

Choppy waters

US-India trade in times of rising protectionism

June 17, 2019

Chartbook



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The US has terminated India's beneficiary status under the Generalized System of Preferences (GSP) trade programme effective June 5, ending over four decades of duty-free access to the US markets for Indian goods.

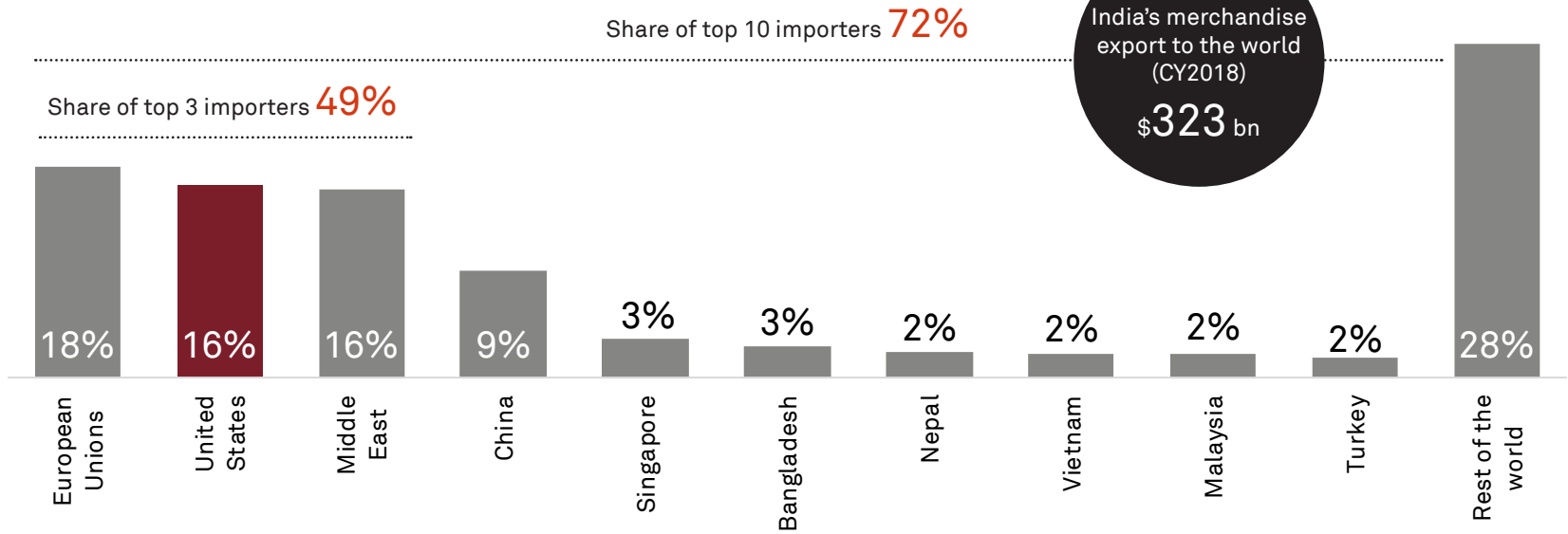
CRISIL Research, however, believes the withdrawal will have limited impact on India's exports, though the timing of the move does hint at trade tightening.

This report delves into trends in US-India trade over the past five years, especially in light of growth in exports to the US from other key countries, and analyses how the withdrawal of GSP benefits, along with various other factors at play, could tip the scales in the countries' bilateral trade.

Around 16% of India's total merchandise exports is to the US

India exported merchandise worth \$323 billion and services of \$205 billion in 2018, aggregating \$528 billion in global trade.

