



EXTERNAL SECTOR OUTLOOK

Current account balance may move into small surplus in Q4 FY2020

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HIGHLIGHTS

- *India's current account deficit narrowed sharply to a low US\$1.4 billion (0.2% of GDP) in Q3 FY2020 from US\$17.7 billion (2.7% of GDP) in Q3 FY2019, and printed slightly lower than our forecast (US\$2-3 billion). Moreover, the current account deficit narrowed in sequential quarters in Q3 FY2020 from the US\$6.5 billion (0.9% of GDP) recorded in Q2 FY2020.*
- *The year-on-year (YoY) decline in the current account deficit was driven primarily by a lower merchandise trade deficit, in addition to a rise in the secondary income flows.*
- *India's foreign exchange reserves rose by US\$21.6 billion (excluding changes in valuation) during Q3 FY2020 as compared to US\$4.3 billion in Q3 FY2019.*
- *In April-December FY2020 or 9M FY2020, India's current account deficit more-than-halved to US\$22.3 billion (1.0% of GDP) from US\$52.6 billion (2.6% of GDP) in April-December FY2019 or 9M FY2019. The decline in the current account deficit in 9M FY2020 relative to 9M FY2019 was driven primarily by a reduction in the merchandise trade deficit to US\$118.9 billion from US\$145.1 billion, respectively.*
- *The impact of the Coronavirus, the decline in crude oil prices, and constrained demand for gold are likely to contribute to a mild current account surplus of US\$0.2-0.5 billion in Q4 FY2020, in contrast to the deficit of US\$4.6 billion in Q4 FY2019.*
- *Merchandise exports and imports are likely to decline to US\$325-330 billion and US\$474-479 billion, respectively, in FY2020 from US\$337.2 billion and US\$517.5 billion, respectively, in FY2019. Accordingly, the merchandise trade deficit is likely to narrow considerably to ~US\$147-152 billion in FY2020 from US\$180.3 billion in FY2019. ICRA expects the services surplus to record a mild improvement to US\$83-85 billion in FY2020 from US\$81.9 billion in FY2019. Remittances are expected to improve by ~5%, whereas primary income outflows are projected to worsen by ~2%, in FY2020 relative to FY2019.*
- *Benefitting from the anticipated decline in the merchandise trade deficit, the current account deficit is forecast by ICRA to decline from US\$57.2 billion in FY2019 (2.1% of GDP) to US\$21-24 billion (0.8% of GDP) in FY2020 and US\$22-25 billion in FY2021 (0.7% of GDP).*

OVERVIEW

Balance of Payments for Q3 FY2020: India's current account deficit narrowed sharply to US\$1.4 billion (0.2% of GDP) in Q3 FY2020 from US\$17.7 billion (2.7% of GDP) in Q3 FY2019, and printed slightly lower than our forecast (US\$2-3 billion). Moreover, the current account deficit narrowed in sequential quarters in Q3 FY2020 from the US\$6.5 billion (0.9% of GDP) recorded in Q2 FY2020 (refer Exhibit 1 and 2). The YoY decline in the current account deficit was driven primarily by a lower merchandise trade deficit, in addition to a rise in the secondary income flows.

The merchandise trade deficit (on a BoP basis) narrowed considerably to US\$34.6 billion in Q3 FY2020 from US\$49.3 billion in Q3 FY2019. Lower crude oil prices, a sharp contraction in non-oil non-gold imports, and subdued domestic growth and demand contributed to the decline in the merchandise trade deficit in Q3 FY2020. The easing in the merchandise trade deficit was led by a sharp 12.5% contraction in merchandise imports to US\$115.9 billion in Q3 FY2020 from US\$132.4 billion in Q3 FY2019, which outpaced the 2.2% YoY decline in merchandise exports to US\$81.2 billion in Q3 FY2020 from US\$83.1 billion in Q3 FY2019, respectively. Non-oil non-gold imports declined by a sharp 11.2% to US\$75.5 billion in Q3 FY2020 from US\$85.0 billion in Q3 FY2019, reflecting subdued domestic investment and consumption demand. Further, net oil imports declined to US\$19.9 billion in Q3 FY2020 from US\$25.4 billion in Q3 FY2019, following the correction of around 7% in crude oil prices between these two quarters. In contrast, gold imports rose slightly to US\$7.3 billion in Q3 FY2020 from US\$7.1 billion in Q2 FY2019, driven by the sharp rise in gold prices between these two quarters.

