Indian Apparel Sector: Government policies drive the growth

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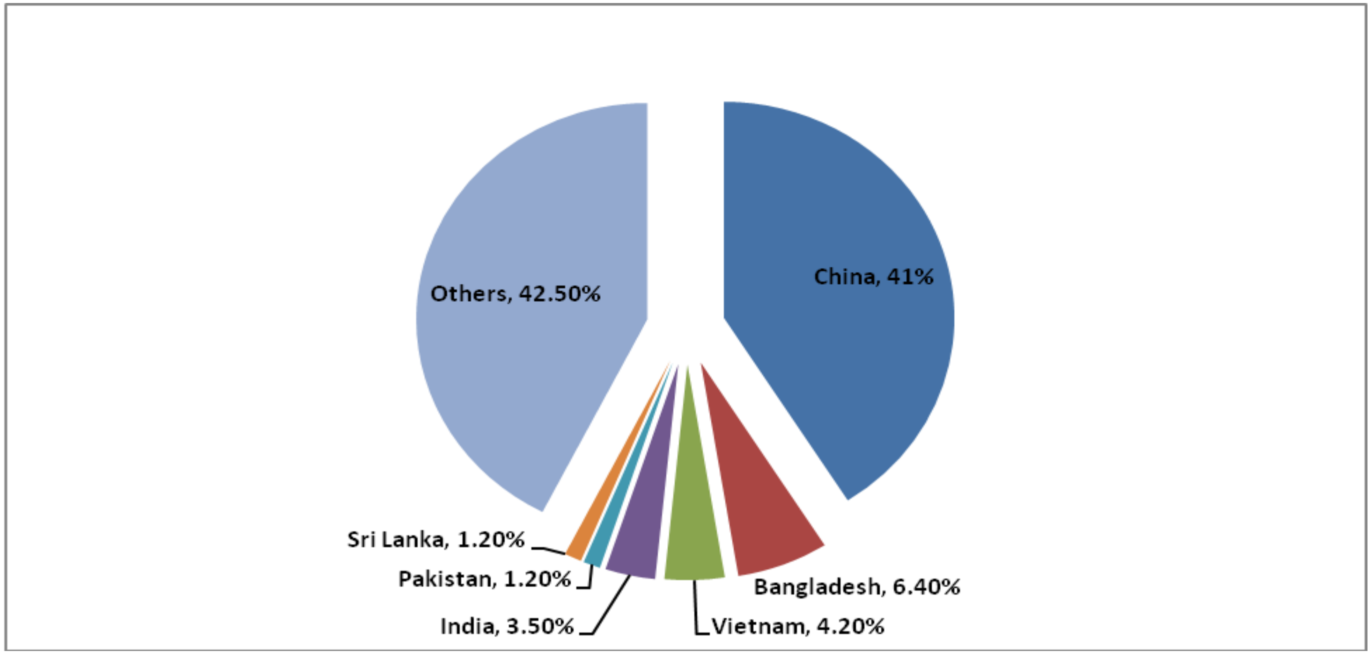
Background

The global apparel market majorly comprises world's large economies of United States of America (USA), European Union (EU), Japan and China. USA and EU are the world's largest apparel importers accounting for 60% of the total global imports, followed by Japan with a share of 7-10%. Countries such as China, Bangladesh, Vietnam, India and Cambodia dominate the exports market, with China accounting for over 40% of the total apparel exports backed by favorable government policies towards the textile sector coupled with economies of scale.

China dominates global apparel Industry (Chart – 1)