The US is one of India's top 3 markets



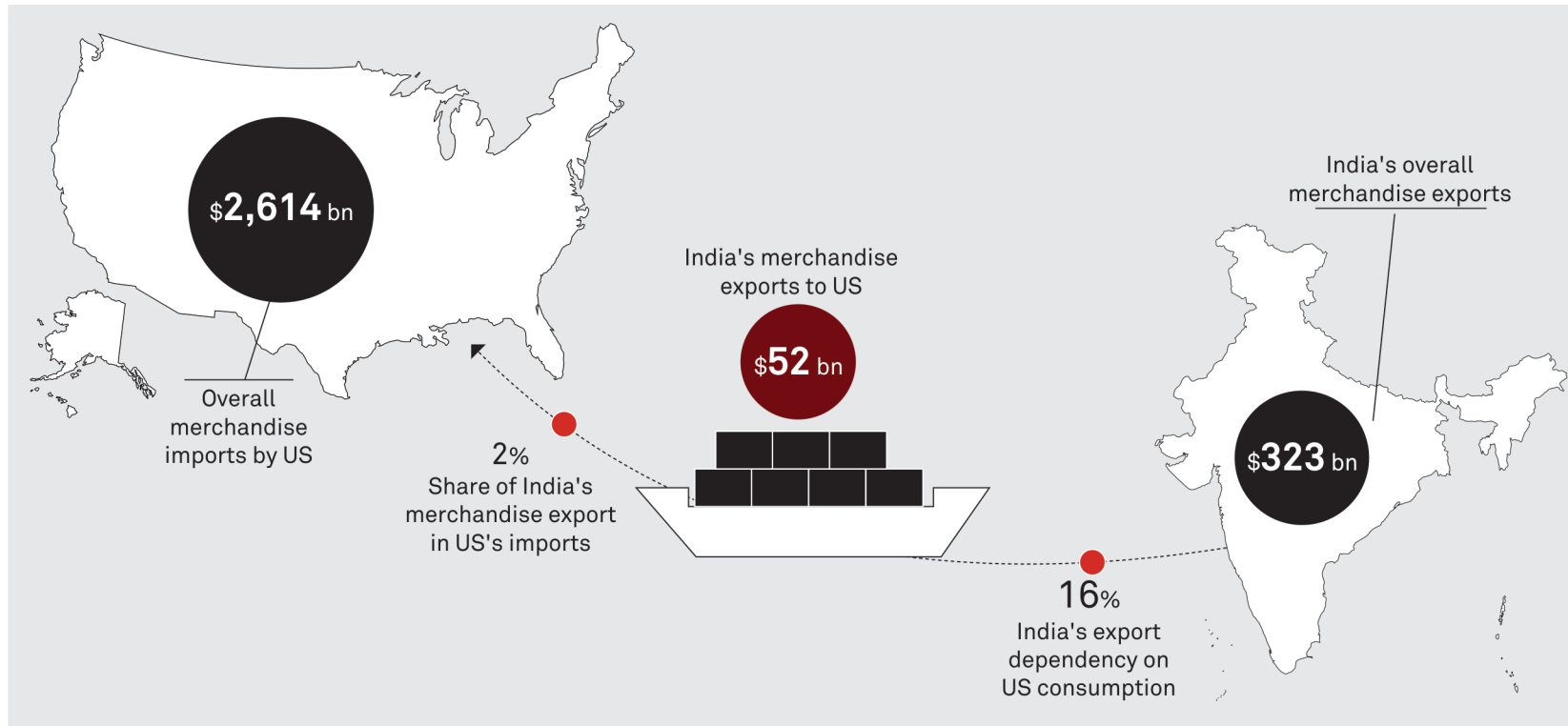
Note: Chart highlights share of India's merchandise exports for calendar 2018
 Source: Directorate General of Foreign Trade (DGFT), International Trade Centre, CRISIL Research

The top three regions – the European Union (EU), the US, and the Middle East – consume almost half of India's merchandise exports.

Over the past three years, India's overall merchandise exports logged a compound annual growth rate (CAGR) of 7% in dollar terms. In comparison, merchandise exports to the US and the EU logged 9% CAGR each, while exports to the Middle East stagnated at 1%.

In calendar 2018, India's goods and services trade with the US totalled \$142.1 billion, of which exports were \$83.2 billion. The US's trade deficit with India, though, has declined continuously over the past five years, from \$31 billion in calendar 2014 to \$24.2 billion in calendar 2018. This is because India's exports to the US have logged a CAGR of 6%, while its imports from the US have run up at 11%.

