Press Release

High commodity prices continue to weigh on trade deficit

Persistent rise in crude oil price to widen CAD to more than USD 90 bn in FY23

06 June 2022

As per the preliminary estimates released by the Ministry of Commerce and Industry, India's merchandise trade deficit widened to a record high level of USD 23.3 bn in May-22 from a deficit of USD 20.1 bn in Apr-22. In value terms, exports further moderated to USD 37.3 bn in May-22 from USD 40.2 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 slightly to USD 60.6 bn in May-22 from USD 60.3 bn in the previous month, given the rising crude oil bill.

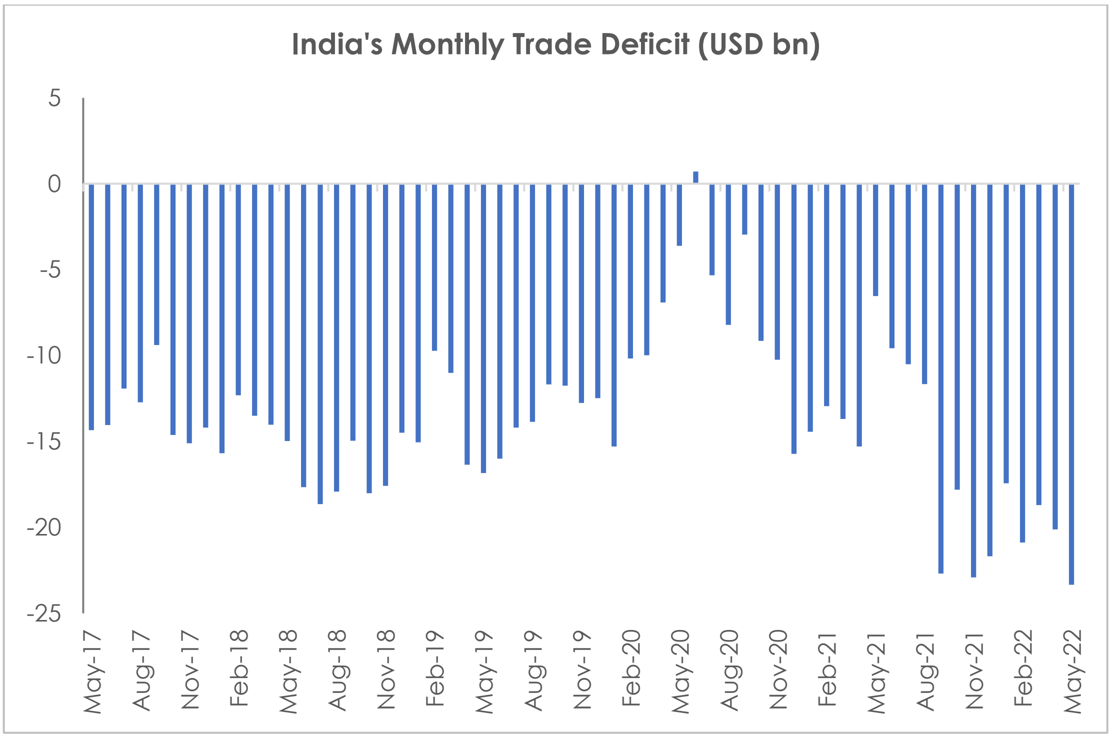
On the exports front, the moderation was driven by non-oil exports while oil exports eased a tad in May-22. On sectoral basis, commodities such as petroleum products, electronic goods, chemicals, and engineering goods remained strong in May-22. While the ongoing conflict is likely to dampen world trade volume (the IMF downgraded its estimate for 2022 world trade volume growth to 5.0% in Apr-22 from 6.0% estimated earlier in Jan-22), the price impact may offset the volume impact. This trend has started to manifest clearly in case of India's exports. 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) would also continue to support exports, besides the inorganic expansion via price effect. However, some normalization in growth is likely in the coming quarters on deceleration in global demand.

Imports rose to USD 60.6 bn in May-22 from USD 60.3 bn in Apr-22 led by gold imports which rose to its highest level in one-year amidst support from festive purchases (Akshaya Tritiya – a key gold-buying festival) and wedding season. Interestingly, oil imports moderated to USD 18.2 bn in May-22 from USD 20.2 bn in Apr-22. This could be possibly on account of cheaper Russian crude oil imports. As per the available data, India's share of oil imports from Russia has increased from 2% to nearly 25% since the onslaught of the geopolitical crisis, with India taking advantage of competitive pricing with an aim to fulfil its heavy oil import requirement. NONG (Non-Oil and Non-Gold) imports eased to USD 36.1 bn in May-22 indicating moderating domestic demand amid higher commodity prices. Notably, looking at the top ten import commodities for May-22, the import of coal has increased significantly by 167% YoY reflecting surge in its prices amidst a global supply shock with Russia and Ukraine being one of the major producers of coal. To avoid a fuel shortage in the background of subdued domestic production and to create buffer stocks, the government has initiated negotiations with a few countries like Russia, Australia and Indonesia to facilitate Coal India Limited import coal at a discounted rate ahead of the onset of monsoon, which may ease the heightened supply pressures in power and other end use sectors. Going forward, with India being a net importing economy, the commodity price effect could be larger for imports. In addition, unlocking of the domestic economy post the Omicron wave along with vaccination drive gaining critical mass (with over 70% of the population having received double dose) is expected to drive domestic demand for imports.

Given, the relentless rise in commodity prices particularly crude oil which has again risen to USD 120 pb, we project current account deficit (CAD) to widen to more than USD 90 bn from an estimated USD 47 bn in FY22. The expectation of the expansion of the current account deficit is not just driven by elevated global commodity prices (in the base case scenario we expect crude oil to average at USD 100+ pb in FY23) but is also linked to the unlocking of the economy reviving pent-up demand and improved vaccination cover aiding organic recovery. Nevertheless, there is considerable uncertainty in projecting trade and current account deficit due to high volatility in commodity prices, which in the current environment is taking cues from unpredictable geopolitical events.

Annexure

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



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