INDIA

ECONOMIC SLOWDOWN AND LIMITED ROOM FOR MANOEUVRE

India's economic growth is slowing down. Household consumption is sluggish, hampered by slower real wage growth and rising debt burdens, and private investment is weak. Given its low degree of openness, India will be little affected by US tariff increases, but it is unlikely to be spared altogether. Its room for negotiation with the Trump administration is limited. However, its domestic market is vast and allows for diversification of production in Asia. In order to take advantage of the Sino-US trade war, India will need to address the structural constraints weighing on the development of its industry quickly. However, the government's room for manoeuvre to push through reforms in the short term is very limited.

ECONOMIC PROSPECTS REVISED DOWNWARDS

According to the IMF's April 2025 forecasts, India is expected to post the highest real GDP growth rate in Emerging Asia over the next three years (6.3% on average). India will be one of the Asian countries least affected by US tariff increases given its low integration into global trade. However, despite enviable forecasts, India's growth has slowed compared to the 2015-2019 period (7.4% on average) and is not enough to increase GDP per capita significantly and create sufficient jobs to reduce the youth unemployment rate (15.5% in 2023, according to the World Bank).

India is facing a slowdown in domestic demand (the main driver of its economic growth). While rural household consumption has supported real GDP growth over the past 12 months, urban household consumption has slowed in line with the deceleration in real wages and the increase in debt servicing (which averaged 7.3% of disposable income for the 2024/2025 fiscal year). However, household debt, estimated at 42.1% of GDP, according to the Bank for International Settlements, remains modest. Although consumer confidence indices recovered slightly at the beginning of the year and the slowdown in inflationary pressures and monetary easing point to a rebound in domestic demand, downside risks remain significant. According to data from the Centre for Monitoring Indian Economy (CMIE), wage growth in listed companies continued to slow in Q1 2025 (+4.8%), falling to just 1% in real terms. On the other hand, rural household consumption is expected to remain robust. Monsoon rains are expected to be slightly higher thannormal (according to initial forecasts by the India Meteorological Department).

Public investment, which had supported economic growth in fiscal years (FY) 2021/2022 and 2022/2023, slowed in FY2023/2024 and FY2024/2025 (fiscal year ending March 2025). Private investment, which was already weak (11.3% of GDP for FY2023/2024), did not pick up. No significant rebound is expected for FY2025/2026, as the high level of uncertainty surrounding US trade policy and its impact on Chinese production overcapacity will prompt Indian companies to exercise greater caution.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, % (1)	7.7	9.2	6.5	6.3	6.7
Inflation, CPI, year average, % (1)	6.7	5.4	4.6	4.1	4.4
General gov. balance / GDP, % (1)	-9.6	-8.5	-7.9	-7.4	-7.0
General gov. debt / GDP, % (1)	84.8	82.5	82.3	82.1	81.0
Current account balance / GDP, % (1)	-2.0	-0.7	-0.8	-1.0	-1.3
External debt / GDP, % (1)	18.4	18.7	18.6	18.4	18.0
Forex reserves (excl. gold), USD bn	498	551	552	580	594
Forex reserves, in months of imports	6.7	7.5	7.2	7.4	7.5

(1) Fiscal year from April 1st of year N to March 31st of year N+1
e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDIA: ECONOMIC GROWTH

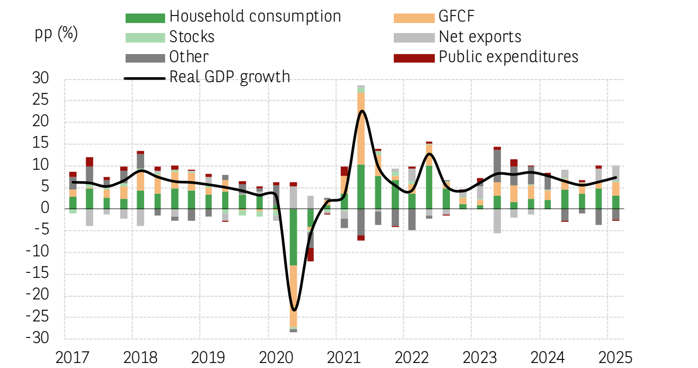

CHART 1 SOURCE: CEIC, BNP PARIBAS

MONETARY EASING CYCLE STARTED IN FEBRUARY 2025

In a disinflationary context (consumer prices rose by only +2.8% year-on-year in May, below the target of 4% +/- 1 pp for the fourth consecutive month), the Reserve Bank of India (RBI) began its cycle of monetary easing in February. Despite the volatility of the rupee (limited by significant intervention by the RBI in the foreign exchange markets), two further rate cuts were implemented in April and June (-25 bp and -50 bp, respectively) and the repo rate was reduced to 5.5%. However, this monetary easing has not yet translated into lower rates on fresh loans, which have, on the contrary, risen sharply in real terms (+200 bp since December 2024). Furthermore, although lower rates should support domestic demand, they will do little to ease the debt burden of the most vulnerable households, whose debt has risen mainly as a result of an increase in unsecured fixed-rate loans.

Despite the slight increase in credit risks (highlighted by the rise in the delinquency ratio, particularly for unsecured household loans), the banking sector should remain solid. Non-performing loan ratios continued to decline in 2024 (to 2.5% in December 2024), capital adequacy ratios are comfortable (16.4%) and provisions covered 77% of non-performing loans in Q3 2024. Non-bank financial companies are the credit institutions most exposed to the economic slowdown and the risk of default by low-income households with unsecured loans.