The US is a key consumer for Indian exporters

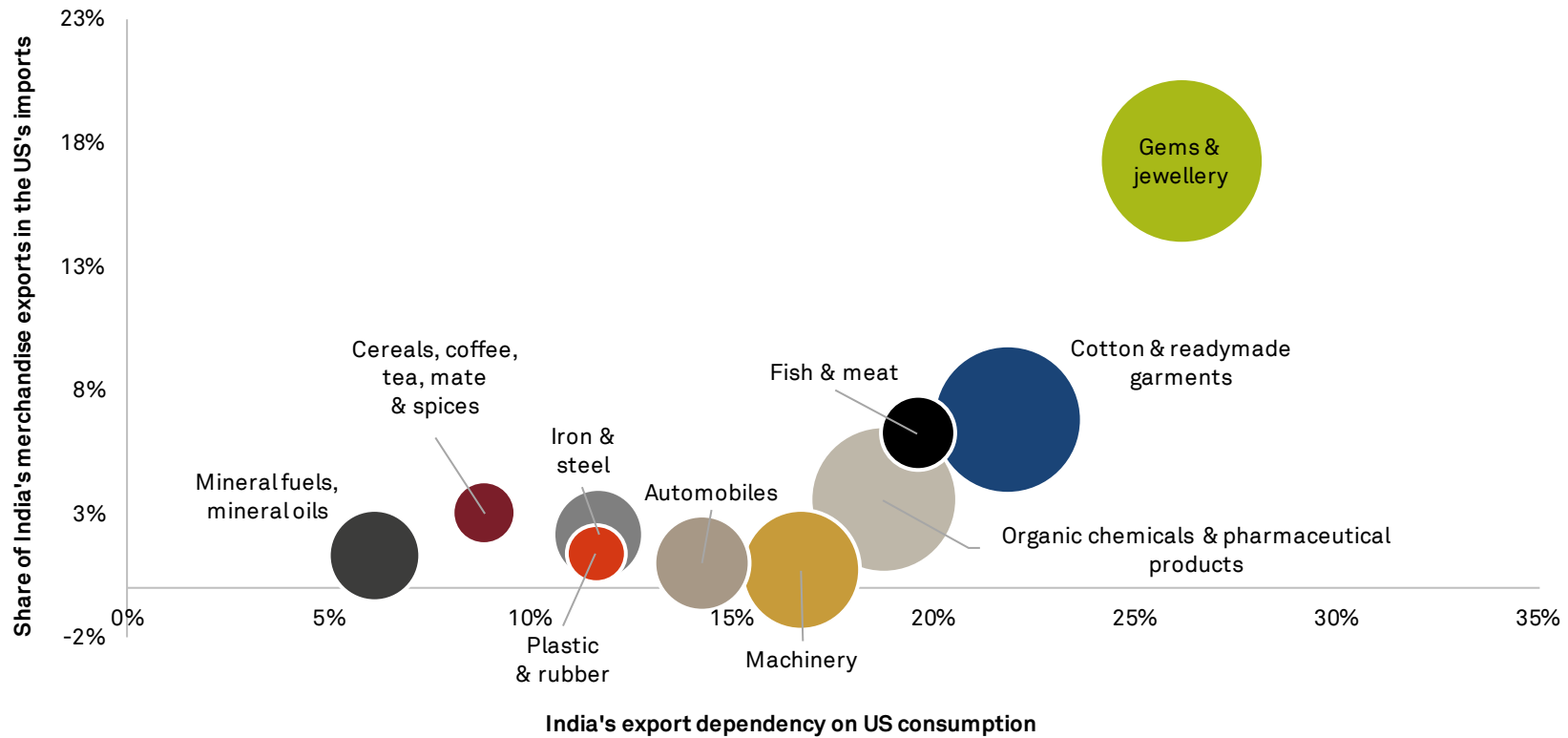


Note: Data for calendar 2018

Source: DGFT, International Trade Centre, CRISIL Research

Viewed from the US perspective, Indian goods contribute to only 2% of its import basket. However, from India's perspective, the US consumes ~16% of its goods exports. Sector-wise, the US is a key market for exporters of gems & jewellery, pharmaceuticals, and apparel from India.

Gems & jewellery has high trade dependency for both countries



Note: Above data indicates share of trade between the US and India for calendar 2018; top-10 sectors shown above account for 90% of India's exports to the US. Size of bubble depicts relative importance of India's merchandise exports to the US.

