

CAD contracts in Q2FY20; weak demand to keep it under check in FY20

India's Current Account Deficit (CAD) contracted to US\$ 6.3bn or 0.9% of GDP in Q2FY20 from US\$ 14.2bn/US\$ 19.1bn or 2.0%/2.9% of GDP in Q1FY20/Q2FY19. This was primarily on account of a 17.5% YoY and 23.9% QoQ decline in trade deficit, thanks to a sharp plunge in oil as well as gold imports, even as exports also registered a modest decline amid weak global demand. Services exports expanded modestly led by higher travel-related and software services receipts. However, capital account balance fell to the lowest in over five quarters led by moderation in FDI as well as FII inflows, banking capital outflows and decline in ECB inflows. This, in turn, resulted in the Balance of Payments (BoP) surplus declining from US\$14bn in Q1FY20 to US\$5.1bn in Q2FY20.

Sustained weakness in domestic consumption demand, coupled with benign crude oil prices, is expected to keep imports in check. Exports, on the other hand, are likely to benefit from the recent steps taken by the Government, further supported by stabilising global environment. The monthly merchandise trade performance points to an even lower CAD in Q3FY20, with the full-year number expected at sub-1.5%. Moreover, foreign portfolio inflows, particularly in equities, have improved significantly in the last quarter amid renewed risk-on sentiments. This, along with sustained FDI inflows, bodes well for financing the CAD and eventually the INR. Key downside risks include a surge in crude oil prices on account of geo-political risks and further deterioration in economic growth leading to foreign capital outflows.

- **Trade deficit declines amid weak domestic demand...:** India's trade deficit contracted to US\$ 38.1bn in Q2FY20 from US\$ 46.2bn in Q1FY20 and US\$ 50bn in Q2FY19. This was largely led by a huge 16% QoQ and YoY decline in oil imports. Gold imports also registered a huge 62% QoQ/53% YoY decline as a sharp surge in gold prices adversely affected domestic demand. Non-oil non-gold imports also declined by a modest 0.5% QoQ/6.4% YoY, reflecting weak domestic demand conditions. Exports also fell by 3.3% QoQ/4.1% YoY, thanks to continued global trade war concerns during the quarter and with weak global demand.
- **...Leading to contraction in CAD:** While merchandise exports contracted, services receipts remained steady on a sequential basis, as a meaningful jump in receipts from travel related services and a modest growth in software earnings more than offset a sharp decline in financial services exports. While remittances grew by a strong 10.8% QoQ/3.5% YoY, investment income witnessed a sharp sequential decline, resulting in Invisibles falling by 0.5% QoQ. Lower merchandise trade deficit, coupled with steady Invisibles, led to a contraction in CAD from US\$ 14.2bn/US\$ 19.1bn or 2.0%/2.9% of GDP in Q1FY20/Q2FY19 to US\$ 6.3bn or 0.9% of GDP in Q2FY20
- **Moderation in foreign inflows leads to narrowing of BoP surplus in Q2:** Despite a contraction in CAD, the BoP surplus declined from US\$ 14.0bn in Q1FY20 to US\$ 5.1bn in Q2FY20, led by a decline in foreign inflows across channels. While foreign direct investments fell from an 11-quarter high of US\$ 13.8bn in Q1FY20 to US\$ 7.4bn in Q2FY20, foreign portfolio inflows also moderated to US\$ 2.5bn in Q2FY20 on account of negative sentiments around the levy of enhanced surcharge on long and short-term capital gains, announced in the Union Budget in July 2019 but later rolled back in late August. After remaining quite strong over the previous two quarters, ECB inflows also declined in Q2FY20 to US\$ 3.4bn, thanks to a sharp surplus domestic systemic liquidity.
- **CAD to remain low; renewed foreign inflows bodes well for the INR:** With global trade concerns abating and economic environment stabilising, exports are expected to gradually pick-up, with recent measures taken by the Government providing further support. Imports on the other hand are expected to remain tepid in the wake of a sustained weakness in domestic demand and subdued crude oil prices. The monthly merchandise trade performance, coupled with expectations of resilient services receipts and steady remittances, points to a further decline in CAD in Q3FY20, with the full-year figure now expected to fall to sub-1.5%. Moreover, with recent reforms announced by the Government, including the cut in corporate tax rates, adding to India's attractiveness as an investment destination, FDI inflows are expected to remain strong. FPI inflows have also picked up meaningfully in Q3FY20, facilitated by renewed global risk-on sentiments. This, in turn, bodes well for CAD financing and the INR. Key downside risks include a surge in crude oil prices on account of renewed geo-political risks and further deterioration in economic growth leading to foreign capital outflows.

