RATINGS & RESEARCH

MACRO PULSE

FEBRUARY 2025

From the desk of the Chief Economist

Dear Reader,

Over the last few weeks, the treatment for India's economic slowdown has been initiated. First, the Government presented a pro-consumption budget through significant tax relief for the middle income category. RBI has also come in to support the recovery efforts through the first rate cut in five years and clear signals to ease the liquidity scenario through the use of various monetary tools.

The results of the next test for the growth slowdown i.e GDP data for Q3FY25 will be published shortly. Our latest India Macro Heat Map which tracks 26 high-frequency indicators, doesn't indicate a very significant ramp up in growth in the third quarter of the fiscal after a subdued 5.4% GDP growth in Q2FY25. Industrial growth (IIP) has seen an improvement to 3.9% in the Dec'24 quarter compared to the multi-quarter low of 2.7% in the previous quarter, but it has not been robust enough due to the slowdown in urban demand and the external headwinds for exports. While we have estimated GDP growth to improve to 6.5% in Q3FY25 primarily driven by solid agricultural growth and a step up in public capital expenditure, the Macro Heat Map indicates that there is a material downside to that forecast. Any GDP growth figure of less than 6.5% in Q3 will increase the downside risks to the 6.4% GDP overall growth estimate for FY25 despite an expected step up in Q4 due to the wedding season and importantly, the mega event – the Maha Kumbh which has the potential to add 30-40 bps to the annual GDP growth figure.

The growth prospects for FY26 are better at this stage with the adoption of fiscal and monetary measures that are supportive of growth. Unfortunately, the monetary policy will need to work within constraints amidst the increased external risks and partly, the domestic food inflation risks. The global uncertainties have seen a sharp spike from a stronger USD and expectation of an aggressive tariff policy from the new US administration, which has already translated to significant capital outflows from India and a pressure on the INR. While headline inflation is set to moderate further in the next 2-3 months, it may be difficult to sustain it within 4.5%, given the sticky nature of food inflation and the climate risks. Therefore, the rate cut cycle is likely to be shallow with possibly another 25 bps cut over the next few months and a holding back on an 'easy' monetary policy.

While the economy still awaits a strong growth in private sector investments, it's worthwhile to highlight one data point from RBI's Gross Deployment of Bank Credit. As of Dec,'2024, the credit growth for medium sized industrial enterprises stood at 19.9% YoY, as against 12.4% YoY for overall non-food credit. This indicates that the mid-corporate segment is likely to lead the way in corporate capex and fund raising going forward.

-Suman Chowdhury, Chief Economist and Executive Director

GDP growth to recover in Q3 FY25

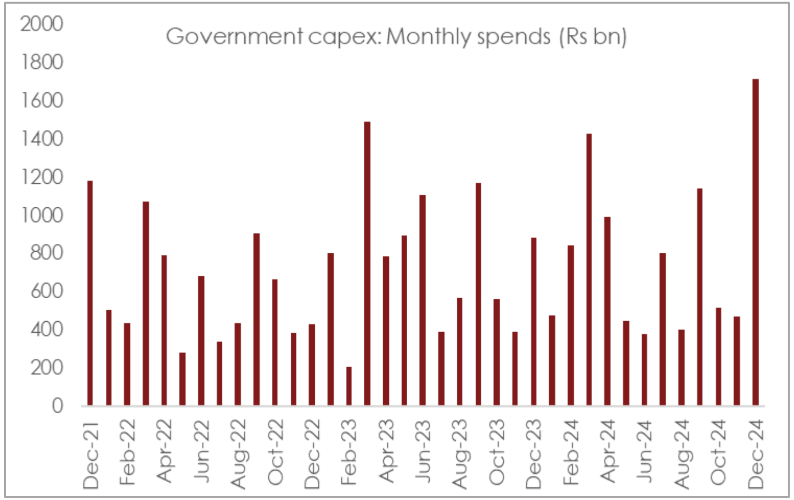
High frequency indicators for Q3 FY25 paint a mixed picture. Having said that, the quarter did coincide with the timing of festive season, and also likely to capture the rebound in activity in select sectors post monsoon season. Corporate sector earnings of listed companies have been modest, led by improved margins, as manufacturing firms benefited from lower raw material, energy, and interest costs. As such, we estimate Q3 FY25 GDP growth to rebound to 6.5%, compared to 5.4% in Q2.

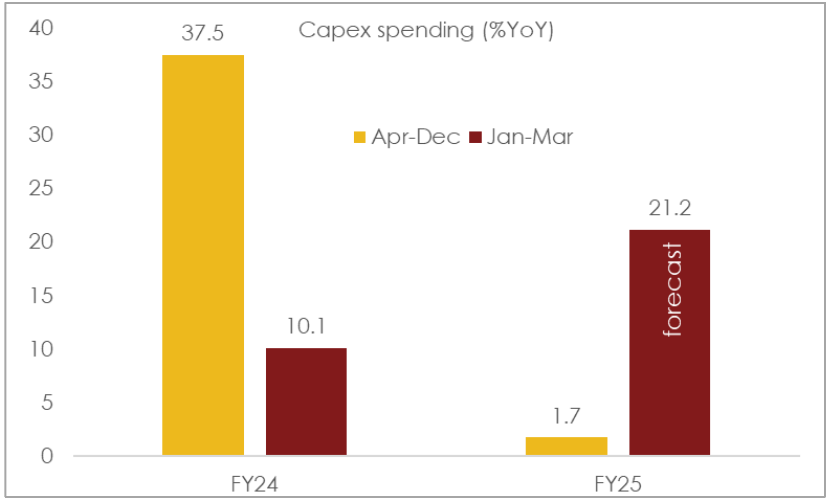
High frequency indicators	Quarterly				
	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25	Q3 FY25
Passenger vehicle sales (%YoY)	25.5	28.3	2.8	-1.9	5.0
Credit card spends (%YoY)	31.6	29.3	24.2	23.6	16.9
Two wheeler sales (%YoY)	22.5	25.4	20.7	12.5	1.4
Tractor sales (domestic, %YoY)	-5.9	-23.0	0.2	-0.2	11.7
Port cargo traffic (%YoY)	10.5	3.1	3.9	6.2	-1.7
Air Cargo traffic (%YoY)	10.2	18.5	13.8	16.2	10.7
Domestic air passenger traffic (%YoY)	9.2	5.2	5.6	7.2	11.4
Intl Air Passenger traffic (%YoY)	18.5	17.1	15.9	10.3	10.0
GST E-way bills (cr)	9.4	9.9	10.0	10.6	11.0
Steel consumption (%YoY)	14.5	10.6	15.0	12.1	7.9
Cement production (%YoY)	5.3	7.5	0.5	3.2	6.9
Manufactruing PMI (index)	55.5	57.5	58.2	57.4	56.8
Services PMI (index)	58.1	61.2	60.5	59.6	58.7
Core industries (%YoY)	8.6	5.8	6.3	2.4	4.0
IIP (%YoY)	6.2	5.1	5.4	2.3	4.5

Back-ended government capex support

Dec-24 capex spend saw the highest monthly disbursal on record; after slow traction upto Nov-24.

Despite Government having scaled down FY25 capex budget (to Rs 10.2 tn from Rs 11.1 tn earlier), Q4 capex spend could see an annualized increase of ~21% to offer sizeable back-loaded support to growth





Budget's consumption bonanza

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FY26 Budget provided a consumption stimulus by announcing a reduction in personal income taxes, that 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 growth stimulus needs to be seen against the backdrop of moderating GDP growth in FY25, led by urban consumption.

