Week Ahead Economic Preview

Global overview

- **Flash PMI surveys for July covering manufacturing and services for the US, Eurozone, UK, Japan and Australia**
- **US jobless claims and home sales**
- **South Korea GDP updates**
- **RBA meeting minutes and BoJ summary of opinions**

Flash PMI updates for the US, Europe and Japan in the coming week will be scrutinised eagerly for further recovery signs at the start of the third quarter, though markets will also parse the survey data to gauge the degree to which the recent backtrack of lockdown measures in some countries affect their recovery paths.

Global business outlook surveys, compiled by IHS Markit, showed that sentiment regarding business activity in the year ahead fell, with profits set to be hit and hiring and investment projected to be stagnant over the coming year. While June PMI surveys hinted at a return of global business activity, adding to signs of a sharp rebound since the height of the COVID-19 lockdowns in April, underlying demand conditions remained frustratingly subdued, with global exports still acting as a key drag on the global economy. The current demand environment also reflects emergency stimulus measures, with fiscal support and employment support schemes temporarily buttressing consumption and job retention.

In the US, with the June PMI having shown signs of business activity nearing stabilisation, focus now shifts to the July flash survey data to gauge if a return to growth for the economy in the third quarter could be on the cards. In addition to IHS Markit PMI surveys, US data will include jobless claims, home sales and regional manufacturing surveys (page 3).

In Europe, the flash PMI data for the Eurozone, Germany, France, and the UK are accompanied by national sentiment surveys in Germany, France and Italy as well as retail sales and household finance figures in the UK (page 4).

In Asia Pacific, flash PMI data are supplemented by key official releases, including South Korea GDP updates, trade figures in Taiwan and Thailand, alongside employment data for Singapore, Hong Kong SAR, and Taiwan. Central bank documents in Australia and Japan will be keenly watched for policymakers' latest assessments of the economic outlook (page 5).

Special reports

UK:.A look at the possible circumstances that could trigger a further enhancement of the Bank of England's QE programme and our assessment of their probability (page 6).

Asia Pacific: An analysis of the recent escalation of tensions between China and India and its impact on bilateral economic ties, as well as broader cooperation in BRICS (page 9).

Upcoming PMI releases

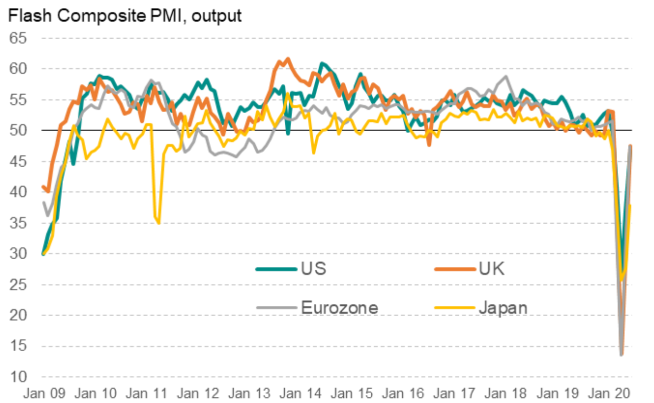
24th July: Flash July PMIs incl. US, Eurozone, Japan, UK and Australia

3rd August: Final Global Manufacturing PMIs

5th August: Final Global Services PMIs

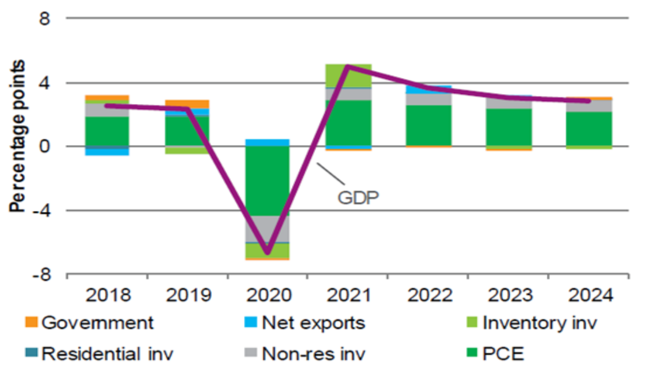
6th August: Detailed global sector PMIs

Flash PMI surveys will provide the first insights into business conditions at the start of the third quarter



Sources: IHS Markit, au Jibun Bank (Japan)

IHS Markit revises up its 2020 US GDP forecast, but rising infections and pause, or backtrack, in reopening plans could undermine the early and strong rebound



Source: IHS Markit, BEA.

