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Current account registers record surplus in Q1; FY21 surplus est. at 1.1% of GDP

India's current account surplus widened meaningfully to record-high levels of US$19.8bn or 3.9% of GDP in Q1FY21 from a modest surplus of 0.1% of GDP in Q4FY20. This was primarily led by a sharp drop in trade deficit to 15-year lows, thanks to a steeper contraction in imports as compared to exports, and relatively steady software earnings. The capital account balance, however, contracted meaningfully to over 27-quarter low of US$0.6bn, attributed to net FDI (foreign direct investment) outflows—the first in last 14 years, as well as ECB (external commercial borrowings) outflows. Nevertheless, the Balance of Payments (BoP) surplus expanded sequentially to US$19.8bn in Q1FY21.

Trade deficit is expected to shrink meaningfully this year, with our estimates looking at a 40%+ drop in FY21. This is amid expectations of a far more severe contraction in imports as compared to exports, reflecting a prolonged impact of COVID-19-induced restrictions and attendant ramifications in the form of job losses and decline in disposable incomes on domestic discretionary consumption demand. Exports, however, should benefit from an aggressive global policy response and a relatively faster global economic recovery. Consequently, we expect a current account surplus of 1.1% of GDP in FY21 vs. a deficit of 0.9% of GDP in FY20—the first surplus on an annual basis in last 17 years. This would translate into a huge BoP surplus for yet another year, notwithstanding lower foreign investments, resulting in continued accretion to FX reserves (US$545bn as of September 18th, +US$69bn FY20TD). This, coupled with the comfort on current account, bodes well for the INR.

- Trade deficit in Q1 shrinks to over 15-year lows**…**: India's trade deficit declined sharply to US$10bn or 2.0% of GDP in Q1FY21—the lowest in last 61 quarters in absolute terms and lowest-ever in terms of % of GDP—from US$35bn in Q4FY20. This was led by a sharp 52% YoY contraction in India's import bill in Q1 FY21, reflecting the adverse impact of COVID-19-induced lockdown on domestic demand, even as exports also declined by a huge 37% YoY as large-scale disruptions in global supply chains and demand led to delays and cancellations of orders. Oil imports contracted by a steeper 62.9% YoY, partly attributed to a sharp drop in crude oil prices, besides a collapsed demand owing to travel restrictions.

Current account surplus expanded to record-high levels of US$19.8bn or 3.9% of GDP in Q1FY21.

- **…leading to record**-high current account surplus: Invisibles fell by a modest 6.2% YoY in Q1FY21, thanks to steady growth in services receipts (+2.1% YoY), partly offset by lower remittances (-5.5% YoY) and higher overseas investment income payments. This, along with a significant contraction in trade deficit, led to current account surplus expanding sharply in Q1FY21 to record-high levels of US$19.8bn or 3.9% of GDP—the second quarter in a row to report a surplus.

- Capital account shrinks to near seven-year lows: On the capital account, net FDI outflows of US$0.4bn—the first outflows on a net basis in the last 14 years, coupled with ECB outflows of US$1.6bn following a surge in borrowing through this route in the previous quarter, led to current account surplus shrinking to a 27-quarter low of US$0.6bn in Q1FY21. NRI deposits, however, improved sequentially to US$3bn in Q1FY21. Nevertheless, a huge current account surplus more than compensated for reduced capital flows, resulting in a modest sequential expansion in BoP surplus to US$19.8bn in Q1FY21 from US$18.8bn in the previous quarter.

Notwithstanding a sharp drop in capital account balance owing to FDI and ECB outflows, BoP surplus expanded to US$19.8bn in Q1FY21.

