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PRODUCTION LINKED INCENTIVE SCHEME, IMPORTS FROM CHINA AND GLOBAL VALUE CHAIN: THE POSSIBLE TRINITY!

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After witnessing pandemic waves in the last two years, we are witnessing a positive trend across various parameters of corporate health. Whether its deleveraging, preserving cash, mobilising funds through equity market or increasing promoters holding, corporates are leaving no stone unturned to keep the balance sheet in shape and preparing themselves for a future ready organization. While private participation in the investment announcements increased to 70% from around 50% a year ago, indicating revival of the capex in the economy, improvement in credit ratios across sectors in 9MFY22 as compared to 9MFY21 suggest improving balance sheet strength and outlook. During the pandemic, more than 1000 listed corporates, in NSE have increased their promoter's shareholding, particularly in sectors including Finance, Textiles, Trading, Chemicals, Pharmaceuticals, IT -Software, Steel, Capital Goods – Non Electrical Equipment, Auto Ancillary etc.

Despite FY21 being overshadowed by the pandemic, Indian corporates have raised an all-time high amount of Rs 1.89 lakh crore through public equity markets, more than double of Rs 91,670 crore raised in FY20. In current year also, in first nine months i.e., up to Dec'2021, corporates raised equity of more than Rs 1.50 lakh crore through public equity market.

Against this backdrop, India has been experiencing robust export performance with Apr'21-Jan'22 cumulative exports at $335.9 billion, which is higher than the maximum amount achieved in any year. Exports of engineering goods, petroleum products, gems and jewellery, organic and inorganic chemicals, drugs and pharmaceuticals, textiles, electronic goods have all done well.

When we look at imports, India continues to reduce its trade deficit with China in FY21, however, share of China in our total merchandise imports has been steadily increasing to 16.5% currently. At 8-digit level, in FY22 Apr-Dec'21 there were 6367 products with total value of $68 billion (or 15.3% of the total imports) imported by India from China. We estimated the import dependence of each product on China, by checking the share of Chinese imports in India's overall imports of these categories. The maximum aggregate value ($9.7 billion) is of the products in which our import dependence on China is between 50-60%, although the number of products is lower. Although number wise the imports were highest in the category where our dependence was lowest (0-10%), the value is not that high at around $1894 million.

The most important imports for FY22 so far are personal computers and parts of telephonic and telegraphic equipment, electronic integrated circuits, solar cells, urea and micro-assemblies' lithium-ion and diammonium phosphate. There are other goods also under the electrical and electronics imports. Our dependence on China is huge in these products, constituting around 48% of total imports of these. Drastic reduction in these areas can only be possible if, we source from other countries, while building a domestic manufacturing base for these. The items in the low value category are a mix of finished goods and intermediate inputs and India has a revealed comparative advantage in most of these imports. If India wants to wean itself off its dependence on China, capabilities have to be developed in these areas, especially chemicals, textiles, footwear, so that both inputs and final consumer goods in these low value imports can be manufactured domestically.

Amidst the increasing imports from China, the PLI scheme deserves to be mentioned. In FY21 of $65 billion of imports from China, around $39.5 billion is commodities and goods where PLI scheme has been announced (textile, agri, electronics goods, pharmaceuticals & chemicals). **If by leveraging PLI scheme we can reduce our dependence on China even to the extent of 20%, then we can add around $8 billion to our GDP and overtime if our dependence is further reduced by 50%, we can add $20 billion to GDP because of the incentives to domestically manufacture these goods owing to the PLI scheme.**

Lastly, about our participation in Global Value Chains (GVC). As per the Global Value Chain Development Report 2021 of ADB India's participation has improved over the years in production-based GVC. The good thing is that there has been a significant improvement in case of medium to high technology manufacturing. When compared to China, India's participation is higher in case of both trade based and production based GVC. India should focus on building the right infrastructure which can help in making India's exports more cost competitive. Also increased investment in R&D spend is required so that more innovative products are developed.

