Photo by Ravi Sharma on Unsplash

Navigating India’s Economic Landscape: Opportunities and Challenges

JULY 24, 2025

Ranil Salgado
IMF Senior Resident Representative
India, Bhutan, & the Maldives
Singapore Seminar Series, STI/IMF RRO

Key Messages

- The economic **outlook for India remains positive**
  - Macroeconomic and financial stability
  - Earlier landmark reforms, which have help set a solid macroeconomic foundation (e.g., GST, inflation targeting, IBC) and help boost underlying growth
  - In the short term, growth has rebounded from the fiscal year second quarter slowdown

- Policy will need to remain nimble to navigate **uncertain times ahead**
  - Fiscal buffers should continue to be rebuilt at an ambitious pace
  - Monetary policy is now broadly neutral, with scope for further easing depending on the data
  - Address pockets of vulnerability in the financial sector

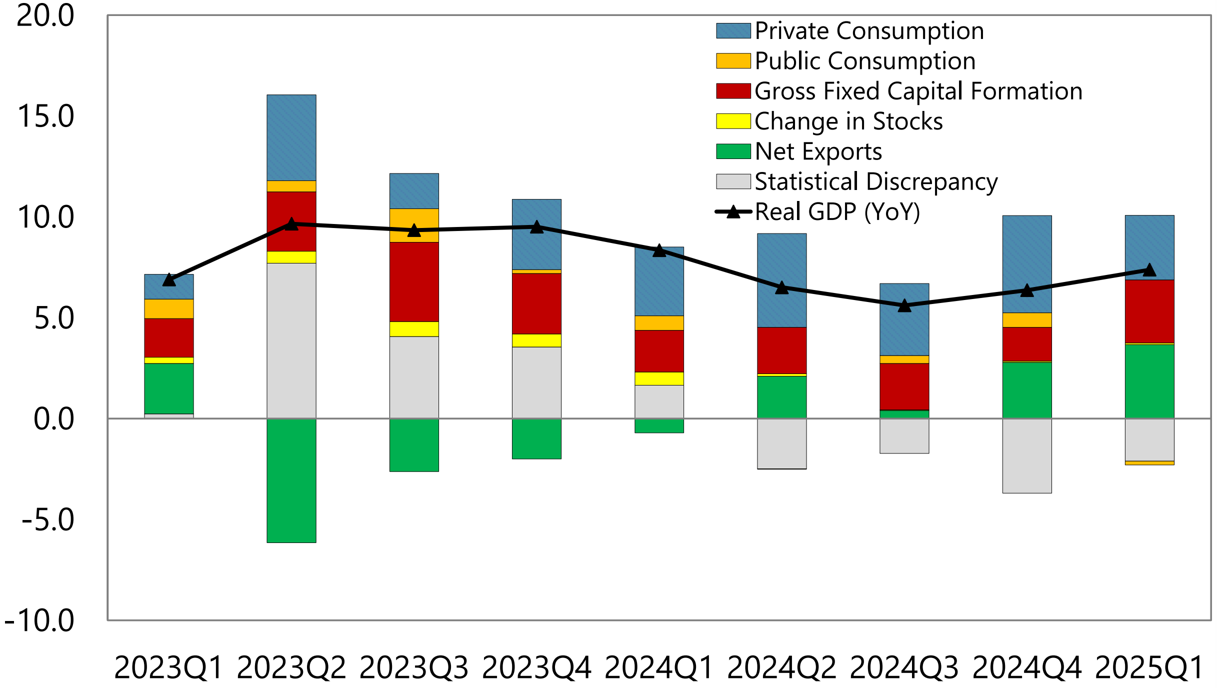
- Strong economic performance provides an **opportunity to advance challenging factor and product market reforms**, particularly to encourage private investment and support the creation of quality jobs

Context

Economy has rebounded as expected...

Contribution to Real GDP Growth

(In percent, year-on-year)



Sources: Haver Analytics; and IMF staff estimates.

Note: Data is presented in calendar year format (e.g. 2024Q3 = Q2 of FY2024/25).

- **Growth** recovered from a temporary slowdown in 2024Q3
- **Private consumption** recovering supported by improved rural demand
- Private corporate **investment** has been less dynamic than expected
- Overall benign **inflation** dynamics, albeit with vegetable price volatility
- Improvement in headline **employment** indicators, but there is room to improve quality of jobs
- Broadly **accommodative financial conditions** despite some tightening

... with risks to the downside

Sources
External risks
Deepening geoeconomic fragmentation
Intensification of regional conflicts
Commodity price volatility

Sources
Domestic risks
Weaker investment and private consumption
Climate and weather-related shocks
Stronger-than-expected acceleration of structural reforms

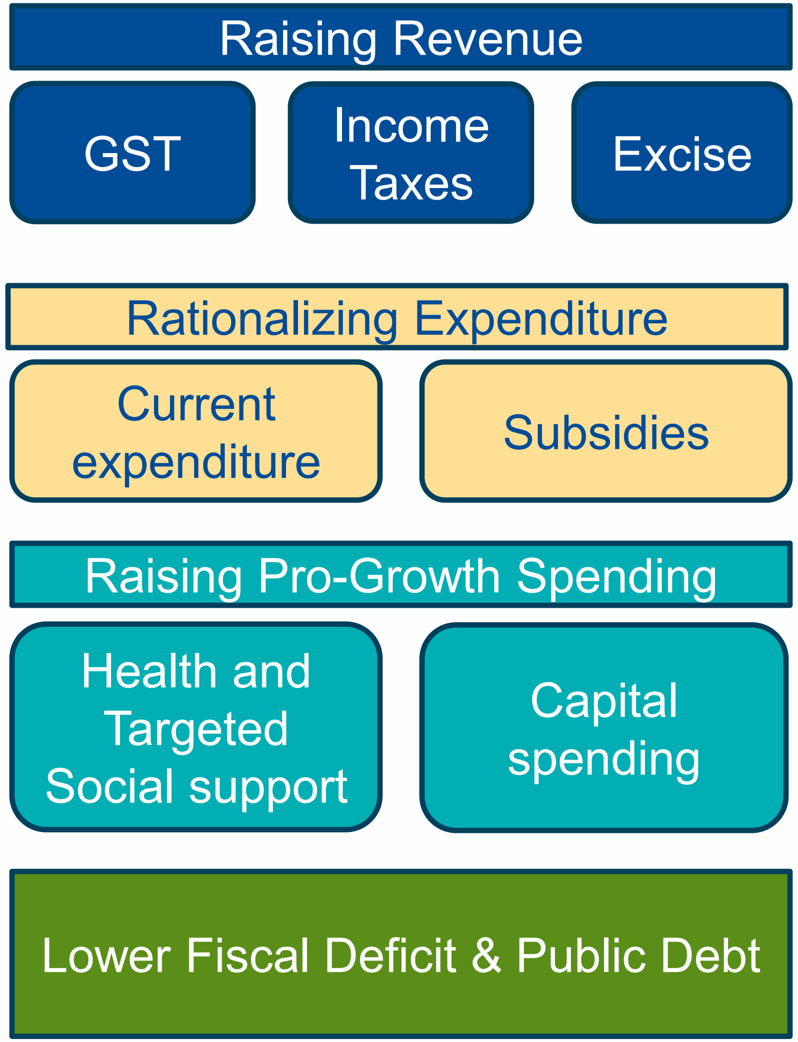
The outlook remains broadly robust despite elevated trade policy uncertainty `

April 2025 WEO: Reference Scenario (26 percent tariff)	FY2024/25	FY2025/26	FY2026/27
Robust real GDP growth (percent)	6.5	6.2	6.3
Declining CPI inflation (percent)	4.7	4.2	4.1
Current account deficit remains narrow (percent of GDP)	0.8	0.9	1.4
Fiscal consolidation broadly continues (general government fiscal balance, percent of GDP)	-7.4	-6.9	-7.2
Public debt gradually declines (percent of GDP)	81.3	80.4	79.6

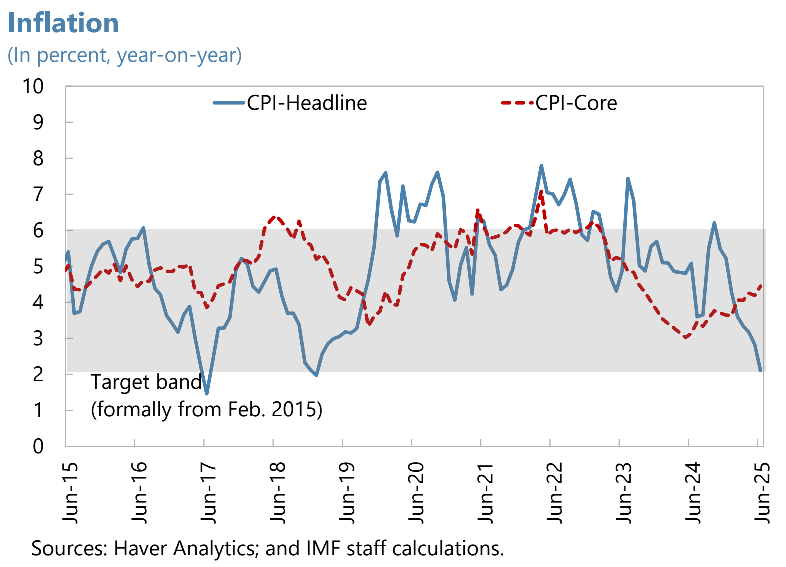
Policy advice

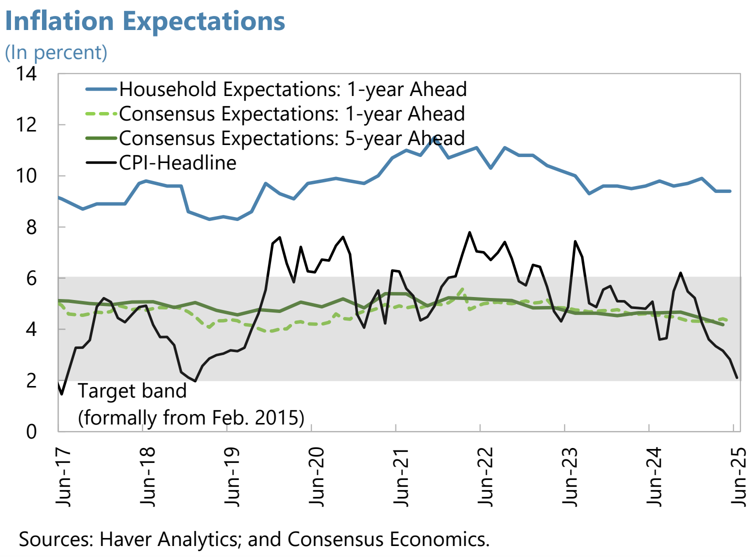
Ambitious fiscal consolidation to rebuild buffers and reduce debt servicing burden

