Macroeconomics | FIRST CUT

Trade deficit balloons

November 2023

In welcome relief, India's merchandise exports rose 6.2% on-year to $33.6 billion in October, after contracting 2.6% in the previous month.

However, it is important to note the exports grew on a low base since merchandise exports stayed largely put sequentially. This was because exports of both oil and gems and jewellery – two of India's top export commodities – remained subdued in October. That said, core exports rose 11.7% on-year during the month due to healthy exports of pharmaceuticals and electronic goods, among others.

A large part of the expansion in core exports is likely a reflection of stocking activities ahead of the festival season, especially in the United States (US), where private inventory investment increased notably in the third quarter. Given overall manufacturng activity remains weak in both the US and the Euro Area (the region's gross domestic product contracted sequentially in the third quarter), it remains to be seen how long the rise in core exports sustains. To be sure, global growth is expected to weaken going ahead as the impact of higher interest rates gains strength.

Cumulatively, India's merchandise exports have declined 7.0% on-year to $244.9 billion during April-October 2023, from $263.3 billion in the year-ago period.

The real surprise was the stark rise in merchandise imports in October, which had contracted consecutively in previous nine months. At $65.0 billion, merchandise imports were up 12.3% on-year in the month. i.e., double the pace of export growth. The increase in imports was boardbased, led by a surge in gems and jewellery imports, up 62.6% on-year to $10.5 billion from $6.5 billion year ago. Oil imports followed, up 8.1%; core imports rose 7.2%.

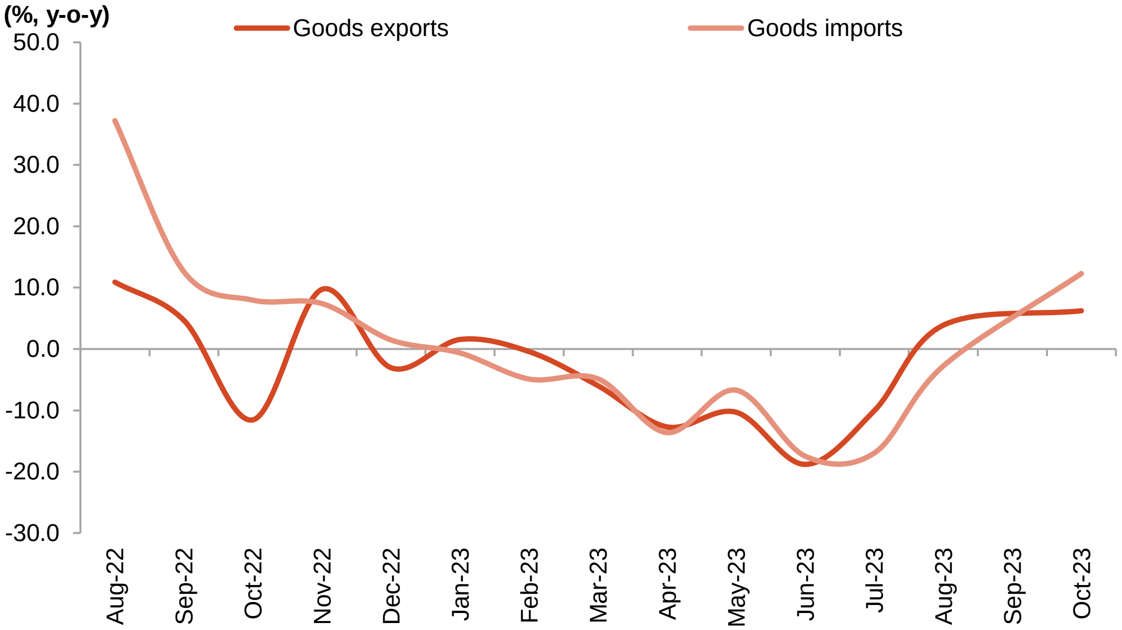
The high growth in gems and jewellery imports represents a 95.4% rise in gold imports (to $7.2 billion from $3.7 billion a year ago) and 124.6% higher silver imports ahead of the domestic festival and marriage season. On the other hand, the imports of pearls, precious and semi-precious stones continued to contract. This is worrisome since the category gets re-exported as opposed to the former which is mostly consumed domestically. That said, import of investment-related goods such as machinery and machine tools also rose significantly in October, suggesting domestic investment momentum not only continued but also gathered more steam post the monsoon season.

