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EXTERNAL DEBT

External debt to GDP ratio at 12-year low in March 2023; sizeable forex reserves provide sufficient cushion

JULY 2023

Highlights

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External debt rose mildly in FY2023 in absolute terms, while touching a 12-year low of 18.9% of GDP

Coverage of external debt provided by forex reserves stood at 92.6% at end-Mar 2023; likely to remain at comfortable levels in Q1 FY2024

A potential rise in CAD and higher short term debt obligations are likely to weigh on India's external position, but surge in FPI inflows and healthy forex reserves offer a cushion

- India's external debt rose by $5.6 billion to $624.7 billion at end-March 2023 from $619.1 billion at end-March 2022. However, excluding valuation gains owing to a stronger $ vis-à-vis the INR and major currencies, external debt would have increased by a sharper $26.2 billion.
- Importantly, external debt eased to a 12-year low of 18.9% of GDP at end-March 2023 (20.0% of GDP at end-March 2022). As a proportion of forex reserves, external debt dipped to 92.6% at end-March 2023 from 98.1% at end-March 2022, and was well above the 71.3% seen in end-FY2013.
- The share of short-term debt by original and residual maturity in total external debt witnessed an uptick in FY2023. Moreover, the ratio of short-term debt to forex reserves increased slightly during the fiscal, implying a mild deterioration, despite the marginal increase in overall external debt.
- With a sequential uptick of $15.7 billion in forex reserves, the coverage of external debt by forex reserves rose to 92.6% at end-March 2023 from 91.9% at end-December 2022. It is likely to remain at similar levels in Q1 FY2024, amid a $14.7 billion increase in reserves in the quarter.
- Outstanding commercial borrowings fell by 1.7% year-on-year (YoY) to $222.0 billion in FY2023, owing to a decline in gross inflows amid a sharper rise in global interest rates vs. domestic rates. However, owing to the sharp rise in ECB approvals in the first two months of FY2024, ICRA expects gross ECB inflows to rise to ~$30-35 billion during the fiscal from $26.0 billion seen in FY2023.
- While higher short term debt obligations impart vulnerability to India's external position in FY2024, the current account deficit is estimated to be moderate (CAD; to $71-73 billion in FY2024). Additionally, continued FPI inflows as well as sizeable forex reserves are likely to provide a cushion.
- Given the slowdown fears in the US economy, the DXY is unlikely to strengthen significantly, notwithstanding the expectations of a couple more rate hikes in the near term. Besides, the decline in crude oil prices and the moderate outlook for India's CAD augurs well for the USD/INR pair. Overall, ICRA expects the INR to trade between 81.0-84.0/$ in Q2 FY2024.

India's external debt rose by mild 0.9% in FY2023; touched 12-year low of 18.9% as % of GDP

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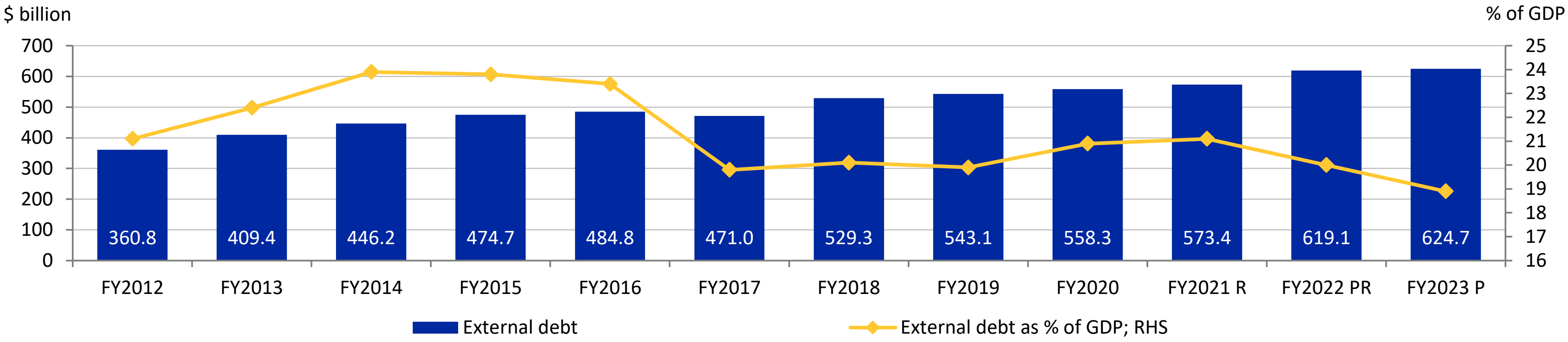
EXHIBIT: Trends in external debt and as % of GDP

