SBI Research: Special Report

India’s Merchandise Exports cross $400 bn: What Next?

22-April-2022

State Bank of India
Mumbai

Executive Summary: India’s exports have been driven by volume in FY22…….1/2

- India’s merchandise exports touched a record $420 billion in FY 2021-22. It took the country a decade to incrementally add another $100 billion ($300 billion mark was touched in FY12) as against reaching $200 billion from $100 billion in only 5 years (FY06 to FY11)
- Emergence of New Trade Corridor through FTAs/ECTA/CEPA, PLI scheme among others have contributed to this growth
- India’s exports of goods and services (% of GDP) which was only 3.7% in 1970 and 6.1% in 1980, reached a peak in 2013 (25.4%) but decelerated thereafter till 2020 (18.7%) mirroring the global trend. The share of service exports in total exports has increased gradually, and significantly from 27% in FY2001 to 41% in FY21, though moderating to 37% in FY22
- Interestingly, the concentration of top 10 countries in our export basket has reduced over the years and share of others have increased, thereby implying diversification of export destinations! Top 15 exports accounted for more than 72% in our total export kitty during Apr-Feb’ FY22
- **Contrary to popular perception, our estimates show that 55% of the increase in exports in FY22 is attributed to quantity effect and the rest 45% is the price effect, indicating that the growth in exports in FY22 could be sustained if we continue to follow right policies. As expected, our results show that only 31% of the increase in exports of petroleum crude and products in FY22 can be attributed to higher quantity and rest 69% is because of higher price**
- In the case of imports, 26% is quantity effect and the rest 74% is the price effect, which is obvious given the elevated level of global commodity/food prices
- India’s agricultural exports rose remarkably despite COVID-19 and crossed the $50 Billion mark in FY22 . However, the large gap in MSP and global prices is likely to incentivise export of wheat from India: This needs to be judiciously balanced with domestic supply of wheat

Executive Summary: India needs to follow a balanced approach to Exports…….. 2/2

- India is following a policy of import rationalisation with China. India imported $5 billion less from China in FY20 vis-a-vis FY19 and further $48 million lower in FY21. However, in FY22 our imports from China increased significantly, reflecting the pandemic induced uncertainties. The share of imports from China has however declined in FY22. Simultaneously, India has been also able to push exports to China and in FY22 it occupies a share of 5.2% of our exports / 3rd in terms of ranking of countries
- India's service exports of Telecommunications, Computer, and Information Services far outpace China. However, China is rapidly catching up and India needs to buckle up in these areas
- India has *revealed comparative advantage* in certain goods where China doesn't have. This includes select chemicals, minerals, stone and glass, animal and vegetable. India needs to protect such products in which it has a Revealed Comparative Advantage over China. This will provide support to MSMEs
- India is pushing for fresh FTAs and trade concessions with major economies and regional blocs in a bid to boost export-oriented domestic manufacturing as it chases an ambitious export target of US$450-500 billion in FY23
- The prime objective of an FTP is to facilitate trade by reducing transaction cost and time. It aims to work with state governments to implement '*District Export Hubs*' that will work towards achieving the export goals of each state
- India recorded a CAD of 1.2% of GDP in Apr-Dec 2021. *FY23 will be a challenging year since as per our estimates, CAD will breach the 2.5% mark and may reach to a decade's high*
- The rupee has remained remarkably stable in the current scenario, thanks to RBI exchange rate policy that has been nicely dovetailed into inflation targeting. Indian regulators and policy makers, and bodies like FEDAI must now use this opportunity to seek equal, and appropriate footing for INR in the changing realms lest we lag behind in a crucial/critical area
- *There is intense debate about what drives Exports growth in the future? Manufacturing OR Services?*
    - We believe that services and manufacturing have to be viewed as complementary and not as exclusive activities. A realignment of India's export strategy that views services as an integral part of manufacturing and structures the regulatory and trade policies consonant with this view, will provide multiple benefits of enhanced productivity, manufacturing competitiveness, export and employment potential, all of which are essential inputs for a strong post-pandemic recovery

Backdrop

- India's merchandise exports touched a record $420 billion in 2021-22, exceeding the government's target by about 5% and recording 44% growth over the previous year, led by robust growth in petroleum products, engineering, gems and jewellery, chemicals, and pharmaceuticals

- The $300 billion mark was achieved in FY12 ($306 billion) and hence India took almost a decade to add incremental $100 billion exports

- The exports' value from $100 billion to $200 billion was reached in 5 years (FY06 to FY11)

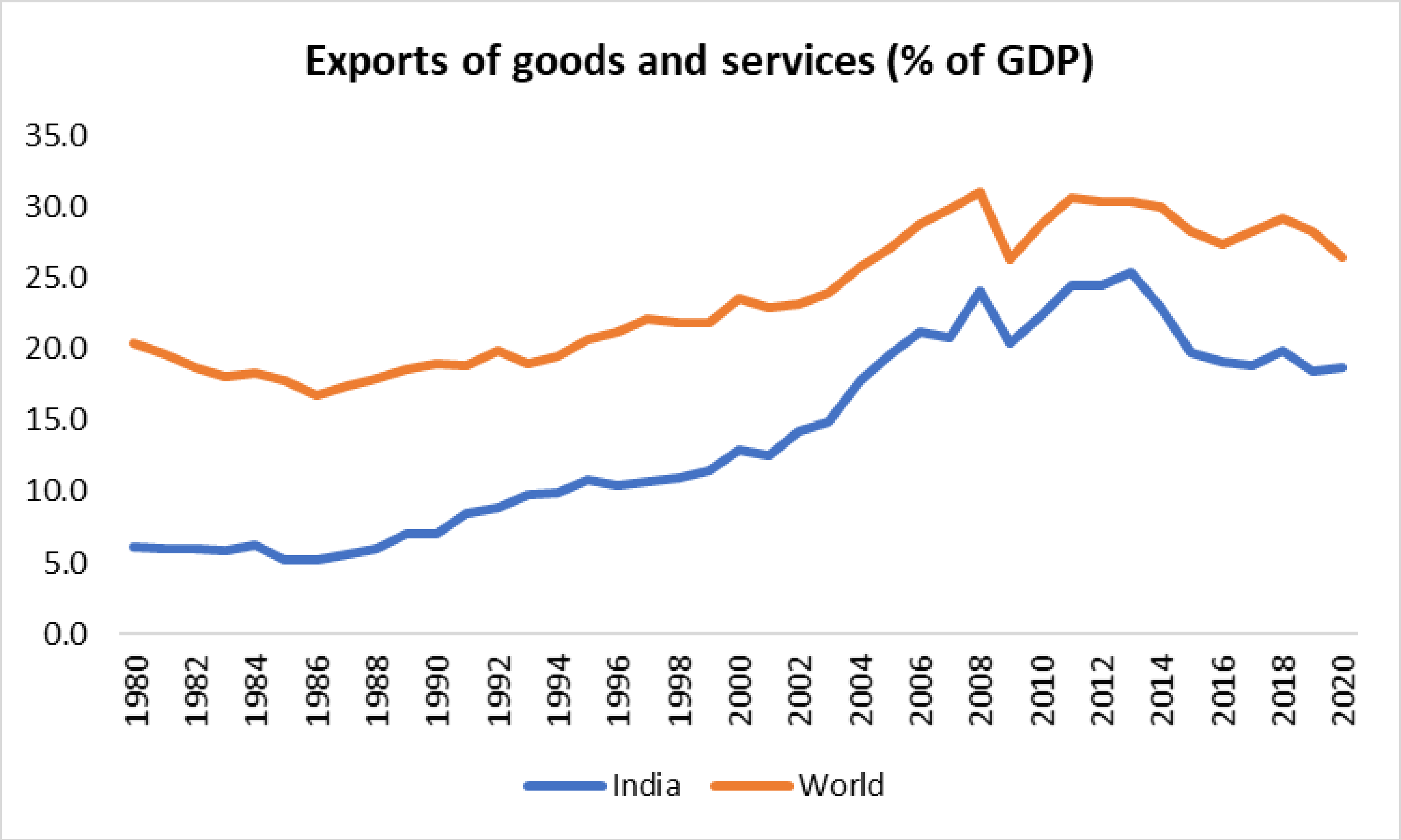
- Various factors contributed to this achievement:
  - Exports of finished or intermediate goods; India was no longer an exporter of primary goods
  - Massive push from the production-linked incentive scheme
  - Multi-year high commodity and food prices

Exports

Direction & Composition

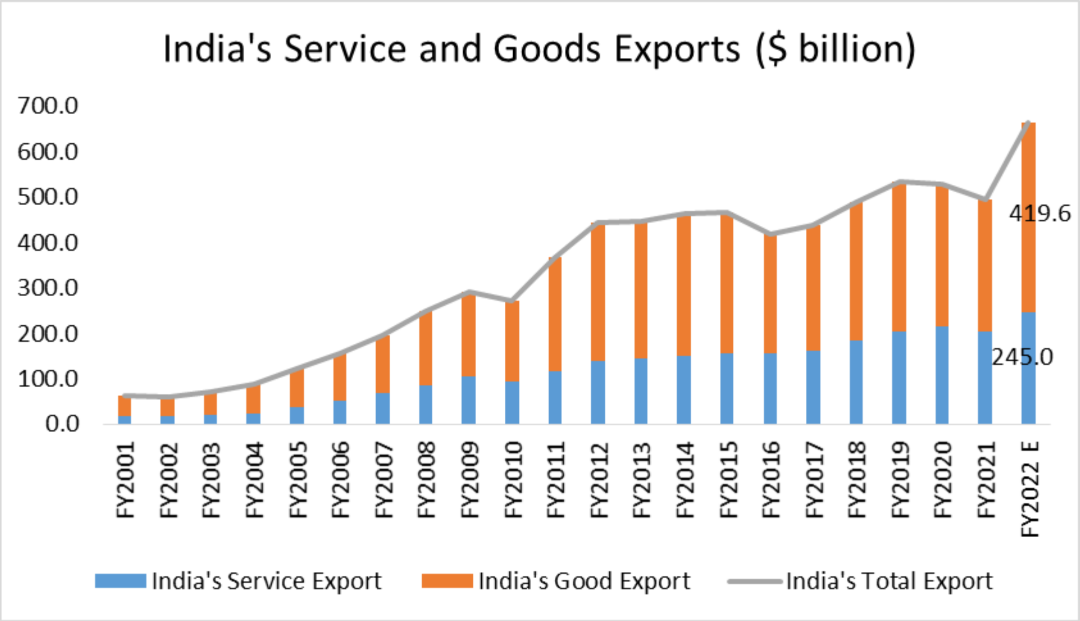
Exports of Goods and Services (% of GDP)

