NSE
Macro Review
October 1, 2019 | Vol. 1, Issue. 16

CAD widens in Q1FY20; weak demand to keep it under check in FY20

India's Current Account Deficit (CAD) expanded to US$14.3bn in Q1 FY20 or 2.0% of GDP from US$4.6bn or 0.7% of GDP in Q4 FY19. This was primarily on account of a 31% QoQ increase in trade deficit as imports rose led by a sharp surge in gold imports, while exports fell amid weak global demand. Services exports also moderated sequentially led by lower receipts from travel related services, partly offset by higher software service receipts. However, strong FDI inflows, lower banking capital outflows and robust ECB inflows resulted in a surplus of US$ 14.0bn on the Balance of Payments in Q1 FY20, broadly similar to that seen in Q4 FY19.

In the wake of a global growth slowdown and ongoing trade war concerns, export growth is expected to remain muted, even as continued moderation in domestic consumption demand and lower crude oil prices are likely to keep imports under check. The monthly merchandise trade performance points to a CAD of near-1.5% of GDP in Q2 FY20. Moreover, FDI inflows are expected to remain strong, further supported by recent cut in corporate tax rates, making India an attractive investment destination. This, in turn, 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 CNY devaluation.

- **Trade deficit widens sequentially…**: India's trade deficit widened to US$46.2bn in Q1 FY20 from US$ 35.2bn in Q4 FY19 and US$ 45.8bn in Q1 FY19. This was largely led by of a 5.2% QoQ increase in imports, led by an 8.7%/39.9% QoQ increase in oil/gold imports, even as non-oil non-gold imports grew by a modest 2.6% QoQ, signalling weak domestic demand conditions. Exports, on the other hand, declined by 5.3% QoQ/-0.8% YoY in the wake of ongoing trade crisis and declining global demand.
- **…Leading to expansion in CAD:** While merchandise trade deficit widened, services receipts also came off on a sequential basis as increase in software earnings (+5.7% QoQ/12.9% YoY) was more than offset by lower receipts from travel related services. However, a strong 11.7% QoQ/5.9% YoY increase in remittances led to Invisibles growing at a modest 4.3% QoQ/6.4% YoY. Lower merchandise and services exports led to widening of CAD on a sequential basis to US$14.3bn in Q1 FY20 or 2.0% of GDP from US$4.6bn or 0.7% of GDP, but lower than the US$15.8bn or 2.3% of GDP in the same period last year.
- **Strong FDI/ECB inflows result in BoP surplus in Q1:** Despite an expansion in CAD, the BoP registered a surplus of US$ 14.0bn in Q1 FY20—similar to the level seen in the previous quarter—supported by strong FDI and ECB inflows as well as lower banking capital outflows. While FDI inflows surged to 11-quarter high of US$13.9bn in Q1 FY20, ECB inflows also remained robust at US$6.4bn. This signals that many corporates and/or NBFCs have resorted to overseas borrowings amid tight liquidity in the domestic market. FPI inflows moderated to US$4.8bn from an eight-quarter high of US$9.4bn in Q4 FY19 amid global risk-off sentiments leading to flight of capital to safe havens including gold. This was partly offset by high banking capital outflows of US$ 8.1bn in Q4 FY19 compared with inflow of US$ 4.9bn in Q3.
- **Subdued domestic demand to keep CAD under check**: The monthly merchandise trade performance points to a CAD of near-1.5% of GDP in Q2 FY20. While the Government has taken several steps over the last one month to boost exports growth, weak global demand environment is expected to continue to put pressure on India's export bill. Imports, on the other hand, are expected to remain under the overhang of a domestic slowdown and subdued crude oil prices. This, along with resilient services receipts and steady remittances, is likely to result in a moderation in CAD in FY20 from 2.1% in FY19. 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, even as FPI inflows may moderate amid weak global investor sentiments. This, in turn, bodes well for CAD financing and eventually the INR. Key downside risks include a surge in crude oil prices on account of renewed geo-political risks and CNY devaluation.

