Press Release

Higher CAD adds to the INR depreciation pressures

With persistent rise in crude oil prices, CAD to widen to USD 105 bn in FY23

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The pressure on India's external metrics has been on the rise since the Ukraine crisis and the consequent spurt in crude oil prices along with weakened global growth and trade outlook. As per the preliminary estimates released by the Ministry of Commerce and Industry, India's merchandise trade deficit posted a fresh record high level of USD 25.6 bn in Jun-22 from a deficit of USD 24.2 bn in May-22. With this the cumulative trade deficit for Q1 FY23 has more than doubled to USD 70.2 bn as compared to USD 31.4 bn recorded in Q1 FY22. Sequentially, in value terms, exports further moderated for the fourth consecutive month to USD 37.9 bn in Jun-22 from USD 39.0 bn in the previous month, manifesting the adverse impact of the slowdown in the global economy due to the geo-political crisis. On the other hand, imports increased marginally to USD 63.6 bn in Jun-22 from USD 63.2 bn in the previous month, given the rising crude oil bill.

On the exports front, the moderation was driven due to oil exports followed by a marginal decline in non-oil exports. Notwithstanding some sequential moderation, the exports of petroleum products has been increasing over the past couple of months. With exports becoming highly remunerative, domestic oil refineries have been able to benefit from the surge in global oil prices. However, in a move to shore up domestic supplies and to recoup some of the lost revenue from excise duty cuts, the Government has raised export duties on petrol and diesel by Rs 6/litre and Rs 13/litre respectively. Additionally, the deceleration in global demand due to weakening growth prospects along with dampening world trade volume (recently the WTO scaled down its projection for merchandise trade volume growth for 2022 to 3.0% from 4.7% projected earlier) is likely to cause a further normalization in India's export growth. Nevertheless, evolving global geopolitical dynamics (diversification of global value chains from China and Russia/Ukraine markets), and policy support through targeted incentive structures like the PLI Scheme and strategic trade partnerships (such as India-Australia trade agreement, and India-UAE trade pact) is expected to support exports, besides the inorganic expansion due to increased commodity prices.

The increase in overall imports has been marginal since the surge in non-oil and non-gold (NONG) and crude oil imports has been largely offset by sequential decline in gold imports amid seasonal factors at play. With an aim to anchor the depreciating bias on rupee due to widening current account deficit and preserve foreign reserves, the government has also increased import duty on gold by a net 4.25% to 15%, which may help to taper the increased trajectory of imports. While petroleum exports have increased by 70% between Feb-22 and Jun-22, petroleum imports have risen by just 35% in the same period. The relatively tepid increase in petroleum imports probably indicates increasing reliance on Russia oil (as per media reports, oil imports from Russia has jumped over 50 times since Apr-22 and now account for 10% of India's crude imports from just 0.2% prior to the war). A persistence of this trend could partially moderate the impact of elevated crude oil prices on India's FY23 current account deficit. NONG imports, a key indicator of domestic demand, soared to USD 40.2 bn in Jun-22 primarily led by coal followed by electronic goods, machinery, and chemical goods. The pressure on NONG imports is expected to remain elevated amidst increased demand for coal in the coming months. High power demand, inadequate coal stock at the power plants and slowdown of mining activities with the onset of monsoon have led the government to initiate negotiations with a few countries like Russia, Australia, and Indonesia to help Coal India Limited (CIL) import coal at a discounted rate. In addition, unlocking of the domestic economy post the taper of the pandemic along with vaccination drive gaining critical mass is likely to keep domestic demand for imports elevated.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "Given the relentless rise in commodity prices particularly crude oil over the last six months, we project current account deficit (CAD) to widen to USD 105 bn in FY23 from USD 47 bn in FY22. The expectation of the expansion of the current account deficit is not just driven by elevated global commodity prices but is also linked to the unlocking of the economy reviving pent-up demand. Additionally, the rapid normalization of monetary policies and spurt in interest rates in developed economies have induced sustained capital outflows, aggravating the pressure on the capital account. The depreciation of the rupee in this background to 79-80 levels per dollar is not really surprising. Commodity prices, however, are showing signs of cooling down and if this trend persists along with lower quantum of rate hikes than expected earlier in developed economies, a part of the depreciation is likely to be reversed."

