NSE

Macro Review

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Trade deficit widens further on strong import growth

India's merchandise trade deficit widened to an 18-month high of US$15.4bn in December 2020 from US$9.9bn in the previous month—in line with market expectations (Consensus est.: US$15.7bn; source: Refinitiv Datastream). This was led by a strong 7.6% YoY growth (+27.5% MoM) in imports—the first YoY expansion in 10 months and the steepest in last 26 months—aided by recovery across the board. While a sequential surge in oil imports was partly led by higher crude oil prices, non-oil, non-gold imports grew at a 26-month high of 8% YoY, reflecting strong consumption demand. Exports also recovered on a sequential basis, albeit at a slower pace, up 15.4% MoM, supported by higher exports of petroleum products and engineering goods. On a YoY basis, however, exports grew by a modest 0.1% YoY. A surge in COVID-19 infections globally and re-imposition of lockdowns and **restrictions have weighed on India's export** activity over the last couple of months.

Continued normalization of business activity and strong festive-led consumption demand, coupled with higher crude oil prices, have led to a robust pick-up in imports over the last few months. Recovery henceforth, however, remains contingent on sustenance of current demand environment. Renewed global lockdowns are likely to encumber any meaningful revival in exports, thereby keeping trade deficit at elevated levels over the next few months. An effective implementation of COVID-19 vaccination drives is crucial for a credible recovery in global trade. Nevertheless, a 52% contraction in trade deficit in the first nine months of this fiscal is likely to translate into a current account surplus of 1.1% of GDP in FY21, further supported by steady services exports. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 0.7% of GDP.

Strong foreign inflows, along with the comfort on current account, bodes well for the INR (+5% against the USD from the April peak level), even as an aggressive RBI intervention has restricted the gains on the INR as compared to other emerging market currencies. Accretion to foreign exchange reserves in this fiscal thus far (+US$110bn) has already reached the levels seen during the Global Financial Crisis (2007-**08), taking India's overall FX** reserves to fresh record-highs of US$586bn (as on January 8th).

- Exports recovered on a sequential basis: Export grew by a modest 0.1% YoY in December 2020 to US$27.2bn, an improvement over an 8.7% YoY contraction in the previous month. On a sequential basis, however, exports registered a strong 15.4% growth. That said, export activity lagged imports, largely attributed to fresh restrictions imposed by several countries due to a surge in COVID-19 cases, particularly in Europe and the US. While a jump in crude oil prices somewhat reduced the pace of contraction in exports of petroleum products on a YoY basis (-35.3% vs. 59.7% in the previous month), exports of gems & jewellery and electronic goods grew at a 23-month and 10-month high of 6.7% and 16.5% respectively, even as the latter two remained stable on sequential basis. Engineering goods recorded a strong 28% growth on a MoM basis in December even as it remained broadly steady as compared to the same period last year, while readymade textiles fell by a 15% YoY, but off a high base. Excluding petroleum products, engineering goods and readymade textiles—accounting for 39% of India's export bill—exports actually grew by 10.1% YoY. On a cumulative basis, exports are down 15.5% YoY in the first nine month of this fiscal.

Exports grew by a modest 0.1% YoY in December but recorded a decent improvement on a sequential basis (+15% MoM).

- Import growth at a 26-month high in December: Imports grew by a 26-month high of 7.6% YoY to US$42.6bn in December, marking the first YoY expansion in last 10 months, led by broad-based recovery. Contraction in oil imports came off meaningfully to 10.6% YoY in December, partly attributed to the recent surge in crude oil prices. Excluding oil, imports grew by a much higher 14.3% YoY, led by a strong 81.8% YoY increase in gold imports. Non-oil, non-gold imports also registered a decent 8.0% YoY expansion—the steepest YoY growth in last 26

Imports grew by a 26-month high of 7.6% YoY in December, marking the first YoY expansion in last 10 months.

months—reflecting a strong festive and pent-up demand and continued normalisation of business activities to pre-COVID levels. On a cumulative basis (Apr-Dec'20), imports are down 28.2% as compared to the same period in the previous year.