THE STAGE IS SET FOR A PRIVATE INVESTMENT REVIVAL

- After witnessing pandemic waves in last two years, we are now seeing a visible positive trend across various parameters of corporate health. Whether its deleveraging, preserving cash, mobilising funds through equity market or to increase promoters holding, corporates are leaving no stone unturned to utilize the opportunity and keep the balance sheet in shape and preparing themselves for a future ready organization.
- While private participation in the investment announcements increased to 70% from around 50% a year ago, indicating revival of the capex in the economy, improvement in credit ratios across sectors in 9MFY22 as compared to 9MFY21 suggest improving balance sheet strength and outlook.
- New investment announcements which were around Rs 10 trillion in last two years, as per Projects Today, improved to Rs 12.78 trillion in first nine months of FY22 (April – Dec), and can report more than 50% growth in FY22 as compared to previous year.
- Major industries where new announcements were made during last nine month includes Roadways (Rs 1.79 lakh crore), Community Services (Rs 1.16 lakh crore), Real Estate (Rs 1.19 lakh crore), Iron & Steel (Rs 1.08 lakh crore) and Non-Conventional power (Rs 0.80 lakh crore).
- Credit ratio (upgrades to downgrades) improved, in 9MFY22 as compared to 9MFY21, across sectors including Cement, Energy, Telecom, NBFC etc.
- During the pandemic, more than 1000 listed corporates, in NSE, increased their promoter's shareholding by nearly 400 basis points to 56.7% at the end of Dec' 2021 from 53% on March'2020. Sectors where increased promoter's shareholding reported includes Finance, Textiles, Trading, Chemicals, Pharmaceuticals, IT -Software, Steel, Capital Goods – Non Electrical Equipment, Auto Ancillary etc.
- Despite FY21 being overshadowed by the pandemic, Indian corporates have raised an all-time high amount of Rs 1.89 lakh crore through public equity markets (including FPO/OFS/QIP/InvITs etc.), more than double of the Rs 91,670 crore raised in FY20. In current year also, in first nine months i.e., up to Dec'2021, corporates raised equity of more than Rs 1.50 lakh crore through public equity market.

New Investment Announcements

Year	Amount Rs lakh crore			Share (%)	
	Govt.	Private	Total	Govt.	Private
FY17	10.17	4.08	14.25	71.36	28.64
FY18	8.23	3.92	12.16	67.72	32.28
FY19	10.24	7.01	17.25	59.37	40.63
FY20	5.57	5.28	10.85	51.34	48.66
FY21	5.28	5.43	10.71	49.30	50.70
FY22	4.04	8.75	12.79	31.59	68.41

Source: Projects Today; SBI Research; FY22 for 9M (April-Dec)

New Investment Announcements Sectorwise (major sector)

Sectors	Number of Projects	Amount Rs Crore
Food Products	221	13,648
Textiles	67	10,190
Basic Chemicals	940	1,66,873
Plastic & Plastic Products	96	39,212
Cement & Asbestos	57	22,878
Iron & Steel	214	1,07,820
Non Ferrous Metals	19	21,838
Electronics	60	72,262
Automobiles	27	31,005
Automobile Ancillaries	48	7,037
Mining	107	51,616
Electricity	25	39,915
Non Conventional Energy	158	79,748
Community Services	2,056	1,16,082
Roadways	1,207	1,79,203
Shipping Infrastructure	40	12,427
Pipelines	85	10,677
Power Distribution	221	4,702
Commercial Complexes	293	31,996
Real Estate	1,148	1,19,224
Industrial & Software Parks	107	25,416
Storage & Distribution	102	19,212
All Sectors	**7,774**	**12,78,105**

Source: Projects Today; SBI Research

Sectorwise Rating Upgrade and Downgrade (select sector)

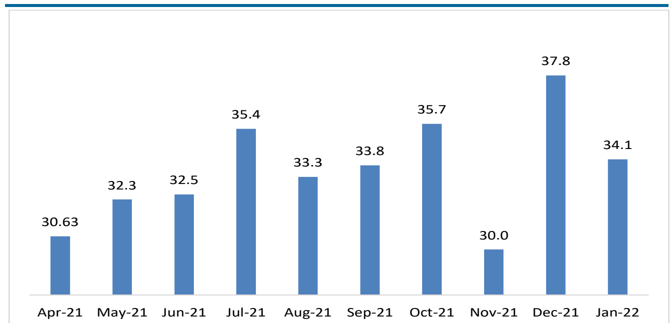
Sector	9MFY21	9MFY22	Change in U/D Ratio
	U/D Ratio	U/D Ratio	
Capital Goods-Non Electrical Equipment	0.12	0.24	0.12
Construction & Engineering	0.15	0.23	0.07
Healthcare	0.32	0.78	0.46
Pharmaceuticals	0.32	0.77	0.46
Steel	0.18	0.49	0.31
IT	0.13	0.38	0.25
Auto Components and Ancilliaries	0.08	0.28	0.20
Fertilizers & Agriculture chemicals	0.28	0.79	0.50
Cement	0.55	1.93	1.38
Energy	0.18	0.70	0.52
FMCG	0.18	0.45	0.27
Automobiles	0.17	0.27	0.11
Telecommunicatin Services	0.11	0.75	0.64
Tyres & Rubber	0.00	0.45	0.45
NBFC	0.12	0.66	0.55

