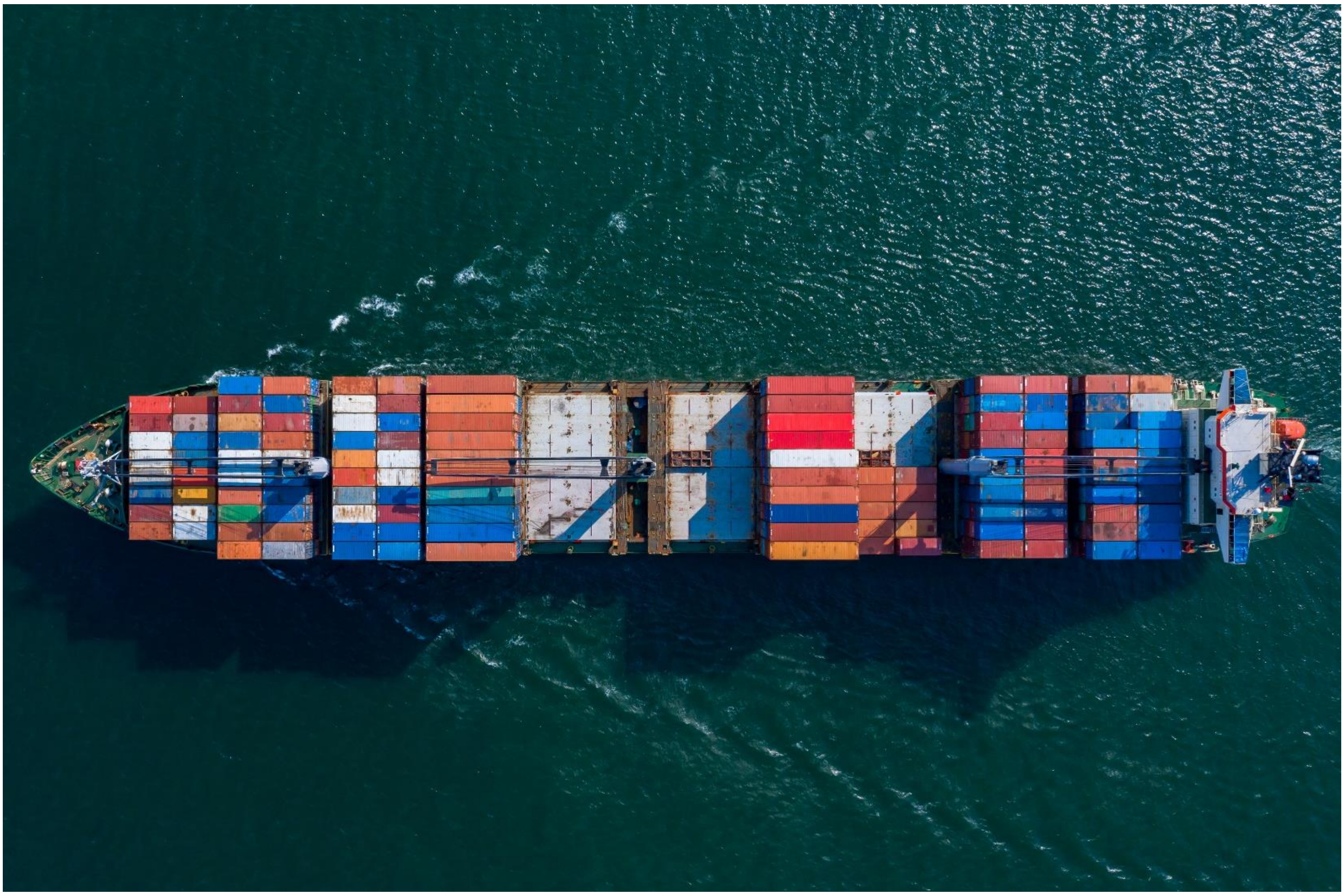
The sail ahead

What might swing India's exports, and what might not

November 2021



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Principal commodities riding on global growth

India's exports have been playing a key role in driving gross domestic product (GDP) growth this fiscal at a time when private consumption and investment are struggling to change course.

Last fiscal, when GDP contracted in the pandemic's wake, net exports (exports minus imports of goods and services) was the largest positive contributor to GDP growth. Particularly, goods exports, with a share of ~12% in GDP, was among the first to cross pre-pandemic levels, in the third quarter of fiscal 2021 itself.

