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Q1FY22 Current Account balance: A positive surprise; surplus after two quarters

India's current account balance surprised on the positive by recording a surplus of US$6.5bn (Consensus: +US$2bn) or 0.9% of GDP in Q1FY22 after registering deficit for two consecutive quarters. This was primarily led by a 26.4%QoQ decline in merchandise trade deficit, thanks to a strong surge in exports (7%QoQ) a sequential drop in imports (-4%QoQ). While exports exhibited resilience on buoyant external demand, imports bore the brunt of renewed COVID-induced restrictions during the virulent second wave, that in turn hampered domestic demand. This was reflected in 7%QoQ plunge in non-oil imports even as oil imports expanded by 8%QoQ. Alongside, a significant moderation in foreign portfolio and ECB inflows were more than offset by robust FDI and banking capital inflows. Higher-than-expected current account surplus and healthy foreign capital inflows resulted in Balance of Payments (BoP) recording a surplus of US$31.9bn in Q1FY22—the second highest record surplus.

With global growth showing signs of moderation in the wake of slowing credit impulse in China and growth peaking out in US and Euro Area, exports are likely to lose some sheen in H2FY22. That said, enhanced fiscal support and significant progress in vaccination drives should limit the downside and continue to provide a conducive environment for exports. Import growth, however, is expected to outpace exports in the wake of a) easing lockdown restrictions, b) increasing pace of vaccinations, c) rising crude oil and other commodity prices, and d) a favourable base. Consequently, we expect current account deficit at balance to slip into deficit again in FY22, with our estimate pegged at 1% of GDP. This, along with moderation in foreign capital inflows in the wake reversal in easy monetary policy conditions in the US, is expected to translate into a significantly lower BoP surplus this year.

Renewed global risk-off environment triggered by China's property and energy sector crisis, soaring commodity prices and a clear indication of initiation of policy normalisation by global central banks including the US Fed and BoE may weigh on EM currencies including the INR. That said, the INR should get support from a gradual pace of normalisation, continued economic recovery, comfortable current account situation and renewed foreign capital inflows into debt markets. Moreover, adequate foreign exchange reserves (US$639bn as on September 17th, +US$62bn in FY22 TD) is expected to curtail the volatility and limit the depreciating bias.

- **Strong exports and lower imports narrowed trade deficit to a three-quarter low:** India's merchandise trade deficit narrowed to a three-quarter low of US$30.7bn in Q1FY22 from US$41.7bn in Q4FY21. This was primarily led by a 6.7%QoQ expansion in the outbound shipments accompanied with 3.7%QoQ curtailment in overall inbound shipments. While exports exhibited resilience on buoyant external demand, imports bore the brunt of localised restrictions imposed in the wake of virulent second wave, that in turn hampered recovery in domestic demand that was shaping up till Q4FY21. Within imports, while non-oil import bill contracted by 6.7%QoQ owing to a sharp drop in gold imports (-56%QoQ), oil imports witnessed a strong growth of 7.5%QoQ, thanks to surging crude oil prices. Non-oil non gold imports, however, grew by a modest 3%QoQ growth, thereby reflecting the impact of relatively less stringent and localised restrictions during second wave. On a YoY basis, imports and exports surged by a strong 102.8% and 87% YoY, albeit off a very depressed base.

India's current account balance surprised on the upside and registered a surplus of US$6.5bn or 0.9%GDP in Q1FY22.

- **Current account balance turned surplus in Q2FY22:** Net invisible receipts grew by 10.8%QoQ to US$37.2bn in Q1FY22, thanks to a surge in net services surplus and lower investment outflows. Services surplus rose by 10%QoQ, broadly led by software services. Alongside, traction in secondary income surplus in the form of higher transfers aided the invisible receipts. A sharp contraction in trade deficit, and strong invisible receipts led to current account balance recording a surplus of US$6.5bn or 0.9% of GDP after registering deficit for two consecutive quarters.

- **Strong FDI and banking capital inflows more than offfset foreign portfolio outflows:** The capital account balance gained significant traction and rose by 110% QoQ to $25.8bn in Q1FY22—the second highest print in last eight quarters. This was primarily on the back of strong foreign direct investment inflows (344%QoQ), supported by a slew of government policy reforms, as well as robust banking capital inflows. However, tepid foreign portfolio inflows during the quarter, weighed down by subdued confidence amidst faltering growth prospects in the wake of renewed COVID-induced restrictions kept capital account surplus in check. Net FPI inflows stood a mere US$0.4bn in Q1FY22, down 95%QoQ. Even net ECB flows declined by 85% QoQ to US$0.9bn against inflows of US$6bn in the previous quarter. Higher-than-expected current account surplus and healthy foreign capital inflows resulted in Balance of Payments (BoP) recording a surplus of US$31.9bn in Q1FY22—the second highest record surplus.

