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Easing Inflation Creates Room for Additional Policy Measures Amid Looming US Tariff Announcement

- As US President Trump's April 2 "reciprocal tariffs" announcement approaches, ad hoc decisions are already dampening business confidence in the US, risking slower growth and increased global market volatility.
- Meanwhile, China is cautiously boosting domestic demand, and Germany's significant fiscal expansion is poised to stimulate EU growth, offering a modestly positive outlook for both regions amidst rising global risks.
- India's real GDP grew by 6.2% YoY in Q3 FY25, in line with our projection, supported by recovery in government spending, private consumption, and positive contributions from services exports.
- High-frequency data suggests continued moderate recovery into Q4, driven by improved industrial activity, resilient services, and positive agricultural trends.
- For FY26, we expect real GDP growth to rise to 6.4% YoY, up from ~6.1% in FY25 (with slight upside potential), supported by policy measures such as monetary policy easing and income tax reductions.
- Despite potential US reciprocal tariffs, India's exposure is limited, as goods exports to the US account for just ~2.2% of India's GDP.
- Sectors such as stones and glass, textiles, pharma, chemicals, machinery, electronics, and food products could be relatively more vulnerable to reciprocal tariffs. However, ongoing India-US trade negotiations could mitigate some of these risks.
- Headline CPI inflation fell to a seven-month low of 3.6% YoY in February, primarily due to a sharp drop in food prices, although core inflation rose slightly to ~4%. Food inflation is expected to remain subdued, but core inflation pressures may persist in the near term.
- The policy space for additional measures has increased with inflation falling below the 4% target. Going forward, the RBI is likely to prioritize supporting economic growth while managing inflation and external uncertainties.
- We now expect cumulative 75-bps repo rate cuts in the current easing cycle, with a 25-bps rate cut expected in April, followed by another 25-bps in June/August.
- The RBI is expected to continue liquidity injections to support economic activity and facilitate the transmission of policy rate cuts, with additional measures expected in April.

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Global uncertainties rise as the deadline for US reciprocal tariffs near

Much of the global economy is on tenterhooks ahead of US President Trump's pending April 2 announcement regarding updates to the US trade policy. In mid-February, Mr. Trump stated that his economic team would review U.S. trade dynamics on a country-by-country basis and present, on April 2, a framework for what he called "reciprocal tariffs. At the time, this seemed to suggest that the Trump Administration was poised to conduct a systematic analysis (whatever the merits of that analysis) and that ensuing trade actions would be a by-product of some sort of defined analytical framework.

Instead, US President Trump's impulsiveness intervened nearly immediately and while the Trump Administration's economics team is systematically analysing US trade dynamics for some sort of April 2 briefing and announcement, Mr. Trump is proclaiming seemingly ad hoc tariffs and other trade-related actions weekly in the run up to April 2. To be sure, some of these announcements have been to spur countries such as Canada and Mexico to act on non-trade matters relevant to the United States (e.g. border security) and have been more bluster than substantive. But the president also has front run his April 2 announcement on substantive matters, most recently announcing a 25% tariff on finished automobile imports.

This haphazard approach risks spurring various adverse consequences. The most notable – and greatest threat to continued solid US economic expansion – is the paralysis this ad hoc policymaking risks injecting into the US economic decision-making. Business confidence is weakening, a rising number of firms in corporate earnings reports are citing "policy uncertainty" as a business risk and hiring and capex plans in sentiment surveys are falling. Likewise, on the consumer confidence front, expectations about future employment prospects are deteriorating and consumers are increasingly worried that tariffs will raise future prices.

To date, actual economic activity has been little affected by this "policy uncertainty." But the longer the prevailing ad hoc policymaking by the Administration persists, the greater the risks to actual activity will become. We are monitoring closely the trend in hiring. Businesses' hiring rate – that is, the ratio of job hires to the labour force – is the lowest since 2011/12. Given that, even a modest pick-up in the layoff rate due to greater worries about the outlook by businesses could send the unemployment rate up quickly and in turn slow sharply consumer spending and domestic demand. A similar dynamic is unfolding in Canada and Mexico, the US's closest trading partners.