Tables/charts for Balance of Payments data

Figure 1: Balance of Payments – Quarterly account

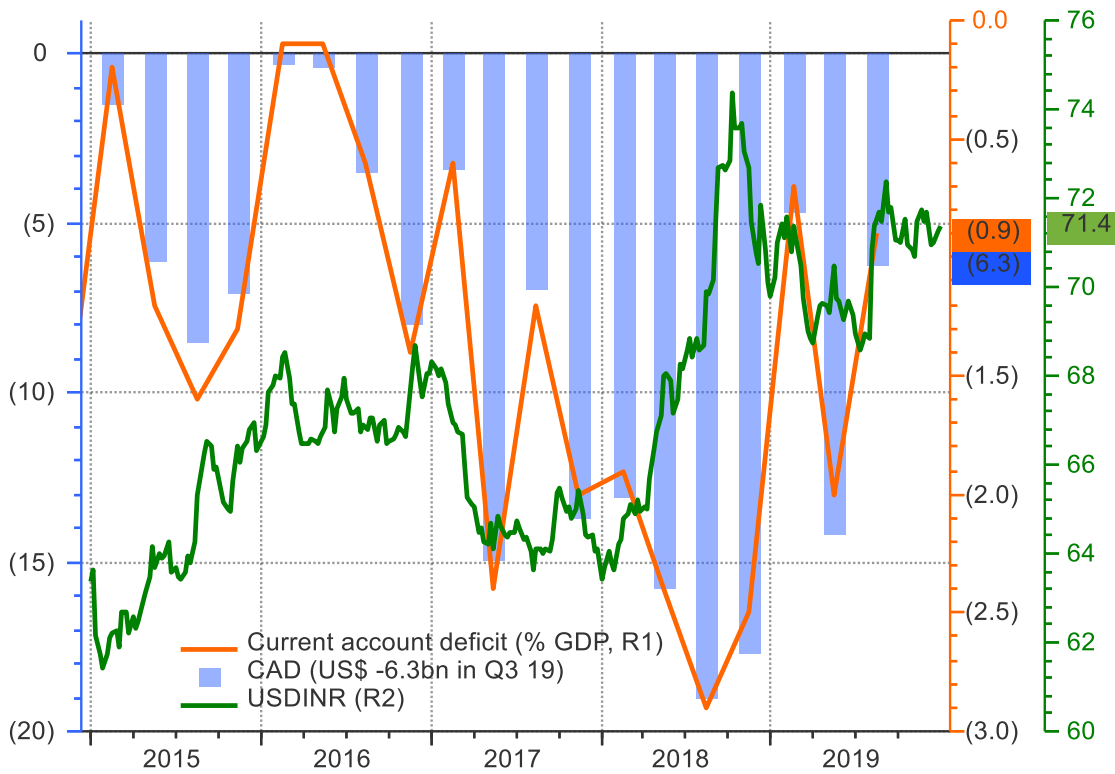
US\$ bn	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20
Current account	-15.8	-19.1	-17.8	-4.6	-14.2	-6.3
<i>CAD/GDP (%)</i>	-2.3	-2.9	-2.7	-0.7	-2.0	-0.9
Trade balance	-45.8	-50.0	-49.3	-35.2	-46.2	-38.1
Merchandise exports	83.4	83.4	83.1	87.4	82.7	80.0
Merchandise imports	129.1	133.4	132.4	122.6	128.9	118.1
Oil imports	34.8	35.3	38.4	32.4	35.4	29.6
Non-oil imports	94.3	98.2	94.0	90.1	93.5	88.5
Net services	18.7	20.3	21.7	21.3	20.1	20.4
Software earnings	18.6	19.3	19.9	19.9	21.0	21.1
Transfers	17.0	19.3	17.4	16.2	18.0	20.0
Other invisibles	-5.8	-8.6	-7.6	-6.9	-6.1	-8.6
Capital account	4.8	16.6	13.8	19.2	27.9	12.1
Foreign investments	1.4	7.6	5.2	15.9	18.7	9.9
FDI	9.6	7.4	7.3	6.4	13.8	7.4
FII	-8.1	0.2	-2.1	9.4	4.8	2.5
Banking capital	10.1	0.5	4.9	-8.1	3.4	-1.8
NRI deposits	3.5	3.3	0.1	3.4	2.8	2.3
Loans	-4.3	6.9	2.9	10.3	9.6	3.2
ECBs	-1.3	2.2	2.0	7.5	6.1	3.4
Others	-8.9	3.0	1.5	0.5	-3.1	-1.7
Errors & Omissions	-0.3	0.6	-0.3	-0.4	0.3	-0.7
Overall balance (BoP)	-11.3	-1.9	-4.3	14.2	14.0	5.1

