ICRA

A MOODY'S INVESTORS SERVICE COMPANY

EXTERNAL SECTOR OUTLOOK

India's CAD trailed expectations in Q4 FY2022; estimated at US$100 billion or 2.9% of GDP in FY2023

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HIGHLIGHTS

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India's current account deficit narrowed to US$13.4 billion in Q4 FY2022 from a 36-quarter high of US$22.2 billion in Q3 FY2022

We foresee the current account deficit to widen to US$100 billion or 2.9% of GDP in FY2023, bloated by higher commodity prices and tepid global demand

Amidst the global headwinds, we expect the INR to trade between 77.0-80.0/US$ in the remainder of H1 FY2023, with a run-up in crude oil prices posing a significant risk to the rupee

India's current account deficit (CAD) deficit narrowed to US$13.4 billion in Q4 FY2022 (-1.5% of GDP) from a 36-quarter high of US$22.2 billion in Q3 FY2022 (-2.6% of GDP), on account of a lower merchandise trade deficit and rise in secondary income inflows. With a sharper YoY expansion in imports (+45.5%) relative to exports (+25.5%) in Apr-May FY2023, India's merchandise trade deficit has more-than-doubled to US$44.4 billion in this period from US$21.8 billion in Apr-May FY2022, partly led by a surge in gold imports. We foresee the current account deficit to widen to US$26 billion in Q1 FY2023, from US$13.4 billion in Q4 FY2022, bloated by higher commodity prices. In FY2023, the CAD may touch a fresh high of US$100 billion or 2.9% of GDP, with crude oil price expected in the range of US$100-120/bbl, and growth of imports outpacing that of exports. Amidst the global headwinds, we expect the INR to trade between 77.0-80.0/US$ in the remainder of H1 FY2023.

- **India's CAD narrowed sequentially in Q4 FY2022:** India's current account deficit narrowed to US$13.4 billion in Q4 FY2022 (-1.5% of GDP) from a 36-quarter high of US$22.2 billion in Q3 FY2022 (-2.6% of GDP), while exceeding US$8.1 billion in Q4 FY2021 (-1.0% of GDP). The sequential narrowing of the deficit in Q4 FY2022 was on account of the decrease in the merchandise trade deficit (to US$54.5 billion in Q4 FY2022 from US$59.7 billion in Q3 FY2022) and primary income outflows (to US$8.4 billion from US$11.5 billion). In the financial account, India witnessed net outflows amounting to US$1.8 billion in Q4 FY2022 – the first in 34 quarters – as against inflows of US$22.7 billion in Q3 FY2022 and US$12.3 billion seen in Q4 FY2021.
- **Higher merchandise trade deficit to widen CAD in Q1 FY2023:** With a sharper YoY expansion in imports (+45.5%) relative to exports (+25.5%) in Apr-May FY2023, India's merchandise trade deficit more-than-doubled to US$44.4 billion in this period from US$21.8 billion in Apr- May FY2022, driven by both oil and non-oil items. Moreover, the average monthly trade deficit of US$22.2 billion in Apr-May FY2023 is higher than the average of US$18.9 billion seen in Q4 FY2022. Overall, we project the current account deficit to double to US$26 billion in Q1 FY2023, from US$13.4 billion in Q4 FY2022, bloated by higher commodity prices.
- **FY2023 deficit to widen to US$100 billion, with surge in crude oil and other commodity prices:** The YoY growth of imports is likely to outpace that of exports in FY2023, with the latter weighed down by a likely moderation in the pace of growth in world trade volumes amidst geopolitical tensions. Moreover, with the price of the Indian crude oil basket in FY2023 ranging between ~US$100-120/bbl, the CAD is projected to widen to an all-time high of US$100 billion (-2.9% of GDP) from US$38.7 billion (-1.2% of GDP) in FY2022. Nevertheless, as a proportion of GDP, the CAD is projected to be much lower than the levels seen in FY2013 (4.8% of GDP).
- **INR to trade between 77-80/US$ until September 2022:** The INR plunged to an all-time low of 78.38 relative to the US$ on June 22, 2022, following the rise in US treasury yields. Notwithstanding the recent dip, large forex reserves, and the RBI's outstanding forward position, (US$63.8 billion in April 2022), are likely to prevent a disorderly depreciation of the INR, despite the global headwinds. Nevertheless, a further run-up in crude oil prices from the current levels poses a significant risk to the INR. Amidst the global headwinds, we expect the INR to trade between 77.0-80.0/US$ in the remainder of H1 FY2023.