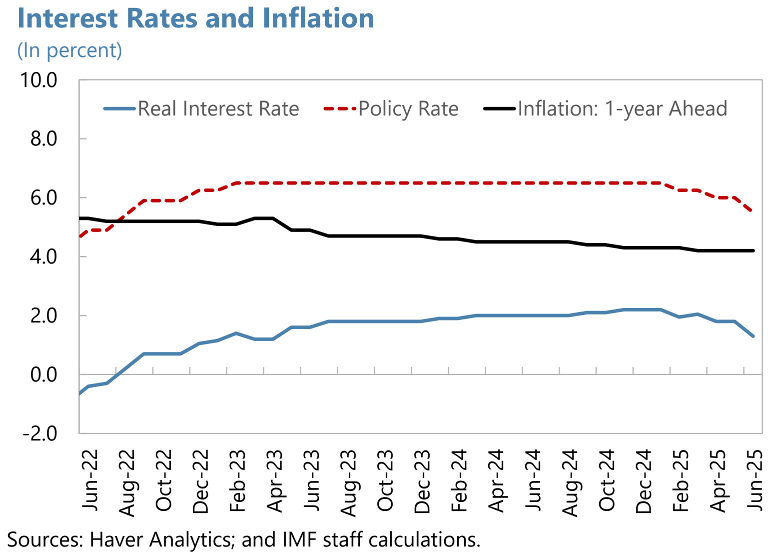
- **The 2025/26 Budget:**
  - **Welcome continued consolidation:** Rationalizing current expenditure
  - Personal income tax reduction: Tax-free threshold: **well above peers**; forgone other expenditure
- **Appropriate to continue consolidation** given a closed output gap and elevated public debt
  - Greater scope to respond to adverse shocks
  - Reduce debt servicing burden; interest payments are currently around 30% of tax revenue
- Development needs are significant and revenue mobilization is below potential → **revenue-based reform**
  - Tax revenue is estimated to be 4 percentage points below potential
  - Creates room for additional spending in priority areas of infrastructure, health and social safety nets
- Short-term **drag on activity** of between 0.1-0.3 percent of GDP, but this is **reversed in the medium term**
  - Debt is below 75 percent of GDP by 2029/30



Room to further cut monetary policy rate if inflation continues to converge to target





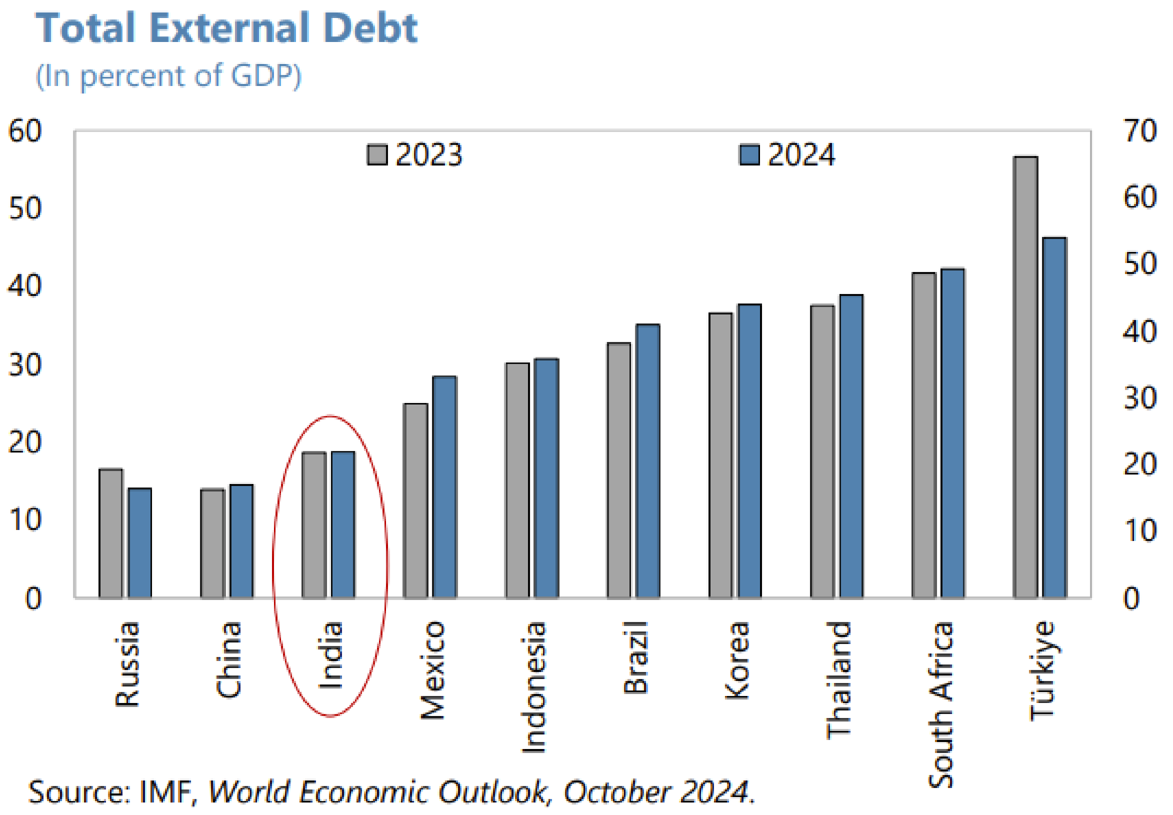


- **Effective** flexible inflation targeting
- Assessment:
  - Welcomed the policy **rate cuts** in February, April and June
  - Stance now broadly neutral

- Recommendation:
  - Scope to **gradually lower** the policy rate if needed
  - Time and pace: **data dependent**
  - Carefully calibrated and clearly communicated.

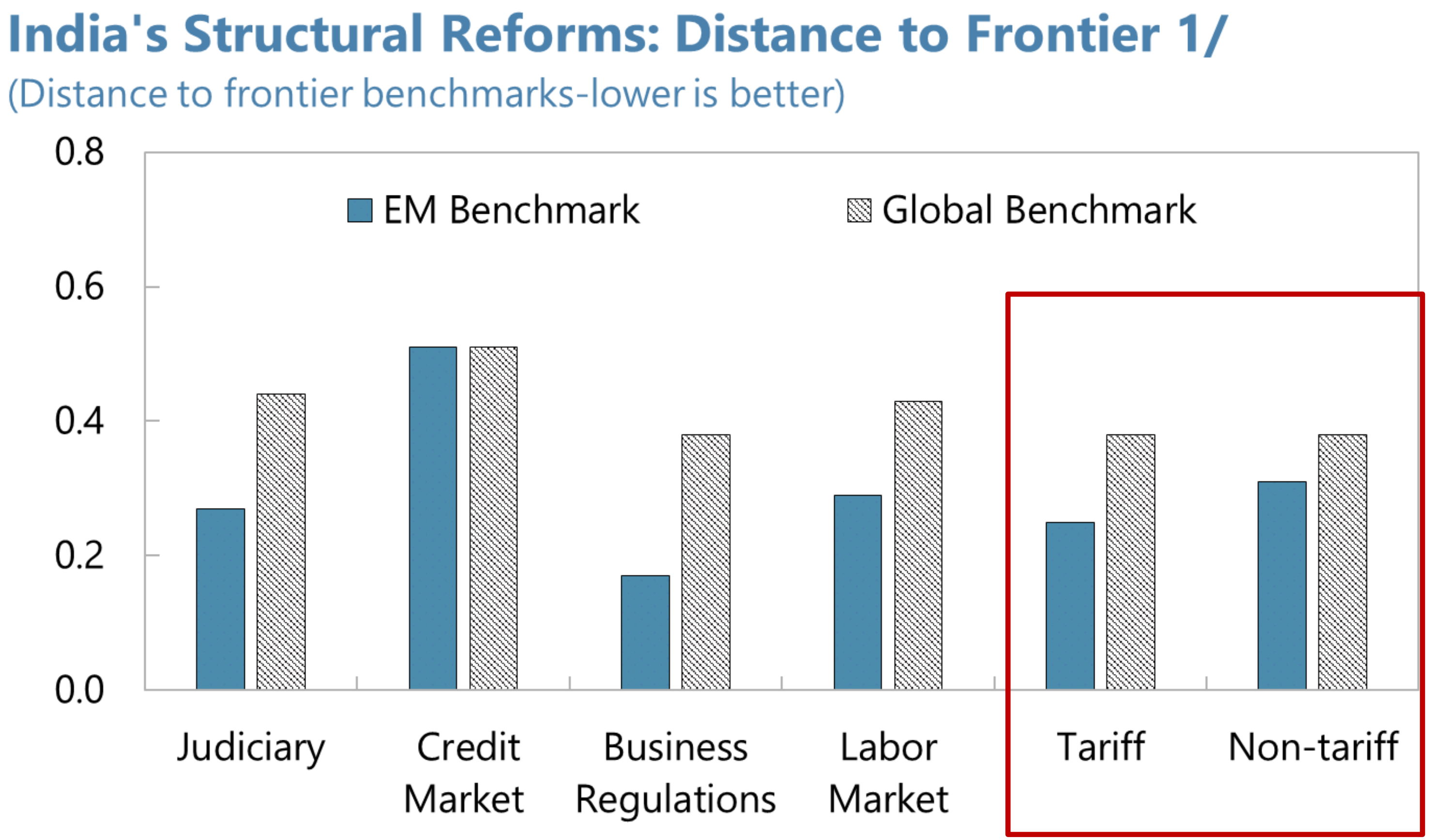
External Debt and Vulnerabilities

India's external debt is relatively low compared to peers



- External debt:
  - ~18.9% of GDP (2024/25 proj.)
  - Short-term debt: ~8.3%
- External vulnerabilities remain low due to:
  - Large reserve buffers
  - Predominantly long-term, low-risk composition

Window of opportunity to address structural issues…



Sources: IMF Structural Reforms in EMDEs Dashboard – version 1.0; and IMF staff calculations.
1/ Distance to frontier is defined as the difference in values between the frontier (best performer) and India. The distance ranges between 0 and 1, where larger values indicate larger distance relative to the frontier.

