INDIA

SIGNIFICANTLY SLOWER GROWTH AND RISING RISKS

Economic growth forecasts for the fiscal year 2024/2025, which ends on 31st March, have been revised significantly downwards. The outlook for the next three years could also be downgraded unless the government and the private sector significantly increase their investment. However, the international economic climate is not conducive to either domestic or foreign investment, even if the direct impact of a potential increase in US tariffs on Indian economic growth would be limited. The recent downward pressure on emerging currencies has not spared the Indian rupee, and the depreciation trend is likely to continue, especially as the new Governor of the Central Bank seems to be focusing on supporting economic growth rather than currency stability.

SIGNIFICANTLY SLOWER GROWTH

Following in the footsteps of the Reserve Bank of India (RBI), the Central Statistical Office (CSO) has revised downwards its growth forecasts for the fiscal year (FY) 2024/2025, which will end on 31st March. These revisions (6.6% and 6.4%, respectively, compared with 8.2% for 2023/2024) reflect the economic growth slowdown recorded between July and September 2024. Growth was up just 5.4% year-on-year (y/y), the lowest rate recorded in the last seven quarters. As a result, in the first half of the fiscal year, growth was just 6% compared with 8.2% at the same time last year. This slowdown is due to a marked deceleration in activity in manufacturing and construction. Activity in the services sector remained solid, although decelerating slightly. Only agriculture rebounded. On the demand side, apart from government spending, all components slowed.

In the second half of the fiscal year (October-March), economic activity should accelerate, but is not expected to exceed 6.7%, according to the RBI. Base effects should be unfavourable and the rebound modest. Since November 2024, all the indicators have picked up, on both the supply and demand sides. Industrial output has accelerated from its low point in August, particularly in the manufacturing sector, and the rebound in steel and cement production suggests that construction activity has picked up. Rural household consumption should continue to be underpinned by good summer harvests, higher-than-average water reservoir levels and better winter sowing than in 2024. On the other hand, although expected to rise, the rebound in urban household consumption could be more muted. Sales of two-wheel vehicles accelerated significantly in the fourth quarter, while growth in car sales, despite returning to positive territory in October after three months of decline, remains sluggish (+4.4% y/y in November).

On the investment front, although the government is likely to accelerate the pace of new infrastructure projects, private entrepreneurs may be more cautious, waiting for a clearer picture of the domestic and international environment. Capacity utilisation rates have reached a plateau and average interest rates on new loans remain more than 40 basis points (bps) higher than last year (in real terms), while the financial situation of companies is less comfortable than at the start of the year (with rising interest charges and a slowdown in profits). Over the next three years, growth is expected to average 6.5%, but downside risks are high and the slowdown in investment is something to keep an eye on. In the absence of a significant rebound, the short- and medium-term growth outlook could be revised downwards.

INFLATION SLOWS THANKS TO FOOD PRICES

In November, inflation slowed to 5.5% y/y, mainly due to the noticeable deceleration in food prices and a favourable base effect.

FORECASTS

	2022	2023	2024e	2025e	2026e
Real GDP growth, % (1)	7.0	8.2	6.3	6.6	6.5
Inflation, CPI, year average, % (1)	6.7	5.4	4.8	4.4	4.3
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	82.9	82.3
Current account balance / GDP, % (1)	-2.0	-0.7	-1.3	-1.5	-1.5
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

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDIA: SLIGHT RISE IN INDUTRIAL OUTPUT

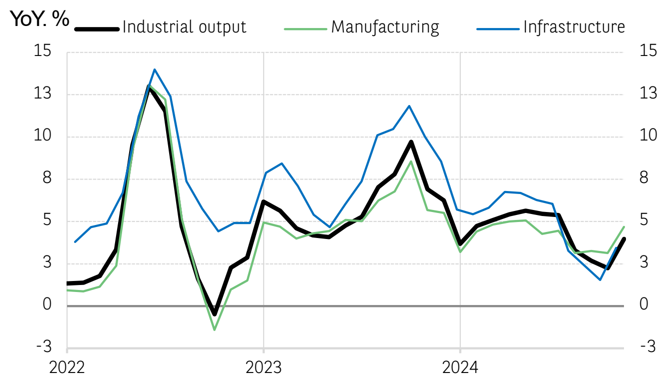

CHART 1 SOURCE: CEIC, BNP PARIBAS

Excluding food and energy, core inflation remained relatively stable at 3.6%. Over the next few months, inflationary pressures should continue to fall, enabling the RBI to ease monetary policy at its next three monetary policy committees, lowering the key rate to 5.75%, despite the downward pressure on the rupee. Indeed, the new Governor of the Reserve Bank of India (RBI) seems to be giving priority to supporting growth rather than the stability of its currency. Such a policy is risky, however, as it would fuel inflationary pressures and penalise consumption by the most disadvantaged households, unless it is accompanied by a reduction in import taxes or an expansionary social policy. This would reduce its budgetary margins for increased investment spending.

