Fourth Quarter CAD narrows, reflecting weak demand conditions

India's Current Account Deficit (CAD) narrowed sharply to US$ 4.6bn or 0.7% of GDP in Q4 FY19 from US$ 17.7bn or 2.7% of GDP in Q3 FY19. This was primarily led by a 15.4% decline in the trade deficit as imports fell reflecting weak demand conditions and lower commodity prices. Lower trade deficit, along with higher FPI and ECB inflows, resulted in a surplus of US$ 14.2bn on the Balance of Payments (BoP) in Q4 FY19—the highest in over 16 quarters. For FY19, the CAD widened to US$ 57bn or 2.1% of GDP—the highest in six years—from FY18's 1.8%. BoP was in deficit of US$ 3.3bn in FY19 vs. a surplus of US$ 43.6bn in FY18.

In the wake of a global growth slowdown and ongoing trade war concerns, exports growth is expected to remain muted, even as moderation in domestic consumption demand and contained crude oil prices are likely to keep imports under check. However, expectation of sustenance of foreign inflows amid dovish stance of global central banks bodes well for financing the CAD, thereby keeping depreciation pressures on the INR under check. Key downside risks include a surge in crude oil prices, renewed geo-political risks and CNY devaluation.

- **Trade deficit at six-quarter low in Q4 FY19**: India's trade deficit contracted to US$ 35bn in Q4 FY19 from US$ 49bn in Q3 FY19 and US$ 41.6bn in Q4 FY18. This was largely led by of a 7.4% QoQ/1% YoY decline in imports. Oil imports fell by 1.9% YoY—the lowest growth in 10 quarters, largely on account of lower crude oil prices. Non-oil non-gold imports also registered a decline of 2.5% YoY, reflecting weak domestic demand conditions. Exports, on the other hand, posted a modest 6.3% YoY growth in the wake of an ongoing trade crisis and declining global demand.
- **CAD narrows sharply in Q4 FY19…**: A significant contraction in merchandise trade deficit led to CAD narrowing to US$ 4.6bn or 0.7% of GDP in Q4 FY19 from 2.7%/1.8% of GDP in Q3 FY19/Q4 FY18. Invisibles remained broadly stable as services exports growth of 5.8% YoY was largely offset by 0.9% YoY decline in remittances owing to lower crude oil prices and a slowdown in global growth.
- **…but widens to six-year high in FY19:** While CAD contracted in Q4 FY19, it was much higher at 2.1% of GDP in FY19 owing to higher crude oil prices and consequently higher oil imports during Apr-Dec 2018, partly offset by relatively stronger exports growth of 12.3% in the first half. The import bill of crude oil and petroleum products grew by a huge 43.5% during first nine months of FY19. In addition, non-oil imports growth was also higher in H1 FY19 (at 9.5% vs. 0.6% in H2 FY19) as domestic demand conditions started weakening in H2.
- **Strong FPI/ECB inflows results in BoP surplus in Q4:** The BoP registered a surplus of US$ 14.4bn in Q4 FY19—the highest in four years—supported by strong FPI and ECB inflows. While FPI inflows surged to US$ 9.4bn vs. outflows of US$ 10.1bn during Apr-Dec 2018, ECB inflows stood at US$ 7.5bn in Q4—the highest ever foreign borrowings in one quarter. This signals that many corporates and/or NBFCs have resorted to overseas borrowings amid tight liquidity in the domestic market. This was partly offset by high banking capital outflows of US$ 8.1bn in Q4 FY19 compared with inflow of US$ 4.9bn in Q3.

  In FY19, BoP was in deficit of US$ 3.3bn compared with a surplus of US$ 43.6bn in FY18, largely attributable to higher oil prices, weak global demand and FPI outflows.
- **Easy global liquidity bodes well for CAD financing and stable INR**: Subdued crude oil prices amid weak global demand environment is likely to keep India's CAD at manageable levels. Additionally, FII inflows are expected to remain supportive in the wake of dovish stance of global central banks. This, in turn, bodes well for CAD financing. In this context, we expect INR to remain broadly stable. Key downside risks include a surge in crude oil prices, renewed geo-political risks and CNY devaluation.

Tables/charts for Balance of Payments data

Figure 1: Balance of Payments – Quarterly account

	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19
Current account	**-13.1**	**-15.8**	**-19.1**	**-17.8**	**-4.6**
CAD/GDP (%)	*-1.8*	*-2.3*	*-2.9*	*-2.7*	*-0.7*
Trade balance	-41.6	-45.8	-50.0	-49.3	-35.2
Merchandise exports	82.2	83.4	83.4	83.1	87.4
Merchandise imports	123.8	129.1	133.4	132.4	122.6
Oil imports	33.0	34.8	35.3	38.5	32.4
Non-oil imports	90.8	94.3	98.1	93.9	90.2
Net services	20.2	18.7	20.3	21.7	21.3
Software earnings	18.6	18.6	19.3	19.9	19.9
Transfers	16.2	17.0	19.3	17.4	16.2
Other invisibles	-7.8	-5.8	-8.6	-7.6	-6.9
Capital account	**25.0**	**4.8**	**16.6**	**13.8**	**19.2**
Foreign investments	8.7	1.4	7.6	5.2	15.9
FDI	6.4	9.6	7.4	7.3	6.4
FII	2.3	-8.1	0.2	-2.1	9.4
Banking capital	4.6	10.1	0.5	4.9	-8.1
ECBs	1.0	-1.3	2.2	2.0	7.5
NRI deposits	4.6	3.5	3.3	0.1	3.4
Others	6.1	-8.9	3.0	1.5	0.5
Errors & Omissions	1.3	-0.3	0.6	-0.3	-0.4
Overall balance (BoP)	**13.2**	**-11.3**	**-1.9**	**-4.3**	**14.2**

