

THE AUSTRALIA-INDIA RELATIONSHIP

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No FTA yet, but deepening trade prospects

- Australia's Prime Minister visited India in April, aiming to further strengthen the economic and political relationship between two countries with many close historical ties. A long awaited free trade agreement has been delayed – perhaps permanently – due to a number of stumbling blocks, particularly in relation to agricultural protectionism and labour mobility. It now looks more likely that the bilateral trade relationship could be advanced on a case by case basis rather than via a wide-ranging trade deal.
- Closer ties are certainly worthwhile as India is the world's third largest economy (behind China and the United States) and has considerable growth potential over the next few decades. Output grew by around 7.4% in 2016 (making it the fastest growing major economy) and its demographic profile is especially favourable for growth (particularly compared with a rapidly ageing China).
- From an Australian perspective, India was our fifth largest export market in 2015-16, with exports totalling \$12.9 billion. That said, exports are quite narrowly based – with coal accounting for the majority of goods exports and education dominating services trade. The government has created an Indian Economic Strategy, aiming to help Australian business tap into India's rapid growth.

CONTENTS

<u>Overview</u>	2
<u>Trade in goods & services</u>	3
<u>Coal</u>	4
<u>Education</u>	5
<u>Gold</u>	6
<u>Agriculture</u>	7
<u>Foreign investment</u>	8

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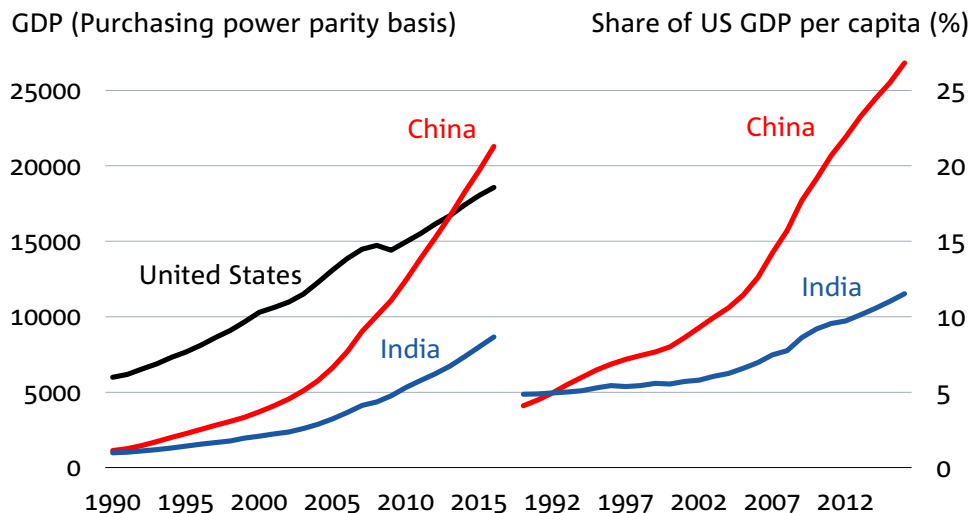
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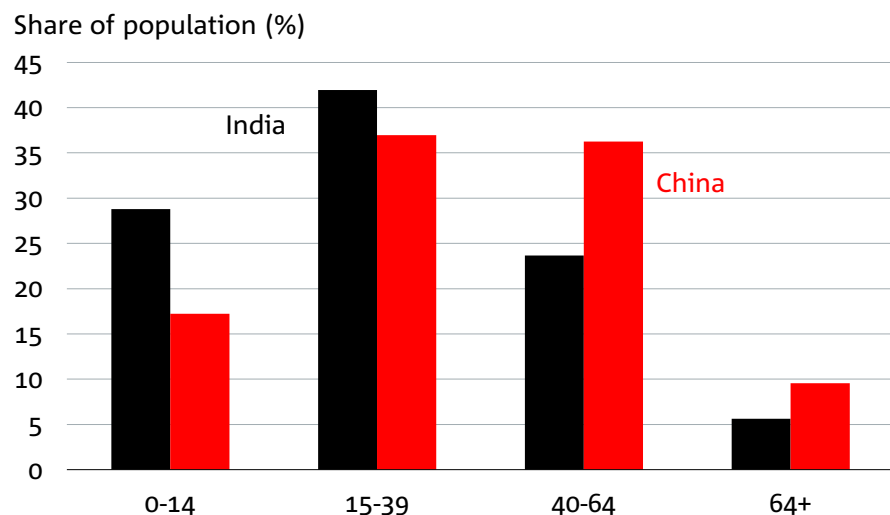
OVERVIEW: WHERE ARE WE NOW