Overview

India's current account deficit narrowed to US$13.4 billion in Q4 FY2022 from US$22.2 billion in Q3 FY2022, led by the narrowing in merchandise trade deficit and lower primary income outflows

CURRENT ACCOUNT DEFICIT NARROWED IN Q4 FY2022: India's current account deficit narrowed to US$13.4 billion in Q4 FY2022 (-1.5% of GDP) from a 36-quarter high of US$22.2 billion in Q3 FY2022 (-2.6% of GDP), while exceeding US$8.1 billion in Q4 FY2021 (-1.0% of GDP; refer Exhibit 1 and 7). The sequential narrowing of the deficit in Q4 FY2022 was on account of a decrease in the merchandise trade deficit (to US$54.5 billion in Q4 FY2022 from US$59.7 billion in Q3 FY2022) and primary income outflows (to US$8.4 billion from US$11.5 billion). Moreover, the services trade surplus rose mildly to US$28.3 billion in Q4 FY2022 from US$27.8 billion in Q3 FY2022, even as the secondary income inflows eased marginally in the quarter. The size of the current account deficit in Q4 FY2022 trailed our forecast of US$15.5-17.5 billion.

On a YoY basis, the merchandise trade deficit widened to US$54.5 billion in Q4 FY2022 from US$41.7 billion in Q4 FY2021. The YoY uptick of 29.7% in merchandise exports during Q4 FY2022 benefitted from the sharp rise in petroleum exports to US$21.3 billion in that period (+160%), from US$8.2 billion in Q4 FY2021. This was chiefly driven the surge in crude oil prices (+61.1%), on account of the healthy demand prospects following the abatement of the Omicron variant led Covid-19 wave across the world. Moreover, non-oil exports grew by 16.4% YoY to US$96.7 billion in Q4 FY2022 from US$83.1 billion in Q4 FY2021. The YoY growth in merchandise imports during Q4 FY2022 was led by the imports of petroleum, crude and products (+72%; to US$49.3 bn in Q4 FY2022 from US$28.7 bn in Q4 FY2021) and non-oil non-gold items. In contrast, gold imports contracted by 53.9% YoY to US$8.2 billion from US$17.8 billion, respectively, owing to the impact of the third wave, as well as the high base (YoY: +244.4% in Q4 FY2021), as per the data released by Ministry of Commerce and Industry. On a BoP basis, net oil imports rose to US$28.0 billion in Q4 FY2022 from US$20.5 billion in Q4 FY2021.

India witnessed net financial outflows amounting to US$1.8 billion in Q4 FY2022 – after a gap of 33 quarters – as against inflows of US$22.7 billion in Q3 FY2022 and US$12.3 billion seen in Q4 FY2021

Net outflows of primary income narrowed slightly to US$8.4 billion in Q4 FY2022 from US$8.7 billion in Q4 FY2021, on account of lower outflows of net overseas investment income (to US$9.1 billion from US$10.3 billion). Moreover, the services trade surplus rose in Q4 FY2022 (to US$28.3 billion from US$23.5 billion in Q4 FY2021), driven by the healthy increase in the net earnings related to telecom, communication and information (to US$29.6 billion from US$23.7 billion) and other business services (to US$3.0 billion from US$0.5 billion). Besides, the net inflows of secondary income increased to US$21.2 billion in Q4 FY2022 from US$18.9 billion in Q4 FY2021, led by personal transfers (to US$21.3 billion from US$18.9 billion, partly stemming from higher workers' remittances).

India witnessed net financial outflows amounting to US$1.8 billion in Q4 FY2022 – after a gap of 33 quarters – as against inflows of US$22.7 billion in Q3 FY2022 and US$12.3 billion seen in Q4 FY2021 (refer Exhibit 2). This was entirely driven by portfolio investment outflows; FPIs withdrew US$15.2 billion from the country in Q4 FY2022– this was the highest ever level of FPI outflows in BOP terms, and nearly thrice as high as outflows of US$5.8 billion in Q3 FY2022. Moreover, the net inflows from external commercial borrowings eased to US$3.3 billion in

India witnessed a drawdown of reserves amounting to US$16.0 billion in the quarter after witnessing an accretion in each of the preceding 12 quarters

Q4 FY2022 (-US$0.4 billion in Q3 FY2022) from US$6.1 billion in Q4 FY2021. In contrast, net FDI inflows increased to a five-quarter high of US$13.8 billion in Q4 FY2022 (+US$4.6 billion in Q3 FY2022; +US$2.7 billion in Q4 FY2021).

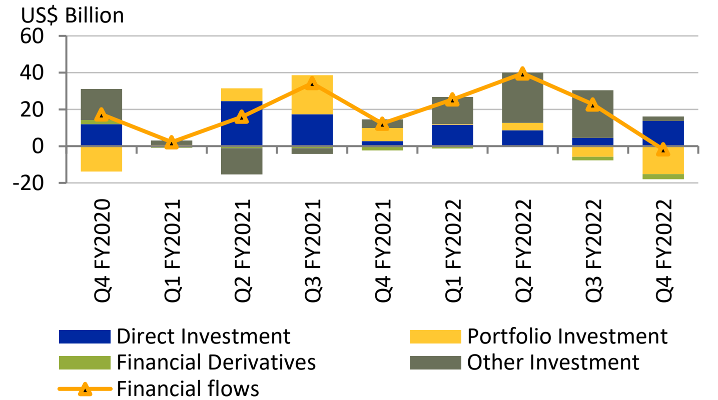
Overall, India witnessed a drawdown of reserves amounting to US$16.0 billion in Q4 FY2022, after witnessing an accretion in each of the preceding 12 quarters (refer Exhibit 3).

