Equity Research

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India

Economy

Declining imports mainly reflect falling import prices, not declining domestic demand

- India's imports declined 6.2% YoY in Jan-Apr'23, leading many commentators to assert that this was evidence of declining domestic demand. Our conclusion from a deep dive into the key sources of decline in India's imports is that 50% of them saw the value of their imports decline because of big YoY declines in import prices (oil, coal, fertilisers and vegetable-oil). Imports of machinery and base metals (together comprising 14% of India's imports) continued to *grow* in FY22 and FY23, and saw no let-up in recent months – evidence of continued strength in India's investment demand. Electronics and chemical imports (which together comprise 19% of India's imports) declined over the past half-year, while their exports continued to grow (very robustly in the case of electronics), suggesting that the import decline was actually evidence of import-substitution. Gems and jewellery imports (9% of total imports) are strongly correlated with gems and jewellery exports, so the latter's sluggishness explains much of the decline in those imports, although a small portion likely also represents weaker domestic demand. That leaves just another 8% of total imports – among which plastic & rubber products (5% of imports) also grew in recent months. So the import data provide scant evidence of any weakness in domestic demand.
- Crude oil, coal, fertilizer and vegetable oil prices had all spiked in Jan-Apr'22 (particularly in Feb'22 and beyond with the onset of the Russo-Ukrainian war). These four categories account for 50% of India's imports. Crude oil prices were down 26% YoY in Mar-Apr'23, and India's oil imports declined 14% YoY for those months; world fertilizer prices declined 35% YoY in Jan-Apr'23, and India's fertilizer imports declined 39% YoY for that period. India's coal imports declined 26.7% YoY in Mar-Apr'23, with benchmark Newcastle coal prices down 39% YoY, while vegetable-oil imports declined 38% YoY in Apr'23 in tandem with the 48% YoY decline in palm-oil prices.
- Machinery and base metal imports (together accounting for 14% of India's imports) continued to expand in FY22 and FY23, and there was no let-up in their growth in Jan-Apr'23 – with machinery imports up 10.8% YoY, and base metal imports up 7.5% YoY in Jan-Apr'23. The sustained growth in machinery and base metal imports reflects the strength of India's investment demand over the past 2 years. And the decline in imports of electronics over the past 7 months has occurred alongside a spectacular increase in electronics exports (+50% YoY in FY23, 26.5% YoY in Apr'23), which suggests that erstwhile electronic imports were being substituted by domestic production. And chemicals too show similar evidence of import-substitution.

India's imports declined in each of the first four months of CY23, shrinking 6.2% YoY in Jan-Apr'23, including a big decline of 14.8% YoY in Apr'23. This has led some commentators to conclude that the import decline is attributable to a contraction in domestic demand. Our contention, however, is that most of the YoY decline in India's imports is due to a decline in import prices. We begin with a break-up of India's imports (*Chart* 1), which shows that fossil fuels (petroleum, coal) and related products (fertilizer) together accounted for 47% of India's imports in FY23--and the prices of crude oil, coal and fertilizers did decline sharply YoY in Jan-Apr'23. Vegetable oils (which account for another 3% of India's imports) also saw their prices decline sharply YoY in Jan-Apr'23. Benchmark palm-oil prices were above MYR5000/tonne from 12th Jan'22 to 21st Jun'22, but have averaged less than MYR4000/tonne in Jan-Apr'23. In Apr'23, palm-oil prices were down 48% YoY, and the value of India's vegetable-oil imports declined 37.7% YoY.