No FTA yet... but deepening co-operation expected in coming years

INDIAN ECONOMY STILL LAGGING ON PER CAPITA BASIS



INDIA HAS FAVOURABLE DEMOGRAPHICS FOR GROWTH



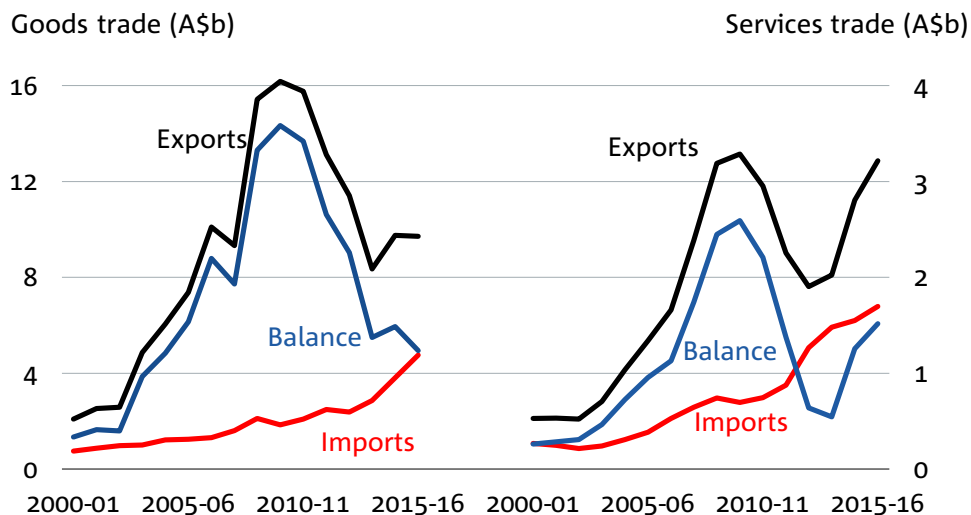
Source: IMF, United Nations, NAB Economics

- Prime Minister Turnbull visited India in early April to boost the trade relationship between Australia and India (which has not advanced as much as hoped). The Turnbull government has created an Indian Economic Strategy to examine opportunities for Australian business to tap into India's economy.
- India is now the world's third largest economy (behind China and the United States) on a purchasing power parity basis. That said, comparisons of GDP per capita show that India is still lagging behind in developmental terms – in 2016 India's GDP per capita was around 12% of the United States' level (compared with almost 27% for China).
- India has considerable growth potential over the next few decades. Its economy grew by around 7.4% in 2016 (making it the fastest growing major economy) and its demographic profile is favourable (particularly compared with a rapidly ageing China).
- From an Australian perspective, India was our fifth largest export market in 2015-16, with exports totalling \$12.9 billion. That said, exports are quite narrowly based – with coal accounting for the majority of goods exports. The proposed Free Trade agreement (FTA) has been delayed – perhaps permanently – due to a number of stumbling blocks, particularly in relation to agricultural protectionism and labour mobility.
- India's agricultural sector is highly fragmented and protected by trade barriers. India's government is concerned that opening agriculture to global competition could have serious economic consequences for its rural workforce and be politically damaging for an Indian government to implement.
- Similarly proposals for increased access to the Australian labour market for Indian workers would be politically contentious here. The recent decision by the Federal Government to replace the 457 visa with a new program with tighter eligibility criteria could affect the likelihood of completing a FTA in the near future. India currently accounts for a quarter of 457 visa applicants.
- Despite limitations surrounding the FTA, the Turnbull visit could contribute to a deeper level of engagement between the two countries. Energy, education and trade were some of the key themes of the visit, along with increased cooperation in defence, counter-terrorism and cyber security. It is likely that the bilateral trade relationship would be addressed on a sector-by-sector basis, as opposed to an overarching FTA.
- One of the key aims of the visit was to take the relationship to a deeper level, reflecting areas of common ground: they are important Asia Pacific economies; they are Commonwealth countries; both have British legal traditions and both are democracies.
- This report examines the Australia-India relationship, including trade (looking closely at education, energy, gold and agriculture) as well as investment flows (an avenue for future co-operation between the countries).