...through horizontal reforms

Union Government

- Deepen economic integration, including reduction of trade restrictions and continued renegotiation of BITs
- Reduce the public footprint in the financial sector
- Climate mitigation policies to achieve net zero emission by 2070

Reform Payoffs: Short Term to Medium and Long Term

Union and State Governments

- Implement labor codes
- Public investment push, supported by a Public Investment Management Assessment
- R&D spending
- Provide strong policy framework to foster a stable macroeconomic environment in the world of heightened uncertainties
- Streamline business regulations
- Facilitate FDI
- Improve quality of education
- Foster skill development programs
- Promote health and nutrition
- Strengthen judicial system
- Advance agriculture and land reforms
- Remove obstacles for female employment
- Strengthen social safety nets
- Implement climate adaptation policies to strengthen climate resilience

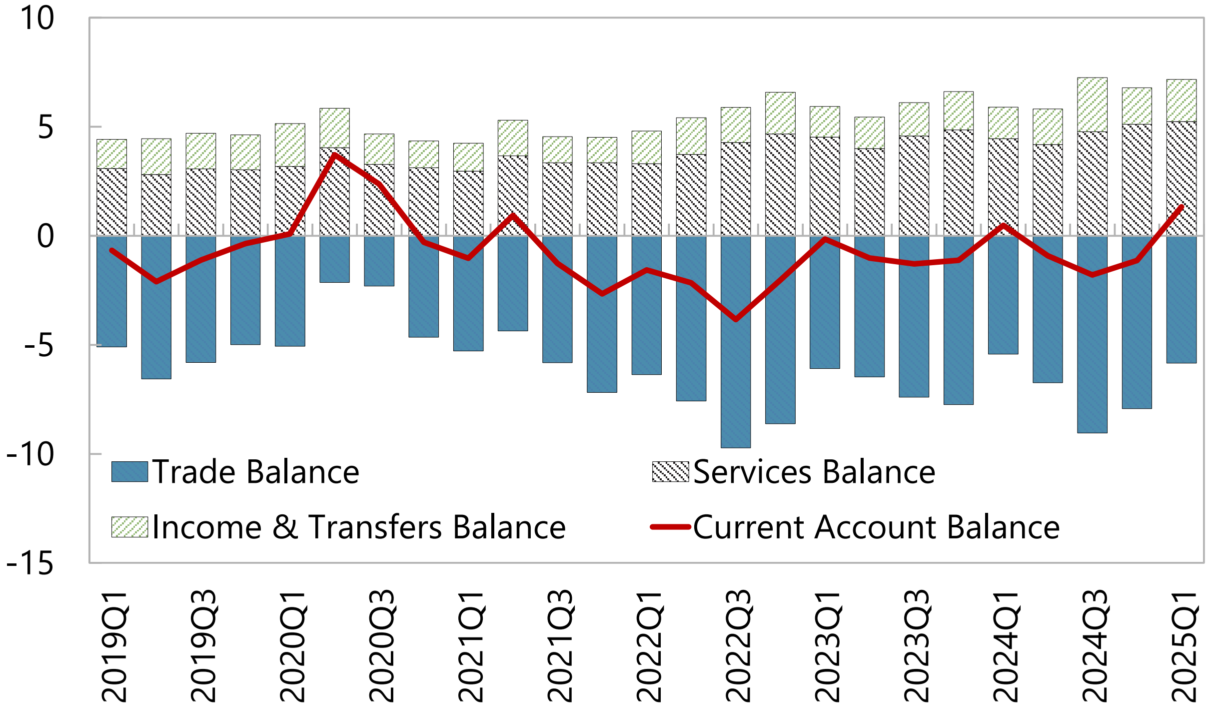
External Sector – A Deep Dive

Current Account Developments

The current account balance has been contained in recent quarters as services exports remained strong and merchandise exports picked up.

Current Account Balance 1/

(In percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.

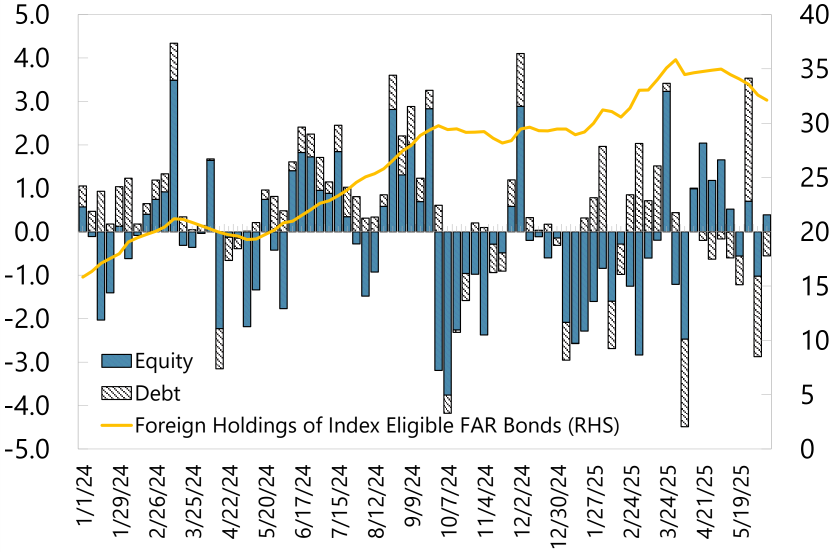
1/ Data is presented in calendar year format, where 2020Q3 = Sep-20.

- FY 2024/25: -0.6% of GDP
- FY 2024/25 (proj.): -0.9% of GDP
- EBA norm: -2.0% of GDP
- Factors:
  - Lower oil prices mitigate the impacts of slower external
  - Strong service exports

Capital Flows and Investment Trends

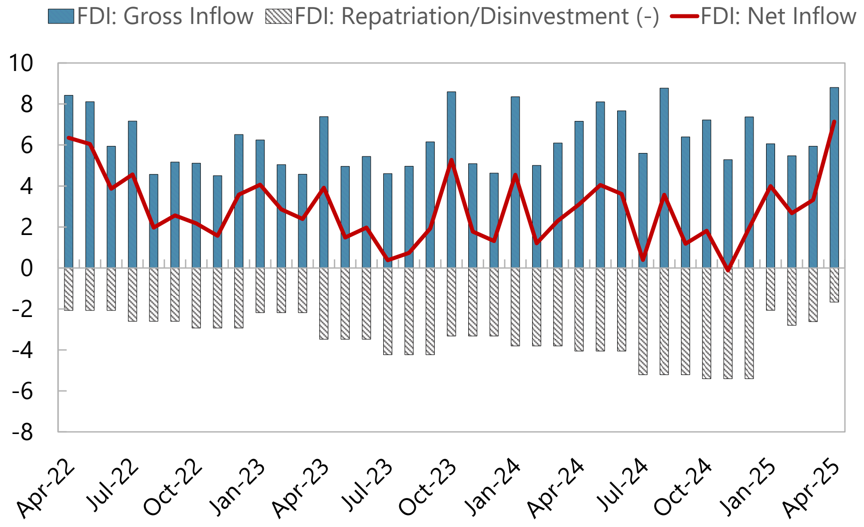
The financial account recorded outflows in recent quarters due to FPI outflows and subdued net FDI, while net inward FDI has shown some signs of recovery as repatriation and disinvestment decreased.

Net Foreign Portfolio Flows
(In USD Billions)



Sources: Haver Analytics; and IMF staff calculations.

Inward FDI
(In USD billion)



Sources: Haver Analytics; and IMF staff calculations.

- Despite India's inclusion into major global bond indices, net FPI inflows decreased to 0.1 percent of GDP in FY25 from 1.2 percent of GDP in FY24
- Key Drivers: Reassessment of the **US monetary policy outlook** and **heightened global trade policy uncertainty**.

