RATINGS & RESEARCH

Macro Pulse Report

March 2025

From Acuité's Research Desk

Dear Readers,

The sentiment around the Indian economy has been bolstered by the recent upward revisions in the GDP numbers. However, the overall growth story remains primarily a function of domestic consumption, which is recovering moderately, and external factors such as a sluggish global economy and trade wars have also tempered the pace of expansion.

Core inflation has shown signs of firming up, rising to 4% as gold prices surged and service costs remained sticky. While the overall disinflationary trend has created space for monetary easing, factors like rupee depreciation and global commodity price movements could pose upside risks. Subdued inflation — marked by a drop in retail CPI to 3.61% — has set the stage for further easing; we expect RBI to deliver another 25bps cut in early April.

Although the RBI slashed the repo rate from 6.5% to 6.25% in February, the transmission of this cut to the broader lending market has been slower than expected. Tight liquidity is constraining banks, with only floating-rate loans reflecting the easing, while fixed-rate loans linked to the MCLR lag behind. Moreover, the persistent liquidity deficit has been a key factor preventing faster transmission of rate cuts into the broader economy. Expectations are that liquidity will improve with the onset of the new fiscal year, aided by a second rate cut in April, enabling banks to pass on lower funding costs to borrowers fully.

Looking forward, India's near-term economic trajectory will be partly contingent on external shocks; with the fiscal year coming to an end, we keep our GDP forecast for FY 25 pegged at 6.4%.

Q3 FY25 GDP strong, FY23-FY24 data stronger

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India's Q3 FY25 GDP growth staged a recovery, clocking a growth of 6.2%YoY higher than 5.6% in Q2 FY25. Growth was driven by improvement in consumption and exports, even as investment growth remained subpar. For the full year, growth now stands revised up by 10 bps to 6.5%.

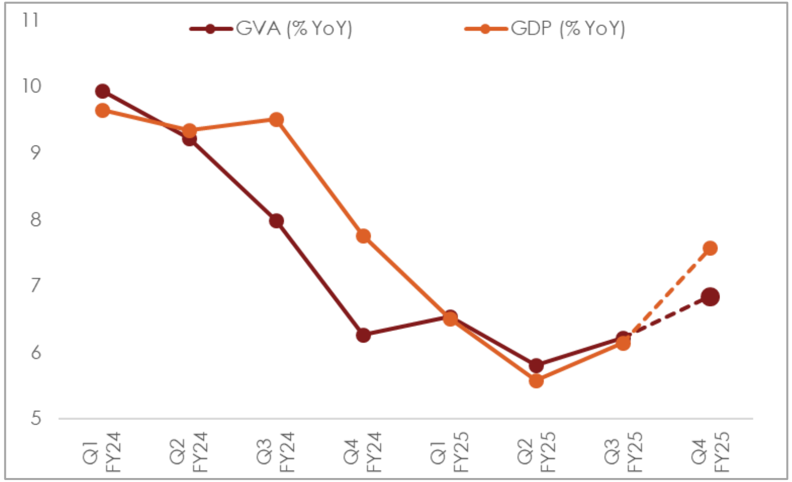
NSO also released final/revised estimates for FY23/FY24

- FY23 GDP final growth now stands at 7.6%, up 60 bps vs. the first revised estimate.
- FY24 GDP growth got reported at 9.2%, up 100 bps vs. the second advance estimate.

	Old			Revised		
	FY23	FY24	FY25	FY23	FY24	FY25
GVA	6.7	7.2	6.4	7.2	8.6	6.4
Agri and allied	4.7	1.4	3.8	6.3	2.7	4.6
Industry	2.1	9.5	6.2	2.5	10.8	5.6
Mining and Quarrying	1.9	7.1	2.9	3.4	3.2	2.8
Manufacturing	-2.2	9.9	5.3	-1.7	12.3	4.3
Electricity, Gas, Water Supply etc.	9.4	7.5	6.8	10.8	8.6	6.0
Construction	9.4	9.9	8.6	9.1	10.4	8.6
Services	10.0	7.6	7.2	10.3	9.0	7.3
Trade, Hotels, Transport, Communication	12.0	6.4	5.8	12.3	7.5	6.4
Financial, Real Estate & Professional Services	9.1	8.4	7.3	10.8	10.3	7.2
Public Administration, Defence	8.9	7.8	9.1	6.7	8.8	8.8
	Old			Revised		
GDP	7.0	8.2	6.4	7.6	9.2	6.5
Private Final Consumption Expenditure	6.8	4.0	7.3	7.5	5.6	7.6
Government Final Consumption Expenditure	9.0	2.5	4.1	4.3	8.1	3.8
Investments	6.6	9.0	6.4	8.4	8.8	6.1
Exports	13.4	2.6	5.9	10.3	2.2	7.1
Less Imports	10.6	10.9	-1.3	8.9	13.8	-1.1

Q4 FY25: Is growth momentum quickening further?

As per NSO's projections, GDP could see a faster acceleration in Q4 FY25 compared to GVA. Imputed GDP growth for Q4 FY25 stands at 7.6%, premised on a 9.9% growth in Private Final Consumption Expenditure (PFCE).



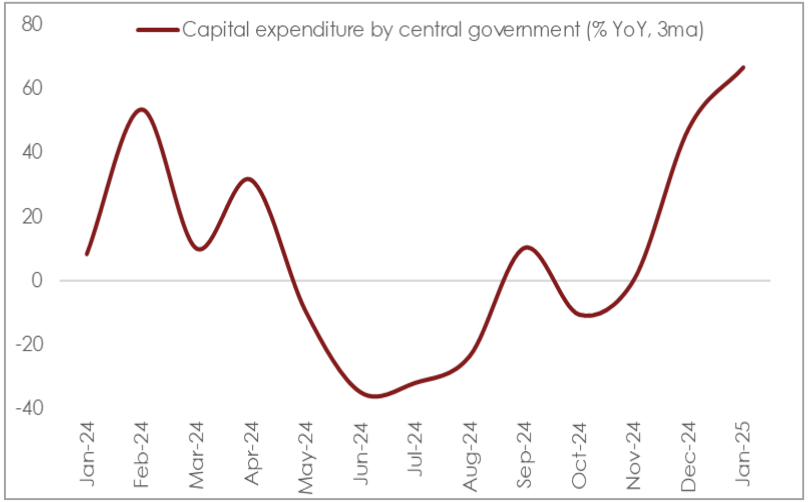
High-frequency lead indicators do paint a better growth picture for Jan-25 so far. Indicators such as steel consumption, cement production, passenger air traffic, and tractor sales have posted strong growth at the start of the calendar year.

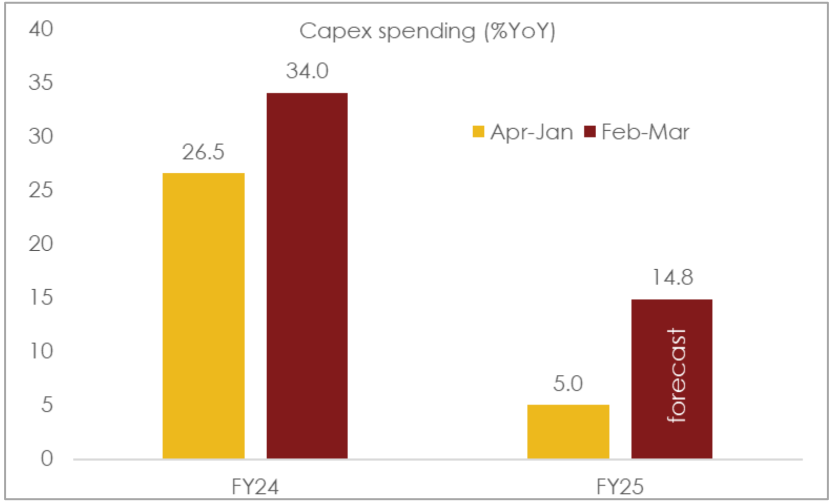
High frequency indicators	Monthly						
	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24	Jan-25	Feb-25
Passenger vehicle sales (%YoY)	-1.8	-1.4	0.9	4.0	10.0	1.6	1.9
Credit card spends (%YoY)	19.9	18.0	16.9	18.1	15.6	13.0	
Two wheeler sales (%YoY)	9.3	15.8	14.2	-1.1	-8.8	2.1	-9.0
Tractor sales (domestic, %YoY)	-5.8	3.7	22.4	-1.3	14.0	11.4	35.9
Port cargo traffic (%YoY)	6.7	5.9	-3.4	-5.0	3.4	6.2	7.4
Air Cargo traffic (%YoY)	12.5	18.0	14.5	9.7	8.0	7.0	
Domestic air passenger traffic (%YoY)	6.7	7.4	9.6	13.8	10.8	14.1	
Intl Air Passenger traffic (%YoY)	11.1	11.2	10.3	10.7	9.0	11.1	
GST E-way bills (cr)	10.5	10.9	11.7	10.2	11.2	11.8	11.2
Steel consumption (%YoY)	10.0	11.8	8.9	9.5	5.2	10.9	
Cement production (%YoY)	-2.5	7.6	3.1	13.5	4.6	14.5	
Manufactruing PMI (index)	57.5	56.5	57.5	56.5	56.4	57.7	56.3
Services PMI (index)	60.9	57.7	58.5	58.4	59.3	56.5	59.0
Core industries (%YoY)	-1.5	2.4	3.8	4.4	4.8	4.6	
IIP (%YoY)	0.0	3.2	3.7	5.0	3.5	5.0	

Q4 FY25: Growth proponents Back-ended government capex supports

Dec-24 and Jan-25 have seen a pick-up in the pace of the Government's capex spending after slow traction up to Nov-24.

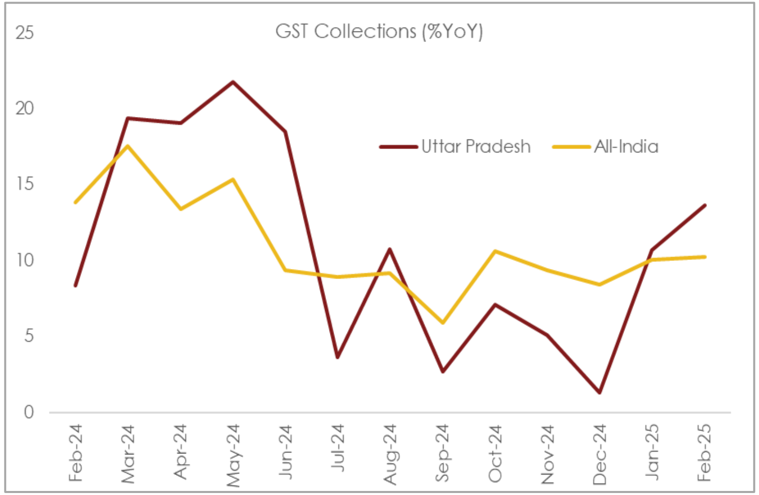
Despite the Government having scaled down FY25 capex budget (to Rs 10.2 tn from Rs 11.1 tn earlier), the last two months of the fiscal year are likely to see an annualized increase of ~15% (3x spending over the same period in the previous fiscal year) to offer sizeable back-loaded support to growth.





Q4 FY25: Growth proponents Maha Kumbh effect

Maha Kumbh pilgrimage that ran over the course of 7 weeks (13th Jan to 26th Feb-25) is likely to have a substantial impact on the economy of Uttar Pradesh.