TRADE IN GOODS & SERVICES

Australia maintains a surplus in both goods and services trade

AUSTRALIA HAS A SIZEABLE TRADE SURPLUS WITH INDIA



- Two-way goods and services trade (both exports and imports) with India was worth \$19.6 billion in 2015-16, making India Australia's tenth largest trading partner. This ranking largely reflects the low level of imports – as, when it comes to exports, India is ranked fifth. Australia runs a sizeable bilateral trade surplus in both goods and services.
- Australia's exports of goods and services to India totalled \$12.9 billion in 2015-16. The main goods exports are coal, vegetables, gold and coal, while education and travel dominate the services trade component.
- Petrochemical products are the primary goods import from India, while personal travel and professional services are the main categories for services imports.
- The total value of good and services exports to India peaked in 2009-10 and has trended somewhat lower since. In a large part this reflects price effects – with coal prices considerably lower than at the height of the mining boom.

GROWTH IN EXPORTS TO INDIA



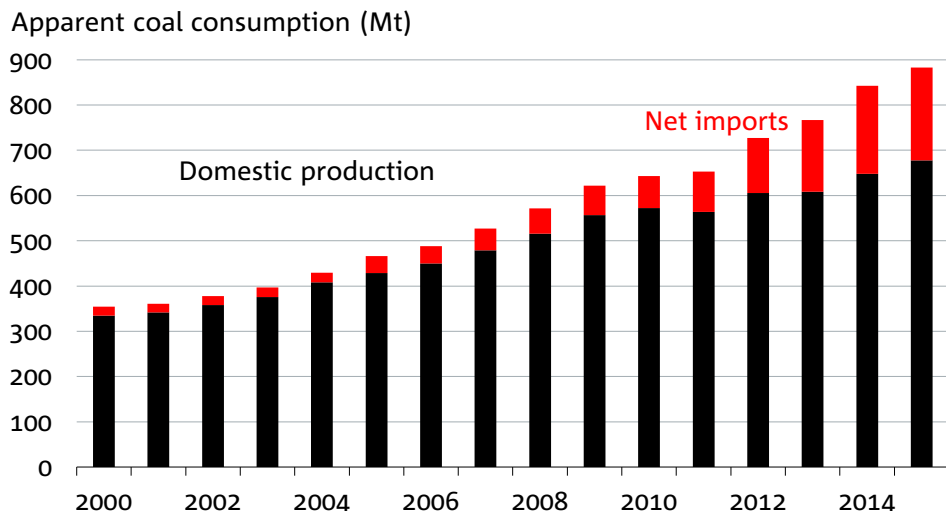
Source: ABS, NAB Economics



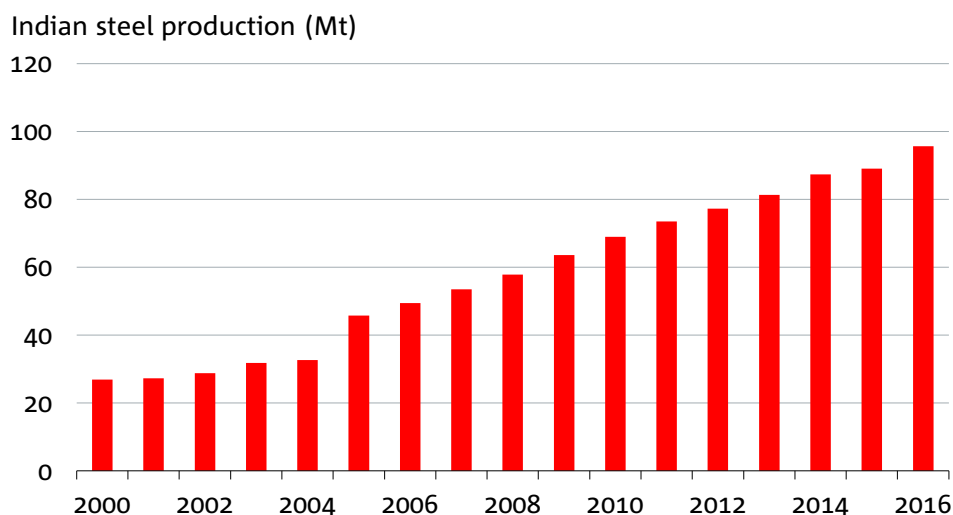
AUSTRALIA'S COAL TRADE WITH INDIA

Coal trade driven by growth in Indian steel output

IMPORTS FILL THE GAP IN INDIA'S DOMESTIC COAL SUPPLY



STEEL OUTPUT GROWTH SUPPORTS IMPORTED COAL DEMAND



Source: BP, UN Comtrade, World Steel Association, NAB Economics

