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Impact of Trump Shock on Indian Economy: An Assessment

FY 2024-25: Year End Macroeconomic Review

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FY 2024-25: Year End Macroeconomic Review

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Abstract: This study provides an assessment of the performance of Indian economy in 2024-25 and a review of the outlook going forward factoring in the impact of disruptive policies of the second Trump administration at home and abroad, especially the announced 'reciprocal' tariff policies that are temporarily paused. The impact of the 'reciprocal tariffs' when the present pause ends is likely to be mixed. While India's top ten exports to the US, such as electronic goods, gems & jewellery, machinery, textiles, metals and transport equipment may be adversely affected by higher tariffs, India may garner greater market share in products such as footwear, apparel, electrical machinery, toys, etc., where India's competitor countries are subject to higher tariffs.

Growth moderated in FY 2024-25, probably due to the slowdown in government spending and investment growth. Inflation being benign has enabled the central bank to change its monetary policy stance to 'accommodative', further cutting the Repo rate and taking other measures to enhance liquidity. Looking forward to FY 2025-26, our outlook for GDP growth remains pessimistic, amid rising trade uncertainty and anticipated slowdown in United States (US) and global growth. However, the accommodative monetary policy stance positions the central bank well to pursue expansionary policies to counter growth slow down.

On the fiscal side, FY 2024-25 saw a sharp contraction in central government's capital expenditure growth. States' combined capital expenditure also contracted sharply during April-Feb 2024-25. The central government has shifted to a new fiscal consolidation framework with debt-to-GDP ratio as the key monitoring target. This provides more elbow room for increasing capex to revive growth should it slow down due to the Trump Shock. Such a slowdown would also lead to a shortfall in budgeted revenues of the central and state governments, thereby raising deficits. This would serve as an automatic stabiliser to help revive growth, which could be reinforced by enhanced government capex.

JEL Classification: E6, E3, E4, H5, H6

Keywords: State of the Economy, Trump tariff shock, growth & fiscal outlook, India

Introduction

The NIPFP mid-year and year-end reviews assess the performance of the economy during the past (fiscal) year, particularly the previous six months and, based on the review, present an assessment of the outlook going forward. However, this year-end review had to go much further because of major developments during the past six months since the October 2024 mid-year review. In particular it had to address the implications of the many disruptive changes President Trump has introduced during his second term, which started earlier this (calendar) year, in United States (henceforth US) domestic policies as well as US foreign policy and, especially, US trade and tariff policies.

Part 1 of the review presents the global context and outlook, taking into account the response of the global economy to Trump 2 policies. It also presents a detailed account of the Trump 'Liberation Day' tariff proposals, especially as it effects India and proposes policy interventions to minimise the adverse impact of these tariff proposals on India's export performance. Part 2 reviews recent performance and the outlook going forward and forecasts growth, with and without taking into account the impact of Trump interventions at home and abroad. It also presents a review of the benign price situation, the inflation outlook going forward and evidence of some positive recent developments on the employment front. Part 3 presents a review and the outlook on monetary policy, especially the recent change in monetary policy stance. It also presents a performance review and outlook for the financial sector. Part 4 presents a review and outlook going forward on the fiscal front, taking into account the possible impact of the Trump shock on Indian growth and revenues. This is finally followed by some concluding remarks.

1. Global developments: Slowing growth, rising uncertainty & impact of tariffs

IMF projects only a marginal dip in global growth amid trade tensions

Growth projections in the International Monetary Fund's April World Economic Outlook attempts to capture the effect of a flurry of tariff announcements by the United States and counter-tariffs announced by other countries. Incorporating the impact of tariffs announced till

4th April, global growth is projected to decline to 2.8 percent in 2025 from 3.3 percent in 2024. For next year, growth is projected at 3 percent (Table 1.1).

To account for the uncertainty in tariff policy, the IMF has put out two alternative growth outlooks in addition to the reference forecast — one excluding the impact of the 2nd April and subsequent tariffs, and second incorporating the impact of tariff announcements made after 4th April.

The biggest hit to growth is projected for the US and China. For the United States, where tariffs constitute a major supply shock, growth is projected to decrease to 1.8 percent in 2025 from 2.8 percent in 2024. China is projected to grow at 4 percent in 2025 from 5 percent in 2024. For the Euro area, growth is projected to decline marginally from 0.9 percent in 2024 to 0.8 percent in 2025 before recovering to 1.2 percent in 2026.

The IMF projects India's growth to decline marginally from 6.5 percent in 2024 to 6.2 percent in 2025, then rise slightly to 6.3 percent in 2026.

Table 1.1: IMF Growth Projections April 2025 Update

Country/Region	2024	Projection 2025	Difference from Jan 2025 Update	Projection 2026	Difference from Jan 2025 Update
World	3.3	2.8	-0.5	3	-0.3
Advances Economies	1.8	1.4	-0.5	1.5	-0.3
United States	2.8	1.8	-0.9	1.7	-0.4
Euro Area	0.9	0.8	-0.2	1.2	-0.2
United Kingdom	1.1	1.1	-0.5	1.4	-0.1
China	5	4	-0.6	4	-0.5
India	6.5	6.2	-0.3	6.3	-0.2
Source: IMF World Economic Outlook, April 2025					

U.S economy is showing signs of slowing amid policy uncertainty

The IMF growth projections seem somewhat optimistic, especially for the U.S. economy. It projects positive, if reduced, growth at 1.8 percent in 2025. In contrast, other high frequency indicators are showing signs of economic contraction. The latest reading of the Federal Reserve Bank of Atlanta nowcast (Figure 1.1) pegged the January-March quarter real GDP to contract by 2.2 percent. The nowcast has been gradually tumbling from the 4 percent growth nowcast reported in early February.

Actual numbers for Q1 of 2025 confirmed the contraction (Figure 1.2). U.S GDP actually contracted by 0.3 percent according to the advance estimate released by the Bureau of Economic Analysis (BEA). This marked the first decline since the Q1 of 2022. The contraction was primarily driven by a surge in imports and a decrease in government spending. In the previous quarter, real GDP had increased by 2.4 percent.

Figure 1.1: Federal Reserve Bank of Atlanta Nowcast of Real GDP

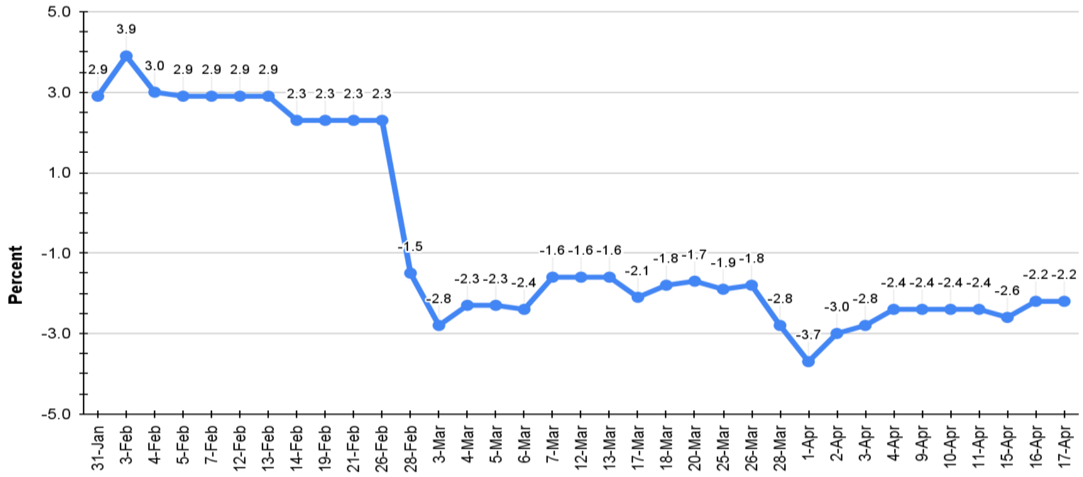
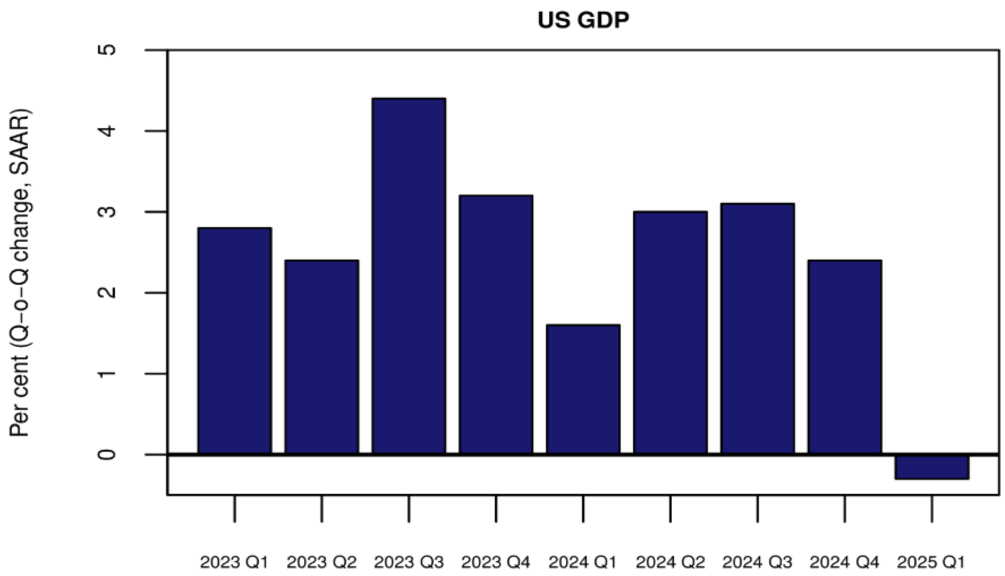


Figure 1.2: Contraction in US GDP



Source: Federal Reserve Economic Data

Policy uncertainty, the expected rise in prices and mass federal layoffs have led to a decline in consumer sentiments and a rise in inflation expectations. The University of Michigan's Index of Consumer Sentiment has been sliding in this calendar year. In April, the index plunged 8 percent from the March value (Table 1.2). Both the index of current economic conditions and index of consumer expectations sharply plummeted in April.

