ICRA

EXTERNAL SECTOR OUTLOOK

Current account deficit narrowed to 2.0% of GDP in Q1 FY2020, driven by a higher surplus of services and secondary income

October 2019

Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Soumyaditya Pal
+91 124 4545 848
soumyaditya.pal@icraindia.com

Medha Sinha
+91 124 4545 399
medha.sinha@icraindia.com

HIGHLIGHTS

- *India's current account deficit narrowed to US$14.3 billion (2.0% of GDP) in Q1 FY2020 from US$15.8 billion (2.3% of GDP) in Q1 FY2019 and printed lower than our forecast of US$16-17 billion. Along seasonal lines, the current account deficit widened substantially relative to the level recorded in Q4 FY2019 (US$4.6 billion; 0.7% of GDP).*

- *The year-on-year (YoY) decline in the current account deficit was driven by an improvement in secondary income inflows and a rise in services trade surplus, the impact of which was partly counteracted by a wider merchandise trade deficit and higher outflow of primary income. Lower crude oil prices helped in restraining the size of the current account deficit in Q1 FY2020, despite a sharp increase in gold imports following the dip in gold prices during that quarter.*

- *India's foreign exchange reserves including valuation changes rose by US$17.0 billion (increase of US$14.0 billion excluding valuation effects) in Q1 FY2020, in contrast to the considerable decline of US$18.8 billion in Q1 FY2019 (fall of US$11.3 billion excluding valuation effects).*

- *Based on the available trends for July-August 2019, we expect the current account deficit to decline substantially to US$10-11 billion in Q2 FY2020 from US$ 19.0 billion in Q2 FY2019, on the back of moderate crude oil prices, a weak appetite for gold imports at current prices as well as subdued domestic demand.*

- *Further, the current account deficit is forecast by ICRA to ease appreciably to ~US$51-53 billion (1.8% of GDP) in FY2020 from US$57.2 billion in FY2019 (2.1% of GDP), unless crude oil prices record a sustained increase or domestic investment and consumption demand display a revival.*

OVERVIEW

Balance of Payments for Q1 FY2020: India's current account deficit narrowed to US$14.3 billion (2.0% of GDP) in Q1 FY2020 from US$15.8 billion (2.3% of GDP) in Q1 FY2019, and printed lower than our forecast (US$16-17 billion). While the current account deficit widened in Q1 FY2020 in comparison to the US$4.6 billion (0.7% of GDP) recorded in Q4 FY2019 (refer Exhibit 1 and 2), this was largely along seasonal lines.

The YoY fall in the current account deficit was driven by an improvement in the net secondary income inflows and the services trade surplus, the impact of which was partly counteracted by a small increase in the merchandise trade deficit and a steeper net outflow of primary income.

The merchandise trade deficit (on a BoP basis) widened mildly to US$46.2 billion in Q1 FY2020 from US$45.8 billion in Q1 FY2019. Merchandise exports declined by 0.8% to US$82.7 billion in Q1 FY2020 from US$83.4 billion in Q1 FY2019, whereas merchandise imports contracted by a narrower 0.2% to US$128.9 billion from US$129.1 billion, respectively. Net oil imports rose only marginally to US$23.4 billion in Q1 FY2020 from US$23.0 billion in Q1 FY2019, dampened by the decline of 6.9% in oil prices between these two quarters. In contrast, gold imports rose by a sharp 35.6% to US$11.4 billion in Q1 FY2020 from US$8.4 billion in Q1 FY2019, with the fall in gold prices in US$ terms boosting demand during that period.

Moreover, the outflow of primary income rose to US$6.1 billion in Q1 FY2020 from to US$5.8 billion in Q1 FY2019. In contrast, the services trade surplus improved to US$20.0 billion in Q1 FY2020 from US$18.7 billion in Q1 FY2019, led by higher net earnings related to telecom, computer and information services. Additionally, the net inflow of secondary income rose to US$18.0 billion in Q1 FY2020 from US$17.1 billion in Q1 FY2019, supported by an uptick in worker remittances to US$13.4 billion from US$11.5 billion, respectively.