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

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

Tax reduction

-To cost exchequer ~Rs 1 tn

Direct cash transfer by states

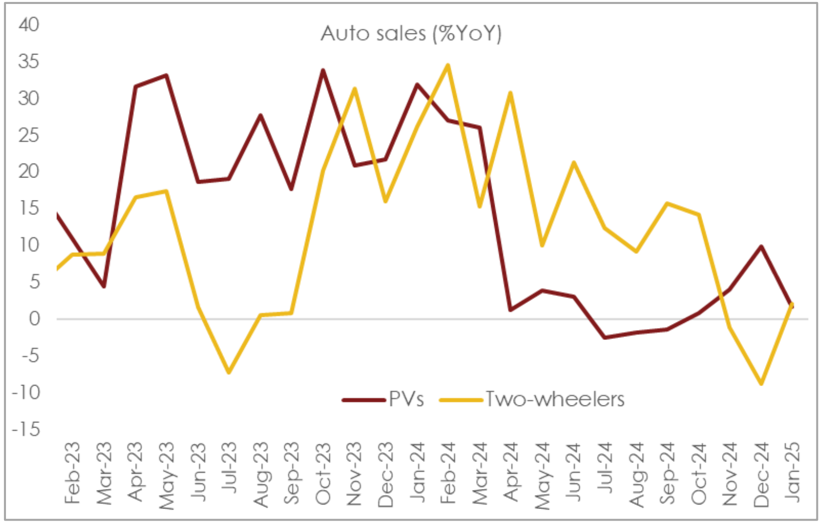
- Total outgo could be close to Rs 2tn

8th pay commission

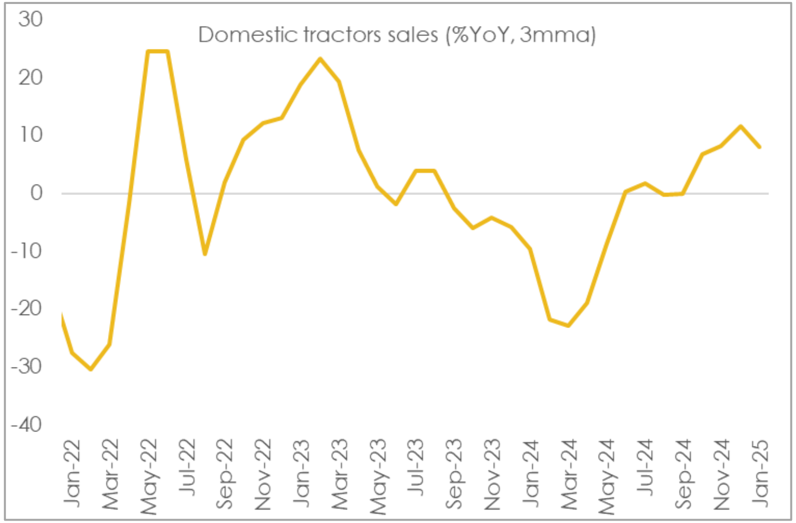
- To be implemented Jan-26 onwards

Rural recovery on track

Jan-25 recorded the highest ever sales of Passenger vehicles at ~4 Lakh units, translating into a growth of 1.6%YoY. Two-wheelers sales too grew by 2.1%YoY, with sales of 15.26 Lakh units. PV sales in latest months, have found support from rural demand, led by Utility vehicles rather than mid-sized/entry-level vehicles.



Tractor sales have been fairly healthy over the last 6 months, amidst above normal monsoon in 2024 and bright prospects of Rabi sowing.



India-US trade relations

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. 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%**

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.

Mission 500

Aims to more than double total bilateral trade to USD 500 bn by 2030

Bilateral Trade Agreement (BTA)

To negotiate the first tranche of BTA by as early as fall of 2025

WHITE HOUSE: FACT CHECK

US average applied Most Favored Nation (MFN) tariff on agricultural goods is 5%. But India's average applied MFN tariff is 39%. India also charges a 100% tariff on US motorcycles, while US charges a meagre 2.4% tariff on Indian motorcycles.

India has already cut tariffs on several items, for example to 30% on high-end motorcycles from 50% and 100% on bourbon whiskey from 150%, while promising to review other tariffs.

FY26 growth outlook: GDP at 6.6%

The consumption boost accorded by the Budget, via reduction in 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 geoeconomic remain uncertain – to weigh on trade, and…

2) Private sector capex recovery timeline

2) Government's fiscal impulse remains lower

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

1) Outlook for Rabi 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 5-month low in Jan-25

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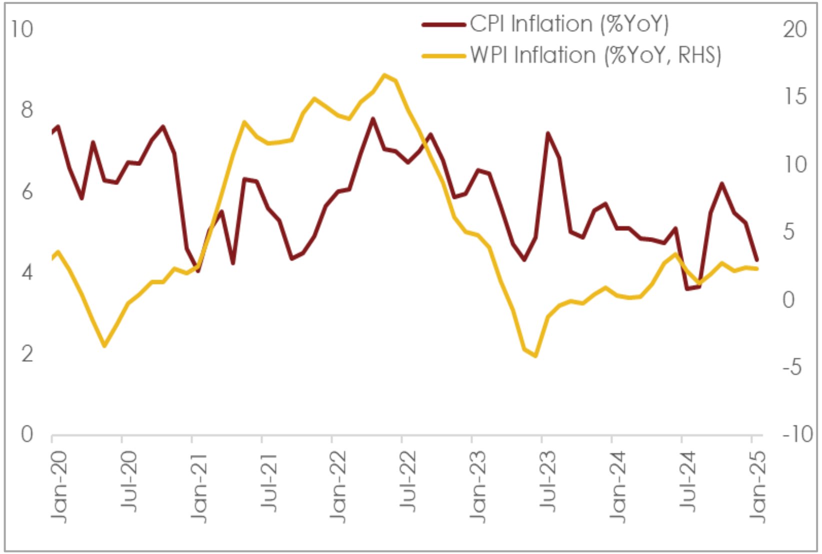
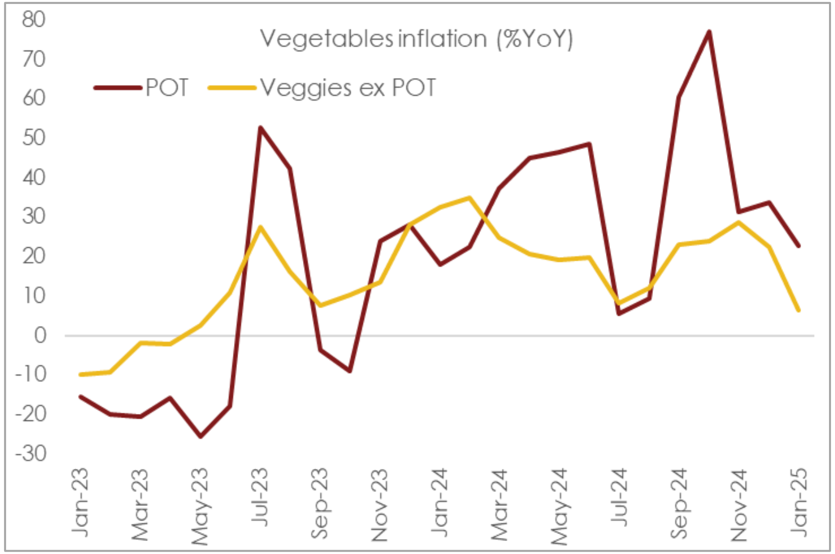
India's CPI inflation decelerated sharply to a 5-month low of 4.31% YoY in Jan-25 from 5.22% in Dec-24. Sequentially, food prices fell by 2.43% MoM, recording their steepest decline in 49 months. Price correction in Jan-25 was led by Vegetables, Pulses and Eggs.

Annualized food inflation retreated sharply to a 5-month low of 5.68% in Jan-25 from 7.69% in Dec-24. Within vegetables, both staples (i.e., POT) as well as seasonal downside to winter vegetables led the decline.



