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Economic Round-up: March 2025

Sweeping blanket tariffs announced by US President Donald Trump will have a significant impact on global trade dynamics. Apart from product-wise and targeted (towards Canada, China and Mexico), tariffs, the Trump administration has now announced 10% baseline tariff on all imports with few exceptions. Country-wise tariffs have also been announced, and amongst major EMs of Asia, India has one of the lowest rate of 26%, after Philippines (17%). These measures may lead to some trade realignment, as countries with lower rate (such as India) will have an opportunity to gain market share. In the US, these import duties are expected to have a notable impact on inflation, which the Fed is already worried about. In their last meeting, inflation estimates for CY25 were revised higher to 2.7% from 2.5% predicted earlier. Elsewhere in Europe, manufacturing activity had just begun stabilizing in recent months, but now with 20% import duty on products of European Union, activity is again expected to come under pressure. EU and China have already stated that counter tariff measures will be announced soon on imports from the US. This escalating trade war will have a direct impact on global growth in CY25. In India, to support growth RBI is expected to cut rates by 25bps this week.

Global Central Banks: In Mar'25, in line with market expectations, US Fed, BoE and BoJ held rates steady, while ECB lowered rates by another 25bps. In the Mar'25 meeting, Fed officials also revised their projections for growth lower and inflation higher for both CY25 and CY26. The central bank acknowledge that a part of this could be attributed to the impact of trade war. Now with Trump administration raising tariff rates much more harshly than expected and to highest since 1910, not only US growth, but global growth will also get impacted. As a cushion to deal with the blow, major central banks are expected to cut rates in the meetings ahead. ECB is expected to cut until Jun'25 and then pause from Jul'25 to take a stock of impact of tariffs on inflation. BoE is also expected to cut rates in May'25 meeting. RBI will most likely deliver another 25bps rate cut this week.

Key macro data releases: CPI inflation softened significantly to 3.6% in Feb'25 compared to 4.3% in Jan'25 (BoB est.: 4.1%). Since May'23, it is for the first time that vegetable inflation went into negative territory. This was led by better arrivals of winter harvest, which has supported prices. **Core CPI** (excl. food and fuel) inched up to 4%. Overall, we believe CPI is likely to undershoot RBI's target of 4.4% in Q4 (BoB est.: 3.8%), which will open more policy space for easing by RBI. **INR** depreciated by 2.4% in FY25, after falling by 1.5% in FY24. The depreciation pressure on INR manifested largely after the US elections results. This year, rupee is likely to find support from improvement in growth prospects, lower inflation and stable external deficits. Overall, we expect INR to trade in the range of 85.5-87.5/$ in FY26. We expect **India's 10Y yield** to trade in the range of 6.25-6.75% in FY26, with downward bias. Favourable liquidity conditions, demand from a risk-off biased sentiments and easier monetary conditions by RBI will allow it to trade with a downward bias.

Macro developments

Global growth: Uncertainties persist

As **US** government begins implementing new set of reciprocal tariffs on major economies and on its auto imports, the trade war is further expected to escalate. Tariffs have been announced on all steel and aluminium imports by the US. Further, the Trump administration has announced 10% import duty on all goods being imported and reciprocal tariffs for each country. For imports from India, reciprocal tariff has been set at 26%. Exemptions given by US include: products on which tariffs have already been announced, essential commodities like pharma, lumber, oil, gas, coal, and rare earth minerals and semiconductors. Initially, President Donald Trump started a trade war with levying 25% tariffs on imports from Canada and Mexico and 20% on Chinese goods. This was met with reciprocal tariff announcements by these countries. As Trump administration widens the net of items on which tariffs are applied, risks to inflation have seen notable increase. This is visible in both consumer expectations and Fed's revised projections. US conference board consumer sentiment signals falling confidence levels (-7.2 points to 92.9 in Mar'25) and rising inflation expectations (5.1%—highest since May'23 and up from 4.7% in Feb'25). Even future expectations index dropped to 12-year low of 65.2 (-9.6 points). A reading below indicates impending recession. US central bank in its latest meeting revised inflation estimate for CY25 higher to 2.7% from 2.5% earlier, acknowledging that a "good part" was on account of tariffs. In contrast, real estate sector appears to be making a comeback, with both new home and pending home sales improving in Feb'25. Labour market also appears to be holding ground (revival in job additions and stable jobless claims) so far.