Away from the prospective US-led attempted reordering of global trade norms and scattershot policymaking, there have been some cautiously positive macro developments in the world's two other large economic regions. China is moving modestly to try to shore up aggregate demand following a multi-year slump. Policy pronouncements around China's annual leadership congress have lacked specificity but have conveyed a sense that policymakers recognize the need to bolster domestic economic activity and are willing to deploy policy measures to do so. These are modest efforts and with a comprehensive framework to deal with the country's property sector problems still lacking, policy is hardly turning super stimulative. Nonetheless, the outlook for Chinese growth in 2025 has improved modestly and in a world where downside growth risks have been rising due to US trade policy, such a development is an incremental positive for the global economy.

Likewise, policy action in Europe is in the process of helping to boost European Union domestic demand. The most notable action on this front is Germany's radical expansion of government spending focused on strengthening German infrastructure and its military. This development is notable for two reasons: First, Germany historically has been fiscally stingy for decades and its recently passed Euro 500 to 600 billion 10-year infrastructure/defence fund represents a dramatic break in that regard. Secondly, due to the atrocities of World War II, Germany has been extraordinarily reluctant to spend more than the bare minimum on its military; however, shifting US military priorities has compelled a dramatic shift on this front. Together, this spending likely will help to spur the pace of broad economic activity in both Germany and other European countries via positive knock-on effects to both hiring and capital spending throughout the industrial sector.

India: Q3-FY25 economic growth in line with expectations, moderate recovery set to continue in Q4

India's economic growth showed moderate recovery in Q3 FY25, with real GDP expanding by 6.2% YoY (in line with our expectation), up from the seven-quarter low of 5.6% YoY in Q2. As anticipated, the recovery was primarily driven by a rebound in government spending and private consumption, with rural demand likely playing a key role. Net exports also contributed positively to overall growth, led by services exports. Investment spending remained stable, with an increase in government capital expenditure offsetting sluggish private investment. On the supply side, growth was mainly supported by robust performance in the agriculture sector, a moderate pick-up in manufacturing, and resilient growth in services. Please refer to the Q3 GDP report for more details.

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India’s GDP estimates at a constant price

(GDP Constant Prices)	% YoY							
	FY24	Q1-FY24	Q2-FY24	Q3-FY24	Q1-FY25	Q2-FY25	Q3-FY25	FY25
Private Consumption	**5.6**	**7.4**	**3.0**	**5.7**	**7.7**	**5.9**	**6.9**	**7.6**
Government Consumption	**8.1**	**5.3**	**20.1**	**2.3**	**-0.5**	**3.8**	**8.3**	**3.8**
Gross Capital Formation	**10.5**	**8.9**	**11.9**	**12.4**	**6.4**	**6.1**	**5.0**	**5.8**
Gross Fixed Capital Formation	8.8	8.4	11.7	9.3	6.7	5.8	5.7	6.1
Exports	2.2	-7.0	4.6	3.0	8.1	2.5	10.4	7.1
Less Imports	13.8	18.0	14.3	11.3	-0.7	-2.5	-1.1	-1.1
Real GDP	**9.2**	**9.7**	**9.3**	**9.5**	**6.5**	**5.6**	**6.2**	**6.5**
Real GDP Excluding Govt Exp	**9.3**	**10.2**	**8.4**	**10.2**	**7.3**	**5.8**	**6.0**	**6.8**

Source: MOSPI, CMIE

The National Statistics Office (NSO) revised FY25 previous quarters' GDP estimates, with Q1 now revised to 6.5% (from 6.7%) and Q2 real GDP to 5.6% YoY (from 5.4%). It also revised the FY24 real GDP growth estimate to 9.2% YoY, up from the previous estimate of 8.2%. The revision was largely driven by stronger private consumption and government spending. For FY23, real GDP growth was revised upward to 7.6% YoY from 7.0%, mainly due to upward revisions in private consumption and investment, partially offset by a downward revision in government consumption.

