

INDIA, CHINA

Saber-rattling reduces probability of a diplomatic resolution

- Following the reported firing of shots at the Line of Actual Control (LAC), the odds of a diplomatic solution to the current standoff have fallen to 25%.
- The new basecase (a 60% probability) is an extended stand-off with periodic flare-ups of violence.
- The likelihood of a sustained military conflict has risen to 15% over the next year given that increased aggression by both sides could lead to an unintended escalation, or less likely, to deliberate steps to trigger a war.

India and China continue to be engaged in a tense standoff at the LAC, with both sides continuing to accuse the other of violating border agreements. Since the August 29-30 incident which saw Indian and Chinese troops standoff near south Pangong Tso lake (please see [India, China: Another border incident underscores continued worsening of bilateral ties](#)), there have been a few developments that have put downward pressure on a successful diplomatic resolution even as the Chinese and Indian foreign ministers meet in Moscow on the sidelines of the Shanghai Cooperation Organization.

First are the reports that there were warning shots fired on 7 September; this is the first time since 1975 that this has happened.

Second, is the reported abduction of 5 Indian citizens from the Indian state of Arunachal Pradesh by the Chinese People's Liberation Army (PLA). While China is reportedly making arrangements to return the men, the initial response was to deny that these men had disappeared from Indian territory, as China considers Arunachal Pradesh as a part of South Tibet.

Third, both sides continue to amass troops on the border. There has reportedly been a significant Chinese build-up on the northern bank of the Pangong Tso lake; last week's encounters took place at the southern bank of the Pangong Tso lake. India is also concentrating troops to counter the Chinese forces, and in some cases, troops are standing about

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100 meters apart, raising the possibility that a mistake could turn deadly.

Given these developments, we are recasting our scenarios. The timeline for this is through spring of next year.

India/China border conflict scenarios

Scenario	Description	Probability	Market impact
Long-lasting standoff with periodic flare-ups and skirmishes with limited casualties	Neither side retreats and troops remain deadlocked, raising the likelihood of clashes between the two militaries.	60%	Markets are likely to react cautiously, as a prolonged standoff likely means more efforts by India to decouple and put up barriers to Chinese investment.
Successful diplomatic negotiations leads to a de-escalation	Negotiations result in both sides withdrawing to their original positions, but this does not mean a defined border, meaning tensions can resume next year.	25%	Markets would react positively to a de-escalation between India and China, but investors would likely remain cautious as any de-escalation is likely to be temporary.
Skirmishes lead to a more sustained and deeper military conflict at the border	Increased aggression by both sides leads to an unintended escalation, or less likely, deliberate steps to trigger a war.	15%	Markets would react negatively to a deeper military conflict between India and China; while risk of an India-Pakistan conflict is generally priced in, conflict with China is not.

Source: Eurasia Group

Scenario 1: Long-lasting standoff with periodic flare-ups and skirmishes with limited casualties (60%)

A big factor in the continued tension is a lack of clarity around where the LAC falls along the border, which makes it easy for both sides to claim the other “crossed” the line. To solve the problem, diplomacy ultimately needs to define the LAC, but neither side is likely to give an inch of perceived territory given the current state of bilateral ties. In the meantime, both sides are fortifying their individual claims and, in the case of China, possibly trying to bite off a bit more while talks are in early stages.

So far, there have been multiple rounds of talks, meetings between the Special Representatives for the Boundary Question, a meeting of the defense ministers, and a meeting of the foreign ministers, and none of these negotiations have been successful in stemming new skirmishes.

India also believes that all past agreements have broken down; in an interview with the Economist, General D.S. Hooda, the former head of India’s Northern Army Command highlighted how not only have the deaths of 20 Indian soldiers on 15 June (see [China, India: Fatalities significantly raise border risks, but diplomacy still in play](#)) eroded whatever little trust remained, and that the firing of weapons means that the old rules that governed the India-China border are no longer applicable. Further, the scope of the standoff has increased to areas that were not previously disputed, including in the Galwan Valley, the site of the 15 June clash, highlighting how much the situation has escalated.

Politically, Prime Minister Narendra Modi cannot retreat. He has already been under criticism for first, failing to acknowledge the Chinese incursions, and then secondly, stating that China had not entered Indian territory (even though it had). Any further loss of territory for India, while not politically devastating, will hurt Modi, who has built his image as a strongman who will protect India.

With Modi being pushed to retaliate against China and show that he will do more than just ban Chinese mobile applications, and President Xi Jinping not backing down either, the signs are pointing towards this border remaining hot and standoffs continuing as both sides are preparing for a long,

entrenched conflict. This is not to say diplomacy will not continue. Commander-level talks are likely to continue, as will diplomatic meetings.

Scenario 2: Successful diplomatic negotiations leads to a de-escalation (25%)

Prior to the shots being fired, Indian commanders believed that after the 15 June incident and prior to the 29 August standoff that there was the potential for talks to work. However, new reports from India indicate that while the commanders spoke on 29 August and that there was an agreement to not make any nighttime movements, the Chinese PLA violated that agreement almost instantly, forcing India to respond.

Within India, there has been a seismic shift in the strategic community, which was once divided on how best to manage China. While some viewed China warily, there were those that there could be some form of collaboration with China on certain issues. Since the events of 15 June, there has been a consolidation of views to now most believing that China is India's principal strategic adversary. This viewpoint is also permeating through the government, which likely now believes that the only way to counter China's belligerence is to match its aggressiveness.

For the current situation to be resolved successfully then, it will need more political will from both Modi and Xi.

2017's Doklam crisis, where Indian and Chinese troops engaged in a 73-day standoff in a remote part of the Himalayas before ultimately disengaging and retreating to their original positions, provides a template for how this current crisis can be resolved (although even if resolved, the underlying issues will still remain). 2017 saw phone calls and meetings between Modi and Xi, which helped ensure successful negotiations. This so far has been non-existent in the current standoff.

A similar resolution, in this case, would likely mean both leaders call on their respective militaries to send troops away from the border and stop infrastructure building. It does not mean a defined LAC, which means tension could resume again in a year or two.

The next opportunity for an in-person meeting is the October SCO leaders meeting; we will be watching for signals from both capitals to see if a Modi-Xi meeting is in the works.

Scenario 3: Skirmishes lead to a more sustained and deeper military conflict at the border (15%)

While we still believe this scenario to be unlikely – as neither side desires a war— we are raising the probability of prolonged armed conflict between the two sides owing to the tense nature of the situation. There has been a significant build-up of troops by both sides and any skirmish has the potential to escalate.

A prolonged border conflict would be a significant escalation and a major market event. It would likely be confined to the border, but it would have long lasting implications for the relationship and stability in the region.

India is preparing as if the talks will not work out. General expectations are that skirmishes like the ones seen on 29-30 August are going to continue, and that China's deployment so far does not show evidence of preparing for a full-blown war. China and India's deployments remain a continued watchpoint. There is likely to be some disengagement over the next few weeks due to cold weather setting in (temperatures can reach up to -40 degrees Celsius), which will restrict troop movements until the spring.

However, if there are further incursions by China into what India perceives as its territory, India will respond aggressively, heightening the risk of a war.

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