



INDIA-UK TRADE

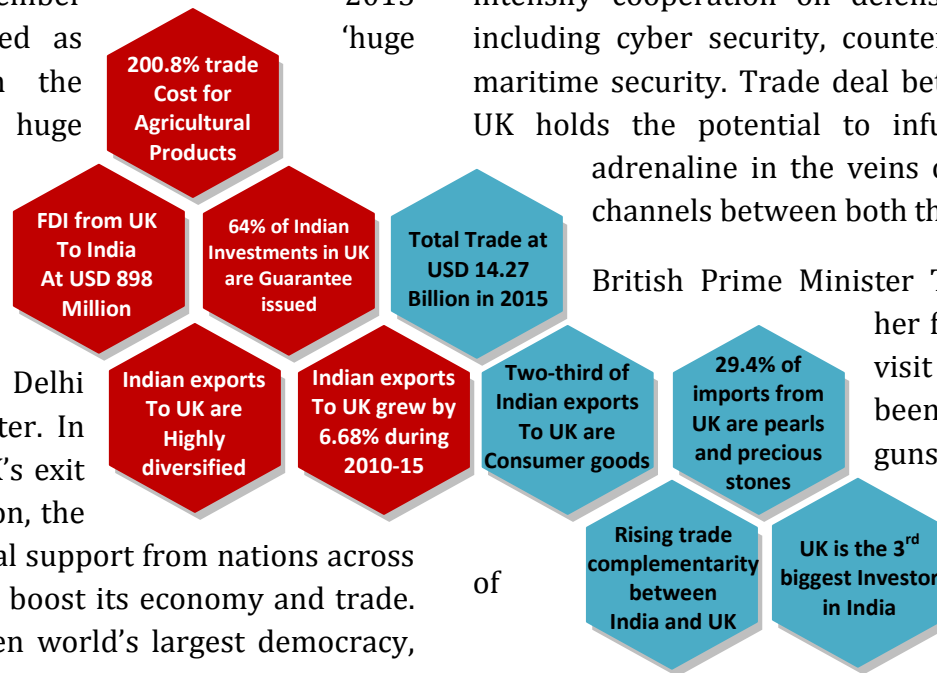
POTENTIAL WAITING TO BE UNLOCKED

PHD RESEARCH BUREAU

PHD CHAMBER OF COMMERCE AND INDUSTRY

INDIA-UK TRADE: POTENTIAL WAITING TO BE UNLOCKED

Prime Minister Shri Narendra Modi's visit to UK in November 2015 was captioned as 'huge moment for both the nations'. Another huge moment for India and UK arrived when British Prime Minister Theresa May arrived at New Delhi exactly one year later. In the aftermath of UK's exit from European Union, the nation seeks external support from nations across the globe to further boost its economy and trade. The rapport between world's largest democracy, viz. India, and world's oldest democracy, viz. UK, can be defined as cordial and accentuating. India has continuously engaged in upgradation of its existing relationship with UK, from mere bilateral trade partners to close strategic partners. Both nations have sought to establish fundamental principles framework to further deepen cooperation. Also, agreed to hold biennial summits for discussions on Defense and



International Security Partnership, which aims to intensify cooperation on defense and security, including cyber security, counter terrorism and maritime security. Trade deal between India and UK holds the potential to infuse tremendous adrenaline in the veins of existing trade channels between both the nations.

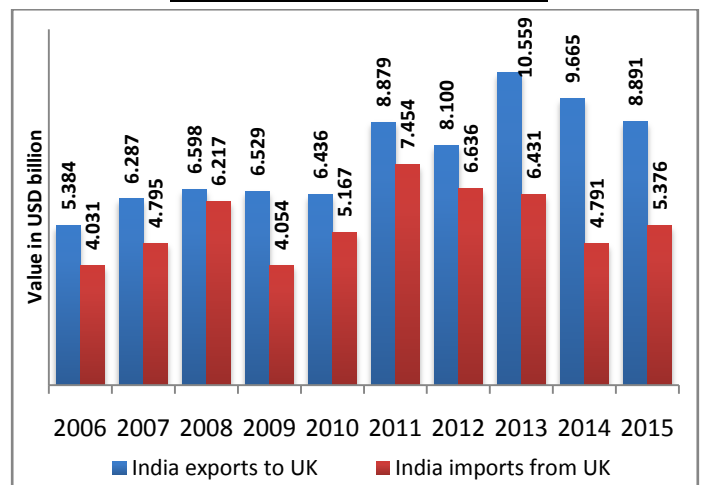
British Prime Minister Theresa May, in her forthcoming first visit to India, has been aiming to go all guns blazing with the development of India-UK strategic partnership and evolving the relationship to new heights, especially in the field of business and investments. The upcoming three-day delegation meet will entirely focus on accentuating business and investments in both the nations, and find a middle ground for India-UK preferential agreement.