While revisions in economic data like GDP are expected as the statistical office gains access to more data, the size of the revisions in GDP and its subcomponents for both the past years and previous quarters of the current fiscal year complicates the forecasting process and could also affect policymaking. According to media reports, the statistical office plans to change the base year (from 2011-12 to 2022-23) to better reflect changes in the economic structure and incorporate more data sources (such as GST and e-commerce) likely by next year. This change might improve the quality of GDP estimates and reduce the size of future revisions.

As per the second advance estimate for FY25, the NSO projects real GDP growth at 6.5% YoY, up from the earlier estimate of 6.4%. However, the required growth rate of around 7.6% YoY in Q4 FY25 to meet the full-year estimate appears overly optimistic when considering expected lower government spending in the final quarter. High-frequency data for January-February 2025 also suggest a continuation of a moderate recovery in early Q4 FY25, partly supported by a boost to economic activity like travel and hotel bookings during Maha Kumbh. As a result, we see a slight upside to our current projection of 6.1% YoY real GDP growth in FY25, even after factoring in reduced fiscal support in Q4.

Economic Recovery in FY26 is expected to gather support from policy actions, US trade policy poses a moderate downside risk

Looking ahead, we expect a moderate recovery in economic growth in FY26, with real GDP projected to increase by 6.4% YoY, supported by cooling inflationary pressures and monetary policy easing.

In light of the need for additional policy measures to support the recovery amidst easing inflationary pressures, we are revising our expectation for cumulative policy repo rate cuts in the current easing cycle to 75 bps, up from 50 bps previously. Following a 25-bps cut in February, we expect the RBI to deliver another 25-bps cut in the April meeting, with a further 25-bps reduction anticipated in June or August. We also anticipate that the RBI will continue to implement measures to address liquidity needs and prevent liquidity tightening from negatively impacting economic activity or hindering the transmission of rate cuts. Additionally, income tax cuts announced in the budget are likely to provide further support to consumption spending.

Despite this, downside risks remain, particularly due to the evolving global trade outlook and heightened uncertainties surrounding US trade policies. However, the impact on India is not expected to be significant, given the economy’s primarily domestic orientation. As highlighted in our previous monthly monitor, India's goods exports to the U.S. account for only ~2.2% of GDP. With the April 2nd deadline approaching for the imposition of reciprocal tariffs by the US, sectors such as stones and glass, textiles, pharma, chemicals, machinery and electronics, food products, and IT & software could be relatively more vulnerable. That said, the extent of the reciprocal tariffs may be limited, as India is actively negotiating with the US to finalize a Bilateral Trade Agreement, likely by fall 2025. According to media reports, the Indian government is open to reducing tariffs on over half of US imports worth $23 billion as part of the first phase of the deal. This raises the possibility that any reciprocal tariffs on India could be less significant in both extent and duration, compared to countries like China and Mexico.

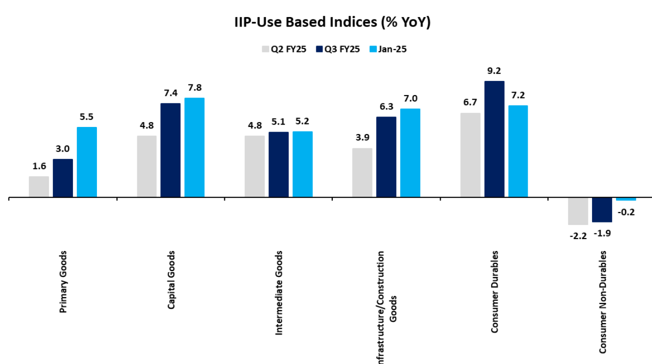
High-frequency data suggests moderate economic recovery to continue in early Q4.

