

Macro View | Impact of US Reciprocal Tariffs

Tit for Tariff: India's stake in the trade spat

- *The across-the-board reciprocal tariff by the US are much more extreme than the base case we had earlier assumed. This presents a downside risk to our India GDP growth forecast to the tune of 30bps (forecast of 6.6% for FY26). We must admit that there continues to be a significant level of tentativeness to this forecast, which hinges on several “unknowns” -- whether other countries like EU and China would retaliate or US will in fact reduce tariffs with successful bilateral negotiations? Will the Fed respond to the likely inflation shock by keeping rates higher for longer or tilt towards supporting growth and cut rates aggressively? Is this the beginning of the end for US dollar dominance? .and many more.*
- *The big risks: A sharp global growth slowdown, particularly in the US (with odds of a recession now increasing to 40%), could lower India's total export volumes – not just in goods but also services. We believe that this is a biggest risk to India GDP growth (estimated at 0.3-0.4 ppt for a 0.8-1% drop in global growth), more so from the direct impact of US tariffs. Moreover, with tariffs of over 50% on China, the risk of oversupply flowing into India and hurting domestic manufacturing remains high.*
- *Is there a tailwind for India? India could benefit with a rise in exports to the US in certain sectors (like textiles and electronics) as our competitors in the space face higher tariffs. In addition, for now, sectors like pharma – a major export item to the US from India - have been kept out of the reciprocal tariff list. The impact on India could also be softened if it is able to get some concessions under the ongoing bilateral talks with the US. However, we must emphasize that this tailwind could be weaker than is being expected, if other countries choose to absorb some of the tariff hikes by reducing prices, are able to negotiate lower tariffs with the US or go down the route of engineering currency depreciation to offset the tariff impact.*
- *Our growth forecast is also heavily reliant on domestic demand conditions improving materially. Both monetary and fiscal accommodation would need to be frontloaded to drive this. In the absence of a strong domestic demand recovery (due to weather related disruptions with risk of heatwaves emerging, increased financial market volatility, inflation spikes etc.) or a more severe downturn in the global economy (full blown trade war with retaliation from other countries), we would need to revise down our growth estimates for FY26 significantly.*
- *For the RBI, we expect 2 consecutive rate cuts – one in April and second in June 2025 of 25bps each. Beyond this the possibility of another rate cut (later in the year) now emerges depending on how global headwinds pan out.*
- *In the currency market, the initial reaction to Trump tariffs has been negative US assets with the US dollar index declining to 101-102 levels and safe havens like the JPY, US treasuries, and gold gaining. The USD/INR pair appreciated yesterday to 85.43 levels on some relief from relatively lower tariffs than our peers and a decline in the US dollar index. We expect this trend to continue in the near-term and revise our near-term range for the pair to 84.50-86.0 (from 86-88 earlier). Beyond the near-term, some return of depreciation pressures is expected as markets price in the “headwinds” to the Indian economy from a global growth slowdown. However, we do believe that the USD/INR pair could perform better than its EM peers over the coming months and the extent of depreciation pressures could be lower than we earlier anticipated. This presents a upside risk (appreciation) to our USD/INR forecasts for FY26 at 88 levels. We wait for the current uncertainty to settle down before revising our forecast.*

