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Outlook on Current Account Deficit

Elevated merchandise trade deficit for Jul-Aug 2022 to widen CAD to massive 5.0% of GDP in Q2 FY2023

SEPTEMBER 2022

Highlights

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ICRA estimates the CAD to rise from 3.6% of GDP in Q1 FY2023 to a massive 5% of GDP in Q2 FY2023, the second highest after Q3 FY2012

We project the FY2023 CAD at 3.5% of GDP, with some moderation in H2 owing to lower commodity prices and their impact on the merchandise trade deficit

The INR is expected to range between 78.5-81.0/US$ in the rest of CY2022

- With a robust 36.8% YoY expansion in imports amidst a 1.2% decline in exports, the merchandise trade deficit increased to US$28.7 billion in August 2022 from US$11.7 billion in August 2021. However, it was slightly lower than the record-high deficit of US$30.0 billion seen in July 2022.
- The monthly average trade deficit trended higher at US$29.3 billion in July-August 2022, relative to US$23.5 billion seen in Q1 FY2023, with the sustenance of a robust domestic demand buoying imports, even as exports witnessed some moderation in the face of global slowdown fears.
- Based on preliminary trends for Jul-Aug 2022, and our expectation for Sep 2022, we project the merchandise trade deficit at US$82-84 billion in Q2 FY2023, nearly twice as high as the year-ago levels, and a 17% increase over the US$71 billion estimated for Q1 FY2023.
- Consequently, the current account deficit (CAD) is projected to widen to an all-time high of ~US$41-43 billion in Q2 FY2023 from the ~US$30 billion expected in Q1 FY2023. It is expected to widen to 5.0% of GDP in Q2 FY2023, the second highest level since Q3 FY2012 (-6.8% of GDP).
- Thereafter, we expect the CAD to moderate to ~2.7% of GDP in H2 FY2023, benefitting from lower commodity prices and seasonally stronger exports; however, a potential recession in major economies may dampen growth in merchandise and services exports in H2 FY2023.
- Overall, the CAD is projected to widen to an all-time high of US$120 billion (-3.5% of GDP) in FY2023 from US$38.7 billion (-1.2% of GDP) in FY2022. Nevertheless, as a proportion of GDP, it is expected to be much lower than the levels seen in FY2013 (-4.8% of GDP).
- With the re-emergence of the FPI equity inflows, we expect the INR to trade between 78.5-81.0/US$ in the rest of CY2022 amidst the global headwinds. While forex reserves have seen a drawdown of US$45.4 billion in FY2023 so far (till Aug 26, 2022), they remain large, and are likely to prevent a disorderly depreciation of the INR.

India's merchandise exports contracted for first time in 18 months in August 2022, amidst flagging external demand

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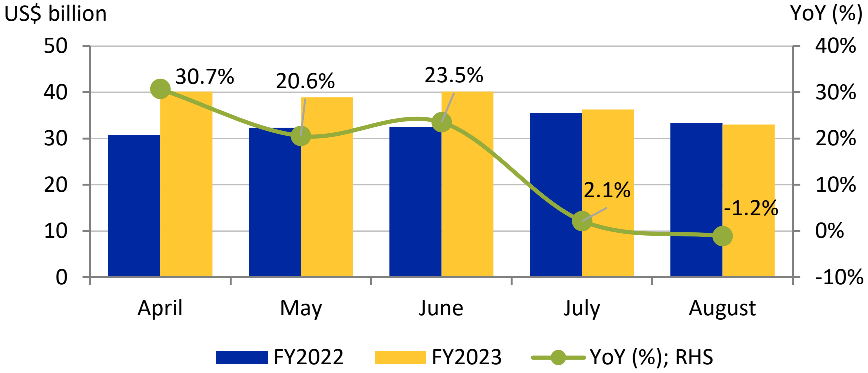
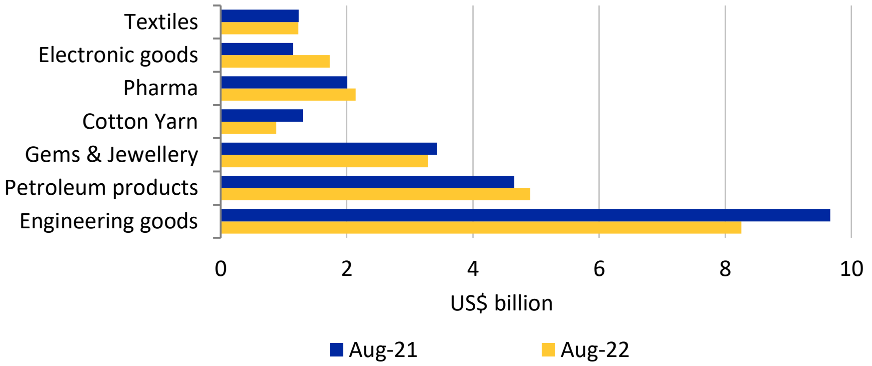
EXHIBIT: India's merchandise exports (US$ billion; YoY%)



