Macroeconomics | FIRST CUT

Trade deficit widens

June 2023

India's merchandise exports extended their declining streak to four months on the trot, shrinking 10.3% on-year to $34.9 billion in May after a 12.5% contraction the previous month.

The decline was led once again by oil exports, which slid 29.9% in May as international crude oil prices have come off their last-year highs, followed by a 12.7% decline in gems and jewellery exports.

Core exports, which exclude the above two categories, shrank a lower 4.0%, suggesting some resilience[1], as reflected in healthy performance in core categories such as electronics, iron ore, and select agriculture commodities. That said, the impact of weakening global demand is clearly visible in most other core export categories.

To be sure, the purchasing managers's index (PMI) for the US and the eurozone, both key export destinations for India's goods exports, have been indicating slackness in their manufacturing sectors.

Merchandise imports declined, too, albeit less than exports. At $57.1 billion in May, merchandise imports were down 6.6% on-year, led by gems and jewellery imports that fell 39.3% on-year. Oil imports fell much less (-6.0%), suggesting a combination of two factors at play: a) India has likely continued to buy discounted crude oil from Russia in large quantities, thereby keeping the overall oil import bill from falling too much, and b) domestic demand for the fuel remains buoyant.

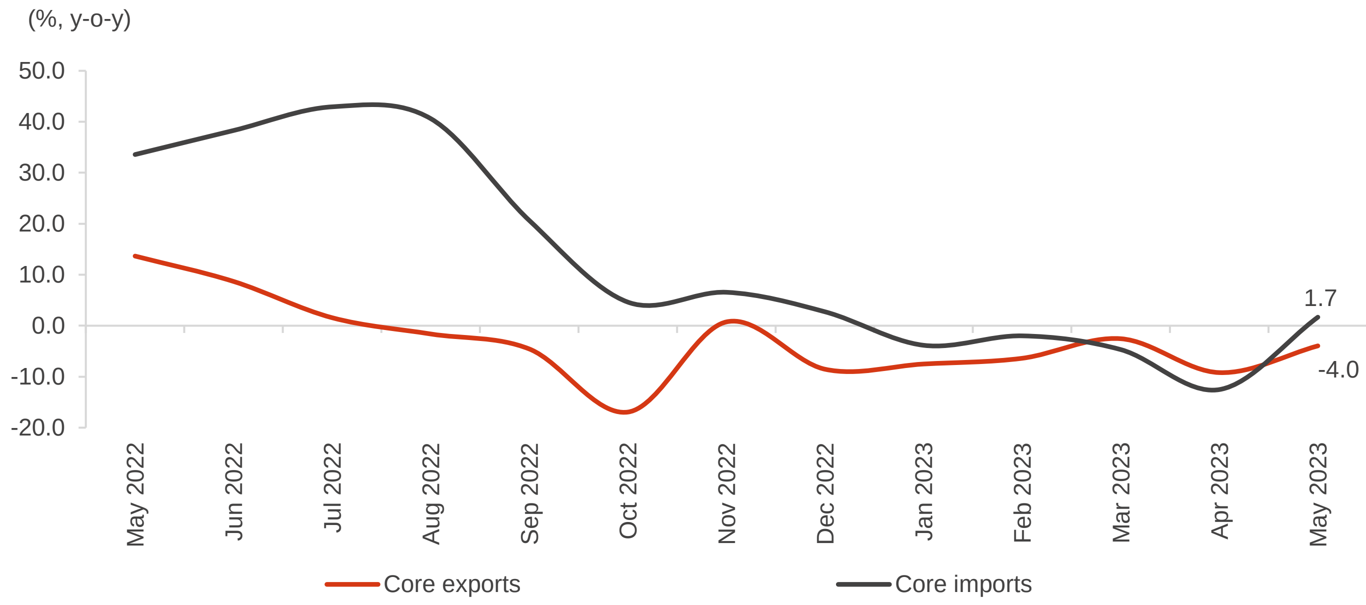
Importantly, core imports returned to positive territory, growing 1.7% on-year, thanks to a surge in demand for investment-related imports such as machiney and project goods. This is in sync with healthy growth momentum seen so far in the first quarter this fiscal. RBI has forecast a growth of 8.0% in gross domestic product (GDP) in the first quarter.