- Current account surplus expected at 1.1% of GDP in FY21: Trade deficit is expected to shrink meaningfully this year, with our estimates looking at a 40%+ drop in FY21. This is amid expectations of a far more severe contraction in imports as compared to exports, reflecting a prolonged impact of COVID-19-induced restrictions and attendant ramifications in the form of job losses and decline in

We estimate a current account surplus of 1.1% of GDP in FY21.

disposable incomes on domestic discretionary consumption demand. Exports, however, should benefit from an aggressive global policy response and a relatively faster global economic recovery. Consequently, we expect current account to continue to report a surplus over the next two quarters, albeit at a reduced pace, translating into a surplus of US$28.1bn or 1.1% of GDP in FY21 vs. a deficit of 0.9% of GDP in FY20—the first surplus on an annual basis in last 17 years. This would translate into a further expansion in the BoP surplus, notwithstanding lower foreign investments, resulting in continued accretion to FX reserves (US$545bn as of September 18th, +US$69bn FYTD). This, in turn, bodes well for the INR.

Figure 1: Balance of Payments – Quarterly account

US$ bn	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21
Current account	-15.8	-19.1	-17.8	-4.6	-15.0	-7.6	-2.6	0.6	19.8
CAD/GDP (%)	*-2.3*	*-2.9*	*-2.7*	*-0.7*	*-2.1*	*-1.1*	*-0.4*	*0.1*	*3.9*
Trade balance	-45.8	-50.0	-49.3	-35.2	-46.8	-39.7	-36.0	-35.0	-10.0
Trade balance/GDP (%)	*-6.7*	*-7.5*	*-7.4*	*-5.0*	*-6.6*	*-5.7*	*-5.0*	*-4.8*	*-2.0*
Merchandise exports	83.4	83.4	83.1	87.4	82.7	80.0	81.2	76.5	52.3
Merchandise imports	129.1	133.4	132.4	122.6	129.5	119.6	117.3	111.6	62.3
Oil imports	34.8	35.3	38.5	32.4	35.4	29.9	31.5	33.8	13.1
Non-oil imports	94.3	98.1	93.9	90.2	94.1	89.7	85.8	77.8	49.2
Invisibles	29.9	31.0	31.5	30.6	31.8	32.1	33.4	35.6	29.8
Net services	18.7	20.3	21.7	21.3	20.1	20.9	21.9	22.0	20.5
Software earnings	18.6	19.3	19.9	19.9	21.0	21.1	21.5	21.1	20.8
Transfers	17.0	19.3	17.4	16.2	18.0	20.0	18.9	18.4	17.0
Investment income	-6.3	-9.1	-8.3	-7.5	-7.0	-9.6	-8.1	-5.6	-8.4
Other invisibles	0.5	0.5	0.8	0.6	0.7	0.7	0.7	0.7	0.7
Capital account	4.8	16.6	13.8	19.2	28.6	13.6	23.6	17.4	0.6
Capital acc./GDP (%)	*0.7*	*2.5*	*2.1*	*2.7*	*4.0*	*1.9*	*3.3*	*2.4*	*0.1*
Foreign investments	1.4	7.6	5.2	15.9	18.8	9.8	17.6	-1.8	0.2
FDI	9.6	7.4	7.3	6.4	14.0	7.3	9.7	12.0	-0.4
FII	-8.1	0.2	-2.1	9.4	4.8	2.5	7.8	-13.7	0.6
Loans	-4.3	6.9	2.9	10.3	9.6	3.1	3.1	9.9	2.3
ECBs	-1.3	2.2	2.0	7.5	6.1	3.3	3.2	10.3	-1.6
Banking capital	10.1	0.5	4.9	-8.1	3.4	-1.8	-2.3	-4.6	2.2
NRI deposits	3.5	3.3	0.1	3.4	2.8	2.3	0.8	2.8	3.0
Others	-2.4	1.5	0.7	1.2	-3.2	2.5	5.2	13.8	-4.2
Errors & Omissions	-0.3	0.6	-0.3	-0.4	0.4	-0.9	0.6	0.9	-0.5
Overall balance (BoP)	-11.3	-1.9	-4.3	14.2	14.0	5.1	21.6	18.8	19.8