EXHIBIT 1: Trends in India's Current Account

Figures in US$ billion	Q4 FY2021	Q1 FY2022	Q2 FY2022	Q3 FY2022	Q4 FY2022	FY2021	FY2022	*Q1 FY2023 ICRA exp.*	*FY2023 ICRA exp.*
Merchandise Exports	91.3	97.4	104.8	108.9	118.0	296.3	*429.2*	*117 to 120*	*472 to 476*
Merchandise Imports	133.0	128.2	149.3	168.7	172.5	398.5	*618.6*	*182 to 185*	*733 to 736*
Merchandise Trade Balance	**-41.7**	**-30.7**	**-44.5**	**-59.7**	**-54.5**	**-102.2**	***-189.5***	***-64 to -66***	***-260***
Net Services	23.5	25.8	25.6	27.8	28.3	88.6	*107.5*	*26 to 28*	*116*
Primary Income	-8.7	-7.5	-9.8	-11.5	-8.4	-36.0	*-37.3*	*-7 to -9*	*-37 to -40*
Secondary Income	18.9	19.0	19.0	21.3	21.2	73.6	*80.5*	*19 to 21*	*82 to 85*
Current Account Balance	**-8.1**	**+6.6**	**-9.7**	**-22.2**	**-13.4**	**+24.0**	***-38.7***	***-24 to -27***	***-100***
Percentage of GDP	*-1.0%*	*+0.9%*	*-1.3%*	*-2.6%*	*-1.5%*	*+0.9%*	*-1.2%*	*-3.1%*	*-2.9%*

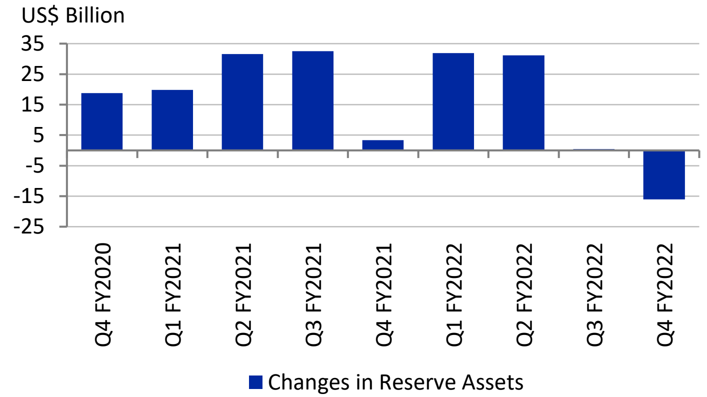
*Surplus (+)/Deficit (-); **Source**: RBI; CEIC; ICRA Research*

EXHIBIT 2: Trends in Financial flows to India



*"-"denotes outflows and vice versa; **Source**: RBI; CEIC; ICRA Research*

EXHIBIT 3: Trends in changes in India's reserve assets



*Change in Reserve Asset [Increase (+)/Decrease (-)]; **Source:** ICRA Research*

Overall, the current account balance reverted to a deficit of US$38.7 billion in FY2022, after having witnessed a surplus of US$24.0 billion in FY2021, as the merchandise trade deficit widened

Exports increased by a considerable 25.5% to US$79.1 billion on a YoY basis in April-May FY2023 from US$62.9 billion in April-May FY2022

The YoY increase in merchandise exports was primarily driven by a low base related to the impact of second Covid wave in India and associated state-level restrictions, as well as the YoY increase of ~63% in international crude oil prices engendered by the Russia-Ukraine conflict

Balance of Payments for FY2022: After having witnessed a surplus of US$24.0 billion (+0.9% of GDP) in FY2021, India's current account balance reverted to a deficit of US$38.7 billion (-1.2% of GDP) in FY2022 (the highest in three years). This was primarily driven by a widening of the merchandise trade deficit to US$189.5 billion from US$102.2 billion, respectively, given the sharper YoY increase in imports (+55.3%) relative to exports (+44.8%), with a healthy recovery in domestic demand. Besides, net primary income outflows increased mildly to US$37.3 billion in FY2022 from US$36.0 billion in FY2021. In contrast, net services receipts surged to US$107.5 billion in FY2022 from US$88.6 billion in FY2021, while secondary income inflows rose to US$80.5 billion from US$73.6 billion, respectively.

Net financial flows to India rose to four-year high of US$$85.9 billion in FY2022 from US$64.7 billion in FY2021 (+US$84.2 billion in FY2020), despite a dip in net FDI inflows (to US$38.6 billion from US$44.0 billion) and large FPI outflows (of US$16.8 billion as against inflows of US$36.1 billion) during the year. The net inflows of external commercial borrowings rose to US$7.4 billion in FY2022 from the muted US$0.2 billion in FY2021. While India witnessed net inflows on account of trade credit amounting to US$20.1 billion (as against net outflows of US$4.1 billion in FY2021), the amount of inflows on account of other receivables/payables account surged to US$12.4 billion in FY2022 (from US$3.6 billion in FY2021).

