

US tariffs: Implications for India

Uncertainty surrounding global trade policy has grown due to fluctuating tariff announcements by the United States (US), with the latest being a 25 per cent additional tariff on imports of automobiles and certain auto components. Other recent measures taken by the US include a 25 per cent additional tariff on imports from Canada and Mexico, a 20 per cent additional tariff on imports from China, and a 25 per cent tariff on aluminium and steel imports. Retaliatory tariff measures announced by other economies and consequent trade war have led to serious concerns around global growth and inflation. Global and Indian financial markets have been very volatile in the midst of these concerns.

India is concerned specifically about the reciprocal tariffs the US has threatened to impose on April 2. India's goods-trade surplus with the US has doubled over the past decade, reaching \$35 billion in FY24, with gems and jewellery, chemicals, electronics, and textiles being large contributors to India's exports to that country. India imposes an average tariff rate of around 11 per cent on US imports, compared to the US' average tariff rate of around 3 per cent on Indian imports. With the simplified assumption that under reciprocal tariffs, the US imposes an additional 8 per cent tariff on all imports from India, our analysis suggests that India's direct export loss from such tariffs could be limited to around \$3.1 billion annually (0.1 per cent of gross domestic product, or GDP). The analysis assumes some rupee depreciation, which would partially offset the impact of higher tariffs. The impact could be more severe, depending on the exact form of reciprocal tariffs. But that is not clear yet.

India has a relatively low trade exposure. Exports

of goods and services account for 21 per cent of GDP, with the share of goods exports being 12 per cent (FY24). Some other Asian economies, such as Thailand, have goods and services exports accounting for around 60 per cent of their GDP. Even with a lower trade exposure, the tariff war would still affect India through various direct and indirect channels. While India's overall exports would feel the pinch as global trade slows, the country could also see increased dumping from China as they face a higher tariff wall from the US. India could also face weaker investment sentiment in the midst of these uncertainties. Moreover, there could be pressure on capital flows and the currency as we have already witnessed in the past few months. As a result, the overall impact of tariffs on India could be more significant than the direct impact alone.



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Capital markets, in India and globally, will remain volatile in the midst of these uncertainties. The Indian rupee has seen some strengthening in the past 30 days after a sharp weakening of 4.4 per cent between October last year and February. We feel the weakening pressure on the rupee will continue, with the currency likely to trade at 88-89 by the end of FY26. We expect the ratio of the current account deficit to GDP to widen. However, we project it to still be comfortable at around 1.1 per cent of GDP in FY26 as against an estimated 0.7 per cent in FY25. Healthy services exports have been supportive of the current account balance in the last few years. Now coming to capital inflows, FY25 has not been a good year. Net FPI (foreign portfolio investment) inflows in FY25 (up to March 28) fell sharply to \$2.7 billion from \$41 billion in FY24. Net FDI (foreign direct investment) inflows amounted to \$1.4 billion in the first 10

months of FY25, down 88 per cent year-on-year. Weak FDI and FPI inflows may continue in FY26, putting pressure on India's balance of payments and the rupee. The Reserve Bank of India (RBI) may be comfortable with some rupee weakening because that could partially blunt the tariff impact. In fact, the yuan may weaken as a countermeasure against the US's tariff actions and that too will put downward pressure on the rupee. During the previous trade war, the US trade-weighted tariff rate on Chinese goods surged to around 21 per cent in 2019 from around 3 per cent in 2018. The yuan depreciated by 10-12 per cent during this period, putting pressure on the rupee.

There are concerns also around inflation being imported into India in the midst of the global trade war. However, with domestic inflation rates moderating, the RBI is likely to focus on supporting growth. We expect the RBI's monetary policy committee to cut the policy rate by 25 basis points in its April meeting. Further rate cuts are possible, depending on the monsoon situation and domestic price rise. If the US Fed continues with policy rate cuts in 2025, pressure on the rupee may ease, giving the RBI more room for further rate cuts.

India has been negotiating with the US for a bilateral trade agreement and the terms of that will play a very critical role in future. The silver lining in the ongoing global turmoil is that India will be compelled to go faster on some of the reforms to ensure growth sustainability. A lowering of tariffs by India will be beneficial in the long run, but the government will have to hasten on reforms to ensure competitiveness among domestic manufacturers. The other very critical piece will be to ensure strong domestic consumption because global demand will remain uncertain in the medium term.

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