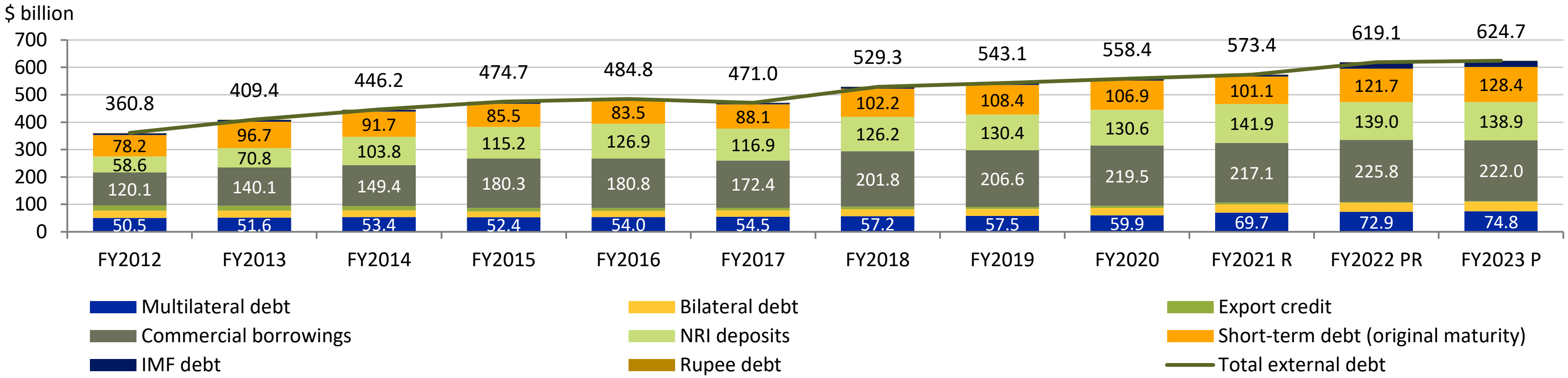


R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- India's external debt rose mildly to $624.7 billion at end-FY2023 from $619.1 billion at end-FY2022, recording an increase of $5.6 billion over the year-ago level. Moreover, the pace of the YoY growth in FY2023 was muted at 0.9%, as against the 8.0% growth seen in FY2022.
- Valuation gains, to the extent of $20.6 billion, due to the appreciation of the US dollar vis-à-vis Indian rupee and major currencies such as yen, SDR and euro suppressed the increase in external debt in FY2023. Excluding these, external debt would have increased by a higher $26.2 billion in FY2023.
- However, external debt as a % of GDP declined to a 12-year low of 18.9% at end-March 2023 from 20.0% at end-March 2022, owing to the rise in nominal GDP during this period (to Rs. 272.4 trillion at end-March 2023 from Rs. 234.7 trillion at end-March 2022).

Rise in short-term debt (by original maturity) pushed up external debt in FY2023

EXHIBIT: Trends in components of external debt



Short-term debt is shown by original maturity basis; R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- The $5.6 billion increase in external debt during FY2023, relative to FY2022, was led by short-term debt (+$6.7 billion), multilateral debt (+$2.0 billion), and bilateral debt (+$2.0 billion). In contrast, commercial borrowings (-$3.8 billion), IMF debt (-$0.6 billion), export credit (-$0.4 billion), NRI deposits (-$0.1 billion) and rupee debt (-$0.1 billion) reported a decline during this period.
- Accordingly, the shares of short-term debt (to 20.6% from 18.7%), bilateral debt (to 5.5% from 5.1%) and multilateral debt (to 12.0% from 11.7%) in total external debt increased at end-March 2023 relative to end-March 2022. In contrast, the share of commercial borrowings (to 35.5% from 36.6%), NRI deposits (to 22.2% from 23.1%), trade credit (to 0.5% from 0.9%), IMF debt (to 3.6% from 3.8%) and rupee debt (to 0.1% from 0.2%) declined during the same period.

Debt of Government and non-government sectors rose in FY2023; loans continued to form the largest part of external debt

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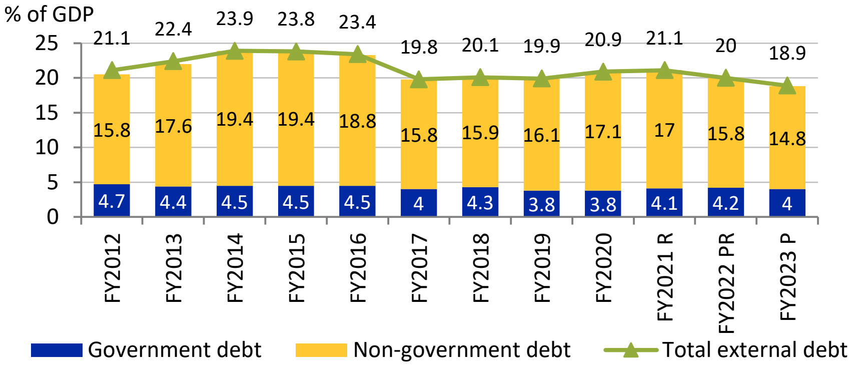
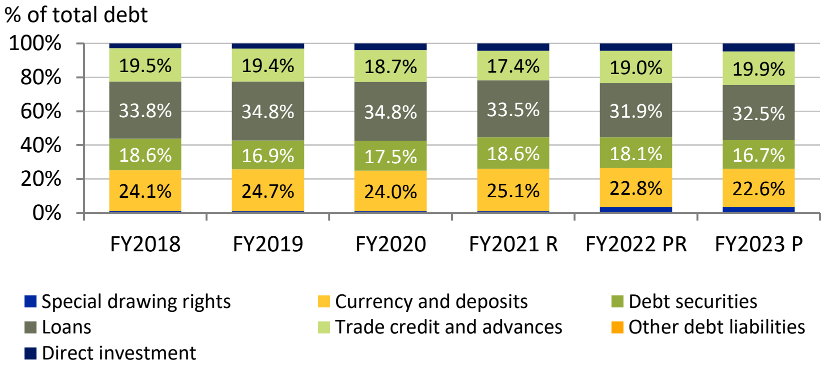
EXHIBIT: Government and Non-government External Debt as % of GDP



