Finance

Macro Outlook 2025

Macroeconomic Outlook 2025

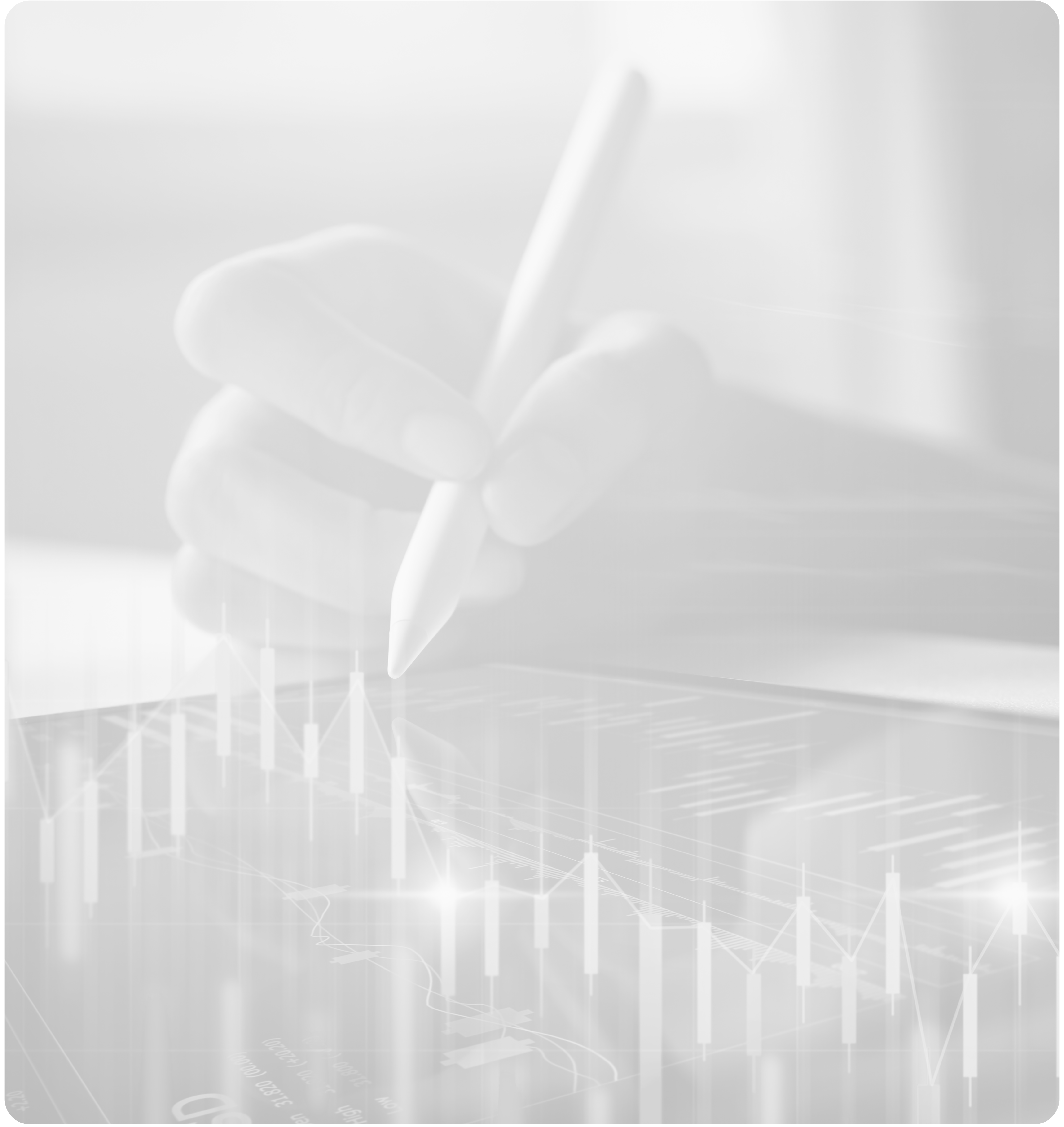
2024 was a year dominated by election-related uncertainties, both in India and abroad, with nearly half the world's population participating in elections across major economies. These political transitions, combined with geopolitical tensions and monetary policy shifts, created significant market volatility.

India's economic growth took a hit because of several domestic and external factors like high and volatile food inflation, weak consumption demand, low employment generation, and low global growth. However, several positive catalysts emerged like strong credit growth, bond market inflows from FPIs and consistent inflows from domestic investors.

As we enter 2025, India is poised to become the world's fourth-largest economy, surpassing Japan's $4.1 trillion GDP, though significant per capita differences remain. Below are a few factors that are working in India's favour:

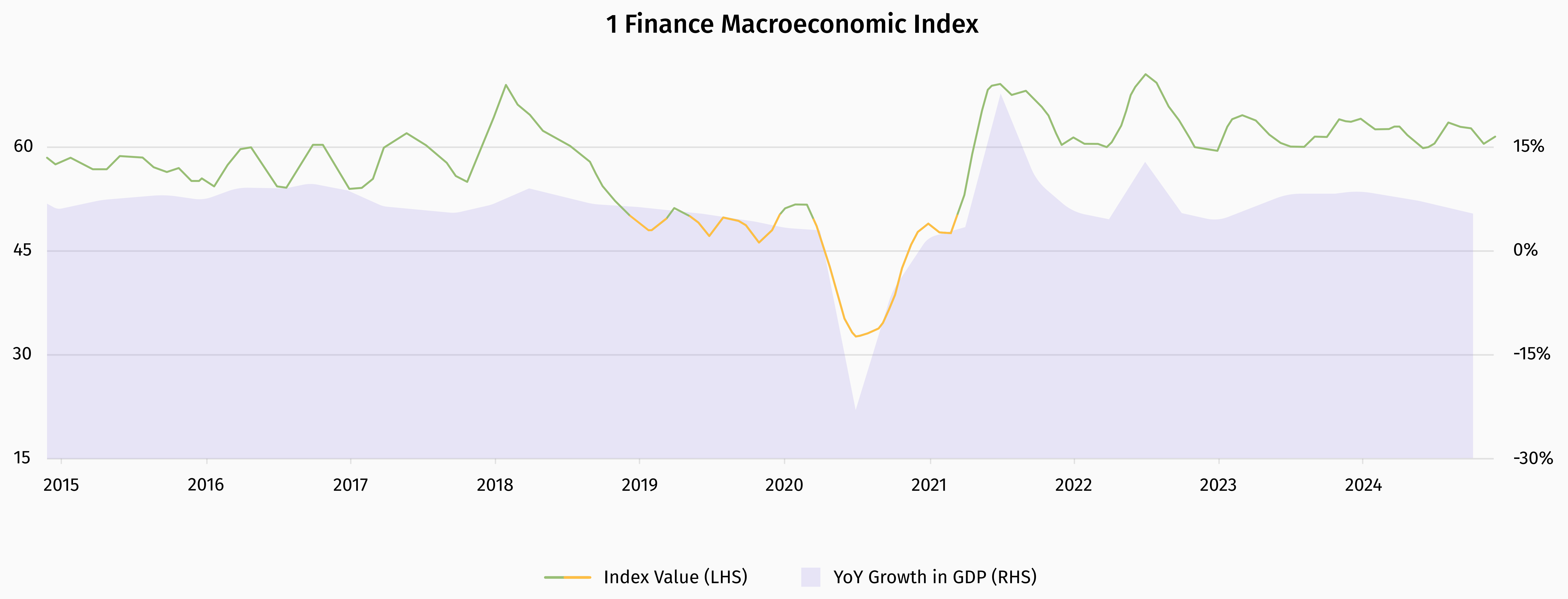
- Food inflation is moderating with strong agricultural output expected.
- Rural consumption is recovering, supported by good monsoons and falling agri input costs.
- The manufacturing sector shows readiness for capex with healthy balance sheets.
- Global growth, projected at 3.3% by the IMF, offers a marginal improvement over 2024's 3.2%, despite rising protectionist pressures.

This outlook weighs these factors to present our comprehensive analysis across asset classes, focusing on key themes that will shape investment opportunities in 2025.

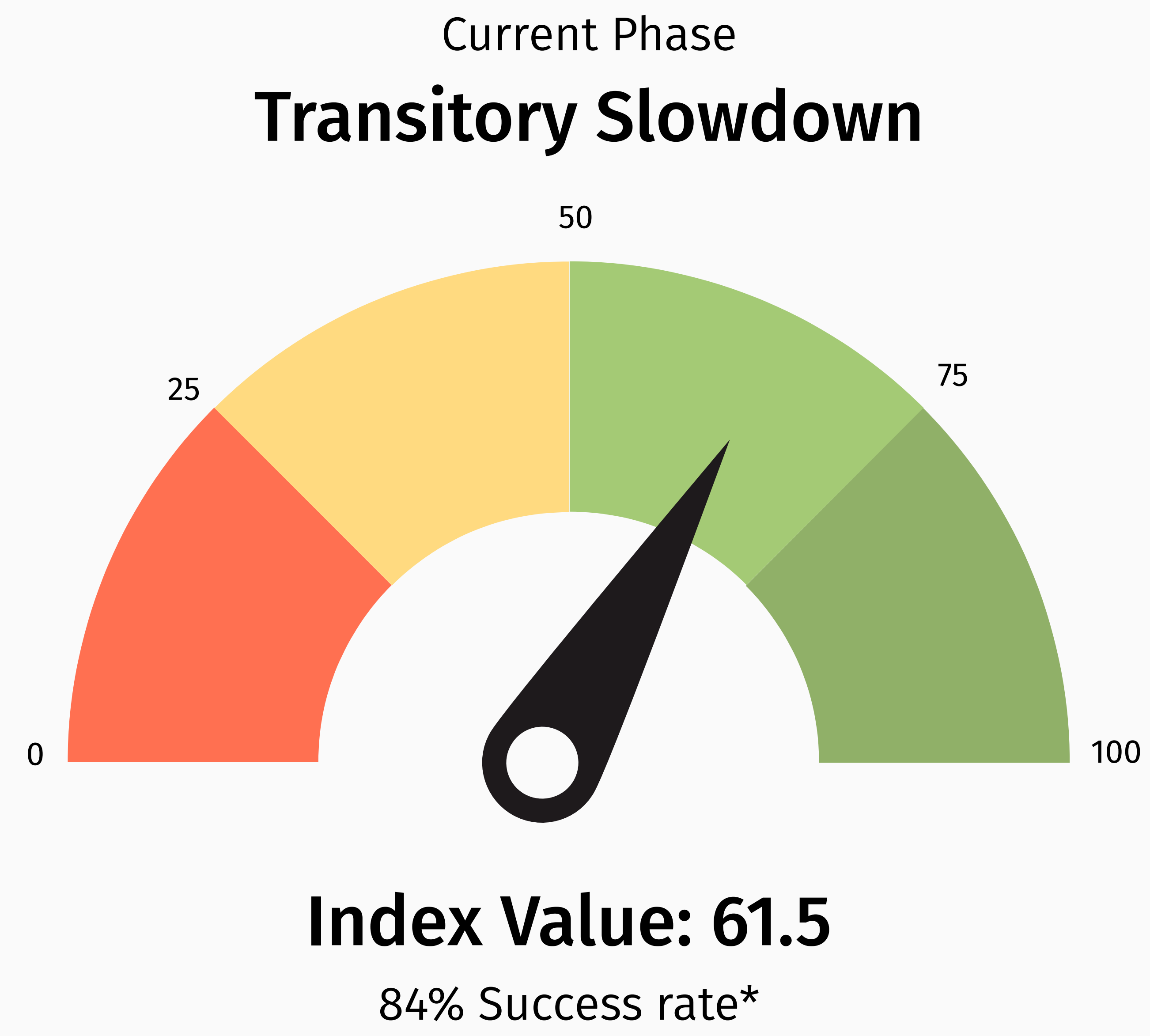


India Poised to Enter 'Recovery' Mode

The 1Finance Macroeconomic Index (1FMI) remained stable in 2024, reflecting economic resilience despite a transitory slowdown. Robust services sector growth offset marginal manufacturing sluggishness, while cooling inflation and strong public capex coupled with increased rural demand signals a pivot toward sustainable growth.