* Trade Dynamics between India and UK

India and UK have expanded their trade relations from USD 9.415 billion in 2006 to USD 14.267 billion in 2015. However, in the recent past, the trade figures between two nations also touched an unprecedented USD 17 billion in 2013. Since then, trade has dropped further.

Furthermore, imports from UK have witnessed signs of revival in the last few months whereas drop in exports has been moderated.

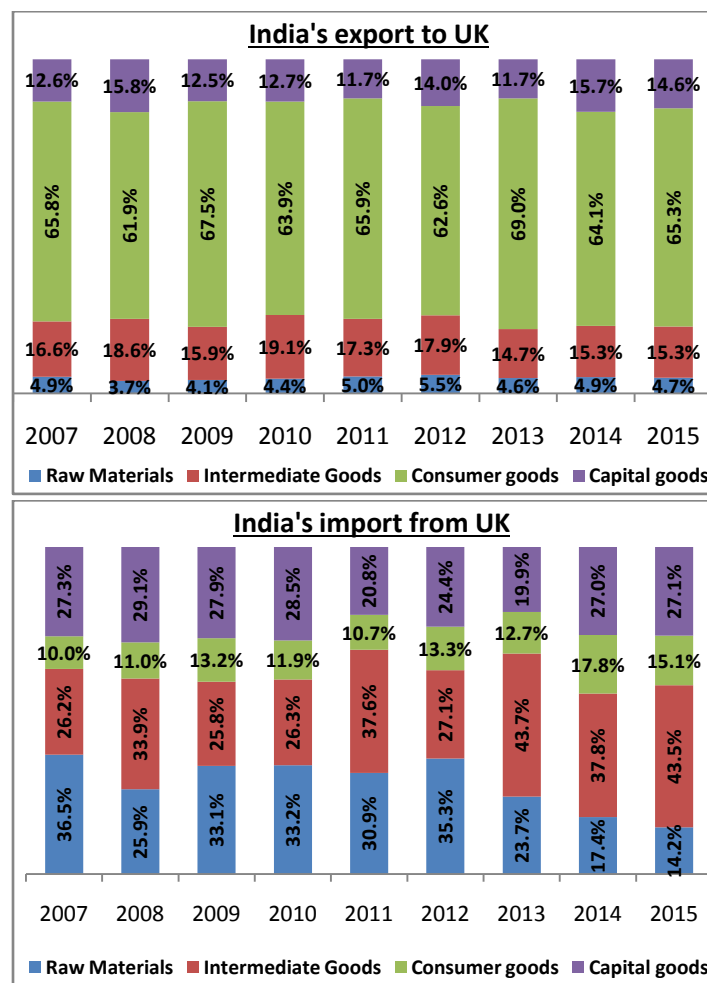
India - UK Trade at a Glance



| USD million | 2006 | 2010 | 2015 |
|------------------------------------|---------|---------|---------|
| India imports from UK | 4.031 | 5.167 | 5.376 |
| Share in India's total imports (%) | [2.26%] | [1.48%] | [1.38%] |
| CAGR imports | - | [6.4%] | [0.80%] |
| India exports to UK | 5.384 | 6.436 | 8.891 |
| Share in India's total exports (%) | [4.44%] | [2.92%] | [3.36%] |
| CAGR exports | - | [4.57%] | [6.68%] |
| India's trade surplus | 1.353 | 1.27 | 3.516 |
| TOTAL TRADE | 9.415 | 11.603 | 14.267 |

Source: PHD Research Bureau; Compiled from Trademap

India has been running in trade surplus with UK for long, which has further grown USD 1.353 billion in 2006 to USD 3.516 in 2015. Importantly, both the nations should focus on developing overall trade than trade surplus.