R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- Outstanding debt of both government (to $133.3 billion in FY2023 from $130.8 billion in FY2022) and non-government (to $491.3 billion from $488.3 billion) sectors increased during FY2023, relative to FY2022.
- As a % of GDP, while government debt declined mildly to 4.0% in FY2023 from 4.2% in FY2022, non-government recorded a relatively larger decline to 14.8% from 15.8% during this period.

EXHIBIT: Instrument-wise classification as % of total external debt

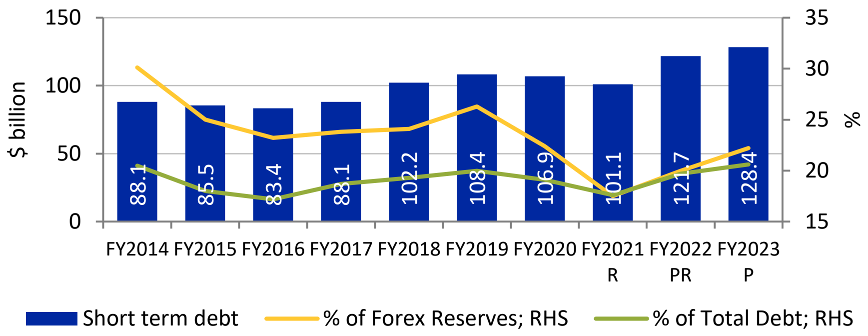


R: Revised; PR: Partially Revised; P: Provisional; Source: GoI; RBI; ICRA Research

- As per the instrument-wise classification, in line with previous-year trends, loans (32.5%) constituted the largest share of total external debt in FY2023
- This was followed by currency and deposits (22.6%), trade credit and advances (19.9%), debt securities (16.7%), direct investment (4.7%), and special drawing rights (3.6%).

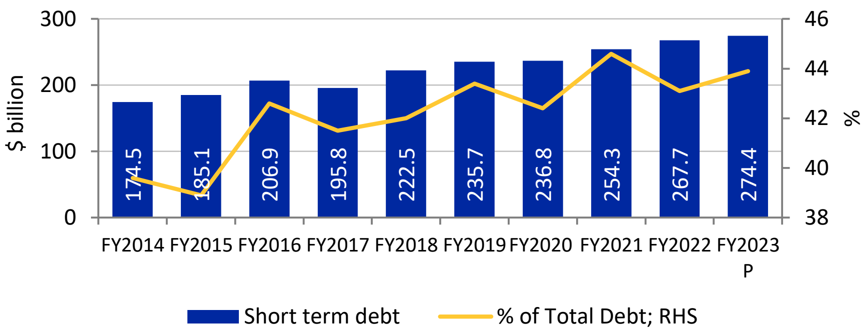
Short-term debt (by original and residual maturity) witnessed an uptick in FY2023

EXHIBIT: Short-term debt (by original maturity)



R: Revised. PR: Partially Revised. P: Provisional; Source: RBI; ICRA Research

EXHIBIT: Short-term debt (by residual maturity)



P: Provisional; Source: RBI; ICRA Research

- After rising quite sharply by ~20% in FY2022, India's short-term debt (with original maturity of up to one year) rose by a milder 5.5% to $128.4 billion at end-March 2023 from $121.7 billion at end-March 2022.
- Moreover, the share of short-term debt (with original maturity of up to one year) in total external debt increased to a 10-year high of 20.6% from 19.7%, respectively. In addition, the ratio of short-term debt to foreign exchange reserves witnessed an uptick in FY2023 (to 22.2% from 20.0%, respectively).
- Similarly, the short-term debt by residual maturity basis (i.e., debt obligations that include long-term debt by original maturity falling due over the next 12 months and short-term debt by original maturity) rose to $274.4 billion at end-March 2023 from $267.7 billion at end-March 2022. In addition, the share of residual maturity short term debt in total external debt rose to 43.9% from 43.1%, respectively.

