NSE

Macro Review

March 16, 2020 | Vol. 2, Issue. 5

Weak domestic demand pulls down CAD to three-year lows in Q3FY20

India's Current Account Deficit (CAD) contracted sharply to US$1.4bn or 0.2% of GDP in Q3FY20 from US$ 6.5bn/US$17.8bn or 0.9%/2.7% of GDP in Q2FY20/Q3FY19. This was primarily on account of a 29.7% YoY decline in trade deficit, thanks to a moderation in non-oil imports—reflecting weak domestic demand—as well as a fall in oil imports, partly also pulled down by a modest decline (-2.2% YoY) in merchandise exports. Exports of Services, however, remained largely steady like last year, led by robust growth in travel-related and software services receipts as well as higher private transfers. The Capital account also widened, thanks to strong capital flows, which in turn resulted in the Balance of Payments (BoP) surplus expanding to a 19-quarter high of US$21.6bn in Q3FY20.

Sustained weakness in domestic consumption demand, coupled with a sharp fall in crude oil prices, is expected to keep imports in check. However, exports are also expected to get hit from global demand weakness in the wake of worsening Corona virus outbreak. This is likely to keep CAD around these levels in the last quarter of the fiscal, translating into FY20 CAD at around 1% of GDP and FY21 is expected to be no different. On the negative side, risk-off in global markets is likely to sustain for now, thereby hurting foreign capital flows into emerging markets including India and consequently putting pressure on CAD financing.

- **Trade deficit declines amid weak domestic demand…**: India's trade deficit contracted to US$ 34.6bn in Q3FY20 from US$ 38.1bn in Q2FY20 and US$ 49.3bn in Q3FY19. This is largely on account of a 4.4% QoQ/10.2% YoY drop in non-oil imports, reflecting weak domestic demand. Oil imports also declined by 18.1% YoY, even as they grew at a decent 5.4% on a sequential basis, reflecting higher prices in the quarter ending December 2019. Merchandise exports also remained benign, rising by a modest 1.5% QoQ but down 2.2% YoY, thanks to sustained impact of trade war during the quarter and weak global demand.

CAD contracted to a 14-quarter low in Q3FY20 on lower trade deficit.

- **…Leading to a sharp contraction in CAD:** Services receipts remained steady as compared to a year ago period, thanks to a meaningful jump in receipts from travel related services, strong growth in software earnings and robust private transfers (remittances). That that, a sharp dip in crude oil prices may hurt remittances from the Gulf nations (account for ~50% of total remittances). Lower merchandise trade deficit in Q3, coupled with steady invisibles, led to a sharp contraction in CAD to a 14-quarter of US$ 1.4bn or 0.2% of GDP in Q3FY20.

- **BoP surplus rises to near 5-year high in Q3FY20:** The BoP surplus expanded from US$5.1bn in Q2FY20 to US$21.6 in Q3FY20—the highest in over five years, led by strong portfolio investments and steady ECB inflows. Foreign direct investments (FDI) rose to US$10bn in Q3FY20, with net investments in the first nine months of this fiscal already exceeding the FY19 figure. Foreign portfolio inflows also expanded to US$7.8bn in Q3FY20, as market sentiments improved first due to roll-back of enhanced surcharge on long and short-term capital gains announced in the Union Budget, and later due to positive global cues related to US-China trade negotiations. ECB inflows also remained steady in Q3, with cumulative flows in FY20 thus far surpassing overall inflows in the previous year.

BoP surplus rose to near 5-year high in Q3FY20 led by strong portfolio investments and steady ECB inflows.