Source: CMIE Economic Outlook, 1 Finance Research



1FMI is an index integrating multiple sub-indices derived from high-frequency indicators, offering nuanced insights into India's economic trends, phases, and near-to-medium-term outlook.

*Success Rate is a measure of how well 1FMI has historically predicted GDP Growth

We predict that there is a **60% probability** of the Indian economy transitioning from the current 'Slowdown' phase, which has been transitory rather than structural, into the 'Recovery' phase.

Current Economic Phase	Scenarios	Potential Outcomes	Economic Phase 2025-end

Current Economic Phase

Transitory Slowdown

- High inflation and interest rates
- Low real wage growth and consumption demand
- Modest industrial output and capacity utilisation
- Slow global economic growth

Scenarios and Potential Outcomes

Repo Rate Drops

65% — Inflation cools down to or below RBI's target (4%)

Domestic Demand Revival **60%**

- Inflation moderates to 4-5%
- Broad-based consumption pickup
- Private capex revival led by manufacturing
- Growth accelerates to 6.5-7%
- 3 rate cuts of 25 bps each in 2025

Demand Collapse **5%**

- Global recession impacts export sectors
- Private investment plans get postponed
- Private consumption weakens significantly
- Growth falls below 5%, with inflation below 3%
- Aggressive rate cuts in excess of 100 bps

Repo Rate Remains High

35% — Inflation hovers around or above RBI's upper limit (6%)

External Vulnerability **10%**

- US implements aggressive trade tariffs
- Sharp rupee depreciation impacts imports
- FPI outflows accelerate significantly
- Import costs surge across sectors
- Trade deficit widens substantially

Policy Stability **20%**

- Global monetary policies remain coordinated
- Domestic consumption gradually improves
- Infrastructure spending maintains momentum
- Inflation stabilises at 5-6%, growth steadies at 6-6.5%
- Delayed rate cuts starting Jun-25

Cost-Push Pressure **5%**

- Geopolitical tensions disrupt supply chains
- Energy and commodity prices surge
- FPI outflows strain rupee stability
- Inflation remains above 6%
- Growth slows to 5-5.5%

Economic Phase 2025-end

Strong Recovery — 60%

- GDP growth driven by domestic demand, robust industrial output and improved global trade
- Strong employment generation, particularly in services and manufacturing sectors
- Revival in demand owing to lower borrowing costs and government welfare programs

Sharp Slowdown — 15%

- Stagnant job creation increases income inequality and risks social unrest.
- Capital flight amid an unfavourable investment climate
- Dependency on fiscal stimulus to counter the slowdown raises public debt levels.

Transitory Slowdown — 25%

- Reduction in pace of economic growth in short-term.
- Medium-term recovery likely through fiscal consolidation and inflation targeting within 4-6% range.
- Geopolitical stability in key trade corridors essential for sustaining investor confidence.
- Household savings rate declines further due to stagnancy in inflation-adjusted income.

The highlighted numbers indicate the probability of different economic scenarios.

The probabilities stated reflect 1 Finance's proprietary framework combining quantitative and qualitative factors. Our methodology evaluates macroeconomic indicators to assess the likelihood of various scenarios, their probable outcomes and their transition into different economic phases.

2025 is the Year to Diversify Across Asset Classes

The risks of remaining concentrated in select asset classes will become apparent in 2025. The biggest focus will be on governments' fiscal policies, central banks' monetary decisions, household consumption and resolution of geopolitical issues.

Asset Class	Outlook 2025	Key Drivers	Risk Factors
India Large Cap Equity	Risk Rating **2**/5 **Positive**	• Revival in rural consumption driven by good monsoon, increase in MSP, and fall in agriculture cost inflation. • Moderation in inflation towards RBI's target of 4% boosting consumer spending. • Clean corporate and banking sector balance sheets providing foundation for growth. • Government's planned capex in H2FY25 to benefit infrastructure and capital goods sectors.	• Rupee depreciation pressure due to strengthening USD and investor capital outflow. • Weak global growth affecting export-oriented sectors.
India Mid, Small and Micro Cap Equity	Risk Rating **5**/5 **Negative**	• Strong domestic manufacturing push through PLI schemes benefiting mid- and small-sized manufacturers.	• Historically high valuations with mid- and small-cap indices trading at premiums of 41% and 8%, respectively, to their long-term medians. • Greater exposure to slowing urban discretionary consumption. • Higher sensitivity to FII flows which could be impacted by US yields.

Asset Class	Outlook 2025	Key Drivers	Risk Factors
US Equity	Risk Rating **3**/5 **Neutral**	• Pro-growth measures including potential tax cuts and deregulation boosting corporate earnings. • Resilient consumer spending supported by tight labor market and strong household balance sheets. • Improvement in fiscal health through proposed federal spending reductions, even if modest compared to targeted $2 trillion cuts.	• High fiscal deficit and historic levels of public debt constraining growth potential. • Elevated equity valuations with S&P 500 P/E ratio at 30.6, ranking in the 96th historical percentile. • Implementation of aggressive trade tariffs triggering inflationary pressures. • Shallower rate cut cycle than market expectations due to sticky inflation.
China Equity	Risk Rating **2**/5 **Positive**	• Comprehensive stimulus package including monetary easing and fiscal expansion with deficit reaching 4% of GDP. • Attractive valuations with Chinese equities trading at significant discounts compared to global peers. • Strong policy support for new growth sectors including semiconductors, EVs, AI, and advanced manufacturing.	• GDP growth slowing to 4.0-4.5% in 2025 due to potential US tariff implementation. • Persistent property sector challenges with new home sales and completions down by more than 50% from peak levels in 2021. • Structural headwinds including aging demographics and weak consumer confidence.
India Ultra Short (<1 year) and Short Term (1-3 year) Bonds	Risk Rating **1**/5 **Positive**	• Expected rate cuts of 50-75 bps in 2025 starting from Feb-25, boosting bond prices. • Strong foreign inflows due to inclusion in global indices (JPMorgan, Bloomberg, FTSE Russell).	• Market liquidity turning into deficit mode affecting short-term rates.

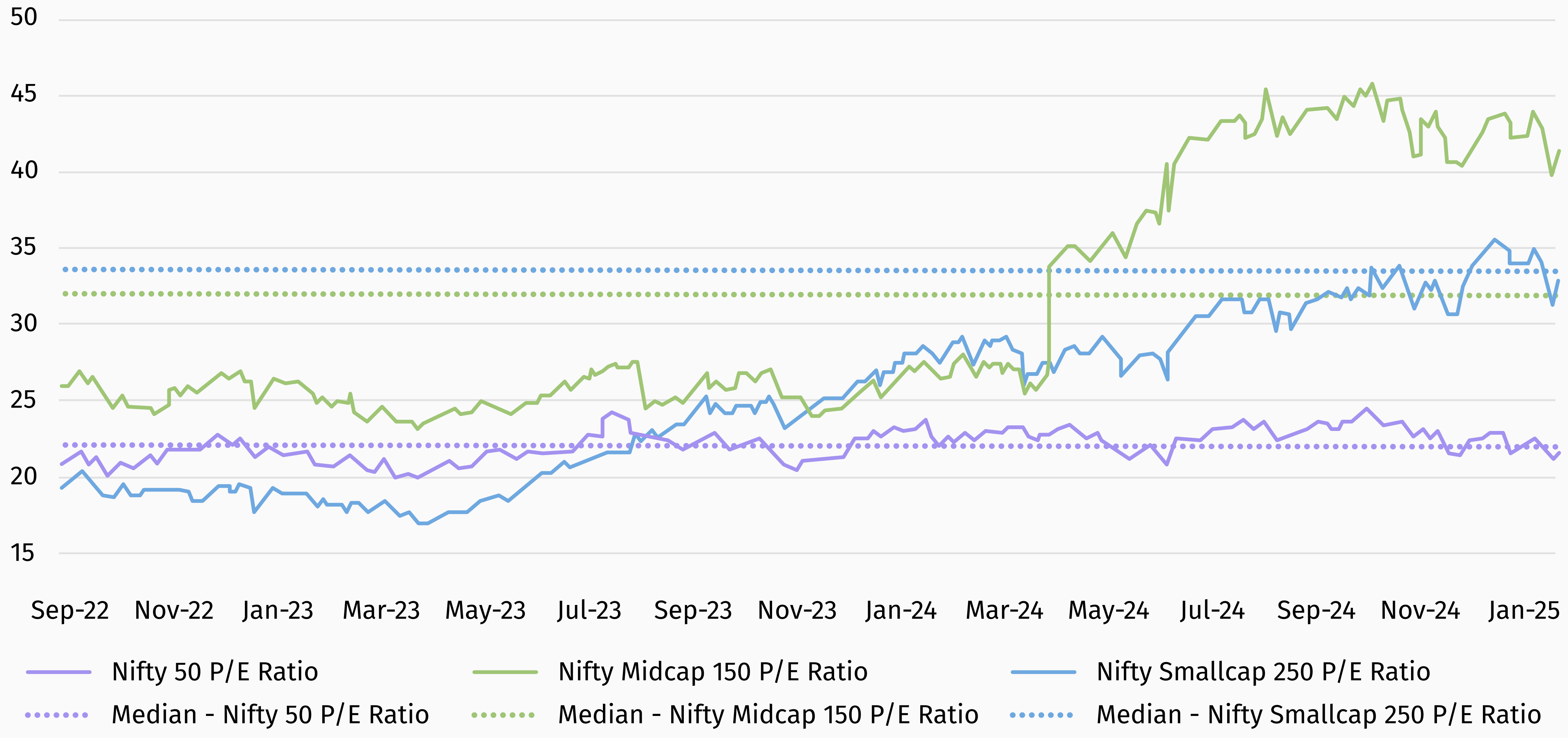
Asset Class	Outlook 2025	Key Drivers	Risk Factors
India Medium/ Long Term Bonds (>3 years)	Risk Rating **2**/5 **Positive**	• Improving fiscal metrics with the government shifting to debt-based targeting from fiscal deficit targeting. • Strong foreign inflows due to inclusion in global indices (JPMorgan, Bloomberg, FTSE Russell). • Clean corporate balance sheets at 15-year low debt-equity ratios supporting credit quality.	• US fiscal expansion and trade policies potentially reigniting inflation there, leading to higher Treasury yields. • Narrowing India-US bond yield spread impacting foreign investment flows amid USD strength.
Gold	Risk Rating **1**/5 **Positive**	• Preference by central banks for gold over USD for FX reserves, with projected net buying of 450 metric tonnes in 2025. • Higher inflation expectations in US due to potential trade tariffs and expansionary fiscal policies. • Geopolitical tensions in Middle East and Eastern Europe driving safe-haven demand. • Moderately loose monetary policy in China supporting prices.	• Adoption of Bitcoin as strategic reserve by developed countries potentially diverting investment flows. • Potential gold sales by Russia (holding 2,336 metric tonnes) due to economic challenges.
India Residential Real Estate	Risk Rating **2**/5 **Positive**	• Expected 50-75 bps rate cuts in 2025 improving home loan affordability, particularly in the end-user and affordable-mid segment categories. • Rapid growth in peripheral areas around metro cities due to improved infrastructure and connectivity. • Increasing demand from HNIs and NRIs in luxury segment driving premium valuations, supported by depreciating rupee and rising disposable incomes.	• High inventory levels in major metropolitan areas impacting price appreciation. • Market consolidation favouring established developers over smaller players.

Risk Rating reflects 1 Finance's proprietary framework combining quantitative and qualitative factors to assess downside risks across asset classes. Our methodology evaluates macroeconomic indicators, valuations, and market dynamics to assign ratings from 1 (lowest risk) to 5 (highest risk).