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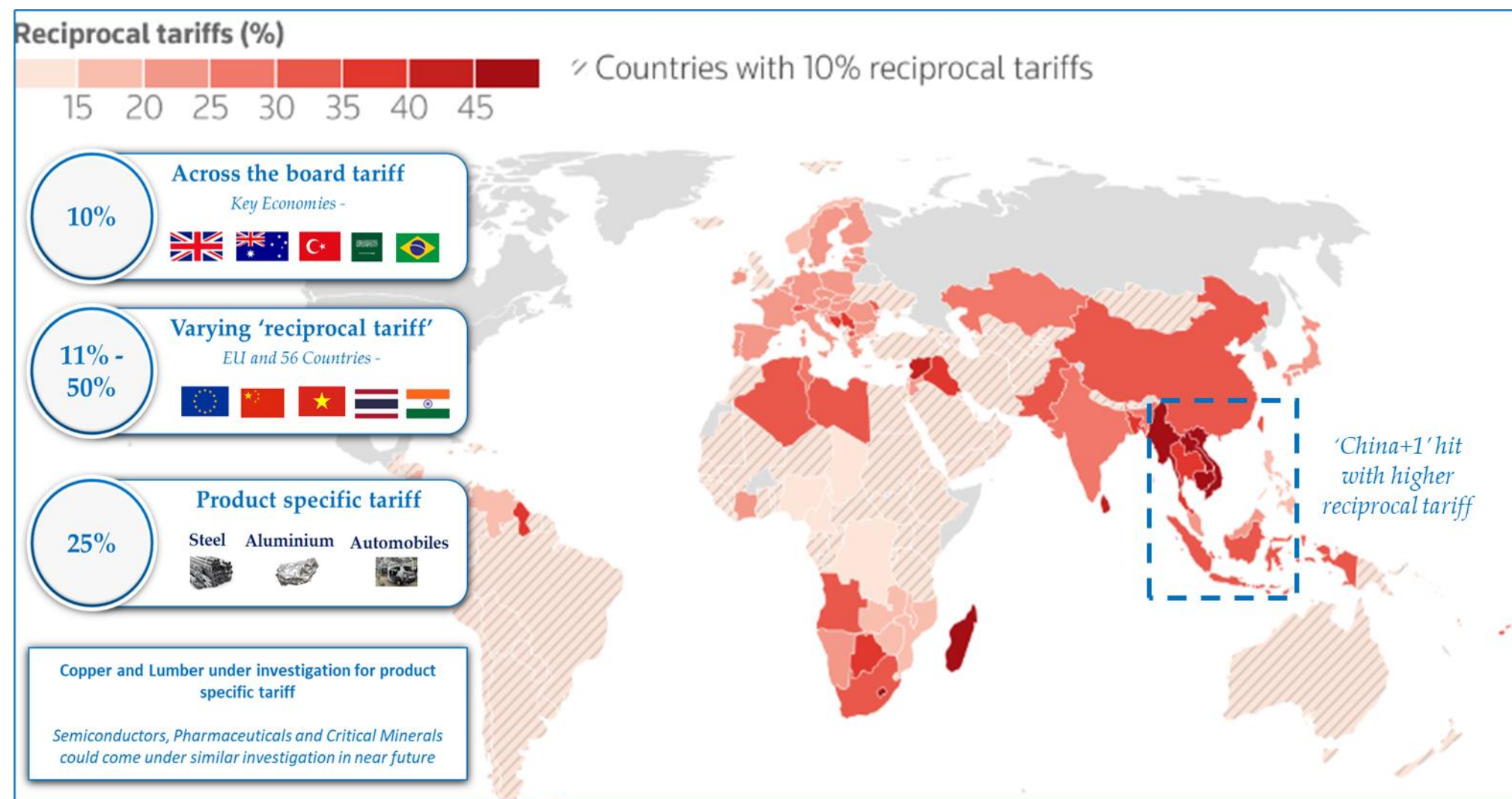
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US Reciprocal Tariffs: More severe than expected

US reciprocal tariffs, if retained at the proposed levels, present downside risk to global growth forecasts by more than 1%.

- **Risk of fragmentation of trade and emergence of trade blocs?** The IMF predicts that in extreme case of retaliatory tariffs from other countries and an eventual fragmentation of global trade with separate trade blocs centred around the US and around China emerging, could reduce Global GDP by 7% over the next 5 years.
- **Hit to China + 1 play:** In Trump 1.0, tariffs had been targeted towards China opening opportunities for diversification to other countries. As a result, the China+1 play emerged, benefitting countries like Mexico, Vietnam, Taiwan etc. However, in Trump 2.0, Asian countries part of the China + 1 play also seem to have been targeted with higher tariffs. This could reduce growth in these economies, particularly given their high reliance on exports. The share of value added in US final demand from China is as high as 19% and for ASEAN it is close to 7% -- making these countries vulnerable not just to tariffs but also a slowdown in US growth.