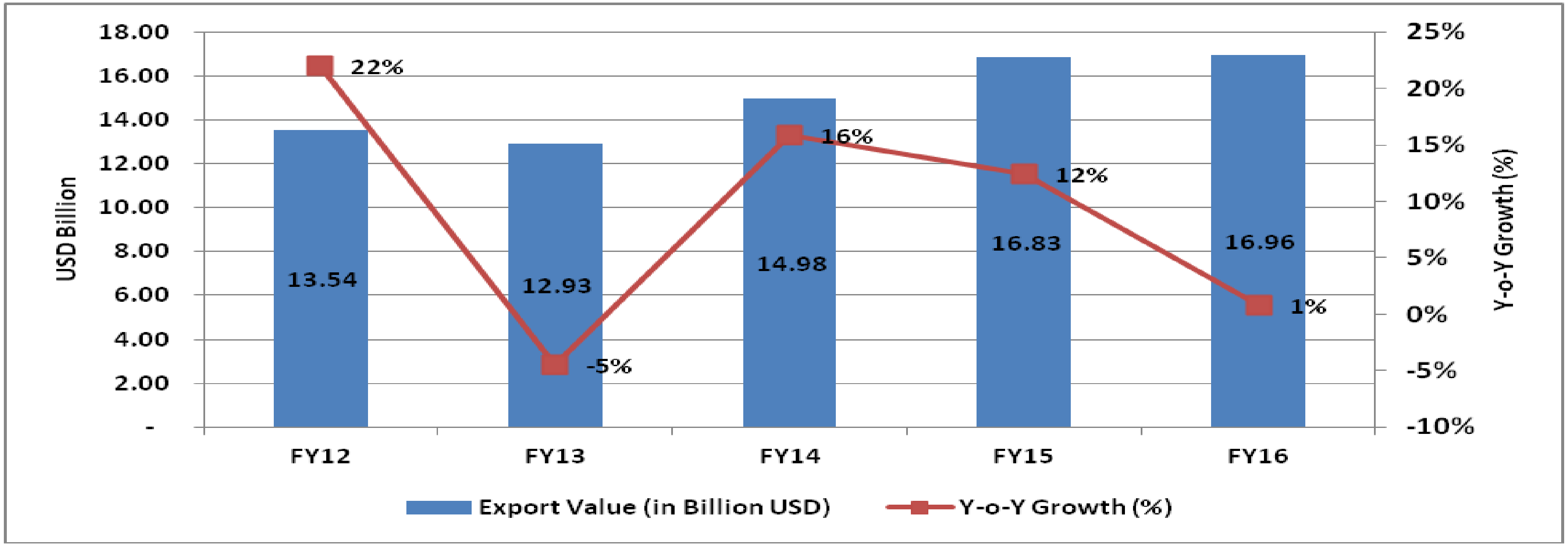


Source: World Bank Report titled "Stitches to Riches" published in March 2016 and CARE Ratings

Indian Apparel Sector

Indian Apparel is the largest segment of the Indian Textile and Clothing Industry (IT&C); accounts 60-65% of the total Industry. Furthermore, it is one of the largest sources of foreign exchange flow into the country. As per the data published by Ministry of Textiles, in its annual report 2015-16, India is ranked as 6th largest exporter of apparel in the world after China, Bangladesh, Vietnam, Germany and Italy.

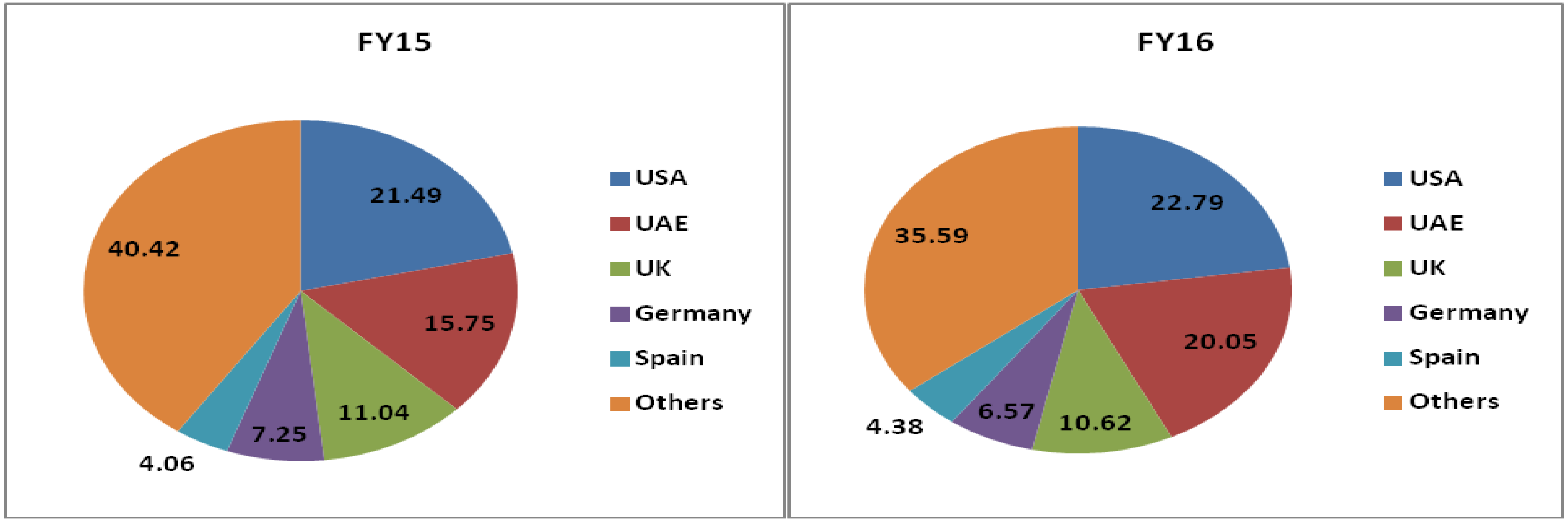
Indian Apparel Exports (Chart – 2)