Bernard Aw

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Economic Preview: Week of 20 July 2020

Publication date: 17 July 2020

Key diary events (UTC)

Monday 20 July

China loan prime rate (Jul)
Germany PPI (Jun)
Taiwan export orders
Hong Kong unemployment rate (Jun)
Japan inflation (Jun)
IHS Markit UK Household Finance Index (Jun)

Tuesday 21 July

RBA meeting minutes (7 Jul)
US Chicago Fed national activity index (Jun)

Wednesday 22 July

au Jibun Bank/IHS Markit flash Japan PMI (Jul)
Thailand trade (Jun)
Malaysia inflation (Jun)
Taiwan unemployment rate (Jun)
US existing home sales (Jun)
South Korea GDP (Adv, Q2)

Thursday 23 July

CBA /IHS Markit flash Australia PMI (Jul) 23:00 UTC
Singapore inflation (Jun)
Germany consumer confidence (Aug)
France business confidence (Jul)
Taiwan industrial output, retail sales (Jun)
US jobless claims (18-Jul), Kansas Fed manufacturing index (Jul)

Friday 24 July

Flash PMI for US, UK, Eurozone, France, Germany (Jul)
Singapore jobless rate (Prelim, Q2), industrial output (Jun)
UK retail sales (Jun)
Italy business and consumer confidence (Jul)
US new home sales (Jun)

Saturday-Sunday 25-26 July

26/7: Vietnam FDI (Jul)
26/7: BoJ Summary of Opinions (14-15 Jul) 23:50 UTC

For further information:

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United States Week Ahead

Flash PMIs, jobless claims and housing data

By Siân Jones

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Following the reversal and pausing of the reopening of over 20 states, key economic data releases will be keenly watched for any signs of a stilted recovery. The release of 'flash' PMI data will give an insight into the health of the private sector as we move into the second half of 2020. Meanwhile, jobless claims data, including continuous claims, will provide a picture of the labour market as uncertainty is heightened.

Flash PMIs

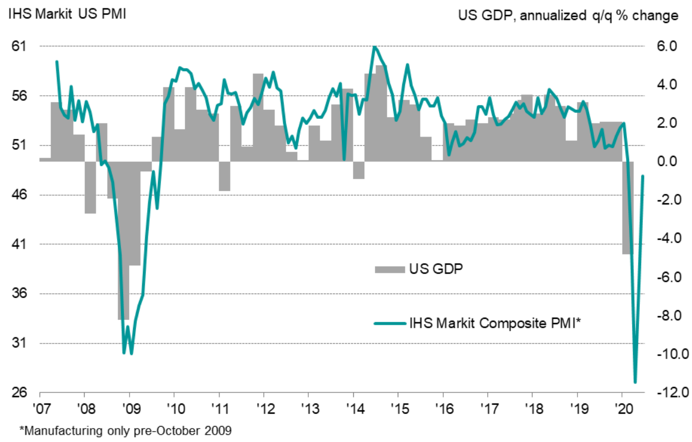
Flash survey data will be eagerly scrutinised after June PMI data signalled moves towards a recovery across the U.S. private sector, with new business in the manufacturing and services sector broadly stabilising following marked contractions in April and May. Although business confidence improved in June among both service providers and manufacturers, anecdotal evidence largely suggested positive sentiment was derived from hopes of an end, or further relaxation, of lockdown measures. Recent news of the pausing of moves towards loosening restrictions and, in some cases, the reversal of measures, could stall progress towards a return to pre-pandemic business activity levels.

Jobless claims and housing data

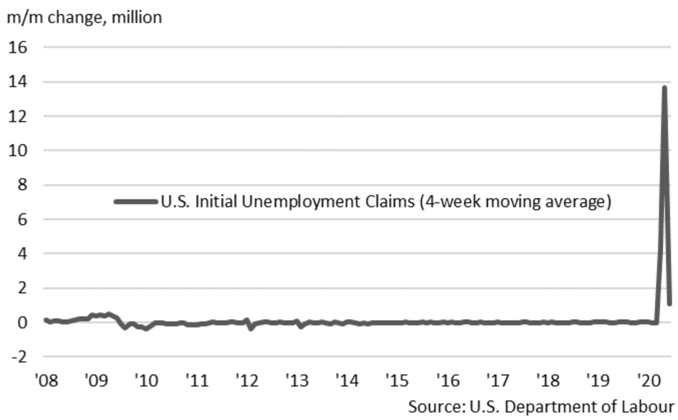
Jobless claims data has continued on a downward trajectory following the historic highs seen during April. Despite the removal of some volatility, the 4-week moving average at the start of July still signalled a greater rise in jobless claims than was seen during the fallout from the global financial crisis. The pausing and reversal of the relaxation of lockdown measures as well as weak client demand may lead to a greater number of continuous jobless claims, signalling an increase in longer-term unemployment.

Meanwhile, housing market data and regional indexes will be updated. Uncertainty surrounding job security and the escalation of the pandemic once more could weigh on the housing market, with the latest data signalling that over 4 million households are still deferring mortgage payments due to the pandemic. This number could rise, however, as additional unemployment payments cease at the end of July.

June data signalled a move towards recovery in the US private sector



Jobless claims growth eases, but remains well above that seen following the global financial crisis



Existing home sales continued to decline in May

Europe Week Ahead

Flash PMIs key releases to watch in quiet week ahead

By Paul Smith

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Following a slew of official data releases over the past few days, a relatively slow week in European economics builds up to next Friday when flash PMIs will offer a glimpse into how the recovery is evolving at the start of the second half of 2020.

Eurozone flash PMIs

Having plumbed unprecedented depths in April, the easing of lockdown measures in May and June helped drive noticeable improvements in the Eurozone PMI numbers – but to levels insufficient to indicate any meaningful recovery in economic growth.

With the speed and shape of the recovery to be largely determined by demand-side developments, analysts are however likely to look beyond the headline PMI numbers next week and assess trends in order books.