Some sectors that could have benefited from the Maha Kumbh generated economic activity are:

- Food items - wheat, flour, sugar, tea, spices, edible oils, vegetables, dairy products
- Retail goods – mattresses, tents, beds, plastic bottles, firewood, heaters, souvenirs, religious items
- Services - Hospitality (hotel, food vendors etc.) and Transport (rail, road, air, cabs, bike taxis)

Although the localized impact of the religious congregation may be significant, the effect on India's growth is likely to be minimal.

Budget's consumption bonanza

The FY26 Budget provided a consumption stimulus by announcing a reduction in personal income taxes, which is likely to cost the exchequer Rs 1 tn. The improvement in disposable incomes of middle-income earners can be expected to support urban consumption over the coming quarters.

The impact of the consumption stimulus could end up being more durable amidst the direct income cash transfers (at state-level) that are likely to play out fully in FY26, along with the impending 8th Pay Commission to be implemented Jan-26 onwards.

Consumption stimulus: Possible impact	
Staples	Food with higher nutritional value
Small-ticket discretionary goods	Home furnishings, Phone, Laptops etc.
Big-ticket discretionary goods	Auto and two-wheeler
Discretionary services	Air travel, Hospitality, Concerts

Tax reduction
-To cost exchequer ~Rs 1 tn

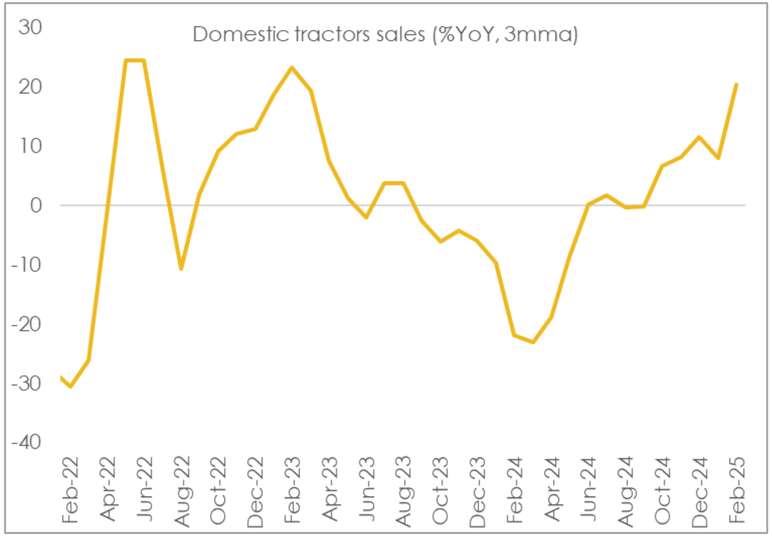
Direct cash transfer by states
- Total outgo could be close to Rs 2 tn

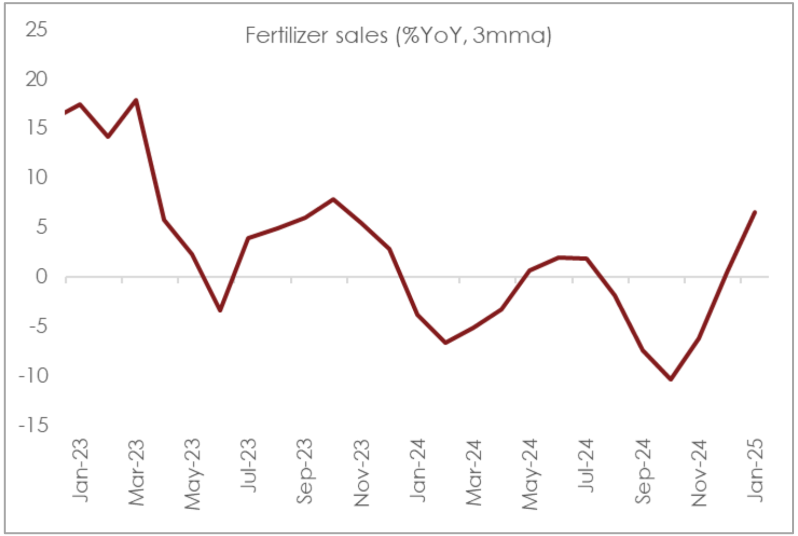
8th pay commission
- To be implemented Jan-26 onwards

Rural recovery on track

Tractor sales have been fairly healthy over the last 2 quarters, owing to above normal monsoon in 2024 and healthy prospects of Rabi production.

Recovery in agriculture is reflected in fertiliser sales, too, which have picked up in recent months to near 1-year highs. Keeping in mind the strength in demand, the Government's import of fertilisers has ramped up in Jan-25.





India-US negotiations: Taking centre-stage

Reciprocal tariffs, that are likely to come into effect from 1st Apr-25, are being keenly watched for impact on trade flows between India and the US. The most vulnerable sectors are chemicals, metal products, gems & jewellery, automobiles, pharmaceuticals, and food products.

India's Top Exports to the USA (Jan-Nov-24, USD bn)	
Electrical Machinery & Equipment	11.3
Gems & Jewellery	8.6
Pharma	8.2
Nuclear Reactors/Boilers/Mechanical Appliances	6.0
Mineral Fuels/Products	4.2
OtherTextile Made Ups	2.7
Iron & Steel Products	2.7
Auto/ Auto Components	2.4
Apparel/Clothing Accessories Knitted	2.4
Organic Chemicals	2.3
Apparel /Clothing Accessories Non-Knitted	2.3
Fishery Products	1.8
Plastic/Products	1.5
Miscellaneous Chemical Products	1.1
Carpets	1.1
Furnishings	1.1
Total	**59.6**
Share in total exports to the US	**80.9%**
Share of exports to US to total exports from India	**18.2%**

India has already cut tariffs on several items, for example, on high-end motorcycles (30%) and bourbon whiskey (between 50 to 100%), while promising to review other tariffs.

Looking beyond near-term uncertainty, PM Modi and US President Trump, at the former's recent visit to the US, displayed camaraderie, promising to strengthen economic ties and enhance bilateral trade, especially in sectors of energy, defence and technology.

India may propose to fix certain quantum or quota of its total oil imports for sourcing crude from the US

The government is working on a list of items on which India is willing to reduce tariffs, aimed at shielding India from reciprocal tariffs.

The government is preparing a ToR for a Bilateral Trade Agreement (BTA), with the aim of concluding the initial phase of discussions by fall 2025.
This initiative reflects the government's commitment to resolving long-standing trade challenges and advancing the shared objective of doubling bilateral trade to USD 500 bn by 2030.

FY26 growth outlook: GDP at 6.6%

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The consumption boost accorded by the Budget, via a reduction in the personal income tax burden on middle-income earners, is likely to add 20-30 bps to headline GDP growth in FY26.

1) Global geopolitics and geoeconomics remain uncertain – to weigh on trade,

2) Private sector capex recovery timeline

3) The government's fiscal impulse remains lower

4) Swing in input price inflation (i.e., WPI) from negative to positive to weigh on manufacturing value-added

5) The early onset of summer remains on watch for any adverse impact on agri-output

1) Outlook for Rabi is positive

2) Rural demand witnessing a gradual recovery, should galvanize further

3) Tax reduction led upside to urban consumption

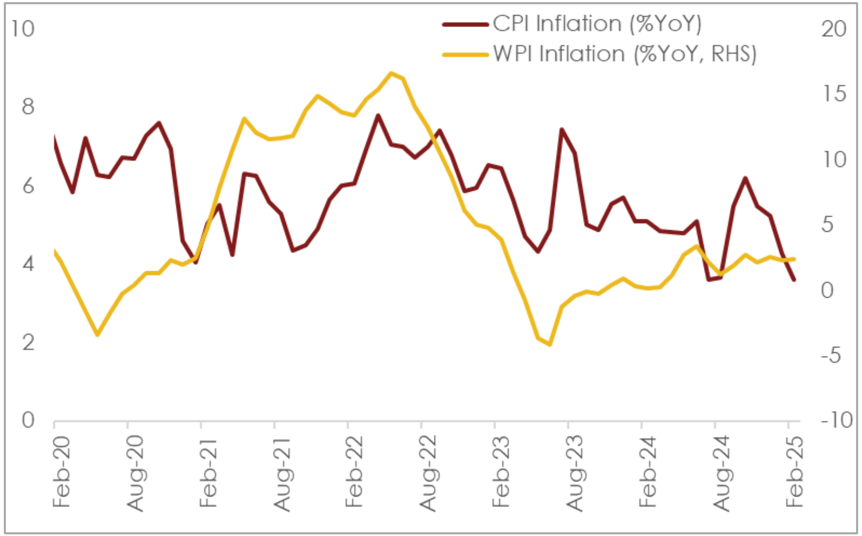
4) Front loading of government capex to offer support to growth

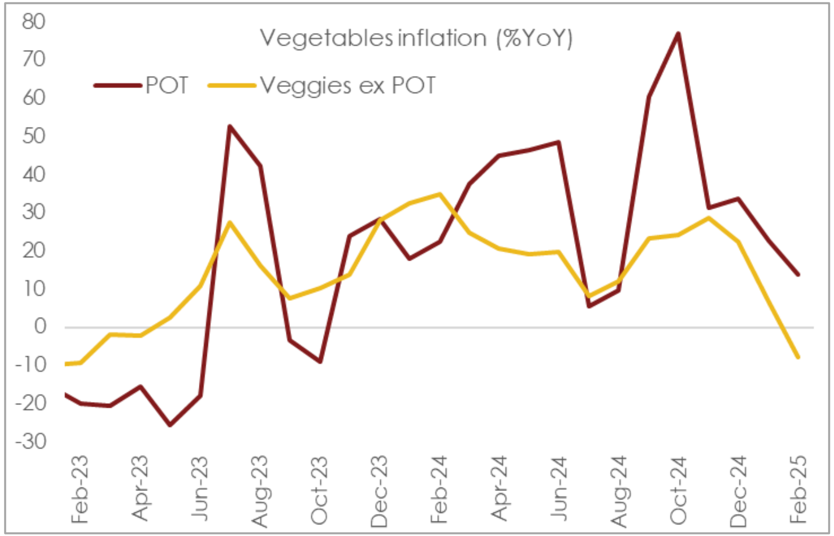
CPI inflation eases to a 7-month low in Feb-25

India's CPI inflation slipped close to its post-COVID low, with the Feb-25 print coming in at 3.61% YoY, down from 4.26% in Jan-25. While market participants expected inflation to show a deceleration towards 4.0% (consensus expectation), the actual print posted a considerable downward surprise.

Annualised food inflation retreated sharply to an 11-month low of 3.84% in Feb-25 from 5.68% in Jan-25.

