

As 2026 nears, can India steady itself in a fragmenting world economy?

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The domestic export-promotion mission marks the beginning of a new industrial policy push. **(AFP)**

SUMMARY

Tariffs, tech wars and shifting alliances defined 2025. Whether India's trade strategy and domestic reforms can withstand a fracturing global economy is the question for 2026.

Crystal ball gazing is rarely a good idea for economists, but the tumult in international relations this year demands an exception. The year 2025 has been one of tariff tantrums, export controls, and the invocation of exceptional legal frameworks across developed economies—each revealing the contours of the true world economic order.

Even though the dollar is said to be losing dominance by “stealth,” it remains undeniable that many countries still need both the US and China. For India, this reality is particularly challenging: nearly a fifth of its exports go to the US, and recent tariffs triggered a sharp decline in shipments in September.

Like many of its peers, India hopes to reduce this reliance and has turned to bilateral trade agreements as a way to access new markets.

The conclusion of the free trade agreement (FTA) with the European Union is being hastened, while agreements with Canada, Chile, and Oman remain works in progress. The domestic export-promotion mission marks the beginning of a new industrial policy push.

Evidence that FTAs or policy measures can meaningfully enhance trade—and whether diversification is achievable in the short term—remains empirically weak. Much will depend on product complementarity and global growth. Meanwhile, protectionist tools are being deployed more liberally, exposing a ramshackle multilateral trading system.

Russia-China faultlines

At the heart of the problem lie Russia’s continued belligerence and China’s near-monopolization of critical minerals and technologies. The EU’s history has compelled it to commit to severing economic dependence on Russia, a shift that has benefited US oil and gas suppliers.

India, an important buyer of Russian energy, has also agreed to meet some of its demand from the US. Yet Russia remains relevant, having worked around the trading system through bilateral deals and its shadow fleet.

On the other hand, Washington's attempts to derail China’s economy have largely fallen flat. Beijing continues to run a trade surplus despite tariffs, and

the emergence of Chinese chip manufacturing capacities underscores how hard it is to dilute China's dominance.

Policymakers also face a moral dilemma: backlash against cheap Chinese exports could raise consumer costs. For India, the way forward lies in strategizing its breakthrough among dominant economic powers, not only as a market but also as a supplier.

Technology partnerships could help India reduce its dependence on the US-China duo. Such partnerships have already been signed with the EU and Japan, but the longer-term challenge will be retaining intellectual capital, something the EU itself struggled with due to overzealous regulation. How India navigates its energy and technology challenges will shape the decades ahead.

India's playbook

In the near term, observers of the Indian economy must watch the trade deficit and the depreciating rupee. Through October, lower average crude prices were offset by volatility in non-oil trade. At the same time, foreign portfolio investors have been selling equities and although domestic investors have cushioned the sell-off, the pressure on the exchange rate is evident.

Conventional wisdom suggests a weaker rupee boosts exports, but India's own experience does not support this for merchandise trade—depreciation may help only specific sectors. The moment is reminiscent of 2013, when the Reserve Bank of India (RBI) eventually intervened to support the rupee during the taper tantrum.

Meanwhile, interest-rate trajectories in Europe and the US have reversed, with the aggressive hikes of 2022 and 2023 now being unwound. With the US Federal Reserve appearing more amenable to rate cuts, inflows into emerging

markets like India could strengthen in the coming months. A glimpse of this was visible in equity flows in October. As a result, pessimism over the external sector may ease, provided concerns around US government debt expansion and asset quality do not reverse the trend.

Beyond external risks, domestic consumption and investment remain central concerns for policymakers. Interest-rate cuts and the RBI's liberalization of select segments aim to spur corporate investment. Meanwhile, the restructuring of goods and services tax (GST) rates is intended to free up budget space for households. The expectation is that lower rates will translate into higher consumption. If the transmission is as swift as anticipated, both investment and consumption could help power faster growth.

Even as India confronts multiple uncertainties, its policy orientation remains aligned with Tinbergen's principle: the number of policy tools is matched to the number of objectives. Whether the current wave of shifts and reforms will yield relief is something 2026 will reveal.

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