With current account balance turning into surplus and capital flows gaining significant traction, BoP surplus for Q1FY22 soared by 840%QoQ/61%YoY to US$31.9bn--second highest record surplus.

- **Expect FY22 CAD at 1% of GDP:** With global growth showing signs of moderation in the wake of slowing credit impulse in China and growth peaking out in US and Euro Area, exports are likely to lose some sheen in H2FY22. However, the moderation is unlikely to be substantial given the existence of enhanced fiscal support and ongoing significant progress in vaccination drives continues to provide a conducive environment for a sustained export growth momentum. Import growth, however, is expected to outpace exports in the wake of a) easing lockdown restrictions, b) increasing pace of vaccinations, c) rising crude oil and other commodity prices, and d) a favourable base. Consequently, we expect current account balance to slip into deficit again in FY22, with our estimate pegged at 1% of GDP. This, along with moderation in foreign capital inflows amid emerging odds of a sooner-than-expected reversal in easy monetary policy conditions in the US, is expected to translate into a much lower BoP surplus this year.

Expect current account balance to slip into deficit again in FY22, with our estimate pegged at 1% of GDP.

- **INR likely to face depreciating pressures:** Renewed global risk-off environment triggered by China's property and energy sector crisis, soaring commodity prices and a clear indication of initiation of policy normalisation by global central banks including the US Fed and BoE may weigh on EM currencies including the INR. That said, the INR should get support from a gradual pace of normalisation, continued economic recovery, comfortable current account situation and renewed foreign capital inflows into debt markets. Moreover, adequate foreign exchange reserves (US$639bn as on September 17th, +US$62bn in FY22 TD) is expected to curtail the volatility and limit the depreciating bias.

Table 1: Balance of Payments – Quarterly account

US$ bn	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22
Current account	**-15.0**	**-7.6**	**-2.6**	**0.6**	**19.0**	**15.1**	**-1.7**	**-8.2**	**6.5**
CAD/GDP (%)	*-2.1*	*-1.1*	*-0.4*	*0.1*	*3.8*	*2.4*	*-0.2*	*-1.0*	*0.9*
Trade balance	-46.8	-39.7	-36.0	-35.0	-10.8	-14.8	-34.5	-41.7	-30.7
Trade balance/GDP (%)	*-6.6*	*-5.7*	*-5.0*	*-4.8*	*-2.2*	*-2.3*	*-4.7*	*-5.4*	*-4.4*
Merchandise exports	82.7	80.0	81.2	76.5	52.4	75.6	77.2	91.3	97.4
Merchandise imports	129.5	119.6	117.3	111.6	63.2	90.4	111.8	133.0	128.1
Oil imports	35.4	29.9	31.5	33.8	13.2	18.8	21.9	28.7	30.9
Non-oil imports	94.1	89.7	85.8	77.8	50.0	71.6	89.9	104.3	97.3
Invisibles	31.8	32.1	33.4	35.6	29.8	29.9	32.8	33.6	37.2
Net services	20.1	20.9	21.9	22.0	20.5	20.9	23.6	23.5	25.8
Software earnings	21.0	21.1	21.5	21.1	20.8	22.0	23.4	23.5	25.1
Transfers	18.0	20.0	18.9	18.4	17.0	18.4	19.3	18.8	18.9
Investment income	-7.0	-9.6	-8.1	-5.6	-8.3	-10.1	-10.9	-9.7	-8.4
Other invisibles	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.9	0.9
Capital account	**28.6**	**13.6**	**23.6**	**17.4**	**1.2**	**16.1**	**33.5**	**12.3**	**25.8**
Capital acc./GDP (%)	*4.0*	*1.9*	*3.3*	*2.4*	*0.2*	*2.5*	*4.5*	*1.6*	*3.7*
Foreign investments	18.8	9.8	17.6	-1.8	-0.2	31.6	38.2	10.0	12.3
FDI	14.0	7.3	9.7	12.0	-0.8	24.6	17.0	2.7	11.9
FII	4.8	2.5	7.8	-13.7	0.6	7.0	21.2	7.3	0.4
Loans	9.6	3.1	3.1	9.9	2.7	-3.8	0.2	7.7	3.2
ECBs	6.1	3.3	3.2	10.3	-1.2	-3.9	-1.2	6.1	0.9
Banking capital	3.4	-1.8	-2.3	-4.6	2.2	-11.3	-7.6	-4.4	4.1
NRI deposits	2.8	2.3	0.8	2.8	3.0	1.9	3.0	-0.5	2.5
Others	-3.2	2.5	5.2	13.8	-3.6	-0.4	2.8	-1.0	6.3
Errors & Omissions	0.4	-0.9	0.6	0.9	-0.4	0.4	0.7	-0.7	-0.4
Overall balance (BoP)	**14.0**	**5.1**	**21.6**	**18.8**	**19.8**	**31.6**	**32.5**	**3.4**	**31.9**

