Manulife
Investment Management

Investment Note

Sep 2025

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As Indian exports to the US face escalating tariffs, we examine the potential impact of these measures, placing them in the context of broader trade dynamics, sector-specific exposure, and macroeconomic implications. While a negotiated resolution remains the likely medium-term outcome, we also assess the risks if tariffs persist and explore possible policy responses.

The impact of US tariffs on Indian exports

Key facts

- From 7 August, Indian goods exports to the US have been subject to a 25% tariff. An additional 25% tariff came into effect on 27 August, effectively raising the headline rate to 50%[1].

- However, not all goods exports are tariffed. Pharmaceuticals, electronics, energy, and chemicals remain exempt. Adjusting for these exclusions, the weighted average tariff burden on the total basket of goods exports is closer to 34%, rather than the full 50%. Even at this level, India is now among the most heavily tariffed trade partners of the US, alongside Brazil and China[1].

- India's tariff is higher than the 15-20% faced by most Asian countries (excluding China). This increases the risk of India's commoditised exports being replaced by other exporting countries[2].

- India's total goods exports to the US today stand at approximately USD 87 billion — equivalent to around 20% of India's total goods exports and about 2% of gross domestic product (GDP) growth. Roughly USD 30 billion of exports, comprising pharmaceuticals, electronics, energy and chemicals, will remain exempt from levies, with the tariff burden falling on the remaining USD 57 billion or 1.3% of India's GDP[2].

- On an annualised basis, this USD 57 billion of goods exports face a potential loss of USD 25–45 billion, depending on demand compression and substitution. We believe such tariffs, if sustained, could impact India's GDP growth and its external balance if there are no policy offsets[3].

Macro impact

1. Trade balance

A potential loss of USD 25–45 billion in goods exports could widen India's current account deficit (CAD) by 60 to 100 basis points (bps). Our earlier assumption of CAD at 0.5% of GDP could shift towards 1.1–1.5% of GDP growth. Even at the upper level of 1.5%, the deficit remains within manageable levels, supported by India's strong foreign currency reserves[3].

2. GDP growth

The USD 57 billion at-risk goods exports represent about 1.3% of India's GDP, and the effective impact could be a hit of 50–80%, translating into a drag of 60–100 bps on GDP growth, without any policy support. These exports are concentrated in textiles, agriculture, and gems & jewellery — sectors that are labour-intensive and more easily replaceable by lower-tariffed suppliers to the US market, including but not limited to other South or Southeast Asian countries[3].

By contrast, large, organised sectors, such as pharmaceuticals, electronics, and chemicals, are not

[1] US White House, August 2025
[2] World Trade Organisation, ITC Trademap, JP Morgan, August 2025
[3] Manulife Investment Management's estimates, August 2025

directly impacted, though they may face indirect effects. We note that the US administration may announce sector-specific tariffs later.

3. Currency impact

A wider CAD could put pressure on the Indian rupee (INR). Depreciation risks would be higher if FDI inflows soften due to policy uncertainty. Importantly, India's large foreign currency reserves and credible macro framework should keep INR volatility contained, even if depreciation pressure arises.

We note that a moderate depreciation of INR could also provide a boost to the rest of India's exports.

4. Policy response

The above impacts on CAD, GDP and INR are quantified on a no-policy-response basis. In practice, policy support will cushion some of the effects. Since the most affected sectors are small and medium enterprise (SME)-heavy, the government will likely extend credit guarantees and ensure working-capital support through lenders, as it did effectively during COVID.

We believe that the Reserve Bank of India (RBI) could cut policy rates by 25–50 bps if the GDP growth impact trends toward more than 50 bps compared with the RBI's GDP growth forecast for India at 6.5% (year-on-year) for FY2026.

We also believe that an eventual deal is likely, with the tariff level aligning with that of other Asian countries. However, over the longer term, reducing reliance on the US market through export diversification will be essential.