Given the sharper rise in imports than exports, the merchandise trade deficit rose to an all-time high of $31.5 billion in October, up from $19.4 billion in September and $26.3 billion in October last year. This will likely correct going ahead since the uptick in gold imports on account of festive demand should subside.

Cumulatively, given merchandise imports have contracted more (-8.9%) than exports (-7.0%) during April to October this fiscal, India's merchandise trade deficit so far this fiscal stands at $147.3 billion, down from $167.1 billion in the year-ago period.

India's services trade surplus rose marginally in September — the month for which final data is available — since services exports remained steady while services imports shrank.

Merchandise imports growth much higher than merchandise exports in October



Source: Ministry of Commerce and Industry, CRISIL MI&A Research

Data highlights

- Even as oil imports surged to $17.7 billion in October, from $13.9 billion in September, oil exports were down to $6.0 billion from $6.5 billion. While the two generally move in tandem, the divergence in October can be explaied by the following: a) Oil imports rose despite some softening on-month in oil prices,[1] suggesting the rise in the dollar value of imports was purely on account of increased import volumes. The latter likely reflects increased stockpiling of oil in view of the Israel-Hamas conflict that erupted last month, and b) the decline in oil exports reflects the impact of lower on-month oil prices clubbed with lower exported volume since (i) most of the oil refineries were partially shut due to maintainence in October and (ii) post monsoon domestic demand for the fuel likely rose, thereby leading to some lowering in exports
- Gems and jewellery exports continued to decline, down 9.8% on-year to $2.9 billion in October. The decline reflects lower demand of this discretionary category in advanced economies and China, where goods demand is slowing. There is also an issue of lower supply or input, as reflected by continuous contraction in the imports of pearls, precious and semi-precious stones, which is a reflection of a drop in the supply of Russian rough diamonds in the global market, according to the industry sources
- That said, growth in a number of core export commodities was healthy in October. Drug and pharmaceuticals and electronic goods, were the leaders, with their exports growing 29.3% and 28.2% on-year, respectively. Enginering goods also registered a healthy positive growth of 7.2%; however, this was the result of a low base effect since sequentially their exports slowed in October
- Among categories having lower export share, on-year growth was healthy in ceramic products and glassware (48.2%), agri commodities such as meat, dairy and poultry products (38.6%) and fruits and vegetables (24.5%), and textile categories such as cotton yarn, fabrics, madeups, handloom products, etc (36.5%) and manmade yarn, fabrics, madeups, etc (10.2%)
- On the import front, as explained earlier, gold imports rose sharply, almost doubling, growing 95.4% on-year in October (compared with just 6.9% on-year in the previous month). This spurred an overall increase in the country's merchandise imports. The positive gold import growth is not only linked to higher on-year gold prices[2] in October but also to the sequential rise (to $7.2 billion, from $4.1 billion in September)
- Electrical and non-electrical machinery import growth rose to 17.6% on-year in October, from 3.9% in September
- Imports increased in some core import categories in October vis-à-vis September, especially coal (4.5% vs -33.4%) and iron and steel (7.4% vs -3.2%). On the other hand, categories such as tranport equipment (-34.0% vs -53.1%) and vegetable oils (-35.7% vs -24.1) continued to decline
- Services exports were stable at $28.4 billion in September (vs $28.7 billion in August) while services imports dropped to $14.5 billion from $15.1 billion. As a result, the services trade surplus improved to $13.8 billion in September, from $13.6 billion in August; it was $12.9 billion in September last year

[1] Brent spot prices averaged $91.1/bbl in October, down from $94.0/bbl in September
[2] International gold price averaged $1916.3/troy oz in Oct 2023, compared with $1664/troy oz in Oct 2022

Outlook

While the slackening in merchandise exports has moderated in recent months, it remains to be seen if this trend can sustain. Exports are facing global headwinds in the form of an expected slowdown in the near term and uncertainties on account of the geopolitical situation.

That said, the expected deceleration in domestic growth in the second half of this fiscal should keep a check on imports. The services trade surplus remains robust and remittances are expected to remain healthy.

As a result, we project India’s current account deficit (CAD), which was 2.0% of gross domestic product in fiscal 2023, to soften to 1.8% this fiscal. Volatility around oil prices, however, could pose some upside risks to the CAD this fiscal year and remains a monitorable.

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