

INDIA

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FISCAL SUPPORT FOR GROWTH

India's economic growth surprised on the upside between April and June 2025 (+7.8% y/y). However, activity is less dynamic than it appears, and the downside risks to growth are high. Household consumption remains sluggish. To support domestic demand and offset the impact of the rise in US tariffs on activity, the government has announced a reduction in VAT rates, even though its fiscal room for manoeuvre is limited. The central bank is likely to remain cautious in its monetary easing, as downward pressure on the rupee remains strong. In the medium term, the growth outlook could deteriorate if the United States maintains tariffs on Indian exports that are much higher than those on products from other Asian countries.

 DOWNSIDE RISKS TO GROWTH

In Q1 of the 2025/2026 fiscal year (April-June 2025), real GDP growth reached 7.8% year-on-year (y/y), outperforming the growth rate of other Asian countries (excluding Vietnam). However, this strong growth in real terms is partly explained by a particularly low GDP deflator (+0.9% vs. 4.8% on average over the last five years). The slowdown in nominal growth (+8.8% vs. 12.2% over the previous two years) is a cause for concern as it echoes the weak growth in corporate revenues, which will weigh on their investments, which are already insufficient to support India's growth potential. While the investment rate has increased by 2.3 points of GDP over the last four years to reach 33.7% of GDP in FY2024/2025, the corporate investment rate has remained stable at 11.3% of GDP, despite the improvement in their financial situation. Households and the government are the main drivers of the increase in investment (in property and infrastructure). The lack of productive investment is weighing on growth prospects.

Economic growth is expected to slow over the rest of the year. Urban household consumption remains sluggish, and the rise in US tariffs is likely to have an impact on activity in labour-intensive sectors such as textiles and jewellery. If US tariffs were to remain at 50%, the cost to the economy could reach 0.6 points of GDP over a full year.

 CAUTIOUS MONETARY EASING

Since the start of the year, the Reserve Bank of India (RBI) has cut its key rates by 100bp. However, its policy easing is on hold and is likely to remain cautious. Despite the downside risks to economic growth, the RBI has kept its key rates unchanged at 5.5% since June, as core inflation (excluding food and energy) remains high (+4.5% y/y in September) and downward pressure on the rupee is strong. The RBI has stepped up its intervention in the foreign exchange market. In addition, excessive rainfall in the country is likely to have an impact on harvests and push prices up.

 RISING PRESSURE ON EXTERNAL ACCOUNTS

Despite solid growth, India has seen significant capital outflows in recent months. Although still strong, its external accounts have deteriorated slightly.

For FY2024/2025, the current account deficit narrowed by 0.1pp to 0.6% of GDP (vs. an average of 0.8% of GDP over the last five years). At the same time, however, the financial account surplus narrowed as net FDI fell. Although India is a major recipient of FDI, it is unable to retain it. Between 2017 and 2024, gross FDI inflows increased by a factor of 1.3, while disinvestments increased by a factor of 2.9. Foreign companies sold their assets and/or repatriated their profits without reinvesting them in the country. Therefore, despite a moderate current

FORECASTS					
	2022	2023	2024	2025e	2026e
Real GDP growth, % (1)	7.6	9.2	6.5	6.7	6.4
Inflation, CPI, year average, % (1)	6.7	5.4	4.6	2.4	4.1
General gov. balance / GDP, % (1)	-9.5	-8.8	-7.8	-7.5	-7.2
General gov. debt / GDP, % (1)	82.7	83.4	82.5	82.8	82.0
Current account balance / GDP, % (1)	-2.0	-0.7	-0.6	-1.0	-1.5
External debt / GDP, % (1)	18.6	18.4	18.8	18.9	18.9
Forex reserves (excl. gold), USD bn	498	551	552	581	590
Forex reserves, in months of imports	6.7	7.5	7.2	7.4	7.4

(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: PRUDENT MONETARY EASING

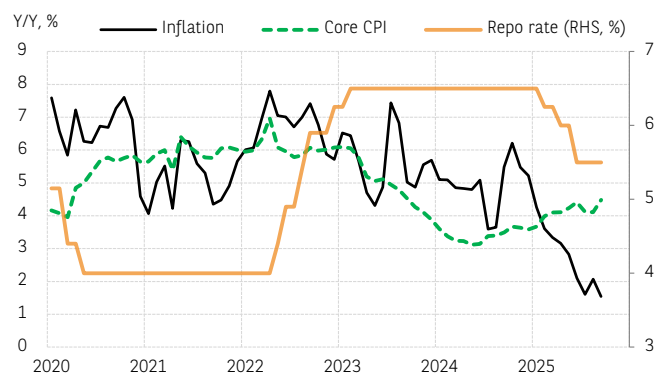


CHART 1

SOURCE: CEIC, RBI, BNP PARIBAS

account deficit, it is not covered by net FDI inflows, making the country dependent on volatile portfolio investments. India (like Indonesia) is therefore particularly exposed to tightening in external financing conditions and changes in US monetary policy.

In Q2 2025, while the current account deficit remained contained, the decline in capital inflows (FDI and portfolio investments) accelerated. Not only did FDI inflows decline, but resident direct investment flows abroad increased (particularly to the United Arab Emirates since the free trade agreement signed between the two countries in 2022). Net FDI amounted to only 0.6% of GDP, compared with 3.7% of GDP in Viet-



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nam, 1.5% of GDP in Malaysia and 0.7% of GDP in Indonesia. Portfolio investment also fell significantly between April and August 2025. Net portfolio investments recorded a deficit of USD 2.5bn, compared with a surplus of over USD 10.4bn in the same period last year. These capital outflows put downward pressure on the rupee (-4% against the USD between April and October). They are the result of i/ the decline in Indian bond yields and the narrowing of their spread with US yields between mid-2024 and mid-2025, ii/ the US tariff surcharge on Indian imports, as well as the measures taken on visas for Indian workers, which could weigh on the profits of Indian companies based in the US and reduce income transfers to India.

