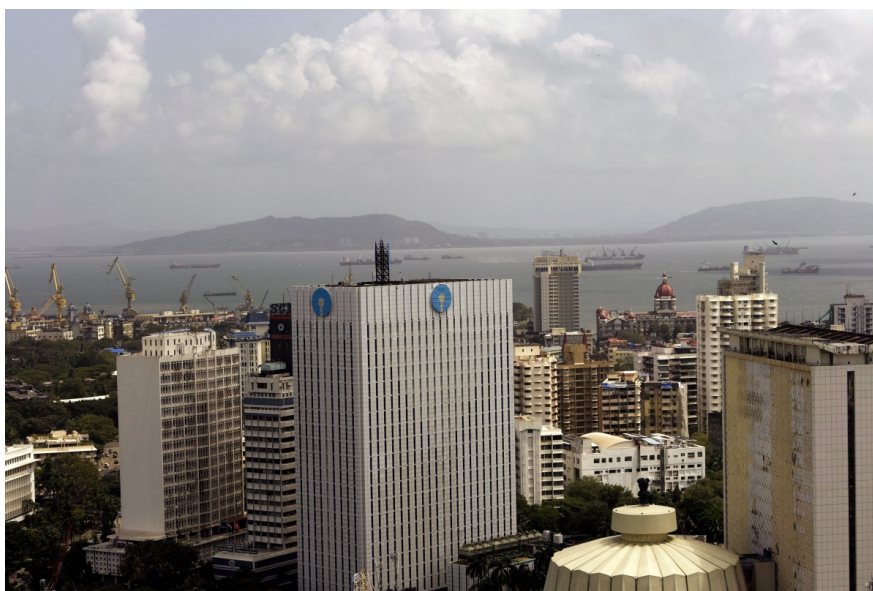


India's external balances: stabilising amid tariff and INR pressures

India's trade deficit widened slightly in the fourth quarter but remained under control. A strong export pivot toward Asia and Africa is helping offset tariff pressures. Expected tariff relief and undervaluation should help stabilise INR

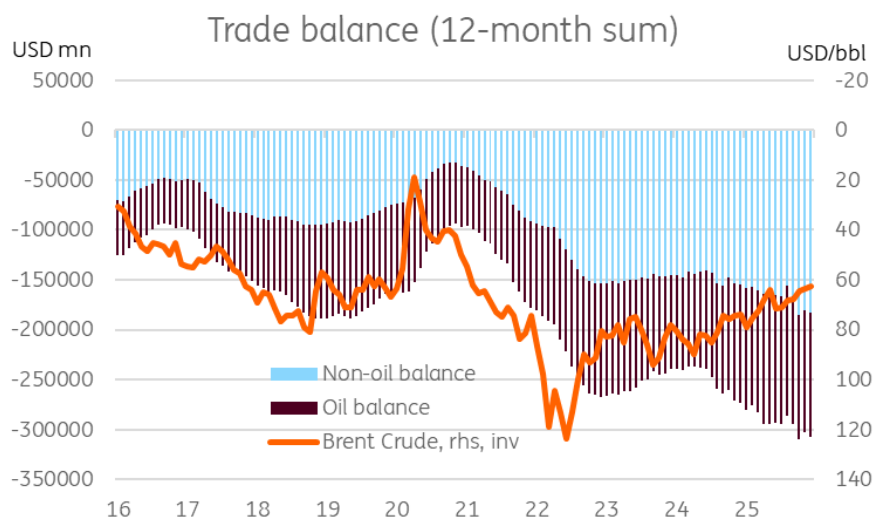


Mumbai's business district

Trade deficit widens slightly but remains under control

India's trade deficit in December edged up to USD 25 billion from USD 24.5 billion in November. Despite this marginal widening, the gap remains significantly lower than the record high of USD 42 billion seen in October. A sharp correction in gold imports since October and a slight improvement in exports have been key factors behind this improvement, while the oil trade balance also continued to improve. For the full year 2025, the trade deficit widened by USD 33 billion, with non-oil trade accounting for nearly 85% of the increase.