India's capital and financial account balance fell to US$13.9 billion in Q1 FY2020, from US$16.1 billion in Q1 FY2019 but rose from US$5.0 billion in Q4 FY2019. Notably, there was a deterioration in the magnitude of net inflows in Q1 FY2020 relative to Q1 FY2019 in the case of NRI deposits (to +US$2.8 billion from +US$3.5 billion), and loans (to +US$1.6 billion from +US$6.3 billion). In contrast, foreign direct investment (to +US$13.9 billion from +US$9.6 billion), portfolio investment (to +US$4.8 billion from -US$8.1 billion), and trade credit and advances (to +US$2.0 billion from -US$3.5 billion) recorded an improvement in Q1 FY2020 relative to Q1 FY2019.

Significantly, foreign exchange reserves rose by US$17.0 billion (including changes in valuation) during Q1 FY2020, in contrast to the substantial decline of US$18.8 billion in Q1 FY2019. Excluding valuation effects, reserve assets increased by US$14.0 billion in Q1 FY2020, in contrast to the fall of US$11.3 billion during Q1 FY2019.

Exhibit 1: Trends in India's Balance of Payments

Figures in US$ billion	Q1 FY2019	Q2 FY2019	Q3 FY2019	Q4 FY2019	Q1 FY2020	FY2018	FY2019	FY2020 ICRA exp.
Merchandise Exports	83.4	83.4	83.1	87.4	82.7	309.0	337.3	*340-345*
Merchandise Imports	129.1	133.4	132.4	122.6	128.9	469.0	517.5	*520-525*
Merchandise Trade Balance	**-45.8**	**-50.0**	**-49.3**	**-35.2**	**-46.2**	**-160.0**	**-180.3**	***-178 to -182***
Net Services	18.7	20.3	21.7	21.3	20.0	77.6	81.9	*84-86*
Primary Income	-5.8	-8.6	-7.6	-6.9	-6.1	-28.7	-28.9	*-28 to -30*
Secondary Income	17.1	19.4	17.4	16.2	18.0	62.5	70.0	*72 to 74*
Current Account Balance	**-15.8**	**-19.0**	**-17.7**	**-4.6**	**-14.3**	**-48.7**	**-57.2**	***-51 to -53***
Percentage of GDP	*-2.3%*	*-2.9%*	*-2.7%*	*-0.7%*	-2.0%	*-1.9%*	*-2.1%*	*-1.8%*

Source: RBI; ICRA research

Exhibit 2: Trends in Merchandise Trade Deficit and Current Account Deficit

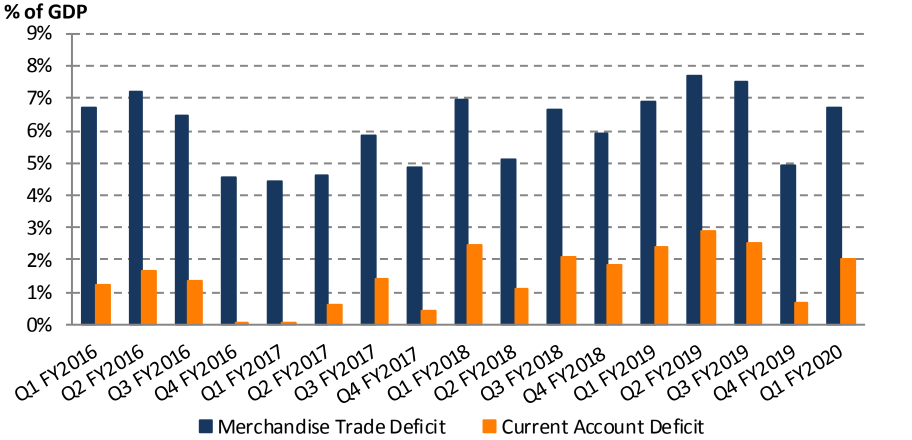
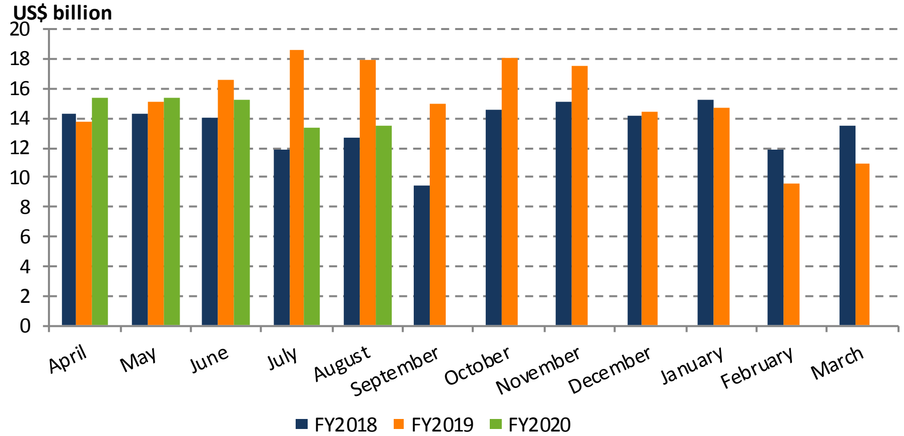