On a more concerning note, year-ahead inflation expectations surged from 5.0 percent last month to 6.5 percent this month. This is the highest reading since 1981 and marked four consecutive months of unusually large increases in inflation expectation. Long-run inflation expectations edged higher from 4.1 percent in March to 4.4 percent in April.

Table 1.2: University of Michigan - Survey of consumers

Months	Index of Consumer Sentiment	Expected change in prices	
		Next year	Next 5 years
Oct 2024	70.5	2.7	3.0
Nov 2024	71.8	2.6	3.2
Dec 2024	74	2.8	3.0
Jan 2025	71.7	3.3	3.2
Feb 2025	64.7	4.3	3.5
Mar 2025	57.0	5.0	4.1
Apr 2025	52.2	6.5	4.4

Source: Survey of Consumers, University of Michighan

EU is ramping up spending, leading to Euro appreciation

A key development in the EU region is Germanys announcement of a large fiscal expansion geared towards enhanced military, infrastructure and climate spending. The €1 trillion package includes €500 billion allocated to a special fund for infrastructure development and €100 billion designated for climate-related investments. The proposed fiscal expansion could lift the long-term growth prospects for Germany and the Euro area and could offset the drag on growth stemming from trade tensions.

Fiscal expansion in the EU and investors' growing concerns about an impending recession in the U.S have led to selling off of USD denominated assets. The loss of the safe haven appeal of the US dollar has led to sharp appreciation of the Euro (Figure 1.3).

China is introducing stimulus measures to boost its economy

China has introduced a range of stimulus measures to bolster growth and soften the economic damage caused by the trade war with the U.S. The monetary policy stimulus includes a cut in the reserve requirement ratio by 50 basis points from May 15, and lowering of borrowing costs. These changes preceded the raft of measures announced in September last year such as reduction of interest rate on existing mortgages and lowering the minimum down payment for second time home buyers to 15 percent.

The monetary stimulus measures are being combined with fiscal stimulus policies. China has set its fiscal deficit target at 4 percent of GDP for 2025, a one percentage point increase from the previous year. It has unveiled a 10 trillion yuan debt package to ease local government financing strains and issued special treasury bonds to replenish core capital of state-owned banks. To stimulate consumer spending, China has also implemented a wage increase for government workers.

Figure 1.3: Appreciation in Euro-dollar exchange rate

Source: BIS

U.S. reciprocal tariffs

Flip flops on U.S. tariff policy are illustrated in Table 1.3. Oddly, the primary basis for setting country-specific 'reciprocal' tariffs is not the tariff structure of the partner country but its trade surplus vis-à-vis the U.S.

Table 1.3: Flip-Flop on US tariff Policy

Date	US Tariff Policy
2nd April 2025	**Liberation day**: US imposes a baseline 10% tariff on almost all countries and an additional reciprocal tariffs on countries that contribute to large, persistent US trade deficits.
9th April 2025	**90-Day pause**: Tariffs imposed on Liberation day were paused for 90-days. However, the 10% baseline tariff on all countries remained in effect. Tariff on China also raised to 125%.
11th April 2025	Imports of smartphones, data storage servers, semiconductors and other electronics were exempted from reciprocal tariffs.
14th April 2025	Notice indicating that the secretary of commerce initiated an investigation on April 1 into whether imports of semiconductors and semiconductor manufacturing equipment, critical minerals and rare earth elements pose a threat to US national security under Section 232 of the Trade Expansion Act of 1962.
29th April 2025	An Executive Order was issued to avoid the cumulative effect of overlapping tariffs on certain articles. This would have the effect of reducing tariff burden on the U.S. automotive sector and some other importers.
14th May 2025	US and China entered into a trade deal on May 14th. The U.S. has agreed to temporarily lower, for 90 days, its overall tariffs on Chinese goods from 145% to 30%, while China will cut its tariffs on American imports from 125% to 10%.

The 'reciprocal tariffs' intended to cushion the U.S from the trade imbalance have been arbitrarily set at half of the trade imbalance. For instance, with India, the U.S has a trade deficit of USD 46 billion. The ratio of this trade deficit to total US imports is 52.6 percent, hence the tariff has been set at 26 percent tariff for India. A broadly similar approach is followed for other countries as well (Table 1.4).

Table 1.4: Cross-country US trade balance and reciprocal tariff rate

Country	2024			Tarrif (2025)
	US: Import ((USD Billion)	US: Export (USD Billion)	Trade Balance (USD Billion)	
China	438.9	143.5	-295.0	245
Mexico	505.9	334.0	-172.0	25
Vietnam	136.6	13.1	-123.0	46
Ireland	103.3	16.5	-87.0	20
Germany	160.4	75.6	-85.0	20
Taiwan	116.3	42.3	-74.0	32
Japan	148.2	79.7	-68.0	24
Korea, South	131.5	65.5	-66.0	25
Canada	412.7	349.4	-63.0	25
India	**87.4**	**41.8**	**-46.0**	**26**
Thailand	63.3	17.7	-46.0	36
Italy	76.4	32.4	-44.0	20
Switzerland	63.4	25.0	-38.0	31
Malaysia	52.5	27.7	-25.0	24
Indonesia	28.1	10.2	-18.0	32
France	59.9	43.5	-16.0	20
Austria	17.6	4.5	-13.0	20
Cambodia	12.7	0.3	-12.0	49
Sweden	18.0	8.2	-10.0	20
Hungary	12.7	3.3	-9.0	20

A 10% base tariff will be applied to imports from all countries, effective April 5, 2025. In addition there will be country specific 'reciprocal' tariffs as explained above. Certain strategic products, including pharmaceuticals, semiconductors, copper, and energy products, are exempt from these tariffs.

India 'reciprocal' tariff of 26 percent is lower than for most of the ASEAN and other competing countries despite its having one of the highest average tariff rates in the world because of its relatively low trade surplus vis-à-vis the U.S.

Impact of US Tariff policy on India's Trade

India's trade in FY 2024-25 is shown in Figure 1.4. During FY 25, the merchandise exports and imports grew by 0.1 percent and 6.2 percent, respectively. The slump in merchandise exports was primarily owing to subdued oil exports. Netting out oil exports, non-oil exports grew by 6 percent, and after excluding gems and jewellery exports, the growth was 7.5 percent (Figure 1.5).

Figure 1.4: India's overall trade

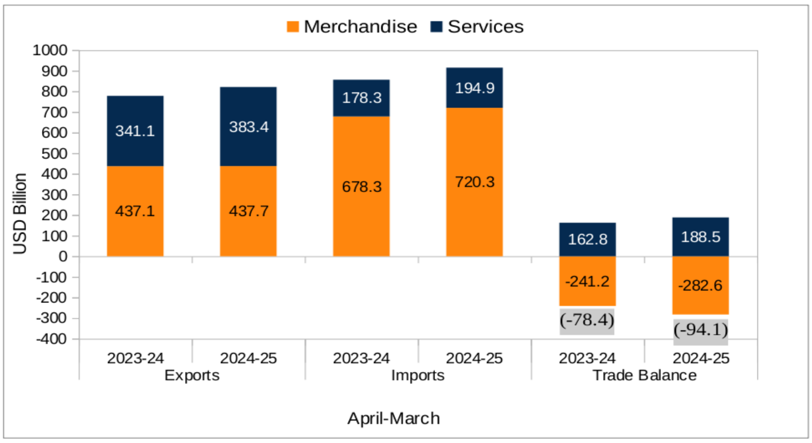
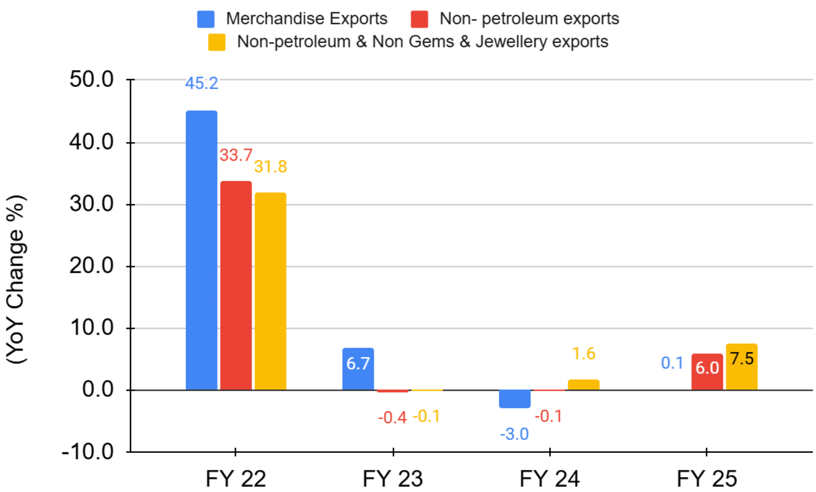


Figure 1.5: Growth in Merchandise exports



With total exports (goods plus services) growth of 6 percent compared to total import growth of 6.8 percent), there was a widening of the trade deficit. The trade deficit rose to USD 94 billion in FY2024-25, up from USD 78.5 billion in the same period of FY2023-24. Since merchandise exports are likely to be hit by tariffs, services exports would have to do the heavy lifting to lower the trade deficit in FY 2025-26.

The impact of tariff threats was visible in the trade data for April, 2025. India's merchandise trade deficit widened to USD 26.42 billion in April, up from USD 21.5 billion in March (Table 1.5).

Table 1.5: Widening of India's trade balance

India's trade balance (USD Billion)			
Month	**Trade Balance**	**Exports**	**Imports**
Jan 2025	-23.08	36.34	59.43
Feb 2025	-14.15	36.82	50.97
Mar 2025	-21.54	41.97	63.51
Apr 2025	-26.42	38.49	64.91
Source: Ministry of Commerce and Industry, CMIE			

While merchandise exports grew by 9 percent, imports grew at a much sharper pace at 19.1 percent (year-on-year basis). The spike in the import bill was led by a sharp 27 percent surge in imports from China. Notably, imports of chemical products spiked by almost 116 percent.