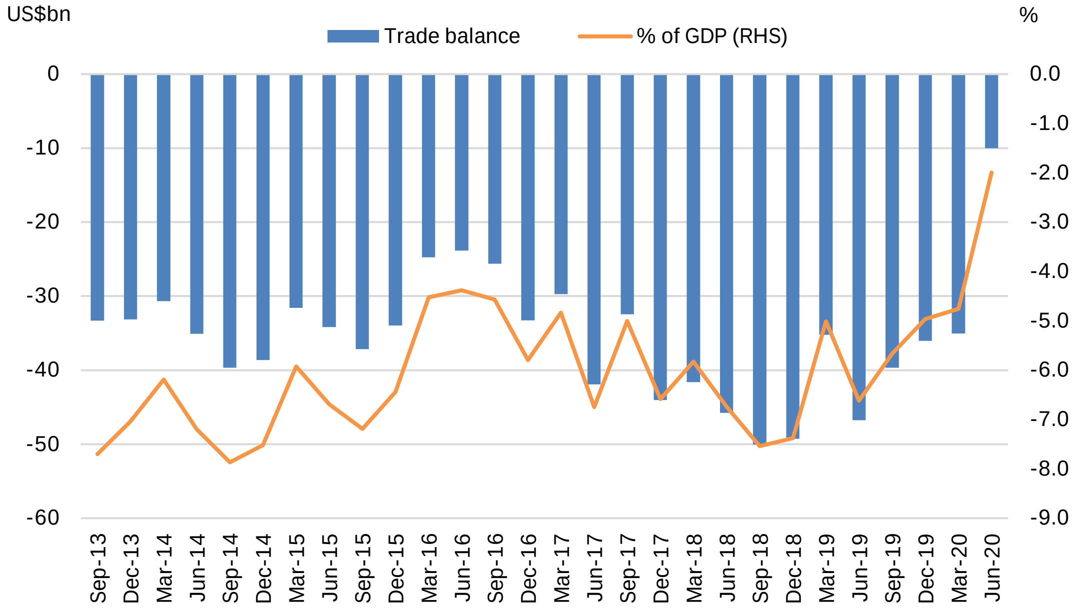
Source: RBI, CMIE Economic Outlook, NSE

Figure 2: Balance of Payments – Annual account

US$ bn	FY16	FY17	FY18	FY19	FY20	FY21E
Current account	-22.2	-14.4	-48.7	-57.3	-24.7	28.1
CAD/GDP (%)	*-1.1*	*-0.6*	*-1.8*	*-2.1*	*-0.9*	*1.1*
Trade balance	-130.1	-112.4	-160.0	-180.3	-157.5	-92.3
Trade balance/GDP (%)	*-6.2*	*-4.9*	*-6.0*	*-6.6*	*-5.5*	*-3.7*
Merchandise exports	266.4	280.1	309.0	337.2	320.4	273.0
Merchandise imports	396.4	392.6	469.0	517.5	477.9	365.4
Oil imports	82.6	86.9	108.7	141.1	130.5	87.1
Non-oil imports	313.9	305.6	360.3	376.4	347.4	278.2
Invisibles	107.9	98.0	111.3	123.0	132.8	120.4
Net services	69.7	68.3	77.6	81.9	84.9	83.0
Transfers	62.6	56.0	62.4	69.9	75.2	67.4
Other invisibles	-24.4	-26.3	-28.7	-28.9	-27.3	-30.0
Capital account	41.1	36.4	91.4	54.4	83.2	44.5
Capital account/GDP (%)	*2.0*	*1.6*	*3.4*	*2.0*	*2.9*	*1.8*
Foreign investments	31.9	43.2	52.4	30.1	44.4	32.5
FDI	36.0	35.6	30.3	30.7	43.0	25.0
FII	-4.1	7.6	22.1	-0.6	1.4	7.5
Loans	-4.6	2.4	16.7	15.9	25.7	15.0
Banking capital	10.6	-16.6	16.2	7.4	-5.3	-5.0
NRI deposits	16.1	-12.4	9.7	10.4	8.6	9.0
Others	3.2	7.5	6.1	1.0	18.4	2.0
Errors & Omissions	-1.1	-0.5	0.9	-0.5	1.0	0.0
Overall balance (BoP)	17.9	21.6	43.6	-3.3	59.5	72.6