Trump 'Liberation Day' Tariff Announcement



Source: U.S. White House, Image Credit: Reuters

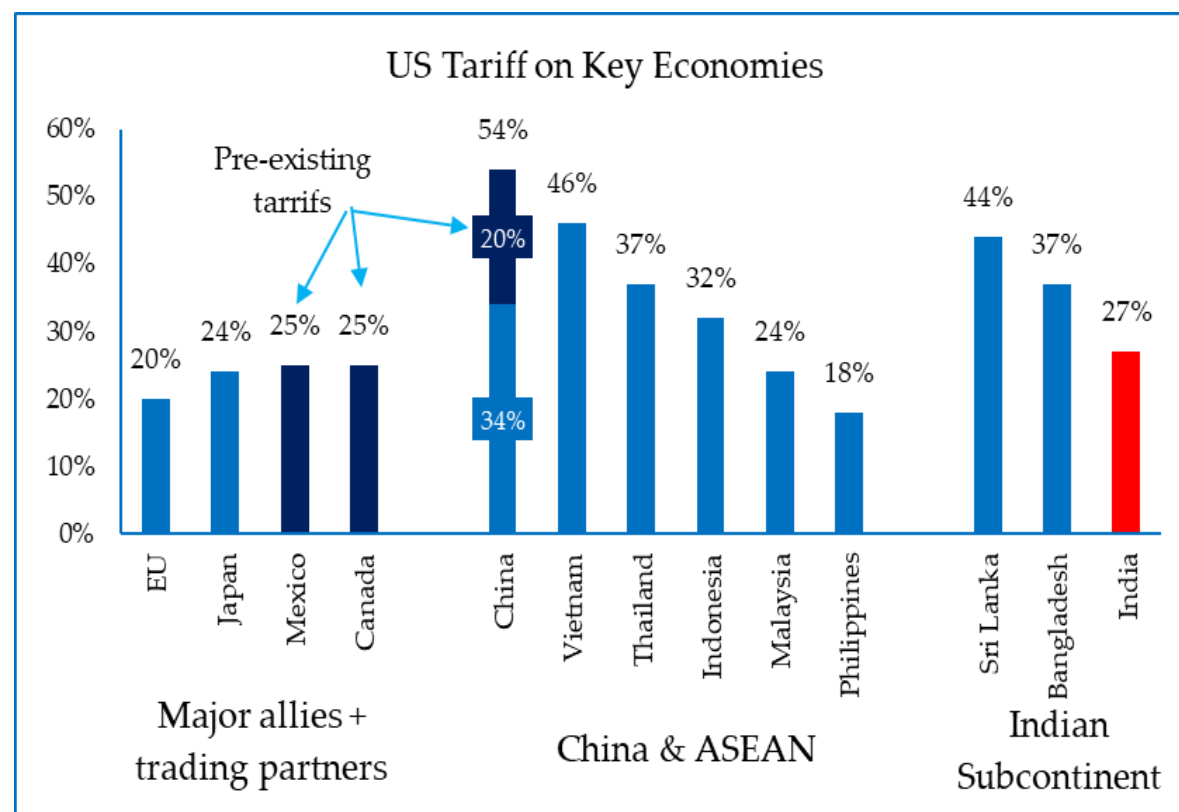
Tariff War and Trade Fragmentation: Risk Scenarios for Global Growth	
IMF Projections	Peterson Institute for International Economics
Impact of 10% tariff and counter-tariff by major trading partners: <ul style="list-style-type: none"> - Global growth down by 0.8% in 2025 and 1.3% in 2026 - US GDP down by 1.0% in 2025 - Impact on global inflation remains muted (10 bps decline) 	Impact of 10% tariff and counter-tariff by major trading partners <ul style="list-style-type: none"> - US GDP by to be lower by 0.3%-0.4% from baseline in 2025 - US GDP to be lower by 0.9% in 2026 and 2027
Impact of Trade Fragmentation: U.S. Bloc, China Bloc, and Non-aligned Bloc <ul style="list-style-type: none"> - In case of mild fragmentation, global GDP could go down by 0.2% from baseline - A situation of extreme fragmentation could reduce Global GDP by 7%. 	Extreme case of 60% Tariff on China and 10% Tariff on all by U.S trading partners, matched by retaliatory tariff from China and RoW <ul style="list-style-type: none"> - Global GDP could go down by as much as 9% by 2028 - Global GDP could be lower by 6.5%-7.0% from baseline over the long-term.