Overall, while net financial flows rose during FY2022, the magnitude of the YoY increase trailed the extent of the deterioration in the current account balance (to a deficit in FY2022 from a surplus in FY2021). This resulted in a halving of the accretion to foreign exchange reserves (on a BoP basis) to US$47.5 billion in FY2022, from US$87.3 billion in FY2021.

CURRENT ACCOUNT DEFICIT TO WIDEN CONSIDERABLY IN Q1 FY2023 IN SEQUENTIAL TERMS

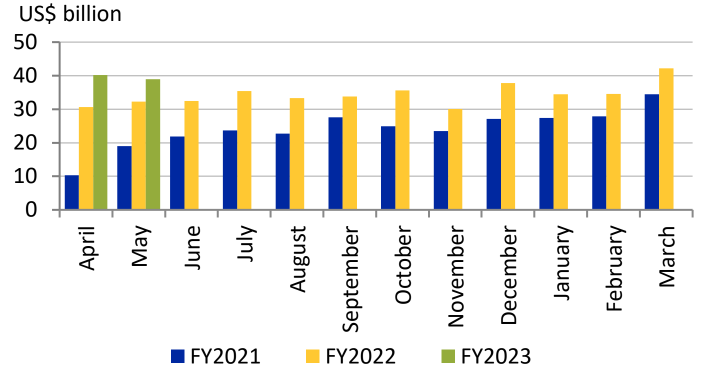
Trends for April-May FY2023 for merchandise trade: The initial data released by the Ministry of Commerce and Industry indicates that merchandise exports increased by a considerable 25.5% to US$79.1 billion in April-May FY2023 from US$62.9 billion in April-May FY2022, recording the highest-ever value witnessed in the months of April and May. However, in absolute terms, merchandise exports eased slightly from US$40.2 billion in April 2022 to US$38.9 billion in May 2022.

The YoY increase in merchandise exports during April-May FY2023 was led by both the oil (+87.6%; to US$16.8 billion in Apr-May FY2023 from US$8.9 billion in Apr-May FY2022), and the non-oil (+15.2%; to US$62.3 billion from US$54.1 billion) segments. The YoY increase of US$7.8 billion (+88%) in oil exports in Apr-May FY2023 was primarily driven by a low base related to the impact of the second Covid wave in India and associated state-level restrictions, as well as the YoY increase of ~63% in international crude oil prices engendered by the Russia-Ukraine conflict. While the substantial YoY rise of US$8.2 billion in non-oil exports in the same period was led by engineering goods (absolute increase: US$2.8 billion; YoY growth: +17.0%), electronic goods (+US$1.15 billion; +59.4%), organic and inorganic chemicals (+US$1.04 billion; +24.7%), agriculture products (+US$0.45 billion; +7.6%), etc.

Merchandise imports expanded by a steeper 45.5% to US$123.5 billion in April-May FY2023 from US$84.9 billion in April-May FY2022, led by the non-oil non-gold segment

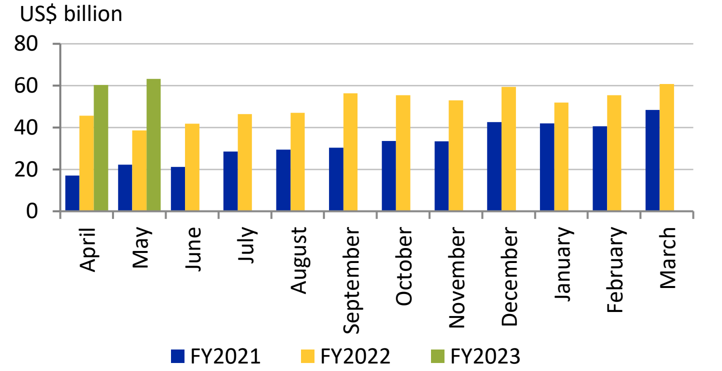
Gold imports increased to US$7.8 billion in Apr-May FY2023 from US$6.9 billion in Apr-May FY2023, amid surge in gold prices

EXHIBIT 4: Monthly Trends in Merchandise Exports



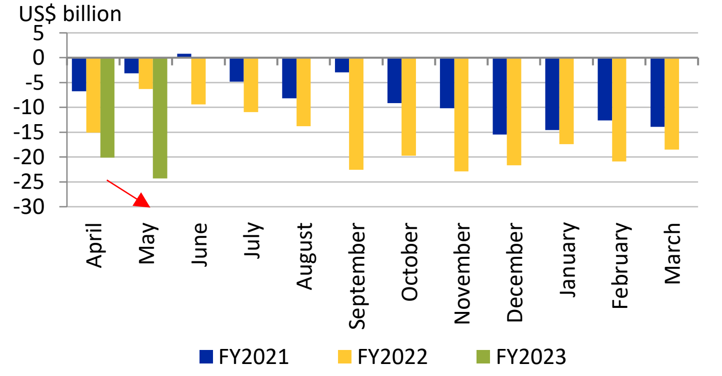
Source: *Ministry of Commerce and Industry, GoI; ICRA Research*