Source: Ministry of Commerce and Industry, GoI; ICRA Research

EXHIBIT: Performance of major export items (US$ billion) in Aug 2021 and 2022



Source: Ministry of Commerce and Industry, GoI; ICRA Research

- India's merchandise exports declined by 1.2% YoY in August 2022 (as per the initial data) to a nine-month low US$33.0 billion from US$33.4 billion in August 2021 (US$36.3 billion in July 2022). This was the first instance of a YoY contraction in 18 months.
- The YoY decline was primarily led by non-oil exports, which dipped by 2.2% to a 15-month low US$28.1 billion in August 2022 from US$28.7 billion in August 2021, partly reflecting the slowdown in external demand. The US$0.6 billion YoY decline in non-oil exports was mainly driven by engineering goods (YoY: -14.6%; to US$8.3 billion in Aug 2022 from US$9.7 billion in Aug 2021), followed by cotton (-32.3%), gems and jewellery (-4.1%), textiles (-0.4%), etc.
- Oil exports rose by a muted 5.4% to US$4.9 billion (six-month low) in August 2022 from US$4.7 billion in August 2021.

In contrast, merchandise imports rose sharply in August 2022, led by crude and coal imports

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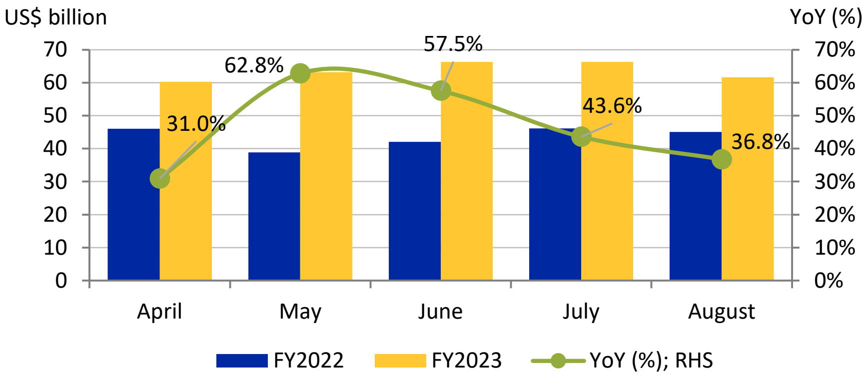
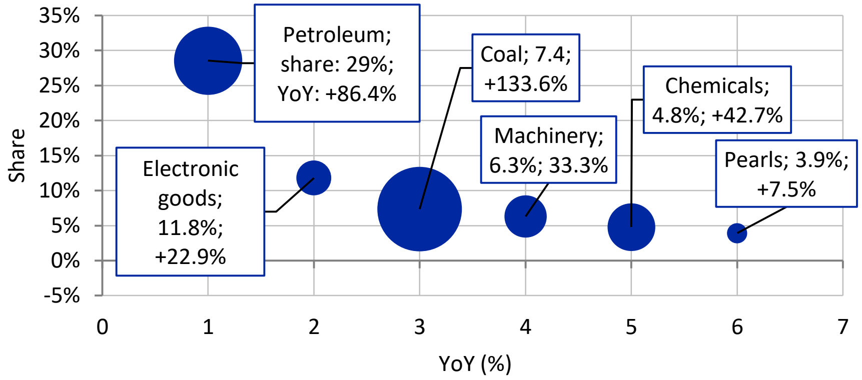
EXHIBIT: India's merchandise imports (US$ billion; YoY%)



Source: Ministry of Commerce and Industry, GoI; ICRA Research

EXHIBIT: Imports of Commodity Groups having major share in overall imports in Aug 2022 and their YoY growth rate

