KERALA ECONOMY
2024, VOL. 5, NO.3. pp 93-96

ISSN : 2583-4436

GIFT GULATI INSTITUTE OF FINANCE AND TAXATION

Global shifts and India's external sector: Analyzing trade, services, and stability in 2024

Anjalikrishna Sudhakaran[1] Amalu Seby[2]

[1&2] Research Scholars, Gulati Institute of Finance and Taxation, Thiruvananthapuram

Abstract

India's external sector has demonstrated remarkable resilience amidst global challenges, with a surge in services exports, stable capital inflows and solid currency management. Despite a declining merchandise trade deficit, the country faces challenges such as the twin balance sheet deficit and potential inflationary pressures. India's strategic approach to the "China+1" policy and its reliance on remittances as a stable source of finance are crucial for maintaining its economic momentum. Consistent growth of the trade share of GDP in recent years is indicative of India's increasing competitiveness in the international market and its future prospects.

Keywords: *Deglobalization, merchandise imports, service exports, remittances, China+1 strategy*

Introduction

The global economy is currently facing numerous challenges, and we are witnessing a notable shift from globalization to deglobalization. This trend is evident in several instances, such as European economies transitioning their energy imports from Russia to Norway and the U.S., and the European Union increasing pipeline gas imports from the U.S. These developments reflect new practices in international trade, such as "decoupling" and the growing narrative of deglobalization. However, these trends are highly heterogeneous across countries.

Despite significant disruptions like the COVID-19 pandemic, the Russia-Ukraine conflict, developments in the Middle East, and the Red Sea crisis, India's external sector has remained robust. This resilience is supported by a moderation in merchandise imports and a rise in service exports. India's trade openness indicator rose from 37.5 in FY05 to 45.9 in FY24, showing the country's increasing integration into the global economy.

India's growing trade footprint

India's trade trajectory has been catching up with global trends. Despite persistent global challenges, overall exports in FY24 grew by 0.23%, while imports declined by 4.9%. According to the Economic Survey, India now competes not only with developing economies but with developed nations in terms of trade and growth. Between 1990 and 2022, both India's and the world's trade share in GDP increased in tandem. However, in 2023, India's trade share in GDP dipped slightly from 50% to 45.9%.

The current account balance has also shown improvement, with the deficit reducing from USD 67 billion (2% of GDP) in FY23 to USD 23.2 billion (0.7% of GDP) in FY24. This improvement is largely due to rising net service exports and increased remittances, both of which have contributed to a decline in the merchandise trade deficit. However, given the global political turmoil and economic uncertainties, this improvement cannot be considered substantial, as the situation could easily reverse.

Capital account stability and challenges

On the capital account side, India has witnessed stability, with FY24 showing improvements due to foreign portfolio investment (FPI) inflows and a net inflow of foreign deposits. India has become the largest recipient of FPI among emerging economies, signalling an optimistic growth outlook. However, declining foreign directinvestment (FDI) inflows remain a concern, particularly in the context of geopolitical crises, supply chain disruptions, and financial market volatility. Both the industry and service sectors' FDI ratios have fallen below pre-pandemic levels.

The rise of India's services exports

Over the past three decades, India's services exports have grown at a compound annual growth rate (CAGR) of 14%. This consistent rise in services exports, coupled with a

moderation in services imports, has led to an increase in net services receipts. India is now the seventh-largest services exporter globally, a significant rise from its 24th position in 2001. Among the top services exports, IT and software services have played a pivotal role, along with the growing prominence of business services

India's emergence as a hub for Global Capability Centres (GCCs) has further bolstered its services export. GCCs are offshore units established by multinational corporations(MNCs) to perform strategic functions, leveraging India's specialized talent, cost advantages, and operational efficiencies. Government initiatives like Digital India and policies aimed at improving the ease of doing business have facilitated this trend, with GCCs becoming an integral part of India's economic growth story.

Currency stability amid global volatility

India's currency has shown remarkable stability, especially when compared to other major currencies against the U.S. dollar in FY24. This stability can be attributed to India's sound macroeconomic fundamentals, better financial stability, and improvements in its external position. Amid rising geopolitical risks, higher interest rates, and volatile global prices, the Indian rupee was one of the least volatile major currencies.

To sustain this stability, India needs to ensure favourable exchange rate conditions to support a balanced balance of payments position. India's forex reserves, as of June 21, 2024, stood at USD 653.7 billion, providing 10 months of import cover and further insulating the domestic economy from global spillovers.

Key challenges ahead

Despite India's strong external position, several challenges loom. The country still faces a twin balance sheet deficit and must carefully manage both external and fiscal stability simultaneously. The influence of the current account deficit (CAD) on inflation poses a challenge for the Reserve Bank of India (RBI), especially in the face of rising global uncertainties, inflationary pressures, and financial market volatility.

A well-coordinated strategy is essential to address these challenges pre-emptively, ensuring that India continues to maintain both internal and external stability.

The china+1 strategy: Balancing trade and investment

India must carefully navigate its economic relationship with China through the "China+1" strategy, which calls for reducing reliance on Chinese imports while still attracting Chinese investments. China dominates global trade, and many countries, including India, aim to diversify their supply chains to reduce dependence on China. However, India's goal of expanding its manufacturing sector and joining the global supply chain might necessitate some level of collaboration with China. Given past tensions, including trade wars and military conflicts, the Indian government must strike a balance. By allowing Chinese investments while curbing imports, India can benefit from foreign investment without becoming overly dependent.

Remittances: A more stable financial source than FDI

Remittances have proven to be a more stable source of finance than FDI, which tends to be pro-cyclical and sensitive to economic downturns. However, remittances are also influenced by the economic conditions of foreign economies, which can lead to destabilizing trends, particularly for India's current account deficit. India should capitalize on its significant remittance inflows, especially from oil-exporting countries, and take advantage of favourable exchange rate movements to manage its external position more effectively.

Conclusion

In an increasingly fragmented global economy, India's external sector remains resilient, supported by a growing services export sector, stable capital inflows, and sound currency management. However, the country must remain vigilant in managing its external and fiscal stability amidst rising geopolitical and economic uncertainties.Pre-emptive strategies and well-coordinated policies will be essential for sustaining India's economic momentum in the years to come.

References

Economic Survey 2023-24, Government of India

Union Budget 2024-25, Government of India