"India's Insular Economy and Export Diversification Shield Growth from US Tariffs"

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"Trade Deficit Widening, but Strategic Agreements and Investments Offer Solutions"

Intro: In a world of economic uncertainties, India faces pivotal challenges and opportunities. At **Socio-economic Voices**, every week we are keeping a close eye on every development. From global trade tensions to domestic fiscal strategies, how India navigates these issues will shape its future growth. In this exclusive interview, with **Sumedha Das Gupta Senior Economist, Economist Intelligence Unit (EIU),** senior journalist **Mahima Sharma** brings insights that offer a deeper look into India's resilience and evolving economic strategies. Read only at **Indiastat.**

MS: With the U.S. imposing a 10% tariff on Indian imports, which sectors do you anticipate will be most affected, and what strategies can mitigate these impacts?

SDG: The impact of the elevated US tariffs at 10% on India's growth trajectory will be moderate. India's generally insular economy and relatively lower dependence on exports as a growth engine compared to China or South-east Asia will serve the economy better in an environment of trade headwinds.

Major sectors that will likely bear the brunt of elevated tariffs include automotives, chemicals, electronics, shrimps, steel, pharmaceuticals, automotive parts, aluminium products and gems and jewellery. These sectors will face lower export orders, slower hiring, limited capacity addition, lower foreign investment and poor stock index performance.

India's key export to the US, namely pharmaceuticals, which account for about 10.1% of India's total exports to the US, is likely to be one of the most affected sectors if tariffs are imposed on this, as gestation periods for moving supply chains in this sector are long. India's prerogative will be to take a conciliatory attitude and work hard on a bilateral trade agreement in the months ahead, with the aim of eventual reprieve from unfair tariffs on both sides. The government will seek special reprieve for these sectors as a part of the ongoing trade agreement talks with the US.

MS: How will the Reserve Bank react to growth concerns emanating from US tariff policies?

SDG: In April the Reserve Bank of India lowered the policy interest rate (the repo rate) by 25 basis points to 6%. The RBI's monetary policy committee also changed its neutral policy stance to an accommodative one, given comfort on inflation. **The monetary easing was the fallout of a favourable inflation environment, which gives the central bank room to accommodate growth concerns.** Risks to growth have risen sharply despite the temporary pause on reciprocal tariffs imposed by the US. India's monetary easing cycle will involve a cumulative 100 basis points of rate cuts across 2025.

Sturdy rural demand, recovery in urban demand, strong government capital spending and robust services exports will provide a floor under economic growth in 2025/26. However, corporate confidence and investment will be cautious despite lower interest rates owing to global policy uncertainty, while exports will be weak over the second half of the ongoing fiscal year. Inflation will cease to be a worrisome factor in monetary policy in the next few months, especially as food inflation will remain benign.

MS: Financial leaders have expressed concerns that the aggressive tariff policies could push the U.S. and the UK into a recession. How might such a downturn in these TWO economies affect emerging markets like India?

SDG: The US accounts for 18% of India's export basket by value. A recession in the US and slower growth in the UK will affect Indian exports. Growth in exports will be lower by about 3 percentage points over fiscal year 2025/26 (April-March), which would knock real GDP growth lower to 6.2% from my earlier baseline forecast of 6.5%. A larger impact on Indian exports will be precluded by market-led currency weakness, export sector diversification efforts, exemptions from tariffs for key export segments and an expedition of negotiations on trade deals to tap into alternative markets. Importantly, Indian service exports, which are largely geared towards the US, will face limited headwinds, suggesting another layer of insulation.

MS: India's current account deficit widened to $11.5 billion (1.1% of GDP) in the third quarter of FY 2024-25. What measures can be taken to address this deficit, and how might it impact external sector stability?