- Trade deficit widened to 18-month highs: Trade deficit widened to an 18-month high of US$15.4bn in December, up 23.4% YoY/56.4% MoM, thanks to recovery in imports significantly outpacing exports. While a strong domestic demand and higher crude oil prices have led to a decent revival in imports over the last few months, Indian exports are making a slow recovery due to fresh lockdowns and other restrictions imposed in countries that are important trading partners, like the US and UK. On a cumulative basis, trade deficit is down 52.2% YoY during Apr-December 2020.

Trade deficit widened to an 18-month high of US$15.4bn in December.

- External environment to remain supportive: Recovery in imports henceforth remains contingent on sustenance of current demand environment. Renewed global lockdowns are likely to encumber any meaningful revival in exports, thereby keeping trade deficit at elevated levels over the next few months. An effective implementation of COVID-19 vaccination drives is crucial for a credible recovery in global trade. Nevertheless, a 52% contraction in trade deficit in the first nine months of this fiscal is likely to translate into a current account surplus of 1.1% of GDP in FY21, further supported by steady services exports. This, coupled with strong foreign capital inflows, should result in a record-high BoP (Balance of Payments) surplus in FY21. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 0.7% of GDP, even as expectations of sustenance of foreign investments is likely to keep the BoP in a comfortably surplus position.

We estimate a current account surplus of 1.1% of GDP in FY21 but expect a deficit of 0.7% of GDP in FY22.

Sustenance of foreign capital inflows should keep the BoP in a comfortably surplus position.

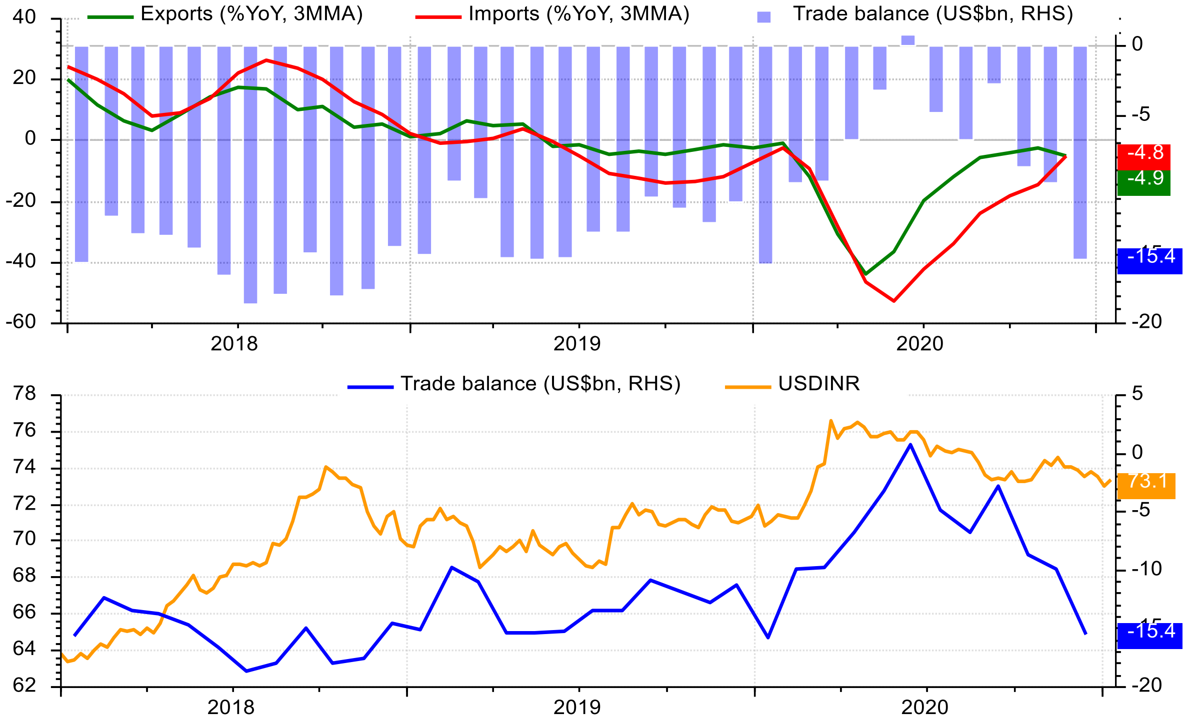
Strong foreign inflows, along with the comfort on current account, bodes well for the INR (+5% against the USD from the April peak level), even as an aggressive RBI intervention has restricted the gains on the INR as compared to other emerging market currencies. Accretion to foreign exchange reserves in this fiscal thus far (+US$110bn) has already reached the levels seen during the Global Financial Crisis (2007-08), taking India's overall FX reserves to fresh record-highs of US$586bn (as on January 8th).

