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The Valuation of policy predictability an impact of bilateral and FTA between countries and their influence on a country stock market: Case study of the India-US Comprehensive Trade Agreement (2026) and the India-EU treaty (2026) on the NSE

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ABSTRACT

This paper looks at how Free Trade Agreements (FTAs) and bilateral trade agreements can affect a country's stock market. It mainly focuses on India and the recent trade developments with the US and the European Union, and their possible impact on the National Stock Exchange (NSE). It also focuses on policy predictability and includes stability of trade policies. However, it states reasons why an FTA alone may not be enough to improve trade or the economy. Political stability, government regulations, infrastructure and the strength of local industries also play an important role for the development. Previous research and historical trade agreements, including NAFTA, have been analysed to understand how trade agreements have affected countries in the past. It also looks at the Synthetic Control Method (SCM), which compares what happened after a trade agreement with what may have happened without it. Overall, the paper tries to understand whether stronger and more predictable trade relationships can affect stock market returns and volatility, and what this could mean for India and the NSE.

Key words: Free Trade Agreements (FTAs), Bilateral Trade, Stock Market Volatility, Stock Market Returns, National Stock Exchange (NSE), Synthetic Control Method, India-US Trade, India-UK Trade

1. Introduction

Trade and the system of governance have been looked at since World War 1. During this time there were not many rules and regulations to protect smaller economies. The rule of the law was that powerful economies usurped or forced smaller nations to follow their diktats by militarily overpowering the smaller countries. These smaller nations had no option but to trade in the commodities that were demanded of them. There was no system of 'comparative advantage' that

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was followed in this system. While trading the political system of democracy or autocracy or socialism was not ever considered. The rule was a powerful nation as compared to a weak smaller country. [6]

Subsequently after World War 2, and in the period of restoration the economies started looking at trade as a viable option to develop. The whole process was effectively put into place after the Cold War (1991) though the process had started in 1947 with the establishment of GATT (General Agreement on Tariffs and Trades). The WTO (World Trade Organization) in its present form was constituted in 1995. It is after 1947 that research moved towards the importance of democracy and its relationship with trade. Not every country has equal resources leading into gaining trade and taking advantage of larger number of resources as well as cheaper systems of extracting trading in them. In this era, trade was now based on trust and rules. Countries with democratic system of government seem to keep to their agreements as democracy requires the necessity of legislative ratification (approval by the parliament or congress). This acts like a permanent commitment for both countries to stick to their signed agreements. Democratic setups lead to greater transparency of reliability of trade agreements as they are answerable to the public and need to be voted into power time and again.

Research on China and ASEAN nations have indicated that from period 2001 to 2020, 'that trade is not just a result of market forces but is deeply tied to diplomatic fluctuations' (Yaren Wang and Yitao Tao, 2024). Their analyses indicated the importance of political relationships between two economies rather than the extent of the powerfulness of any one nation. Thus, it is the system of governance, market forces, and relationships between two countries that determine trade relations. For trade to prosper, there needs to be stability and positive political interactions between countries. [2]

Besides relationship and democracy in countries the other factors that are important are:

- Financial sector efficiency
- Stringent laws in place to protect commercial contracts
- Unfettered flow of market information through free press

Research on African countries have indicated that the above three are equally or more important than democratic institutions as 'democratic reversal' or a shift towards autocracy is easily possible resulting in decline in trade flows. What research has indicated in these countries is political stability as economic requirement for regional integration in Africa.[3]

Baccini and Urpelainen have indicated that countries need a 'commitment mechanism' which is a fool proof watertight mechanism for counties to remain with each other once they have signed the trade agreements. If leaders and governments think of retracting their steps, it would be an

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extremely expensive proposition. This ensures the economy functions in a democratic setup and the expenditure involved in violating trade agreements and going back to autocracy or dictatorship makes it extremely expensive and challenging. [4]

Besides democracy and economic considerations, some researchers have indicated that democratic small poor economies have the right to protect their citizens in achieving food health security. This would involve protecting these sectors and thus not allowing free trade in these areas. There would be basic social commitments on the part of the democratic government towards its citizens. This would then restrict the areas where trade can take place with other economies being dependent on the type of country that trade agreements are signed. Social welfare is an important factor that needs to be considered while adopting trade agreements. The opening of the economy in such cases may not be economically, socially, and politically viable. [5]

While previous research acknowledges that trade and currency risks are linked, older studies suffer two major limitations. First, they rely on "time-invariant" measures, meaning they treat a country's geographical distance or trade network as something that stays frozen forever. Second, they rely on "two-country models" that analyze only two nations at a time, failing to capture how a massive, interconnected global economy works.

