

Cohesion MK Best Ideas

Reaction to US Tariffs on Indian Exports

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Cohesion
Accessing India's Growth



Our view on the US tariffs on Indian exports

It is difficult to provide a definitive response to the latest tariff news because it is so hard to say whether this is really “it”. Last week, we witnessed new executive orders from President Trump, imposing new tariffs on almost 70 trading partners effective from August 7th. This was followed by a further announcement that an additional 25% “penalty” tariff might be imposed, albeit there is a three-week delay before this might come into effect.

These days, such announcements have to be read in conjunction with President Trump’s running narrative on Truth Social and also put into context with President Trump’s negotiating style. Therefore, we must consider two scenarios – firstly, that this really is “it” and how might India deal with the tariffs for the foreseeable future? And what if this isn’t “it”, but merely negotiating tactics?

Scenario 1: This is “it”

We believe that it is unlikely that this is the final tariff position. Nevertheless, if we assume that it is, we do not think that it poses significant problems for India. Since last week, we have seen economists rushing out estimates as to the likely impact of a 25% tariff on annual GDP. These suggest a fall of around 0.2-0.4% per annum. Whilst this might be disastrous for some Western economies and wipe out their entire wafer-thin GDP growth, it would be only a small dent for India. Ratings agency ICRA has suggested that Indian GDP for this financial year might fall from 6.5% to 6.2%. Annoying but hardly a disaster. Few economists have yet updated their forecasts for the additional 25% tariff, but those that have appear to be pencilling in around 6%.

The story of the Indian economy is heavily based on domestic growth, which in turn is based on demographics. None of this will change. India still has by far the strongest population growth over the coming decades of any major country. Those people, most of whom are in their prime working, spending and saving years, will be driving transformational growth in consumption.

According to the World Bank, only around 23% of India’s GDP is reliant on exports, and of these, only around 17.5% go to the US. Therefore, less than 4% of India’s GDP is reliant on the thing that’s making all the news. It must also be remembered that large tranches of the Indian export market have already been excluded from tariffs, including pharmaceuticals, refined oil products, electricals and gemstones. This reduces the potential impact even further.

As we have argued in recent newsletters, the vast majority of US imports from India would be hard or impossible for the US to replace. Wonderful businesses such as Dynamatic Technologies are trusted partners of major US companies, and we see no way that Boeing, John Deere or Lockheed Martin are going to take chances with new suppliers for such critical parts. With companies such as Shilpa, their competitive advantage versus a start-up US manufacturer of pharmaceutical ingredients is vast. We don't see American workers willing to work for wages comparable to those paid for skilled jobs in India. Therefore, we view the majority of Indian exports to the US as safe, albeit with some price increases passed through to US consumers. The potential damage is therefore a small percentage of US imports that are in turn a small percentage of the Indian economy. Will that amount to 0.2 or 0.5%? We aren't economic forecasters, but basic maths suggests that this is about 5-10% of exports to the US lost. That isn't unreasonable and represents a very manageable figure.

It is also possible that a slight weakening in demand might cause the RBI to adopt an even more expansionary monetary policy, following on from rate cuts that began earlier this year, including an outsize 0.5% cut in June. The RBI recently cut its inflation outlook for the next 12 months, and this is likely to give them the comfort that they can cut again if they need to defend economic growth. Such an action would likely be taken positively by equity markets.

We believe our portfolio is well insulated by our choice of companies. All of our stocks are either domestically focused or export goods and services that have a moat of competitive advantage that will allow them to pass on a large part of the tariffs to their customers. For almost all of our investee companies that do export to the US, this market represents a small minority of their revenues and earnings.

There may well be volatility over the coming days. So far, investors appear to be taking a measured view and correctly assessing that the impact will be modest, although we will be keeping a close eye on portfolio flows over the weeks ahead. If there is volatility, we will embrace it. Volatile share prices cause investors to make mistakes, and we can take advantage of this by buying from the fearful. It is possible that sector-specific exemptions or retaliations over the coming weeks can create opportunities, and we have a useful buffer of cash in the portfolio to take advantage of these.

Scenario 2: This isn't the final tariff position

It is very difficult to predict what President Trump will do next. However, the last few months have demonstrated that he is willing to use shock tactics in an attempt to bring opponents to the negotiating table. China and the EU both faced much greater headline tariffs, but negotiations successfully reduced them. It appears that President Trump is currently frustrated by the indifference of the Kremlin to his threats and has pivoted to putting pressure on Russia's partners, with India chosen as a purchaser of Russian oil and (to a diminishing extent, arms). President Trump's decision to "punish India" for purchasing Russian oil, despite explicit encouragement from the US and others to provide stability in the oil market, is somewhat perplexing and doubtless frustrating for negotiators.

President Trump has always extolled the warmth of his relationship with Prime Minister Modi. We suspect that this personal relationship has yet to be utilised in these negotiations, as it has been teams of bureaucrats from both sides that have been locked in talks. India has been adamant in defending its domestic agriculture industry, a clear sign of how important the domestic economy is and how fiercely it is defended. India has vast numbers of micro and small businesses, and it is probably more important that these are protected than anything else.

There are probably hard lines that India will have to stick to (as will the US), but there may well be some compromises that Prime Minister Modi can offer directly to President Trump to allow the latter to claim success. High import tariffs are likely to hurt US consumers more than they hurt India ultimately, and President Trump may well be looking for concessions that will allow him to climb down. We wouldn't be at all surprised to see President Trump announcing a new deal with India over the coming weeks on Truth Social and praising India as a close partner, as he has done several times with other partners.

Conclusion

It is annoying and frustrating to have such disruptions. We are sure that countless investors and business leaders around the world feel the same.

We remain vigilant of ongoing developments. US negotiators are already diarised to visit India from August 25th. India has been careful over the last few days to be calm and conciliatory in its language, and we believe that there is every likelihood that a better final deal will emerge. However, regardless of the final position, we feel sure that the net impact on India's long-term growth trajectory will be slight and certainly much less than some of the more sensational headlines would suggest. Come what may, we have a terrific portfolio of companies that are doing exciting things, and we continue to look forward with confidence.

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