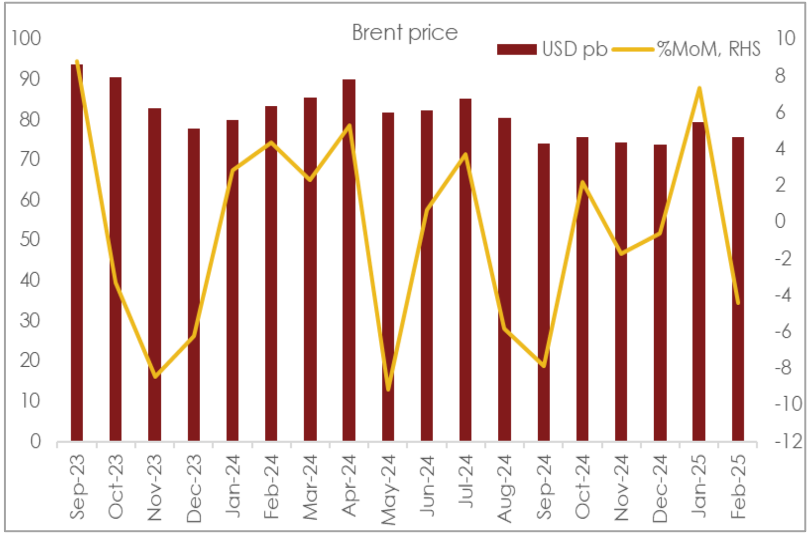


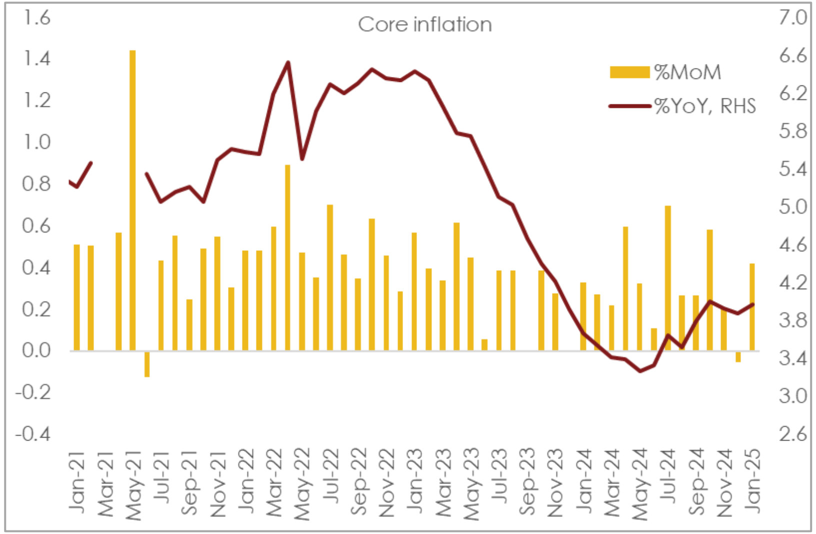
POT = Potatoes, Onion, Tomato,

Crude and core both offer comfort

Upside to oil prices in Jan-25 from imposition of renewed US sanctions on Russian crude has dissipated now, with price of Brent falling from its Jan-25 peak of USD ~84 pb to USD 76-77 pb currently. Expectation of capacity expansion in US energy production under Trump 2.0 regime appears to be tilting the balance in favor of supply.

However, upside risk to inflation* has emerged with a sharp pace of recent rupee depreciation. This risk needs to be assessed in conjunction with the expected disruption to global trade under the likelihood of President Trump pressing tariffs on most of the countries in 2025.





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

Veggies and wheat on watch, as summer sets in early

Signals from daily mandi prices suggest that key vegetable prices have further softened in Feb-25, albeit by a lesser degree. In fact, they are now showing signs of bottoming out, amidst an early start to summer season.

Despite warmer weather, wheat crop remains resilient, with no instances of shriveling/spoiling of the standing crop, so far.

Vegetables (%MoM)	Oct-24	Nov-24	Dec-24	Jan-25	Feb-25
Bitter Gourd	-7.2	-4.6	-2.1	25.1	6.7
Brinjal	23.7	-18.5	-10.9	-20.0	37.3
Cabbage	4.3	0.6	-10.8	-35.0	8.9
Cauliflower	1.0	-14.5	-32.5	-27.6	61.3
Chilly	18.0	-24.1	-10.3	12.7	22.3
Garlic	7.7	0.3	6.8	-12.4	-27.8
Ginger	-2.3	-23.1	-12.7	-10.4	19.7
Okra	-0.7	4.1	4.5	25.7	1.0
Onion	6.2	7.5	-13.6	-17.3	9.0
Peas	14.4	-47.8	-45.8	-39.0	-25.1
Potato	6.8	1.5	-5.8	-18.1	32.8
Tomato	39.8	-27.9	-11.5	-37.9	-13.3
All Vegetables	**10.0**	**-9.0**	**-8.4**	**-13.1**	**7.3**

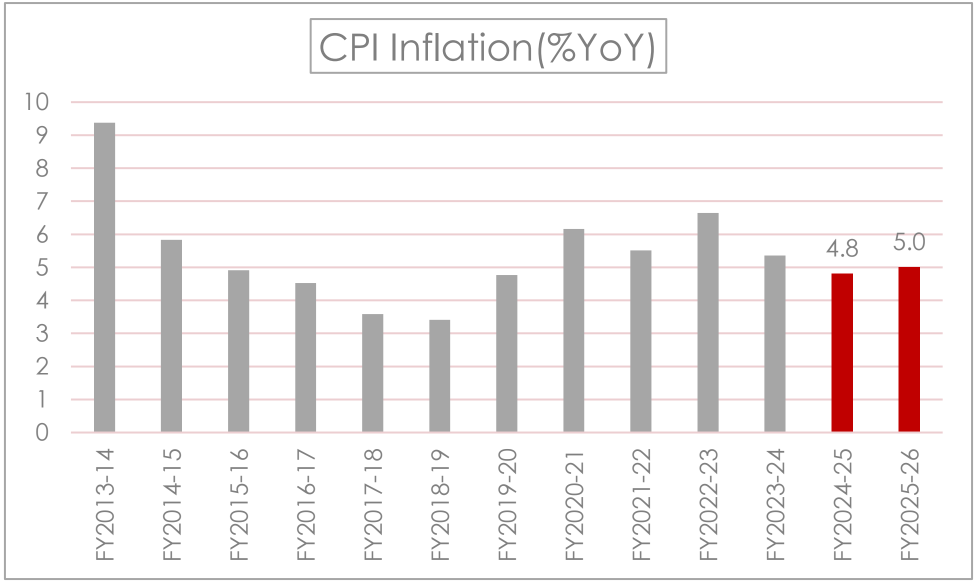
*up to 18th Feb-25

Crops	Area Sown (in lakh ha, as of 10th Feb-25)		%YoY
	FY24	FY25	
Wheat	**318.3**	**324.9**	2.1
Rice/Paddy	**40.6**	**42.5**	4.8
Pulses	**137.8**	**140.9**	2.2
Coarse cereals	**55.5**	**55.3**	-0.4
Oilseeds	**99.2**	**97.5**	-1.8
Total	**651.4**	**661.0**	1.5

POT = Potatoes, Onion, Tomato,

FY26 CPI inflation: Risk of Stickiness

We retain our FY25 CPI estimate of 4.8% and our FY26 call of inflation slightly inching up to 5.0%.



Snapshot of Apr-Dec FY25 fiscal performance

The cumulative fiscal deficit for the period Apr-Dec FY25 stood at 58.2% of the revised estimate, lower than 59.4% of actuals in the corresponding period in FY24. This is predominantly on account of relatively lower pace of capital expenditure, notwithstanding the lower pace of revenue accretion.

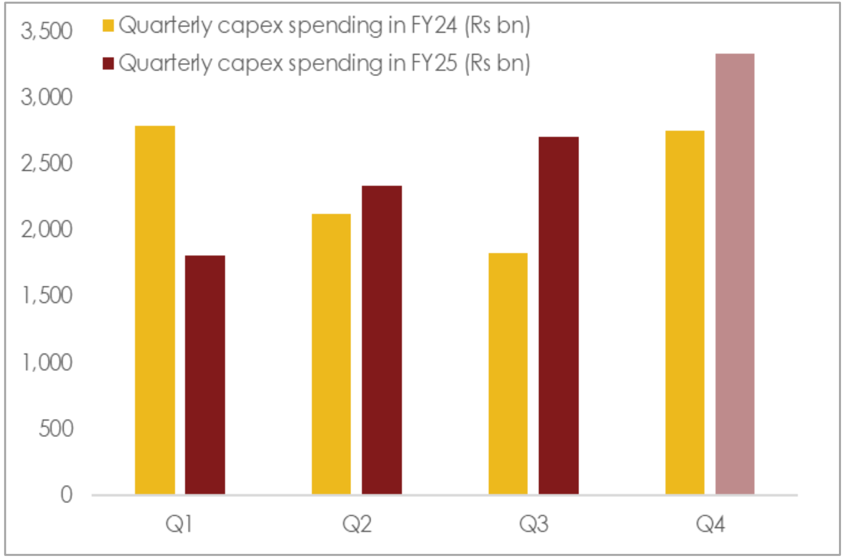
Key Fiscal Variables (Cumulative position, as of December)				
	% of FY Actual/Target		%YoY	
	FY24	FY25	FY24	FY25
Revenue Receipts	74.9	74.2	15.4	12.2
Net Tax	74.4	72.1	11.2	6.5
Non-Tax	77.7	84.3	45.8	43.3
Non-Debt Capital Receipts	49.0	46.3	-46.2	-7.9
Total Receipts	**74.3**	**73.7**	**13.5**	**11.9**
Revenue Expenditure	68.1	68.9	2.3	7.0
of which, Interest Payments	70.3	71.0	9.9	8.0
of which, Major Subsidies	66.9	80.1	-21.0	10.9
Capital Expenditure	71.0	67.3	37.5	1.7
Total Expenditure	**68.7**	**68.5**	**8.4**	**5.8**
Fiscal Deficit	**59.4**	**58.2**	**-**	**-**

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

On aggregate basis, gross tax collection in FY25 so far is running close to the revised target. However, there are internal variations, with upside in income tax and customs, being offset by downside in corporate tax, excise, and GST.