- Sequentially, food prices fell by 1.64% MoM, with significant price correction seen in Vegetables (-11.20% MoM)

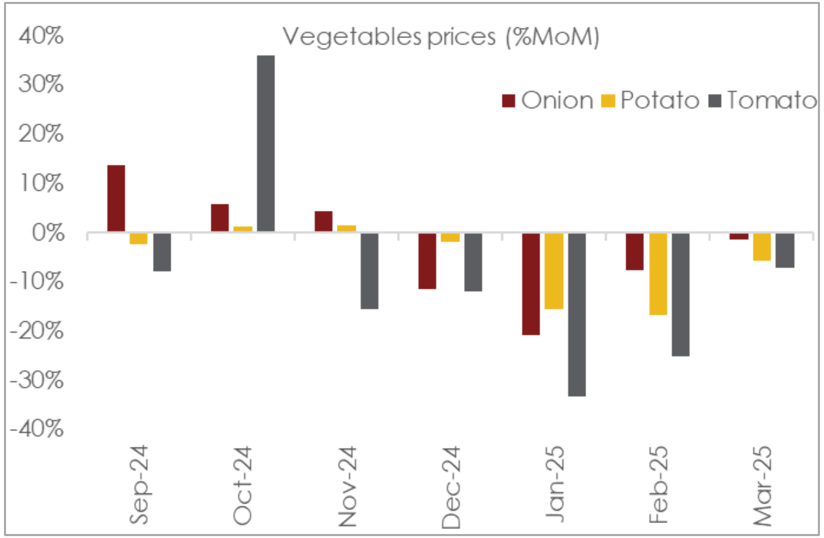




POT = Potatoes, Onion, Tomato,

Veggies and wheat on watch, as summer sets in early

Signals from daily mandi prices suggest that correction in key vegetable prices has eased significantly in Mar-25, so far.



POT = Potatoes, Onion, Tomato,

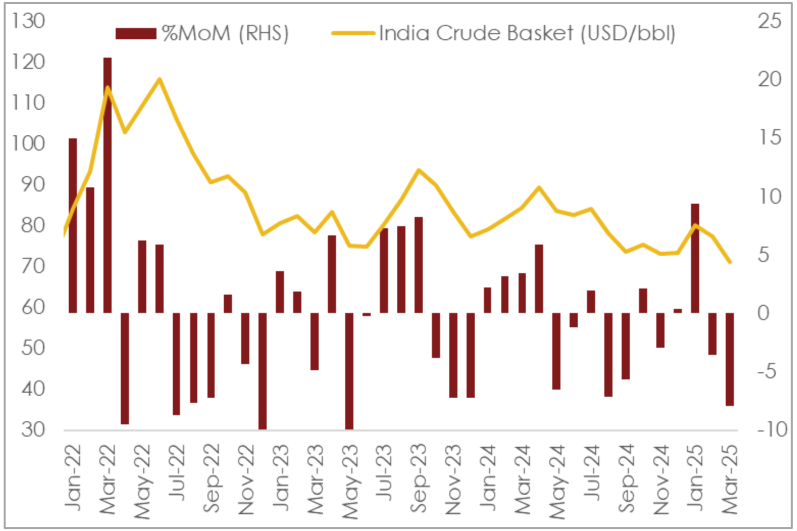
Despite early onset of summer, sowing for the summer crop (i.e., Zaid) has though seen a good start.

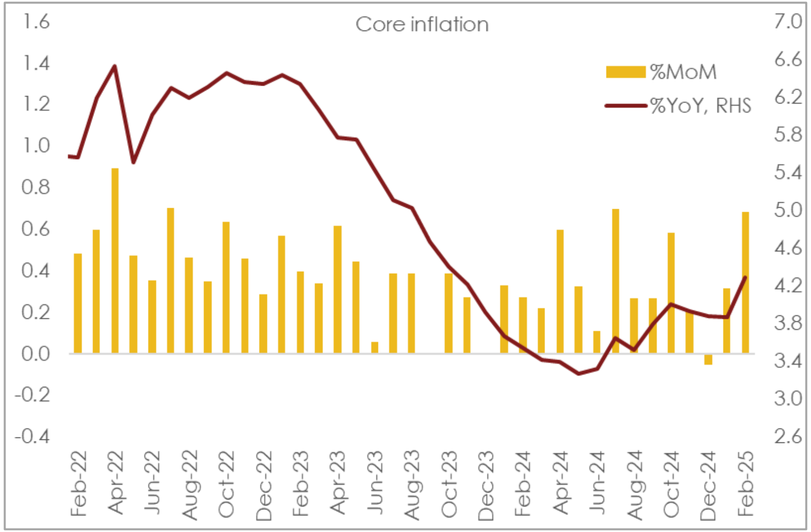
Summer Sowing Area Coverage (7th Mar-25, in lakh ha)			
Crop Category	Area Sown (2024)	Area Sown (2025)	% change
Rice	**24.3**	**27.1**	**11.5**
Pulses	**2.1**	**5.0**	**144.4**
– Greengram	1.3	3.6	168.1
– Blackgram	0.6	1.3	106.0
– Other Pulses	0.1	0.1	56.1
Coarse Cereals	**2.0**	**2.9**	**45.0**
– Jowar	0.1	0.3	344.8
– Bajra	0.3	0.5	59.4
– Ragi	0.1	0.1	26.8
– Small Millets	0.0	0.0	
– Maize	1.5	2.0	28.3
Oilseeds	**2.6**	**2.5**	**-4.7**
– Groundnut	1.7	1.5	-7.4
– Sunflower	0.1	0.2	15.4
– Sesamum	0.8	0.8	2.0
– Other Oilseeds	0.1	0.0	-59.7
Total	**31.0**	**37.5**	**21.1**

Crude and core both offer comfort

Globally, crude prices have been fairly benign in the USD 70-75 pb range amidst concerns about demand being lower and OPEC+'s decision to enhance supplies in the near term.

While the Feb-25 uptick in core inflation was driven by an upside in domestic gold prices (global price surge + Rupee depreciation), marginal upside risks to retail inflation have emerged with the recent rupee depreciation*.



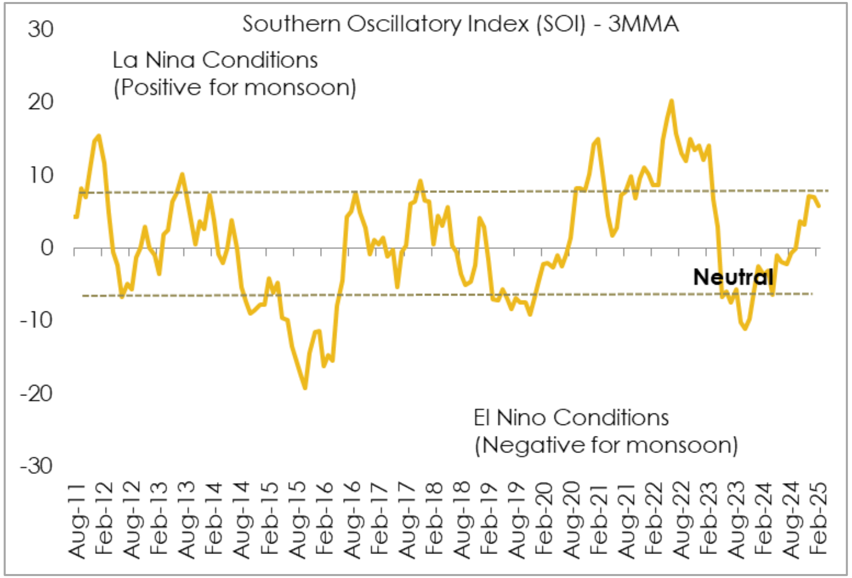


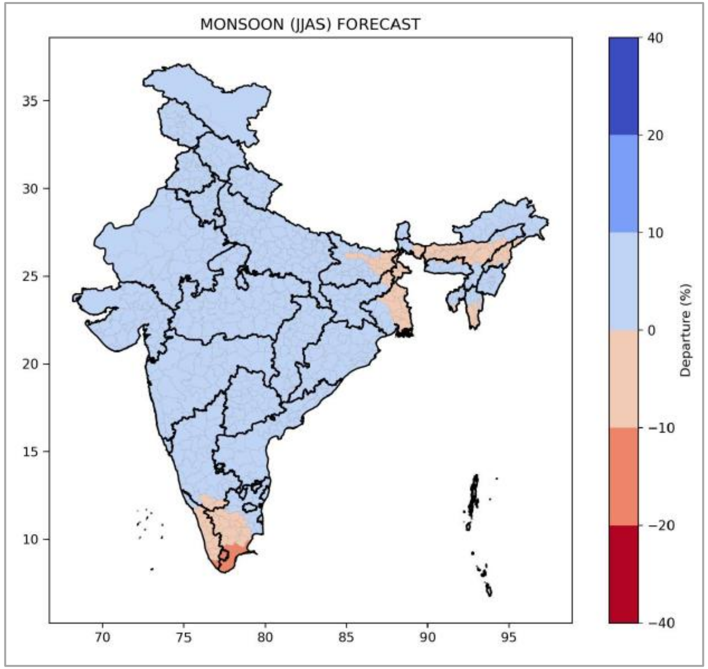
*As per the RBI, a 5% weakness in the rupee adds about 35 bps of upside to headline inflation.

2025 Southwest monsoon will be critical

ENSO conditions are likely to remain neutral going into the summer months. This should prove to be neutral for Southwest monsoons.

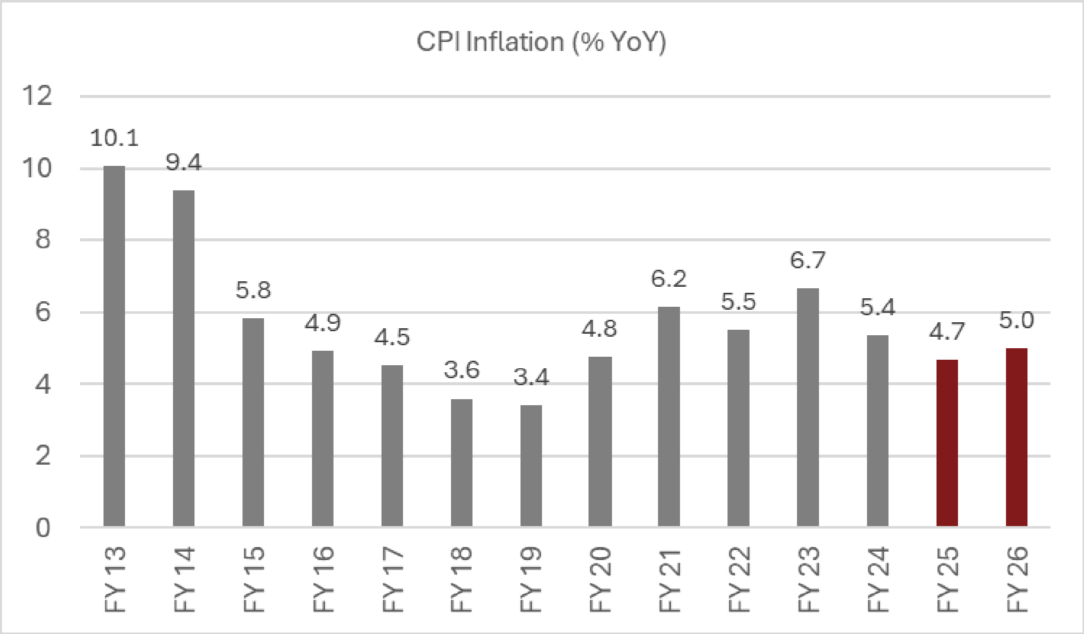
As per NIRUTHI - a private weather forecaster, for India's Southwest Monsoon season, rainfall is forecast at 102% of LPA at an all-India level.





FY26 CPI inflation: To post moderate 5% increase

Against FY25 average CPI of 4.7%, we estimate inflation to inch up to 5.0% in FY26



Snapshot of Apr-Jan FY25 fiscal performance

The cumulative fiscal deficit for the period Apr-Jan FY25 stood at 74.5% of the revised estimate, higher than 66.7% of actuals in the corresponding period in FY24. This is predominantly on account of the relatively lower pace of revenue accretion (esp. net tax and divestments), while expenditure disbursal retained its comparative momentum.