EXHIBIT 5: Monthly Trends in Merchandise Imports



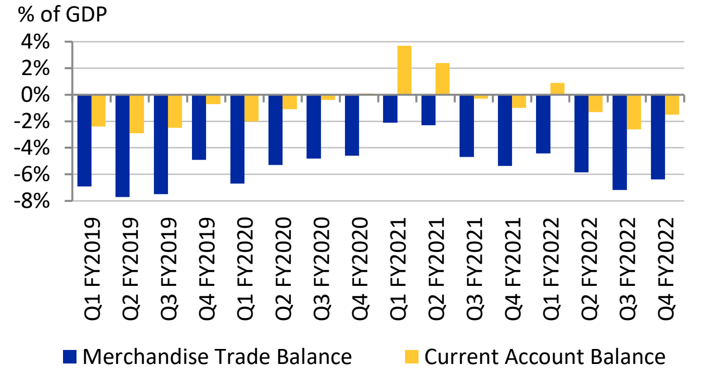
Source: *Ministry of Commerce and Industry, GoI; ICRA Research*

EXHIBIT 6: Monthly Trends in Merchandise Trade Balance



Source: *Ministry of Commerce and Industry, GoI; ICRA Research*

EXHIBIT 7: Trends in Merchandise Trade Balance and Current Account Balance



Source: *Ministry of Commerce and Industry, GoI; ICRA Research*

Sequentially, India's merchandise trade deficit widened to a massive US$24.3 billion in May 2022 from US$20.1 billion in April 2022, driven by sequential dip in non-oil exports amidst a sharp jump in gold imports

Overall, in FY2023 so far, India's merchandise trade deficit more than doubled to US$44.4 billion in Apr-May FY2023 from US$21.8 billion in Apr-May FY2022, driven by oil deficit as well as non-oil deficit

Merchandise imports expanded by a steeper 45.5% to US$123.5 billion in April-May FY2023 from US$84.9 billion in April-May FY2022 (refer Exhibit 4 and 5), led by the non-oil non-gold segment (+US$18.7 billion; to US$76.4 billion in Apr-May FY2023 from US$57.8 billion in Apr-May FY2022), and the imports of petroleum, crude and products (+US$19.2 billion; to US$39.4 billion from US$20.2 billion; benefitting from a YoY surge of ~63% in crude oil prices), partly boosted by elevated prices and a relatively low base of the second wave in April 2021. Within the non-oil non-gold segment, there was a healthy YoY growth during April-May FY2023 in the imports of items such as coal, coke and briquettes (+US$6.4 billion; +159.8%), electronic goods (by +US$3.1 billion; +33.3%), organic and inorganic chemicals (+US$2.1 billion; +45.9%), agricultural commodities (+US$0.9 billion; +27.0%), machinery, electrical and non-electrical goods (+US$0.7 billon; +11.4%), and pearls, precious and semi-precious stones (+US$0.7 billion; +13.7%), etc. In addition, gold imports increased to US$7.8 billion in Apr-May FY2023 from US$6.9 billion in Apr- May FY2022, amid a rise in gold prices. Moreover, in absolute terms, merchandise imports increased to US$63.2 billion in May 2022 from US$60.3 billion in April 2022.

Sequentially, India's merchandise trade deficit widened to a massive US$24.3 billion in May 2022 from US$20.1 billion in April 2022, driven by sequential dip in non-oil exports amidst a sharp jump in gold imports. Overall, in FY2023 so far, India's merchandise trade deficit has more-than-doubled to US$44.4 billion in Apr- May FY2023 from US$21.8 billion in Apr-May FY2022, driven by both the net oil deficit (to US$22.6 billion in Apr-May FY2023 from US$11.3 billion in Apr-May FY2022), as well as the non-oil deficit (to US$21.8 billion from US$10.5 billion).

Early trend for June 2022: As per the early estimates shared by the Ministry of Commerce and Industry, India's merchandise exports rose by 24.2% during June 1-7, 2022 to US$7.6 billion, following healthy growth in sectors like engineering, gems and jewellery and petroleum products. Additionally, imports increased by ~77% to US$16 billion during the first week of June 2022, led by petroleum, crude, coal, coke and briquettes, gold and chemicals. **Based on the expectation that gold imports may reduce after the Akshaya Tritiya season, the trade deficit may demonstrate some moderation in the June 2022. Overall, we foresee the current account deficit to double to ~US$26 billion in Q1 FY2023, from US$13.4 billion in Q4 FY2022, bloated by higher commodity prices.**

Trends for Apr-May 2022 for services trade: As per the data released by the RBI, services exports and imports witnessed a YoY growth of 25.1% and 46.1% (refer Exhibit 8 and 9), respectively, in April 2022 (+9.8% and +3.4%, respectively, in April 2021), and exceeded the respective pre-Covid levels of April 2019 by 25.1% and 23.2%, respectively. With a sharper YoY expansion in imports vis-à-vis exports, services trade surplus rose by a mild 1.3% YoY to US$8.5 billion in April 2022; nevertheless, it was a significant 28.3% higher than the surplus recorded in April 2019. The initial estimates provided by the Ministry, which will be revised based on RBI's subsequent release, indicated a mild uptick in the YoY growth of services exports to 30.3% and a slight easing in the growth for services imports to 45.0% in May 2022, compared to April 2022. This resulted in a rise in the trade surplus to ~US$8.9 billion from US$8.5 billion, respectively. **We expect the services trade balance to increase to US$116 billion in FY2023 on the back of robust services exports and a weaker INR, even if there is some recovery in outbound tourism.**