Key sectors that are vulnerable

The top 10 exports of India to the U.S in 2023-24 are shown in Table 1.6. Broad sectors like electronic goods, gems & jewellery, machinery, textiles, metals and transport equipment are subject to elevated risk due to tariffs. Gems and jewellery exports are vulnerable because the competing countries are subject to lower tariffs. India could lose its market share. However, some of the sectors like pharmaceuticals, mineral fuels, etc., have been exempted for now. This could cushion the impact of tariff induced cost escalation. In general, sectors reliant on U.S. markets may experience pricing pressures, deferred orders, and supply chain adjustments.

Table 1.6: Top 10 exports of India to the US

Items	Share in total exports to US (Percent)
	2023-24
Electronic goods	13.5
Gems & jewellery	12.8
Drug formulations, biologicals	10.3
Machinery & instruments	9.1
Petroleum & crude products	7.5
Agricultural & allied products	6.5
Readymade garments	6.1
Textiles (excluding readymade garments)	6
Ferrous and non-ferrous metals	5.5
Transport equipment	3.4
Inorganic/organic/agro chemicals	3.2

While exports would be impacted due to tariffs, there may be a window of opportunity to garner greater market share in sectors where India's competitor countries are subject to higher tariffs. Table 1.7 shows products where those countries that have higher market share are subject to much higher tariffs than India. For instance in footwear, China, Vietnam, Indonesia, Italy and Cambodia account for 45.5 percent of total exports to the U.S.

Table 1.7: Window of opportunity in some sectors due to lower relative tariffs

HS 2 Digit	Share of Countries (Tarrif differential > 0)	Top Exporting Countries
Footwear, Gaiters	45.5	China, Vietnam, Indonesia, Italy, Cambodia
Apparel Articles & Accessories, Knit or Crochet	30.2	China, Vietnam, Cambodia, India, Indonesia
Rubber & Articles Thereof	29.4	Thailand, Mexico, Canada, China, Japan
Apparel Articles & Accessories, Not Knit Etc.	29.2	China, Vietnam, India, Indonesia, Mexico
Furniture; Bedding	27.7	China, Vietnam, Mexico, Canada, Italy
Electric Machinery Etc; Sound Equip	21.9	China, Mexico, Vietnam, Taiwan, Malaysia
Nuclear Reactors, Boilers, Machinery	20.3	China, Taiwan, Japan, Germany, Canada
Nat Etc Pearls, Prec Etc Stones	19.6	Switzerland, India, Canada, Mexico, Italy
Toys, Games & Sport Equipment	13.3	China, Vietnam, Mexico, Taiwan, Japan
Articles Of Iron Or Steel	12.2	China, Mexico, Canada, Taiwan, South Korea

Even if China is excluded, India can potentially garner greater market share from Vietnam and Indonesia that are subject to much higher tariffs of 46 percent and 32 percent, respectively. Similar opportunities exist in sectors such as apparel articles, furniture, toys and sport equipment, etc. At the same time, a multi-product and multi-country dumping threat looms over India. Countries like China/Vietnam/ Indonesia/ Cambodia/ Thailand/ Taiwan/ Switzerland with higher tariffs as against India may divert goods to India, risking import surges and dumping across multiple products. Table 1.8 shows some of the product categories which China exports to both the US and India. Due to higher U.S. tariffs on China, some of the key commodities that it could try to dump in India include Resins, Paper, Rubber, etc. Preliminary evidence of this is visible in the April data for imports. Notably, imports from China surged by 27 percent and imports of artificial resins surged by 14 percent.

Table 1.8: China's exports of selected products to India and USA

Commodity	China's share in India's imports	China's share in U.S imports
Artificial resins, plastic materials	25.0	26.0
Paper and paper board	19.8	13.9
Rubber products	12.5	7.0
Graphite	48.3	59.7

Expected direct export loss on account of increased tariffs

Summing up, there would be sectors where India could gain market share due to the new U.S.

tariffs, but at the same time some sectors could be adversely impacted on account of the rollout of reciprocal tariffs. Table 1.9 presents an estimate of export loss due to tariffs. The loss in export share will depend on tariff differential and the extent of substitutability, which in turn depends upon price elasticity of demand. Taking these factors into account, direct export loss is expected at USD 14 billion amounting to 0.38% of GDP.

Table 1.9: Expected direct export loss on account of reciprocal tariffs

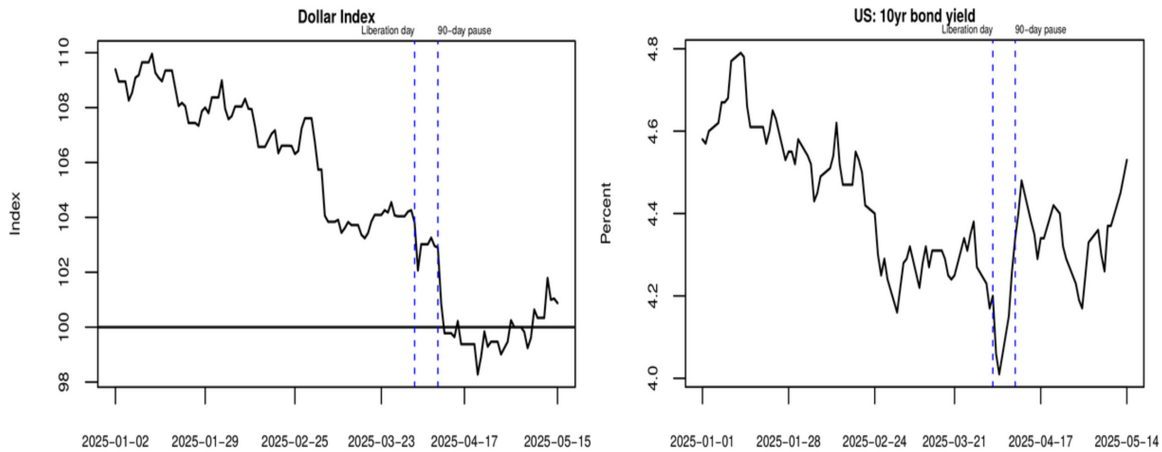
Sector	Exports to US FY24 (USD Mln)	Tariff Rate	Elasticity	Rationale	Export Loss (USD Mln)
Inelastic Products (0.1 - 0.4)					
Marine products	2499	0.26	0.3	India better positioned than Vietnam, Indonesia on account of lower tariffs	194.9
Gold and other precious Metal Jewellery	3306	0.26	0.4	Style, Design and Exclusiveness; India enjoys Competitive Advantage	343.8
Cotton fabrics, Made-ups etc	2615	0.26	0.4	Stands to gain from Cambodia, Vietnam, Thailand, China on account of Tariff differential	271.9
Elastic Products (> 0.4)					
Products of Iron and Steel	2782	0.26	1.0	Competition from USMCA put India in disadvantage position; Substitutible product	723.3
Electronic components	2697	0.26	1.0	Competition from USMCA besides South Korea, Japan and Malaysia putting India in disadvantage position on account of lower tariffs	701.1
Organic chemicals	1107	0.26	1.2	Competitive and substitutable nature of organic chemicals in global trade.	345.2
Total	77515				13951
India's GDP (USD Million; 2023)					3638490
Loss in Exports (Per cent to GDP)					**0.38%**

Source: Ministry of Commerce and Industry; IMF WEO Outlook - April 2025
India's GDP is from IMF WEO for the year 2023

Pause on tariff rollout: Markets punished tariff-induced uncertainty

Usually, when there is heightened uncertainty in the global economy, investors flock to the safety of the dollar and US Treasury bonds. This pushes up their prices and lowers their yields. This time for several days after the announcement of reciprocal tariffs, the reverse happened (Figure 1.6).

Figure 1.6: US dollar index (left panel) and 10 year bond yield (right panel)



Source: Yahoo Finance and Federal Reserve Economic Data

In particular, between the announcements of “Liberation day” tariffs and the 90-day pause, the yield on the US 10 year bond surged from 4.2 percent to 4.5 percent. The 30 year bond jumped to 4.8 percent on 9 April from 4.5 percent on 2 April. The dollar depreciated by 1.5 percent during this period. The aggressive nature and unpredictability of the tariffs led investors to question the reliability of US Treasuries as a safe haven. The sharp surge in the US bond yields was perhaps one of the reasons that triggered the decision to halt the rollout of tariffs.

Despite the announced pause, India’s growth prospects are likely to be adversely affected in our view owing to the direct impact of US tariffs plus the indirect impact of a slowing U.S. economy via its adverse effect on global growth. However, there is also a view that if other countries respond to the Trump policy moves by strengthening WTO compliant trade among themselves and deepening their supply-chain relationships, there could also be a net positive impact on global trade and growth (Mundle 2025).

Policy measures to cushion the impact of trade uncertainty

Certain policy measures can be undertaken by India to abate the adverse impact of US tariff policy and consequent trade uncertainty (Table 1.10).

Table 1.10: India’s policy measures to counteract trade uncertainty

S.No.	Policy Measures	Details
1.	Reduce trade deficit with the US	• **Increase imports of of US hydrocarbons, portable nuclear power plants, etc.**
2.	Accelerate Trade Negotiations & Secure Sector-Specific Exemptions	• Finalize the US trade deal • Leverage exemptions (e.g., pharmaceuticals) to expand exports in critical sectors, while negotiating duty waivers for auto components and electronics
3.	Diversify Export Markets away from US & Strengthen Domestic Manufacturing	• Target trade diversion opportunities in the EU, UK, and ASEAN markets as US-China tensions escalate • Boost "Make in India" initiatives, particularly in semiconductors, renewable energy, and electronics, to reduce import reliance and attract US investment

4.	Calibrated Concessions	• Reduce tariffs on select US goods (e.g., ethane, LPG, aerospace components) to foster reciprocity and ease trade tensions • Enhance PLI schemes for vulnerable sectors (gems, textiles, auto parts) to improve global competitiveness
5.	Strengthen export infrastructure and logistics	

2. Domestic Developments: Growth, Inflation & Employment

Aggregate demand growth moderated in 2024-25 due to decline in government spending and investment growth

Real GDP growth in India was high at 9.2 per cent in FY 2023-24 owing to strong multiplier effects from high public sector capex, but it moderated to 6.5 per cent in 2024-25, presumably due to a slowdown in growth of both Govt. Final Consumption expenditure and in Gross Fixed Capital Formation (Table 2.1).