Source: PHD Research Bureau; Compiled from WITS

Majority of the exportable goods from India to UK are focused in the consumer goods segments, viz.

nearly 66%. The rest, viz. Raw materials, intermediate goods, and Capital goods, comprised only 34% of the share. The trend in the basket of goods, based on level of processing, has remained consistent for a long time.

Conversely, basket of import from UK has gradually shifted from raw materials to intermediate goods. In 2007, nearly 37% of the imports from UK comprised of raw materials; followed by capital goods and intermediate goods, each held share of 27%. After 8 years, intermediate goods captured the majority share in overall imports from UK to India, viz. 44%, followed by 27% share of capital goods, 15.1% share of consumer goods, and 14.2% of raw materials.

Top 10 imported items from UK

| HS Code | Product Description | 2015 | | |
|---------|---|----------------------------|--------------------------------|-----------------------------|
| | | Imported Value USD million | Share in total imports from UK | Share in imports from World |
| 71 | Natural or cultured pearls, precious or semi-precious stones | 1581.381 | 29.42% | 2.65% |
| 84 | Machinery, mechanical appliances, nuclear reactors, boilers | 699.053 | 13.00% | 2.18% |
| 72 | Iron and steel | 422.719 | 7.86% | 3.61% |
| 85 | Electrical machinery and equipment and parts thereof | 348.679 | 6.49% | 0.97% |
| 90 | Optical, photographic, cinematographic, measuring, checking, precision | 268.682 | 5.00% | 3.74% |
| 76 | Aluminum and articles thereof | 221.224 | 4.12% | 6.12% |
| 22 | Beverages, spirits and vinegar | 204.43 | 3.80% | 36.61% |
| 88 | Aircraft, spacecraft, and parts thereof | 173.528 | 3.23% | 6.13% |
| 39 | Plastics and articles thereof | 133.063 | 2.48% | 1.17% |
| 87 | Vehicles other than railway or tramway rolling stock, and parts and accessories thereof | 107.711 | 2.00% | 2.18% |

Source: PHD Research Bureau; Compiled from trademap

Top imported items from UK comprised of natural pearls and precious stones (29.42%), followed by machinery and mechanical appliances (13%), iron

and steel (7.86%), electrical machinery and equipment (6.49%) among others. Interestingly, beverages, spirits and vinegar imports from UK form a significant share in the overall imports from world. Around 37% of the imports of beverages, spirits, and vinegar in India are from UK.

Top 10 exported items to UK

| HS Code | Product Description | 2015 | | |
|---------|---|----------------------------|------------------------------|--------------------------------|
| | | Exported Value USD million | Share in total exports to UK | Share in overall imports in UK |
| 62 | Articles of apparel and clothing accessories, not knitted or crocheted | 909.339 | 10.23% | 6.93% |
| 61 | Articles of apparel and clothing accessories, knitted or crocheted | 897.695 | 10.10% | 6.72% |
| 84 | Machinery, mechanical appliances, nuclear reactors, boilers | 678.888 | 7.64% | 0.88% |
| 71 | Natural or cultured pearls, precious or semi-precious stones | 522.723 | 5.88% | 1.63% |
| 87 | Vehicles other than railway or tramway rolling stock, and parts and accessories thereof | 491.600 | 5.53% | 0.63% |
| 64 | Footwear, gaiters and the like; parts of such articles | 483.730 | 5.44% | 6.62% |
| 30 | Pharmaceutical products | 457.815 | 5.15% | 1.36% |
| 85 | Electrical machinery and equipment and parts thereof | 399.089 | 4.49% | 0.66% |
| 73 | Articles of iron or steel | 307.013 | 3.45% | 3.38% |
| 42 | Articles of leather; saddlery and harness; travel goods, etc. | 292.514 | 3.29% | 8.02% |