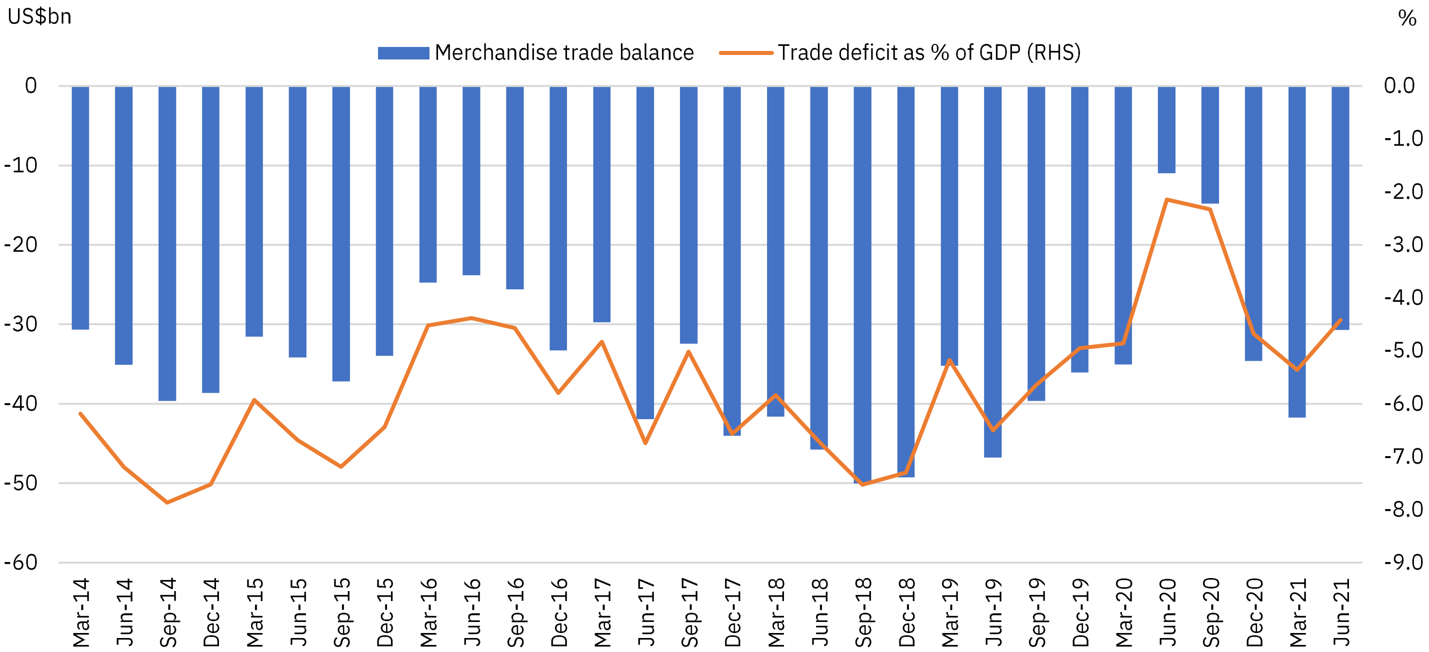
Source: RBI, CMIE Economic Outlook, NSE

Table 2: Balance of Payments – Annual account

US$ bn	FY16	FY17	FY18	FY19	FY20	FY21	FY22E
Current account	**-22.2**	**-14.4**	**-48.7**	**-57.3**	**-24.7**	**23.9**	**-29.8**
CAD/GDP (%)	*-1.1*	*-0.6*	*-1.8*	*-2.1*	*-0.9*	*0.9*	*-1.0*
Trade balance	-130.1	-112.4	-160.0	-180.3	-157.5	-102.2	-158.9
Trade balance/GDP (%)	*-6.2*	*-4.9*	*-6.0*	*-6.6*	*-5.5*	*-3.8*	*-5.2*
Merchandise exports	266.4	280.1	309.0	337.2	320.4	296.3	373.1
% YoY	*-15.9*	*5.2*	*10.3*	*9.1*	*-5.0*	*-7.5*	*25.9*
Merchandise imports	396.4	392.6	469.0	517.5	477.9	398.5	532.0
% YoY	*-14.1*	*-1.0*	*19.5*	*10.3*	*-7.6*	*-16.6*	*33.5*
Oil imports	82.6	86.9	108.7	141.1	130.5	82.7	135.2
Non-oil imports	313.9	305.6	360.3	376.4	347.4	315.8	396.8
Invisibles	107.9	98.0	111.3	123.0	132.8	126.1	129.1
Net services	69.7	68.3	77.6	81.9	84.9	88.6	91.2
