BALANCE OF PAYMENTS

31 December 2019

Lower CAD and higher inflows to support INR

Led by a sharp dip in trade deficit, India's CAD narrowed to US$ 6.3bn (0.9% of GDP) in Q2 from US$ 14.2bn (2% of GDP) in Q1. However, BoP surplus shrunk to US$ 5.1bn from US$ 14bn in Q1 due to lower foreign investments. We expect BoP surplus to increase in H2 as foreign inflows have been higher in Q3 and are likely to sustain. At the same time, imports are likely to remain tepid. A combination of lower CAD in FY20 (1.3% of GDP from 2.1% in FY19) and resumption in foreign inflows will ensure steady INR despite higher oil prices.

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CAD narrowed sharply in Q2: Driven by lower trade deficit, India's CAD narrowed to US$ 6.3bn in Q2FY20 (0.9% of GDP) from US$ 14.2bn in Q1FY20 (2% of GDP). Trade deficit in Q2FY20 fell to US$ 38.1bn from US$ 46.2bn in Q1, led by lower oil and gold imports. While merchandise exports eased marginally, services (net) receipts increased a tad bit to US$ 20.4bn in Q2FY20 from US$ 20.1bn in Q1FY20. However, remittances maintained momentum and are now at US$ 20bn compared with US$ 18bn in Q1.

BoP surplus at US$ 5.1bn in Q2FY20: BoP surplus narrowed to US$ 5.1bn in Q2FY20 versus US$ 14bn in Q1FY20 despite a sharp contraction in trade deficit by US$ 8.1bn on a QoQ basis. This is due to a deceleration in FDI inflows from an 11-quarter high of US$ 13.8bn in Q1 to US$ 7.4bn. FII inflows and ECB inflows too were subdued at US$ 2.5bn (US$ 4.8bn in Q1) and US$ 3.4bn (US$ 6.1bn in Q1) respectively. Banking capital outflows too contributed to the decline at US$ 1.8bn in Q2 versus an inflow of US$ 3.4bn in Q1FY20.

BoP surplus to expand in H2: CAD narrowed to 1.5% of GDP in H1FY20 from 2.6% of GDP in H1FY19. This decline is attributed to lower trade deficit led by dip in both oil and non-oil imports. BoP surplus in H1FY20 is at US$ 19.1bn versus depletion of US$ 15.2bn in H1FY19. The biggest change in BoP is pick-up in FPI inflows from outflows last year. While oil prices have risen recently, non-oil imports are likely to remain lacklustre. In addition, FDI inflows have maintained their momentum at US$ 3.3bn in Oct'19. So have FPI inflows at US$ 6.1bn in Q3FY20. As a result, we expect BoP surplus at US$ 43.4bn in FY20 and CAD at 1.3% of GDP (2.1% in FY19). While INR depreciated by (-) 2.3% in CY19 (-8.5% in CY18), higher foreign inflows should lend support to INR even as oil prices inch up in CY20.

KEY HIGHLIGHTS

- CAD narrows to 0.9% of GDP in Q2FY20 from 2% of GDP in Q1FY20.
- BoP surplus at US$ 5.1bn from US$14bn in Q1FY20.
- CAD to narrow to 1.3% of GDP in FY20. BoP surplus at US$ 43.4bn.

FIG 1 – BOP QUARTERLY ACCOUNT

(US$ bn)	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Current account	**(19.1)**	**(17.8)**	**(4.6)**	**(14.2)**	**(6.3)**
CAD/GDP (%)	**(2.9)**	**(2.7)**	**(0.7)**	**(2.0)**	**(0.9)**
Trade balance	(50.0)	(49.3)	(35.2)	(46.2)	(38.1)
- Merchandise exports	83.4	83.1	87.4	82.7	80.0
- Merchandise imports	133.4	132.4	122.6	128.9	118.1
--Oil imports	35.3	34.7	32.4	35.3	29.6
--Non-oil imports	98.1	97.7	90.2	93.6	88.5
- Net Services	20.3	21.7	21.3	20.1	20.4
--Software	19.3	19.9	19.9	21.0	21.1
Transfers	19.3	17.4	16.2	18.0	20.0
Other invisibles	(8.6)	(7.6)	(6.9)	(6.1)	(8.6)
Capital account	**14.6**	**13.8**	**19.2**	**27.9**	**12.1**
% of GDP	**2.2**	**2.1**	**2.7**	**4.0**	**1.7**
Foreign investments	5.8	5.2	15.9	18.7	9.9
- FDI	7.4	7.3	6.4	13.8	7.4
- FII	(1.6)	(2.1)	9.4	4.8	2.5
Banking capital	0.5	4.9	(8.1)	3.4	(1.8)
Short-term credit	4.8	(0.7)	1.5	2.0	(0.6)
ECBs	2.0	2.0	7.2	6.1	3.4
External assistance	0	1.7	1.3	1.5	0.4
Other capital account items	1.5	0.7	1.2	(3.7)	0.8
E&O	0.6	(0.3)	(0.4)	0.3	(0.7)
Overall balance	(3.9)	(4.3)	14.2	14.0	5.1

Source: CEIC, Bank of Baroda Research

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