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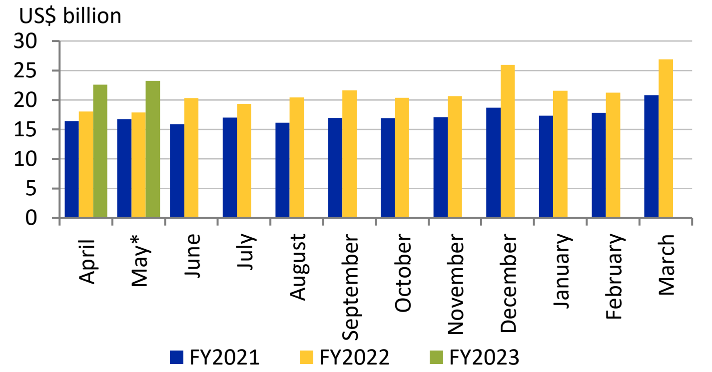
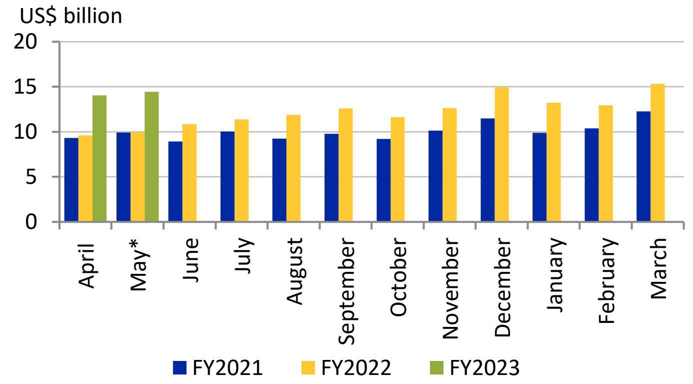
EXHIBIT 8: Monthly Trends in Services Exports



Data for May 2022 are based on initial estimates by the Ministry of Commerce and Industry; **Source: RBI; Ministry of Commerce and Industry; ICRA Research*

EXHIBIT 9: Monthly Trends in Services Imports



*Data for May 2022 are based on initial estimates by the Ministry of Commerce and Industry; **Source:** RBI; Ministry of Commerce and Industry; ICRA Research*

AVERAGE CRUDE OIL PRICE OF US$100-120/BARREL COULD WIDEN CAD SIGNIFICANTLY TO 2.9% OF GDP IN FY2023

A stronger INR relative to CNY doesn't bode well for the competitiveness of Indian exports of certain products, such as textiles and agricultural goods

In its World Economic Outlook (WEO) report released in April 2022, the IMF projected the growth in the global economy to moderate from 6.1% in CY2021 (+5.9% in Jan 2022 forecast) to 3.6% each in CY2022 (+4.4% in Jan 2022) and CY2023 (+3.8% in Jan 2022), amidst tensions between Ukraine and Russia, global monetary policy tightening, limited fiscal space in advanced economies and slowdown in China due to its stringent 'zero-Covid' policy. Similarly, the IMF revised its growth projections for world trade volumes of goods and services downwards to 5.0% (+6.0% in Jan 2022 WEO) in CY2022 and 4.4% (+4.9% in Jan 2022) in CY2023, while remaining higher than the projected broader global recovery. Additionally, the outlook for tourism-related services is expected to remain subdued in CY2022 because of the ongoing Russia-Ukraine war and lingering effects of the pandemic.

Moreover, the INR has appreciated by 2.5% relative to the CNY during FY2023 so far (till June 22, 2022), due to Covid-related restrictions in China impacting its growth outlook. A stronger INR relative to CNY doesn't bode well for the competitiveness of Indian exports of certain products, such as textiles and agricultural goods. Additionally, the recent ban of wheat exports by the GoI and the increase in export duties on iron ore and steel products, to curb domestic inflationary pressures, would impact exports of these commodities.

ICRA expects non-oil exports to rise by ~5% in FY2023, amidst tepid global trade, relatively weaker CNY and export restrictions levied by the GoI

While the slowdown in the YoY expansion of non-oil merchandise exports (to +12.6% in May 2022 from +17.7% in April 2022) raises concerns around the external demand amidst the ongoing Russia-Ukraine conflict, the rise in the growth of ports cargo (to +8.9% from +5.5%) suggests that commodity price movements may be obscuring the analysis. **Regardless, the increase in key commodity prices amid the ongoing geopolitical conflict, elevated freight costs, persistent shortage of containers, as well as supply chain disruptions do not augur well for the performance of inbound/outbound cargo shipments at ports.** Nevertheless, the extension of the Interest Equalization Scheme for Pre and Post Shipment Rupee Export Credit Scheme up to March 31, 2024 for MSME exporters by the Central Bank is a positive move to support outbound shipments.