- **CAD expected to remain low but global risk-off to hurt foreign capital flows:** Improvement in global trade prospects with the signing of US-China trade deal early this year was short-lived as the recent outbreak of Novel Coronavirus has severely impacted global growth, thereby hurting exports. On the positive side, imports are also expected to remain tepid in the wake of a sustained weakness in domestic demand and a sharp fall in crude oil prices. As such, CAD is expected to remain range-bound in the last quarter of the fiscal, translating into FY20 CAD at

CAD is expected to remain benign but lower foreign capital inflows due to global risk-off may exert pressure on the BoP.

around 1% of GDP. FY21 CAD is expected to be no different, with a potential sustenance of current low crude oil prices imparting further downside pressure. Despite lower CAD, its financing may emerge a concern in FY21 if the recent trend of huge foreign capital outflows sustains in the wake of ongoing risk-off environment, thereby putting pressure on the INR.

Figure 1: Balance of Payments – Quarterly account

US$ bn	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20
Current account	**-15.8**	**-19.1**	**-17.8**	**-4.6**	**-14.4**	**-6.5**	**-1.4**
CAD/GDP (%)	*-2.3*	*-2.9*	*-2.7*	*-0.7*	*-2.0*	*-0.9*	*-0.2*
Trade balance	-45.8	-50.0	-49.3	-35.2	-46.2	-38.1	-34.6
Merchandise exports	83.4	83.4	83.1	87.4	82.7	80.0	81.2
Merchandise imports	129.1	133.4	132.4	122.6	128.9	118.1	115.9
Oil imports	34.8	35.3	38.4	32.4	35.4	29.8	31.4
Non-oil imports	94.3	98.2	94.0	90.1	93.5	88.3	84.4
Net services	18.7	20.3	21.7	21.3	20.1	20.4	21.9
Software earnings	18.6	19.3	19.9	19.9	21.0	21.1	21.5
Transfers	17.0	19.3	17.4	16.2	18.0	20.0	18.7
Other invisibles	-5.8	-8.6	-7.6	-6.9	-6.3	-8.8	-7.4
Capital account	**4.8**	**16.6**	**13.8**	**19.2**	**28.2**	**12.3**	**22.4**
Foreign investments	1.4	7.6	5.2	15.9	19.0	10.4	17.8
FDI	9.6	7.4	7.3	6.4	14.2	7.9	10.0
FII	-8.1	0.2	-2.1	9.4	4.8	2.5	7.8
Banking capital	10.1	0.5	4.9	-8.1	3.4	-1.8	-2.3
NRI deposits	3.5	3.3	0.1	3.4	2.8	2.3	0.8
Loans	-4.3	6.9	2.9	10.3	9.6	3.1	3.1
ECBs	-1.3	2.2	2.0	7.5	6.1	3.3	3.2
Others	-8.9	3.0	1.5	0.5	-3.8	0.6	3.7
Errors & Omissions	-0.3	0.6	-0.3	-0.4	0.2	-0.7	0.7
Overall balance (BoP)	**-11.3**	**-1.9**	**-4.3**	**14.2**	**14.0**	**5.1**	**21.6**

