Ecowrap

'Be the Bank of Choice for a Transforming India'

# HOW CAN COVID BENEFIT INDIA WITH TRADE AND FACTORY DIVERSION FROM CHINA

Issue No. 8, FY21
Date: 07 May 2020

2019 was not a good year for merchandise trade, with the rise in global protectionism and slowing global demand. In 2020 also the merchandise trade volume could fall by as much as 31.9%. The extent of uncertainty is very high, and it is well within the realm of possibilities that for both 2020 and 2021 the outcomes could be sub optimal.

There is now a renewed discussion of whether countries apart from China could benefit in the post pandemic world. However, when we look at the % share in world merchandise exports, China has actually gained market share from 2018 and currently commands 13.2% share in world merchandise exports and is still the world's biggest goods exporter. To get an idea, as to whether the world exports have actually moved in favor of other Asian countries vis-à-vis China in recent years we estimated the value of the commodities exported by 15 Asian countries including India to the world as the % share of China's top commodity exports. The exercise was done for 2018 and 2019. **The data shows that Viet Nam has been the highest gainer, with its Electrical Machinery, Furniture, Clothing, Footwear and Leather industries performing remarkably well. In 2019, many of these countries grew rapidly in these sectors. As far as India was concerned, India gained in Organic Chemicals and Iron & Steel. However, in Apparels, Vietnam, Cambodia, Bangladesh all gained significant share and was larger than India. India lost in leather exports to Cambodia and Indonesia that could have been diverted from China.**

To understand whether India can benefit if factories from China were relocated, we looked at the Capital Goods, Consumer Goods, Intermediate Goods and Raw Materials Revealed Comparative Advantage for India and China. **Although, the Revealed Comparative Advantage for India is lower than China as far as Capital Goods Exports are concerned, India can still capitalize on this opportunity to push its Capital Goods exports. However, the bigger opportunity right now is in Consumer Goods Sector, in which India has an RCA greater than China.** For Consumer Goods Sector, looking at the MSME profile of the country, the biggest concentration is in the textile and clothing sector(17.30%), food products (12.30%) and crop and animal production (10.0%). Although we do have comparative advantage in textiles and animal goods, in food products we are not competitive. The Government can give a direct push to this sector, so that MSME firms involved in food product manufacture get benefitted.

Although 2020 is a lost year, in terms of trade, India can think long-term and build relations so that it can occupy the space vacated by China. When we look at the value of merchandise exports, for 2019, China exported $2.5 trillion worth of goods, while India exported $0.3 billion worth of merchandise. This means that China exports 7 times the amount of goods India exports in a year. **India can look in the range of incremental exports growing by $20 billion in the least favorable outcome to a significant $193 billion jump in the 5 year horizon, only if it builds its capabilities and captures share from China**. Taking a look at Viet Nam, which has rapidly captured merchandise exports, it is also touted that a fair number of the factories being rapidly put up in Vietnam are owned and financed by the same Chinese companies being dislodged in their home country. However, there is no denying the fact that Viet Nam has gained in this trade war, with its cheap labor and cheap currency. How, India maneuvers the geo-political space will clearly determine how successful it is in becoming an export behemoth. **With just 1.7% in world's merchandise exports, India has a long road ahead to catch up with China. But it must be now, now and now !**