- Coal is by far Australia's largest export to India – accounting for around 56% of Australia's merchandise exports to India in 2016. The vast majority of this – around 90% – is metallurgical coal (used in the steel industry), reflecting India's limited domestic supplies of high quality coking coal.
- Much like China, India is a major coal producer, with imports filling the gap between domestic supply and consumption – at around 23% of the total in 2015. However imports fell in 2016, with stronger domestic production and weaker than expected demand from electricity generators reducing thermal coal import requirements. In contrast, imports of metallurgical coal were essentially unchanged.
- Prospects for growth in thermal coal exports to India are limited. India's National Electricity Plan was released in December 2016. Under the proposal, no additional coal fired generation (aside from the 50 gigawatts of capacity currently under construction) would be required in the next decade. Increased coal consumption over this period is expected to be met by higher domestic production (with imports at around 50 million tonnes a year – below current levels).
- In contrast, prospects are stronger for metallurgical coal – reflecting continued growth in steel output. Over the past decade, steel production in India has grown by around 6.8% a year, with India being the third largest steel producer in 2016 (behind China and Japan). Australia's Department of Industry forecasts Indian steel output to rise over the next few years – up to 118 million tonnes in 2022 (up from around 96 million tonnes in 2016).

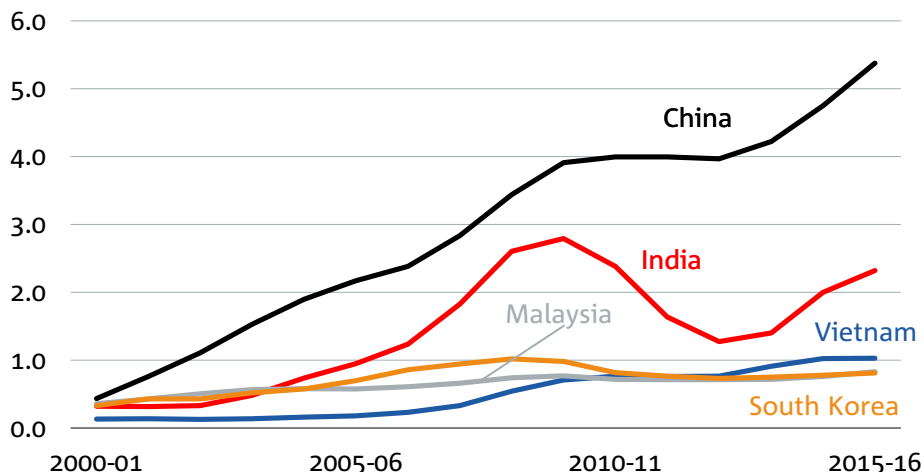


EDUCATION SERVICES

India is an important source of foreign students; Higher education likely to be the growth area