In case of **Europe**, economic conditions have begun to stabilize. Manufacturing PMI for EZ rose to 48.7—26 month high in Mar'25 from 47.6 in Jan'25. In Germany and France too activity contracted at a slower pace in Mar'25. Germany noted an increase in new orders (particularly domestic) for the 1st time since Mar'22. Services activity remained in expansionary zone (50.4 in Mar'25 versus 50.6 in Feb'25). In Germany, pace of expansion slowed (50.2 versus 51.1), while in France the pace of contraction eased (46.6 versus 45.3). Inflation so far continues to follow the disinflationary process with CPI at 2.3% in Feb'25 from 2.5% in Jan'25. As a result, ECB is expected to continue cutting rates aggressively until Jun'25 but is expected to pause in Jul'25. By then, the possible impact of Germany's expansionary fiscal policy will also be clear. Higher spending on infrastructure and defence is expected to boost growth.

China's official manufacturing PMI index inched up in Mar'25 to 50.5 (highest since Mar'24) from 50.2 in Feb'25, supported by rebound in domestic new orders. Private survey (Caixin/S&P) of smaller and medium sized companies also noted improvement, as the manufacturing PMI index rose to 51.2 in Mar'25 from 50.8 in Feb'25, reflecting higher demand of Chinese goods on ahead of escalating trade war between US and China. However, employment continued to decline and deflationary pressures remain. China's industrial production also rose by 5.9% in Jan-Feb'25 period versus est.: 5.3%, but was slower than 6.3% increase in Dec'24. Also, as importers bargained for lower prices, industrial profits of the Chinese companies got impacted and were down by (-) 0.3% from 11% in Dec'24. Domestic demand was steady as retail sales rose by 4% in Jan-Feb'25 following 3.7% rise in Dec'24.

India’s growth maintains momentum in Q4

India’s GDP growth softened to 6.2% in Q3FY25, following 9.5% growth in Q3FY24. GVA registered a growth 6.2% in Q3FY25 in line with our expectation compared with a growth of 8.0% in Q3FY24. Tepid growth was noted in manufacturing (3.5% from 14%) and mining (1.4% against 4.7%), which was expected given only gradual improvement in corporate profits. Growth in trade, hotels (6.7% from 8%) and financial sector (7.2% from 8.4% in Q3FY24) also softened in Q3FY25.

In Q4, mixed signals of growth are visible. Indicators which are showing an improvement include: GST collections (average Rs 1.92 lakh cr in Q4 versus Rs 1.82 lakh cr last year, e-way bill generation (18.9% in Jan-Feb’25 versus 17.6% in Jan-Feb’24 and 16.9% in Q3FY25) and toll collections (average 17.2% growth in Q4FY25 versus 14% in Q3FY25). On the other hand, indicators like air passenger traffic, vehicle registrations, cooled down in Q4 versus Q3. However, we see an upside bias to GDP growth in Q4FY25 supported by domestic consumption demand.

Central bank actions

RBI MPC lowered the repo rate by 25bps from 6.5% to 6.25% in its Feb’25 meeting. Stance was kept at neutral. Now in the upcoming policy meet (Apr’25), the central bank is expected to cut rates by another 25bps. Since the last meeting, inflation has come under control, which gives RBI more room to adopt for “less restrictive” monetary policy, and also support growth. The central bank expects growth to improve in FY26 to 6.7% from 6.4% in FY25. Inflation is projected to come down to 4.2% in FY26 from 4.8% in FY25. CPI will remain broadly sticky in Q4FY25 (4.4%) and Q1FY26 (4.5%). We also expect the stance to be changed to “accommodative” and some revision to GDP forecasts. We have priced in 75bps (cumulative) reduction in rates in this cycle.

US Fed in its Mar’25 meeting decided to keep policy rates on hold at 4.25-4.50%. This decision was driven by steadiness in labour market, overall strength of the economy and pressure build up on prices. The central bank also revised its GDP and inflation projections. The Fed now expects GDP growth to slow down to 1.7% in CY25 from 2.1% estimated earlier (Dec’24). Even next year (CY26), momentum will be slower (1.8%) than what was anticipated earlier (2%). On the other hand, inflation is now expected to be firmer (2.7%) than expected (2.5%) in CY25 and CY26 (2.2% versus 2.1%). The FOMC statement acknowledged that “uncertainty around the economic outlook has increased”, given the current trade war situation. For a “good part” this was also responsible for upward revision of the inflation numbers. The dot plot now indicates 2 rate cuts in CY25.

