Macroeconomics | FIRST CUT

Narrowing deficit

May 2023

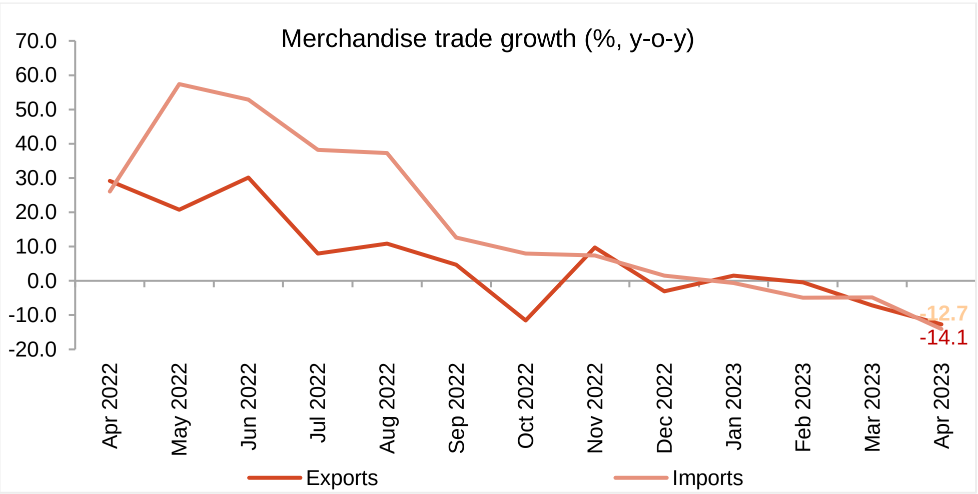
India's merchandise exports fell 12.7% on-year to $34.7 billion in April, following a 7.2% contraction the previous month. With this, India's merchandise exports have now contracted for three consecutive months on an on-year basis. Though the decline in exports was broad-based (across oil, gold[1] and core[2]), gold and oil exports fell more than core, reflecting healthy performance in select core categories such as electronics, agriculture, and pharmaceuticals.

Interestingly, merchandise imports fell at a much faster pace than exports; down 14.1% on-year to $49.9 billion in April. Like exports, decline in imports, too, was broad-based, led by decline in gems and jewellery, followed by oil and core. However, some investment-related imports increased, confirming that domestic investment revival continues even as some other parts of the economy may be seeing demand moderation.

All said, it is important to keep in mind that a part of the slowdown, in both exports and imports, is attributable to the price effect as international commodity prices, which shot up because of the Russia-Ukraine conflict in February last year, are now correcting. However, the following two facts – 1) post-pandemic demand surge is normalising, especially as the impact of monetary policy transmission of rate hikes (both abroad and domestically) gathers pace, and 2) the expenditure focus currently remains on services – suggest that goods demand is bound to witness sluggishness going ahead.

With merchandise imports falling significantly and outpacing the decline in merchandise exports, the trade deficit touched a 20-month low of $15.2 billion in April, down from $18.6 billion in March and $18.4 billion in April last year. While the decline is merchandise trade favours the balance of trade, this could also be an indication of weakening domestic demand momentum, which is to be expected with real gross domestic product (GDP) growth this fiscal projected[3] to slow down to 6.0% from 7.0% in the last.

Imports fell more than exports



Source: Ministry of Commerce and Industry, CRISIL

1 Represents total gems and jewellery exports
2 Represents total non-oil and non-gold exports
3 CRISIL forecast

Data highlights

- Decline in overall merchandise exports was led by gems and jewellery exports, which contracted 30% on-year. Given that international prices of gold and silver rose, on-month and on-year, the 30% value decline is exports suggests weakening demand in the importing nations, given their discretionary nature. To be sure, the US was the largest destination for India's gems and jewellery exports last fiscal. Also, gold jewellery exports to the United Arab Emirates — one of the leading destinations — seem to be struggling, which is worrisome in the light of the trade pact India signed with the region last year.

- Petroleum exports declined 17.6% on-year, as oil prices corrected to $84.1/barrel[4] from $105.8/barrel a year ago. That said, the decline in oil exports last month was lower than in March and February, as crude oil prices have corrected recently (from $78.5/barrel in March) with the announcement of oil supply cut by OPEC+. At the same time, engineering goods exports, India's largest export item, contracted 7.2%. Also, the decline in labour-intensive exports worsened, with textiles (readymade garment) down 23.1% (following 16.8% contraction in March) and leather down 17.4% (-16.6% in Mach).

- That said, pharmaceutical exports grew 10.4% on-year in April, followng average 4.5% growth in the previous two months. Some agriculture goods continued healthy export performance as well. Rice exports rose 24.0% (up from an average 13.5% in the previous three months), oil meals 95.1%, and spices 14.4%.

- Imports decline was led by 41.5% on-year drop in gold imports to a mere $1.0 billion in April vs $3.3 billion in March. Pearls, precious, and semi-precious stones imports fell 18.7%. Petroleum imports slipped 14.0% to $15.2 billion.

- While most import categories witnessed negative growth, electrical and non-electrical machinery — a proxy for investment demand — continued to grow positively, registering double-digit growth of 15.2% on-year. Iron and steel imports (in which India has become a net exporter), too, witnessed healthy growth of 14.5%, reflecting robust domestic demand, which is linked to the infrastructure sector, and subdued demand in other major economies, which is redirecting these exports to India.

- Services exports continued to increase in double digits in March (the latest month for which final data is available), as oposed to contraction in goods exports, thereby mitigating a part of the deficit in the latter. At $30.5 billion, services exports increased 13.1% on-year in March. In contrast, services imports rose 6.0% to $16.3 billion. As a result, services trade surplus improved to $14.2 billion from $11.6 billion a year ago. That said, services exports growth slowed down in March (as was pointed out in our last note), from an average 26.3% growth in the previous three months. This likely reflects slowdown in demand for information technology services in the US and Europe because of stress in the banking sector.

Outlook

Merchandise exports are expected to face headwinds from the anticipated slowdown in global growth, largely premised on lower growth in advanced economies such as the US and the euro area — both key export markets for India. Further, deceleration in domestic growth could lead to some softening in imports.

[4] Average Brent spot price during the month

The narrowing trade deficit is beginning to have a salutary effect on India's current account defict (CAD), which we expect to moderate to 2% of GDP from 2.5% estimated for this fiscal. And, the risks to CAD are tilted to the downside.

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