The net inflow of secondary income rose to US\$18.7 billion in Q3 FY2020 from US\$17.4 billion in Q3 FY2019, led by the uptick in worker remittances and personal transfers to US\$14.0 billion and US\$18.7 billion, respectively, in Q3 FY2020 from US\$11.6 billion and US\$17.2 billion, respectively, in Q3 FY2019. Additionally, the services trade surplus posted a marginal uptick to US\$21.9 billion in Q3 FY2020 from US\$21.7 billion in Q3 FY2019, led by higher net earnings related to telecom, computer and information services (to US\$21.9 billion from US\$20.3 billion), and to a smaller extent, financial services (to US\$0.6 billion from US\$0.3 billion). Moreover, the outflow of primary income eased to US\$7.4 billion in Q3 FY2020 from US\$7.6 billion in Q3 FY2019.

India's capital and financial account balance declined to US\$0.7 billion in Q3 FY2020, from US\$18.1 billion in Q3 FY2019 and US\$7.1 billion in Q2 FY2020. Notably, there was a deterioration in the magnitude of net inflows in Q3 FY2020 relative to Q3 FY2019 for NRI deposits (to -US\$3.1 billion from +US\$5.0 billion), financial derivatives (to +US\$0.1 billion from +US\$0.5 billion), loans (to +US\$1.4 billion from +US\$8.6 billion), trade credit and advances (to -US\$1.4 billion from -US\$0.7 billion), and other investments (to +US\$4.5 billion from +US\$8.1 billion). In contrast, net inflows of FDI (to +US\$10.0 billion from +US\$7.3 billion) and portfolio investment (to +US\$7.8 billion from -US\$2.1 billion) recorded an improvement during the two quarters. Significantly, foreign exchange reserves rose sharply to US\$21.6 billion (excluding changes in valuation) during Q3 FY2020 from US\$4.3 billion in Q3 FY2019.

Exhibit 1: Trends in India's Balance of Payments

Figures in US\$ billion	Q3 FY2019	Q4 FY2019	Q1 FY2020	Q2 FY2020	Q3 FY2020	FY2018	FY2019	<i>FY2020 ICRA exp.</i>
Merchandise Exports	83.1	87.4	82.7	80.0	81.2	309.0	337.2	325 to 330
Merchandise Imports	132.4	122.6	128.9	118.1	115.9	469.0	517.5	474 to 479
Merchandise Trade Balance	-49.3	-35.2	-46.2	-38.1	-34.6	-160.0	-180.3	-147 to -152
Net Services	21.7	21.3	20.1	20.4	21.9	77.6	81.9	83 to 85
Primary Income	-7.6	-6.9	-6.3	-8.8	-7.4	-28.7	-28.9	-29 to -32
Secondary Income	17.4	16.2	18.0	20.0	18.7	62.5	70.0	73 to 75
Current Account Balance	-17.7	-4.6	-14.4	-6.5	-1.4	-48.7	-57.2	-21 to -24
<i>Percentage of GDP</i>	<i>-2.5%</i>	<i>-0.7%</i>	<i>-2.0%</i>	<i>-0.9%</i>	<i>-0.2%</i>	<i>-1.9%</i>	<i>-2.1%</i>	<i>-0.8%</i>