Source: Crisil; SBI Research; U/D - upgrade to downgrades

EXPORTS CONTINUE TO REMAIN ROBUST

- After posting a record monthly exports of $37.8 billion in Dec'21, India witnessed a robust export performance in Jan'22 as well amounting to $34.06 billion representing 23.4% yoy growth. Engineering goods, petroleum products, gems and jewellery, organic and inorganic chemicals, drugs and pharmaceuticals, textiles, electronic goods have been the major exports during the month. Cumulatively, Apr'21-Jan'22 exports were $335.5 billion, which is higher than the maximum amount achieved in any year.
- 2-digit HS classification shows that top 15 commodity exports accounted for more than 72% in our total exports during Apr-Dec'21. A large number of these commodities showed higher export growth not only viz-a-viz 2020, but also in relation to corresponding periods of 2019 as well as 2018.
- In particular, exports of iron and steel showed robust growth of more than 100% over the past three years. Electrical machinery is another component whose exports increased close to 50% in Apr-Dec'21 when compared to Apr-Dec'20 and also Apr-Dec'18. Export of aluminium also grew strongly viz-a-viz the previous 3 years.
- Mineral fuel, oil and products which is our biggest export component grew significantly over 2020, but it can also be attributed to higher oil prices besides increase in volume growth.
- Gems and jewellery, Apparel & Clothing (knitted or crocheted), vehicles (other than railway or tramway) and nuclear reactor, boiler and machinery grew strongly during Apr-Dec'21 when compared to Apr-Dec'20. However, their growth was less when compared to the previous two years.
- Cotton is another component whose exports grew abundantly over 2020 as well as 2019. Exports of cereals too grew during Apr-Dec'21 specially when compared to the same period in 2019 and 2018. If we look at the total agriculture exports, that have increased significantly around 18% to $41.9 billion in FY21 from $35.6 billion in FY20.
- Pharma exports are another interesting component as their growth stalled this year when compared to last year, however its growth is decent when compared to Apr-Dec of 2019 and 2018.

Exports FY22 ($ bn)



Source: Ministry of Commerce

Commodity Exports ($ mn)

	Apr-Dec 2021	% yoy over 2020	% yoy over 2019	% yoy over 2018	PLI
Mineral Fuels, Oils & Products	47,694	159.8	43.4	26.8	
Gems & Jewelery	29,034	71.0	3.2	-3.0	
Nuclear Reactors, Boilers, Machinery	18,228	40.2	15.1	18.2	Y
Iron And Steel	17,622	106.3	143.5	144.2	
Organic Chemicals	16,297	24.7	23.8	21.7	Y
Vehicles other than Railway or Tramway	14,512	56.8	12.4	6.9	Y
Pharmaceutical Products	14,426	0.6	17.4	33.6	Y
Electrical Machinery	14,262	47.9	25.8	55.4	Y
Cereals	9,054	34.4	95.3	59.5	Y
Cotton	7,779	91.0	95.8	32.7	Y
Aluminium And Articles	7,382	79.8	90.9	69.9	
Plastic And Articles	6,748	33.3	24.9	11.3	
Articles of Iron Or Steel	6,305	38.9	18.8	17.9	
Apparel & Clothing (Knitted Or Crocheted)	5,908	34.7	2.5	3.6	Y
Fish & other Aquatic Invertabrates	5,500	37.2	9.4	10.3	
Total of top 15	**2,20,750**	**62.2**	**31.3**	**26.1**	
India's Total Export	**3,05,026**	**51.5**	**28.0**	**25.0**	

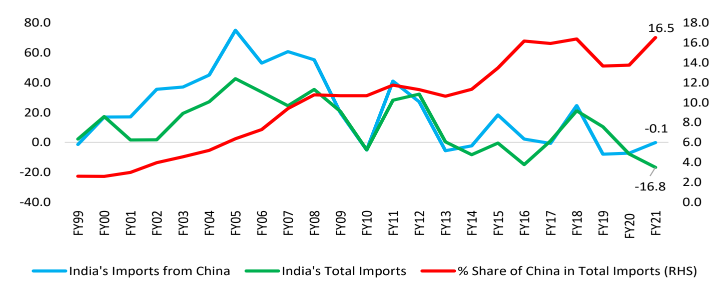
Source: Ministry of Commerce, SBI Research

- It is pertinent to note that the major sectors in which the PLI scheme has been introduced includes automobiles, food products, specialty steel, pharmaceuticals, electronics/technology goods, textiles, aviation. Thus, PLI scheme has benefited many of the top 15 commodity exports, specially mobile and electronic goods, drugs and pharma.