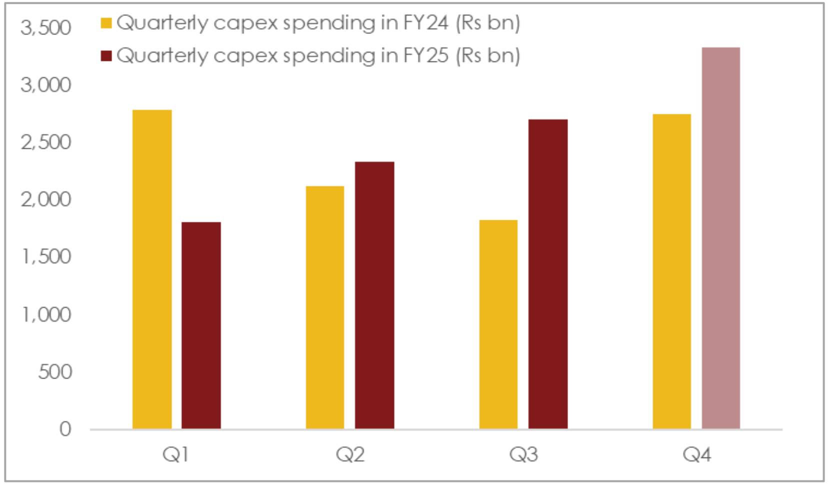
Key Fiscal Variables (Cumulative position, as of January)				
	% of FY Actual/Target		%YoY	
	FY24	FY25	FY24	FY25
Revenue Receipts	81.3	76.8	15.5	6.9
Net Tax	80.8	74.4	11.3	1.3
Non-Tax	84.1	88.1	46.4	38.3
Non-Debt Capital Receipts	56.6	49.5	-40.2	-14.6
Total Receipts	**80.8**	**76.3**	**13.9**	**6.6**
Revenue Expenditure	75.4	76.1	1.4	6.8
of which, Interest Payments	*77.2*	*76.9*	*11.2*	*6.5*
of which, Major Subsidies	*76.3*	*88.1*	*-21.0*	*7.0*
Capital Expenditure	76.0	74.4	26.5	5.0
Total Expenditure	**75.5**	**75.7**	**5.9**	**6.4**
Fiscal Deficit	**66.7**	**74.5**	**-**	**-**

Tax revenue remains on track; Capex disbursal to pick-up sequentially

On aggregate basis, gross tax collection in FY25 is running somewhat below the revised target. Upside in income tax, customs, and GST collections is getting offset by downside in corporate tax and excise collections. Underperformance by net tax revenue is largely on account of front loading of tax devolution to states and is likely to smoothen by Mar-25.

Growth in key tax categories	FY25 BE (%)	FY25 RE (%)	Apr-Jan FY25 (% YoY)
Gross Tax	**10.8**	**11.2**	**10.3**
Corporate Tax	12.0	7.6	-0.6
Income Tax	13.6	20.3	22.0
Customs	2.9	1.7	8.6
Excise	4.5	-0.1	-1.3
GST	10.9	10.9	11.4
Net Tax	**11.0**	**9.9**	**1.3**

Notwithstanding a slow start to capex disbursals in FY25, the momentum appears to be picking up sequentially on a QoQ basis.



Note: Q4 FY25 is derived basis RE

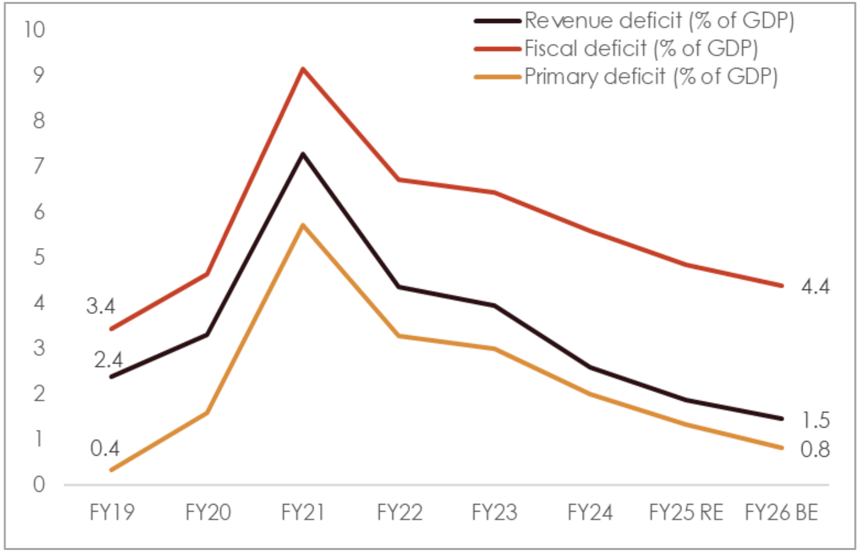
FY26 Union Budget: At a glance

The government revised lower its target for FY25 fiscal deficit to 4.8% of GDP from 4.9% earlier. For FY26, the Union Budget projects a fiscal deficit ratio of 4.4%, the lowest in the post-COVID phase. At a headline level, the entire compression in fiscal deficit in FY26 is budgeted to be driven by curbing revenue expenditure by 40 bps.

	In Rs bn			As % of GDP		
	FY24	FY25 RE	FY26 BE	FY24	FY25 RE	FY26 BE
Revenue Receipts	27,290	30,880	34,204	9.2	9.5	9.6
Gross Tax Revenue	34,655	38,535	42,702	11.7	11.9	12.0
Net Tax Revenue	**23,273**	**25,570**	**28,374**	**7.9**	**7.9**	**7.9**
Non-Tax Revenue	**4,018**	**5,310**	**5,830**	**1.4**	**1.6**	**1.6**
Dividends & Profits	1,709	2,893	3,250	0.6	0.9	0.9
Non-Debt Capital Receipts	**598**	**590**	**760**	**0.2**	**0.2**	**0.2**
Disinvestments	331	330	470	0.1	0.1	0.1
Total Expenditure	44,434	47,165	50,653	15.0	14.6	14.2
Revenue Expenditure	**34,943**	**36,981**	**39,443**	**11.8**	**11.4**	**11.0**
Interest Payment	10,639	11,379	12,763	3.6	3.5	3.6
Subsidy	4,349	4,279	4,262	1.5	1.3	1.2
Capital Expenditure	**9,492**	**10,184**	**11,211**	**3.2**	**3.1**	**3.1**
Revenue Deficit	7,652	6,101	5,238	2.6	1.9	1.5
Fiscal Deficit	**16,546**	**15,695**	**15,689**	**5.6**	**4.8**	**4.4**
Primary Deficit	5,908	4,316	2,926	2.0	1.3	0.8

FY26 revenue deficit to be below pre-COVID level; borrowings to remain ranged

The revenue deficit is budgeted to moderate to an 18-year low of 1.5% of GDP in FY26. The primary deficit is gradually getting aligned with its pre-COVID level.



The Budget pegs FY26 gross and net market borrowings at Rs 14.8 tn and Rs 11.5 tn, respectively. The increase in net g-sec borrowing in FY26 is inorganic in nature due to higher than budgeted buybacks (GoI conducted Rs 882 bn worth of buybacks in FY25 against its budgeted target of Rs 302 bn). Seen as a ratio to GDP, FY26 net g-sec borrowing stands at a 4-year low of 3.0%.

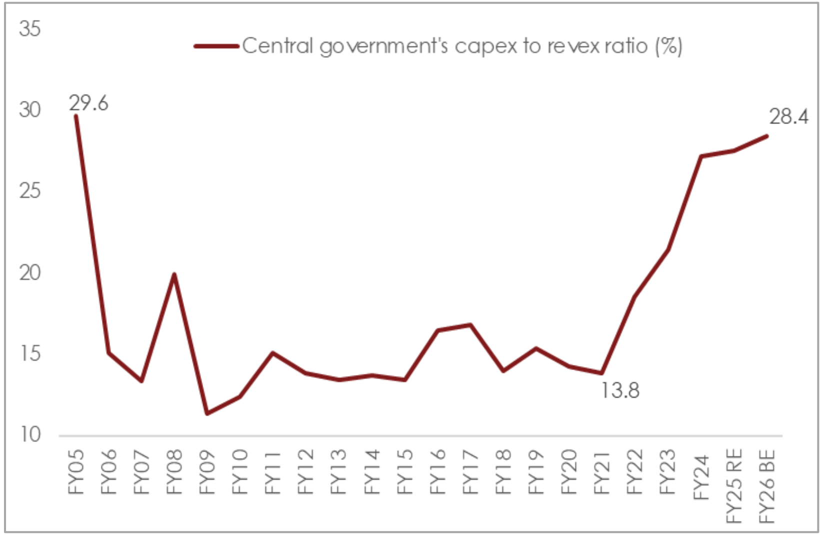
Key Sources of Financing Fiscal Deficit (Rs bn)			
	FY24	**FY25 RE**	**FY26 BE**
External Debt	551	320	235
Net Market Borrowing	12,261	9,851	11,538
G-Sec	**11,778**	**10,745**	**11,538**
T-Bill	483	-895	0
Small Savings	4,514	4,119	3,434
State Provident Funds	51	50	50
Others*	-838	-45	407
Cash Drawdown	8	1401	25
Total	16,546	15,695	15,689

* Includes Internal Debt and Public Account (other than SPF)

We expect the FY26 fiscal deficit target of 4.4% of GDP to be met.

Expenditure quality to get healthier in FY26; New operational target from FY27

Notwithstanding the pruning of overall expenditure, the spending mix is set to improve further in FY26, with the capex/revex ratio budgeted to increase to its highest level in 21 years.



The central government will switch to a debt targeting framework from FY27. As per the budget documents, the central government would endeavour to keep fiscal deficit in each year from FY27 such that the central government debt is on declining path towards the range of 49-51% of GDP by FY31 vis-à-vis 56.1% projected for FY26.

FY26 Union Budget's projection of central government's debt (% of GDP) by FY31

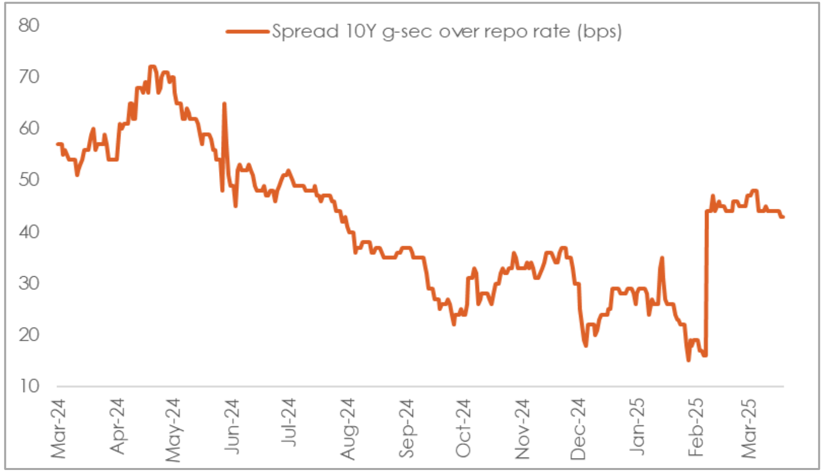
	Mild Case	Moderate Case	High Case
FY31 (Projected with 10.0% Nominal GDP growth)	52.0	50.6	49.3
FY31 (Projected with 10.5% Nominal GDP growth)	51.0	49.7	48.4
FY31 (Projected with 11.0% Nominal GDP growth)	50.1	48.8	47.5

Note: Central government debt as per FY25 RE and FY26 BE is at 57.1% and 56.1% of GDP respectively.

