ICRA

Outlook on Current Account Deficit

CAD narrowed to lower-than-expected $8.3 billion in Q2 FY2024; higher trade deficit to push up CAD sharply to $18-20 billion in Q3 FY2024

DECEMBER 2023

Highlights

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CAD narrowed to $8.3 billion in Q2 FY2024, trailing ICRA's expectations

Decline in financial flows more than offset the QoQ dip in CAD, leading to lower reserve accretion in Q2 FY2024, vis-à-vis Q1 FY2024

Higher merchandise trade deficit to push up CAD to $18-20 billion in Q3 FY2024; full-year CAD projected at 1.5% of GDP, unless commodity prices rebound sharply

- India's current account deficit (CAD) narrowed to $8.3 billion (-1.0% of GDP) in Q2 FY2024 from $9.2 billion in Q1 FY2024 (-1.1% of GDP), trailing ICRA's forecast of $13 billion for that quarter, largely led by a smaller-than-anticipated merchandise trade deficit of $61.0 billion.
- Net financial flows to India declined sharply to $10.0 billion in Q2 FY2024 from $34.2 billion in Q1 FY2024 on account of a sharp dip in net FPI and banking capital inflows and a turnaround in net FDI and External Commercial Borrowings (ECB) to outflows from inflows in the previous quarter.
- Overall, the QoQ decline in net financial inflows was quite large in Q2 FY2024 vis-à-vis Q1, which more than offset the mild dip in CAD between these quarters. This compressed the reserve assets accretion to $2.5 billion in Q2 FY2024 from $24.4 billion in Q1 FY2024 (on a BoP basis). However, this contrasted with the $7.3 billion decline in India's forex reserves during the quarter.
- Owing to the surge in the average monthly merchandise trade deficit during Oct-Nov 2023 vis-à-vis Q2 FY2024, and ICRA's expectations for Dec 2023, the CAD is projected to more-than-double to $18-20 billion in Q3 FY2024 (-2.1% of GDP) from $8.3 billion in Q2 FY2024 (-1.0% of GDP).
- ICRA estimates India's merchandise exports to contract by 6.5-7.0% in FY2024, steeper than the ~5% fall expected in imports. Nevertheless, the merchandise trade deficit is expected to print slightly lower in FY2024 vis-à-vis the levels seen in FY2023.
- Overall, ICRA projects the CAD to narrow to $52-55 billion (-1.5% of GDP) in FY2024 from $67.0 billion (-2.0% of GDP) in FY2023, unless commodity prices chart a sharp rebound in the remaining part of the fiscal.
- ICRA expects the USD/INR pair to trade between 83.0-83.5/$ over the next few months, unless a ratcheting up of geopolitical tensions leads to a sharp depreciation in EM currencies. Thereafter, the inclusion of Indian bonds in the J.P. Morgan GBI-EM Global Index is likely to favour the INR.

Developments in India’s BOP in Q2 FY2024

Although India’s CAD narrowed slightly on a QoQ basis in Q2 FY2024, the sharp fall in financial flows led to significant dip in reserve accretion in the quarter vis-à-vis Q1 FY2024

CAD narrowed sequentially to $8.3 billion in Q2 FY2024, while trailing ICRA's forecast owing to a lower-than-expected merchandise trade deficit

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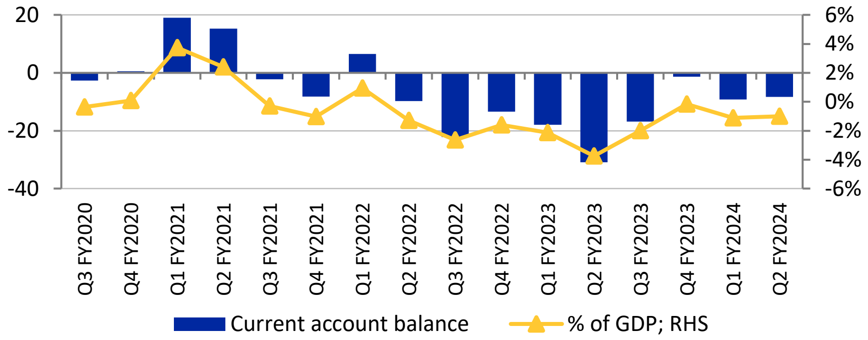
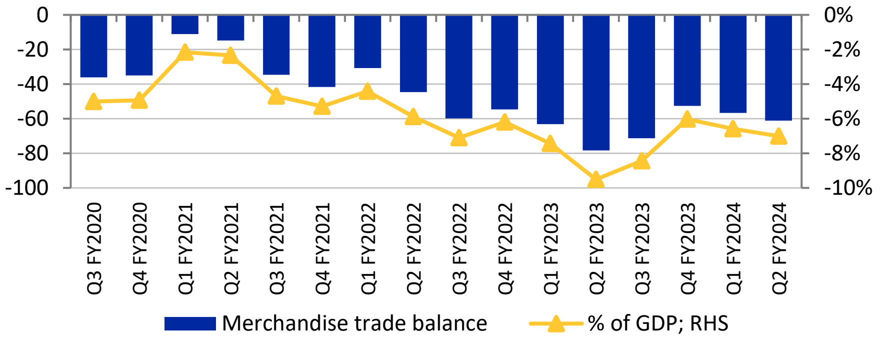
EXHIBIT: Current Account Balance – $ billion and % of GDP