Bank of England (BoE), in line with market expectations, held rates unchanged at 4.5% in its Mar’25 meeting, after reducing it by 25bps in the Feb’25 meeting. This decision was approved by 8-1 vote versus expected 7-2 vote majority, thus highlighting that more members are cautious given the heightened uncertainty around global trade war. The central bank also revised its peak inflation projection marginally upward to 3.75% in Q3CY25, up from 3.7% expected earlier. Tax hike proposal for employers is expected to impact services inflation. Despite this, growth projections were revised upward to 0.25% for Q1Y25 from 0.1% earlier. Currently, as inflation has begun slowing, analysts expect 55% chance of a rate cut by BoE in May’25 meeting.

ECB, lowered rates further by 25bps in its Mar’25 meeting, bringing the deposit rate to 2.5% from 2.75% earlier (Jan’25). In the latest meeting, setting the stage for a pause, the central bank stated that the “monetary policy is becoming meaningfully less restrictive”. Disinflationary process remains on track, but upside risks remain on account of impact of global trade war led by the US. Analysts thus expect 2more rate cuts (Apr’25 and Jun’25) and then a pause by ECB in Jul’25 meeting.

BoJ raised its policy rate by 25bps, with a split 8-1 vote in Jan'25. The short-term policy rate currently stands at 0.5% (highest in 17 years), up from 0.25%. Guidance remained the same. In its Mar'25 meeting, these rates and guidance were left unchanged. Recently released minutes for Jan'25 meeting show that central bank Governor Ueda also cautioned that stronger wage growth and food cost burden could push inflation higher. Now given the latest inflation numbers (higher than expected Tokyo CPI print for Mar'25), analysts expect that BoJ rate hike could get preponed to May'25 meeting from Jun/Jul'25 meeting.

Data Releases

Bonds Wrap

India's 10Y yield headed southwards in a steady manner throughout FY25. The narrative started with sharp fall in US 10Y yield at the beginning of FY25, with front-loading of rate cut by Fed far ahead of the RBI cycle. The second important driver of domestic yield has been the India's phased increase in weight in global bond index which has garnered significant FPI flows especially through the FAR route, which has favoured India's yield. Other factors such as buoyant demand conditions, especially from Banks, MFs and PFs have also supported yields especially in an environment where system liquidity remained tight. Government's finely tuned borrowing program with more supply of securities towards the short end speaks of keeping the long part of India's yield curve broadly stable. Further, even the continuous adherence to the fiscal roadmap has also boosted investor confidence. In FY26 we remain bullish on yield. We expect India's 10Y yield to trade in the range of 6.25-6.75% in FY26, with downward bias. Favourable liquidity conditions, demand from a risk-off biased sentiments and easier monetary conditions by RBI will allow it to trade with a downward bias.

Currency update

INR depreciated by 2.4% in FY25, after falling by 1.5% in FY24. The depreciation pressure on INR manifested largely after the US elections results, with the domestic currency falling by close to 4% in a span of 4-months. This was also exacerbated by persistent FPI outflows, particularly from the domestic equity markets. Despite this, INR's performance when compared with other global currencies was relatively stable, with a stronger dollar weighing on all major currency pairs. However, towards the end of the year, a reversal in dollar strength and FPI inflows into debt, supported a rally in INR, with the domestic currency recouping as much as 2.4% in a single-month alone. The coming year is likely to be marked by a period of volatility awaiting clarity on US tariff policies. This will also set the stage for the Fed's rate actions, in turn affecting how the dollar behaves. On the domestic front, INR is likely to find support from improvement in growth prospects, lower inflation and stable external deficits. Overall, we expect INR to trade in the range of 85.5-87.5/$ in FY26.

India-US rate differentials in FY25

Policy rate differential between India and US widened in FY25. This was on account of steeper rate cut cycle by Fed till now, compared to RBI. On the other hand, RBI's rate cut cycle came much later as inflation was the major barrier. Going ahead as well, we expect policy rate differential between India and the US to show some upward bias but the extent would dependent on underlying geopolitical dynamics and its impact on future monetary policy decisions. Yield differential in an ideal situation should mirror policy rate differential. However, the similar was not observed in FY25. Yield differential between India and US softened in contrast to stiffening of policy differential between India and US. This was on account of firmness in US 10Y yield due to expectation of higher inflation. However, we expect some firmness in India and US yield differential since risk off sentiment will keep US 10Y yield capped to some extent. For India, the benchmark yield had largely been range-bound. The higher yield differential between India and US in the near term will be supportive of FPI flows and hence is expected to provide currency some support. Inflation differential will also be tilted in favour of India as domestic food prices are largely contained. This will give RBI further headroom for more policy space to support growth.

