Economics

DBS Focus

India: Resilient remittances

DBS Group Research April 30, 2019

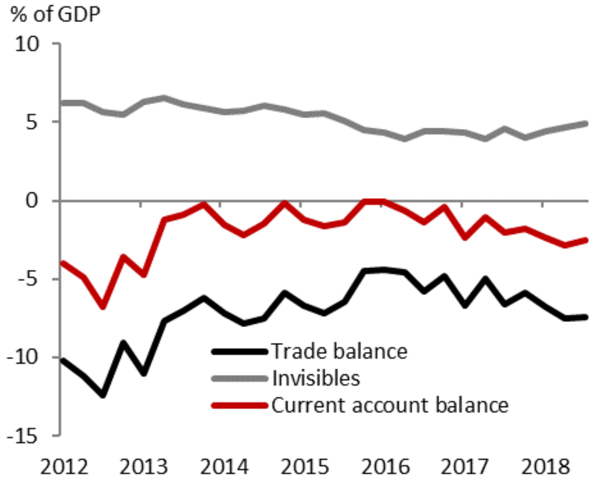
Radhika Rao
Economist

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *Earnings from India's invisibles have played an important role in containing the overall current account deficit*
- *In this note, we focus on one sub-component – remittances*
- *Apart from software receipts, remittances have been a key source of resilience for India's external balance*
- *India received the highest remittances on record last year, followed by China, Mexico, Philippines and Egypt. Volatility in these flows is the least in China and most in Egypt*
- *Utilising Rudyard Kipling's "six honest serving men", we answer the What, Why, When, How, Where and Who, of India's remittance inflows*
- *These flows have positive multiplier effects for the recipient economy on consumption, routed as bank deposits and at the margin, investments*
- *We conclude by assessing exogenous factors that influence these remittance trends*

Earnings from invisibles have played an important role in containing India's overall current account deficit (CAD). In this note, we focus on one of invisibles' key sub-components - remittances. Apart from software receipts, remittances have been a key source of resilience for India's external balance, accounting for more than half of the total invisibles last year, and offsetting 40% of the trade deficit.

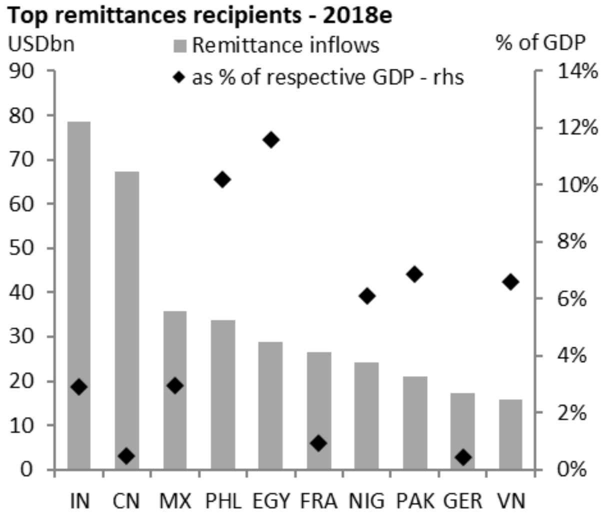
Current account math - invisibles + trade balance



Source: CEIC, DBS Group Research

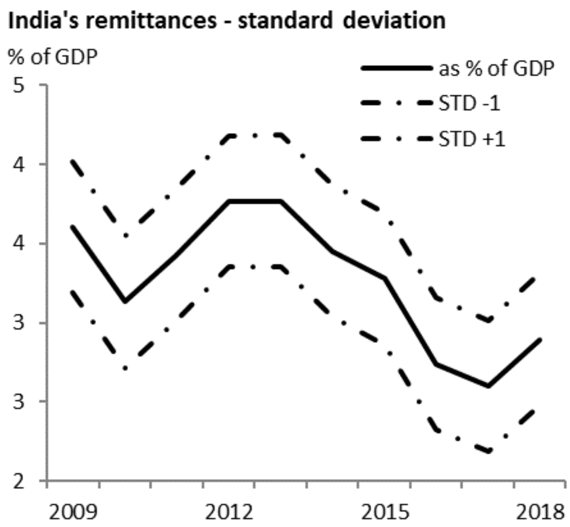
Remittances depend on a host of factors, including global growth conditions, economic situation in the host country, oil prices and migration policies, amongst others. **Utilising Rudyard Kipling's "six honest serving men", we answer the What, Why, When, How, Where and Who, of India's remittance inflows.**