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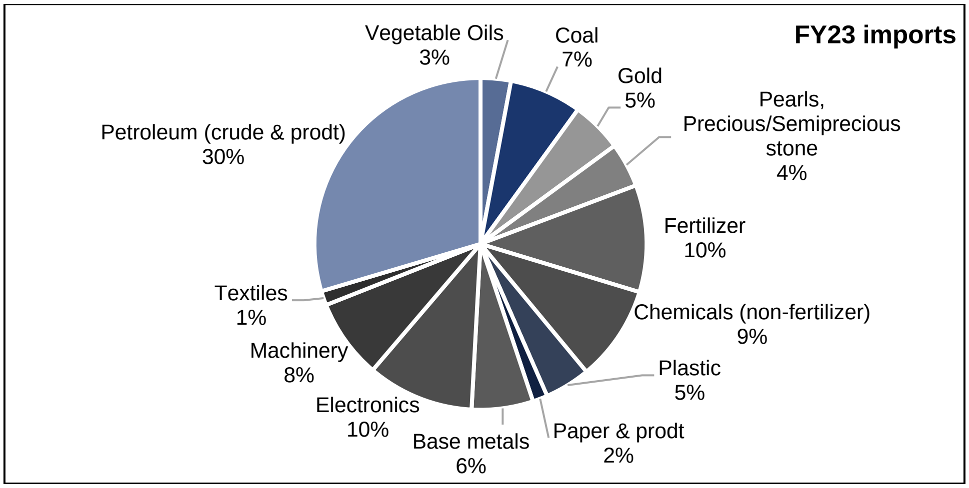
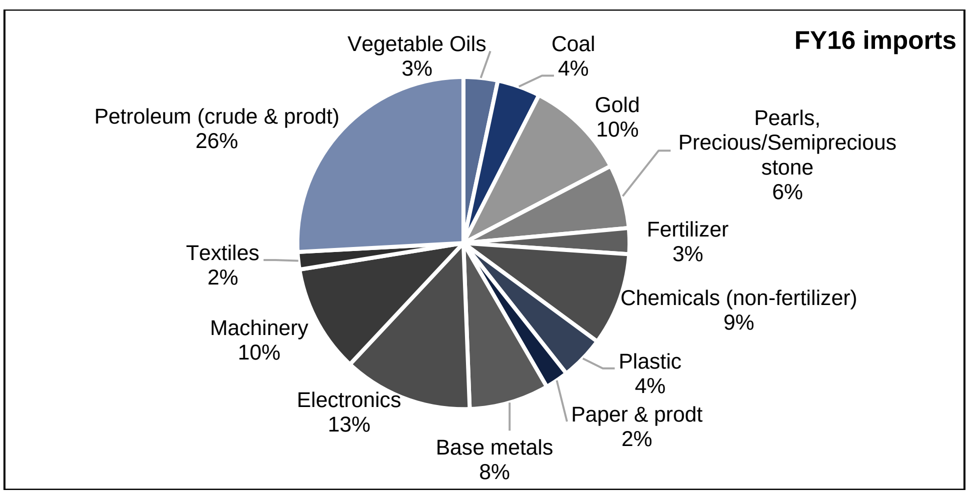
Chart 1: Fossil fuels and electronics are the largest imports



Source: I-Sec, based on data from CEIC

Declining fertilizer and vegetable-oil imports reflect YoY decline in their prices. The major difference in commodity composition of India's imports in FY16 (Chart 2) relative to FY23 is the lower share for petroleum (26% in FY16 vs 30% in FY23), coal (4% in FY16 vs 7% in FY23) and fertilizer (3% in FY16 vs 10% in FY23). The World Bank's global fertilizer price index, for instance, reached a 10-year high in Apr'22, and was down 47% YoY in Apr'23. Global fertilizer prices were down 35% YoY in Jan-Apr'23 – which helps explain the 39.3% YoY decline in India's fertilizer imports in Jan-Apr'23. The spike in fertilizers' share in India's imports during FY23 was, in turn, closely linked to the big spike in global fertilizer prices, particularly in H1FY23.