Coverage of external debt by forex reserves rose at end-March 2023, while trailing 100% for fifth straight quarter

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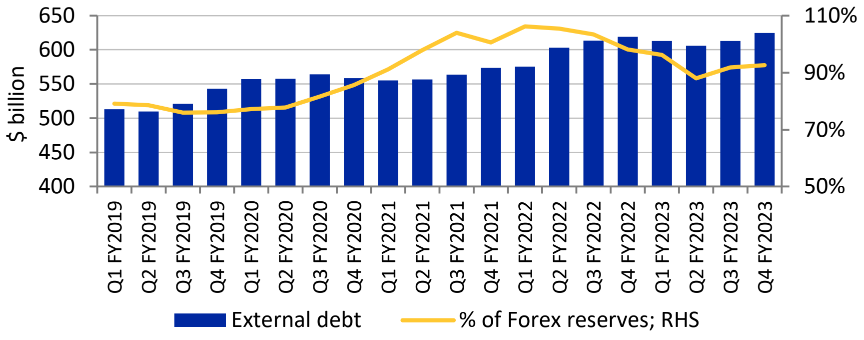
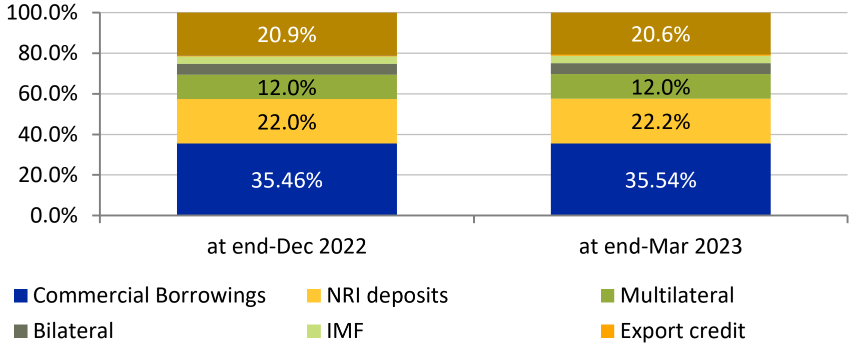
EXHIBIT: Quarterly trends in External Debt



Source: RBI; ICRA Research

EXHIBIT: Composition of External debt



Source: RBI; ICRA Research

- In sequential terms, India's external debt rose modestly by 2.1% to $624.7 billion at end-March 2023 from $612.0 billion at end-December 2022.
- With a quarter-on-quarter (QoQ) uptick of 2.8% or $15.7 billion in foreign exchange reserves, the coverage of external debt by forex reserves rose to 92.6% at end-March 2023 from 91.9% at end-December 2022, while remaining below the 100% mark for the fifth consecutive quarter.
- While the share of short-term debt in total external debt has declined mildly to 20.6% at end-March 2023 from 20.9% at end-December 2022, that of long-term debt witnessed a rise to 79.4% from 79.1%, respectively.
- Within the long-term segment, the share of bilateral debt (to 5.5% from 5.4%), NRI deposits (to 22.2% from 22.0%), and commercial borrowings (to 35.54% from 35.46%) reported a sequential uptick at end-March 2023, relative to the previous quarter. In contrast, there was a marginal decline in the share of other constituents in the total external debt between these two quarters, such as rupee debt (to 0.13% from 0.14%), multilateral debt (to 11.98% from 12.05%), export credit (to 0.47% from 0.49%), and IMF debt (to 3.56% from 3.60%).

Outstanding commercial borrowings dipped by ~2% in FY2023, owing to sharper rise in global interest rates vis-à-vis domestic rates

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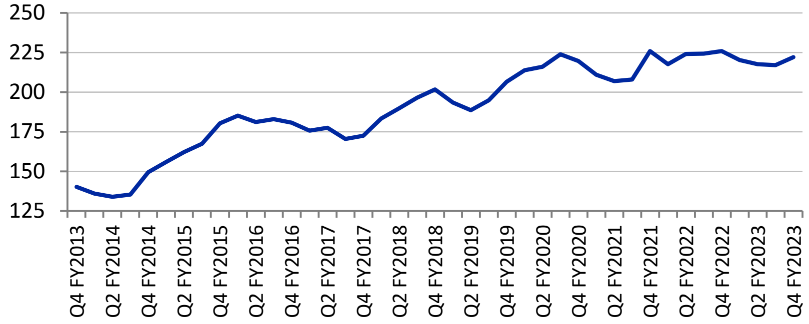
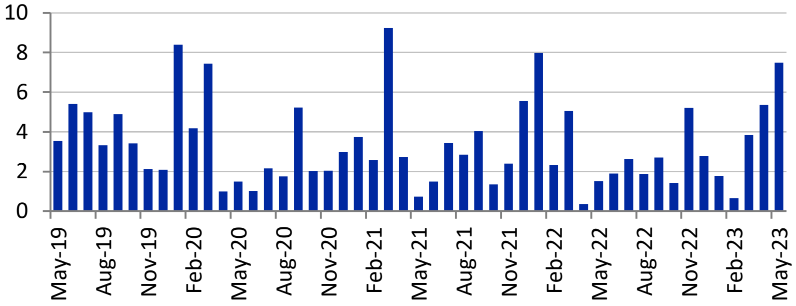
EXHIBIT: Trends in Commercial Borrowings ($ billion)



Commercial borrowings includes bank loans, bonds and loans/securitised borrowings with multilateral/bilateral guarantee and IFC(W); Source: RBI, ICRA Research

