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MACRO ECONOMIC ARTICLE

Sailing Through Storms

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ECONOMIC OUTLOOK

Sailing Through Storms

India Remains a Bright Spot Despite Heightened Risks Worldwide

By Dharmakirti Joshi

Global macroeconomic waters are at their choppiest in decades, with uncertainties exceeding the levels experienced during the 2008 Global Financial Crisis and the onset of the Covid-19 pandemic in 2020.

Yet, India keeps sailing through the troubled waters, demonstrating strength and resilience.

The current fiscal has commenced strongly, with gross domestic product (GDP) growth in the first quarter surpassing expectations by printing at 7.8%, driven by government investments and consumer spending.

This has also prompted an upward revision in the GDP forecasts for this fiscal. The Reserve Bank of India (RBI) cranked up its previous call by 30 basis points to 6.8%, while the International Monetary Fund (IMF) has pegged 6.6% from 6.4%.

The Purchasing Managers' Index (PMI) data indicates economic activity remained robust well into the second quarter, with manufacturing and services indices averaging 59.1 and 61.7, respectively.

To be sure, India is not alone in experiencing growth upgrades. The IMF has also increased its growth projections for global GDP by 20 basis points to 3.1% for 2025, alongside those of various other economies. The upgrades are primarily due to better-than-anticipated performance in the first half of the year. In the case of the US, though, S&P Global has noted that data centers and related activities contributed significantly, accounting for 0.5 percentage point of GDP growth in the second quarter.

One reason for the sustained growth in the first half of the year, including in India, is that the full impact of tariffs will be felt in the latter half. The first half also had the advantage of frontloading of exports to the US. Consequently, growth is expected to slow in the second half.

Without a trade agreement, we estimate the textiles, gems and jewelry, and seafood sectors—comprising nearly a quarter of India's total exports to the US—will be the most adversely affected by tariffs. Micro, small, and medium enterprises (MSMEs), which make up over 70% of these sectors, will face significant challenges.

Overall, however, the tariffs are unlikely to significantly impact India's macroeconomic landscape this fiscal, as strong domestic demand and favourable policy measures, along with a shift in trade to other regions, will partly mitigate these challenges.

The 50% tariffs the US imposed in September led to an 11.9% decline in India's exports to that country that month. But exports to other markets rose 10.9%—as it did for some other countries.

In any case, India's goods exports to the US represent only about 0.2% of its GDP.

We project the Indian economy to grow at 6.5% this fiscal year and 6.7% in 2026-27, supported by a combination of good luck, buffers and conducive policies.

External resilience is reinforced by a low current account deficit (CAD), robust foreign exchange reserves, and a manageable level of external government debt. The foreign exchange reserves, capable of covering over 10 months of imports, provide a buffer at a time when financing even a low CAD can be challenging due to volatile capital flows. In the first quarter of the current fiscal, capital flows were inadequate to cover the CAD of 0.2% of GDP.

Favourable external factors, such as low crude oil prices and another spell of above normal southwest monsoon, have played a significant role.

With crude oil prices expected to hover around \$65 per barrel (compared with \$78 last fiscal), growth is likely to be supported, while keeping fuel inflation and CAD in check.

While the monsoon was in excess in some regions, no substantial impact on national agriculture is anticipated. Furthermore, healthy groundwater and reservoir conditions will support winter crops.

India's resilience is also underpinned by the solid balance sheets of banks and corporations. A recent study by Crisil Ratings indicated corporate credit quality for large and mid-sized companies is strong, with upgrades outpacing downgrades. Bank balance sheets are also in good shape, and Crisil anticipates non-performing assets (NPAs) will reach a decade-low of 2.3-2.5% by March 2026.

But domestic companies remain cautious about investments because of lingering global uncertainties and excess capacity in China. Not surprisingly, the current investment cycle has been driven by households and government spending.

Cyclical support for the economy has come from the 100-basis point cuts in the repo rate and the cash reserve ratio, although complete transmission to lending rates is still awaited.

Fiscal policy is constrained by targets and lower-than-expected nominal GDP growth, which hampers tax collections.

However, capital expenditure (capex) was front-loaded in the first half and is expected to slow down in the second half. Given the matrix, private consumption is emerging as the more prominent driver of the economy than investments. Low food inflation is bolstering discretionary spending, particularly among lower-income groups where food has a higher weight in their consumption basket. We now anticipate headline inflation to be at 2.5% in fiscal 2026.

The rationalisation and reductions in goods and services tax (GST) rates are enhancing private consumption among the middle class, complementing income tax cuts and interest rate reductions implemented this year. Over time, simplifying the GST rate structure is expected to improve compliance and formalization, benefiting the economy structurally.

As global trends shift towards more protectionist policies and tariff barriers, accelerating economic reforms becomes essential to enhancing India's growth potential and mitigating external risks.

The budget for next fiscal will have to address these.

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