Source: PHD Research Bureau; Compiled from trademap

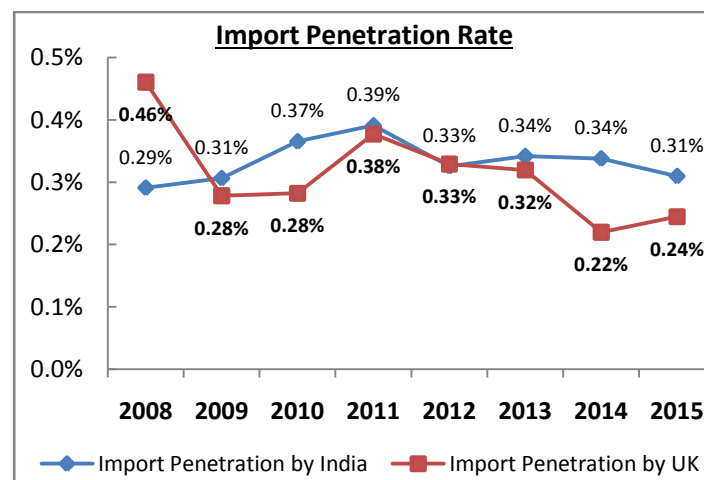
Among top exported items to UK, Apparels and clothing accessories, both knitted and non-knitted, attained the top position. Approximately, 21% of the Indian exports to UK are in the form of apparels and clothing accessories. It is followed by machinery (7.64%), natural pearls and precious stones (5.88%), and others.

Other top products exported by India to UK's market include vehicles, footwear, pharmaceuticals, iron and steel articles. It can also be highlighted that around 13.5% of the overall

UK's import demand for apparels and clothing accessories is fulfilled by India. Similarly, around 8% of the UK's import demand of leather articles, travel goods, etc is fulfilled by India.

* Bilateral Trade Analysis and Interpretation

Import Penetration (IP) Rate examines the degree of domestic demand (the difference between GDP and net exports) is satisfied by imports. It is also termed as self-sufficiency ratio at the sectoral level. At bilateral level, it is the ratio of total imports from trade partner to domestic demand, as a percentage. It provides a broad scenario of the degree of vulnerability to certain types of shocks in the partner's economy. IP rate lies between 0 (no imports) to 100%¹ (when all domestic demand is satisfied by imports only) – a case of no-domestic production.

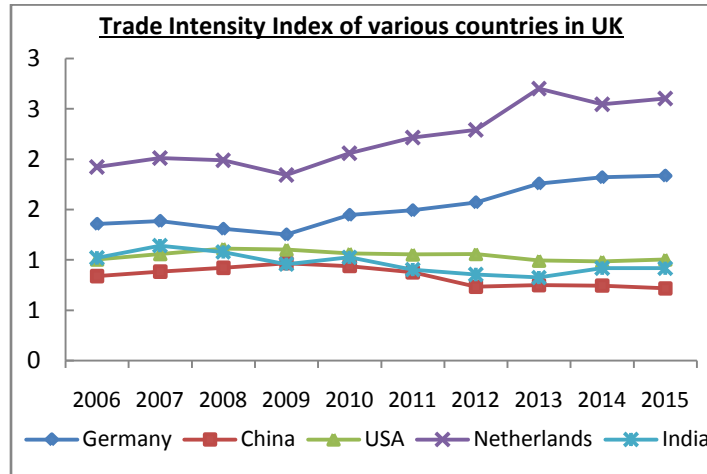


Source: PHD Research Bureau;

Based on the import penetration chart, India's penetration in UK's economy is comparatively more than UK's penetration in Indian economy. However, the import penetration by UK in India has witnessed a surge in the recent few years. India's penetration rate in UK has hovered in the range of 0.3% – 0.4%. Due to low penetration rate, the impact of Brexit was at its minimal in India.

¹ During application, Index can go beyond 100% if re-exports are not accounted for.

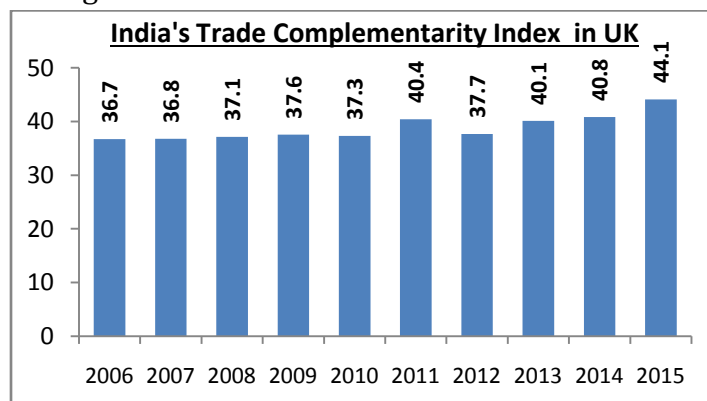
Trade Intensity Index (TII) is a uniform export share that describes whether a country exports more or less to a destination than world does on average. TII value greater than 1 indicates an intense trade relationship, or significant presence of exporter nation in importer's market.



