

INDIA-CHINA RAPPROCHEMENT: WHAT ARE THE LONG-TERM PROSPECTS?

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China-India relations, which have long been fraught, were further complicated by the 2020 military standoff on the Himalayan border. The political disruption had a significant impact on Chinese companies' presence in India. And yet, India's dependence on Chinese imports has increased since.

The Indian economy is decelerating at a challenging time for Prime Minister Modi, who governs in a coalition. China could offer a partial solution to India's economic woes by providing manufacturing FDI and creating jobs. The Modi-Xi 'rapprochement' after their encounter at the October 2024 BRICS summit signals that relations could improve. India may be willing to accept targeted investment from China, but relations are unlikely to fully normalise, particularly since the 2025 India-Pakistan military stand-off.

There are three main reasons for this. First, the Indian army remains cautious about the situation at the border and security risks relating to China. Second, the United States under President Trump will exert pressure on Modi not to depend further on China. This is even more relevant in the context of Trump's threat to impose tariffs on India. Third, Indian public opinion on China and the Belt and Road Initiative remains negative.

India is predicted to experience greater growth than China in the coming decades, meaning China could lose its upper hand in economic relations between the two countries. This, however, will depend on how dependent India becomes on China for imports or for jobs through FDI and other channels. The militarised border, India's asymmetric economic dependence on China and China's leadership in the Global South will still shape the relationship even if the Indian economy grows to a similar size to China's. India-China 'rapprochement' is possible but will remain fragile and is unlikely to be maintained in the long run.

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1 How have China-India relations evolved?

The relationship between China and India has been marked by cooperation and rivalry, with economic engagement offset by tensions and security concerns. Since the installation of Xi Jinping as Chinese President in March 2013 and the election of Narendra Modi as Prime Minister of India in May 2014, relations have remained thorny, and their long-standing border dispute has become even worse.

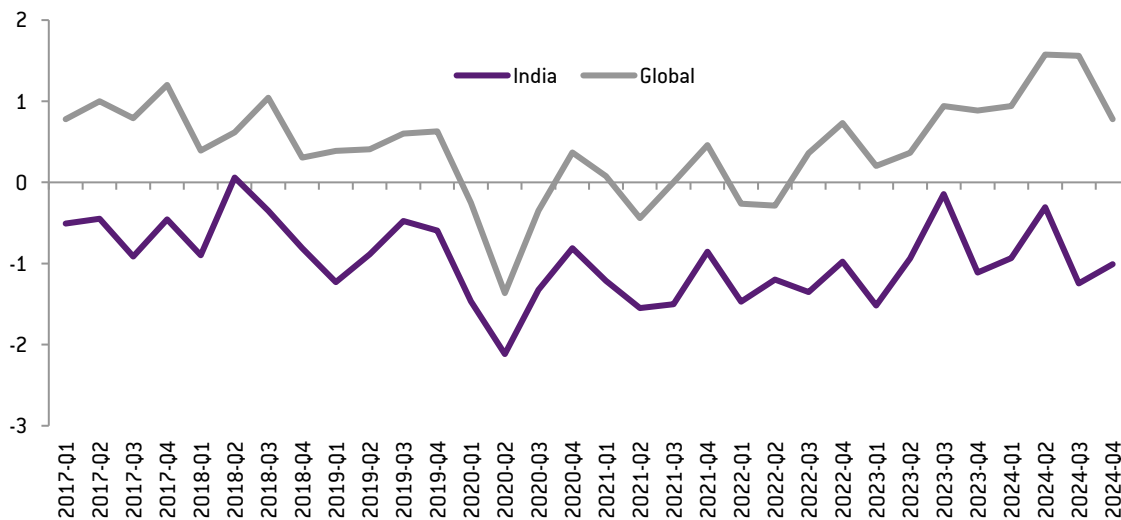
During President Xi's visit to India in September 2014, the countries aimed to redefine their relationship through a closer developmental partnership to advance common interests and regional and global stability and prosperity. Efforts were made to enhance trade and investment through the Five-Year Development Program for Economic and Trade Cooperation¹.

Since then, the India-China bilateral relationship has seen positive and negative developments in economy, defence and security. On 16 June 2017, a military face-off between India and China started on the Doklam plateau, a strategically important region at the trijunction of India, China and Bhutan, which lasted for 73 days. On 27 April 2018, Modi went to Wuhan for an informal summit. Both sides agreed to improve military communications to prevent miscalculations at the China-India border and committed to establishing better crisis management mechanisms (Joshi, 2018). Modi also expressed his concerns about the growing bilateral trade deficit, while Xi agreed to open China's market to Indian products (Kumar and Singh, 2018).

Despite this rather successful Wuhan summit, problems continued to pile up right after, starting with China's push to have India become a member of the Belt and Road Initiative (BRI). Indian public sentiment about China and its BRI remains much more negative than that of the rest of the world (Figure 1).

¹ See 'Joint Statement between the Republic of India and the People's Republic of China on Building a Closer Developmental Partnership' of 19 September 2014, <https://www.mea.gov.in/bilateral-documents.htm?dtl/24022/Joint+Statement+between+the+Republic+of+India+and+the+Peoples+Republic+of+China+on+Building+a+Closer+Developmental+Partnership>.

Figure 1: India and global sentiment towards China and the Belt and Road Initiative



Source: Natixis

India is strongly opposed to the BRI for two reasons: first, an important part of the BRI, the China-Pakistan Economic Corridor, passes through Pakistan-occupied Kashmir. China’s strong cooperation with Pakistan under the BRI was perceived by India as a potential security threat, which became even more obvious in the lead-up to the 2019 Indian general elections as tensions with Pakistan flared up after a suicide bomber targeted a convoy of Indian paramilitary police in Jammu and Kashmir². Closer China-Pakistan relations since then have not helped, especially since the terrorist attack in Indian-administered Kashmir on 22 April, which was met with India’s ‘Operation Sindoor’, comprised of multiple strikes on Pakistan. China has played a significant role in supplying Pakistan with advanced weaponry used to shoot down Indian aircraft³.

Second, India feared that a successful BRI could put China in a leadership role in the Global South. To some extent, this has happened, evident in China’s central role in an expanded BRICS. India’s role as *de-facto* leader of the G33, a coalition of 47 developing countries coordinating positions on trade and economic issues at the World Trade Organisation (WTO), has lost its lustre as the G33 has become increasingly ineffective. India’s reluctance to engage in trade agreements, including the Regional Comprehensive Economic Partnership (RCEP), has not helped it to maintain a leading role in the Global South⁴.

² BBC, ‘Kashmir attack: Bomb kills 40 Indian paramilitary police in convoy’, 14 February 2019, <https://www.bbc.com/news/world-asia-india-47240660>.

³ Leela Jacinto, ‘Chinese weapons pass combat test in India-Pakistan clash – with flying colours’, *France 24*, 14 May 2025, <https://www.france24.com/en/asia-pacific/20250514-chinese-weapons-pass-combat-test-in-india-pakistan-clash-%E2%80%93-with-flying-colours>.

