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Tariffs on India might not bite too hard

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We think the recent escalation in India-US trade tensions are more bark than bite given that both sides insist they remain interested in a trade deal. We do however expect that negotiations could be protracted and episodes of elevated tariff rates cannot be precluded. Nevertheless, we maintain India equities as Attractive given that robust economic growth and policy support should enable outperformance over the medium term. Other Attractive equities options in Asia include China tech and Singapore equities, with both the CNY and SGD likely to be key beneficiaries of gradual de-dollarization.

The Trump administration has escalated its trade dispute with India, imposing 25% tariffs on Indian imports effective 1 August, plus levying an unspecified “penalty” for India’s continued purchases of Russian energy and military equipment. President Trump also specifically cited India’s “non-monetary trade barriers” as another area of contention. Given that the 25% tariff rate is at the higher end of the range of market expectations, investors are wondering if the macro environment has become too challenging for Indian equities to perform.

Our sense is that this is not the case. The escalation needs to be put in the right context, and investors also need to consider the mitigating factors that will cushion the tariff impact. For starters, both President Trump and Treasury Secretary Bessent have said that these measures are aimed at coaxing India into being more accepting of US demands. For its part, India has replied that it remains committed to “protecting and promoting the welfare of farmers, entrepreneurs, and Micro, Small and Medium Enterprises (MSMEs)”. Nonetheless, it intends to achieve a “fair, balanced, and mutually beneficial bilateral trade agreement”. This points to the likelihood of an agreement eventually.

In the meantime, a key mitigating factor is India’s relatively closed economy and its lower dependence on exports. These should both lower the initial damage from tariffs, while also increasing the effectiveness of monetary and fiscal stimulus.

On that note, we expect the Reserve Bank of India (RBI) to retain its pro-growth stance and cut its policy rate another 75bps through 1Q26, and the cash reserve ratio 100bps by December 2025. Additionally, the ongoing review of both the pay structure for federal employees and the goods and services tax (GST) could bring changes that yield a modest boost to domestic demand over the coming quarters. With robust domestic demand unencumbered by benign inflation, we see India's economy growing 6.4% and 6.7% in 2025 and 2026, compared to global and Asian growth rates of 2.9% and 4.8% in 2025, and 2.8% and 4.4% in 2026.

India equities also supported by fundamentals. Given robust economic growth, we continue to believe that two years of double-digit earnings growth are on the cards. We would also point out that since India's key export segments of pharmaceuticals and IT services are exempt from US tariffs, the impact on the aggregate EPS of the Nifty index should be further blunted. With the tariff situation for these two segments already cleared up, investor focus is likely to fall squarely on earnings. On that note, we now expect 11.6% EPS growth in FY26 and 14.1% growth in FY27.

The canny investor might note that valuations for India equities are not cheap. We agree, but would suggest not being too concerned with near-term downside risk given that RBI easing and benign inflation should allow the 10-year Indian government bond yield drift lower to 6% around the end of the year, from around 6.4% currently. This easier market liquidity should be sufficient to keep India equities supported until earnings growth comes to the fore.

INR's medium-term prospects supported by economic fundamentals. We remain optimistic about the INR's outlook over the medium term. This is mainly underpinned by the Indian economy's resilient growth dynamics, well-contained inflation, and improved fiscal discipline. The INR's recent underperformance has been largely due to equity-related outflows, dollar demand from importers, and RBI FX reserve accumulation, but we expect these to fade away in the coming months as the Federal Reserve restarts its rate-cutting cycle. We expect the USDINR to gradually decline toward 85 by end-2025 and then further to 84 by mid-2026 amid broad USD weakness.

China tech and Singapore stocks are other Asian favorites. We think that both the CNY and SGD are likely to be beneficiaries of de-dollarization and investors looking to diversify excess USD exposure in portfolios can consider assets denominated in these two currencies. We see the USDCNY drifting to 7.10 at end-2025 and 7.00 by mid-2026, with risks still skewed toward further downside. We remain constructive on the overall China tech sector but recommend that investors take a selective approach to positioning. We remain constructive on AI development in China over the medium term, pending catalysts to revive sentiment. In the meantime, we recommend shifting the investment focus to the entertainment platforms segment, given relatively benign competition there, high earnings visibility, and robust cash flow.

We see the USDSGD declining to 1.26 by end-2025 from around 1.30 currently. For investors looking to hold SGD assets, we see Singapore equities as Attractive. Singapore offers a defensive bulwark amid ongoing geopolitical uncertainty, backed by a stable currency, generous dividend yields, and a steady earnings outlook. The ongoing equity market reforms provide additional catalysts with potential value-up initiatives to unlock shareholder value.

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