5. Overall assessment

If tariffs continue for the short to medium term, the impact on growth, CAD, GDP and the INR remains manageable with policy support. If they persist over the longer term (more than 12 months), indirect effects could build. These would filter through supply chains, negatively affecting the labour market, consumer and investor confidence, as well as broader economic momentum. This is not our base case, but this situation has highlighted the need for deeper structural reforms for expediting investments, reviving domestic consumption and diversifying export markets.

Sector impacts

From a sectoral lens, the immediate pressure points are textiles, gems & jewellery, and agriculture. When combined, these form a modest share of India's GDP growth. By contrast, higher-value-added goods exports like pharmaceuticals, electronics and the most significant IT services remain exempt from tariffs. We will explore these in more detail below.

1. SMEs are impacted

SMEs account for over 50% of India's total exports, and many tariff-affected categories are SME-dominated. Sectors, such as textiles, marine products, and gems & jewellery, together employ nearly 50 million people. A decline in exports could put around 5 million jobs at risk, or roughly 10% of sectoral employment.

In the near term, these industries could face order losses and lower margins. Lenders in these sectors may also see some pressure, though an expected government credit guarantee and sector-specific support should limit risks.

2. Large organised sectors are not directly affected

Domestic organised consumer and infrastructure sectors are not directly impacted. Likewise, services exports — notably IT and pharmaceuticals — remain outside the tariff scope, insulating India's globally competitive sectors. This limits the direct impact on earnings of listed companies.

3. Opportunities in import substitution

Parallel to mitigation efforts, India's import substitution agenda continues to gain traction. The Production Linked Incentive (PLI) scheme in electronics manufacturing is a case in point. The PLI scheme enables India to build competitive scale and reduce its reliance on imports. Over time, these initiatives can offset part of the external drag, while laying the groundwork for new export opportunities.

Finally, we note that India's IT services exports through the global capability centres of mostly US corporations, and electronics and smartphone exports to the US have driven India's total exports post COVID and narrowed India's CAD. We continue to expect robust growth in those sectors alongside lower imports of electronics and energy due to the domestic pivot to renewable energy. These should help mitigate some of the potential downside from higher-than-expected tariffs. Still, for the sectors that are impacted and to contain indirect impact, policy response will be crucial.

Policy response will be critical

India has policy flexibility, fiscal strength, and monetary headroom to cushion the near-to-medium-term impact, without compromising on macro stability.

1. Fiscal and monetary measures are already in Place

The Indian government has announced a reform on its indirect tax system – GST (Goods & Services Tax) 2.0 – a simplified indirect tax regime with structurally lower tax rates, effective 22 September, 2025. The indirect tax reductions for a range of categories (including autos, consumer durables, packaged foods, and essentials) are expected to release approximately USD24 billion of consumer purchasing power. (Please refer to our investment note "GST 2.0 — A Structural Tax Cut at the Right Time" for more details.) This is on top of income tax cuts amounting to USD12 billion already announced in February. Both direct and indirect tax cuts put together can provide domestic demand support.

The RBI has already lowered policy rates by 100 bps and ensured ample liquidity in the market. Since the inflation has remained benign, we believe the RBI has room to further cut rates by another 25-50 bps in case the GDP growth impact by higher-than-expected US tariffs trends toward more than 50 bps compared with RBI's GDP forecast as mentioned earlier.

All such support is possible without impacting India's macro stability.

2. Sector-specific support

The government is likely to roll out targeted measures for SME-heavy sectors, including credit guarantees and easier access to working capital. Such schemes have precedents from the COVID period, when they were deployed successfully without destabilising fiscal balances. Incentives could also be rolled out that aim to diversify the markets for goods exports.

3. Macro strengths

India's macro balance sheet remains robust: a fiscal deficit of 4.4%[4], a stable central government debt-to-GDP of almost 57%[5], strong foreign currency reserves of nearly USD700 billion[6], and moderating inflation all provide policymakers room to manoeuvre.