EXHIBIT: Trends in monthly ECB approvals ($ billion)

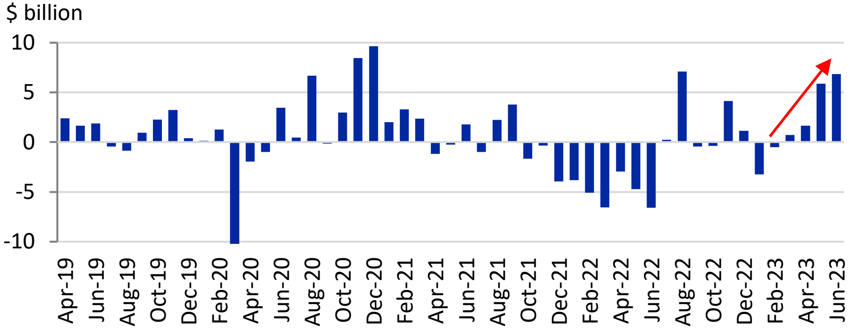


Source: RBI, ICRA Research

- Outstanding commercial borrowings stood at $222.0 billion at end-March 2023, 1.7% lower than the year-ago levels ($225.8 billion at end-March 2022), owing to a decline in gross inflows amid a sharper rise in global interest rates relative to domestic rates. As a proportion of GDP, they eased to 6.5% by end-March 2023 from 7.2% by end-March 2022.
- After declining by a sharp 32% in FY2023, gross ECB approvals surged to $12.8 billion in Apr-May 2023 ($1.9 billion in Apr-May 2022), higher than the total ECB flows seen during Apr-Oct 2022 ($11.8 billion).
- The interest rate differentials between Indian and overseas borrowing costs have narrowed significantly and are likely to edge lower in the near term amid the expectations of two more rate hikes by the US Fed (as per the June 2023 dot plot) and an extended pause by the MPC through the remainder of FY2024. **Nevertheless, owing to the sharp increase in the first two months of FY2024, ICRA expects gross ECB inflows to rise to ~$30-35 billion during the fiscal from $26.0 billion seen in FY2023.**

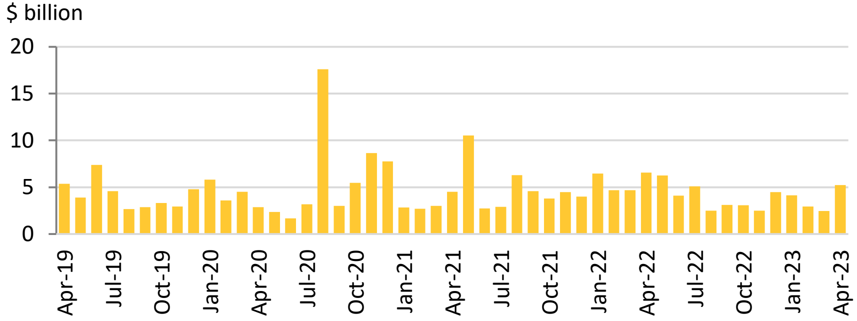
FPIs have pumped $14.4 billion into Indian equities in FY2024 so far, driven by strong domestic macros amid external slowdown fears

EXHIBIT: Trends in net FPI flows



Including Debt VRR segment; Source: NSDL, CDSL; ICRA Research

EXHIBIT: Trends in gross FDI flows into equity segment



Source: RBI, ICRA Research

- FPIs have remained net buyers since March 2023, with net inflows into the overall segment (equity, debt and hybrid) rising to a nine-month high of $5.9 billion in May 2023 from $1.7 billion in April 2023, supported by strong domestic macros vis-à-vis other EMs and developing countries amid slowdown concerns in advanced economies. This trend was driven mainly by inflows in the equity segment (to +$5.3 billion in May 2023 from +$1.4 billion in April 2023). In June 2023, overall net inflows rose further to $6.8 billion (highest since Aug 2022) while remaining healthy, led by the equity segment (+$5.7 billion).
- **After withdrawing $5.5 billion in FY2023, FIIs have invested a net amount of $14.4 billion in FY2024 so far (till June 30, 2023). A relatively stronger growth outlook for India vis-à-vis other similar economies may support equity inflows in this fiscal. However, the tighter disclosure norms for FPIs could impact flows to some extent. Overall, ICRA estimates FII inflows at $15-20 billion in FY2024.**
- Gross FDI inflows into the equity segment declined by 21% YoY in April 2023 to $5.2 billion from $6.6 billion in April 2022. **Global headwinds could restrict the gross FDI inflows at $45-50 billion in FY2024, similar to $47.3 billion recorded in FY2023.**

Coverage of external debt provided by forex reserves likely to remain at comfortable levels in Q1 FY2024