Transfers	62.6	56.0	62.4	69.9	75.2	73.5	75.7
Other invisibles	-24.4	-26.3	-28.7	-28.9	-27.3	-36.0	-37.8
Capital account	**41.1**	**36.4**	**91.4**	**54.4**	**83.2**	**63.7**	**69.0**
Capital account/GDP (%)	*2.0*	*1.6*	*3.4*	*2.0*	*2.9*	*2.4*	*2.3*
Foreign investments	31.9	43.2	52.4	30.1	44.4	80.1	52.0
FDI	36.0	35.6	30.3	30.7	43.0	44.0	40.0
FII	-4.1	7.6	22.1	-0.6	1.4	36.1	12.0
Loans	-4.6	2.4	16.7	15.9	25.7	6.9	10.0
Banking capital	10.6	-16.6	16.2	7.4	-5.3	-21.1	5.0
NRI deposits	16.1	-12.4	9.7	10.4	8.6	7.4	10.0
Others	3.2	7.5	6.1	1.0	18.4	-2.2	2.0
Errors & Omissions	-1.1	-0.5	0.9	-0.5	1.0	-0.3	0.0
Overall balance (BoP)	**17.9**	**21.6**	**43.6**	**-3.3**	**59.5**	**87.3**	**39.2**

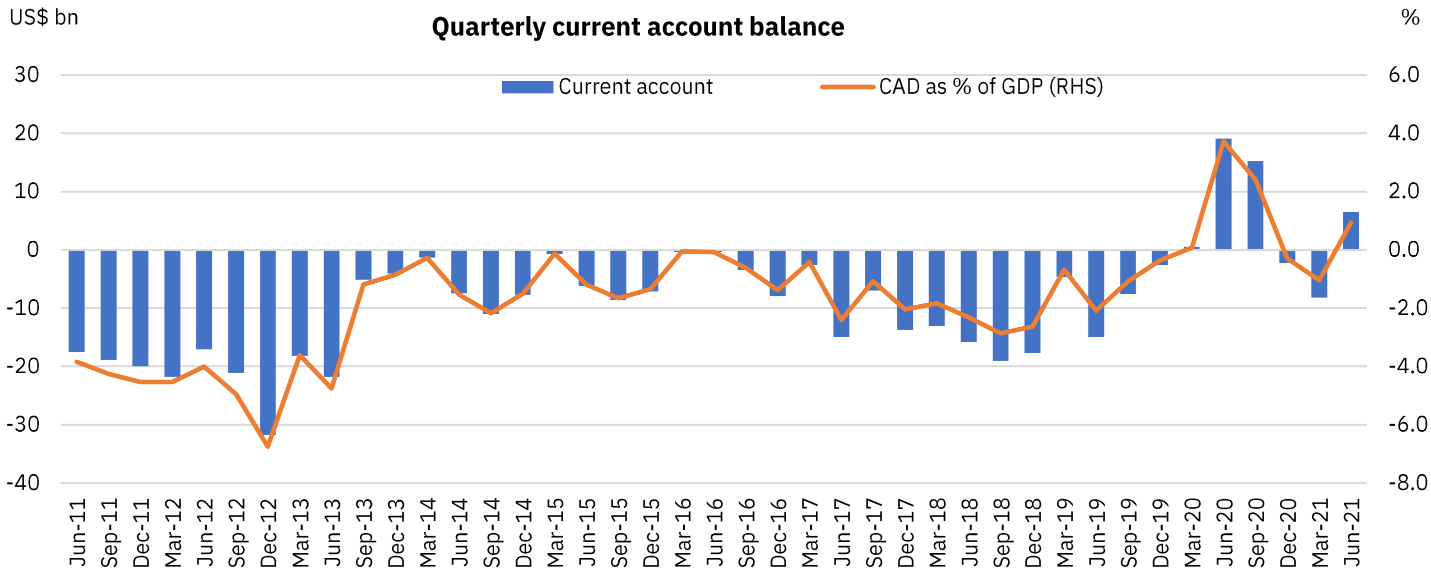
Source: RBI, CMIE Economic Outlook, NSE

Figure 1: Trade deficit narrowed substantially in Q1FY22...



Source: RBI, CMIE Economic Outlook, NSE.

