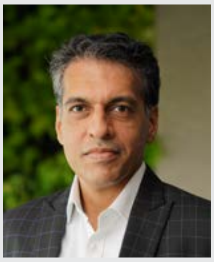
Risk Perspectives

February 2026

Introduction



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In an era marked by heightened uncertainty and rapid change, risk has moved to the centre of decision making. Shifting geopolitics, evolving trade relationships, and accelerating technological advances are reshaping the global economic landscape. For businesses, policymakers, and investors alike, the task at hand now is to build the resilience, agility, and foresight needed to succeed across the many possible outcomes arising from these shifts.

This edition of Risk Perspectives brings together timely insights on the forces which are likely to shape India's economic and business environment in the period ahead. It explores how state level fiscal choices can influence long term growth, the strategic implications of newly concluded and evolving trade agreements, and the need for organisations to prepare for uncertainty even as opportunities expand. It also examines the potential impact of the bursting of the AI investment bubble—moving from exuberance to discipline—and the transformative impact of rapidly advancing technologies on operating models, particularly in the IT and services sector.

Across these themes, a consistent message emerges—sustainable success requires pairing ambition with prudence. Organisations that adopt scenario based planning, invest with clear value creation in mind, strengthen governance, and continuously reskill their workforce will thrive. By proactively identifying risks and acting with strategic intent, leaders can turn uncertainty into a source of enduring competitive advantage.

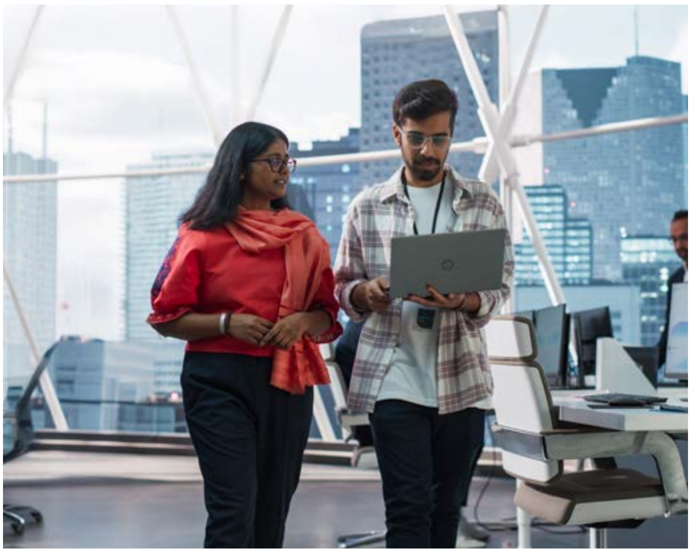
Read on for more details.

01

Increasing unconditional cash transfers could crowd out productive investments

Union Budget 2026–27 targets a fiscal deficit of 4.3% of GDP, an improvement from 4.4% in FY26 and significantly lower than the peak of 9.2% during the COVID-19 pandemic. The central government's debt-to-GDP ratio has declined from approximately 61% in FY21 to about 55.6% in FY26, with a medium-term target of 50% by FY31. While fiscal consolidation at the central level remains on track, the Economic Survey 2025–26 notes a growing shift towards unconditional cash transfers (UCTs) amid constrained fiscal space for states.

UCTs now constitute a rising share of state-level welfare spending. Aggregate expenditure on these programmes—particularly those targeted at women—is estimated to be around ₹1.7 lakh crore in FY26, comparable to the combined annual budgets (₹1.88 lakh crores) of the Northeastern states. The number of states implementing the transfers has increased more than fivefold between FY23 and FY26, with half of them estimated to be in revenue deficit.



Implications and imperatives

High UCTs too, amongst other factors, have contributed to rising combined gross fiscal deficit of states, increasing from 2.6% of GDP in FY22 to 3.2% in FY25 provisional actuals, and the revenue deficit widening from 0.4% to 0.7% of GDP, indicating continued borrowing for revenue expenditure. The committed expenditures, salaries, pensions, interest, and subsidies—absorbed 62% of states' revenue receipts in FY24, leaving limited fiscal space.

The rapid expansion of UCTs raises concerns about potential crowding out of productive investments required for growth, such as investments in employment, skills, and human capital. Apart from constraining the fiscal space for the governments, such benefits could also lead to a decline in female labour force participation.

Given this context, businesses would need to take proactive measures to fill the potential gaps in creating enabling infrastructure for growth by collaborating with governments for mass-scale skilling of the people, strengthening the government initiatives in healthcare through technology-led solutions, and enabling greater female participation in the labour force. This approach could also create growth and investment opportunities in the EdTech and HealthTech sectors.