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

Growth in key tax categories	FY25 BE (%)	FY25 RE (%)	Apr-Dec FY25 (% YoY)
Gross Tax	**10.8**	**11.2**	**10.8**
Corporate Tax	12.0	7.6	2.7
Income Tax	13.6	20.3	22.2
Customs	2.9	1.7	7.6
Excise	4.5	-0.1	-1.4
GST	10.9	10.9	10.1
Net Tax	**11.0**	**9.9**	**6.5**



Note: Q4 FY25 is derived basis RE

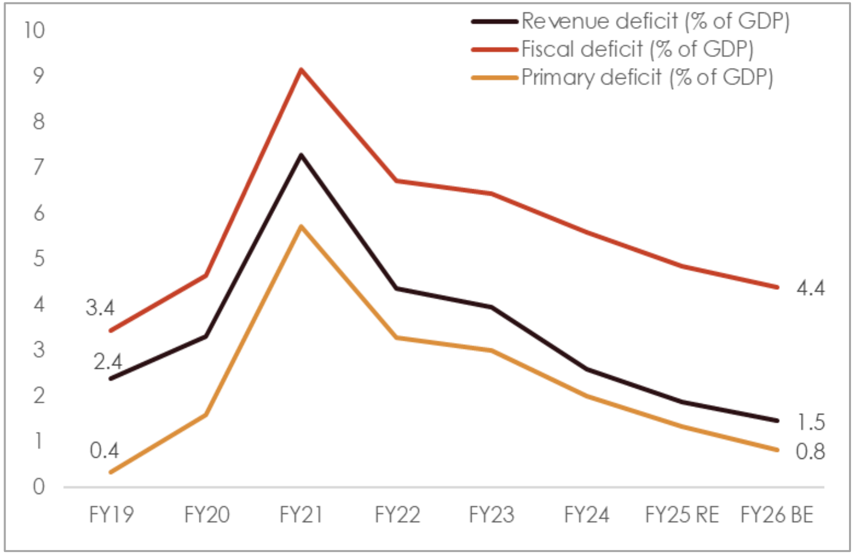
FY26 Union Budget: At a glance

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

Revenue deficit is budgeted to moderate to an 18-year low of 1.5% of GDP in FY26. 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 buyback in FY25 against its budgeted target of Rs 302 bn). Seen as a ratio to GDP, FY26 net g-sec borrowing stands at 4-year low of 3.0%.

Key Sources of Financing Fiscal Deficit (Rs bn)

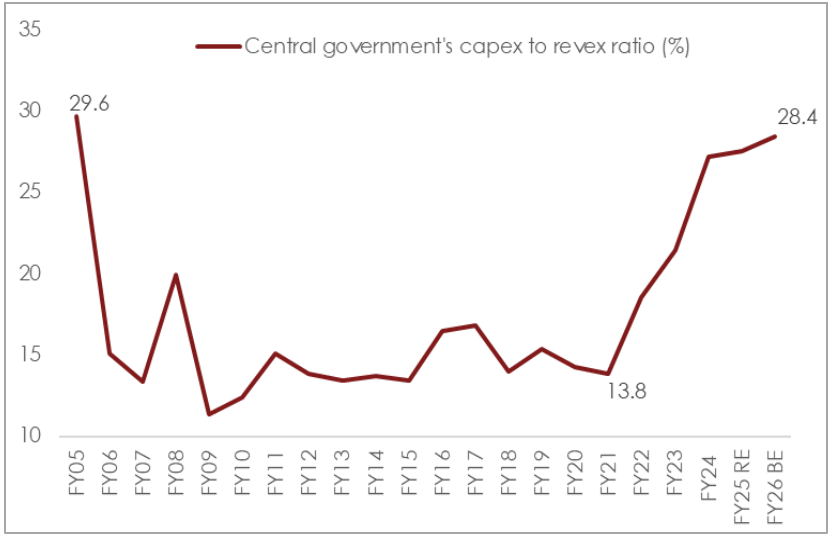
	FY24	FY25 RE	FY26 BE
External Debt	551	320	235
Net Market Borrowing	12,261	9,851	11,538
G-Sec	**11,778**	**10,745**	**11,538**
T-Bill	483	-895	0
Small Savings	4,514	4,119	3,434
State Provident Funds	51	50	50
Others*	-838	-45	407
Cash Drawdown	8	1401	25
Total	16,546	15,695	15,689

* 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 49-51% of GDP range by FY31 vis-à-vis 56.1% projected for FY26.

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

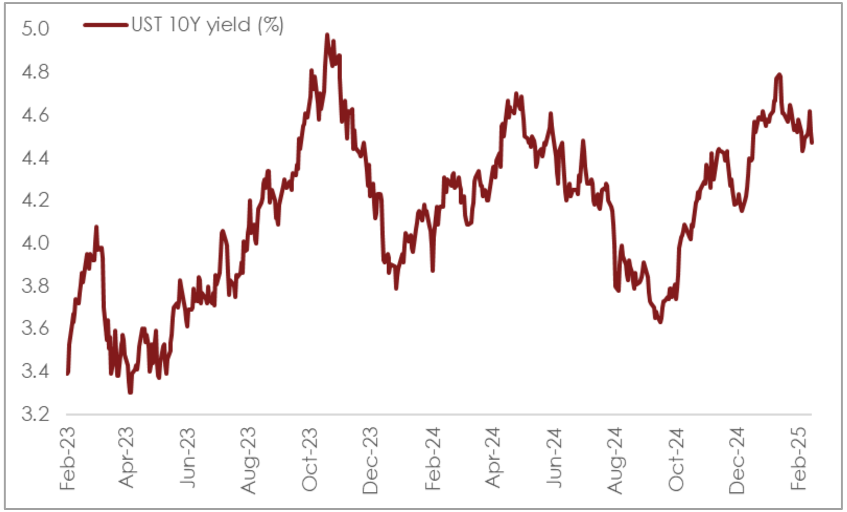
	Mild Case	Moderate Case	High Case
FY31 (Projected with 10.0% Nominal GDP growth)	52.0	50.6	49.3
FY31 (Projected with 10.5% Nominal GDP growth)	51.0	49.7	48.4
FY31 (Projected with 11.0% Nominal GDP growth)	50.1	48.8	47.5

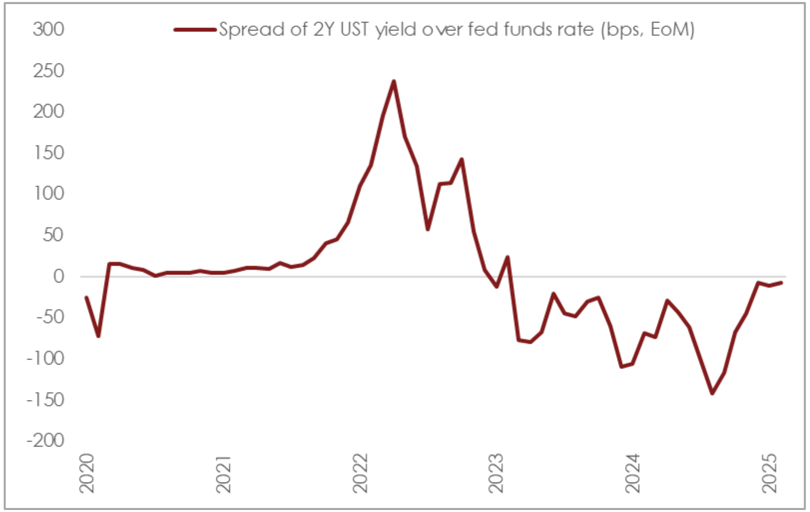
Note: Central government debt as per FY25 RE and FY26 BE is at 57.1% and 56.1% of GDP respectively.

US rates aligning with the new political-economic reality

Notwithstanding the recent moderation, the 10 UST yield is up by 82 bps since the US Fed pivoted in Sep-24 with a 50 bps rate cut.

The term premium for the 2Y bond (captured by the spread of the 2Y UST yield over the fed funds rate) is now close to zero, a sharp reversal from -142 bps seen in Aug-24. This reflects the likely combination of pressures on both US fiscal (likely to be expansionary under Trump 2.0 regime) and monetary (in the form of inflation stickiness) policies.