Source: DGFT, International Trade Centre, CRISIL Research

Moderate impact seen for gems & jewellery exporters

Indian exporters of gems and jewellery faced headwinds in fiscal 2019 in the form of stringent lending rules, working-capital crunch, and a significant drop in bars and coins as well as silver jewellery exports.

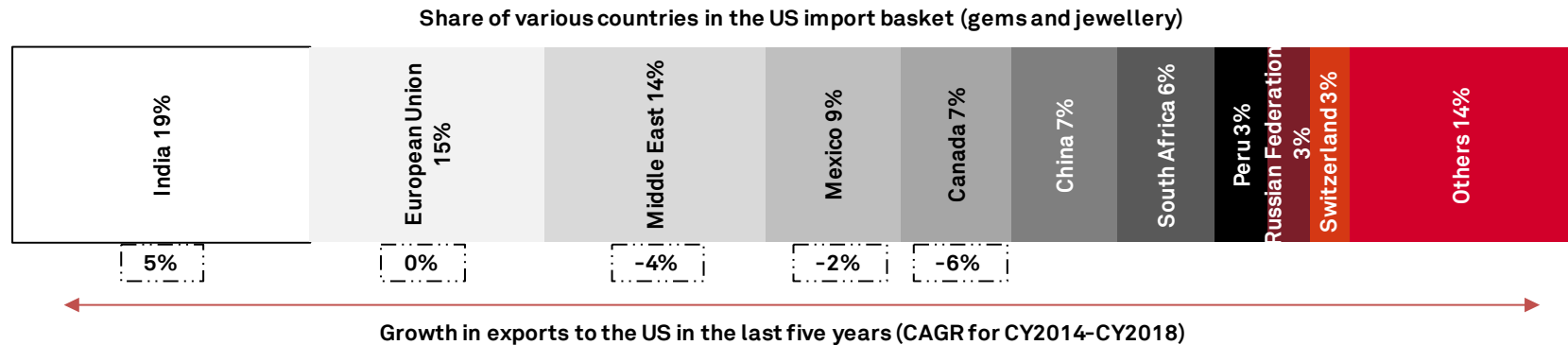
In the first half of the fiscal, despite a rise in cut and polished (C&P) diamonds as well as gold jewellery exports, gems and jewellery exports declined ~2.5% because of a significant drop in gold bars and coins and silver exports (~87% on-year decline in both). While exports of bars and coins declined owing to the Indian government’s decision to ban shipments of gold with purity of over 22 carats, silver jewellery exports waned because of an increase in exports from Thailand, Indonesia, and China.

C&P diamonds and gold jewellery (constituting ~80% of total exports) saw higher demand from key export markets such as the US, United Arab Emirates and Hong Kong in the first half, growing ~7% on-year. However, tightening credit situation, working capital crunch, and demand slowdown in some key destinations impacted C&P diamond exports in the second half, and it fell ~4%.

The government doubled the import duty on C&P diamonds from 2.5% to 5.0% in Union Budget 2018-19, and increased it further to 7.5% in September 2018. However, if key export destinations reciprocate by imposing import duties on C&P diamonds, exports from India may suffer

India tops the list of exporters to the US in gems & jewellery

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Note: Above data indicates value share (dollar terms) of trades for calendar 2018 based on two-digit HS codes used for gems and Jewellery (71). Data highlights that India’s gems and jewellery exports to the US grew at 5% CAGR between 2014 and 2018; India’s share in the US’ imports was 19% in 2018.

Source: DGFT, International Trade Centre, CRISIL Research

CRISIL Research’s assessment of GSP eligible tariff lines indicates that withdrawal of GSP benefits will moderately affect exporters of gems and jewellery, as ~15% of India’s exports to the US benefited from GSP in calendar 2018. However, increasing competition from Israel, Mexico, and Canada remains a monitorable. Withdrawal of GSP

will lead to additional duties worth approximately 7% for exports of jewellery of precious metals and imitation jewellery. Additional duties will hinder competitiveness of Indian exporters (in case prices are hiked) and put pressure on margins (while absorbing partial duty hike).

Limited impact seen for pharma

The US market accounts for 35-37% of India’s formulation exports. Blockbuster drugs going off-patent and marketing exclusivity aided growth of Indian formulation exporters between fiscals 2012 and 2016. However, regulatory woes, wholesale consolidation in the US market, and rising competition substantially impacted formulation exports players in fiscals 2017 and 2018, leading to flat growth.

