2Q BoP at record high led by current account surplus and robust capital flows

India's current account remained in surplus for the third quarter in a row at US$19.2bn or 2.4% of GDP in Q2FY21—a tad lower than the record-high surplus of US$19.2bn or 3.8% of GDP in the previous quarter. This was on the back of a 24% YoY drop in trade deficit and steady net invisible receipts, even as trade deficit widened on a sequential (QoQ) basis as the economy gradually opened up following the easing of lockdown restrictions. The capital account balance, however, improved meaningfully led by record-high FDI (Foreign Direct Investment) and strong foreign portfolio inflows, with the latter supported by global monetary easing. This, along with a strong current account surplus, resulted in the Balance of Payments (BoP) surplus rising to record-high levels of US$31.6bn in Q2FY21.

Even as trade deficit is expected to widen in the second half of the fiscal thanks to weak global growth outlook and continued normalisation of domestic economy, the full year figure is expected to remain reasonably lower than last year. Our estimates point to near-40% drop in trade deficit in FY21, thereby translating into a current account surplus of 1.1% of GDP in FY21—the first in 17 years. This, coupled with strong foreign capital inflows, should result in a record-high BoP surplus in FY21. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 0.7% of GDP, even as expectations of sustenance of foreign investments is likely to keep BoP in a comfortable surplus position for the third year in a row.

Strong foreign inflows, along with the comfort on current account, bodes well for the INR (+4.9% against the USD from the April peak level), notwithstanding aggressi**ve RBI intervention. India's foreign exchange reserves have** touched fresh record highs of US$581bn as on December 18th, implying an accretion of ~US$106bn in FY21 thus far. This, in turn, has weighed on the INR—it is the worst performer among major Asian currencies in 2020.

- Trade deficit widened in Q2 as economy opened up gradually post lockdown…: India's trade deficit widened on a sequential basis from a 15-year low of US$10.8bn in the previous quarter to US$14.8bn in Q2FY21. This was primarily on the back of moderation in YoY contraction in India's import bill, down 24.4% YoY in Q2FY21 to US$90.4bn vs. -51.3% YoY in the previous quarter, even as exports also improved meaningfully (-5.5% YoY to US$75.6bn vs. 36.7% YoY drop in the previous quarter). While oil imports fell by a strong 37% YoY—attributed to weak demand and lower crude oil prices as compared to the year ago period, non-oil imports fell by relatively lower 20.3%, reflecting gradual normalisation of economic activity as lockdown restrictions were gradually lifted. On a YoY basis, trade deficit was still down 24.4% in Q2FY21.

Current account remained in surplus for the third quarter in a row at US$19.2bn or 2.4% of GDP in Q2FY21—a tad lower than the record-high surplus of US$19.2bn in in the previous quarter.

- **…leading to moderation in current account surplus**: Net invisible receipts remained steady on a QoQ basis at ~US$30bn in Q2FY21 but fell by a modest 5.5% YoY. This was led by a 7.3% QoQ/5.9% YoY growth in services receipts, partly offset by a 7.8% YoY drop in transfers. Steady invisibles and widened-yet-benign trade deficit led to current account balance remaining in surplus for the third quarter in a row at US$15.5bn in Q2FY21 or 2.4% of GDP—a tad lower than the record-high surplus of US$19.2bn or 3.8% of GDP in the previous quarter.

- Capital account balance improved meaningfully leading to record-high BoP surplus in Q2: On the capital account, record-high FDI inflows of US$24.6bn in Q2FY21, thanks to a few large deals including overseas investments in Reliance Jio, and strong foreign portfolio inflows (US$7.0bn in Q2—primarily into equities), supported by an easy global fiscal and monetary policy regime, led to current account surplus widening sharply from a 27-quarter low of US$1.0bn in Q1 to US$15.4bn in Q2. This was partly offset by net ECB outflows and moderation in NRI deposits. Consquently, BoP surplus in Q2 rose to record-high levels of US$31.6bn (US$51.4bn in H1FY21, +1.7x YoY).

A current account surplus and strong capital flows led to BoP surplus widening to record-high levels in Q2FY21.