⁴ Surupa Gupta and Sumit Ganguly, ‘Why India Refused to Join the World’s Biggest Trading Bloc’, *Foreign Policy*, 23 November 2020, <https://foreignpolicy.com/2020/11/23/why-india-refused-to-join-rcep-worlds-biggest-trading-bloc/>.

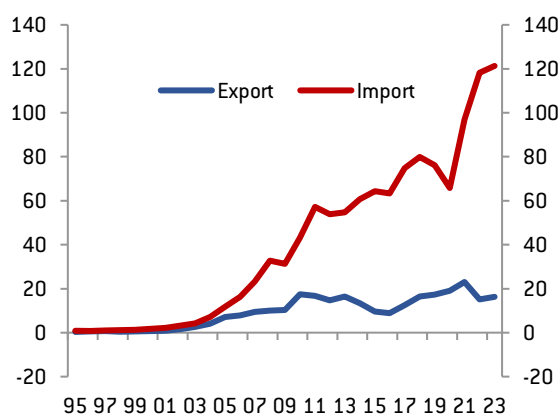
Beyond India's concerns about China's relations with Pakistan and its growing leadership in the Global South, the military stand-off at the Himalayan border in 2020 immediately derailed the economic relationship and high-level contacts between the two countries (Li, 2023). In the next section we will analyse the causes and consequences of this standoff. It is important to understand that China-India relations can often be seen as a triangle, with the third actor being the United States, particularly since Trump presented his Free and Open Indo-Pacific strategy.

While there have been some signs of tensions easing since the BRICS summit in Kazan in October 2024⁵, doing business together will remain difficult as the uncertainties about bilateral relations have not fully disappeared. In fact, while the Government of India has decided to stabilise bilateral ties with China, military tensions continue to simmer and the chances of a full-fledged conflict cannot be ruled out (Bajpae and Jie, 2025).

Economic ties

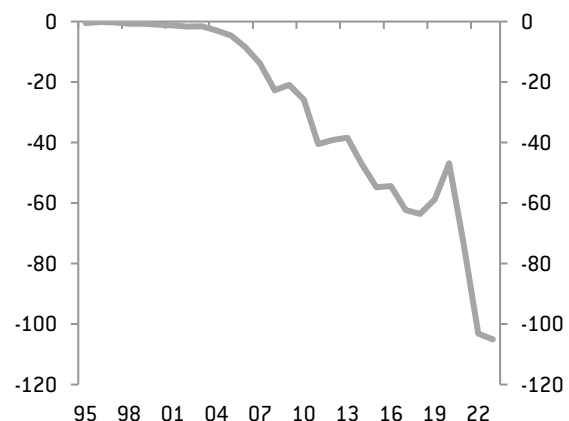
Economic ties between India and China remain relevant but are very concentrated in Indian imports from China, with minimal Indian exports to China and investment between the two. India has been facing an increasingly large trade imbalance, created by its growing reliance on Chinese imports and stagnating exports to China (Figure 2). These imports have continued to increase despite Indian efforts to limit imports through non-tariff barriers including quality controls. The trade deficit reached \$100 billion in 2022 and has remained at that level since (Figure 3). China is India's largest trading partner on the import side while it ranks fourth on the export side (Figure 4 and 5).

Figure 2: India trade with China (billions \$)



Source: Natixis based on OECD TIVA.

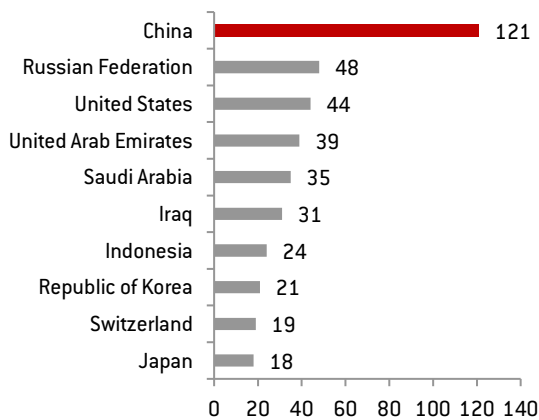
Figure 3: India trade balance with China (billions \$)



Source: Natixis based on UNCTAD.

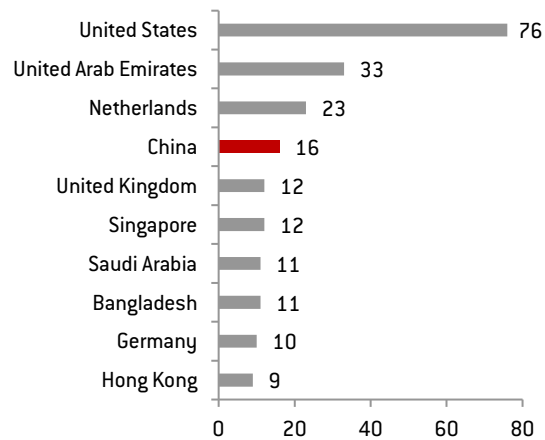
⁵ See press release of 23 October 2024 of the Ministry of External Affairs of the Government of India 'Meeting of Prime Minister with Mr. Xi Jinping, President of the People's Republic of China on the margins of the 16th BRICS Summit', <https://www.mea.gov.in/press-releases.htm?dtl/38457>.

**Figure 4: India largest import partners
(billions \$)**



Source: Natixis based on UNCTAD.

**Figure 5: India largest export partners
(billions \$)**



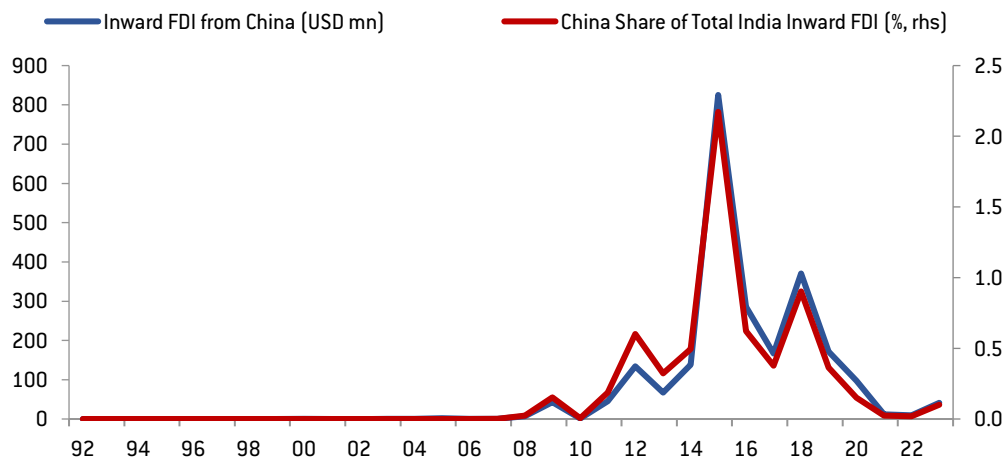
Source: Natixis based on UNCTAD.