Source: PHD Research Bureau;

It is quite clear from the chart above that compared to Netherlands and Germany, India's presence in UK is at the lower side. Even other top exporters in UK such as China and US, are not able to create a significant presence in UK. However, India's TII has been gradually and consistently growing over the years.

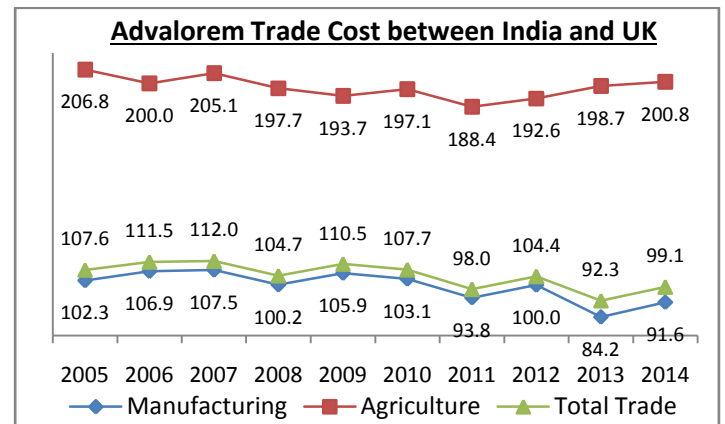
Trade Complementarity Index (TCI) is a nuanced overlap index wherein the index exhibits the degree of alignment of export pattern of one country with the import pattern of its partner's country. A high degree of TCI assumed to indicate more favourable prospects for a successful trade arrangement.



Source: PHD Research Bureau;

It is quite evident from above that India's export pattern is increasingly in tandem with UK's import pattern. In case of lower trade barriers, Indian exports have rising growth prospects in UK's market. Over the years, the pattern of products exported by India has become more and more aligned with the pattern of products that UK imports from the world.

Trade cost analysis provides an optimal viewpoint to access the overall cost as a percentage of overall export, which is incurred during trade between two nations. Trade costs are the price equivalent of the reduction of international trade compared with the potential implied by domestic production and consumption in the origin and destination markets. Higher bilateral trade costs result in smaller bilateral trade flows.



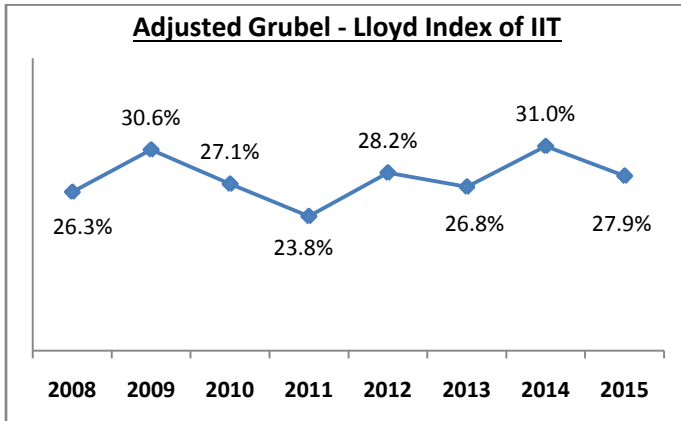
Source: PHD Research Bureau;

The major impediment faced by Indian products is from the category of Agricultural products. On an average, agricultural products face a staggering 200% of trade cost. On the other side, manufacturing products face one of the lowest trade cost, viz. around 92% in 2014.

In a nutshell, at an aggregate level, trade cost has witnessed a sudden surge in 2014 primarily on the back of rising agricultural trade cost and abrupt rise in manufacturing trade cost as well.

Grubel - Lloyd Index (GLI) is an indicator to measure the scale of intra-industry trade between nations. Nations can hugely benefit from intra-

industry trade due to exploitation of economies of scale. GLI lie between 0 and 100%, wherein 0 indicates pure inter-industry trade and 100% indicates pure intra-industry trade. Adjustments are made if there are any total trade imbalances in a country.

