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EXTERNAL DEBT

External debt to GDP ratio at 13-year low at end-March 2024; ample forex reserves provide cushion against rising external obligations

JUNE 2024

Highlights

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External debt rose by $39.7 billion YoY to $663.8 billion at end-March 2024, but moderated to a 13-year low of 18.7% as a proportion of GDP

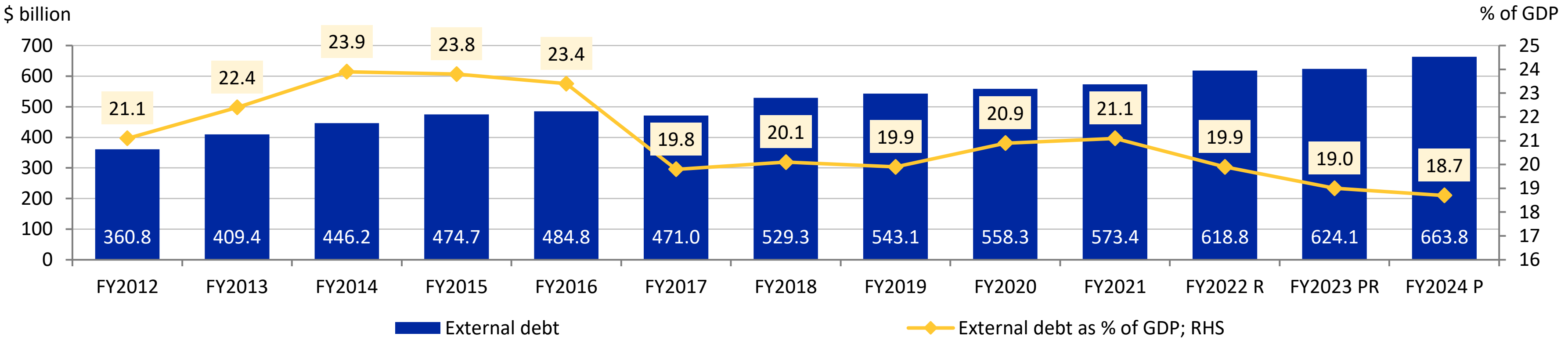
Coverage of external debt provided by forex reserves surged to eight-quarter high 97.4% at end-Mar 2024

While India's external obligations (CAD + short-term debt by residual maturity) are expected to climb in FY2025, these may edge lower as a proportion of forex reserves

- India's external debt rose by $39.7 billion to $663.8 billion at end-March 2024 from $624.1 billion at end-March 2023. A bulk of the aforesaid uptick stemmed from commercial borrowings, which increased by $29.4 billion on a year-on-year (YoY) basis in FY2024.
- Nevertheless, external debt/GDP ratio moderated to a 13-year low of 18.7% at end-March 2024 (19.0% at end-March 2023), aided by the stronger expansion in nominal GDP (+9.6%) vis-à-vis the external debt (+7.9%). However, the debt service ratio rose to 6.7% in FY2024 from 5.3% in FY2023.
- The share of short-term debt by original and residual maturity in total external debt eased to a three- and four-year low of 18.5% and 42.9%, respectively, in FY2024 after witnessing uptick in FY2023. Nevertheless, the latter category witnessed a yearly increase in absolute terms in FY2024.
- With a sequential uptick of $24.0 billion in reserve assets, the coverage of external debt by forex reserves improved to an eight-quarter high of 97.4% at end-March 2024 from 96.3% at end-December 2023. It may ease in Q1 FY2025, amid a muted $6.5 billion rise in reserves in the quarter.
- Given the expectations of the FPI-debt inflows amounting to $20-24 billion in FY2025 owing to the bond index inclusion, the external debt of the Government is set to rise sharply in the fiscal. This is also likely to weigh on the overall external position in FY2025, while helping to finance an anticipated small current account deficit (CAD). Nevertheless, forex reserves have remained sizeable, which will provide some cushion.
- Owing to the uptick in short-term debt by residual maturity and the expected increase in the CAD, India's external obligations are set to increase in FY2025. However, as a proportion of forex reserves, these are set to ease slightly in FY2025, thereby providing comfort.
- ICRA expects the INR to trade between 82.5-84.0/$ in the rest of H1 FY2025, with the inclusion of Indian bonds in J.P. Morgan's GBI-EM Global Index from end-June 2024 auguring favourably for the USD/INR pair. However, any untoward depreciation in EM currencies in the event of an escalation in geopolitical conflicts could exert some pressure on the Indian currency.

India's external debt/GDP ratio moderated to a 13-year low 18.7% in FY2024, amid a stronger growth in nominal GDP vis-à-vis external debt

EXHIBIT: Trends in external debt and as % of GDP



R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- India's external debt rose by $39.7 billion to $663.8 billion at end-March 2024 from $624.1 billion at end-March 2023. Additionally, the pace of the YoY growth in FY2024 was higher at 6.4%, as against the tepid 0.8% growth seen in FY2023.
- The valuation effect, to the extent of $8.7 billion, owing to the appreciation of the US dollar vis-à-vis Indian rupee and major currencies such as Yen, the SDR and Euro suppressed the increase in external debt in FY2024. Had it not been for this, the external debt would have increased by a larger $48.4 billion in FY2024.
- Nevertheless, external debt as a % of GDP moderated to a 13-year low of 18.7% at end-March 2024 from 19.0% at end-March 2023, owing to the stronger growth in nominal GDP (+9.6%; to Rs. 295.4 trillion at end-March 2024 from Rs. 269.5 trillion at end-March 2023) vis-à-vis the external debt (+7.9%, in INR terms) in the fiscal.
- Notably, the debt service (i.e. principal repayments and interest payments) rose to 6.7% of current receipts at end-March 2024 from 5.3% at end-March 2023 – this is the highest ratio since FY2018 (7.5%, barring Covid-led surge in FY2021: 8.2%).