Assessing implications for India Growth

- **India faces lower tariffs than its peers – Assessing the gains from the tariff arbitrage:** While Trump has imposed universal tariffs, the fact that India faces relatively lower tariffs as compared to the likes of China (at 54%), Vietnam (at 42%), Thailand (at 37%) etc. provides it with a “tariff arbitrage” that could make India’s exports more competitive.
 - **For instance, the additional tariff of close to 54% on Chinese goods could increase India’s exports to the US by USD 16 billion – 3.7% of total goods exports.** This could be in sectors like textiles and electronics. This considers only the market share gains due to China’s exports to US going down and could imply higher benefit for India if it gains market share from other Asean countries as well that face higher tariffs. In FY25TD, textiles and apparel accounts for a share of ~8% in India’s total exports and 1.5% in India’s GVA in 2024.
 - **However, if and how much India can benefit from this remains to be seen, since competitor countries could choose to absorb some of the tariff increases by lowering prices of exports to remain competitive or offset some of the impact through currency depreciation (China did this in Trump 1.0, with the CNY depreciating by ~ 10-15% during the 2018-20 trade war).**
 - **Any rupee appreciation could offset tariff arbitrage:** On the other hand, if the rupee continues to appreciate vis-à-vis the USD and performs better than its peers on return of capital (in part due to rotation of capital out of China to India), better domestic growth prospects etc., this could offset some of the benefit for India due to relatively lower tariffs.
 - **Domestic value added to India exports is low:** Moreover, any increase in Indian exports to the US should also be assessed in terms of their domestic value added and the multiplier it can create for domestic growth. For instance, in the case of India’s electronic exports, the domestic value-added component is relatively low, with the major focus on smart phone assembly so far. India imports ~43% of total electrical and electronic imports from China.

- India could get tariff concessions with the BTA going through:** Negotiation with the US could pave the way to a Bilateral Trade Agreement (BTA), reducing the negative impact from announced tariffs. India could narrow down its trade surplus with the US by importing more of energy, gems and Jewellery and defence products, and by reducing import tariffs on certain goods from the US. However, if India sharply reduces import tariffs on US goods under BTA, it could also raise the risk of higher imports and oversupply from countries like China flowing into the domestic market. Moreover, it could also raise imported costs in certain segments where we shift towards US products, due to higher shipping costs.
- Global growth slowdown: Indian exports are found to be more sensitive to global income/demand than price, reflecting higher risk from global slowdown.** Therefore, downside risk to US growth could negatively impact Indian exports with the US being India's major export destination (~19%). The income elasticity of Indian exports is estimated at 3.4 -- simply put a 1% change in global growth leads to a 3.4% change in Indian exports. **Global growth moderation by 0.8-1% could lead to ~0.3-0.4 ppt reduction in India GDP growth.**