Table 2.1: Year-on-Year growth rates in aggregate demand and components

Demand components	**2023-24 YoY (%)**	**2024-25 YoY (%)**	**2024-25 Q1 YoY (%)**	**2024-25 Q2 YoY (%)**	**2024-25 Q3 YoY (%)**	**2024-25 Q4 YoY (%)**
Aggregate demand (GDP)	9.2	6.5	6.5	5.6	6.4	7.4
Govt. Final Consumption Exp. GFCE	8.1	2.3	-0.3	4.3	9.3	-1.8
Private Final Consumption Exp. PFCE	5.6	7.2	8.3	6.4	8.1	6.0
Gross Fixed Capital Formation GFCF	8.1	7.1	6.7	6.7	5.2	9.4
Net Exports	386.3	-71.5	-32.6	-8.9	-102.3	1084.6

Source: CSO, MOSPI, Second Advance estimates

However, private consumption demand growth accelerated to 7.2 per cent in 2024-25. The real trade deficit (net exports) also declined compared to the previous year.[1]

Comparing growth rates across the quarters of 2024-25, growth of aggregate demand, public and private consumption demand improved in H2 FY 25. However, both public and private consumption expenditure growth which improved significantly in Q3 FY 25, fell sharply again in Q4 FY 25. Investment growth remained moderate during the first three quarters, but recorded an impressive growth of 9.4 per cent in the last quarter of FY 25, a sign of improving investors' sentiment in the country.

Table 2.2: Year-on-Year growth rates in GVA and components

Demand components	**2023-24 YoY (%)**	**2024-25 YoY (%)**	**2024-25 Q1 YoY (%)**	**2024-25 Q2 YoY (%)**	**2024-25 Q3 YoY (%)**	**2024-25 Q4 YoY (%)**
GVA	8.6	6.4	6.5	5.8	6.5	6.8
1.**Agriculture, forestry & fishing**	2.7	4.6	1.5	4.1	6.6	5.4
2.**Industry**	10.8	5.9	8.5	3.8	4.8	6.5
2.1 Mining & Quarrying	3.2	2.7	6.6	-0.4	1.4	2.6
2.2 Manufacturing	12.3	4.5	7.6	2.2	3.6	4.8
2.3 Electricity, gas, water & other utilities	8.6	5.9	10.2	3.0	5.1	5.4
2.4 Construction	10.4	9.4	10.1	8.4	7.9	10.8
3.**Services**	9.0	7.2	6.8	7.2	7.4	7.3
3.1 Trade, hotel, transports communication, broadcasting (TRC)	7.5	6.1	5.4	6.1	6.7	6.0
3.2 Financial, real estate & professional services (FIN)	10.3	7.2	6.6	7.2	7.1	7.8
3.3 Public administration, defence & other services (PAD)	8.8	8.9	9.0	8.9	8.9	8.7

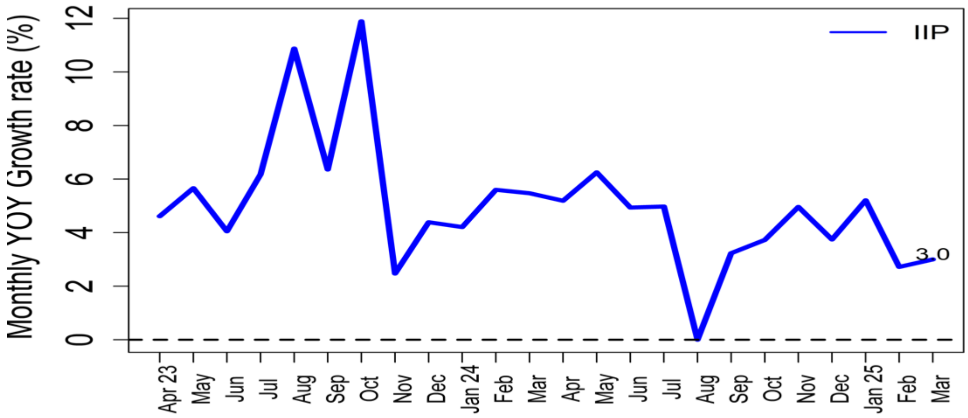
Source: CSO, MOSPI

On the production side growth of Gross value Added (GVA) moderated across non-agricultural sub-sectors, except for Public Administration and Others Services (Table 2.2). Within Public administration, defence & other services (PAD), the component 'other services', comprising of private education and health, accounted for the robust growth in PAD. Agriculture grew by 4.6 per cent in FY 25, up from 2.7 per cent in FY 24, due to favourable weather conditions and the surge in global prices of wheat. While services maintained robust growth of over 7 per cent across the quarters of FY 25, growth in industry and its sub-sectors slowed during H1 FY 25, but improved in H2 FY 25.

[1] Since real trade balance was in deficit in 2023-24, a negative growth rate of net exports in 2024-25 indicates an improvement in the trade balance.

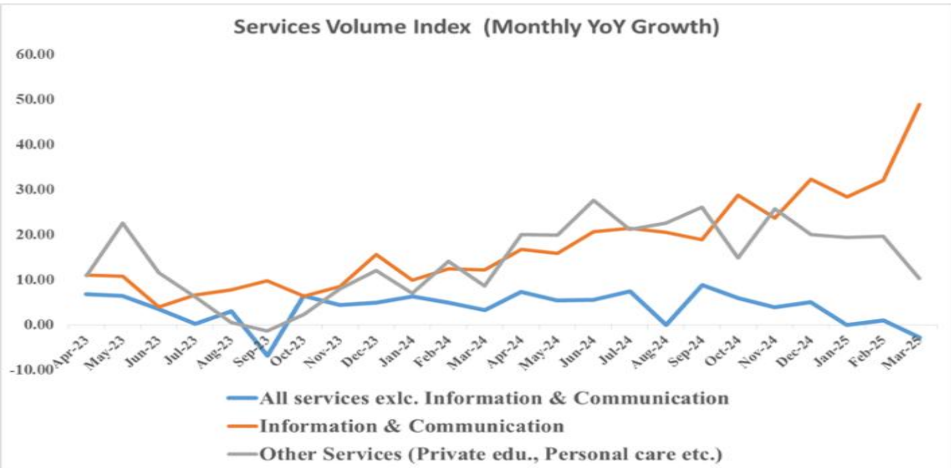
GDP growth revived sharply during the last quarter of 2024-25, possibly due to the sharp revival in investments as per the official provisional estimates of GDP. But curiously, most hard indicators on the production side still depict muted growth. For instance, while the industrial GVA has grown at a rate of 6.5 per cent in Q4 FY 25, the official Index of Industrial Production (IIP) growth has remained muted at only 3.6 per cent in this quarter (Figure 2.1). For the services sector, Services Volume Index of CSO also indicates uneven services growth, as overall services, except for Information & Communication and Other services, has contracted in this quarter (Figure 2.2). This mismatch between the recently released GDP estimates and other official data on sectoral production growth needs reconciliation.

Figure 2.1: Industrial growth suffered broad-based downturn in Q4 FY 25



Source: NSO

Figure 2.2: Overall services sector contracting, except for Information and Communication and other services



Source: CSO

Table 2.3: NIPFP's growth projections & Comparable forecasts & other organisations

	FY 23-24	FY 24-25	**FY 25-26**	Q1 25-26	Q2 25-26	Q3 25-26	Q4 25-26
Actual	9.2	6.5					
NIPFP (H)			6.6	6.7	6.3	6.8	6.3
RBI			6.5	6.5	6.7	6.6	6.3
IMF			6.2				
World Bank			6.3				

Source: NIPFP; MOSPI; RBI; IMF; World Bank

Growth outlook for FY 2025-26

For the financial year 2025-26, **6.6 percent is our baseline forecast** generated by NIPFP's high-frequency indicator model (Table 2.3) following Bhattacharya, Bhandari and Mundle (2023). Our baseline forecast for the full year FY 26 and also for the four quarters of FY 26 are similar to those of the RBI.

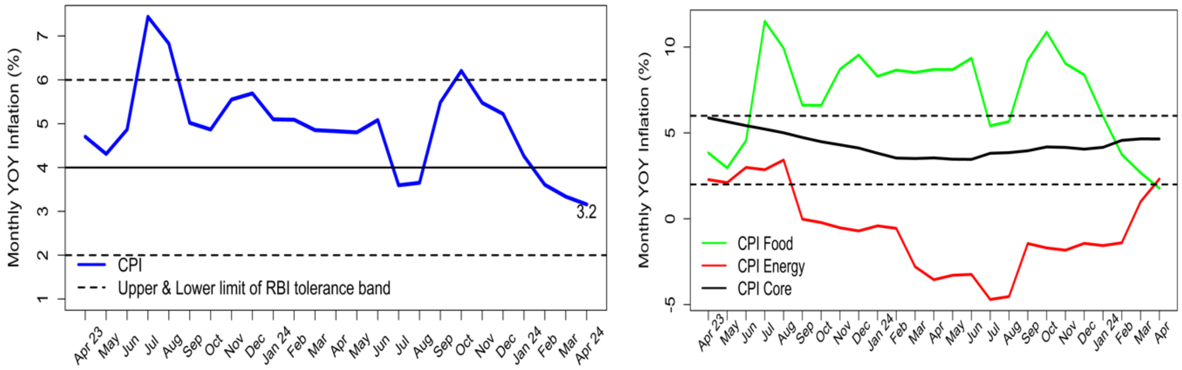
This baseline projection does not factor in the impact of the tariff announcements by U.S. president Mr. Donald Trump (henceforth the "Trump shock"). In order to assess the possible effects of **the Trump shock on the Indian economy and hence growth forecasts for FY 26**, we consider two alternative scenarios. **In our scenario I**, we assume that while the Trump shock will adversely affect India's exports and hence growth via terms-of-trade effect, on the other hand India will gain from tariff differential with its competitors, with a positive impact on country's exports, with a net zero effect from terms-of-trade channel. ***However, the Indian economy will be adversely impacted via income effect from a global growth slowdown predicted by IMF for 2025-26.*** Taking into account IMF's global growth rate projection of 2.8 per cent for FY 26, ***we predict 5.8 per cent growth for India in FY 26, a 0.8 per cent decline from our baseline projection.***

