

INDIA

ROBUST GROWTH, BUT AI POSES CHALLENGES FOR EMPLOYMENT

India’s economic growth is projected to be +7.6% for FY 2025/26, ranking among the highest in Asia. Monetary easing and VAT cuts have bolstered domestic demand. The medium-term outlook remains favourable. The reduction in US tariffs and the gradual rollout of new free trade agreements (FTAs)—including with the US, EU, UK and EFTA—should bolster exports. After decades of protectionism, India is opening up its economy to attract FDI, develop industry, and create high-quality jobs. The government acknowledges the risks that AI poses to employment in the IT services sector.

ROBUST GROWTH DESPITE THE RISE IN US TARIFFS

The Indian economy has demonstrated remarkable resilience to US tariff increases, supported by expansionary monetary and fiscal policies. According to preliminary estimates from the National Statistical Office (MOSPI), growth could reach 7.6% for the entire 2025/2026 fiscal year (FY) (ending March 2026) compared to 7.1% one year earlier, making it one of the highest growth rates in Asia, following Vietnam (+8%).

This economic growth rate aligns with average of the previous five years (excluding the pandemic year) and exceeds the IMF’s estimated potential growth rate of 6.5%. Economic activity in 2025 was primarily driven by domestic demand, which benefited from three key factors: lower interest rates amid declining inflationary pressures, favourable agricultural output, and the VAT reductions implemented in September.

For the FY2026/2027, growth is projected to moderate slightly but remain robust, bolstered by sustained household consumption, rising public investment, and a recovery in exports facilitated by the significant reduction in US tariffs (from 50% in August 2025 to 10% as of February 24, 2026, following the US’s Supreme Court’s invalidation of reciprocal tariffs).

The primary immediate risk to growth stems from significant rising oil prices (especially if India stops buying oil from Russia) and the adoption of new US sectoral tariffs if India fails to sign the trade agreement negotiated in February (the signing of which was suspended after the reciprocal tariffs were struck down).

EMPLOYMENT CHALLENGES PERSIST

Labour market conditions continue to represent a structural weakness for India. While unemployment remains high, particularly among young people, the labour market has shown signs of improvement since late 2024. However, job creation is still concentrated in low-value-added sectors, especially agriculture. Informal employment, despite declining by 2 percentage points (pp) over the last five years, still accounts for 88.4% of total employment according to ILO data. The implementation of labour market reforms adopted in 2020, which are taking effect since the start of the year, may help promote formal job creation and raise household incomes.

Data from the Center for Monitoring Indian Economy (CMIE) indicates that the unemployment rate averaged 6.8% during the first nine months of the FY2025/2026, compared to 8.1% in the same period of the previous year. Evidence of improved job creation includes a 15.3% reduction in applications for agricultural work under the MGNREGA programme in rural areas, and a 7.1% increase in the NAUKRI Job Index between April and December 2025 in urban areas. However, the unemployment rate has fallen most significantly in rural areas, where the quality of jobs remains comparatively poor.

FORECASTS

	2023	2024	2025e	2026e	2027e
Real GDP growth, % (1)	7.2	7.1	7.6	7.0	6.8
Inflation, CPI, year average, % (1)	5.4	4.6	2.1	4.1	4.3
General gov. balance / GDP, % (1)	-9.2	-8.2	-8.0	-7.9	-7.7
General gov. debt / GDP, % (1)	84.9	84.0	84.3	83.6	81.7
Current account balance / GDP, % (1)	-2.3	-0.8	-0.6	-1.2	-1.3
External debt / GDP, % (1)	16.8	19.8	20.1	20.0	19.8
Forex reserves (excl. gold), USD bn	551	547	553	575	580
Forex reserves, in months of imports	7.5	6.8	6.7	7.0	7.0

(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

RUPEE: THE WORST PERFORMANCE AGAINST THE USD AMONG ASIAN COUNTRIES IN 2025

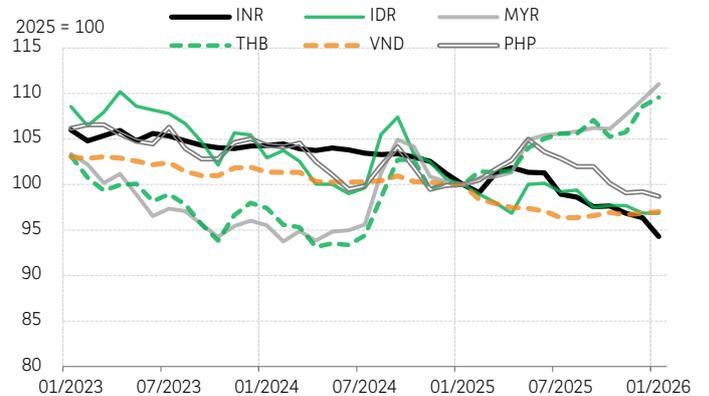


CHART 1

SOURCE: RBI

END OF THE MONETARY POLICY EASING CYCLE

In 2025, the Reserve Bank of India (RBI) reduced its policy rates by 125 basis points. Inflation decelerated to 2.2% from 4.9% in 2024, primarily due to a decrease in food prices (-0.2% in 2025 compared to +8.4% in 2024). Monetary policy easing supported a recovery in bank lending, which grew by 14.5% year-on-year in December 2025, up from 11.2% in the previous year.

Despite inflation remaining well within the central bank's target range of 4% +/- 2pp, policymakers are expected to maintain policy rates at current levels over the next twelve months. This cautious stance reflects both robust growth and concerns about potential downward pressure on the rupee.