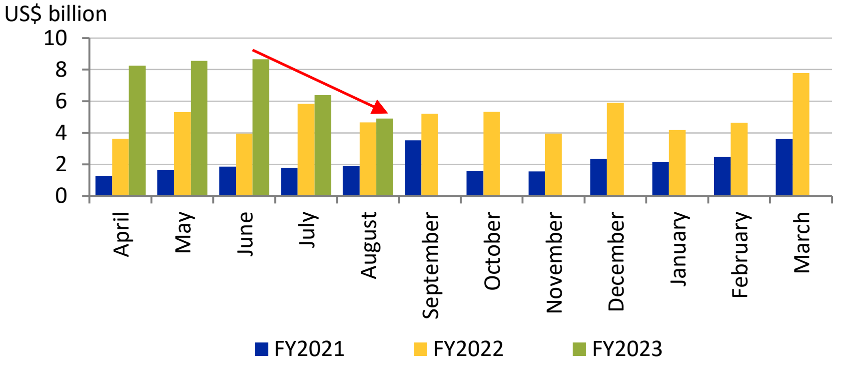


Source: Ministry of Commerce and Industry, GoI; ICRA Research

- India's merchandise imports reported a YoY expansion of 36.8% to US$61.7 billion in August 2022 from US$45.1 billion in August 2021, remaining above US$60 billion for the sixth consecutive month.
- The US$16.6 billion YoY increase in merchandise imports was driven by oil imports (YoY: +86.4%; to US$17.6 billion in August 2022 from US$9.4 billion in August 2021). Moreover, coal, coke and briquettes (YoY: +133.6%), electronic goods (+11.8%), electrical and non-electrical machinery (+33.3%), chemicals (+42.7%), pearls, precious and semi-precious stones (+7.5%), constituted ~35% of the total rise in imports.
- In contrast, gold imports (-47.5%; to US$3.5 billion in August 2022 from US$6.7 billion in August 2021) declined following the hike in the import duty on gold to 15.0% from 10.0% in July 2022, offering some relief.

Oil exports and imports declined sharply on a sequential basis in August 2022

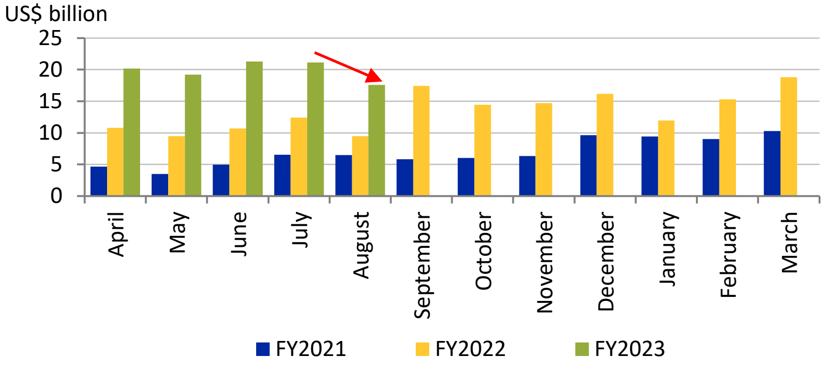
EXHIBIT: Monthly trends in oil exports



Source: Ministry of Commerce and Industry, GoI; ICRA Research

- Oil exports fell to a six-month low US$4.9 billion in August 2022 from US$6.4 billion in July 2022 and the average monthly print of US$8.5 billion in Q1 FY2023. The sequential decline largely reflects the impact of the export duty on certain fuels that the GoI had imposed on July 1, 2022.
- Moreover, the YoY growth in oil exports moderated to an 18-month low of 5.4% in August 2022.

EXHIBIT: Monthly trends in oil imports

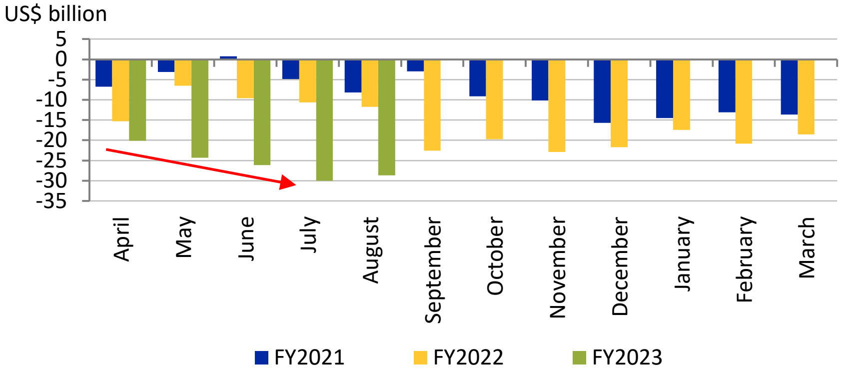


Source: Ministry of Commerce and Industry, GoI; ICRA Research

- In MoM terms, oil imports dipped by 16.7% in August 2022, reflecting the lower demand for crude oil following the decline in oil exports, as well as the moderation in prices relative to July 2022.
- However, on a YoY basis, oil imports expanded by a substantial 86.4% to US$17.6 billion in August 2022 from US$9.4 billion in August 2021.
- **While the recovery in domestic mobility is expected to boost India's oil imports, any further dip in crude oil prices in conjunction with the impact of the export duty on POL products could temper the value of imports.**

