–17, defense spending has nearly tripled to ₹7.85 lakh crore in FY2026–27. If the India–Pakistan situation remains tense, pressure to sustain or accelerate this trajectory will persist, placing further strain on fiscal arithmetic.

The financial route map must therefore solve a difficult equation: **modernize the military, maintain fiscal discipline, and still fund the welfare and infrastructure spending that fuels inclusive growth.**

3.3 Atmanirbhar Bharat and the Defense-Industrial Dividend

India's strategic response to this dilemma has been to convert defense spending into an **economic stimulus** through indigenization. The "Make in India" and "Atmanirbhar Bharat" (Self-Reliant India) defense programs aim to reduce import dependency — which historically consumed a large share of the capital budget — and instead route spending through domestic manufacturers.

This approach promises a double dividend: enhanced strategic autonomy (reducing vulnerability to supplier-nation geopolitics) and domestic employment and technology

development. Defense exports have also grown, with India targeting ₹50,000 crore in defense exports by 2028, turning a historically import-heavy sector into a potential source of foreign exchange earnings.

4. FISCAL ARCHITECTURE: CONSOLIDATION UNDER PRESSURE

4.1 Fiscal Deficit and Debt Dynamics

India's fiscal position remains a structural concern. Moody's has consistently noted that India's debt-to-GDP ratio, while improving, remains significantly above the Baa-rated sovereign peer median of approximately 57%. Debt affordability — the share of revenue consumed by interest payments — remains weaker than peers, constraining fiscal flexibility precisely when geopolitical shocks demand rapid spending responses.

The government's fiscal consolidation plan calls for a gradual reduction in the deficit, but the combination of elevated defense expenditure, continued welfare commitments (food security, rural employment schemes), and the need for infrastructure investment makes rapid consolidation politically and economically difficult.

A slower pace of fiscal consolidation is now widely anticipated for FY27, partly offset by a benign inflation trajectory that provides the RBI space for accommodative monetary policy. The risk, however, is that if a global recession materializes — driven by Middle East energy disruptions or an escalation of US–China trade conflict — tax revenue growth could disappoint, widening the deficit further.

4.2 Revenue Strategy

India's revenue strategy in this environment has several pillars:

Tax Buoyancy: The formalization of the economy, driven by digital payments, GST compliance improvements, and expanded direct tax coverage, has steadily improved revenue buoyancy. Direct tax collections have grown consistently above nominal GDP growth.

Disinvestment: The government has pursued asset monetization — selling stakes in public sector enterprises and monetizing infrastructure assets through InvITs (Infrastructure

Investment Trusts) and other vehicles — though disinvestment targets have historically been missed when equity markets turn volatile amid geopolitical uncertainty.

Trade Deal Revenue Implications: The landmark India–UK Free Trade Agreement (signed May 2025) and the anticipated India–US bilateral trade deal will affect customs revenue in the near term while boosting long-term export growth and FDI inflows.

5. TRADE RECALIBRATION: NAVIGATING SANCTIONS, TARIFFS, AND SHIFTING ALLIANCES

5.1 India's Strategic Trade Positioning

India's trade policy in the wartime environment has been defined by pragmatic multi-alignment. India has continued to purchase discounted Russian crude oil, maintaining energy import costs below global benchmarks — a significant fiscal saving at a time of volatile oil prices. This has drawn criticism from Western partners but reflects India's prioritization of energy security and cost management over geopolitical signaling.

Simultaneously, India has deepened trade ties with the West. The India–UK FTA — the first major trade deal India signed with a G7 economy in decades — signals India's integration into Western-aligned supply chains for goods, services, and technology. Ongoing negotiations for a US–India bilateral trade agreement, if concluded, would significantly reshape India's export and investment landscape.

5.2 Supply Chain Diversification: India as an Alternative to China

The US–China trade war and Western sanctions on China-linked technology have accelerated a global search for alternative manufacturing hubs. India has benefited substantially, with increased FDI flows in electronics, semiconductors, pharmaceuticals, and renewable energy. Apple's decision to expand iPhone manufacturing in India, alongside investments by Samsung, Foxconn, and others, exemplifies this structural shift.

However, realizing this opportunity fully requires India to address persistent structural challenges: labor law rigidity, land acquisition complexity, logistics infrastructure gaps, and skill mismatches. The financial route map must therefore include sustained investment in these enablers.

5.3 Red Sea and Strait of Hormuz Disruptions

The Middle East conflict has significantly disrupted two critical shipping corridors — the Red Sea (via the Bab-el-Mandeb Strait, affecting Suez Canal traffic) and the Strait of Hormuz (through which approximately 20% of global oil trade passes). For India, a nation deeply dependent on West Asian energy imports and whose export and import logistics rely on these routes, the financial implications are substantial.

Higher shipping costs and longer transit times add to import costs, contribute to domestic inflation, and compress export margins. India has responded by accelerating port infrastructure development on both coasts, diversifying energy supplier relationships, and advancing its own strategic petroleum reserve capacity.

6. MONETARY AND FINANCIAL SYSTEM RESILIENCE

6.1 Foreign Exchange Reserves and Rupee Management

India's foreign exchange reserves have served as a critical buffer against external shocks. The RBI has actively managed the rupee, intervening in currency markets to prevent excessive volatility that would destabilize import costs and inflation. Reserves above \$600 billion provide approximately 10 months of import cover — a substantial cushion.