INDIA – SECOND MOST IMPORTANT MARKET AFTER CHINA

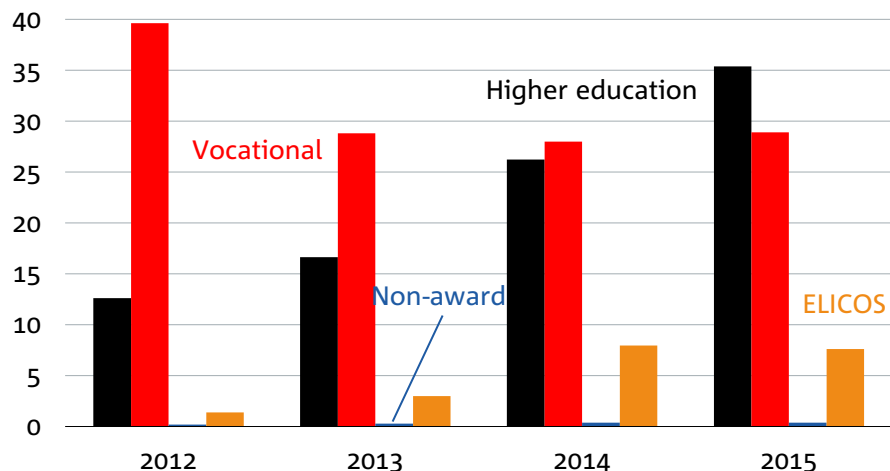
Education exports (A\$b)



- Education exports (from international students living and studying in Australia) totalled \$19.9 billion in 2015-16 – accounting for around 29% of Australia’s total services exports.
- Overall, education is Australia’s third largest export category, following iron ore and coal. Higher education is the largest revenue generator – contributing over two-thirds of total education exports.
- By country, India is the second most important market for education exports – following China – with exports totalling \$2.3 billion in 2015-16. Indian exports have risen in recent years, but are off the peak levels of 2009-10.
- There is a clear growing trend in terms of higher education enrolments among Indian students – overtaking vocational education in 2015 to be the largest category – in stark contrast to vocational education’s dominance in 2012.
- Prospects for growth in Australian exports are boosted by trends in other key markets. Potential visa restrictions in the United States and uncertainty in the UK (related to Brexit) offers opportunities for Australian providers to tap into the growing Indian Higher Education student market. These are the two countries traditionally favoured by Indian students.
- There were ten university vice-chancellors accompanying the Australian Prime Minister and Education minister on the April Indian visit – highlighting the importance of the Indian student market.

HIGHER EDUCATION GROWING STRONGLY

Student enrollments ('000)