Valuation Divergence in Indian Equities Should Reduce

The recent run-up in valuations of mid and small cap companies was due to stabilisation of input cost inflation to reasonable levels (post geopolitical conflicts led supply chain disruptions) leading to margins expansion and earnings growth. With uncertainty around foreign capital inflows, rupee stability and domestic/global growth, there are few immediate drivers of earnings growth for them and hence valuations seem high. Large caps are much better placed to benefit from the current economic scenario.

Large Caps are Expected to Lead Performance in 2025



Source: CMIE Economic Outlook, 1 Finance Research

Select Sectoral Themes to Perform Better

Given the elevated starting valuations for certain sectors, the room for valuation re-rating for them is minimal. However, the key to building a robust equity portfolio will be in finding the beneficiaries of a weaker rupee, pickup in domestic consumption and government CAPEX.

Sectors	Current Valuation		Valuation Level					
IT	Expensive P/E	33.6	9.6	16.7	19.7	26.0	34.5	51.8
Banks	Reasonable P/B	2.2	0.8	1.1	2.0	2.7	3.0	5.0
PSU Banks	Reasonable P/B	1.2	0.4	0.7	0.9	1.3	1.9	2.8
Auto	Reasonable P/E	22.3	7.8	16.9	20.4	33.2	47.5	60.0
Energy	Expensive P/E	15.7	7.7	11.0	12.2	14.1	15.9	18.2
Pharma	Reasonable P/E	34.7	19.9	28.9	33.1	45.5	52.4	83.3
FMCG	Expensive P/E	45.1	27.0	31.3	35.6	42.0	44.5	51.5
Metals	Expensive P/E	20.1	3.7	8.3	10.7	15.5	25.6	45.4
Infrastructure	Reasonable P/E	23.7	12.7	16.8	19.7	26.5	37.9	77.4
Realty	Reasonable P/E	47.9	4.2	16.8	28.6	48.3	67.5	87.2

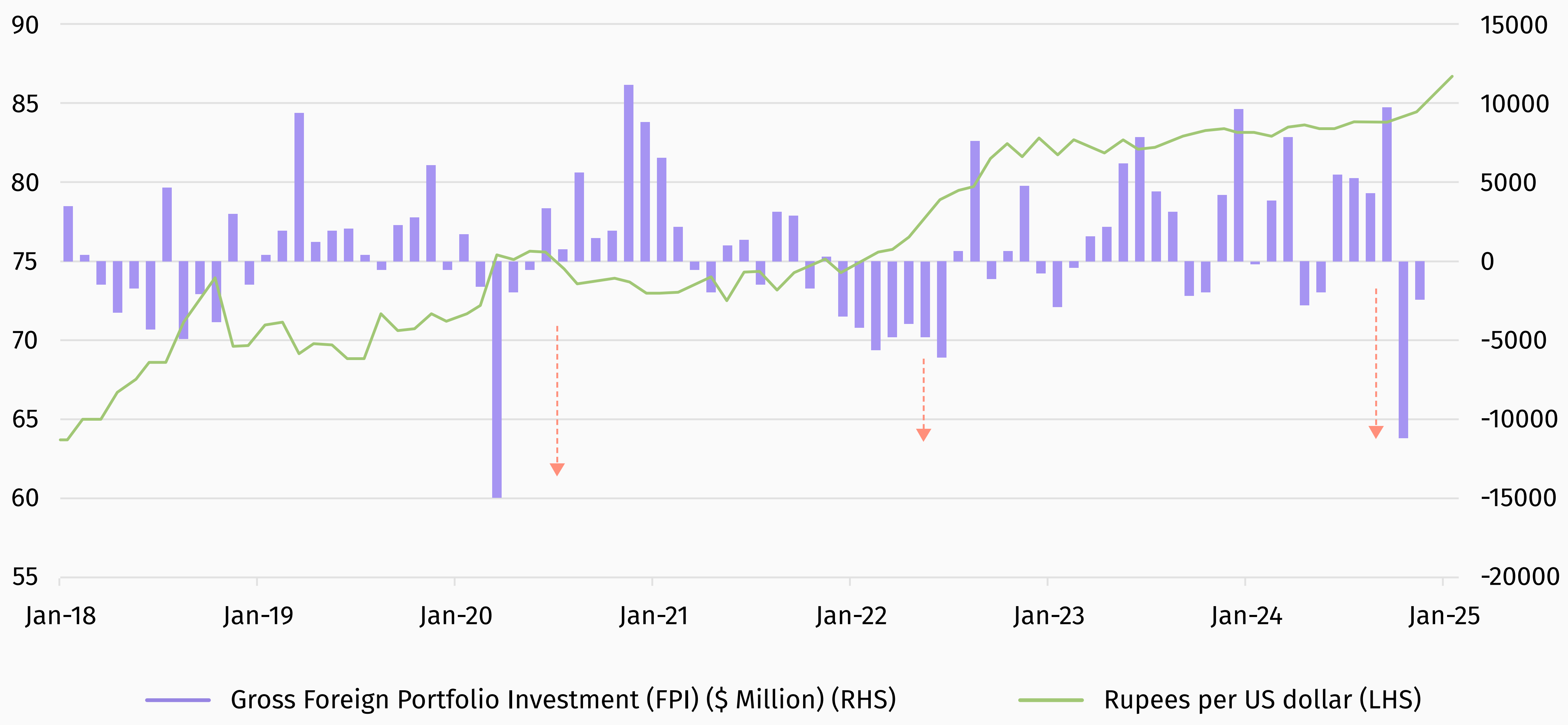
Source: CMIE Economic Outlook, 1 Finance Research

Rupee Depreciation to Continue in Near-term

The rupee, which was quite stable in 2023 and 2024, has seen significant depreciation recently due to both domestic and global factors, such as limited FX intervention by the RBI, FPI outflows due to a pickup in US inflation, and fresh US sanctions on Russia's oil.

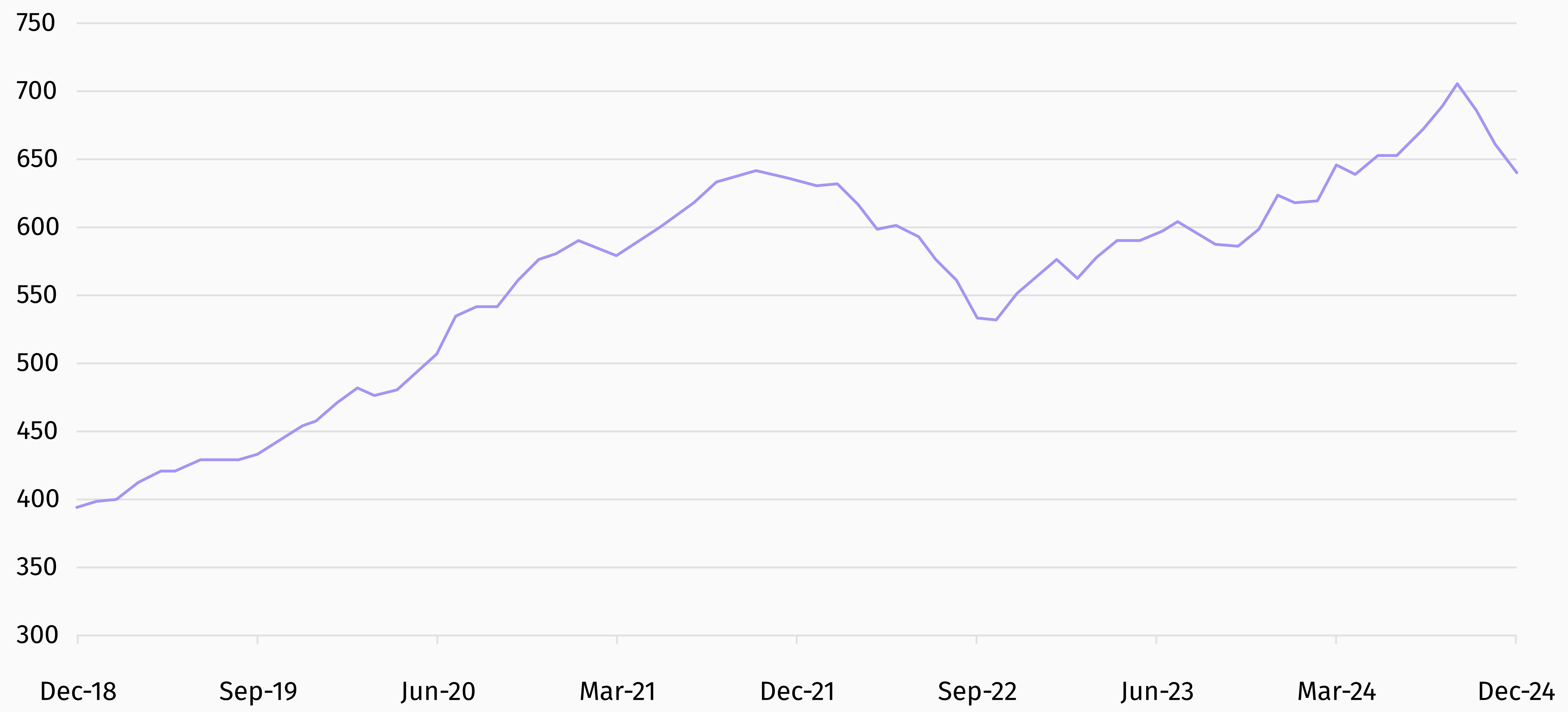
The RBI reduced its foreign exchange reserves by nearly $70 billion from their peak of $705 billion in Sep-24. However, FX intervention is expected to be limited under the newly appointed RBI governor, unless extreme circumstances arise.

Rupee Depreciation Pressure Due to Strengthening USD and Investor Capital Outflow



Source: CMIE Economic Outlook, 1 Finance Research

India's Foreign Exchange Reserves ($ Billions)

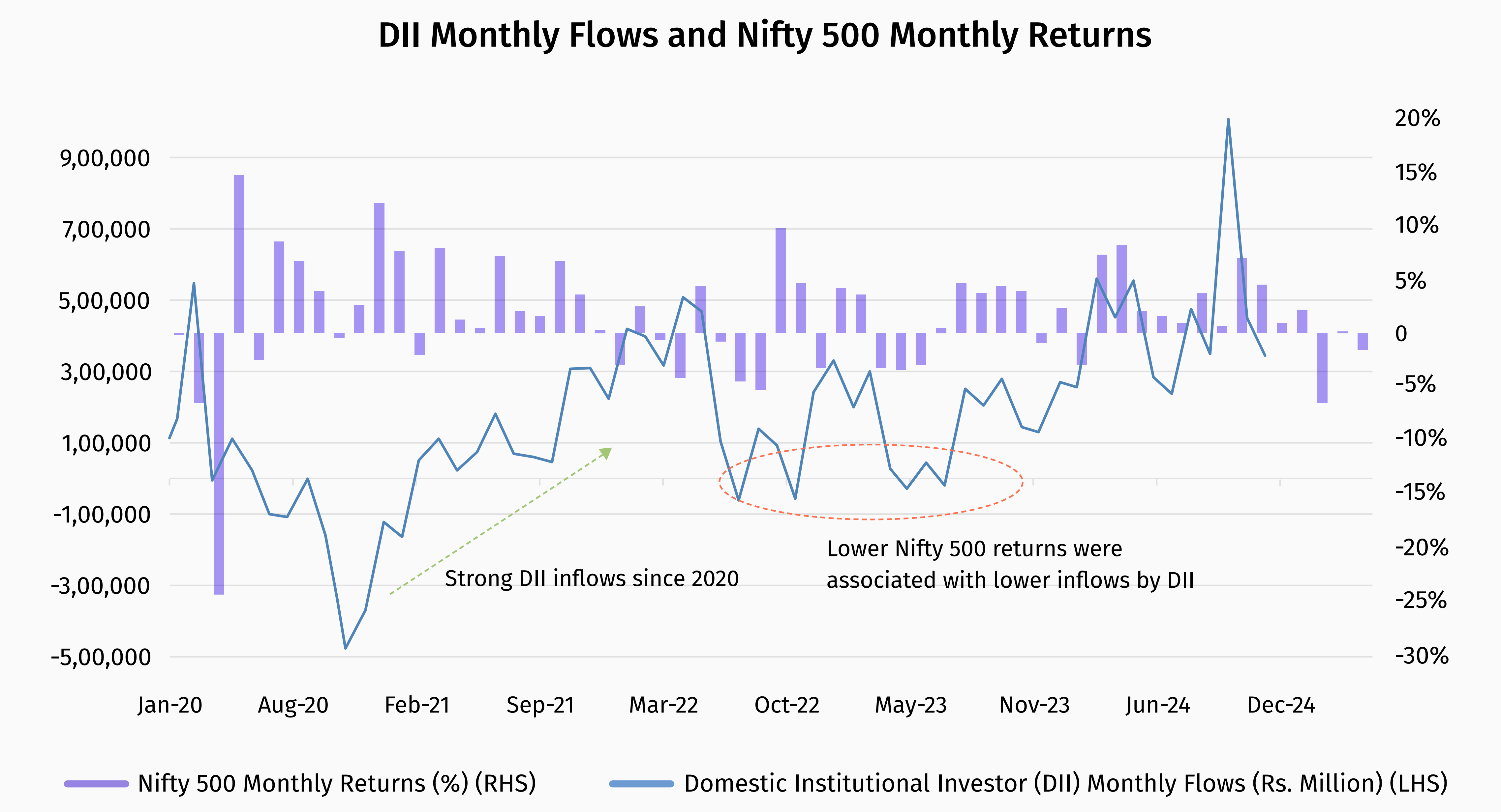


Source: CMIE Economic Outlook, 1 Finance Research

DII Inflows Unlikely to Maintain Past Momentum

DII inflows have been quite strong in a largely unidirectional Indian stock market since 2020. In 2024, DIIs provided support to market valuations, offsetting the impact of foreign capital outflow. But when markets consolidate DII flows become negative.