Annexure

Chart 1: India's merchandise trade deficit widens to yet another record high level

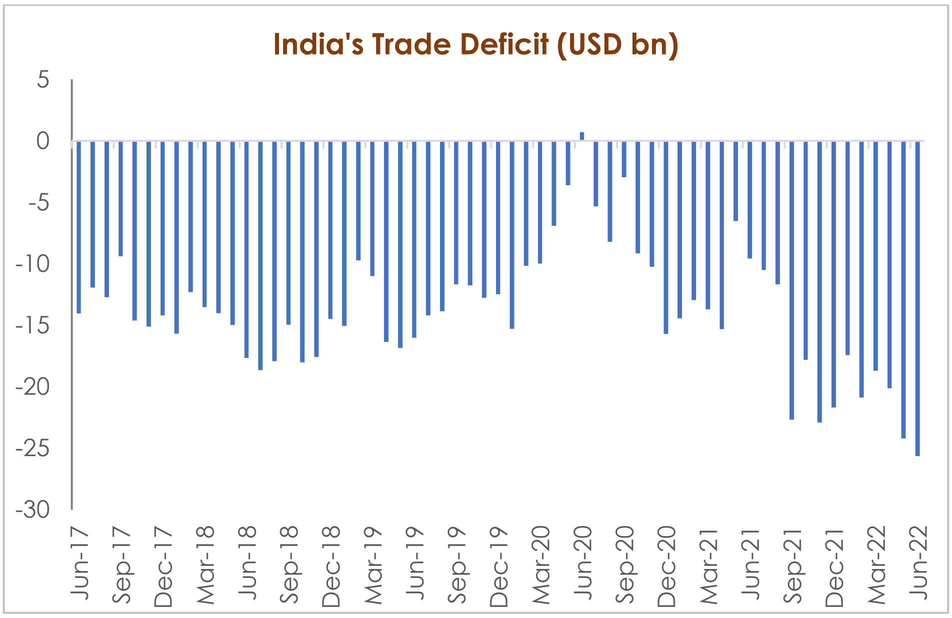
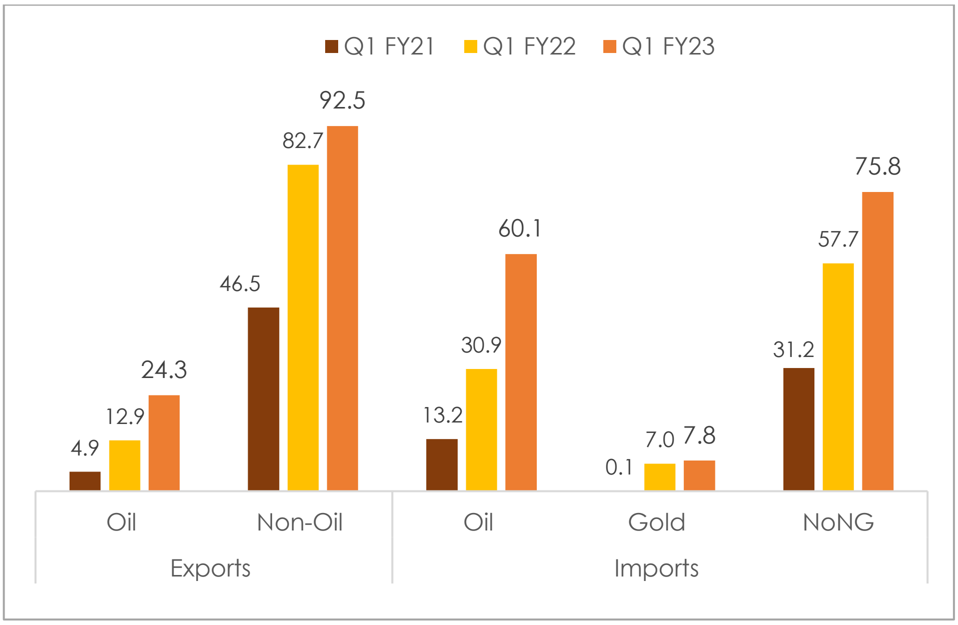


Chart 2: India's cumulative merchandise trade deficit in Q1 FY23 widens to USD 70.2 bn



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