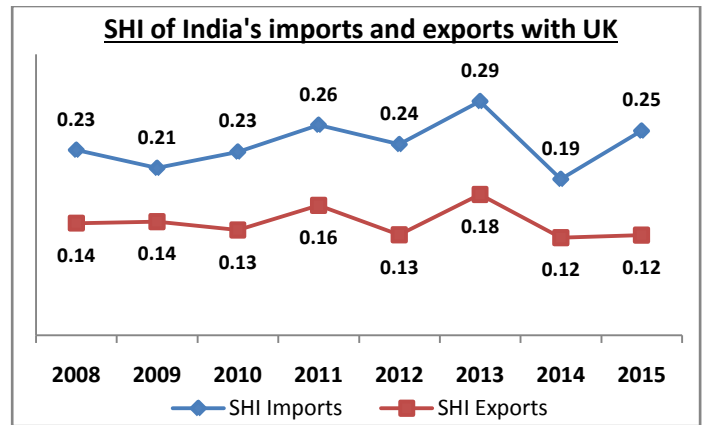


Source: PHD Research Bureau;

India and UK's intra industry trade have remained on the moderate side. Although, satisfactory performance at IIT level, trend in adjusted GLI suggests a significant drop since 2008.

Based on the adjusted GLI numbers, around 27.9% of the trade is intra-industry trade form in 2015. Intra-industry trade between India and UK, however, witnessed a drop in rate from 31% in 2014. To develop trade further, it is essential for both the nations to continuously indulge in high intra-industry trade to exploit the economies of scale.

Sectoral Hirschman Index (SHI) indicates the sectoral concentration of a region's exports. It describes the degree to which a nation's exports are dispersed across different economic activities. SHI lie between 0 and 1 wherein value closer to 1 indicates that exports are concentrated in fewer sectors.



Source: PHD Research Bureau;

Compared to imports from UK, India's exports are more diversified. Although both imports and exports from UK are on the lower plane for degree of concentration, imports witnessed a plummet in diversification in the basket of products from UK. Thus, imports from UK are relatively more focused on fewer products than India's export to UK.

The crux of the above trade analysis suggest that there lies huge potential of growth in trade between India and UK, on the back of rising trade complementarity, intensity and moderation in trade costs. To further trade prospects, a serious attempt has to be made by both nations to develop intra-industry trade, viz. continuously engage in trading of products from similar industries.

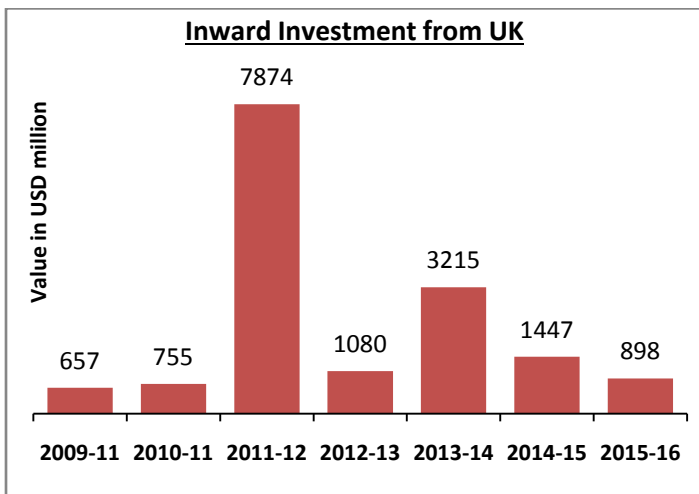
* The Investment Story

During the launch of the marquee "Make in India" campaign, Prime Minister Shri Narendra Modi asserted that FDI is a responsibility of Indians and an opportunity for the world. The definition of FDI, in his dictionary, for the people of India is 'First Develop India'. Undoubtedly, collaboration of India and UK in the realm of investment and business can truly transform both the nation's entrepreneurial ecosystem.

Britain has invested nearly USD 22.002 billion as FDI in various forms. Of total FDI, Britain ranked 3rd with of 8.93%, preceded by Mauritius and Singapore.