However, the global growth projections of IMF possibly accounted for only tariff effects, not the upcoming disruptions due to major policy changes in US, including massive shrinking of the Federal Government. Hence, impact of disruptions due to US policies on global growth including India can be larger than projected. Such a scenario, **Scenario II** in our analysis, can be compared with the experience during the Global Financial Crisis (GFC) of 2008-09. Following GFC, global growth declined from 5.3 in 2007 to 2.9 in 2008 and to -0.4 in 2009, before recovering to 5.2 per cent in 2010 due to massive fiscal and monetary stimulus. Correspondingly, Indian GDP growth declined from 7.4% in 2007-08 to 4.3% in 2008-09, before rebounding to 6.9% in 2009-10 with the aid of fiscal and monetary stimulus. ***If the domestic policy disruptions in US leads to a recession comparable with the GFC, with spill over effects on the global economy, including*** **India, growth in the** ***Indian economy could decline to around 4 per cent in FY 2025-26.***

Headline inflation below 4 per cent target due to moderating food inflation

CPI food inflation has been moderating since November 2024 due to declining inflation rates for most food items, except edible oils, fruits and sugar, and deflation in vegetable and pulse prices (Figure 2.4). CPI Core inflation on the other hand was increasing at a mild rate due to rise in house rent, maintenance cost & water charges; price of medicines & health professional fees; transport charges; educational items & fees for web-based professional trainings, and gold prices.

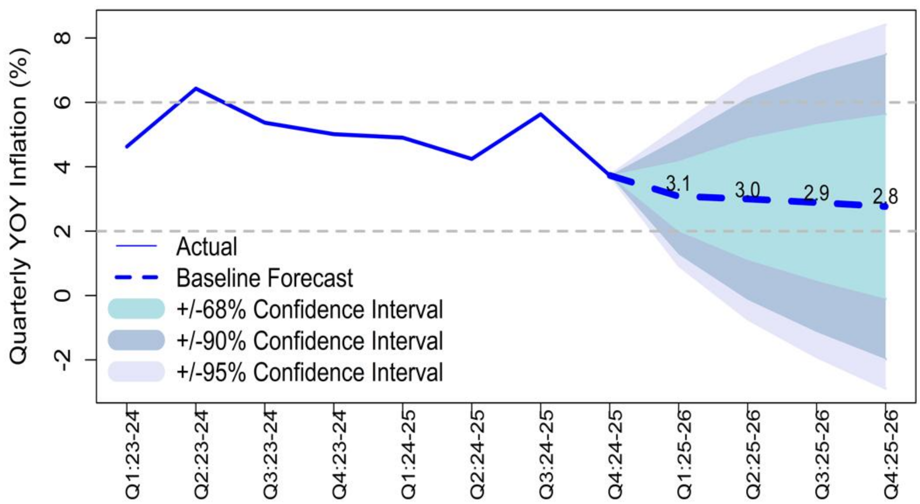
Figure 2.4: Headline inflation below 4% target on account of moderating food inflation, while core inflation rising, and energy price changes rebounds



Source: CSO, Authors' estimates

Our baseline inflation projection for FY 2025-26 is at 3.1 per cent with inflation forecast for the quarters as follows: 3.1% in Q1, 3.0 in Q2, 2.9% in Q3, 2.8% in Q4 (Figure 2.5). A rebound in core inflation due to supply constraints in services & energy price inflation pose upward risk for inflation in the current year. On the other hand, the possibility of a global

Figure 2.5: Inflation forecast at 3.1 per cent for FY 2025-26



Source: Bhattacharya & Kapoor (2020)

growth slow down due to the Trump shock may act as a negative external demand shock, which could further moderate our domestic headline inflation.

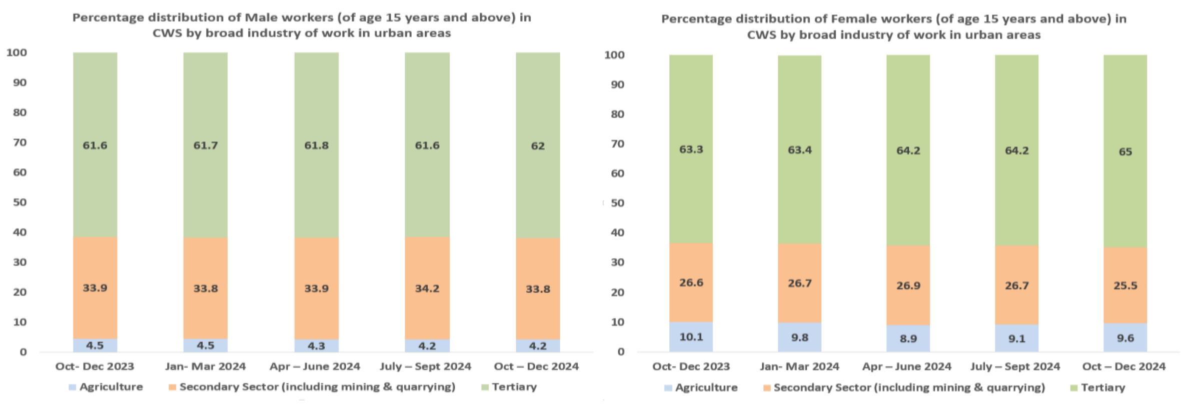
Overall employment indicators improving and showing a transition of female employment from informal to formal jobs

According to the Periodic Labour Force Survey of NSSO, there has been an overall improvement of quarterly urban labour market indicators for both males and females in October-December 2024-25 compared to the same period previous year. Labour Force Participation Rate (LFPR) for males rose from 74.1 to 75.4 per cent from Oct-Dec 2023 to Oct-Dec 2024, while LFPR for females increased from 25 to 25.2 per cent. The Working Population Ratio (WPR) for males rose from 69.8 to 70.9 per cent, while that for females increased from 22.9 to 23.2 per cent. Unemployment rate (UR) remained unchanged at 5.8 per cent for males while it declined from 8.6 to 8.1 per cent for females.

At the sectoral level, for male employment, the share of industry remains fairly stable, while there is a shift of shares from agriculture to services. In the case of female employment there is a shift to services from both agriculture and industry (Figure 2.6).

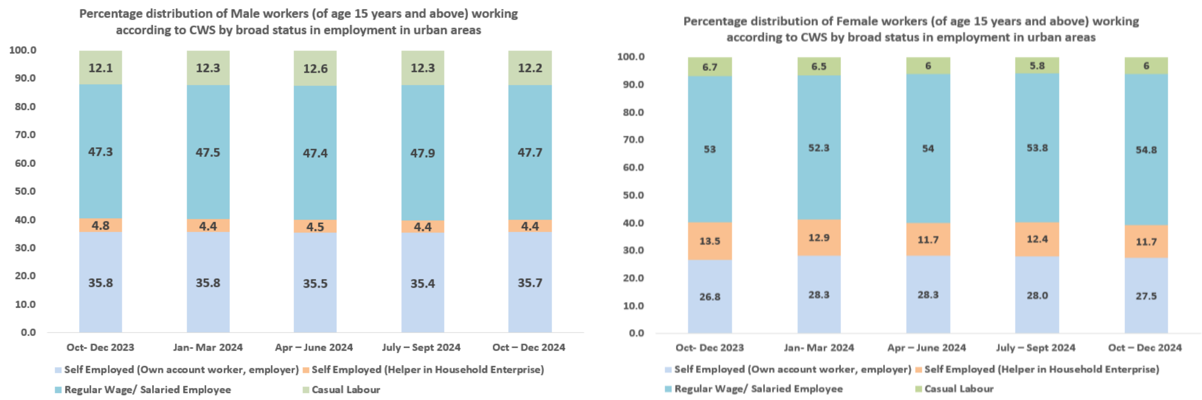
A very positive development is that the share of formal employment has been rising and higher for women workers than for male workers. There was also a shift in shares of female employment from unpaid helpers and casual workers to own account employers/workers and regular wage and salaried workers between Oct-Dec 2023 to Oct-Dec 2024 (Figure 2.7). The share of male employment as regular wage/salaried employees and casual workers increased marginally while declining for own account workers/employers and unpaid helpers.

Figure 2.6: Services share of employment rising for both male and female



Source: PLFS, NSSO

Figure 2.7: Share of formal employment rising, especially for female workers



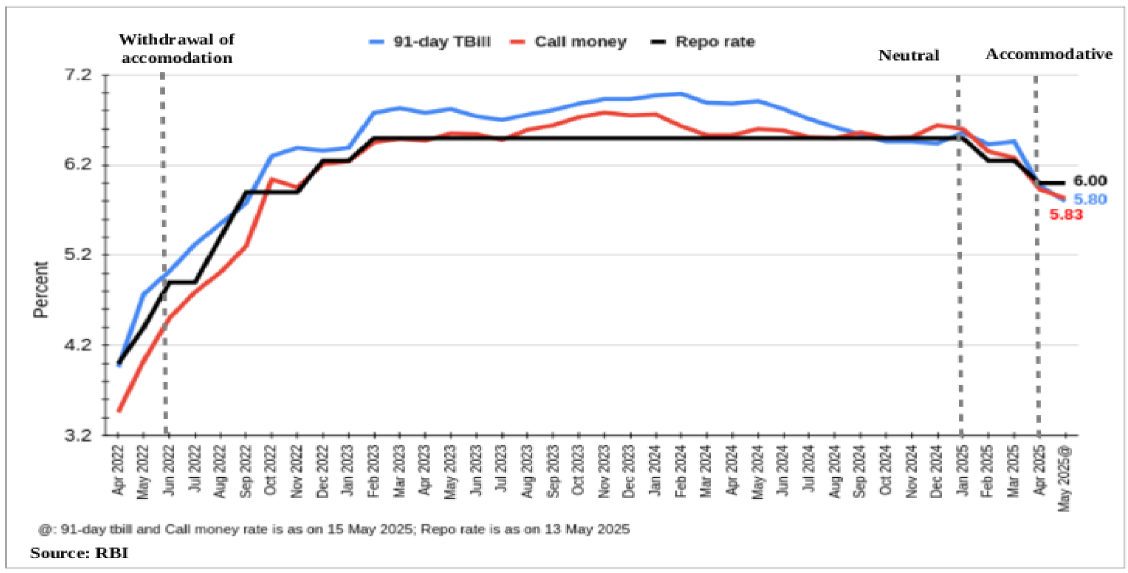
Source: PLFS, MOSPI

3. Monetary policy & Financial markets

Monetary policy

There has been considerable action on the monetary policy front since the NIPFP mid-year economic review last October (Bhattacharya et.al. 2024). The RBI changed its policy stance to neutral in February and to accommodative in April (Figure 3.1). It has also cut the policy repo rate by 50 basis points in this calendar year till May. The policy repo rate was reduced from 6.5 percent to 6.25 percent in February and further to 6 percent in April.