Figure 1: India monthly trade balance for December 2020

	Exports		Imports								Trade balance
	US$ bn	%YoY	Total (US$ bn)	%YoY	Oil imports (US$ bn)	%YoY	Non-oil imports (US$ bn)	%YoY	Gold Import (US$ bn)	%YoY	US$ bn
Dec-20	27.1	0.1	42.6	7.6	9.6	-10.6	33.0	14.3	4.5	81.8	-15.4
Nov-20	23.5	-8.7	33.4	-13.3	6.3	-43.4	27.1	-1.2	3.0	2.6	-9.9
Dec-19	27.1	-2.7	39.6	-6.5	10.7	-0.6	28.9	-8.5	2.5	-3.9	-12.5
FY21TD	201.3	-15.5	261.5	-28.2	53.9	-44.3	207.6	-22.4	16.8	-27.2	-60.2

Source: Ministry of Commerce, CMIE Economic Outlook.

Figure 2: India monthly trade balance trend



Source: Refinitiv Datastream.

Figure 3: Non-oil, non-gold imports trend

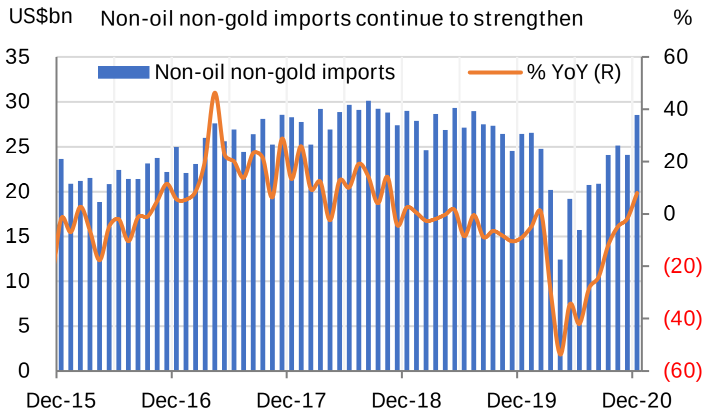
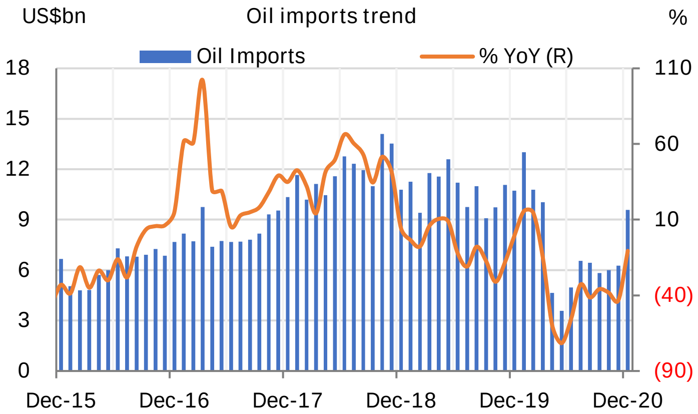
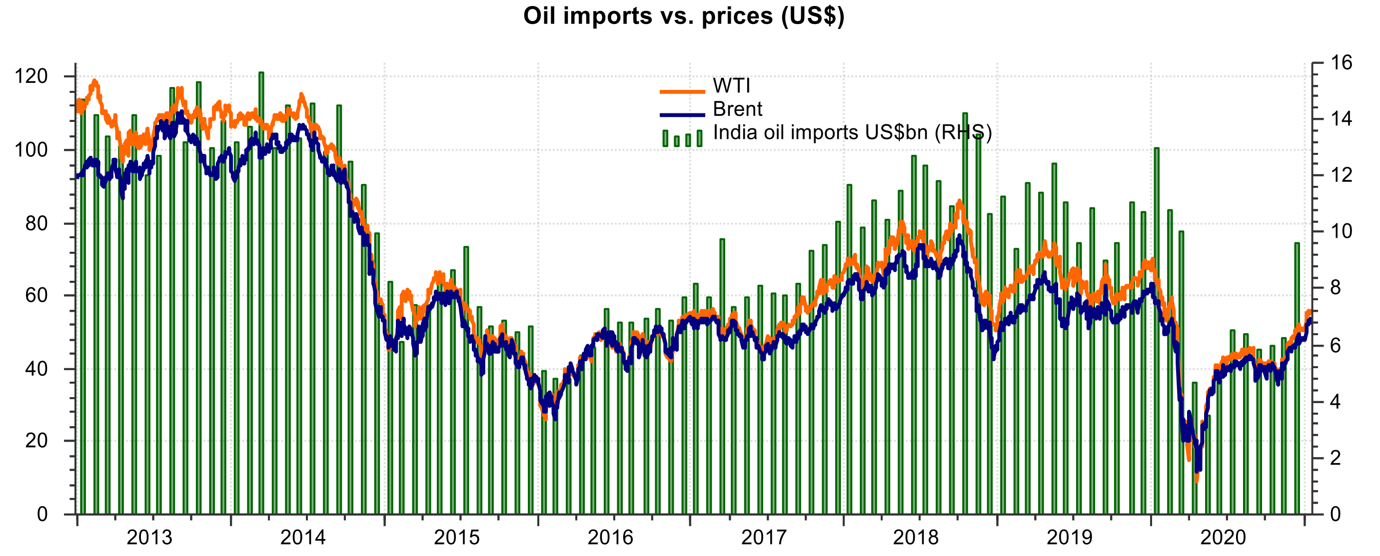


Figure 4: Oil imports trend



Source: Ministry of Commerce, CMIE Economic Outlook.

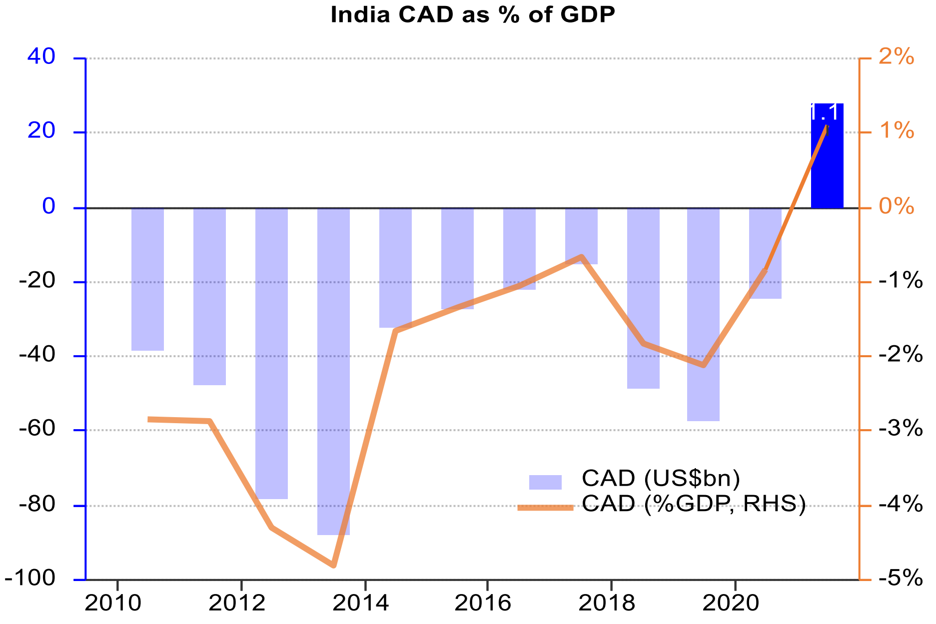
Figure 5: Oil imports vs. Brent crude oil prices trend



