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Morning Briefing

India Needs More Reforms

Check out the accompanying chart collection.

Executive Summary: India's economy is generating some serious steam—GDP is growing at a fast and accelerating clip, industrial production is at a record high, and inflation has dropped below the central bank's target. But the stats don't tell the whole story: William reports that India is in dire need of structural reforms to address unemployment and broaden the benefits of rapid growth to the entire economy. Without these and other reforms recommended by the OECD, the country is ill prepared to shoulder Trump's 50% tariffs on exports to the US.

Weekly Webcast. If you missed Monday's live webcast, you can view a replay *here*.

India I: Growing Faster Than China. On any list of major economies having a solid 2025, India deserves a place near the top. GDP growth in Asia's third-largest economy actually accelerated during Q2, to *7.8% y/y* from 7.4% y/y in Q1.

Headwinds abound, of course. The biggest is US President Donald Trump's 50% tariff on US imports from Prime Minister Narendra Modi's economy. Another: the impacts of a slowing Chinese economy that's exporting deflation and overcapacity to the rest of Asia.

Growing faster than China offers India an enviable amount of cushion. Yet can India's *nearly $4 trillion economy* continue to beat the odds as Trump's tariffs hit? It may be a lot harder than global investors appear to think.

Let's explore the strengths and weaknesses India carries into its dustup with the Trump White House:

(1) *Momentum, for now*. Granted, a lower GDP deflator probably contributed to India's Q2 upside surprise, as *Goldman Sachs argues*. Yet the size of the gains in *private consumption expenditures* (7.0%), government spending (7.4%), manufacturing (7.7%), construction (7.6%), and financial and business services (9.5%) suggests the upside was no fluke.

“As a consumption-driven economy, India is well-positioned to mitigate [its] challenges through recent policy measures,” said Carlos Casanova at Union Bancaire Privée.

Among those measures: an accommodative Reserve Bank of India (RBI) rate policy and tax reforms aimed at boosting domestic demand and offsetting the damage from US tariffs. New Delhi is achieving the latter by shifting the goods and services tax (a.k.a. GST) system to *two rate levels* from four. That reduces the tax rate on most goods from 12% to 5%; goods previously taxed at 28% are now taxed at 18%.

(2) *Tariff shock*. Yet the tariff shock bearing down on India might quickly collide with the economy’s pre-existing frailties. Chief among them is weak jobs growth, particularly among India’s fast-swelling youth population. This is complicating efforts to spread the benefits of rapid GDP to India’s *1.46 billion people* (*Fig. 1* and *Fig. 2*).

“The Modi economic model has clearly spurred GDP growth,” said Hung Tran at the Atlantic Council. “But its fruits have tended to accrue to a small percentage of the population, *raising the number of billionaires to 271* in the process.”

(3) *Inequality boom?* In fact, inequality might now be worse than under British colonial rule, according to a *new report* from the World Inequality Lab.

In 2023, when India surpassed China as the most populous nation, much was made of its “demographic dividend” versus aging economies from East to West. Half of India’s population is below the age of 25, while 65% is under 35—the mirror image of rapidly aging China’s population distribution.

But enviable demographics can be a nightmare if a nation doesn’t create enough jobs to absorb the waves of new entrants to the labor force. For India, that’s roughly 12 million jobs per year.

(4) *Unreliable data*. In July, the unemployment rate among urban youth aged 15 to 29 years *increased to 19.0%* from 18.8% in June. In rural India, it was 13.0%.

Economists worry, though, that India’s unemployment data may be unreliable and masking deeper weakness. A July *Reuters poll* found that more than 70% of independent economists—37 of 50—believe India’s official jobless rate is inaccurate. Many think it could be twice the official 5.2% level. The reason may be the way employment is calculated in India.

“We have a massive employment problem and that is not reflected in the data,” Pranab Bardhan of the University of California, Berkeley, *told Reuters*. “Most Indian workers are underemployed. If you are able-bodied and you did not work for any time, not even one hour in the last six months, unless you are rich, how did you feed yourself? ... So you scrounge around and do something. And then you are [officially counted as] employed. Now what does that employment mean?”