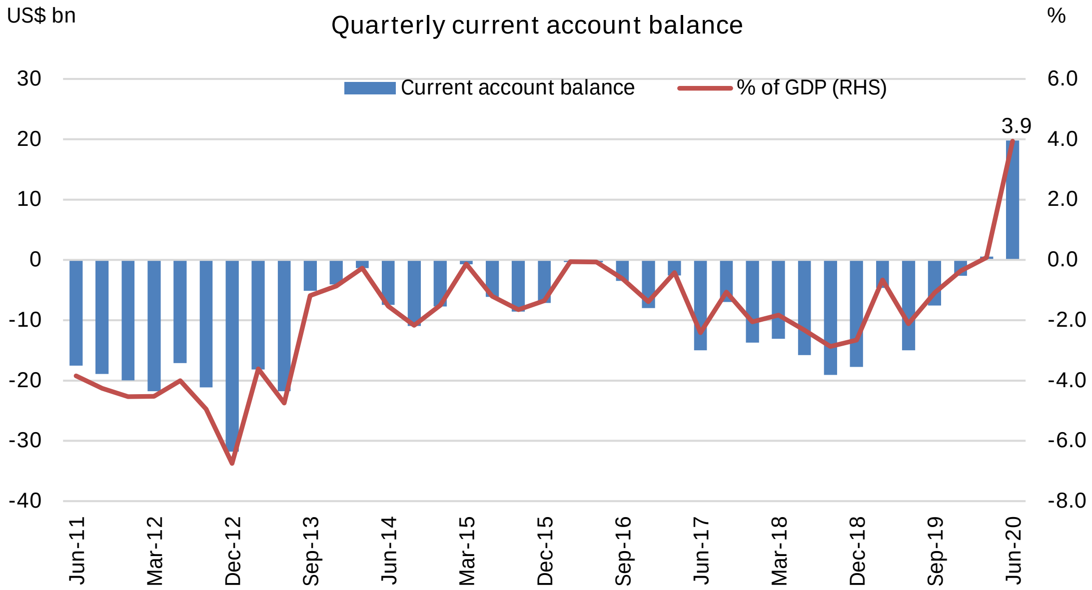
Source: RBI, CMIE Economic Outlook, NSE

Figure 3: Trade deficit declines to over 15-**year lows in Q1FY21...**



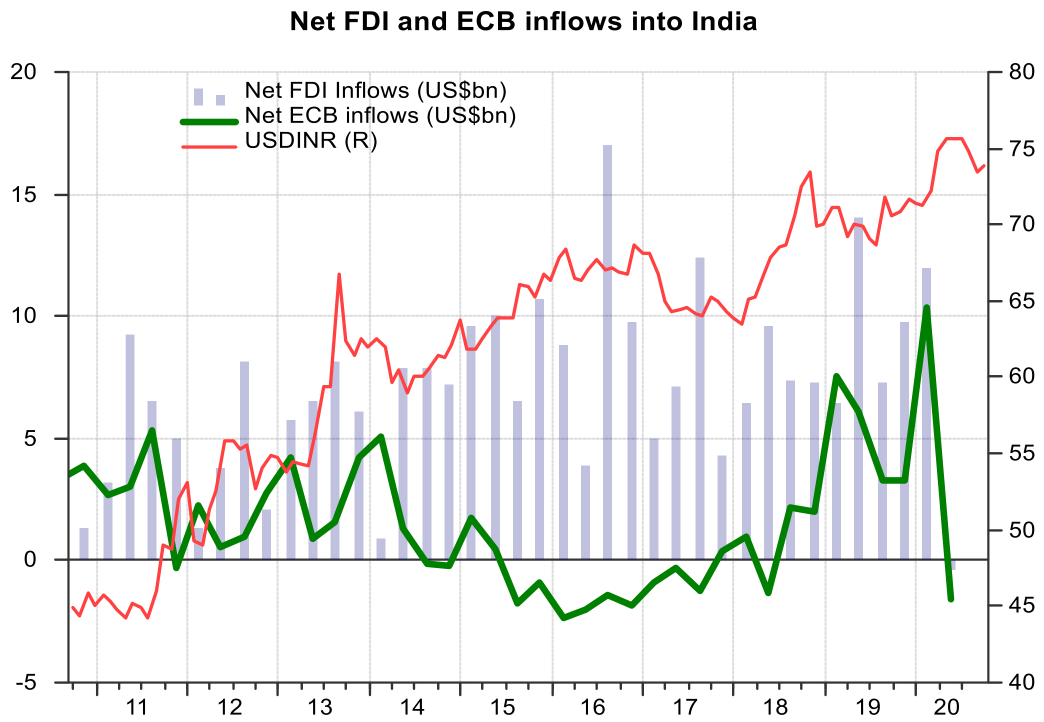
Source: RBI, CMIE Economic Outlook, NSE.

