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US tariffs force India's banks to reassess trade risks

Test is whether stress will be concentrated or systemic, as the country hedges its bets

by **Sweta Roy**

Strained relationship? India and the US are drifting further apart as the former looks to Europe as a strategic hedge © AFP via Getty Images

India's exporters are grappling with elevated US tariffs and prolonged trade uncertainty, but banks and policymakers see the stress as concentrated rather than systemic — at least for now.

A headline tariff rate of 50 per cent now applies to a large share of India's exports to the US, raising concerns about trade flows, exporter liquidity and bank exposure. Yet the overall impact on trade volumes and financial stability has so far been relatively

"India's overall export performance has held up better than expected," a Citibank spokesperson tells The Banker. "Tariff-exempt segments such as electronics continue to perform strongly, and exporters have been able to redirect shipments to alternative markets. There is also still hope of a trade deal announcement, which could limit second-round effects on employment and investment, although uncertainty continues to weigh on sentiment."

Structural uncertainty is redefining risk

Former finance secretary Arvind Mayaram cautions that India should view the current US tariff rhetoric not as temporary negotiating brinkmanship, but as part of a "broader, more durable shift in trade and industrial policy". While some tariffs may still be tactical, he says the deeper message is the "normalisation of trade restrictions as tools of domestic economic and strategic policy".

The line between short-term noise and long-term risk, Mayaram argues, lies "less in market reactions and more in policy intent". Trade measures that are "embedded in legislation, enjoy bipartisan support or are aligned with industrial policy objectives should be treated as durable". Even when specific measures are delayed or diluted, the "elevated probability of abrupt policy shifts alters the risk environment in a lasting way", he says.

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>
> **Arvind Mayaram**

Volatile demand and pricing complicate credit assessment and heighten counterparty risk for exporters. At the same time, currency swings push up hedging costs and strain balance sheets, particularly among smaller firms, with knock-on effects for the banks that finance them.

Yet trade policy risk in India is still largely treated as episodic rather than structural. Banks and regulators continue to rely on historical trade patterns and conventional sectoral exposure metrics, rarely factoring in sustained trade fragmentation or geopolitical risk in stress testing. Mayaram says that if trade frictions persist, a gradual recalibration will be needed, including “more explicit recognition of trade and geopolitical uncertainty” in supervisory assessments, stronger stress testing of trade-exposed portfolios and enhanced internal risk capabilities within banks.

“The global trade environment has changed in a lasting way,” he says. “Policymakers and financial institutions will need to adapt structurally, rather than just respond tactically.”

Currency volatility is the hidden pressure point

Banks say the most immediate stress is emerging not through rising defaults but through currency volatility. Sharp swings in the rupee have pushed up hedging costs, increasing funding expenses for exporters with dollar-denominated exposure.

“These channels matter for funding stability,” says a Citi spokesperson, pointing to the Reserve Bank of India’s active management of liquidity through open-market operations and foreign-exchange swaps.

weak equity markets and broad dollar strength. In January alone, foreign portfolio investors sold more than $2.4bn of Indian equities.

Trade negotiations complicate the outlook

Uncertainty has been amplified by the nature of India's trade talks with the US, which economists say now extend well beyond conventional trade issues.

"The negotiations have taken much longer than expected because they are no longer just about tariffs or market access," says Sonal Varma, managing director and chief economist for Asia at Nomura. "Geopolitical considerations are now being negotiated alongside trade."

Varma adds that unresolved legal questions in the US — particularly around the authority underpinning the tariffs — have left timelines unclear. "From India's perspective, the negotiations are open-ended, and that uncertainty itself has become a constraint."

Stress concentrated in labour-intensive sectors

The impact is most visible in labour-intensive sectors with high US exposure, such as textiles and leather, where exports have declined and margins have compressed. Equity flows have also remained persistently negative, weighing on sentiment and the rupee.

US tariffs of up to 50 per cent have hit India's labour-intensive export sectors, with textile and apparel exports falling 12.9 per cent in October 2025, according to the Confederation of Indian Textile Industry. Production at small and medium-sized units has dropped

The strain is spreading to leather, where Crisil Ratings expects revenues to decline by 10-12 per cent this fiscal year and export volumes to fall by 13-14 per cent, amplifying margin and liquidity pressures given that the US accounts for about 22 per cent of exports.

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>
> **Sonal Varma**

“In financial-stability terms, the risks are concentrated rather than systemic,” Varma says. “Micro, small and medium-sized exporters in labour-intensive sectors are facing cash-flow pressure, but this does not yet pose a broader banking-system risk.”

Beyond existing tariffs, Washington has introduced an additional layer of geopolitical risk. President Donald Trump has approved a bipartisan Russia sanctions bill that could impose tariffs of up to 500 per cent on countries, including India, that continue to buy Russian oil, according to US senator Lindsey Graham.

Parthasarathi Patnaik, chief risk and data officer at trade-finance platform Vayana, estimates that if tariffs were to rise further, cash-flow stress could emerge within one to three months among MSMEs and mid-sized exporters.

“In vulnerable upstream segments, such as textiles and chemicals, 40-70 per cent of exporters could face payment delays,” Patnaik says.

Banks say trade-finance availability remains adequate, although costs and risk perceptions have risen.

Letters of credit and supply chain finance have come under pressure as exporters seek additional protection, Patnaik says. Costs for letters of credit have risen by 5–10 per cent, while repayment cycles for supply chain finance are lengthening.

Receivables financing is also under strain, with US buyers delaying payments and open-account trade becoming riskier. During earlier shocks, including the pandemic, supplier financing in affected sectors fell by 25–30 per cent, according to Patnaik.

Digital platforms act as a buffer

Fintech-led trade-finance infrastructure is increasingly cushioning the impact.

Vayana, the country's largest supply-chain finance platform, says it has facilitated more than $55bn in supply-chain finance, reducing funding timelines from weeks to days and cutting costs by 2–3 per cent. Real-time risk monitoring has helped reduce default rates by 10–15 per cent, according to its internal data. Banks say such platforms are helping prevent temporary trade shocks from translating into sustained liquidity or credit stress.

Europe emerges as a strategic hedge

India is accelerating efforts to diversify export markets, with Europe emerging as a key alternative. Analysts say a prospective EU trade agreement could help redirect up to 84 per cent of exports affected by US tariffs.

with the UK, Australia, New Zealand, Switzerland, Norway, Iceland, Liechtenstein, Oman, Israel, Japan and South Korea.

Around 55 per cent of India's exports are exposed to the highest US tariffs. "The 50 per cent tariff applies to roughly 55 per cent of India's export basket," Varma says. "High-growth segments such as electronics and smartphones are currently excluded, so the impact is concentrated rather than systemic."

"Completely moving away from the US market is not realistic, but opening up alternative consumer markets — especially in Europe — can help offset some of the impact," she adds.

"Trade finance itself is unlikely to become a major constraint. Banks are willing to extend credit, and given the strong capital position of the banking system, this does not look like a systemic risk," Varma says.

While tariffs remain elevated, Indian officials say talks are progressing, with commerce secretary Rajesh Agrawal describing a US trade deal as "very near".

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