Preliminary merchandise trade data[1] shows that the run continues — goods exports have grown more than 55% on-year this fiscal (April-October).

Buoyed, the Government of India has set a merchandise export target of $400 billion for the fiscal[2]. Achieving this would require an average 18.4% on-year growth in the remaining months.

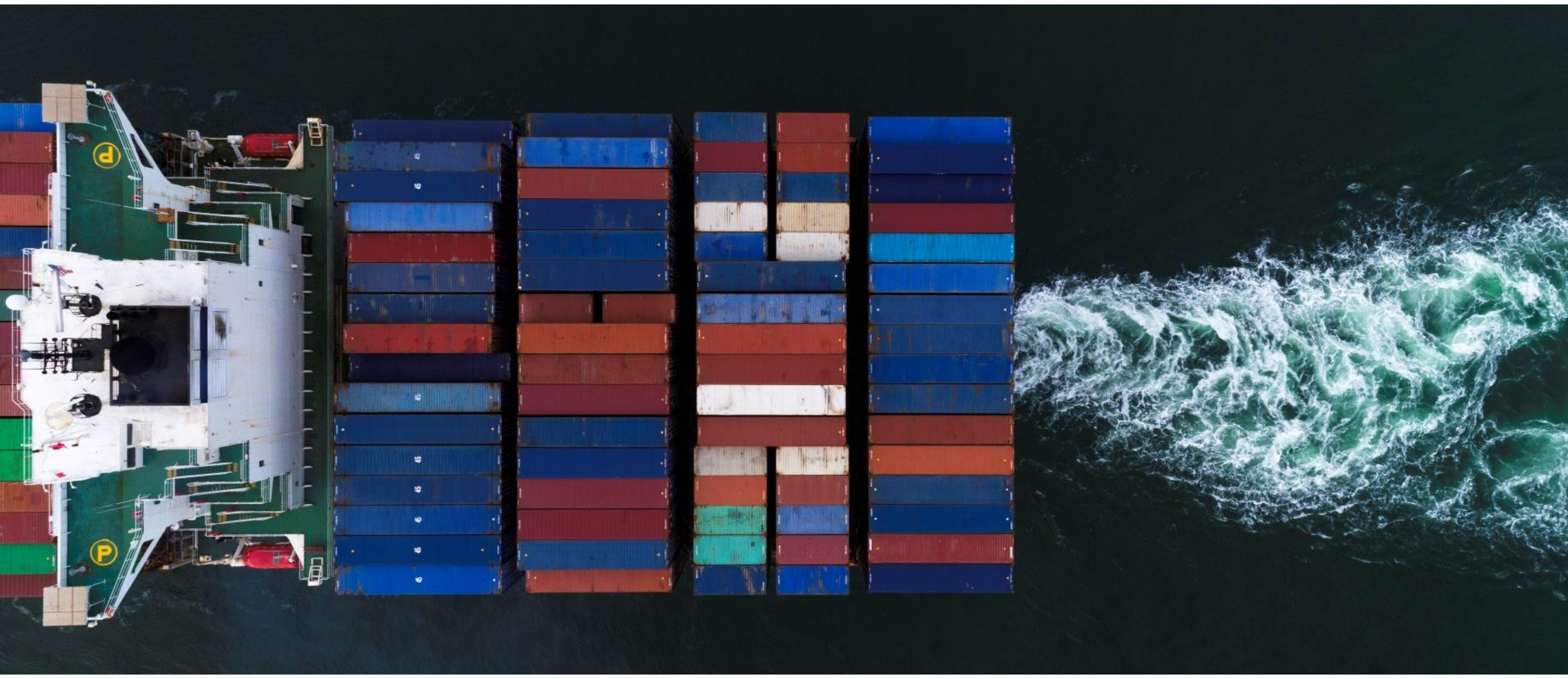
Global factors have clearly been providing leverage -revving up global growth, inventory restocking in early 2021 as economies opened up, and a pandemic-induced shift towards consumption of goods and away from services. For most of this year, India's exports have been lifted by the rising global tide.

Not all these factors may continue lending support, though. August and September saw a sequential decline in India's merchandise exports on a seasonally adjusted basis. But after that, there was some pick-up in October.