Source: Centre for Monitoring Indian Economy (CMIE)

In CY15, the global apparel trade actually de-grew by nearly 5% partly due to lower realization of textile products on the back of lower fiber prices and partly due to weak demand from EU and Japan. Despite the weak global apparel trade, the Indian apparel exports grew by 1% in FY16 (in dollar terms; refers to the period April 1 to March 31) as compared with FY15. Furthermore, it is to be viewed in accordance with the fall in cotton and polyester yarn prices along with the depreciation of Indian rupee vis-à-vis USD. The average cotton and polyester yarn prices declined by nearly 6% and 9%, respectively, during FY16 over FY15. Hence, positive growth of nearly 1% indicates volume growth in apparel export. The growth in Indian apparel export is supported by steady recovery in US economy. The Indian rupee depreciated by nearly 6-7% during FY16 over FY15; hence, the growth in rupee term at 7.7% is much higher than the growth in USD terms.

% share of various countries to India's total apparel exports (Chart – 3)



Source: CMIE

Despite increase in the export of Indian apparels in value terms, its market share has remained stable due to higher growth rates of its competing nations like Bangladesh and Vietnam led by favorable government policies in terms of incentivizing the sector through trade agreements with world's largest apparel importing nations like US and EU.

Continued thrust from Governments through favorable policies; although scope for betterment

In developing countries like India, it is important to explore ways to boost the standard of living and reduce poverty. Government of India (GoI) is increasingly focusing on policy to create jobs that are good for development. Export-oriented apparel Industry provides significant opportunity for employment creation due to relatively low skill requirement. Furthermore, it also has a unique ability to attract female workers.

GoI, in its budget for 2016-17, has allocated a sum of Rs.1,480 crore towards the Amended Technology Upgraded Fund (A-TUF) Scheme incentive and Rs.100 crore under the Scheme for Integrated Textile Parks (SITP). Furthermore, to encourage the export of value-added products, GoI also provides higher capital subsidy under A-TUFS to weaving and garmenting units as compared with the subsidy to spinning units. Furthermore, in the Union Budget 2016-17, the customs duty rate of 5% on specified fibers and yarns used in the production of apparel was reduced to 2.5%. Moreover, the export incentive under the duty draw back scheme has been increased to 10.5% from previous 7.2% along with 3% interest subvention on pre- and post-shipment rupee export credit facility availed by apparel exporters.

Furthermore, GoI recently announced Rs.6,000 crore package for textile and apparel sector which includes additional incentives for duty drawback scheme for apparels, flexibility in labor laws and tax and production incentives to garment manufacturing units. This would also fuel the growth in the Indian garment sector. Moreover, GoI is actively considering Free Trade Agreement with EU which will allow duty free access of Indian garment in EU, which is the world's second largest export destination for readymade garment.

These attempts are also in line with government's vision to maximize the employment generation and value creation within the country under 'MAKE IN INDIA' campaign. However, India needs to adopt more favorable policies to increase market access, ease import barriers, improve export logistics, labor reforms and facilitate foreign investment.

Trans-Pacific Partnership (TPP)

The TPP is a trade agreement among twelve Pacific Rim countries signed on February 4, 2016. It has not entered into force. The TPP would create a free-trade zone amongst 12 member nations. The countries involved in TPP include Australia, United States, Canada, Vietnam, Japan, Chile, Malaysia, Brunei, Mexico, Singapore, Peru and New Zealand. The countries within its scope account for 40% of the world's economic output. The TPP agreement will eliminate or reduce duties on textile and apparel goods that originate from any of the twelve participating countries provided the specific "Rule of Origin" requirements are met i.e. "Yarn forward" rule; whereas the Indian apparel exports would be subject to 15-45% duty. However, the Indian apparel exports are partially protected from the adherence to the "Yarn forward" rule i.e. the yarn used in manufacturing textile and apparel goods must be spun or extruded in one of the TPP participating countries for the final goods to qualify for benefits. Furthermore, Indian apparel export is also relatively protected due to China not being the party in TPP which is the largest apparel exporter in the world.