Commercial borrowings was largest contributor to increase in external debt in FY2024

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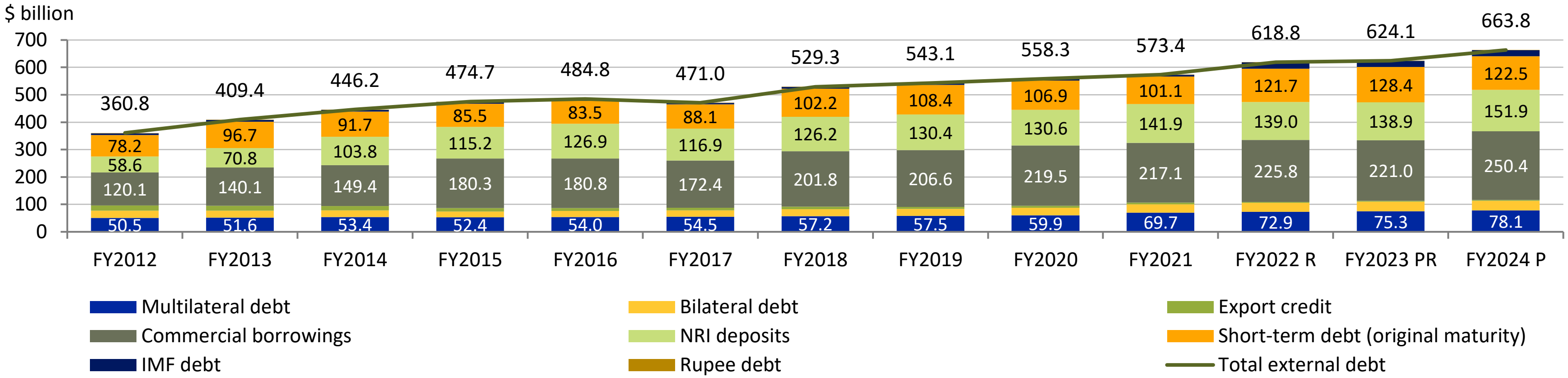
EXHIBIT: Trends in components of external debt



Short-term debt is shown by original maturity basis; R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- The $39.7 billion increase in external debt during FY2024, relative to FY2023, was led by commercial borrowings (+$29.4 billion), which reported the largest rise on a YoY basis since FY2018 (+$29.5 billion). This was followed by an uptick in NRI deposits (+$13.0 billion), multilateral debt (+$2.8 billion), and bilateral debt (+$0.7 billion) in FY2024 over FY2023 levels. In contrast, short-term debt (-$5.9 billion) and the IMF debt (-$0.4 billion) reported a decline during this period, while the export credit (at $2.9 billion) and rupee debt (at $0.9 billion) stood in line with the levels seen at end-March 2023.
- Accordingly, the shares of commercial borrowings (to 37.7% from 35.4%) and NRI deposits (to 22.9% from 22.3%) in total external debt increased at end-March 2024 relative to end-March 2023. In contrast, the share of short-term debt (to 18.5% from 20.6%), bilateral debt (to 5.3% from 5.5%), multilateral debt (to 11.8% from 12.1%) and IMF debt (to 3.3% from 3.6%) declined during the same period.

Increase in external debt of non-government exceeded that of government in FY2024; loans continued to form the largest part of external debt

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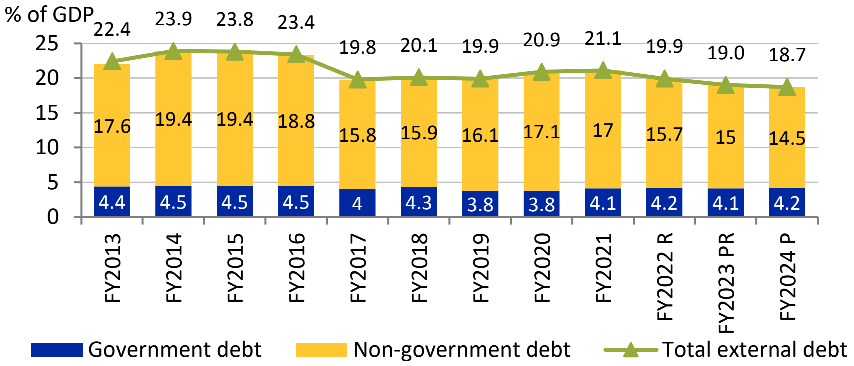
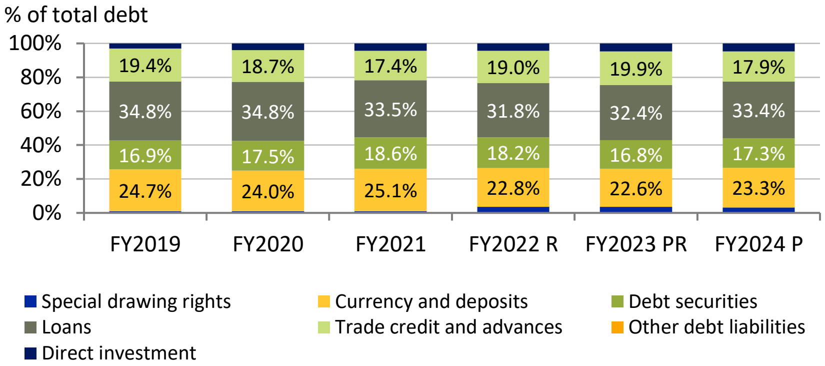
EXHIBIT: Government and Non-government External Debt as % of GDP