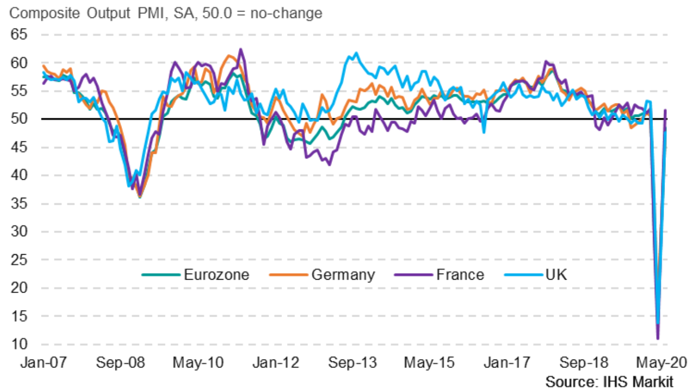
So far, this crucial component of the PMI has remained frustratingly weak, especially for exports. While there has been some release of pent-up demand from households, who have benefitted from income protection measures and provided some much-needed support to regional consumption, social distancing measures and caution amongst businesses has stymied the recovery.

UK PMI, household finances, retail sales

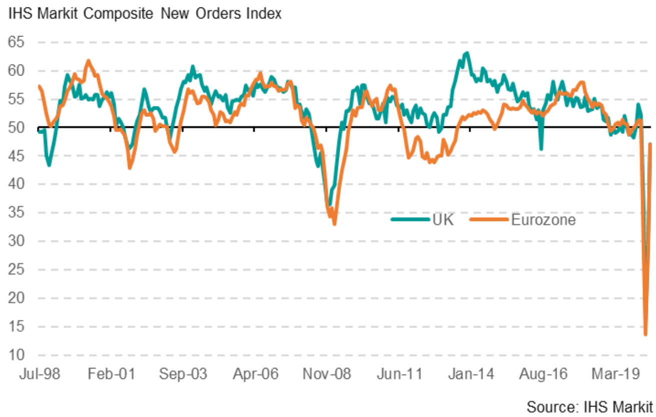
While UK PMI data have followed a similar trajectory to the euro area, the recovery according to official data is proving tepid at best. May's monthly GDP data showed only modest growth with economic output still down around -25% compared to February. Already seemingly behind the global recovery curve, we look to the July flash PMI numbers to gauge whether the country is getting itself back on track.

Although the further easing of lockdown measures should help – and drive a further uplift in the survey data – high frequency indicators suggest ongoing caution is being exercised, especially among consumers. Monday's Household Finance Index from IHS Markit will therefore provide further clues to the mood of UK households, while June's retail sales data, released Friday, will offer additional evidence on the scale of economic activity post-lockdown.

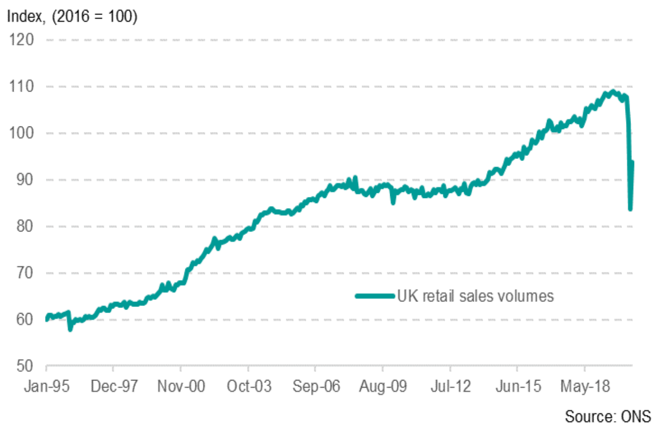
July PMI data to indicate whether growth is finally taking root across Europe…



…with order books holding the key to recovery



The UK is experiencing a tepid recovery, but the ongoing easing of lockdown measures should help to support growth over the rest of the summer



Asia Pacific Week Ahead

Flash PMI data, Korea GDP, Asia trade and jobs numbers

By Bernard Aw

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The pace of recovery at the start of the third quarter will be sought from the July flash PMI numbers for major economies. In Asia, these include Japan and Australia, which will gather great interest amid a rise in new infections as both countries have been reopening parts of their economy. Markets will continue to eye any risk of a widening second wave of infections worldwide as lockdown measures in a number of countries were reimposed.

In addition to the PMI releases, other key Asian data highlights include employment numbers in Singapore, Hong Kong and Taiwan which will be scrutinised for clues that further (or extended) policy support is needed, as well as trade figures in Taiwan and Thailand which will provide insights into the health of regional trade conditions. South Korea also releases its second quarter GDP in the same week. Details of July policy meeting in Australia and Japan can be gleaned from the release of minutes and summary of opinions, respectively.