Source: RBI; ICRA research

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

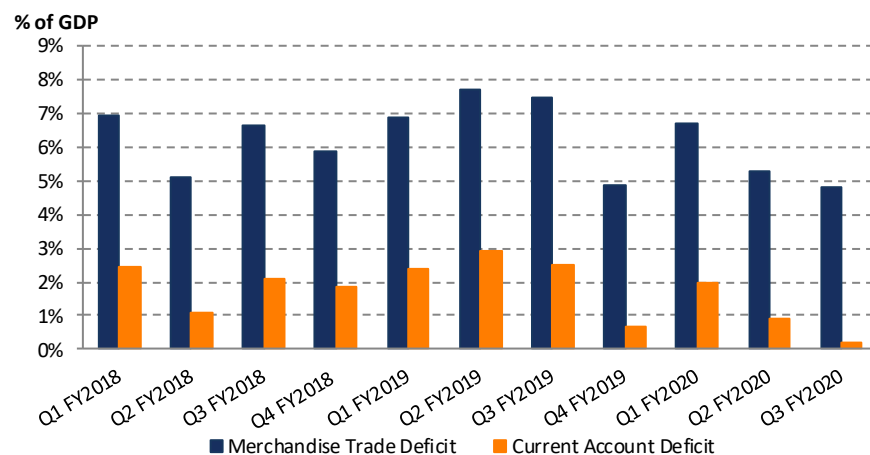
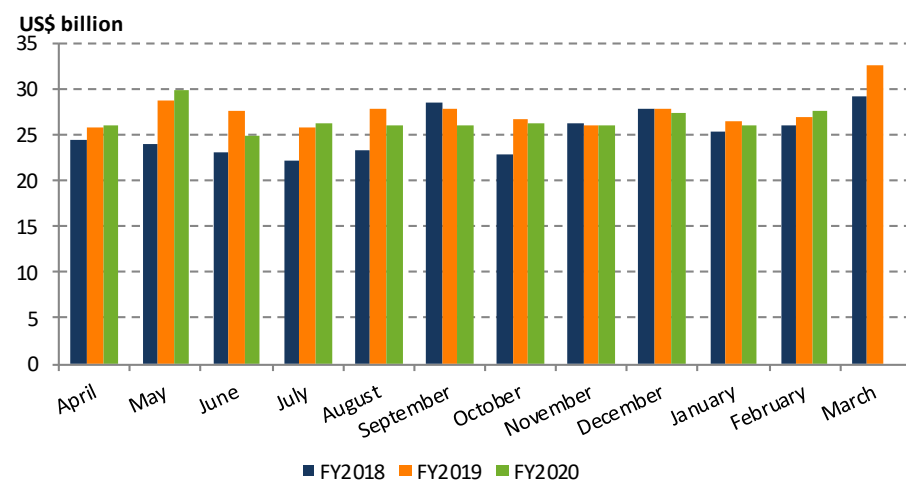
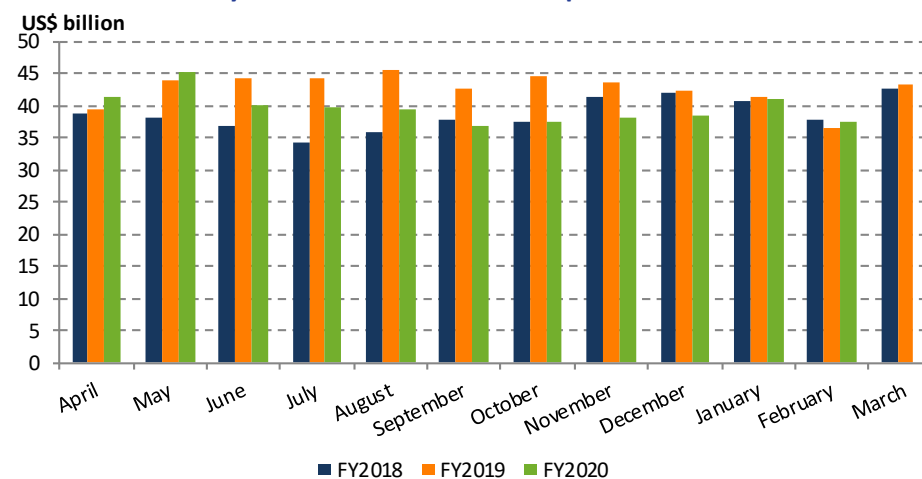


Exhibit 3: Monthly Trends in Merchandise Trade Deficit



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, Gol; ICRA research

Balance of Payments for 9M FY2020: In 9M FY2020, India's current account deficit declined to US\$22.3 billion (1.0% of GDP) from US\$52.6 billion (2.6% of GDP) in 9M FY2019, driven primarily by a reduction in the merchandise trade deficit to US\$118.9 billion from US\$145.1 billion, respectively.