However, sustained global uncertainty, capital outflows to safe-haven dollar assets, and elevated oil prices continue to pressure the rupee. The financial route map requires maintaining adequate reserves while not exhausting them in futile defense of any particular exchange rate level.

6.2 Capital Market Stability

Indian equity markets have shown moderate resilience amid global volatility, underpinned by strong domestic institutional investor participation — a structural change from earlier cycles when foreign institutional investor (FII) outflows could destabilize markets severely. Domestic mutual fund flows, driven by systematic investment plans, now provide a stabilizing counter-weight.

Nevertheless, as analysts at Edelweiss Mutual Fund noted in early 2026, broader

geopolitical risks are not fully priced into Indian equities, particularly in rate-sensitive and globally linked sectors. A further escalation of Middle East tensions or a breakdown of India–Pakistan ceasefire could trigger sharp corrections.

6.3 Banking Sector Health

The Indian banking sector enters this challenging period in significantly better health than a decade ago. Non-performing asset ratios have declined substantially following the IBC (Insolvency and Bankruptcy Code) reforms and RBI's asset quality review. However, credit growth remains below its potential — the poor transmission problem — partly because elevated global uncertainty makes banks risk-averse and borrowers cautious.

7. KEY RISKS AND VULNERABILITIES

India's financial route map faces several critical risk scenarios:

Energy Price Shock: A closure of the Strait of Hormuz — even temporarily — could spike oil above \$150 per barrel, dramatically widening India's current account deficit, depreciating the rupee, stoking inflation, and forcing the RBI to abandon its easing stance. This single scenario could subtract 1–2 percentage points from GDP growth.

Fiscal Slippage: The combination of defense expenditure pressures, possible Pakistan-related economic disruptions, and revenue shortfalls in a global slowdown scenario could push the fiscal deficit well above targets, potentially triggering a sovereign rating concern.

China Factor: India's complex relationship with China — a major trading partner and adversarial neighbor — means that any deterioration in bilateral ties (such as the border standoffs of previous years) creates financial uncertainty. India's dependence on Chinese imports for electronics, pharmaceuticals, and solar panels represents a structural vulnerability.

Domestic Political Economy: Coalition pressures, state election cycles, and welfare spending commitments can subordinate fiscal discipline to political imperatives, a recurrent pattern in Indian fiscal history.

Global Recession Risk: If geopolitical tensions trigger a global recession, India's export revenue, remittance flows (the largest in the world at over \$100 billion annually), and FDI could all decline simultaneously, stressing the balance of payments.

8. STRATEGIC RECOMMENDATIONS: THE FINANCIAL ROUTE MAP FORWARD

Based on the analysis above, India's financial route map for navigating the wartime global crisis should rest on five strategic pillars:

Pillar 1 Fiscal Discipline with Strategic Flexibility

India must maintain its fiscal consolidation trajectory while building a war chest — a contingency reserve — for geopolitical emergencies. This requires improving revenue buoyancy through continued formalization and plugging GST leakages, while ring-fencing critical capital expenditure from cyclical fiscal pressures.

Pillar 2 — Energy Security as Financial Security

The most dangerous financial risk India faces is an energy shock. The route map must accelerate the domestic renewable energy transition (India's 500 GW renewable target by 2030), diversify crude oil suppliers across Russia, Gulf states, Africa, and the Americas, and expand strategic petroleum reserves. Every dollar saved on oil imports improves the current account, reduces inflation, and preserves foreign exchange.

Pillar 3 — Defense Indigenization as Economic Development

The defense budget surge must be made productive for the broader economy. Indigenization targets must be backed by genuine technology transfer, domestic R&D investment, and competitive procurement practices that build a viable defense industrial base rather than merely substituting domestic monopolies for foreign suppliers.

Pillar 4 — Trade Deals as Growth Architecture

The India-US trade deal, if concluded, alongside existing agreements with the UAE, Australia, and the UK, can transform India's export trajectory. The financial route map must use trade diplomacy to lock in preferential access for Indian goods and services in major markets, while managing the adjustment costs for domestic industries facing import competition.

Pillar 5 — Financial System Deepening

India's capital markets, banking system, and insurance sector must be deepened to mobilize the domestic savings needed to fund defense, infrastructure, and welfare simultaneously without excessive dependence on foreign capital. Pension fund reform, corporate bond market development, and deeper retail participation in equity markets are all essential components.

9. CONCLUSION

India navigates the global wartime crisis from a position of relative but fragile strength. Its economy is growing faster than almost any peer. Its credit rating has been upgraded. Its trade relationships are diversifying. Its democratic institutions provide a degree of policy stability that authoritarian competitors cannot match.

Yet the vulnerabilities are real. Energy dependence, fiscal pressures from surging defense needs, the unresolved China challenge, and the risk of being drawn more deeply into regional conflict all threaten to disrupt the growth trajectory that represents India's most powerful long-term strategic asset.

The financial route map is not simply a technical economic document — it is a statement of national strategy. In an era where financial resilience is as important as military capability, India's ability to sustain growth, maintain fiscal credibility, and invest in its own productive capacity will determine whether 2026 is remembered as the year India consolidated its rise, or the year external shocks derailed it.

The path is demanding. But the structural foundations — demographic dividend, digital infrastructure, entrepreneurial dynamism, and democratic legitimacy — make it navigable. What is required is the political will to stay the course.

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