R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- Outstanding external debt of both Government (by $15.4 billion to $148.7 billion in FY2024) and non-government (by $24.4 billion to $515.1 billion) sectors increased in FY2024 over FY2023, although the extent of the rise was sharper in the latter.
- As a % of GDP, while government debt inched up slightly to 4.2% in FY2024 from 4.1% in FY2023, non-government moderated to 14.5% from 15.0%, respectively.
- **With expectations of FPI-debt inflows amounting to $20-24 billion in FY2025 owing to the bond index inclusion, the external debt of the Government is set to rise sharply in the fiscal.**

EXHIBIT: Instrument-wise classification as % of total external debt



R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- As per the instrument-wise classification, in line with previous-year trends, loans (33.4%) constituted the largest share of total external debt in FY2024.
- This was followed by currency and deposits (23.3%), trade credit and advances (17.9%), debt securities (17.3%), direct investment (4.7%), and special drawing rights (3.3%). Compared to FY2023, the share of trade credit and advances, and the SDR has moderated in FY2024, which was offset by the rise in share of loans, currency and deposits, and debt securities.

Short-term debt by original maturity moderated in FY2024 from the peak of FY2023, while short-term debt by residual maturity rose further

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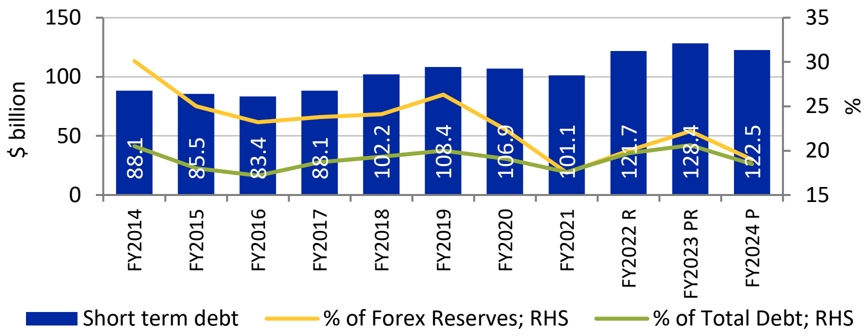
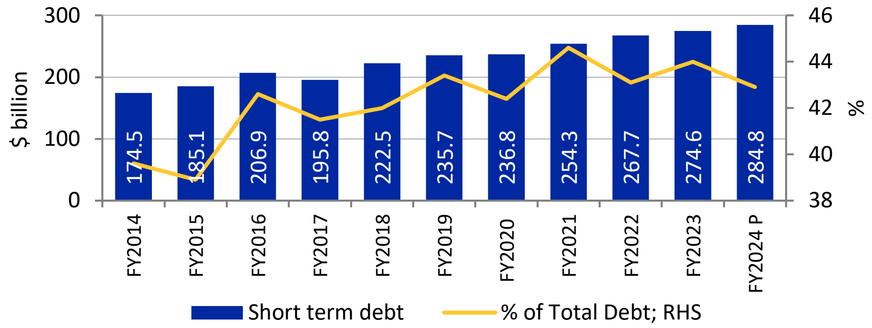
EXHIBIT: Short-term debt (by original maturity)



R: Revised. PR: Partially Revised. P: Provisional; Source: RBI; ICRA Research

EXHIBIT: Short-term debt (by residual maturity)



P: Provisional; Source: RBI; ICRA Research

- While remaining elevated, India's short-term debt (with original maturity of up to one year) has moderated slightly to $122.5 billion in FY2024 from the peak of 128.4 billion in FY2023. Moreover, the share of short-term debt (with original maturity of up to one year) in total external debt dipped to a three-year low 18.5% from 20.6%, respectively.
- Additionally, the ratio of short-term debt to foreign exchange reserves declined in FY2024 (to 19.0% from 22.2%, respectively).
- However, the short-term debt by residual maturity basis (i.e., debt obligations that include long-term debt by original maturity falling due over the next 12 months and short-term debt by original maturity) rose to an all-time high of $284.8 billion at end-March 2024 from $274.6 billion at end-March 2023. Nevertheless, the share of short-term debt by residual maturity in total external debt eased to a four-year low of 42.9% from 44.0%, respectively.

