Perspectives of Trade Wars and its Impact on Australia & India

What is a Trade War?

Given the significant recent discussion on "trade wars" and its impact on the level of global growth and on individual countries, we thought we should provide perspective on this argument in terms of Australia's risk in comparison to India's.

Firstly, lets understand what a trade war refers to. According to the dictionary it means "*a situation in which countries try to damage each other's trade, typically by the imposition of tariffs or quota restrictions*". This can have a significant impact on the status quo and is unlikely to sit well with investors/investment markets.

Given the rapid globalisation we have experienced over the past few decades, bi-lateral trade agreements can be impacted regardless of whether they are between US and China or not. Supply chains are intricately linked and a shift in pricing can have an impact elsewhere. For example, what might be a direct opportunity to a competitor through rising prices caused by tariffs, may end up leading to higher input costs for the business.

Australian Economy

In fact, the *Citigroup Economics team* estimates that three years after trade barriers go up the Australian economy would be A$21bn smaller and that would lead to 70,000 more people being unemployed, the AUD would fall 6% and inflation would rise. Given household debt is at a record high, a trade-war could have potentially disastrous outcomes for the economy, especially given it's a battle between our two biggest trading partners.

Australia's GDP is US$1.2trillion. Australia's foreign trade can be summed as follows for FY17:

	Merchandise US$	Services A$	Total A$
Exports	225	62	387
Imports	214	65	379
Trade Balance	+11	-3	+8

All figures in billion

Source: DFAT, ABS, IMF plus various sources

India's Economy

The size of the Indian economy is almost double that of Australia with lower concentration of contributors to GDP. Whilst, all regions are likely to be impacted, some countries like India may have a lesser impact given the level of dependence the economy has on local demand. As India's economy grows at a rapid pace from its demographics and resulting locally generated demand, it has the potential to be less reliant on global partnerships. India's economy also benefits from significant services exports courtesy to IT Services/Outsourcing and prominent presence in the global generics pharmaceutical market.

Today however, trade is quite significant in relevance to its US$2.3trillion size economy. India's foreign trade can be summed as follows for FY17:

	Merchandise US$	Services US$	Total US$
Exports	303	175	478
Imports	460	105	565
Trade Balance	-157	70	-87