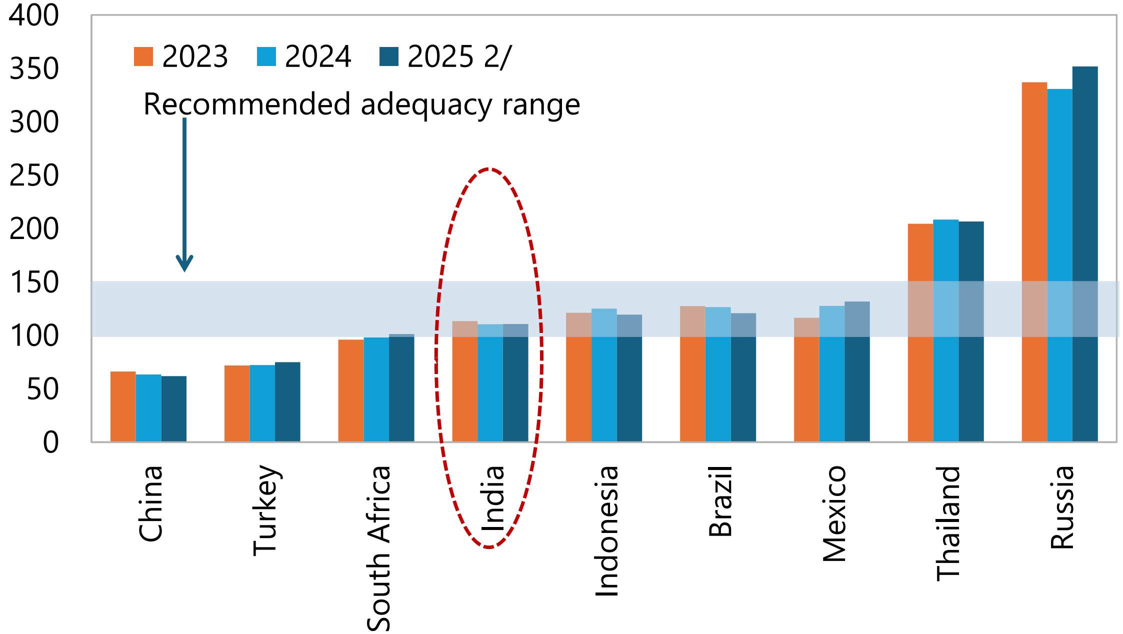
- Net FDI
  - Declined close to zero in FY25
  - Signs of recovery as repatriation and disinvestment slowing down in FY26

Foreign Exchange Reserves

Adequate FX reserves mitigate external vulnerabilities.

Estimated Reserve Adequacy 1/

(Official reserves as a percent of IMF country-specific metric)



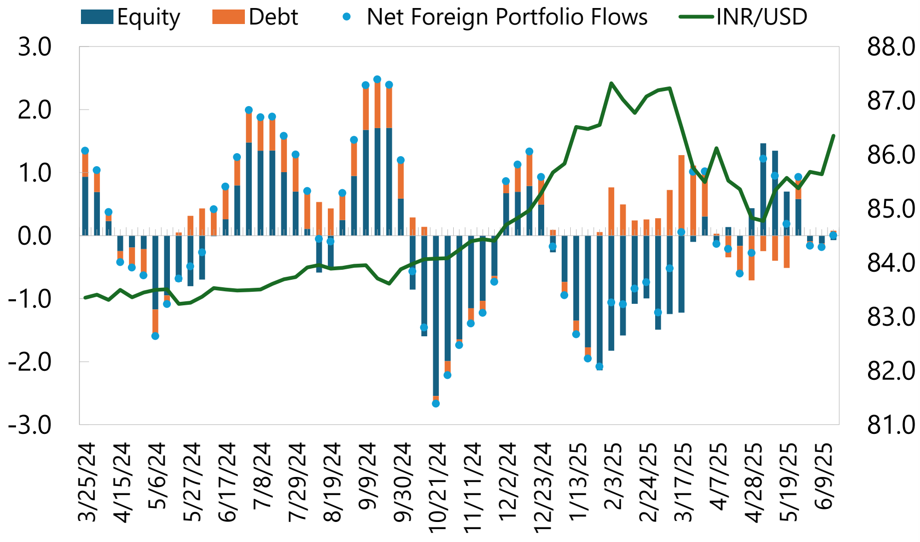
Sources: IMF, *International Financial Statistics*; and IMF staff calculations.
1/ Data is presented in calendar year format.
2/ Estimates for 2025.

- Reserve dynamics:
  - Peaked at ~$706 bn (Sep 2024)
  - Dropped to ~$640 bn (Dec 2024), still above 2023 levels
  - Currently, as of 11 July 2025, at ~$696 bn
- Reserve adequacy:
  - ~8 months of imports
  - >100% of ARA metric

Exchange Rate Assessment

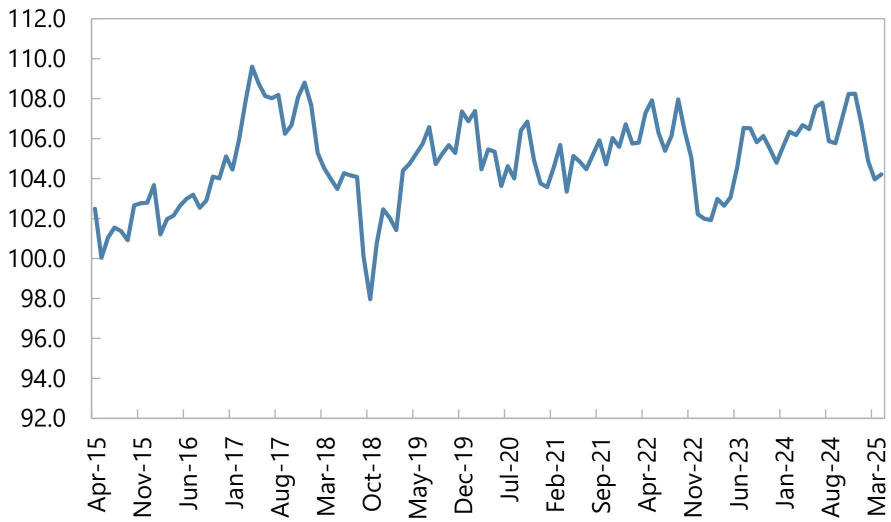
Broadly stable real effective exchange rate

India: Net Foreign Portfolio Flows and Exchange Rate 1/
(LHS: in USD Billions, four-week moving average; RHS: INR/USD)



Sources: Haver Analytics; and IMF staff calculations.
1/ Includes registered Foreign Portfolio Investors.

India: Real Effective Exchange Rate

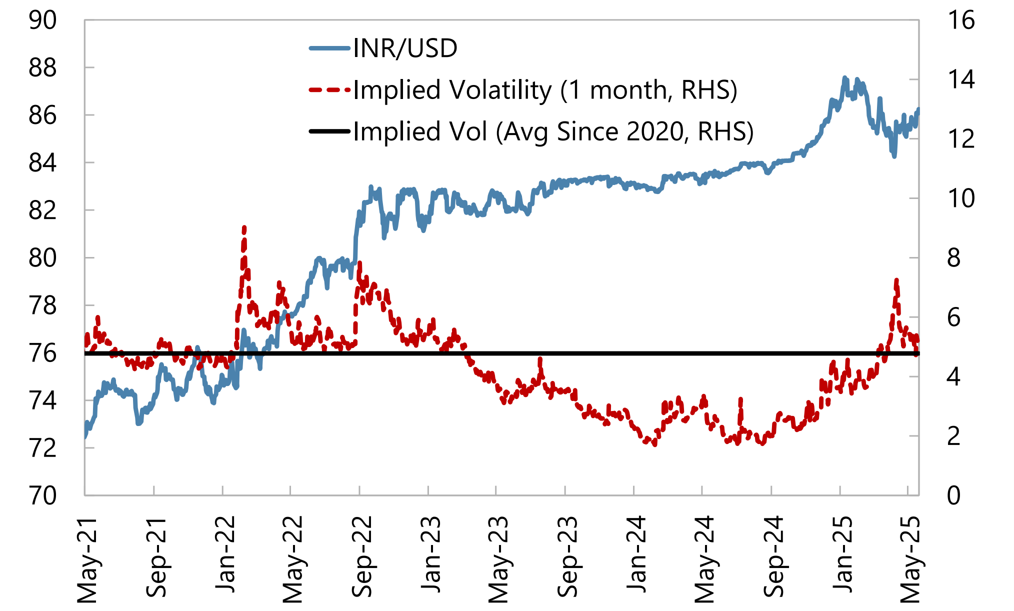


Source: IMF, *Information Notice System*.

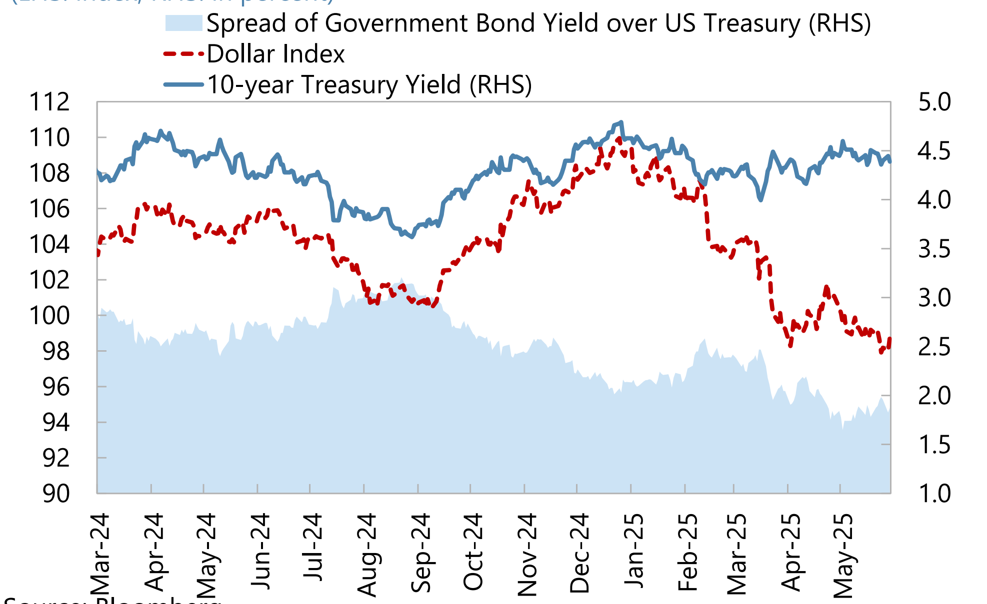
- As of March 2025, the REER was about 2.8 percent below its 2024 average.
- The IMF staff CA gap implies a REER gap of −9 percent

Exchange rate flexibility and spreads

The rupee has experienced more flexibility and higher volatility since November 2024.