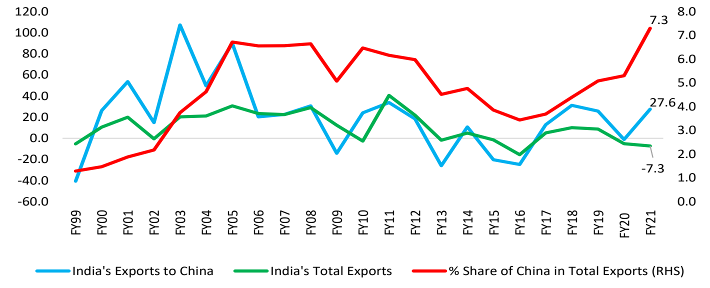
INDIA CONTINUES TO REDUCE TRADE DEFICIT WITH CHINA IN FY21

- In FY20 India imported $5 billion less from China than in FY19 and further $48 million less in FY21. However, share of China in total merchandise imports has steadily increased to 16.5% currently. Interestingly, the CAGR for India's overall imports between FY97 and FY21 is 10.1% while that for imports from China is 20.4%, almost double.
- When we look at our exports to China, share of China in our total exports has been rising since FY17 and it now stands at 7.3%. When we compare the CAGR of India's overall merchandise growth rate between FY98 and FY21, with China's CAGR, there is good news. The CAGR for India overall is 9.6% and that for China is 15.8%.

Imports growth from China (% yoy)



Exports growth to China (% yoy)



Source: SBI Research, CMIE

HOWEVER, HUGE DEPENDENCE STILL REMAINS

- At 8-digit level, in FY22 Apr-Dec'21 there were 6367 products with total value of $68 billion (or 15.3% of the total imports) imported by India from China. We estimated the import dependence of each product on China, by checking the share of Chinese imports in India's overall imports of these categories. The maximum aggregate value ($9.7 billion) is of the products in which our import dependence on China is between 50-60%, although the number of products is lower. Although number wise the imports were highest in the category where our dependence was lowest (0-10%), the value is not that high at around $1894 million.

- The most important imports for FY22 so far are personal computers and parts of telephonic and telegraphic equipment, electronic integrated circuits, Solar cells, urea and micro-assemblies' lithium-ion and diammonium phosphate. There are other goods also under the electrical and electronics imports. Our dependence on China is huge in these products, constituting around 48% of total imports of these. Drastic reduction in these areas can only be possible if, we source from other countries, while building a domestic manufacturing base for these.

- When we look at the data where the import value was between $100 million and $500 million, where the import dependence was more than 50%, the sectors in which the imports are concentrated are Chemicals especially Organic, Machinery and Mechanical appliances and Electrical Machinery, Textiles and Textile Articles, Motorcycle Accessories, Oxygen Therapy Apparatus etc.

- On the other end, if we take commodities which have an import value of less than $100 million, but which command more than 90% share in our imports, we have more than 877 products from China worth around $3.7 billion. The concentration again is in Organic Chemicals, Machinery and Mechanical Appliances & Electrical Machinery, Textiles.

India's Import dependence on China

% Share of Chinese Imports in total imports	No of products	Amount ($ mn)
0-10	1287	1894
10-20	816	4018
20-30	706	5237
30-40	550	8898
40-50	461	9139
50-60	476	9724
60-70	428	6556
70-80	386	9088
80-90	364	5486
90-100	893	7588

Source: Ministry of Commerce, SBI Research

Sectors with concentration of $ 100 -$500 million product imports with more than 50% import dependence

HS Section	Description	Amount ($ million)
16	Machinery & mechanical appliances; electrical equipments, sound recorders & reproducers, television image & sound recorders and reproducers, parts and acessories of such articles	3648
6	Products of Chemicals or allied industries	2583
11	Textile & Textile articles	442
17	Vehicles, Aircrafts, Vessels & Transport Equipment	262
20	Miscellaneous manufactured articles	233
18	Optical, Photographic, Cinematographic, Medical or Surgical instruments	160
5	Mineral Products	127
15	Base Metals & articles	111
7	Plastic, Rubber & articles	103

Source: Ministry of Commerce, SBI Research

- The items in the low value category are a mix of finished goods and intermediate inputs and India has a revealed comparative advantage in most of these imports. If India wants to wean itself off its dependence on China, capabilities have to be developed in these areas, especially chemicals, textiles, footwear, so that both inputs and final consumer goods in these low value imports can be manufactured domestically.