Source: CSO, MOSPI, NSE

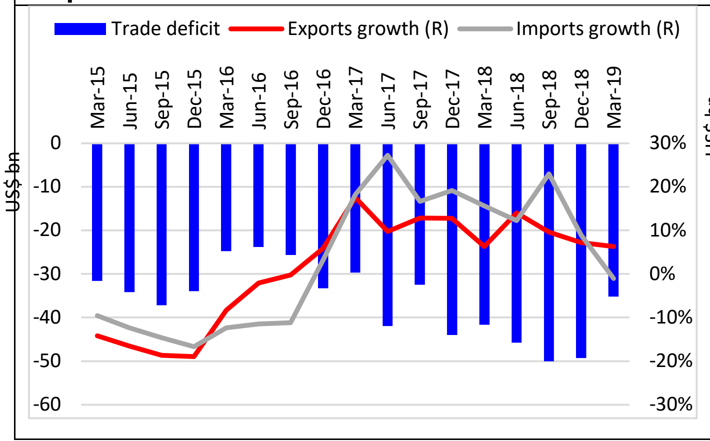
Figure 2: Balance of Payments – Annual account

	FY16	FY17	FY18	FY19
Current account	**-22.1**	**-15.2**	**-48.7**	**-57.2**
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	305.7	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	**41.2**	**36.3**	**91.4**	**54.4**
Foreign investments	31.5	43.2	52.4	28.3
FDI	36.0	35.6	30.3	30.7

FII	-4.5	7.6	22.1	-2.4
Banking capital	10.6	-16.6	16.2	7.4
ECBs	-1.6	6.5	13.9	10.4
NRI deposits	16.1	-12.4	9.7	10.4
Others	-15.4	15.5	-0.8	-2.1
Errors & Omissions	-1.1	0.4	0.9	-0.5
Overall balance (BoP)	**18.0**	**21.4**	**43.6**	**-3.3**

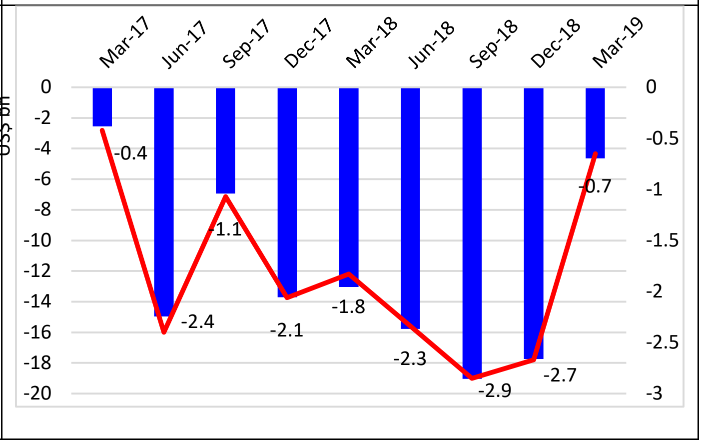
Source: CSO, MOSPI, NSE

Figure 3: Trade deficit declines to six-quarter low in Q4 owing to weak demand and low crude oil prices



Source: CSO, MOSPI, NSE

Figure 4: CAD contracts sharply in Q4 FY19 on lower trade deficit...



Source: CSO, MOSPI, NSE

Figure 5: ...But widens to six-year high in FY19

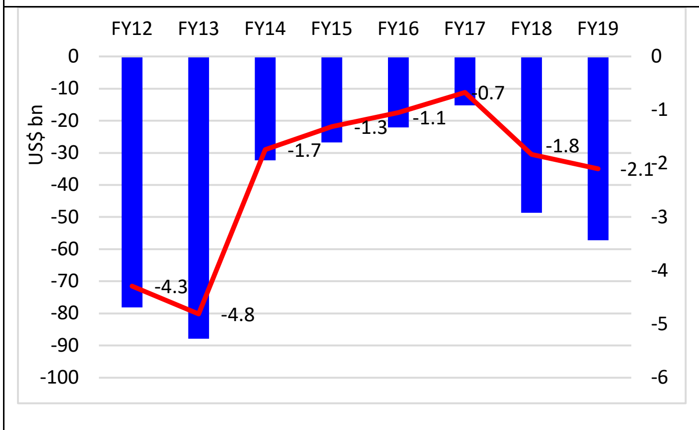
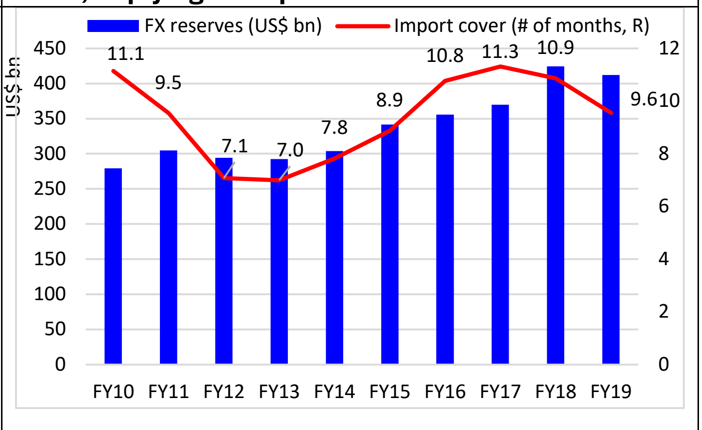


Figure 6: FX reserves decline by US$ 12.5bn in FY19, implying an import cover of 9.6 months



Source: CSO, MOSPI, NSE

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