Since Modi came to power, there was an attempt to address India's unequal trade relationship with China by attracting foreign direct investment (FDI) into manufacturing to reduce dependency on Chinese imports and create more jobs in the formal economy but with increasingly constraints, especially since the military stand-off in 2020. This is particularly important for Modi, as the lack of formal jobs was one of the issues that may have led to the rather disappointing result for his party in the 2024 general elections⁶.

However, Chinese FDI into India remains extremely low (Figure 6) and even more so for manufacturing. This can be explained, at least partially, by the many restrictions imposed by India, especially when it comes to Chinese FDI. China is interested in the Indian market as it is the only country big enough to become the main player in an alternative supply chain. China's core interest would be to avoid India creating its own manufacturing capacity independently of China, which further increases China's interest in investing in manufacturing in India and its exports of intermediate goods.

⁶ Catherine Davison, "People had had enough": Why Modi's victory in India looks like a loss', *Devex*, 10 June 2024, <https://www.devex.com/news/people-had-had-enough-why-modi-s-victory-in-india-looks-like-a-loss-107742>.

Figure 6: India inward FDI from China



Source: Natixis based on CEIC.

Chinese investors, instead, seem to be increasingly interested in the Indian market given its strong growth and its size. For example, in 2023, BYD, the largest producer of electric vehicles (EVs) in the world, expressed interest in manufacturing in India by proposing a \$1 billion investment plan in collaboration with a local partner⁷. While this proposal has not yet received approval from the Indian government, there could be a breakthrough if the situation at the border could be fully normalised. In the same vein, in September 2024, Lenovo announced plans to manufacture artificial intelligence (AI) servers at its facility in Puducherry, India⁸. Additionally, Lenovo has inaugurated a research and development lab focused on AI servers in Bengaluru. Finally, Shein, the global fast-fashion retailer of Chinese origin, has re-entered the Indian market, after having been forced to abandon it in 2020, through a strategic partnership with the retail arm of Reliance⁹. Fast fashion is not a strategic industry, and it is therefore much easier for it to go through India's investment screening than it is for other sectors.

Security issues

India and China have experienced a complex and often contentious relationship marked by deep-seated historical tensions, territorial disputes, and periodic escalations. The 1962 Sino-Indian War, triggered by disagreements over the demarcation of the Himalayan border was a significant flashpoint, resulting in a decisive Chinese victory and lingering mistrust. Since then, the Line of Actual Control

⁷ *Business Today*, "It's a no for now": Piyush Goyal clears air over BYD's plans to enter India', 7 April 2025, <https://www.businesstoday.in/india/story/its-a-no-for-now-piyush-goyal-clears-air-over-byds-plans-to-enter-india-471076-2025-04-07>.

⁸ *Pro MFG Media*, 'Lenovo Expands India Operations, Begins AI Server Manufacturing in Puducherry', September 2024, https://www.promfgmedia.com/lenovo-expands-india-operations-begins-ai-server-manufacturing-in-puducherry.php?article_id=3303.

⁹ Nirmala Ganapathy, 'Five years after ban, Shein is back in India. Or is it?', *The Straits Times*, 15 March, 2025, <https://www.straitstimes.com/asia/south-asia/five-years-after-ban-shein-is-back-in-india-or-is-it>.

[LAC], the *de facto* border, has been a source of frequent friction, with both countries maintaining large military presences in the region (Joshi, 2018).

Although in second order compared to border clashes, relations between India and the US constitute a second important factor in China-India relations. The official announcement of the Free and Open Indo-Pacific (FOIP) strategy in 2017, saw the US seek closer relations with India¹⁰. In the same vein, the Quadrilateral Security Dialogue (Quad), initially formed in 2007, by President Bush, which went dormant in 2008 due to Australia's fears of provoking China, was resuscitated by Trump in 2017, bringing the US and India closer¹¹. How much these security issues may have weighed in the 2020 military stand-off versus other, more economic, reasons, is hard to tell.

Before the 2020 military stand-off in the Galwan Valley, India and China had established border agreements that laid down a series of protocols for the armed forces and diplomats of both sides to follow given the lack of officially recognised borders¹². In 2003, then prime ministers Atal Bihari Vajpayee and Wen Jiabao signed a separate pact that led to the appointment of a 'Special Representative' for both sides, entrusted with the task of bringing out a political solution to the border question. This eventually came to be known as the 'SR Dialogue' and it has become a channel of communication between the countries because they have the political mandate to discuss the border issue. Finally, in 2012, a Working Mechanism for Consultation and Coordination on India-China Border Affairs (WMCC) was set up with the sole objective of addressing border issues. A similar dialogue mechanism also exists between military commanders in charge of the border on each side, which is generally held at a neutral point along the border.

None of these protocols or the dialogue between special representatives prevented a 2020 stand-off. Its origin could possibly have an economic rationale. In fact, in April 2020, India issued Press Note 3, that sought to restrict FDI from China and other countries that share a land border with India. The directive stipulated that any entity from a country that shares a land border with India must get government prior approval from the official authorities before investing in India. This also included

¹⁰ Alyssa Ayres, 'More Prominence for India and the Indo-Pacific in the U.S. National Security Strategy', Council on Foreign Relations, 18 December 2017, <https://www.cfr.org/blog/more-prominence-india-and-indo-pacific-us-national-security-strategy>.

¹¹ Associated Press, 'What is the Quad, and how did it come about?', *The Guardian*, 24 May 2022, <https://www.theguardian.com/world/2022/may/24/what-is-the-quad-and-how-did-it-come-about>.

¹² The six border protocols are: Agreement on the Maintenance of Peace and Tranquillity along the Line of Actual Control in the China-India Border Areas (1993); Agreement between the Government of the People's Republic of China and the Government of the Republic of India on Confidence-Building Measures in the Military Field along the Line of Actual Control in the China-India Border Areas (1996); Protocol between the Government of the Republic of India and the Government of the People's Republic of China on Modalities for the Implementation of Confidence Building Measures in the Military Field along the Line of Actual Control in the India-China Border Areas (2005); Agreement between the Government of the Republic of India and the Government of the People's Republic of China on the Political Parameters and Guiding Principles for the Settlement of the India-China Boundary Question (2005); Agreement between the Government of the People's Republic of China and the Government of the Republic of India on the Establishment of a Working Mechanism for Consultation and Coordination on China-India Border Affairs (2012) and Agreement between the Government of the Republic of India and the Government of the People's Republic of China on Border Defence Cooperation (2013).

indirect investments where the beneficial owner is from a country that shares a land border with India¹³.