Commodity price movement in FY25

In the last financial year (Apr'24-Mar'25), it was interesting to see that while metal prices noted some significant increases, energy prices remained muted and agriculture products showed mixed trends. Edible oil prices increased steeply, but prices of rice and wheat remained low. Amongst major metals, gold rose the most and more sharply in H2FY25 (Oct'24-Mar'25), as US Presidential election results increased global growth uncertainties significantly. As President Donald Trump made his intentions clear to levy tariffs on US imports, traders front-loaded their demand to evade the initial impact of tariffs, thus leading to higher demand for metals like aluminium, zinc, and copper. However, the increase has remained range bound as China's economy continues to struggle. Gold prices have flourished in the times of increased economic uncertainties. Agriculture products, particularly oil prices, have been impacted by adverse weather conditions and shift in production towards biodiesel fuels in Indonesia. In contrast, robust production of wheat, rice and cotton led to their prices declining in FY25. Going forward, as uncertainty regarding the trade war and its impact on economic activity is likely to persist for some time, gold prices are expected to remain elevated. However, other metal prices will note some headwinds in in case demand weakens. Pressure on edible oil production is likely to continue this year which will keep their prices higher some time.

WPI inflation ticks higher

WPI inflation rose a tad to 2.4% in Feb'25 from 2.3% in Jan'25, led by slower pace of contraction in fuel and power inflation and pick up in manufactured product inflation. On the other hand, food inflation moderated further. As a result, core inflation rose to 1.3% from 0.9%. Food inflation softened to 5.9% in Feb'25, helped by largely broad-based slowdown. Vegetable inflation index eased the most, followed by food-grain inflation and inflation of protein-based items (milk, eggs meat and fish). Amongst vegetables, tomato and potato prices registered a decline, while that of onions are showing some build up. Within fuel, mineral oil and electricity indices decelerated at a much slower pace, even as international oil prices fell, thus reflecting the impact of pressure on domestic currency. Within manufactured products, food, basic metals (mainly aluminium and copper) and equipment (electrical/machinery/ transport) led inflation higher. Going forward, as trade war deepens further and uncertainty around Fed rate cut looms, volatility in market is expected to remain. Commodity prices are seeing some build up in pressure as demand rose ahead of tariff implementation dates.

Food: A sigh of relief

CPI inflation softened significantly to 3.6% in Feb'25 compared to 4.3% in Jan'25 (BoB est.: 4.1%). 6 out of 12 broad categories of food showed softening. Among them, the slowing down of vegetable inflation was noteworthy. Since May'23, it is for the first time that the YoY series of vegetable inflation went into negative territory. It declined by -1.1% in Feb'25 compared to 11.3% in Jan'25. This is led by better arrivals of winter harvest, which has supported prices. Apart from this inflation of protein-based items, also softened. Meat and fish inflation edged down. Eggs inflation went into negative territory. Core CPI (excl. food and fuel) inched up to 4%, on YoY basis. The major push came from miscellaneous items. Within this, personal care and effects rose by 13.6% from 10.6%, driven by higher international gold prices housing. Some momentum was visible in case of health and transport and communication. Overall, we believe CPI is likely to undershoot RBI's target of 4.4% in Q4 (BoB Best.: 3.8%), which will open more policy space for easing by RBI. We do not see major risks lurking for food inflation.

Industrial production growth accelerates

IIP growth rose to 5% in Jan'25 compared with a growth of 4.2% in Jan'24. This was much higher than our estimate of 3% increase. The improvement was led by manufacturing sector which expanded to 5.5% in Jan'25 (3.6% in Jan'24). Mining sector growth decelerated to 4.4% against a growth of 6.6% last year. Electricity output also moderated down to 2.4% (3-month low) compared with a growth of 5.6% in Jan'24. On a FYTD basis, IIP growth eased to 4.2% (6% growth last year) and registered much slower growth across the board. Mining and manufacturing growth eased down to 3.4% (from 8.3%) and 4.2% (5.5% last year) respectively in FYTD'25. Even electricity growth turned out to be slower at 5.1% against 6.8% growth noted last year for the same period. Going forward, Industrial production is expected to grow at a stronger pace in Q4 with support from government capex which is expected to pick up further pace. RBI tinkering with policy rates will also bodes well for the economy. However, there are downside risk pertaining to the external sector amidst the enveloping threat of tariff war.

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