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# External sector review

*India's external sector is ending FY23 on a much more strong footing than what was expected at the start of the year. While surging commodity prices led to burgeoning external deficits during the first half of the year increasing risks to global growth, the consequent correction in commodity prices has helped the external sector in H2FY23. After surging to a 37-quarter high of 4.4% of GDP, CAD is expected to moderate going forward. A stronger than expected moderation in merchandise deficit and resilient services exports have lent considerable support to India's CAD. We expect CAD in a comfortable range of 2.4%-2.5% in FY23, and even lower in FY24 (1.9%-2.2%). This should support INR. However, concerns remain on the capital account side with FDI, FPI and ECB inflows expected to be lower.*

## Merchandise trade performance

India's export and growth contracted at a faster pace of 8.8% in Feb'23 compared with a decline of 6.6% in Jan'23. Even imports dipped by 8.2% in Feb'23, after falling 3.6% in Jan'23. The sharper pace of decline in imports vis-à-vis exports led to a further narrowing of trade deficit to US$ 17.4bn in Feb'23 from US$ 17.7bn in Jan'23, and US$ 18.7bn in Feb'22.

In FYTD23 (Apr'22-Feb'23), exports have increased by 6.8%, compared with a growth of 47.1% in the same period last year. It must be noted that the impressive growth in FYTD23 came on a low base in FY21, due to the disruptions caused by the pandemic. Even so, India's export growth has lost momentum in the last few months amidst a decline in external demand. Table 1, gives the commodity wise breakup of exports for the top 10 commodities. These account for about 78% of total exports this years.

**Table:1: India's top 10 export items**

| Item | Share in total (%) | FYTD22, US$ bn | FYTD23, US$ bn | FYTD22, % YoY | FYTD23, % YoY |
|---|---|---|---|---|---|
| Engineering goods | 24.0 | 101.1 | 96.6 | 50.1 | (4.5) |
| Petroleum products | 17.3 | 57.7 | 69.9 | 162.1 | 21.3 |
| Gems & jewellery | 8.7 | 35.3 | 35.2 | 57.6 | (0.3) |
| Organic & inorganic chemicals | 6.8 | 26.5 | 27.3 | 33.8 | 3.0 |
| Drugs & pharma | 5.7 | 22.2 | 22.9 | 0.4 | 3.1 |
| Electronic goods | 5.1 | 13.8 | 20.7 | 42.8 | 49.8 |
| RMG of all textiles | 3.7 | 14.3 | 14.7 | 31.6 | 3.3 |
| Cotton Yarn/Fabrics./ Handloom etc. | 2.5 | 8.6 | 10.0 | 12.3 | 16.1 |
| Rice | 2.5 | 14.0 | 9.9 | 60.0 | (28.9) |
| Plastic & linoleum | 1.9 | 9.0 | 7.6 | 33.3 | (14.8) |
| **Total exports** | | **377.4** | **403.1** | **47.1** | **6.8** |

Source: CEIC, Bank of Baroda Research

Engineering goods which account for about 24% of India's exports (FYTD23), have declined by 4.5% this year. This is mainly on account of weak demand from key markets such as China, EU and US. Slowdown in iron and steel exports due to government's decision to levy an export duty on certain iron and steel products between May-Nov'22, also impacted exports of engineering goods. A sharp contraction was also visible in exports of rice which declined by 28.9% this year. Lower domestic production and higher prices which forced the government to put a ban on exports of broker rice as well imposition of a 20% export duty, contributed to lower exports. Exports of plastics and gems and jewellery were also lower in FYTD23 on a YoY basis.

On the positive side, exports of certain items such as electronics showed a marked improvement despite unfavorable external climate. This has been possible due to the government's PLI scheme which has promoted domestic manufacturing of a number of electronic items.

In FYTD23 (Apr'22-Feb'23), India's imports rose by 18.9% building on a 59.2% increase in the same period last year. This can be explained by higher commodity prices due to the Russia-Ukraine war, as well as increased domestic consumption due to pent-up demand.

**Table:2: India's top 10 import items**

| Item | Share in total (%) | FYTD22, US$ bn | FYTD23, US$ bn | FYTD22, % YoY | FYTD23, % YoY |
|---|---|---|---|---|---|
| Petroleum, crude & products | 29.7 | 140.7 | 194.2 | 94.6 | 38.1 |
| Electronic goods | 10.7 | 65.0 | 70.0 | 34.3 | 7.7 |
| Coal, Coke & briquittes, etc | 7.1 | 27.1 | 46.3 | 86.7 | 70.8 |
| Machinery, electrical and non-electrical | 6.3 | 36.4 | 41.3 | 36.9 | 13.6 |
| Gold | 4.9 | 45.1 | 31.7 | 72.8 | (29.7) |
| Organic & inorganic chemicals | 4.7 | 27.5 | 30.8 | 55.1 | 12.1 |
| Pearl, precious, semi precious stones | 4.2 | 27.6 | 27.7 | 68.8 | 0.4 |
| Transport equipment | 3.4 | 18.6 | 22.4 | 23.2 | 20.5 |
| Artificial resins, plastic materials, etc | 3.3 | 18.3 | 21.3 | 55.1 | 16.5 |
| Iron & steel | 3.2 | 15.8 | 20.7 | 47.6 | 30.8 |
| **Total imports** | | **550.0** | **653.8** | **59.2** | **18.9** |

