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Indian equities can withstand the tariff test

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Indian equities and the INR have come under pressure as tariff negotiations with the US hit an impasse. We think that the US's 50% tariff on imports from India is likely a pressure tactic, and an eventual deal still seems likely. For now, India's relatively closed economy leaves its equity market fairly insulated, and we expect double-digit earnings growth for next two years. We thus maintain our "Attractive" view on Indian equities and would increase exposure on any selloffs.

Over the last six weeks or so, both the INR and Indian equities have come under pressure as the US-India tariff negotiations hit an impasse. The Trump administration has since imposed a total of 50% tariffs on Indian exports to the US, comprising both "reciprocal tariffs" and a penalty for buying Russian oil. Since 27 June, the MSCI India (MXIN) has fallen 7.6%, compared to a 3% decline in the MSCI Asia ex-Japan (MXASJ). Over that period, the INR has lost 2.3% against the USD, even as the broad USD (DXY index) has risen just 0.8%. With India depending on imported oil for 88% of its consumption and 36% of that coming from Russia (versus just 2% before 2022), investors would be justified in worrying that India equities might not be able to outperform.

While it is indeed more likely than not that India's equity market will remain under pressure from elevated volatility, we do not think that the recent developments constitute sufficient reason to abandon our Attractive view on India equities. For sure, the difficulties met by India's attempts to secure a trade deal with the US has been somewhat surprising given the appearance of warm relations between the Modi and Trump administrations.

Nevertheless, we think that the recent escalation in tariff tensions most likely represent a negotiation maneuver rather than a permanent deterioration in diplomatic relations. Both sides had previously expressed a strong desire to reach a trade deal, and the listing of specific areas of contention will be helpful in moving the negotiations forward. We think

that while India will not budge on opening up the agricultural sector, buying more US imports and/or reducing (or ending) purchases of Russian oil are key areas of potential compromise.

In the meantime, India's relatively closed economy and its lower dependence on exports will likely help blunt the economic impact. These should both lower the initial damage from tariffs, while also increasing the effectiveness of monetary and fiscal stimulus measures. India's dependence on imported oil from Russia might be less of a worry than it might seem.

Earnings growth can still drive Indian equities' outperformance. The key driver for Indian equities remains the strong earnings growth story, especially as the earnings downgrade cycle is nearing a bottom. The high share of domestically-generated revenues makes the Indian equity market one of the most insulated in Asia, with less than 8% of MXIN company revenues coming from the US, and this too primarily from the service-oriented IT sector which is tariff-exempt. RBI easing and benign inflation should allow the 10-year Indian government bond yield to drift lower to 6% around the end of the year, from around 6.4% currently. Private consumption and government spending continue to support the economy and should drive earnings growth of 11.6% in FY26 (2QCY25-1QCY26) and 14.1% in FY27. We thus maintain our "Attractive" view on Indian equities and would increase exposure on any selloffs.

USDINR likely to resume medium-term decline. While volatility could remain elevated in the near term, RBI intervention could help to limit USDINR spikes and help stabilize the pair. Additionally, the USDINR is approaching strong resistance levels, with the INR already having significantly weakened on both the NEER and REER (nominal and real trade-weighted) basis. We would look for the USDINR to move back below 87 in the coming months, before gradually declining to around 84 in 1H26.

OPEC+ production increases should keep oil markets stable. Given the potential for India to switch to non-Russian oil as part of a trade deal with the US, the demand-supply dynamics in the oil market will have a significant bearing on India's economy. On 3 August, eight members of OPEC+ decided to reverse previous oil production cuts by 547,000 barrels per day (bpd) for September. This takes the aggregate effective production increase since March to 2.5 million bpd (2.4% of global demand)—its had previously been intended to span 18 months but was accelerated amid US pressure. China's stockpiling efforts have helped to absorb the added supply, and it has already built up significant reserves. The eight OPEC+ members are set to meet monthly (next on 7 September) and could consider a further unwinding of the next tranche of 1.65 million bpd of production cuts.

Currently, the price gap on Russian oil has narrowed significantly to its smallest since 2022, and India's oil refiners have already been reported to have begun shifting to non-Russian supply. Our central scenario sees the price of Brent crude oil hovering around USD 68/barrel, but much will depend on the Trump-Putin meeting in Alaska on 15 August and the Trump administration's willingness to put pressure on buyers of Russian oil. For now, we do not see a switch to non-Russian oil materially hurting the Indian economy or its equity market.

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