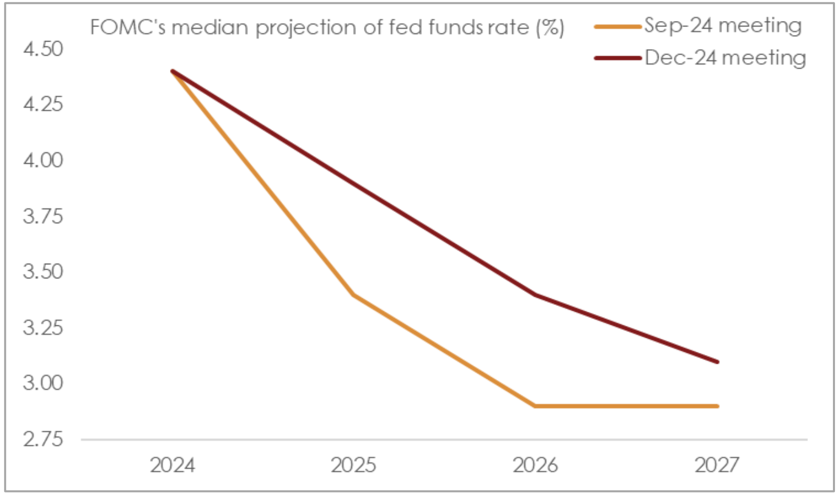




Implications for Fed's monetary policy and its impact on India

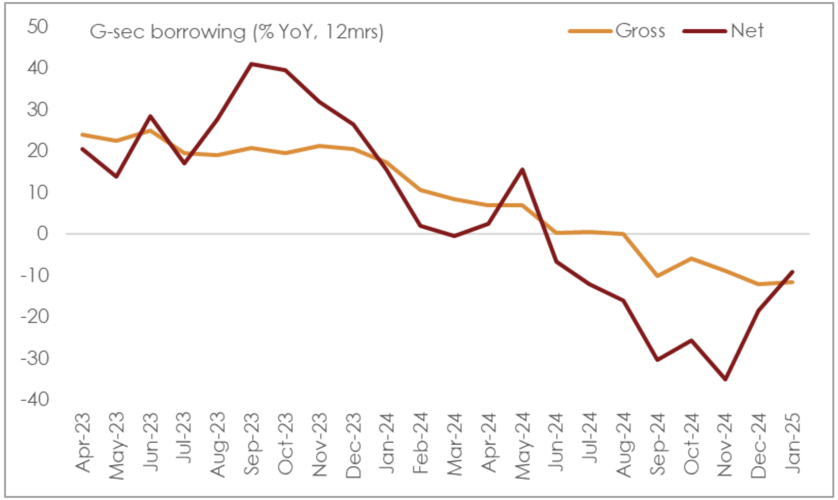
Although the US Fed delivered a fast paced 100 bps cumulative rate cut in 2024, it raised the projection for fed funds rate for end 2025 and 2026 by 50 bps each respectively. This implies just 50 bps rate cut in the whole of 2025 compared to the Sep-24 projection of 100 bps rate cut. Interest rate futures market is currently pricing 36 bps rate cut in 2025.

Any attempt at further pricing out of Fed's interest rate cuts would weigh upon global rates sentiment and potentially limit the space for monetary easing by EM central banks in 2025. However, we believe this will have a minimal impact on the Indian g-sec market, which currently has a supply tailwind. The 10Y g-sec yield is currently trading at 6.79%, close to its lowest levels in over 3-years.



G-sec supply-demand situation continues to remain supportive

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 buybacks have been concluded for g-secs maturing in FY26).



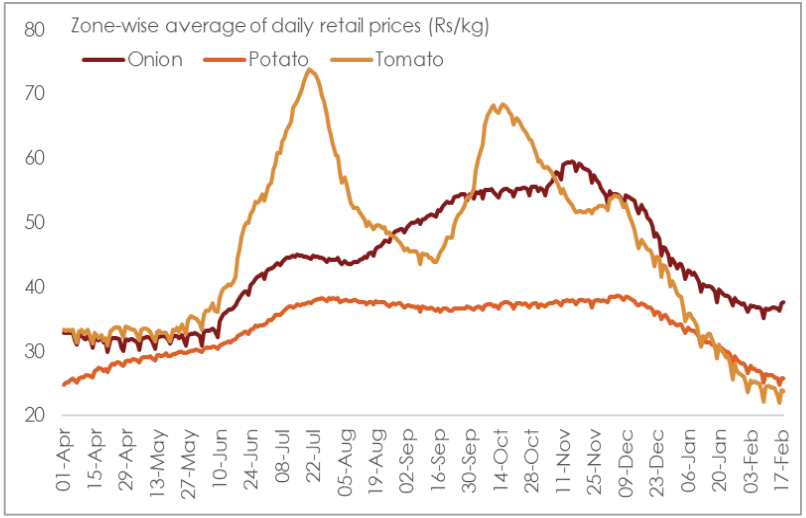
The RBI has also been conducting OMO purchases (Rs 1388 bn so far) to infuse durable liquidity, thereby absorbing 59% of the net g-sec issuances between Jan-Feb 2025.

In addition, aided by India's index inclusion, FPI debt flows continue to remain in positive territory (aggregating at USD 11.9 bn on FYTD basis) despite persistent weakness seen in FPI equity flows.

	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

Inflation: As old concerns begin to fade, new ones emerge

Food inflation moderated to a 5-month low of 5.7% in Jan-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 Feb-25, albeit to a moderate degree.



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 87 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

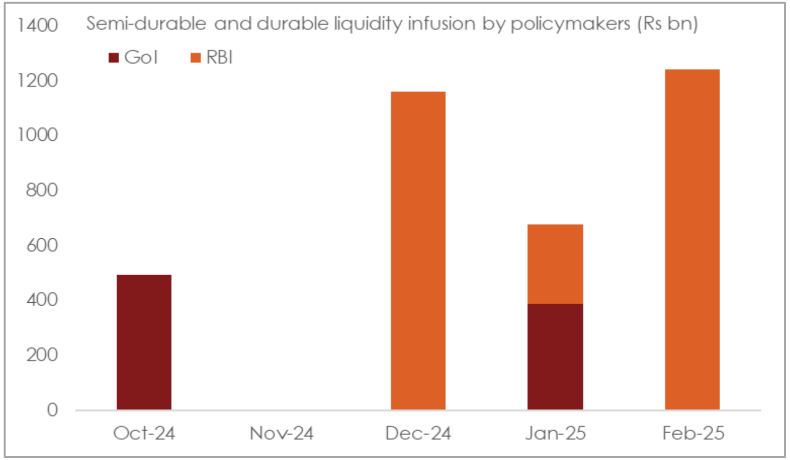
	Apr-24 MPR	Oct-24 MPR
Assumption	83.0 in FY25	83.5 in H2 FY25
Actual/ Projected	84.5 in FY25	85.6 in H2 FY25

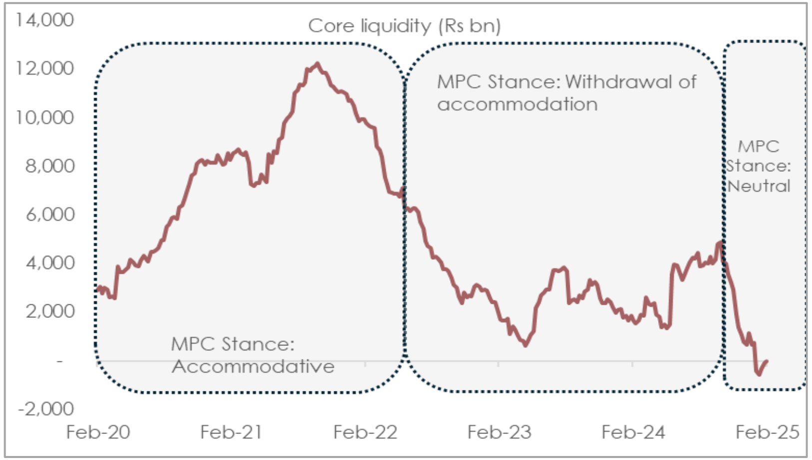
Note: Actual data is until Feb 18th. Full year actual is imputed assuming Feb 18th level of USDINR remains constant until Mar 31st.

Rates outlook

The policymakers have infused Rs 3.6 tn worth durable and semi-durable liquidity in H2 FY25 so far.

