Tariff Wars - Good news is; it is unlikely to have a sizable impact on Indian trade

The reciprocal tariffs applicable to India kick off from the first week of April. The fears are that it could hit external trade in a big way. Such fears are unfounded, and the impact may only be marginal.

What is India worried about?

The major concern for India is that the Trump government is dead serious on imposing reciprocal tariffs on all nations. For India, the reason it matters, is that the US is the largest export destination as of date. Most of India's other trading partners like China, Russia, UAE, Iraq, and Saudi Arabia are adding to India's trade deficit. The US is one of the few countries in the world that contributes to India's surplus. Of course, that is just part of the worry. The bigger is services.

Services trade is a saving grace

If you look at the services exports from India in FY25, it is almost 85% of total goods exports. More importantly, it is the services trade that creates a surplus of nearly $18 billion each month. That is what has kept India's current account deficit in check. For instance, if you look at the break-up of services exports, more than 80% is accounted for by the IT exports, and these predominantly go to the US. There are concerns that if India does not open up services to US companies, then there could be some sort of retaliation on services too. That is something India cannot afford, more so with tech spending under pressure!

Punitive tariffs has its limits

As much as punitive tariffs appear to be the easy way out for the US, it is going to be a sticky game. Canada is already reconsidering its fighter jets orders with the US, if the punitive tariffs on Canada were to continue. Mexico has put similar retaliatory tariffs on the US. The EU is soon likely to respond, but there seem to be other developments. The EU has committed $850 billion to defence, and Germany is planning to open its purse string for a big defence investment. All

that is not good news as it dilutes the hold that the US has over the rest of the world. For long, the US economy and the US dollar has been the fulcrum of world trade. If that changes; it is the US dollar exuberance that will be in trouble.

A lot of bark, but little bite

India is still an inward-looking economy and, even in a worst-case scenario, the tariff war is unlikely to substantially put pressure on India's trade equations. The US may impel India to buy more of US crude, but that may not be such a bad thing, after all. While some impact of reciprocal tariffs is likely to hit India, the bigger concern would be steel and other metals being dumped into India. That could be the real concern, if the US starts putting punitive tariffs. It is very likely that good sense would prevail even with the Trump-Musk duo. India has to play its trade cards smartly, and not be too aggressive in its response!

Sensex Rally - Is the worst over? It may be too early as it is just liquidity driven

As the week to 21-March came to close, it looked like the bulls had the upper hand all over again. Sensex gained more than 3,000 points and FPIs were slowly turning net buyers. There is more to it!

What changed this week?

Actually, if you were to describe the rise in the market this week in one word, it would be "liquidity." OK, FPIs were net sellers in the week, but they did turn net buyers on the last day and also bought into debt. But the real reason for the spike was not just about flows but about the impression that the liquidity taps were once again being opened by the US Federal Reserve. That is what came out of the Fed monetary policy that was presented on 19-March. It was not the status quo on rates, but liquidity boost.

Cutting on bond reduction

The Fed balance sheet had reached a peak of $9.2 trillion after the pandemic, so Fed has been steadily buying back bonds since early 2022. It started with $90 billion a month, then reduced it to $60 billion a month last year, and the latest Fed policy has further reduced it to $40 billion. That means, the Fed is satisfied by the balance sheet reducing to $6.7 trillion and sees it fit to infuse more liquidity into the system. Such a liquidity infusion normally provides a boost to assets in emerging markets, and that is exactly what we saw in the Indian markets. It may not really last!

Recent US macros are worrying

However, Indian investors must pause before celebrating this temporary surge in liquidity. The latest quarterly macro updates presented by the US Fed, along with the Fed policy statement, has some key concerns. For 2025, the GDP growth estimate has been lowered by 40 bps to 1.7%. At the same time, unemployment has increased by nearly 10 bps to 4.4%. To add to the woes, the core inflation in the US is expected to be higher by 30 bps at 2.8%, against earlier estimates. The moral of the story is that, the US economy looks far from being in fine fettle and

that is not great news for the world economy. It is unclear if the stiff US market valuations can be supported by an uncertain economic situation. That remains a key challenge for India.

Take it with a pinch of salt

Indian investors must take the recent really in the stock markets with a pinch of salt. It is more of a one-week rally after close to 4 months of persistent selling in markets. Most of the macro issues are still there. Indian growth is still sluggish, valuations are stiff, the quarterly numbers are under stress, and operating margins are squeezed. FPI flows are still elusive and we have not even started seeing green-shoots of FPI flows coming back. The rally this week looks like a knee-jerk reaction to the good news on liquidity. Investors must not read too much beyond that point!

SGB Headache - Government may be staring at a big hole in gold bond redemptions

It may be a full one year since the last issue of sovereign gold bonds. However, the outstanding SGBs are still a major pain point for the government. There is a huge cost to be incurred on these SGBs.

Some interesting SGB numbers

In the last 8 years since the government started issuing sovereign gold bonds, it has been one of the big success stories in fund raising. The government raised a sum of ₹72,274 crore, by selling close to 146.96 tons worth of gold bonds. Until now, the government has redeemed just 16.84 tons worth of gold bonds, most of it as part of full redemption. Investors prefer to hold the SGBs for full tenure as it allows them tax-free capital gains. The big challenge is that there is another 130.12 tons of SGBs yet to be redeemed with market price twice the inflow price.

Why is the cost of SGBs a worry?

There are 3 major costs that the centre has to incur on SGBs. The first is 2.5% annual interest on the cost value of the bonds. Secondly, there is capital gains tax foregone since the bonds are exempt from capital gains tax, once the investor holds it for the full tenure of 8 years. But, the biggest cost to the government is the spike in gold prices. The government has given a sovereign guarantee on interest and on protecting capital in grams of gold. Between the first issue of SGB and today, the price of domestic gold is up 3-fold from ₹2,800/gram to ₹8,600/gram.

How big is hole for the centre?

That would entirely depend on the kind of gold prices that we see from here. If gold price falls, then the centre stands to gain, but that looks unlikely. If gold stays at the current market price, the centre will end up paying nearly 105% more than it realized. However, if gold prices are up by an average 20%, which is very likely, then the government may end up paying 136% more than what it realized from the issue of gold bonds. In the case of the gold price going up 40% on an average from here, the centre would end up paying 167% more than it realized. In short,

everything depends on the price of gold. Looking at the way gold has been rallying amidst global uncertainty, it does look like gold prices may have more legs in the days ahead. That is not good news.

Where did SGBs go wrong?

One can argue that timing was wrong. In a sense, the government expected that the 2017 revival would work against gold prices. However, the next few years were racked by uncertainty; including COVID pandemic, global inflation, Ukraine war, Middle East stand-off and now Trump tariffs. This mountain of uncertainty led to a spike in the demand for gold. While price spike was a big factor, there are 2 areas the government erred. Firstly, it should have stopped the SGB issues long back, at least around the pandemic. Of course, such a gold liability should not have been left unhedged in first place!

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