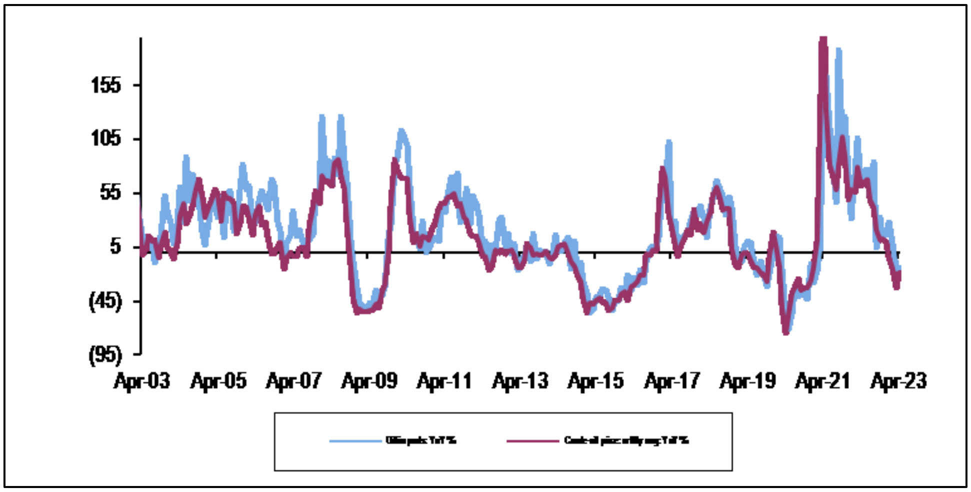
Chart 2: Oil, coal, fertilizer shares lower in FY16, reflecting lower prices



Source: I-Sec, based on data from CEIC and US Bureau of the Fiscal Service

Similarly, the decline in India's oil imports in Mar-Apr'23 is attributable to the 26% YoY decline in Brent crude oil prices during those months. Crude oil and petroleum products accounted for 29.3% of India's imports in FY23 – up from 21.7% in FY16. As Chart 3 shows, India's oil imports are strongly correlated with Brent crude oil prices. The spike in Brent crude in Feb-Aug'22 caused a big spurt in the value of India's crude oil imports in H1FY23. Now, with Brent crude prices declining YoY, the value of India's oil imports is also falling. In Mar-Apr'23, the average Brent crude oil price was down 26% YoY, and India's oil imports declined 14.4% YoY.

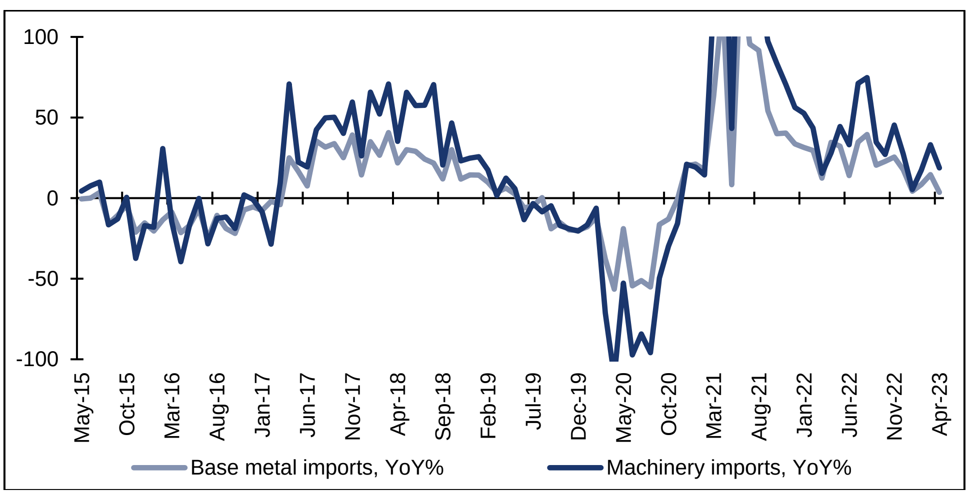
Chart 3: Oil imports strongly correlated with Brent crude oil price



Source: I-Sec, based on data from CEIC

Machinery and base metal imports have sustained steady growth over the past 2 years (with no let-up in recent months), suggesting a clear rebound in investment demand. Machinery and base metals together accounted for a modest 14% of India's imports in FY23, but imports of both machinery and base metals continued to grow throughout FY22 and FY23, and also grew in Jan-Apr'23. (For Machinery, we have used the YoY growth in "electrical & non-electrical machinery" for Apr'23, as that is available from the Quick Estimates for Apr'23, not the broader category of Machinery). Machinery imports grew 10.8% YoY in Jan-Apr'23, while base metal imports grew 7.5% YoY. The sustained growth in machinery and base metal imports over the past 2 years suggests that a clear-cut recovery in investment spending has occurred over the period, generating import demand.