Neo classical trade theories propounded that trade would be good for all economies as it would encourage the production of commodities that countries have expertise in. Nations benefit in specializing in what they are relatively best at and thus trading in that good. This scenario is an ideal situation where there are no barriers to entry or exit and it helps in larger consumer choice at cheaper rates increasing overall standard of living at same time. Free trade concept may help the consumers but at the same time it may harm producers and domestic industries which are unable to compete with inexpensive imports resulting in them shutting down impacting employment and growth of the country. This results in the governments stepping in to help this sector by imposing taxes on goods like clothes and agricultural commodities which are being produced primarily by developing nations. It creates an unfair system where developing nations face trade barriers that are about 50% higher than richer economies, making it extremely difficult for them to compete globally.

2. Literature Review/ Background

Instead of assuming that a good government directly causes trade to increase researchers have looked at the exact relationship and process of how good leadership translates into trade. Large amount of earlier research focused on factors like corruption and political stability that influence trade. But recent papers have focused on governance and day to day business as equally crucial

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factors influencing the level of trade. Indicators from World Bank and other worldwide agencies like business index are measures in the way, governments influence trade flows, and domestic business environment. Enhancing smoother conditions would lead in encouraging businesses into entering international markets. What is important is political stability and the business environment in an economy.

Another factor that is important in understanding international transactions is whether buyers are “spot buying” or “relational buying.” Though “relational buying” depends on long term relations that are nurtured overtime. On the other hand, spot buying means the buyer is going to “shop” for suppliers in search of low prices. But this may lead to constantly changing suppliers and may result in undependable supply sources. Spot buyers may also face supply chain vulnerabilities during economic or political upheaval. Expanding global trade volume involves a lot more than reduction of state corruption or fixing broad regulations, it depends on creating environmental conditions such that both buyers and sellers nurture long term relationships.

Research of the disruption during Covid 19 Pandemic has brought to the fore front that simplifying customs procedure and paperwork at the borders are not the only factors in encouraging trade, neither are trade agreements between countries. Also important are corruption levels, legal framework and a robust domestic environment that encourages production.

Some researchers have indicated that international trade does not only restrict itself in trading of commodities but is also a primary tool for spreading civilization, language and culture between different societies.

For years, economists assumed that a country's currency value should be tied directly to its economic fundamentals such as output produced and trade. However, when research looked at the emerging data, there was a lacuna. This mystery came to be known as the exchange rate disconnect puzzle. There are two major risks ***Idiosyncratic risk*** and ***Systematic risk.*** **Idiosyncratic risk** is a risk unique to one country; however, **systematic risk** is like a global storm it impacts everyone at the same time. Trade agreements act like financial shock absorbers against those global storms. When two countries sign a trade deal, actual trade volume jumps by 50% over the next five years. As they are now buying and selling so many commodities and services from each other, their business cycles are locked together. When trade economies are intertwined with each other, any global storms would hit countries at the same time as they move in perfect synchronization, resulting in their exchange rate being stable. Signing a trade deal reduces a country's vulnerability to the minimum in case of a global storm. Moreover, if two large economies such as US and China get into a trade war, it is possible that they can absorb the damage internally. However, other smaller countries are likely to suffer. This leads to distrust in the global trade network, as it is possible that smaller countries' currencies became wildly

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unstable. A trade war between large economies causes collateral damage that hurts the poorest nations the most.

Free Trade Agreements (FTAs) are important in the business world today because they get rid of trade barriers like taxes on imports (Tariffs). By making it easier to trade across borders, FTAs help economies grow, open new markets for businesses, and force companies to be more innovative and beat the competition. However, these deals also cause some serious problems. When countries start focusing only on what they are best at making (specializing), some local industries can't compete and end up shutting down, which leads to people losing their jobs. In addition, the money made from these trade deals isn't shared equally, which increases inequality. Due to this, leaders need to look at both the advantages and disadvantages of FTAs so they can make trade rules that help the economy grow more equitably.

While economists know that global stock markets are connected, influence of external factors like oil prices or imported inflation have an impact, indicating the close relationship between international trade and a countries domestic market. When countries trade heavily, they become vulnerable to each other's supply and demand shocks, which quickly impacts local stock market volatility. This study looks at a network of eleven major global economies from 2000 to 2021, tracking the way in which the entire global trade network impacts stock markets as a whole and the direction in which they move. A country's position as an importer has an effect on the trading partner's stock market than if its position was that of an exporter, giving investors and policymakers a much better tool in predicting impact of how shifts in trade cause stock market chain reactions around the world.