In May 2020, China's People's Liberation Army transgressed the border leading to a bitter military standoff in the eastern part of Ladakh¹⁴. This led to a complete plummeting of ties with both sides ramping up troop deployments with a real risk of a military confrontation. India also took an unprecedented step of banning Chinese apps including Shein, TikTok, WeChat and PUBG Mobile, following the standoff¹⁵. New Delhi said it took this step to safeguard its national security and sovereignty.

The relationship between Prime Minister Modi and President Xi significantly worsened. When Modi went to Samarkand, Uzbekistan in 2022 for the Shanghai Cooperation Organisation (SCO) Summit, he did not shake hands with Xi¹⁶. As chair of G20, India invited President Xi to attend the 2023 summit in New Delhi, but he sent his deputy¹⁷.

The 2020 standoff was an important wake-up call for India in terms regarding China's massive increasing in military capabilities given the rapid increase in military spending¹⁸ and its more aggressive stance with its neighbours and beyond (Masuda and Mattelaer, 2024). While both countries have engaged in a plethora of defence dialogues, underlying tensions regarding border security and China's strategic partnerships, particularly with Pakistan, have complicated these discussions and the larger bilateral relationship. The unresolved border issue continues to be a major security concern, with both countries enhancing their military presence along the LAC. Despite occasional agreements to manage border tensions, the security environment remains fragile, with both sides maintaining a cautious stance¹⁹.

¹³ Parina Muchhala and Harshita Srivastava, 'Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?' *Lexology*, 4 February 2025, <https://www.lexology.com/library/detail.aspx?g=c6bd8252-99c9-419c-8d6d-a20b46185dcd>.

¹⁴ Hannah Ellis-Petersen, 'China and India move troops as border tensions escalate', *The Guardian*, 27 May 2020, <https://www.theguardian.com/world/2020/may/27/china-and-india-move-troops-as-border-tensions-escalate>.

¹⁵ Agence France-Presse, 'India bans 118 Chinese apps, accusing companies of stealing data', *The Guardian*, 3 September 2020, <https://www.theguardian.com/world/2020/sep/03/india-bans-118-chinese-apps-accusing-companies-of-stealing-data>.

¹⁶ *India Today*, 'No handshake, no smiles: PM Modi, Chinese President Xi Jinping share stage at SCO summit', 16 September 2022, <https://www.indiatoday.in/world/story/no-handshake-no-smiles-pm-modi-chinese-president-xi-jinping-share-stage-at-sco-summit-2001050-2022-09-16>.

¹⁷ YP Rajesh, Krishn Kaushik and Martin Quin Pollard, 'Xi skipping G20 summit seen as new setback to India-China ties', *Reuters*, 5 September 2023, <https://www.reuters.com/world/xi-skipping-g20-summit-seen-new-setback-india-china-ties-2023-09-05/>.

¹⁸ According to Tian *et al* (2024), the top three largest military spenders in 2023 were the United States, China and Russia.

¹⁹ For a full analysis of the India-China military standoff, see <https://carnegieendowment.org/events/2025/01/india-china-border-event?lang=en>. For a summary of China's views beyond the general situation, listen to <https://podcasts.apple.com/hk/podcast/third-plenum-implications-for-european-businesses-with/id1729083514?i=1000663311722&l=en-GB>.

2 How important is the recent turnaround?

Despite the negative consequences of the 2020 border standoff, India and China continued to hold steady military and diplomatic communication. Both sides are working to resolve or at least mitigate the faceoff in three phases: disengagement, de-escalation and de-induction (ie gradual removal) of troops.

The first phase, that of disengagement of troops, or pull-back of troops from a confrontational posture, started in February 2021 but a much clearer step-up in disengagement started after Modi and Xi's meeting in Kazan (Russia) on the sidelines of the BRICS Summit on 23 October 2024. This important meeting was followed by a meeting between India and China's ministers of foreign affairs on the sidelines of the G20 in Brazil on 19 November 2024. At that meeting, China requested that India ease visa restrictions on Chinese tourists and businesspeople and the countries discussed strengthening transport links and data-sharing on shared rivers²⁰.

The question of whether this 'rapprochement' is real remains. On the one hand, both sides have started to implement disengagement processes that entailed not just the pulling back of the troops but also removing temporary structures. And yet, China and India have been actively building infrastructure along the LAC, including roads, bridges and military installations, which has been the main source of tension and the catalyst for standoffs in the past.

Nonetheless, a positive development took place on 26-27 January 2025, when the Foreign Secretary of India, Vikram Misri, went to Beijing. This was the first visit of a high-level official since the military stand-off. During the visit, it was decided that both sides would restart direct flights that first got suspended due to the COVID-19 pandemic and never resumed because of the border standoff²¹.

While clearly positive, the reality is very little action has followed the high-level visits, making the 'rapprochement' more symbolic, at least in terms of lifting bilateral restrictions, especially on India's side.

²⁰ *The Economic Times*, 'G20 Summit: EAM Jaishankar and Chinese counterpart Wang discuss steps to stabilise ties', 19 November 2024, <https://economictimes.indiatimes.com/news/india/g20-summit-eam-jaishankar-and-chinese-counterpart-wang-discuss-steps-to-stabilise-ties/articleshow/115461309.cms>.

²¹ See Ministry of External Affairs of the Government of India press release of 27 January 2025, 'Visit of Foreign Secretary to China', https://www.mea.gov.in/press-releases.htm?dtl/38946/Visit_of_Foreign_Secretary_to_China.

3 How much is the current rapprochement related to the economic situation?

The thaw in bilateral relations which started last October at the highest level seems to be economically motivated. China's share in India's industrial goods imports has soared over the last 15 years, highlighting a deepening dependency on Chinese products including telecoms, machinery and electronics. India's reliance on China extends to critical sectors such as pharmaceuticals, electronics, solar power cells, electric vehicles and heavy machinery. India also imports a significant portion of its active pharmaceutical ingredients from China, making its pharmaceutical industry particularly vulnerable to disruptions in Chinese supply chains.

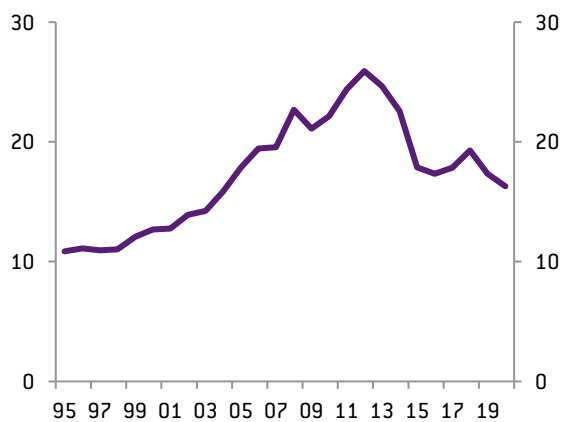
This dependency has been flagged as a national security – or at least economic – concern due to the strategic implications it poses. The two key factors that have fuelled this dependence on China are absence of an ecosystem of innovation and a robust industrial policy. India's efforts to attract FDI to diversify its supply chain have not fully materialised, and there's an acknowledgment that reducing reliance on China requires substantial investment in research, development and manufacturing capabilities by India's corporate sector.