Source: Refinitiv Datastream.

Figure 6: Current account surplus pegged at 1.1% of GDP in FY21; expect deficit of 0.7% of GDP in FY22

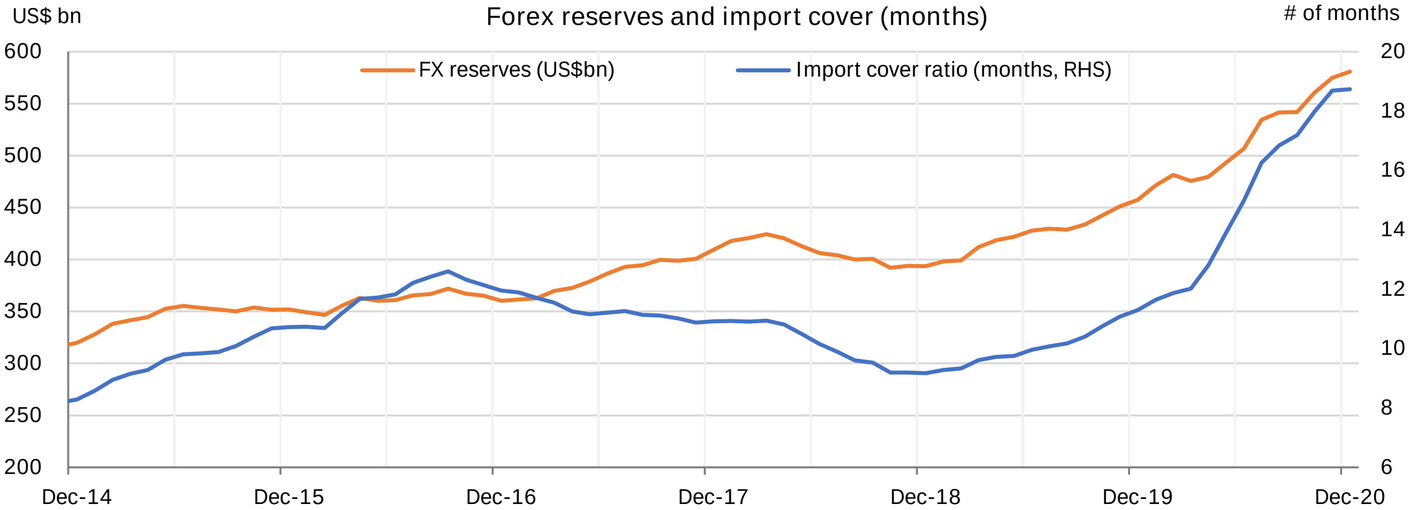
A significant contraction in trade deficit in FY21 is expected to translate into a current account surplus of 1.1% of GDP in FY21—the first surplus in 17 years, vs. a deficit of 0.9% of GDP in FY20. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 0.7% of GDP, even as expectations of sustenance of foreign investments is likely to keep BoP in a comfortable surplus position for the third year in a row.