Exhibit 3: Monthly Trends in Merchandise Trade Deficit



Source: RBI, Ministry of Commerce and Industry, GoI; ICRA research

Exhibit 4: Monthly Trends in Merchandise Exports

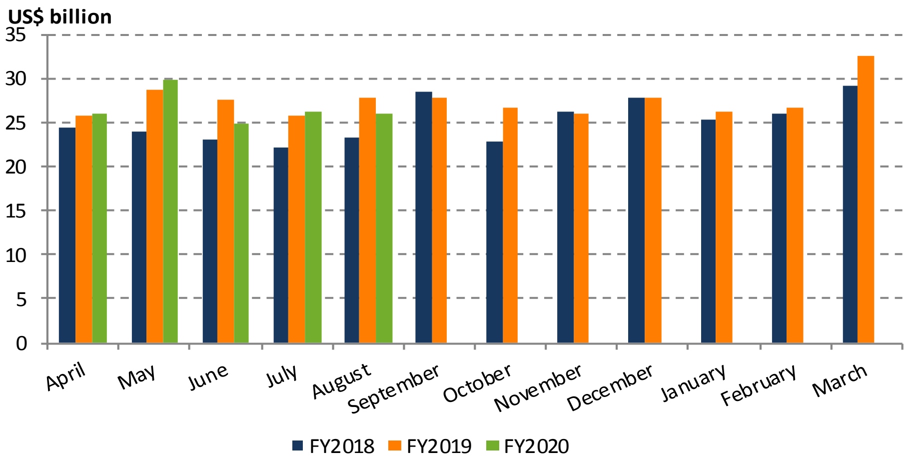
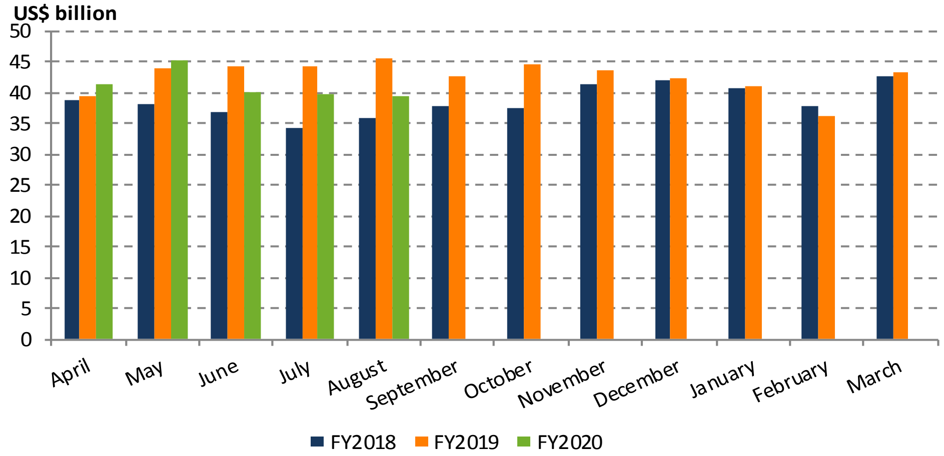


Exhibit 5: Monthly Trends in Merchandise Imports



Source: Ministry of Commerce and Industry, GoI; ICRA research

Trends for July-August 2019: The initial data released by the Ministry of Commerce and Industry indicated that merchandise exports declined by 2.1% to US$52.5 billion in July-August 2019 from US$53.6 billion in July-August 2018 (refer Exhibit 4), led by the 1.1% dip in non-oil exports (to US$45.5 billion from US$46.0 billion) and 7.8% contraction in oil exports (to US$7.0 billion from US$7.6 billion). The US$0.5 billion YoY decline in non-oil exports in July-August 2019 was driven by sectors such as engineering goods (-US$0.8 billion; -5.8%), cotton yarns, fabrics and handloom products (-US$0.3 billion; -16.7%), and gems and jewellery (-US$0.3 billion; -5.1%). However, there was a healthy 48.6% uptick in the exports of electronic goods to US$2.0 billion in July-August 2019 from US$1.4 billion in July-August 2018, which benefitted from the measures introduced by the government to support domestic production.

