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India's Trade Reality: Goods Trade Imbalance with China Spikes

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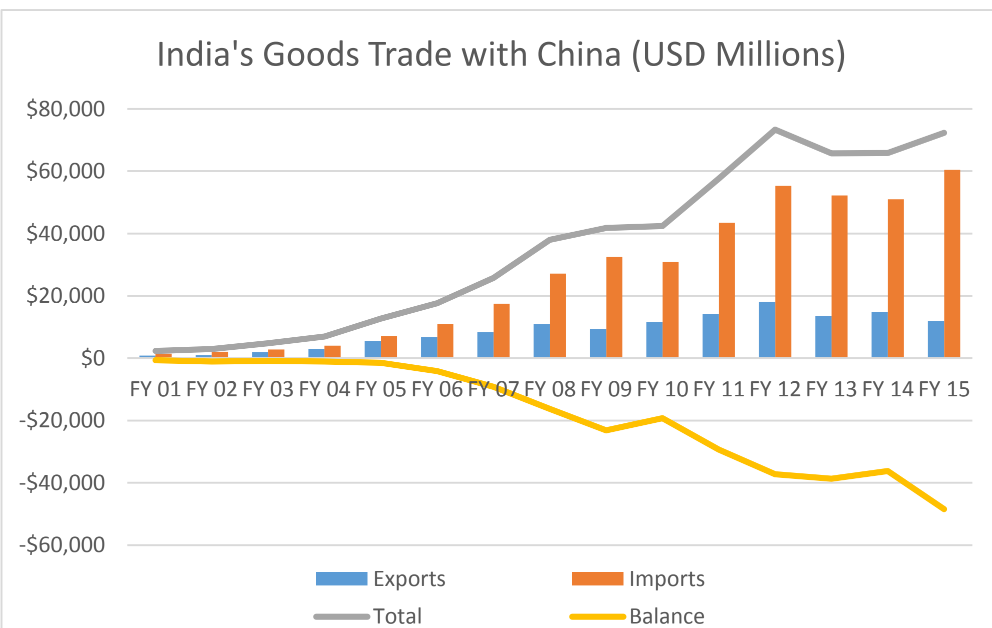
India's Ministry of Commerce and Industry recently released its country-by-country trade data for fiscal year 2015. Alarmingly, the nation's trade deficit with China has spiked by 34 percent to $48.5 billion—nearly 3 percent of the nation's GDP. It was the quick rise of a big trade deficit with China that fueled India's adoption of mandatory local manufacturing rules in 2010. This new set of data means that the pressure to maintain such rules is not likely to abate any time soon—underscoring the need for the U.S. government to maintain its pursuit of positive economic cooperation in other areas.

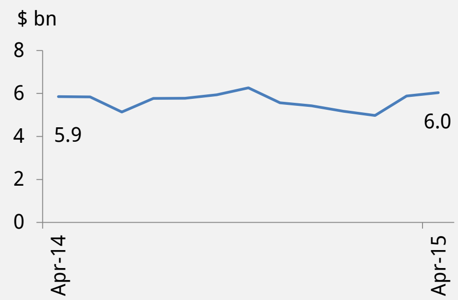
Far too often, the fact that China has grown to be India's largest trading partner in goods is pointed to as proof of a burgeoning relationship. Total trade between India and China was $72 billion in FY 2015, about $8 billion higher than with the United States, which is India's second-largest trade partner. Yet the size and growth of India-China trade masks a more disconcerting problem—China enjoys a 4-to-1 surplus in its goods trade with India. This trade imbalance has triggered several policy measures from New Delhi, particularly compulsory local manufacturing rules, which have riled U.S. companies and triggered a variety of reactions in Washington, D.C.



Ahead of India's release of its country-specific trade data, there were clear signs of a further weakening of the nation's trade balance with China. In mid-April, the Commerce Ministry released a big-picture review of the nation's balance-of-trade for FY 2015. The ministry revealed that, despite a 16 percent drop in India's oil import bill, the nation's net trade deficit increased by nearly 1 percent.

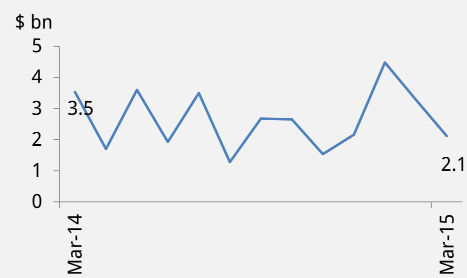
KEY DATA

+5.5%



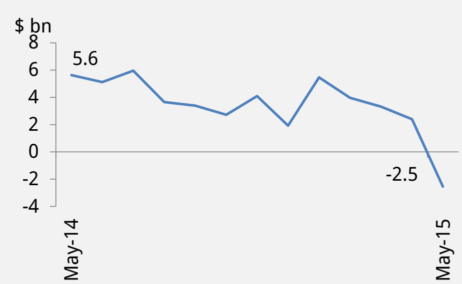
Increase in U.S.-India goods trade, 12-month rolling average, per U.S. Census*

+40.8%



Increase in FDI, 12-month rolling average, per DIPP

+415.3%



Increase in FII, 12-month rolling average, per NSDL

*Same as previous newsletter

India's overall trade deficit came in at $137 billion in FY 2015. This is well below India's peak trade deficit of $190 billion from FY 2013. Maintaining a high trade deficit has not caused a dramatic outflow of the nation's foreign currency reserves. India's current account deficit is relatively stable at 1 percent of GDP, buoyed by remittances and India's dynamic services trade. And India's capital account remains healthy, as foreign investment has started to pick up again. However, economic policymakers often look at a country's industrial capacity as foundational to economic stability. Stimulating the rapid escalation of local manufacturing has been a cornerstone of the Narendra Modi government in its first year, most notably through the "Make in India" campaign and accompanying reforms such as increases in foreign direct investment (FDI) caps, opening new sectors for private industry, and lengthening industrial licenses.

It is interesting to note that despite U.S. concerns over India's compulsory local manufacturing rules, we have seen a surge of U.S. exports to India in recent months. In the most recent 12-month period, U.S. exports to India have grown a bit faster (6.8 percent) than our imports from India (5.2 percent), as compared to the previous 12 months. This pace has accelerated in 2015, with U.S. exports to India growing 14.4 percent in January-April 2015 over the same period the year before. U.S. imports from India barely grew at all. It is critical that the United States begin to achieve greater parity in its goods trade with India. However, the downside is that a resurgence in U.S. exports to India at a time when India's deficit with China is expanding could add further pressure in New Delhi to look for quick ways to offset these trade flows.

So the precarious trade triangle between the United States, India, and China will remain an important factor in U.S.-India relations. India's imbalance in goods trade may increase New Delhi's appetite to maintain or expand market access restrictions and may reduce interest in fully embracing agreement-based trade liberalization through the World Trade Organization or other pending trade agreements. The overall positive direction of our bilateral relationship provides greater scope to engage on trade barriers. Getting a strong article covering "Performance Requirements" in our Bilateral Investment Treaty talks (which is in the U.S. model, but not in India's revised model) can also alleviate some of these concerns. But ultimately the pressures will likely persist unless "Make in India" is a success.

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