Source: ABS, Department of Education and Training, NAB Economics

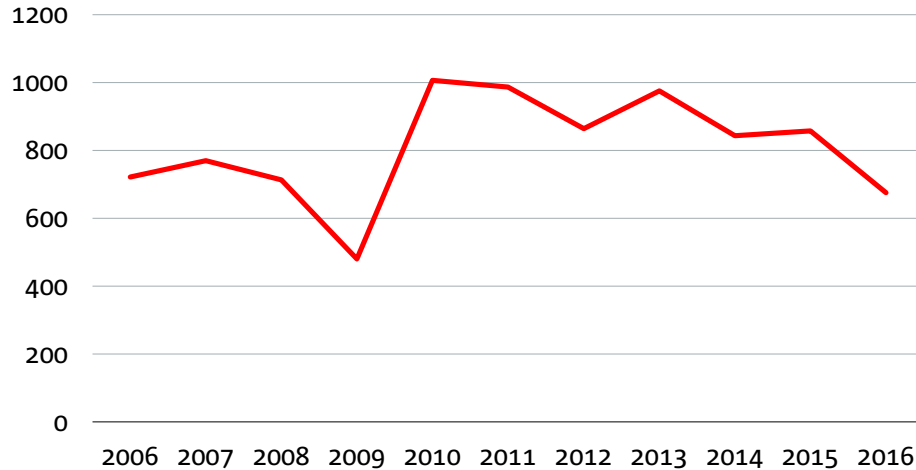


GOLD DEMAND

Australian overall exports strong in 2016; exports to India should improve in 2017 as Demonetisation effects wane

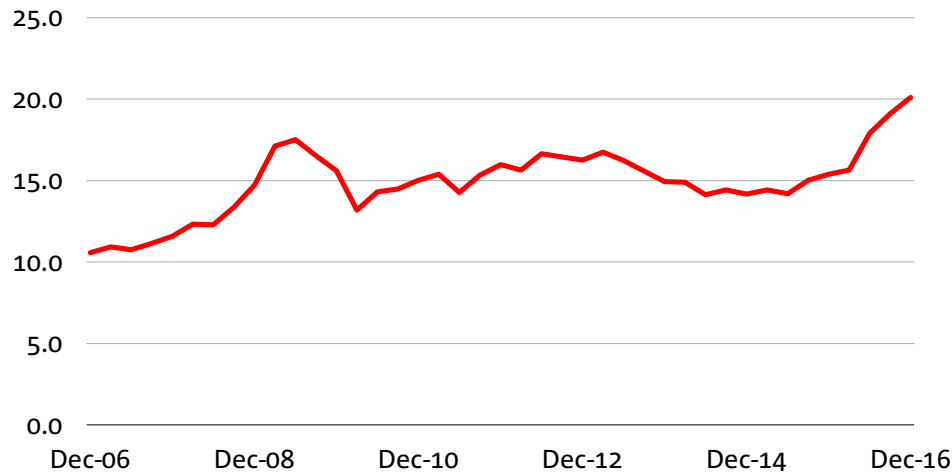
INDIAN GOLD DEMAND: DEMONETISATION IMPACT

Indian gold demand (tonnes)



AUSTRALIAN GOLD EXPORTS: OVERALL INCREASE

Australian gold exports (A\$b) (12 month rolling sum)



Source: World Gold Council, ABS, NAB Economics

- Indian consumer gold demand declined in 2016, impacted largely by the demonetisation program. The cash crunch led to 676 tonnes of gold demand in India, well below recent trends. The brunt of this decline was borne by falling jewellery demand, which fell from 662 tonnes in 2015 to 514 tonnes in 2016.
- Demand is likely to increase in 2017, with the remonetisation process well underway. In Q1 2017 an estimated 230 tonnes has been imported, compared with just 30 tonnes was imported in Q4 2016. Gold imports are expected to remain strong in April due to the Akshaya Tritiya festival on the April 28th, which is considered an auspicious period for gold purchases.
- The value of Australian non-monetary gold exports totalled \$20.1 billion in 2016, an increase of 30%. This reflected both higher export volumes (329 tonnes, a 17% increase) and a higher gold price (the average was US\$1248 an ounce – an increase of 7.7%).
- This growth came despite weaker demand from India in 2016. According to data from the UN Comtrade, gold exports to the UK and Hong Kong more than made up for the shortfall in exports of gold to India. Some of the exports to Hong Kong and the UK might have ended up in China.
- Australian exports of gold to India totalled \$686 million in 2015/16, making it the third largest goods export category, but down from almost \$900 million the year before.