Merchandise imports recorded a significant contraction of 12.0% to US$79.3 billion in July-August 2019 from US$90.1 billion in July-August 2018 (refer Exhibit 5). The downtick in oil prices led to oil imports contracting by 15.6% to US$20.5 billion in July-August 2019 from US$24.3 billion in July-August 2018. Moreover, non-oil non-gold imports declined by 5.8% in July-August 2019, led by consumer sectors such as electronic goods (-3.0%) and pearls, precious and semi-precious stones (-26.5%), and industrial inputs such as organic and inorganic chemicals (-11.1%), coal (-12.8%), electrical and non-electrical machinery (-4.1%) and transport equipment (-30.8%). Additionally, gold imports contracted by a sharp 53.4% to US$3.1 billion in July-August 2019 from US$6.6 billion in July August 2018, with a shrinkage in demand following the increase in global gold prices, along with a hike in import duty on gold announced in the Union Budget for FY2020 that was presented in July 2019.

Based on these trends, the merchandise trade deficit fell considerably to US$26.9 billion in July-August 2019 from US$36.6 billion in July-August 2018 (refer Exhibit 3), according to the data released by the Ministry of Commerce.

Expectations for Q2 FY2020: Based on the available trends for July-August 2019, we expect the current account deficit to decline substantially to US$10-11 billion in Q2 FY2020 from US$19.0 billion in Q2 FY2019, on the back of moderate crude oil prices, a weak appetite for gold imports at current prices as well as subdued domestic demand.

Expectations for FY2020: Weak global growth is expected to restrain the demand for Indian merchandise exports in FY2020. Moreover, we do not expect many export categories to benefit from the continuing trade tensions between the US and China, barring a few items such as wheels and specialty chemicals. Further, lower crude oil prices in FY2020 relative to FY2019 may hamper remittances as well as demand for Indian goods from the OPEC group, particularly the Middle Eastern countries. Higher gold prices may also restrain demand for gems & jewellery exports. However, if the correction in the INR on an REER basis sustains, it may modestly improve the volume growth of Indian exports in certain sectors.

ICRA expects merchandise exports to rise by ~1-2% to ~US$340-345 billion in FY2020, with a ~1% contraction in oil exports (assuming an average oil price of ~US$64/barrel) and a mild ~2-3% growth in non-oil exports.

ICRA expects merchandise imports to grow by 1.0-1.5% to ~US$520-525 billion in FY2020. With a fall in the average crude oil price to US$64/barrel in FY2020 from ~US$70/barrel in FY2019, oil imports are likely to decline by 1.5-2% to ~US$138-139 billion in FY2020 from ~US$141 billion in FY2019. Cumulatively, gold imports have declined by 3.5% in April-August 2019, with demand constrained in recent months on account of the recent sharp uptick in gold prices as well as the increase in the import duty for gold. Following the start to the festive season, the volume of gold imports may improve during the rest of FY2020. Overall, the value of gold imports is likely to remain largely steady at ~US$33-34 billion in FY2020 (US$32.8 billion in FY2019).

The merchandise trade deficit is likely to remain steady at ~US$178-182 billion in FY2020 relative to US$180.3 billion in FY2019. The services trade surplus and remittances are expected to improve by around 4% each in FY2020 from their levels in FY2019, whereas primary income outflows are projected to worsen by ~1-2% in FY2020 relative to FY2019. Overall, ICRA expects the current account deficit to ease appreciably to US$51-53 billion or 1.8% of GDP in FY2020 from US$57.2 billion or 2.1% of GDP in FY2019, unless crude oil prices record a sustained increase or domestic investment and consumption demand display a revival.

ICRA

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.icraresearch.in