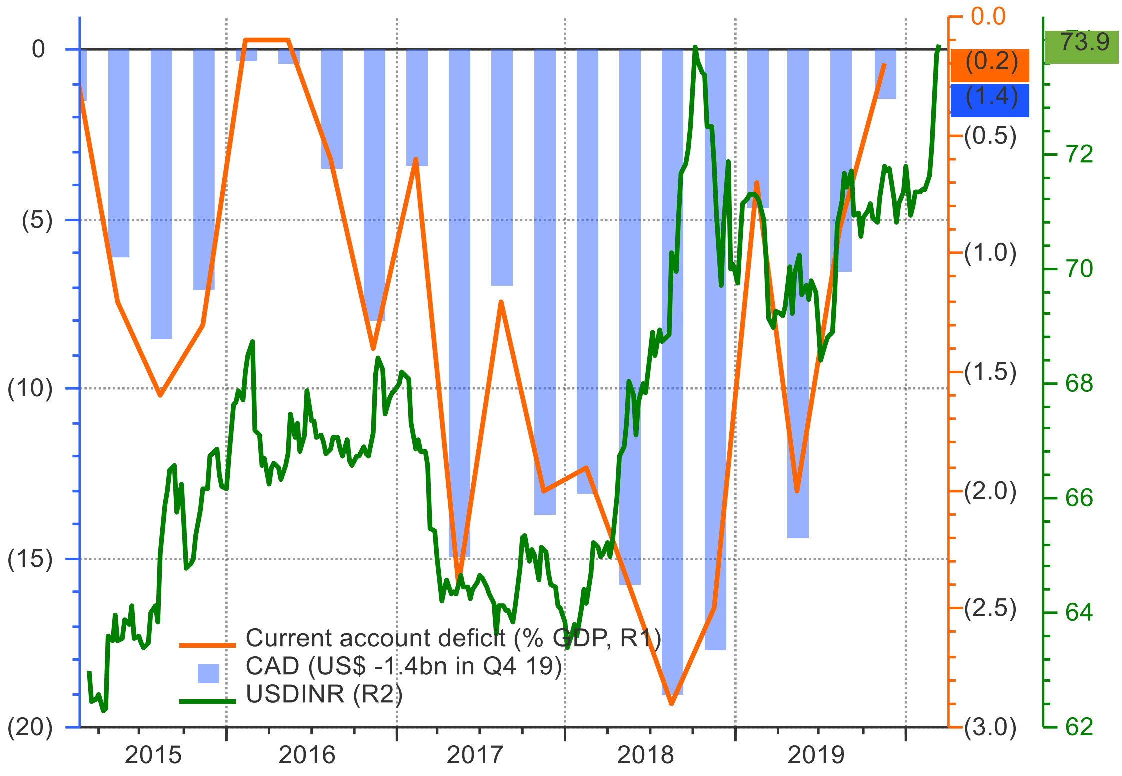
Source: CSO, MOSPI, NSE

Figure 2: Balance of Payments – Annual account

US$ bn	FY16	FY17	FY18	FY19
Current account	**-22.2**	**-15.3**	**-48.7**	**-57.3**
CAD/GDP (%)	*-1.1*	*-0.7*	*-1.8*	*-2.1*
Trade balance	-130.1	-112.4	-160.0	-180.3
Merchandise exports	266.4	280.1	309.0	337.2
Merchandise imports	396.4	392.6	469.0	517.5
Oil imports	82.9	86.9	108.7	140.9
Non-oil imports	313.5	305.6	360.3	376.6
Net services	69.7	67.5	77.6	81.9
Software earnings	71.5	70.1	72.2	77.7
Transfers	62.6	56.0	62.4	69.9
Other invisibles	-24.4	-26.3	-28.7	-28.9
Capital account	**41.1**	**36.5**	**91.4**	**54.4**
Foreign investments	31.9	43.2	52.4	30.1
FDI	36.0	35.6	30.3	30.7
FII	-4.1	7.6	22.1	-0.6
Banking capital	10.6	-16.6	16.2	7.4
NRI deposits	16.1	-12.4	9.7	10.4
Loans	-4.6	2.4	16.7	15.9
ECBs	-4.5	-6.1	-0.2	10.4
Others	3.2	7.5	6.1	1.0
Errors & Omissions	-1.1	0.4	0.9	-0.5
Overall balance (BoP)	**17.9**	**21.6**	**43.6**	**-3.3**