SDG: India's persistent current-account deficit will add to depreciation pressures on the Indian rupee, which is already roiled by policy uncertainty emanating from the US. The RBI will continue to use its substantial foreign-exchange reserves to intervene in the currency market to defend the value of the rupee, which will help to arrest a steeper decline. Large surpluses on the services and secondary income accounts will help to partly offset the impact of the merchandise trade deficit. Despite immigration concerns, IT, IT-enabled services and financial technology will grow strongly, as technology upgrades deliver greater productivity among Indian firms that are global leaders in this space.

MS: What will be the implication of US tariffs on countries that purchase oil or gas from Venezuela for Indian oil imports?

SDG: The US decision to impose a 25% secondary tariff on importers of Venezuelan oil will create immediate economic pressure on India's energy sector, despite the South American country's relatively small share in India's crude import basket. Oil imports from Venezuela have generally offered heavy discounts compared to Brent crude, in the range of US$8-10 per barrel (a 9-11% discount), attracting price-sensitive refiners. Refiners will now face higher input costs as they shift to other import sources to avoid the imposition of US tariffs on Indian products. This increase may be manageable for now, because of the limited share of imports from Venezuela, but the loss of discounted supply could squeeze margins for refiners that rely on this grade of oil.

Although India's reliance on Venezuela for crude oil imports has softened in recent years, this announcement will expedite the country's efforts to diversify its oil import sources. Firms will engage in negotiations with sources from Guyana, Brazil and Africa to diversify the import pipeline.

MS: India's foreign exchange reserves rose to $665.4 billion as of March 28, 2025, the highest in nearly five months. How do robust forex reserves influence India's economic resilience and policy options?

SDG: India's foreign exchange reserves play a key role in defending the rupee against swift depreciation, import payments and debt repayments. FX reserves in general provide 8-10 months of import cover in India, which is sufficiently robust to ensure no shortages in the event of a trade disruption.

The RBI also relies significantly on FX reserves to support the rupee at times when global volatility and contagion lead to a sell-off in emerging market assets such as India, and lead to a depreciation in the rupee against the US dollar. **By running down its FX reserves, the RBI shores up support for the rupee to prevent a tailspin in the currency, which can have adverse effects for financial markets, affect investor confidence in the Indian economy and assets adversely, and make imports more expensive.** At this point of time, the RBi's FX reserves corpus will prove more than sufficient to defend the rupee against contagion that will arise from policy uncertainty in the US.

MS: The merchandise trade deficit widened to $21.94 billion in December 2024. What are the underlying causes of this widening deficit, and how can India enhance its trade balance?

SDG: The widening trade deficit has been the result of both an uneven performance in exports and a high import bill, especially for items like gold. Uncertainties related to emergent tariffs in the US will imply some meaningful front-loading of export orders over April-June 2025. India will also continue negotiations on bilateral trade agreements. **These trade pacts will largely benefit sectors such as pharmaceuticals, electronics, automotives and textiles through foreign direct investment, policy support for domestic production and increased access to foreign markets.** Tailwinds such as lower global crude oil prices will ease the import bill.

MS: The unemployment rate in India stood at 7.8% in September 2024. What structural reforms are necessary to address unemployment, particularly among educated youth?

SDG: India's share of world GDP (at market exchange rates) remains low, at about 3% in 2023, compared with its 19% share of the world's population. This highlights significant scope for further economic development. Low average productivity in India remains a key reason for persistent unemployment and low incomes. For instance, the gap in productivity between the agriculture sector and high-growth industries such as information technology (IT) is vast. Surprisingly, the segment facing the highest rates of unemployment comprises young and highly educated individuals who, in theory, should be well-positioned to benefit from a flourishing economy. **This paradox underscores the existence of structural challenges within the labor market, where the mismatch between skill sets and available opportunities remains a substantial barrier for this demographic.** The overall labour participation rate remains very low and consistently falls short of 50%, reflecting many qualified individuals not opting to join the labour force owing to the dearth of lucrative opportunities.