4. Forward outlook

These levers ensure that in the short to medium term, the tariff impact can be absorbed without significant dislocation. In the medium term, we expect a deal lowering tariff levels in line with other Asian countries, bringing relief. Over the long term, reforms to ease investments, strengthen domestic demand and diversify export markets will be key to reducing India's vulnerability to such shocks.

Stock market impact and positioning

1. Market reaction in August

Indian equities traded flat in August, reflecting tariff risk and the cushioning role of policy support. Investors are factoring in the GST stimulus, income tax relief, and ample liquidity, which together limit downside pressure. However, in the short term, there could be varied sectoral impacts.

[4] Ministry of Finance, Government of India, February 2025
[5] CEIC, September 2024
[6] Bloomberg, Reserve Bank of India, September 2025

2. Our positioning

The tariff-exposed sectors — agriculture, gems & jewellery, and textiles — are a small share of the stock market, and we hold no direct exposure.

Our portfolio is aligned with domestic and structural growth themes as previously described under our 5D framework - **D**igitisation, **D**eglobalisation, **D**ecarbonisation, **D**emography and **D**eficit Reduction:

- Consumer Cyclicals: Benefiting from GST cuts, income tax relief, and lower rates. Structurally, sectors like consumer tech, travel, auto, and white goods should continue to see growth. These remain part of our *digitisation* and *demographic* themes.

- Domestic Infrastructure: Positive infrastructure supporting domestic growth, such as telecom, hospitals, renewable power, and real estate. These sectors' growth is, in turn, supported by market consolidation, asset completion, and cash-flow improvements. These remain a part of our broader theme of *de-carbonisation* and *deficit reduction*.

- Electronics Manufacturing: The growing consumption of white goods and electronic items like mobile phones, laptops, etc., has boosted domestic manufacturing. We expect better value addition in those sectors due to component manufacturing, supported by policy-driven import substitution via PLI schemes. This is a part of our *de-globalisation* theme, where import substitution benefits companies in such sectors.

- Pharmaceuticals: Outside of China, India remains a key country in contract research, development and manufacturing (CRDMO) of small molecules for global pharmaceutical companies, with its scale and skill unmatched outside China and South Korea. This remains a part of our *de-globalisation* theme, where Indian exporters could potentially gain market share due to supply chain diversification out of China.

- Tactically, we now see more opportunities in tier-2 Indian IT stocks, which exhibit better growth profiles. We believe that with US Federal Reserve rate cuts and other pro-growth measures, the US corporate sector will resume spending on IT services. India's IT sector has also undergone both price and time correction, thus making the valuation attractive.

Conclusion

The extent of US tariffs on Indian goods exports is higher than expected and, therefore, disruptive in the short term, but their impact is concentrated, manageable, and mitigable. A part of India's export base remains exempt, and even under stress scenarios, the drag on GDP growth and the current account deficit could be cushioned by strong policy support and macro fundamentals.

The primary pressure falls on SME-heavy, labour-intensive sectors such as textiles, agriculture, and gems & jewellery, where employment risks are real but containable. For listed markets, the impact is limited, as these sectors form only a small portion of market capitalisation. Our portfolios remain positioned in areas with structural and policy tailwinds — consumption, infrastructure, electronics, pharmaceuticals and, tactically, IT.

In the short to medium term, India has the fiscal, monetary, and external buffers to manage the shock. The key risk lies in a prolonged continuation of higher tariffs (more than 12 months), which could gradually create indirect effects across supply chains, employment, jobs, investment flows, and broader economic momentum.

Our base case remains that eventual resolution will contain risks, but the current episode highlights the importance of continued reforms for expediting investments, deeper domestic demand revival, and diversification of export markets.

Overall, we believe India's growth story continues to remain intact, albeit with some near-term friction. Support will come from policy, resilient medium-term fundamentals, and a structural shift toward deeper reforms that focus on longer-term development.

Investment Considerations

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