Sources: Bloomberg; and IMF staff calculations.



Source: Bloomberg.

- Foster **FX market development**
- Prevent moral hazard by encouraging firms to **actively hedge**
- Reduce the need to hold **precautionary FX reserves**

- The **sovereign spread** over US treasury has **decreased significantly** amid the broad depreciation of the U.S. dollar.

Financial Sector Assessment Program 2024

Analytical Highlight: Financial Sector Assessment Program

Pillar 1: Systemic risk analysis

- Bank
- NBFC
- Mutual fund
- Systemwide
- Climate change

Pillar 2: Oversight

- Banking Supervision
- NBFC Supervision
- Securities Supervision
- Rated ICP assessment
- Cyber risk
- Macroprudential
- AML/CFT (FATF)

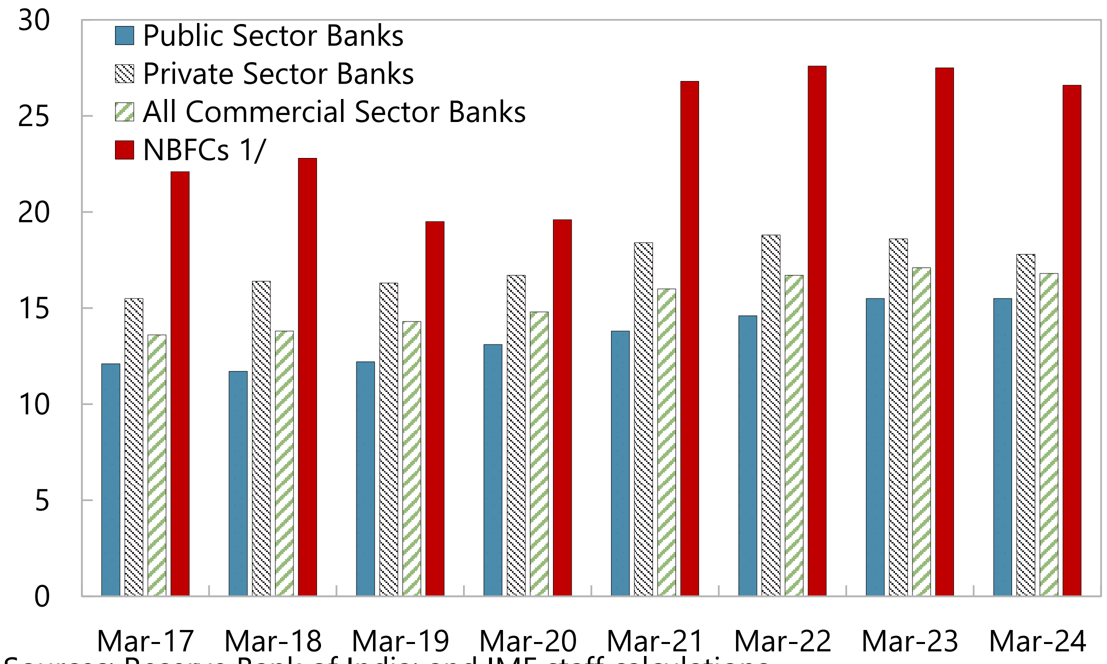
Pillar 3: Crisis management

- 2017 follow up
- + resolution, loss allocation and resolution funding, deposit insurance
- Systemic liquidity, ELA

Financial Sector

Capital Adequacy Ratio of Financial Institutions

(Percent of Risk-Weighted Assets)



Sources: Reserve Bank of India; and IMF staff calculations.

1/ excluding core investment companies

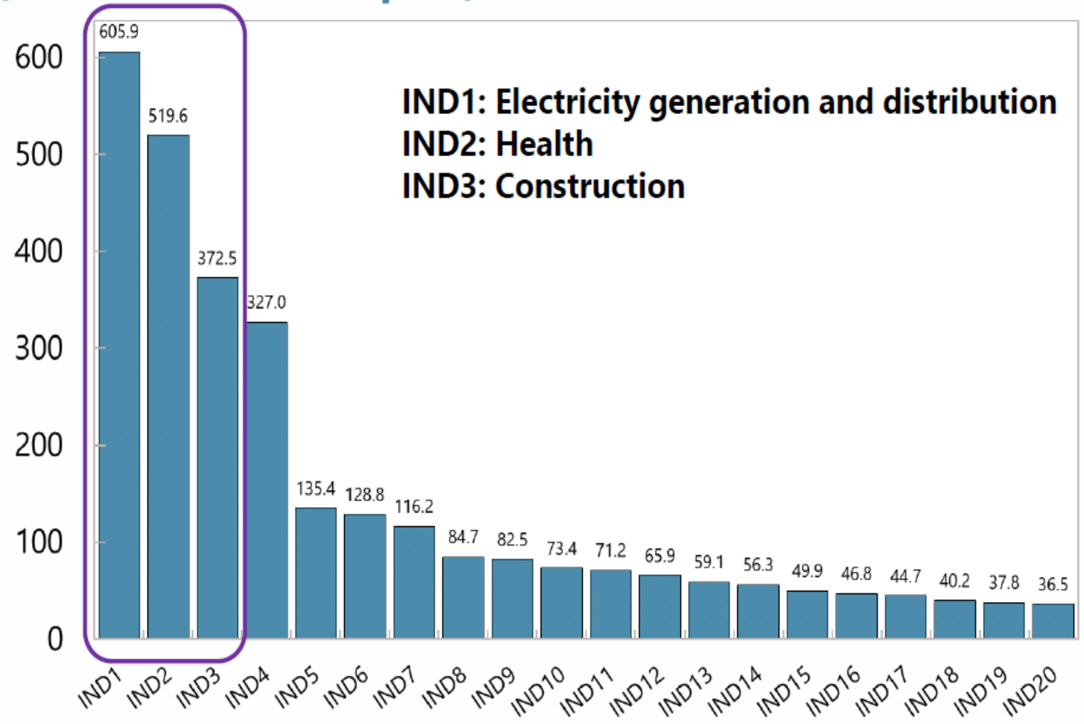
Financial system has become more resilient and diverse

- Stronger asset quality, capital adequacy, provisioning, profitability
- Continued efforts on MSMEs and capital markets should pay dividends

Resilient financial sector: opportunity to address remaining pockets of vulnerability

NBFC credit exposure

(Percent of Tier 1 Capital)



- **Systemic risks remain contained** but need to focus on remaining pockets of vulnerability.
  - Concentration risks among some NBFCs → narrow the regulatory gap between private institutions and PSUs
  - Sustainable unsecured personal lending → borrower-based measures e.g. DSTI
  - Increase PSB capital to build resilience for future downturn
  - Set a releasable CCyB
- **Prioritize financial stability and strengthen oversight**
  - Full independence and discretion for all regulators
  - Expedite IFRS9 adoption, including ECL
- **Strengthen crisis management tools**
  - Bank resolution framework

The average temperature and extreme heat events increased in India

- In addition to increase in the average temperature, climate change also increased the volatility, reducing the frequency of years with average temperatures.

- The warming is unevenly distributed across seasons and regions, with considerably more warming in the pre-monsoon season than in other seasons and larger increase in North Indian than the rest of the country.