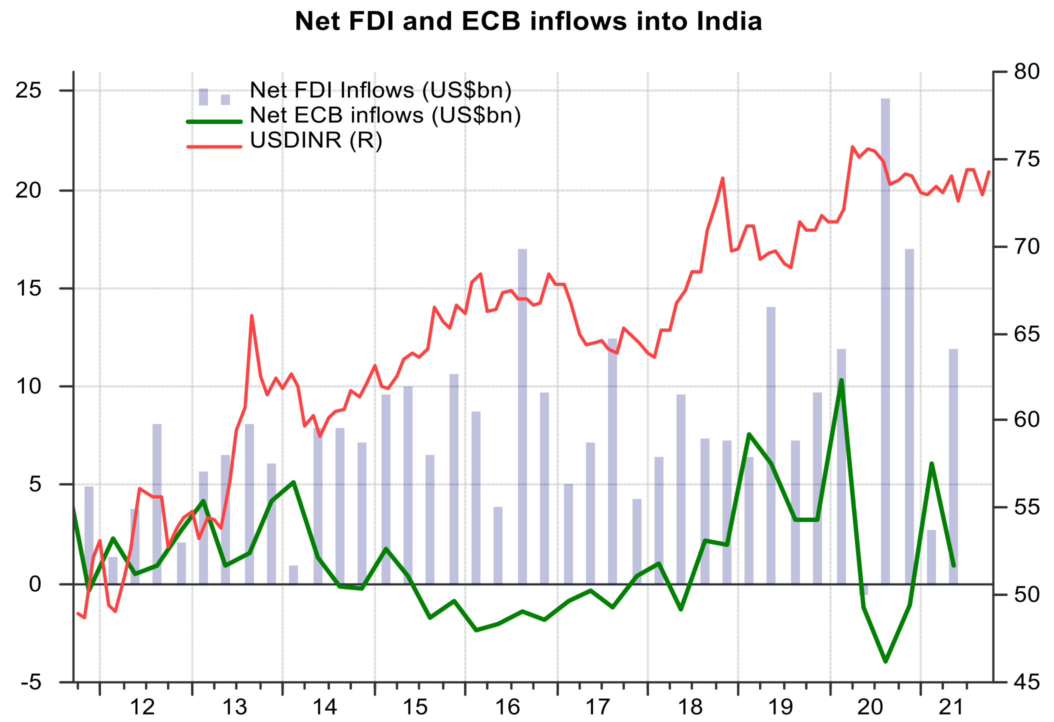
Figure 2: ...turned current account balance into surplus



Source: CMIE Economic Outlook, NSE

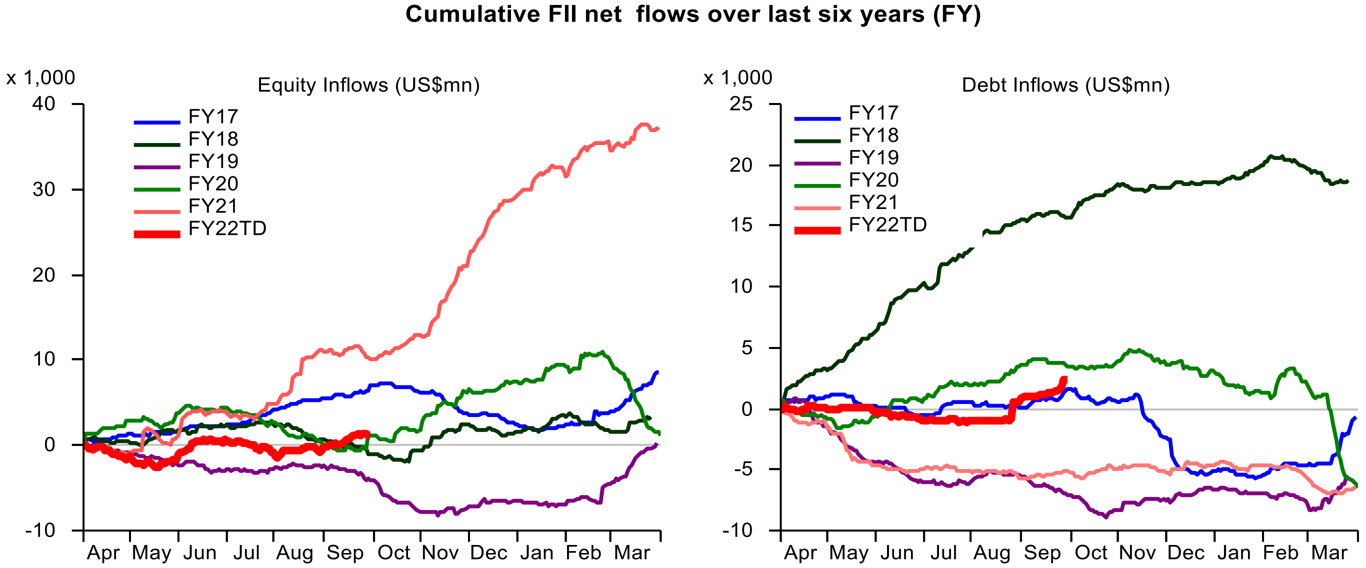
Figure 3: Net quarterly FDI and ECB inflows into India

