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India's external sector: A strong revival after COVID-19

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1. The context

The closure of borders and other restrictions to contain the spread of COVID-19 had limits on cross-border movement of people and goods, significantly influencing the merchandise trade in 2020 (Kakarlapudi, 2021). As the countries eased their restrictions, the first half (H1) of 2021 witnessed accelerated global economic activity hovering the merchandise trade above its pre-pandemic level but the pick-up momentum was weakened due to the rapid spread of Delta variant and the threat of new variants. Adding to the havoc created by the pandemic, the persistent inflation in the United States and concerns about China's real estate sector had slowed down the revival of economic growth. The International Monetary Fund (IMF) lowered its global economic growth prediction for 2022 by 0.5 percentage points (from 4.9 to 4.4). Global trade trends are likely to reflect these macroeconomic trends. Major economies like the U.S., China, Brazil, and South Africa faced deceleration in Q3 despite advancements in Q1 and Q2. Despite these, the Indian external sector has exhibited immense resilience during the year, which points to the growing revival of the economy. In this context, the economic survey 2021-22 discusses the country's recovery path from the pandemic. Analysing the global trade patterns, the economic survey mainly deals with India's performance in merchandise trade, trade in services, the balance of payments, forex reserves and external debt position of the country. This article focuses on the performance of the external sector of India. In the sections to follow, we present major highlights in merchandise trade, balance of payments, forex position and external debt.

2. Merchandise trade

Owing to the recovery of global demand and the revival in domestic activity, the country's merchandise trade has surpassed the pre - COVID levels in 2021- 22. Compared with the previous year, a growth rate of 49.7 per cent and 69 per cent was witnessed in the country's merchandise exports and imports respectively. The merchandise exports crossed US$ 100 billion in Q2 and Q3 of 2021-22 driven mainly by the strong growth in petroleum, oil, and lubricants (POL) exports, which accounts for around 15 per cent of the overall exports. Non-POL exports reached US$ 257.5 billion in 2021-22 (April-December), with a growth of 40.1 per cent from the previous year's same period and 24.9 percent over 2019-20 (April-December). Exports of pearls, precious and semi-precious stones, and gold and other precious metal jewellery increased by 88 per cent in April-November 2021 compared to the same quarter last year, as a result of various government initiatives such as lower import duties on precious metals, resolution of procedural issues to improve ease of doing business, and a revival in demand in major export markets. The agricultural exports continue to grow strongly in 2021-22, benefiting from increased demand for staples during the COVID-19 pandemic. Agriculture and allied products exports, which included marine and plantation products, increased by 23.2 per cent to US$ 31billion from April to November 2021, compared to the same period in 2020-21, surpassing pre-pandemic levels. This indicates prospects for agricultural export diversification and strengthening in the future years.

Diversification of export destinations and import sources has been a major agenda of the country for the past 25 years. Yet, over 40 per cent of the exports is accounted by only seven countries with USA alone accounting for 18 per cent of total exports

The crude petroleum continues to be the highest commodity to be imported followed by gold imports. As a result of significant rise in crude oil prices, POL imports rose by 119.2 percent to US$ 118.3 billion in April-December, 2021 over previous during the same quarter and surpassed the pre-pandemic levels. China remained the top import source of the country, and the Survey has stated India has diversified its import sources and reduced China's share in imports from 17.7 per cent to 15.5 per cent when compared with the previous year. However, in February 2022, the trade with China crossed US$ 125 billion, indicating a surge in trade with the same.

3. Trade in services

The service trade remained more resilient to the pandemic. Both exports and imports of services had a slowdown during the Q1 of 2021-22 due to the pandemic, but they regained their momentum from Q2 onwards. Even though the global restrictions due to the pandemic have resulted in poor tourism revenues, India had a notable performance in the world service trade with a record growth of 18.4 per cent during 2021-22 (April-December) over the corresponding period of the previous year. This is mainly because computer, business and transportation services constitute top services exports. The increased demand for digital support, cloud services, infrastructure modernization and increased cross border trade activities contributed to the surge in the export of services.