Figure 3.1: Monetary policy rate cut and change in policy stance

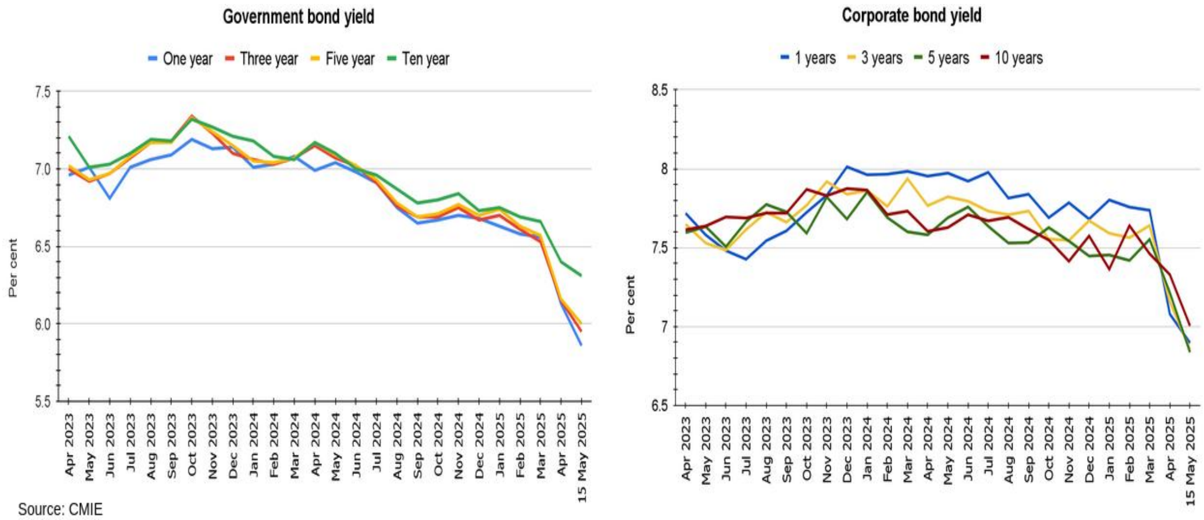


The call money rate, after hovering closer to the policy repo rate, has moderated sharply. Going forward, a deeper rate cut cycle is expected post the change in stance to accommodative to stimulate growth keeping in view Trump’s tariff shock.

Government bond yields have eased across maturities

Government bond yields across maturities have trended downwards due to monetary easing and decline in inflation (Figure 3.2). India's sovereign bond inclusion in the global emerging market bond indices such as JP Morgan Bond Index and the Bloomberg index also contributed to greater demand for bonds from foreign investors. This led to softening of yields. Mirroring the trend in government bond yields, corporate bond yields have also edged downwards across maturities.

Figure 3.2: Easing bond yields



Source: CMIE

Liquidity has turned to surplus post RBI intervention

After being in surplus mode from June 2024 till mid December 2024, liquidity in the banking system turned into a deficit. Towards the end of January 2025, the liquidity deficit rose to a record Rs. 3.3 trillion, highest in 15 years. RBI intervened with a series of measures to ease the liquidity deficit: a 50 basis points cut in the Cash Reserve Ratio (CRR) to 4 percent in two tranches, overnight variable repo auctions, open market purchases of government bonds, and USD/INR buy/sell swaps. Following these measures liquidity has been back in surplus mode since March (Figure 3.3). From March to 15th May 2025 liquidity has been in surplus to the tune of around Rs. 1.6 trillion on average as compared to an average deficit of Rs. 1.01 trillion from December 2024 till February 2025.

Credit growth has moderated and is likely to remain subdued

Non-food bank credit growth year-on-year moderated further during February- March 2025. Credit growth was mainly on account of the increase in credit disbursal to industry (particularly medium and large) and the services sector while growth in personal loans remained moderate (Figure 3.4).

Deposit growth remained flat since the last fortnight of December 2024 (27th December 2024) at around 10%. As on 2nd May 2025 credit growth at 9.9%, including the HDFC merger impact, fell below the rate of deposit growth at 10%.

Figure 3.3: RBI interventions have eased banking system liquidity conditions

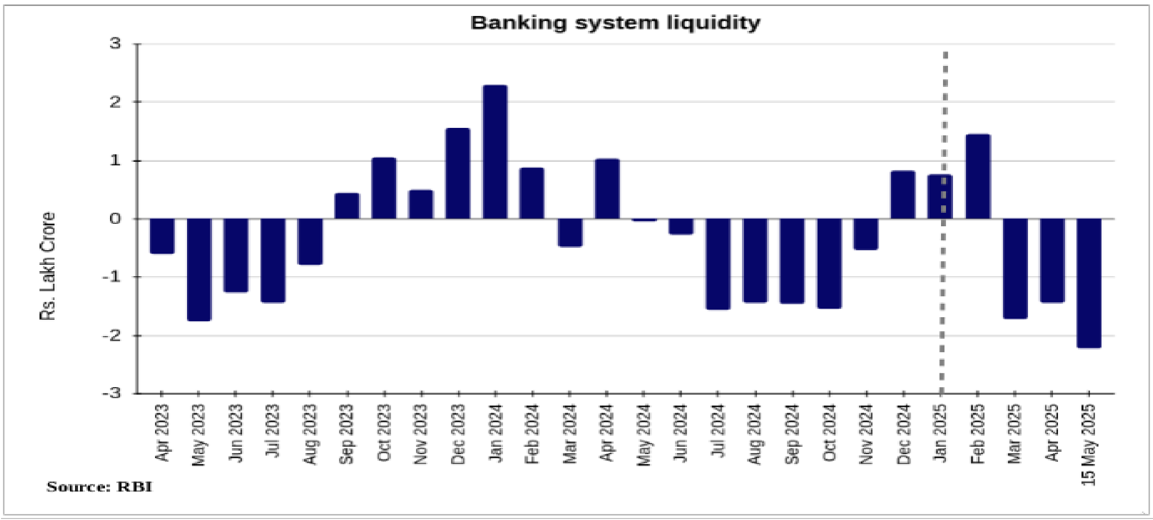
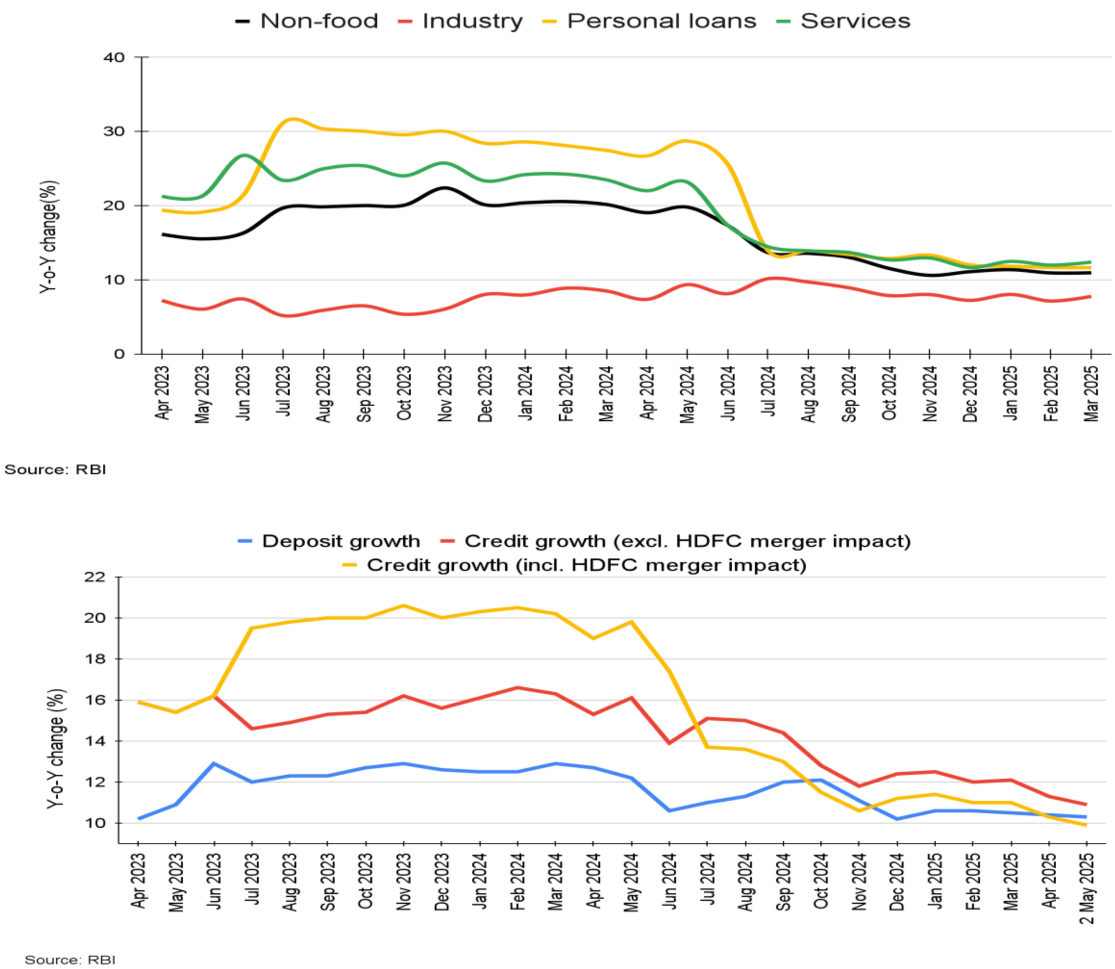