- India's exports of goods and services (% of GDP) which was 3.7% in 1970 and 6.1% in 1980, reached peak in 2013 (25.4%) but decelerated continuously thereafter till 2020 (18.7%) mirroring the global trend
- In FY22, the share of exports in GDP has already crossed 20.8%: at 18% growth rate, the share could reach the peak again in FY26



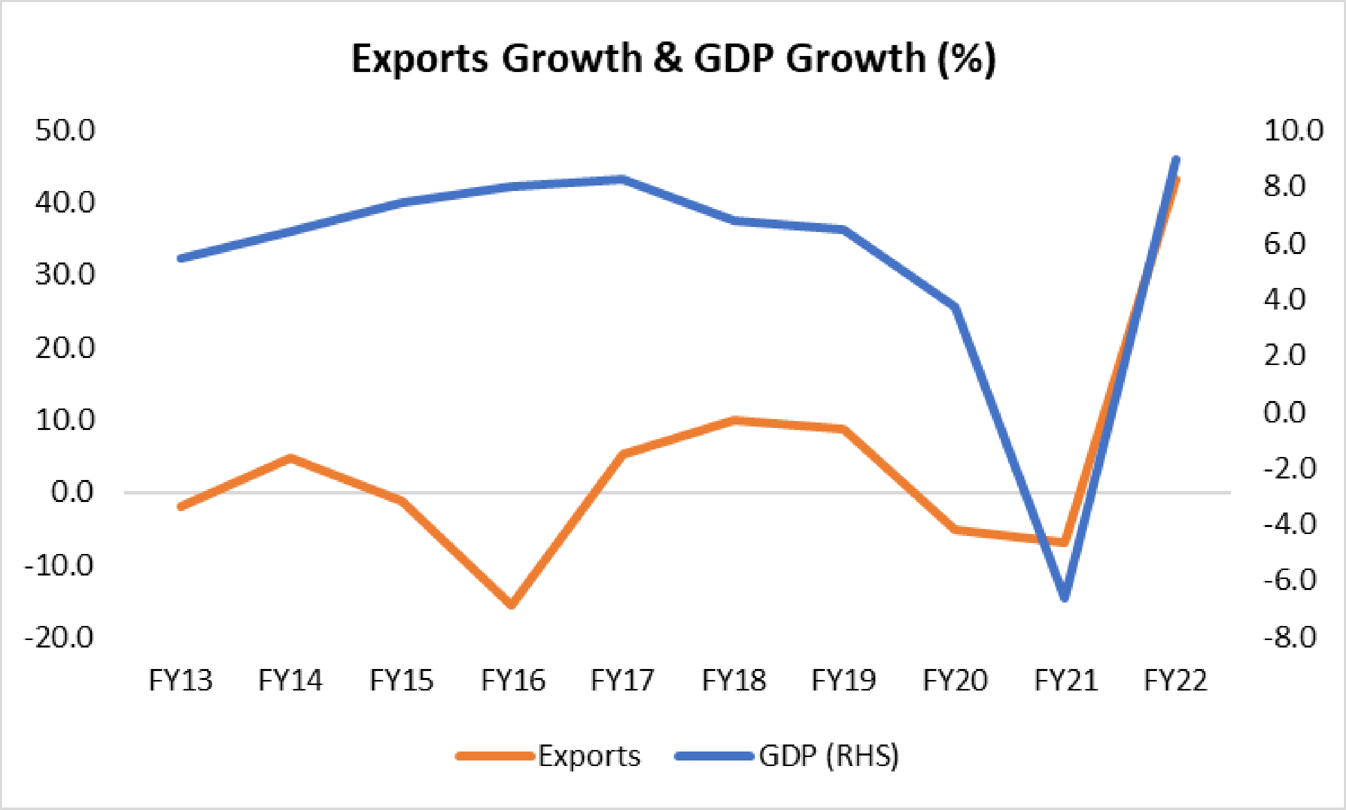
Exports of Goods and Services

- India's exports of services is expected to be $245 billion for FY22, and with goods export at $420 billion thereby total trade at $665 billion
- The share of service exports in total exports has increased gradually from 27% in FY2001 to 41% in FY2021, but it has moderated to 37% in FY22 reflecting the pandemic induced disruptions



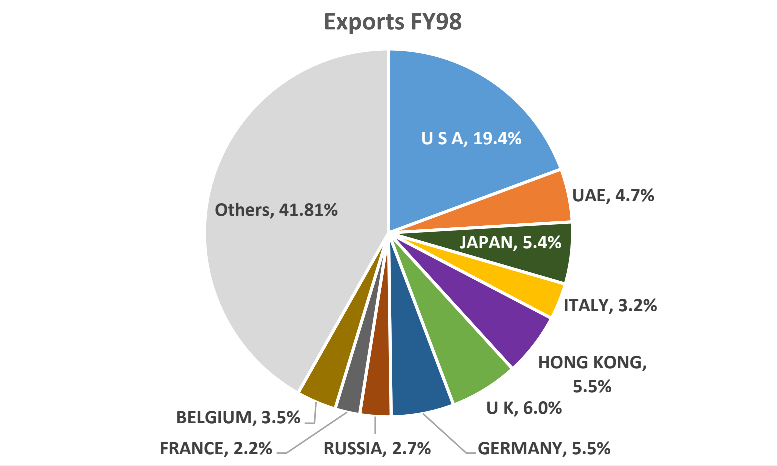
Exports Growth and GDP Growth

- The decline in share of exports in GDP is largely due to deceleration in economy
- Both exports growth and GDP growth are positively correlated and reinforce each other

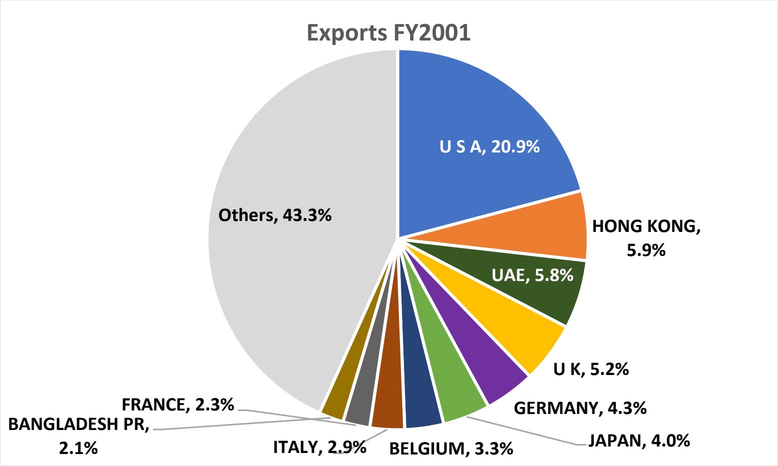


Exports – Preference more towards South South trade……..

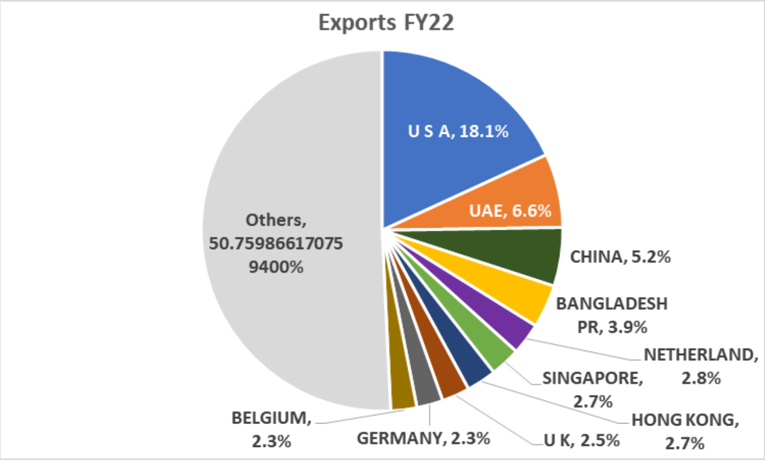
- Perusal of data for the last 25 years shows that of the 10 major export partners of India, 6 remains the same over the period
- However, Japan, Italy, Russia and France have been replaced by China, Bangladesh, Netherland and Singapore. India's exports have moved more towards South-South trade
- Share of the USA in our exports increased to 20.9% in FY2001 compared to 19.4% in FY98. However, it has declined again to 18.1% in FY22. Meanwhile, our exports have increased to Bangladesh, China, Singapore, and even Netherlands!
- Till FY2000, not many developing countries were among our export destinations. Even China did not find a place in our top 10 export destinations. Even in FY01 China appeared as our 15th largest export destinations with a share of less than 2% of our total exports. However, in FY22 it occupies a share of 5.2% of our exports / 3rd in terms of share
- Interestingly, the concentration of top 10 countries in our export basket has reduced over the years and share of others have increased, thereby implying diversification of export destinations!