4. Balance of payments

The significant deceleration in merchandise imports over exports resulted in a surplus in the current account in the Q1 of 2020-21. The lockdown imposed during the second wave of COVID-19 has also witnessed a surplus in the current account. But the surplus in the current account was not sustained as it moved to the deficit when the lockdown restrictions were relaxed. With a revival in domestic activity, and global demand recovery, merchandise exports and imports rebounded significantly. They surpassed pre-pandemic levels resulting in a rise in the merchandise trade imbalance. Thus, as the trade grows, so do the trade imbalances. The increase in imports post lockdown has further widened the trade deficit. The drastic rise in the value of exports and imports also reflects the high commodity price. Rising prices of commodities including crude oil and coal have played a significant role in adding to India's import bill and widening the trade deficit.

5. Foreign direct investments (FDI)

From April 2019 to October 2020, there was a remarkable rise in FDI, but by November 2021, net FDI recorded a lower inflow of US$ 24.7 billion. Even though India remained a favourable destination for FDI during the crisis period, it has not continued to be so. Global uncertainty about US monetary policy normalisation, rising global oil costs, fear of additional COVID-19 variants, and high inflationary pressures kept FPI flows volatile. The current account deficit of 0.2 per cent of GDP in the H1 of 2021-22 was adequately cushioned by robust capital flows and resulted in a balance of payments (BoP) surplus of US$ 63.1 billion

in H1 of 2021-22, leading the country to perceive a massive increase in the forex reserves during 2021-22. The forex reserves of the country crossed the milestone of US$ 600 billion, touching US$ 635.4 billion in September 2021 and came to be the fourth largest forex reserve holder in the world after China, Japan and Switzerland.

6. External debt

Crossing the pre-crisis level, the external debt of India grew by 3.9 per cent to reach US$ 593.1 billion by September 2021. Increased reserves led to improvement in external sector vulnerability indicators like debt service (i.e., principal repayments and interest repayments) and the share of short-term debt in total external debt, forex reserves to total external debt, short term debt to forex reserves. The sizable accretion in reserves indicates the resilience of the external sector. India's external debt continues to be below what is estimated to be optimal for an emerging market economy. Globally, the debt of the countries has surged during the pandemic. Advanced countries have resorted to more borrowings and, on average, have spent 11.5 per cent on fiscal policies and 10 per cent on monetary policies. The U.S. has spent 25 per cent on fiscal policies and only 2.5 per cent on monetary policies. These countries have gotten back to their pre-pandemic levels in most sectors. India has expended only 4.3 per cent on fiscal policies but 6.1 per cent on monetary policies. In the wake of the pandemic, a country's external debts can also be viewed as how they have responded to the pandemic. Even if India had space to exploit the borrowing option for more aggravate covid relief measures, it has not been resorted for this.

The union budget has an important role in reviving the economy to the pre-pandemic levels. During her budget speech, Finance Minister Nirmala Sitharaman has quoted that "Several duty exemptions have been granted to various sectors like power, fertilizer, textiles, leather, footwear and food processing. These exemptions have hindered the growth of the domestic capital goods sector". Reasonable tariffs are conducive to the growth of the domestic industry. To promote the domestic industry, the import duties of finished goods for which the domestic manufacturing capacity exists has been increased. These align with the Atmanirbhar Bharat and 'Make in India' goals.

7. Conclusion

India's external sector is a crucial component in driving the country's economic growth. The resilience of the external sector is a signal indicating the revival of the economy from the effects of the pandemic. According to the Survey, India's external sector is well supported by exports, capital inflows, low current account deficits and external financing requirements, and high forex reserves, with various external vulnerability indicators well within manageable limits, and the country is far better prepared to face external shocks that may arise as a result of advanced economies tightening their monetary policy stance as inflation pressures rise. However, the high growth rate figures in the various indicators could also be a statistical fallacy as it was calculated from the previous year's value which has recorded a significant fall due to the pandemic. The budget should have adopted further schemes and initiatives to boost exports and promote growth and resilience of the external sector to reduce the adverse impact of COVID-19. Along with this it should have also brought out the strategies to attract the FDI but, the document is silent on such strategies.

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