- Current account surplus expected at 1.1% of GDP in FY21: Weak global growth outlook amidst a continued surge in COVID-19 infections and consequent re-imposition of lockdown restrictions are likely to weigh on exports over the coming months. This, coupled with continued normalisation of domestic economy, would lead to widening of trade deficit in the second half of the fiscal. That said, the full-year's figure is expected to remain reasonably lower than last year, with our estimates factoring in a near-40% YoY drop in trade deficit in FY21, thereby translating into a current account surplus of 1.1% of GDP in FY21—the first in 17 years. This, coupled with strong foreign capital inflows, should result in a record-high BoP surplus in FY21. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 0.7% of GDP, even as expectations of sustenance of foreign investments is likely to keep BoP in a comfortable surplus position for the third year in a row.

  Strong foreign inflows, along with the comfort on current account, bodes well for the INR (+4.9% against the USD from the April peak level), notwithstanding aggressive RBI intervention. India's foreign exchange reserves have touched fresh record highs of US$581bn as on December 18th, implying an accretion of ~US$106bn in FY21 thus far). This, in turn, has limited the gains on the INR—the worst performer among major Asian currencies in 2020

We estimate a current account surplus of 1.1% of GDP in FY21 but expect a deficit of 0.7% of GDP in FY22.

Sustenance of foreign capital inflows should keep the BoP in a comfortably surplus position.

Figure 1: Balance of Payments – Quarterly account

US$ bn	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
Current account	-19.1	-17.8	-4.6	-15.0	-7.6	-2.6	0.6	19.2	15.5
CAD/GDP (%)	*-2.9*	*-2.7*	*-0.7*	*-2.1*	*-1.1*	*-0.4*	*0.1*	*3.8*	*2.4*
Trade balance	-50.0	-49.3	-35.2	-46.8	-39.7	-36.0	-35.0	-10.8	-14.8
Trade balance/GDP (%)	*-7.5*	*-7.4*	*-5.0*	*-6.6*	*-5.7*	*-5.0*	*-4.8*	*-2.1*	*-2.3*
Merchandise exports	83.4	83.1	87.4	82.7	80.0	81.2	76.5	52.4	75.6
Merchandise imports	133.4	132.4	122.6	129.5	119.6	117.3	111.6	63.1	90.4
Oil imports	35.3	38.4	32.4	35.4	29.8	31.5	33.8	13.2	18.8
Non-oil imports	98.2	94.0	90.1	94.1	89.8	85.8	77.7	49.9	71.6
Invisibles	31.0	31.5	30.6	31.8	32.1	33.4	35.6	30.0	30.3
Net services	20.3	21.7	21.3	20.1	20.9	21.9	22.0	20.5	21.2
Software earnings	19.3	19.9	19.9	21.0	21.1	21.5	21.1	20.8	22.3
Transfers	19.3	17.4	16.2	18.0	20.0	18.9	18.4	17.0	18.4
Investment income	-9.1	-8.3	-7.5	-7.0	-9.6	-8.1	-5.6	-8.2	-10.0
Other invisibles	0.5	0.8	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Capital account	16.6	13.8	19.2	28.6	13.6	23.6	17.4	1.0	15.4
Capital acc./GDP (%)	*2.5*	*2.1*	*2.7*	*4.0*	*1.9*	*3.3*	*2.4*	*0.2*	*2.4*
Foreign investments	7.6	5.2	15.9	18.8	9.8	17.6	-1.8	-0.2	31.6
FDI	7.4	7.3	6.4	14.0	7.3	9.7	12.0	-0.8	24.6
FII	0.2	-2.1	9.4	4.8	2.5	7.8	-13.7	0.6	7.0
Loans	6.9	2.9	10.3	9.6	3.1	3.1	9.9	2.5	-4.2
ECBs	2.2	2.0	7.5	6.1	3.3	3.2	10.3	-1.4	-4.3
Banking capital	0.5	4.9	-8.1	3.4	-1.8	-2.3	-4.6	2.2	-11.2
NRI deposits	3.3	0.1	3.4	2.8	2.3	0.8	2.8	3.0	1.9
Others	1.5	0.7	1.2	-3.2	2.5	5.2	13.8	-3.6	-0.7
Errors & Omissions	0.6	-0.3	-0.4	0.4	-0.9	0.6	0.9	-0.4	0.6
Overall balance (BoP)	-1.9	-4.3	14.2	14.0	5.1	21.6	18.8	19.8	31.6