Our analysis of merchandise trade so far in this fiscal suggests that:

- India's post-pandemic merchandise exports surge has largely been driven by items with greater responsiveness to global growth. Incidentally, these also have a high share in India's exports basket
- That said, compared with the pre-pandemic levels, growth in merchandise export value in the current fiscal has outpaced growth in export volumes, which suggests that high international commodity prices have provided a disproportionate lift to exports
- Despite higher commodity prices, the terms of trade, or ToT (the ratio of export to import prices) remain in favour of exporters — but that, too, has narrowed of late
- India's exports may continue to benefit from a rise in external demand in the short run owing to their historically high responsiveness to global growth. But risks to global trade persist from supply-chain disruptions and material shortages, uncertainties around the impact of the Covid-19 delta variant, and medium-term scarring of global potential output

[1] Preliminary data released by Ministry of Commerce and Industry on November 1, 2021
[2] For reference, merchandise exports totalled $313.1 billion in fiscal 2020, and $290.9 billion in fiscal 2021



Which commodities have contributed to the spurt in exports?

In the current fiscal so far (April-October), merchandise exports[3] has grown more than 55% on-year, in value terms. To be sure, the massive growth comes over last year's low base. However, exports have also surpassed the pre-pandemic levels of the corresponding period in fiscal 2020 by ~26%. Apart from these, some mild improvement is also seen in India's share in global merchandise exports.

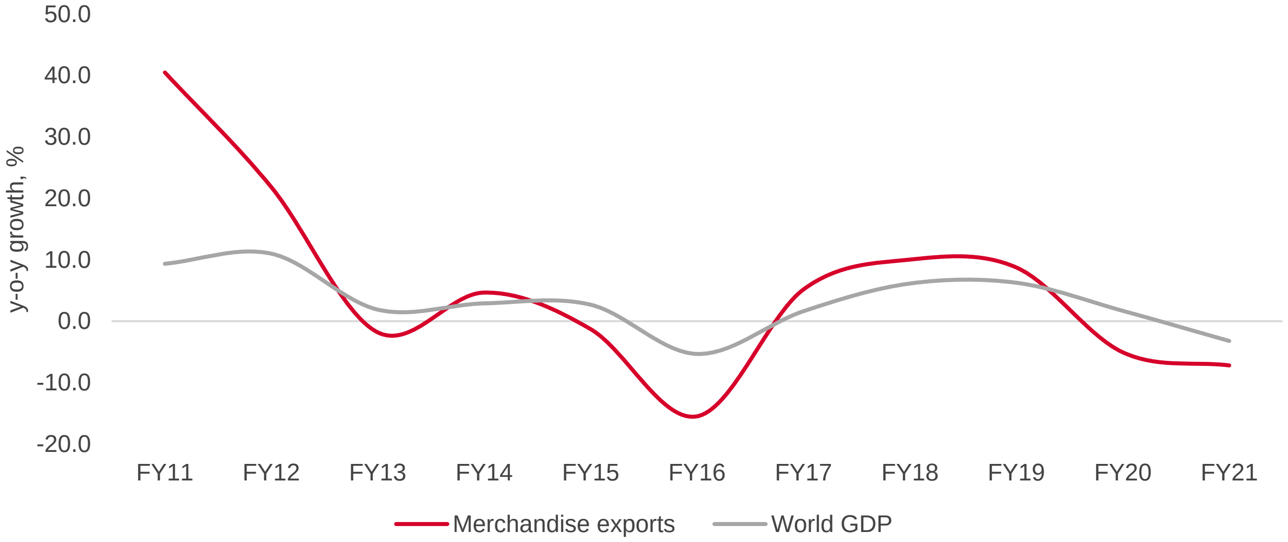
That India's merchandise exports has soared in line with the rebound in global growth this fiscal is not unexpected. Historically, India's exports have largely moved in-step with global growth.

For instance, in the post-global financial crisis years (fiscals 2011 and 2012), when fiscal and monetary stimulus supported global GDP, India's exports were on an upswing. Fiscal 2019, too, saw concomitant high global and exports growth (see figure below).

For the full decade (fiscals 2011 to 2019), export elasticity to global GDP was 1.7 on average, highlighting their high[4] responsiveness to global growth.

