SOCIO-ECONOMIC VOICES

"Economic Resilience in India Needs Tough Measures to Overcome Inflation and Global Uncertainty"

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Forecasting India's Economic Trajectory - Challenges and Strategic Solutions for the Decade Ahead

Intro: This week on **Indiastat**, we have economist **Kashyap Arora** writing to us from Canada. In this interview, with **Mahima Sharma** he discussed India's economic future, focusing on challenges like inflation, global uncertainties and slow growth. On **Socio-economic Voices** he shares the key factors shaping the current state of the India economy, including policy responses and demographic shifts. With the world facing economic volatility, India's potential is vast, and this conversation highlights how the country can navigate its path to sustainable growth and stability. Take a read at the EXCLUSIVE...

MS: With India's trade with Quad countries increasing by 18% in 2024, how can it leverage shifting global power dynamics to secure favorable trade agreements and enhance access to global capital markets? How should India's foreign policy adapt to capitalise on opportunities in technology transfer, supply chain resilience, and manufacturing?

KA: India's 18% growth in trade with the Quad nations in 2024 underscores its growing integration into the Indo-Pacific framework. However, it is essential to prioritise technology partnerships with nations, particularly the U.S. to offer a more sustainable pathway to economic growth. Collaborative efforts in emerging technologies, such as semiconductors, AI, and renewable energy development, align with India's long-term goals. **For example, the U.S.-India Initiative on Critical and Emerging Technologies (iCET) focuses on fostering innovation in semiconductors and AI. Leveraging such technologies can improve supply chain resilience and operational efficiency, which is vital for scaling India's manufacturing GDP share.**

India's engagement is primarily driven by bilateral free trade agreements (FTAs) and strategic collaborations rather than multilateral mechanisms. Crucial examples include the India-Australia Economic Cooperation and Trade Agreement (ECTA), the India-EFTA Trade and Economic Partnership Agreement (TEPA) signed in March 2024, a significant step in reducing tariffs, expanding market access, and fostering deeper economic collaboration with the European Free Trade Association bloc, as well as, ongoing trade negotiations with the UK.

However, India must prioritise expanding multilateral agreements to further capitalise on global power shifts. Positioned as a neutral economy in the "China+1" diversification strategy, India can attract investments from firms seeking alternatives to China. India can enhance its role in reshoring and nearshoring strategies by **fostering trade deals that emphasise supply chain resilience and integrating into "green" and "secure" global supply chains.**

Manufacturing also requires targeted incentives including policies like the Production Linked Incentive (PLI) scheme encourage global firms to invest in India; targeted infrastructure development, such as the Bharatmala road project, and logistics optimisation are key to integrating India into global value chains. Foreign policy must prioritise fostering innovation-driven collaborations, and trade deals should focus on technology transfer. India's growing middle class and youthful population, as well as its economic growth and improvement in the investment climate, are crucial factors.

However, challenges like low labour force participation, lack of precise skill training, and overreliance on imported components must be addressed to maximise the benefits of trade liberalisation and manufacturing incentives. While India has progressed with FTAs like ECTA and TEPA, selective participation in multilateral frameworks such as RCEP could unlock broader opportunities.

MS: Given the global tightening of monetary policies, especially in advanced economies like the US (Federal Reserve interest rate hikes) and the EU (ECB tightening), how do you foresee this affecting India's capital inflows and currency valuation? For instance, India saw a 5% decline in foreign direct investment (FDI) in the last quarter, primarily due to global liquidity constraints. What steps should India take to buffer against such outflows?

KA: I necessarily do not expect the trend of monetary policy tightening to continue, particularly as inflationary pressures ease and growth becomes imperative. However, under Donald Trump, if the U.S. continues to run an expansionary policy (and also imply higher tariffs), then inflationary trends can persist, making the Federal Reserve keep interest rates higher for longer.

Coming to the global impact of tightening monetary policy, when interest rates in advanced Western economies, particularly the U.S., are higher, their financial assets become more attractive, leading to capital outflows from India. Comprehending the impact mechanism, capital outflows exert downward pressure on the Indian rupee.

Notably, the impact of an increase in foreign interest rates is more immediate and pronounced on portfolio investments than on FDI, as these are highly sensitive to changes in global interest rates. FDI is also driven by long-term factors such as market size, labour costs, and business environment rather than short-term interest rate fluctuations. However, global rate hikes also increase the cost of external capital, and a depreciating rupee further increases repayment obligations for foreign-currency-denominated loans. Such a scenario can reduce foreign direct investment (FDI) inflows.

Recent developments in India's financial markets have underscored factors impacting equity valuations and currency stability. **Foreign investors net sold Indian stocks in November, adding to October's approximately $11 billion outflows on a net basis.** The trend reflects factors, including ongoing concerns over elevated U.S. bond yields and a strengthening dollar. The Indian rupee has experienced depreciation pressures against the U.S. dollar as on December 02, 2024. In response, the Reserve Bank of India (RBI) has actively intervened by selling dollars to mitigate volatility and curb further depreciation of the rupee, which can put pressure on its foreign reserves.