Industrial production showed a notable uptick in January, growing by 5.0% YoY, up from 3.5% in December, marking the second consecutive month of sequential pick-up in growth. The manufacturing sector was a key driver, expanding by 5.5% YoY (vs. 3.4% in December), alongside mining, which grew by 4.4% (vs. 2.7% in December). However, momentum in the electricity sector slowed, due to lower power demand amidst a rise in temperatures.

Manufacturing growth was broad-based in January, with strong contributions from electrical equipment, fabricated metal products, metallic minerals, petroleum products, and transport equipment, indicating improving industrial demand. Despite this, the PMI manufacturing index slowed to 56.3 in February, the lowest reading since December 2023, suggesting an uneven recovery in the sector.

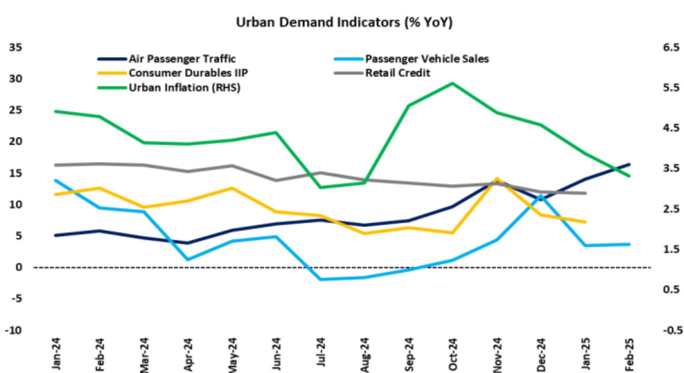
A closer look reveals that industrial activity was mainly driven by capital goods (7.8% YoY) and infrastructure & construction goods (7.0%), both benefiting from robust central government spending. Central government capital expenditure surged by 51.4% YoY in January, with FYTD (April-January) growth tracking at 5.0%. Revised estimates indicate that central government capital expenditure is expected to grow by 14.8% YoY for the remainder of the year, supporting overall economic growth though less than in Q3. In contrast, private-sector capital spending has likely remained subdued. Looking ahead, moderate domestic recovery and heightened global trade uncertainty are expected to delay a broad-based recovery in private investment.

Relatively broad-based recovery in industrial activity



Source: CMIE

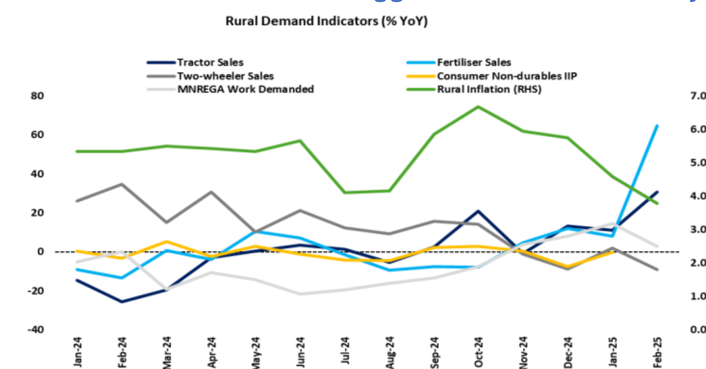
Urban demand indicators mixed



Source: CMIE; RBI

Within the IIP, consumer durables grew at a robust 7.2% YoY in January, but the pace of expansion slowed to a three-month low, indicating sluggish and uneven urban demand. This is further reflected in weaker passenger vehicle sales, slower GST collections, and electronic payment data. However, select indicators like domestic passenger traffic showed improvement, likely driven by rising travel during the MahaKumbh. In terms of outlook, factors such as the income tax cut, a fall in urban inflation, and the monetary policy easing could provide a boost to urban demand heading into FY26. Additionally, there are early signs of improvement in formal sector employment, as reflected in PMI surveys, the positive Naukri JobSpeak index, and improving salaried employment data from CMIE, all of which could support urban consumption into FY26.