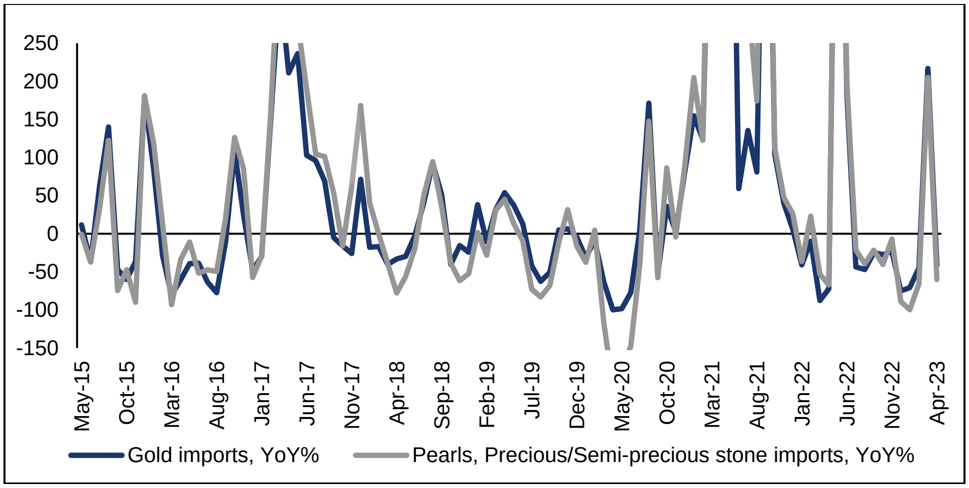
Chart 4: Machinery and base metal imports grew, reflecting the capex rebound



Source: I-Sec, based on data from CEIC

Both exports and imports of gems and jewellery have declined in recent years, with the decline in imports likely reflecting weaker global demand for India's jewellery exports. For imports, 'gems and jewellery' are divided between gold and 'pearls, precious and semi-precious stones' (as well as a smaller category, silver). There is a remarkably high correlation between gold imports and 'pearls, precious and semi-precious stone' imports, suggesting that gold imports too are primarily for jewellery (rather than hoarding, as for instance, in the form of gold bars). Even most speculative holders of gold appear to hold it primarily in the form of jewellery. The recent trend decline in gems and jewellery imports has occurred in tandem with a decline in exports of gems and jewellery, suggesting that these imports are declining because the global demand for India-made jewellery is weakening.

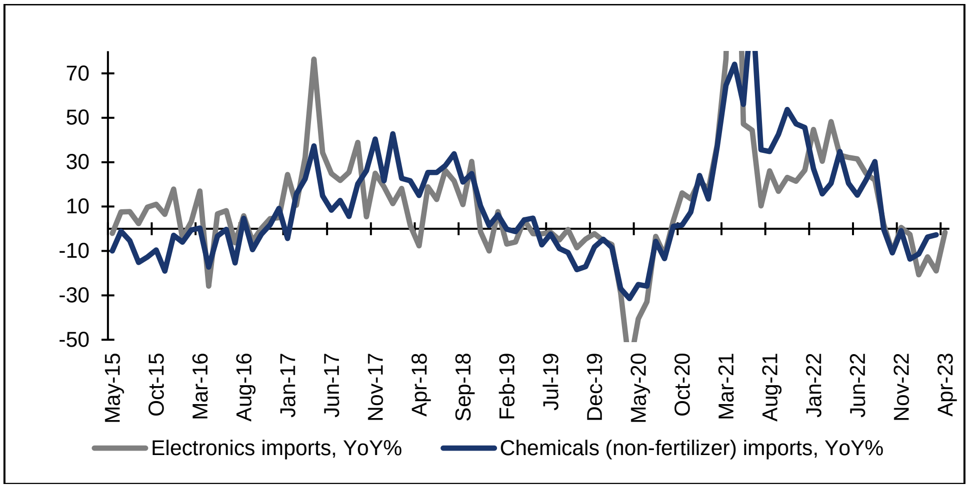
Chart 5: Declining imports of gems & jewellery reflect declining exports