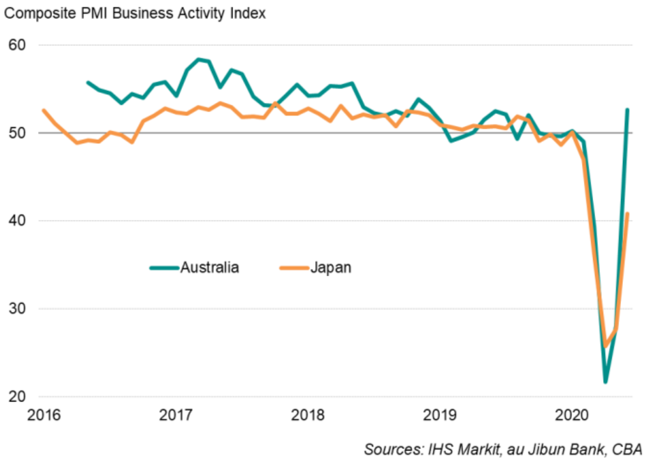
Flash PMI in Australia and Japan

Recent PMI surveys provided an early indication that the worst of the economic impact from the pandemic outbreak appears to have peaked in April, with the easing of COVID-19 related restrictions benefiting parts of the economy, most notably the service sector. However, further improvements in the PMIs will be needed to justify growing expectations that the economic recovery is gaining traction. In that regard, flash PMI updates for Japan and Australia in Asia will be scrutinised eagerly. With a rise in new cases in both economies, details of the PMI surveys, such as new orders and business confidence, will provide clues of the state of recovery.

South Korea GDP

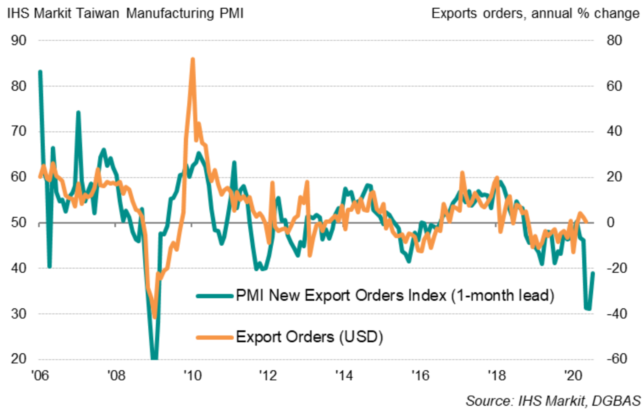
Advance estimates of the second quarter GDP in South Korea will be eyed to gauge the extent of the damage to the economy. Manufacturing PMI data already hint at a decline in economic activity, with IHS Markit projecting a -1.1% year-on-year contraction during the second quarter.

In June, business activity in Australia returned to growth while Japan's downturn eased. Flash PMI data for July will be updated in the coming week



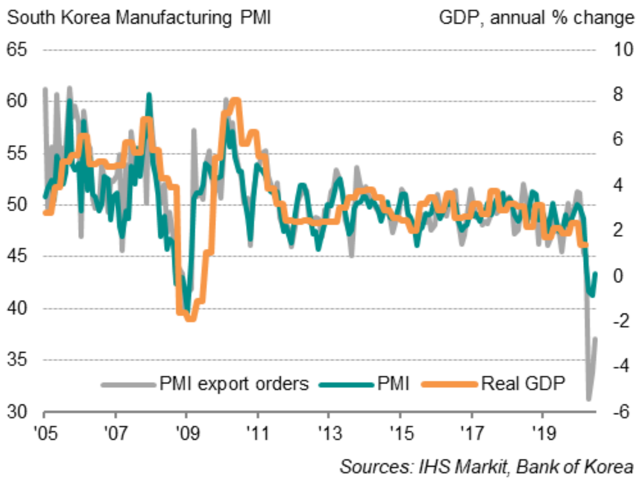
Sources: IHS Markit, au Jibun Bank, CBA

Taiwan PMI and export orders



Source: IHS Markit, DGBAS

South Korea PMI hints at falling economic activity



Sources: IHS Markit, Bank of Korea

Europe
Special Focus

Bank of England reloads QE bazooka to support COVID-19 hit economy, could more follow?

By Raj Badiani

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The Bank plans to increase the target stock of purchased UK government bonds by an additional GBP100 billion, to take the total stock of asset purchases to GBP745 billion, or around 35% of GDP. However, a further enhancement of its asset purchase program is unlikely unless the UK is hit by a second coronavirus disease 2019 (COVID-19) virus wave, triggering a second national lockdown, or the economic recovery peters out due to soaring unemployment or adverse Brexit developments.

BOE extends QE measures

The Bank of England's Monetary Policy Committee (MPC) voted unanimously to maintain the Bank Rate at 0.1% at its 18 June meeting.

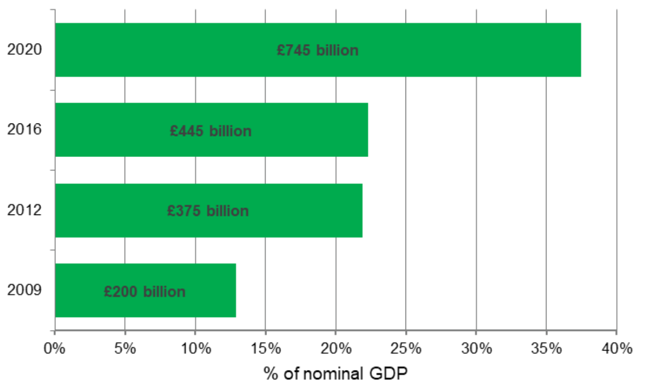
The MPC also voted unanimously for the Bank of England (BOE) to continue with the existing program of GBP200 billion (USD248 billion) of UK government bond and sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves. In addition, after a majority vote of 8-1, the Bank will increase the target stock of purchased UK government bonds by an additional GBP100 billion, to take the total stock of asset purchases to GBP745 billion.