Top countries among others include Malaysia, Canada, China, Saudi Arabia, Indonesia

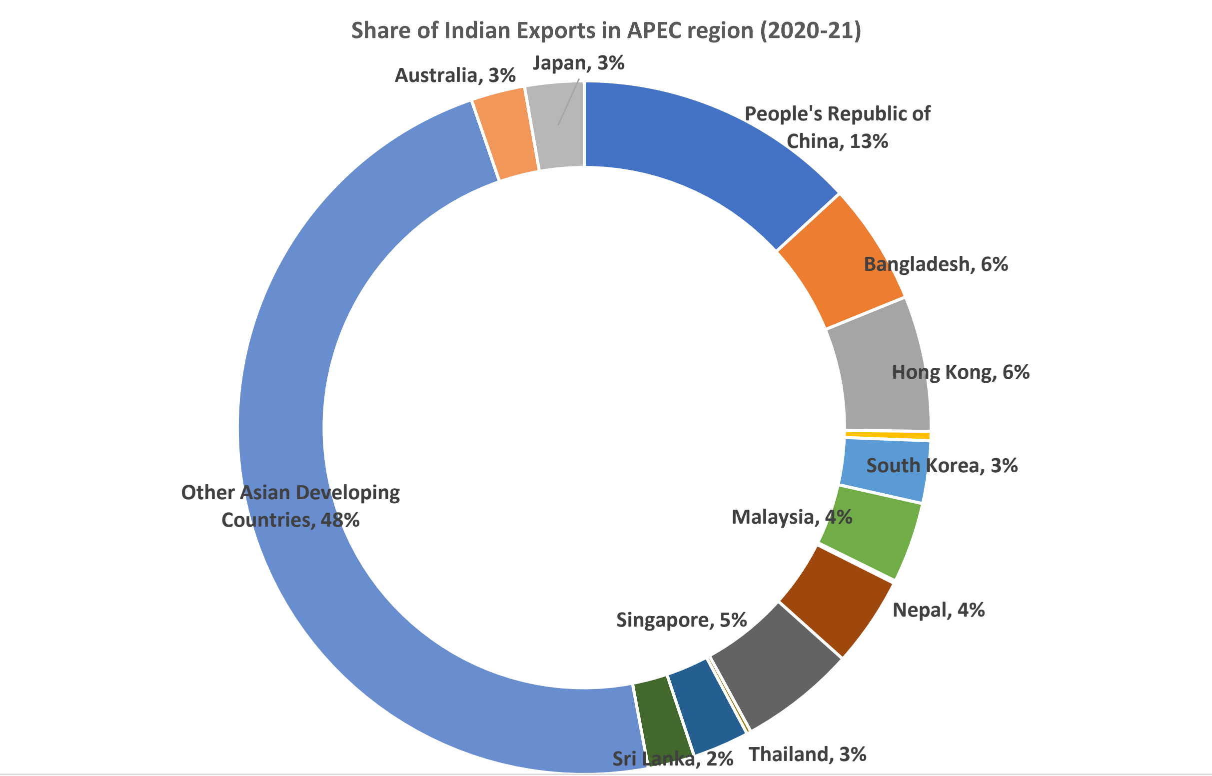


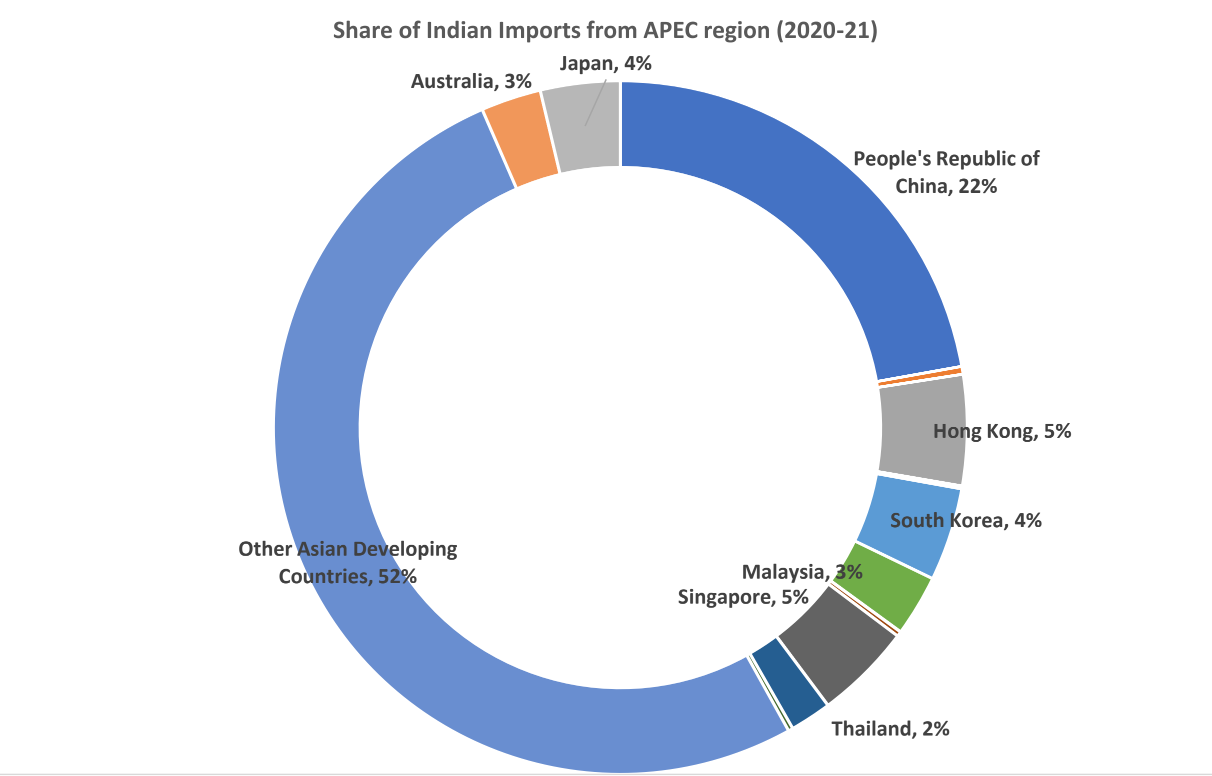
Top countries among others include Russia, Netherlands, Singapore, China, Saudi Arabia



Top countries among others include Saudi Arabia, Indonesia, Italy, Australia, South Korea

……..India's Direction of Trade with APEC reveal export diversification





Top 15 Exports account for 72%

- 2-digit HS classification shows that top 15 exports accounted for more than 72% in our total exports during Apr-Feb' FY22. Many of these commodities showed higher export growth not only viz-a-viz corresponding period of FY21, but also in relation to corresponding periods of FY20 as well as FY19

Commodity Exports ($ mn)					
	Apr-Feb FY22	% yoy over FY21	% yoy over FY20	% yoy over FY19	PLI
Mineral Fuels, Oils & Products	59,511	157.1	48.3	34.8	
Gems & Jewelery	35,471	57.4	4.2	-4.2	
Nuclear Reactors, Boilers, Machinery	22,793	36.3	17.7	21.2	Y
Iron And Steel	21,005	101.8	142.9	137.8	
Organic Chemicals	19,887	23.7	22.5	22.1	Y
Vehicles other than Railway or Tramway	17,882	48.4	15.0	9.2	Y
Electrical Machinery	17,862	42.8	26.2	56.4	Y
Pharmaceutical Products	17,552	-0.2	16.5	32.4	Y
Cereals	11,572	31.4	93.4	60.8	Y
Cotton	9,864	81.2	86.7	38.3	Y
Aluminium And Articles	9,401	83.2	99.5	80.2	
Plastic And Articles	8,274	33.1	27.7	13.2	
Articles of Iron Or Steel	7,894	34.4	20.1	20.3	
Apparel & Clothing (Knitted Or Crocheted)	7,396	30.4	5.1	4.6	Y
Apparel & Clothing (Not Knitted Or Crocheted)	6,885	32.6	-6.4	-6.5	
Total of top 15	**2,73,247**	**59.0**	**31.3**	**26.1**	
India's Total Export	**3,77,436**	**48.6**	**28.8**	**25.8**	
Source: Ministry of Commerce, SBI Research					

Commodity Exports – Price Effect and Quantity Effect

- Using the principal commodities data value and quantity of available commodities, we estimated the price and quantity effect of the change in value in FY22 (till Feb) over the same period in FY21
- These commodities had a share of 50% in our export basket. Our estimates show that 55% of the increase in exports is the quantity effect and the rest 45% is the price effect
- Our results show that only 31% of the increase in exports of petroleum crude and products in FY22 can be attributed to higher quantity and rest 69% is because of higher price
- For certain other commodity groups including chemicals, leather, ores and minerals the quantity impact was the primary factor in driving exports in FY22 over FY21
- Higher quantity effect implies that export momentum can be sustained if we continue to focus on the right policies

Exports: Quantity & Price Effect			
Commodity Groups	**Share in total Exports**	**Quantity Effect**	**Price Effect**
Agri and Allied Products	8.2%	68%	32%
Base Metals	8.5%	19%	81%
Chemicals and Related Products	11.4%	343%	-243%
Gems and Jewellery	0.0%	108%	-8%
Leather and Leather Manufactures	0.2%	217%	-117%
Marine Products	1.9%	67%	33%
Ores and Minerals	1.0%	399%	-299%
Others	0.3%	62%	38%
Paper and Related Products	0.0%	49%	51%
Petroleum Crude and Products	15.4%	31%	69%
Plantation	0.4%	85%	15%
Plastic and Rubber Articles	1.0%	-69%	169%
Textiles and Allied Products	1.4%	39%	61%
Total (for 73 commodities)	49.8%	**55%**	**45%**