Figure 4: **...**Leading to current account surplus expanded to record-high levels in Q1FY21



Source: Refinitiv Datastream, NSE

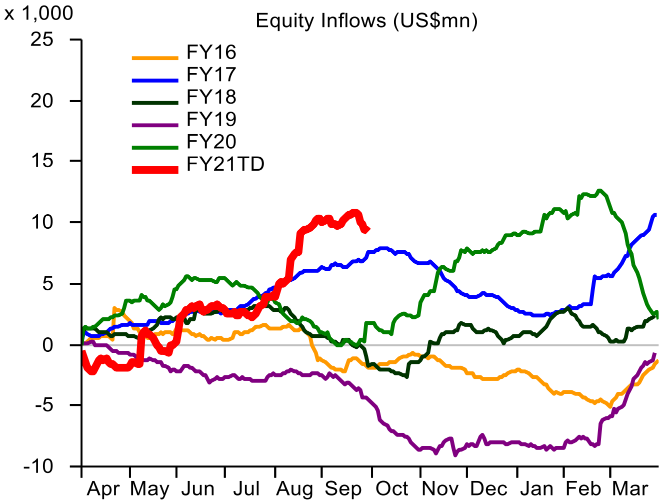
Figure 5: **FDI and ECB recorded net outflows in Q1FY21...**

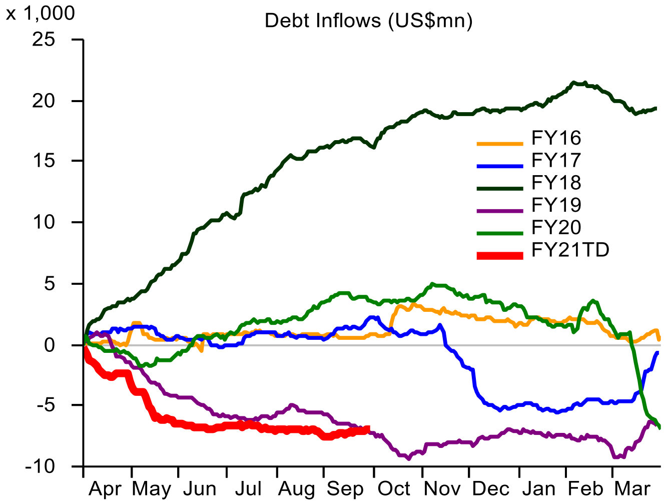


Source: Refinitiv Datastream, NSE

Figure 6: **...**more than offsetting the impact of renewed foreign portfolio inflows during the quarter**...**

Cumulative FII net flows over last six years (FY)