Sources:
Government of India, Economic Survey 2025–26,
PwC, Catapulting India's next growth leap

02

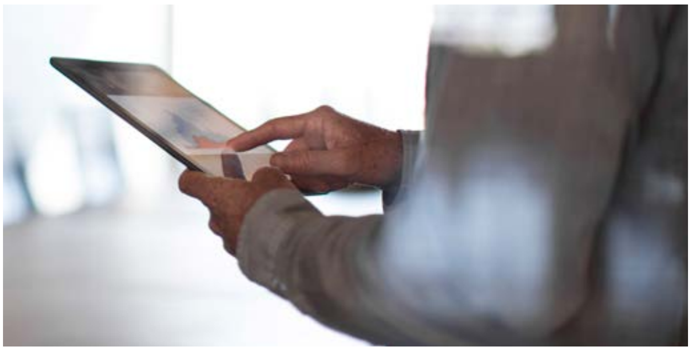
Trade deals: Early days to lock long-term strategy, yet businesses need to plan ahead

India made progress in trade negotiations with two of its key economic partners, the United States (US), and European Union (EU), in 2026.

In January 2026, India and the EU concluded negotiations on a free trade agreement (FTA), targeting a combined market opportunity of $24 trillion. The FTA offers market access for over 99% of India's exports by trade value while preserving policy space for sensitive sectors. Bilateral merchandise trade between India and the EU was valued at approximately ₹11.5 lakh crore ($136.54 billion) in 2024–25, with exports from India totaling ₹6.4 lakh crore ($75.85 billion). Services trade reached ₹7.2 lakh crore ($83.10 billion) in 2024.

In early February 2026, India and the US drafted a framework for an interim trade agreement, which removes the punitive 25% US tariff on Indian goods and reduces US reciprocal tariffs from 25% to 18%. Under the agreement, India would also lower tariffs on certain industrial and agricultural products from the US and plans for purchases exceeding $500 billion in energy, information and communication technology, coal, and other products from the US.

However, in mid-February, US's Supreme Court ruled against the imposition of the reciprocal tariffs imposed in August 2025, prompting US to impose global tariffs of 15% across all countries, with immediate effect, for the next 150 days.



Implications and imperatives

Despite fluid trade dynamics, India's trade outlook has improved, with ongoing negotiations potentially expanding access to European markets, particularly for micro, small and medium enterprises (MSMEs) in sectors such as textiles, leather, chemicals, and food. The deal with EU could also help Indian firms realign supply chains through high tech imports from the EU, while reduced US tariffs may restore export competitiveness.

However, potential gains could be impacted if the US were to conclude competing bilateral agreements. For example, the recent US–Bangladesh deal allowing duty free imports of Bangladeshi apparel made from US cotton, could erode India's relative competitive advantage for apparel exports to US, and potentially disrupt exports of raw cotton and yarn to Bangladesh.

As negotiations are yet underway and specifics yet to emerge, amid geopolitical uncertainty, locking into long-term strategies would be premature. Instead, businesses should consider adopting agile, scenario-based planning to capture early opportunities while mitigating risks. This includes conducting market assessments, scanning the relevant regulatory environments for strengthening compliance with regulatory, ESG and data standards, and upgrading certifications. Businesses could explore investment opportunities in clean energy, HealthTech, and digital infrastructure enabled by prospective cost effective high tech imports.

Sources:
Factsheet on India-EU trade deal, US Government Factsheet, US Government Statement

03

AI investment bubble to recalibrate return on investment expectations

In 2025, global venture capital (VC) investment in AI firms accounted for 61% of the total VC funding of USD 258.7 billion indicating that the share of investments in AI firms doubled from 30% in 2022. This significant increase has prompted concerns regarding the possibility of an ‘AI bubble’, like the dot-com period of the late 1990s. Leading AI companies have attained substantial valuations underscoring the intense pursuit of AI investments.

The International Monetary Fund (IMF), in its World Economic Outlook update (January 2026) cautions that if the anticipated productivity gains from AI fail to materialise, a sharp revaluation could trigger an abrupt market slump and erode investor wealth with global spillover effects. However, AI sector’s crash is considered to be less likely to impact the global markets due to the small role of debt in funding it.

Implications and imperatives

While AI’s transformational promise remains real, a disorderly correction could lead to startup failures, asset price declines, and tighter financing, A sharp dip in global financial and currency markets could cause a ripple effect on Indian markets as well, causing volatility in the short run.

Potentially lower or delayed returns on AI investments are unlikely to derail adoption but could recalibrate expectations of benefits and tighten investment criteria. Attractive valuations, due to the correction in asset prices, may also spur consolidation through increased M&A activity.