While Net FDI inflows surged at exorbitant high rate (344%QoQ), net ECB inflows moderated by 85%QoQ



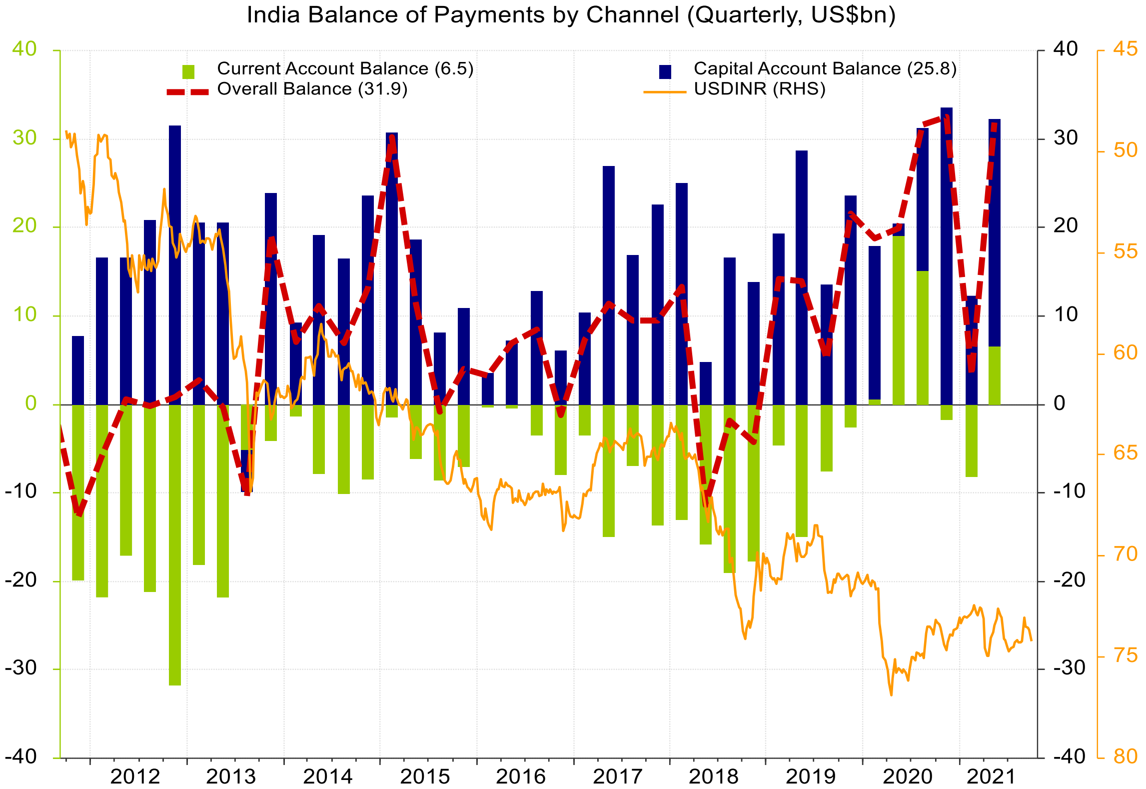
Source: Refinitiv Datastream, NSE

Figure 4: FPI flows into equities moderating amid renewed risk-off environment



Source: Refinitiv Datastream, NSE

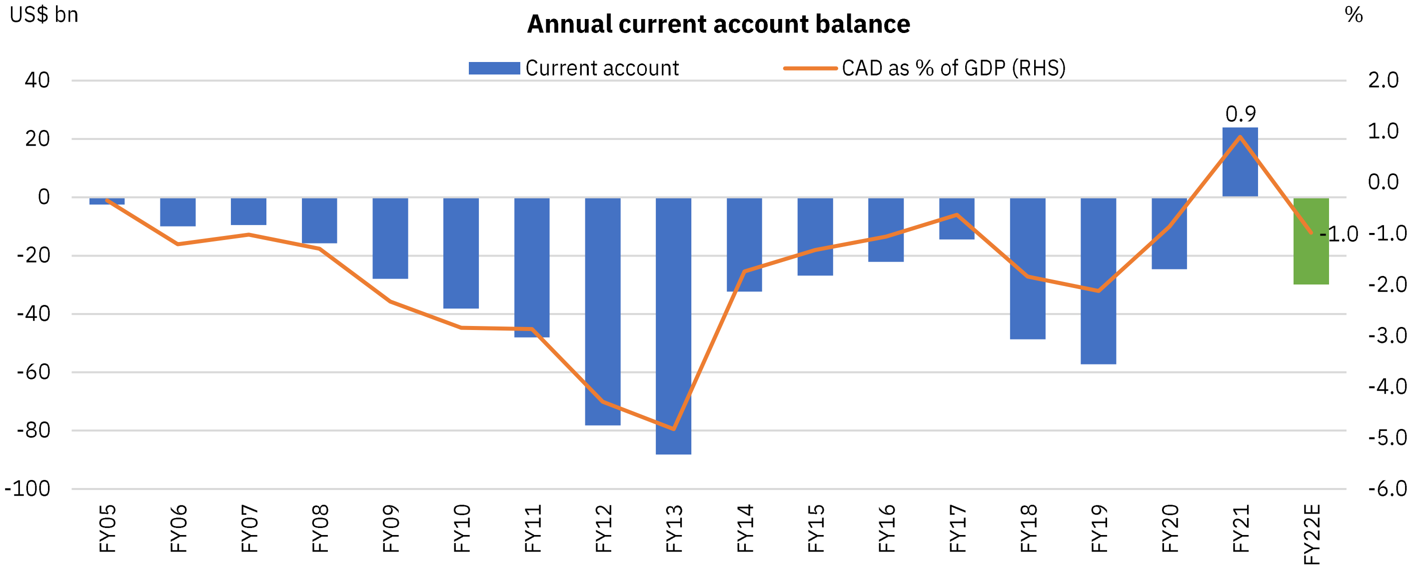
Figure 5: BoP surplus gained significant traction in Q1FY22



Source: Refinitiv Datastream, NSE