With merchandise imports falling less than merchandise exports, the trade deficit perked up again, to a five month high of $22.1 billion in May from $15.1 billion in April and $16.4 billion on average during January-April 2023.

If imports remain robust for longer, India's current account deficit, which likely fell below 2% in 2022-23, could see some pressure in the current fiscal.

[1] Core exports were marginally up on-month in seasonally adjusted terms

Core imports rose in May even as core exports continued to fall



Source: Ministry of Commerce and Industry, CRISIL

Data highlights

- Decline in overall merchandise exports was led by oil exports, which contracted 29.9% on-year to $5.9 billion, a reflection of lower crude oil prices. Brent crude was down to $75.7/barrel in May, from $84.1/barrel in April and $112.4/barrel in May 2022. Export of other top commodities also continued to decline. Engineering goods exports were down 4.2% to $9.3 billion, gems & jewellery down 12.5% to $2.8 billion, and chemicals down 12.7% to $2.2 billion.
- Pharmaceutical exports, which had shot up in April (10.4% on-year), climbed down in May and were up only 0.8% on-year at $2.1 billion, suggesting the surge in April was likely one-off.
- Decline in labour-intensive exports continued, with textiles (readymade garment) down 12.7% on-year in May, 'cotton yarn, fabrics, madeups, handloom products, etc' down 11.7%, and leather down 8.4%.
- Some core categories continued their good show: electronic goods exports were up 74.% on-year (partly on account of a low base as electronic exports had fallen sharply in May last year), iron ore exports rose 48.3% on-year (continuing to benefit from the duty withdrawal), and key agricultre exports such as oil meals, oil seeds and rice grew 52.9%, 25.0% and 14.3% respectively. Within the agriculture space, May saw a surge in exports of spices (up 49.8% on-year) and other cereals (68.0%). The latter represents rise in India's exports of millets, maize, and other coarse grains, likely reflecting the government's efforts to promote their production and farmers seeking to reap some benefit in the light of continued ban on wheat exports.
- The 39.3% decline in gems & jewellery imports was premised largely on lower 'pearl, precious, semi precious stones' imports, in turn reflecting lower demand overseas of their finished products. While gold imports also fell sharply (by 38.7% on-year), it was driven purely by a high base; sequentially, gold imports rose in May (despite international gold prices remaining high at $1992.13/troy oz in May vs $1999.7/troy oz in April), likely reflectnig increased seasonal demand domestically.

- While most import categories witnessed negative growth, electrical and non-electrical machinery and machine tools imports — proxy for investment demand — surged, registering double-digit growth of 25.4% on-year and 22.3%, respectively. Project goods imports also rose sequentially in May.
- Worryingly, growth in services exports fell to single digits in April, reflecting the slowdown in advanced economies, especially the US, where the banking sector (a large importer of India's software exports) crisis continues to unfold. In April, services exports grew 7.4% on-year (down from an average 23.8% in the previous three months) to $25.8 billion. As per preliminary data for May, growth in services exports fell further to a mere 0.7%. A saving grace for now is that services imports have shrunk, keeping the services trade surplus from falling too much. The situation on the services trade front will remain monitorable as these have been instrumental in offseting the impact of deficit in goods trade.

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.

Narrowing trade deficit had a salutary effect on India's CAD — expected to have ended lower than 2% of GDP — in fiscal 2023. We expect CAD to remain at ~2% of GDP this fiscal as exports continue to decline at a greater pace than imports.

Analytical contacts

Dharmakirti Joshi
Chief Economist, CRISIL Ltd
dharmakirti.joshi@crisil.com

Adhish Verma
Senior Economist, CRISIL Ltd
adhish.verma@crisil.com

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

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