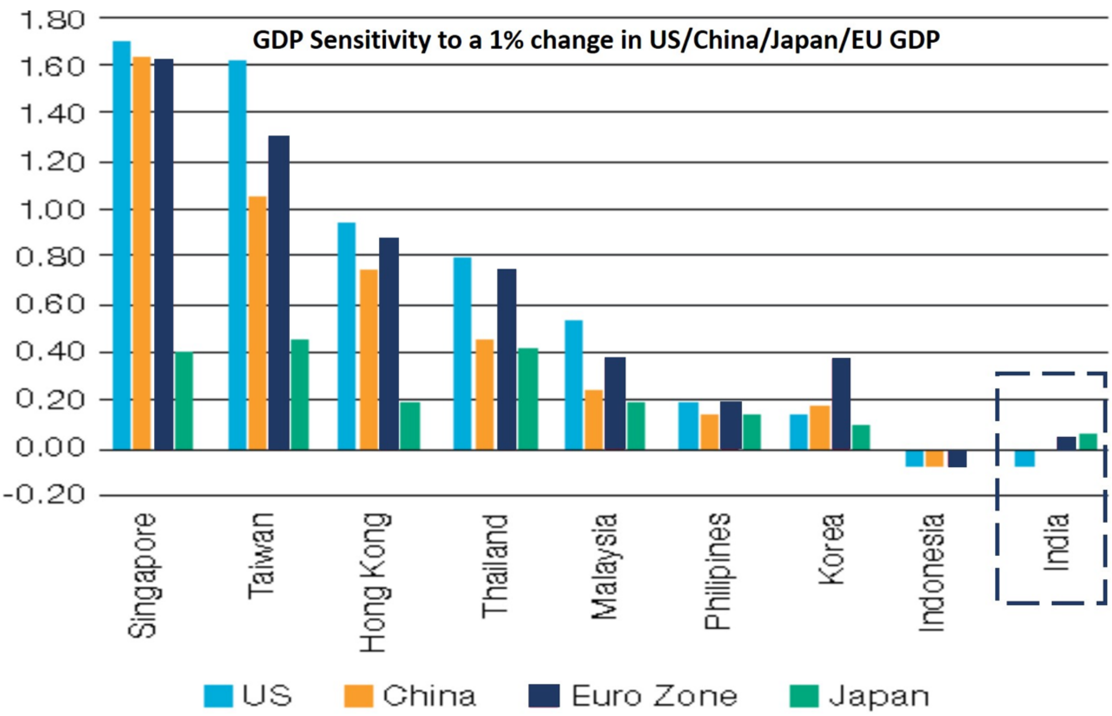
All figures in billion

Source: DGCI&S for Merchandise; RBI for Services (Apr17-Feb18)

Australia vs India

India's trade comparison to Australia with the US/China illustrates a far lower reliance on partnerships with significant concentration**. Australia's partnerships with China and the US account for 36% of trade relationships compared to India's 19%.** India's also has a more evenly distributed set of partnerships with trade partners in comparison to Australia.

Additionally, the **nature of Australia's exports is more likely to be impacted by a global growth slowdown, particularly in China**. Commodities like Iron-Ore, Coal, Aluminium and Copper which Australia exports in abundance are typically more cyclical in nature and likely to be impacted by slowing of global trade should the stand-off between China and US continue. Compared to other emerging markets, India is less likely to be impacted by a slowdown in global growth as can be seen in the chart below.



India's economy and trade is more related to consumption and includes automobiles, pharmaceuticals and precious metals. Whilst all industries are likely to be impacted by a protracted trade war, it is more likely cyclical industries will see a bigger impact, particularly when you can't offset if with a burgeoning local environment. The strength of India's consumption based economy gives it resilience to sustain and even grow while the trade wars settle or lead to a different trade regime.

Therefore, while both Australia and India have a trade to GDP ratio above 40%, illustrating that they are relatively high up the totem pole in terms of openness of their economy, **the cyclicality of Australia's exports and the concentration of its trade partners, put its economy at a risk than India's in the event of trade wars.**

Merchandise Export/Import	Australia		India	
Main Export Partners	China Japan EU Korea US	31.6% 13.9% 7.5% 6.7% 4.6%	EU US UAE Hong Kong China	17.6% 16.1% 11.5% 5.1% 3.4%
Main Import Partners	China EU US Japan Thailand	23.4% 19.3% 11.5% 7.7% 5.7%	China EU US UAE Saudi Arabia	17.0% 11.3% 5.7% 5.4% 5.2%
Major Exports	Iron-Ore Coal Gold Gas Agriculture		Precious Stones Oil & Minerals Motor Vehicles Industrial Machinery Pharmaceuticals	
Major Imports	Petroleum Automobiles Consumption Goods Medical Data Processing Equip.		Oil & Mineral Fuels Precious Stones Electrical Machinery Industrial Machinery Chemicals	

Source: WTO Statistics Database". World Trade Organization (FY17)

<u>All Economies at Risk, but Some Less than Others</u>

The risk that we highlight is that if global investors see the potential uprising of global trade as a risk-off event, then it is likely that all investment markets will be impacted as repatriation of capital occurs. Given that global investors are still significant (but reducing) as a component of India's capital markets, this could have a detrimental impact. However, this means less dependence on foreign flows in Indian Equities. Furthermore, this comes at a time when the local market is experiencing a structural change in savings, as domestic flows increase to financial assets at the expense of physical assets. The majority of Domestic fund flows are coming through monthly investment plans which are more stable and expected to grow larger as the India consumption story unravels through financial savings.