Source: CSO, MOSPI, NSE

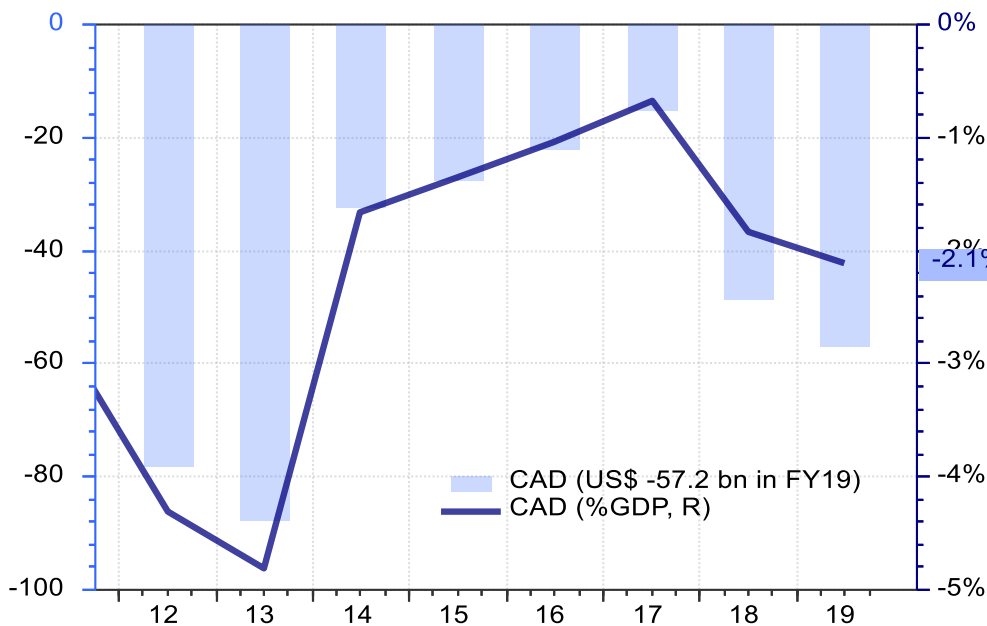
Figure 2: Balance of Payments – Annual account

US\$ bn	FY16	FY17	FY18	FY19
Current account	-22.2	-15.3	-48.7	-57.3
<i>CAD/GDP (%)</i>	-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

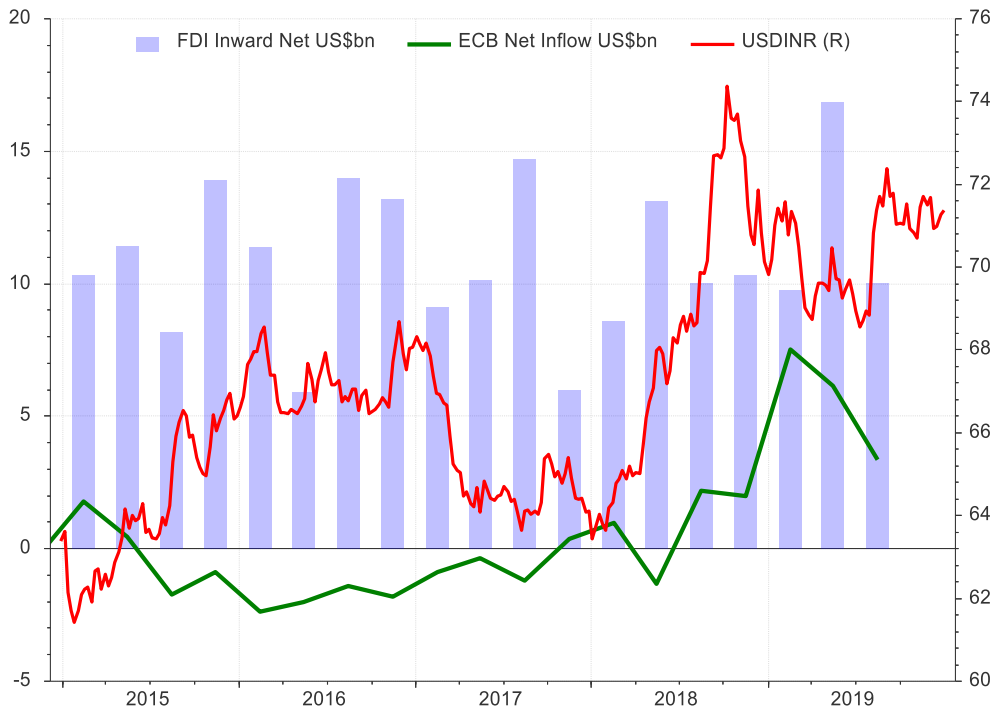
Figure 3: Quarterly current account deficit (CAD) contracts in Q2FY20 thanks to lower trade deficit...