Weaker non-oil trade balance



Diversification drives India's export rebound

One key takeaway from today's data is that export growth has begun to normalise despite the imposition of a steep 50% tariff on exports to the United States. Recent trends point to strong diversification efforts, with notable gains in exports to Africa and North Asia. China, in particular, is emerging as a more significant export destination for India. Historically, India has maintained a substantial trade deficit with China. However, recent data indicates a positive shift, with exports to China rising by around 20% year-on-year in 2025. Although China's share of India's total exports remains modest at 4%, compared to the United States' dominant 20%, this development marks an encouraging step toward reducing India's reliance on Western markets.

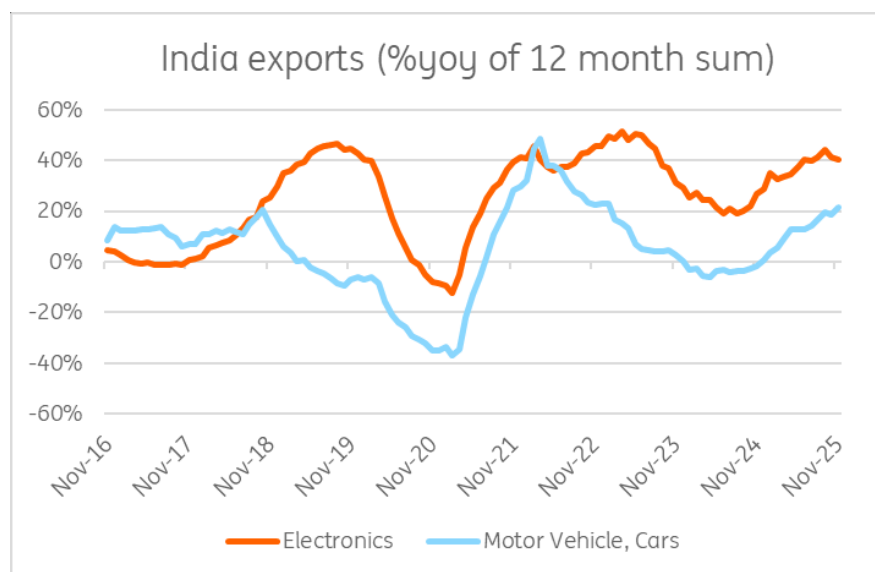
Further signs of Asia-centric diversification are evident in the growth of exports to Taiwan, which increased by 10% during the same period. While Taiwan is not yet a major export partner, the uptick suggests deeper integration of India's technology supply chains within Asia, reinforcing the country's strategic pivot toward regional trade partnerships.

Electronics exports surge ahead in 2025

Electronics has emerged as the standout performer in India's export basket, growing by 40% YoY in 2025 till November, and outpacing other sectors by a wide margin. A key catalyst behind this surge is the smartphone-focused Production-Linked Incentive (PLI) scheme, which has attracted global giants like Apple and Samsung alongside domestic players. These companies are using the incentives to ramp up production and ship more devices overseas. Apple, for instance, has turned India into its second iPhone hub after China.

On the flip side, petroleum exports aren't looking as bright, down 15% YoY in 2025 till November. The advantage Indian refiners had from cheap Russian crude is fading fast thanks to US sanctions. Even when that discount was in play, exports were already sliding. Now that the cost edge is gone, the decline could accelerate.

Electronics leading export growth



Source: CEIC

Current account balance expected to improve from current levels

We estimate that the current account deficit widened to -2% of GDP in 4Q'25 from -1.3% in 3Q. For the full year, however, the shortfall remained relatively modest at -0.6% of GDP. The Indian rupee ended the year as Asia's weakest currency, weighed down by accelerating portfolio outflows from equities in December amid muted earnings and stretched valuations. The central bank's growth-inflation assessment broadly aligns with ours, indicating room for further policy easing. That said, INR weakness has eroded currency-adjusted returns for bond investors, triggering foreign institutional outflows from debt markets as well.

Looking ahead, we expect India to secure lower tariff rates, which should help narrow the trade deficit - currently estimated at 2% of GDP for 4Q25 - and provide some support to the rupee over the next three to six months. From a valuation perspective, the sharp decline in the rupee's real effective exchange rate should also act as a buffer against further downside.

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