"-" denotes outflows and vice versa; Source: RBI; ICRA Research

EXHIBIT: Merchandise Trade Balance - $ billion and % of GDP



"-" denotes outflows and vice versa; Source: RBI; ICRA Research

- Contrary to ICRA's expectations of an uptick, India's CAD dipped slightly to $8.3 billion in Q2 FY2024 (-1.0% of GDP; ICRA's exp.: $13 billion) from $9.2 billion in Q1 FY2024 (-1.1% of GDP), led by a smaller-than-anticipated merchandise trade deficit of $61.0 billion in that quarter. This was significantly lower than the CAD of $30.9 billion in Q2 FY2023, owing to a narrower merchandise trade deficit as well as a higher services trade surplus.
- On a YoY basis, the merchandise trade deficit narrowed to $61.0 billion in Q2 FY2024 from $78.3 billion in Q2 FY2023, amidst a sharper dip in imports (-10.9%), relative to exports (-3.0%), given the correction in global commodity prices as well as slowdown in external demand.
    - The imports of petroleum, crude and products contracted by a steep 23.6% YoY in Q2 FY2024 (to $40.8 billion in Q2 FY2024 from $53.4 billion in Q2 FY2023, amid a ~12% decline in the price of the Indian basket of crude oil). In contrast, gold imports rose to $12.6 billion from $9.8 billion, respectively, partly led by a low base, pre-festive demand, etc. Non-oil non-gold imports reported an 8.5% YoY dip in Q2 FY2024, on a BoP basis.
    - While oil exports fell by 4.6% YoY in Q2 FY2024, non-oil items saw a narrower 2.6% moderation (on a BoP basis). amidst the continued weakness in external demand

Services trade surplus at all-time high in Q2 FY2024; earnings from invisibles rose by ~11% YoY in the quarter

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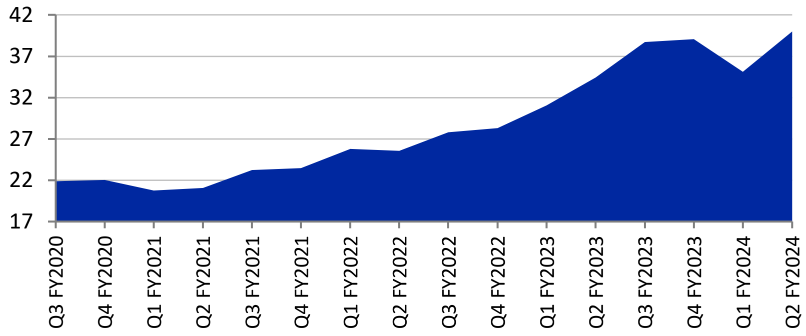
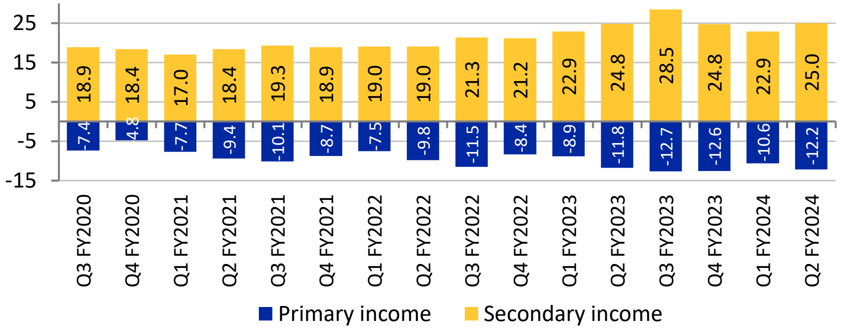
EXHIBIT: Services Trade Account - Net Flows ($ billion)