Reciprocal tariff on India is relatively lower compared to most peers



Source: U.S. White House

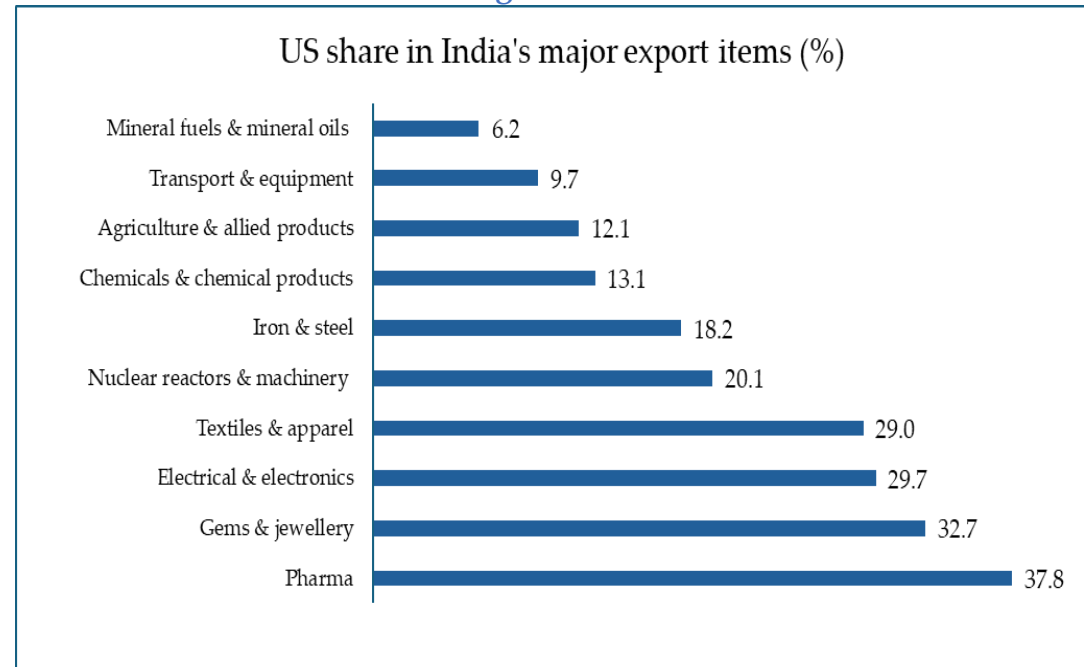
Impact on India's key exports to U.S.

Exempted Products	
Products	Exports to U.S. (FY24)
Pharmaceuticals	\$8.1 Billion
Petroleum	\$5.8 Billion
Gems & Jewellery**	\$4.6 Billion
Semiconductors	\$2.0 Billion
** Excluding diamond jewellery	

Key exports under reciprocal tariff	
Products	Exports to U.S. (FY24)
Electricals & Electronics*	\$9.0 Billion
Machinery	\$6.2 Billion
Diamond Jewellery	\$5.4 Billion
Textiles & Garments	\$4.7 Billion
Iron & Steel Products	\$3.3 Billion
Automobiles & Parts	\$ 2.7 Billion
*Electronics excludes semiconductor equipment	

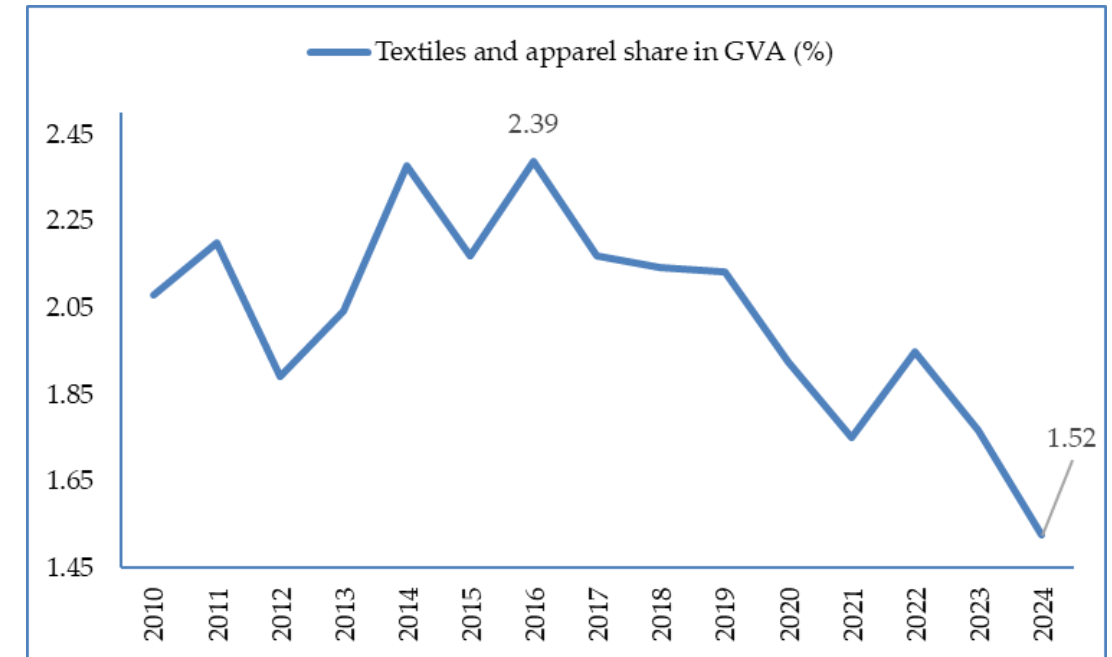
Source: Ministry of Commerce, Media Releases, HDFC Bank