EXTERNAL ACCOUNTS WEAKENED IN 2025

In 2025, India's external accounts deteriorated slightly, although they remain sound. As of mid-February, the country held substantial foreign exchange reserves amounting to USD573.6 billion, which provide coverage for 6.7 months of imports and fulfil all short-term financing requirements. The deterioration in external accounts was attributed three main factors: a widening current account deficit, net portfolio investment outflows, and a decline in foreign direct investment during the fourth quarter, which were insufficient to offset the current account deficit. Consequently, the rupee depreciated by 4.8% against the US dollar between the end of 2024 and the end of 2025, and by 8% in nominal effective terms, marking one of the weakest performances among emerging Asian currencies (see Chart 1).

Unlike Southeast Asian countries, which saw an average export growth of 12.7% in current dollar terms during 2025, Indian exports grew by just 0.6% over the same period. The strong export performance in the first half of 2025 was reversed in the second half, with exports declining by 3.6% compared to the first half. This reversal followed the US' implementation of a 25% surcharge on tariffs for imports from India in response to India's purchases of Russian oil. The tariff increases effectively raised the average tariff rate on Indian goods from 2.4% in 2024 to 35.1% in August 2025 (compared to 19% for Vietnamese products and 16.2% for Thai products). As a result, India's exports to the United States contracted by 22.1% in the second half of 2025 compared to the first half.

Moreover, India has not benefited from the strong global demand for electronic products driven by the artificial intelligence boom, as it lacks a significant presence in this segment. While India's electronics exports have grown rapidly, they remain concentrated in smartphones. Consequently, India's share in global goods exports declined by 0.1 percentage points in the first ten months of 2025, falling to just 1.7% according to IMF data, while Southeast Asian countries increased their market share.

Throughout FY2025/2026 as a whole, the current account deficit is projected to widen by 0.6 percentage points to 1.2% of GDP. However, this deficit is unlikely to be entirely covered by FDI inflows. While net FDI has increased from the previous year due to strong inflows in the first half of 2025, it is expected to remain below 1% of GDP, which is significantly lower than the levels observed in Southeast Asian economies (1.4% of GDP in Malaysia, 1.6% in Thailand, and 3.9% in Vietnam).

The country has also experienced significant portfolio investment outflows, which can be attributed to both the decline in bond yields associated with monetary easing and concerns regarding US tariff policies.

Although India's external position remains stable, the structurally low level of FDI is a cause for concern. India's limited integration into global value chains and its pressing need for foreign technology to develop its industrial sector and create high-quality jobs (requiring 12 million new jobs annually to absorb the workforce) suggest that attracting FDI would improve both productivity and household incomes.

After decades of protectionist policies, government initiatives to strengthen ties with numerous countries of all sizes and the proliferation of free trade agreements over the past year (with the United Kingdom in July 2025, Oman in December 2025, and the European Union in January 2026), demonstrates the Modi government's commitment to accelerating India's integration into global trade.

INDIA'S AI READINESS: FALLING BEHIND REGIONAL PEERS

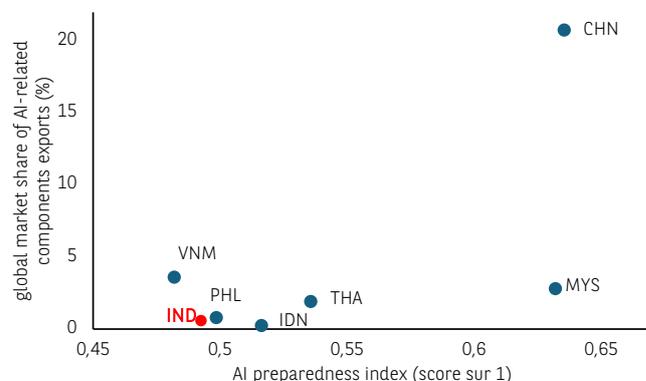


CHART 2

SOURCE: IMF, OXFORD ECONOMICS

From a geopolitical perspective, this trade strategy reflects Indian government's multi-alignment approach but also its willingness to shield its economy from potential tensions with the United States and/or China.

AI DEVELOPMENT PRESENTS EMPLOYMENT CHALLENGES

The development of artificial intelligence (AI) currently poses more challenges than opportunities for India. The country's comparative advantage in AI-related products remains minimal, accounting for just 0.6% of global exports in 2024 according to WTO definitions. Although India maintains a strong position in IT services exports (accounting for 10.6% of global exports in 2024), its ability to deploy AI technologies nationally lags behind that of Thailand and Malaysia (see Chart 2).

India's implementation of AI faces several limitations, including inadequate infrastructure (ranked 68th out of 83 countries in the Global AI Index) and a lack of IT equipment (87th out of 173 in the ICT component of the IMF's AI Preparedness Index). The country's education and training systems are insufficient to facilitate widespread AI adoption, as evidenced by its low score of 0.4 out of 1 in the skills sub-component of the Technology Readiness Index. Given the nature of its labour market and current government policies, India is poorly equipped to rapidly adapt to AI technologies, ranking 85th out of 173 countries in the human capital and labour policies sub-component of the AI Preparedness Index - well behind most Southeast Asian nations (with the exception of Vietnam).

The high rate of informal employment within the Indian labour market and the limited capacity for large-scale workforce retraining make it particularly vulnerable to AI-driven disruption. The advantages of AI development may only benefit a small segment of the population, potentially worsening inequality. According to the Stanford AI Index Report, AI poses significant risks, particularly to low-skilled IT service jobs, which accounted for 1.4% of total employment in 2024.

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