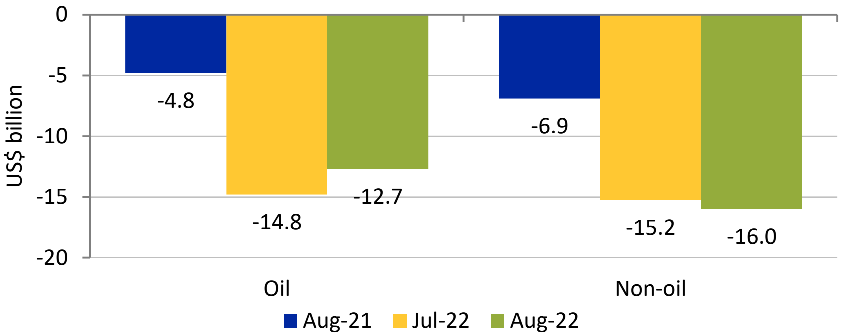
Second-highest ever merchandise trade deficit witnessed in August 2022

EXHIBIT: India's merchandise trade deficit (US$ billion)



Source: Ministry of Commerce and Industry, GoI; ICRA Research

EXHIBIT: Oil and Non-oil Trends for merchandise trade deficit



Source: Ministry of Commerce and Industry, GoI; ICRA Research

- With a robust 36.8% YoY growth in imports amidst a 1.2% contraction in exports, the merchandise trade deficit more than doubled to US$28.7 billion in August 2022 from US$11.7 billion in August 2021. However, it was mildly lower than the all-time high deficit of US$30.0 billion seen in July 2022, led by oil.
- More than 55% of the YoY widening in the trade deficit in August 2022 was on account of non-oil items such as coal, organic and inorganic chemicals, etc. even as gold imports recorded a sharp YoY decline.
- Given the resilience in domestic demand, and hence, imports, amidst concerns regarding exports in the face of global slowdown fears, the merchandise trade deficit is likely to remain elevated relative to the year-ago levels; however, we are cautiously optimistic that it will temper in sequential terms going ahead, owing to lower commodity prices, change in coal blending norms as well as seasonally stronger exports.

Merchandise trade deficit expected to nearly double in Q2 FY2023 compared to year ago levels

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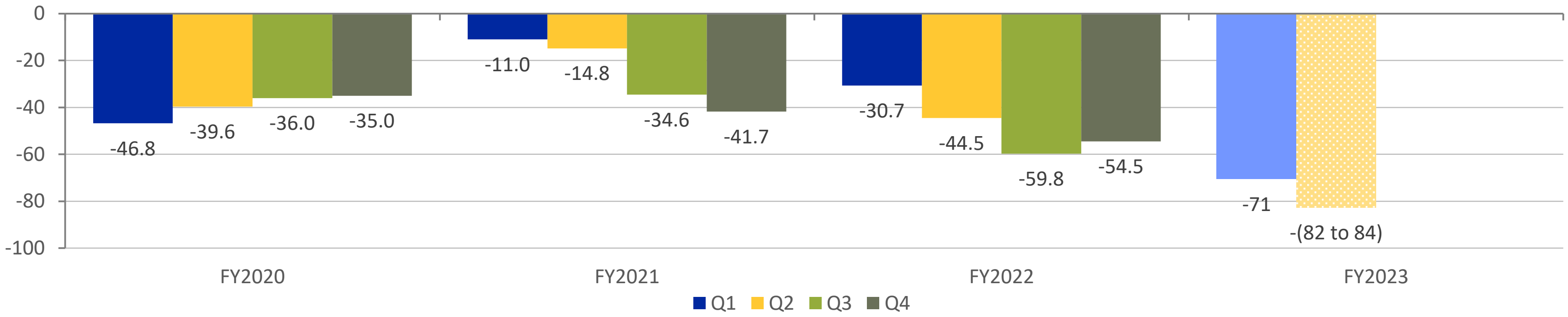
EXHIBIT: Quarterly trends of merchandise trade deficit (on BoP basis)



ICRA's proj for Q2 FY2023 includes preliminary estimates for July and Aug 2022, and our expectation for Sep 2022; Source: RBI; Ministry of Commerce and Industry; ICRA Research

- With imports remaining above US$60 billion and exports witnessing a sequential dip, the average monthly trade deficit is trending higher at US$29.3 billion in July-August 2022, relative to US$23.5 billion seen in Q1 FY2023, implying that the current account deficit is likely to widen further in the ongoing quarter from the estimated levels for Q1 FY2023.
- **Based on preliminary trends for July-August 2022, and our expectation for September 2022, we project the merchandise trade deficit at a record US$82-84 billion in Q2 FY2023, nearly twice as high as the level seen in Q2 FY2022, and a worrying 17% higher than the US$71 billion estimated for Q1 FY2023.**

Services trade surplus rose in July 2022 relative to average monthly levels seen in Q1 FY2023; potential recession in major countries poses risk to exports in H2

