Shifting trade dynamics: What US Tariffs mean for India

Capital SPROUT

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Chairman's Message

Greetings from Capital Sprout,

It gives me great pleasure to share with you this edition of Capital Sprout's Wealth Bulletin, where we explore the shifting trade landscape and its implications for Indian markets. In this issue, we analyze the latest U.S. tariff policies, their global impact, and what they mean for Indian investors navigating these changes

In recent months, the United States has introduced a series of tariff policies aimed at addressing trade imbalances and protecting domestic industries. While these measures primarily target imports from key trading partners such as China, Canada, and Mexico, their impact extends far beyond these nations, influencing global trade flows, supply chains, and investor sentiment. Given India's significant role in global trade and its deep economic ties with the U.S., these developments hold substantial implications for Indian markets and industries.

For Indian investors, understanding these tariff shifts is essential to navigating market uncertainties, identifying potential risks, and capitalizing on emerging opportunities. This newsletter explores the broader consequences of U.S. tariff policies, their direct and indirect effects on India's economy, and what investors should watch for in the coming months.

I trust you will find this issue valuable and informative.

CA Dr. Rajesh Khandol

The recent tariff changes introduced by the U.S. primarily target key sectors such as technology, automotive, energy, and industrial manufacturing. These tariffs have been imposed in response to concerns over unfair trade practices, intellectual property violations, and the need to boost domestic production. However, the global ramifications of these protectionist measures are significant.

Key Implications:

- **Supply Chain Disruptions:** With higher tariffs on imports from China, many multinational corporations are seeking alternative production and supply chain solutions. This shift could benefit emerging markets, including India, as companies look for new manufacturing bases.

- **Retaliatory Measures:** In response to U.S. tariffs, affected nations such as China and the European Union have imposed their own counter-tariffs, escalating global trade tensions and impacting the cost of goods worldwide.

- **Investor Uncertainty:** The uncertain trade landscape has led to increased market volatility, with investors adopting a cautious approach amid fears of slowed economic growth and corporate earnings decline.

According to recent reports, the ripple effects of U.S. tariffs are already being felt across financial markets. Key indices such as the S&P 500 and Dow Jones Industrial Average have shown fluctuations in response to tariff announcements, reflecting broader investor concerns. Meanwhile, global commodity markets, particularly metals and energy, are experiencing price swings due to shifting trade dynamics.

What is the impact of tariffs on the U.S. economy?

Need to go through macro statistics of import export first to understand the impact of tariffs on the US economy;

Export			Import		
Total	Goods	Services	Total	Goods	Services
$3.19 trillion	$2.08 trillion	$ 1.11 trillion	$4.11 trillion	$3.20 trillion	$ 0.91 trillion
▪ USA accounts for 18% of Total Export Trade of the World ▪ **Key Export Partners:** Canada and Mexico were the top single-country export partners of the United States in 2024. ▪ **Top Exports:** Civilian aircraft parts, oil, gasoline and other fuels, low-value shipments, and liquefied natural gas (LNG) and other petroleum gases			▪ USA accounts for 15% of Total Import Trade of the World ▪ **Key Export Partners:** China was the top supplier of goods to the United States, followed by Mexico and Canada ▪ **Top Imports:** Machinery (including computers and hardware), consumer goods, capital goods, and industrial supplies.		

USA's major Import Export with other country
(Amount in Billion USD)

Country	Import by USA	Export to USA	Total
India	87.40	41.80	129.20
China	438.90	143.50	582.40
Mexico	456.00	243.00	699.00
Japan	401.20	269.82	671.02
Russia	3.00	0.52	3.52

The effective U.S. tariff rate is now at its highest level since the 1940s after U.S. President Donald Trump signed an executive order to impose 25% tariffs on Canada and Mexico on March 4. A new order was also signed for China, increasing tariffs to 20% from 10%.

How important is U.S. trade with Canada, Mexico, and China?

Canada, Mexico, and China combined account for 40% of U.S. trade. The implementation of tariffs is likely to have a significant near-term impact on the U.S. economy, because the U.S. is not able to immediately ramp up oil production by growing or increasing production capacity for many goods.

How much revenue could tariffs generate for the U.S.?

Based on 2024 import data from Canada, Mexico, and China, the announced tariffs could boost total U.S. tariff revenues by about $300 billion, assuming demand remains unchanged. This would amount to roughly one-third of the annual cost of Trump's proposed extension to the Tax Cuts and Jobs Act.

How easy or difficult is it to substitute away from tariffed imports?

Many of the imported goods are not easily substituted in the U.S. economy. For example, Canada, Mexico, and China account for 60% of aluminum, lumber, and energy product imports. Energy infrastructure takes years to develop, and the U.S. is highly dependent on Canada for electricity imports (specifically in the Northeast) in addition to crude oil due to geographic proximity. Moreover, nearly one-third of fruits and vegetables consumed by Americans are imported from Canada and Mexico. .

