BALANCE OF PAYMENTS

12 March 2020

Favourable outlook on CAD

India's CAD fell to US$ 1.4bn (0.2% of GDP) in Q3FY20 from US$ 6.5bn in Q2FY20 (0.9% of GDP) on the back of lower trade deficit. Software receipts were resilient. With sharp increase in FPI inflows in Q3, BoP surplus rose to US$21.6bn from US$ 5.1bn in Q2. Outlook on CAD is quite favourable with (-) 29% decline in oil prices in Mar'20. While our base case is CAD of 0.6% in FY21, it assumes oil at US$ 55/bbl. Lower oil prices may even result in a surplus. This bodes well for INR and we expect it to come back to 70-72 to US$.

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CAD narrowed sharply in Q3: Led by sharp reduction in trade deficit, India's CAD fell to US$ 1.4bn in Q3FY20 (0.2% of GDP) from US$ 6.5bn in Q2FY20 (0.9% of GDP). Trade deficit fell to US$ 34.6bn in Q3 from US$ 38.1bn in Q2, led by moderation in non-oil imports (muted domestic demand). Merchandise exports rose marginally to US$ 81.2bn in Q3 compared to US$ 80bn in Q2 and services (net) receipts increased to US$ 21.4bn in Q3 from US$ 20.4bn in Q2. Private transfers (remittances) were up by 8% in Q3. This may see a dip as remittances from Gulf may be muted on the back of large dip in oil prices.

BoP surplus at US$ 21.6bn in Q3FY20: Capital inflows increased to US$ 22.4bn in Q3 from US$ 12.3bn in Q2 on the back of higher FDI and FPI inflows. FDI inflows gained pace and rose to US$ 10bn in Q3 from US$ 7.9bn in Q2. FPI inflows increased to US$ 7.8bn from US$ 2.5bn in Q2. Banking capital outflows continued at an accelerated pace of US$ 2.3bn in Q3 versus US$ 1.8bn in Q2. However, FPI inflows have reversed in Q4 to outflows of US$ 500mn and may increase further as we see risk-off in global markets related to coronavirus.

Lower oil prices to narrow CAD: While we will see FPI outflows in Q4, CAD is expected to remain range bound as oil prices have dipped in Mar'20 and non-oil imports will be muted. In fact, we may see a current account surplus in the near-term if non-oil imports continue to slide and oil prices sustain at this level. Our base case is CAD of 0.6% of GDP in FY21 on an average crude price of US$55/bbl. If prices are materially lower, current account may be in surplus. At the same time, we see FDI and FII inflows gaining pace as a number of strategic sales are lined up next year. The above backdrop is favourable for INR and we see it coming back to 70-72 range to US$ once risk-off subsides.

FIG 1 – BOP QUARTERLY ACCOUNT

(US$ bn)	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
Current account	**(17.8)**	**(4.6)**	**(14.4)**	**(6.5)**	**(1.4)**
CAD/GDP (%)	**(2.7)**	**(0.7)**	**(2.0)**	**(0.9)**	**(0.2)**
Trade balance	(49.3)	(35.2)	(46.2)	(38.1)	(34.6)
- Merchandise exports	83.1	87.4	82.7	80.0	81.2
- Merchandise imports	132.4	122.6	128.9	118.1	115.9
--Oil imports	38.4	32.4	35.3	29.6	31.4
--Non-oil imports	94.0	90.2	93.6	88.5	84.5
- Net Services	21.7	21.3	20.1	20.4	21.9
--Software	19.9	19.9	21.0	21.1	21.5
Transfers	17.4	16.2	18.0	20.0	18.7
Other invisibles	(7.6)	(6.9)	(6.3)	(8.8)	(7.4)
Capital account	**13.8**	**19.2**	**28.3**	**12.3**	**22.4**
% of GDP	**2.1**	**2.7**	**4.0**	**1.7**	**3.1**
Foreign investments	5.2	15.9	19	10.4	17.8
- FDI	7.3	6.4	14.2	7.9	10.0
- FII	(2.1)	9.4	4.8	2.5	7.8
Banking capital	4.9	(8.1)	3.4	(1.8)	(2.3)
Short-term credit	(0.7)	1.5	2.0	(0.6)	(1.4)
ECBs	2.0	7.5	6.1	3.3	3.2
External assistance	1.7	1.3	1.5	0.4	1.3
Other capital account items	0.7	1.2	(3.8)	0.6	3.7
E&O	(0.3)	(0.4)	0.2	(0.7)	0.7
Overall balance	(4.3)	14.2	14.0	5.1	21.6

Source: CEIC, Bank of Baroda Research

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