The several initiatives by the different Modi governments, such as 'Make in India,' officially launched by Prime Minister Narendra Modi in September 2014, and 'Aatmanirbhar Bharat'²² (or self-reliance) have not led to an increase in FDI, especially in manufacturing. The Production Linked Incentive²³ scheme introduced since 2020 to boost local production has failed to attract investors. One could argue that the push towards import substitution has worked if measured by the reduction in foreign content of Indian exports, or the so-called 'backward participation in the jargon of global value chains' (Figure 7). But this does not need to be a good thing unless such substitution is a consequence of an increase in competitiveness of Indian products. The reality is that India's import tariffs are high and have been ramped up even further since 2022 (Figure 8). By making imported goods more expensive, the substitution towards domestic content has accelerated in the past few years but has not really achieved the goal of increasing manufacturing capacity locally.

²²Aatmanirbhar Bharat (or 'self-reliant India') is a phrase the Prime Minister of India Narendra Modi has started using in relation to the country's economic development plans. The phrase is an umbrella concept for the BJP's plans for India to play a larger role in the world economy, and for it to become more efficient, competitive and resilient.

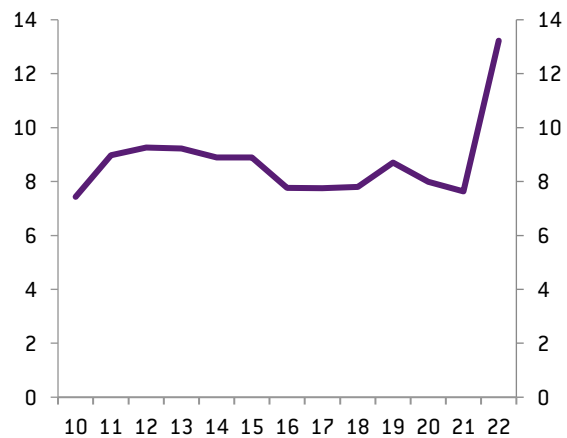
²³ The Production Linked Incentive (PLI) scheme was introduced by the government of India in 2020 as part of its efforts to boost domestic manufacturing and reduce the country's dependence on imports.

Figure 7: Backward participation with the world (% of gross exports)



Source: Natixis based on OECD TIVA.

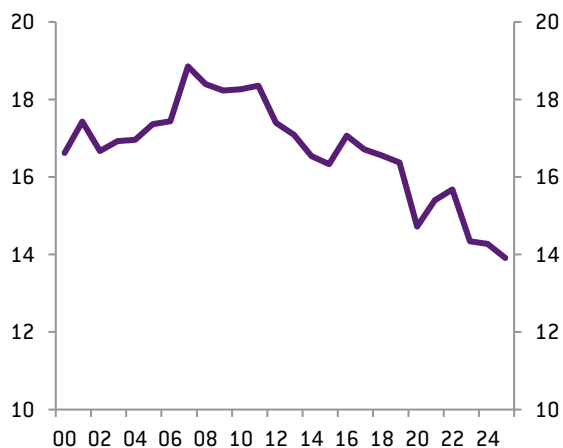
Figure 8: India Intermediate goods tariff (effectively applied, simple average)



Source: Natixis based on UNCTAD TRAINS.

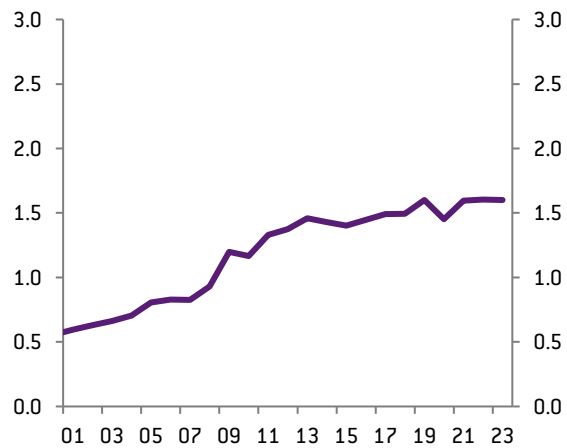
On the contrary, the share of manufacturing in India's GDP continues to decline and is now 14 percent (Figure 9). Another sign of India not having gained competitiveness is its stagnant share of exports as a percentage of global exports (Figure 10).

Figure 9: India: manufacturing as share of GDP



Source: Natixis based on CEIC.

Figure 10: India: share of global exports



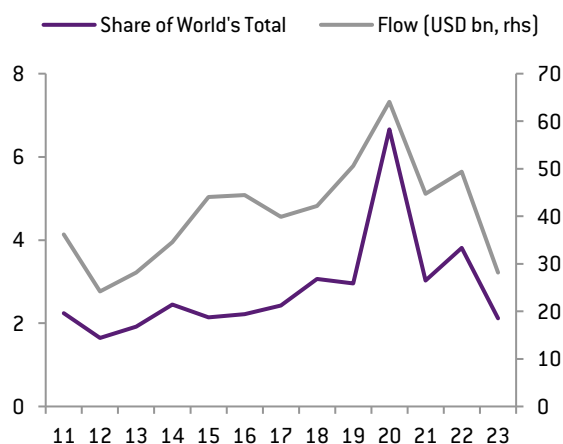
Source: Natixis based on UNCTAD.

India's lack of external competitiveness, especially against China, is behind its increasing trade deficit and overall dependence on Chinese goods.

Prime Minister Modi – who is now much more constrained politically compared to his previous two terms as he is in a coalition government – is increasingly focused on the economy. FDI from China, especially in manufacturing, could help create new jobs which the Modi government needs. In fact, many argue that one of the reasons for Modi to have lost part of its constituency during the general

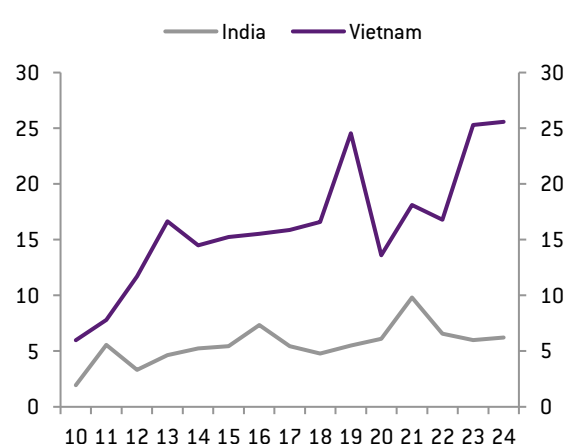
elections last May was the lack of job creation²⁴. While Modi might have preferred non-Chinese FDI, India has not been able to attract much FDI, with its global share stagnating at 2 percent (Figure 11). The situation is even worse for manufacturing. Vietnam alone attracts more FDI in manufacturing than the whole of India and the gap is only increasing (Figure 12).