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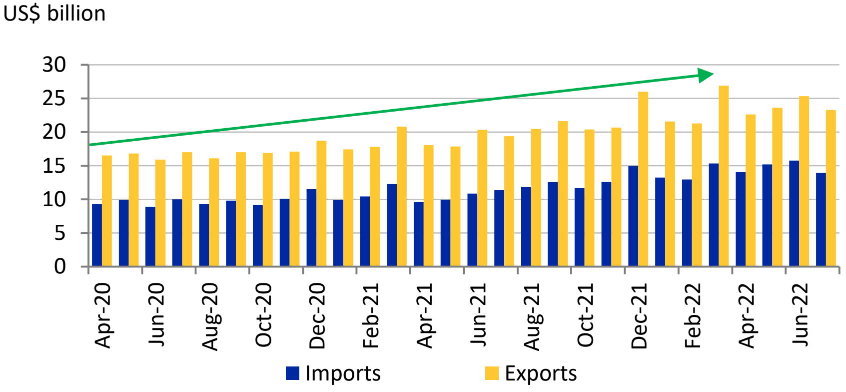
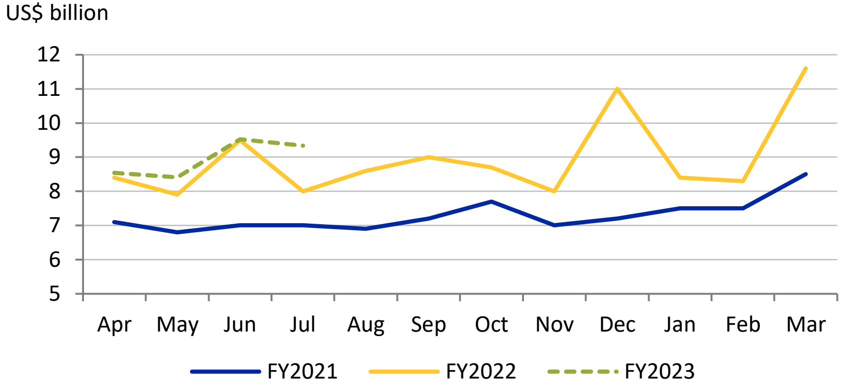
EXHIBIT: Services imports and exports (US$ billion)



Source: Ministry of Commerce and Industry, GoI; ICRA Research

EXHIBIT: Services trade balance (US$ billion)



Source: Ministry of Commerce and Industry, GoI; ICRA Research

- While services exports eased to a three-month low of US$23.3 billion in July 2022, trending a mild 2.4% lower than the Q1 FY2023 average (US$23.8 billion), this depicted a healthy YoY expansion of 20.2% in the month, on the back of sustained demand for IT services, as well as the low base.
- Similarly, services imports declined to five-month low US$13.9 billion (-7.2% over Q1 FY2023 average) in July 2022 but were 22.3% higher than year-ago levels.
- With a sharper decline in imports vs. the exports in July 2022, relative to the Q1 FY2023 average, services trade surplus rose to US$9.3 billion from US$8.8 billion, respectively. Further, the surplus in FY2023 so far remains comfortably higher than the levels seen in the corresponding period of FY2020-21.
- **We expect the services surplus to rise to US$115-117 billion in FY2023 from US$107.5 billion in FY2022, on the back of robust exports and a weaker INR, in spite of some recovery in outbound tourism. However, a potential recession in the US, the UK and Europe may dampen software exports in H2 FY2023.**

Current account deficit set to widen to a sharp 5.0% of GDP in Q2 FY2023

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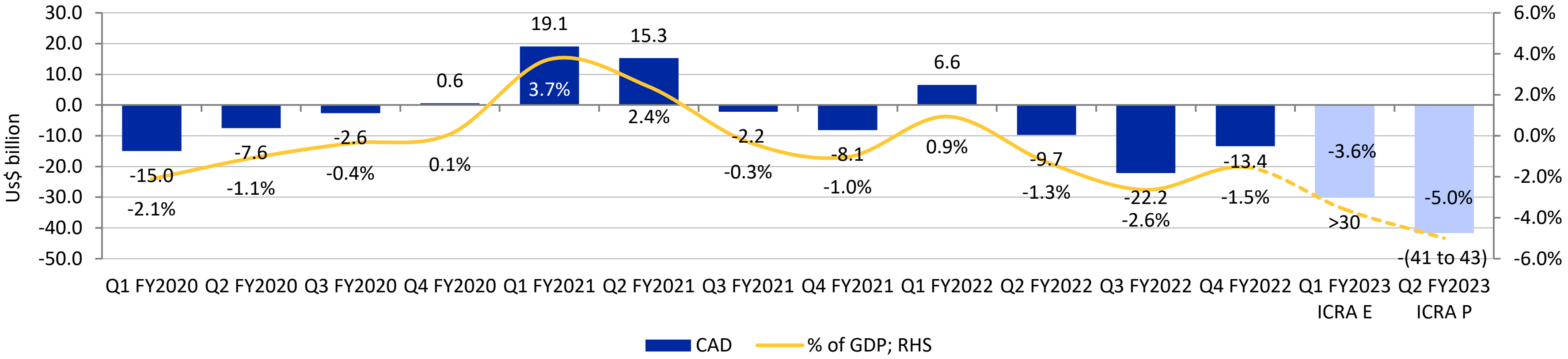
EXHIBIT: India's Current Account Deficit (US$ billion and % of GDP)



