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ECONOMIC DECOUPLING FROM CHINA – COULD INDIA STAND TO GAIN?

CURRENT SCENARIO

In the last few months, China, the world's second largest economy, has seen the worst spread of Covid-19 since the start of the pandemic in 2019. Since late March 2022 China's largest urban economy, Shanghai - a city of 25 million people, has been on a strict lockdown on account of spread of the Omicron variant of Covid-19. In the past week, the capital city of Beijing has been reporting increasing numbers of cases with stricter lockdown measures being implemented. As estimated by Nomura's chief China economist Ting Lu, about 327.9 million people in more than 40 cities are affected by the latest lockdowns, nationwide. While the rest of the world seems to be resuming normality, China's "zero tolerance" covid policy still seems to be on the forefront. From a social standpoint, China's "zero tolerance" covid policy has impacted the daily lives of millions with majority being restricted to their apartments for months with limited supplies. From an economic standpoint, the policy has completely disrupted supply chain and had an enormous impact on many sectors, inter alia, retail, consumer goods, manufacturing, F&B and tourism.

STATISTICS

A recent survey conducted by the American Chamber of Commerce, China1 reflected that the foreign business community's confidence in doing business in China continuous to decrease, with 100% of respondents reporting an impact of China's policies concerning the recent outbreak. Over 50% of the respondents reported either delaying or decreasing their investments into the Chinese markets on account of the recent Covid-19 outbreak. Over 60% of respondents reported challenges to the supply chain primarily due to disruptions to transportation and shipping networks.

Similarly, a recent survey conducted by the European Union Chamber of Commerce, China reflected that 60% of respondents have decreased their 2022 revenue forecast and 78% of respondents feel that China is a less attractive investment destination because of its more stringent COVID-19 restrictions. Nearly 23% of respondents surveyed are reconsidering whether to shift planned investments to another country, more than double the number from the last survey conducted two months prior.

As per the statistics released by the National Bureau of Statistics of China on 16 May 2022, China's industrial output dropped by 2.9% in April from a year earlier and retail sales in April shrank 11.1% year-on-year2. While these numbers are reflective of the short-term impact of the stringent lockdown measures on China's economy, in the long run, with the increasing challenges being faced by foreign businesses in China, economic decoupling from China will continue to gain tremendous significance for many foreign companies invested in the Chinese economy.

China's strict lockdown measures have curbed workers to their homes, manufacturing units have been closed or working at limited capacity with a sharp decline in domestic demand. Ports have been working at limited capacity which is impacting exports and thus impacting global supply chain. China's borders have remained closed since 2020 which is not only having a huge impact on its tourism sector but also driving many foreign talents away from China. While these issues may not have been as alarming in 2020 but in 2022 when most countries are moving past the pandemic and choosing to live with it in some form, the economic effect of China's strict covid policies and measures may be catastrophic.

DECOUPLING TREND

Recently, many large companies such as Apple, General Electronics, Starbucks, Amazon, and Adidas for whom China is not only a large manufacturing base but also a large consumer market have expressed concerns about their future investment strategies for China. Estée Lauder's, Chief Financial Officer Tracey Travis on a recent earnings call mentioned that the company's sales fell 4% in Asia Pacific over the last quarter, which was "driven entirely by Greater China".

Some companies such as Starbucks for whom China is the second largest market have declined to make a forecast at all with CEO Howard Schultz calling it "the only responsible course of action." He mentioned "the situation in China is unprecedented" and "the conditions in China are such that we have virtually no ability to predict our performance in China in the back half of the year."

In April, Apple's CEO Tim Cook "warned of huge losses related to the Covid-19 outbreak in China, saying that supply chain issues could hit its sales by as much as $4 billion to $8 billion this quarter" 3. Tesla's massive factory in Shanghai not only caters to the domestic Chinese market but also acts as the export hub for its large European markets. The recent data from the China Passenger Car Association reported Tesla's sales plunge of 98% and production decline by 81% since March 2022 with 0 Shanghai-made vehicles exports in April, compared with 60 exported in March. This week, Airbnb China Co-Founder and Chairman, Nathan Blecharczyk announced that the company will be completely exiting the Chinese domestic markets starting from July 30, 2022.

The trend of economic decoupling from China began at the advent of the pandemic in 2020. Complete disruptions in the global supply chain brought about by the spread of the pandemic in Wuhan - China, made many countries question their dependence on China. However, back then many global leaders were of the view that having spent years to penetrate the Chinese markets, reducing dependence on China cannot be achieved instantaneously. But with the current lockdown in China many global conglomerates have started thinking their China plus one strategy with increased vigor.

WHY INDIA?

Tech Giants such as Apple and Samsung have already started increasing their production in India signifying their diversification from the China supply chain. This could only become an increasing trend across many sectors and a huge opportunity for the Indian economy.

India has the largest youth workforce in the world and is the third largest consumer market behind the US and China. With a large majority of Indian managers being highly educated, English speaking and having global expertise across different markets, the cultural gap for foreign investors entering the Indian markets could stand reduced.

In the recent past, Prime Minister Narendra Modi has been seemingly trying to improve India's geopolitical ties with many countries which may further boost the co-operation between India and other economies. In February 2022, India signed the Comprehensive Economic Partnership Agreement (CEPA) with the UAE. Almost after a decade of negotiations, in April 2022, India and Australia signed an interim free trade deal which is expected to almost double bilateral annual trade within the next five years. India and the European Union are set to hold an initial round of negotiations on a Free Trade Agreement (FTA) in June 2023 with the aim of concluding an FTA by late 2023 or early 2024. India also seems to be hopeful in concluding an FTA with the United Kingdom within the end of the year. As for Japan, during the recent visit of the Japanese Prime Minister Fumio Kishida to India for an annual summit, the two countries reaffirmed their roadmap for deepening the Special Strategic and Global Partnership in a post-Covid world. During the Quad Leaders in-person Summit in Japan this week, the US president Joe Biden also expressed its intent to work in close co-operation with India.

To boost foreign investment the government of India has launched many initiatives such as "Digital India", "Make in India" and "Skill India Initiative". On the regulatory forefront, the Foreign Direct Investment Policy of India, tax, employment, and intellectual property related laws/regulations are also being continually improved and strengthened to increase the ease of doing business in India. The Indian government is also investing considerable sum to improve its infrastructure which is often considered one of the key draw backs of the Indian economy. All the above factors combined could make India the next global manufacturing powerhouse.

CONCLUDING THOUGHTS

Having said that there is also a lot that India could learn from China's successes and mistakes. While the Chinese bureaucratic policies may be rigid in some regards, it has also been flexible and quick to attract large foreign investments into the country. The large investments made by China especially in its technology and infrastructure has already proved to be far more efficacious than India.

The opportunity window for the Indian economy is short. In 2020, Vietnam gained a lot more compared to the Indian economy from a similar global scenario. The low labor cost, free trade agreements such as the EU-Vietnam FTA, attractive foreign direct investment policy and foreign exchange and trade control measures led to Vietnam gaining an advantage over the Indian economy. This time around, it is only with the aggressive policy support from the government can India stand to gain an advantage and grow into the next manufacturing powerhouse. The time for India to act upon this opportunity is now.

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