The extended QE announcement was expected after all the MPC members had agreed in the May meeting that further monetary support could be required and the minutes showed that all members accepted that the "the prospective weakness in employment and inflation, and downside risks around aspects of the medium-term outlook, might necessitate further monetary policy action".

With GDP shrinking by around a fifth during the peak of COVID-19 virus-related national lockdown, the door opened for the MPC to expand the new QE program.

The Bank wants to slow the pace of its QE purchases to complete the additional GBP100 billion by the end of this year. The total stock of the Asset Purchase Facility (APF) had reached GBP613 billion by 17 June, implying that an additional GBP162 billion of UK government bonds and GBP5.8 billion of investment-grade corporate bonds had been purchased since March.

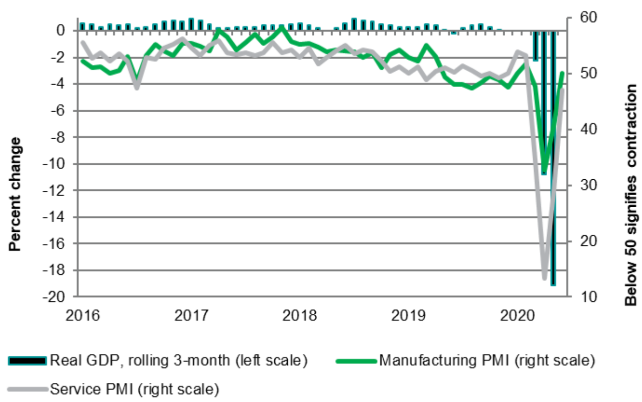
BoE: Cumulative purchases under QE (% of GDP and billions of £)



Notes: 2009 is financial crisis, 2012 is Eurozone debt crisis, 2016 is Brexit referendum result, 2020 is COVID-19 pandemic

Source: BoE, IHS Markit

Latest UK real GDP and PMI headline developments



Sources: IHS Markit, ONS

What next for the MPC? Sit tight?

The Bank's decision to expand its bond-buying scheme by GBP100 billion in the June meeting was at the lower end of market expectations, with some arguing for an expansion of GBP150-200 billion. In addition, the markets didn't expect the slower pace of the bond-buying program, roughly by half from current levels, or the BOE's chief economist Andy Haldane's dissenting vote.

This could suggest that the Bank is at the upper end of its support, or even showing some signs of "bailout fatigue." Indeed, an emerging narrative from the MPC's June meeting is that "the hit to the economy would be less severe than initially feared". Indeed, the MPC minutes from the 18 June point to payments data suggesting a recovery in consumer spending in May and June. Importantly, the Bank expects "the level of GDP in the second quarter might be 20% below its level in the final quarter of 2019, rather than the 27% published in the May Report".

Haldane went a step further when arguing that the UK economy is recovering faster than previously thought from the COVID-19 crisis, arguing a V-shaped economic recovery is underway, which could spur higher inflation, underpinning his opposition to expanding the QE program on 18 June. He notes the UK economy will benefit from “a stronger than predicted underlying strength in consumer spending across the country. "

Although the Bank’s May growth projections look increasingly dated, it expects the economy to contract by 14% in 2020, the largest drop on record since the Office for National Statistics (ONS) started compiling GDP data from 1949. A less negative view of the second quarter is likely to result in a lower projection for GDP contraction in 2020.

The Bank expects the economy to grow by 15% in 2021 and returning to its pre-virus peak by the middle of next year. The hope is that the government and Bank's financial and income support measures will limit any permanent scarring on the economy.

Furthermore, dissenting voices about the expanded QE program are being raised outside the MPC. Paul Tucker, the former deputy governor at the Bank, argues that the expanded QE scheme is raising the prospect of “monetary financing” in which central banks fund state spending directly, and could trigger a period of hyper-inflation. He points out that the path of gilt purchases by the Bank tracks perfectly the path of gilt issuance by the government. More will follow, with general borrowing requirements in the current financial year (FY; from April 2020 to March 2021) expected to reach 17% of nominal GDP or GBP330 billion (IHS Markit, July update).

Or more QE to follow?

The Bank could decide to increase the target stock of purchased UK government bonds for a third time during the COVID-19 crisis. The triggers could be

- Haldane’s view of a V-shaped recovery is not shared by all MPC members. Indeed, MPC member Silvana Tenreyro has stated publicly that she is ready to support further stimulus to protect the recovery from the COVID-19 lockdown. She argues a strong V-shaped recovery is unlikely and points to several recovery obstacles, ranging from continued risk aversion from consumers fearing COVID-19 infection, social distancing and protective COVID-19 measures restricting activity in several sectors and higher unemployment.
- If the UK is hit by a second wave of infections, triggering a second national lockdown.
- The termination of the Coronavirus Job Retention Scheme at the end of October could prompt a second wave of substantial job losses, leading to an even more elevated unemployment rate.
- The increasing risk that the UK-EU trade talks could fail, with the UK having to resort to World Trade Organization (WTO) terms when trading with the EU from the 1st January 2021. This is likely to launch a new recession in the UK in the first half of 2021, and we would expect the Bank to step in with a further expansion in the QE programme.