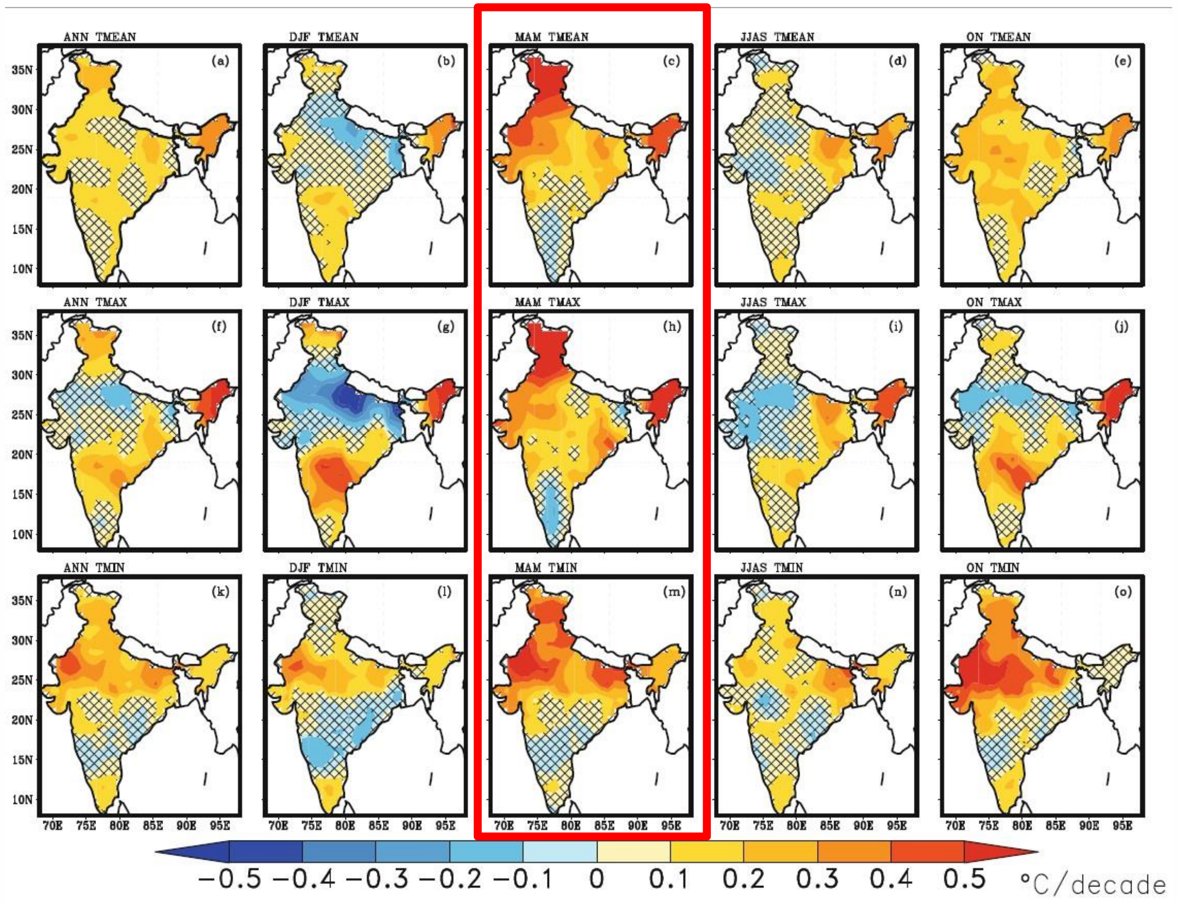


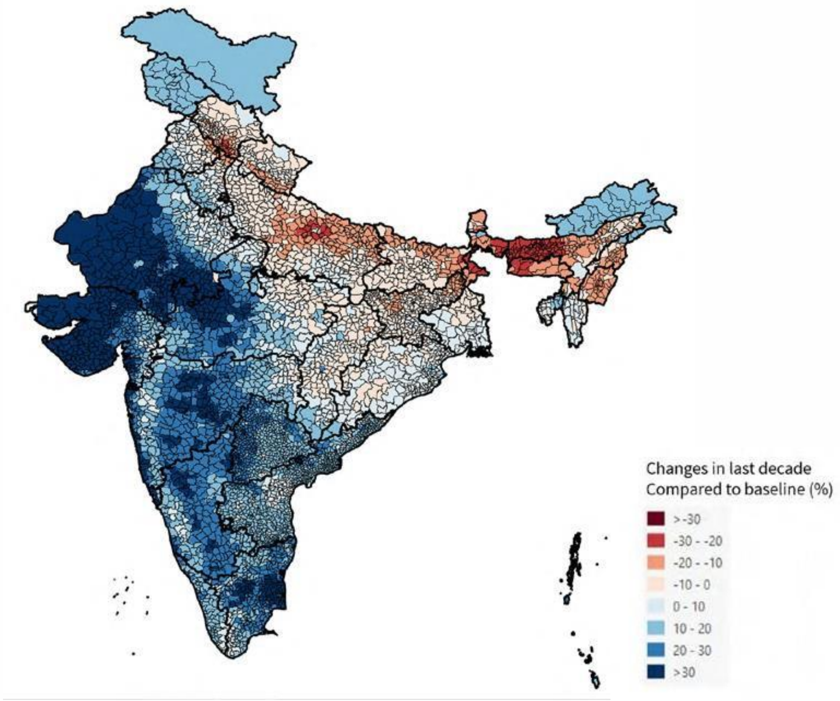
Fig. 2.4 Spatial distribution of observed annual and seasonal trends (°C per decade) for (top panel) mean, (middle panel) maximum and (bottom panel) minimum temperatures in (left to right panels) annual (ANN), winter (December–February, DJF), pre-monsoon (March–May, MAM), monsoon (June–September, JJAS) and post-monsoon (October–November, ON) seasons during the period 1986–2015. The grid boxes are hatched where the trends are insignificant (i.e. a trend of zero lies inside the 95% confidence interval)

Source: Sanjay et al., 2020.

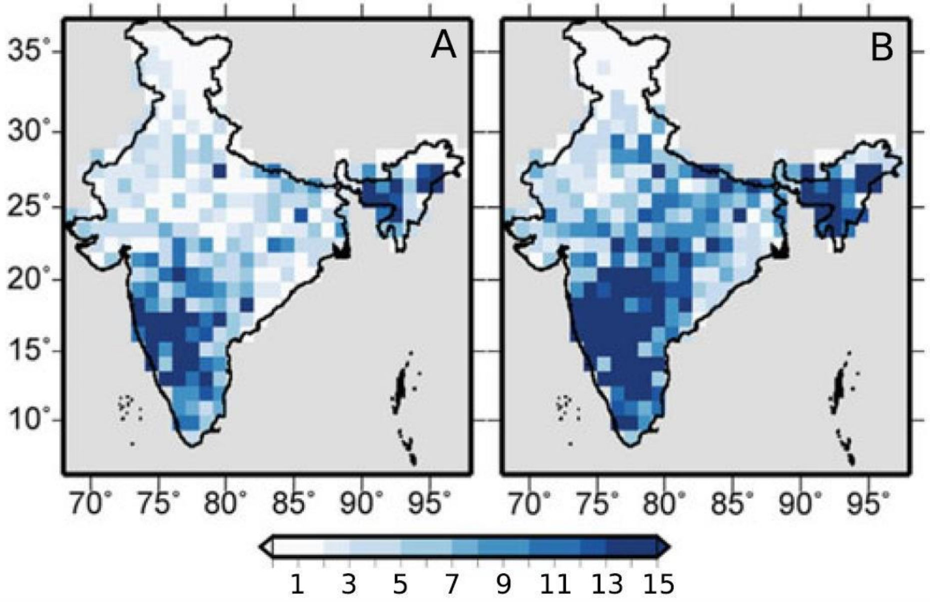
Climate change has altered India’s monsoon patterns

- Climate change has altered India’s monsoon patterns, characterized by decreased overall rainfall, heightened frequency and intensity of extreme rainfall, and an escalating vulnerability to drought.

Changes in summer monsoon rainfall
(percent change in 2012-2022 compared to 1982-2011)



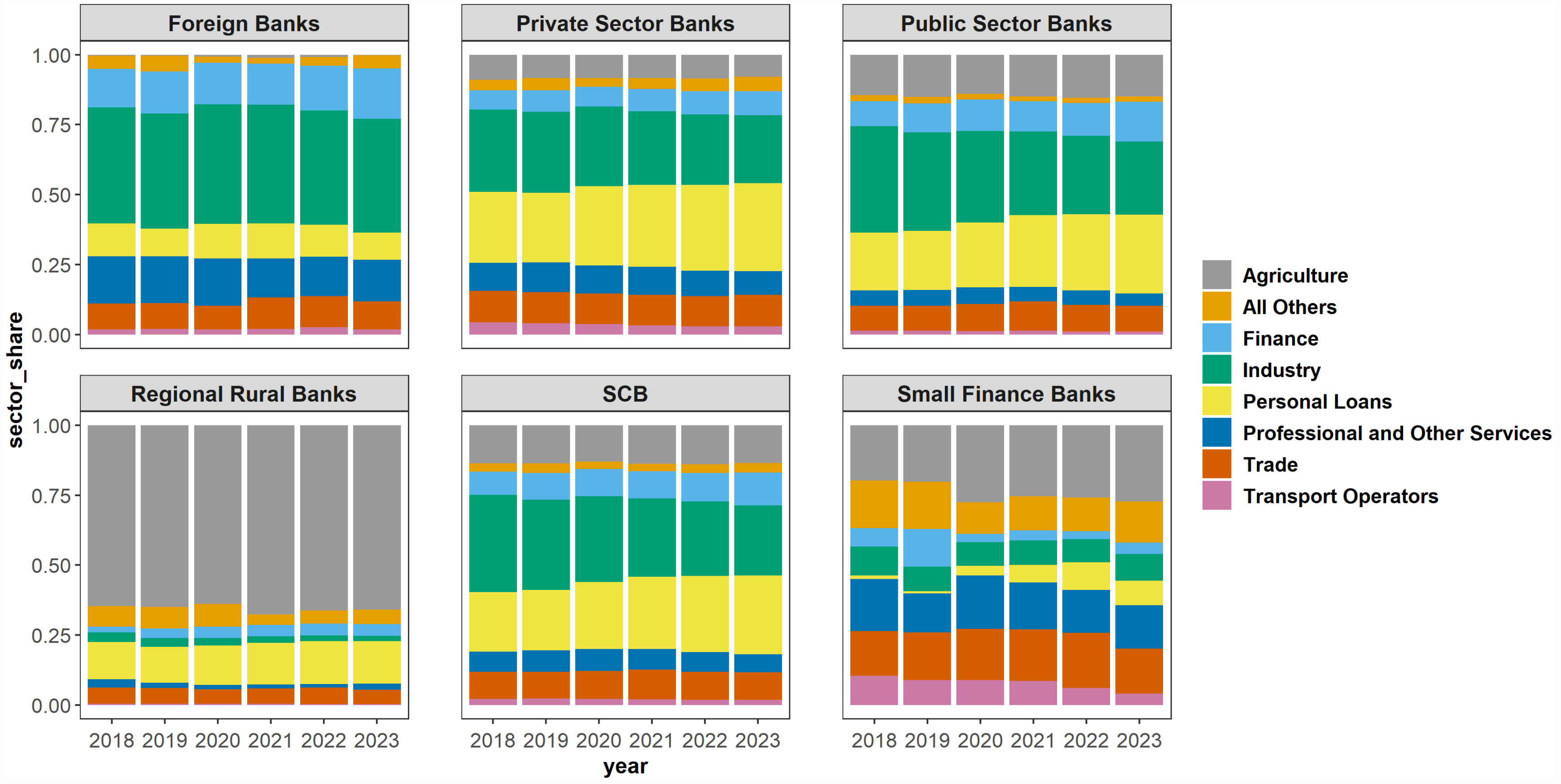
Frequency of Extreme Precipitation Events
(multi-model mean for near future [A] and far future [B])



Sources: Mukherjee et al., 2017; Kulkarni et al., 2020.

The financial system is exposed to the agricultural sector

Agricultural credits account for 13% of total SCB credits.