Rates stable, but term premium rises

The 10Y g-sec yield has traded in a narrow range of 6.66-6.73% since the last MPC review in Feb-25. Although yields rose after the announced rate cut (likely due to caution on INR and lack of any upfront announcement of liquidity infusion), they stabilised in recent weeks, with 10Y g-sec currently trading at 6.66%. Stepping up of OMO purchases, moderation in US yields, and stability in INR have all contributed towards this.

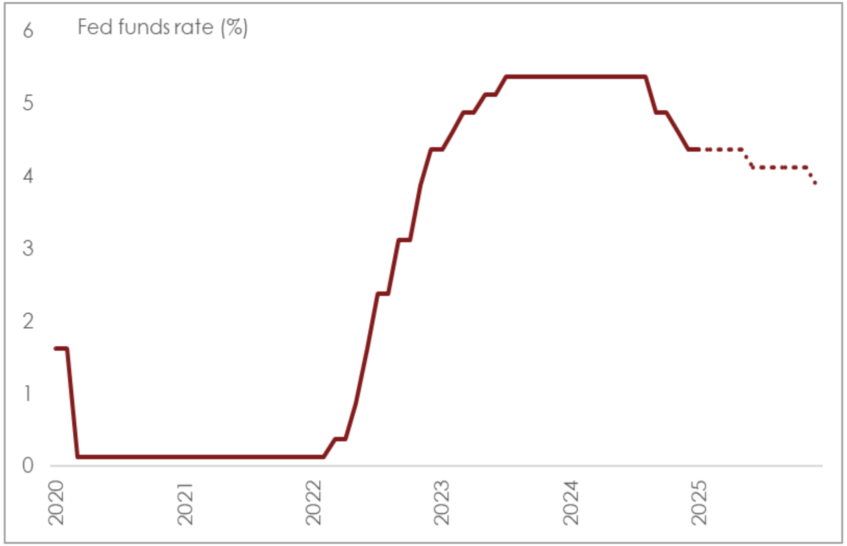
Despite the first rate cut by the MPC in 5 years, term premium (proxied by the spread between yields and the monetary policy rate) rose sharply. This points towards the likelihood of market participants expecting a shallow rate easing cycle.

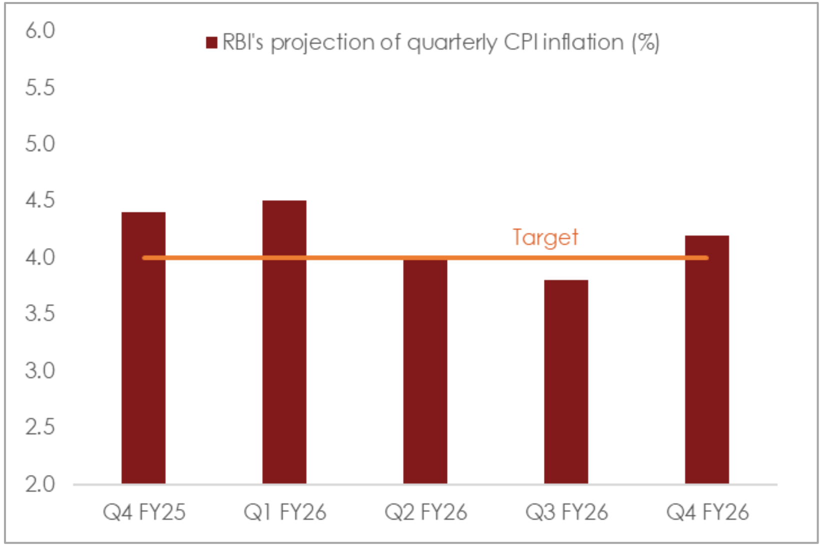


RBI’s shallow rate easing cycle

After front-loading 100 bps rate cut in 2024, the US FOMC projects just 50 bps of incremental easing in 2025 as inflation continues to remain higher than the target.

RBI’s projection of 4.2% average CPI inflation in FY26 is the lowest in the post-COVID phase. Assuming it is met, a repo rate of 6.00% would imply a comfortable *ex-ante* real rate of 1.8%. This implies scope for a 25 bps rate cut in the Apr-25 policy review.

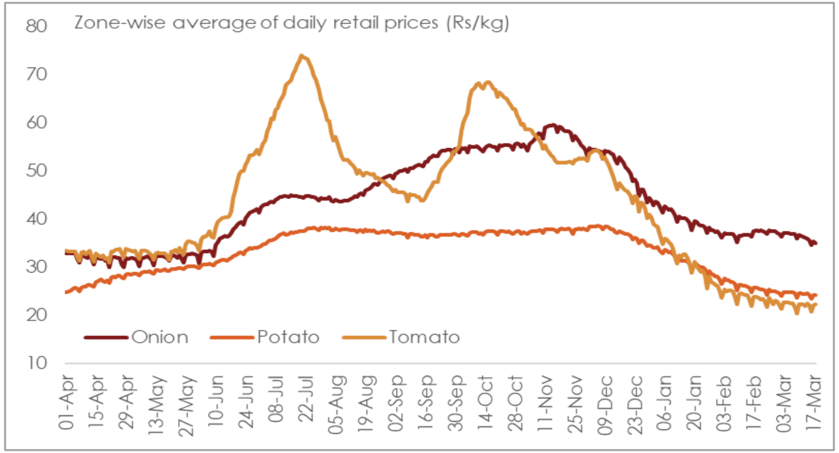




If global trade has a severe impact on 2025 global growth, then central banks might cut more than what is currently priced in.

Inflation: Food concerns fade, FX concern emerges

Food inflation moderated to a 21-month low of 3.8% in Feb-25 from its recent peak of 9.7% in Oct-24. Incremental information depicts further correction in mandi prices for key vegetable prices like Tomato, Onion, and Potato in Mar-25, albeit by a moderate degree.



A pick-up in the pace of rupee depreciation since Oct-24 could add upside to inflation. While the RBI assumed an average USDINR rate of 83.5 for H2 FY25 (Monetary Policy Report, Oct-24), the current spot rate is much higher, around 86.5 levels. A 5% depreciation in INR adds about 35 bps to CPI inflation, ceteris paribus.

As such, we maintain our call of a shallow rate easing cycle, with the MPC pausing after another 25 bps rate cut in Apr-25.

RBI's assumption of USDINR for inflation forecasting

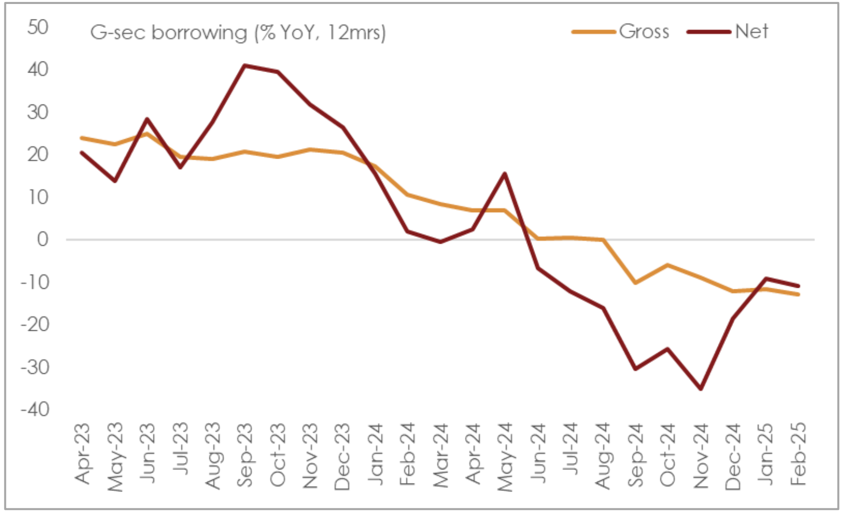
	Apr-24 MPR	Oct-24 MPR
Assumption	83.0 in FY25	83.5 in H2 FY25
Actual/ Projected	84.6 in FY25	85.6 in H2 FY25

Note: Actual data is until Mar 18th. Full year actual is imputed assuming Mar 18th level of USDINR remains constant until Mar 31st.

G-sec supply-demand situation continues to remain supportive

The benefit of fiscal consolidation is manifesting in the form of annualized contraction in g-sec supply. In addition, the central government has been conducting g-sec buybacks to infuse liquidity (as of date, Rs 882 bn worth of buybacks have been concluded for g-secs maturing in FY26).

The RBI has also been conducting OMO purchases (Rs 2888 bn so far) to infuse durable liquidity, exceeding the net g-sec issuances between Jan-Mar 2025.

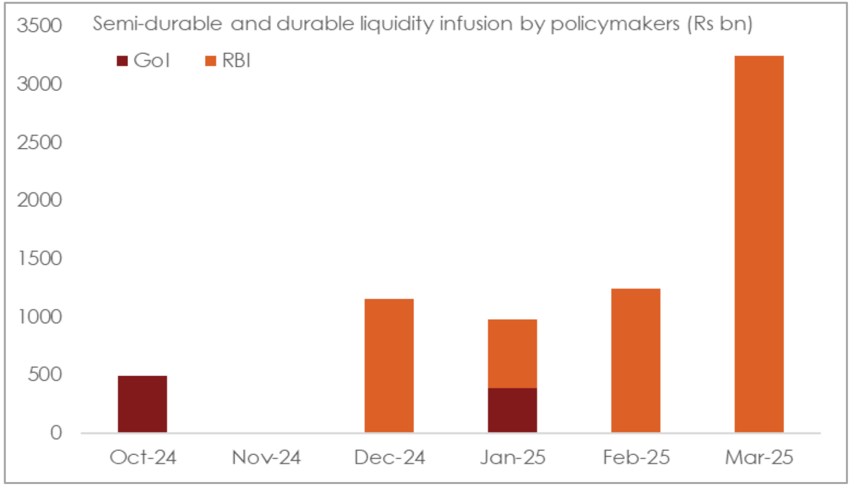


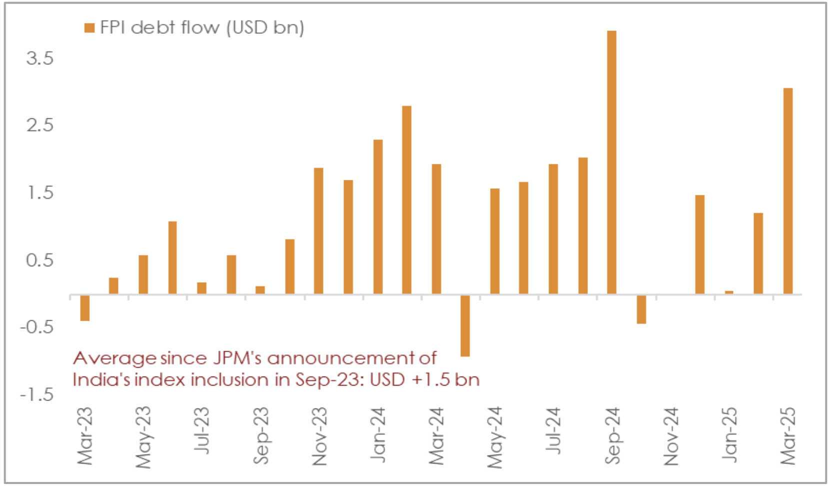
	Net g-sec issuance (Rs bn)	Net OMO purchase (Rs bn)	OMO purchase as % of issuance
Jan-25	1100	588	53.5
Feb-25	1250	800	64.0
Mar-25	320	1500	468.8

Rates outlook

The RBI will cumulatively infuse Rs 6.24 tn of semi-durable/durable liquidity via CRR cut, OMO purchases, and buy-sell FX swap between Dec-24 and Mar-25 (including scheduled operations). This will push core liquidity towards a surplus of Rs 2 tn by the end of Mar-25 vs a deficit of Rs 15 bn at the end of Feb-25.