Or the Bank could consider negative interest rates

After previously ruling out negative rates because of their impact on the banking system's capacity to lend, the Bank's governor is considering negative interest rates after the policy rate was cut to a 325-year low of 0.1%. That said, negative rates remain unlikely, with modest changes in the cost of credit unlikely to revive limp demand for credit. In addition, the potential impact on bank profitability is a concern, with UK retail deposit rates unlikely to drop below zero.

Our assessment

We expect the Bank to adopt a wait-and-see approach over the next few months, monitoring the height of the GDP bounce-back in the third quarter. Critically, the MPC will evaluate consumer behaviour following the reopening of non-essential shops (from 15th June) and most consumer-facing services (4th July).

Our baseline GDP forecast is similar to Tenreyro’s view of “an interrupted or incomplete ‘V-shaped’ trajectory, with the first quarterly step-up in Q3”.

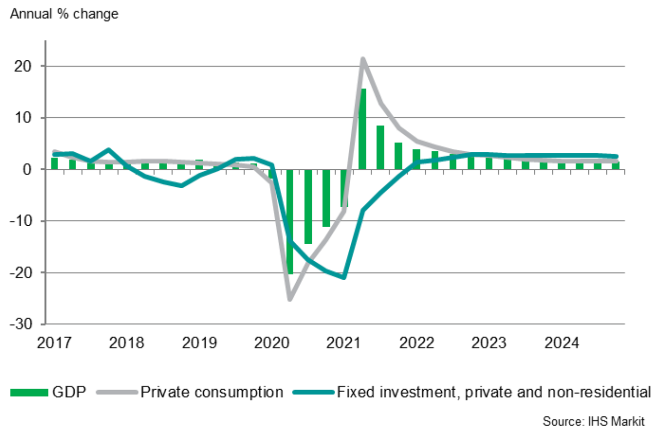
The end of the second quarter appeared to be uneven. We estimate real GDP growth accelerated in June from 1.8% month-on-month in May, but the pick-up could have been limited by many consumer-facing services remaining shut during the month.

Economic Preview: Week of 20 July 2020

Publication date: 17 July 2020

The latest PMI data suggest that the economy is past the worst, but activity levels remained low during June. The IHS Markit/CIPS PMI for the UK signalled the highest reading in four months in June. Specifically, the composite index measuring output across the manufacturing and service sectors stood at 47.4 in June, up from 13.8 in April and 30.0 in May, the lowest level since the survey began in January 1998.

UK real GDP (actual and projections)



Note: Latest projections as of July 2020

The service-sector downturn has bottomed out with more businesses starting to reopen and adapt their operations to meet the social distancing requirements. However, many service providers face several challenges, namely rising COVID-19 virus-related operating costs alongside the need to resort to heavy price discounting to attract reluctant consumers. Increasing job shedding across the economy is a major obstacle to reviving new businesses.

GDP developments in July and August are critical to the Bank's immediate narrative. Our view is that the strength of the rebound during the third quarter GDP is at risk from the COVID-19 virus protocols damaging trading conditions, while many consumers remain wary owing to COVID-19 virus infection fears. Our fear is that consumer-facing services are operating well below their full capacity, while high-street retailers are reporting notably lower foot traffic when compared to a year earlier.

We expect the economy to contract by 11.9% this year before expanding by 4.9% in 2021. Clearly, our growth assessment for 2021 is cautious, and reflects several recovery headwinds. These include poorer labour market conditions, which will blight the pace of revival in consumer spending decisions; lost productive capacity, with many consumer-facing service providers and retailers struggling to navigate through the COVID-19 crisis.

Our Brexit baseline assumes that the UK and the EU will strive to avoid a disorderly Brexit from January 2021. They are likely to seek mutually acceptable temporary emergency measures to facilitate further negotiations and avoid disruptions to the highly integrated supply chains, cross-country travel, and the use of services, with the EU and UK economies scarred by the virus crisis.

On balance, our short-term growth position is on the cusp where the Bank could lean towards reloading the QE bazooka for a third time to mitigate the impact of the COVID-19 lockdown.

APAC
Special Focus

India-China Economic Relations: Assessing the Impact of Escalating Geopolitical Tensions

By Rajiv Biswas

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The recent escalation in geopolitical tensions between China and India following the border clash in Ladakh has created significant economic shockwaves to China-India bilateral economic relations.

Over the past decade, economic relations between China and India had strengthened significantly, as reflected both in rising bilateral trade and investment flows as well as joint multilateral initiatives. However, the recent escalation in tensions has created considerable uncertainty about the future path of bilateral economic ties between India and China, as well as the implications for co-operation between India and China on multilateral initiatives such as the BRICS Forum and the New Development Bank.

Escalating bilateral tensions disrupt trade flows

Bilateral trade between India and mainland China almost doubled in the past decade, rising from USD 42 billion in the financial year (FY) 2009-10 to USD 82 billion by FY2019-20. When Hong Kong SAR is included in China's trade figures, total bilateral trade doubled from USD 55 billion in the FY2009-10 to USD 110 billion in the FY2019-20.