104 historical trade agreements would be analyzed using the Synthetic Control Method (SCM) as this method creates an artificial twin country of existing data indicating the path that an economy would follow if it had not signed any agreement. The results of the analysis indicate that trade deals would increase exports by at least 80% over 10 years. The main beneficiary would be the emerging markets when they partner with advanced economies. Agreements like NAFTA have successfully generated increased export growth for the US, Mexico, and Canada, causing only minor import disruptions for countries outside the deal. Exporting countries invest a lot of money to build massive factories for specific buying countries, a sudden drop in demand from an importer leaves the exporter stuck with extra goods and forced to cut prices, which destroys their profits and crashes their stock market. On the other hand, if an exporting country suffers a supply shock and stops producing, the importing country faces only minor, indirect adjustments because it can easily switch and buy from a different global supplier.

Past data on trade agreements is divided into backward-looking historical analysis (ex-post) and forward-looking future simulations (ex-ante). Traditional ex-post studies often relied on a gravity

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equation that underestimated trade growth because it treated agreements as random events, ignoring the selection bias where countries endogenously partner with nations they already trade heavily with. When newer research corrected this bias, it revealed that trade deals can boost trade by 100% over a decade, though they sometimes trigger trade diversion by reducing business with outside nations. In contrast, ex-ante studies use computer models to simulate future trade deals, but these predictions face massive uncertainty because hidden non-tariff barriers are incredibly difficult to measure. As a result, forward-looking models frequently underestimate real-world success sometimes by tenfold which motivates this paper to complement flawed future predictions by using the Synthetic Control Method to accurately evaluate the historical impact of past trade agreements.

3. Research gap and methodology

This paper analyses the impact of Foreign Trade Agreements (FTA) and bilateral agreements on domestic stock markets volatility along with domestic internal conditions that enhance trade and improve balance of payments conditions of nations. Emphasis would primarily be on developing economies like India. 104 historical trade agreements would be analyzed using the Synthetic Control Method (SCM) as this method creates an artificial twin country of existing data indicating the path that an economy would follow if it had not signed any agreement. In-depth studies on agreements like NAFTA would be analyzed.

The methodology adopted would be the mixed method type both quantitative and qualitative. Quantitative analyses of 104 historical trade agreements would be studied and so also would be agreements like NAFTA which improved trade between US, Mexico and Canada but did not adversely impact other trading partners. All data sourced would be from authentic secondary sources.

4. Analysis

The impact of trade could be analyzed by formulating four main hypotheses to understand the linkage between trade and stock markets.

The first model H1: A tighter international trade network leads to stronger stock market connectedness at a system-wide level amongst economies. This means that as countries become more interconnected through global trade, their stock markets are expected to move in synchronization because an economic shock in one country can be easily transmitted to the entire global network.

H_2: An economy's position as an importer leads to stock returns spillovers to their trading partner. This studies a country's role as an importer which impacts its trading partners. If a major

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importing country has a strong economy, it buys more goods, which directly boosts the businesses and stock markets of the countries exporting to it.

H_3: An economy's position as an exporter creates a stock return spillover to its trading partner. This looks at the supply side. If an exporting country faces a problem and stops selling goods, it creates a supply shock. This can cause uncertainty and higher costs for its importing partners, which can drag the importer's stock market down.

H_4: An economy's position as an importer is a stronger generator of stock return spillover to its trading partner than being an exporter. This highlights a clear imbalance, meaning a drop in demand from an importing country hits its partner's stock market a lot harder than a supply issue from an exporter would. It basically means that it is difficult for an exporting country to find new buyers when a deal falls through.

The Synthetic Control Method (SCM) is a model that works by creating an identical situation for every county considering those projects that are impacted by exports, and similar projects were considered without exports. This model compares a country's actual progress in terms of the economic impact of the trade agreement. The analysis indicated a major economic impact due to the countries entering a trade agreement. Some countries experienced an 80% increase in exports over ten years since the agreement was signed. The maximum benefit was in the case of a developing economy as it had now greater access to a developed economies market based on trade agreements.

Trade talks in recent years have moved towards Preferential Trade Agreements (PTAs). These include reduction of tariffs as well as custom regulation and product standards. For example, trade agreement between Europe and Indonesia (the EU-IDN CEPA in 2018) would create the largest macroeconomic boost, expanding Indonesia's GDP by 2.13% primarily by lowering non-tariff barriers. But at the same time the deal is highly regressive, it would worsen income inequality due to the fact that there would be a high demand for high tech service sector. This would lead to increasing wages of the highly educated workers leaving the poorer low skilled population behind. This highlights that policymakers should not just look at total economic growth but must analyze the trade-offs of each agreement to understand the costs and benefits with respect to its citizens.