"-" denotes outflows and vice versa; Source: RBI; ICRA Research

EXHIBIT: Secondary and Primary Income Account- Net Flows ($ billion)



"-" denotes outflows and vice versa; Source: RBI; ICRA Research

- India's services trade surplus rose to an all-time high of $40.0 billion in Q2 FY2024 from the three-quarter low of $35.1 billion in Q1 FY2024. Moreover, it exceeded the year-ago level of $34.4 billion seen in Q2 FY2023, owing to all-time high net earnings related to telecom, communication and information (to $35.6 billion in Q2 FY2024 from $33.0 billion in Q2 FY2023), other business services (to $7.8 billion from $5.2 billion) as well as financial services (to +$0.9 billion from +$0.5 billion).
- The net inflows of secondary income inched up to $25.0 billion in Q2 FY2024 from $24.8 billion in Q2 FY2023, while also exceeding the Q1 FY2024 level ($22.9 billion), led by the uptick in personal transfers (to $25.3 billion from $24.9 billion). In contrast, net outflows of primary income widened to $12.2 billion in Q2 FY2024 (-$10.6 billion in Q1 FY2024) from $11.8 billion in Q2 FY2023, reflecting the trend for outflows of net overseas investment income (to -$13.8 billion from -$13.3 billion).
- Overall, earnings from invisibles rose by 11.2% to $52.7 billion in Q2 FY2024 from $47.4 billion each in Q2 FY2023 and Q1 FY2024. This, along with the YoY dip in the merchandise trade deficit supported the lower CAD print in that quarter, relative to Q2 FY2023.

Financial flows fell sharply to $10.0 billion in Q2 FY2024, leading to a significantly lower accretion to reserves vis-à-vis in Q1

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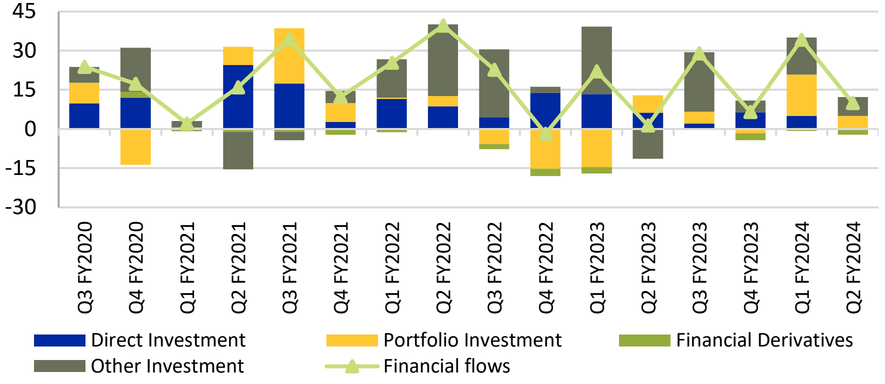
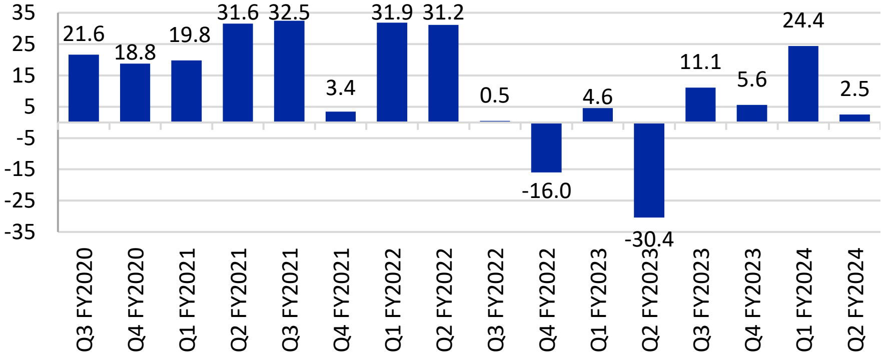
EXHIBIT: Trends in Financial flows to India ($ billion)



