Macroeconomics | FIRST CUT

CAD narrows on services exports, remittances

March 2023

That, and robust financial flows lead to forex accretion in the third quarter

India's current-account deficit (CAD) narrowed to 2.2% of GDP in the third quarter of fiscal 2023 from 3.7% in the second quarter, thanks to a lower merchandise-trade deficit and higher surplus in services trade. This was buttressed by an increase in foreign remittances during the quarter.

Not only did the CAD narrow in the third quarter, but also the financial flows were more than sufficient to fund the CAD, leading to an accretion to foreign exchange reserves, as against the depletion in the previous quarter. To be sure, while both foreign portfolio investments (FPI) and foreign direct investments (FDI) fell on-quarter in the third quarter, it was the sharp uptick in other investments (mainly banking capital) that resulted in the wider financial-account surplus.

Robust services exports and remittances helped narrow CAD substantially in the third quarter

Balance of payments: Highlights

CAD narrowed precipitously to $18.2 billion (2.2% of GDP) in the third quarter (Oct-Dec) of fiscal 2023, from $30.9[1] billion (3.7% of GDP) in the second quarter of fiscal 2023 and $22.2 billion (2.7% of GDP) in the third quarter of fiscal 2022. With this, CAD stood at $67.0 billion (or 2.7% of GDP) during April-December 2022, compared with $25.3 billion (1.1% of GDP) in the year-ago period. That said, CAD peaked in the second quarter of fiscal 2023 and appears to be on a decline now.

CAD narrowed in the third quarter, as goods trade deficit declined to $72.2 billion from $78.3 billion in the second quarter (imports declined faster than exports), helped by a moderation in international energy prices, particularly oil and natural gas.

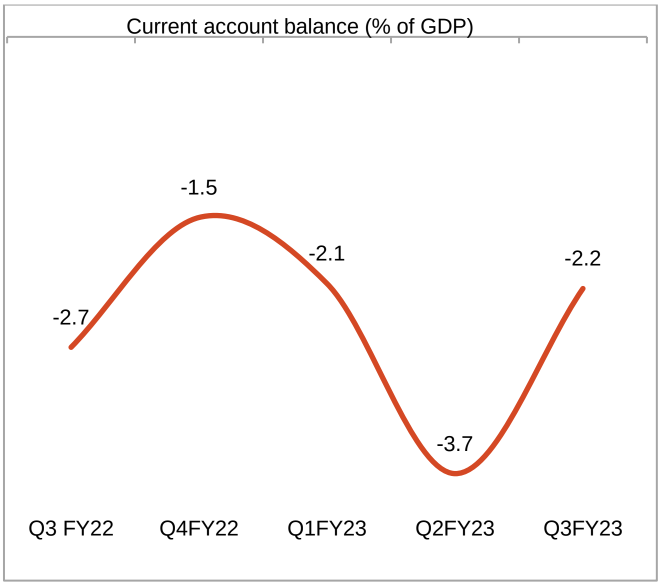
At the same time, services trade surplus rose to $38.7 billion from $34.4 billion in the second quarter, thanks to a healthy uptick in services exports (IT, business and travel services). It is noteworthy that travel services were back in surplus for the first time since the fourth quarter of fiscal 2020 - i.e., January-March 2020 quarter - thanks to the surge in personal travel, reflecting the uptick in the number of foreigners visiting India. Business travel, however, remains in the red.

[1] Revised down from $36.4 billion (4.4% of GDP) provided earlier by RBI, due to downward adjustment to customs data. At the same time Q1FY23 CAD was revised down to 2.1% of GDP from 2.2% earlier due to upward revision in the GDP estimate by the NSO

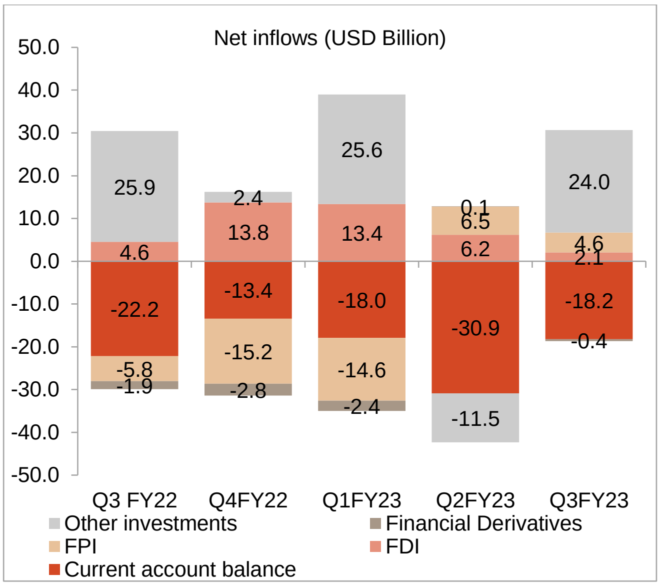
Further supporting the reduction in CAD was a rise in secondary-income surplus[2], reflecting robust personal transfers (largely foreign remittances), which increased to $28.4 billion from $24.9 billion in the previous quarter.

On the other hand, primary income (which represents investment-income from abroad) remained a drag on the current account, with the net outgo rising to $12.7 billion in the third quarter of fiscal 2023, from $11.8 in the second quarter.

CAD narrowed in the third quarter…



…and financial flows more than funded it



Source: RBI

Banking capital surged, while FDI and FPI flows dwindled

Net financial flows also improved, with financial surplus remaining in access of the CAD, reversing the trend in the previous quarter. Net inflow under the financial (sum of FDI, FPI, financial derivatives and other investments) and capital accounts amounted to $30.2 billion in the third quarter, up from $1.4 billion in the previous quarter.

It is noteworthy that net FPI inflow declined to $4.6 billion in the third quarter, from $6.5 billion in the second quarter. Likewise, net FDI inflow dwindled to $2.1 billion from $6.2 billion. Net outflow under external commercial borrowings (ECB) rose to $2.6 billion from $0.5 billion, reflecting higher interest cost of borrowing abroad amid a depreciating rupee.

What saved the day was the return of banking capital (or deposit-taking corporations, except the central bank) inflow at $12.0 billion, as against a net outgo of $10.9 billion in the previous quarter. Likewise, 'other accounts receivable/payable' witnessed an inflow of $7.8 billion, as against an outflow of $3.8 billion in the previous quarter. However, both of these flows are volatile components and cannot be relied on as a more durable source of funding — like the FDI, which has been declining. Hence, financing of CAD will remain a monitorable.

Two other categories that supported financial flows during the third quarter were NRI deposits, which rose marginally to $2.6 billion, from $2.5 billion previous quarter. At the same time, India also saw a surge in trade credit to $2.7 billion in the third quarter from a mere $310 million in the second quarter.

[2] All figures are on net basis unless otherwise specified

Financial flows in excess of CAD meant an accretion of forex reserves of $11.1 billion in the third quarter of fiscal 2023, unlike in the second quarter when there was a depletion of $30.3 billion, as the RBI tried to step in to arrest the rupee decline.

Outlook

Given the sharp decline in CAD in the third quarter and a downward revision of CAD in the previous quarters, CRISIL expects the CAD to settle around 2.5% of GDP for fiscal 2023, compared with the earlier estimate of 3.0%.

Softer global commodity prices and slower domestic growth are likely to temper our core imports. Along with this, buoyant services exports and robust remittances bode well for the current account. Given these factors, we expect CAD to decline to 2.0% of GDP in fiscal 2024. That said, financing of CAD could remain challenging, if FDI flows do not revive and FPI inflows remain weak.

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