Source: CEIC, Bank of Baroda Research

In terms of commodity wise composition of imports, the top 10 import items account for over 77% of total imports. Almost all import items have seen an increase in FYTD23 in value terms. Gold has been the only exception. In fact, compared with US$ 45bn in FYT22, gold imports have declined to US$ 31.7bn this year. In volume terms, gold imports have declined sharply by 26% (Apr-Jan'23). Despite lower global prices, the domestic price of gold was higher due to a significant depreciation in INR, which weighed on demand. Gold prices in India increased by around 9% in FYTD23.

Oil is the most significant item in the import basket, accounting for close to 30% of total imports. Oil imports have increased sharply by 38.1% in FYTD23, amidst an increase in oil prices. Oil prices have increased by 26% in FYTD23. Another import item which showed a sharp increase this year is coal. Higher global prices as well as increased demand from domestic industries following easing Covid-19 restrictions impacted demand. Despite the government's hopes of reducing dependence on imported coal, higher domestic energy needs and low domestic production, have necessitated the need for importing coal.

## Services trade in FYTD23

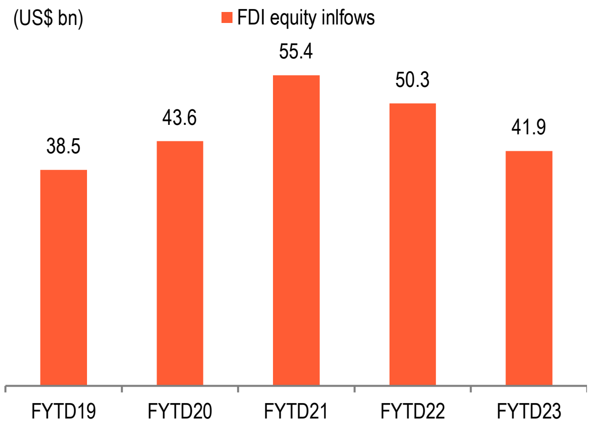
India's services exports have performed very well this year. Despite the moderation in global economy, services exports have risen by 30.5% this year (Apr-Feb'23). On the other hand, services imports have increased by 24.6% in the same period. As a result, India's services balance has increased to US$ 133bn compared with US$ 95.9bn in the same period last year. This is positive for India's external position as it will help to fund the huge merchandise deficit.

## FDI flows in FYTD23

On the capital account side, foreign inflows are an important source of funding the current account deficit. For this, India relies on FDI, FPI and ECB inflows, amongst others. FDI inflows (equity) into India stand at US$ 41.9bn in FYTD23 (Apr-Jan'23), lower than US$ 50.3bn in the same period last year. However, the total FDI inflows (which also includes reinvested earnings and other capital) has increased to US$ 61.5bn between Apr-Jan'23, compared with US$ 45.9bn in the same period last year.

Disaggregated data from Department of Policy and Promotion (DIPP) which gives data till Dec'22, shows that equity inflows into automobile industry and computer software and hardware, have declined sharply in FYTD23. These together account for over 25% of total FDI inflows. On the other hand, inflows into services and trading which account for about 29% of total FDI inflows, have increased in the same period.