Source: Refinitiv Datastream, NSE

Figure 7: Forex reserves are all all-time high levels, leading to a sharp rise in import cover

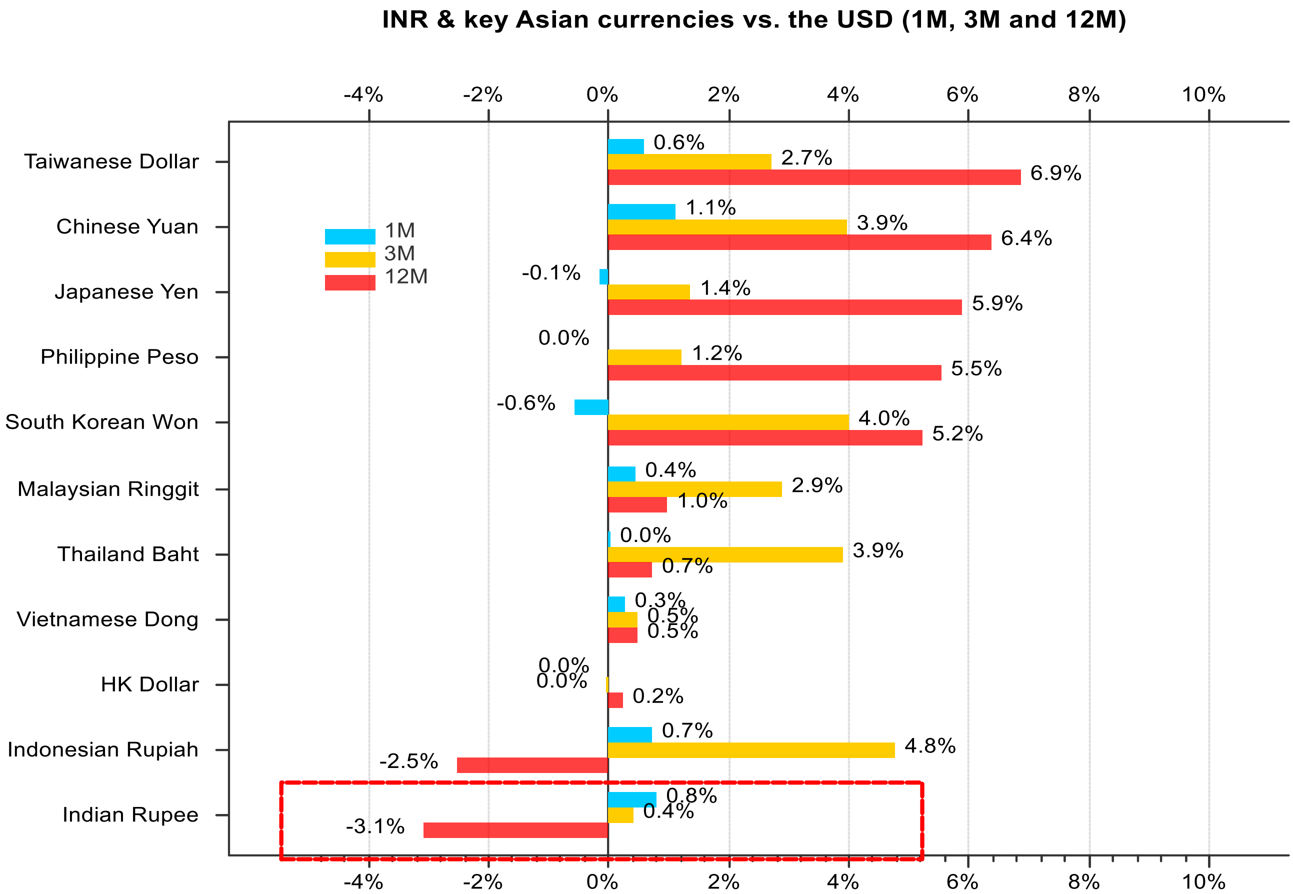
A significant accretion to forex reserves over the years, and particularly this fiscal year (+US$ 110bn in FY21 till date), has resulted in a significant improvement in import cover.



Source: CMIE Economic Outlook, NSE.

Figure 8: Aggressive RBI intervention has weighed on the INR this year

Aggressive dollar purchases by the RBI—reflected in record-high FX reserves—have constrained gains on the INR. The INR is the worst performing currency among major Asian currencies in 2020.



Source: Refinitiv Datastream.

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