On a high base, ICRA expects non-oil exports to rise by ~5% to US$370-375 billion in FY2023 from US$354 billion in FY2022 amidst tepid global trade, relatively weaker CNY vis-à-vis the INR and export restrictions/duties on certain items levied by the GoI to curb domestic inflation. The impact of these factors would be partly offset by elevated commodity prices, and PLI-support from the Government to some sectors. Moreover, tea and apparel exports from India may receive a boost in FY2023, as the supply of these items is impacted by the ongoing economic crisis in Sri Lanka. **Overall, ICRA expects merchandise exports to rise by ~10% to US$472-476 billion in FY2023 from US$429.2 billion in FY2022, driven by the anticipated surge in the value of oil exports and a modest increase in non-oil segment.**

ICRA expects merchandise exports to rise by ~10% to US$472-476 billion in FY2023 from US$429.2 billion in FY2022, driven by the anticipated surge in the value of oil exports and a modest increase in non-oil segment

With some satiation of pent-up demand, we believe gold imports would moderate to US$36-40 billion in FY2023 from US$46.2 billion in FY2022, although the demand from wedding and festive seasons is likely to be similar to pre-Covid levels

ICRA projects merchandise imports to rise by ~19% to US$733-736 billion in FY2023 from US$618.6 billion in FY2022, driven by non-gold components

The average international price of crude oil, in Indian basket terms, jumped to US$116.5/bbl during June 1-22, 2022, 6.5% higher than US$109.3/bbl in May 2022, on account of rising concerns regarding the supply increases amid fresh sanctions by EU countries on Russian oil and the improved demand outlook after the reopening of Chinese cities. While concerns around supply are likely to drive movements in oil prices in the near term, a slowdown or a recession in the US and the EU could bring demand concerns to the centre stage during the course of the year; crude oil prices have declined in recent sessions led by fears of recession. **ICRA expects the price of the Indian basket of crude oil price to range between US$100-120/bbl through the remainder of FY2023 amidst lack of clarity on the volume and discount, at which Indian companies may be purchasing Russian crude. Net oil imports are estimated to rise to US$145-150 billion in FY2023 from US$95.6 billion in FY2022.**

With some satiation of pent-up demand, we believe gold imports are likely to moderate to US$36-40 billion in FY2023 from US$46.2 billion in FY2022, although the demand from the wedding and the festive seasons is likely to be similar to pre-Covid levels.

Non-oil non-gold imports have expanded by 32.3% to US$76.4 billion during Apr-May FY2023 from US57.7 billion in the year-ago period on account of the surge in commodity prices. This trend is expected to continue in the near term given the supply disruptions engendered by the geopolitical conflict. The de-escalation of such tensions could lead to a correction in the prices of a few commodities, and subsequently moderate the value of non-oil non-gold imports to some extent.

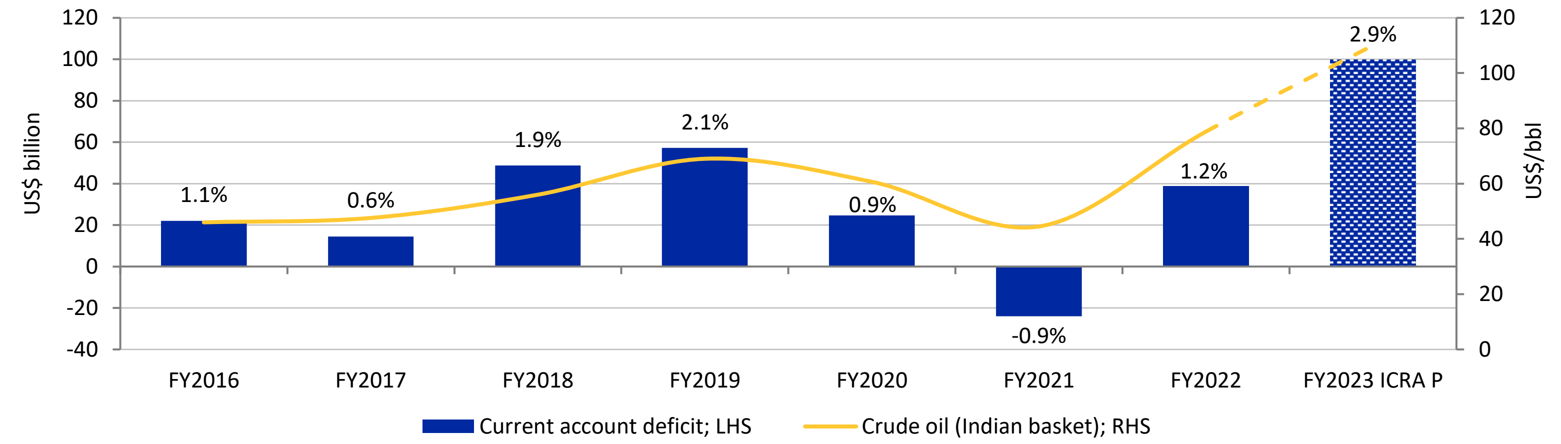
ICRA estimates the non-oil non-gold imports to grow by ~11% to US$444-451 billion in FY2023 from US$404.7 billion in FY2022, partly boosted by commodity price inflation, a back ended pick-up in investment activity, and modest recovery in domestic consumption.