What cautions us about DII flows is that since 2020 a lot of young domestic investors, with little experience in volatile times, have entered the stock market.



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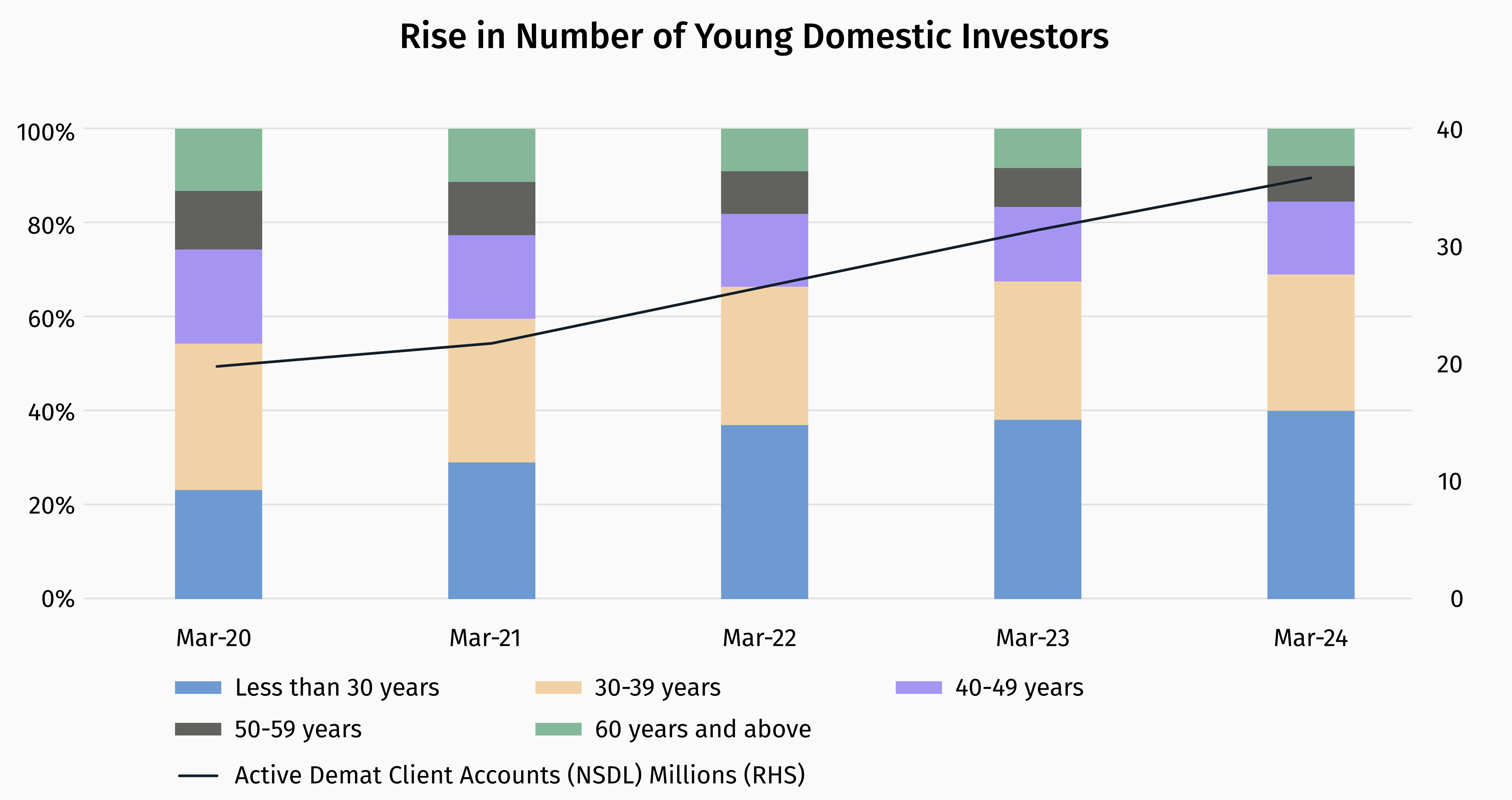


Source: NSE India, CMIE Economic Outlook, 1 Finance Research

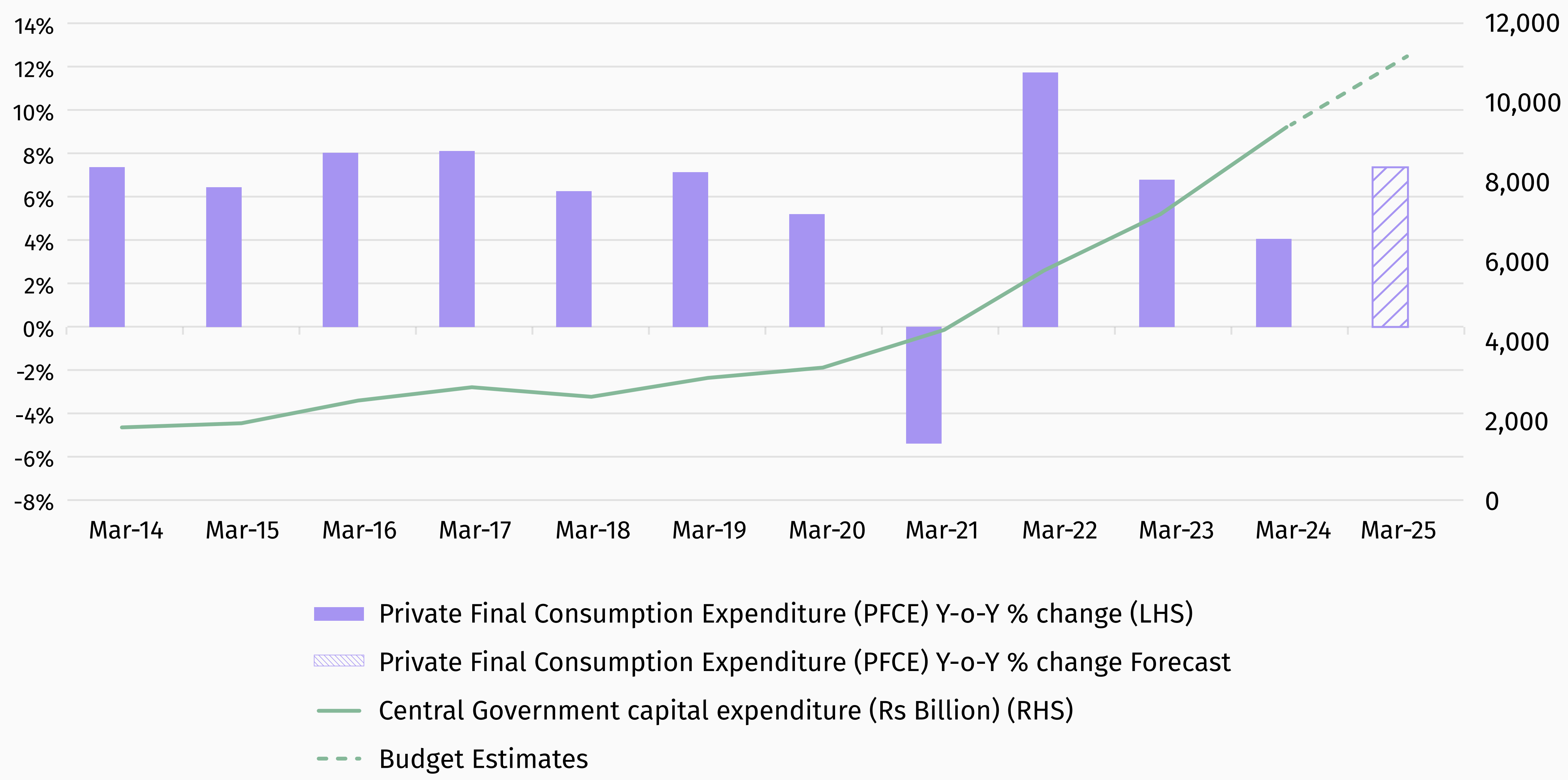
Government's Infrastructure Push Drives Recovery

The government's capex focus on infrastructure, particularly roads, railways, and urban development, has created employment and boosted rural incomes. This, combined with moderating inflation, has driven consumption recovery back to pre-COVID levels, especially in rural areas.