India II: Where Modinomics Disappoints. Duvvuri Subbarao, an RBI governor from 2008 to 2013, *noted recently* that “unemployment is one of our big challenges and I don’t believe the government data reflects the true ground situation.” The bigger problem, though, is what kind of jobs India is creating, Subbarao argues. He recommends focusing more on manufacturing to maximize employment rather than prioritizing less labor-intensive sectors like information technology and finance.

Clearly, this has occurred to Modi’s inner circle, which launched the “Make in India” initiative 11 years ago. The goal, as envisioned in 2014, was to boost the manufacturing share of GDP from about 17% to 25% by 2022. Unfortunately, manufacturing is now *less than 16% of GDP*.

This failure is a microcosm of a broader failure of Modinomics. It’s why the Indian economy entered the Trump 2.0 era off balance. Let’s take a deeper look:

(1) *Microcosm of failure*. Modi’s emphasis has been on attracting splashy investments and hitting newsy milestones rather than doing the heavy lifting under the surface to strengthen human capital and raise productivity.

For example, Team Modi rejoiced last month over the news that Apple is producing all four iPhone 17 models in India. “Apple isn’t abandoning China, but it is de-risking by building parallel supply chains, and India has emerged as the most critical alternative,” said Sanyam Chaurasia at advisory firm Omdia, calling Apple’s pivot a “*watershed moment*” as US tech giants try to limit the damage from Trump’s tariffs on products produced in China.

(2) *China+1 strategy*. Amazon, Google, *Intel*, Lockheed Martin, and a who’s-who of Western names are upping investments in India as part of a “China+1” strategy. Yet these anecdotes belie data showing that Modi’s big talk of transforming India into a manufacturing hub, versus Xi Jinping’s China, is just that.

Now, rather than taking on China, Modi’s India is joining forces with Asia’s top manufacturing power. On August 31, Modi was in China for the first time in seven years to strengthen trade ties amid tariff uncertainty. Modi stood *shoulder to shoulder* with Xi Jinping and Russia's Vladimir Putin.

(3) *High cost of Russian oil.* India's voluminous purchases of Russian oil, in contradiction of US tariffs, prompted Trump World to impose a 50% tariff on India.

Many economists see the Modi-goes-to-China narrative as signifying an increasing push for a less US-centric multipolar world. The overt displays of camaraderie among Xi, Modi, and Putin sent optics of defiance to a White House trying to subjugate the economies of China and India.

In telegraphing defiance, though, Modi may have painted an even bigger target on India's back.

(4) *Tensions at DEFCON 1. "*The relationship is really on *shaky ground* right now," Lisa Curtis, a national security adviser during Trump 1.0, told POLITICO. "We're at a DEFCON 1 on the US-India relationship."

It's not clear whether or how Trump World might retaliate against Modi for his perceived insubordination. Trump has avoided escalating tensions, and his take on India has been all over the place.

Early last week, *Trump called* US-India dynamics "a totally one-sided disaster!" By Friday, Trump said that though he doesn't "like what [Modi is] doing at this particular moment," the US and India "have a special relationship. There's nothing to worry about. We just have moments on occasion."

Yet on Friday, Commerce Secretary Howard Lutnick stressed that hard feelings remain. He told Bloomberg it's "*ridiculous*" that India continues to purchase oil from Russia and that New Delhi pick a side. That goes, too, from a move by the BRICS nations to replace the dollar as the reserve currency.

"Either support the dollar, support the United States of America, support your biggest client, who is the American consumer, or I guess you're going to pay a 50% tariff," Lutnick said.

India III: 50% Tariffs Have New Delhi Scrambling. For many, the Trump-versus-Modi subplot is quite the head-turner. During the Trump 1.0 years from 2017 to 2021, Washington had few closer allies than the Indian leader. In September 2019, Modi and Trump packed 50,000 people into a Houston stadium for what Trump called a "*profoundly historic event.*" All that hugging and hand-holding seems like a long time ago.

Let's examine how the situation has devolved and what it means for India's ability to shoulder 50% US tariffs:

(1) *7% growth harder to sustain*. The rancor—and the uncertainty surrounding the US-New Delhi state of play—has Team Modi scrambling to keep GDP growth north of 7.0% y/y and to ensure that more Indians' incomes don't drop as tariffs batter business confidence.

The tension spotlights the macro-micro divide that has widened on Modi's watch. India's macro trajectory is well understood. Back in May, the International Monetary Fund (IMF) projected that India's nominal GDP would reach a Japan-topping *$4.19 trillion* by year-end.