What is the quantum of remittances? India was the highest recipient of remittances last year, at a record high of USD79bn, up from USD50bn in 2008-09, followed by China, Mexico, Philippines and Egypt, according to World Bank data. As a % of GDP, these flows carry varying weightage for each of the economies, which signal how crucial these are for external balances and as a driver for consumption. India's accounts for ~3% of GDP, smaller than the 10% and 11% for Philippines and Egypt respectively. China attracted the second highest inflows last year, but these make less than 1% of GDP, suggesting that trade surpluses are a bigger support for its current account balance.



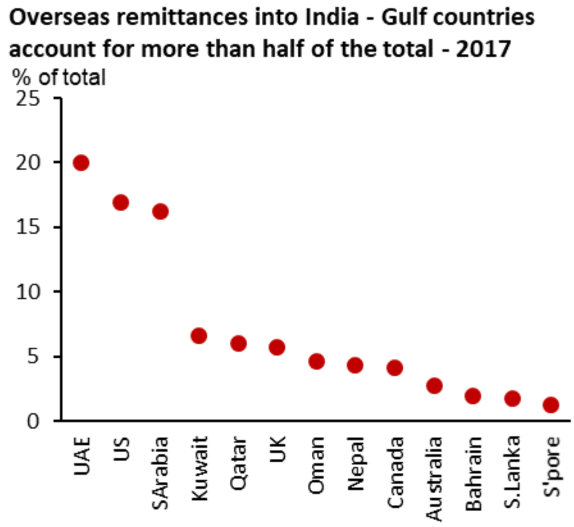
Source: World Bank, DBS Group Research

Are these flows volatile? To establish this, we calculate the standard deviation of these flows (% of GDP) in the past ten years to India and other four top recipient economies – China, Mexico, Philippines and Egypt. The outcome shows us that volatility in remittances is the least in China, with India and Mexico as the next best, while Egypt's gyrates the most. Apart from the modest scale of deviation, the chart below also reveals that even as India's nominal remittances have been rising, its ratio as a % of GDP has moderated since the financial crisis.



Source: IMF, World Bank, DBS Group Research

Where do these remittances originate? More than half of the remittances into India originate in the Middle-Eastern countries. UAE topped the table with a 20% share last year, while neighbouring countries of Saudi Arabia, Kuwait, Qatar and Oman accounted for the rest. The US is the second key originating economy as shown in the chart below, with the UK, Malaysia, Canada, Hong Kong, and Australia amongst the top ten sources.

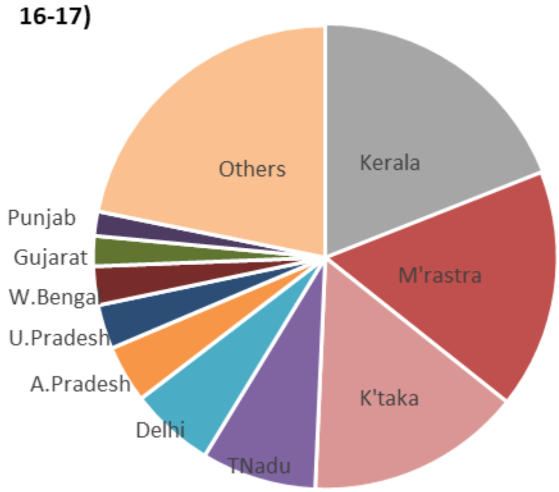


Source: World Bank, DBS Group Research

As of December 2018, there are about 30mn overseas Indians, of which 13mn are Non-Resident Indians (NRIs) and 17mn are People of Indian Origin [1]**.** The highest concentration of NRIs is in the Gulf countries, which includes ~24% in Saudi Arabia, 20% in UAE and 4-8% each in Kuwait, Oman and Qatar. A bigger share in the number of migrants to the Gulf but comparably smaller share in remittances can be explained by the composition of the workforce that heads to this bloc, which is mainly semi-skilled and unskilled workers according to the ILO. Comparably, the Indian diaspora in the US has a relatively lower proportion of NRIs but is the second biggest contributor to overall remittances, which is likely a reflection of the migrants' skills-trained and higher earning capacity [2].