However, with core liquidity remaining in deficit due to FX intervention pressures, the neutral monetary policy stance is getting diluted, which in turn is hampering transmission. We expect further measures on liquidity (OMO purchases or temporary and targeted CRR relaxation) to be undertaken by the RBI.





We maintain our 10Y g-sec yield forecast of 6.60% for Mar-25, followed by a drift lower towards 6.40% by Mar-26. INR depreciation poses risk to our view.

INR pivots from being one of the best performers in 2024 to one of the worst in 2025

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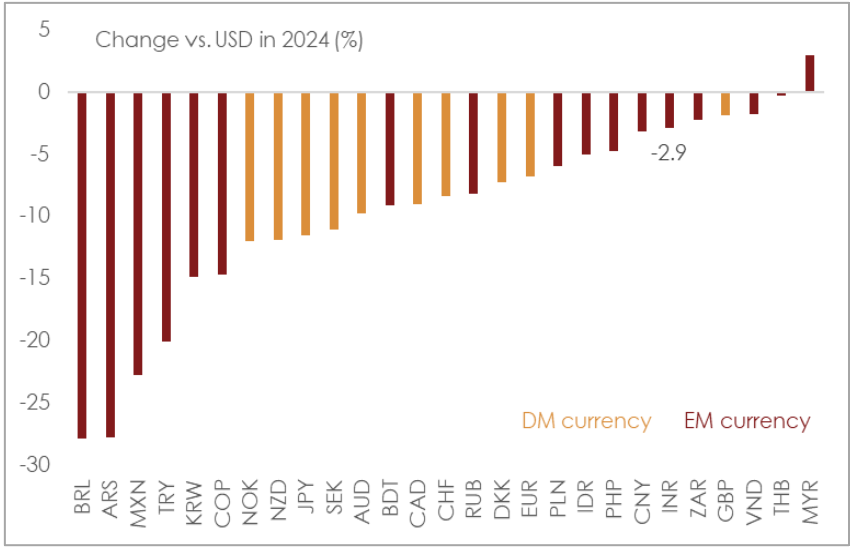
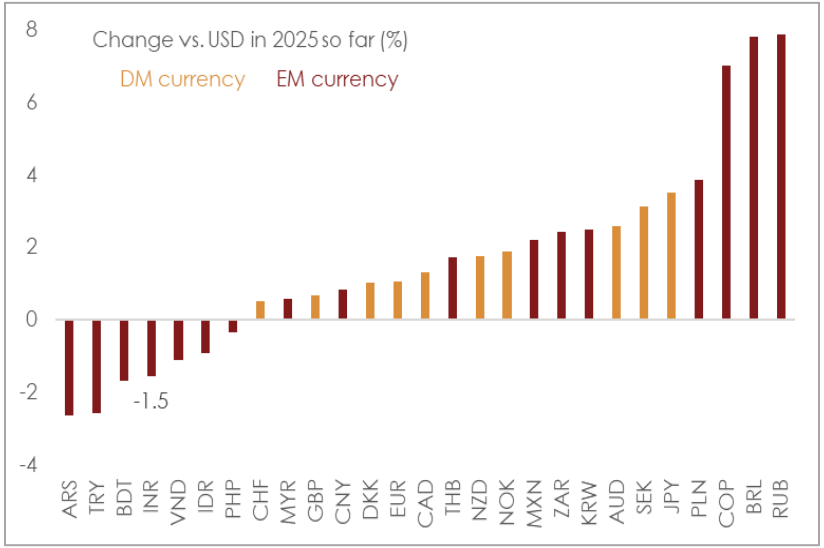
On a relative basis, INR was one of the best performing currencies amongst key DM and EM currencies vs. the USD in 2024. It had weakened by 2.9% in 2024 vs. the median depreciation of 9.4% and 7.1% seen in DM and EM currencies respectively.

In contrast, 2025 has started on a cautionary note for INR. On a relative basis, INR has become an underperformer. So far, it has weakened by 1.5% vs. the median appreciation of 1.5% and 1.3% seen in DM and EM currencies respectively.

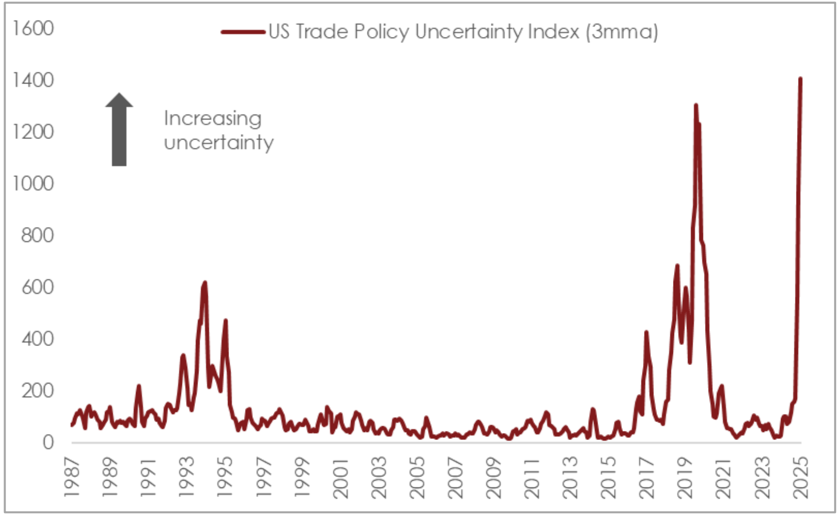


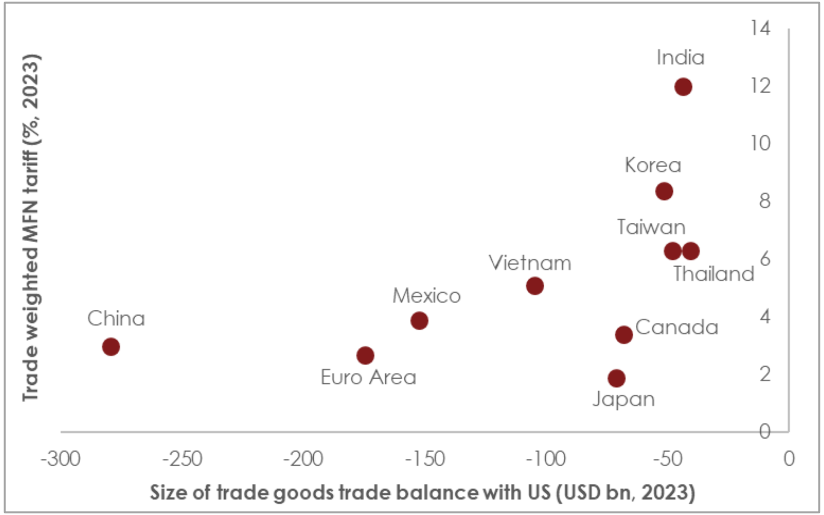


Global trade uncertainty and vulnerabilities for India

Within one month of assuming office, US President Trump is announcing sweeping changes to US trade policy, which has heightened global trade uncertainty. The stance so far remains ambiguous with focus shifting from country wise merchandise trade deficit to imposition of universal tariffs on select goods, and currently to reciprocal tariffs.

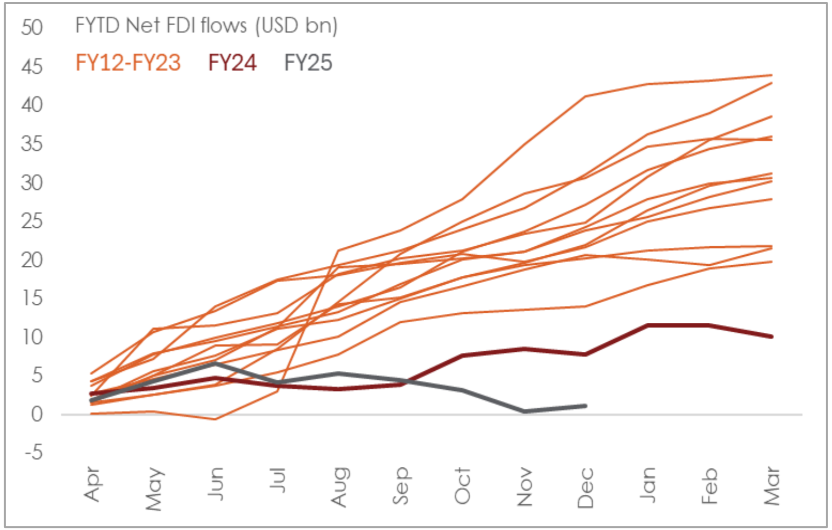
From a merchandise trade perspective, US ran a deficit of USD 44 bn with India in 2023 – the 9th largest amongst major trade partners. However, from a tariff perspective, India weighted average MFN tariff rate of 12.0% (in 2023) was one of the highest amongst major trade partners of US. This renders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