"-" denotes outflows and vice versa; Source: RBI; ICRA Research

EXHIBIT: Trends in changes in India's reserve assets ($ billion)



Change in Reserve Asset [Increase (+)/Decrease (-)]; Source: RBI; ICRA Research

- Financial inflows to India dipped sharply to $10.0 billion in Q2 FY2024 from $34.2 billion in Q1 FY2024, while exceeding the year-ago level of $1.4 billion in Q2 FY2023.
  - The sequential decrease was largely driven by the sharp fall in net FPI inflows to $4.9 billion in Q2 FY2024 (+$6.5 billion in Q2 FY2023) from $15.7 billion in Q1 FY2024. Additionally, the FDI segment witnessed a turnaround, recording net outflows of $0.3 billion in Q2 FY2024 (+$6.2 billion in Q2 FY2023) after witnessing inflows of $5.1 billion in Q1 FY2024; this was the first instance of net FDI outflows in 13 quarters.
  - The turnaround in external commercial borrowings (to -$2.9 billion in Q2 FY2024 from +$5.7 billion in Q1 FY2024) and the sharp dip in net inflows of banking capital (to $1.2 billion from $10.6 billion) also pulled down the aggregate financial inflows to India in Q2 FY2024 vis-à-vis Q1 FY2024. In contrast, net inflows on account of trade credit amounted to $3.5 billion in Q2 FY2024 as against net outflows of $5.0 billion in Q1 FY2024.
- Overall, the QoQ decline in net financial inflows was quite large in Q2 FY2024 vis-à-vis Q1, which more-than-offset the mild dip in CAD between these two quarters. This led to a sharp fall in accretion of reserve assets on a BoP basis to $2.5 billion in Q2 FY2024 (-$30.4 billion in Q2 FY2023), from $24.4 billion in Q1 FY2024 (on a BoP basis). However, this contrasted with the $7.3 billion decline in India's forex reserves during the quarter.

Preliminary trends for Oct-Nov 2023 and ICRA’s outlook for FY2024

Higher merchandise trade deficit to widen CAD to $18-20 billion in Q3 FY2024

FY2024 CAD foreseen at 1.5% of GDP

Merchandise imports recorded sharper YoY uptick, relative to exports in Oct-Nov FY2024

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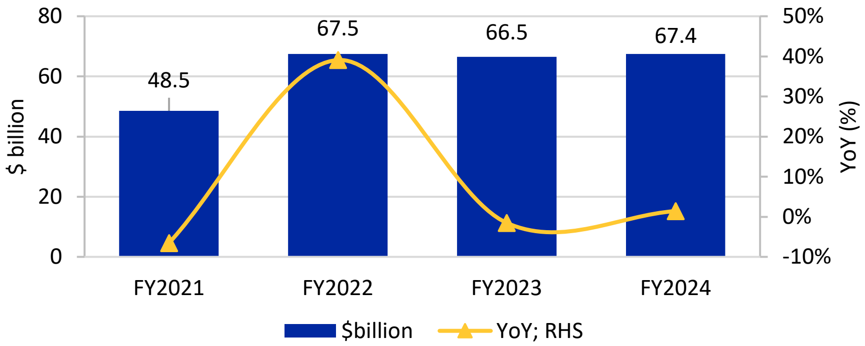
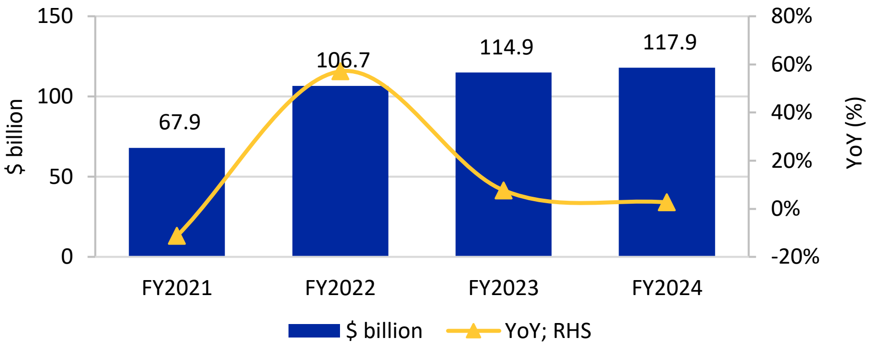
EXHIBIT: October-November Trends in Merchandise Exports of FY2021-24