The RBI's monetary policy stance further complicates this scenario, as the central bank is expected to maintain current interest rates in the near term, with potential easing measures, such as a reduction in the cash reserve ratio, being considered to enhance liquidity. However, **domestic demand resilience and policy buffers (e.g., forex reserves and fiscal measures) could mitigate the severity.** India's prudent fiscal and monetary management offers some protection.

MS: Given the geopolitical tensions in Eastern Europe and the Middle East, how should India balance its energy needs with the demand for security of supply in the global energy market? With energy prices expected to increase by 10-15% globally in 2025, what steps should India take to ensure affordable energy access for its population, particularly in rural areas?

KA: India's heavy reliance on oil imports, with over 80% of its oil needs met through imports, makes it particularly susceptible to global supply disruptions. The Middle East remains a critical region for India's energy imports.

Escalating conflicts in the Middle East and sanctions on some of the large oil supplier nations have historically led to volatility in oil prices. India has diversified its energy import portfolio to mitigate some of these risks. **Russia has emerged as a significant supplier,** not only reducing over-reliance on any single region but also letting India leverage competitive pricing in the global market. A significant development is the deepening energy cooperation with Guyana, a nation recently emerging as a notable oil producer. In November 2024, during a state visit by Prime Minister Narendra Modi to Guyana, the two countries signed a MoU to strengthen cooperation in the hydrocarbon sector.

Additionally, India is investing in renewable energy sources to reduce dependence on imported fossil fuels. This transition enhances energy security and aligns with global sustainability goals. However, events including, the recent COP29 summit and the re-election of President Donald Trump do present both challenges and opportunities for India's pursuit of energy security, as well as its transition to renewable energy. At COP29, developed nations committed to providing $300 billion annually by 2035 to assist developing countries in combating climate change, failing way short of the earlier targeted figures. Furthermore, the Trump administration is poised to focus on increasing fossil fuel production and the possibility of potentially scaling back from international climate agreements. It could lead to lower global crude oil prices and reduce the pace of transition to renewable energy.

Overall, to navigate the complex interplay of geopolitical tensions, international climate commitments, and domestic energy needs, India should continue diversifying energy import sources and engage with a broad coalition of nations to advocate for adequate climate finance and support. Furthermore, at a domestic level, it can continue investing in renewable energy capacity development and aim to provide affordable access to all population segments. **Expanding renewable energy mini-grids and investing in solar and wind energy projects are pivotal** in enhancing access and affordability in rural areas.

MS: As global migration patterns shift due to climate change and conflict, how can India strengthen its socio-economic infrastructure to accommodate an influx of migrants while providing jobs and ensuring social stability? What policy initiatives are required to integrate these populations into India's growing economy?

KA: Moreover, a perspective on rural-urban migration trends is vital in India, where economic migration is crucial as the country grows. At a broader level, to accommodate an influx of migrants, India must adopt a multi-faceted approach that strengthens socio-economic infrastructure and ensures social stability. Strategies and policy initiatives include:

- **Enhancing urban and rural infrastructure, including climate-resilient infrastructure development in regions prone to minimise future displacements.**
- **Expansion of employment opportunities**
- **Framework for social integration**
- **Leveraging technology**

There is also a need to strengthen regional and global diplomatic efforts and engagements for international migration trends. **India should focus on engaging in robust regional and global mechanisms like the Colombo Process to address migration challenges more effectively.**

Pivotally, efforts to support the migrant population will require significant investments towards affordable housing, Transportation infrastructure, provision of essential services such as water, sanitation, and electricity). These are essential, particularly in urban areas where the pressure is bound to be much more significant. Moreover, from a public policy perspective, an inclusive policy framework providing migrants rights, access to benefits, better public health and education services, and better public education, welfare programs are of utmost importance for human resource development. As India would look to increase the share of the manufacturing sector in its GDP, it is necessary to increase access to targeted training programs customized to migrants' abilities and the market demand.

There also needs to be a greater effort put in towards strengthening rural infrastructure so as to prevent overburdening urban areas, primarily job-creating projects. Furthermore, support to small and medium enterprises (SMEs) in collaboration with specific labour-intensive manufacturing industries is required. In terms of rural entrepreneurship, the government should try and promote agro-industries.

Technology should also be leveraged, including through initiatives such as establishing a centralised database tracking movements, demographics, and skills. The government should also set up an independent body to monitor migration-related programs and document socio-economic impacts through periodic surveys and other secondary data gathering techniques to refine policies based on real-time needs.

MS: In light of global economic uncertainty and tightening financial conditions, what are the key challenges India faces in maintaining its current growth trajectory? (For example, with global growth projections revised downward to 3.2% in 2024, how does India ensure that its growth rate of 5.4% remains robust despite external pressures?) What sectors should India prioritise to maintain strong economic performance?

KA: India's aspiration to sustain a robust growth rate amid global economic uncertainty and tightening financial conditions presents multifaceted challenges. The recent deceleration to 5.4% in the July-September quarter of 2024, the slowest in seven quarters, underscores vulnerabilities in manufacturing and consumption sectors.