[3] In US dollar terms
[4] Absolute values of elasticity more than one is interpreted as high sensitivity to global growth. Elasticity is calculated as ratio of growth in exports to growth in world GDP

India's export growth has moved in lockstep with global GDP growth in the past decade



Note: FY21= 2020 for World GDP

Source: Ministry of Commerce and Industry, International Monetary Fund, CEIC, CRISIL

Commodity wise, those with relatively higher share in India's total merchandise exports have also exhibited high elasticity to global growth. These include engineering goods, petroleum products, gems and jewellery, and chemicals.

Exports of these commodities also show positive correlation to global growth

Principal commodities(share in merchandise exports, %)	Elasticity to global GDP growth					
	Engineering goods (25.1)	Petroleum product (13.4)	Gems and jewellery (11.4)	Organic and inorganic chemicals (7.1)	Drugs and pharmaceuticals (6.6)	Electronic goods (3.7)
FY15-19 average	**3.7**	**2.9**	**1.1**	**3.8**	**0.3**	**0.2**

Source: Ministry of Commerce and Industry, IMF, CEIC, CRISIL

A few of these commodities have been among the top five contributors to export growth this fiscal, and also during past years of high export growth (fiscals 2012 and 2019 – see table below). Moreover, the exports of these commodities have also crossed the pre-pandemic levels this fiscal.

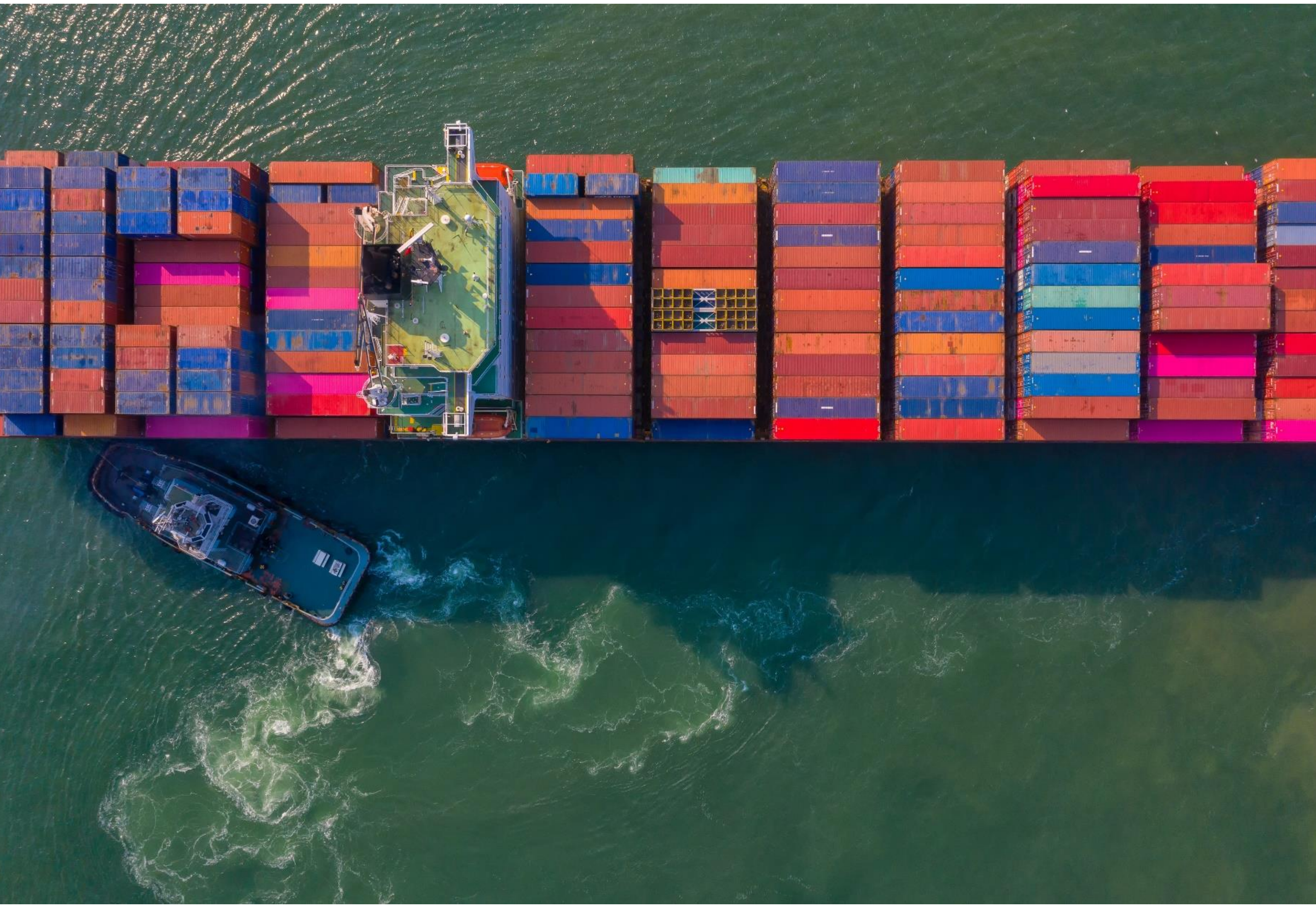
Cumulatively, this suggests that these principal commodities will continue to perform better so long as global growth stays strong.