Aided by India's index inclusion, FPI debt flows continue to remain in positive territory (aggregating at USD 15.7 bn on a FYTD basis) despite persistent weakness seen in FPI equity flows.



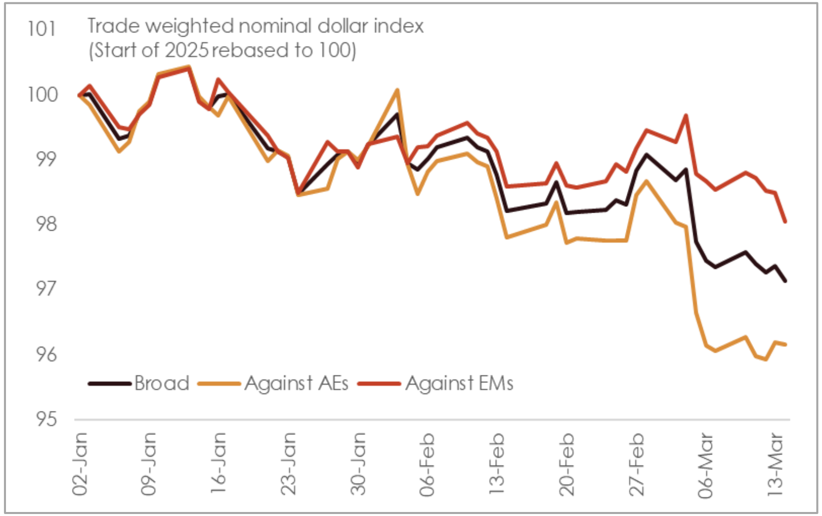


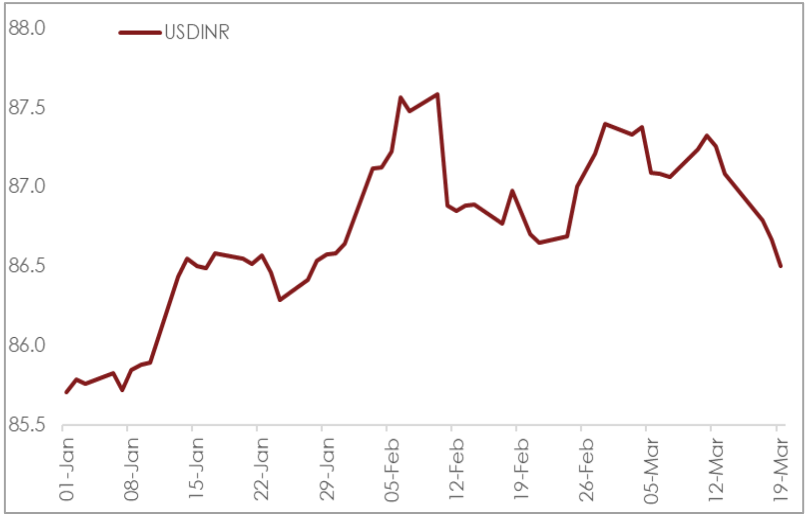
We maintain our 10Y g-sec yield forecast 6.40% by Mar-26. INR depreciation poses risk to our view.

USD weakness helping INR

On a trade-weighted basis, the dollar index has weakened by 2.7% in 2025 so far. The weakness is more pronounced against developed currencies vis-à-vis emerging market currencies.

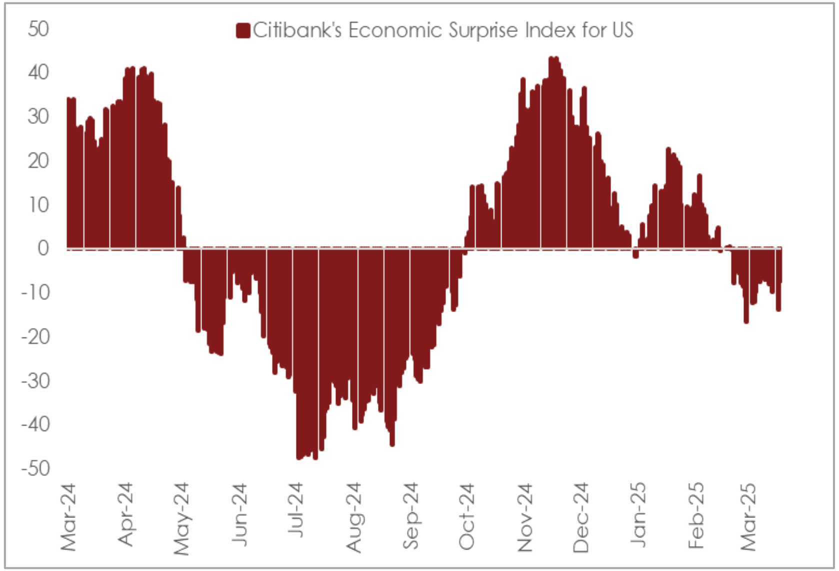
Gradual USD weakness until mid-Feb did not have any impact on the INR. However, as the pressures on the USD picked up thereafter, INR started stabilizing, and in recent days has shown bouts of strength. Having said that, INR remains one of the relative underperformers vis-à-vis major currency pairs on a CYTD basis.



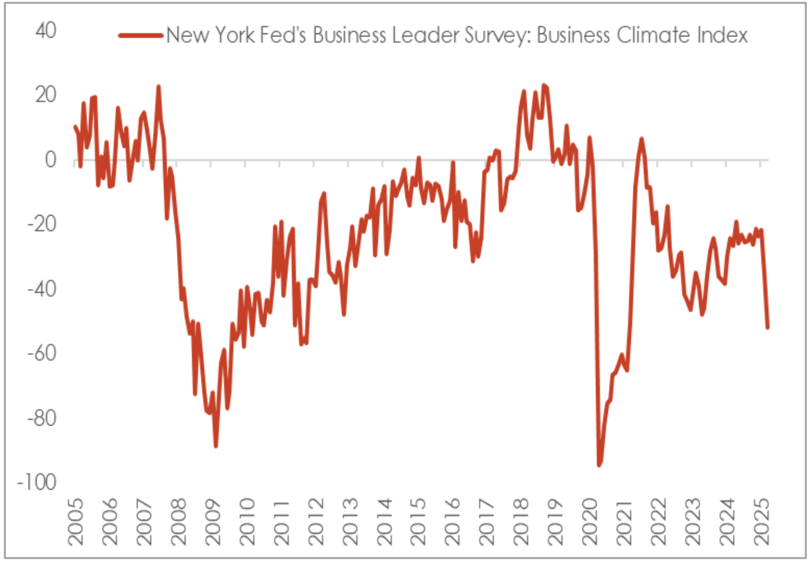


Headwinds for 'US exceptionalism'?

On an aggregate basis, downside surprises to US economic data has become prominent. Citibank's Economic Surprise Index for the US has been in negative territory since mid-Feb-25.



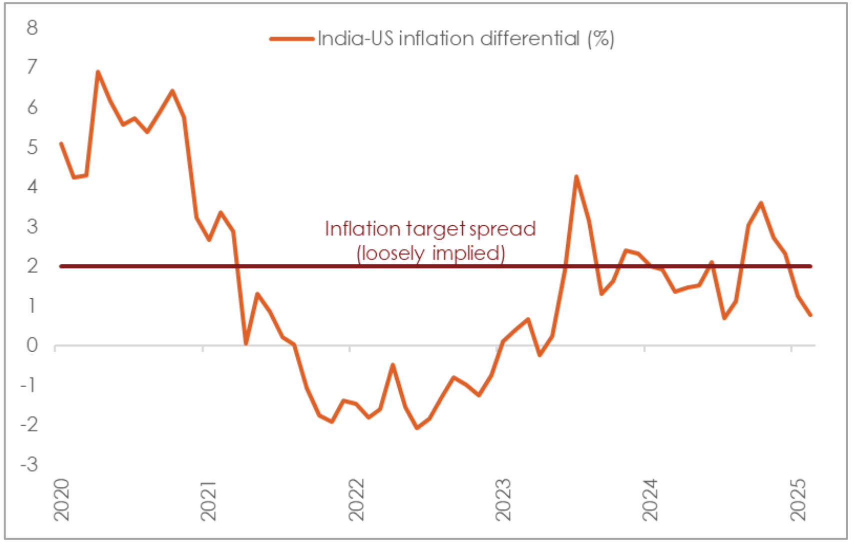
Most forward-looking business sentiment indicators have tumbled sharply in the last 3-4 months. Heightened uncertainty on trade, labour availability, and prices is dampening business risk appetite. If unaddressed, this could portend the beginning of a slowdown in the US.

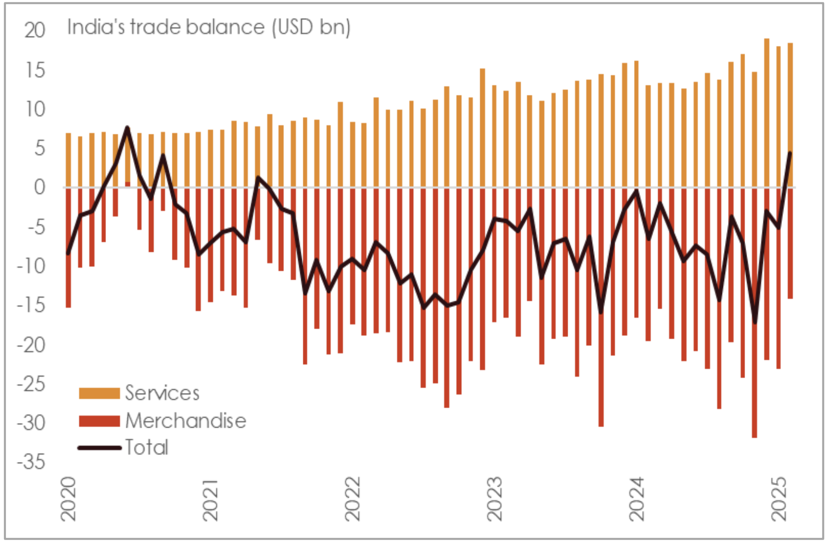


Meanwhile, fundamentals improving for INR

Fast deceleration in India's inflation compared to US has turned the inflation spread in favor of India. CPI inflation spread between India and US has been under 2 percentage points over Jan-Feb 2025.

While India's merchandise trade deficit has corrected sharply from its record level of USD 31.8 bn in Nov-24 to USD 14.1 bn in Feb-25, the services trade surplus over the corresponding period has increased from USD 14.8 bn to USD 18.5 bn. On a accumulative basis, total trade balance recorded a rare surplus in Feb-25.