Moreover, the services trade surplus (to US\$62.4 billion from US\$60.6 billion) and secondary income inflows (to US\$56.7 billion from US\$53.8 billion) recorded an improvement in 9M FY2020 relative to 9M FY2019. In contrast, the outflows from primary income rose to US\$22.5 billion from US\$21.9 billion, respectively.

India's capital and financial account balance declined considerably to US\$22.1 billion in 9M FY2020, from US\$52.6 billion in 9M FY2019. Notably, there was a deterioration in the magnitude of net inflows in 9M FY2020 relative to 9M FY2019 for NRI deposits (to -US\$5.8 billion from +US\$9.2 billion), loans (to +US\$10.0 billion from +US\$14.3 billion), trade credit and advances (to +US\$0.0 billion from +US\$0.6 billion), and other investments (to +US\$14.7 billion from +US\$22.5 billion). In contrast, net FDI inflows recorded an uptick to US\$32.1 billion during 9M FY2020 from US\$24.3 billion during 9M FY2020. Moreover, inflows from financial derivatives rose to US\$1.9 billion from US\$0.3 billion, respectively. The inflows from portfolio investment stood at a healthy US\$15.1 billion in 9M FY2020, in contrast the outflows of US\$11.9 billion in the corresponding period of FY2019. Significantly, foreign exchange reserves expanded by a considerable US\$40.7 billion (excluding changes in valuation) during 9M FY2020, as opposed to the US\$17.5 billion decline recorded in 9M FY2019.

Trends for January-February FY2020: The initial data released by the Ministry of Commerce and Industry indicates that merchandise exports rose by a muted 0.6% to US\$53.6 billion in January-February FY2020 from US\$53.3 billion in January-February FY2019, led by oil exports (+6.4%; to US\$6.7 billion from US\$6.3 billion), which offset the mild contraction in non-oil exports (-0.1%; to US\$46.9 billion from US\$47.0 billion). The latter was primarily driven by gems and jewellery (-US\$1.1 billion; -16.2%), and agricultural goods (-US\$0.4 billion; -7.6%), whereas there was a YoY pickup in electronic goods (+US\$0.6 billion; +35.0%), engineering goods (+US\$0.3 billion; +2.4%), organic and inorganic chemicals (+US\$0.3 billion; +9.2%), and drugs and pharmaceuticals (+US\$0.3 billion; +10.3%).

Merchandise imports recorded a subdued 0.8% growth to US\$78.6 billion in January-February FY2020 from US\$78.0 billion in January-February FY2019 (refer Exhibit 4 and 5), primarily on account of a 14.8% YoY uptick in oil imports to US\$23.7 billion from US\$20.7 billion, respectively. In contrast, gold imports recorded a sharp YoY decline of 19.4% to US\$3.9 billion in January-February FY2020 from US\$4.9 billion in January-February FY2019, reflecting the constrained demand for gold amid high global prices. Moreover, non-oil non-gold imports contracted by 2.9% to US\$51.0 billion in January-February FY2020 from US\$52.5 billion in January-February FY2019, with a wide disparity in the trends of its constituents. For instance, there was a sharp decline in merchandise imports of sectors such as iron and steel (by -US\$0.7 billion; -25.7%), organic and inorganic chemicals (by -US\$0.5 billion; -13.3%), electronic goods (by -US\$0.5 billion; -5.5%), coal (by -US\$0.7 billion; -17.0%), and metalliferous ores and other minerals (by -US\$0.2 billion; -22.5%) in January-February FY2020 relative to January-February FY2019. The contraction in these items is likely to reflect a combination of factors, including constrained production in China, lower commodity prices as well as subdued domestic demand. In contrast, there was a healthy YoY expansion in the imports of items such as vegetable oil (by +US\$0.3 billion; +19.4%), fruits and vegetables (by +US\$0.1 billion; +40.4%), machinery (by +US\$0.4 billion; +6.4%), and pearls, precious and semi-precious stones (by +US\$0.2 billion; +5.1%) during these two periods.