The top five contributors to export growth this fiscal were also major drivers in the past

FY22 (April-October)	FY19	FY12
Engineering goods	Petroleum products	Petroleum products
Petroleum products	Engineering goods	Gems and jewellery
Gems and jewellery	Organic and inorganic chemicals	Cereals
Organic and inorganic chemicals	Electronic goods	Organic and inorganic chemicals
Electronic goods	Drugs and pharma	Drugs and pharma

Note: FY12 and FY19 also saw sharp, double-digit growth in crude oil prices, suggesting that high prices may have contributed to petroleum product exports driving merchandise exports

Source: Ministry of Commerce and Industry, CEIC, CRISIL



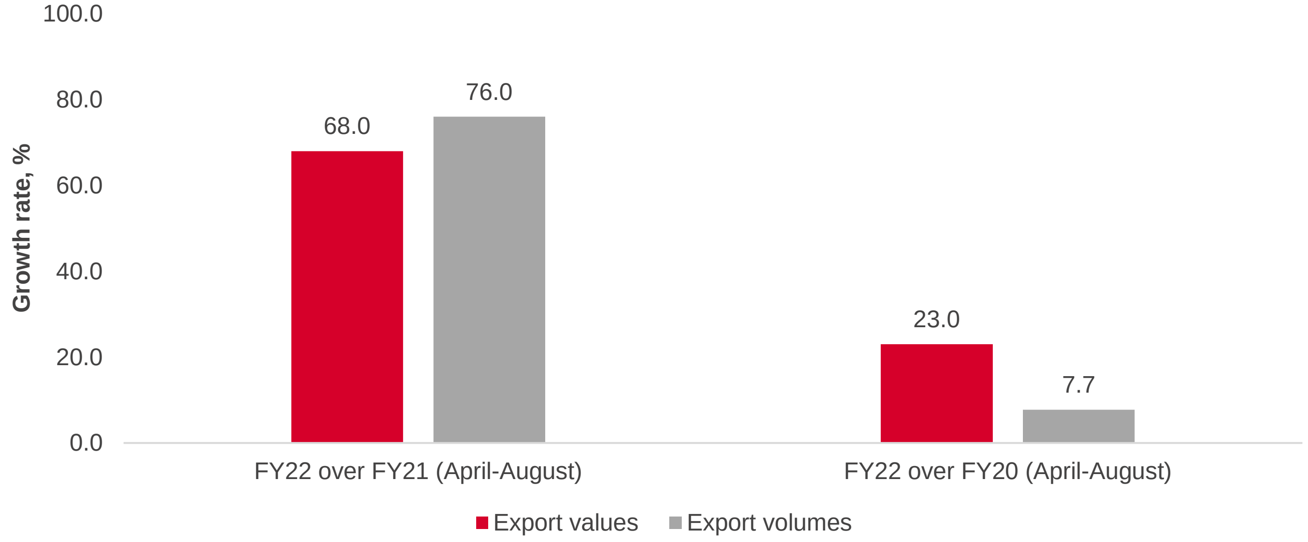
What's driving export growth — prices or volumes?