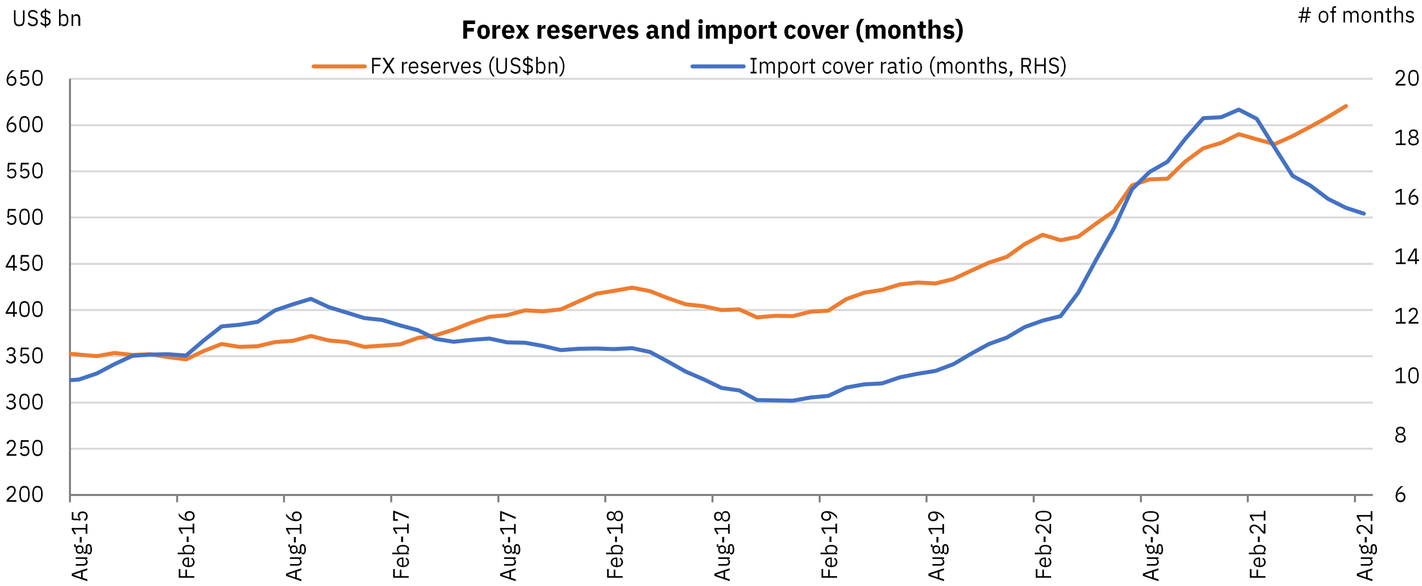
Figure 6: Current account deficit pegged at 1.0% of GDP in FY22

India's current account recorded the first ever surplus since FY04 of US$23.9bn (0.9% of GDP) in FY21 against a deficit of US$24.7bn (0.9% of GDP) in FY20, primarily attributed to lower trade deficit and higher software receipts. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 1.0% of GDP, reflecting higher non-oil imports and rising crude oil prices.