Source: Refinitiv Datastream, NSE

Figure 4: ...and is expected to fall to sub-1.5% of GDP in FY20 from 2.1% in FY19
India CAD as % of GDP


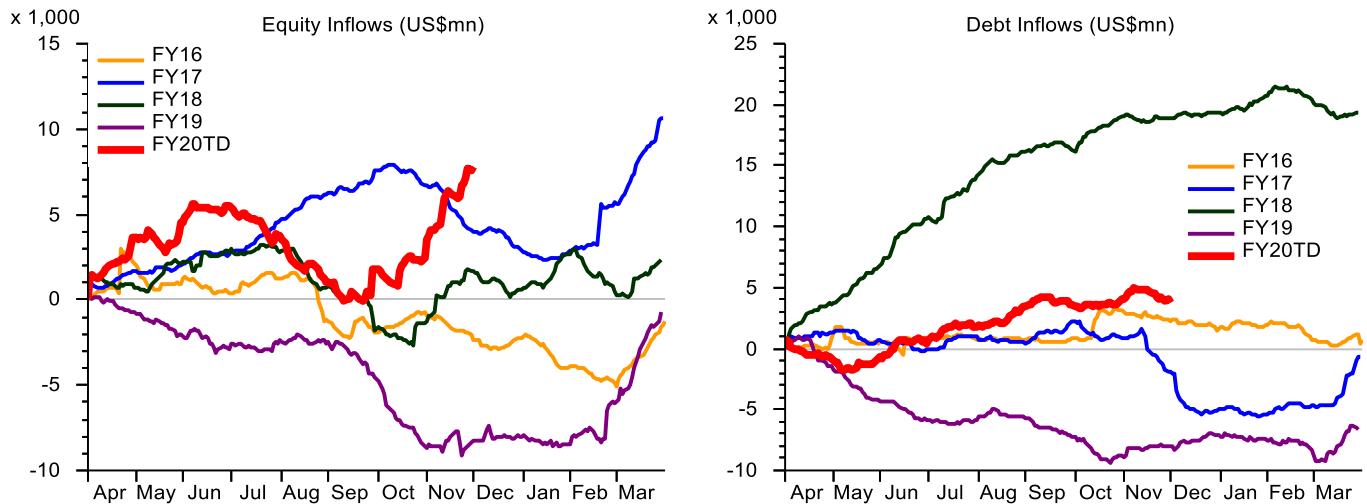
Source: Refinitiv Datastream, NSE

Figure 5: FDI as well as ECB inflows moderated in Q2FY20...
Foreign direct investments into India