Source: SBI Research, CEIC

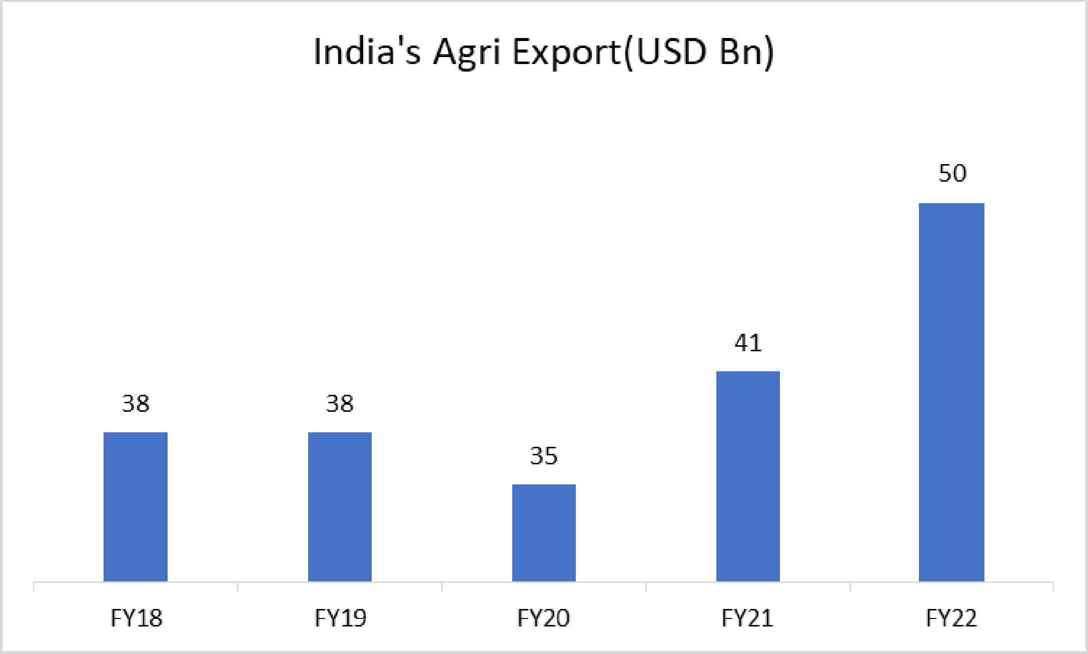
Commodity Imports – Price Effect and Quantity Effect

- Our imports have also increased significantly, around 55% yoy in FY22 to $610 billion
- We estimated the price and quantity effect of the change in value in FY22 (till Feb) over the same period in FY21
- The total value of these commodities increased over 76%, and interestingly of this only 26% is the quantity effect and the rest 74% is the price effect
- Higher import value of petroleum crude and products in FY22 is mainly on account of higher prices with price effect at more than 90%

Imports: Quantity & Price Effect			
Commodity group	**Share in Total Imports**	**Quantity effect**	**Price effect**
Petroleum Crude and Products	25.8%	9%	91%
Chemicals and Related Products	8.9%	35%	65%
Gems and Jewellery	8.8%	106%	-6%
Ores and Minerals	5.1%	1%	99%
Agri and Allied Products	4.7%	10%	90%
Base Metals	3.6%	6%	94%
Plastic and Rubber Articles	2.4%	20%	80%
Plantation	0.2%	48%	52%
Textiles and Allied Products	0.1%	49%	51%
Leather and Leather Manufactures	0.1%	-21%	121%
Others	0.1%	68%	32%
Paper and Related Products	0.1%	-63%	163%
Marine Products	0.0%	-523%	623%
Total (for 70 commodities)	59.9%	**26%**	**74%**
Source: SBI Research, CEIC			

India’s Agri Exports touched a new high in FY22……..

- Government of India's consistent and concerted endeavours to usher in reforms for boosting agricultural exports have been highly fruitful and is currently showing results. India’s agricultural exports rose remarkably despite COVID-19 and crossed the $50 Billion mark in FY22
- Efforts are being made to expand India’s agri-export basket and promote export of products unique to India



…..India needs to strike the right balance in terms of wheat exports

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- Russia and Ukraine together accounted for ~30% of global wheat exports and the war has resulted in exorbitant increase in wheat prices (almost double)
- The large gap in MSP and global prices is likely to incentivise export of wheat from India: This needs to be judiciously balanced with domestic supply of wheat
- Further there is a widening gap between MSP and Mandi Prices in current fiscal. Historically, a larger gap has stoked higher food inflation during FY13-FY14 as open market purchase have been at a higher price. With global wheat prices much higher than Mandi prices, this will put pressure on Mandi prices. This indicate that the wheat prices might remain elevated in the coming months, also providing an upside risk for food inflation

India's Wheat Export History

	Export value in Rs Cr	Export value in USD Mn	Global Price (Rs/Quintal) end March	MSP (Rs/Quintal)	Mandi Prices (Rs/Quintal) end March
FY19	424	60.24	1380	1840	2024
FY20	444	62.82	1482	1925	2007
FY21	4173	567.93	2023	1975	1928
Apr-Feb 2022	14477	1942.6	3972	2015	2257

Source: SBI Research

Gap Between MSP and MP(Rs/ Quintal)

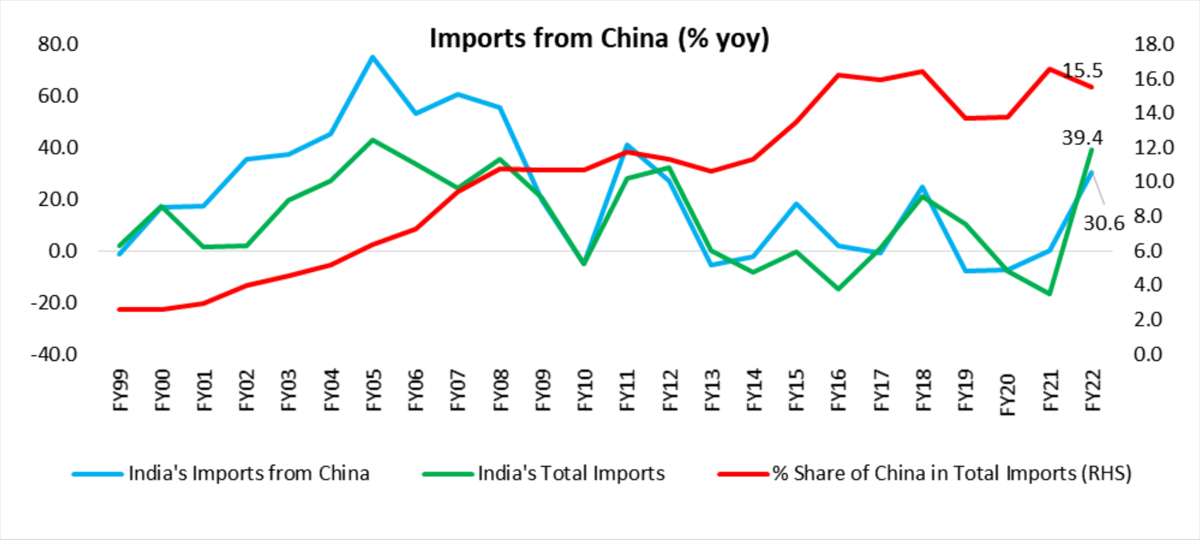
FY	MSP	Mandi Prices	MP-MSP	Cereal Inflation
FY11	1120	1398	278	-
FY12	1285	1303	18	-
FY13	1350	1617	267	10.3
FY14	1400	1717	317	12.4
FY15	1450	1720	270	5.2
FY16	1525	1724	199	1.8
FY17	1625	1828	203	4.2
FY18	1735	1818	83	3.5
FY19	1840	2024	184	2.1
FY20	1925	2007	82	2.8
FY21	1975	1928	-47	3.8
FY22	2015	2257	242	0.5

Source: SBI Research

India & China

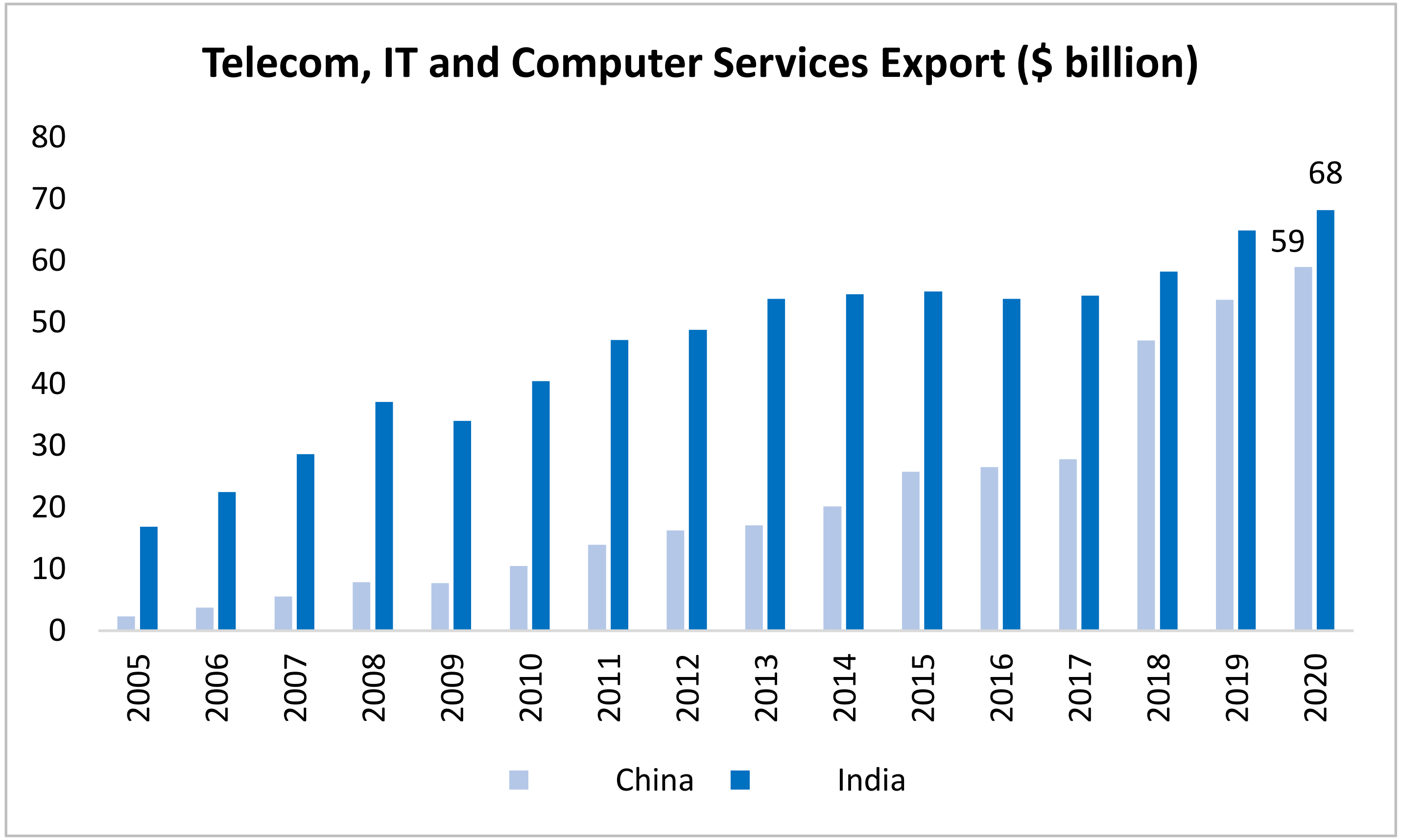
China is India's 3rd largest export market……