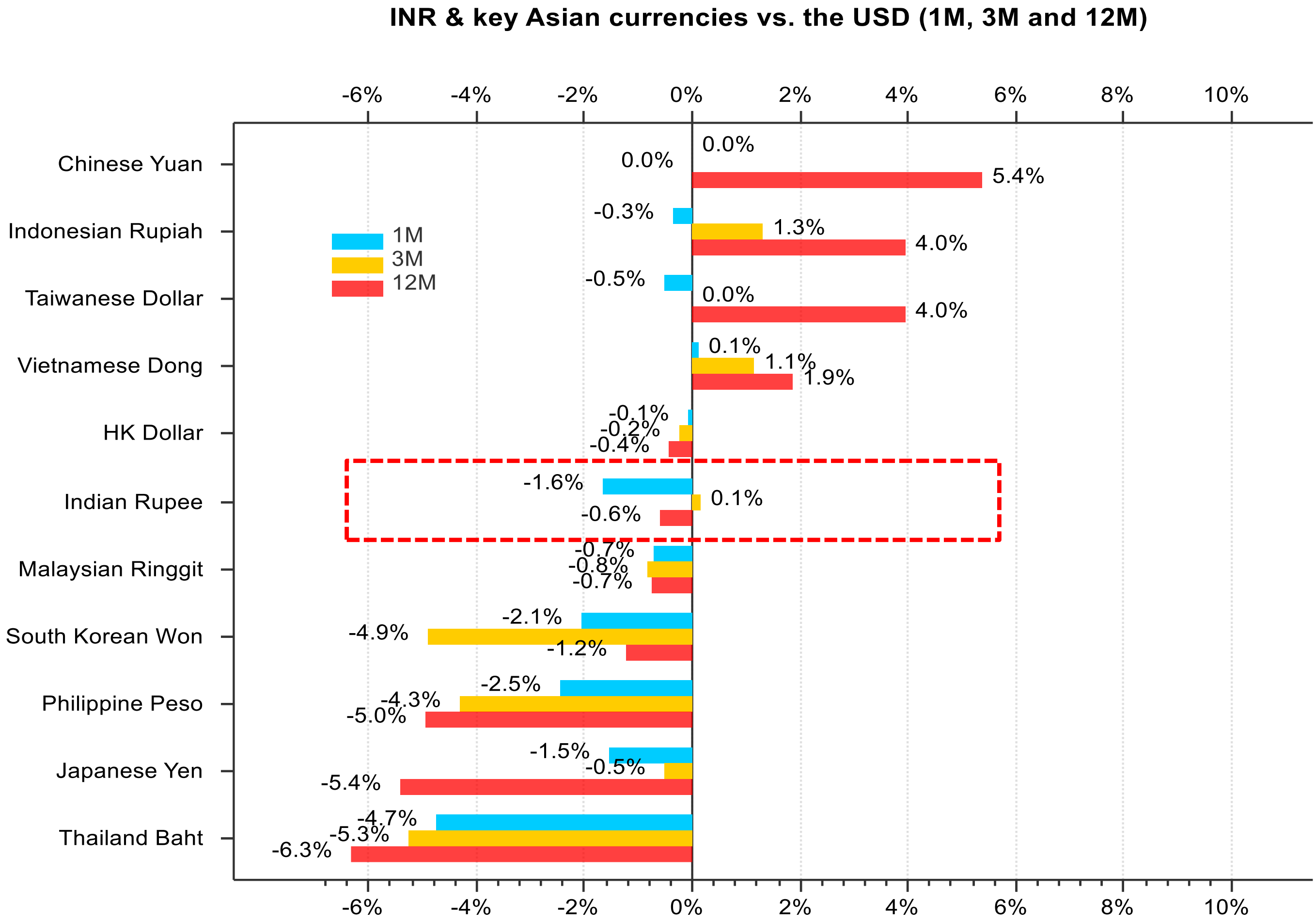
Source: Refinitiv Datastream, NSE

Figure 7: Forex reserves remain at more-than-adequate levels



Source: Refinitiv Datastream, NSE

Figure 8: INR vs. other key Asian market currencies



Source: Refinitiv Datastream, NSE

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