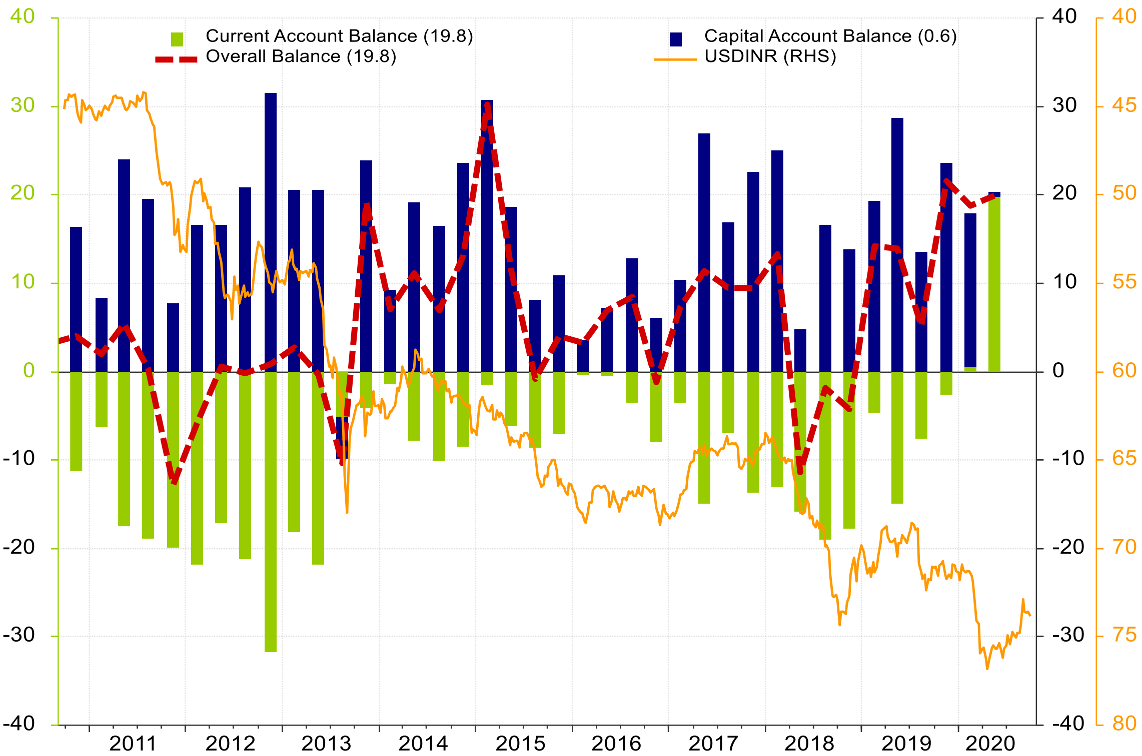




Source: Refinitiv Datastream, NSE

Figure 7: **...translating into a sharp drop in capital account surplus**

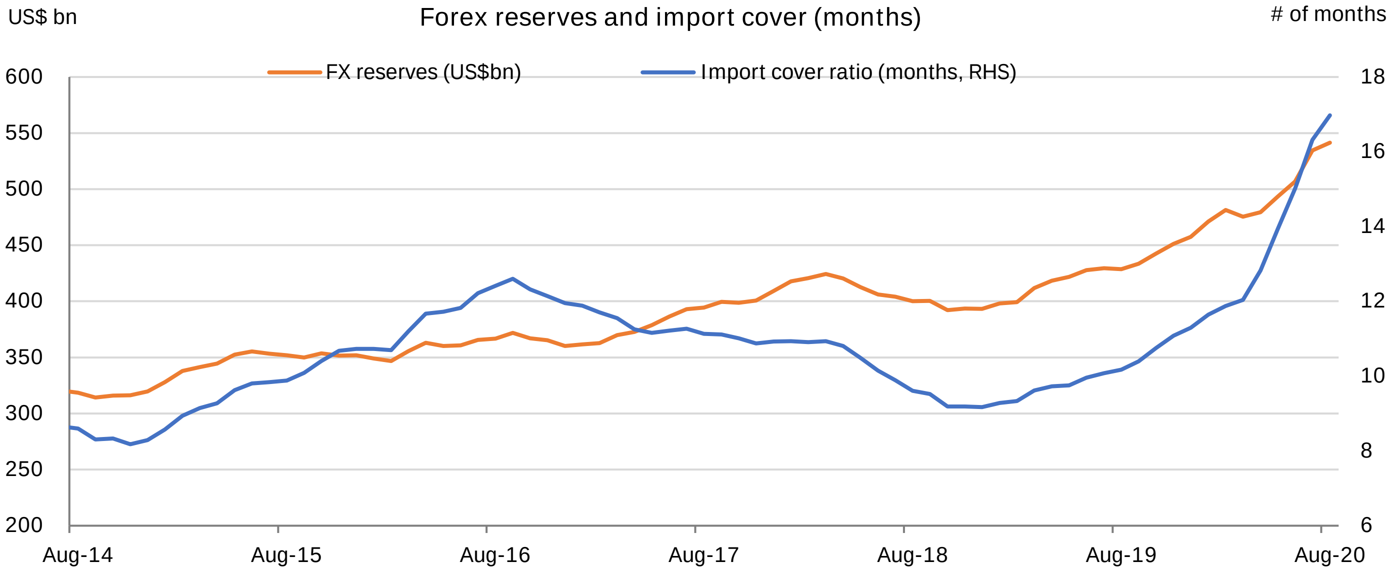
India Balance of Payments by Channel (Quarterly, US$bn)