Source: RBI; ICRA Research

- Owing to the surge in the merchandise trade deficit on account of the fallout of higher commodity prices, we estimate India's current account deficit to have crossed ~US$30 billion in Q1 FY2023 (-3.6% of GDP), equivalent to ~80% of the full year CAD for FY2022. This is likely to be similar to the levels seen in taper-tantrum-inflicted deficit during Q3 FY2013 (-US$31.9 billion).
- **Based on the trends available for July-August 2022, we project the current account deficit to surge further to an all-time high of ~US$41-43 billion in Q2 FY2023. As a proportion of GDP, we peg the CAD at a massive 5% in Q2 FY2033, up from the 3.6% estimated for Q1 FY2023; this would be the second highest quarterly level of the CAD to GDP ratio, after the 6.8% seen in Q3 FY2012.**

With a relatively stronger growth in imports vis-à-vis exports, merchandise trade deficit likely to bloat to US$288-290 billion in FY2023 from FY2022 levels

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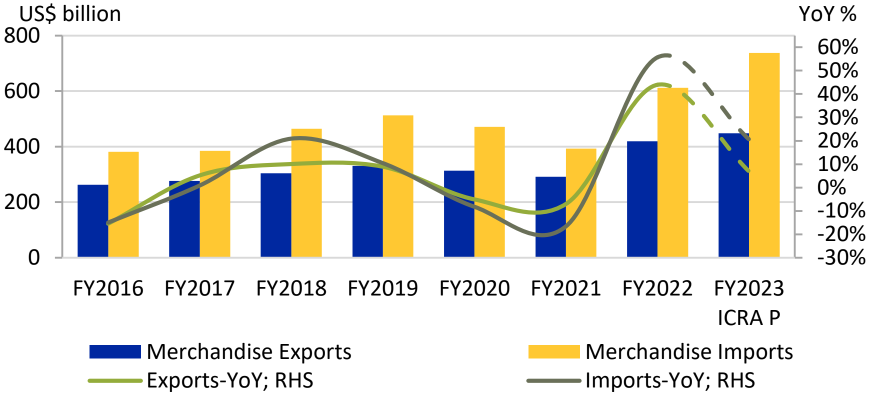
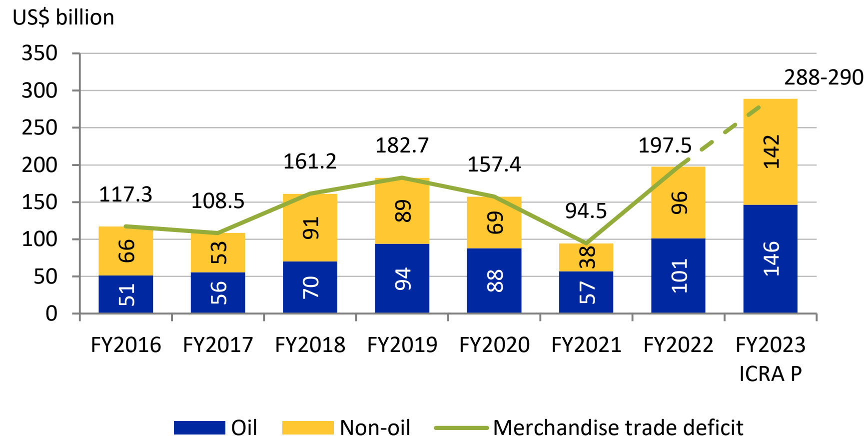
EXHIBIT: Annual Merchandise export and imports (US$ billion and YoY growth)



P: Projected; Source: Ministry of Commerce and Industry; ICRA Research

EXHIBIT: Annual oil, non-oil and merchandise trade deficit (US$ billion) and ICRA's forecasts for FY2023



P: Projected; Source: Ministry of Commerce and Industry, GoI; ICRA Research

- ICRA estimates merchandise imports to surge by ~21% at US$735-739 billion in FY2023 (US$611.9 billion in FY2022), aided by resilience in domestic demand, and higher imports of certain non-gold items such as coal to meet domestic requirements in the first half of the year.
- However, growth of merchandise exports is projected at a relatively lower ~7% to US$447-449 billion in FY2023 from US$419.7 billion in FY2022, with slowdown in global growth amid Monetary Policy tightening. The extent of the fall in the momentum of exports remains a monitorable, going forward.
- Consequently, the merchandise trade deficit is set to bloat to ~US$288-290 billion in FY2023, from US$197.5 billion in FY2022, driven by both oil and non-oil segments.