LEVERAGING PLI CAN ADD UPTO $20 BN IN GDP

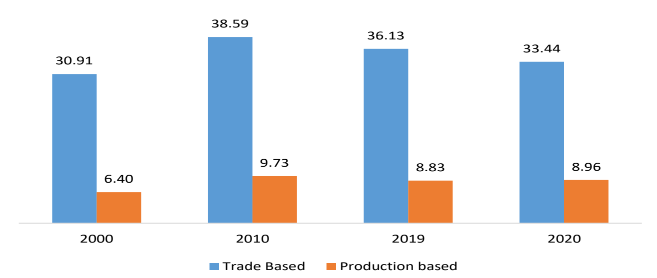
- Coming back to imports in FY21 of $65 billion of imports around 39.5 billion is commodities and goods where PLI scheme has been announced (textile, agri, electronics goods, pharmaceuticals & chemicals).
- If because of the PLI scheme we can reduce our dependence on China even to the extent of 20%, then we can add around $8 billion to our GDP and overtime if we reduce our dependence by 50%, we can add $20 billion to GDP because of the incentives to domestically manufacture these goods owing to the PLI scheme.

Imports from China in sectors where PLI has been announced ($ mn)	
Agriculture goods	302
Electronics	23731
Textiles	2193
Chemicals	13599
Total imports from China in PLI sectors	39825
If we reduce our dependence by 20%, addition to GDP	7965
If we reduce our dependence by 30%, addition to GDP	11948
If we reduce our dependence by 50%, addition to GDP	19913
Source: SBI Research, CMIE	

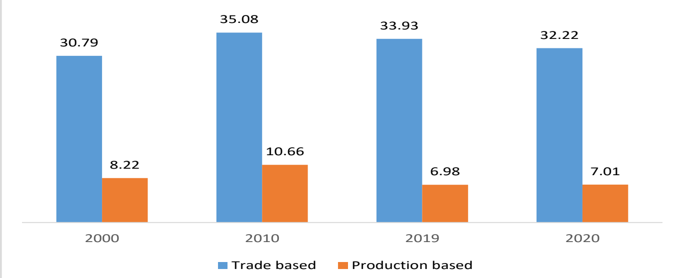
GLOBAL VALUE CHAINS AND INDIA

- India should integrate more and more into the Global Value Chains (GVCs). GVCs refer to international production sharing, a phenomenon where production is broken into activities and tasks carried out in different countries.
- Countries can participate in GVCs by engaging in either backward or forward linkages. Backward linkages are created when country A uses inputs from country B for domestic production. Forward linkages are created when country A supplies inputs that are used for production in country B.
- The Global Value Chain Development Report 2021 of ADB calculates GVC in two ways.
- In the trade-based approach of Borin and Mancini (2019), the GVC participation rate is measured as the share of indirect trading in gross exports. This is the portion of exports whose underlying value added crosses two or more borders before final consumption. The production- based approach is based on forward GVC participation rate of Wang et al. (2017), and measures the GVC participation rate as the share of the unfinished exports of domestic value added in total value added generated. This is the portion of gross domestic product that goes into exports of intermediates.
- India's participation has improved over the years in production-based GVC. The good thing is that there has been a significant improvement in case of medium to high technology manufacturing. When compared to China, India's participation is higher in case of both trade based and production based GVC.
- With Atmanirbhar Bharat, the Government hopes to increase our forward participation in GVC. Although India's fairly integrated in global value chains and has a higher level of upstreamness than many other nations, ultimately what matters is how much the exports of a country can command in value terms, because of their level of sophistication or quality. In case of India sophisticated merchandise exports in the form of capital goods needs to be encouraged.
- Furthermore, the focus should be on building the right infrastructure which can help in making India's exports more cost competitive. Another area is increased investment in R&D spend so that more innovative products are developed. India is planning to get integrated more and more into the global value chains and if India does not spend more on building its research capabilities it will get stuck in exporting low value intermediate inputs.

GVC participation rate of India



GVC participation rate of China



Source: ADB, SBI Research

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