Source: Ministry of Commerce and Industry; ICRA Research

EXHIBIT: October-November Trends in Merchandise Imports of FY2021-24

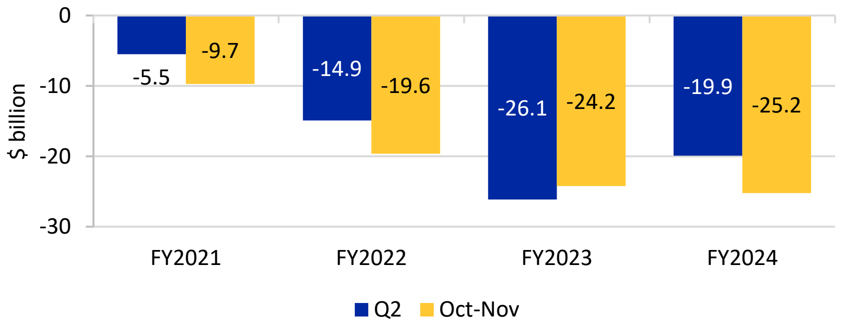


Source: Ministry of Commerce and Industry; ICRA Research

- As per the data released by Ministry of Commerce and Industry, India's merchandise exports have risen by a marginal 1.4% YoY to $67.4 billion in October-November FY2024 from $66.5 billion in the year-ago period. This was driven by the shallow uptick in non-oil exports (+3.5%), with the persisting weakness in exports of chemicals (-6.4%), readymade garments (-11.8%) and agri products (-0.5%) partly offsetting the uptick seen in electronic goods (+13.4%), cotton yarn (+20.5%), engineering goods (+1.9%), etc. However, exports of petroleum products trailed the year-ago level by 6.2% during October-November FY2024, with crude oil prices trending 3.7% lower on a YoY basis.
- Merchandise imports rose by a relatively sharper 2.7% YoY to $117.9 billion in October-November FY2024 from $114.9 billion in the year-ago period, led by gold (+53.8%) and non-oil non-gold items (+1.2%; owing to a rise in imports of electronic goods, iron and steel, non-ferrous metals, electrical and non-electrical machinery, etc.), even as oil imports dipped by 4.8%.

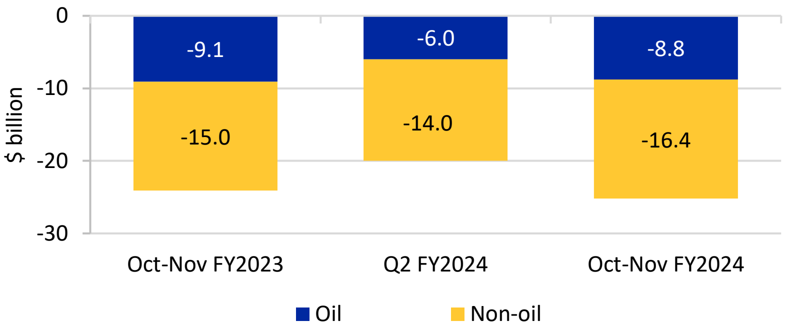
Average monthly deficit in Oct-Nov FY2024 widened from Q2 FY2024 levels, while also exceeding year-ago levels