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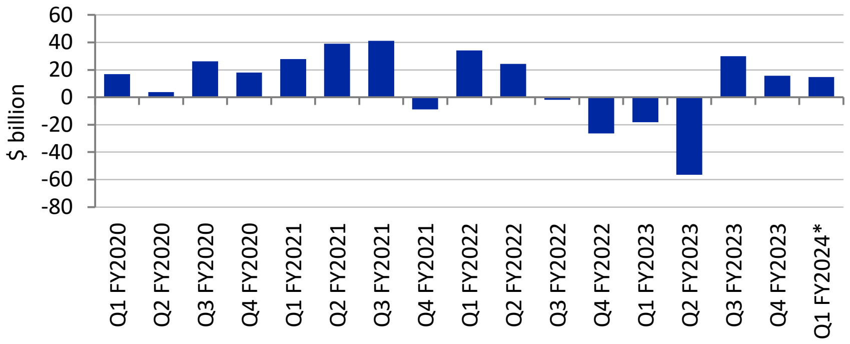
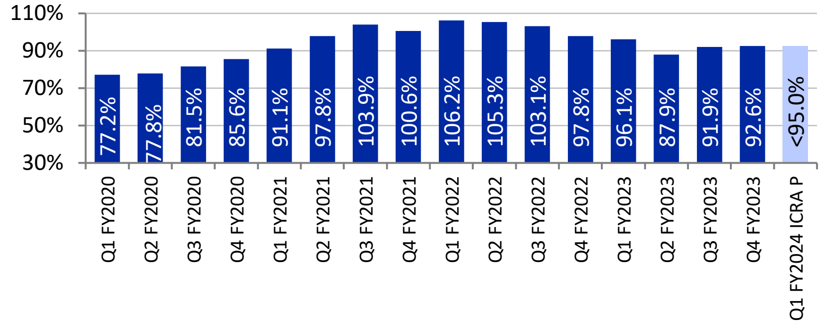
EXHIBIT: Quarterly changes in India's reserve assets ($ billion)



Source: RBI; ICRA Research

EXHIBIT: Forex reserves as % of External Debt (%)



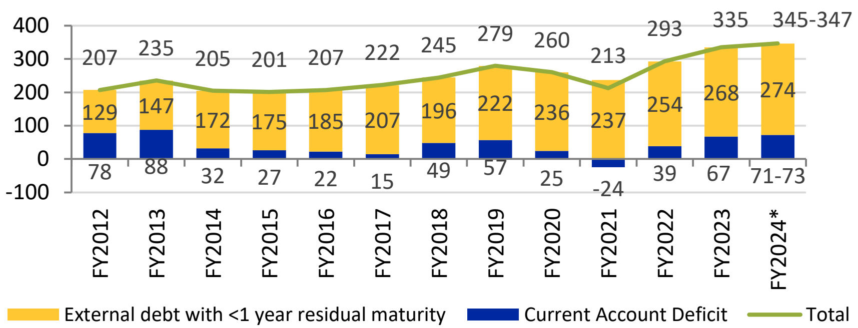
Source: RBI; ICRA Research

- India's reserve assets rose to $578.4 billion in Q4 FY2023, even as the magnitude of the rise more-than-halved to $15.7 billion from $30.1 billion in Q3 FY2023. The uptick was largely on account of an increase in foreign currency assets. Subsequently, reserve assets have risen by $14.7 billion to $593.2 billion as on June 23, 2023*, amid an increase in foreign currency assets, with the RBI likely to have bought dollars during the quarter.
- India has recorded modest net inflows of $1.9 billion under the FII-debt segment (including VRR flows) in Q1 FY2024 (till Jun 30, 2023), while inflows from ECB, net of refinancing stood at $12.8 billion during Apr-May 2023.
- **Overall, given the rise of $14.7 billion in reserve assets in Q1 FY2024*, the coverage of external debt provided by forex reserves is likely to remain at comfortable levels in Q1 FY2024, similar to Q4 FY2023 (92.6%), notwithstanding the sharp rise in ECB inflows during Apr-May 2023.**

**Data for Q1 FY2024 has been computed by subtracting the forex reserves data published in the RBI's weekly statistical supplement as at end-Jun 2023 from the reserve assets as per the International Investment Position data as at end-Mar 2023.*

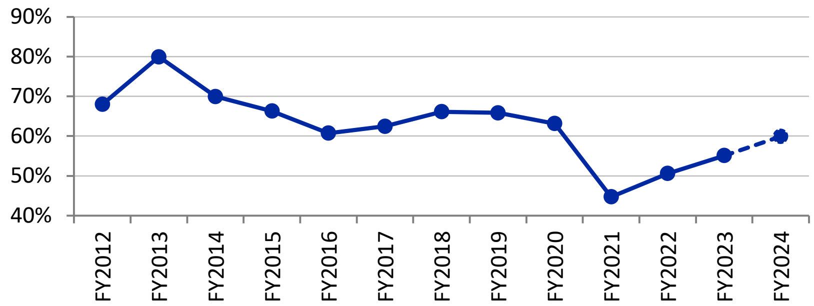
India's external obligations to remain high in FY2024, but trail FY2013 levels as a proportion of forex reserves

EXHIBIT: Trends in India's Current Account Deficit and External debt with <1 year residual maturity ($ billion)



**Denotes residual maturity of o/s external debt for upto one year as at end-March 2023 and we have included our CAD projections for FY2024; Source: RBI, ICRA Research*