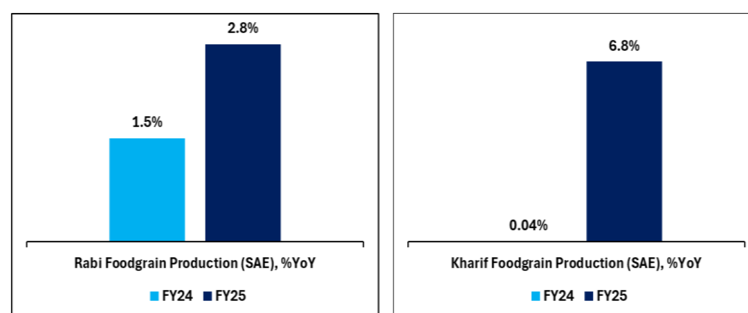
Rural demand indicators suggest continued recovery



Source: CMIE

On the other hand, rural demand has likely played a significant role in supporting economic growth in Q3, with momentum continuing into the current quarter. This is evident from several high-frequency indicators including fertilizer sales, tractor sales, and three-wheeler sales. However, some weakness was observed in rural job demand under MNREGA, likely due to the seasonal lull following the completion of the Rabi sowing season. This trend is also reflected in the recent uptick in the rural unemployment rate, as reported by CMIE. While expectations of a historically high Kharif output (6.8% YoY, according to the Second Advance Estimate) and easing inflationary pressures should help sustain rural demand, pressures in the rural labour market could act as a drag.

Healthy Kharif and Rabi production outlook continue to support rural demand



Source: CMIE; RBI; Note: For FY24, the YoY change is based on actual output

Trade deficit narrowed to a nearly 3.5-year low as imports slump exceeds the fall in exports

India's merchandise trade deficit narrowed to US$ 14.05 billion in February, the lowest since August 2021. Both exports and imports saw double-digit declines, but a sharper fall in imports contributed most to the reduced deficit. Exports dropped by 10.8% YoY in February, marking the steepest decline in 20 months, partly due to a

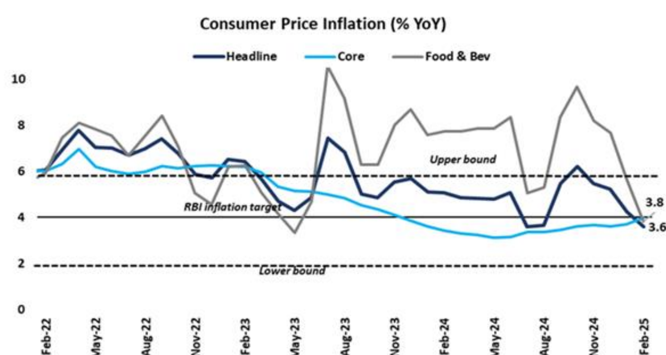
high base from last year. The sustained weakness in exports suggests that external demand is unlikely to drive economic recovery in the near term. Imports also fell by 16.3% YoY in February, driven by a 29.6% drop in oil imports and a significant 62% plunge in gold imports. Even non-oil, non-gold imports also saw sharp declines, signalling weakening domestic demand. If these trends persist, they could hinder recovery. However, some of these shifts may reflect uncertainty around US trade policies, which could be impacting logistics, making it necessary to wait for a few more months of data to better assess underlying demand conditions.

On a positive note, the services trade surplus rose to US$ 18.5 billion in February. Services exports surged 23.6% YoY, up from a 12% increase in January, while services imports grew by 8.7% YoY, slowing from 12.6% in January. This shift helped the overall trade balance swing to a surplus of US$ 4.43 billion for the first time since May 2021, providing potential support to Q4 GDP growth. However, the external sector outlook in FY26 remains clouded by continued uncertainty around US trade policy.