EXHIBIT: Monthly Average Trends in Merchandise Trade Balance



Source: Ministry of Commerce and Industry; ICRA Research

EXHIBIT: Monthly Average Trends in Trade Balance of Oil and Non-oil items

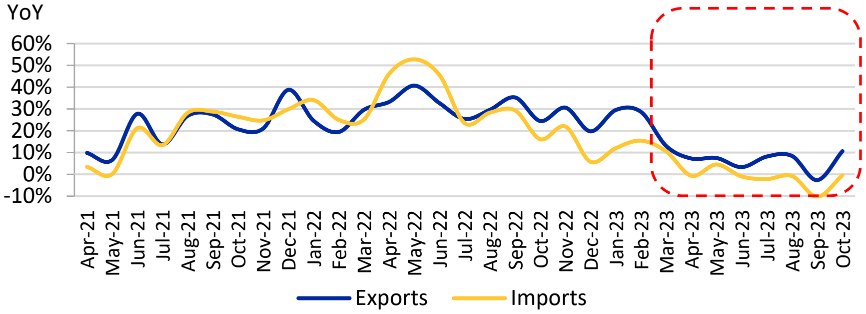


Source: Ministry of Commerce and Industry; ICRA Research

- With a slightly sharper YoY increase in imports vis-à-vis exports, the merchandise trade deficit widened to $50.5 billion in October-November FY2024 from $48.4 billion in the year-ago period. This was predominantly led by non-oil items, while the deficit on oil products dipped during this period.
- However, in sequential terms, the monthly average deficit of $25.2 billion in October-November FY2024 trended higher than the average of $19.9 billion seen during Q2 FY2024, driven by both oil (-$8.8 billion in Oct-Nov FY2024 vs. -$6.0 billion in Q2 FY2024) as well as non-oil items (-$16.4 billion vs. -$14.0 billion).
- **Based on preliminary trends for October-November 2023 and ICRA's expectation for December 2023, the merchandise trade deficit is projected to widen to $75-77 billion in Q3 FY2024 from $61.0 billion in Q2 FY2024, while also mildly exceeding the levels seen in Q3 FY2023 ($71.3 billion).**

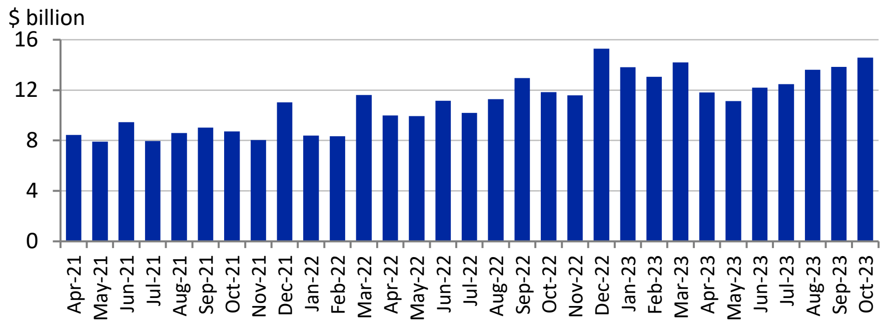
Services trade surplus witnessed an uptick in Oct 2023; surge in merchandise trade deficit to lead to more-than-doubling of CAD to $18-20 billion in Q3 FY2024

EXHIBIT: Trends in Services Exports and Imports



Source: RBI; ICRA Research

EXHIBIT: Trends in Services Trade balance



Source: RBI; ICRA Research

- The YoY growth in services exports rose to 10.6% in October 2023 (+24.4% in Oct 2022) from 4.2% in Q2 FY2024 (+30.2% in Q2 FY2023), while printing in double digits after a gap of six months. However, this uptick in growth was largely led by a favourable base as well as a shift in the festive calendar in 2023 vis-à-vis 2022; ICRA believes that it would be more meaningful to look at the average YoY growth performance in October-November 2023.
- Services imports contracted by a marginal 0.4% YoY in October 2023, narrower than the 4.6% decline seen in Q2 FY2024. Benefitting from this, India's services trade surplus expanded by 23.1% YoY to touch a 10-month high of $14.6 billion in October 2023, as against the monthly average of $13.3 billion in Q2 FY2024.
- **Overall, owing to the sharp sequential uptick in merchandise trade deficit in October-November 2023, ICRA estimates the CAD to more-than-double to $18-20 billion (-2.1% of GDP) in Q3 FY2024 from $8.3 billion (-1.0% of GDP) in Q2 FY2024.**

CAD projected to print at $52-55 billion or ~1.5% of GDP in FY2024, unless commodity prices rebound sharply in Q4