- India imported $5 billion less from China in FY20 than in FY19 and further $48 million lower in FY21. However, in FY22 our imports from China increased by $19 billion
- But the good thing is that the share of China in total merchandise imports has moderated to 15.5% currently
- Interestingly, the CAGR for India's overall imports between FY97 and FY21 is 11.1% while that for imports from China is 20.8%, almost double. No wonder, China is our biggest importer!
- When we look at our exports to China, share of China in our total exports has been rising since FY17 but has fallen to 5.2% in FY22. When we compare the CAGR of India's overall merchandise growth rate between FY98 and FY22, with CAGR of our exports to China, there is good news. The CAGR for Indian exports overall is 10.4% and that for exports to China is 14.8%



India leads in service exports: Telecom, IT&CS Exports… but can China be far behind?

- Although China's services exports are greater than India, the progress India has made on the services front is laudable
- India exports a far greater amount of Telecommunications, Computer, and Information Services than China
- However, China is rapidly catching up and India needs to buckle up



India's Revealed Comparative Advantage over China

- India has revealed comparative advantage in certain goods where China doesn't have. This includes select chemicals, minerals, stone and glass, animal and vegetable

- However, China also has revealed comparative advantage in many goods where India has advantage. Such goods include footwear, hides and skins, metals, textiles and clothing

- India might consider restrictions on certain products in which it has a Revealed Comparative Advantage over China. This will provide support to MSMEs

- A special mention is needed of industries like leather articles, apparels and fabrics, footwear and chemicals, where India has a revealed comparative advantage

Revealed comparative advantage (2019)		
	China	India
All Products	1	1
Capital goods	1.52	0.49
Consumer goods	1.07	1.39
Intermediate goods	0.69	1.59
Raw materials	0.11	0.56
Animal	0.28	1.50
Chemicals	0.54	1.55
Food Products	0.29	0.56
Footwear	2.63	1.44
Fuels	0.11	0.77
Hides and Skins	2.03	2.23
Mach and Elec	1.85	0.44
Metals	1.06	1.22
Minerals	0.11	1.03
Miscellaneous	1.37	0.50
Plastic or Rubber	0.92	0.74
Stone and Glass	0.5	3.68
Textiles and Clothing	2.17	2.85
Transportation	0.33	0.74
Vegetable	0.25	1.51
Wood	0.71	0.32
Source: WITS		

Drivers of Exports Growth

Exports & PLI

- 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 (see slide 6)
- Potential of PLI can be found if we can reduce our import reliance of these commodities from China
- During FY22 (Apr-Feb'22), India imported $45 billion of goods including Agricultural goods, Electronics, Textiles and Chemicals where PLI has been announced. If India can reduce its dependence on imports from China of these goods to the extent of 20% then we can add up to $9.0 billion to our GDP and it has potential to add $20 billion if we can reduce our dependence of imports of these goods from China by 50%!

Imports from China in sectors where PLI has been announced ($ mn)	
Agriculture goods	295
Electronics	23731
Textiles	2903
Chemicals	18155
Total imports from China in above PLI sectors	45084
If we reduce our dependence on China by 20%, addition to GDP	9017
If we reduce our dependence on China by 30%, addition to GDP	11948
If we reduce our dependence on China by 50%, addition to GDP	19913
Source: SBI Research, CMIE	

Emergence of New Trade Corridor through FTAs

- India is pushing for fresh FTAs and trade concessions with major economies and regional blocs in a bid to boost export-oriented domestic manufacturing as it chases an ambitious export target of US$450-500 billion in FY23
- India is exporting raw or semi-processed goods in a big way; the FTAs are aimed at increasing exports of finished or intermediate goods
- The growing list of countries and regional blocs negotiating trade deals with India includes UK, Russia, Canada, the GCC, and the Southern African Customs Union. Trade deals have already been reached with the UAE and Australia
- India wants the ASEAN countries to lower market restrictions in the agriculture and automotive sectors as well as reciprocate its own FTA concessions. These concerns are also why India walked away from the Regional Comprehensive Economic Partnership (RCEP) in November 2019
- ASEAN bloc to do away with its non-tariff barriers, saying that equitable trade between the two regions would see trade flows worth US$200 billion

India-Australia Economic Cooperation and Trade Agreement (IndAus ECTA)

- India and Australia signed their Economic Cooperation and Trade Agreement in April – the interim trade agreement before a full trade pact is negotiated. It is expected to be implemented in about four months.
- IndAus ECTA will provide zero-duty access to the bulk of India's exports to Australia (96%), including engineering goods, gems and jewelry, textiles and apparel, and leather etc. After five years, this will be expanded to 100% of Indian goods
- It is estimated that the bilateral trade in goods and services to be at US$45-50 billion over five years and the ECTA could also generate over one million jobs in India
- Under the ECTA, 85% of Australian exports will enjoy zero-duty market access, including coal, LNG, alumina, metallic ores, sheep meat and wool; duties will be lowered on Australian wines, cotton, almonds, lentils, and certain fruits – oranges, mandarins, apricots, and strawberries
- Tariffs on Australian avocados, onions, pistachios, macadamias, cashews in-shell, blueberries, raspberries, and blackberries will be eliminated over seven years.
- India will not relax tariffs on certain products considered as 'sensitive sectors', such as dairy products, wheat, rice, chickpeas, beef, sugar, apples, toys, and iron ore
- In services, Australia has offered 135 sub-sectors to India, while India offered 103 sub-sectors to Australia. Key areas of India's interest like education, IT, business, professional services, health, audio-visual, etc. have been committed by Australia under ECTA

India-UAE CEPA

- India-UAE CEPA Signed, which prospects for US$100 billion in Annual Bilateral Non-Oil Trade
- Major Indian exports to the UAE are refined petroleum products, minerals, cereals, sugar, fruits, vegetables, tea, meat, seafood, textiles, engineering, machinery products, and chemicals.
- Major Indian imports from the UAE are petroleum and petroleum products, precious metals, stones, gems and jewelry, minerals, chemicals, and wood and wood products.
- CEPA with the UAE, which eliminates duties for 90% of India's exports to thin value terms to the UAE, covering sectors including gems and jewellery, textiles, leather, and engineering goods.

India-UK FTA negotiations

- India-UK trade pact could boost total trade by £28 billion by 2035 and nationwide wage growth by up to £3 billion

India-Russia trade and investment relationship following Putin's 2021 visit

- India-Russia signed deal worth INR 51 billion (US$689.90 million) for the joint production of more than 500,000 AK-203 assault rifles at a facility in the Amethi district of Uttar Pradesh
- Russia also agreed to provide reliable long-term supplies of coal to India for steel production through an MoU
- Discussions also took place on Russian participation in India's Production-Linked Incentives (PLI) program for specialty steel

New Foreign Trade Policy

New Foreign Trade Policy

- The prime objective of an FTP is to facilitate trade by reducing transaction cost and time

- The current FTP 2015-20 was considered progressive because it consolidated various export incentive programmes into broadly two schemes – the Merchandise Exports from India Scheme (MEIS) and Services Exports from India Scheme (SEIS)

- Old FTP had certain limitations, which cropped up from time to time and with the onset of the pandemic hurdles, exporters and related associations have key expectations from the anticipated FTP

- The new FTP aims to work with state governments to implement 'District Export Hubs' that will work towards achieving the export goals of each state

New Foreign Trade Policy - Expectations

- WTO-compliant tax incentives: Government has announced the Remission of Duties or Taxes on Export Products (RoDTEP) scheme, effective January 1, 2021. It replaces MEIS. Rates and conditions for the new scheme are yet to be announced.