How This Affects Indian Indices

India's stock markets have reacted to these global trade developments, witnessing fluctuations in major indices. Recent data shows:

- Nifty 50 declined by 0.29% to 22,481.75, while the BSE Sensex fell by 0.32% to 74,108.62, reflecting investor concerns over global trade disruptions and capital outflows.

- Foreign Institutional Investors (FIIs) have adopted a cautious stance, with net outflows increasing amid global economic uncertainty.

- The Indian Rupee has faced depreciation pressure due to capital flight towards the U.S. dollar, driven by risk-averse investor behavior.

Direct Impact on India:

- **Trade Balance**: Indian industries that export to the U.S. (such as IT services, pharmaceuticals, and textiles) could face challenges if additional tariffs are imposed.

- **Inflationary Pressures:** Higher tariffs on imported goods could lead to increased costs for Indian manufacturers relying on U.S. imports, potentially affecting production costs and retail prices.

- **Corporate Earnings:** Companies with substantial exposure to U.S. markets may see earnings pressure due to rising trade barriers and shifting supply chains.

According to estimates from the State Bank of India, even if the U.S. raises tariffs to 15-20%, the resulting decline in Indian exports to the U.S. is expected to be limited to around 3-3.5%.

Sector-Wise Breakdown

Several Indian industries are experiencing mixed impacts from U.S. tariffs. Some are facing challenges, while others may find new opportunities due to shifting trade patterns.

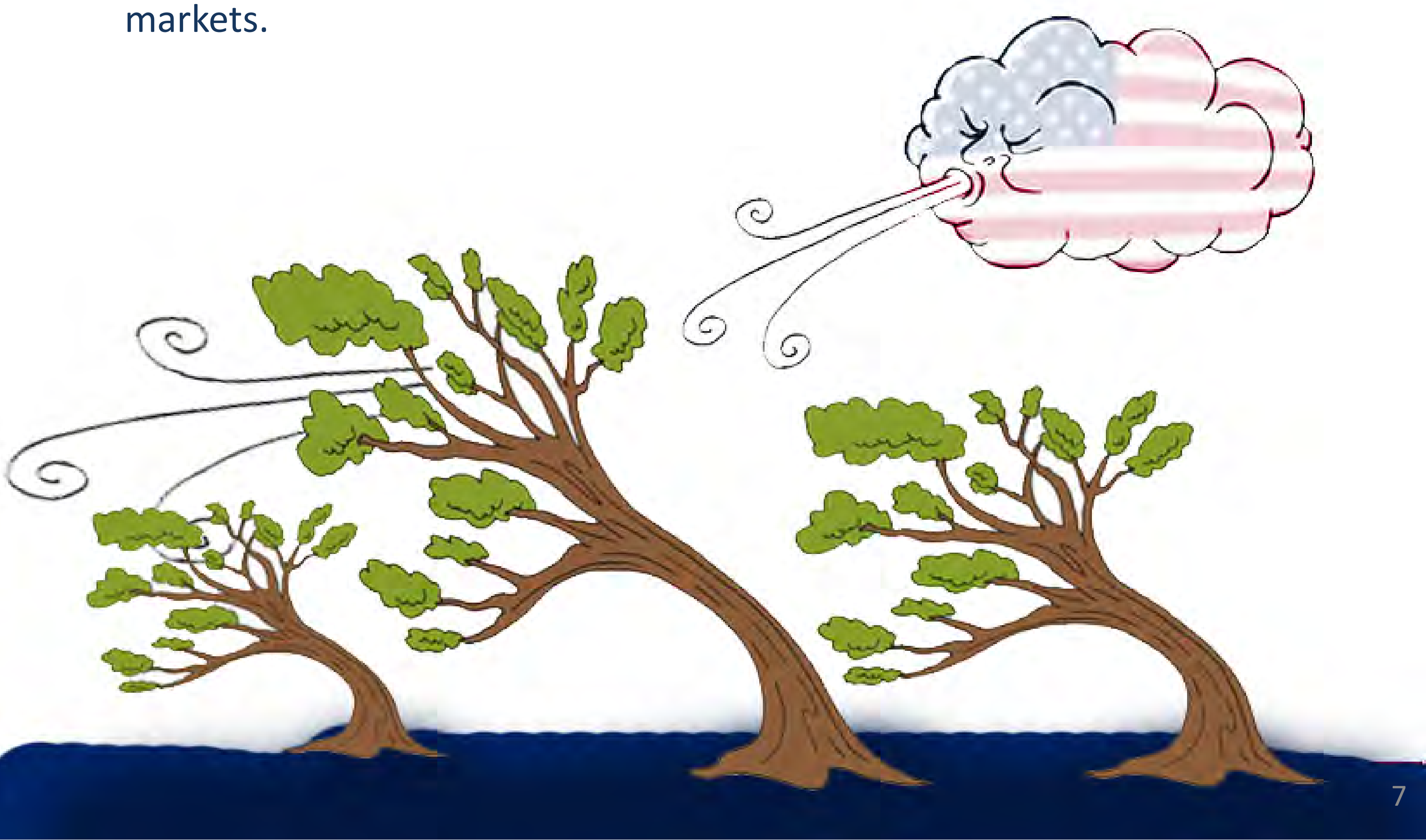
Industries Facing Headwinds:

- **Information Technology (IT):** Indian IT firms generate significant revenue from U.S. clients. Increased costs for U.S. companies due to tariffs may reduce outsourcing budgets, affecting demand for Indian IT services.