Who are the beneficiaries and how are the funds utilised? Two-third of the remittances is received by four main states – Kerala (19%), Maharashtra (17%), Karnataka (15%) and Tamil Nadu (8%), according to a central bank's survey [2]. This also mirrors the state-wise composition of offshore migrants.

State-wise destination for remittances (% of total; 16-17)



Source: RBI, DBS Group Research

Nearly 60% of the funds are used by the beneficiary/ recipient for family maintenance and sustenance purposes, another 20% held as deposits with banks, 8% into physical asset investment e.g. property/ equities and rest miscellaneous purposes which might include healthcare, recreation etc. **Given the high proportion of funds being diverted for family consumption purposes, suggests these flows are bound to continue barring unforeseen circumstances for the remitter e.g. retrenchment, closure of company etc.**

How are the funds remitted? The size-wise distribution of these remittances reveals that 70% of the transfers are above USD500 (or equivalent) and between USD200-USD500 make a third and rest is smaller than USD200, according to an RBI survey. The preference to accumulate and transfer bigger amounts is prudent and intuitive, as costs of remittances vary with the quantum – bigger the amount, lesser the per dollar overhead (see table).

Table: Cost of remitting funds to India - formal banking channels

Modes of transfer	Public sector banks	Private sector banks	Foreign banks
%		USD200	
Direct transfer to Bank a/cs or e-transfer	0-6.7.0	0-4.0	0-2.1
SWIFT	0-21.3	0-22.7	0-12.7
RDA/ Vostro a/c	0-13.5	0-11.8	0-8.5
%		USD500	
Direct transfer to Bank a/cs or e-transfer	0-5.5	0-1.7	0-3.1
SWIFT	0-8.6	0-9.2	0-7.7
RDA/ Vostro a/c	0-5.5	0-4.8	0-14.1

Source: RBI survey; DBS Group Research

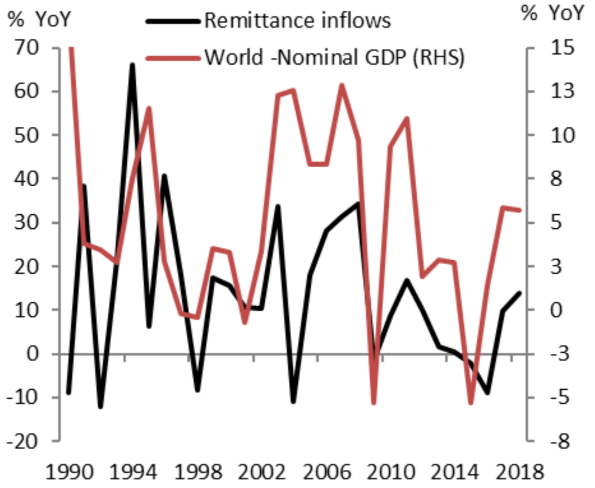
Clearly, transactions are sensitive to costs, incurred by the sender and the recipient. These costs are influenced by various factors, including distance between the host and recipient economy, financial infrastructure, market competition and quantum of the transfer. Other factors like exchange rates, instruments utilised etc. also add/ reduce the cost entailed.

Amongst the various formal channels of transfer, the survey finds that Rupee Drawing Arrangements (RDA)/ vostro accounts are the most preferable route, accounting for over two-thirds of the total flows. This route involves the remitter depositing money through his banks that act as authorised dealers, which then passes funds to the recipient via cheques/ money transfers. **Bulk of these are transacted through private and foreign banks and less through public-sector banks.** This comes down to the cost differentials between public-sector and private/ foreign banks. The latter have the advantage of varying costs across different centres/ countries, apart from better access to competitive foreign currency conversion charges and commission structures. Relatively low costs of this channel are a draw for most remitters, particularly from the Gulf countries. The other preferable channels are SWIFT payments, followed by direct transfers, cheques/ drafts.