Inflation falls to a seven-month low in February

On a positive note, the headline CPI inflation declined to a seven-month low of 3.6% YoY in February, down from 4.3% in the previous month. This marks the first time since August 2024 that headline inflation has fallen below the RBI's 4% inflation target. The sharp moderation in inflation is attributed to a significant easing in food and beverage inflation, despite a modest uptick in core inflation.

Headline Inflation falls below 4%, led by a sharp drop in food inflation



Source: CMIE

Food and beverage inflation decelerated to a near 21-month low of 3.8% YoY (vs. an average of +7.5% over the past six months), primarily driven by a decline in vegetable prices (-1.1% vs. an average of +26% YoY over the past six months) and pulses prices (-0.3% vs. an average of +7.1% over the past six months). There was also moderation in the prices of eggs, meat & fish, cereals, and milk, along with continued deflation in spices and fuel prices. On a month-on-month basis, vegetable prices continued to show a deflationary trend for the fourth consecutive month, owing to improved supply and favourable seasonal factors. Meanwhile, core inflation edged up slightly from 3.71% in January to 3.97% in February. The rise was largely driven by an uptick in the personal care segment (13.6% vs. 10.6% in January), reflecting an increase in gold prices.

Looking ahead, food inflation is expected to remain subdued, supported by historically high agricultural output (Kharif foodgrain is estimated to grow by 6.8%, according to the Second Advance Estimates), healthy reservoir levels, and positive Rabi crops outlook. However, the recent heatwave forecasts could pose risks to food inflation in the coming months. At the same time, we anticipate core inflation to exceed 4% in the near term, as both the PMI manufacturing and services indices indicate that inflationary pressures are running above long-term averages. The WPI inflation for manufactured goods has also risen in February to an almost two-year high of 2.9%. However, input prices, according to the PMIs, have stabilized in the manufacturing sector, while service sector input prices have eased to a four-month low, suggesting that the rise in core inflation may not be persistent. Overall, we expect headline CPI inflation to remain just below 4% in March, leading to an average of around 4.0% for Q4-FY25. This would be below the RBI's projection of 4.4% for the quarter, strengthening the case for monetary policy easing.

With inflation below the 4% target, the RBI to step up support for economic growth; a 25-bps rate cut is expected in April

With the RBI's stated objective of aligning headline inflation with the 4% target (within a band of +/-2%), we expect the RBI to cut the repo rate by 25-bps at the April meeting and announce additional measures. We also expect the RBI to tone down its concerns over inflation and place greater emphasis on supporting economic growth in the upcoming monetary policy statement. While inflation will remain a key focus, the RBI is likely to underscore the importance of maintaining a durable alignment of inflation with the target, especially in the context of rising core inflation and the heightened uncertainties surrounding US trade and tariff policies. Accordingly, the RBI will likely adopt a balanced stance on its future guidance, to continue to consider incoming economic data and developments on US tariffs. As a result, we believe that the RBI will retain its policy stance at "Neutral" in the April meeting to maintain policy flexibility, with a potential shift to "Accommodative" in the June or August meeting.

On liquidity management, the RBI continues to take proactive measures to address the systemic liquidity deficit. The increased foreign exchange interventions, seasonal

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FY25-end demand, increase in currency circulation, and tax payments are exerting pressure on systemic liquidity, although central government spending provides some offset. Systemic liquidity has been in deficit since the second week of December, with the average deficit rising from Rs 0.6 lakh crore in December to Rs 2.0 lakh crore in January, and Rs 1.6 lakh crore in March (as of data till 25th). This is despite the RBI announcing several liquidity-boosting measures, including USD/INR Buy/Sell Swaps, Variable Rate Reverse Repo (VRR) operations, and Open Market Operations (OMOs) since December.