Banking Sector Health Supports Growth Momentum

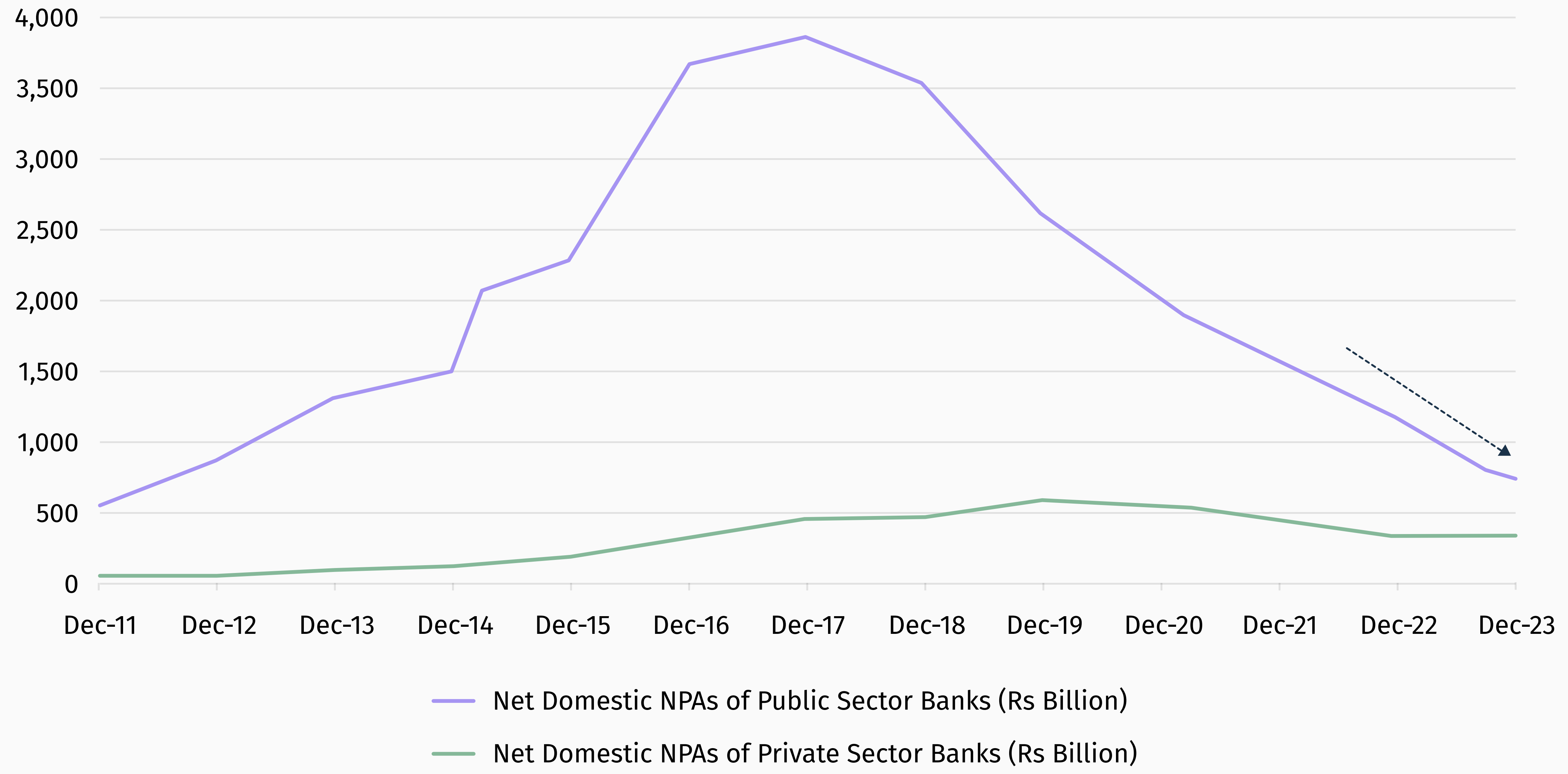
Public and private sector bank NPAs have dropped to historic lows, creating a strong base for India's growth. This improved asset quality, along with expected rate cuts and government spending on infrastructure in 2025, positions banks to fund the next phase of private sector expansion. Companies with low debt levels are well-positioned to take advantage of this banking sector's strength as consumer demand recovers.

Private Consumption Growth Back at Pre-Covid Levels



Source: CMIE Economic Outlook, 1 Finance Research

Clean Banking Sector Balance Sheet

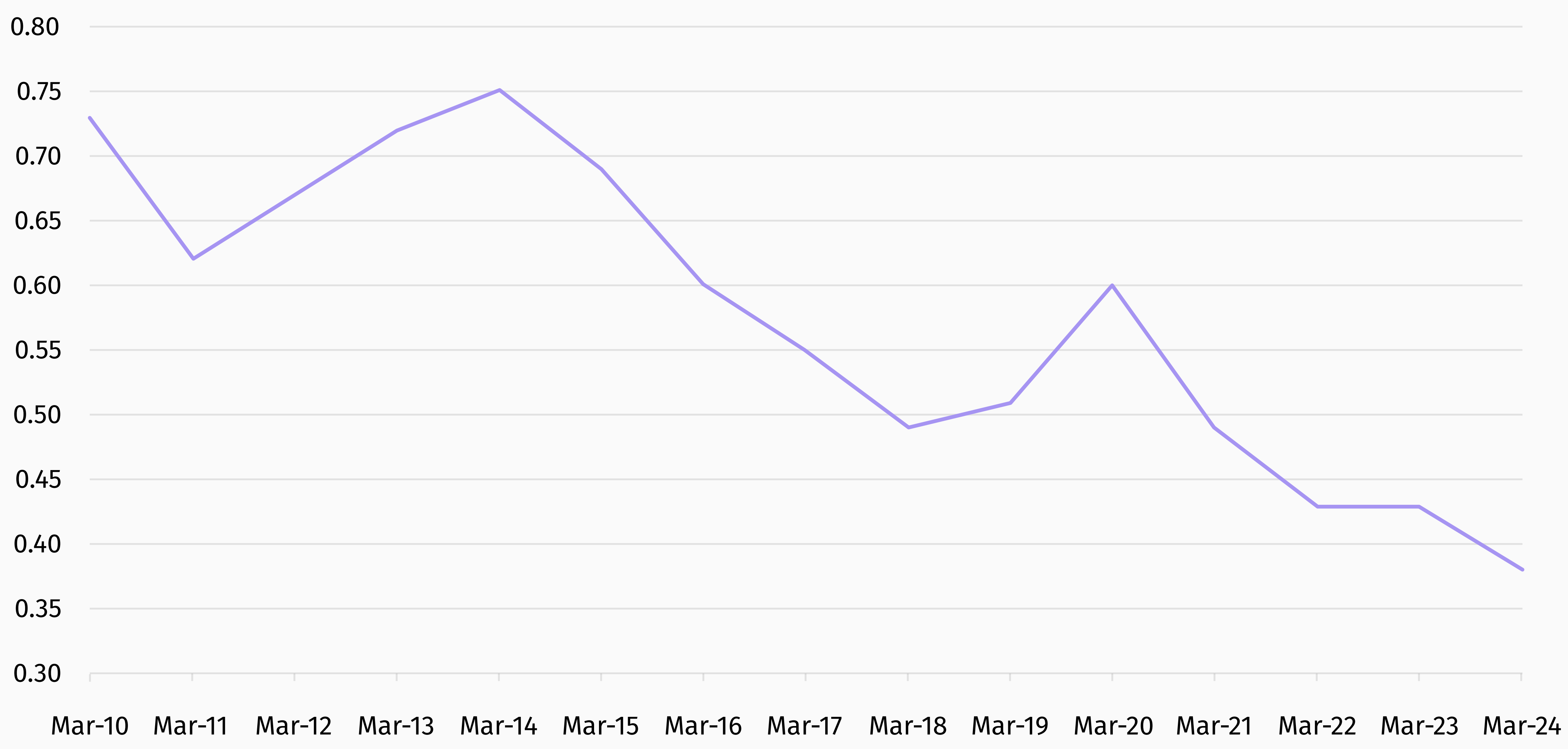


Source: CMIE Economic Outlook, 1 Finance Research

Manufacturing Sector Ready for Capex Cycle

Manufacturing companies' debt-to-equity ratios have reached multi-decade lows, while capacity utilisation has remained above 70% since the end of 2021, creating significant headroom for expansion. This balance sheet strength, combined with PLI schemes across 14 sectors and expected rate cuts in 2025, positions the sector well for growth. Large manufacturers are particularly well-placed to benefit from the government's ₹1.97 lakh crore PLI outlay and rising domestic consumption.

Debt to Equity Ratio: Manufacturing Sector

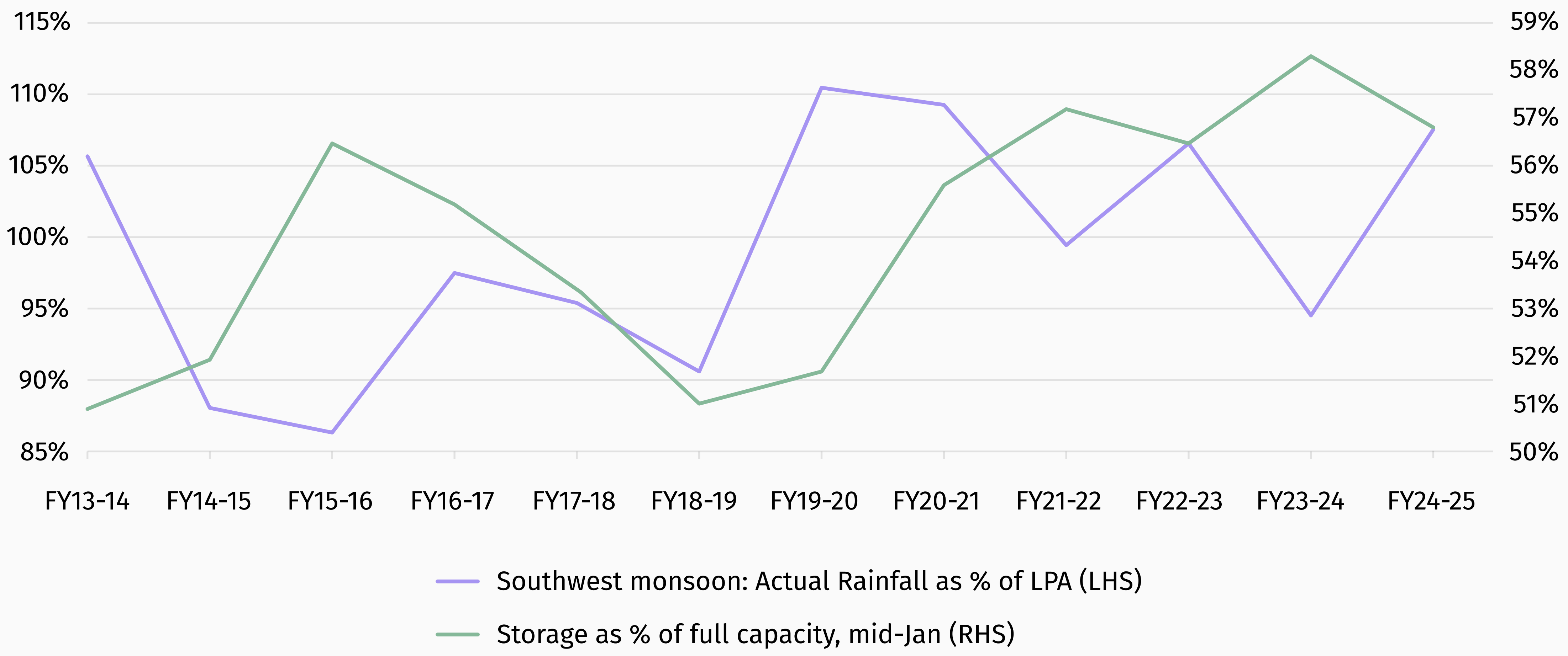


Source: CMIE Economic Outlook, 1 Finance Research

Agriculture Recovery to Drive Rural Growth

Above-normal monsoon rainfall at 106% of LPA in 2024 has significantly improved reservoir levels across regions. This has created a strong foundation for Rabi crops in 2025.