Source: I-Sec, based on data from CEIC

Recent decline in electronics imports likely reflects import-substitution, and the same probably applies to chemicals (both categories of exports have been growing, electronics spectacularly). In FY23, imports of electronics and chemicals (other than fertilizers) accounted for 10% and 9% of India's imports, respectively. Apart from the covid period (FY21) imports of electronics and chemicals had grown strongly between FY16 and H1FY23, but have been declining YoY in the past 7 months. For electronics, we can be reasonably sure that this primarily reflects the substitution of erstwhile imports with domestic production – and exports. Electronics exports have been particularly strong in the past 6 years (excluding the covid year), with electronics exports in FY23 up 296% vs the FY16 level; in FY23, electronics exports grew 50.6% YoY (and they were up 101.5% vs FY20, the last pre-covid year). The robust growth in electronics exports, at the same time that electronics imports were declining, suggests that erstwhile imports of electronics were being substituted by domestic production. Similar logic also applies to chemicals (other than fertilizers): chemical exports in FY23 were up only 1.9% YoY, but they were 122.5% higher than in FY16, and 35% higher than in FY20 (the last pre-covid year). Chemical exports and imports weakened together in H2FY23, so the decline in chemical imports over the past 6 months is most likely linked to the moderation in chemical exports (and possibly to modest import-substitution as well). The chemicals trade deficit has also narrowed in the past half year.

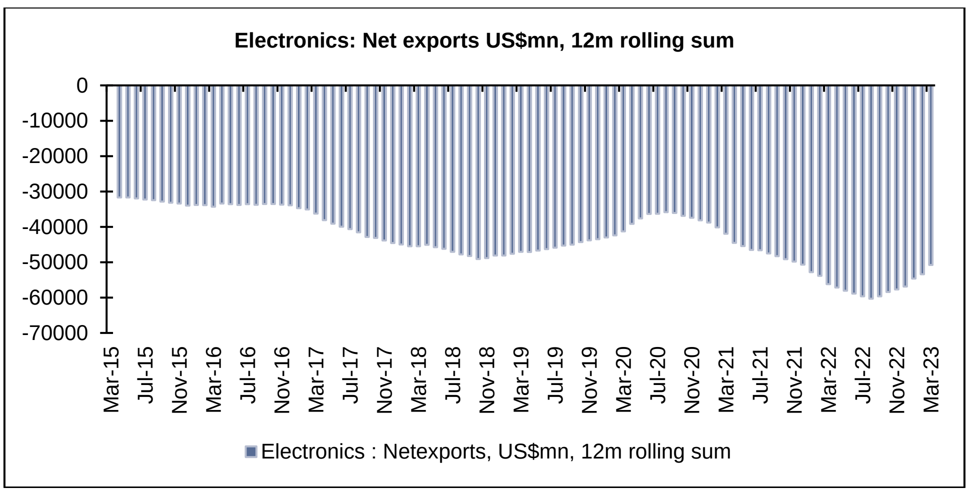
Chart 6: Declining electronics imports reflect import-substitution; likely true for chemicals too



Source: I-Sec, based on data from CEIC

The inexorable widening of the trade deficit in electronics has also been turned around, particularly since Aug'22, as electronics export growth strongly outpaced electronic imports. And then the latter began declining in recent months, even as electronics exports continued their robust growth, helping to cut into the large electronics trade deficit.