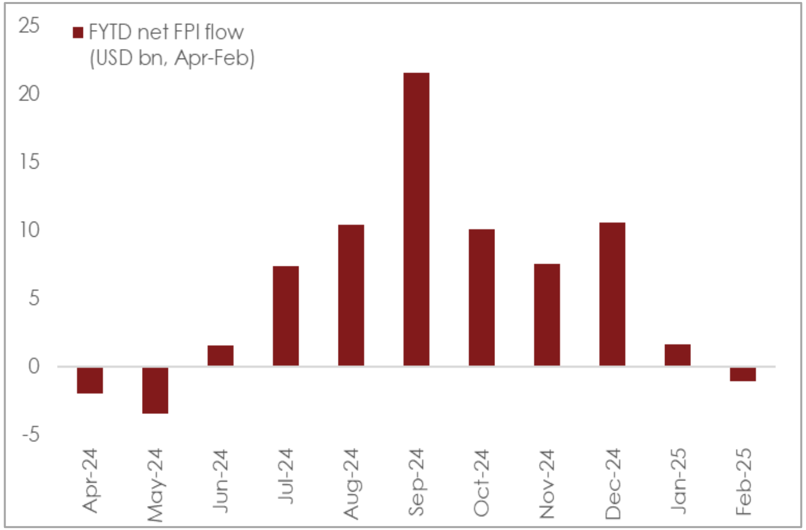


Foreign investment flows have been weak

Weakness in net FDI flows has 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 1.2 bn between Apr-Dec.



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 -1.1 bn.



BoP reflecting the pressures, while stretched overvaluation persists

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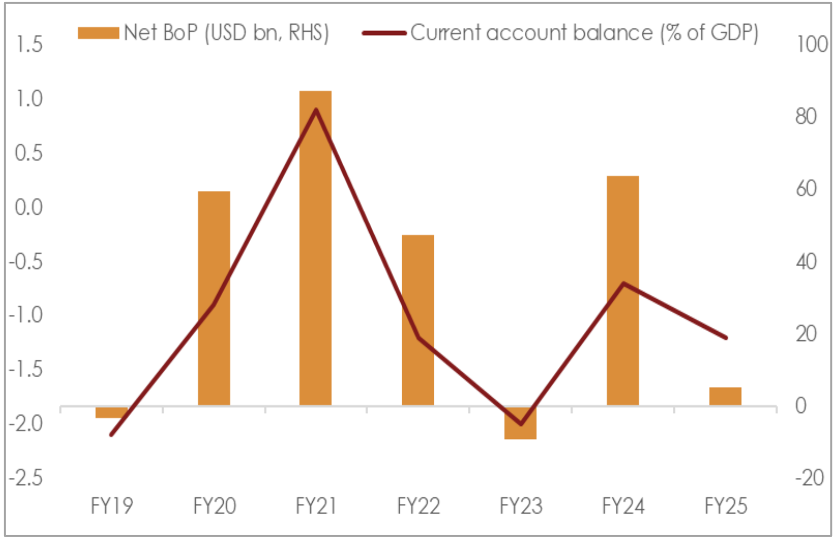
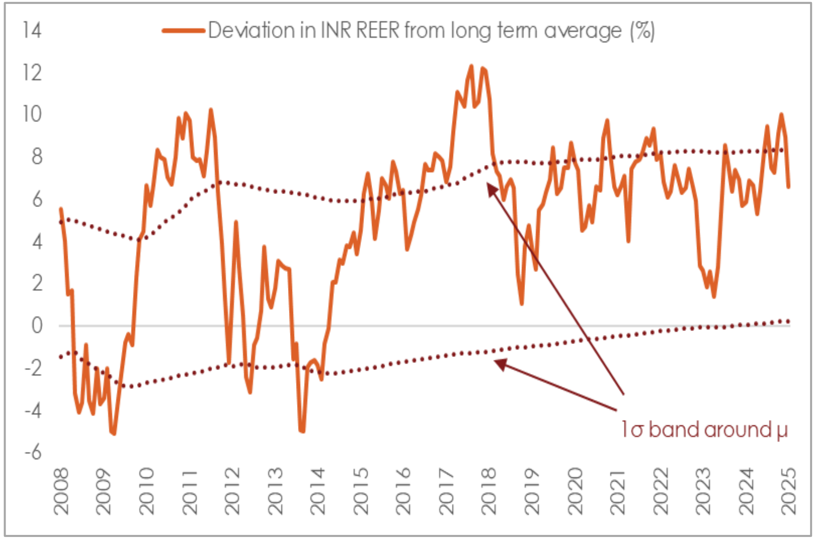
While we maintain our FY25 current account deficit and BoP forecast of 1.2% of GDP and USD 5 bn respectively, downside risks have emerged for both on account of sharp downward revisions to merchandise trade data and weakness in foreign investment flows.

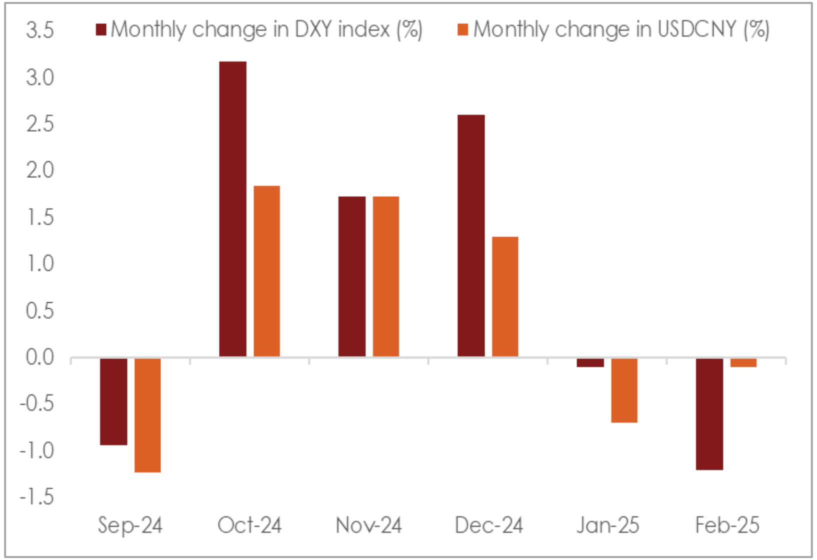
Basis REER, we estimate INR to be 6.6% overvalued (as of Jan-25) vis-à-vis its long period average. Stretched levels of currency overvaluation has historically resulted in a correction in the spot rate. However, the sharp adjustment in INR over Jan-Feb 2025 is likely to have curbed overvaluation to more normal levels.



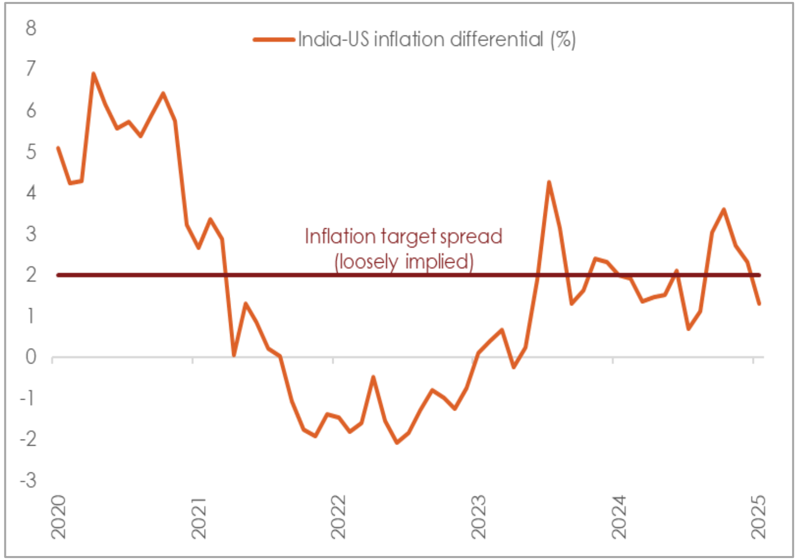


Although global backdrop stays adverse, there are early signs of moderation in pressure

In last 4-months, the broad-based strength in the USD coupled with weakness in CNY has been weighing upon EM currencies, like the INR. However, the DXY rally seems to be losing steam, while CNY is showing signs of stabilization.