Above Normal Monsoon Leads to Higher Reservoir Levels

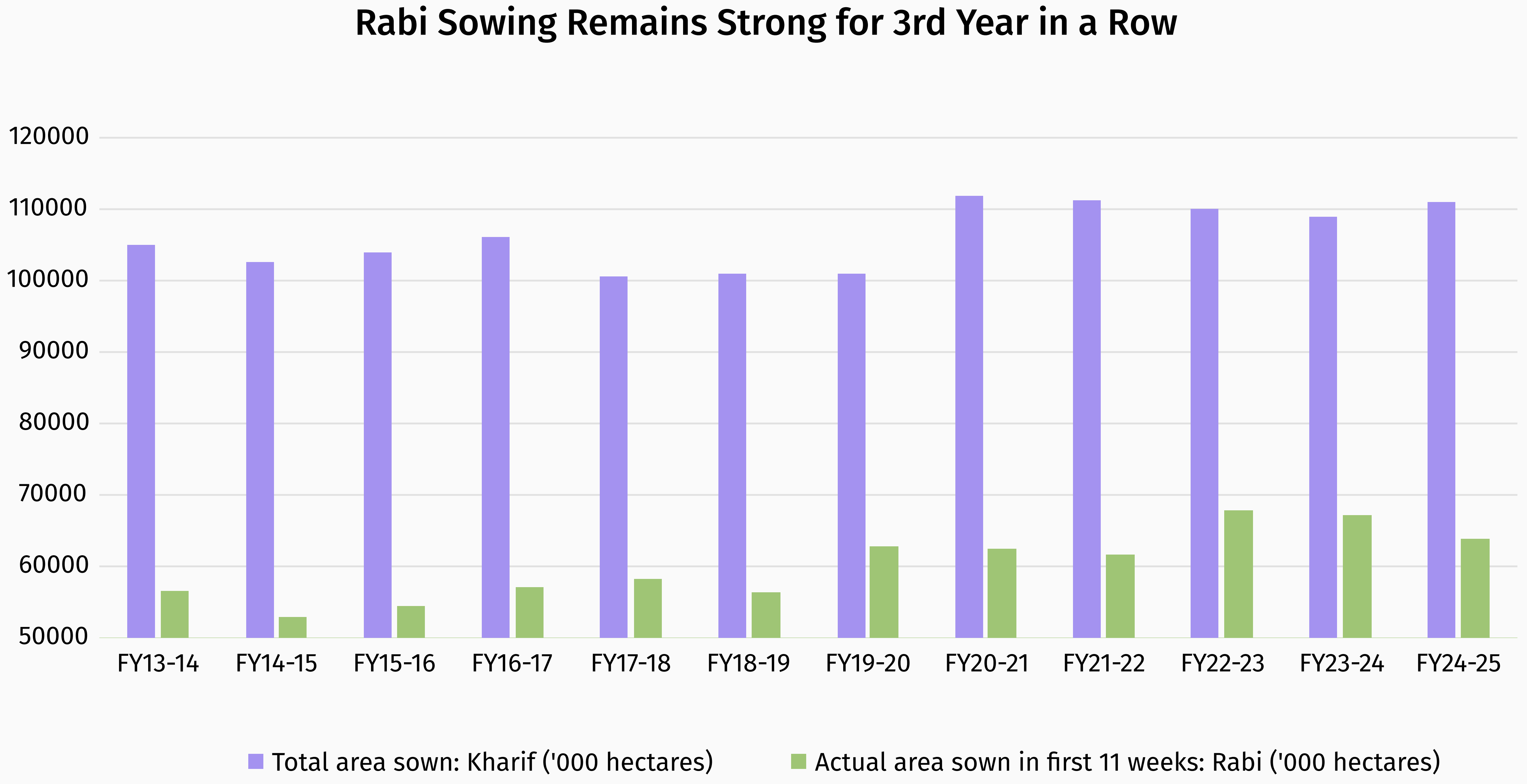


Source: CMIE Economic Outlook, 1 Finance Research

Agriculture Recovery to Drive Rural Growth

Early Rabi sowing data indicate robust sowing for the third year in a row. These sowing trends and early predictions of above-normal rainfall in 2025 should deliver 4%+ agricultural growth. This increased production should help moderate food inflation.

Rural consumption is showing signs of revival, supported by good agricultural performance and moderating input costs. Rural inflation has been sequentially coming down from an average of 6.9% (2022) to 5.8% (2023) and then to 5.4% (2024). In 2025, it is anticipated that improved agricultural incomes and further cooling of rural inflation will increase demand in rural areas.



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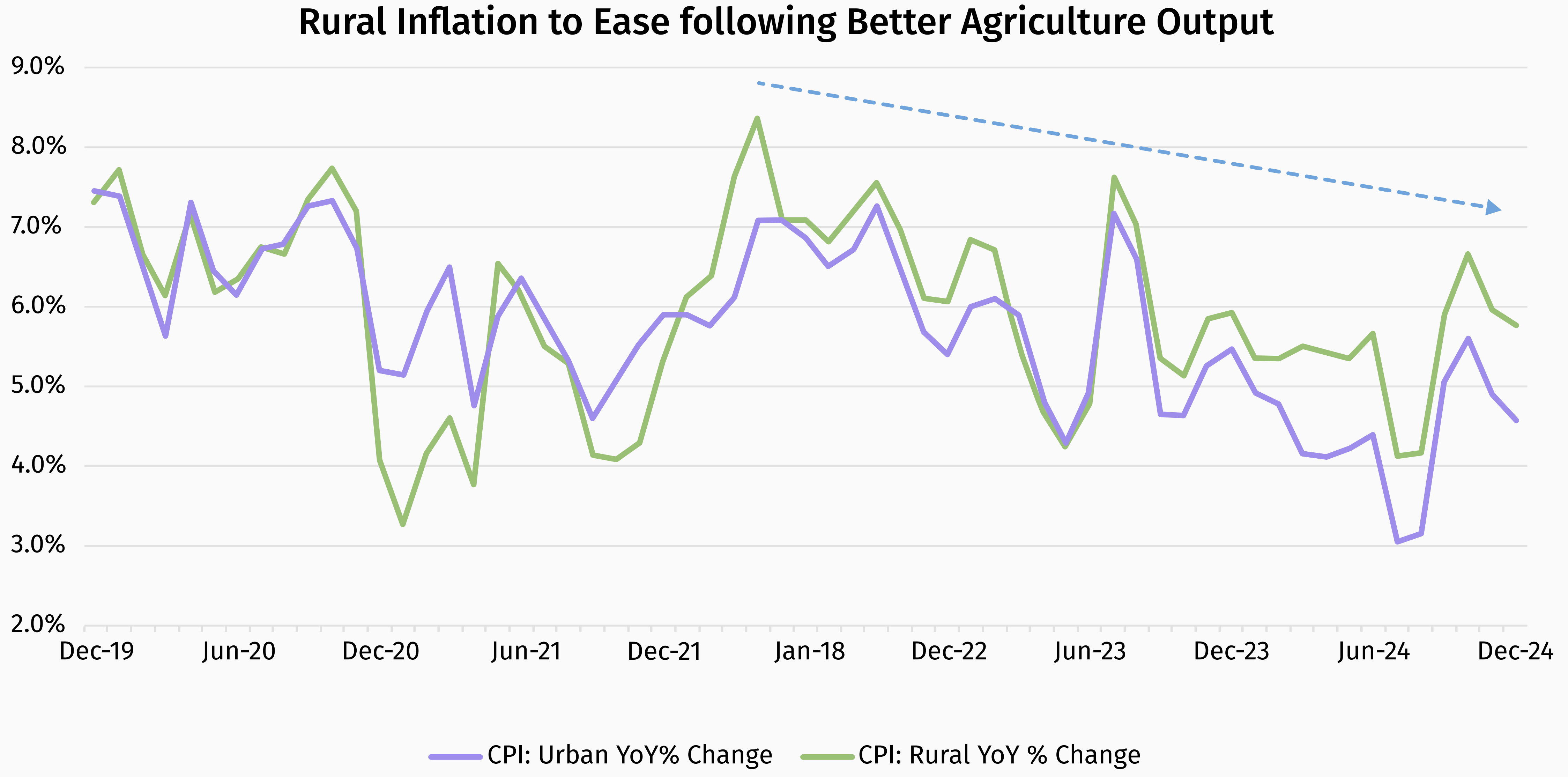


Source: CMIE Economic Outlook, 1 Finance Research

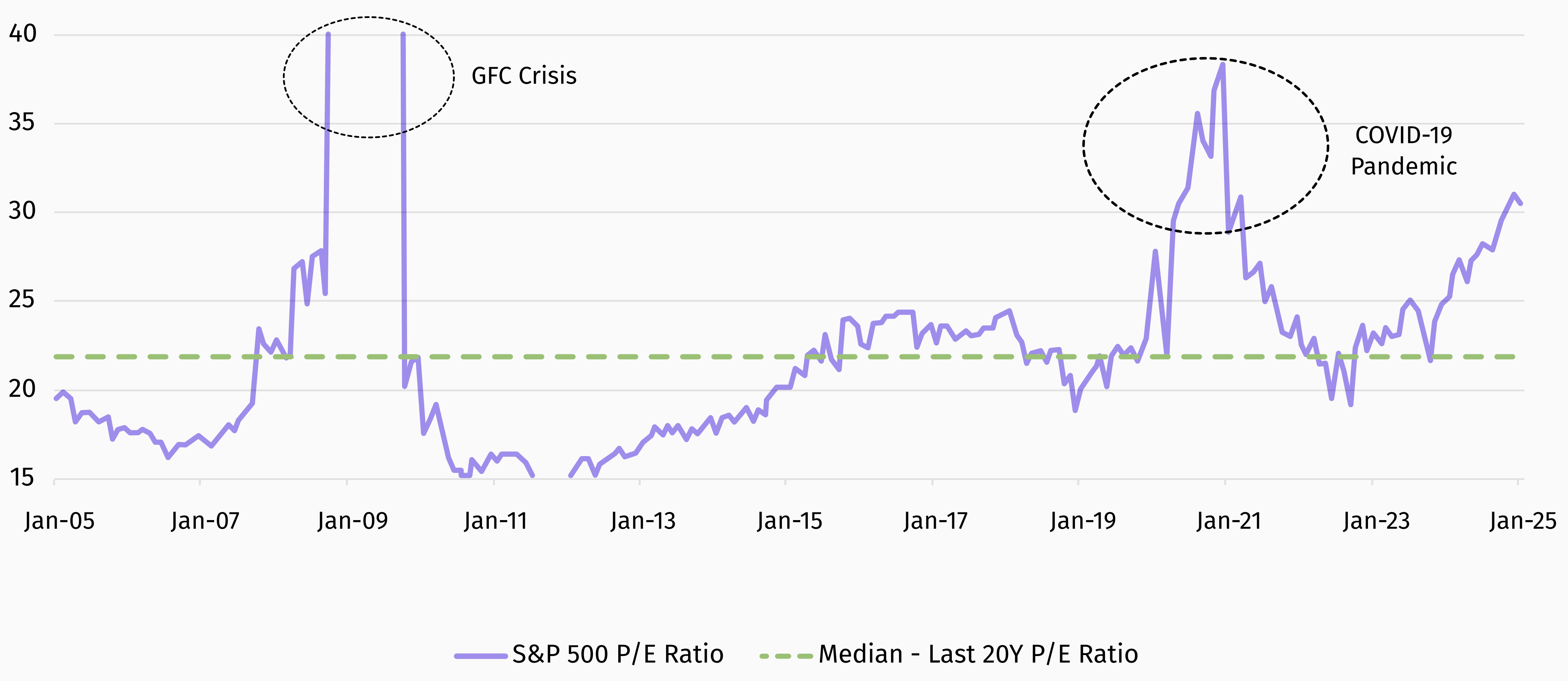
US Market Rally Faces Multiple Stress Tests

The US equity market enters 2025 with mixed signals. While consumer spending remains resilient, supported by a tight labour market and strong household balance sheets, structural challenges loom large. The S&P 500's current P/E ratio at 30.6x, ranking way above the last 20-year median P/E ratio of 21.9x, suggests limited room for further valuation expansion.

The proposed federal spending reductions, even if modest compared to the targeted $2 trillion cuts, could help improve fiscal health. However, this comes amid concerns about sticky inflation and potential trade tariffs that could trigger inflationary pressures. The Fed's likely shallower rate cut cycle than market expectations adds another layer of uncertainty.

The combination of high fiscal deficit, historic levels of public debt, and elevated equity valuations creates a challenging environment for US equities in 2025. While pro-growth measures including potential tax cuts could boost corporate earnings, the market appears to have already priced in an optimistic scenario.

