Impact of US-China and US-Iran relations

US-China

On May 10, the US raised tariffs from 10% to 25% on USD 200 billion worth of imports from China and is threatening tariffs on an additional USD 325 billion worth of Chinese goods. China retaliated by promising to raise tariffs further on USD 60 billion in US exports.

Renewed talks of escalating tariffs and trade tensions between the US and China unnerved markets in India. Indian benchmarks ended down for the ninth consecutive session on Monday, May 13, 2019. On the same day, the rupee slipped to an over-two-month-low as foreign funds extended their share sale. With the latest string of losses, the Sensex has equalled its nine-session losing streak in February this year. Nifty equalled its 2011 losing streak with this fall.

However, India was not alone in this fall. Global stock markets have tumbled after the US threat to impose new tariffs on Chinese exports. As on May 13, the month-to-date change in the various indices was: China Shcomp (-5.67%), India Sensex (-4.97%), Japan Nikkei (-4.8%), South Korea Kospi (-5.65%), Singapore STI (-4.88%) and Hong Kong HSI (-3.87%).

The impact on US producers with significant exposure to Chinese markets was also captured in stock market valuations. The equity price performance of US companies with high sales to China underperformed relative to the US businesses exposed to other international markets, after retaliatory tariffs by China were implemented.

There could be implications for the world at large. With Chinese goods being taxed at a higher rate in the US, other countries can pitch in and fill the gap. This opens up opportunities for other exporters, including India. India needs to make use of this opportunity to significantly enhance its exports.

To substantively benefit from this situation, India requires a strategic approach to convert this opportunity into a major gain. India needs to focus on becoming a new powerhouse as a global hub for exports, with a major positive impact on competitiveness and job creation. India needs to take its vision of ease of doing business and Make in India to the next level.

At the same time, China is likely to get more aggressive with exports and the world should watch out for dumping of goods as it seeks to regain markets. There is also a possibility of China depreciating its currency so as to get a competitive edge, like in 2015. This would have ramifications for other countries as China has enough power to move the currencies.

Meanwhile, US government also intends to terminate India's designation as a beneficiary developing country under the Generalised System of Preference (GSP) programme. However, a group of 25 influential American lawmakers has urged the US Trade Representative not to terminate the GSP programme with India, saying the country's companies seeking to expand their exports to India could be affected. The final decision of the US remains to be seen.

Overall, the repercussions can be – more volatility in both commodity prices and currencies as the trade war escalates. Global trade would get more volatile and also affect investment flows.

US-Iran

In another development from the US, on May 2, the Trump administration brought to an end the waiver the US had granted to 8 countries, including India, of sanctions on imports of oil from Iran.

Even with the waivers, sanctions had significantly reduced global oil supply. According to the International Energy Agency, Iran's oil exports had fallen to 1.1 million barrels per day in March 2019, as compared with 2.3 million barrels in June 2018, just after the US sanctions were announced.

That shortfall worsened an oil supply situation that was already affected by a host of other factors. One was the political standoff in Venezuela, which drastically reduced production in and exports from there. Another factor was Saudi Arabia, which decided to join other OPEC nations and enter into an alliance with Russia and 10 other non-OPEC countries to cut production and hold back from the market more than half a million barrels of crude every day. In little more than a year, the spot price of Brent crude rose from around USD 45 a barrel to around USD 85 a barrel.

The removal of Iranian oil from India's energy sourcing basket may have major implications, given that India has been a major importer of Iranian oil. India imported 23.5 million tonnes in 2018-19 from Iran. India would need to come up with options that offer terms as attractive as those offered by Iran, including 60-day credit, free insurance and shipping. Finding an alternative supplier at competitive terms quickly for India may be tough.

While Saudi Arabia, UAE and other OPEC countries would likely fill the gap created by lower Iranian exports, it would come at the cost of a significant reduction in the spare capacity and also increase the risks of a potential conflict in the Middle East.

Oil prices are expected to rise in the foreseeable future. That is not likely to be good news for the government that is taking control now. The price of India's crude import basket, which was in decline, has been rising since the end of last year.

While consumption of crude and petroleum products in India has been continually rising, touching 212 billion tonnes in 2018-19, the share of net imports in consumption has hovered around 93% for the last 4 years.

So, the trade and current account deficits on India's balance of payments are expected to widen, creating uncertainty among foreign investors even when the political landscape cleared. There is also the possibility of higher inflation, as the effects of higher oil prices pass through.

As mentioned earlier, the threat of the US-China trade war can be converted into an opportunity by India to increase its exports. Increasing exports would bring in more foreign exchange for India. This foreign exchange could then be used by India to purchase oil from alternative sources.