Given these trends, ICRA expects merchandise imports to rise by ~19% to US$733-736 billion in FY2023 from US$618.6 billion in FY2022, driven by the non-gold components. The rise in imports is expected to exceed that in exports as we expect domestic demand growth to outpace external demand.

Given ICRA's projections for merchandise exports and imports, the merchandise trade deficit is expected to rise considerably to ~US$260 billion in FY2023, from ~US$189.5 billion in FY2022. The global economic recovery is expected to boost the services trade surplus by ~8% in FY2023 and secondary income by ~4-5%, while the outflow of primary income may increase by ~3% in FY2023 relative to FY2022. Given our assumption of the average price of the Indian crude oil basket in FY2023 at ~US$100-120/bbl, the CAD is projected to widen to an all-time high of US$100 billion (-2.9% of GDP) from US$38.7 billion (-1.2% of GDP) in FY2022. Nevertheless, as a proportion of GDP, CAD is projected to be much lower than the levels seen in FY2013 (-4.8% of GDP).

The CAD is projected to widen to an all-time high of US$100 billion (-2.9% of GDP) from US$38.7 billion (-1.2% of GDP) in FY2022

EXHIBIT 10: Current Account Balance, Crude oil Price, and ICRA's expectations for FY2023



Labels indicate current account balance as a % of GDP; Deficit (-)/Surplus (+); P: Projected; ***Source:*** *RBI; ICRA Research*

Global monetary policy tightening, elevated crude oil prices and general risk aversion towards EM assets would continue to put an upward pressure on the USD/INR pair; we expect the INR to trade between 77.0-80.0/US$ in the remainder of H1 FY2023

US$/INR TO TRADE BETWEEN 77.0-80.0/US$ IN REMAINDER OF H1 FY2023: The Dollar index had touched a 20-year high of 105.5 on June 14, 2022, driven by rising US treasury yields, protracted geopolitical tensions, elevated commodity prices, heightened volatility in global financial markets, and uncertainty amid fresh waves of Covid-19. While the Indian currency had hovered between 77.5 and 78.0 between May 16, 2022 and June 10, 2022, it seems to have decisively broken the 78-mark since June 13, 2022. Subsequently, the INR plunged to an all-time low 78.38 relative to the US$ on June 22, 2022 (refer Exhibit 11), following the rise in US treasury yields.

Going forward, global monetary policy tightening, elevated crude oil prices and general risk aversion towards EM assets would continue to put an upward pressure on the USD/INR pair. The policy tightening by the US Fed amid the risk aversion environment is expected to strengthen the US Dollar, thereby imparting a depreciating bias to the INR against the US$.

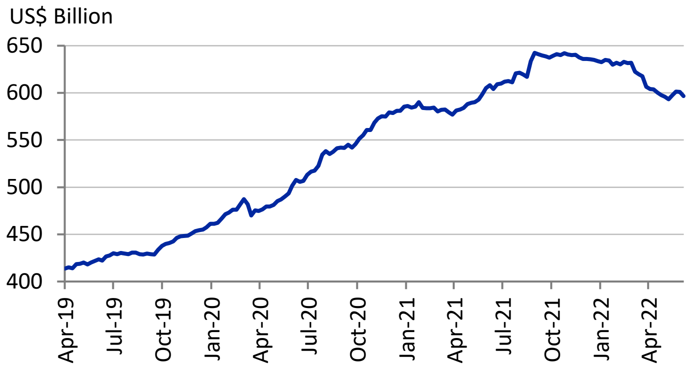
India's foreign exchange reserves eased from US$633.6 billion as on Dec 31, 2021 to US$596.5 billion as on June 10, 2022 (refer Exhibit 12), on account of a decrease in foreign currency assets, with the RBI likely to have sold dollars to ease the volatility in the INR. The RBI's large dollar sales in March 2022 (US$20.1 billion) were partially matched by the increase in the RBI's outstanding forward position (+US$16.7 billion) in the month. **Notwithstanding the recent dip, large forex reserves and the RBI's outstanding forward position, at US$63.8 billion in April 2022, are likely to prevent a disorderly depreciation of the INR despite the global headwinds. Nevertheless, a run-up in crude oil prices from**

current levels poses a risk to the INR. Amidst the global headwinds, we expect the INR to trade between 77.0-80.0/US$ in the remainder of H1 FY2023.

EXHIBIT 11: Movement in USD/INR exchange rate

Source: *Bloomberg; RBI; ICRA Research*

EXHIBIT 12: Trends in India's forex reserves (US$ billion)



Source: *RBI; ICRA Research*

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