SOCIO-ECONOMIC VOICES

Indian Economy: The Impact of Tariff Friction

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How well can the Indian economy be expected to function amid global volatility and trade uncertainty? This is a key question today. Another important consideration is the short-term and long-term effects of tariff friction. The sudden disappearance of multilateral trade norms and the inactivity of the WTO have created a new survival scenario. Before delving into these issues, it is worthwhile to review the resilience of the Indian economy based on recent performance indicators.

Indian economic growth and inflation have remained aligned with projected trajectories at the end of the financial year 2024–25. Evidence for this is drawn from the Economic Survey 2024–25, the RBI's March 2025 report, and the RBI Governor's speech on monetary policy. GDP growth for 2024–25 is estimated at 6.5%; gross capital formation rose by 6.1%, and private consumption expenditure grew by 7.1%. Headline CPI inflation was 5.4% in 2023–24, and it came down to 3.6% in February 2025. For 2024–25 (eleven months), it is expected to average 4.75%. This moderation was supported by lower food prices—particularly vegetable prices—and by declining prices in the fuel group. However, core inflation remained at 4.1% in February 2024, which is within guardrails. In other words, both growth and inflation remained within acceptable limits in 2024–25.

High-frequency indicators from the last quarter of 2024–25 are quite encouraging. E-bills increased by 19.4%, and gross GST revenues rose by 9.9% in March 2025. Consumption of finished steel and cement increased by 10.9% and 10.5%, respectively. Investment indicators such as IIP capital goods and capital goods imports grew by 7.8% and 7.5%. Capacity utilisation, according to OBICUS data, stood at 75.3%. The services sector continues to perform well; services exports of software and business services grew by 11.8% in the first two months of 2025.

Exports of goods and services are expected to grow by 6% in 2024–25, while imports are projected to grow by 7.3%. The current account deficit, at 1.1% of GDP, is expected to remain manageable. However, the growth in merchandise exports has been modest—virtually unchanged from 2023–24. In contrast, services exports have shown stellar performance. These are the starting conditions for 2025–26. The domestic economy remains robust, though evolving global conditions may raise concerns for the external sector.

Continued trade frictions and related capital outflows could marginally affect growth. The RBI has revised its GDP growth projection for 2025–26 down from 6.7% to 6.5%. The Governor acknowledged this candidly in his monetary policy statement. To support the domestic economy, the RBI reduced the repo rate to 6% and adopted an accommodative stance. Should inflation continue to fall, the repo rate could glide further down to 5.5%. This accommodative monetary policy and the availability of adequate liquidity are expected to smooth the domestic growth process. Indeed, robust agricultural output, a manufacturing revival, and a resilient services sector could help maintain growth momentum.

On the demand side, rural demand has revived, and urban demand is expected to pick up due to lower food prices, tax exemptions, improved credit availability, investments in urban infrastructure and new city developments. Indian economic growth remains primarily driven by private consumption and domestic investment; exports play a comparatively limited role, unlike in the case of China.

The newly announced tariff regime of the USA has created trade friction and the possibility of disruptions in supply chains and price instability. Furthermore, it has contributed to global financial market volatility. Exchange market instability seems imminent. In the short run, the country most likely to be affected is the USA itself, as the measures may dampen GDP growth even in the absence of a recession. Simultaneously, they could push up inflation. On the financial side, bond and equity markets may experience major disruptions—bond prices have fallen, and yields have risen, which is not a positive signal for the US economy. In response, a three-month moratorium on the imposition of new tariffs has been granted to negotiating countries other than China.

Tensions with China have escalated, and the US appears to be attempting to isolate it. One of the key long-term objectives of the US seems to be reshoring manufacturing and expanding employment, although concrete steps are not yet clear.

As for India, merchandise exports to the US are estimated at $80 billion on a pro-rata basis. Actual data for April to December 2024 shows that as a percentage of GDP, this constitutes around 2.1%. However, higher US tariffs, along with exchange rate adjustments, could reduce GDP by approximately 0.2% to 0.5%. Thus, the overall adverse impact is likely to be limited. The RBI may have already accounted for this. That said, there are several indirect long-term effects. These relate to supply chain disruptions and potential dumping by China, which may face excess capacity in metals, chemicals, and pharma APIs. The Indian IT services sector may also be affected due to slower US growth, order delays, and deferrals of renewals and new contracts.

In the era of globalisation, rule-based multilateral trade, as well as regional trade agreements (RTAs), supply chains were constructed across countries. These are now at risk of severe disruption. Moreover, a slowdown in US growth could lower global growth even if a recession is avoided. Under such circumstances, excess capacity in emerging economies may lead to aggressive, below-cost competition and outright dumping, particularly by China. This can affect our share in non-US economies. In this context working out a mutually beneficial bilateral trade agreement with USA would be useful. After all, around 19% of India's exports go to USA.

Notwithstanding these challenges, the Indian economy is likely to be affected only at the margins. The core domestic growth momentum is expected to remain largely intact.

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