Figure 11: India: inward FDI flow



Source: Natixis based on UNCTAD.

Figure 12: India and Vietnam inward FDI in manufacturing (billions \$)



Source: Natixis based on CEIC.

The Chinese government has not issued any official statement explicitly encouraging Chinese investment in India, but it has consistently advocated for a fair and non-discriminatory business environment for Chinese enterprises operating in India²⁵. Chinese companies, especially in the EV sector, have been much more outspoken. For example, SAIC Motor, China's largest automaker, has shown significant commitment to the Indian market through its subsidiary, MG Motor India, which it acquired in November 2023, SAIC, with a 35 percent share, from India's JSW Group. Further emphasising its commitment, SAIC announced plans in May 2024 to invest up to \$2 billion in India by the end of the decade. The investment includes setting up a second manufacturing plant and aims to produce and sell over a million vehicles annually²⁶.

BYD has not yet secured approval of its proposal for a \$1 billion investment in India through a joint venture with Megha Engineering²⁷. Beyond India's market size, making sure that India remains linked

²⁴ Saumya Roy "Destruction of jobs": India election turns spotlight on a dream gone sour', *Al Jazeera*, 6 May 2024, <https://www.aljazeera.com/economy/2024/5/6/india-elections-focus-on-increasing-informalisation-of-work-for-youth>.

²⁵ *Global Times*, 'India should provide fair, non-discriminatory business environment for Chinese companies to invest and operate in India: Chinese FM', 19 January 2024, <https://www.globaltimes.cn/page/202401/1305722.shtml>.

²⁶ Ketan Thakkar. 'MG parent SAIC to invest up to USD 2 billion in India; to offer a range of compact cars, SUVs', *Autocar India*, 9 May 2024, <https://www.autocarindia.com/industry/mg-india-parent-saic-to-invest-usd-2-billion-for-new-products-431532>.

²⁷ *The Economic Times*, 'India keeps China's BYD at red signal, shifts gears to court Elon Musk's Tesla', 8 April 2025, <https://m.economictimes.com/industry/renewables/india-hits-the-brakes-on-chinas-byd-amid-it-shifting-gears-to-court-elon-musk-owned-tesla/articleshow/120082249.cms>.

to the Chinese supply chain is important for Chinese companies and even more so for the Chinese leadership as it reduces the West's options for derisking /decoupling.

4 How might US-India relations influence the rapprochement?

In his first term, President Trump sought to build a closer relationship with India, mostly on security issues, through the FOIP strategy and the Quad. Trump met with Modi twice in the weeks after his second presidency started, first for the Quad summit on 21 January and then for a bilateral meeting in Washington DC on 13 February. This visit ended on a positive note, in part because Modi decided to buy more military equipment from the US and oil and gas while also announcing a reduction of import tariffs on some US exports right before the visit²⁸. Beijing responded cautiously to the Modi-Trump summit, emphasising that their bilateral cooperation should not harm a third country's interests²⁹. This response clearly indicates that Beijing is worried about the US meddling with Beijing 'rapprochement' with India and the related business opportunities.

More generally, the Trump administration has been deepening ties with New Delhi through a combination of defence cooperation, trade negotiations and a shared stance on countering China's growing influence. Although Trump is clearly focused on his 'America First' policy, he has recognised India as a critical economic and strategic partner. Modi and Trump set a goal to double bilateral trade to \$500 billion by 2030, and negotiations for a trade agreement are underway³⁰. The agreement aims to provide security and transparency for American companies interested in India and, reciprocally, for Indian firms in the US.

In this context, the Trump's administration imposition of 'reciprocal' tariffs of 24 percent on India was received very negatively in New Delhi. At the time of writing, the tariffs have been suspended until 9 July, with negotiations ongoing³¹. The main hurdles are in agriculture, intellectual property and digital trade. Outcomes could range from an interim deal boosting trade to \$300 billion by 2028, to stalled talks risking \$20 billion in losses, or a limited pact phasing in reforms by 2030. A successful deal, especially if accompanied by a trade agreement, could make India an alternative global manufacturing hub which is not overtly dependent on China. US companies, encouraged by the Trump administration, are seeking this alternative. On 6 May the United Kingdom and India concluded negotiations on a trade deal³². On the EU side, the FTA negotiations, which were relaunched in June 2022, are important for

²⁸ See 'United States-India Joint Leaders' Statement' of 13 February 2025, <https://www.whitehouse.gov/briefings-statements/2025/02/india-joint-leaders-statement/>.

²⁹ *The Economic Times*, 'Bilateral cooperation should not harm third party: China on Modi-Trump meeting', 14 February 2025, <https://economictimes.indiatimes.com/news/international/world-news/bilateral-cooperation-should-not-harm-third-party-china-on-modi-trump-meeting/articleshow/118249461.cms>.

³⁰ PTI, 'India, US aim to double bilateral trade to USD 500 bn by 2030, announces plan for mega trade deal', *CFO from the Economic Times*, 14 February 2025, <https://cfo.economictimes.indiatimes.com/amp/news/india-us-aim-to-double-bilateral-trade-to-usd-500-bn-by-2030-announces-plan-for-mega-trade-deal/118249983>.

³¹ PTI, 'US suspends additional 26% tariff on India till July 9: White House', *The Economic Times*, 10 April 2025, <https://economictimes.indiatimes.com/news/economy/foreign-trade/us-suspends-additional-26-tariff-on-india-till-july-9-white-house/articleshow/120170428.cms>.

³² Dentons, 'The UK-India Free Trade Agreement', 8 May 2025, <https://www.dentons.com/en/insights/articles/2025/may/8/the-uk-india-free-trade-agreement>.

India (with the EU being its largest trading partner on the export side) and for the EU, which is looking to expand market access but also to offer its companies a different destination to produce, other than China, in line with the EU's China derisking strategy.

While these two deals were expected to be concluded in 2025, Trump's tariff threat is making India put its attention on the US, which could have consequences in terms of a potential delay in the conclusion of negotiations with the EU.

Trump's ability to keep India away from opening up to Chinese foreign direct investment will likely hinge on Trump's final decision on reciprocal and/or sectoral tariffs on India and whether a trade agreement can be finalised. Without real outcomes on the economic side, Trump's proactive courtship of India might not be enough to avert this risk as India needs to create manufacturing jobs more than ever.

5 What to expect in the short run?

India and China are in regular discussion regarding de-escalation across the LAC, but the process is advancing very slowly and requires sustained dialogue. Trump's push to isolate China and China's disdain for the Quad, further complicate the situation. India is planning to host the Quad Summit this year, which President Trump may attend, although there is no confirmation yet³³. On the other hand, Trump threatened BRICS nations with a 100 percent tariff on all imports into the US if they proceeded with launching a common currency, just hours before his meeting with Modi³⁴.