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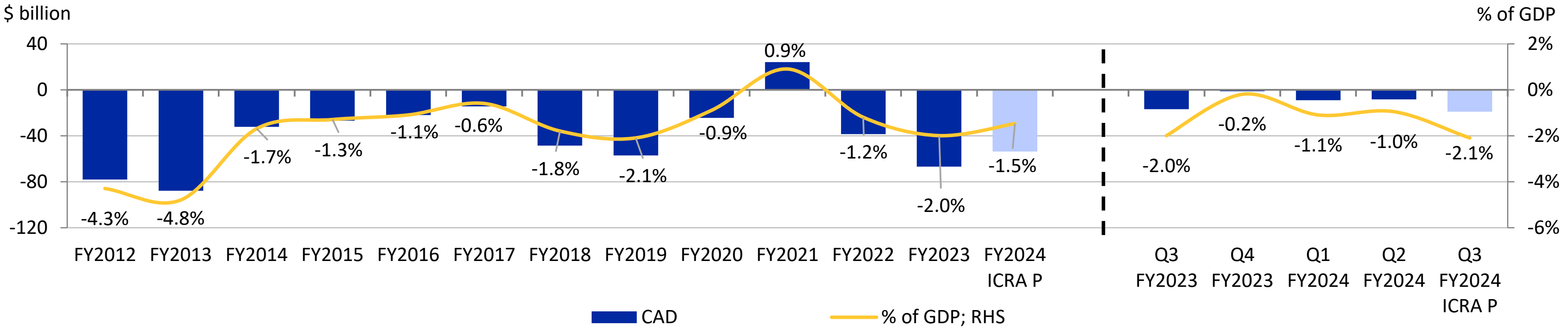
EXHIBIT: Trends in Current Account Deficit ($ billion; % of GDP)

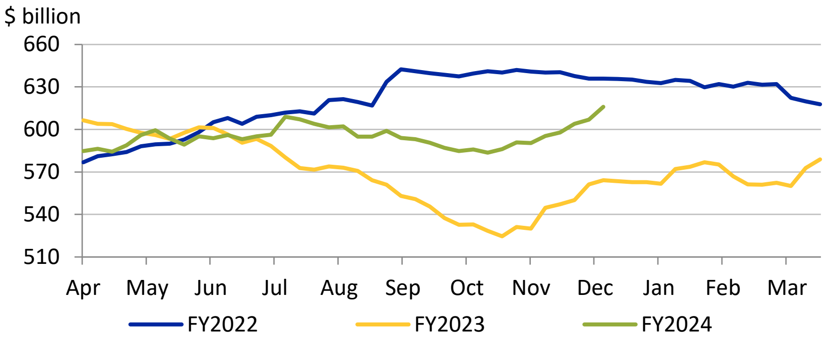


**P: Projected; Data labels correspond to CAD as % of nominal GDP; ICRA's nominal GDP Proj. has been used for FY2024; Source: RBI; CEIC; ICRA Research*

- ICRA estimates India's merchandise exports to contract by 6.5-7.0% in FY2024, mildly steeper than the ~5% fall expected in imports, led by a weak global demand, impact of sub-par and uneven monsoon on domestic agri production, and continuation of export ban on certain items, even as lower commodity prices would act as a dampener for both exports and imports. Nevertheless, the merchandise trade deficit is expected to print slightly lower in FY2024 vis-à-vis the levels seen in FY2023.
- ICRA believes that the headwinds stemming from a slowdown in Advanced economies are likely to weigh on IT service exports in FY2024, especially the BFSI segment. **Benefitting from lower imports, ICRA foresees India's services trade balance at $153-158 billion in FY2024, higher than $143.3 billion seen in FY2023.**
- **Overall, ICRA projects the CAD to narrow to $52-55 billion (-1.5% of GDP) in FY2024 from $67.0 billion (-2.0% of GDP) in FY2023, unless commodity prices chart a sharp rebound in the remaining part of the fiscal.**

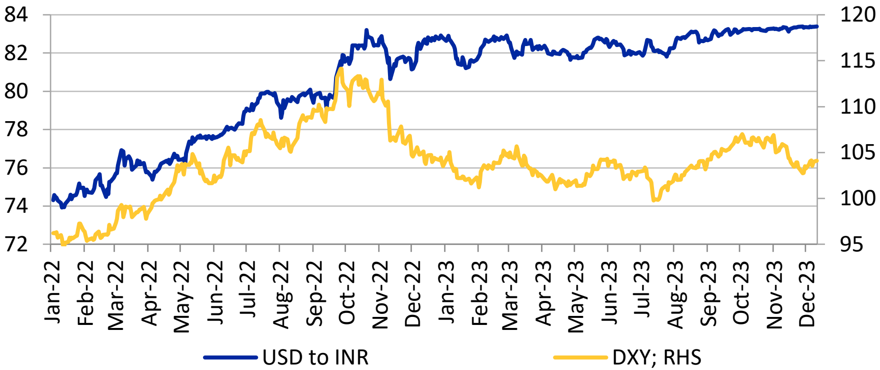
Forex reserves have increased sharply in Q3 FY2024 partly led by valuation gains

