Macroeconomics | FIRST CUT

Narrowing trade deficit

March 2023

India's merchandise exports fell 8.8% on-year to $33.9 billion in February 2023[1]. A large part of the decline was because of oil exports plunging 28.6% on-year, which was also the first annual decline since February 2021. While some base effect was at play, there was a significant sequential decline as well. Even non-oil exports fell a moderate 4.3% on-year.

Sequential decline in oil exports was somewhat surprising as global crude oil prices were relatively stable ($80.25/barrel in February vs. $80.41/barrel in January 2023) and the government had reduced tax on petroleum exports mid last month. It is likely that a sharp surge in oil exports (which rose 50% on-year between April 2022 and February 2023, compared with 7.6% rise in overall goods exports) on the back of higher discounted crude oil imports from Russia is starting to normalise.

Core (non-oil, non-gold) exports fell 6.4% on-year in February, too, though lesser than the 8.8% decline in overall merchandise exports. This was because growth in the US and in Europe, which account for ~34% of India's goods exports, remained resilient. That said, there appears to be a shift from goods towards services demand, which is less import intensive. Hence, the goods export slowdown will continue and could intensify as the impact of monetary policy tightening gathers pace.

Meanwhile, merchandise imports fell by a slightly lesser 8.2% on-year to $51.3 billion in February. In fact, core (non-oil, non-gold) imports shrank at a much smaller rate of 2.0%, indicating that domestic economic activity is still showing resilience.

As a result of the sharper decline in overall exports vis-à-vis overall imports, India's merchandise trade deficit widened marginally to $17.4 billion in February from $16.6 billion in January 2023. Nevertheless, merchandise trade deficit remains on the decline as softening international commodity prices help reduce India's import bill.

Merchandise trade deficit on a declining trend

[1] Please note that due to upward revision in data for the previous month (to $35.8 billion from $32.9 billion), merchandise exports in January grew 1.5% rather than 6.6% contraction estimated earlier

Source: Ministry of Commerce and Industry

Year-to-date (April 2022 to February 2023), merchandise exports stood at $405.9 billion, up 7.6% from $377.4 billion in the year ago period. Imports, on the other hand, rose a sharper 19.2% to $655.4 billion from $549.9 billion. As a result, the cumulative trade deficit widened to $249.5 billion from $172.5 billion.

Data highlights

- February saw some of India's key export items return to a positive growth trajectory. For instance, gems and jewellery and pharmaceutical exports grew 13.8% and 4.7% on-year, respectively, after contracting in the previous two months. Thanks to push from the Production Linked Incentive scheme, electronics exports continued their stellar performance, rising 30% on-year in February. In fact, some of the low value exports have displayed healthy export growth, too. Particularly oil meals, which posted export growth of a massive 221% in February (44% so far this fiscal), owing to high export of for rapeseed and soyabean meals

- On the other hand, export of engineering goods, India's largest export item, continued to contract (-9.7%). Likewise, chemical exports shrank 12.3%. Worryingly, labour intensive sectors, demand from which has been affected the most given their discretionary nature, continued to reel. Textile (readymade garment) and raw textile exports were down 12.1% and 17.5%, respectively, in February. Also declining were handicraft exports (-28.3%), leather exports (-14.5%), and plastic and linoleum (-25.9%)

- Among the key import items, gems and jewellery imports contracted – pearl, and precious and semi-precious stone imports decreased 20.9% on-year in February, gold imports were down 44.9% and silver declined 97.3%. Petroleum imports also slipped 4.3%, the first month of contraction since September 2022. Fertiliser imports plummeted 59.3% owing to a decline in international natural gas and other fertiliser prices

- In contrast, iron and steel imports clocked 16.5% on-year growth. Likewise, project goods and transport equipment, i.e. auto parts, grew 22.5% and 49.2%, respectively, thereby keeping core imports sticky. A part of these could be a result of dumping in India as demand in advanced economies stays subdued

- The deficit in merchandise trade continues to be mitigated to a large extent by surplus in services trade. In January 2023 — the latest month for which final data was available — services trade surplus widened to $13.8 billion from $8.4 billion a year ago. Services exports grew 29.6% on-year to $28.0 billion, far outpacing growth of 7.5% on-year in service imports to $14.2 billion. It should be noted, though, that January services export number has been revised down to $28.0 billion from $32.2 billion estimated in the previous month. That said, services exports continue to display healthy growth, providing a buffer to the overall trade deficit

Outlook

Exports are expected to face headwinds from 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.

The falling trade deficit is beginning to have a salutary effect on India's current account defict (CAD), which we expect to moderate to 2.4% of gross domestic product from 3.0% estimated for the current fiscal. And the risks to the CAD are tilted downwards.

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