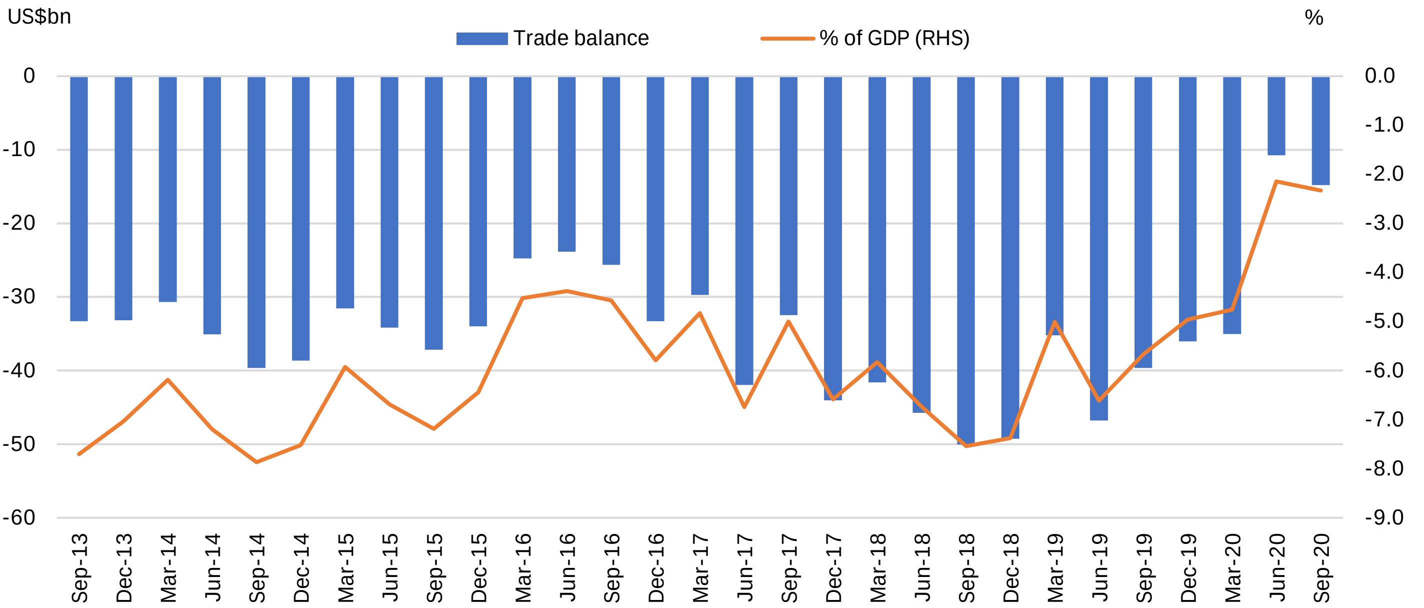
Source: RBI, CMIE Economic Outlook, NSE

Figure 2: Balance of Payments – Annual account

US$ bn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22
Current account	-22.2	-14.4	-48.7	-57.3	-24.7	28.2	-21.2
CAD/GDP (%)	*-1.1*	*-0.6*	*-1.8*	*-2.1*	*-0.9*	*1.1*	*-0.7*
Trade balance	-130.1	-112.4	-160.0	-180.3	-157.5	-92.5	-144.2
Trade balance/GDP (%)	*-6.2*	*-4.9*	*-6.0*	*-6.6*	*-5.5*	*-3.6*	*-4.8*
Merchandise exports	266.4	280.1	309.0	337.2	320.4	276.9	315.7
Merchandise imports	396.4	392.6	469.0	517.5	477.9	369.4	459.9
Oil imports	82.6	86.9	108.7	141.1	130.5	82.5	101.3
Non-oil imports	313.9	305.6	360.3	376.4	347.4	286.9	358.7
Invisibles	107.9	98.0	111.3	123.0	132.8	120.7	123.0
Net services	69.7	68.3	77.6	81.9	84.9	83.6	86.1