US share in major export items: Pharma and Gems & jewellery account for the highest share

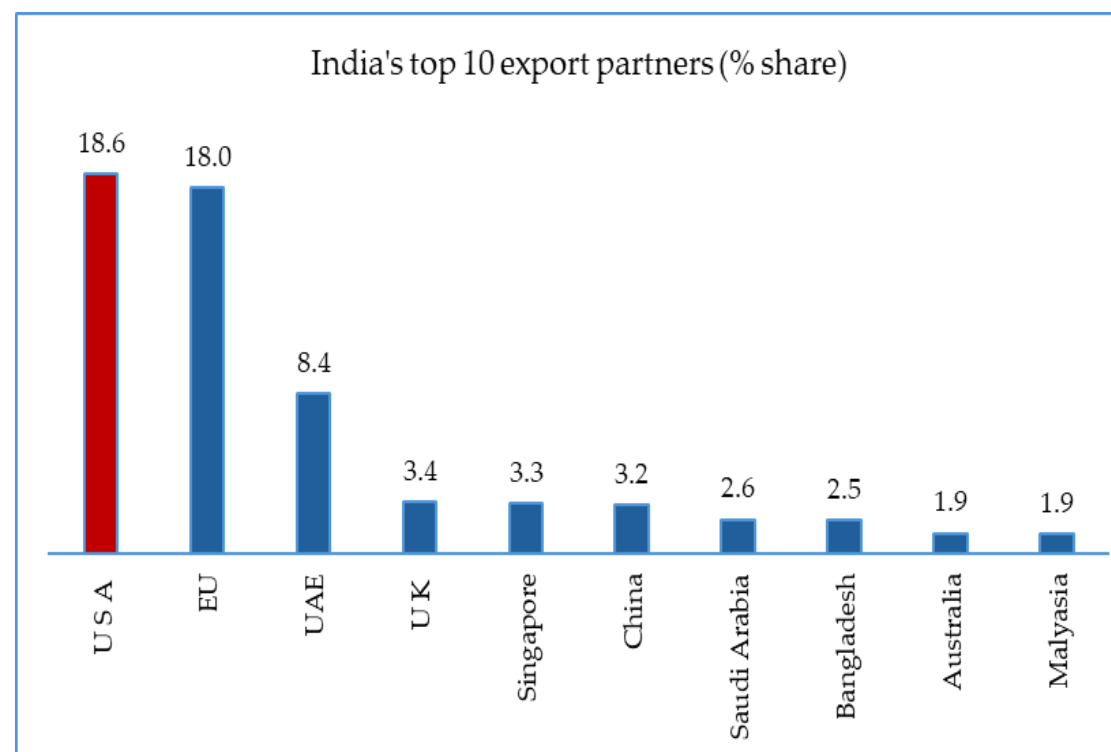


Source: Ministry of trade and commerce, HDFC Bank Research

Share of textiles and apparel in India's GVA

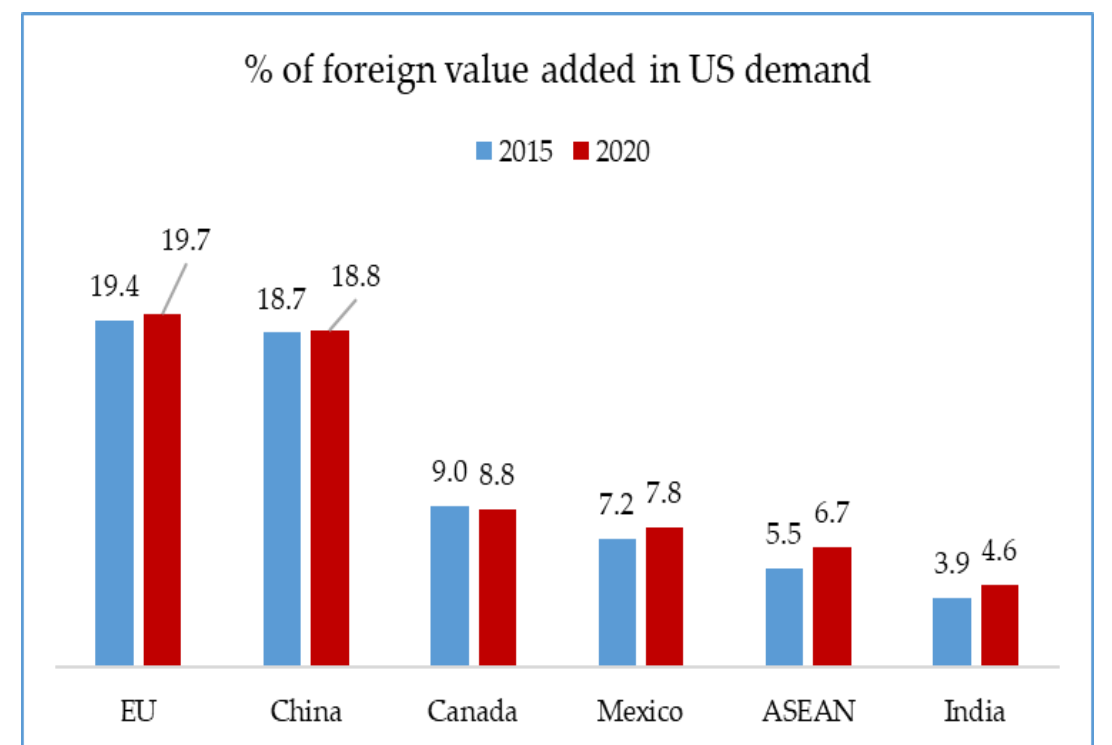


US accounts for ~19% of India's total exports



Source: Ministry of trade and commerce, HDFC Bank Research

India's valued added share in US final demand