Although they generally have sufficient capital to cope with an increase in credit risk (the CAR stood at 27.2% in Q3 2024), not all of them would be able to meet regulatory solvency ratios in the event of even a moderate shock to the economy, unlike banks, according to the latest RBI stress tests.

WHAT ROOM FOR NEGOTIATION IS THERE WITH DONALD TRUMP?

The United States is India's largest export trading partner (18.3% of goods exports in 2024). Before the Trump administration announced the increase in US tariffs on 2 April, the effective rate on Indian products was only 2.4%. If no agreement was signed between the two countries by 9 July, the effective rate could be raised to 18.8% (including new tariffs on automobiles, steel and aluminium). The increase in customs duties could cost the Indian economy up to 0.3 pp of GDP (all other things being equal), given the share of value added included in Indian exports to the US (85% of the value of exported products) and assuming that the elasticity of exports to custom duties is 1.

The Modi government's room for manoeuvre in negotiations with the Trump administration is limited, but not zero. India is not a strategic trading partner for the US, unlike China: imports from India accounted for only 2.7% of US imports of goods and 4.7% of its imports of services in 2024. Although India is a major supplier of textiles, vegetable fibres (particularly for paper) and jewellery, these products are easily substitutable. Its room for negotiation on other exported products is even more limited. Even though exports of pharmaceuticals and telephones account for 13.9% and 9.9% of its total exports to the US, India supplies only 6% and 7.8% of the pharmaceuticals and telephones imported by the US, respectively. However, India could offer the US government privileged access to its domestic market. In 2023, the effective tariff rate on US imports of goods stood at 9.6%. Tariffs were particularly high for food products (39.3%) and motor vehicles (21.3%). Furthermore, according to UNCTAD, 74% of Indian imports were subject to non-tariff barriers in 2024. The US government could also put pressure on India to replace Russian oil with US oil, although this would not be optimal for India for cost reasons (crude oil prices and transport costs) and due to the nature of the imported oil. The Indian government had already floated the idea of increasing its purchases of US gas last March.

Finally, the question arises as to what extent India could benefit from the reorganisation of value chains in Asia. It has many advantages over other Asian countries due to its strong growth, large population, large skilled workforce (119 million Indians had higher education level in 2024, according to the International Labour Organization) and very competitive wages.

It could become even more attractive if its customs duties in the United States were (effectively) lower than those of other Asian countries. However, on the one hand, the Trump administration has threatened US companies seeking to set up operations in India, and on the other hand, the country also has many disadvantages. To date, its manufacturing capacity is too underdeveloped to make the country the new factory of the world. Value added in manufacturing accounts for only 12.5% of GDP. Structural constraints, which weigh on foreign investment and hamper the development of its industry, remain strong. This is reflected in the low level of FDI, which has been falling steadily (in nominal terms and as a percentage of GDP) since 2021. FDI inflows to India reached their lowest level in 15 years in 2024 (0.7% of GDP), despite multiple tax incentives for foreign companies. By way of comparison, FDI received by Vietnam amounted to 4.2% of GDP in 2024.

NET FDI INFLOWS STILL LOW IN INDIA

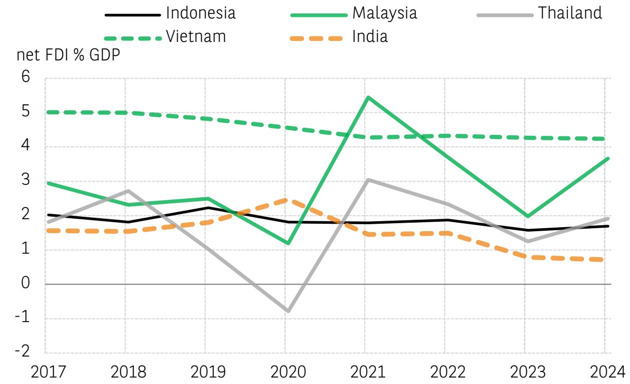

CHART 2

SOURCE: CEIC, BNP PARIBAS

Although FDI flows are low and mainly concentrated in services (particularly IT), they have enabled India to increase its export market share, particularly in mobile phones.

India remains insufficiently integrated into world trade, particularly in Asia. China is its main supplier (15.5% of its imports), but it exports relatively little to Asian countries as a whole (9.5% to ASEAN-6 and 3.4% to China). Similarly, the share of Asian investment in India (excluding investment from Singapore, which does not allow the origin of the funds to be identified) is low and no significant change has been recorded since Donald Trump's first term in office. However, despite failing to develop its trade and financial ties with Asian countries, India has increased its trade with the United States. The amounts invested remain modest, but their share of FDI flows received by the country has increased significantly over the last five years, reaching an average of 14.9% of the flows received (compared to 6.9% over the 2015-2019 period).

In order to take advantage of the upcoming adjustments in global trade, the Modi government must lift protectionist barriers. Recent free trade agreements and economic partnership agreements are a step in this direction, notably the agreement signed with the United Kingdom in May, which could come into force in a year's time, and the agreement currently being negotiated with the EU, which could be concluded in December if the talks scheduled for September are successful. However, they will not be enough if reforms to liberalise the country do not accelerate. The labour market reform adopted in 2020 is not expected to be implemented before 2026 (at best), and the land acquisition reform has still not been passed by Parliament. Modi's obligation to negotiate with the smaller parties in his coalition will further reduce his room for manoeuvre in liberalising the economy.

Article completed on 13 June 2025

Johanna Melka

johanna.melka@bnpparibas.com