External debt rose by ~3% QoQ at end-March 2024; coverage by forex reserves at eight-quarter high

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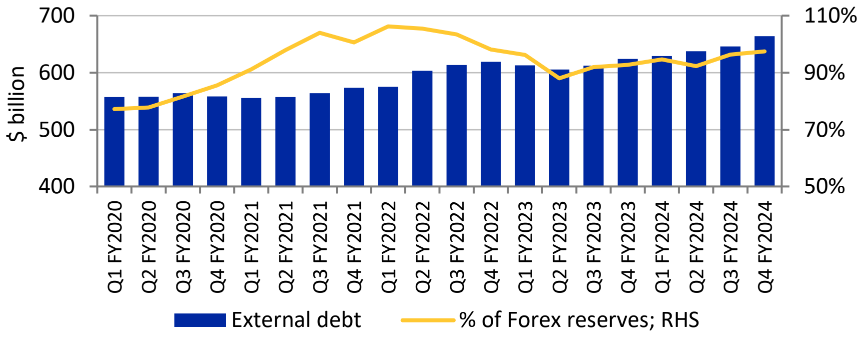
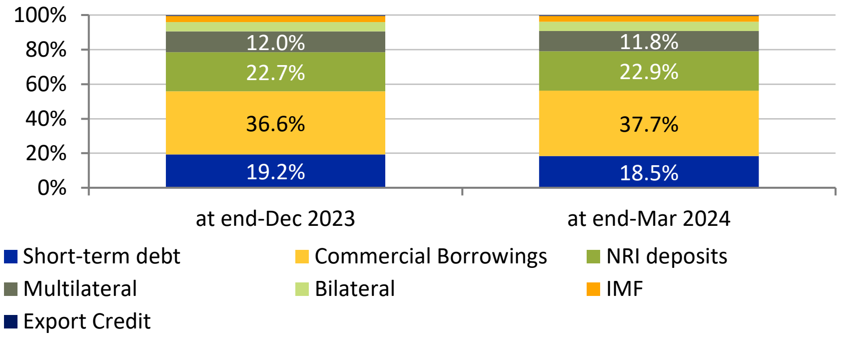
EXHIBIT: Quarterly trends in External Debt



Source: RBI; ICRA Research

EXHIBIT: Composition of External debt



Source: RBI; ICRA Research

- In sequential terms, India's external debt rose modestly by 2.7% to $663.8 billion at end-March 2024 from $646.1 billion at end-December 2023. With a quarter-on-quarter (QoQ) uptick of 3.9% or $24.0 billion in reserve assets, the coverage of external debt by forex reserves rose to an eight-quarter high of 97.4% at end-March 2024 from 96.3% at end-December 2023, even as it remained below the 100% mark for the ninth consecutive quarter.
- While the share of short-term debt in total external debt has declined mildly to 18.5% at end-March 2024 from 19.2% at end-December 2023, that of long-term debt rose to 81.5% from 80.8%, respectively.
- Within the long-term segment, the share of commercial borrowings (to 37.7% from 36.6%), NRI deposits (to 22.9% from 22.7%), rupee debt (to 0.13% from 0.12%), and export credit (to 0.44% from 0.43%) reported a sequential uptick at end-March 2024, relative to the previous quarter. In contrast, there was a marginal decline in the share of other constituents in the total external debt between these two quarters, such as bilateral debt (to 5.3% from 5.5%), multilateral debt (to 11.8% from 12.0%), and IMF debt (to 3.3% from 3.4%).

Outstanding commercial borrowings surged by 13.3% in FY2024, despite elevated global interest rates

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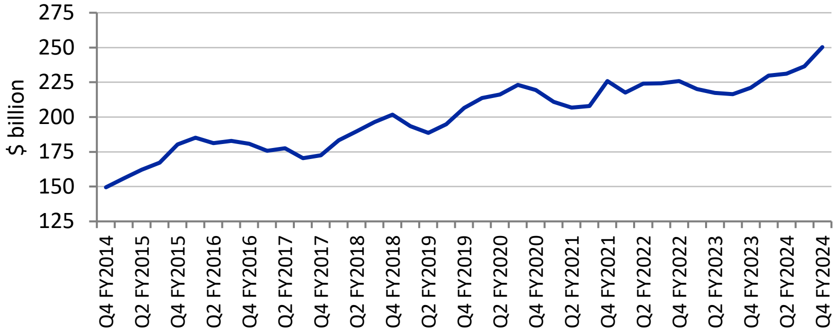
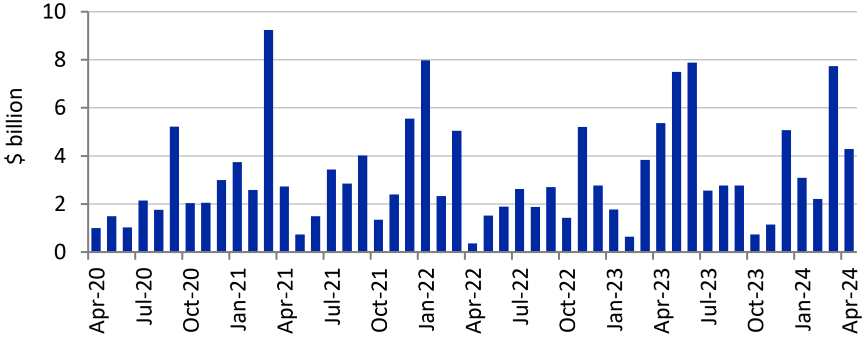
EXHIBIT: Trends in Commercial Borrowings