US Equity Market is Quite Expensive



Source: CMIE Economic Outlook, 1 Finance Research

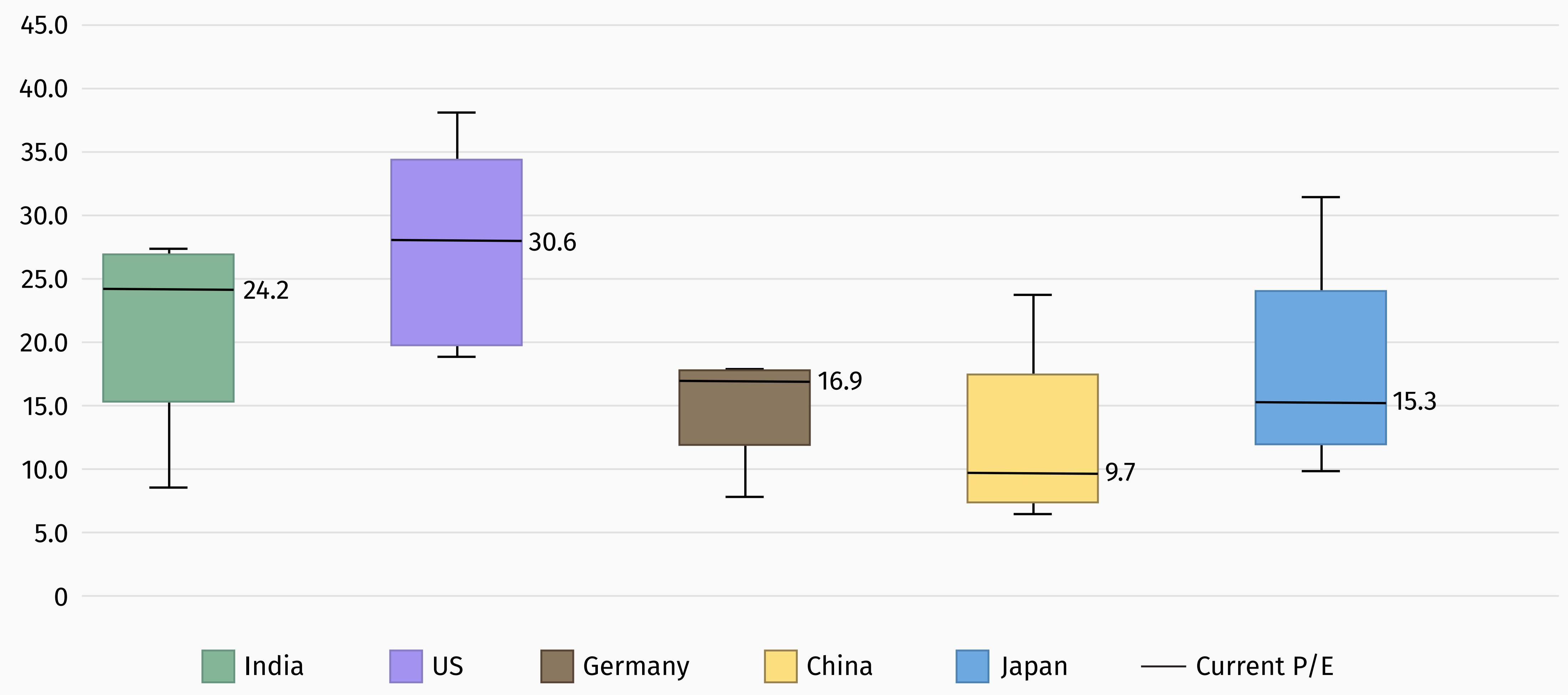
China's Growth Revival Hinges on Policy Support

China's equity market presents a compelling opportunity in 2025, driven by aggressive policy measures to combat deflation and revive growth. The comprehensive stimulus package, including monetary easing and fiscal expansion reaching 4% of GDP, aims to stabilise the economy. Chinese equities trading at significant discounts to global peers offer attractive entry points for long-term investors.

The government's strong policy support for new growth sectors, including semiconductors, EVs, AI, and advanced manufacturing, demonstrates a clear shift towards high-value industries. This transition, backed by moderately loose monetary policy, positions China's technology and manufacturing sectors for potential outperformance.

However, structural challenges persist. GDP growth is expected to moderate to 4.0-4.5% in 2025 due to potential US tariff implementation. The property sector continues to struggle, with new home sales and completions down by more than 50% from 2021 peaks. Ageing demographics and weak consumer confidence present additional headwinds that could limit the pace of economic recovery.

P/E Valuation of China versus Other Top Economies



Source: World PE Ratio, 1 Finance Research

P/E Ratios are based on iShares MSCI India ETF, S&P 500, iShares China Large-Cap ETF, iShares MSCI Germany ETF, and iShares MSCI Japan ETF.

Box Plot Interpretation:

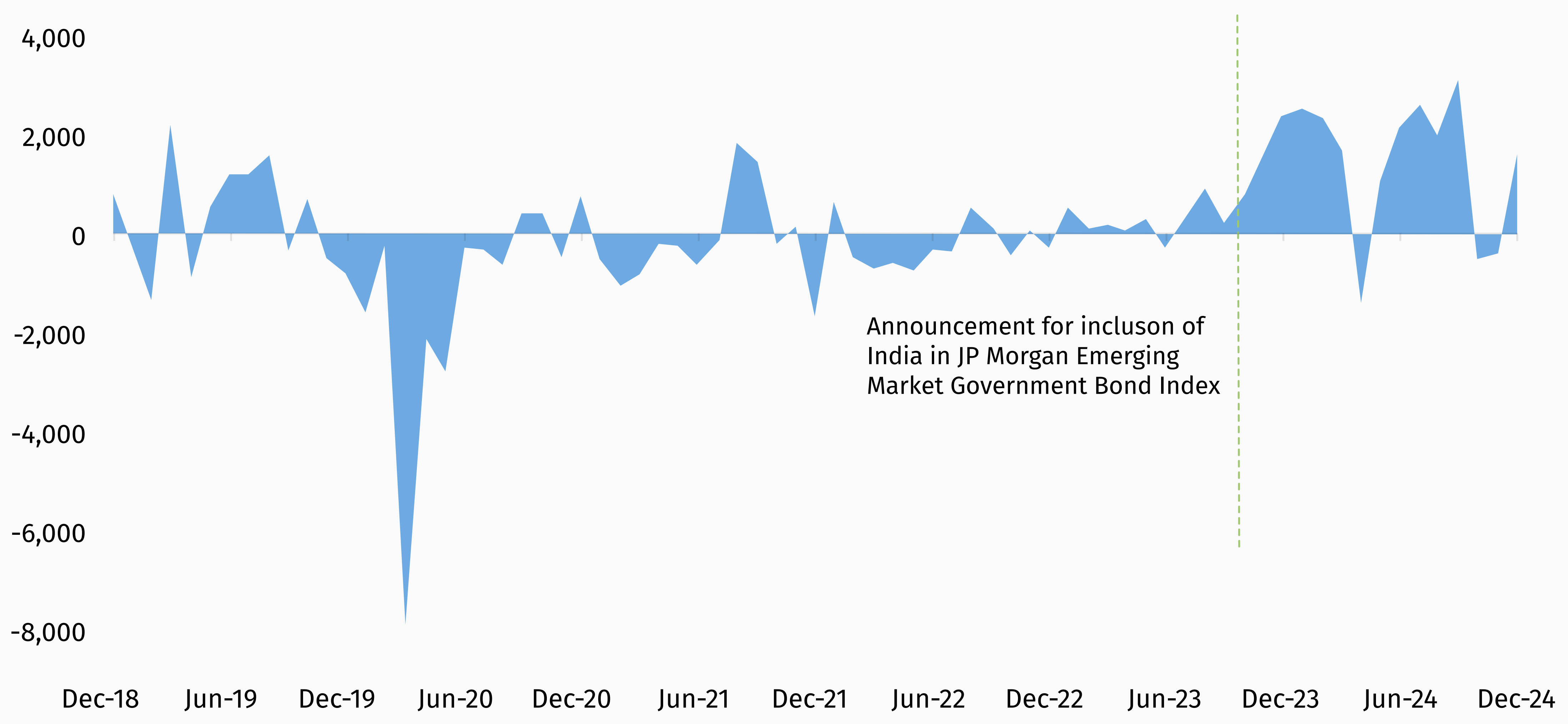
1. Centerline shows the current P/E ratio
2. The box represents one standard deviation range based on P/E values over 10 years
3. Whiskers show minimum and maximum P/E values over 10 years

India Short-Term Bonds to Lead Rate Cut Rally

FPI inflow into Indian bonds has been significantly influenced by the country's inclusion in the JP Morgan Bond Index, which started in Jun-24 and will end in Mar-25. FPI inflows, among other things, have caused bond yields across maturities to decline by 50 basis points since the inclusion announcement in Sep-23. The yield curve has remained relatively flat over this time.

Meanwhile, the differential between India and US 10-year bond yields has fallen to a multi-decade low of 2.1%, which after adjusting for the rupee's depreciation rate versus the dollar makes long-term US bonds more appealing to foreign investors.

Global Bond Index Inclusion Impact - FPI Inflows in Debt (Rs Million)



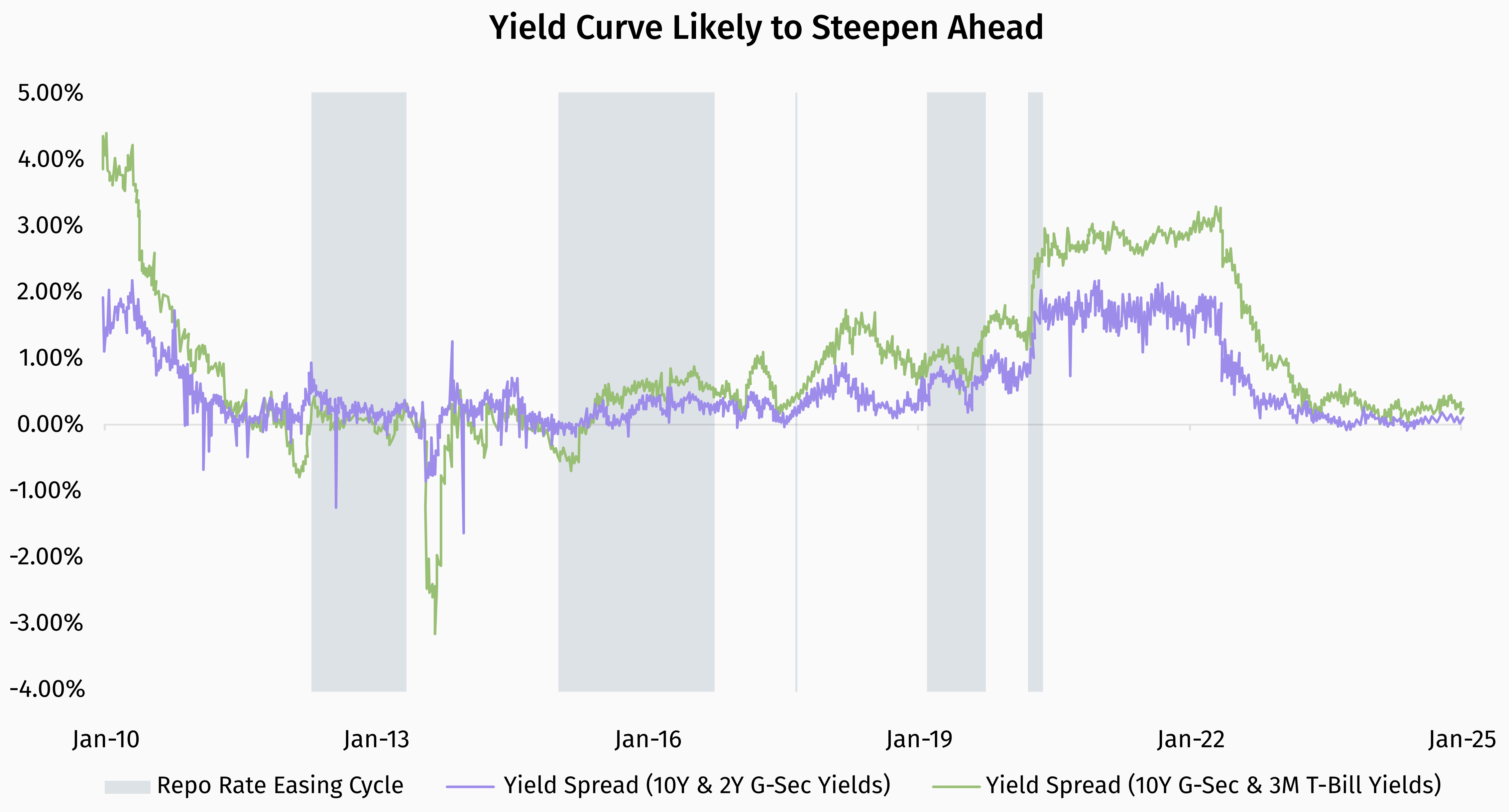
Source: CMIE Economic Outlook, 1 Finance Research

India 10Y vs Us 10Y Yield Spread

Source: Federal Reserve Economic Data (FRED), CMIE Economic Outlook, 1 Finance Research

India Short-Term Bonds to Lead Rate Cut Rally

With longer-term yields under pressure and a gradual and shallow rate cut cycle beginning in 2025 with a total repo rate decrease of 50-75 basis points, short-term bonds (with maturities of less than three years) are expected to experience a higher fall in yields than long-term bonds. This could cause a steepening of the yield curve.