- Easy credit access: A long-standing demand of exporters, especially MSMEs, is credit access

- R&D service exports – The government is planning to add a new section on R&D service exports in the new FTP. This will render special focus on export of R&D services, as it is one of the fastest-growing segments among India's service exports

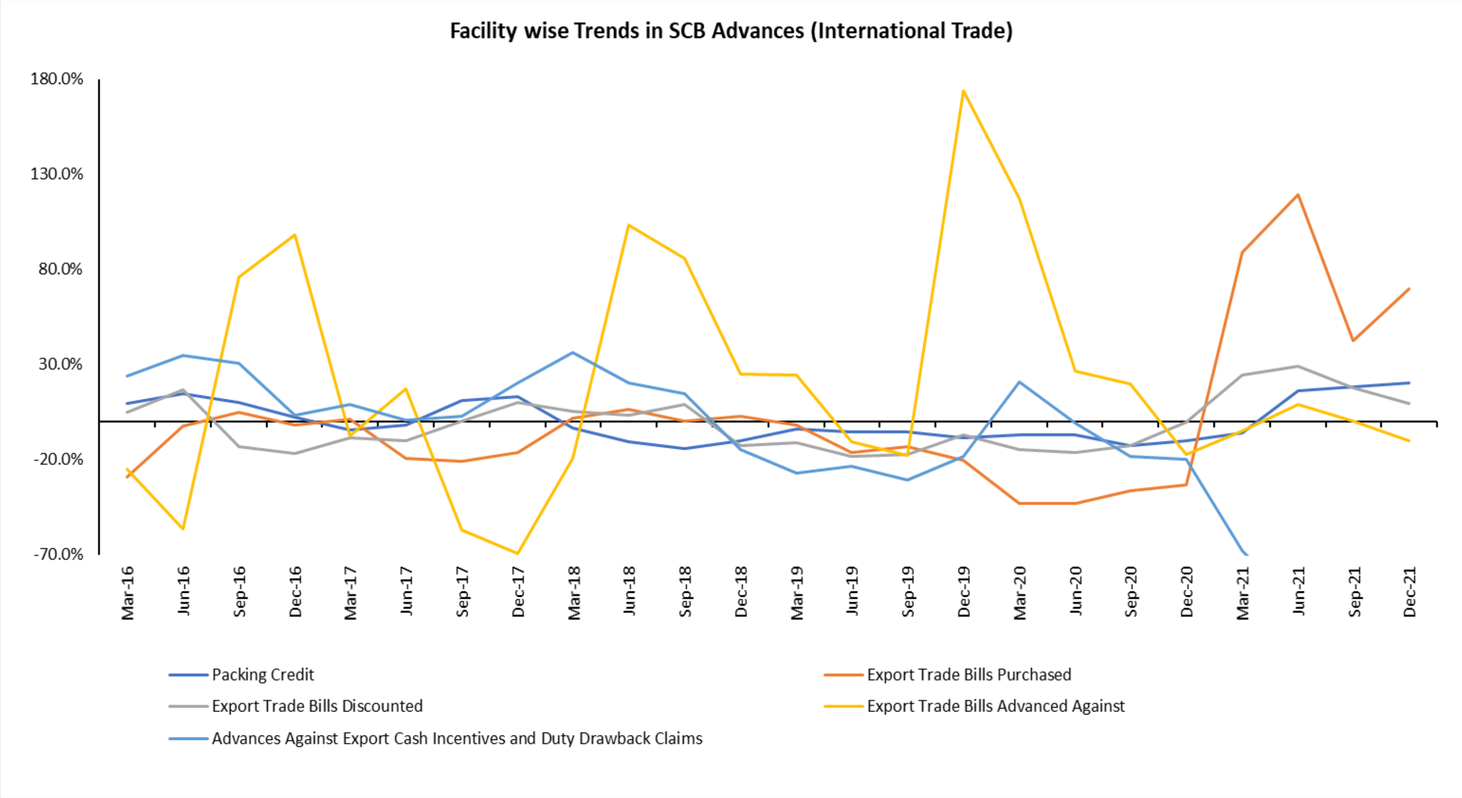
- E-commerce exports – According to Grant Thornton insights, India's e-commerce sector is the fastest-growing segment and expected to grow to US$ 188 billion by 2025, from about US$ 60 billion in 2020. The new FTP will have a separate chapter on e-commerce. Additionally, it will also have more HSN (Harmonised System of Nomenclature) codes for traded goods, which will help in proper categorisation.

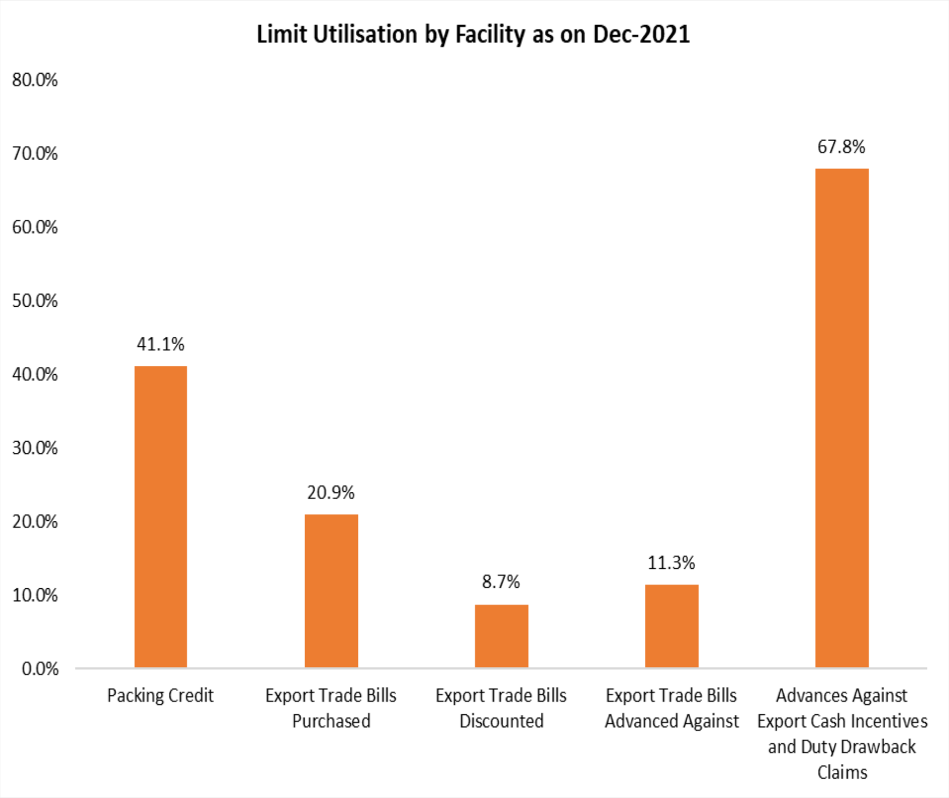
- Infrastructure upgrade and digitisation – India needs to invest in upgrading export infrastructure such as ports, warehouses, quality testing and certification centres to stay ahead of technology-advanced countries such as China.

New Foreign Trade Policy – Additional Expectations

- New FTP should focus on introducing schemes that will bolster capabilities of Indian companies in areas such as technological upgrade, innovation and product development
- New trade policy frame should also facilitate end to end planning of agriculture exports
- PLI Scheme is already geared to exports in 14 strategic areas

Trends in SCB Trade Finance by Facility





The Dichotomy of Payment/Settlements and Financial Messaging Systems can be the New Normal

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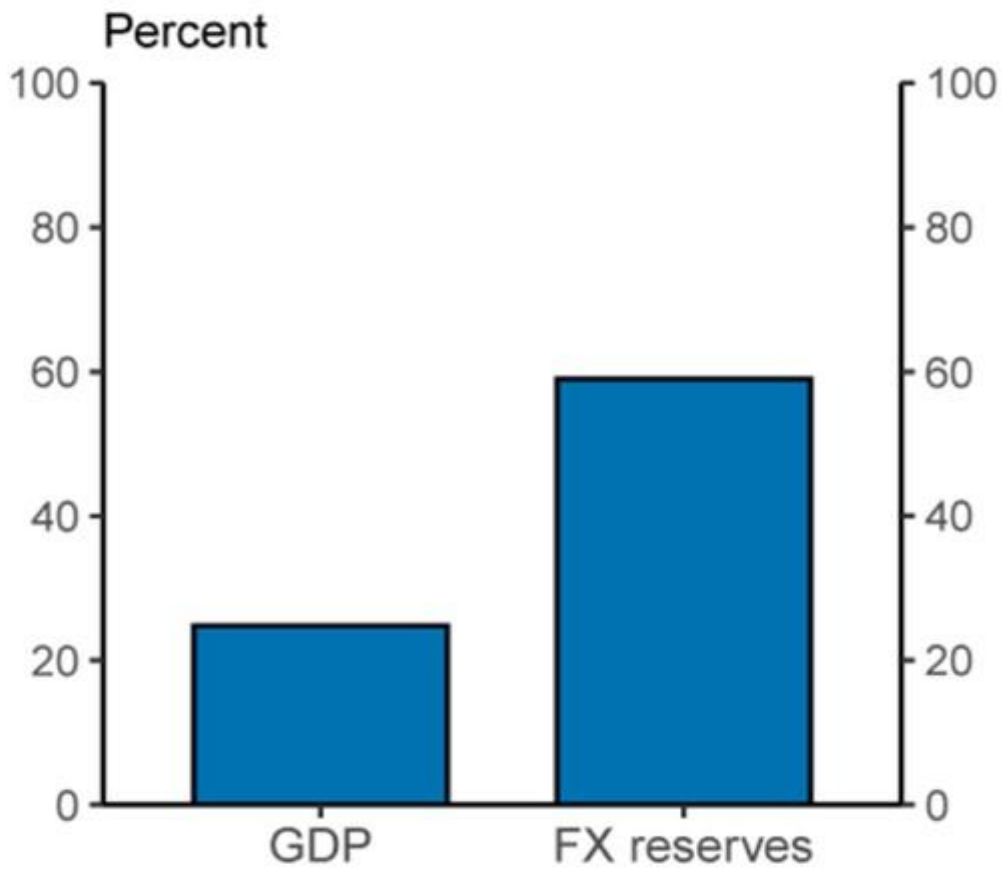
- The geopolitical scuttle can probably be a blessing for the RBI, giving it extra ammunition to seek dominance in the changing world order as alternate payment and settlement mechanisms are explored and finally put to test by nations though RBI would have to tread the path cautiously, not risking being labelled an outlier
- **The proposed RBI / VEB (SDC) arrangement for Rupee-Ruble cross currency pairing** (*taking cue from the platform established in early 90s*) could well be a harbinger of more concerted efforts to settle payments in non-dollar currencies among interested jurisdictions from BRICS or SAARC countries, say for a start, with more countries looking at India's sovereign Financial Messaging Systems (SFMS), while also remaining connected with a central system like SWIFT. However, the vulnerability to cyber attacks and hacking would require a robust fire walling as also greater AML-CFT measures adoption
- Ideally, RBI would do well to explore bilateral netting of trades / contracts, making actual transfers for outstanding amount only at periodic frequency while vying for making Rupee the base currency in settlements. **RBI may look at ameliorating the indigenous SFMS system** along the lines of Russian SPFS or Chinese CIPS (Cross border Inter bank Payment Systems), offering a secured and reliable financial messaging alternative to trading partners, leveraging CBDC that is estimated to take centre stage in wholesale banking transactions going forward.
- The bouncing back of Ruble in recent days to almost pre-war levels, with Europe's dependency on Russian energy being a catalyst, underpins the somewhat ineffectiveness of current sanctions apparent as Germany and Italy are likely to continue utilising the Gazprombank/Sberbank lifeline inbuilt in SWIFT sanctions to thwart any negative impact on mammoth domestic energy procurements. That should also anchor India's quest to build a dedicated payment mechanism for energy related payment and settlements as a long-haul measure

……USD has been the natural ‘store of value’………….. TILL NOW!!