Source: Refinitiv Datastream, NSE

Figure 8: Forex reserves are all all-time high levels, leading to a sharp rise in import cover

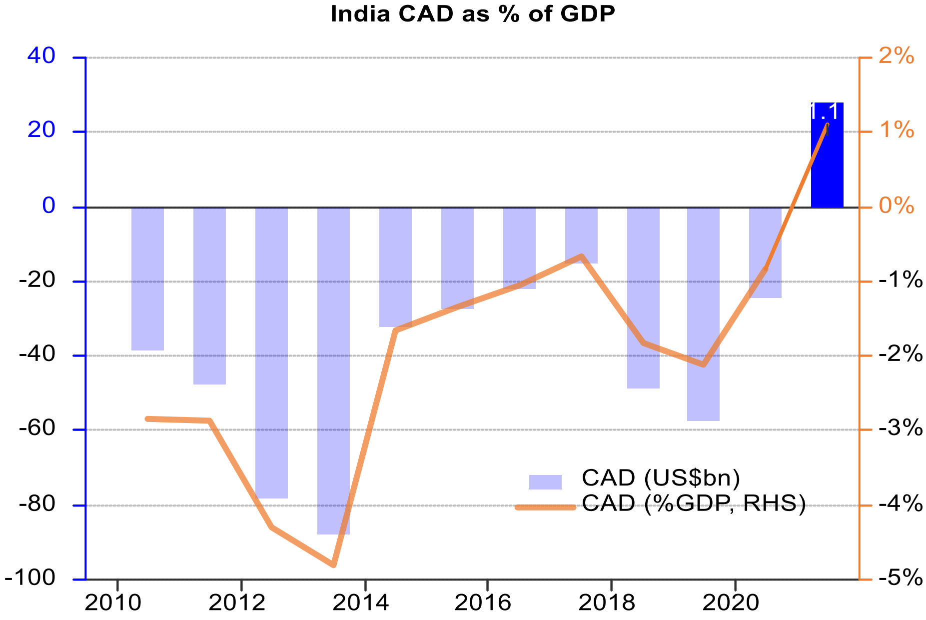
A significant accretion to forex reserves over the years, and particularly this fiscal year (+US$ 69bn in FY21 till date), has resulted in a significant improvement in import cover, further supported by moderation in domestic demand. After falling to eight months in 2014, India's import cover has improved sharply to nearly 17 months now, thereby significantly reducing India's external vulnerability.



Source: Refinitiv Datastream, NSE

Figure 9: Current account surplus expected at 1.1% of GDP in FY21

A significant contraction in trade deficit in FY21 is expected to translate into a current account surplus of 1.1% of GDP in FY21—the first surplus in 17 years, vs. a deficit of 0.9% of GDP in FY20.



Source: Refinitiv Datastream, NSE

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