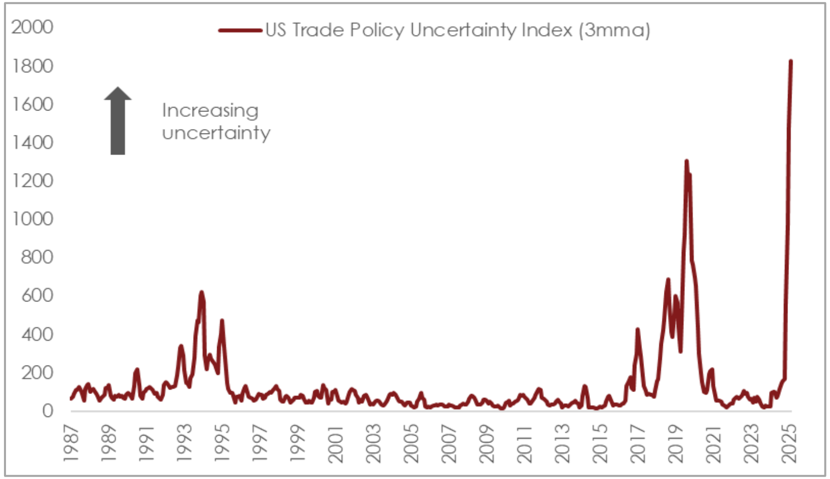


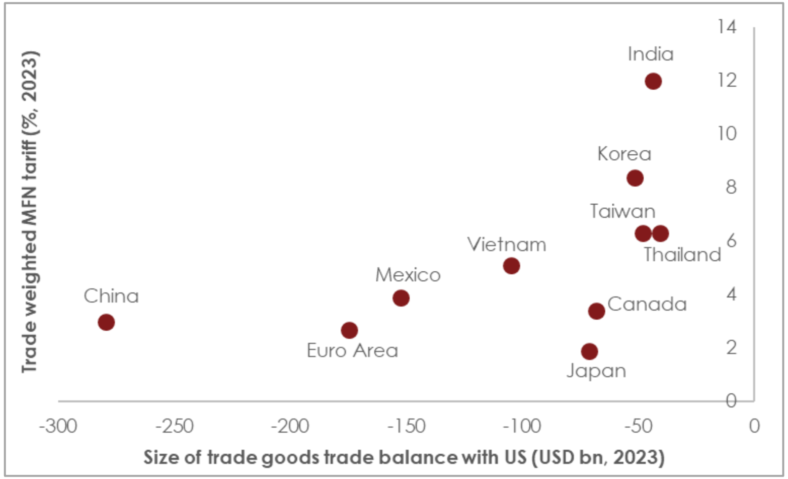


However, heightened global trade uncertainty could provide risk

While Trump started off with the idea of putting different layers of universal tariff on countries with which the US had a trade deficit, he now favours the imposition of 'reciprocal tariffs' on each of the trading partners. The ambiguity and frequent volte face in communication has resulted in a record spike in the US Trade Policy Uncertainty Index (a simple gauge based on news articles).

From a merchandise trade perspective, US ran a deficit of USD 44 bn with India in 2023 – the 9th largest amongst major trade partners. However, from a tariff perspective, India's weighted average MFN tariff rate of 12.0% (in 2023) was one of the highest amongst major trade partners of the US. This renders India vulnerable to the imposition of reciprocal tariffs by the US from Apr-25.

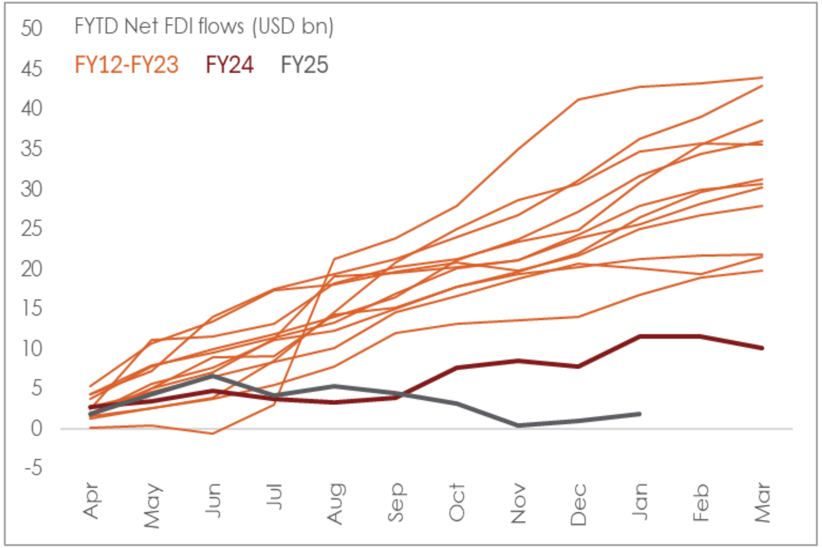


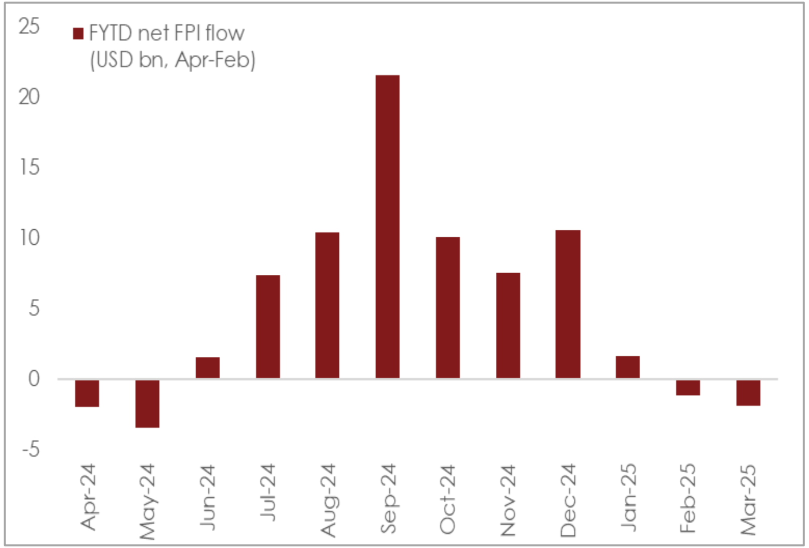


Foreign investment flows have been weak

Weakness in net FDI flows has been accentuated since FY24 on account of a pick-up in repatriation by MNCs/PE investors. In FY25, net FDI flows have plummeted to an anemic level of just USD 1.9 bn between Apr-Jan.

Meanwhile, FPI flows continue to remain weak as well as volatile on account of elevated geopolitical and geoeconomic uncertainties. The cumulative FYTD portfolio flows currently stand at USD -1.9 bn.

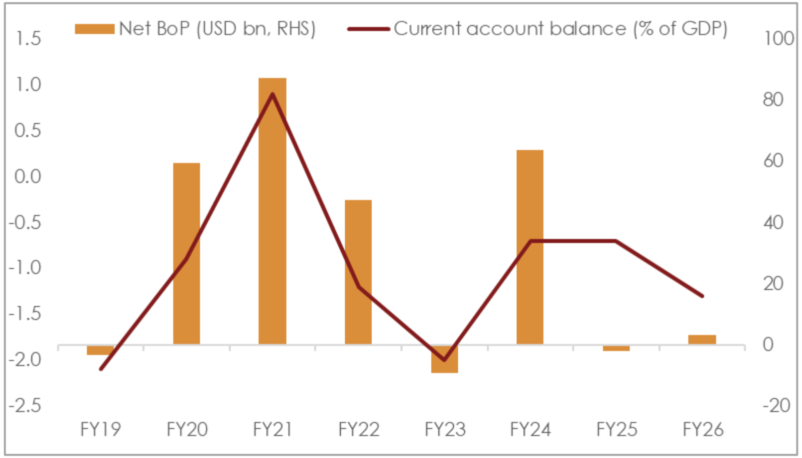


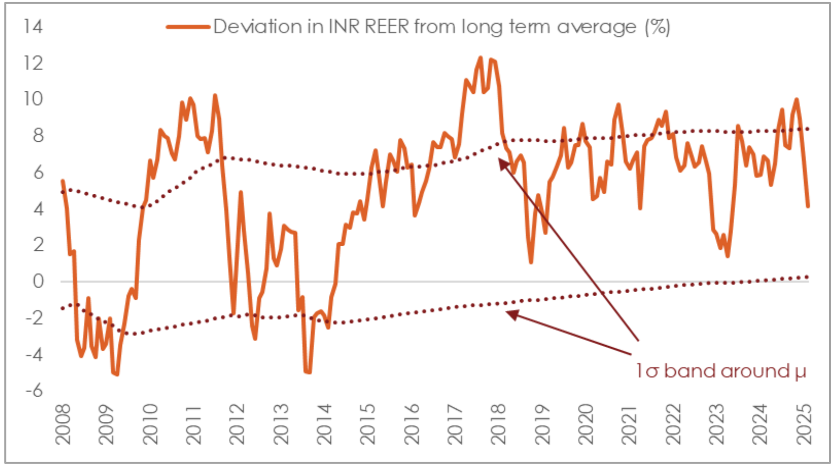


Rupee outlook

We have revised our FY25 current account deficit forecast to 0.7% of GDP from 1.3% with a downside earlier (this is on account of major data revisions and a sharp correction in the merchandise deficit for Feb-25). The FY25 BoP estimate stands adjusted at USD -2 bn vs. USD -5 bn earlier. We maintain the FY26 CAD and BoP surplus forecast of 1.3% of GDP and USD 3 bn for now.

Basis REER, we estimate INR to be ~4% overvalued (as of Feb-25) vis-à-vis its long-period average. With this, INR overvaluation levels have dropped to a 21-month low and now no longer give an impression of being stretched. This will curb excessive incremental pressure for INR weakness.