In August 2025, the US government imposed a 25% 'reciprocal' tariff on goods imported from India and an additional 25% 'punitive tariff' in response to India's purchases of Russian crude oil. The effective tax rate imposed by the United States on Indian products has therefore been raised from 2.4% at the end of 2024 to 36.4%, a level well above that of other Asian countries (including China). Since 2022, the purchase of Russian crude oil at a price below the international market price has helped to ease pressure on the country's external accounts. The share of Russian crude oil imports rose from just 1.9% at the end of 2021 to 33.5% in June 2025. Russia has become India's leading supplier of crude oil. However, the recent decision by the US government to ban all entities (American or otherwise) from buying oil from Russia's two main companies (Lukoil and Rosneft) will force Indian companies to source their supplies (at least in part) from other countries, and notably the Gulf. Given that India purchased an average of 1.76 million barrels per day from Russia in FY2024/2025, and the price difference between Brent and Urals averaged USD 13.14 per barrel, if India stopped buying Russian oil, its current account deficit could increase by 0.2 points of GDP (without taking into account the effect this could have on its refined oil exports, as India would lose competitiveness).

Moreover, if US tariffs on Indian imports were to remain unchanged, the surcharge on Indian products would lead to an increase in the current account deficit of 0.7 points of GDP. The United States is the main market for Indian exports (18.3% of exports, i.e. 2.1% of GDP in 2024).

In addition to the evolution of the current account (which should remain below 2% of GDP even if tariffs are maintained at 50%), the question is what will happen to FDI and portfolio investments. In the short term, Indian bonds should benefit from a favourable interest rate spread with US bonds, given the expected cut in key rates by the US Federal Reserve. However, FDI, which is already low, could decline further if the US government maintains tariffs on Indian products that are higher than those imposed on other Asian countries. Although FDI is currently concentrated mainly in services, electronics and telecommunications (43% of FDI received), which are not currently affected by the tariff hike, the surcharge could severely limit investment in industry and weigh on medium- and long-term growth. If the 25% surcharge were lifted, the effective rate would then be 20.8% (compared with 19.3% for Vietnam), which would allow India to avoid being overly penalised compared with its neighbours and to hope to attract foreign investment.

Whatever the outcome of the negotiations with the US administration, the risks to India's external accounts should remain contained. Foreign exchange reserves are abundant and sufficient to cover the country's external financing needs. They stood at USD 566 bn at the end of October, equivalent to 7.4 months of imports and 1.9 times the external debt service.

INDIA: NET CAPITAL INFLOWS REACHED A LOW POINT

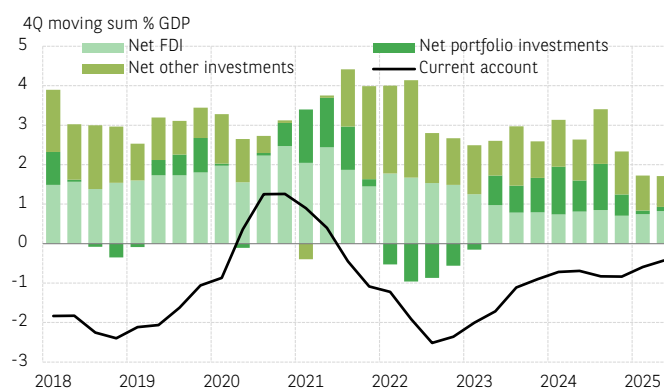


CHART 2

SOURCE: CEIC, RBI, BNP PARIBAS

LOWER VAT RATES DESPITE LIMITED FISCAL ROOM FOR MANOEUVRE

India's public finances are not highly vulnerable to the international financial environment, but they remain the Achilles heel of the economy. The fiscal room for manoeuvre to support its economy is limited. Firstly, because the fiscal deficit and government debt are already high. Secondly, because fiscal revenues are among the lowest in Asia. For FY2024/2025, they amounted to just 9.3% of GDP, while in the ASEAN-5 countries (excluding Singapore) they ranged from 12.9% of GDP in Indonesia to 18.2% of GDP in Thailand. Finally, the burden of interest payments on government debt is particularly heavy: in FY2024/2025, they consumed 36.3% of government revenues. Nevertheless, faced with the risk of an economic slowdown, the government has lowered VAT rates. Since 22 September, the VAT rate on non-durable goods has been cut from 12% to 5%, and the VAT rate on durable and semi-durable goods (such as cars) has been reduced from 28% to 18%. The reduction in VAT rates could generate an increase in growth of 0.6pp over a full year, which could therefore offset the negative effect of US tariffs. The loss of revenue for the central government should be offset by the end (from 2026) of the financial compensation it pays to the States (planned since the introduction of the VAT rate). The loss of revenue for the States should be offset by the introduction of a 40% VAT rate on luxury goods. The central government is expected to meet its target of reducing the deficit by 0.4pp to 4.4% of GDP.

Despite the high level of public debt (82.5% of GDP for FY2024/2025), refinancing risks are moderate because the debt structure is not risky, and the government has access to abundant domestic savings. In Q1 2025, 83.6% of general government debt was domestic. Although 66.8% of the debt is market debt, refinancing risks are limited. The average maturity of the debt is 13.2 years. Treasury bills with a maturity of less than one year account for only 6.2% of total central government debt. Moreover, market debt is almost entirely held by domestic financial institutions and denominated in local currency. At the end of August 2025, foreign investors held only 2.9% of all government-issued debt securities (equivalent to 1.1% of GDP).

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