The future can often seem ever brighter. In an *August 27 report*, EY.com predicted that Indian GDP will reach $20.7 trillion in purchasing-power-parity terms by 2030 and perhaps $34.2 trillion by 2038.

(2) *India is uniquely placed*. DK Srivastava of EY India noted that the economy is *uniquely placed* to thrive in the years ahead. It's not challenged by a crushing national debt load like the US, an aging population like China, or heavy reliance on global trade like Japan and Germany.

"India's comparative strengths, its young and skilled workforce, robust saving and investment rates, and relatively sustainable debt profile will help sustain high growth even in a volatile global environment," Srivastava argued. "By building resilience and advancing capabilities in critical technologies, India is well-placed" to become a *developed nation* by 2047.

(3) *Lack of reforms catching up*. But India needs annual GDP growth of *at least 8.0%* to get there. The slow pace of reforms at the micro level complicates these grand aspirations. In a *June report*, the Organisation for Economic Co-operation and Development (OECD) said priorities include: strengthening social safety nets, better targeting government subsidies for maximum efficiency, raising public investment; and establishing more active labor market policies.

Rationalizing subsidies and expanding tax bases alone would improve the quality and sustainability of public finances. Here, particular emphasis should be raising labor force participation, especially among women.

(4) *Empowering women*. Although female employment has increased markedly, from 17.5% in fiscal 2017–18 to 31.7% in fiscal 2023–24, "strengthening women's access to formal jobs will require coordinated reforms in childcare availability, safe and affordable transportation, skill-building, and enforcement of workplace protections," the OECD argued.

The OECD's further advice: India would do well to accelerate trade liberalization efforts, simplify customs procedures, reduce its tariffs, improve the efficiency of logistics networks, upgrade digital infrastructure, and reduce regulatory uncertainty.

Since taking power in 2014, Modi's Bharatiya Janata Party has been too slow to increase the availability of long-term finance by deepening capital markets and improving credit access for small and midsized enterprises.

Such reforms would strengthen the investment climate and ensure that this year's gains in the BSE Sensex and Nifty 50 stock benchmarks, modest as they are, don't disappear. The Sensex was *up 3.2% ytd* as of Monday's market close; the Nifty was *up 4.7% ytd*.

(5) *Rocky stock market performance*. Indian stocks had a rocky August as investors balanced the implications of Trump's tariffs and prospects for Federal Reserve rate cuts. In the first week of August, both bourses sustained their worst losses *in five years*. This year's performance is a far cry from the *8%-plus gains* in 2024 (*Fig. 3*).

(6) *Solid economic performance*. Nevertheless, the latest batch of economic indicators is quite impressive. Industrial production jumped to a record high in July (*Fig. 4*). Inflation has been trending downward, with the annual consumer price inflation rate falling to 1.6% in July 2025, a significant drop from 2.1% in the previous month (*Fig. 5*). This marks the ninth consecutive decrease and brings inflation firmly below the RBI's target range of 2.0%-6.0%. This decline is largely attributed to a fall in food prices, particularly vegetables. In response to these developments, the RBI has lowered its repo rate from 6.50% at the start of this year to 5.50% (*Fig. 6*).

(7) *Strong men aren't reformers*. Global investors seem to be realizing that "strongman" leaders are often surprisingly weak reformers. The reign of China's Xi Jinping has attracted foreign capital but failed to create an innovative and productive economy. The economy of Putin's Russia is famously backward. Modi likewise is a prime example.

To Modi's credit, he has opened a variety of tightly controlled Indian sectors, including aviation, defense, insurance, and finance services. But attracting increased investment per se won't strengthen the investment environment. Splashy successes—like Modi's tech start-up boom—do little to spread the benefits of economic growth.

If Modi thought doing so was hard before Trump's 50% tariff, imagine what the year ahead will be like.

