Macroeconomics | FIRST CUT

CAD rises from lows

September 2023

Merchandise trade deficit rose, services trade surplus and remittances fell in the first quarter

While India's current-account deficit (CAD) narrowed on-year, it rose sequentially in the first quarter of this fiscal, thanks to a rise in merchandise-trade deficit and lower surplus in services trade. Secondary income surplus, largely reflecting remittances, declined as well.

Financial flows also went up significantly and were more than sufficient to fund CAD, leading to an accretion in foreign exchange reserves. The uptick in financial flows was largely a result of surge in foreign portfolio investments (FPI), and other investments (largely banking capital), even as foreign direct investment (FDI) softened a bit.

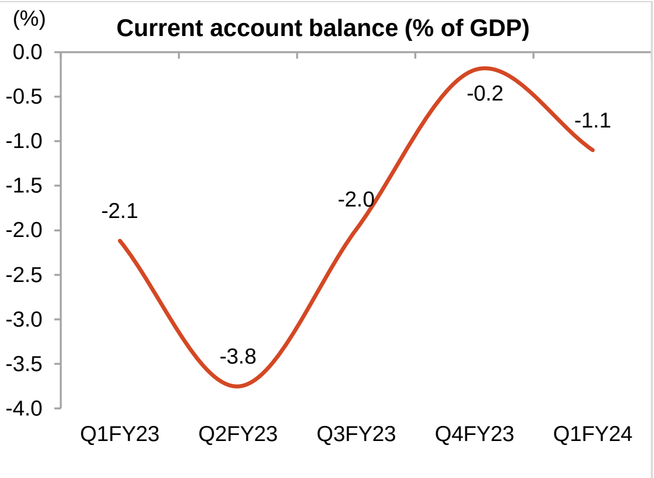
While the CAD remains manageable, the current uptick in oil prices means some upside pressure going ahead

Balance of payments: Highlights

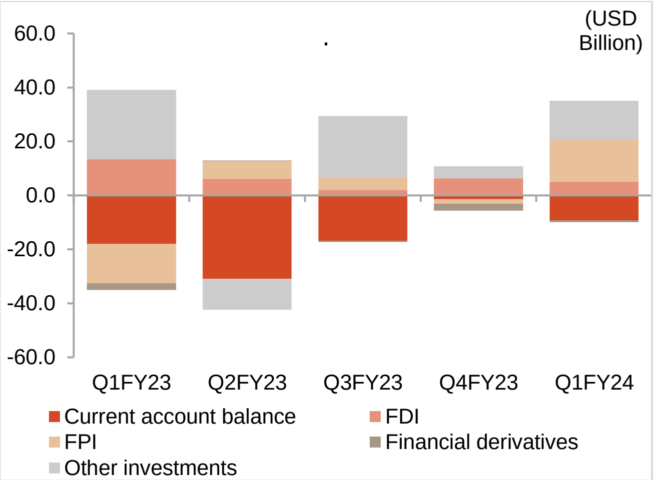
India's CAD rose to $9.2 billion (1.1% of GDP) in the first quarter (Apr-Jun) of fiscal 2024, from $1.3 billion (0.2% of GDP) in the fourth quarter of fiscal 2023. That said, CAD was down from $17.9 billion (2.1% of GDP) in the first quarter of fiscal 2023.

The sequential rise in CAD was a result of a) rise in goods trade deficit to $56.6 billion from $52.6 billion in the fourth quarter as exports declined at a greater pace than imports with the latter reflecting resilience in the domestic economic activity, b) fall in services trade surplus to to $35.1 billion from $39.1 billion, largely on account of the deficit in travel services as Indians spent abroad more than vice versa during the quarter, and c) secondary income surplus, which largely reflects personal transfers (which includes worker remittances) from abroad, came down to $22.9 billion from $24.8 billion. Decline in personal transfers remains monitorable, especially amidst slowing global growth as this is an important component that compensates a part of the deficit in the merchandise trade thereby keeping CAD in check.

CAD went up in the first quarter…



…but financial flows more than funded it



Source: RBI

Financial flows funded the CAD, thanks to higher FPI flows and return of banking capital

Net financial flows were not only higher on-quarter, but also more than sufficient to finance the deficit in the current account, thereby leading to a healthy accretion of foreign exchange (forex) reserves during the first quarter.

Net inflows under the financial (sum of foreign direct investments [FDI], foreign portfolio investments [FPI], financial derivatives and other investments) and capital accounts amounted to $34.4 billion in the first quarter, up from $6.5 billion in the fourth quarter. But given that CAD during the first quarter was only $9.2 billion, $24.4 billion of forex reserves accretion happened in the first quarter (compared with $5.6 billion accretion in the previous quarter).

The financial flows in the first quarter were led by net FPI inflows at $15.7 billion (compared with -$1.7 billion in the previous quarter). Thanks to India's stable macros and robust corporate results, Indian economy attracted healthy FPI inflows during the quarter. This was followed by 'other investments', where the surplus was $14.3 billion, up from $4.5 billion previous quarter. This was largely the result of a return of banking capital (or 'deposit-taking corporations, except the central bank').

Within 'other investments', External commercial borrowings (ECB) too registered a healthy growth, rising to $5.6 billion, from $1.7 billion previous quarter, refecting among others a stable rupee.

Net FDI, on the other hand, softened to $5.1 billion in Q1FY24, from $6.4 billion in Q4FY23 and $13.4 billion in Q1FY23. This is worrisome and a monitorable as FDI is a more stable source of financing the CAD.

Outlook

The decline in services trade surplus during the first quarter seems to be have got corrected in the second quarter and is likely to remain healthy going ahead. However, decline in personal transfers will need monitoring, especially as global growth is expected to slow down.

The recent uptick in oil prices will also weigh on merchandise trade deficit. Brent spot has already crossed $95/bbl from an average $86.2/bbl in August. Together, these have put an upside to our CAD call of 1.8% of GDP for this fiscal.

At the same time, given weakening global growth and tighter monetary policies in advanced economies, financial flows are expected to be volatile. CAD should be manageable and its financing is unlikely to be a major concern if there are no major setbacks on oil and remittances.

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