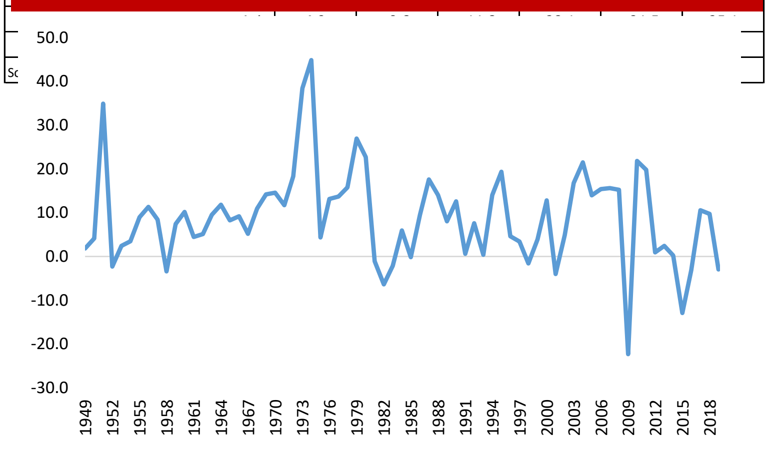
## WORLD MERCHANDISE TRADE : WHERE WE ARE AND WHERE WE ARE HEADED

- 2019 was not a good year for merchandise trade, with the rise in global protectionism and slowing global demand. World merchandise trade registered a decline for the year of -0.1% in volume terms after rising by 2.9% in the previous year. Meanwhile, the dollar value of world merchandise exports in 2019 fell by 3% to US$ 18.89 trillion. The bitter battle between US and China and US's protectionist stance was dragging trade sentiments down for entire 2019. This year, there was the expectation that US and China will reach an understanding.
- However, the COVID-19 has hit the world, destroying any chances of improving trade prospects this year at least. Restrictions on movement and social distancing to slow the spread of the disease mean that labour supply, transport and travel are today directly affected in ways they were not during the financial crisis. Entire sectors of national economies have been shut down, including hotels, restaurants, non-essential retail trade, tourism and significant shares of manufacturing.
- Keeping these things in mind, WTO has come up with projections for world merchandise trade under two distinct scenarios(: (1) a relatively optimistic scenario, with a sharp drop in trade followed by a recovery starting in the second half of 2020, and (2) a more pessimistic scenario with a steeper initial decline and a more prolonged and incomplete recovery.
- Under both scenarios, the merchandise trade volume is expected to fall by 12.9% and 31.9% in 2020. If the pandemic is brought under control and trade starts to expand again, most regions could record double-digit rebounds in 2021 of around 21.3% in the optimistic scenario and 24% in the pessimistic scenario. The WTO further states that the extent of uncertainty is very high, and it is well within the realm of possibilities that for both 2020 and 2021 the outcomes could be above or below these outcomes.

Merchandise trade volume Annual % Change : WTO Projection

| | Historical | | Optimistic Scenario | | Pessimistic Scenario | |
|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 (P) | 2021 (P) | 2020(P) | 2021(P) |
| **Volume of World Merchandise Trade** | 2.9 | -0.1 | -12.9 | 21.3 | -31.9 | 24.0 |
| **Exports** | | | | | | |
| North America | 3.8 | 1 | -17.1 | 23.7 | -40.9 | 19.3 |
| South and Central America | 0.1 | -2.2 | -12.9 | 18.6 | -31.3 | 14.3 |
| Europe | 2.0 | 0.1 | -12.2 | 20.5 | -32.8 | 22.7 |
| Asia | 3.7 | 0.9 | -13.5 | 24.9 | -36.2 | 36.1 |
| Other regions | 0.7 | -2.9 | -8.0 | 8.6 | -8.0 | 9.3 |
| **Imports** | | | | | | |
| North America | 5.2 | -0.4 | -14.5 | 27.3 | -33.8 | 29.5 |

World Annual Merchandise Exports Growth(Value terms)




