Recent Trade Deals and Fiscal Consolidation in Budget Support India's Credit Fundamentals

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CareEdge Global believes that the recently announced trade deals with the US and the European Union (EU), two leading trading partners for India, combined with the fiscal policy path outlined in the Union Budget 2026-27 uphold **India's (CareEdge Global BBB+/Stable)** credit profile.

The new India-US trade agreement is expected to lower US tariffs on imports from India to 18% from a currently prevailing cumulative headline tariff of 50% The proposed tariff could improve India's relative competitiveness of exports. Together with India's trade engagement with the EU, this could enhance the diversification and scale of India's exports and supports medium-term growth prospects.

At the same time, the Union Budget signals a steady and calibrated approach to fiscal consolidation, anchored in maintaining deficit target with continued emphasis on capital investment.

CareEdge Global Ratings expects these developments to cement India's growth trajectory. Further, a sustained commitment to medium-term fiscal consolidation bodes well for the country's sovereign credit profile.

Trade Deals a Positive for India's Credit Fundamentals

1. **US Trade Deal**

   Recent trade developments support India's sovereign credit profile by reducing external uncertainty and strengthening medium-term export competitiveness. The reduction in US tariff rates on imports from India to 18% could improve visibility around India's external trade environment.

   While India's trade dependence on the US is relatively low, higher reciprocal tariffs were expected to have a modest direct impact on growth, of 0.3-0.4%. However, India's improved relative tariff positioning vis-à-vis peers could mitigate these risks while further, enhance competitiveness and improve external position.

2. **EU Trade Deal**

   This is complemented by the recently concluded trade agreement with the EU, under which the EU will eliminate or reduce tariffs on 99% of imports from India over a seven-year period, while India will reciprocally reduce or eliminate tariffs on 97% of EU shipments.

   Together, these agreements broaden market access for Indian exporters, particularly in labour-intensive sectors such as apparel, gems and jewellery, and footwear, which have been affected by higher global trade barriers.

From a credit perspective, the improved tariff setting supports near-term growth prospects and enhances the predictability of export-linked revenues. By placing India on a more competitive footing relative to other emerging market exporters, these agreements could support export momentum amid a fragmented global trade environment.

Further, the improvement in external competitiveness has positive spillovers for capital flows and currency dynamics. Although the rupee remains under pressure, lower tariffs could help ease external pressure over time by supporting export receipts and investor confidence. This could partially offset persistent portfolio outflows, while ongoing reforms aimed at improving the investment climate continue to underpin India's medium-term FDI attractiveness.

Overall, these trade developments can be credit-positive over the medium term, as they contribute to a more predictable external environment, support foreign exchange earnings, and strengthen India's capacity to absorb external shocks. A more stable and diversified trade framework could help contain pressure on the current account and support currency stability, reinforcing India's external resilience and sovereign credit fundamentals.

India's Union Budget Supports Fiscal Consolidation

From a sovereign credit perspective, the budget broadly supports fiscal discipline, while retaining the growth target. Capital spending remains a priority, revenue expenditure including subsidies and administrative outlays, will likely see moderation.

Revenue assumptions underlying the targeted fiscal deficit appear largely credible. Some moderation in tax revenue is expected, reflecting ongoing GST rationalisation and income-tax relief measures introduced in FY26. This is expected to be partly offset by higher non-tax revenue, with dividend and surplus transfers providing near-term fiscal support.

The Centre's fiscal deficit is budgeted to decline to 4.3% of GDP by FY27, while achieving the target of 4.4% for FY26. This should gradually improve the debt metrics. The latest budget also marks the first year of debt-to-GDP as the new fiscal anchor. Along this line, the budget aligns with the medium-term debt sustainability framework, aiming for a gradual moderation in the debt-to-GDP ratio to 55.6% in FY27 from 56.1% in FY26. This measured approach will balance the fiscal adjustment scale as well as preserve the growth momentum amid a challenging external environment.

With fiscal consolidation being pursued at a gradual pace in FY27, we expect targeted reduction in the debt ratio to ~50% by FY31 to stem from a materially steeper and more sustained consolidation effort going ahead. That said, in a global environment where sovereign debt is mounting amid heightened uncertainty, India is one of the few economies to likely witness a downtrend in public debt over the medium term.

It is important to note the budget emphasises on maintaining India's growth momentum through continued prioritisation of capital expenditure. Public investment growth remains strong, reflecting an improvement in the quality and productivity of spending. The budget places emphasis on strengthening domestic competitiveness through investments in future-oriented sectors, such as logistics, manufacturing, skilling and supply-chain resilience, to combat external headwinds.

We believe that, while the path to fiscal consolidation remains intact, the credibility of non-tax revenue assumptions, particularly disinvestment proceeds remain a monitorable. The Centre has consistently fallen short of its disinvestment targets over the past six consecutive years. Renewed underperformance on disinvestment receipts could exert pressure on the fiscal balance.

Additionally, India's interest burden remains elevated relative to similarly rated sovereigns, reflecting way higher public debt and sovereign borrowing costs. This constrains debt affordability and limits fiscal flexibility.

More so, rising indebtedness of state governments, despite consolidation at the central level, could weigh on the country's overall fiscal outlook. State governments account for roughly one-third of general government debt, which is elevated at ~7.7% of GDP in FY26. Further, states have reported higher fiscal pressure due to rise in committed expenditure, particularly subsidies, salaries and social welfare schemes, along with weak revenue flexibility lately. These factors remain a structural drag on India's fiscal profile.

Conclusion

Overall, India's sovereign credit profile continues to be supported by resilient growth prospects, improving external visibility, and a calibrated approach to fiscal consolidation. Recent trade agreements reduce external uncertainty and enhance India's relative export competitiveness, while the FY27 Budget reinforces medium-term growth through a continued emphasis on public capital expenditure and investment-led expansion. While India's public debt levels and interest burden remain elevated, resilient domestic demand, diversified growth drivers, and comfortable external buffers are expected to support macroeconomic stability over the near to medium term. Sustained progress on revenue mobilisation, delivery on disinvestment targets, and effective debt management will be critical to maintaining fiscal credibility and supporting India's credit profile over the medium term.

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