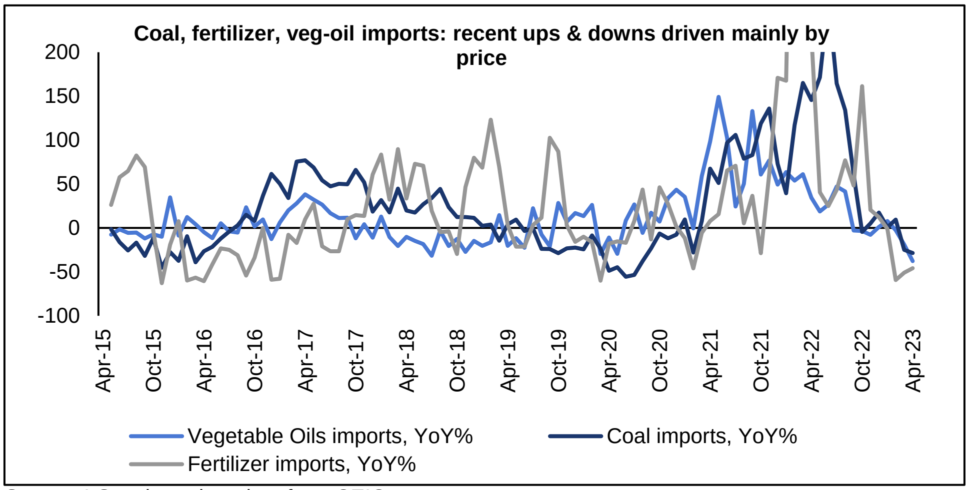
Chart 7: Declining electronics trade deficit since Aug'22 provides more evidence of import-substitution



Source: I-Sec, based on data from CEIC

Declining commodity prices explain the YoY decline in imports of crude oil, coal, fertiliser and vegetable oil in Jan-Apr'23. The prices of not only crude-oil, but also coal, fertiliser and vegetable oil rose sharply in CY22, with the Russo-Ukrainian war adding to an already-rising trend for all those prices. Over the past half-year, however, the prices of all those commodities have cooled off rapidly, helping to explain the sharp decline in India's imports of crude oil, coal, fertiliser and vegetable oils in Jan-Apr'23.

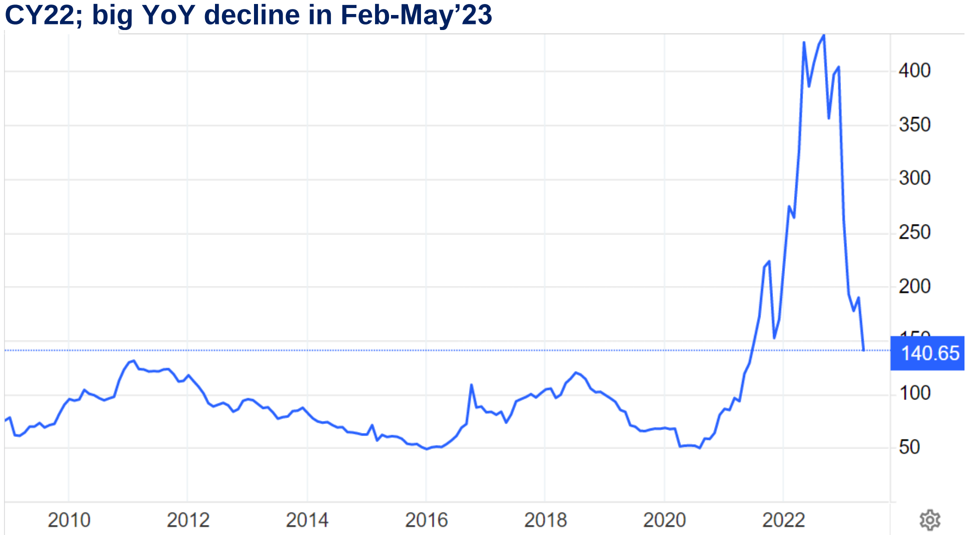
Chart 8: Commodity imports decline with lower commodity prices



Source: I-Sec, based on data from CEIC

Last year's surge in coal imports purely a functioning of a massive spurt in coal prices; their cooling since will mean big YoY declines in coal imports in H1FY24. Chart 9 shows a dramatic rise in the benchmark Asian coal price (Newcastle coal futures) starting in 4QCY21, with the price remaining above US$400/tonne through most of CY22. A post-covid surge in demand, exacerbated by supply disruptions caused by the Russo-Ukrainian war, were responsible for the huge price spike, which began to cool off from the start of CY23, with a particularly sharp decline in Feb-May'23 to US$140.65/tonne on 29th May'23. With no sign of any serious pickup in China's demand for coal, prices are likely to trend lower amid a recession in the West. The YoY decline in coal prices (as well as crude oil prices) will automatically reduce India's fossil-fuel import bill in Apr-Sep'23.

