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A) INDIAS CURRENT ACCOUNT DEFICIT

India's Current Account Deficit To Widen To 2.5% Of GDP In FY19: Moody's, Experts

India's current account deficit (CAD) will widen to 2.5 per cent of the GDP in the current fiscal due to higher oil prices that has been accentuated by rupee depreciation, Moody's and other experts have said

Rupee last week dropped to a record low of 70.32 to a US dollar as political turmoil in Turkey and concerns about China's economic health continued to support safe-haven assets and weighed on emerging market currencies.

Joy Rankothge, Vice President - Senior Analyst, Moody's Investors Service said while the weaker rupee will benefit exports at the margins, it is unlikely to reverse the trade deficit, which hit a five year high of USD 18.02 billion in July.

India's current account deficit is likely to widen to 2.5 per cent in FY 2018-19, up from 1.5 per cent in fiscal 2017 due to higher oil prices and strong non-oil import demand as domestic demand accelerates," he said. "Net oil imports accounted for 2.6 per cent of GDP in FY 2017-18 and will increase further in fiscal 2019."

Rajiv Biswas, APAC Chief Economist, IHS Markit, said the significant depreciation of the rupee against the US dollar since the beginning of 2018 reflects a number of factors.

"A key driver has been gradual US Fed monetary policy tightening, which has resulted in USD appreciation against many other currencies globally. However, the rupee weakness also reflects India's widening current account deficit as higher world oil prices have pushed up oil import costs.

A further negative for the INR is that a number of economic crises in large emerging markets including Argentina, Venezuela and Turkey, have made global investors more cautious about emerging markets currencies and equities," he said.

Sunil Sinha, Principal Economist, India Ratings and Research, said the rupee depreciation will have both positive and negative impact on the economy.

"On the negative side it will increase the oil import bill leading to higher current account deficit.. Also, costly oil import would seep into the economy via higher inflation, make infra and other projects, which have a large import content, expensive and will even make critical imported defense items more expensive," Sinha said.

On the positive side, he said as an overvalued rupee was hurting export competitiveness, it will improve export competitiveness of Indian goods and services. Also, it will improve the top line/bottom line of the companies especially export oriented IT/IT services companies.

"Net-net it may inflict some pain in the short run, but would lead to gain in the medium to long term," he said.
Rankothge said Moody's expect the ongoing cyclical recovery in growth to continue with GDP growth averaging around 7.4 per cent this year and next driven by the underlying growth momentum in the economy, pre-election spending and a pickup in rural demand to largely offset the impacts of a weaker rupee and rising oil prices. From a sovereign risk perspective, low foreign currency debt and long average debt maturity minimize exposures to rising rates and currency weakness," he said.

Sinha said trade position may worsen in the short term because of the oil/other items import bill rising immediately, while the benefit of export competitiveness benefiting the economy largely in the medium to long term.

CAD to come under pressure this fiscal. India Ratings expects CAD to touch 2.6 per cent of GDP in FY19," he said.

Biswas said rupee depreciation is not occurring in isolation, as many other emerging markets currencies have also shown significant depreciation against the USD this year, including the Chinese Yuan, Indonesian rupiah and Malaysian ringgit.

The Turkish lira has crashed by 40 per cent against the USD since the beginning of 2018, as that nation is engulfed by a financial crisis. Therefore, India's relative competitiveness against many emerging markets competitors has not improved that much despite the rupee depreciation against the USD," he said

Biswas said a further widening of the CAD is expected in 2018-19 to around 2.4 per cent of GDP, due to a further increase in the oil import bill and the impact of rupee depreciation on import costs.

B) WHAT A WIDENING CAD PORTENDS FOR THE ECONOMY

Mint analyses the possible reasons and their impact behind India's widening current account deficit (CAD)

India's current account deficit (CAD) widened to a four-quarter high at 2.4% of gross domestic product (GDP) in the April-June period from 1.9% in the January-March quarter of 2017-18. Mint analyses the possible reasons and their impact.

Why is CAD rising?

Tensions in the Gulf region, US sanctions on Iran and the instability in key oil exporting nation Venezuela pushed global crude prices above the $75-a-barrel mark. Being a net importer of fuel, India's trade deficit went up. Petroleum ministry data shows that while India's oil imports rose 5.6% in Q1FY19, oil price in the Indian basket surged 46% in that time. A weakening rupee has made imports costlier. The China-US trade war may hamper export growth, while rising investment demand will lead to more imports. This may further widen CAD in FY19.

Is the rise in CAD worrying?

Amid rising global volatility, CAD financing is a worry. CAD will be financed through a mix of FDI, portfolio flows, foreign reserve management. While FDI flows rose in recent years, a strong dollar, tighter global financial conditions have put more pressure on portfolio investments. In Q1FY19, the net outflow of portfolio investments was $8.1 billion, against a $2.3 billion inflow in Q4FY18. IMF said that based on India's historical cash flows, capital inflow curbs, global markets may not be able to finance a CAD above 3% of GDP.

How will a widening CAD impact the rupee?

Higher CAD will put the rupee under pressure and may raise the cost of overseas borrowing. Depleting forex reserves could raise CAD further.

Why does CAD matter?

Current account balance measures the external strength or weakness of an economy. It largely consists of the country's trade balance in goods and services with the rest of the world, and private transfer receipts, primarily representing remittances in the case of India. A current account surplus implies the country is a net lender to the rest of the world, while a deficit indicates it is a net borrower.

Where will India's CAD end up in FY19?

CAD forecast in FY19 ranges from 2.5% to 2.9%. IMF has projected India's CAD to widen to 2.6% of GDP in 2018-19. India Ratings expects CAD to be at 2.6% of GDP in FY19, while Icra says it would widen to 2.8%. Kotak Securities said that assuming Brent crude prices at an average of $72.5 a barrel, CAD will rise to 2.9% of GDP. But at current levels, India's CAD is much narrower than the near 5% of GDP during the taper tantrum in 2013.