Figure 3.4: Moderation in non-food bank credit growth (upper panel) and fortnightly growth in credit and deposit (lower panel)



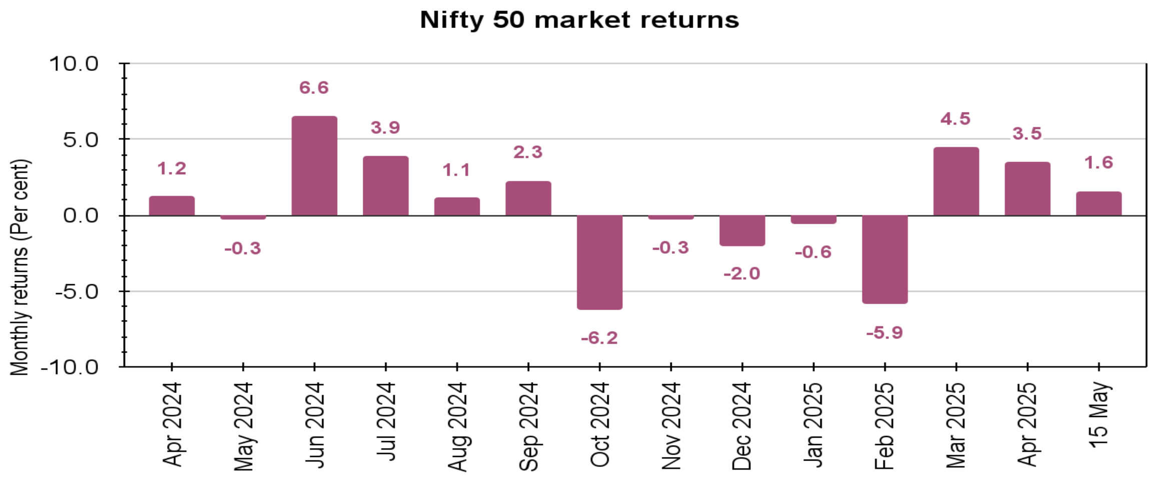
In the coming months, credit is expected to moderate further with banks exercising caution with respect to unsecured retail credit. RBI has recently upped the efforts on curtailing the growth of bank credit in this segment as it shows early signs of stress in the form of increasing non-performing assets. RBI has asked banks to set stricter thresholds with respect to granting unsecured credit.

The capital market has staged a recovery, FPI flows remain volatile

The capital market has registered positive returns since March 2025. The 90-day pause on imposition of reciprocal tariffs imposed by the U.S authorities brought a breather for the Indian stock market. However, the on- off strategy with respect to tariffs by the US has led to a considerable increase in uncertainty and volatility in the markets (Figure 3.5.a).

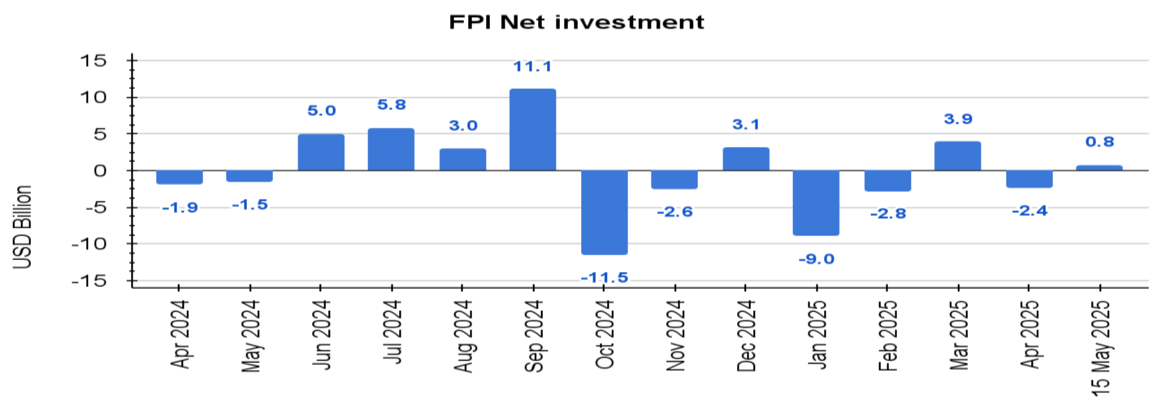
FPI flows over the past few months have also remained volatile on account of uncertainties regarding tariffs. During the first four months of calendar year 2025, FPIs were net sellers in three months (Figure 3.5.b).

Figure 3.5.a: Financial markets have staged a recovery



Source: NSE

Figure 3.5.b: Volatility in FPI flows



Source: NSDL

Going forward, volatility is expected to persist with numerous political-economic developments impacting the global economy. Additionally, narrowing of the spread between Indian and US bond yields might limit FPI investments in Indian government bonds.

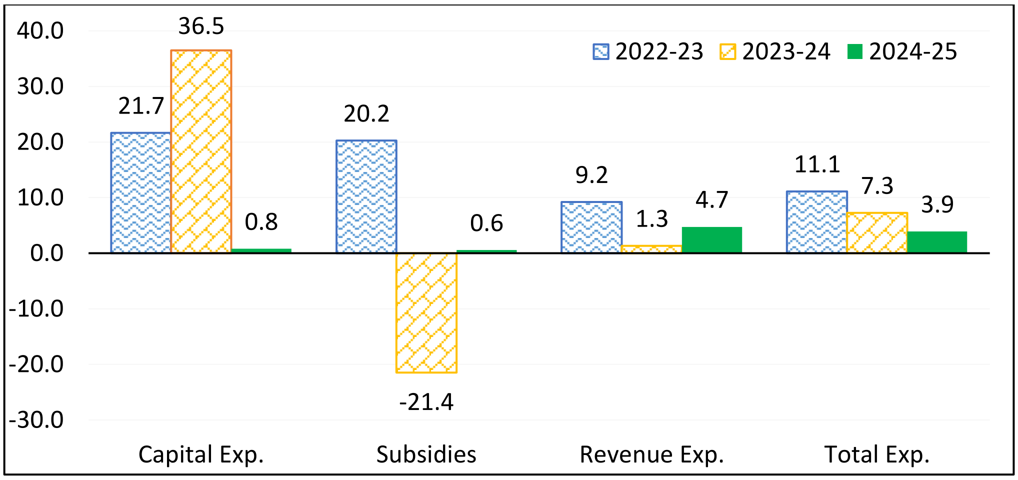
4. Fiscal Outlook: Central and State Governments

Central government

The massive thrust on capital expenditure (Capex) which had been the hallmark of central government's fiscal policy in recent years was discontinued in 2024-25. The growth in capex was less than 1 percent during April-Feb 2025 as compared to 36.5 percent during April-Feb 2024 and 21.7 percent during April-Feb 2023 (Figure 4.1). In 2024-25, the Union government drastically cut its capex growth to meet the committed fiscal deficit target of 4.9 percent of GDP. The growth in revenue expenditure during this period has been moderate at 4.7 percent with no significant change in major subsidies (food, fertiliser and petroleum).[2] As a result, the growth in total expenditure has been modest. In 2025-26 (BE), capex is budgeted to increase by 10 percent while revenue expenditure is budgeted to grow by 6.7 percent.

On the revenue side, income tax and Central GST revenues have been buoyant during April-Feb 2025. However, there was some contraction in corporate tax growth due to falling corporate profits. Excise duty revenue continued to decline during this period while customs duty growth was moderate at 4.2 percent (Table 4.1). Non-tax revenue growth has been very high at 37 percent due to enhanced dividends from RBI. In 2024-25 the RBI transferred Rs. 2.1 trillion to the government. For 2025-26 (BE), gross tax revenue of the central government is projected to grow at a modest 10.8 percent, while the nominal GDP growth is projected at 10.1 percent.

Figure 4.1: Year-on-Year growth in Expenditure (Apr-Feb; %)



Source: Controller General of Accounts (CGA); Union Budget

[2] The level of major subsidies in Apr-Feb 2025 was similar to that during 2023-24.

Central government's fiscal deficit (FD) at 4.7 percent of GDP in 2024-25 was lower than the target of 4.9 percent. Sharp contraction in capex growth enabled overshooting of the FD target. For 2025-26, the FD target is set at 4.4 percent of GDP which is lower than the earlier FD reduction goal of 4.5 percent announced by the finance minister in her 2021-22 budget speech.

The estimates of revenues and expenditure for 2025-26 (BE) preceded the Trump tariff shock. Actual revenues and expenditures may turn out to be significantly different. This may have implications for the fiscal consolidation target announced by the government in its 2025-26 budget.

Table 4.1: Y-o-Y growth in Central Government Revenue Collection (%)

Indicators	**2023-24 April-Feb**	**2024-25 April-Feb**	**2025-26BE over 2024-25RE**
GDP	12.0	9.9	10.1
Centre's Net Revenue*	11.6	13.5	10.8
Gross Tax Revenue (GTR)	13.4	10.9	10.8
Corporation Tax	17.3	1.9	10.4
Income tax	25.8	22.0	14.4
Union Excise duties	-5.8	-1.4	3.9
CGST	13.7	11.1	11.3
Customs duty	3.9	4.2	2.1
Non-Tax Revenue (NTR)	44.9	36.9	9.8

Note: * net of states' share in central taxes and collections under NCCD to be transferred to NDRF
Source: Controller General of Accounts (CGA); Union Budget

From the 2025-26 budget, the central government shifted to a new fiscal consolidation framework with debt-to-GDP ratio as the key monitoring target. As debt to GDP ratio is less sensitive to change in fiscal deficit level compared to the fiscal deficit to GDP ratio, this gives more flexibility for fiscal management. The new fiscal consolidation framework gives more elbow room for increasing capex to revive growth. The government also announced a new fiscal consolidation roadmap for the period 2026-27 to 2030-31 (i.e., award period of 16th FC) with debt-GDP ratio as the new fiscal monitoring target. It gave a terminal year targets based on three scenarios but did not specify year-wise debt-to-GDP targets in each of the scenarios. The aim is to set FD each year such that debt-GDP ratio of 50 percent ±1 percent is attained by 31 March 2031.