For non-bank/ financial institutions, Money Transfer Operators (MTOs) have a clear advantage, particularly amongst migrant workers who might not be financially savvy or for beneficiaries who might not have access to proper banking channels in their countries. Notably, costs of routing funds through MTOs is lower than banks and hence are utilised for low value cash transactions, helped further by the proliferation of internet-based transfer/ digital payment options.

Why does the external environment matter for remittance trends? Assessing the factors that influence remittance trends, **historically, there is an observable correlation between remittances and a) global growth; b) broad direction of oil prices; and more recently likely c) restrictive migration polices.** Comparison of the swings in world nominal GDP and remittances in the chart below, shows that global growth has had a tell-tale impact on remittances. Tougher economic times in the host country, episodes of fiscal tightening and political compulsions, can also cause volatility in the migrant flows and earning capacities, as well as volume of remittances transferred back home.

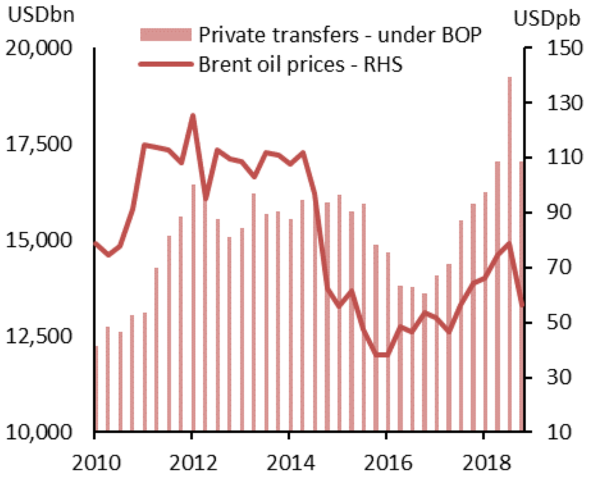
Remittance flows into India vs World GDP



Source: World Bank, DBS Group Research

Under b) anecdotal trends point to a linkage between oil and remittances, along with a decent correlation coefficient. This could be causal as well, since a sizeable funds are sent from Gulf/ oil-producing countries. This is also validated by the drop in migration trends to the Gulf countries during episodes of low oil prices, which sometimes may put economic strain on the host countries.

Oil prices vs offshore remittances



Source: CEIC, DBS Group Research

And more recently, the risk of restrictive migration stemming from protectionist and nationalist policies; a case in point are stricter income and skill requirements for labour movement into the US in the past two years. This has resulted in a drop in approved H1B applications to the US, from 364k in 2017 to 331k in 2018, according to press reports citing US government agencies.

There are few factors that could soften the downside impact. Effect of oil is two-pronged, while high oil prices increase the import bill, there is also a concomitant improvement in remittances, thus acting as a counterbalance for the current account math. On a related vein, dependency on the Middle east, though still sizeable, has moderated, as the share of other destination countries (that of the West) has risen. This is likely to provide some buffer to these flows during volatile oil price swings. Lastly, with most beneficiaries likely to utilise these funds towards their consumption and sustenance needs, these are bound to continue barring unforeseen circumstances.

In all, we expect offshore remittances to remain a key source of support for India's external balance, even as its pace of growth remains vulnerable to gyrations in global growth trends or other exogenous factors. At the same time, concerted efforts to make goods and services' exports more competitive is necessary to lower the structural current account deficit, thus lowering the economy's vulnerability to global risk sentiments.

Notes:

[1] India's Ministry of External Affairs; December 2018

[2] RBI Bulletin; Globalising People: India's Inward Remittances; November 2018

Group Research

Economics & Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Masyita Crystallin, Ph.D.
Economist – Indonesia & Philippines
+62 21 2988-4003 masyita@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Neel Gopalakrishnan
Credit Strategist
+65 6878-2072 neelg@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Ma Tieying
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist – Eurozone, India & Thailand
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Duncan Tan
FX & Rates Strategist - ASEAN
+65 6878-2140 duncantan@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 687-4033 philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).