EXHIBIT: Trends in India's external obligations (current account deficit + short term debt with residual maturity <1 year) as a % of foreign exchange reserves



Source: RBI, ICRA Research

- India's short-term debt with residual maturity of less than 1-year increased by a modest 2.5% to $274.4 billion by end-March 2023 from $267.7 billion at end-March 2022. Besides, the current account deficit is projected to increase to $71-73 billion in FY2024 from $67.0 billion in FY2023 owing to a widening in the merchandise trade deficit and subdued services exports owing to a slowdown in major economies, while remaining moderate at ~2.0% of GDP.
- This implies that India's external obligations (short term debt with residual maturity < 1-year + current account deficit) for FY2024 will be an elevated $345-347 billion, relative to the $335 billion seen in FY2023. As a proportion of forex reserves, these obligations are estimated to rise to 59.9% in FY2024 (using reserve asset at end-March 2023) from 55.1% in FY2023 but remain well below the ~80% seen in FY2013, when India had seen a current account deficit of $88 billion.
- **While a potential mild increase in the absolute size of the current account deficit (to $71-73 billion in FY2024) and higher short term debt obligations impart vulnerability to India's external position in FY2024, continued FPI inflows as well as sizeable forex reserves are likely to provide a cushion.**

INR appreciated by 0.2% in FY2024 so far, amid FPI equity inflows and downtrend in crude oil prices

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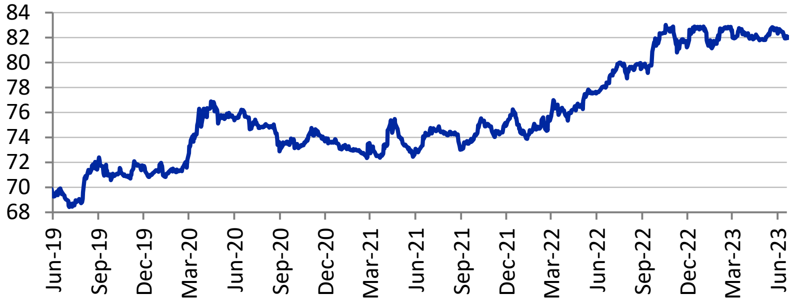
EXHIBIT: Movement in USD/INR exchange rate



Source: Bloomberg; RBI; ICRA Research

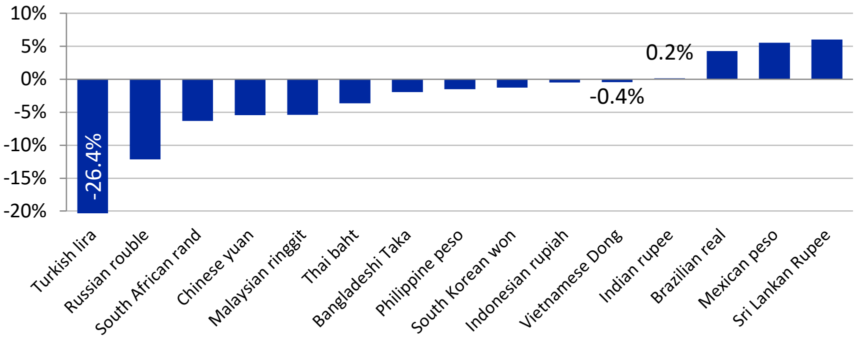
EXHIBIT: Movement in Dollar Index (DXY)

Source: Bloomberg; RBI; ICRA Research

- The Dollar index had weakened to 101.0 on April 13, 2023 from the peaks of 105.7 recorded on March 8, 2023, with the unfolding crisis in the US banking system. Thereafter, the Index has risen modestly to 103.3 on June 29, 2023 underpinned by the increase in UST yields after the stronger-than-expected US GDP data for Q1 CY2023 and drop in weekly jobless claims, which strengthened the expectations of additional tightening by the US Fed.
- Similarly, the INR had strengthened from 82.7/$ on March 16, 2023 to 81.8/$ on April 13, 2023. Subsequently, it depreciated to a three-month low of 82.8/$ on May 23, 2023, before recording mild gains, and hovered around 82.0/$ levels in recent sessions.
- After weakening by 7.8% in FY2023, the INR has appreciated by a mild 0.2% against the USD in FY2024 so far (till June 30, 2023), amid a fall in crude oil prices and net FPI inflows in Indian equities. This is despite a 0.4% increase in the DXY during the same period.