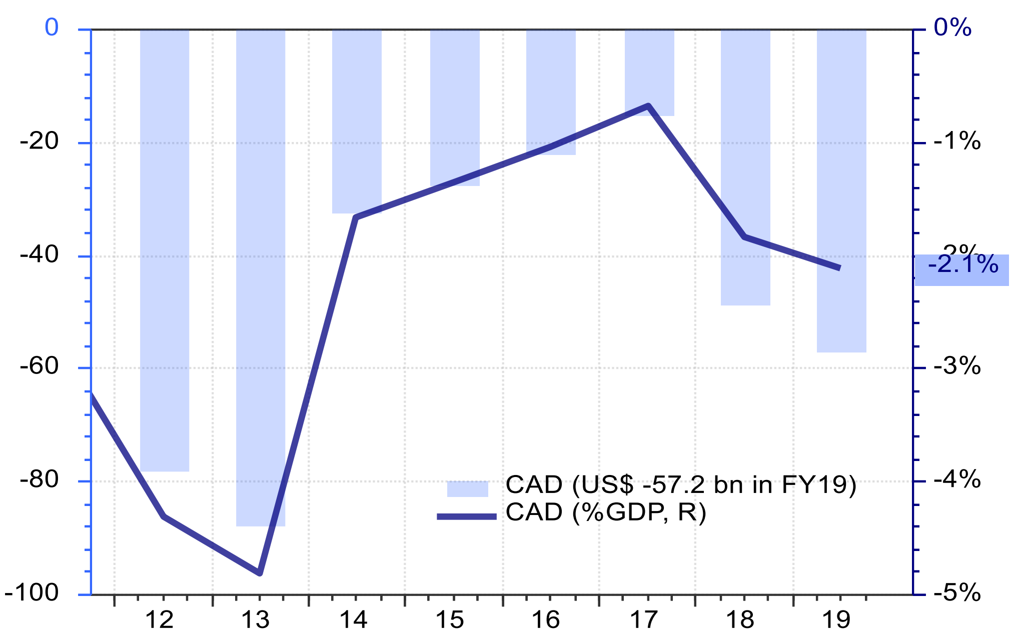
Source: CSO, MOSPI, NSE

Figure 3: Quarterly current account deficit (CAD) contracts sharply in Q3FY20 thanks to lower trade deficit...



Source: Refinitiv Datastream, NSE

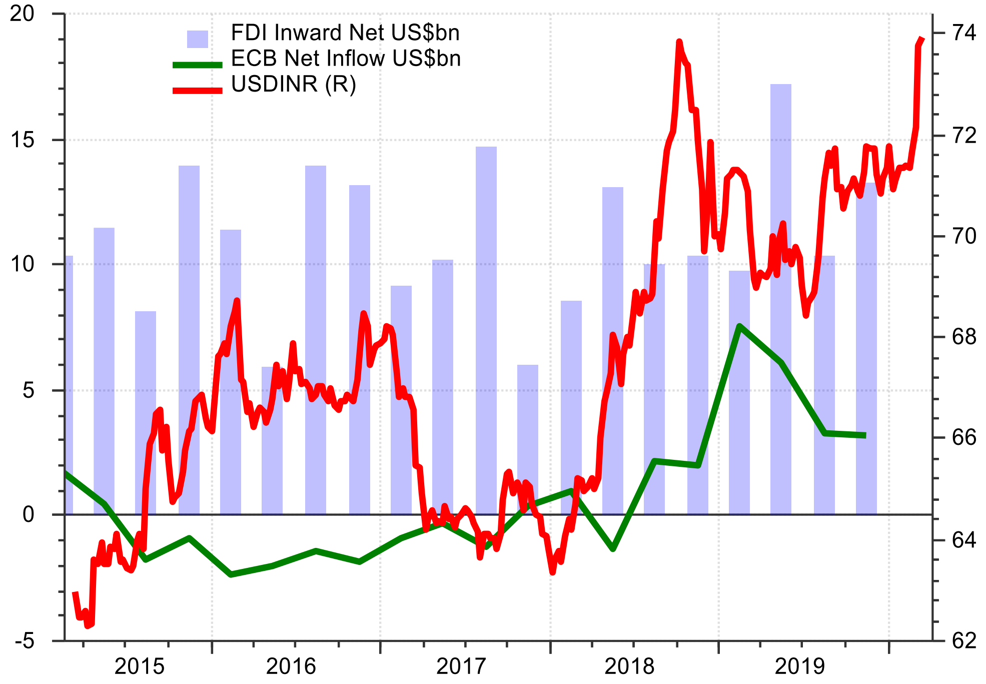
Figure 4: ...and is expected to fall to near-1% of GDP in FY20 from 2.1% in FY19



Source: Refinitiv Datastream, NSE

Figure 5: Foreign direct investments improved, and ECB inflows remained steady in Q3FY20...