Source: OECD, HDFC Bank Research

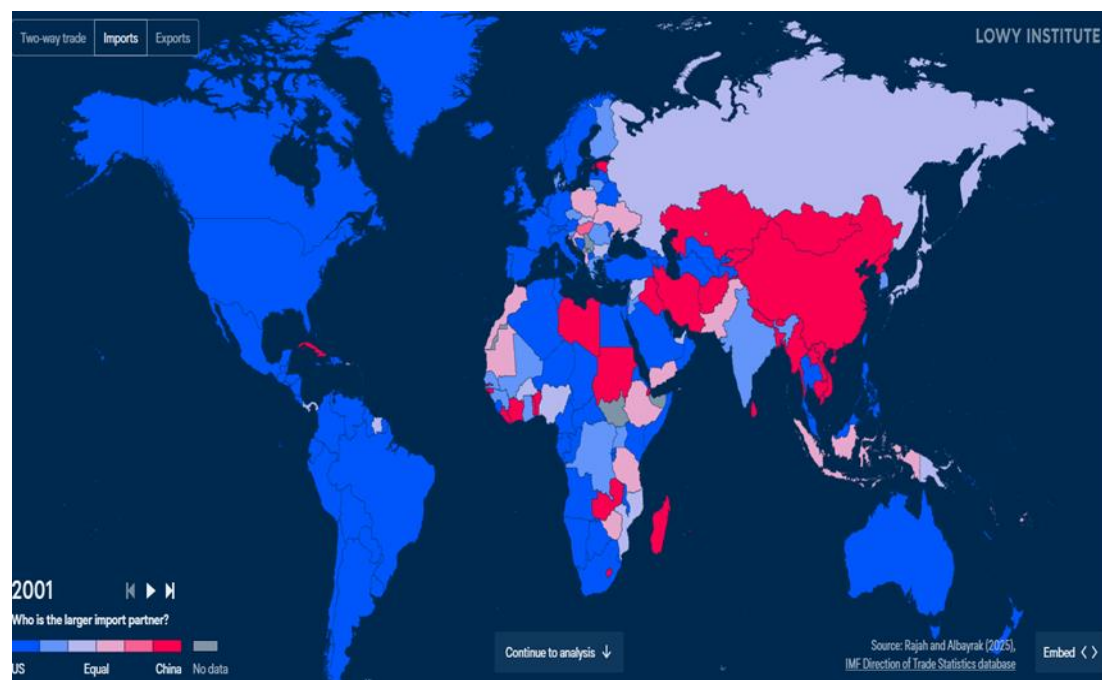
The Oversupply risk: China's trade linkages with the rest of the world have deepened

China's trade linkage with the world has widened significantly over the last two decades with this being driven primarily by the dominance of imports from China to other countries rather than a significant increase in exports to China.