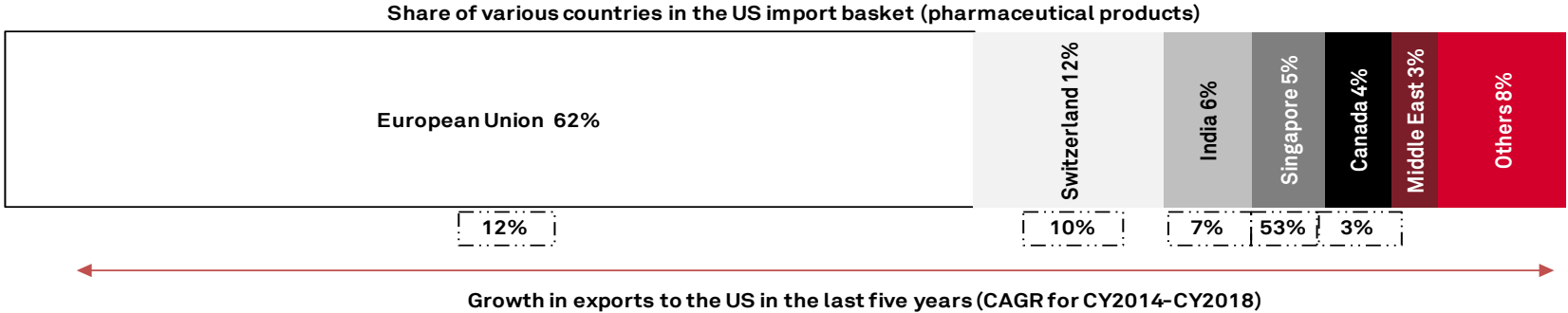
In fiscal 2019, formulation exports rebounded as players focused on new launches in conventional segments and on niche, speciality, and limited competition products. Although pricing pressure exists in the US market, it is likely to have fallen to mid-single digits in fiscal 2019.

Price erosion is expected to moderate going ahead. Though competitive intensity in the US market peaked in 2017, the situation is seen improving.

Indian pharmaceutical players have substantially expanded their presence in the generic drugs market with an increasing number of entities seeking abbreviated new drug application (ANDA) approvals as well as tentative approvals from the US Food and Drug Administration (FDA). As per the US FDA, India ranks second, after the US, in the number of ANDA approvals received.

Thus, India is better placed than most other exporting countries to address the growing generic drugs market in the US, though Indian companies face intense competition from Ireland, Germany, and Switzerland.

Focus on specialty and niche products to boost India’s pharma exports to the US



Note: Above data indicates value (dollar terms) share of trade for calendar 2018 based on two-digit HS codes used for pharmaceutical products (30). Data highlights that India’s pharma exports to the US grew 7% CAGR between 2014 and 2018; India’s share in US’ imports was 6% in 2018..

Source: DGFT, International Trade Centre, CRISIL Research

CRISIL Research believes the impact of GSP withdrawal on pharmaceutical exporters will be minimal as exporters follow ANDA route for US market. Growth momentum in exports to the US market is

likely to continue as pricing pressure normalises and manufacturers look at niche molecules, speciality drugs, complex generics and biosimilars.