Given the potential constraints from the Trump administration and the Indian Army's own doubts about the de-escalation process (Bloomfield, 2021), any opening must be targeted and not increase India's dependence on China in strategic sectors. In that regard, India has no plans to remove the restrictions on Chinese FDI under Press Note 3 although it may still grant specific approval of FDI that creates a large number of jobs in the manufacturing sector.

India has already removed the ban on the Shein app, under Reliance control although it seems difficult to imagine that the lifting of the ban will extend to information-related apps such as Tiktok.³⁵ This is all the more the case since the Indian government cannot really confirm that China is no longer active at the border nor is India which is still expanding infrastructure networks at the LAC.

Against this backdrop, a Modi-Xi meeting at the SCO summit will be important. China holds the rotating presidency from 2024-2025 and will host the next summit. Modi's decision to attend the summit will depend on domestic and external factors. On the domestic side, India expects China to follow the

³³ The importance of the Quad summit cannot be overstated; President Trump hosted a meeting with Quad foreign ministers in Washington DC on 21 January 2025, one day after his inauguration.

³⁴ *The Economic Times*, 'Donald Trump declares "BRICS is dead," claims 100% tariff threat stopped Bloc's dollar moves', Feb 14, 2025, <https://economictimes.indiatimes.com/news/economy/foreign-trade/donald-trump-declares-brics-is-dead-claims-100-tariff-threat-stopped-blocs-dollar-moves/articleshow/118226943.cms>.

border protocols and not engage in border incursions by unilaterally changing the status quo. On the economic side, the deceleration of the Indian economy plays in China's favour as India needs to create more jobs in the formal economy and also increase its manufacturing capacity. Externally, Trump's tariff threat will be key and the confirmation that the US will continue to cooperate militarily with India at the highest end. Modi would be expecting the two agreements signed under the Biden administration on AI and critical and emerging technologies to be maintained³⁶. Trump's visit to Delhi for the Quad summit could also be decisive.

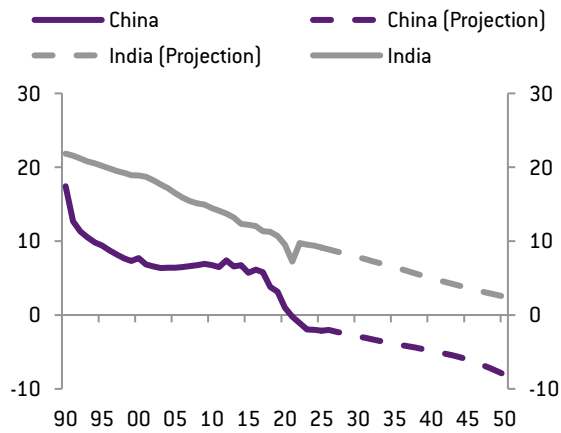
Given the rapidly evolving nature of Indo-Chinese and Indo-US relations. Modi is likely to continue pursuing strategic autonomy for India.

6 What about the long run?

The current unbalanced state of play, in which China has an economy five times the size of India's, and a much bigger military capacity, is likely to continue for some time, but will change. The growth differential for the next decades is clearly in India's favour. The Chinese economy has been decelerating for more than 10 years and will continue to do so with GDP growth expecting to hover around 2.3 percent by 2035 and around 1 percent, by 2050. The further reduction in growth from 2035 stems from China's rapid depopulation (Figure 13) but, also, the fact that the urbanisation process, which is now mitigating the impact of depopulation in productivity and, thus, economic growth, will be completed (García Herrero and Xu, 2023) (Figure 14). India's demographic dividend remaining positive for at least 15 more years and, even if declining over time, the gap China will remain the same. Furthermore, India's urbanisation process is still at its infancy, especially when compared with China (with 36 percent urbanisation rate compared to 66 percent for China).

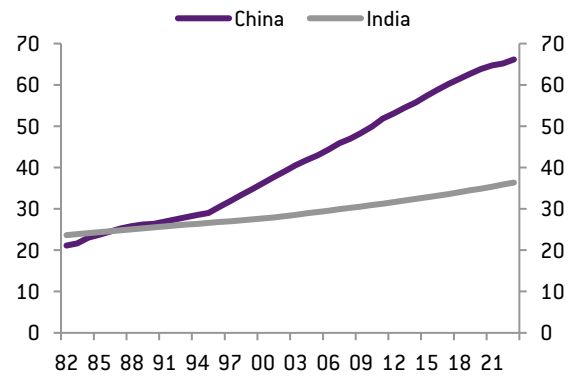
³⁶ The US-India Artificial Intelligence (USIAI) Initiative was launched in 2021 under the Indo-US Science and Technology Forum, this initiative aims to facilitate bilateral research and development in AI, promote innovation and build an AI workforce. Second, the United States–India Initiative on Critical and Emerging Technology (iCET), announced in May 2022, iCET focuses on collaboration in critical technologies, including AI, quantum computing, semiconductors and telecommunications.

Figure 13: China and India rate of natural change of population



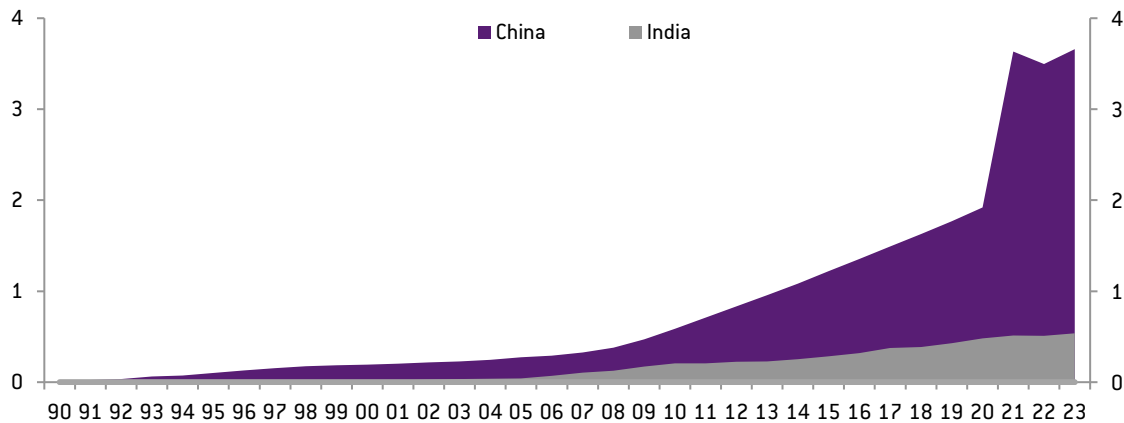
Source: Natixis, World Bank.

Figure 14: China and India: urbanisation rate (%)



Source: Natixis, CEIC.