Source: Refinitiv Datastream, NSE

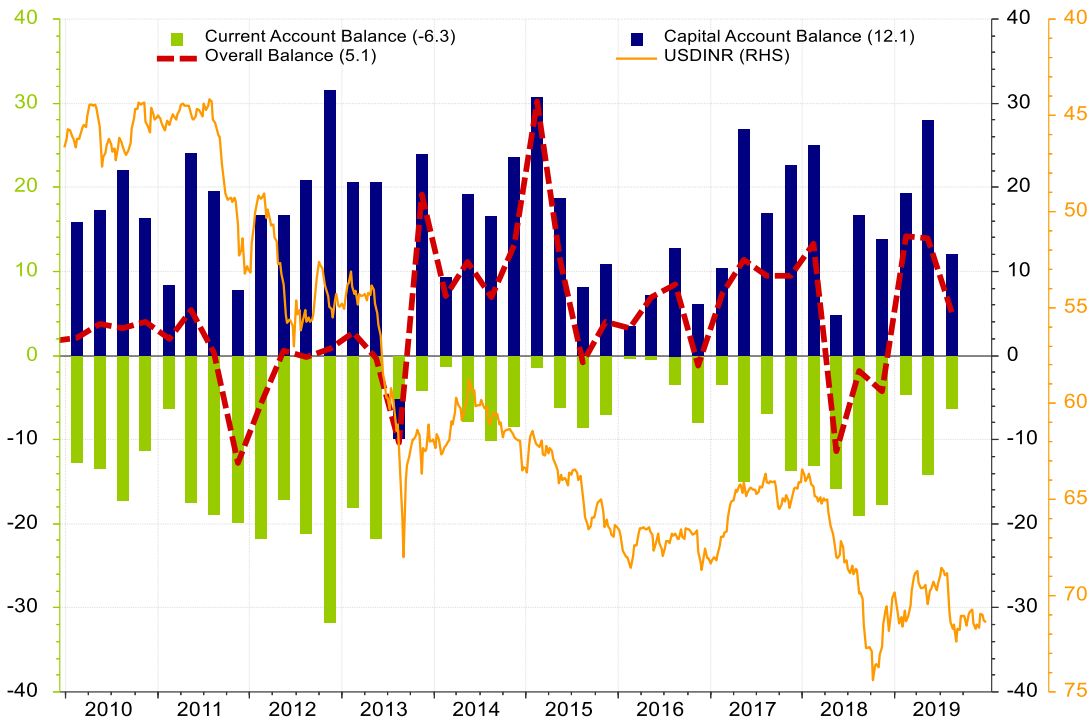
Figure 6: ...and so did foreign portfolio inflows even as they have picked up meaningfully in Q3FY20...
Cumulative FII net flows over last five years (FY)



Source: Refinitiv Datastream, NSE

Figure 7: ...resulting in a decline in BoP surplus in Q2FY20

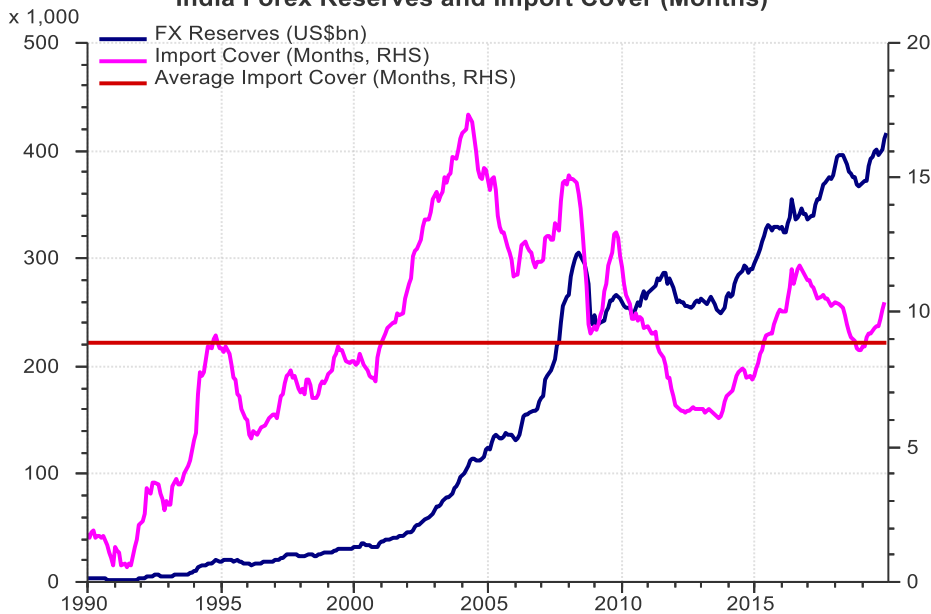
India Balance of Payments by Channel (Quarterly, US\$bn)



Source: Refinitiv Datastream, NSE

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

India Forex Reserves and Import Cover (Months)



Source: Refinitiv Datastream, NSE

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