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CURRENT ACCOUNT DEFICIT TOUCHING 2.8% IN FY19

Against the backdrop of rising oil price and lukewarm export growth Current Account Deficit is expected to reach 2.8% of GDP ($75 billion) in FY19, with merchandise trade imbalance likely to increase to $188 billion as against $160.0 billion in FY18.

Amidst the recent devaluation of the Chinese Yuan, our imports from China increased in May'18 and Jun'18 after witnessing a decline in Apr'18. However, the good thing is that the growth remains modest in yearly terms. The trend of the manufacturing goods imports remains the same and within manufacturing, imports of electronic goods have declined on annual basis, though marginally so far this fiscal. Thus the argument that depreciation of the Chinese currency is responsible for increased imports from the country does not seem appropriate. However, on the downside, electronic imports have stayed at the same level now for almost a year indicating our inability to contain imports. Thus the huge increase in trade deficit is more linked to the average export performance in FY19 so far.

The data from PPAC reveals that while the volume of oil imports by India has increased by 5.6% in the first three months of this fiscal, oil price (Indian basket) has increased 46% during the same period.

Had the oil price remained the same as in 2017, our crude oil import bill would have been 31.7% lower in Q1 FY19. Whereas if the volume of crude oil import had remained the same as in previous year, our crude import bill would have been 5.5% lower, thereby showing that price effect reigns supreme.

When it comes to financing the current account deficit, non-debt creating (Foreign Direct Investment & Foreign Portfolio Investment) capital inflows constituting around 44% of the total capital flows, are expected to be the major source. However, debt creating inflows which increased in the last fiscal year are expected to remain on the higher side this year as well. This will imply pressure on rupee in case there is a sudden reversal of capital flows.

The financial account surplus is expected to come around $59 billion, lower than previous fiscal ($91.4 billion) due to foreign portfolio outflows which have already amounted to $9.3 billion till Jun'18. Portfolio outflows have happened this year since the US economy and dollar started strengthening. This is expected to turn India's overall Balance of Payment into deficit mode after 6 years, thereby implying forex reserves depletion of $16 billion (0.6% of GDP) in the current fiscal.

FY19 CAD TO REACH 2.8% OF GDP

- Rising oil price has already had an impact on our external balance in the last fiscal and is likely to have a further deteriorating effect on India's current account balance this year too. We estimate that FY19 Current Account deficit might reach 2.8% of GDP ($75 billion) with merchandise trade imbalance expected to increase to $187.8 billion as against $160.0 billion in FY18.

RECENT JUMP IN ELECTRONICS IMPORTS NOT BECAUSE OF CHINA IMPACT

- The latest trade figure shows a jump in trade deficit to 18 billion in Jul'18 on account of lukewarm export performance amidst higher import bill. Oil imports experienced yearly growth 57.4% to $12.4 billion from $7.8 billion in Jul'17. Non-oil imports also witnessed higher growth of $31.4 billion in July'18 (average growth of 30.8% since Nov'17) on account of higher imports of engineering goods, electronics, metals and machinery.
- Amidst the recent devaluation of the Chinese Yuan, our imports from China increased in May'18 and Jun'18 after witnessing a decline in Apr'18. However, the growth remains modest in yearly terms. The trend of the manufacturing goods imports remains the same and within manufacturing, imports of electronic goods have declined on annual basis so far this fiscal. Thus the argument that depreciation of the Chinese currency is responsible for increased imports from the country does not seem appropriate.

India's imports from China ($ billion)

	Apr-17	May-17	Jun-17	Apr-18	May-18	Jun-18
All commodities	5.9	5.9	6.2	4.9	6.1	6.4
Manufactured goods	5.7	5.7	6.0	4.6	5.9	6.1
Electronic goods	2.5	2.4	2.5	1.5	1.9	2.0

Source: SBI Research

- Thus the huge increase in trade deficit is more linked to the average export performance so far in FY19.

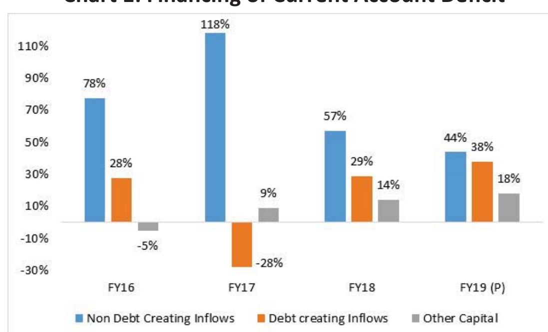
INCREASING OIL IMPORT BILL: VALUE OR VOLUME EFFECT OR BOTH?

- Oil import bill has increased owing to increase in oil price increase as well the as increase in quantity of oil imported. The data from PPAC reveals that while the volume of oil imports by India has increased by 5.6% in the first three months of this fiscal, average oil price (Indian basket) has increased 46% during the same period.
- Our estimates show that had the oil price remained the same as in 2017, our crude oil import bill would have been 31.7% lower in Q1 FY19. Whereas if the volume of crude oil import had remained the same as in previous year, our crude import bill would have been 5.5% lower, thereby showing that price effect reigns supreme.

FINANCING CAD:DEBT AND NON DEBT CREATING FLOWS

- The current account deficit is still expected to be majorly financed by non-debt creating (Foreign Direct Investment & Foreign portfolio Investment) capital inflows, around 44% of the total capital flows.
- However, debt creating inflows which increased in the last fiscal year are expected to remain on the higher side this year as well. This will imply pressures on rupee in case there is a sudden reversal of capital flows.
- The financial account surplus is expected to come around $59 billion, lower than previous fiscal ($91.4 billion) due to foreign portfolio outflows which have already amounted to $9.3 billion till Jun'18. Portfolio outflows have happened this year since the US economy and dollar started strengthening. This is expected to turn India's overall Balance of Payment into deficit mode after 6 years, thereby implying forex reserves depletion of $16 billion (0.6% of GDP) in the current fiscal.

Chart 1: Financing of Current Account Deficit



Source: RBI, SBI Research

ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of "tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis".

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management , corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

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