FY2023 CAD projected at 3.5% of GDP in FY2023, with some moderation in H2

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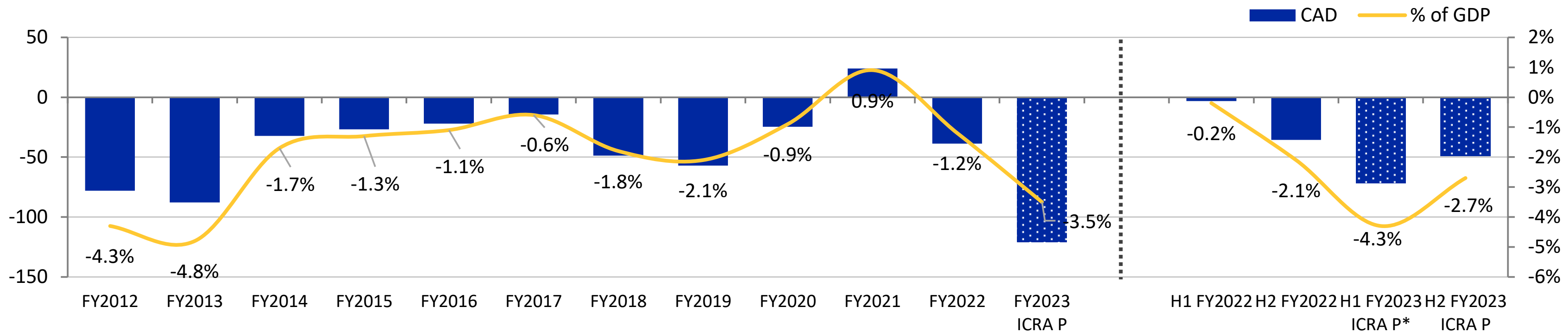
EXHIBIT: Trends in Current Account Deficit (US$ billion; % of GDP)



**P: Projected; Data labels correspond to CAD as % of nominal GDP; ICRA's nominal GDP Proj. has been used for FY2023; Source: RBI; CEIC; ICRA Research*

- While a sequential dip in commodity prices since mid-June 2022 and some reduction in the net volume of oil imports should temper the monthly merchandise trade deficit prints going ahead, the strength of merchandise and services exports in the face of the global slowdown fears, remains crucial. **We expect the merchandise trade deficit to widen to US$288-290 billion in FY2023 from US$197.5 billion in FY2022.**
- **We project the CAD at an all-time high of US$120 billion (-3.5% of GDP) in FY2023, considerably higher than the US$38.7 billion (-1.2% of GDP) in FY2022. Nevertheless, as a proportion of GDP, the FY2023 CAD is expected to be much lower than the levels seen in FY2013 (-4.8% of GDP).**
- **On a sequential basis, the CAD is likely to moderate to ~2.7% of GDP in H2 FY2023, from the ~4.3% of GDP expected in H1 FY2023, benefitting from easing commodity prices and a seasonal uptrend in exports.**

INR remained relatively stable in August 2022 despite sharp moves in DXY

EXHIBIT: Movement in USD/INR exchange rate

Source: Bloomberg; RBI; ICRA Research

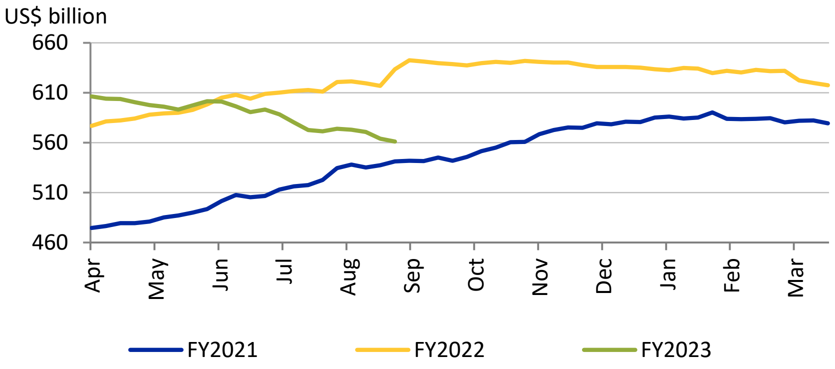
EXHIBIT: Trends in DXY

Source: Bloomberg; RBI; ICRA Research

- The INR has depreciated by 5.4% against the US dollar in FY2023 so far (till Sep 5, 2022), amidst prolonged geo-political tensions, significant FPI outflows, aggressive monetary policy normalisation by the US Fed and a strengthening US dollar, rise in crude oil prices and a general risk aversion towards EM assets.
- Nevertheless, this was much lower than the sharp 12.0% rally in the dollar index that was seen during this period.
- After the cooler-than-expected US inflation data, the dollar index had fallen to 105.1 on August 11, 2022 from 108.5 on July 13, 2022. Subsequently, it has charted a sustainably robust uptrend, crossing 110 levels intraday on Sep 5, 2022 for the first time in over 20 years, following the comments made by the Fed Chair during the Jackson Hole symposium on the need to curb inflation, indicating aggressive rate hikes, going forward. Notwithstanding the sharp moves in the DXY during August 2022, the INR has remained relatively stable during the month.