Figure 15: China and India stock of FDI (trillions of \$)



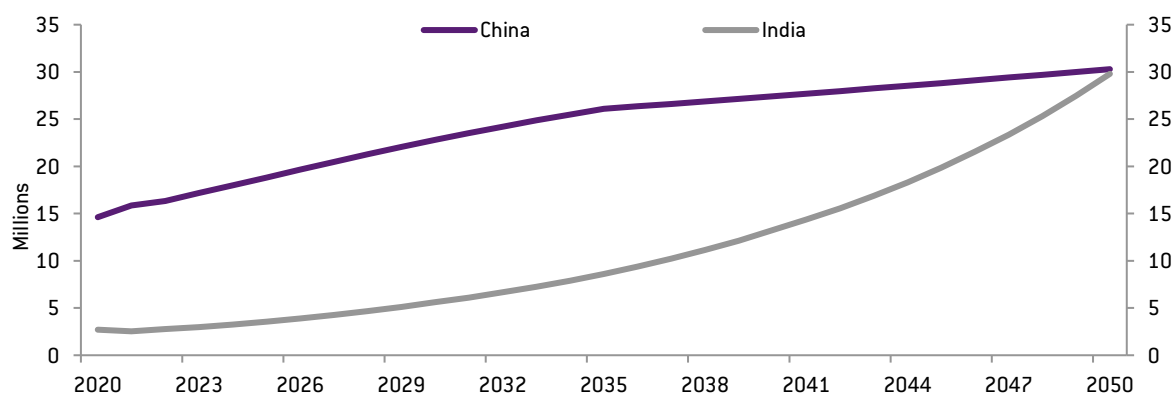
Source: Natixis, CEIC.

Finally, India's stock of capital is much lower than that of China (Figure 15). Given the massive infrastructure gap, this also explains why the return on investment is so much higher, feeding the positive growth differential for India. With conservative growth forecasts for India (at 6 percent until 2030, which is below consensus,³⁷ and coming down to 5.5 percent and 5 percent until 2035 and 2040, respectively, and 4.5 percent by 2050), India's growth will continue to outpace that of China by an increasing margin. In fact, China's growth is expected to grow by only 2.3 percent by 2035 given the

³⁷ S&P expects India to grow above 6.6% by 2030-31; see S&P Global press release of 19 September 2024, 'India is set to become the third-largest economy by 2030-31 with projected annual growth of 6.7%, according to S&P Global', <https://www.spglobal.com/en/press/press-release/india-is-set-to-become-the-third-largest-economy-by-2030-31>.

lower labour productivity and return on assets and only 1 percent thereafter until 2050, as the growth engine stemming from urbanisation is exhausted (for more details about China’s long-term prospects, please see García Herrero (2023)). With such growth differential, in India’s favour, and the Indian rupiah expected to appreciate against the RMB because of the convergence³⁸, India should be able to reach China’s size by 2050 in dollar terms.³⁹

Figure 16: Real GDP Forecast (\$ trillion)



Source: Natixis based on IMF.

Whether such projection will become true depends on a large number of factors from China and India. China’s risks to this growth scenario are mainly on the downside due to the very rapid accumulation of debt and geopolitical tensions with the US. Still, there is potential upside from China’s technological upgrade and increasingly dominant role in the Global South. The latter is particularly important for India since it would come at its expense. India’s growth prospects are also at stake. This is yet another reason for India to remain cautious in its relations with China as it might come at a cost in terms of India’s influence in the Global South and, especially, its neighbourhood.

As for India, the downside risks to this growth scenario stem from the rather stagnant reform agenda and the very limited attraction of FDI, especially in manufacturing. FDI would be highly beneficial for India to create more jobs in the formal sector, supporting the urbanisation process and also the creation of a middle class but this seems to depend on China, as the West does not seem to be investing enough in India’s manufacturing. This could of course change if the US puts more emphasis on India as part of its Ind-Pacific strategy but also if India strikes a trade and investment deal with the EU, following its deal with the UK. The growth divide between the North and the South is another important risk as are tensions with Pakistan on the external side.

India’s upper hand regarding growth prospects is important to understand China’s interest in engaging with India. China has created a web of dependent relations on the economic front with many countries.

³⁸ The rupiah is expected to appreciate 10 percent against the RMB every 5 years, or 2 percent per year.

³⁹ India’s GDP in purchasing power parity (PPP) should be similar to that of China earlier since India is further away from equilibrium prices and exchange rate.

This is particularly true for Asia but also beyond. India is an outlier given long-term security concerns. China is fully aware that India is the only economy that can become as large as that of China in the foreseeable future, making fostering economic relations (especially asymmetric ones with China as investor and exporter) crucial. This is particularly important in the current context of fierce strategic competition with the US. Ultimately, India's increasing economic weight could tilt the balance of power between the US and China.

7 Conclusions

China-India relations have never been easy, especially since the 2020 military standoff on the Himalayan border. This sudden severe disruption in political relations also had a major toll on Chinese investment in India, especially e-platforms, which had to abandon the Indian market.

At the same time, and ironically, India's import dependence on China has only increased.

Given that the Indian economy is decelerating at a challenging time for Prime Minister Modi, who governs in a coalition, China could offer a partial solution to India's economic woes by providing manufacturing FDI and creating jobs in the formal economy, which is probably behind the Modi-Xi 'rapprochement' after their encounter at the BRICS summit last October. And yet, this important signalling has not yet led to economic decisions bringing the two countries closer together.

One of the key question marks is which measures to bring the economies closer will go through and it seems clear that it will be targeted Chinese investment into India for manufacturing. And yet, it is very unlikely that relations will fully normalise. There are three main reasons for this. First, the Indian army remains cautious as to the situation at the border but also more generally in terms of security risks relating to China directly or indirectly (Joshi and Mukherjee, 2018). Second, Trump will exert pressure on Modi to remain well anchored in the Indo-Pacific strategy and not depend further on China. This is even more the case given the very real tariff threat that Trump has imposed upon India. Third, Indian public opinion is still very negative on China and the BRI.

In the short run, Modi's potential visit to China for the SCO summit later this year is clearly an important event where economic cooperation could be enhanced, in terms of China's new investment in India in the manufacturing sector. This development needs to be followed against the backdrop of Trump's pressure on India, whether negative through the threat of tariffs to be imposed on Indian exports to the US, but also positive, with Trump's potential visit to India for the Quad summit later in 2025.

Finally, in the long run, the positive growth differential in India's favour should give him the upper hand when it comes to economic relations, which is very different from the current juncture. This, however, will depend on how much India might have become dependent on China not only in terms of imports, which is the case today, but also for jobs through FDI and other potential channels. While the Modi administration will push for strategic autonomy, the attempts so far have not been successful. More investment from the West (US and/or Europe) could be a way out but it remains stubbornly low. In

other words, India's challenges regarding China – a militarised border, an increasingly asymmetric economic dependence and China's growing leadership in the Global South, including India's neighbourhood, remain important. They make a 'rapprochement' only tactically possible but surely fragile and unlikely in the medium run.

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