Chart 9: Newcastle Coal futures, US$/tonne: Unusually large spike in 4QCY21-CY22; big YoY decline in Feb-May'23



Source: Trading Economics

Similarly, palm oil prices spurted upward in Jul'21-Jul'22, rising past MYR6000/tonne. (MYR=Malaysian ringgit). Prices of palm oil and other vegetable oils (including sunflower and soya oil, of which Ukraine was a major world producer) have also become more correlated with Brent crude oil prices, because a portion of vegetable oil output is converted into biodiesel, making it a substitute for petroleum products. Palm oil prices cooled sharply after Aug'22, and now (at MYR3403/tonne on 29th May'23) are barely half their peak value from last year. MYR appreciated against USD between Nov'22 and Mar'22, but MYR has depreciated in the past two months. The decline in palm oil and other vegetable-oil prices will be a boon to India in the next half year, sharply shrinking India's commodity import bill.

Chart 10: Palm Oil price (MYR/Tonne): Big spike in Jul'21-Jul'22; sharp YoY decline since Oct'22

Source: Trading Economics

India's economy to gain from a positive terms of trade shock in H1FY24. The major implication of the dramatic surge in commodity (crude-oil, coal, fertiliser, vegetable oil) prices in Feb-Sep'22 was to hugely inflate one-half of India's imports in FY23. Now, with those commodity prices substantially lower, India's economy will gain a significant fillip from the YoY decline in these commodity prices in H1FY24. In effect, India's terms of trade will be substantially more positive, providing the equivalent of a tax cut to India's commodity-using consumers and businesses. That will give an extra fillip to the YoY growth in India's domestic demand in FY24, as some consumption and investment is shifted away from imports.

Recent reports

Date	Report
24-05-2023	US default remains unlikely, but this is Round 1 of protracted negotiations to cut excessive public debt
17-05-2023	Trade deficit narrows, likely pushing the current account into surplus for another couple of quarters
16-05-2023	Inflation recedes enough to preclude more tightening; industrial fragility suggests room for rate cuts by Q3FY24
04-05-2023	Global growth prospects clouded, but India's 7%+ real GDP growth to be spurred by investment and net exports
13-04-2023	Goldilocks redux: Industrial output accelerates in Jan-Feb'23, inflation recedes in Mar'23
03-04-2023	Twin Deficit Watch: CAD on track to stay below 2% of GDP in FY23, fiscal deficit below 6% of GDP
23-03-2023	FOMC hikes 25bp (as expected); its dot plots suggest another 25bp hike in CY23 and mild recession ahead
22-03-2023	CA surplus likely in Q4FY23, and services to provide a fillip in FY24 too amid slowing goods trade
15-03-2023	Elevated core inflation requires further US tightening; banking woes to necessarily alter the mix of measures
13-03-2023	Industrial output accelerates in Jan'23, spurred by capex; labour-intensive manufacturing remains a drag
28-02-2023	US inflation shock implies more aggressive tightening ahead, while a recession remains imminent
16-02-2023	Trade deficit likely to narrow sharply in Jan-Sep'23, but labour-intensive export revival remains elusive
14-02-2023	Inflation spike illusory (distorted by food-grain weights), but could induce a hawkish policy response
10-02-2023	RBI stays hawkish; we expect inflation to recede faster than RBI projects, requiring no more hikes in CY23
08-02-2023	US Economy: Recession imminent, but more monetary tightening needed to tame inflation
02-02-2023	FY24 Budget: Balancing act achieves fiscal prudence while boosting capex further
31-01-2023	Twin Deficit Watch: Revenue strength provides room for manoeuvre on the Budget; CAD set to moderate
13-01-2023	Goldilocks economy? Industrial growth rebounds and inflation continues to abate
29-12-2022	Twin Deficit Watch: CAD likely peaked in Q2FY23; fiscal improvement persists despite higher subsidies
15-12-2022	Recession inevitable amid Fed hawkishness; inflation will wane and rate cuts are likely in H2CY23
13-12-2022	A positive real rate is restored, as inflation abates and industrial output also wanes
13-12-2022	Foreign exchange reserves being rebuilt, as INR holds steady against a depreciating USD
07-12-2022	RBI tightens monetary policy as expected; no further rate hikes are likely in FY23, in our view
01-12-2022	Fixed investment spending is being crowded-in as government borrowing stays below target
24-11-2022	Period of surging USD over, but India likely to persist with mildly weaker NEER
12-11-2022	Crises of domestic overcapacity and external overlending loom as Xi Jinping reduces focus on the economy
05-11-2022	Holding up half the sky: Developed economies head to recession, but emerging economies remain resilient
19-10-2022	Twin Deficit Watch: Sep'22 saw a positive shift in goods trade, while surging direct taxes buoyed the fiscal position
13-10-2022	Dismal industrial performance amid high food-driven inflation
03-10-2022	RBI raises repo rate as expected; external balances to improve as inflation differentials begin favouring INR
28-09-2022	Low external debt is underpinned by large voluntary capital inflows
22-09-2022	FOMC implicitly acknowledges its policy error; to front-load further rate hikes
21-09-2022	Supply-side measures sacrifice growth to slay inflation
01-09-2022	Investment-led recovery to buoy the economy amid global slowdown