Additionally, the low participation rate of women has worsened this, as more women have opted out of the labour force amid the pandemic. The country's economic progress is broadly premised on a shift up the value chain in IT, manufacturing, business and information services, as well as other sectors, and the shift of the workforce from rural labour into more productive urban jobs. The issue of underemployment will be addressed gradually as educational attainment improves and skilling initiatives take shape.

Corporate training provided by companies will also contribute to bridging skill gaps. The working-age population will continue to grow by 1% per year on average over this decade. India's median age of 28.4 years compares with that of 38.4 years in China. Absorbing additional labour supply creates strong incentives for the government to develop the manufacturing sector. A large proportion of the workforce will, however, still not find employment in productive formal-sector jobs, remaining a limit on growth potential.

MS: FDI inflows increased by 17.9% year-on-year to $55.6 billion during April-November FY25. What factors are driving this surge, and how can India sustain and further attract FDI?

SDG: India remains a key destination for FDI, driven by its large market, strong economic growth and evolving policy landscape. India attracted US$237bn in FDI in 2019-23, ranking as the eighth-largest recipient globally and maintaining its dominance in South Asia, where it accounted for 86% of regional inflows. **FDI inflows to India will pick up** as firms in the manufacturing and services sectors look to cater to the vast Indian market by setting up domestic operations. **India's skilled workforce and liberalised FDI regime continue to attract capital,** particularly in IT, electronics and infrastructure.

Government policies, including the PLI schemes, have spurred investment in electronics and renewables, though structural challenges persist. **Land acquisition hurdles, bureaucratic inefficiencies and restrictive local sourcing rules remain key deterrents. Labour laws have become more flexible, but regulatory disparities between states and a slow legal system still pose barriers to the ease of doing business.** Looking ahead, the government will probably continue to liberalise FDI in key sectors, including defence, insurance and space. **Renewable energy, which accounted for just 5% of FDI in 2021-24, to become a major investment area** as India advances towards its target of net zero emissions by 2070.

MS: India's government debt-to-GDP ratio is projected to be 87.5% by the end of 2024. What are the potential risks of high public debt, and what fiscal strategies can be employed to manage it effectively?

SDG: India's public debt is moderately large but mainly domestic in composition, mitigating exchange-rate risk. **An unblemished repayment record, strong economic growth and large foreign-exchange reserves reduce the risk of any sovereign default.** Slow fiscal consolidation will remain a feature of debt management. However, the government's ability to achieve consistent fiscal consolidation, along with enhanced transparency and strong revenues, increases the likelihood of a modest downward trend in government debt over the medium term. **Moderation in consumer price inflation over 2025 will raise real returns on the sovereign's assets and reduce the risk premium on the sovereign's debt.** The government has a strong commitment to honouring debt obligations. Moderating growth, gradual weakening in the currency and a persistent current-account deficit will restrain a swift reduction in public debt obligations.

ABOUT SUMEDHA DAS GUPTA

She holds a Masters degree in Economics from Delhi School of Economics, and has been working in India for the past 12 years. She currently works for the Economist Intelligence Unit, and I am a senior economist tracking India and the broader South Asian region. The focus areas are macroeconomics, political and geopolitical research and analysis. She specialises in financial market research for currencies and debt markets. She is well experienced in working on public finance ratings at the sovereign and sub-sovereign levels. She has been a winner of Focus Economics forecast awards over the years.

About the Interviewer

Mahima Sharma is an Independent Journalist based in Delhi NCR. She has been in the field of TV, Print & Online Journalism since 2005 and previously an additional three years in allied media. In her span of work she has been associated with CNN-News18, ANI - Asian News International (A collaboration with Reuters), Voice of India, Hindustan Times and various other top media brands of their times. In recent times, she has diversified her work as a Digital Media Marketing Consultant & Content Strategist as well. Starting March 2021, she is also a pan-India Entrepreneurship Education Mentor at Women Will - An Entrepreneurship Program by Google in Collaboration with SHEROES. Mahima can be reached at media@indiastat.com