Commercial borrowings includes bank loans, bonds and loans/securitised borrowings with multilateral/bilateral guarantee and IFC(W); Source: RBI, ICRA Research

EXHIBIT: Trends in monthly ECB approvals ($ billion)



Source: RBI, ICRA Research

- Outstanding commercial borrowings stood at a record-high of $250.4 billion at end-March 2024, 13.3% higher than the year-ago levels ($221.0 billion at end-March 2023), amid the surge in gross inflows owing to some big-ticket approvals, even as global interest rates remained elevated. As a proportion of GDP, it rose to an eight-quarter high of 7.1% by end-March 2024 from 6.7% by end-March 2023.
- After surging to $48.8 billion in FY2024 ($26.0 billion in FY2023), gross ECB approvals fell by ~20% YoY to $4.3 billion in April 2024 from $5.4 billion in April 2023.
- **Going ahead, ICRA expects gross ECB approvals to remain sizeable at $40-45 billion in FY2025, albeit lower than the levels seen in FY2024. A broad-based surge in ECB inflows is unlikely in the near term, with global borrowing costs expected to only witness a back-ended moderation in FY2025. The timing of rate cuts in India and their transmission to domestic bank lending rates would also impact the demand for ECBs.**

FPI debt inflows to remain robust at $20-24 billion in FY2025, owing to Bond Index inclusion

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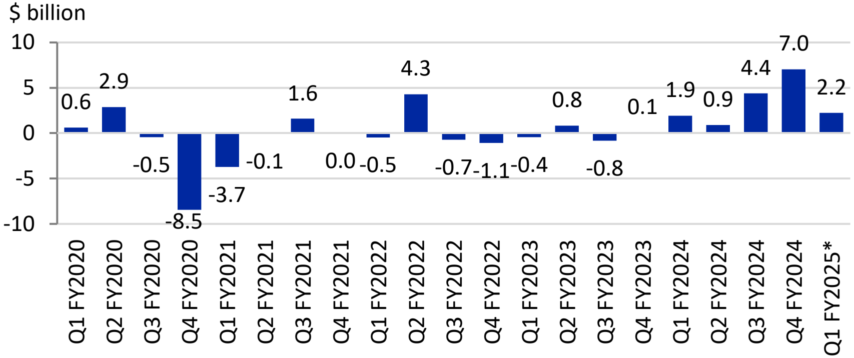
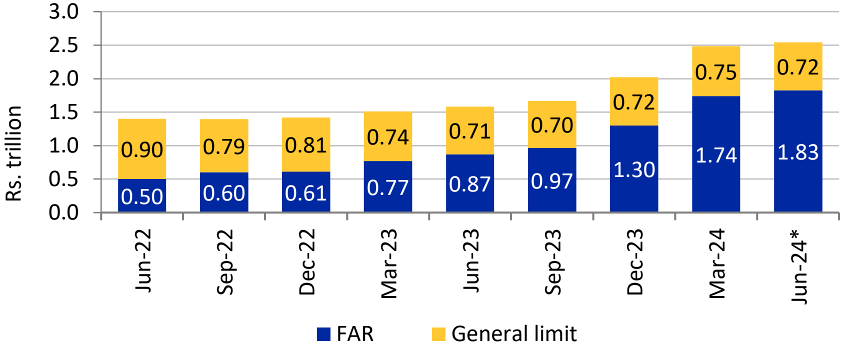
EXHIBIT: Trends in net FPI debt flows



**Up to June 25, 2024; Including Debt VRR segment; Source: NSDL, CDSL; ICRA Research*

EXHIBIT: Central government securities held by FPIs under Fully Accessible Route (FAR) and General Investment Route (GIR)