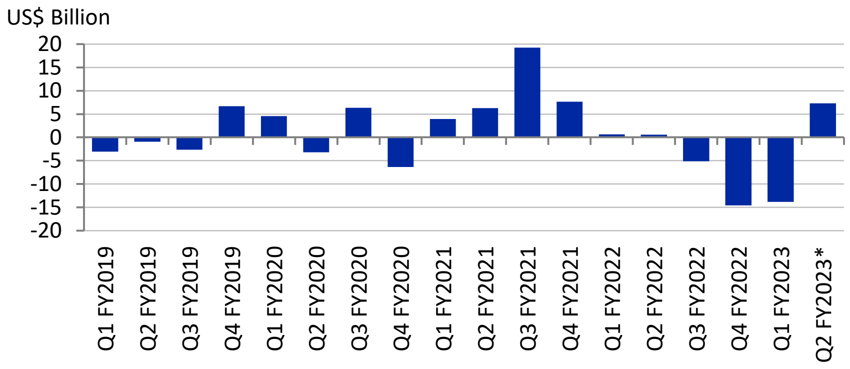
INR to trade between 78.5-81.0/US$ in rest of CY2022 amidst global headwinds

EXHIBIT: Foreign exchange reserves



Source: RBI; ICRA Research

EXHIBIT: FPI flows-Equity segment



**As of Sep 2, 2022; Source: NSDL; ICRA Research*

- With the re-emergence of FPI equity inflows, we expect the INR to trade between 78.5-81.0/US$ in the remainder of CY2022, amidst the global headwinds.
- The foreign exchange reserves held by the RBI stood at US$561.0 billion as on August 26, 2022, witnessing a drawdown of US$45.4 billion in FY2023 so far (till August 26, 2022). This resulted in a forex cover of FY2022 imports falling to below 11 months (10.9 months till Aug 26), similar to the levels seen in H2 FY2020.
- Nevertheless, the reserves remain large, and are likely to prevent a disorderly depreciation in the event of any further strengthening in the dollar or a re-emergence of risk aversion towards EM assets.
- The recent comments from the RBI regarding preventing excessive volatility and anchoring expectations around the depreciation of the INR, suggest that the INR is likely to trade in a narrow band.

RBI's measures likely to gradually increase foreign inflows; steps towards internationalisation of rupee effective over medium term

Measures announced by the RBI since July 2022

Exemptions for FCNR (B) and NRE deposits mobilized by banks

July 6, 2022

- Temporary withdrawal of interest rate ceiling applicable to incremental FCNR (B) and NRE deposits until Oct 31, 2022.
- Exemption for maintenance of CRR and SLR for FCNR (R) and NRE deposits

Relaxations for overseas foreign currency borrowings

July 7, 2022 and Aug 1, 2022

- Increase in automatic route limit to raise ECBs to US$1.5 billion from US$0.75 billion
- All-in-cost ceiling for ECBs raised by 100 bps till Dec 31, 2022, only to eligible borrowers of investment grade rating from Indian Credit Rating Agencies (CRAs)

Trade settlement in INR

July 11, 2022

- Additional arrangement for invoicing, payments, settlement of exports/imports in the INR; opening up of special INR vostro accounts, setting off of export receivables against import payables, etc.

Relaxations in FPI investments in debt segment

July 7, 2022

- Investments by FPIs in G-secs and corporate bonds made between July 08, 2022 and October 31, 2022 shall be exempted from the limit on short-term investments till maturity or sale of such investments.

Summary

FY2023 Outlook

Merchandise Trade	Merchandise Trade Balance	Services Trade Balance	Current Account Deficit	INR/USD
Exports in FY2023: US$447-449 billion YoY: +7% Imports in FY2023: US$735-739 billion YoY: +21%	Merchandise trade deficit in FY2023: US$288-290 billion YoY: +46%	Services trade surplus in FY2023: ~US$115-117 billion YoY: +8%	CAD: Q1 FY2023: >US$30 billion; 3.6% of GDP Q2 FY2023: US$41-43 billion; 5.0% of GDP H2 FY2023: US$48-50 billion; 2.7% of GDP FY2023: ~US$120 billion; 3.5% of GDP	INR: 78.5-81.0/US$ in remainder of CY2022

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Thank You!