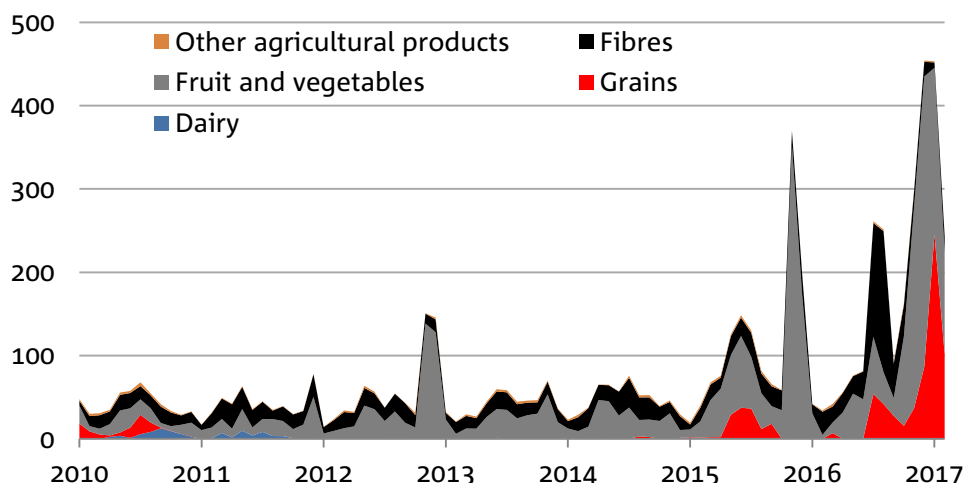


AGRICULTURE

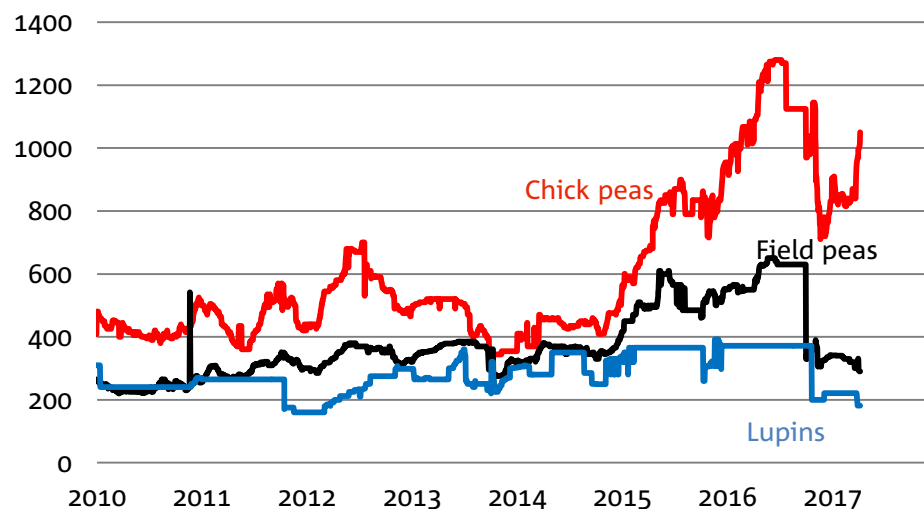
Australia maintains a surplus in both goods and services trade

VALUE OF AUSTRALIAN AGRICULTURAL EXPORTS TO INDIA

million AUD monthly



SELECTED PULSE PRICES (A\$/TONNE)