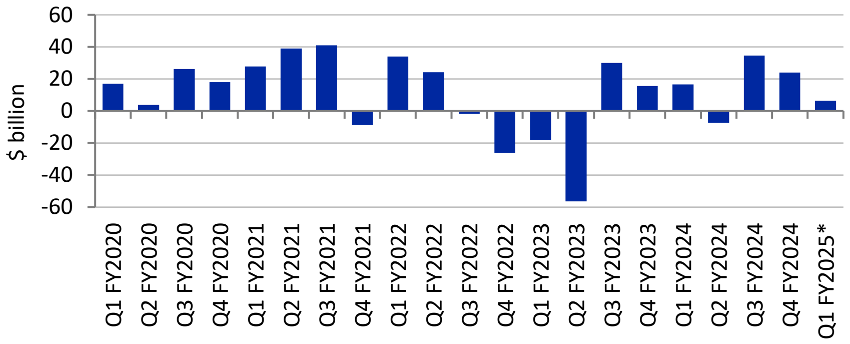


**As on June 26, 2024; Source: NDSL; ICRA Research*

- FPIs turned into net sellers in April 2024, with net outflows in the debt segment amounting to $0.9 billion, relative to net inflows of $1.9 billion seen in March 2024, on account of Election-related uncertainty, delayed expectations of rate cuts in the US, and ongoing geopolitical conflicts. Thereafter, FPIs have reverted to net purchases, with the overall debt inflows amounting to $1.6 billion each in May 2024 and June 2024 so far (up to June 25). Overall, the net FPI inflows in the debt segment stood at $2.2 billion in Q1 FY2025 so far, significantly lower than $7.0 billion seen in Q4 FY2024.
- **ICRA estimates FPI debt inflows to remain robust at $20-24 billion in FY2025 ($14.2 billion in FY2024), supported by the Bond Index inclusion during FY2025. However, an escalation in geopolitical tensions, expectations of rate cuts in the US and their implications for the DXY and INR continue to be key monitorables.**
- The FPI holdings in G-secs through the fully accessible route (FAR) rose sharply to Rs. 1.8 trillion in June 2024 so far (as on June 26) from Rs. 1.7 trillion in March 2024**. The inclusion of India's G-secs in the J.P. Morgan Government Bond Index from end-June 2024 will lead to a sharp increase in the FAR holdings during the fiscal.**

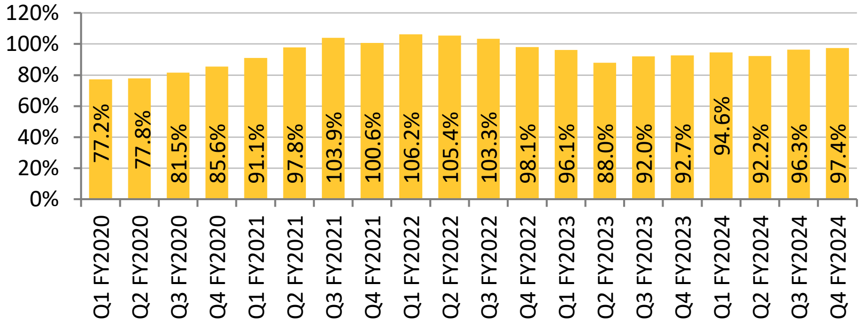
Coverage of external debt provided by forex reserves may decline in Q1 FY2025, while remaining at comfortable levels

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



Source: RBI; ICRA Research

EXHIBIT: Forex reserves as % of External Debt (%)



Source: RBI; ICRA Research

- India's reserve assets rose to a record-high of $646.4 billion in Q4 FY2024, even as the magnitude of the rise dipped to $24.0 billion from $34.7 billion in Q3 FY2024. The uptick was largely on account of an increase in foreign currency assets. Subsequently, foreign exchange reserves have risen by $6.5 billion to $652.9 billion as on June 14, 2024*, amid an increase in foreign currency assets (+$3.6 billion).
- India has recorded modest net inflows of $2.2 billion under the FII-debt segment (including VRR flows) in Q1 FY2025 (till Jun 25, 2024), while inflows from ECB, net of refinancing and the NRI deposits stood at $3.6 billion and $1.1 billion, respectively, in April 2024.
- **Given the mild rise of $6.5 billion in reserve assets in Q1 FY2025*, the coverage of external debt provided by forex reserves is likely to have dipped in Q1 FY2025, while remaining at comfortable levels. Looking ahead, the impending FII-debt inflows on account of India's inclusion in the J.P. Morgan EM Bond Index from end-June 2024 and the Bloomberg EM Local Currency Government Index from January 2025 is likely to push up the country's external debt through the ongoing fiscal.**

**Data for Q1 FY2025 has been computed by subtracting the forex reserves data published in the RBI's weekly statistical supplement as on June 14, 2024 from the reserve assets as per the International Investment Position data as at end-Mar 2024.*

India's external obligations to rise in FY2025

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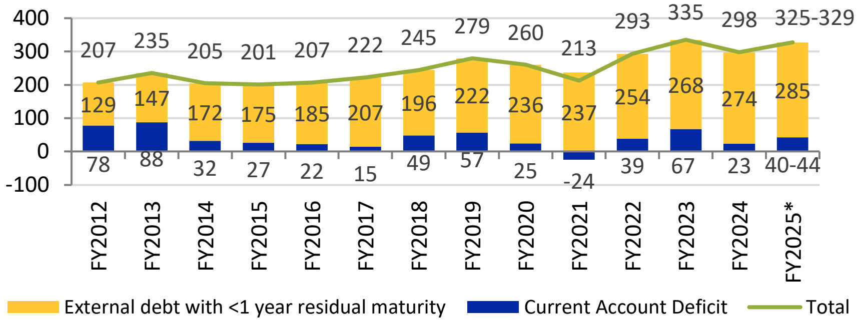
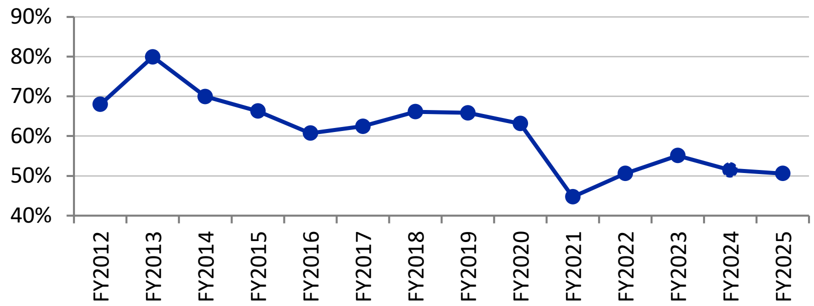
EXHIBIT: Trends in India's Current Account Deficit and External debt with <1 year residual maturity ($ billion)



