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Impact of proposed 25% US tariff on India – sentiment-driven, not material

President Trump announced that he would levy tariffs on Indian exports to the United States of 25%, effective August 1st. While lower than the initial tariff rate of 26% announced on "Liberation Day," the India tariff rate seems high relative to recent deals negotiated with other countries. An additional measure introduced was a penalty for India's imports of Russian energy and defense.

While eye-catching, we see this announcement as an invitation to negotiate rather than as a final deal. India has expressed a strong inclination to reach a bilateral trade agreement with the US. Putting the economic implications into context, India's overall goods exports to the US are valued at approximately 2% of Indian GDP. We are watching this space as developments unfold, but want to point out the following:

- Within the MSCI India's top 30 listed stock universe, no stock faces a material direct hit, with Reliance Industries being the only name that could see any real impact. Even here, it's worth noting that refined energy exports were exempt during the last tariff episode in April.

- Any impact is expected to be confined to a handful of smaller-cap auto ancillary, chemical, and textile exporters, which are not significant index constituents.

On the broader US-India trade negotiations:

- India has resisted full market access for US dairy and agricultural products, driven by employment sensitivities in rural India. We do not expect this stance to change.

- Instead, India may look to broaden strategic and economic engagement via higher crude oil purchases, more defense contracts, and civil nuclear cooperation.

In fact, deepening ties between India and the US have been an economic priority for many years. India has already adjusted to the realities of supply chain dislocations. Just as "China+1" strategies initiated under the first Trump presidency led to the emergence of new sectors in India like electronics manufacturing services (EMS), renewable equipment, and auto ancillaries, we see a strong likelihood that these industries will gather pace and that new categories will also emerge from renewed tariff pressures globally.

Ultimately, we believe India stands to gain in this environment. We continue to see appeal in India's large and diversified economy, with the sustained strength of domestic demand and the growth of new sectors helping to offset external shocks. A good example from the EMS space is smartphones. During the first Trump administration, Apple expanded its production footprint in India. Fast forward to today and India now accounts for 20% of its final assembly of iPhones, showcasing the speed at which manufacturing has progressed in the seven years since President Trump announced his first tariffs in January 2018 [see India's Enviable Position. **India's enviable positioning | Allianz Global Investors**].

In conclusion, there is no change to our constructive view on Indian equities, as the impact remains more sentiment-led rather than fundamentally disruptive to longer-term growth. The merits of demographic advantages, consumption potential, and ongoing structural reforms position India well for future growth. In the near-term, there are positive domestic factors at play such as consumption stimulus from the government's income tax relief policies, central bank interest rate cuts, and a recovery in capital investment due to improved weather conditions. These measures have been undertaken to revitalise economic growth momentum after a period of tight credit conditions and weak corporate and consumer spending.

At Allianz Global Investors, we aim to look through short-term market volatility and remain focused on high-quality stocks that have undergone significant share price corrections despite demonstrating resilient earnings growth. Our approach is anchored on maintaining portfolio diversification while selectively increasing exposure across sectors where we identify structural tailwinds.

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