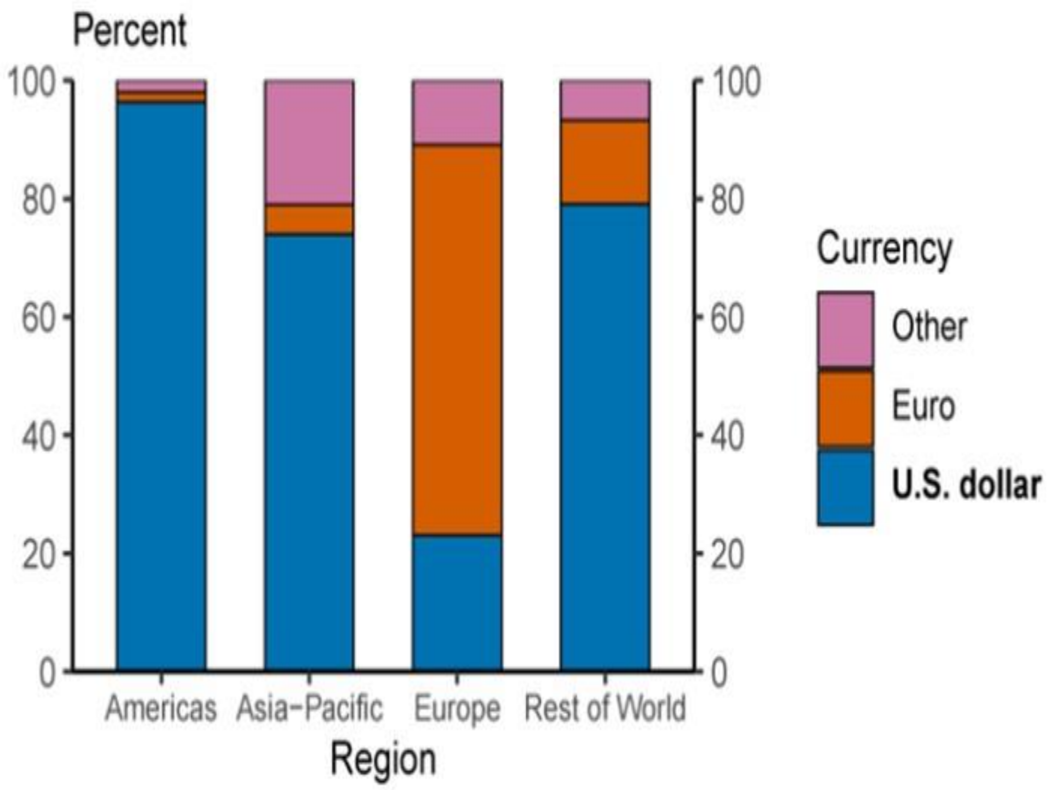
Figure 1. U.S. share of world GDP vs. U.S. dollar share of international reserves



Note: U.S. share of 2020 nominal world GDP compared to the dollar's share of globally disclosed foreign exchange reserves in 2020-Q4. At current exchange rates.

Source: IMF COFER; IMF World Economic Outlook database.

Figure 5. Share of export invoicing



Note: Average annual currency composition of export invoicing, where data are available. Data extend from 1999 through 2019. Regions are those defined by the IMF. Legend entries appear in graph order from top to bottom.

Source: IMF Direction of Trade; Central Bank of the Republic of China; Boz et al. (2020); Board staff calculations.

Way Forward

The Changing Landscape of Global Currency Realignments……

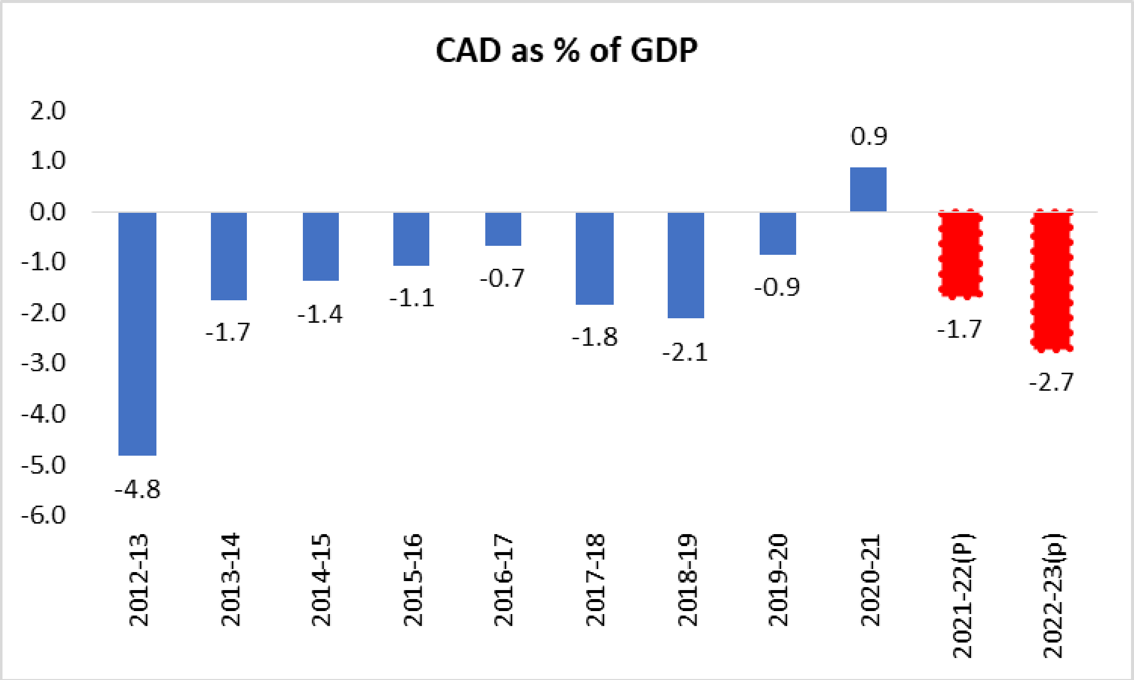
- Hitherto, USD has remained the natural choice of transaction and settlements for global trade (as per SWIFT data), driven primarily by the huge trust reposed in the Greenback, with ample liquidity, along with well developed independent legal system to settle disputes and some legacy from the days of Bretton Wood, stamping it as the ultimate store of value. This might change as more Central Banks seek a wider role at the tumultuous geo-political world stage
- Currencies like Renminbi and Rouble, with strong pitching by the respective regulators would look at forging new tie ups, luring non-west countries for non-dollar settlements at lucrative terms, eventually diverging from the usual preferences to a large extent. CBDCs could be a potential mechanism, with its failure-proof, low transactional cost model likely to promote settlements in wholesale banking soon. Already, select Central Banks' forex reserves holding are signalling asset diversification assiduously built over the years, fortressing themselves from the economic eventualities of a lop-sided world of present. **All the more a case for Indian regulators and policy makers, and bodies like FEDAI to seek equal, and appropriate footing for INR in the changing realms lest we lag behind in a crucial/critical area**
- The resurgence of the Rouble, primarily woven around Europe's energy demands, should also acknowledge the steps taken by Russian Central Bank in anchoring the currency and their well-planned divergence from traditional currencies while logging enhanced gold reserves as more Russian banks could be cut off from the SWIFT. That bears a testimony to the innate strengths of a Central Bank, and its acrobatics to come out tacitly from a situation, even if cornered badly. The direct payment/settlement platform between RBI and VEB (SDC) seems to have factored this probability well by keeping individual banks outside the mechanism, cementing the safety net.
- **The fluid like scenario would throw many challenges, but so would be the opportunities, we believe for adoption of a new world order, at least in terms of currency and trade algorithms.**

What will drive drives Exports Growth in Future? Manufacturing <u>OR</u> Services ???