Source: SBI Research

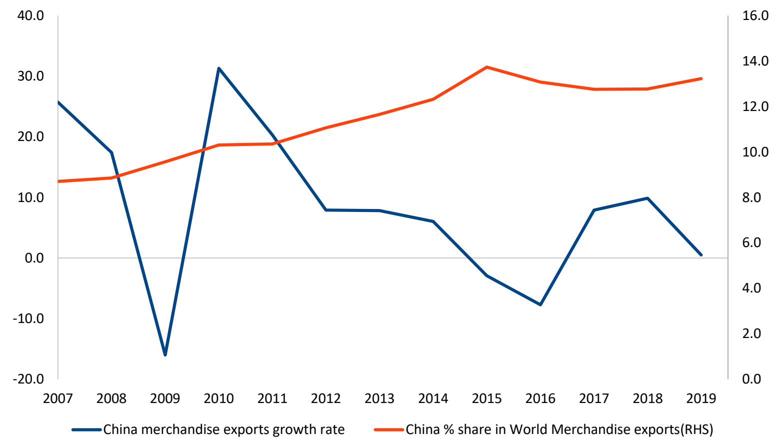
## CHINA AND WORLD MERCHANDISE TRADE

- Over the years, China has seen its exports growth decline. After 2008 crisis, it saw a sharp rebound in its merchandise exports. However, after growing 31.3% in 2010, the growth has sharply come down as world demand slowed. Chinese exports recovered in 2017 and 2018. However, the growing trade tension with USA pushed the growth rate down for China. Despite that it managed to grow positively by 0.5%.
- However, when we look at the % share in world merchandise exports, China has steadily gained market share over the years, till 2015 and was at 13.7% in 2015. There was some decline in its overall merchandise exports share after that but from 2018, China has gained 40 bps and commands 13.2% share in world merchandise exports and is still the world's biggest goods exporter.
- Thus for countries to cut China completely out of the equation post COVID is nearly impossible unless countries are ready to either slow down their consumption for a few years at least or are ready to spend massive amounts in terms of relocating factories to neighboring Asian economies and/or paying more wages to workers in their home countries. Commodity wise composition shows that machinery and transport equipment are China's biggest exports. Out of the $24944 billion worth goods exported in 2019, 48% was machinery and transport equipment and moving this quickly is challenging.
- To understand whether India can benefit if factories were relocated, we constructed a Capital Goods Index by dividing China's capital goods exports to World Manufacturing Output and calculating its growth. The growth rate of such Capital Goods exports to global manufacturing ratio for China has already been slowing down after the 2008 crisis. With the backlash due to COVID-19, China can see further decline in the growth rate of its capital goods exports to World Manufacturing Output ratio. However, its base is huge compared to other Asian economies.

## ARE COUNTRIES IN ASIA REALLY GAINING AT THE COST OF CHINA?

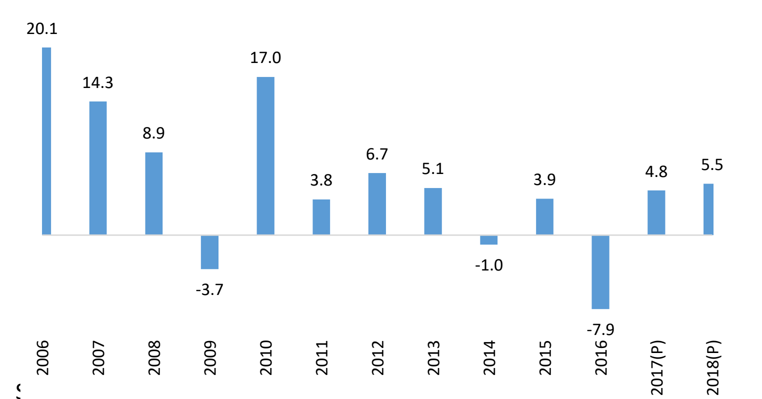
- To get an idea, as to whether the world exports have actually moved in favor of other Asian countries vis-à-vis China, we also calculated the value of the commodities exported by 15 Asian countries including India to the world as the % share of China's top commodity exports of those commodities to the world. The exercise was done for 2018 and 2019. And then we calculated the change in the % share.
- The data shows that Viet Nam has been the highest gainer, with its Electrical machinery, Furniture, Clothing, Footwear and Leather industries performing remarkably well. In 2019, many of these countries grew rapidly in these sectors. However, as a % of Chinese Exports to the World these countries exports are very less. As far as India was concerned, India gained in Organic chemicals and Iron & Steel. However, in apparels, Vietnam, Cambodia, Bangladesh all gained significant share. India lost in share of leather exports to Cambodia and Indonesia.

**China's Merchandise Export**




Source: SBI Research

**China Capital Goods Exports Contribution Index**




- If we only consider the countries whose world exports are 10% or more as compared to China's exports and which have grown by more than 15% , the countries which emerge are Cambodia in Knitted and Crocheted Clothing, Indonesia and Malaysia in Iron and Steel and Vietnam in Electrical Machinery, Furniture, Clothing and Leather.
- However, in case of machinery and mechanical appliances none of these Asian economies can hold a candle to China at least right now.

