

EcoFlash

India: Trade Agreements to Attract Foreign Investment

On 2 February, President Trump announced the approval of a trade agreement with India, reducing "reciprocal" tariffs on Indian imports from 25% to 18% and eliminating the 25% "penalty" imposed on oil purchases from Russia. As a result, Indian goods will face lower tariffs than those from Southeast Asian countries (excluding Singapore), especially Vietnam and Thailand.

While India has signed several trade agreements since last year (including a deal with the EU in January), these arrangements will mean it is no longer penalised compared to its Asian neighbours, both on the U.S. and European markets. However, the short- to medium-term impact on its growth will remain modest. The Indian government's primary goal is to attract and retain foreign investment to develop its industry and create high-quality jobs.

Immediate Cut in U.S. Tariffs on Indian Imports

On 2 February, President Trump announced that "reciprocal" tariffs on Indian imports would be immediately reduced from 25% to 18%, and the 25% penalty on Russian oil purchases would be lifted. The effective average tariff rate would therefore drop from 35.1% to 15.6%, which is lower than the rates for other Southeast Asian countries (excluding Singapore), especially Vietnam (19%) and Thailand (16.2%).

While the full details of the agreement are not yet public, India has reportedly pledged to cease Russian oil purchases and increase imports of U.S. (and possibly Venezuelan) oil—a shift that has already been underway since September (with a 70.1% increase in U.S. oil imports between September and November 2025 compared to the same period last year). In late 2025, Russia was still India's leading crude oil supplier (33% of imports during the first 11 months of 2025, vs. 6.8% for the U.S.).

Free Trade Agreement with the EU

In January, India also signed a free trade agreement (FTA) with the European Union, covering 99.5% of Indian goods and services exported to the EU, which accounts for 21.1% of India's total exports. Previously, Indian products faced tariffs ranging from 4% to 26% (with an average effective rate of approximately 10%). Once fully implemented (expected by late 2026 at the earliest), the FTA will reduce tariffs to near-zero on most products, boosting exports of labour-intensive goods (such as textiles, footwear, leather and jewellery). India will now benefit from tariff conditions comparable to those of Vietnam, one of its key competitors in these industries.

India's Multi-Alignment Strategy Through Trade Agreements

The entry into force of the FTA with the European Free Trade Association (EFTA) in October 2025, along with deals signed with the UK (July 2025), Oman (December 2025), the EU (January 2026), and the U.S. (February 2026), reflects the Modi government's push to accelerate India's integration into global trade. From a geopolitical standpoint, this trade strategy underscores India's "multi-alignment" approach, which seeks to balance relationships with major economic blocs.

Short-Term Relief for India's External Accounts

In the short term, the U.S. tariff reduction will ease pressure on India's external accounts, which deteriorated in 2025. Trade performance was negatively impacted by uncertainty surrounding U.S. trade policy, the 25% surcharge on Indian exports to the U.S. (effective since August 2025), and India's weak competitiveness in the semiconductor and integrated circuit sectors.

Between late 2024 and late 2025, the rupee depreciated by 4.8% against the dollar and 8% in nominal effective terms, marking one of the worst performances among emerging Asian currencies. By late January, it hit a record low of INR 92 per USD. However, since the U.S. trade agreement was announced, the rupee has appreciated by 1.7% against the dollar.

Growth Support for FY2026/2027

The U.S. trade agreement has the potential to enhance India's FY2026/2027 growth forecast by 0.2 percentage points (projected to be between 7% and 7.4%, according to government estimates). Domestic investment is expected to benefit from improved trade relations with the U.S. and lower lending rates (a 100-basis-point reduction in 2025), while exports are expected to increase. The U.S. continues to be India's primary export market (18.3% of exports, or 2.1% of GDP).

Modest Direct Impact from EU Market Access

The EU FTA, which is anticipated to be ratified by late 2026 or early 2027, has the potential to contribute an additional growth of between 0.1 and 0.3 percentage points to the Indian economy due to the direct impact of increased exports, given that Indian exports to the EU account for 2.3% of GDP. However, this is not the most significant effect that is expected. The primary objective of the Indian government is to attract foreign direct investment (FDI).

India's net FDI remains very low (expected to remain under 1% of GDP this year, compared to 1.4% in Malaysia, 1.6% in Thailand, and 3.9% in Vietnam). However, the country urgently needs foreign technology to advance its industry sector, integrate into global value chains, and generate 12 million high-quality jobs annually to accommodate its workforce. These employment opportunities would boost productivity and increase household incomes.

Historically characterised by a high level of protectionism, India cannot sustain high growth rates without attracting and retaining foreign investment. To achieve this, it must further liberalise its domestic market and continue with structural reforms¹.

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¹ See Chart of the week of 02/07/2025: “[India attracts FDI but fails to retain it](#)”.