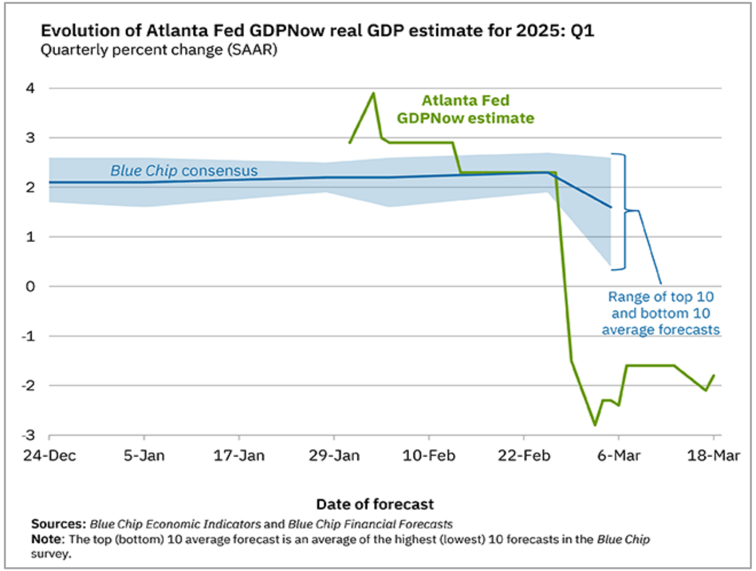




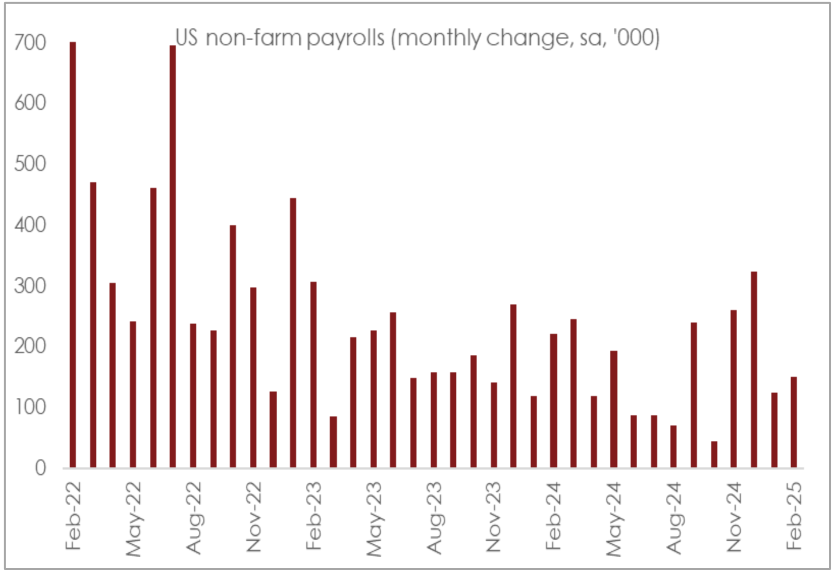
Considering the known-unknown geopolitical and geoeconomic risks, we maintain our USDINR call of 89.5 before end FY26.

US economy: Slowing down

The GDP-Now model estimate for US real GDP growth (seasonally adjusted annual rate) in the first quarter of 2025 stands at -1.8% (as of 18th Mar-25)

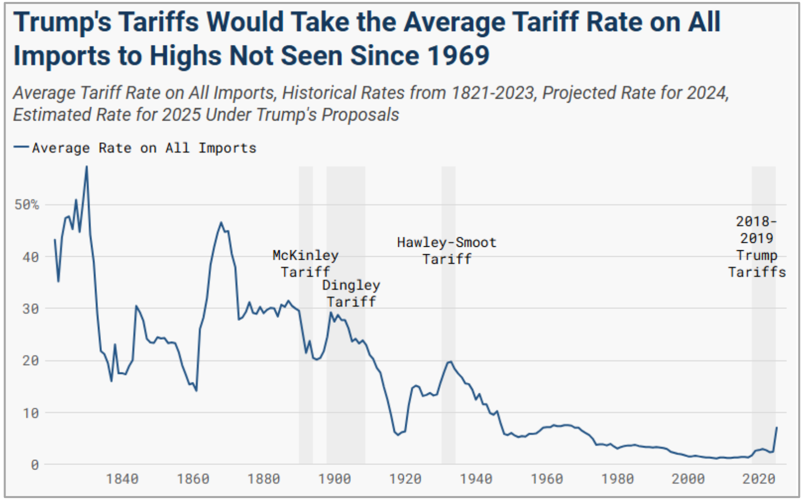


Non-farm payrolls have risen at a tepid pace over Jan-Feb-25, falling short of expectations. This was accompanied by the unemployment rate edging higher to 4.1% from 4.0% in Jan-25.



Tariffs: Inferior outcomes?

In large part, US growth expectations are getting adjusted lower owing to implementation of tariffs and impending reciprocal tariffs, due early Apr-25.



An economic study pegs tariffs on Canada and Mexico to reduce long-run GDP by 0.3%, the tariffs on China by 0.1%, and the expanded steel and aluminum tariffs by less than 0.05%, all before foreign retaliation.

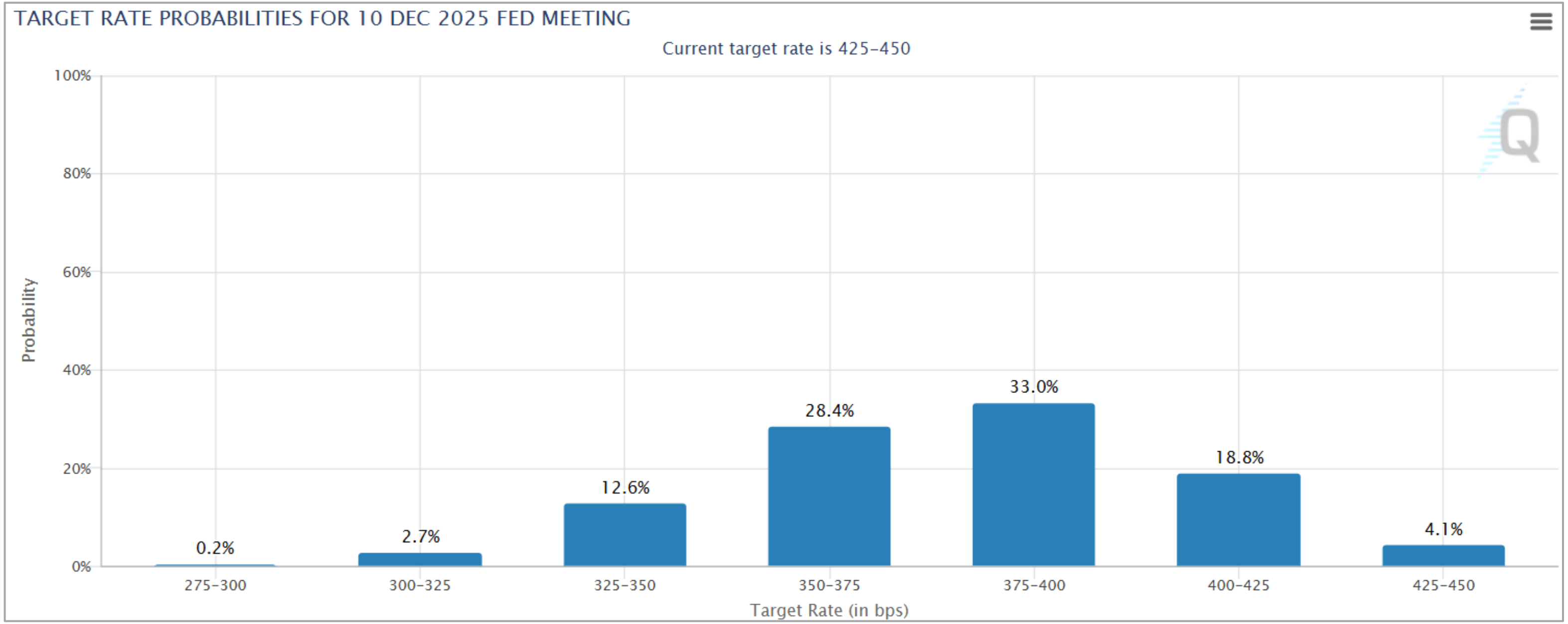
Table 1. Estimated Impact of President Trump's Proposed Tariffs

	Canada/Mexico	China	Expanded Steel and Aluminum Tariffs
GDP	-0.3%	-0.1%	Less than -0.05%
Capital Stock	-0.3%	-0.1%	Less than -0.05%
Pre-Tax Wages	0.0%	0.0%	0.0%
Full-Time Equivalent Employment	-269,000	-73,000	-17,000

Assumptions
1) 25% tariff on all imports from Mexico
2) 25% tariff on all imports from Canada excluding HTS codes 2709, 2710, 2711, and 2716, which are subject to a 10 percent tariff,
3) 10% tariff on all imports from China and ending de minimis treatment of all Chinese imports.
4) End to all country exemptions for the existing Section 232 steel and aluminum tariffs and increasing the rate on existing tariffs to 25%
*Trump Tariffs: The Economic Impact of the Trump Trade War

Fed rate cuts: 50 bps or more?

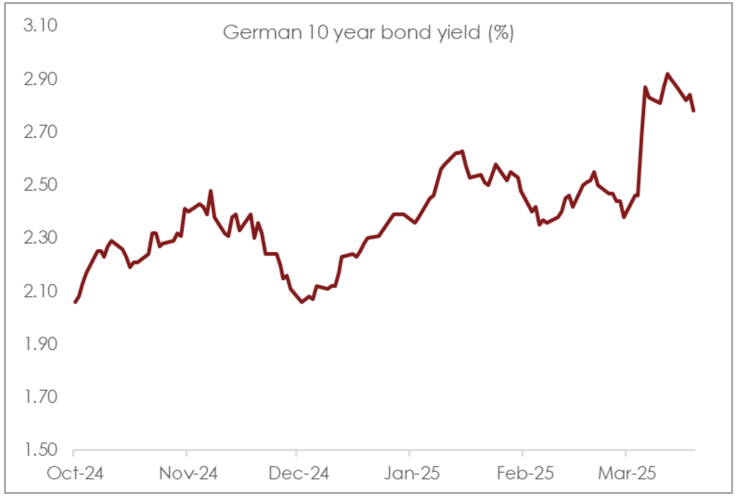
After a status quo in Mar-25 policy, Fed is expected to announced two more rate cuts of a cumulative 50 bps by Dec-25 end, as per market consensus estimates as of now. If growth was to surprise negatively by more than expected, the quantum of rate cut could go up.



Germany shifts gears

The German parliament has agreed to a EUR 500bn infrastructure fund and changes to the debt brake to allow for higher defence spending and more fiscal space for state governments. This is likely to support Germany's GDP growth, which has stagnated over 2023-24.

As per Germany's DIW economic institute, the fiscal measures could boost economic output by an average of more than 2% points per year over the next 10 years. As a reaction to the fiscal stimulus, German 10-year bond yields have surged to 16-month high.



Summary

Since our previous update in Feb-25, a lot has changed. The NSO revised India's FY23 and FY24 GDP growth by 60 bps and 100 bps to 7.6% and 9.2%, respectively. The sharp upward revisions to past activity data tell us that the post-COVID rebound in economic growth was much stronger than estimated earlier. While the FY25 GDP growth estimate of 6.5% also saw an upward revision by 10 bps, it was paltry in comparison. Based on the FY25 annual estimate, the derived GDP growth for Q4 comes at 7.6% YoY. If realised, that would be a 4-quarter high print and would give credence to the view that the sharp slowdown seen in H1 FY25 was due to transient factors like weather disruptions and administrative/procedural delays on account of general elections and government formation.

The macro comfort has started to spill beyond growth. India's inflation has decelerated at a fast pace - from its recent peak of 6.21% YoY in Oct-24, CPI inflation dropped to a 7-month low of 3.61% in Feb-25. The delayed but emphatic correction in food prices in the last 4 months opened up space for the MPC to announce its first rate cut after a gap of 5 years. In recent weeks, the RBI has followed up strongly with measures for durable liquidity infusion in a bid to improve the monetary policy transmission mechanism while also signalling the potential for further rate cuts.

This has provided comfort to g-sec yields and INR. Global financial conditions have provided a supportive backdrop of late, marked by a moderation in US yields and a softening of the USD. Market participants are critically assessing the narrative of 'US exceptionalism', with a tariff-led trade war perceived as a significant destabilizing risk factor. Notably, the US Fed remains committed to further monetary easing, with the FOMC dot plot signalling a 50 bps cumulative rate cut before the end of 2025.

For India, the spectre of reciprocal tariffs by the US is going to be a key risk factor to watch. We hope that policymakers will arrive at a middle ground via diplomatic and strategic negotiations.

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