Tables/charts for Balance of Payments data

Figure 1: Balance of Payments – Quarterly account

US$ bn	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20
Current account	**-13.1**	**-15.8**	**-19.1**	**-17.8**	**-4.6**	**-14.3**
CAD/GDP (%)	*-1.8*	*-2.3*	*-2.9*	*-2.7*	*-0.7*	*-2.0%*
Trade balance	-41.6	-45.8	-50	-49.3	-35.2	-46.2
Merchandise exports	82.2	83.4	83.4	83.1	87.4	82.7
Merchandise imports	123.8	129.1	133.4	132.4	122.6	128.9
Oil imports	33	34.8	35.3	38.5	32.4	35.22
Non-oil imports	90.8	94.3	98.1	93.9	90.2	93.7
Net services	20.2	18.7	20.3	21.7	21.3	20.0
Software earnings	18.6	18.6	19.3	19.9	19.9	21.0
Transfers	16.2	17	19.3	17.4	16.2	18.0
Other invisibles	-7.8	-5.8	-8.6	-7.6	-6.9	-6.1
Capital account	**25**	**4.8**	**16.6**	**13.8**	**19.2**	**27.9**
Foreign investments	8.7	1.4	7.6	5.2	15.9	18.7
FDI	6.4	9.6	7.4	7.3	6.4	13.9
FII	2.3	-8.1	0.2	-2.1	9.4	4.8
Banking capital	4.6	10.1	0.5	4.9	-8.1	-3.9
NRI deposits	4.6	3.5	3.3	0.1	3.4	2.8
Loans	7.0	-4.3	6.9	2.9	10.3	9.9
ECBs	1.0	-1.3	2.2	2.0	7.5	6.4
Others	4.7	-2.4	1.5	0.7	1.2	3.2
Errors & Omissions	1.3	-0.3	0.6	-0.3	-0.4	0.4
Overall balance (BoP)	**13.2**	**-11.3**	**-1.9**	**-4.3**	**14.2**	**14.0**

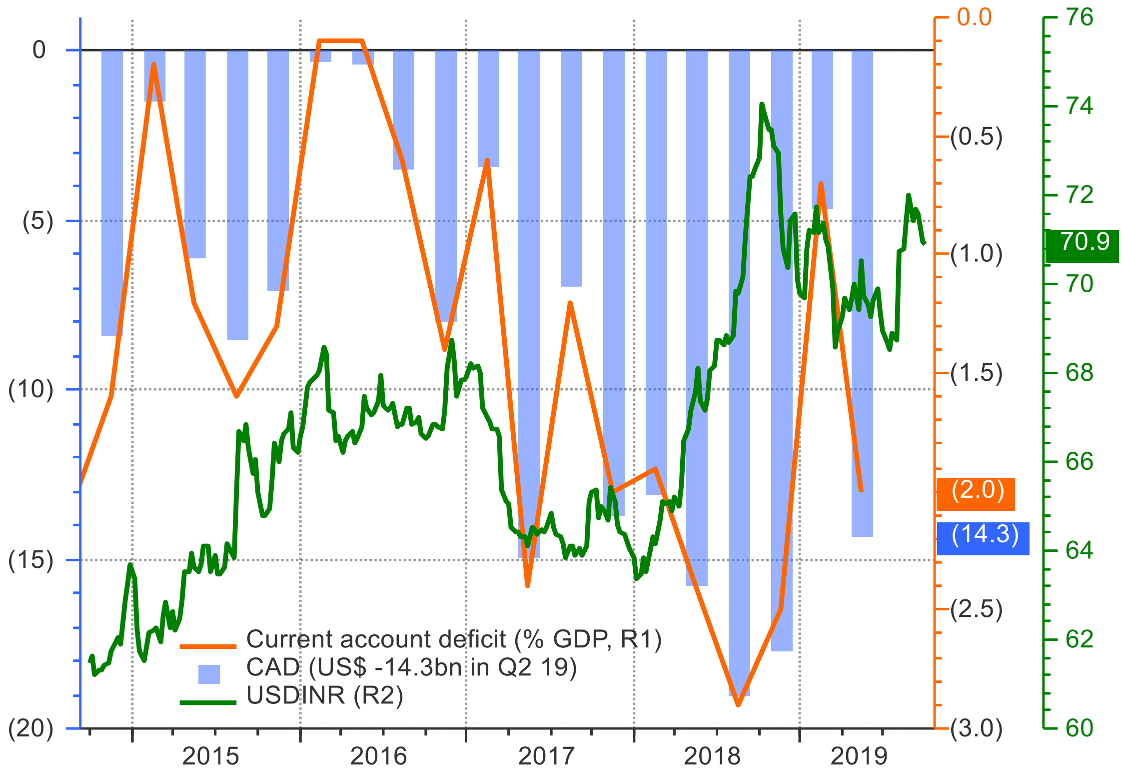
Source: CSO, MOSPI, NSE

Figure 2: Balance of Payments – Annual account

US$ bn	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
Errors & Omissions	-1.1	0.4	0.9	-0.5
Overall balance (BoP)	**18.0**	**21.4**	**43.6**	**-3.3**