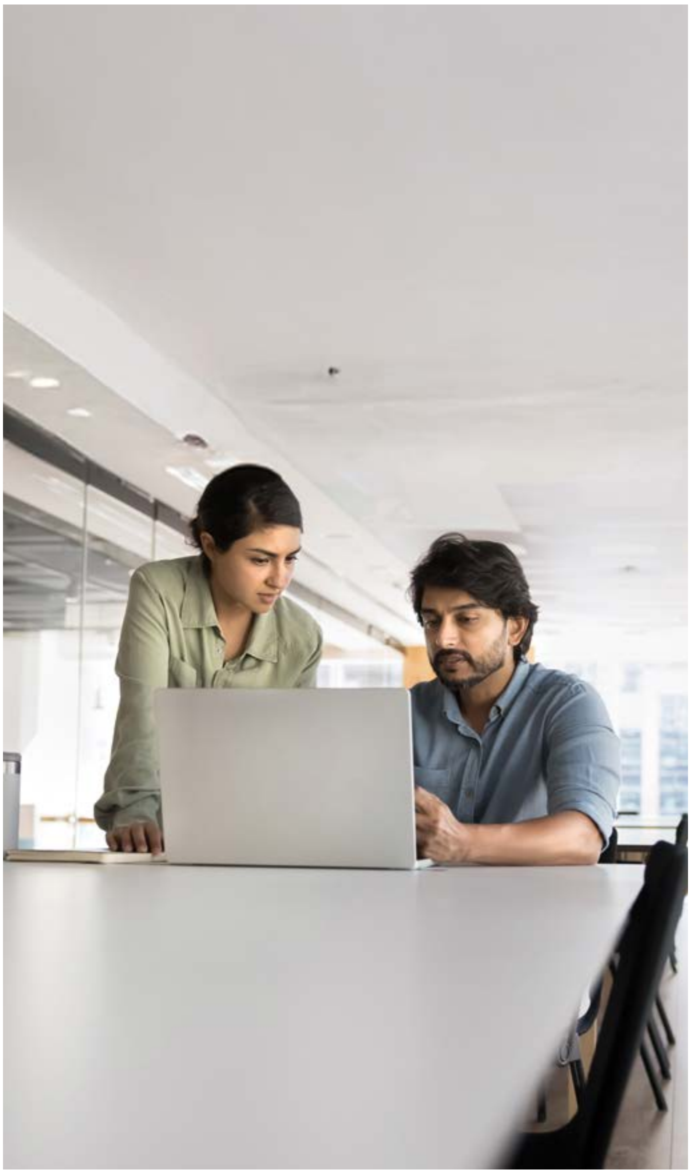
To safeguard themselves from future instances of meltdown of markets, organisations need to proactively prepare for market volatility through regular stress testing and multiple scenario planning.

Source:
IMF; OECD, Venture capital investments in artificial Intelligence through 2025

04

Rapidly evolving technology to transform the Indian IT sector's operating model

In early 2026, Indian IT stocks shed over ₹6 lakh crore (~$50 billion) in market value within days as investors reacted to new AI tools which demonstrated dramatic gains in coding and process automation. What was unsettling for the market was the realisation that the core tasks of software development, testing, and maintenance—the backbone of India's $280 billion IT outsourcing industry—are increasingly being performed by AI.



Implications and imperatives

Recent advances in generative and agentic AI could disrupt India's IT services sector. The IMF estimates that up to 40% of global jobs could be affected by automation. For India's IT majors, this shift challenges the manpower intensive, outsourcing-led model that underpinned their growth. AI driven automation threatens core revenue streams—application development, maintenance, and testing—which accounted for 48% of leading top Indian IT and ITES firms' revenues in FY25

This disruption could trigger an operating model reinvention for IT and ITES companies where transformation could extend beyond task automation to a fundamental redesign of workflows, with work reclassified into technology led, hybrid (human plus technology), and human led activities. To remain competitive, firms must recalibrate skill and technology requirements while investing in AI platforms, scalable infrastructure, and deeper integration of AI into client solutions.

Sustained competitiveness will depend on embracing AI to drive productivity, redefining roles, and evolving into AI driven technology partners. Successful execution could not only help firms retain relevance but also enable them to transfer these capabilities to clients across sectors, supporting broader operational reinvention. The effectiveness of AI strategies will be measured not by opportunity identification alone, but by the ability to execute, scale, and embed AI across delivery models, core operations, and client engagements.

Sources:
The Economic Times; IMF; Staff Discussion Notes: Bridging Skill Gaps for the Future; Nasscom Press Release

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