**Denotes residual maturity of o/s external debt for up to one year as at end-March 2024 and we have included our CAD projections for FY2025; Source: RBI, ICRA Research*

EXHIBIT: Trends in India's external obligations (current account deficit + short term debt with residual maturity <1 year) as a % of foreign exchange reserves



Source: RBI, ICRA Research

- India's short-term debt with residual maturity of less than 1-year rose mildly by 3.9% to $285.0 billion by end-March 2024 from $274.4 billion at end-March 2023. Besides, ICRA projects the current account deficit to widen sharply to ~$40-44 billion in FY2025 from $23.2 billion in FY2024 owing to a rise in the merchandise trade deficit on the back of domestic demand and higher commodity prices, while remaining comfortable at ~1.1% of GDP.
- This implies that India's external obligations (short term debt with residual maturity < 1-year + current account deficit) for FY2025 will rise by ~10% to $325-329 billion from $298 billion in FY2024, albeit lower than the peak of $335 billion in FY2023. However, as a proportion of forex reserves, these obligations are set to ease slightly to 50.6% in FY2025 (using reserve assets at end-March 2024) from 51.4% in FY2024, and remain below the pre-pandemic levels of over 60%.
- **Even though short-term obligations have risen, India's external position remains comfortable, owing to the cushion provided by the sizeable forex reserves.**

INR depreciated by 0.2% against the $ in FY2025 so far

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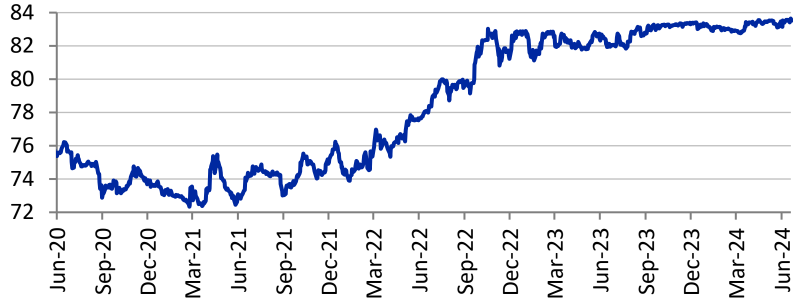
EXHIBIT: Movement in USD/INR exchange rate



Source: Bloomberg; RBI; ICRA Research

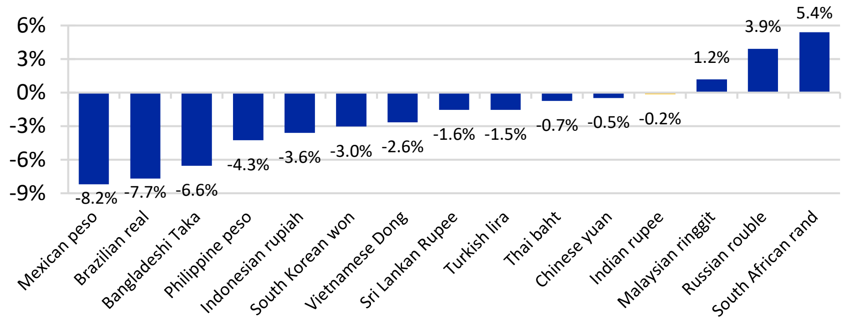
EXHIBIT: Movement in Dollar Index (DXY)

Source: Bloomberg; RBI; ICRA Research

- The Dollar index had strengthened by 1.2% between end-March 2024 and June 24, 2024, amid the expectations of a delay in rate cuts by the US Fed. The INR has remained quite stable, depreciating by just 0.2% against the $ during this period.
- The USD/INR pair had fallen to a record-low of 83.65/$ as on June 20, 2024, while averaging at 83.42/$ in Q1 FY2025 so far (up to June 24; 83.04/$ in Q4 FY2024), amidst the uptrend seen in the DXY as well as FPI equity outflows recorded in the ongoing quarter so far.

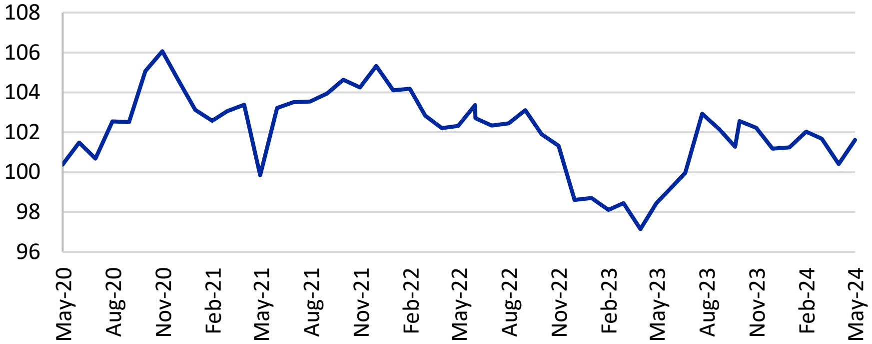
INR outperformed most EM currencies vis-à-vis $ in FY2025 so far; continued outperformance may weigh on India's export competitiveness