RBI's durable liquidity measures since December

RBI's Measures	Auction Date	Injected Amount (INR Cr)
OMO Purchase	January 2025	38,825
OMO Purchase auction	January 30, 2025	20,020
	February 13, 2025	40,000
	February 20, 2025	40,000
	March 12, 2025	50,000
	March 18, 2025	50,000
Term Repo Auctions	February 7, 2025	50,010
	February 14, 2025	75,003
	February 21, 2025	57,951
USD/INR Buy Sell Swap	January 31, 2025	44,000
	February 28, 2025	88,000
	March 24, 2025	86,000
Total Liquidity Injected		6,39,809
50-bps CRR cut	December Policy Meeting	1,16,000
Total Liquidity Injected (including CRR cut)		7,55,809
Total Liquidity Infusion as % of Banking Deposits		3.4%

Source: RBI

In March, the RBI announced additional steps to infuse liquidity, amounting to approximately Rs 1.86 lakh crore. This included OMO purchase auctions of G-Sec for a total of Rs 1,00,000 crore and a USD/INR Buy/Sell Swap auction of USD 10 billion for a tenure of 36 months. The RBI also continues to conduct daily and short-term VRR operations. Since December, cumulative liquidity measures have totalled Rs 7.5 trillion, including the CRR cut. Despite RBI interventions, the interbank call rate averaged 6.27% (26th March) in the current week, remaining slightly above the policy repo rate. We expect further liquidity injection operations to counterbalance the liquidity reduction caused by the maturity of (previously conducted) VRR operations in early April. The RBI may step up its liquidity infusion measures, aiming to provide adequate liquidity, potentially even a small surplus, to facilitate the transmission of policy rate actions. Further, the anticipated payout of RBI's dividend to the government in May could also help alleviate liquidity pressures assuming the government front-loads its spending in FY26.

Market Update

Bond Market: India's G-Sec bonds rallied in March. The G-Sec yield curve has shifted downward over the past month, with the 10-year G-Sec yield hitting 6.64% (25th March), one of its lowest levels in nearly three years. Meanwhile, 3-month and 1-year bond yields have remained near February-end levels. While short-term rates remain elevated due to liquidity pressures, the mid-to-long end of the curve is being supported by RBI OMOs, FPI debt inflows, softer US Treasury yields, lower crude oil prices, and fiscal consolidation. We expect the benchmark India's G-Sec 10-year yield to ease further given expectations of additional monetary policy easing and OMO purchases into FY26.

Equity Market: Domestic equity markets rebounded in the second and third weeks of March, with the Nifty 50 Index closing 7% higher by March 25 (from the February-end level), erasing all CY25 YTD losses. This followed five consecutive months of correction including a sharp 6% fall in the Nifty 50 Index in February. The stock market recovery in March is fuelled by positive global and domestic cues—particularly expectations that US tariffs may offer some exceptions and relief, alongside growing hopes of monetary easing by the RBI after a sharp fall in inflation, which boosted investor sentiment. Additionally, the prolonged market correction has also possibly led to value buying.

Domestic investors continued to support the market, while foreign investors remained cautious, with outflows of Rs 273 billion in March compared to Rs 297 billion outflows in February. This caution stems from uncertainties around US tariff policies, although the intensity of FPI outflows has diminished. We expect volatility to persist in the near term, driven by Trump's unpredictable tariff stance.

Currency Market: The rupee also recovered in March. A pullback in the US Dollar Index in March helped currencies across the Asia region recover after several months of depreciation. The Indian Rupee has appreciated by 2% against the USD in March (data till 25th), with the USD/INR trading at 85.76, following a 1% depreciation in February. The overvaluation of the Rupee in REER terms also eased, dropping from 104.8 in January to 102.4 in February. Despite several months of RBI's FX interventions, India's foreign exchange reserves have declined from a peak of ~US$705 billion in September 2024 to US$654 billion by March 14. However, the reserves remain adequate to cover ~11 months of imports and 91% of external debt (outstanding at September end), providing a strong cushion in case of high volatility and/or global shocks.

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