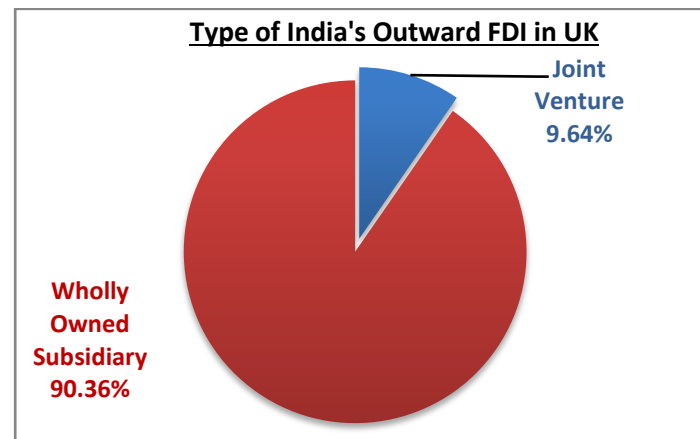
In the past 16 years, UK has invested nearly USD 22 billion in various forms of Foreign Direct Investment in India. It has been ranked 3rd biggest investor in India, preceded by Mauritius and Singapore.

On the flip side, India has invested around USD 1.25 billion in UK between 1st Nov 2015 and 30th Sep 2016. Of total outward FDI in India, UK's share stood at 5.33% for the aforementioned period. Around 90% of the investments, based on the control and business structure, are in Wholly owned subsidiaries while the rest are in Joint Ventures, during the same period.



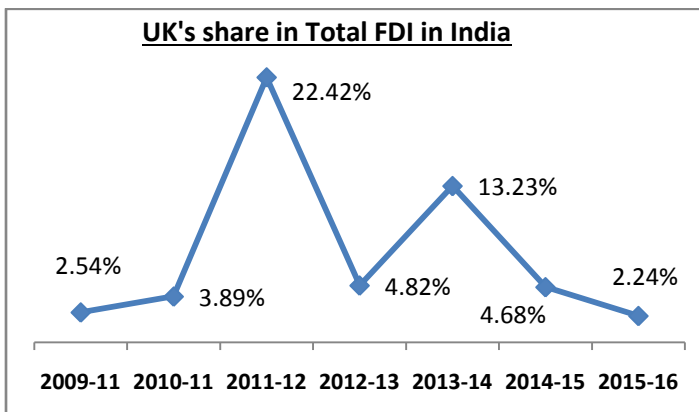
Source: PHD Research Bureau;

Based on recent FDI statistics, India has been able to attract USD 898 million during April 2015-March 2016. Compared to the investments by UK in 2011-12, the share in 2015-16 is miniscule.



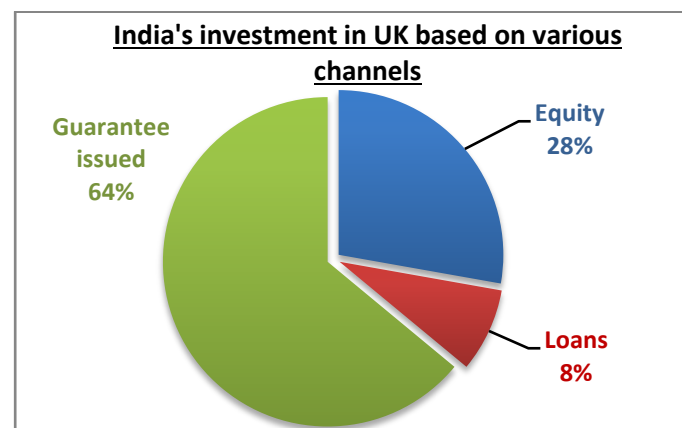
Source: PHD Research Bureau;

On the investment route front, India has preferred guarantees issued channel relatively more than Equity and Loans channel of investment during Nov 2015 – Sep 2016. Around 64% of the investments from India were channeled in UK through guarantees issues, followed by equity (28%) and loans (8%).