Source: ABS, Bloomberg, NAB Economics

- India is a massive producer and consumer of farm products – consuming around 94 million tonnes of wheat, 99 million tonnes of rice, 22 million tonnes of corn, 27 million tonnes of oilseeds, 6 million tonnes of cotton, 60 million tonnes of milk, 5 million tonnes of butter and 28 million tonnes of sugar in 2015.
- Australian agricultural trade with India is dominated by grain, nuts (especially almonds) and fibres. Australian exports of pulses surged in 2015/16, with poor Indian monsoon conditions in 2014 and 2015 pushing up the price of chick peas and lentils in the past two years. Australian growers have responded to these high prices by substantially increasing their plantings of pulses.
- India, with its high rates of vegetarianism, is the world's largest chick pea producer and a huge consumer of pulses for their high protein content. Australia's chick pea, split pea and lentil producers are focussed largely on the Indian market.
- Over 90% Australian chick peas and lentils are exported, of which over 80% are destined for the subcontinent. Consequently, the performance of Indian domestic chick pea (gram) and lentil (urad) crops is a major driver of Australian prices.
- Food security, price stability and supporting farm incomes are crucial policy goals in India and all lead to a focus on promoting local self-sufficiency for foodstuffs. Consequently, Indian demand for farm products is largely met by local supply with imports generally playing a comparatively minor role, with high protection contributing to this outcome.
- We have been cautious around the trajectory of chick pea prices for some time (they exceeded AUD1,200/tonne last year following two poor Indian monsoon seasons). With the return of more favourable conditions to India last year prices receded to the AUD800 range, but they have jumped this year, again surpassing AUD1,000/tonne. Although it is fair to say that our expectations around chick pea prices have not materialised, it is unlikely that these prices are sustainable. Nonetheless, chick peas are likely to remain more expensive than alternative crops this season.

FOREIGN INVESTMENT IN AUSTRALIA

Mining & Energy dominate

MINING DOMINATES OVERSEAS INVESTMENT IN AUSTRALIA

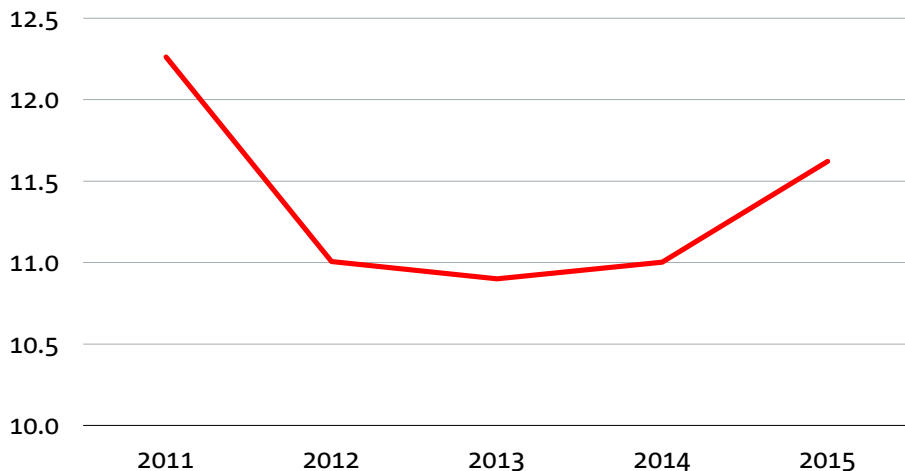
Stock of foreign investment by sector 2015 (\$ billions)



- The mining sector is the largest recipient of overall international investment in Australia. According to ABS data, the total stock of foreign investment in the mining sector was \$295 billion, followed by manufacturing at \$86 billion and real estate at \$64 billion. Other key sectors for foreign investment include: finance and insurance, wholesale and retail trade, information and communications technology, transport and construction.
- The total stock of Indian investment in Australia declined between 2012 and 2014 – following from a recent high of \$12.2 billion in 2011. That said, there was an upward trend in 2015 – with investment totalling \$11.6 billion. Overall, India is the 24th largest foreign investor in Australia.
- Analysis from fDi Intelligence suggests that the main sectors for Indian investment in Australia are coal and oil & gas. There has also been significant investment in renewable energy, metals, software and IT services and financial services.
- Australian investment in India has gradually increased over the past few years – with the stock rising to \$10.6 billion in 2015. A closer relationship between Australia and India may support growth in foreign investment in both countries.

INDIAN INVESTMENT IN AUSTRALIA: RECOVERING

Stock of Indian investment in Australia (\$ billion)



Source: ABS, NAB Economics



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