Calendars

US: Tues: NFIB Small Business Optimism Index 101.0; Payrolls Benchmark. **Wed:** Headline & Core PPI 0.3% & 0.3%; Atlanta Fed GDPNow 3.0%; Wholesale Inventories 0.2%; MBA Mortgage Applications. (Source: FX Street)

Global: Tues: France Industrial Production -1.2%; Eurogroup Meetings; Japan Machine Tool Orders 3.6%y/y; China CPI & PPI -0.2% & -2.9%y/y. Nagel. **Wed:** Italy Industrial Production 0.3%; Japan PPI -0.1%m/m, 2.7%y/y; Japan BSI Large Manufacturing Conditions -3.3. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): During the September 5 week, forward earnings rose simultaneously for all three indexes for the 13th time in 15 weeks. LargeCap's forward earnings rose for a 16th straight week, its longest winning streak since it did so for 38 weeks through the September 13, 2024 week. MidCap's has dropped in just two of the 16 weeks since it bottomed during the May 16 week. SmallCap's has risen for 15 straight weeks since it bottomed during the May 23 week, matching the prior longest winning streak when it did so nearly four years ago for 15 weeks through the December 17, 2021 week. LargeCap's forward earnings rose 0.5% w/w to its 14th straight weekly record high. MidCap's gained 0.5% w/w to its first record week in the 22 weeks since the April 4 week. SmallCap's rose 0.3% w/w to a 51-week high and is 9.9% below its June 2022 record. LargeCap's forward earnings has soared 29.7% from its 54-week low during the week of February 1, 2023; MidCap's is just 9.7% above its 55-week low during the week of March 10, 2023; but SmallCap's has lagged considerably and is up just 5.5% from a very recent 42-month low during the May 23 week. These three indexes' forward earnings downtrends from mid-2022 to early 2023 and again during Trump's Tarriff Turmoil were relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Here are the latest consensus earnings growth rates for 2024, 2025, and 2026: LargeCap (9.7%, 10.3%, 13.6%), MidCap (0.4, 2.2, 17.3), and SmallCap (-10.2, 4.0, 17.6).

S&P 500/400/600 Valuation (*link*): Valuations were little changed for these three indexes during the August 29 week. LargeCap's forward P/E ticked down 0.1pt w/w to 22.1, and is just 0.3pt below its four-year high of 22.4 during the July 25 week. It's now 5.1pts above the seven-month low of 17.0 during the October 27, 2023 week. That compares to a 30-month low of 15.1 at the end of September 2022 and an 11-year low of 11.1 during March 2020. MidCap's forward P/E rose 0.2pt w/w to a 32-week high of 16.4. It's now 0.7pts below its 40-month high of 17.1 during the November 29 week and 4.2pts above the 12-month low of 12.2 in October 2023. That compares to a record high of 22.9 in June 2020, when forward earnings was depressed, and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E ticked up 0.1pt w/w to a 29-week high of 15.7. It's 2.8pts above its 17-month low of 12.9 during the April 4 week and 5.1pts above its 14-year low of 10.6 in September 2022, but remains 1.9pts below its 41-month high of 17.1 during the November 29 week. That compares to a record high of 26.7 in early June 2020, when forward earnings was depressed, and a record low of 10.2 in November 2009 during the Great Financial Crisis. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E is at a 27% discount to LargeCap's P/E, up from a 26-year low 29% discount just weeks earlier, which matched its similar 29% discount during the July 5, 2024 week. That compares to a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021. SmallCap's P/E is at a 30% discount the LargeCap's P/E, up from a 13-month-low 33% discount several weeks earlier. That compares to a 23% discount during the November 29 week, which was its best reading since the March 2, 2023 week. It's now just 4ppts above its 24-year-low 34% discount during the July 5, 2024 week. SmallCap's P/E is at a 4% discount to MidCap's, up from a 13-month low 6% discount several weeks earlier and a 20-year-low 10% discount in late 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

Global Economic Indicators

Germany Industrial Production (*link*): German industrial production jumped in July despite a further drop in exports to the US, indicating the sector's ability to adapt in the face of tariffs. July's *industrial production* jumped 1.3% following June's upwardly revised 0.1% uptick—from the initial estimate of a 1.9% drop. July's gain was led by advances in the production of machinery & equipment (9.5%) and pharmaceuticals (8.4), while energy output contracted 4.5% during the month. Construction output edged up 0.3%. *Excluding energy and construction*, production rose 2.2% during July. *By sector*, production of capital (3.0) and consumer (2.1) goods posted solid gains during the month, while intermediate (0.8) goods production posted a more modest increase. *Exports* fell an unexpected 0.6% in July, led by a 7.9% plunge in exports to the US—its fourth successive monthly decline, to the lowest level since December 2021.

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