EXTERNAL ACCOUNTS: RISING TENSIONS

India's external accounts are structurally robust. Its foreign exchange reserves are plentiful (in mid-January, they covered 1.8 times the country's short-term external financing needs), its current account deficit is moderate (0.8% of GDP on average over the last five years), and its external debt is low (19.3% of GDP). In addition, although India is vulnerable to commodity price shocks, particularly oil as a net importer, it has managed to reduce its exposure by importing oil from Russia at below-market prices. The main areas of concern are the very low level of FDI (which has been falling for two years) and the country's greater vulnerability to external shocks with the inclusion of sovereign bonds in the emerging indices.

The current account deficit, which rose slightly in Q2-Q3 2024 (to 1.2% of GDP), is no longer covered by net FDI flows (which fell to just 0.2% of GDP). Despite this, pressures on the balance of payments were limited thanks to foreign portfolio investment. However, since October, as a result of significant capital outflows caused by the prospect of a status quo in US monetary policy, downward pressure on the rupee has increased significantly and foreign exchange reserves have fallen by more than 11.5% (USD -70 bn). In mid-January, the rupee was trading close to INR87 to USD1, an all-time low. This trend is set to continue with the expected rise in the current account deficit and the fall in domestic interest rates. Furthermore, the new Governor of the RBI appears to be adopting a different strategy from that of his predecessor, who had made the stability of the rupee his main objective. Allowing the rupee to depreciate would increase the competitiveness of Indian exports, but it could also attract the attention of the new Trump administration.

TRUMP 2.0: WHAT ARE THE CONSEQUENCES?

The potential increase in US tariffs will have a moderate impact on the Indian economy.

In 2018, the Trump administration imposed tariffs on some Indian products, in particular steel (25%) and aluminium (10%), which then accounted for around 6% of Indian exports to the US. In 2019, it also abolished the preferential tariff policy (0% customs duty) in force on automotive components, chemical products and nuclear reactors, which then accounted for around 12% of exports. The introduction of these tariffs led to a fall in exports over the following two years (particularly for automotive components), but exports then rebounded strongly. The US has remained India's leading export partner, accounting for 17.6% of its total exports. In 2024, the US trade deficit with India, despite being larger than the US trade deficit with Indonesia and Malaysia, remained modest (USD 45bn) compared with that with China and Vietnam (USD 293 bn and USD 122 bn, respectively). However, as in other Asian countries (apart from Malaysia), this deficit has increased significantly since 2020 (+62%). However, the sharp rise in Indian exports to the US does not reflect a shift of Chinese production to India, but rather a shift of US companies to 'friendly' countries. Although precious stones are still the leading export to the US (13.4% of exports to the US), the share of machinery and electrical equipment has risen sharply since 2020, reaching 13% of goods exported to the US in 2023 (vs. 3.2% in 2018). Exports of smartphones and semiconductors increased by a factor of 3.2 between 2022 and 2023. This very sharp increase is the result of the influx of FDI into these sectors from 2020 onwards.

INDIA: EXPORTS TO THE US

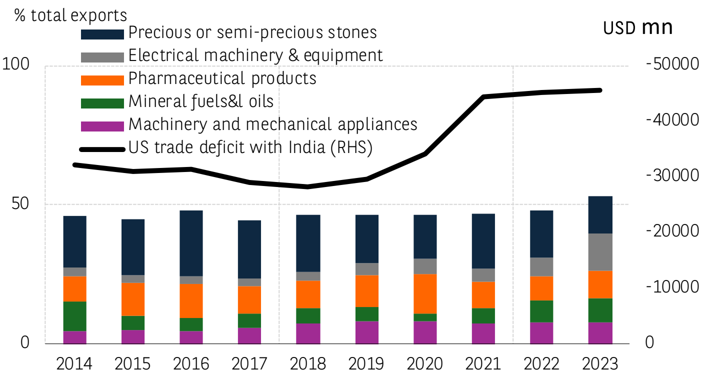

CHART 2 SOURCE: CEIC, BNP PARIBAS

Despite a modest trade surplus with the US, and despite the fact that it has not been accused of manipulating its currency, India, as the ninth largest import partner of the US, could nonetheless face a further increase in US tariffs unless it lowers its customs duties on imported US products. But its room for manoeuvre when it comes to 'negotiating' with the US is limited. The US already has a more favourable tariff policy than its other trading partners. The weighted average tariff rate on its imports of agricultural products from the US was just 1.8% in 2022 (compared with 4.7% for the EU, its leading trading partner for this type of goods). For its imports of non-agricultural products, the rate was just 2.7% in 2022 for US products (compared with 3.5% for EU products).

However, if the new Trump administration were to decide to increase its tariffs on products imported from India, the impact on the Indian economy would be modest. Exports to the US accounted for 2% of its GDP in 2023. The adoption of a 10% tariff on Indian goods exported to the US could generate a 0.2 pp drop in its GDP (assuming that the elasticity of exports to customs duties is 1.3, as indicated in the 2024 study by Haberkorn, Hoang, Lewis, Mix and Moore).

If the Trump administration were to spare India, the country could benefit from a redirection of trade flows with the US as a final destination, as the cost of its abundant labour remains much lower than in other Asian countries and its performance in logistics is equivalent to that of Vietnam. However, the government still needs to remove the constraints that weigh on the development of its manufacturing sector and penalise FDIs, which remain strong despite the Modi government's efforts.

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