Given these trends, the trade deficit rose somewhat to US\$25.0 billion in January-February FY2020 from US\$24.8 billion in January-February FY2019 (refer Exhibit 3), according to the data released by the Ministry of Commerce.

Expectations for Q4 FY2020 and FY2020: Merchandise exports and imports have displayed a subdued trend so far in FY2020, contracting by 1.5% and 7.3%, respectively, on account of factors such as muted commodity prices, as well as weak domestic and global demand. Moreover, with worsening global sentiments in light of the impact of coronavirus, we do not expect any meaningful pickup in Indian exports or imports in March 2020. In addition, an unfavourable base effect would also weigh upon the YoY trends in exports and imports in March 2020.

The impact of the Coronavirus, the decline in crude oil prices, and constrained demand for gold are likely to contribute to a small current account surplus in Q4 FY2020. ICRA expects the merchandise trade deficit to narrow to ~US\$30-33 billion in Q4 FY2020 from US\$35.2 billion in Q4 FY2019. The services surplus for Q4 FY2020 is forecast at ~US\$22.0 billion, similar to the print in Q4 FY2019. Additionally, remittances are expected to improve, whereas primary income outflows are projected to worsen in Q4 FY2020 relative to Q4 FY2019. Accordingly, ICRA expects a marginal current account surplus of US\$0.2-0.5 billion in Q4 FY2020, in contrast to the deficit of US\$4.6 billion in Q4 FY2019 (0.7% of GDP).

Overall, merchandise exports and imports are likely to decline to US\$325-330 billion and US\$474-479 billion, respectively, in FY2020. Accordingly, the merchandise trade deficit is likely to narrow considerably to ~US\$147-152 billion in FY2020 from US\$180.3 billion in FY2019. ICRA expects the services surplus to record a mild improvement to US\$83-85 billion in FY2020 from US\$81.9 billion in FY2019. Remittances are expected to improve by ~5%, whereas primary income outflows are

projected to worsen by ~2%, in FY2020 relative to FY2019. Benefitting from the anticipated decline in the merchandise trade deficit, the current account deficit is forecast by ICRA to decline to US\$21-24 billion (0.8% of GDP) in FY2020 from US\$57.2 billion in FY2019 (2.1% of GDP).

Expectations for FY2021: The growing risks related to the spread of the Coronavirus have dampened hopes of a swift recovery in global economic growth, and would continue to constrain trade and tourism in the near term. Moreover, the considerable fall in crude oil prices in recent weeks may weigh upon remittances, as well as demand for Indian goods from the Middle Eastern countries. At present, we expect India's exports to contract in H1 FY2021.

On the import side, low commodity prices, particularly, for crude oil, would keep the import bill in check in H1 FY2021. In addition, elevated gold prices would weigh upon the demand for gold imports in the coming months, despite the improved outlook for rural demand. An uptick in non-oil non-gold import demand in FY2021 would be contingent upon the broader recovery in domestic growth and consumption demand, which appears unlikely in H1 FY2021.

ICRA expects merchandise exports and imports to decline by 2-4% in FY2021 to ~US\$315-320 billion, and US\$455-460 billion, respectively (assuming an average oil price of US\$45-50/barrel, building in some normalisation of crude oil prices in H2 FY2021). As a result, merchandise trade deficit is expected to print at ~US\$135-140 billion in FY2021, unless commodity prices rise significantly following an easing of risk-off sentiment related to the spread of the Coronavirus outbreak. Moreover, lower crude oil prices are likely to constrain remittances. The services trade surplus is likely to decline modestly, whereas the outflow of primary income may narrow to some extent. Overall, we expect the current account deficit to print at US\$22-25 billion in FY2021 (0.7% of GDP).

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