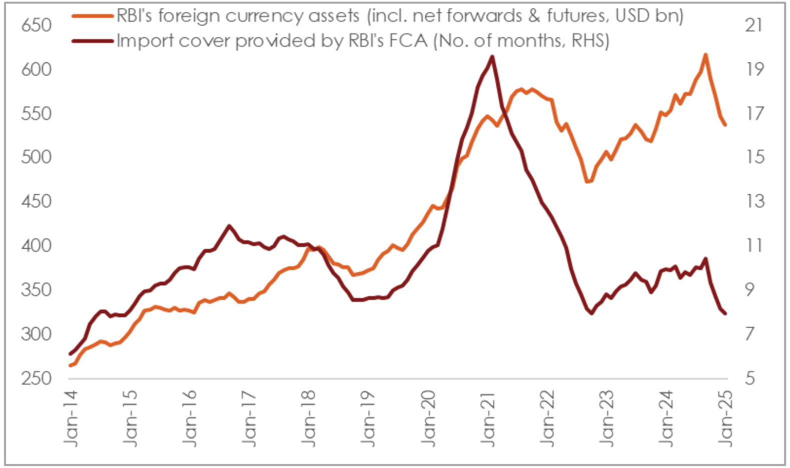


With ebbing of domestic food inflation pressures, India's inflation differential vs. the US has now fallen below 2% (loosely implied differential in their respective targets). This bodes well for INR from a medium-term perspective.



INR outlook

Sharp drawdown in RBI's fx assets coupled with a pick-up in imports has resulted in the import cover falling to under 8 months (estimated) in Jan-25, the lowest in nearly 10-years.



IMF projects India to be the fastest growing country within G20 over the course of 5-years.

Year	Fastest Growing G20 Country	GDP growth of fastest growing country	Average G20 GDP growth excl. fastest growing country
2025	India	6.5%	2.3%
2026	India	6.5%	2.4%
2027	India	6.5%	2.2%
2028	India	6.5%	2.2%
2029	India	6.5%	2.1%

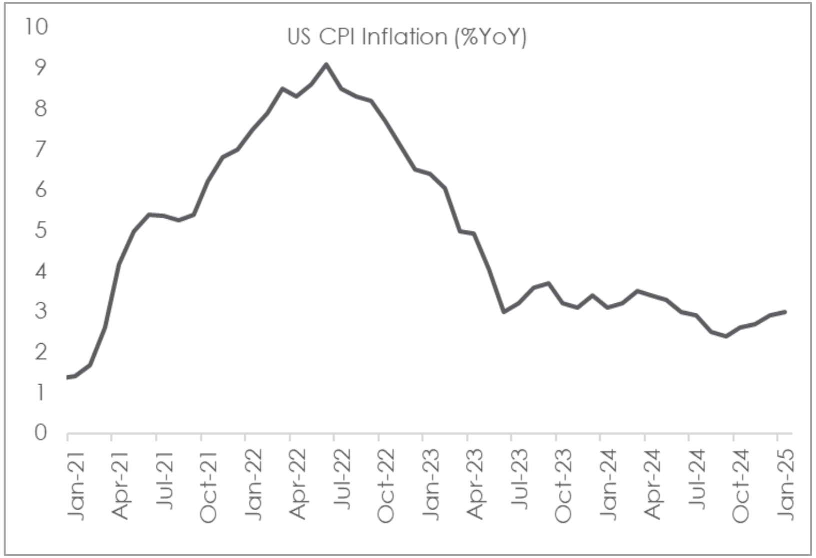
Note: Forecasts sourced from the IMF

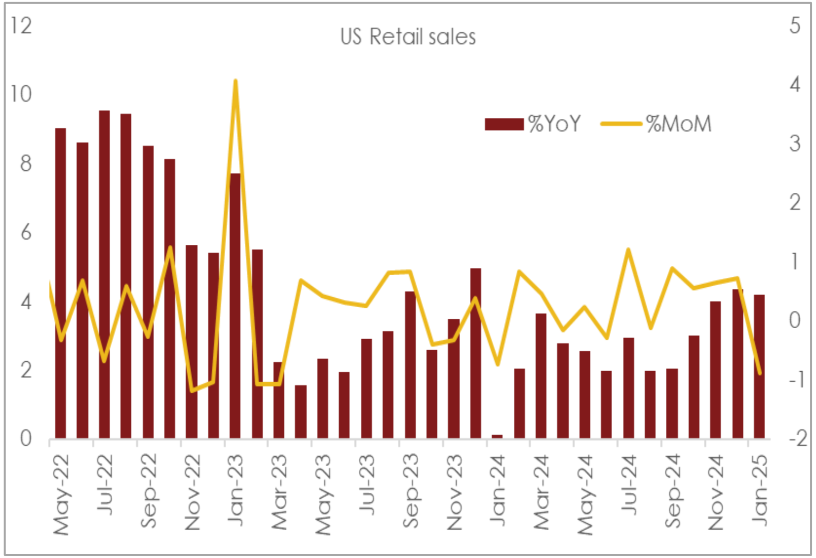
Considering the known-unknown geopolitical and geoeconomic risks, we acknowledge the upside to our USDINR call for end FY25 to 87.0 and expect further increase towards 89.5 before end FY26.

US CPI Inflation: Turning up again

Jan-25 CPI inflation reinforced concerns that the disinflationary process has come to an early end. CPI inflation surprised on the higher side, coming in at 7-month high of 3.0% in Jan-25 compared to 2.9% in Dec-24.

US economy recorded an unexpectedly sharp drop in retail sales (-0.9%MoM) suggesting that consumers tightened their belts to start the year.





US tariff announcements: Unleashing uncertainty

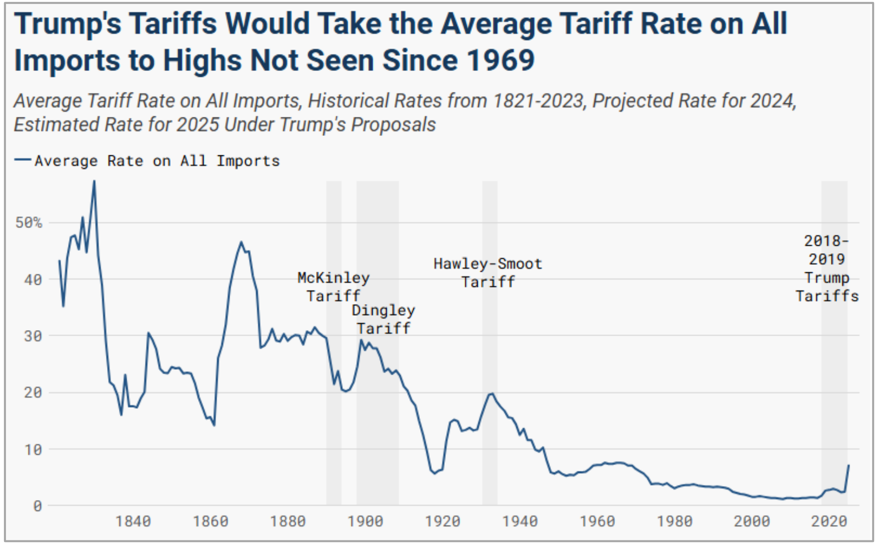
Given the outsized share of China, Mexico and Canada in US trade flows, focus of Trump tariffs has been on the three economies primarily. Tariffs on Mexico and Canada have been suspended for now, after both countries pledged to boost border enforcement. Having said, reciprocal tariffs are likely to be rolled out with 'Rest of world' beginning 1st Apr-25, which could have deeper and meaningful impact on global trade flows.

Top 15 US trading partners (Goods only, USD bn, as of Sep-24)

Timeline of tariff related activity, so far	
Nov-24	President-elect Trump's proposed 25% tariffs on Canada and Mexico and 10% tariff on China.
Jan-25	25% tariffs on Canada and Mexico could begin February 1, 2025.
Feb-25	10% tariff on all products from China comes into effect, tariffs on Canada and Mexico temporarily suspended after both countries pledged to boost border enforcement
Feb-25	Trump raised steel and aluminum tariff to 25%, without exceptions and exemptions

Tariffs: Inferior outcomes?

A study estimates average tariff rate on all imports to triple from its current rate of almost 2.5% to more than 7.0% if threatened tariffs on China, Mexico, and Canada are imposed. The average rate on all imports would climb to a more than 50-year high.



The same study pegs tariffs on Canada and Mexico would 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

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