DBS Flash

India's trade deficit with China has improved

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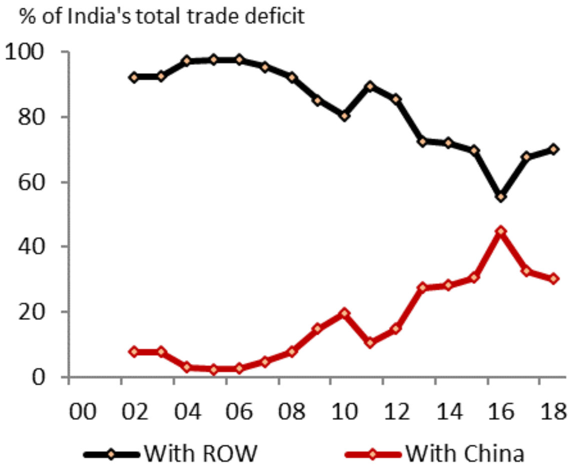
- *India's trade deficit is set to be wider again in FY19 but there are reasons to cheer.*
- *Export growth has slowed but imports have fallen at a faster pace.*
- *India's bilateral trade deficit with China may have peaked and started to narrow but this was not due to a weak exchange rate.*
- *Composition of the trading basket remains largely unchanged.*
- *Yet, the Chinese yuan is still monitored for its influence in the INR effective exchange rates.*

India's overall trade deficit in the first eleven months of FY19 (USD170bn) was wider than the whole of FY18 (USD162bn).

Yet, there is reason for cheer in the February trade data. The monthly trade deficit shrank sharply to USD9.6bn vs USD14.7bn a month before and the average USD16bn in April-January. While export growth was slow, imports contracted at a faster pace from an 8% drop in oil purchases and -4% fall in non-oil imports (owing to lower gold). Despite the challenging global backdrop, India has less to worry about its sizeable trade deficit with China.

India's bilateral trade deficit with China has narrowed at the fastest pace in nearly a decade. During the first ten months of FY19, India's exports to China increased 17% YoY, outpacing the 10% growth in overall exports. A concurrent 14% YoY plunge in imports from China, which bucked the 13% rise in overall imports, helped to axe a fifth of the deficit. If this run rate persists, the bilateral trade deficit could narrow to USD55bn (2% of GDP) in FY19, after peaking at a record high of USD63bn (2.3% of GDP) in FY18. Despite this, China still accounts for more than a third of India's total deficit (see chart).

India's Bilateral trade deficit with China vs ROW (Rest of the World)



Source: CEIC, data transformations are by DBS Group Research

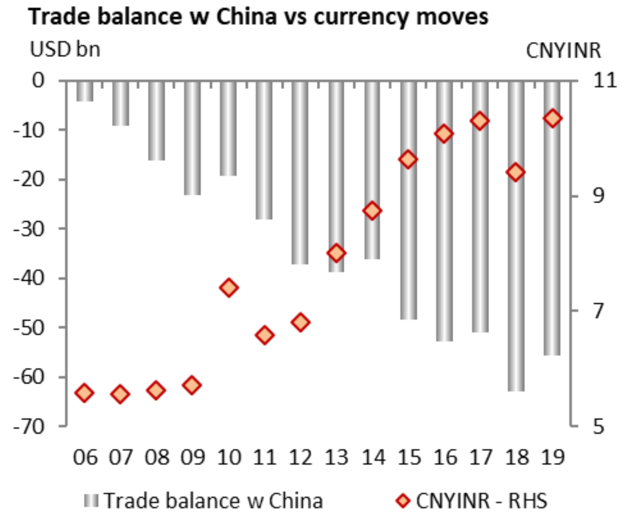
Three trends in India-China trade

Firstly, India has been exporting more of the same products to China. Primary and intermediate products still account for a bulk of India's shipments to China including petroleum oils, seafood, vegetable fats, animal feed, iron ore residue, amongst others [1]. The smaller weightage of manufactured goods was consistent with China's preference to source raw materials and intermediate goods from its Asian trading partners and complete the value-added process domestically.

Secondly, India's imports from China are heavy on manufactured items, particularly electronics and electrical equipment alongside pharmaceuticals. A modest reduction here in FY19 imports likely reflects the impact of the Indian government's efforts to impose anti-dumping duties, and efforts to attract production onshore. Nonetheless, the nature of India's imports from

China remains manufacturing-intensive; for instance, reliance on consumer electronics and semi-conductors, might expand further as Chinese brands continue to improve their footprint in India's smartphone market.

Finally, India's trade deficit with China is likely to be driven more by the above structural factors than mere currency movements. For example, the bilateral deficit tripled between 2009 and 2018, during which the rupee depreciated ~50% against the Chinese yuan and 47% vs the US dollar.



Source: CEIC, DBS Group Research

Given its trade composition, demand was likely to have been driven by lower import landing costs, easier access/ availability, limited logistical constraints and unsuitable domestic alternatives.

On the other hand, the yuan has a notable influence on the INR nominal and effective exchange rates. The yuan has the second highest weightage in the INR 6-currency trading basket [2] and third highest in the 36-currency weights.

If not for the narrower India-China gap, India's overall trade deficit in FY19 would have ballooned more, in addition to higher oil imports. More such needs to follow to support the call that the "Made in India" strategy has started to pay dividends by improving the product mix towards more high value added and manufactured goods. A cheaper currency has not been a panacea for India's trade deficit, and unlikely to be so in the future.

Notes:
[1] Hindu Business Line;
https://www.thehindubusinessline.com/opinion/chinese-cheer-for-indian-exports/article26431736.ece
[2] Reserve Bank of India;
https://rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=148

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).