India’s GDP faces large tariff hit

Steep US tariffs pose a clear downside risk to India’s growth. Recent tax rate cuts may partially offset the impact, but a lack of meaningful export diversification suggests the drag on growth will be significant. Deflationary effects could push already low CPI inflation down further, bringing forward rate cuts. This sets a supportive backdrop for bonds

New Delhi, India

In Asia, the big story has been India, with US President Trump’s steep 50% tariffs on Indian imports officially taking effect – a move that includes a 25% penalty on India for its continued oil imports from Russia. At a broad level, the macro impact looks relatively manageable. India exported about US$87bn worth of goods to the US in FY2025 – that’s less than 2% of its GDP. Once you factor in tariff-free categories like pharma and electronics, and adjust for domestic value added, the actual GDP exposure to these tariffs drops to around 1.2-1.3%. IMF estimates suggest that over the long run, a 1% increase in India’s international export prices could lead to a drop in export volume growth – around 0.9% across all industries, and about 1.1% for manufacturing. Assuming a full tariff pass-through and no trade diversion, the direct hit to output would then be 0.6-0.7% of GDP.

However, the impact would be much larger given the second-round effect on employment and consumption. Labour-intensive sectors like textiles, leather, and jewellery face the highest downside risk – not just in terms of exports, but also employment. These industries operate on thin margins and are highly price-sensitive, making them especially vulnerable to tariff shocks. Plus,

since they rely more on low-skilled labour, they're easily substitutable by countries like Vietnam and Bangladesh, which offer similar products at competitive prices.

Can Asia fill the export gap? We doubt it. India's shrinking regional trade tells a different story. What's most striking about India's trade direction is that its trade with the rest of Asia has been going down steadily over the past few years.

One of the recent measures that could partially offset the tariff impact has been cuts to GST (Goods and Services Tax) rates for some commodity groups. Taxes on essential items – including food products, basic household goods, consumer electronics, and small motor vehicles – have been significantly reduced, while life-saving drugs and health and life insurance have been made entirely tax-free. These reforms are designed to directly boost consumption, especially among middle- and lower-income households. Importantly, these changes are projected to lift consumption by 0.1-0.2% of GDP – providing a timely boost to economic growth.

The downside risks to growth create more room to ease monetary policy. The export losses from high US tariffs and GST cuts would reinforce the disinflationary trend. We estimate that a full pass-through of GST rate cuts to the consumer could lower CPI inflation by 1 percentage point or by 50bp in a more conservative scenario. This strengthens our case for another 50bp Repo rate cut by the Reserve Bank of India (RBI) over the next six months, with rising risks of the RBI front-loading cuts in the fourth quarter.

Active RBI intervention is expected to cap USD/INR around 89.0 in the near term. However, the risk of further weakness persists if India fails to negotiate tariff levels lower. A prolonged export slowdown could structurally weaken India's current account balance, adding sustained pressure on the currency.

Author

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

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