Date	Report
30-08-2022	US Economy: Far from recession now, but clearly headed toward one by Q1CY24
22-08-2022	Growth will be marginally less robust as India sacrifices external strength to tackle inflation
28-07-2022	The global investment drought & China's quarter-century of over-investment
28-07-2022	FOMC surprises (a bit) positively, with another 75bps hike; suggests smaller hikes in future
15-07-2022	Twin Deficit Watch: Both deficits remain on a stable path, despite the noise
13-07-2022	Growth gains ground, but inflation remains troubling
16-06-2022	Tight labour market obliges the Fed to quickly reverse its policy error
08-06-2022	RBI hikes 50bp as expected; policy to focus on bringing inflation into line
01-06-2022	China faces the perfect storm: global tightening, capital flight, over-capacity
01-06-2022	Rebounding GFCF a positive in Q4FY22; will take the growth baton from exports in FY23
31-05-2022	IPEF and new FTAs to add medium-term dynamism to India's export engines
24-05-2022	Growth was under-estimated in CY21, but reforms will spur strong growth in CY22 and CY23
05-05-2022	MPC's inter-meeting rate hike: countering commodity inflation, and containing fallout from USD strength
30-04-2022	US Economy: Weak GDP print for Q1 ironically reflects ample evidence of an overheating economy
13-04-2022	Twin Deficit Watch: BoP current account to improve; revenue surge provides fiscal leeway for FY23
09-04-2022	Monetary policy remains accommodative, but with a subtly hawkish twist
07-04-2022	Monetary Policy errors have raised the risk of recession by 2024
30-03-2022	Firing on all monetary cylinders, China's "selection-year" rebound is being derailed by covid
25-03-2022	Global GDP to decelerate as FOMC tightens faster; robust external balances bolster India's monetary autonomy
16-03-2022	Binary risks from revival of the JCPOA (Iran nuclear deal) and the wider impact of financial sanctions on Russia
11-03-2022	A pro-incumbent win for BJP in 4 states, but longer-term challenger rises in Punjab
03-03-2022	Higher oil prices in H1CY22 (and lower in H2) to bring forward India's rate hikes
23-02-2022	The Risks from a Russia-Ukraine war: Higher oil prices, European recession
11-02-2022	RBI is in calm seas despite the storm of imminent US tightening
10-02-2022	A credible path toward crowding-in private investment
31-01-2022	Budget Preview: Robust fiscal health opens numerous policy options
25-01-2022	US Economy: Inflation is a monetary phenomenon; FF rate at 1.25% by end-2022 to contain it
21-01-2022	Re-globalisation to drive growth momentum in 2022

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