Macroeconomics | FIRST CUT

CAD goes leaner

March 2024

Strong services trade surplus and remittances primary reason

India's current account deficit (CAD) narrowed to $10.5 billion (1.2% of GDP) in the third quarter of fiscal 2024, from $11.4 billion (1.3% of GDP) in the second quarter. On year, too, the deficit narrowed. The benign CAD deficit came in despite wider deficits in the merchandise trade account and primary income acount, which mainly includes net income from investments abroad. A higher combined surplus in services trade and secondary income – which mainly includes remittances – offset the impact of wider merchandise-trade and primary-income account deficits.

CAD funding was comfortable, driven by a net increase (8.3% on-quarter) in financial flows during the third quarter, primarily driven by an uptick in both direct and portfolio investments and leading to net accretion in foreign exchange reserves .

Softer crude oil prices and moderation in domestic growth will keep the trade deficit in check (through lower requirement of imports), despite expected tepid growth in the export of goods amid uneven global growth and geopolitical uncertainty. Additionally, robust services-trade surplus and healthy remittances should keep the CAD in check. We expect CAD to remain at 1.0% of GDP in fiscals 2024 and 2025.

Key data points for the third quarter

- CAD narrowed to 1.2% of GDP in third quarter, from 1.3% in second quarter
- Trade deficit was unchanged at 2.9% of GDP, -- while merchandise trade deficit widened to 7.9% of GDP from 7.5% and services surplus rose to 5% of GDP from 4.7%
- Primary-income account deficit widened marginally to 1.5% of GDP from 1.4%, while secondary-income account surplus improved to 3.2% from 2.9%
- Net financial inflows rose to 1.3% of GDP, from 1.2%
- There was a net accretion of $6 billion to foreign exchange reserves during the quarter, compared with $3 billion in the second quarter

CAD at 1.2% of GDP for April-December in fiscal 2024

- India's CAD narrowed to $10.5 billion (1.2% of GDP) in the third quarter from $11.4 billion (1.3% of GDP) in the second quarter, and substantially lower than $16.8 billion (2.0% of GDP) in the year-ago third quarter. With this, CAD during the first three quarters of fiscal 2024 stands at 1.2% of GDP

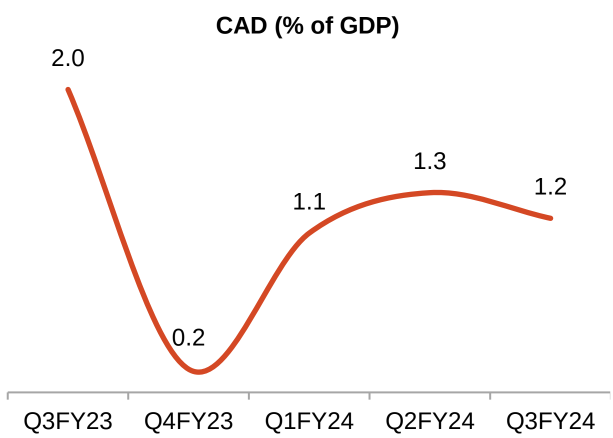
- Goods trade deficit widened to $71.6 billion from $64.53 billion, as imports grew 3.16% on-quarter and exports declined 1.49% on-quarter during the third quarter

- Meanwhile, services-trade surplus improved to $45.02 billion from $39.94 billion, supported by an increase in travel services, which turned positive after staying in the red for two quarters. Travel-services surplus was

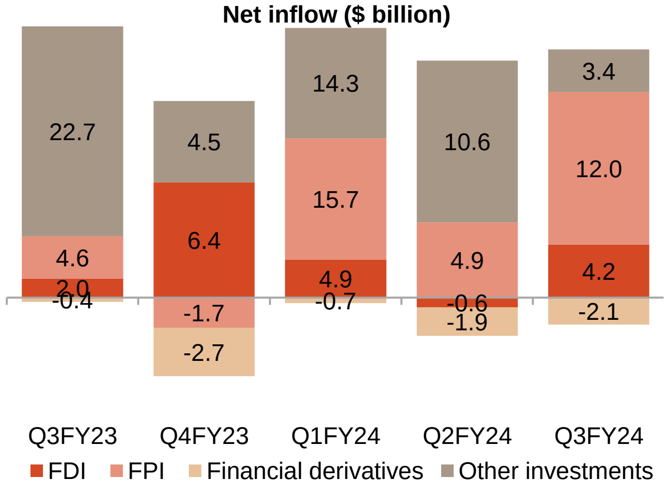
$2.36 billion in the third quarter, as against -$1.18 billion in the second quarter and -$3.08 billion in the first quarter. Further, IT[1], professional and management-consulting exports rose during the quarter

- Primary-income account deficit widened to $13.2 billion from $11.8 billion
- Secondary-income surplus, however, improved to $29.32 billion from $24.95 billion (reflecting personal transfers, including worker remittances). Gross secondary income increased 12.03% to $31.53 billion, compared with $28.15 in the previous quarter

CAD narrows in the third quarter…



…and financial flows improve



Source: Reserve Bank of India, CRISIL

Portfolio investments dominate capital inflows in the third quarter

- While CAD narrowed, net financial flows improved on-quarter in the third quarter
- Net inflow from foreign portfolio investors (FPIs) improved to $12.01 billion, compared with $4.95 billion. Much of this net inflow was from equity and investment fund shares ($6.7 billion) compared with debt securities ($5 billion)
- Net foreign direct investment (FDI) inflow turned postive, at $4.18 billion, as against a net outflow of $0.63 billion in the second quarter, because of higher gross inflow (14%) and lower outflow (-15%) on-quarter in the third quarter
- Other investments declined to $3.37 billion from $10.64 billion. These investments comprise non-resident Indian (NRI) deposits, external commercial borrowings (ECBs), other loans and trade credit. Within the category, net inflow under NRI deposits improved to $3.9 billion from $3.2 billion, even as ECBs recorded further outflow of $2.63 billion comapred with $1.9 billion outflow in the previous quarter

Foreign exchange reserves extend build-up

- Foreign exchange reserves rose by $5.99 billion in the third quarter, compared with an accretion of $2.52 billion in the second quarter, taking the country's foreign exchange reserves to $620.44 billion as of

[1] Consists of telecom, computer and information services

December-end, from $590.70 billion as of September-end. The reserves rose further to $642.63 billion as of March-end 2024

- A narrower trade deficit and healthier services surplus and remittances flows could bring further improvement in CAD
- In the third quarter, the rupee depreciated 0.7% compared with the second quarter to settle at an average 83.2/$. However, during the fourth quarter, the rupee appreciated 0.3% on average to 83.02/$.

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