International commodity prices have been on an upswing in the current year. Crude prices have soared 93% on-year (on average, in April-October 2021), and metals and minerals prices, by ~57%. Both demand and supply factors are at play here: a rebound in industrial output in China in the initial months of 2021 and a strong recovery in the US put upward pressure on industrial commodity prices. For metals, supply constraints have driven the surge, owing to mining disruptions in key producing nations.

A rise in commodity prices affects India's exports, too. But even as we see high growth in *export value*, we need to separately assess what is happening to *volumes*. Data provided by the Directorate General of Commercial Intelligence and Statistics (DGCIS) on export quantity indices (QI) suggests that export volumes during April-August this fiscal rose a massive 76% over a low base of fiscal 2021.

Compared with fiscal 2020, or the pre-pandemic level, volumes are only up 7.7% (for the corresponding period), whereas the value of exports has risen 23%. Growth in volume, therefore, is lagging. Further, the volume increase this year was also much lower than the 5-year average (fiscals 2015 to 2019) growth in QI of 13.6%.

Export volumes show 'optically' higher growth over last year's low base, but it is lower than growth in value over the pre-pandemic period



Source: DGCIS, Ministry of Commerce and Industry, CRISIL

Impact of the commodity price shock on ToT

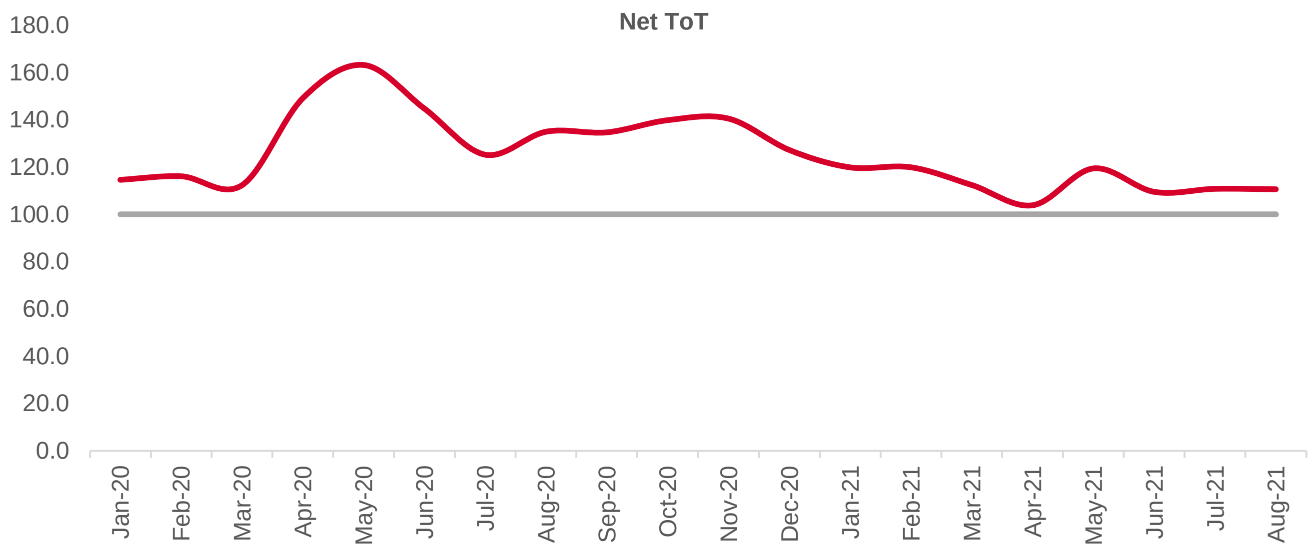
Note that a rise in international commodity prices affects imports too. Some of India's principal commodity exports have high import intensity (i.e. much of imports get translated into exports). Import intensity of petroleum and products, gems and jewellery, and drugs and pharma was as high as 91.4%, 63.2%, and 38.9%, respectively, in fiscal 2014 (ISID, 2020).[5] This can affect the earnings of exporters from specific commodities, as they are impacted by higher import costs.

Data provided by DGCIS suggests that in the current fiscal, the net ToT remains above 100 — implying that the relative price of exports is still higher than that of imports. However, ToT has trended down, particularly in this fiscal so far.

This suggests that import prices are now growing at a faster clip than exports. This affects the earnings of exporters, as a rise in import prices reduces the net earnings received through exports, even if the ToT is above 100 (given the high import intensity).