- In a recent interview ((The Wire, Feb-22), Former RBI Governor had suggested that exports of information technology-enabled services (ITeS) along with professional services such as consultancy, legal, medicine, accounting should, instead of manufacturing, should become the mainstay of India’s export strategy
- While it is true that ITeS, software and consultancy services have accounted for a major proportion of India’s services exports in the past, and more significantly during the pandemic, a focus on these services as a primary growth driver for India’s exports may, however, be misplaced
- There are several issues regarding focusing on services exports:
  - Given the level of unemployment and low growth exclusive focus on services is not appropriate at this juncture
  - The necessary regulatory policies for liberalisation of services include, among others, issues of data privacy, storage and localisation that have been difficult for India to negotiate, both in the preferential trade agreements (PTAs) and at the multilateral level. India has raised doubts on the legality of plurilateral agreements for liberalisation of these services and/ or governance rules in the digital trade domain under the WTO, and has generally stayed out of these discussions
  - Even more importantly, “mode-4”/ movement of professionals — considered, thus far, as India’s predominant comparative advantage in the services sector — has been the single most important factor for India’s prolonged and often stalled services sector negotiations in preferential trade agreements as well as at the WTO Doha Development Agenda
  - Even where mode-4 liberalisation has been included in the bilateral agreements actual movement of professionals remains subject to difficulties of getting visas, language and cultural barriers
- All these aspects should, in fact, be reasons for India to revisit its approach to exports of services and we believe that services and manufacturing must be viewed as complementary and not as exclusive activities
- A realignment of India’s export strategy that views services as an integral part of manufacturing and structures the regulatory and trade policies consonant with this view, will provide multiple benefits of enhanced productivity, manufacturing competitiveness, export and employment potential, all of which are essential inputs for a strong post-pandemic recovery

CAD may rise to a decade high in FY23

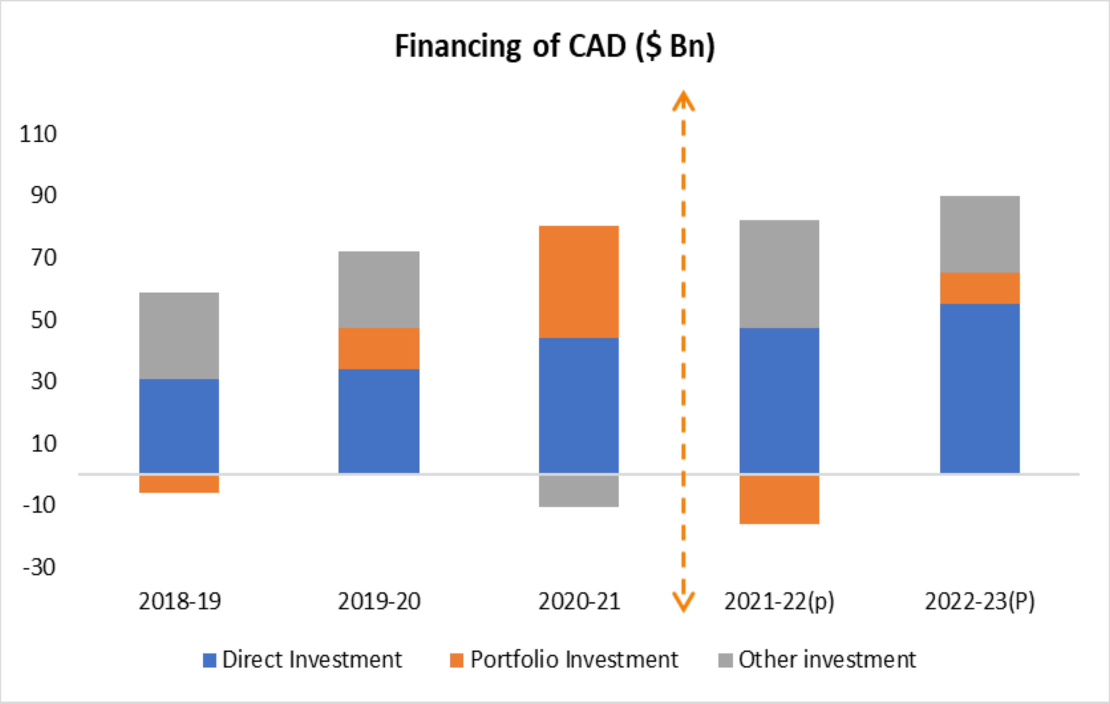
- India recorded a current account deficit of 1.2% of GDP in April-December 2021 as against a surplus of 1.7% in April-December 2020 on the back of a sharp increase in the trade deficit
- For the whole fiscal we believe the CAD will be at 1.7% of GDP
- FY23 will be a challenging year since as per our estimate CAD will breach the 2.5% mark and may reach to a decade high

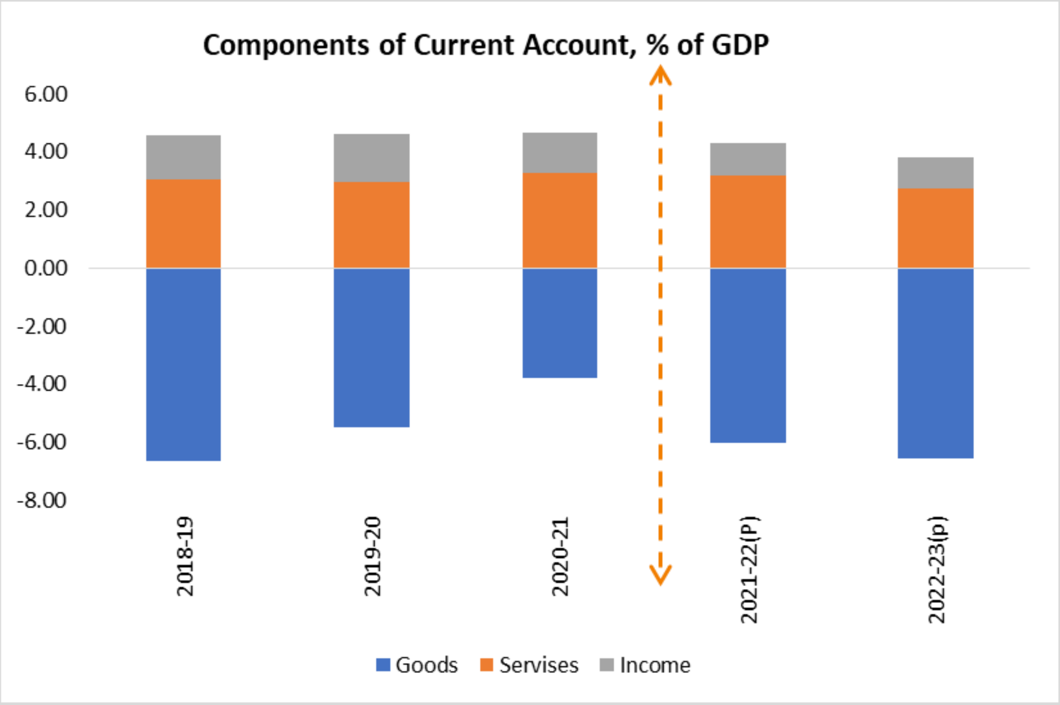


Financing & Composition of CAD remain biased in favour of more stable capital flows

- Foreign Direct Investment could be the largest source of CAD financing in FY23, followed by FII inflows

- Loans in the form of external commercial borrowings, trade credit and banking capital also contributed





Outlook on APEC Trade and Future Opportunity

- Few Countries dominate and determine India's APEC trade

- Other countries in APEC – Vietnam and Indonesia have attracted the relocating companies from China

- Current trends look like individual FTAs will drive future trade

    - India and Australia signed a comprehensive interim free-trade agreement that will provide zero duty exports to 100% tariff lines from India to the Australian market, benefiting labour-intensive sectors besides providing greater access to the services space

    - Tariffs will be eliminated on more than 85% of Australian goods export to India, which will rise to about 91% over 10 years. While 97% of Indian goods will immediately gain preferential access to Australia

Exchange Rate will continue to hold fort irrespective of CAD

- Based on turnover figures published by RBI (even with cancellation and roll over figures embedded in total), in the forex market, excess demand of USD in the merchant forwards was continually outpacing the demand from merchant spot during Apr'21-Feb'22 (cumulatively) with excess/ merchant demand in the November-February period at $30.2 billion

- This changed in March'22 to excess supply in merchant segment as announcement of RBI swap transactions may have resulted in merchants squaring off in forward segment to take advantage of rise in forward premia

Turnover in the foreign exchange market ($ mn)

Month	Merchant			Interbank			Grand Total	IB SWAP
	Forward Excess Demand	Spot Excess Demand	Total Excess Demand	Forward Excess Demand	Spot Excess Demand	Total Excess Demand		
Mar-22*	-3,813	2,395	-1,419	7889	-4164	3,725	2,306	-13,474
Feb-22*	2,321	1,270	3,591	3025	-5181	-2,156	1,434	2,114
Jan-22*	7,524	-1,108	6,416	-2135	-3807	-5,942	474	-737
Dec-21	8,406	-1,467	6,939	5055	-10793	-5,738	1,201	-29,091
Nov-21	9,380	3,918	13,298	-352	-6967	-7,319	5,979	-38,875
Oct-21	7,400	-8,054	-655	5016	-8367	-3,350	-4,005	-12,635
Sep-21	7,684	-5,575	2,109	2468	-3853	-1,385	724	-29,125
Aug-21	8,117	-4,598	3,519	-7174	1452	-5,723	-2,204	-18,220
Jul-21	2,900	-8,546	-5,647	-421	4812	4,391	-1,255	3,365
Jun-21	6,579	-5,396	1,183	3616	1529	5,145	6,327	19,120
May-21	7,903	-1,254	6,650	4008	-3536	472	7,121	6,483
Apr-21	717	-4,092	-3,375	10924	-3107	7,817	4,442	10,087
Mar-21	6,386	-5,415	971	9881	128	10,009	10,980	-4,810
Feb-21	-1,450	-2,830	-4,280	2922	9171	12,093	7,813	2,087
Jan-21	6,695	-8,014	-1,319	4990	1383	6,373	5,054	19,714
Dec-20	4,521	-12,779	-8,258	7610	-929	6,680	-1,578	9,029

Source: RBI, SBI Research,*Jan till14th, Feb From 14 to 28 and March till 11th

- Also, in the interbank market, there has been mostly excess demand of dollars in the forwards, indicating appetite of market players seeking increased arbitrage in the shorter term with Inter-bank SWAP segment providing an evidence as exchange levels have embraced volatility during the last few months thank you

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