EXHIBIT: India's Foreign Exchange Reserves



Source: RBI; ICRA Research

EXHIBIT: Movement in USD/ INR reference rate and DXY



Source: RBI; FBIL; CEIC; ICRA Research

- India's foreign exchange reserves have risen by $29.1 billion during Q3 FY2024 (up to Dec 15, 2023) as against the $9.3 billion increase that was seen in the first half of the fiscal, suggesting that financial flows are likely to have seen a significant increase during this period thereby offsetting the sharp increase in the merchandise trade deficit. However, a part of this increase in forex reserves in Q3 FY2024 is also likely to have been driven by valuation gains, with both – the DXY and the UST yield declining quite sharply since end-October 2023; this has coincided with the $29.9 billion increase in forex reserves between Oct 27, 2023 and Dec 15, 2023.
- The USD/INR pair has largely remained stable during Q3 FY2024 so far, trading in a very narrow range of 83.00-83.40/$ during the quarter so far (up to Dec 22, 2023)
- **Going ahead, factors such as geopolitical tensions, FPI flows, crude oil prices, and trends in the DXY are likely to guide the trajectory of INR in the near term. ICRA expects the USD/INR pair to trade between 83.0-83.5/$ over the next couple of months, unless a ratcheting up of geopolitical tensions leads to a sharp depreciation in the EM currencies. Thereafter, the inclusion of Indian bonds in the J.P. Morgan GBI-EM Global Index and expectations of a pivot to rate cuts by the US Fed are likely to favour the USD/INR pair in the next fiscal year.**

Annexure

EXHIBIT: Trends in India's Current account

Figures in $ billion	Q2 FY2023	Q3 FY2023	Q4 FY2023	Q1 FY2024	Q2 FY2024	Q3 FY2024 ICRA P	FY2021	FY2022	FY2023	FY2024 ICRA P
Merchandise Exports	111.9	105.6	115.8	105.0	108.5	104 to 106	296.3	429.2	456.1	422 to 427
Merchandise Imports	190.2	176.9	168.4	161.6	169.5	180 to 182	398.5	618.6	721.4	683 to 688
Merchandise Trade Balance	***-78.3***	***-71.3***	***-52.6***	***-56.6***	***-61.0***	***-75 to -77***	***-102.2***	***-189.5***	***-265.3***	**-259 to -263**
Net Services	**34.4**	**38.7**	**39.1**	**35.1**	**40.0**	**39 to 41**	**88.6**	**107.5**	**143.3**	**153 to 158**
Primary Income	**-11.8**	**-12.7**	**-12.6**	**-10.6**	**-12.2**	**-11 to -13**	**-36.0**	**-37.3**	**-45.9**	**-48 to -50**
Secondary Income	**24.8**	**28.5**	**24.8**	**22.9**	**25.0**	**28 to 30**	**73.6**	**80.5**	**100.9**	**101 to 103**
Current Account Balance	***-30.9***	***-16.8***	***-1.3***	***-9.2***	***-8.3***	***-18 to -20***	***+24.0***	***-38.7***	***-67.0***	**-52 to -55**
Percentage of GDP	**-3.8%**	**-2.0%**	**-0.2%**	**-1.1%**	**-1.0%**	**-2.1%**	**+0.9%**	**-1.2%**	**-2.0%**	**-1.5%**

EXHIBIT: Trends in India's Financial account

Figures in $ billion	Q2 FY2023	Q3 FY2023	Q4 FY2023	Q1 FY2024	Q2 FY2024	FY2021	FY2022	FY2023
Financial flows	**1.4**	**28.9**	**6.5**	**34.2**	**10.0**	**64.7**	**85.9**	**59.0**
Direct investment	6.2	2.0	6.4	5.1	-0.3	44.0	38.6	28.0
Portfolio investment	6.5	4.6	-1.7	15.7	4.9	36.1	-16.8	-5.2
Financial derivatives	0.1	-0.4	-2.7	-0.7	-1.9	-4.8	-6.4	-5.4
Other investment*	-11.5	22.7	4.5	14.2	7.2	-10.6	70.5	41.5

**other investments include ECBs, banking capital, trade credit and advances, other accounts receivable/payable, etc.; P: Projected;* ICRA's nominal GDP forecast has been used for FY2024; *Source: RBI; ICRA Research*

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Thank You!