A few sectors are already seeing this. Domestic players in petrochemicals and pharmaceuticals are facing margin pressures owing to rising raw material costs. In the gems and jewellery sector, while rising demand is expected to aid profitability, higher rough diamond prices could curtail margin expansion.

The ToT advantage is slowly petering out



Note: Value above 100 implies export prices are higher than import prices

Source: DGCIS, Ministry of Commerce and Industry

[5] M. Paul, R. Kumar, "Import Intensity of India's Manufactured exports: an Industry level analysis", Institute for Studies in Industrial Development, February 2020

Why is India's exports momentum slowing?

In September, India's merchandise exports declined on a seasonally adjusted basis for the second consecutive month. The slowdown in exports corresponds to a loss in the momentum in global trade, reasons for which are mostly supply-driven. As major advanced economies reopened in 2021, rising demand chased constrained supply owing to container shortages (which then fed into higher shipping costs), and semiconductor and chips shortage, etc.

Further, major export hubs in Asia, including China, Vietnam, Indonesia, Malaysia, were hit by a surge in delta variant in mid-2021, which further constrained industrial production. For India, the resultant sequential decline in exports in September was largely reflected in slowdown in exports to China and Association of Southeast Asian Nations, or ASEAN. Some mild weakness was also seen in exports to the US. Commodity wise, exports of engineering goods, drugs and pharmaceuticals, and gems and jewellery have seen a softening of momentum on-month.

In October, though global manufacturing remained in expansion mode, as suggested by IHS Markit and JP Morgan's Global Manufacturing PMI, the rate of expansion was the slowest in 16 months. It stated that "near-stalling of international trade flows", "disruption to raw material deliveries" and the resulting input shortages were the reasons behind slowing of output. Global supply chains remained under pressure, and supplier performance deteriorated across industries (source: IHS Markit Press Release, November 2021).

What lies ahead?

Global GDP and trade indicators look upbeat, and that's good news for India's exports. Global GDP growth is expected to stay strong this calendar year and next. S&P Global[6] forecasts it at 5.8% and 4.4%, respectively, both much higher than the decadal average. Global trade too, is forecast to be ~28% higher in 2021 on-year, according to the United Nations Conference on Trade and Development (UNCTAD). Advanced economies (AEs) in particular, are expected to recover faster from the pandemic, given "faster reopening amid limited projected scarring of potential output"[7]. Given the high positive elasticity of India's exports to global growth and the impetus from external demand of AEs, we have enough reason to believe that exports will drive GDP growth this fiscal. This optimism is supported by the fact that merchandise exports to AEs account for ~48% of India's total exports historically and have contributed ~50% to export growth this fiscal.

But risks to global trade persist, both in the short and medium term. A recent UNCTAD report[8] states that the momentum seen in global trade in 2021 may be short-lived, as it partially reflects an inventory restocking cycle in 2021 after very low inventory-to-sales in 2020 owing to the pandemic. Further, the spread of the delta variant, especially in AEs, shows that while vaccines may blunt the virus, they do not defeat it. This could also affect external demand. On the supply side, if bottlenecks in international shipping and material shortages persist, the resultant spike in input costs may also act as an impediment (see box on '*Why is India's exports momentum slowing?*').

Over the medium term, trends in trade protectionism (seen before the pandemic) and continued trade tensions between the US and China may affect global trade. Lastly, the pandemic has itself weakened fundamental drivers of global growth, which will reflect in lower potential growth prospects over the next decade[9].

PLI scheme will be a crucial bridge between short-term opportunities and longer lasting export growth. The post-pandemic spurt in global trade in 2021 thus offers a short-run opportunity for Indian exports to ride the rising tide. The government has targeted $400 billion in merchandise exports for this fiscal, of which ~58% has been achieved in the first seven months.

It has also set an ambitious target of $1 trillion in exports by fiscal 2025[10]. This will, in big part, depend on the success of the production-linked incentive (PLI) scheme. The scheme has given a much-needed booster dose to capital expenditure and is expected to raise industrial capex worth 2.2 lakh crore over the scheme period. Sectors such as pharmaceuticals, telecom equipment, mobile, and electronics are expected to see more greenfield capex led by PLI[11]. Enhancing domestic production capacity would also open avenues for exports in hitherto import-dependent sectors. Additionally, improvement in export competitiveness through a focus on reduction in trade costs would also help convert this opportunity into a longer-term consolidation of India's share in global trade.