5. Impact on the stock market of the UK and the US trade agreements

The UK bilateral trade agreement was signed on July 24th, 2025. The immediate impact on the Indian stock market is indicated below:

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Date	BSE Sensex	NSE Nifty 50
July 24th, 2025	82,184.17	25,062.10.
July 25th	82,789.23	25,243.30
July 28th	76,765.92	23985.35
July 29th	77,655	24250
July 30th	77,726.62	24,275.85

Source: https://www.ibef.org/economy/india-uk-comprehensive-economic-and-trade-agreement-ceta

The UK India trade agreement is primarily in Indian textiles and apparel exports. These commodities faced duties between 10–12% in the UK, and after the agreement would achieve duty free access resulting in the possibility of increasing exports by US$ 1.35 billion annually. A long with this Indian pharmaceutical firms will benefit from fast-track market access in the UK, along with mutual recognition of Good Manufacturing Practices and reduced inspection duplication. Tariffs on Indian gems and jewelry will be eliminated, improving competitiveness in a segment currently exporting over US$ 1.63 billion to the UK each year.

A result of this would be that India would reduce its current levels of 150% tariff on Scotch whisky to 75% over 3 years, with further reduction to 30% under a quota of 2 million liters (about 528344 gal) annually. For UK this agreement would allow their automobiles, to be exported into India at lower tariffs from the current 100% to 50% for up to 10,000 units annually, covering high-end electric and hybrid vehicles.

The US bilateral trade agreement timeline:

Date	BSE Sensex	NSE Nifty 50	Reaction of the Index
13 February,2025	85,871.73	26,341.20	Increased by 2.5%*
5th March,2025	83,739.13	25,727.55	Decreased by 3%**
2nd April,2025	76,617.44	23,332.35	Decreased by 8.3%***
31st July 2025	81,185.58	24,768.35	Increased by 6.9%****

Source: https://timesofindia.indiatimes.com/business/india-business/stock-market-today-live-updates-nifty50-bse-sensex-july-31-2025-donald-trump-25-tariff-on-india-impact-india-us-trade-deal-penalty-for-russia-oil-top-reasons/articleshow/123009220.cms

*-Positive announcements as far as the US-India trade agreement was concerned

**-Negative sentiments of the trade agreement between US and India lead to a decline in Indias stock market.

***-The decline was due to negative impact of trade agreement

****-The rise was due to positive announcements.

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Both table 1 and 2 indicate the impact of announcements of trade agreements between the India and UK and India and the US. It is clearly seen that positive announcements result in an increase in the indices of the India stock market while negative statements result in a decline. The tables clearly bring out the volatility of the Indian stock market due to agreements that are announced and signed.

6. Limitations

A major limitation that was encountered was the dependance on secondary data. No independent primary research, such as surveys or raw financial data collection, was conducted due to paucity of time and money. The findings presented were dependent on the scope and methodologies of the existing literature. Furthermore, as the India–EU Free Trade Agreement (signed in January 2026) and the ongoing India–U.S. bilateral trade negotiations are recent developments; long-term historical data tracking their direct effects on the National Stock Exchange (NSE) is not yet available. This paper relies on historical control methods and predictive simulations to project outcomes, which introduces a degree of uncertainty.

7. Conclusion and the way forward

India has spent the last decade signing many free trade agreements. These have basically been bilateral ones within Asia and with countries in South America. The trade impact has not been as expected, maybe due to strict rules of origin, snail-paced tariff cuts, and narrow product lists. In addition to these factors, existing policies in the domestic country may have acted as a hinderance to the development of export-oriented MSME (Marginal Small Micro Enterprise). Some of the problems that developing economies need to overcome are domestic policy measures that restrict the development of export industries. These industries should be encouraged with respect to logistics, infrastructure labor laws, and adequate credit. India could also consider reduction of tariffs on those imported inputs which would help the Indian companies be a part of the Global Value Chain.

India major exports since the 1990s have been in the service industry, there must be a concerted effort by the government to increase exports of good and commodities from the manufacturing sectors. This ideally should be from the MSME sector as workers that move from the agricultural sector can be gainfully employed in this sector. The extent of skills required is not as intense as those in the services sector. Given that India is presently undergoing “demographic dividend” it is essential to skill these workers and gainfully employ them in the MSME areas. This would naturally increase the export potential of this sector as well as solve the growing problem of unemployment in the Indian economy.

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Bilateral and Multilateral would help in provision of dedicated markets to the manufacturing sector in India ensuring an increasing demand for their product.

All FTA agreements need to be understood and drafted in a manner that it is a positive situation for all countries involved. It is important to also protect domestic industries and not suddenly open it up to competition. This has by and large been invoked by the Indian government in terms of the agricultural sector. The agricultural sector in India supports a large percentage of the workforce but at the same time adds little to the country's GDP. Thus, whatever trade policy is followed should adequately consider that competition does not impact the labor force being out of jobs but at the same time they should ensure that the sector produces commodities that are competitive both in terms of price and quality.

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