India’s fiscal deficit, projected at 5.6% of GDP for FY24, shows progress in fiscal consolidation, though public debt remains elevated at 81.9% of GDP. **While India benefits from domestically held, rupee-denominated debt, rising debt burdens, especially in the U.S., could pose challenges.**

Downward revision of global growth potentially dampens demand for India's exports, particularly pronounced adverse effects on sectors reliant on external markets, such as information technology services. **Furthermore, elevated inflation, especially in food prices (10.9% in October 2024), has eroded household purchasing power, affecting private consumption.** Meanwhile, restrictive monetary policies to control inflation increase borrowing costs, dampening consumer spending and private investment. A measured easing of interest rates, while potentially invigorating domestic borrowing and investment, could disadvantage foreign investments if interest rates abroad remain higher.

One must understand if there is a need to boost the demand or supply side.

India must prioritise sectors with high growth potential. **The manufacturing sector, which slowed to 2.2% growth in the July-September quarter of 2024, requires revitalisation through:**

- targeted incentives
- Investments
- skill upgradation
- a greater share in global trade through FTAs & participation in multilateral trade agreements, enhancing the manufacturing base and gaining a more significant share in global exports.

In agriculture, ongoing measures such as adoption of advanced technology, modern agricultural practices and continuous efforts to improve irrigation can stabilize rural incomes and increase consumption. Further, enhanced storage infrastructure, and supply chain and logistics improvements are essential to minimize post-harvest losses and bolster productivity, ensuring the sector's sustainable contribution to the economy.

The services sector, which contributes significantly to the GVA, remains vital for economic performance. **IT, financial services, and tourism investments can harness India's skilled workforce and create employment.**

Infrastructure development also offers substantial growth opportunities; the government's infrastructure spending underscores specific potential to stimulate economic activity. Also, expanding renewable energy initiatives can align India with global sustainability goals while reducing reliance on energy imports.

MS: India has seen a significant increase in global investment in its renewable energy sector, with foreign direct investments in clean energy reaching $10 billion in 2024. How can India capitalise on these global trends to not only accelerate its green transition but also create new jobs and improve socio-economic outcomes, particularly in rural areas?

KA: India's renewable energy sector has attracted substantial foreign direct investment (FDI), reaching $10 billion in 2024. This influx presents a pivotal opportunity for India to accelerate its green transition, generate employment, and enhance socio-economic conditions.

Significantly, as of 2023, **India's renewable energy sector employed** approximately 1.02 million individuals. Hydropower was the largest employer, engaging nearly 453,000 people, followed by the solar photovoltaic (PV) sector, with 238,000 jobs—a significant 18% increase from 2022. The wind power sector contributed around 52,200 jobs.

Notably, a multiplier effect is at play where an initial investment in green investments generates additional economic activity through increased spending and production. This effect is more pronounced in sectors with high labour intensity and local content. **The World Economic Forum estimated that India's green transition could have an economic impact exceeding $15 trillion by 2070.**

However, there is a need to work further on strengthening individuals' technical skills. These can include expertise in renewable energy technologies, retrofitting, sustainable agriculture, and waste management techniques. **Moreover, generalized skills such as** problem-solving, adaptability, and project management are equally vital. The training budget should be increased to meet the growing demand.

In addition, there is a need to invest in local manufacturing of renewable energy components to reduce import dependence and to create jobs. There should also be encouragement to adopt renewable energy technologies through **affordable financing options** for small and medium enterprises (SMEs) and rural entrepreneurs. Thus, financial institutions have a role to play.

A stable policy environment also fosters investor confidence and facilitates long-term planning. **Supportive policies and regulations are crucial,** including clear and consistent policies, tax incentives, subsidies, and approval processes. **Indian government and entrepreneurs should also continue collaborating with countries experienced in renewable energy** to enhance capabilities and accelerate the transition. International partnerships can facilitate efficient technology transfer, capacity building, and access to best practices.

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About Kashyap Arora

Kashyap Arora is an economist with global experience in economic and financial modelling, policy appraisal and strategic consulting. He has led projects and consulted with organisations, including the University of Cambridge, Standard and Poor, Consider Canada City Alliance and Centre for Policy Research. Kashyap holds a master's degree in economics and international financial economics from the University of Warwick, UK. He has authored research articles and briefs for organisations and independent platforms and presented on markets and pressing global issues at esteemed institutes and forums, including the Canadian Economic Association (2023) and the U.S. Embassy.

About the Interviewer

Mahima Sharma is an Independent Journalist based in Delhi NCR. She has been in the field of TV, Print & Online Journalism since 2005 and previously an additional three years in allied media. In her span of work she has been associated with CNN-News18, ANI - Asian News International (A collaboration with Reuters), Voice of India, Hindustan Times and various other top media brands of their times. In recent times, she has diversified her work as a Digital Media Marketing Consultant & Content Strategist as well. Starting March 2021, she is also a pan-India Entrepreneurship Education Mentor at Women Will - An Entrepreneurship Program by Google in Collaboration with SHEROES. Mahima can be reached at media@indiastat.com