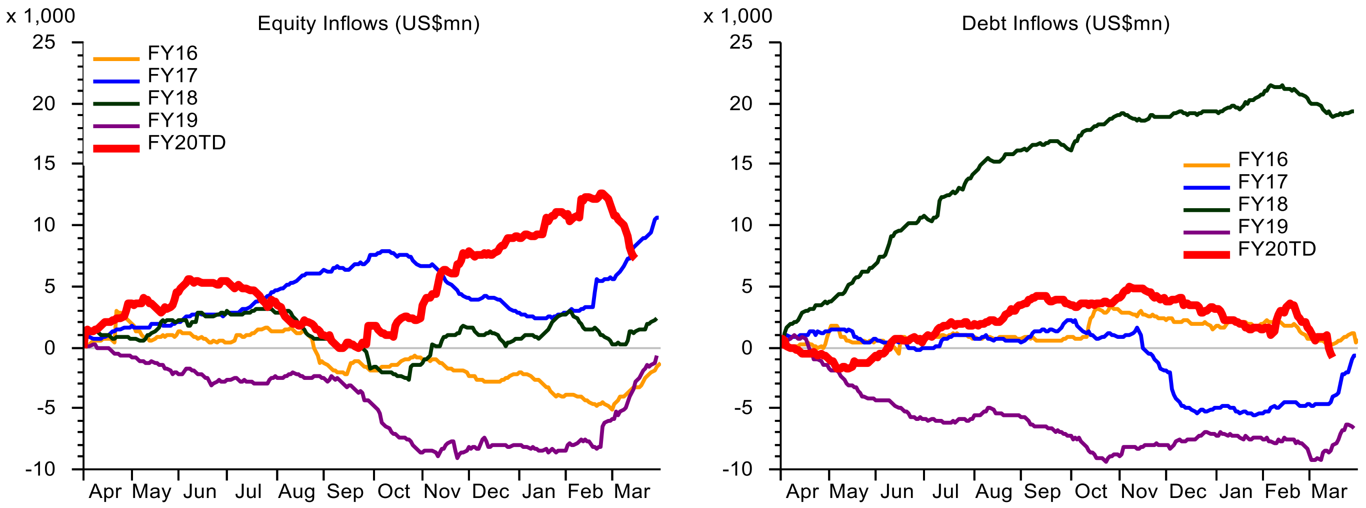
Foreign direct investments into India



Source: Refinitiv Datastream, NSE

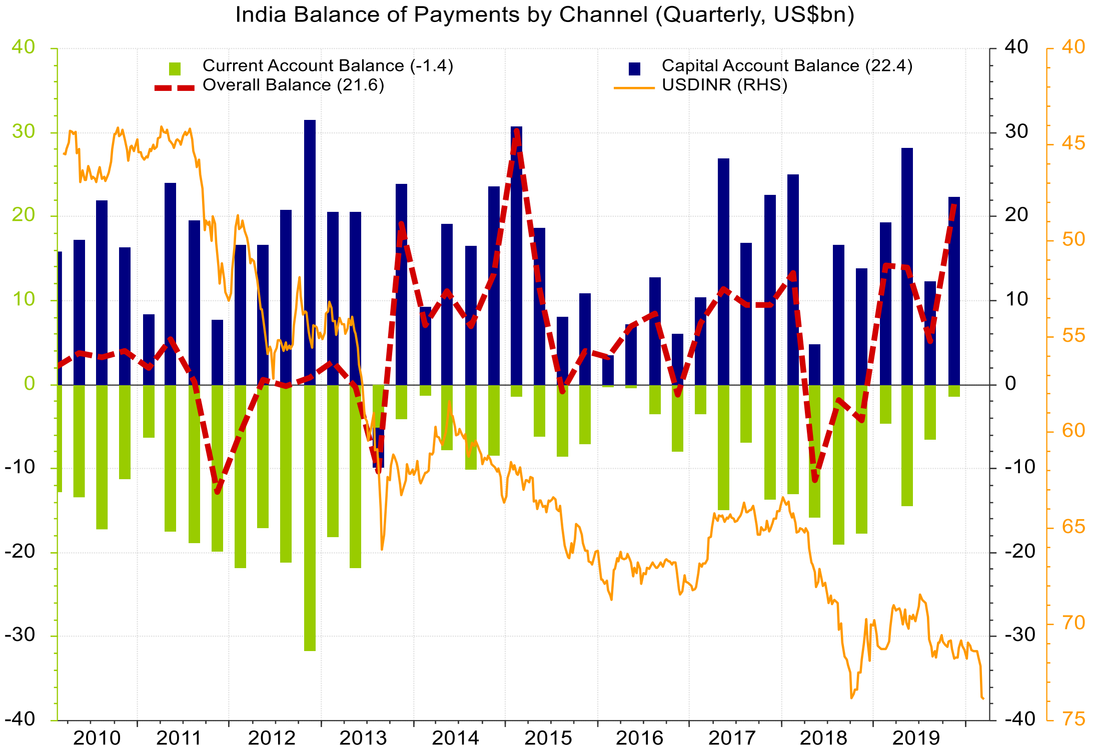
Figure 6: ...and foreign portfolio inflows picked up meaningfully in Q3FY20, even as there have been outflows in this quarter amid rising global risk-off...