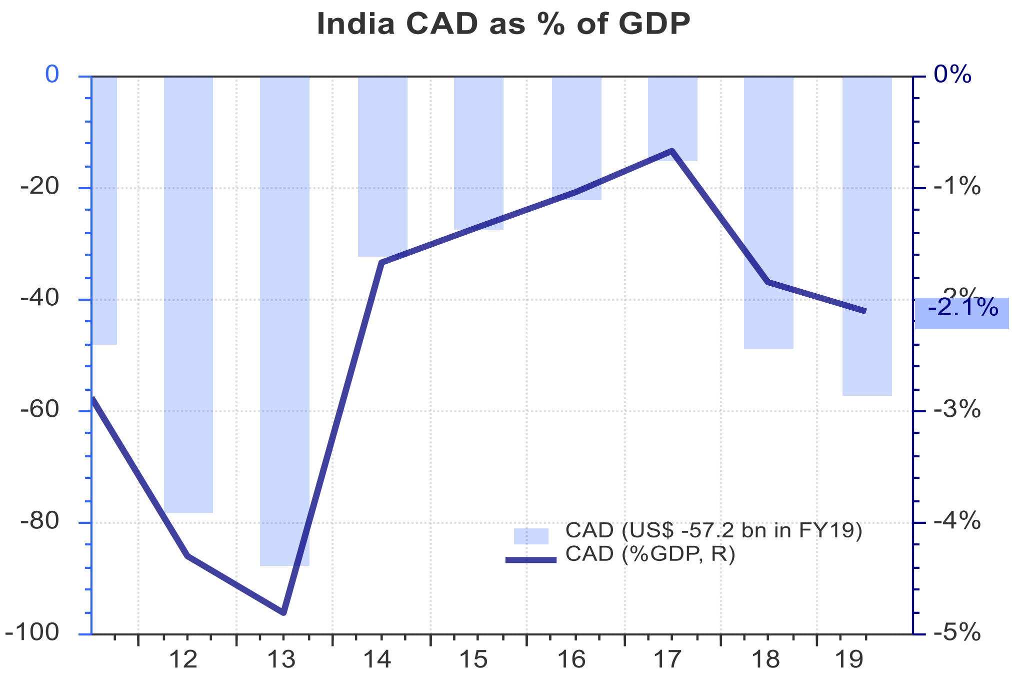
Source: CSO, MOSPI, NSE

Figure 3: Quarterly current account deficit (CAD) expands in Q1FY20



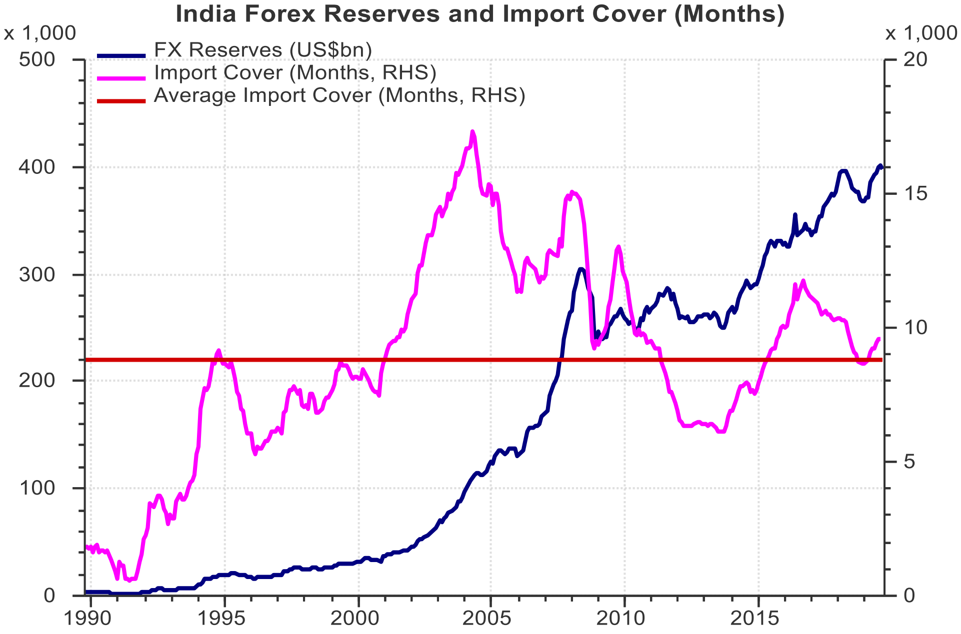
Source: Refinitiv Datastream, NSE

Figure 4: CAD widened to a six-year high in FY19 but expected to moderate in FY20



Source: Thomson Reuters, NSE

Figure 5: India forex reserves and import cover trend



Source: Refinitiv Datastream, NSE

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