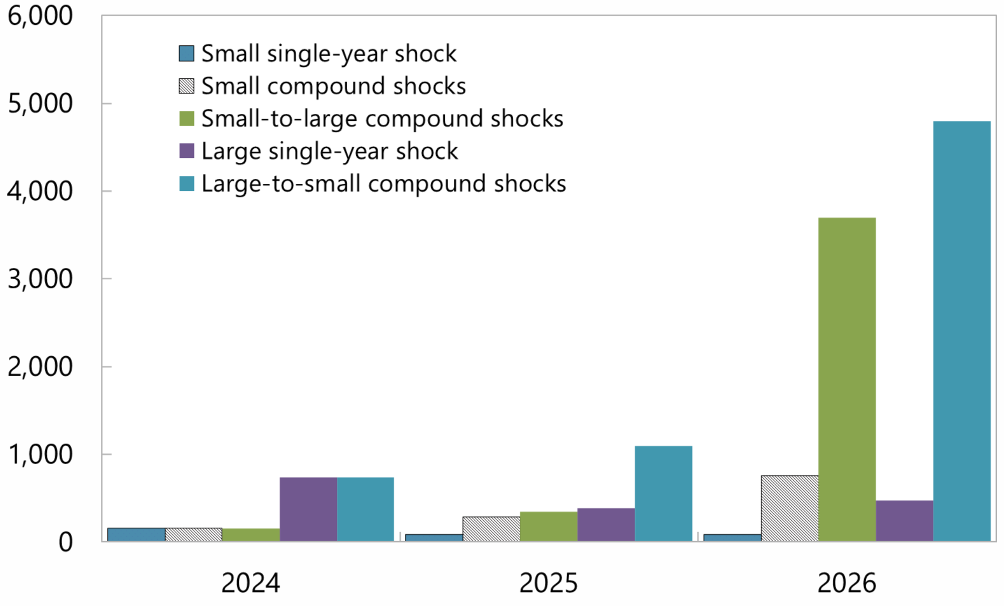


Potential Financial Losses on Agriculture Loans

- The agricultural sector is vulnerable to climate shocks. Although it is resilient to small, single-year climate events, compounding climate shocks—without adequate adaptation and protection measures—can result in cascading effects and significant financial losses.

Annual Expected Losses on Agriculture Loans

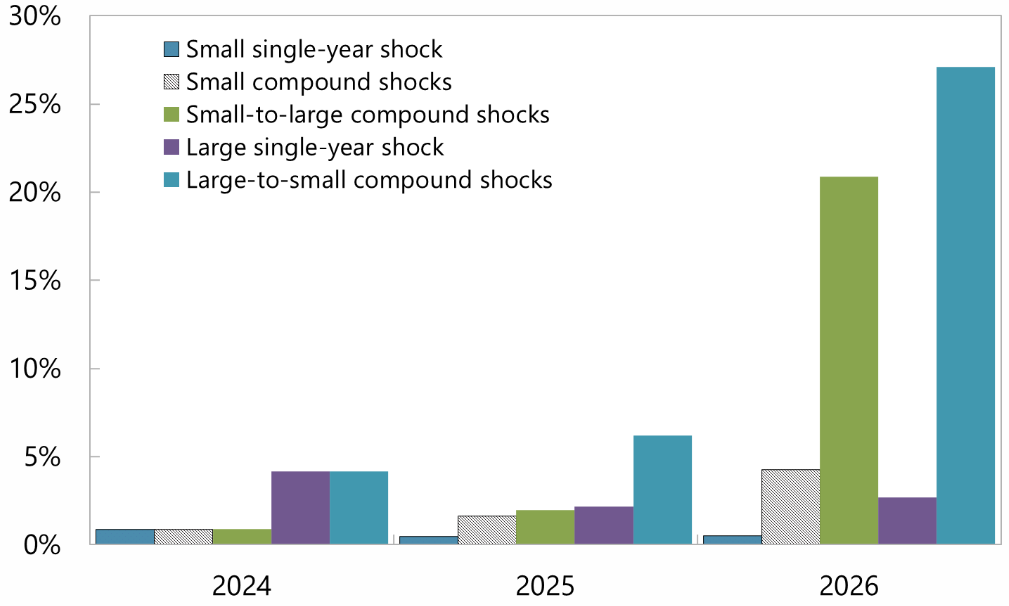
(deviation from baseline, in billion INR)



Source: IMF staff.

Expected Losses due to Climate Change as a Share of Total Agriculture Exposure

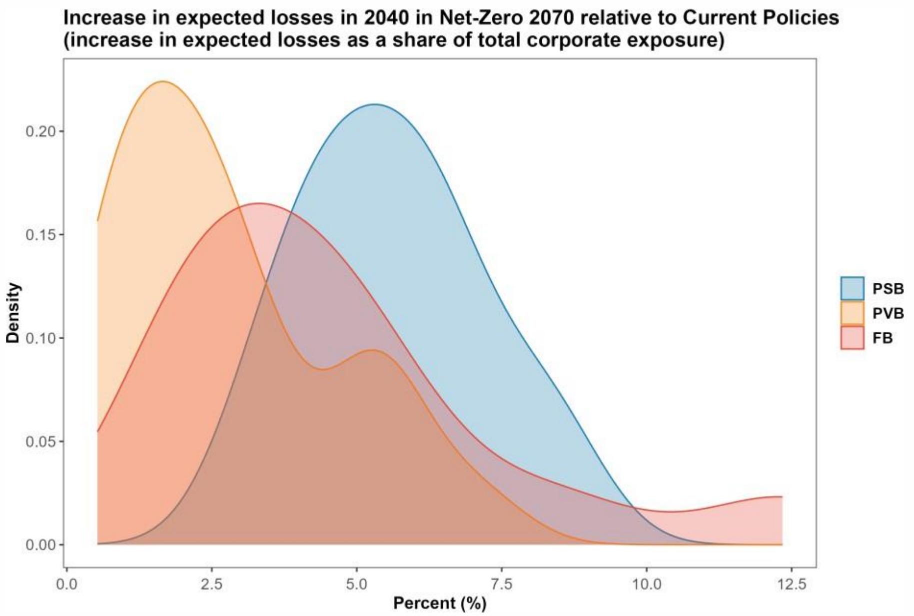
(In percent of total agricultural loans)

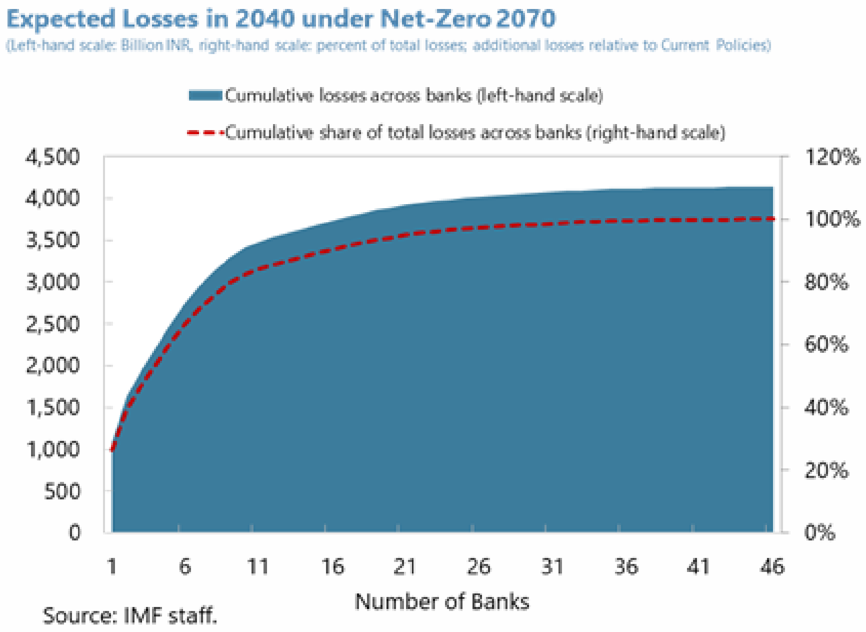


Source: IMF staff.

Transition risks are concentrated in a few banks

- PSBs with greater exposure to carbon-intensive sectors are more vulnerable to transition risks and, on average, face larger increases in expected losses by 2040.
- Expected losses would be considerably higher in the tails and concentrated in a few banks.



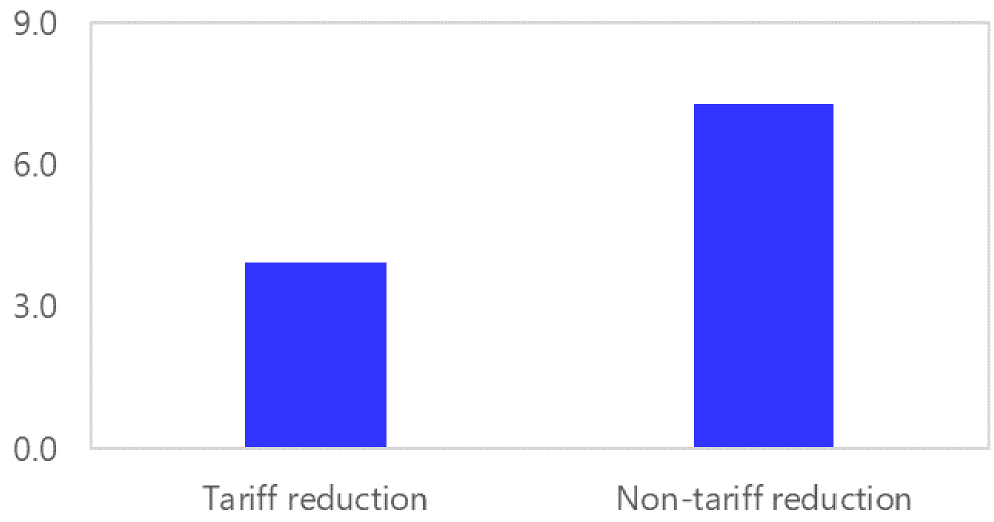


Analytical Highlights

Fostering trade integration and boosting foreign direct investment

- **Good progress on reducing trade barriers and promoting trade integration**
  - Comprehensive tariff reduction and simplifications
  - Bilateral trade agreements: UK, EFTA
- **Continue to prioritize high-quality and deep trade agreements**
  - Ongoing BTA talks: US, EU, New Zealand, Australia, LATAM, etc
  - Regional trade blocs: South Asia, RCEP(?), [CPTPP]
- **Revamp bilateral investment protection treaties (BITs)**
- **Reducing trade barriers could boost FDI**