**Country-wise % share change of commodity exported as % of China's exports to World between 2018 and 2019**

| HS Class. | Commodity Name | Bangladesh | Cambodia | India | Indonesia | Malaysia | Pakistan | Sri Lanka | Taiwan | Thailand | Viet Nam |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 85 | Electrical machinery and equipment and parts thereof... | 0.0 | 0.0 | 0.4 | 0.7 | -0.3 | 0.0 | 0.0 | 0.2 | -0.2 | 5.9 |
| 84 | Machinery, mechanical appliances, nuclear reactors, boilers... | 0.0 | 0.0 | 0.3 | 0.3 | -0.7 | 0.0 | 0.0 | 1.2 | -0.3 | 1.3 |
| 94 | Furniture; bedding, mattresses... | 0.0 | 0.4 | 0.1 | 0.6 | 0.3 | 0.1 | 0.0 | 0.0 | 0.0 | 4.7 |
| 39 | Plastics and articles thereof | 0.0 | 0.1 | -1.0 | -0.4 | -0.4 | 0.0 | 0.0 | -4.5 | -2.3 | 0.1 |
| 87 | Vehicles other than railway or tramway rolling stock... | 0.0 | 0.2 | -1.2 | -0.7 | 0.3 | 0.0 | 0.0 | 0.6 | -1.6 | 0.3 |
| 90 | Optical, photographic, cinematographic... | 0.0 | 0.0 | 0.1 | 0.9 | 0.6 | 0.0 | 0.0 | -1.1 | -0.3 | -2.9 |
| 61 | Articles of apparel and clothing accessories, knitted or crocheted | 1.1 | 3.4 | 0.8 | 1.0 | 0.1 | 0.8 | 0.4 | 0.0 | 0.2 | 3.7 |
| 73 | Articles of iron or steel | 0.0 | 0.0 | -0.4 | -0.4 | -0.1 | -0.1 | 0.0 | -1.8 | -0.9 | -0.2 |
| 62 | Articles of apparel and clothing accessories, not knitted or crocheted | 2.6 | 4.4 | 1.6 | 1.5 | 0.1 | 1.6 | 0.1 | 0.0 | 0.1 | 5.3 |
| 95 | Toys, games and sports requisites; parts and accessories thereof | 0.0 | 0.1 | 0.0 | 0.5 | 0.1 | 0.1 | 0.0 | -0.1 | -0.1 | 2.1 |
| 29 | Organic chemicals | 0.0 | 0.0 | 2.4 | 0.0 | -1.1 | 0.0 | 0.0 | -3.5 | -2.1 | 0.3 |
| 64 | Footwear, gaiters and the like; parts of such articles | 0.2 | 3.0 | -0.1 | 4.7 | 0.0 | 0.1 | -0.1 | 0.0 | 0.0 | 16.0 |
| 27 | Mineral fuels, mineral oils ... | 0.0 | 0.0 | -10.7 | -7.2 | -9.2 | -0.2 | 0.0 | -2.2 | -4.7 | -3.2 |
| 72 | Iron and steel | 0.0 | 0.0 | 3.2 | 5.7 | 4.2 | 0.0 | 0.0 | -0.1 | -0.1 | -2.9 |
| 42 | Articles of leather; saddlery and harness; travel goods, handbags... | 0.2 | 3.3 | 0.1 | 1.7 | 0.0 | 0.2 | 0.0 | 0.2 | 0.4 | 4.9 |
| 63 | Other made-up textile articles; sets; worn clothing... | -0.3 | 0.1 | -0.4 | -0.1 | -0.1 | 0.3 | 0.0 | 0.0 | 0.2 | 0.3 |

Source: SBI Research, International Trade Centre

## WHERE DOES INDIA STAND

- Although for India, the Capital goods Revealed Comparative Advantage is less than 1, India can capitalize on this opportunity to push its capital Goods exports. **However, the bigger opportunity right now is in Consumer Goods Sector, in which India has a RCA greater than China.**
- For Consumer Goods Sector, looking at the MSME profile of the country, the biggest concentration is in the textile and clothing sector (17.30%), food products (12.30%) and crop and animal production (10.0%). Although we do have comparative advantage in textiles and animal goods, in food products we are not competitive. The Government can give a direct push to this sector, so that MSME firms involved in food product manufacture get benefitted.
- Although 2020 is a lost year, in terms of trade, India can think long-term and build relations so that it can occupy the space vacated by China. When we look at the value of merchandise exports, for 2019 (calendar year), China exported $2.5 trillion worth of goods, while India exported $0.3 billion worth of merchandise. This means that China exports 7 times the amount of goods India exports in a year. Of course, for India to become as big as China in a span of two years is difficult, but it can occupy some space in the coming few years and work towards building its capabilities so that it can command a larger share in the medium and long term.
- India can look in the range of incremental exports growing by $20 billion in the least favorable outcome to a significant $193 billion jump in the 5 year horizon, only if it builds its capabilities and captures share from China. We have a vary small manufacturing base as compared to China and Government will have to give significant push both in terms of strategic relations and structural reforms .
- Taking a look at Viet Nam, which has rapidly captured merchandise exports, there is some issue of transshipments and it is also touted that a fair number of the factories being rapidly put up in Vietnam are owned and financed by the same Chinese companies being dislodged in their home country. However, there is no denying the fact that Viet Nam has gained in this trade war, with its cheap labor and cheap currency. However, it is a small developing country with a population of 10 crore.
- In the list of countries we have considered, India is one country which can fulfil the global demands with its sizeable population. However, India will have to take a hard look at its labor reforms and currency outlook to gain market share. There is the issue of infrastructure which is pivotal in determining the extent to trade will grow. China has built up over the past four decades immense roads, ports and freight handling capabilities and India would require massive investments in these areas to reach that level.
- Also every sector has its unique requirements India has a diversified trade basket and it needs to analyze and meet the requirements of various sub-sectors individually.
- Then there is the issue of its relationship with its key trade partners. How, India maneuvers the geo-political space will clearly determine how successful it is in becoming an export behemoth. With just 1.7% in world's merchandise exports, India has a long road ahead to catch up with China.
- Although, COVID can dampen demand for the coming years, it does provide an opportunity for global trade rebalancing and India needs to play its cards right to gain something out of this catastrophe.