**Fig: 1: FDI inflows into India have moderated, led by computer software and hardware industry**



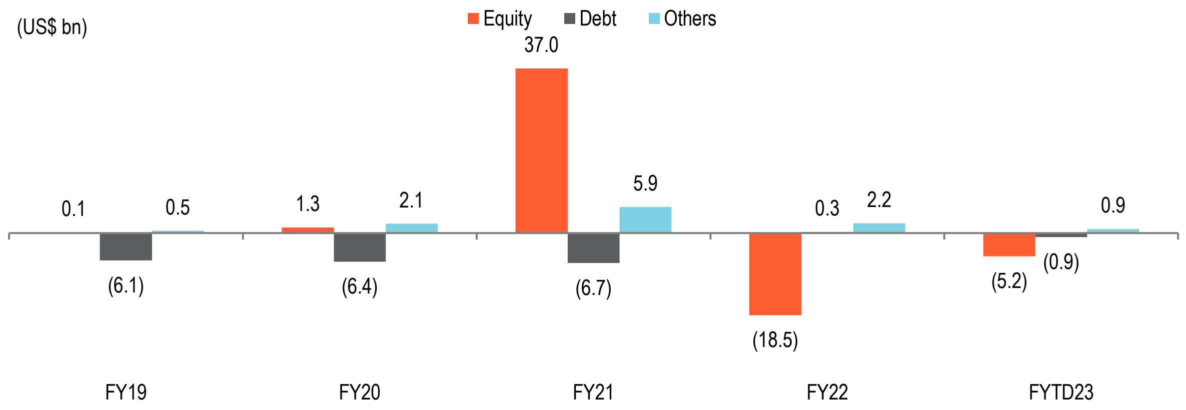

| | % share | FYTD22 | FYTD23 |
|---|---|---|---|
| Computer soft. & hard. | 22.0 | 10.3 | 8.1 |
| Services Sector | 17.7 | 5.3 | 6.5 |
| Trading | 11.3 | 3.0 | 4.1 |
| Drugs and Pharma | 4.9 | 1.2 | 1.8 |
| Non-Conventional Energy | 4.5 | 1.2 | 1.7 |
| Automobile industry | 3.5 | 6.0 | 1.3 |
| Education | 3.4 | 3.0 | 1.3 |
| Construction | 3.4 | 1.6 | 1.2 |
| Telecommunications | 1.9 | 0.6 | 0.7 |
| Consultancy services | 1.3 | 1.0 | 0.5 |
| **Total** | | **43.2** | **36.7** |

Source: CEIC, Bank of Baroda Research | *Note data for total FDI equity inflows is from RBI and is up to Jan'23. Data for sector wise inflows is from DIPP and is upto Dec'22

**FPI flows in FYTD23**

Apart from FDI, FPI inflows also help in bridging the financing gap on the external side. However, while FDI inflows are much more stable and productive, FPI flows tend to be more volatile. In FYTD23, FPI inflows have remained largely negative. In fact, in 7 out of the 11 months (excluding Mar'23), FPIs have been negative driven by a global risk-off sentiment and synchronized monetary policy tightening. Total outflows from India stand at US$ 5.2bn so far (data up to 24 Mar 2023), almost entirely driven by outflows from the equity segment.

**Fig: 2: FPIs have remained negative**

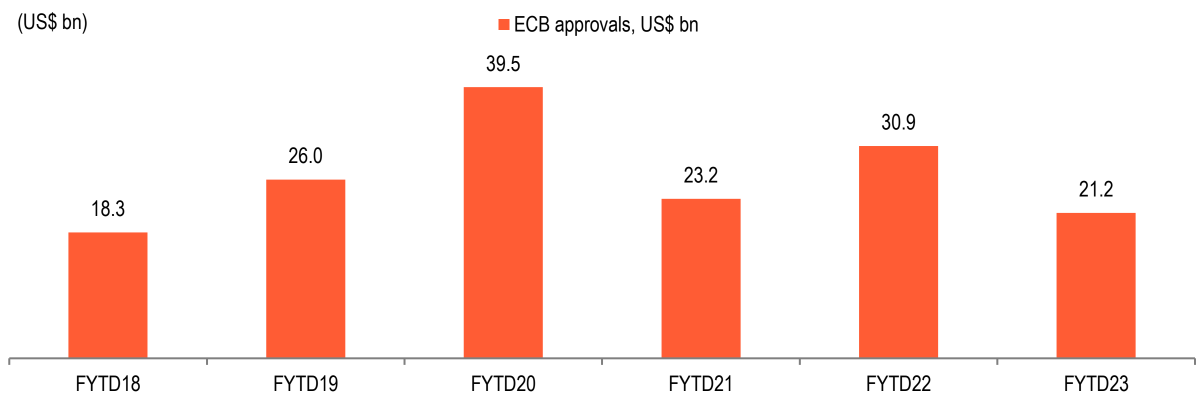



Source: NSDL, Bank of Baroda Research | *Note data as of 24 Mar 2023

**ECB inflows**

Apart from FDI and FPI, ECBs too play an important role in India's Balance of Payments. However, there has been a slowdown in ECB approvals by RBI in recent months. In fact, ECB approvals in FYTD23 have been lower at US$ 21.2bn compared with US$ 30.9bn in the same period last year. This is due to higher global interest rates, as well as volatility in exchange rate have weighed.

**Fig: 3: ECB approvals have been lower**




Source: CEIC, Bank of Baroda Research | *FYTD-Apr-Jan

**Current account deficit**

India's current account deficit (CAD), swelled to 4.4% of GDP in Q2FY23. This was driven by a sharp pickup in merchandise trade deficit due to higher commodity prices as well as pent-up demand. However, we do believe that the worst is over. In recent months, merchandise trade deficit has moderated. While exports have been impacted due to weak external demand, imports have dipped by much more due to lower global commodity prices, as well as weakening domestic demand. Hence, *we expect CAD to moderate to 2.2% of GDP in Q3FY23. Higher than expected moderation in imports as well as continued strength in services imports suggest that CAD may shrink further to 0.8%-1% of GDP in Q4FY23. Overall for FY23, CAD is estimated at ~2.4%-2.5% of GDP, versus ~3% estimated earlier. For FY24, CAD is expected in the range of 1.9%-2.2% of GDP.*



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