No major impact on apparels

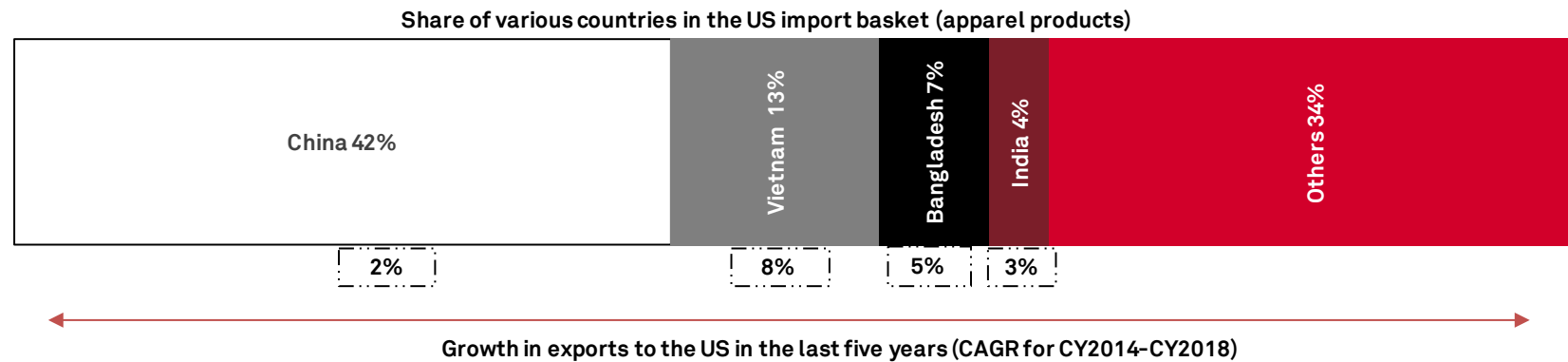
Over the past five years, India’s apparel exports to the US (in value terms) rose at 3% CAGR. However, developing nations such as Vietnam, Indonesia, and Bangladesh have upped the game, claiming a greater share in the exports pie to the US. This is on account of India’s low competitiveness in terms of fewer free trade agreements (FTAs) and higher labour costs compared with Bangladesh, China, and Vietnam.

While the impact of GSP withdrawal on apparel exports is minimal, the 4% subsidy offered by the government under the Merchandise Export

Incentive Scheme (MEIS) remains a monitorable. If MEIS benefits are not renewed, it would lead to deterioration of export competitiveness, thereby impacting exports to the US.

On the other hand, increase in export incentives in the form of the recently enhanced rates under the Rebate of State and Central Taxes and Levies scheme in apparel will be supportive. Under the scheme, effective March 2019, the rebate for apparels has been increased from 1.7% to 6.05%.

Continuation of export incentives essential for India apparel exporters to grow share in the US import basket



Note: Above data indicates volume share of trades for calendar 2018 based on two-digit HS codes used for apparel products (61 and 62). Data highlights that India's apparel exports to the US grew 4% CAGR between 2014 and 2018; India's share in the US's imports was 4% in 2018.

Source: DGFT, International Trade Centre, CRISIL Research

The decision of the US to not participate in the Trans-Pacific Partnership (TPP) will help Indian exporters in the long run. However, growth in garment exports seems capped as the US is gradually shifting to manmade fibre apparels, in which China and Vietnam are better placed and command a favourable product mix. Even without the TPP, Vietnam is competitive in the US market owing to its manmade fibre-dominated product mix, low labour cost, and investments in the textile space by Chinese companies.

Indian exporters additionally face high pricing pressure from low-cost suppliers in countries such as Bangladesh and Vietnam. Progress on the EU-Vietnam FTA would add to the challenges.

Meanwhile, China has been losing share in the US and the EU on-year, due to the US-China trade war and rising labour cost. But that lost share has been captured by new low-cost export apparel countries such as Cambodia and Myanmar.

Overall, GSP withdrawal will have low-to-moderate impact

Total goods and services trades of the US with India stood at \$142.1 billion in 2018, with exports from India accounting for ~\$83.2 billion. Of these, exports from India under GSP benefits are estimated to be 7.5-7.8%. The scheme helped Indian exporters save duties worth ~\$260 million in 2018, translating into 4% duty benefits.

However, based on the assessment of overall exports from India and duty benefits withdrawn under GSP, CRISIL Research believes the GSP withdrawal will have a low impact on Indian exporters, overall. Pharmaceuticals and apparels exporters would face minimal impact, though gems and jewellery exporters to the US could face moderate headwinds.

GSP to have low impact on India's overall export trade



Sectors	Gems and jewellery	Pharmaceutical products	Textiles and apparels
World exports (\$ bn)	622	600	481
India's share in world exports	6%	2%	3%
Impact of GSP withdrawal on India's exports to the US	Medium	Low	Low
Impact of GSP withdrawal on India's overall exports	Low	Low	Low

Note: Moderate impact = 5 -15%; low impact = < 5%
Source: DGFT, International Trade Centre, CRISIL Research

Notes

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