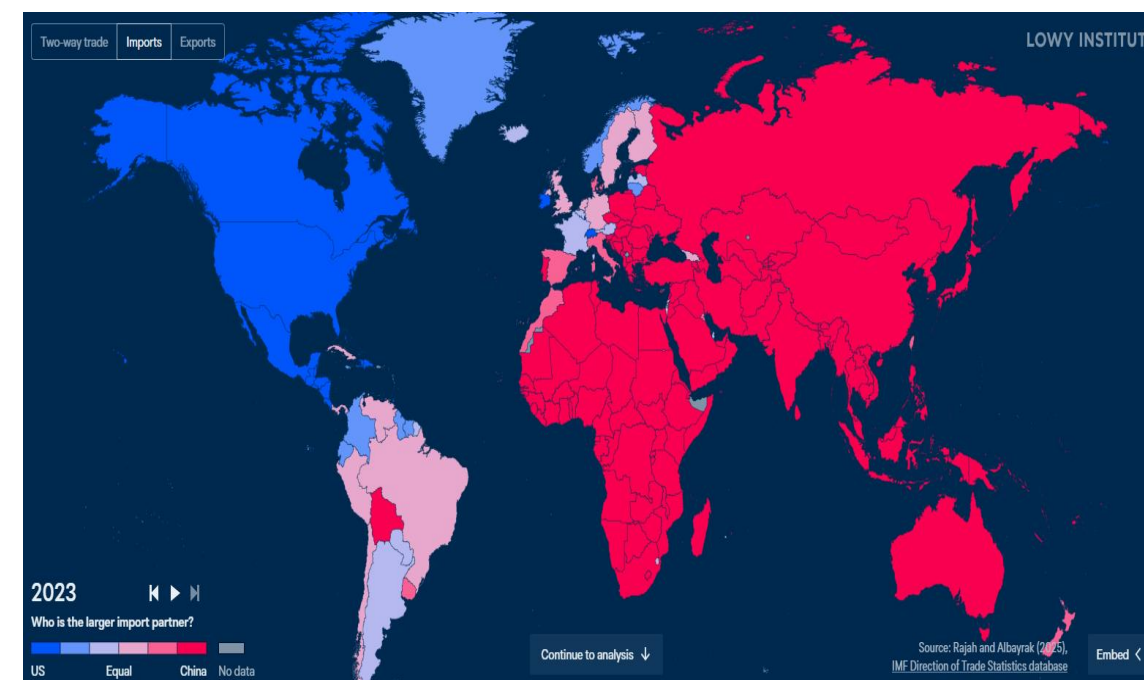
- The Lowy Institute in a recent research paper estimates that about 80% of countries now trade more with China than with the US in 2023. On the other hand, the US is important in terms of demand for exports from the rest of the World particularly as US started importing more from other countries like Vietnam, Mexico and shifted away from China after Trump 1.0 tariff hikes.
- This increase in imports from China is a combination of 1) US tariffs leading to China diversifying to other markets and 2) a redirection of its exports (parts and components) via other countries that are finally catering to the US market.
- With the tariff increase on Chinese goods effectively being raised to over 60% now, it is more likely that more of Chinese supply could flow through in other markets. **This makes domestic manufacturing in countries like India vulnerable to cheaper Chinese oversupply.**

Who is the largest import partner for the World? The maps below show how China has gained prominence as the major import partner over the last two decades. This only accelerated post Trump 1.0 tariffs. Blue colour signifies where US is the largest import partner for countries while red colour shows where China is the largest import partner (Analysis by Lowy Institute).

2001: US was the largest import partner for a number of countries



2023: China has taken over as the largest import partner for most of the world



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