- **Engineering Goods:** Approximately $7.5 billion worth of engineering goods exports to the U.S. could be affected by the new tariffs, leading to concerns among exporters about declining orders and rising costs.

- **Pharmaceuticals:** The U.S. is one of the largest markets for Indian generic drug manufacturers. Any trade restrictions or additional regulatory hurdles could impact export growth.

- **Textiles & Apparel:** Tariffs on imported raw materials could increase production costs, making Indian textile exports less competitive in global markets.



Industries Benefiting from Trade Shifts:

- **Manufacturing:** As global supply chains shift away from China, India stands to gain as an alternative manufacturing hub. Recent government initiatives, such as the Production-Linked Incentive (PLI) scheme, aim to boost domestic manufacturing.

- **Auto Sector:** With increasing scrutiny on Chinese exports, Indian automotive component manufacturers may witness higher demand from international markets.

- **Renewable Energy**: India's renewable energy sector may attract more investment as countries seek to diversify their energy sources away from traditional suppliers.

Indian companies are adapting by diversifying their supply chains, expanding into new markets, and leveraging policy support from the government to mitigate the impact of global trade shifts.

Why Are We in a Bear Run?

While U.S. tariffs are a significant factor in recent market movements, they are not the sole driver of the current bearish sentiment. Other global and domestic factors contribute to market volatility:

High-Interest Rates: The U.S. Federal Reserve's tight monetary policy has led to rising borrowing costs, reducing corporate investment and consumer spending.

Global Economic Slowdown: Key economies, including the Eurozone and China, are experiencing slower growth, impacting global demand and trade.

Geopolitical Tensions: Conflicts in various regions, coupled with trade uncertainties, have heightened risk perceptions among investors.

Domestic Market Factors: In India, concerns over inflation, policy reforms, and fiscal deficit management are adding to investor caution.

Increase in LTCG Tax: The rise in Long-Term Capital Gains (LTCG) tax from 10% to 12.5% has signaled a discouragement of long-term holdings, leading to investor exits and added pressure on the stock market.

Financial Year-End Profit Booking: As the financial year comes to a close, many investors are engaging in profit booking, further contributing to market fluctuations.

Historical data suggests that periods of trade tensions often result in short-term market downturns, followed by stabilization as businesses adjust to new trade policies. Experts advise investors to adopt a long-term perspective, focusing on fundamentals rather than short-term volatility.

What’s Next

Looking ahead, the trajectory of global markets will depend on how trade tensions evolve and whether governments adopt measures to mitigate economic disruptions. Key areas to watch include:

- **Future U.S. Trade Policies:** Will there be further tariff escalations, or will negotiations lead to a resolution?

- **India’s Policy Response:** How will the Indian government support affected industries through policy interventions and trade agreements?

- **Investor Sentiment**: Will capital flows stabilize, or will risk aversion continue to pressure emerging markets?

For Indian investors, staying informed and agile is key. While uncertainties persist, market volatility also presents opportunities for strategic investments. Sectors with strong growth potential and resilience to global trade shifts may offer attractive prospects in the long run.

As always, diversification, risk management, and a focus on long-term fundamentals remain crucial in navigating these evolving trade dynamics.

Performances | Feb 2025

(1) Equity Market

Indices	01-02-2025	28-02-2025	High	Low
BSE S&P SENSEX	77,637.01	73,198.10	78,735.41	73,141.27
NIFTY 50	23,528.60	22,124.70	23,807.30	22,104.85

(2) Mutual Fund

AUM Data of Mutual Fund for the Month of Feb 2025

(INR. In Lakh Crore)

Particulars	AUM As On 31-01-2025	Fresh Fund Mobilize During Feb-25	Redemption During Feb-25	AUM As On 28-02-2025
Total AUM of all mutual funds scheme	63.87	10.28	9.88	64.27
AUM of equity oriented (growth) schemes	27.11	0.54	0.25	27.40

Source: Association of Mutual Fund of India (AMFI)

SIP Contribution

(INR. In Crore)

Month	SIP Contribution	SIP AUM
Feb-2025	25,999	12,37,784

(3) FII & DII Inflow/Outflow Position – Feb 2025

FII's selling in the month is 0.59 Lakh.
DII's buying in the month is 0.65 Lakh

(INR. In Crore)

FII /DII	Gross Purchase	Gross Sale	Net
FII	2.59 Lakh	3.18 Lakh	(0.59) Lakh
DII	2.77 Lakh	2.12 Lakh	0.65 Lakh

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