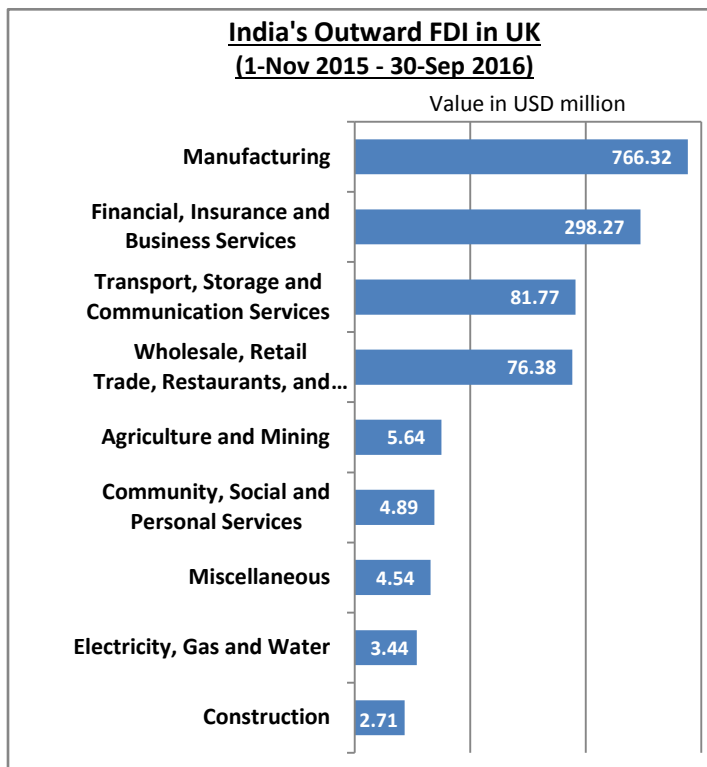


Source: PHD Research Bureau;

As far as share goes, in the overall FDI attracted by India, the numbers registered mundane performance. Although UK is the third biggest investor in India, there is an urgent need to revive the falling share of UK in the recent past. However, recently implemented conducive business policies and initiatives such as liberation of FDI norms, forthcoming GST mechanism, among others will truly propel the inward investments in a fast mode.



Source: PHD Research Bureau;



Source: PHD Research Bureau;

Further elaborating into India's investment in UK revealed that majority of investments were in the Manufacturing sector, viz. around USD 766.32 million; followed by Financial, Insurance and Business services (USD 298.27 million); Transport, Storage and communication services (USD 81.77 million). The lower order includes construction sector with USD 2.71 million and electricity, gas and water with USD 3.44 million worth investments.

* Conclusion

India and UK relationship is bound by long history. India holds the position of being the fastest expanding economy in the world at 7.6% in FY 2016-17.

Prospective bilateral agreement and growth avenues would push trade between India and UK to USD 20 billion by 2020 from the current level of at around USD 14.3 billion in 2015-16.

Indian exports into UK are mainly focused on Consumer Goods, viz. nearly 65% of the total exports. On the other hand, nearly 43.5% of the

total imports from UK are focused on Intermediate goods.

Although the trend in India's exports to UK has remained in favour of consumer goods over the years, India's import from UK underwent dramatic shift from raw materials, viz. 36.5% of the overall imports from UK during 2007, to intermediate goods, viz. 43.5% presently.

India's penetration in the UK's market has remained consistent, UK's penetration rate revealed signs of substantial revival in the recent past. Also, Indian products hold significant footprint in the UK's market based on the intensity index of India in UK.

India's export pattern has become more and more aligned with the import pattern of UK over time. Both nations witnessed a favorable complementarity scenario, which exhibits substantial potential trade gains for both the nations.

Also, the basket of exportable products from India remained opulently diversified compared to the importable basket from UK over time, thereby rendering Indian exporters relatively less susceptible to volatility in a turbulent trade scenario.

It has been indicated by Grubel-Lloyd Index that India-UK trade emanates lower than expected intra-industry trade figures and to push trade further, both nations must engage in higher intra-industry trade in the medium to long run. Also, it is essential to reduce the exorbitant trade cost between India and UK for agricultural products to provide that much needed impetus to the agrarian exports.

With further liberalization of FDI policy in different segments and the advent of GST next year, FDI from UK is expected to touch a new growth trajectory. Undoubtedly, collaboration of India and UK in the realm of investment and business can

truly transform both the nation's entrepreneurial ecosystem.

Going ahead, it is essential for both the parts to become proactive and become prompt in finalizing the bilateral agreement to rejuvenate the falling trend in trade. Both nations should continuously meet and engage in discussions related to mitigating bilateral trade issues, defense ties, renewable energy, skill development and other vital areas.

Going ahead, growth prospects for trade and development between two countries are very promising and sustainable, not only for the coming years but for the coming decades.