Source: CMIE Economic Outlook, 1 Finance Reasrech

Gold Set to Benefit from Rate Cut Cycle

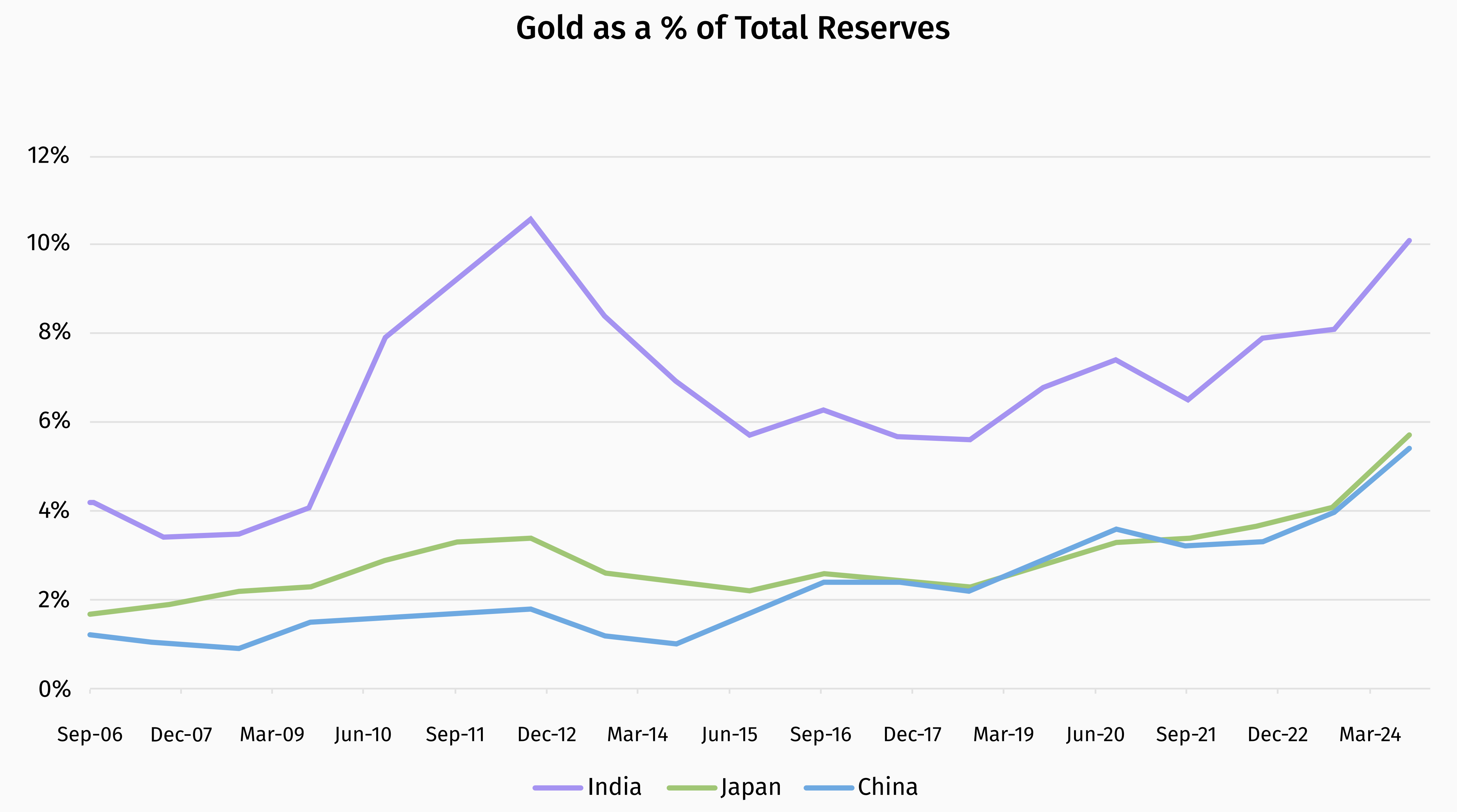
In the last five rate cut cycles covering the last 20 years, anytime the repo rate was cut in response to an economic slowdown rather than a significant financial crisis, Gold outperformed the Nifty 50 in the subsequent one-year period. This demonstrates gold's potential to offset risks, especially during phases of monetary policy transitions.

Date of First Rate Cut	Reason	Repo Rate		1Y Returns	
		Starting	1Y Later	Gold	Nifty 50
20 Oct 2008	GFC Crisis	9.00%	4.75%	11%	64%
17 Apr 2012	Private capex slowdown	8.50%	7.50%	12%	8%
14 Jan 2015	Export weakness	8.00%	6.75%	-4%	-9%
07 Feb 2019	Growth deceleration	6.50%	5.15%	23%	9%
26 Mar 2020	COVID-19 Emergency	5.15%	4.00%	51%	68%

Source: ACE MF, 1 Finance Reasrech

Gold prices as of Gold London AMR (INR)

Further, according to the World Gold Council, central banks worldwide have been adding approximately 400 metric tonnes (MT) of gold annually to their reserves since 2009. Over the past five years, China (316 MT), India (235 MT), and Japan (81 MT) have added the most gold to their reserves among the major economies.

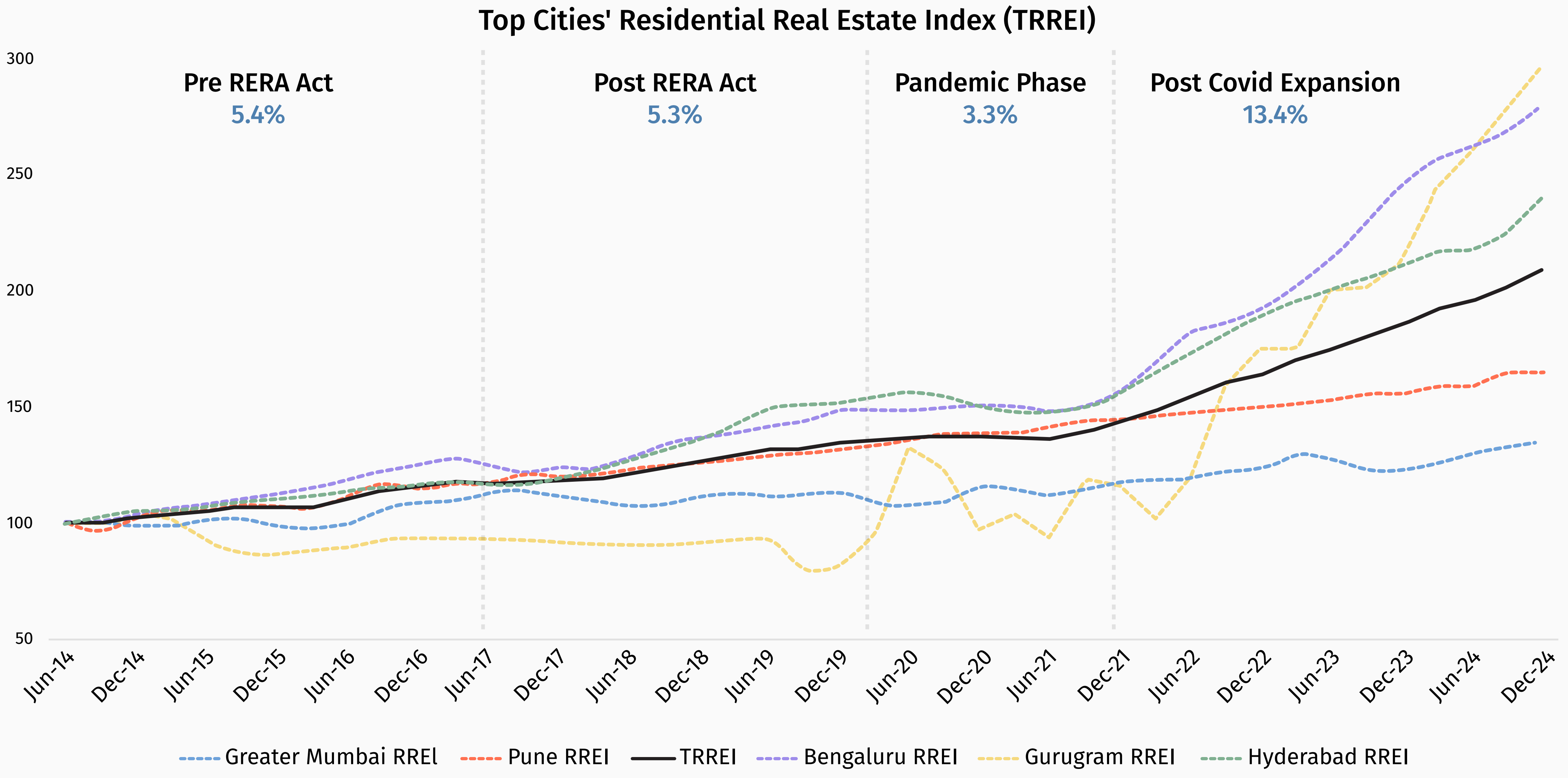


Source: World Gold Council, 1 Finance Reasrech

Rising Incomes and Rate Cuts to Drive Residential Prices

Despite high mortgage rates, residential unit sales in the top cities have been brisk. This is indicative of the lack of rate sensitiveness of buyers of high-end, luxury units. Sales volumes in 2025 are likely to be lower than 2024 levels, but demand should remain robust, helping deliver significant price appreciation.

The increased demand resulted in fewer months of inventory available through most of the top cities, although inventory levels still remain high for certain cities.



Source: CRE Matrix, NHB, 1 Finance Research

The CAGR returns for each phase are written in blue

Quarter	Greater Mumbai	Pune	Bengaluru	Gurugram	Hyderabad
Q4 2023	52	33	10	4	16
Q1 2024	54	33	11	6	17
Q2 2024	52	32	9	7	18
Q3 2024	51	32	17	7	23
Q4 2024	48	31	10	15	17
Unsold Inventory*	1,85,975	2,40,355	55,483	17,863	98,206
Monthly Unit Sales**	3,893	7,640	5,403	2,169	5,970

Source: CRE Matrix, 1 Finance Research. Quarters mentioned as per Calendar Year.

* As of Q4 2024

** Last 8 quarter average of units registered

Looking Ahead

As we progress through 2025, political transitions and policy shifts are taking centre stage, with nearly half the world's population having participated in elections in 2024. The impact of these democratic exercises is now unfolding across major economies.

The Indian government's execution in terms of capital expenditure and policy building will be critical in building key infrastructure, boosting consumption among the Indian population and giving confidence to the corporate sector to start investing in more capacity building. With public and private sector bank NPAs at historic lows and manufacturing companies' debt-to-equity ratios at multi-decade lows, the foundation for this growth is already in place.

The decisions taken by the new president of the largest economy in the world will shape world trade, impact inflation through expansionary policies and ultimately affect the already stretched valuations of the US stock market, where the S&P 500's P/E ratio stands at 30.6x. Meanwhile, China's growth trajectory, while challenged by property sector issues and deflation risks, could benefit from comprehensive stimulus measures and policy support for new growth sectors.

Key themes shaping 2025:

- Rate cuts by major central banks amid growth-inflation balance
- Potential trade policy shifts under new U.S. administration impacting global markets
- Valuation normalisation across market segments in India
- Infrastructure push and rural consumption driving India's growth
- Gold's strategic importance in portfolio diversification

While uncertainties around global trade policies and monetary easing could create market volatility, India's strong domestic fundamentals and policy continuity provide a stable foundation for growth. The focus should remain on careful asset allocation and risk management as markets negotiate these transitions.