The States

Growth of total revenue receipts, aggregated across 23 states[3] for which data was available, fell drastically from 10.3 percent in 2023-24 (April-Feb) to 6.4 percent during the same period in 2024-25 (Table 4.2). The own revenue receipt of states, comprising of own-tax revenue (OTR) and own non-tax revenue, accounted for about 64 percent of their total revenue receipts, while the share of transfers from the central government accounted for the remaining 36 percent. The

[3] Does not include Arunachal Pradesh, Bihar, Goa, Manipur and Sikkim.

own-tax performance of the 23 states, which accounted for about 88.3 percent of own revenues, was weak, its growth falling from about 11.2 percent during April-Feb 2024 to 8.6 percent in 2024-25 (Table 4.2). However, there were large inter-state variations around this average performance, ranging from an OTR increase of 23.6 percent in case of Assam to a decline of (-) 2 percent in Telangana. In 2025-26, the combined all-states (all 28 states) own-tax revenue has been budgeted to grow by 14 percent, the implied buoyancy being greater than 1 if average GSDP grows by 12 percent.

Table 4.2: Y-o-Y growth in State Governments' Revenues (%)

Indicators	**2023-24 April-Feb**	**2024-25 April-Feb**	**2025-26BE over 2024-25RE**
GSDP	11.6	10.9	12.0
1. Total Revenue Receipt (TRR)	10.3	6.4	12.0
2. Own Revenue Receipt (ORR)	11.9	7.8	14.5
- Own Tax Revenue (OTR)	11.2	8.6	14.1
- Own Non-Tax Revenue (ONTR)	17.6	2.2	16.9
3. Central Transfers (CT)	7.7	3.9	8.7
- Devolution	27.0	15.0	10.4
- Grants-in-Aid	-20.0	-21.7	5.1

Source: Comptroller and Auditor General of India (C&AG); State Budgets

The growth in central transfers, the other component of states' revenues, has been modest at about 4 percent during April-Feb 2025. Devolution to states increased by 15 percent on average but was largely offset by a 21.7 percent decline in central grants to states as evident from Table 4.2. Grants declined in all but three states – Chhattisgarh, Karnataka and Rajasthan. This decline in grants to states in 2024-25 came on top of a sharp fall in grants in the previous year (i.e., April-Feb 2024). For 2025-26, the all-states combined budget indicates a 10.4 percent increase in devolution and 5 percent increase in grants.

From the examination of state budgets, the estimates of revenues for 2025-26 (BE) seems unduly optimistic. While own revenues and own-tax revenue respectively grew by 7.8 percent and 8.6 percent during April-Feb 2025, the states have collectively budgeted for them to grow by 14.5 percent and 14.1 percent respectively in 2025-26. Own non-tax revenue has been budgeted to grow by about 17 percent in 2025-26 (BE), as compared to the realised growth of only 2.2 percent during April-Feb 2025. Even central transfers are budgeted to grow by 8.7 percent as compared to the realised growth of less than 4 percent in 2024-25. The all-state GSDP growth projection at 12 percent also may be somewhat unrealistic.

On the expenditure side, during April-Feb 2025 the combined capex of 23 states contracted by (-) 2.1 percent (Table 4.3). This is despite the Rs. 1.5 trillion 50-year interest loan provision from the central government in 2024-25. The combined all-states total expenditure growth of 9 percent during April-Feb 2025 was driven by revenue expenditure. Setting aside large inter-state variations, revenue expenditure grew by 11 percent on average. For 2025-26 (BE), the all-states revenue expenditure is budgeted to grow by 9.2 percent while the capital expenditure is budgeted to increase by 15.1 percent, which again seems unduly optimistic given the 2.1 percent contraction in capex in 2024-25.

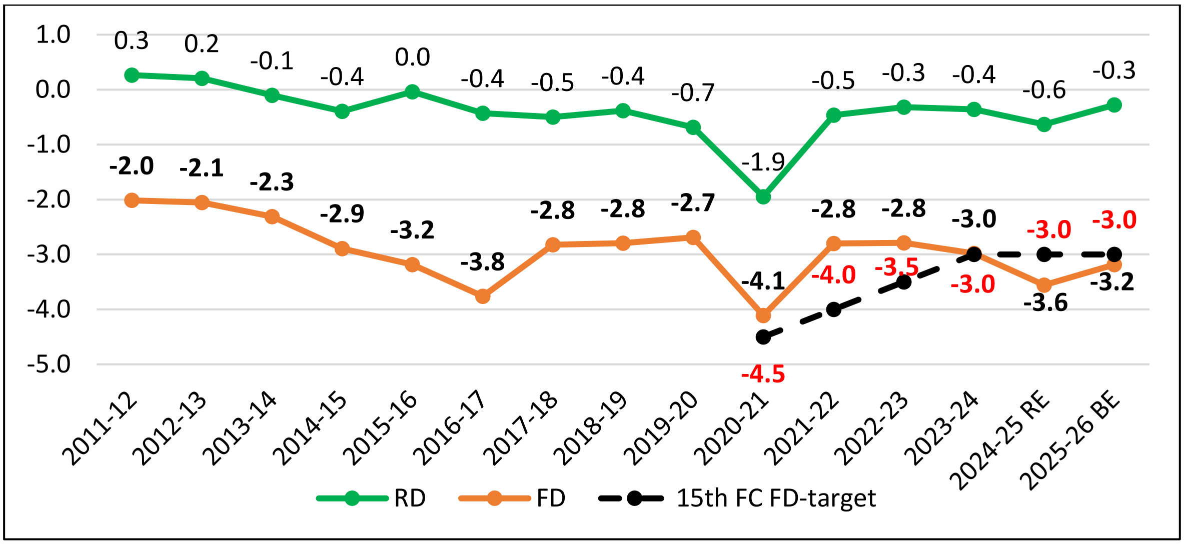
Table 4.3: Y-o-Y growth in State Governments' Expenditures (%)

Indicators	2023-24 April-Feb	2024-25 April-Feb	2025-26BE over 2024-25RE
Total expenditure	12.3	9.1	10.1
Revenue expenditure	9.3	11.0	9.2
Capital expenditure (Capex)	34.4	-2.1	15.1

Source: Comptroller and Auditor General of India (C&AG); State Budgets

States' fiscal consolidation has been resumed post-pandemic. Although the all-state combined fiscal deficit as percent of GDP increased to 3.6 percent in 2024-25 (RE) from 3 percent in 2023-24 (Figure 4.2), in 2025-26 it is budgeted to improve to 3.2 percent, close to the 15th FC target of 3 percent. The all-states combined liabilities are projected at 28.6 percent of GSDP in 2025-26, which is well below the 15th FC recommended level of 32.5 percent.

Figure 4.2: Deficits - States (% of GSDP)



Source: Finance Accounts and Budget documents of states; MoSPI; Report of 15th Finance Commission

The budgeted combined fiscal deficit of the centre plus states in 2025-26 at 7.6 percent of GDP is higher than the 15th FC prescribed limit of 6.8 percent. However, as per the new fiscal performance monitoring framework, the relevant monitoring variable is the debt-to-GDP ratio. In this context, the all-states liabilities, centre's liabilities and combined liabilities of centre and states are all within the 15th FC recommended levels.

Possible Impact of Trump Tariff Shock

Finally, an observation on the impact of the Trump shock. As noted above, the recent IMF growth projections underestimate the impact of the shock on both global and Indian growth. If one were to factor in the disruptions due to major policy changes in the US, including massive shrinking of the Federal Government, and emerging evidence of an impending US recession the impact on global and Indian growth would be probably be significantly larger than projected by the IMF.

A recent episode of such disruptions was seen during the global financial crisis in 2008-09 when union government's revenue receipts growth fell from 24.7 percent in 2007-08 to (-)0.30 percent in 2008-09. However, it rebounded to 6 percent in 2009-10 and 37.6 percent in 2010-11 thanks to strong monetary and fiscal stimulus measures.

Similar disruptions in growth will again adversely affect revenues of the government (both Union and sates). This calls for strong fiscal and monetary stimulus measures within the new fiscal consolidation framework as was undertaken during the 2007-8 financial crisis.

Concluding remarks

India's recent economic performance has been robust. While the price situation has been benign, India has remained, as often noted, the fastest growing major economy with GDP growth in the 6-7 percent range. However, the outlook going forward is dominated by the impact of President Trump's disruptive policies at home and abroad during his second term, especially his tariff policies which are currently paused. The adverse impact of these tariff policies for India may be less than often feared. This is partly because the tariffs faced by India are lower relative to our competitors and may even enable India to gain market share in the US. It is also partly because the Trump administration itself may lower the rates or allow exemptions when the pause ends and partly because India and the US may soon have a Bilateral Trade Agreement which could moderate the tariff impacts. The paper has also suggested a number of measures which could minimise the adverse impact of the tariffs.

More concerning is the possible macroeconomic effects of Trumps policies on US and global growth. The recent IMF projection seem to underestimate these effects because the US is clearly heading towards a recession with possibly strong knock on effects on global and Indian growth. A recent analogous event was the Great Recession which followed the financial crisis of 2008. Indian growth declined by about 2 percentage points before recovering thanks to strong fiscal and monetary policy stimulation. Recent cuts in the Repo rate and other liquidity enhancing measures have been a part of the RBI's modified policy stance to 'accommodative', which positions it well for expansionary policies should the growth rate decline. It helps that the inflation outlook is very benign. On the fiscal front the reduction in capex by the central and state governments is probably a major accounting for growth moderating below 7 percent after 2023-24. If growth declines further due to the Trump shock, that will reduce revenue growth and increase the deficit. This itself will be an expansionary automatic stabiliser to contain any decline in growth. Growth will also be stimulated if the recent compression of government capex is reversed on the expenditure side, since the multiplier effect of investment – whether public or private- is much stronger than that of public or private consumption expenditure. The announced shift to the Debt-GDP ratio from the Fiscal Deficit-GDP ratio as the key monitoring variable for fiscal consolidation also provides the required elbow room for reviving capex led growth

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