| Revealed comparative advantage (2018) | | |
|---|---|---|
| | China | India |
| All Products | 1 | 1 |
| Capital goods | 1.6 | 0.42 |
| Consumer goods | 1.04 | 1.39 |
| Intermediate goods | 0.65 | 1.71 |
| Raw materials | 0.1 | 0.53 |
| Animal | 0.27 | 1.35 |
| Chemicals | 0.54 | 1.64 |
| Food Products | 0.3 | 0.59 |
| Footwear | 2.63 | 1.49 |
| Fuels | 0.08 | 0.77 |
| Hides and Skins | 2.08 | 2.33 |
| Mach and Elec | 1.96 | 0.39 |
| Metals | 0.95 | 1.33 |
| Minerals | 0.12 | 0.9 |
| Miscellaneous | 1.4 | 0.38 |
| Plastic or Rubber | 0.85 | 0.76 |
| Stone and Glass | 0.51 | 4.00 |
| Textiles and Clothing | 2.1 | 3.16 |
| Transportation | 0.32 | 0.57 |
| Vegetable | 0.23 | 1.63 |
| Wood | 0.64 | 0.31 |
| Source: WITS | | |

| Potential for exports in China's top commodity exports | | | | | | |
|---|---|---|---|---|---|---|
| HS Class | Commodity Name | China's exports in 2019 ($ billion) | India's exports in 2019 ($ billion) | Potential for exports assuming India captures 1% of demand from China($ billion) | Potential for exports assuming India captures 5% of demand from China($ billion) | Potential for exports assuming India captures 10% of demand from China($ billion) |
| 85 | Electrical machinery and equipment and parts thereof... | 671 | 15 | 6.71 | 33.55 | 67.10 |
| 84 | Machinery, mechanical appliances, nuclear reactors, boilers... | 417 | 21 | 4.17 | 20.85 | 41.70 |
| 94 | Furniture; bedding, mattresses... | 99 | 2 | 0.99 | 4.97 | 9.95 |
| 39 | Plastics and articles thereof | 84 | 7 | 0.84 | 4.22 | 8.44 |
| 87 | Vehicles other than railway or tramway rolling stock... | 74 | 17 | 0.74 | 3.72 | 7.44 |
| 90 | Optical, photographic, cinematographic... | 73 | 3 | 0.73 | 3.65 | 7.30 |
| 61 | Articles of apparel and clothing accessories, knitted or crocheted | 71 | 8 | 0.71 | 3.57 | 7.14 |
| 73 | Articles of iron or steel | 70 | 7 | 0.70 | 3.48 | 6.96 |
| 62 | Articles of apparel and clothing accessories, not knitted or crocheted | 67 | 9 | 0.67 | 3.34 | 6.68 |
| 95 | Toys, games and sports requisites; parts and accessories thereof | 63 | 0 | 0.63 | 3.14 | 6.28 |
| 29 | Organic chemicals | 57 | 18 | 0.57 | 2.84 | 5.68 |
| 64 | Footwear, gaiters and the like; parts of such articles | 48 | 3 | 0.48 | 2.39 | 4.78 |
| 27 | Mineral fuels, mineral oils ... | 47 | 44 | 0.47 | 2.35 | 4.70 |
| 72 | Iron and steel | 39 | 10 | 0.39 | 1.97 | 3.95 |
| 42 | Articles of leather; saddlery and harness; travel goods, handbags... | 30 | 3 | 0.30 | 1.48 | 2.96 |
| 63 | Other made-up textile articles; sets; worn clothing... | 28 | 5 | 0.28 | 1.40 | 2.79 |
| | | | Total | **19.38** | **96.92** | **193.84** |
| Source: SBI Research, International Trade Centre, Items marked in yellow are where India's comparative advantage lies | | | | | | |

*****



**Contact Details:**
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
:@kantisoumya