In the longer term, the passage of TPP may put India to disadvantageous position compared with Vietnam which has gained duty-free access to US. Textile and garments produced from yarn and fabric made by a TPP nation will qualify for duty-free status. However, lack of sufficient spinning and weaving capacities may constrain member countries till the time required capacities are built. Thus, despite the TPP agreement, it does not put India in disadvantageous position to a large extent for the time being. Though to safeguard business interests, India's some of the largest apparel manufacturing groups like Arvind, Raymond, etc, have started setting-up their manufacturing facilities in some of the African countries like Ethiopia which have duty free access to the US market.

Outlook

Increase in Chinese apparel prices could provide higher demand for Indian Garments

During recent years, China has seen a sustained rise in its wage costs, which may lead to potential increase in its apparel prices. As a result, China is shifting its production base to higher value-added industries like electronics and curtailing low value-added production like textile and apparel. This presents a huge opportunity for south Asian countries including India to increase their share of exports.

As per the recent study conducted by World bank, a 10% increase in Chinese export prices would result in the United States increasing its imports from India by 14.62% and from Bangladesh by 13.58%. Countries such as Vietnam and Cambodia would benefit even more where exports would increase by 37.71% and 51.25%, respectively.

With expected reduction in China's cost competitiveness and reduced focus on textiles, India has the chance of increasing its share in global apparel exports. Although India is expected to gain market share, Southeast Asian countries like Cambodia, Indonesia and Vietnam are expected to benefit more in overall export performance.

Traditionally, India is a net exporter of cotton yarn accounting for 30-35% of the production, which can be diverted for the production of cotton-based apparels leading to more value creation within the country. With Government's continued thrust on export of value-added products like garments, it provides an opportunity for Indian textile industry to increase its share of garment exports. This would also provide higher foreign exchange earnings and create higher employment.

Increasing opportunity in domestic market

The growth in the organized retail market in India has led to increase in the sale of Branded apparel in the domestic market. The organized retail apparel market is growing rapidly due to increased consumer spending, high brand consciousness, rising income and purchasing power, increasing number of dual income nuclear families, changing lifestyle and consumer behavior. Organized retail in India is the most dynamic industry and represents a huge opportunity for domestic markets.

As per the report published by the World Bank, the apparel produced domestically is sizeable and growing, particularly for large Asian economies such as China and India. Bangladesh and Vietnam are strong performers in terms of export growth, yet neither has a formal retail apparel industry. As per the data published by World Bank in its report, 'Stitches to Riches' in March 2016, the apparel retail market in these two countries combined is less than $3 billion, whereas India's market is valued at $40 billion, which is almost entirely produced within the country. If production for the domestic and export markets are combined, India's value jumps to $57 billion, compared with $24 and $20 billion in Bangladesh and Vietnam, respectively.

Conclusion

With increasing competition from Bangladesh and Vietnam along with the passage of TPP, the export demand for Indian apparel is expected to moderate. Furthermore, with recent depreciation of pound vis-à-vis the various currencies including US dollar and Indian rupee, the prices of apparel are expected to go up in the region which may lead to decline in the exports of Indian apparel to UK which is among the top exporting destination. However, given the continuous efforts by the Government of India to response the increasing competition from Vietnam and Bangladesh, India is in a sweet spot to increase its market share in world apparel trade given the declining competitiveness of China which is the largest apparel exporter in the world. CARE Ratings strongly believes that the role of the government is very crucial for the overall growth of the Indian Apparel sector.

Moreover, the growth in the organized retail industry is expected to pick up in next two years with increasing GDP per capita and the Indian apparel demand is at the cusp of significant growth, as the economy crosses USD 2,000 GDP per capita. As per the data published by Boston Consulting group, Indian retail market is projected to double from $600 billion in 2015 to $1 trillion by 2020. Also, the increasing percentage of the youth in the country together with rising urbanization, rising mall culture, changing fashion trends and retail penetration would continue to support the growth of Indian apparel sector.