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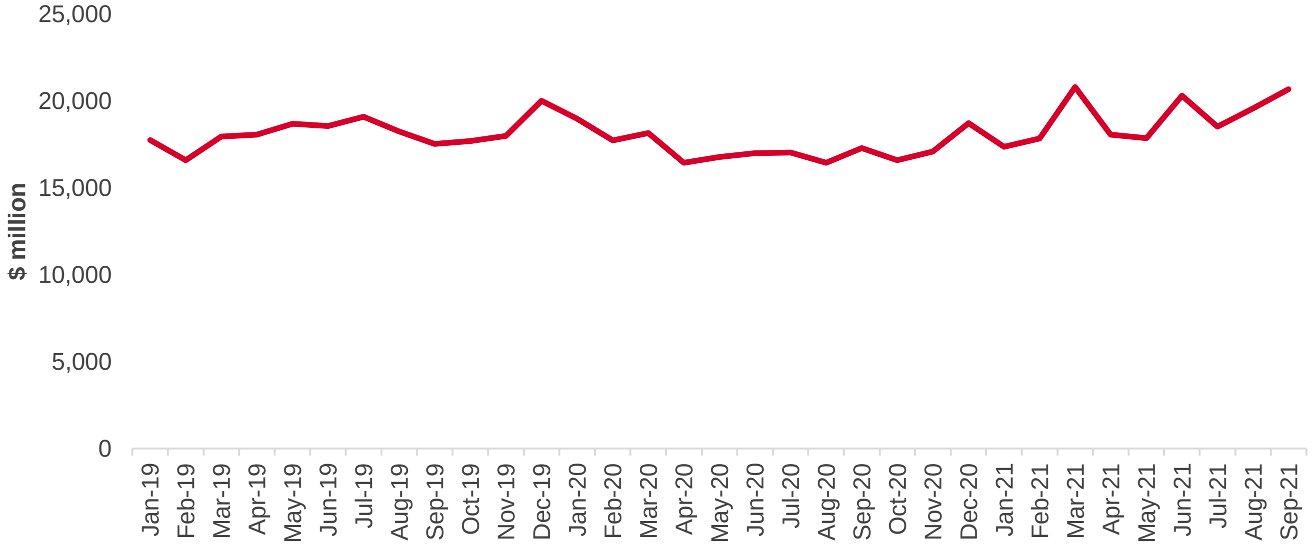
[6] October 2021
[7] World Bank, June 2021
[8] Trade and Development Report, September 2021, UNCTAD
[9] World Bank, January 2021
[10] See Business Standard (December 2020), https://www.business-standard.com/article/economy-policy/will-meet-1-trn-export-target-by-25-says-goyal-industry-seeks-more-help-120120300006_1.html
[11] Read CRISIL's October 2021 report '*Stage set for private investment cycle'* for more details

Annexure

Lagging services exports growth expected to pick up as economies reopen further

India's services exports account for ~8% of GDP. The pandemic led to a contraction in services exports by 5.4% last fiscal. While merchandise exports had started showing signs of recovery towards the end of fiscal 2021, and spurted further this fiscal 2022, growth in services exports lagged. It grew merely 14% (that too, on a low base) in the first half of this fiscal vs over 50% for merchandise exports. It has managed to cross its pre-pandemic level, though.

Services exports shows slight uptick in September



Source: Ministry of Commerce and Industry, CEIC, CRISIL

Slower growth in services exports vis-à-vis merchandise exports is attributed to the shift in consumption behaviour during the pandemic towards goods and way from services. Recall that services were among the worst hit during the pandemic, owing to social-distancing restrictions.

Globally too, several types of services trade remained depressed till mid-2021, such as tourism, transport, maintenance and repair, and recreational services. On the other hand, trade in information technology and financial services, have benefitted due to increased remote work and rise in activities conducted over the internet (UNCTAD, September 2021). There thus exists not only a sectoral divide between services and goods in terms of recovery, but also within the services sector — between financial and digital services, on the one hand, and the contact-based hospitality and entertainment sectors, on the other.

Learning to live with the virus, reopening of most major economies, progress in vaccinations and gradual normalisation in demand patterns are expected to result in partial recovery in services exports this fiscal.

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