However, India does run a chronic trade deficit with mainland China, which has risen from USD 19.2 billion in FY2009-10 to USD 48.6 billion in FY2019-20. This large trade imbalance has been a source of significant trade frictions and a key focus for bilateral trade negotiations in recent years.

India's trade deficit with Hong Kong SAR has also risen in recent years, reaching around USD 6 billion in 2019-20, with significant transhipments being routed from mainland China to India via the Hong Kong SAR, particularly of electronics products such as integrated circuits and flash memories. Consequently, the combined trade deficit that India has with mainland China and Hong Kong SAR reached USD 54.6 billion.

Following the recent Ladakh border clash in mid-June, the worst border confrontation in the past 45 years, economic ties have deteriorated rapidly. The Indian government announced on 3rd July that imports of power equipment from China will need to be authorised by the Indian government, which is expected to result in a collapse in new Indian purchases of Chinese power equipment.

India's Power Minister R K Singh stated on 3rd July that India will no longer import power equipment from China and has also indicated that orders for power equipment will shift to the domestic power equipment manufacturing industry. The Power Minister stated that: "We have decided not to buy from prior-reference countries (China and Pakistan). Any equipment imported will need permission. And we will not give permissions for equipment from China and Pakistan."

India imported around USD 2.8 billion of power equipment for non-renewable power projects in the 2018-19 financial year. In recent years, a large share of total imported solar power equipment had also been from China.

Impact on Technology Sector

India has also announced a ban on 59 Chinese mobile phone apps being used in India, such as TikTok, WeChat and Helo, on the grounds of security concerns. India is not alone in considering such actions in relation to mobile phone apps from China. The US Secretary of State Mike Pompeo has stated that the US is considering a ban on some Chinese mobile applications, with Australia also reported to be considering such action.

In June, India also informed two large domestic telecoms network operators not to use Chinese-made telecommunications equipment for their 4G network upgrade. Instead the Indian telecoms firms are urged to use either domestic telecoms equipment or alternative foreign sourcing for telecoms equipment for their 4G network upgrade, which is partly financed by the Indian government. Around USD 8 billion is provided by the Indian government for network upgrades, to help operators Bharat Sanchar Nigam Limited (BSNL) and Mahanagar Telephone Nigam Limited (MTNL).

The Indian government has also discussed the future role of Chinese telecommunications equipment in India's future 5G rollout plans, although no decision has yet been announced about any specific measures. However, with Australia having already decided in 2018 not to permit Huawei to participate in Australia's

5G rollout and the UK government having just decided to also remove Huawei equipment from the UK 5G network by 2027, there are heightened uncertainties about the Indian government's future policy actions on this issue.

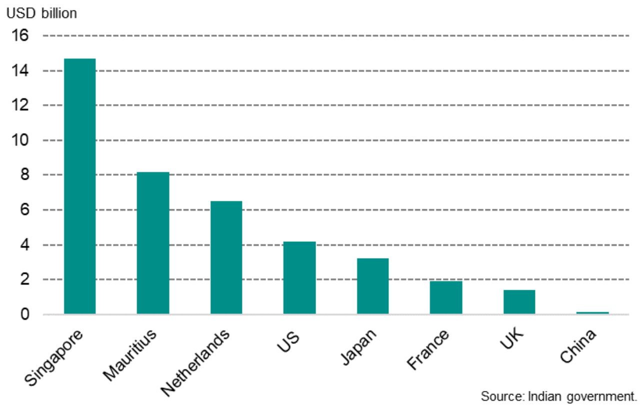
Disruption of Bilateral Investment Flows

Due to the increased bilateral tensions, foreign direct investment (FDI) flows between India and China are also expected to be disrupted, at least in the near term. China has become a growing source of foreign direct investment (FDI) into India in recent years. Direct FDI inflows from China to India still remain relatively low cumulatively compared to the US and EU, according to government statistics. Direct recorded FDI from China in FY2019-20 was only USD 163 million, and cumulative FDI from China over the past four financial years amounted to just USD 1 billion.

However, significant investment flows from Chinese companies are estimated to come through other financial centres, such as Mauritius. Estimates of total Chinese FDI into India, taking into account investment flows via other financial centres, range up to around USD 10 billion over the past four financial years. An estimated 70 Chinese companies and venture capital funds have invested in Indian start-up companies, particularly in the technology sector.

Due to the surge in global FDI into India over the past five years, the sourcing of investment inflows into India is diversified geographically. In the FY2019-20, India recorded USD 50 billion of FDI from other countries, with major international financial centres being key sources. Singapore was the largest source, at USD 14.7 billion, followed by Mauritius at USD 8.2 billion. Mauritius is a preferred investment routing for overseas Indian investments, while Singapore is a key Asian financial centre used by many multinationals to make FDI investments across the Asia region.