EXHIBIT: FYTD exchange rate movements of EM currencies relative to the $



Till June 24, 2024; Source: Bloomberg; ICRA Research

EXHIBIT: Index of REER for INR (40 Country, Export Based Weights)



Source: RBI; ICRA Research

- In FY2025 so far, the INR has depreciated by 0.2% against the $, faring better from as many as 11 EM currencies in our sample set, including the Chinese yuan (-0.5%), Thai baht (-0.7%), Turkish lira (-1.5%), Sri Lankan rupee (-1.6%), Vietnamese dong (-2.6%), South Korean won (-3.0%), Indonesian rupiah (-3.6%), Philippine peso (-4.3%), Bangladeshi taka (-6.6%), Brazilian real (-7.7%), and the Mexican Peso (-8.2%).
- Notably, the INR has appreciated against the CNY by 3.6% in FY2024 and 0.3% in FY2025 so far (till June 24, 2024). This is likely to have made imports from China more attractive, while also weighing upon India's export competitiveness for some segments.
- The 40-country, export-weighted Real Effective Exchange Rate (REER) remained flat in May 2024 vis-à-vis March 2024. It had risen by 3.3% through FY2024 (March 2024 vs. March 2023), indicating that the INR had appreciated (in real terms) against a basket of currencies during the fiscal, which is likely to have impacted India's export competitiveness.
- If the USD/INR pair remains stable while other EM currencies weaken against the $, then it would likely dull India's export competitiveness going ahead.

INR to trade between 82.5-84.0/$ in the rest of H1 FY2025

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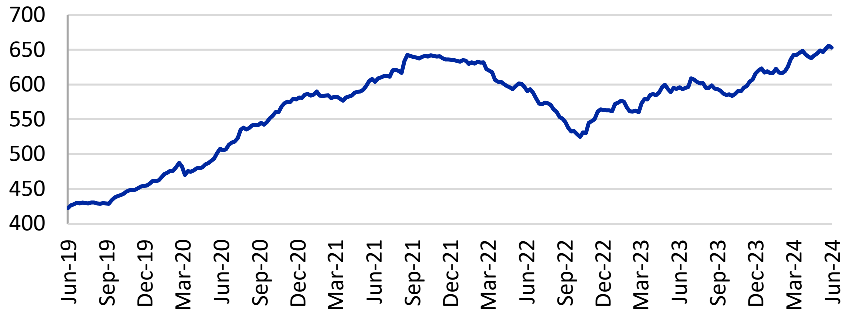
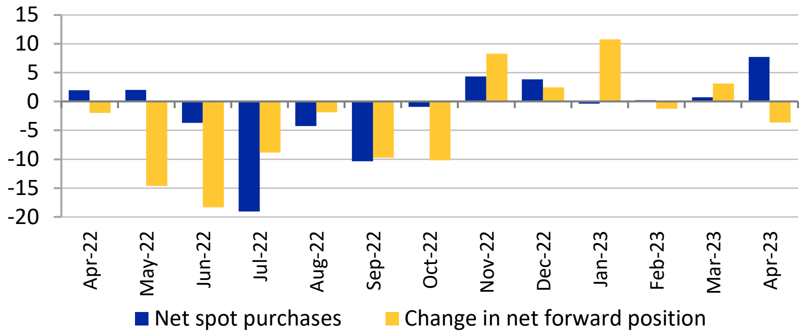
EXHIBIT: Trends in India's forex reserves ($ billion)



Source: RBI; ICRA Research

EXHIBIT: Trends in RBI's net spot purchases of the US dollar and outstanding forwards ($ billion)



Source: RBI; ICRA Research

- India's foreign exchange reserves rose to $652.9 billion as on June 14, 2024 from $645.6 billion as on March 29, 2024. This translates to an increase of $7.3 billion in FY2025 so far, lower than the increase of $17.7 billion recorded in the corresponding period of FY2024. The forex cover relative to the trailing 12 months of merchandise imports stood at a healthy 11.6 months on June 14, 2024 from 10.8 months recorded at end-March 2024.
- The RBI conducted net forex purchases of $23.8 billion in Q4 FY2024, before turning a net seller in April 2024 ($3.6 billion). Additionally, its outstanding net sales in the forward market surged to $16.3 billion by the end of April 2024 from $0.5 billion by the end of March 2024, while contrasting with outstanding net purchases of $19.9 billion seen at end-April 2023.
- **ICRA expects the INR to trade between 82.5-84.0/$ in the rest of H1 FY2025, with the inclusion of Indian bonds in J.P. Morgan's GBI-EM Global Index from end-June 2024 auguring favourably for the USD/INR pair. However, any untoward depreciation in EM currencies in the event of an escalation in geopolitical conflicts could exert some pressure on the Indian currency. Nevertheless, we believe that the extent of volatility in the USD/INR pair is likely to remain contained, as witnessed over the last few quarters.**

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Thank You!