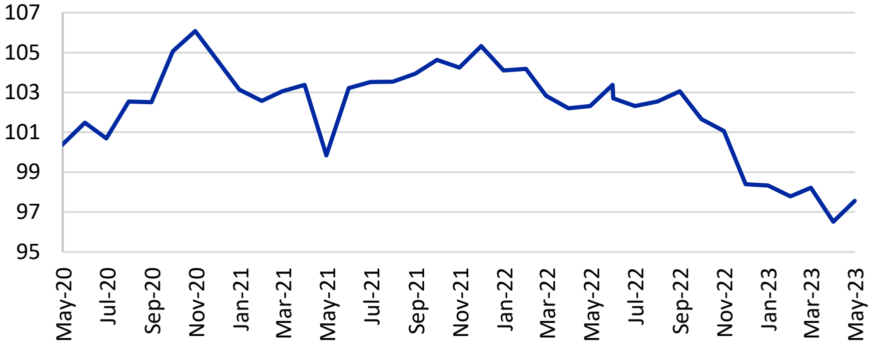
INR outperformed several EM currencies vis-à-vis $ in ongoing fiscal; continued outperformance could dull India's export competitiveness

EXHIBIT: FYTD exchange rate movements of EM currencies relative to the S$



Till June 30, 2023; Source: Bloomberg; ICRA Research

EXHIBIT: Index of REER for INR (40 Country, Export Based Weights)



Source: RBI; ICRA Research

- In FY2024 so far, the INR appreciated by 0.2% against the $, faring better from as many as 11 EM currencies in our sample set, including the Indonesian rupiah (+0.02%), South Korean won (+0.1%), Vietnamese dong (-0.3%), Philippine peso (-1.7%), Bangladeshi taka (-2.0%), Thai baht (-3.2%),South African rand (-3.6%), Chinese yuan (-4.8%), Malaysian ringgit (-5.4%), Russia rouble (-8.6%), and Turkish lira (-26.4%).
- The 40-country, export-weighted Real Effective Exchange Rate (REER) had fallen by a sharp 4.8% to 98.2 in March 2023 from 103.1 in Sep 2022, implying that INR depreciated (in real terms) against a basket of currencies in H2 FY2023, which is likely to have augured well for India's export competitiveness. Thereafter, the REER rose slightly to 97.6 in May 2023 from 96.5 in April 2023.
- If the USD/INR pair remains stable while other EM currencies weaken against the $, then it would likely dull India's export competitiveness going ahead.

ICRA foresees INR trading between 81-84/$ in Q2 FY2024

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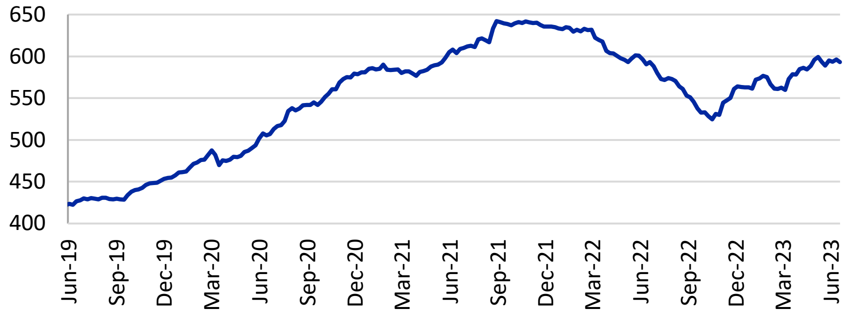
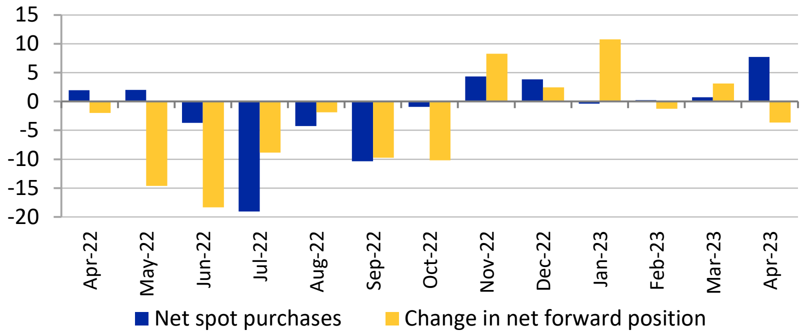
EXHIBIT: Trends in India's forex reserves ($ billion)



Source: RBI; ICRA Research

EXHIBIT: Trends in RBI's net spot purchases of the US dollar and outstanding forwards ($ billion)



Source: RBI; ICRA Research

- India's foreign exchange reserves rose by $30.3 billion to $593.2 billion on June 23, 2023 from $562.9 billion on Dec 30, 2022, partly driven by revaluation gains from the dip in the UST yields as well as likely dollar purchases during this period. The forex cover relative to the trailing 12 months of merchandise imports stood at a healthy 10.2 months on June 23, 2023, higher than the low of 8.8 months recorded at end-Oct 2022.
- The RBI conducted net forex purchases of $0.62 billion in Q4 FY2023, and a sharp $7.7 billion in April 2023 (22-month high). However, its outstanding net purchases in the forward market moderated by $3.7 billion to $19.9 billion in April 2023 from the nine-month high of $23.6 billion in March 2023, while remaining sharply lower than the $63.8 billion seen at end-April 2022.
- **Given the slowdown fears in the US economy, the DXY is unlikely to strengthen significantly notwithstanding the expectations of a few more rate hikes in the near term. Besides, softening in crude oil prices and the moderate outlook for India's current account deficit augurs well for the USD/INR pair. Overall, ICRA expects the INR to trade between 81.0-84.0/$ in Q2 FY2024.**

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Thank You!