Cumulative FII net flows over last five years (FY)



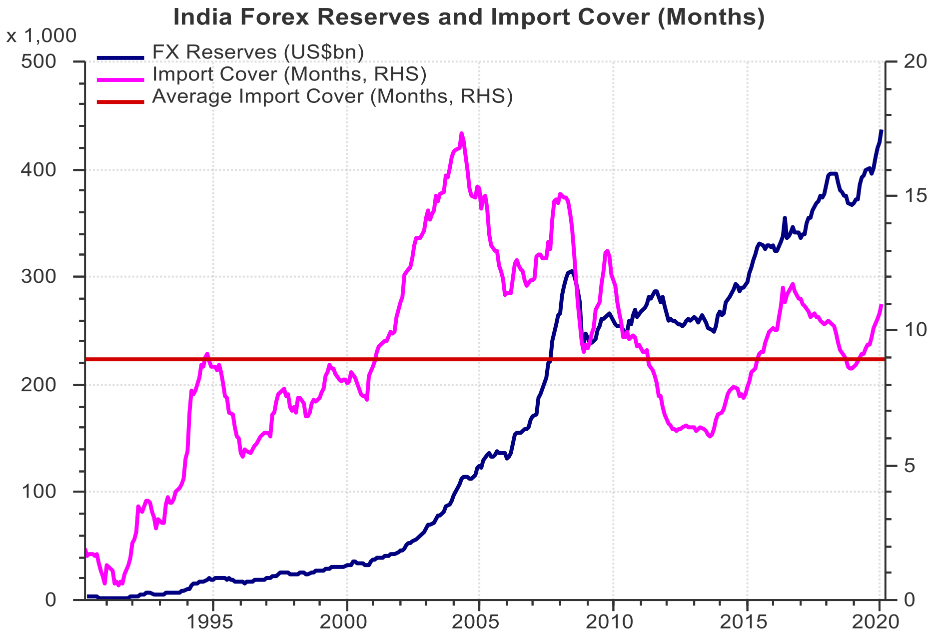
Source: Refinitiv Datastream, NSE

Figure 7: ...resulting in a huge BoP surplus in Q3FY20



Source: Refinitiv Datastream, NSE

Figure 8: Forex reserves are all all-time high levels, leading to a rise in import cover to ~11 months



Source: Refinitiv Datastream, NSE

Economic Policy & Research

Tirthankar Patnaik, PhD	tpatnaik@nse.co.in	+91-22-26598149
Prerna Singhvi, CFA	psinghvi@nse.co.in	+91-22-26598316
Ashiana Salian	asalian@nse.co.in	+91-22-26598163
Runu Bhakta, PhD	rbhakta@nse.co.in	+91-22-26598163