Medium-term Impacts of Reducing Trade Barriers
(FDI, in percent)

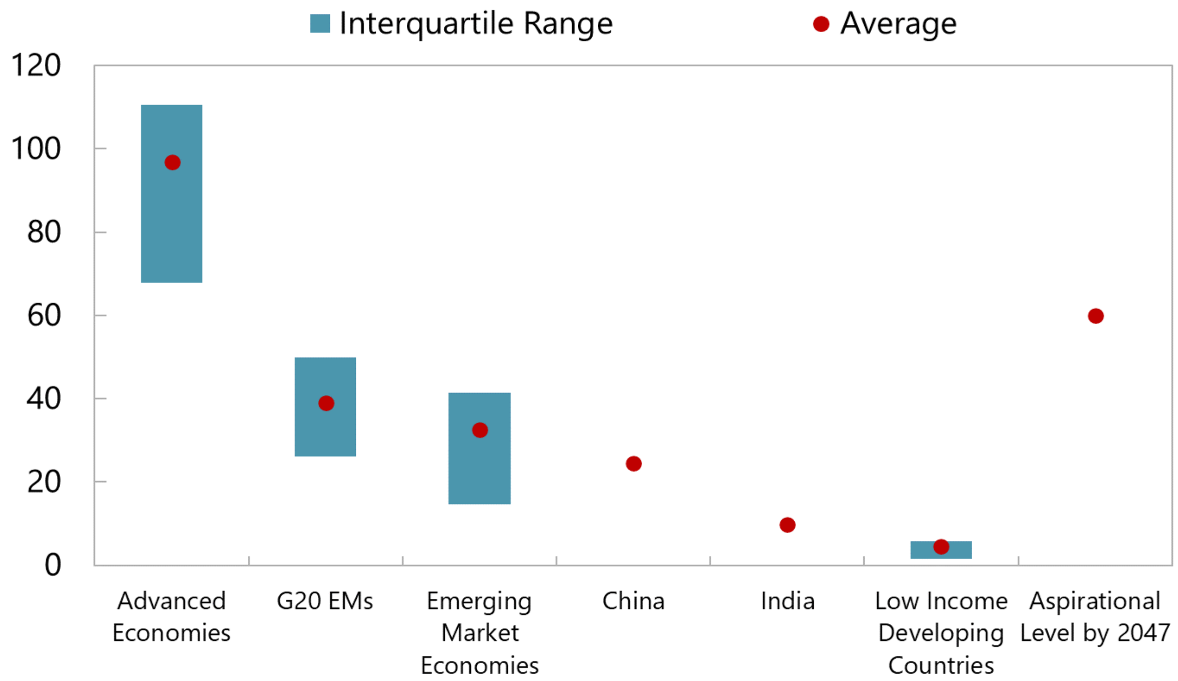


Assume closing 25 percent of reform gaps relative to EM frontiers
*** Medium-term refers to t+3

Reigniting Private Investment in India

Private Capital Stock per Capita

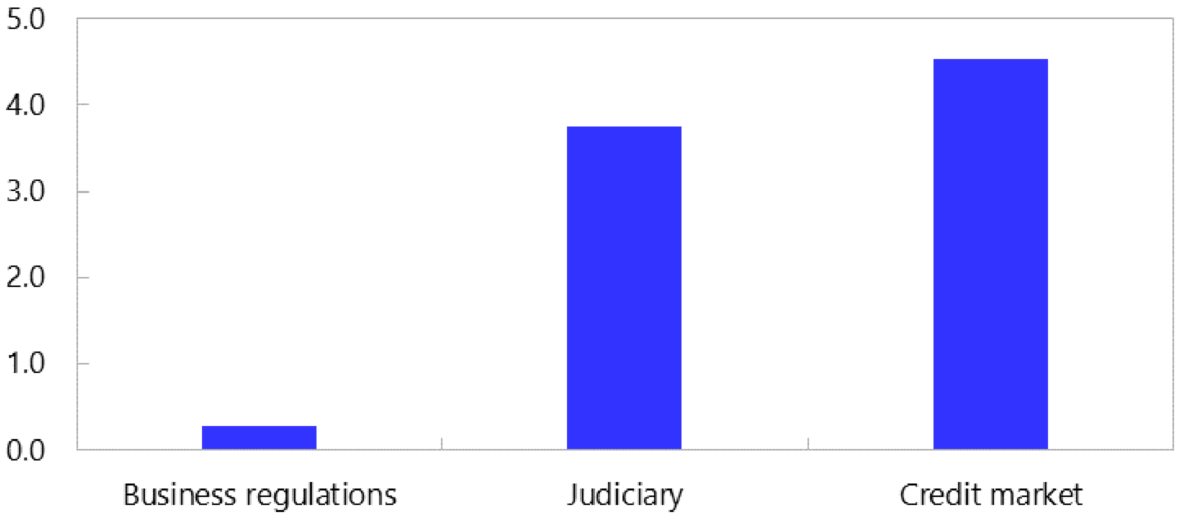
(2019, in thousands of constant 2017 international dollars)



Source: IMF staff estimates based on IMF Investment and Capital Stock Dataset (2021).

Medium-term Impacts of Structural Reforms on Private Investment

(In percent)

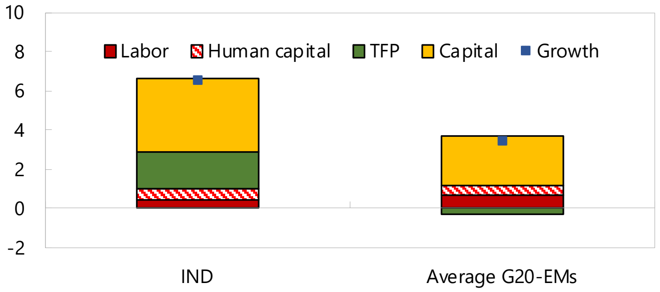


Assume closing 25 percent of reform gaps relative to EM frontiers
*** Medium-term refers to t+3

- Private investment, while relatively high in international comparison, *needs to increase more* to build the capital stock needed for India's economic development.
- *Substantial gains possible* from implementing structural reforms

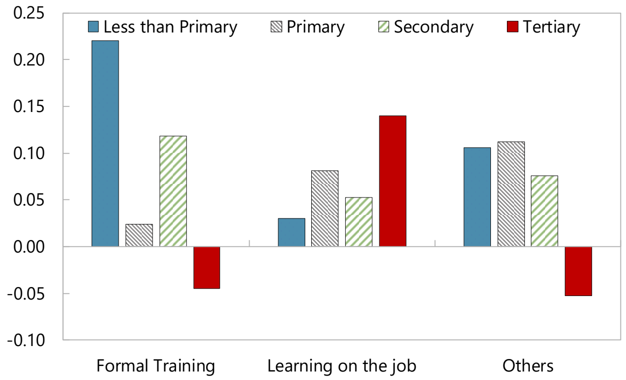
Enhancing the Contribution of Labor to the Economy

India: GDP Growth Decomposition
(Percentage points, average 2010-19)



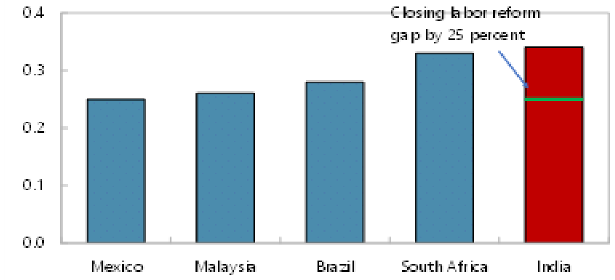
Sources: Penn World Table 10.1; and IMF staff calculations.
Note: China's growth decomposition is based on Muir D. et al (2024), *China's Path to Sustainable and Balanced Growth*, IMF working paper.

Returns to Training: By Level of Education



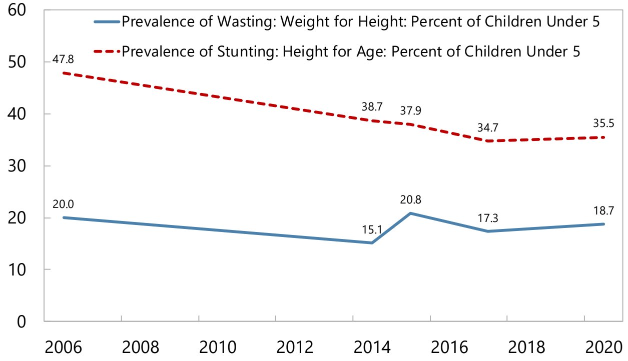
Source: IMF staff estimates based on PLFS.

India: Labor Market Reform: Distance to Frontier 1/
(Distance to frontier benchmarks-lower is better)



Sources: IMF Structural Reforms in EMDEs Dashboard – version 1.0; and IMF staff calculations.
1/ Distance to frontier is defined as the difference in values between the frontier (best performer) and India. The distance ranges between 0 and 1, where larger values indicate larger distance relative to the frontier.

India: Prevalence of Wasting and Stunting in Children



Sources: NFHS 3,4 & 5; Rapid Survey on Children (2013–14) Ministry of Women and Child Development; and Comprehensive National Nutrition Survey, Ministry of Health and Family Welfare (2016–17).

- India's growth has been driven by capital and TFP. *Labor* has contributed relatively less
- There are significant returns to formal *education*
- Formal *training* also has significant returns specially for workers with incomplete primary and secondary education
- Reducing the *labor market reform gap* by 25 percent relative to frontier EMs, could create an additional 44 million jobs by FY2029/30
- *Wasting and stunting* remain prevalent, putting a premium on public health interventions

Thank you!
Questions?