India: FDI inflows by country (FY2019-20)

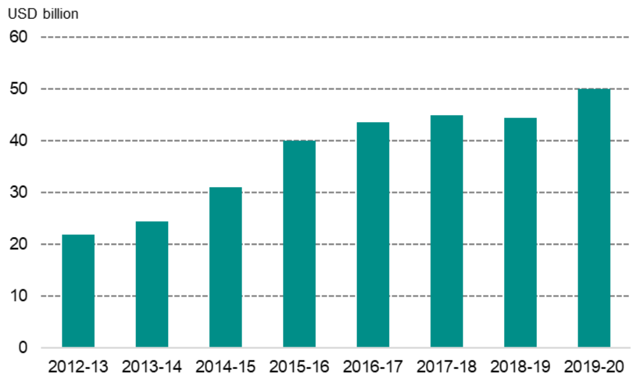


Source: Indian government.

Even before the Ladakh clash, Chinese FDI into India was impacted by new restrictions that were announced by the Indian government on 22nd April. Under the new regulations, which were introduced due to concerns by the Indian government about predatory takeovers of Indian companies during the pandemic, all foreign direct investments from neighbouring countries must be submitted for Indian government approval, with no industry sectors open any longer to neighbouring countries under the automatic investment routes. The impact on the inflows of new FDI in 2020 will be dependent on the Indian government's investment approval process and the criteria that will be used to make the decisions on whether to approve new investments. An estimated 50 Chinese FDI approvals are currently under review by the Indian government.

Indian investment into China could also be impacted by the deteriorating bilateral relations. Over the past decade, an increasing number of Indian multinationals in the IT, manufacturing, health care and pharmaceuticals sectors have established operations in mainland China, including Tata Jaguar Land Rover, Mahindra and Mahindra and Dr Reddy's Laboratories. Large Indian IT firms also have business operations in mainland China, including Infosys, Wipro and Tata Consultancy Services.

India: Total FDI inflows



Source: Indian government.

Any concerns that India may have had about a slowdown in new FDI inflows from China have been substantially alleviated in recent weeks, following large-scale new FDI flows announced from other economies, notably the US. In mid-July, Google has announced a USD 10 billion investment into Google India's Digitization Fund, while Walmart announced it is leading a USD 1.2 billion fresh capital injection by a group of investors into Flipkart, an Indian ecommerce company in which Walmart had previously acquired a majority stake. Taiwan's Foxconn is also planning an additional USD 1 billion investment in India to expand its factory facilities to increase production of mobile phones.

BRICS Forum and New Development Bank

The BRICS Forum is a major policy initiative for economic co-operation among five large emerging markets nations, comprising China, India, Brazil, Russia and South Africa. The escalating tensions between China and India have created significant uncertainties about how India and China can continue to co-operate in the BRICS Forum, at least in the near-term. In 2014, the New Development Bank (NDB), a multilateral development bank, was created by the BRICS member countries as a major joint initiative to provide infrastructure financing for developing countries. With the NDB headquartered in Shanghai, there is also uncertainty about India's future co-operation on this initiative, at least in the near-term outlook.

Implications for supply chains

China's exports to India accounted for around 14.1% of India's total merchandise imports in FY2019-20. This has raised concerns about India's vulnerability to potential supply chain disruptions.

Among the largest imports from China are electronics and electrical equipment, notably mobile phones and electronic components such as integrated circuits and transistors. Another key import from China is equipment for nuclear power plants. Other important imports from China include auto parts, chemicals and pharmaceuticals. Many of these finished products, intermediate goods and industrial materials can eventually be sourced either domestically from Indian suppliers or through imports from other countries, with South Korea, Japan, the EU and US being among the potential alternative suppliers of advanced technological manufactures such as power equipment, telecommunications equipment and industrial machinery.

However, the process of diversifying supply chains does take time, depending on the product, as Indian importers would need to find alternative suppliers. The Confederation of All India Traders (CAIT) has identified around 500 categories of products that India imports from China which it has said can be substituted for by domestic Indian products. For China, given the large trade surplus with India and the relatively small share of total Chinese imports sourced from India, there is relatively low vulnerability to supply chain disruptions due to Indian exports.

Outlook and Implications

As a result of the escalation in geopolitical tensions between China and India, economic ties have already been significantly disrupted. Since June, India has taken action to significantly reduce imports of Chinese power equipment, as well as instructing several state telecommunications companies not to use Chinese telecoms equipment for their upcoming 4G network upgrade. A large number of Chinese mobile applications have also been banned.

Many Indian firms are also trying to reduce their supply chain vulnerability to imports from China, albeit it may take some time for them to establish alternative sourcing of manufactures and raw materials.

The near-term outlook is for further disruption to bilateral economic ties, as the Indian government is likely to consider further policy measures that could impact bilateral trade and investment. There are also risks to multilateral co-operation between China and India on initiatives such as the BRICS Forum and the New Development Bank.

Meanwhile the escalating tensions between China and India are likely to divert Indian orders for a wide range of imports towards alternative suppliers, with manufacturers in the EU, US, Japan and South Korea likely to be key beneficiaries of the trade diversion for high technology goods.

Given the strategic importance of China and India as the two largest emerging market economies in the world, finding a path towards reconciliation over the medium term will be important not only for better bilateral relations and Asia-Pacific regional stability, but also for multilateral initiatives such as the BRICS Forum and New Development Bank, which can play an important future role in accelerating the economic development of developing countries.