Transfers	62.6	56.0	62.4	69.9	75.2	69.4	70.8
Other invisibles	-24.4	-26.3	-28.7	-28.9	-27.3	-32.3	-33.9
Capital account	41.1	36.4	91.4	54.4	83.2	75.0	64.0
Capital account/GDP (%)	*2.0*	*1.6*	*3.4*	*2.0*	*2.9*	*2.9*	*0.0*
Foreign investments	31.9	43.2	52.4	30.1	44.4	68.0	45.0
FDI	36.0	35.6	30.3	30.7	43.0	38.0	35.0
FII	-4.1	7.6	22.1	-0.6	1.4	30.0	10.0
Loans	-4.6	2.4	16.7	15.9	25.7	10.0	12.0
Banking capital	10.6	-16.6	16.2	7.4	-5.3	-5.0	5.0
NRI deposits	16.1	-12.4	9.7	10.4	8.6	9.0	10.0
Others	3.2	7.5	6.1	1.0	18.4	2.0	2.0
Errors & Omissions	-1.1	-0.5	0.9	-0.5	1.0	0.0	0.0
Overall balance (BoP)	17.9	21.6	43.6	-3.3	59.5	103.2	42.8

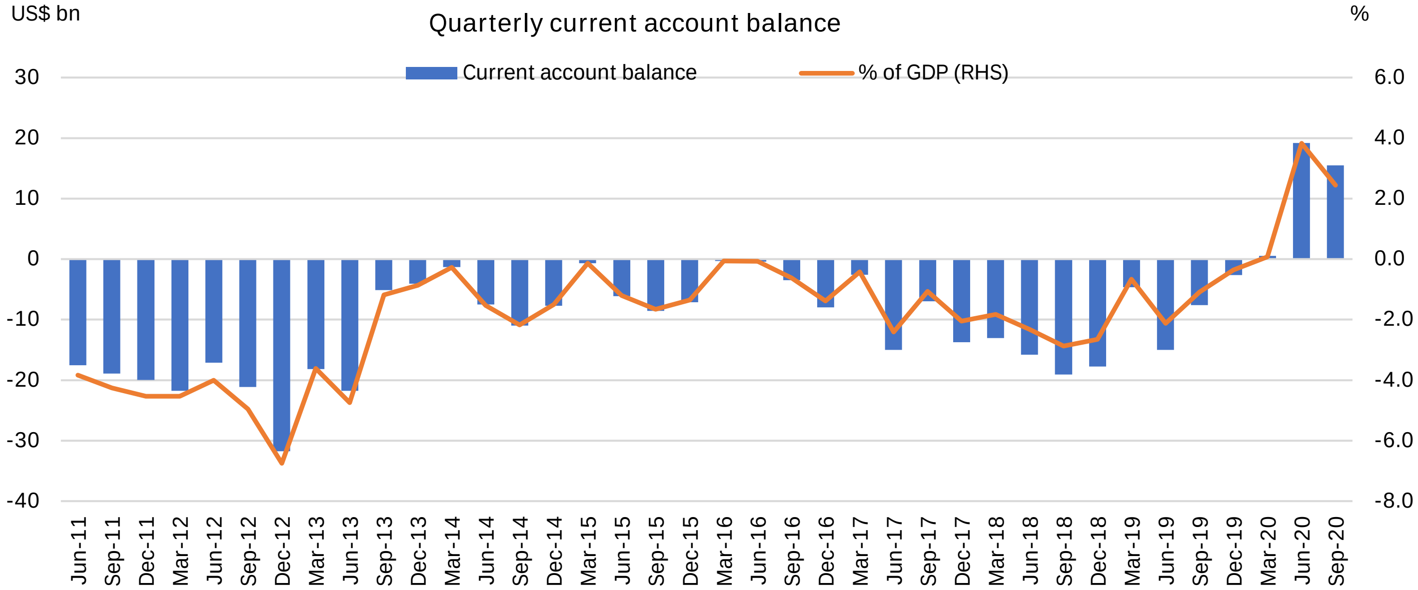
Source: RBI, CMIE Economic Outlook, NSE

Figure 3: Trade deficit widens in Q2FY21...



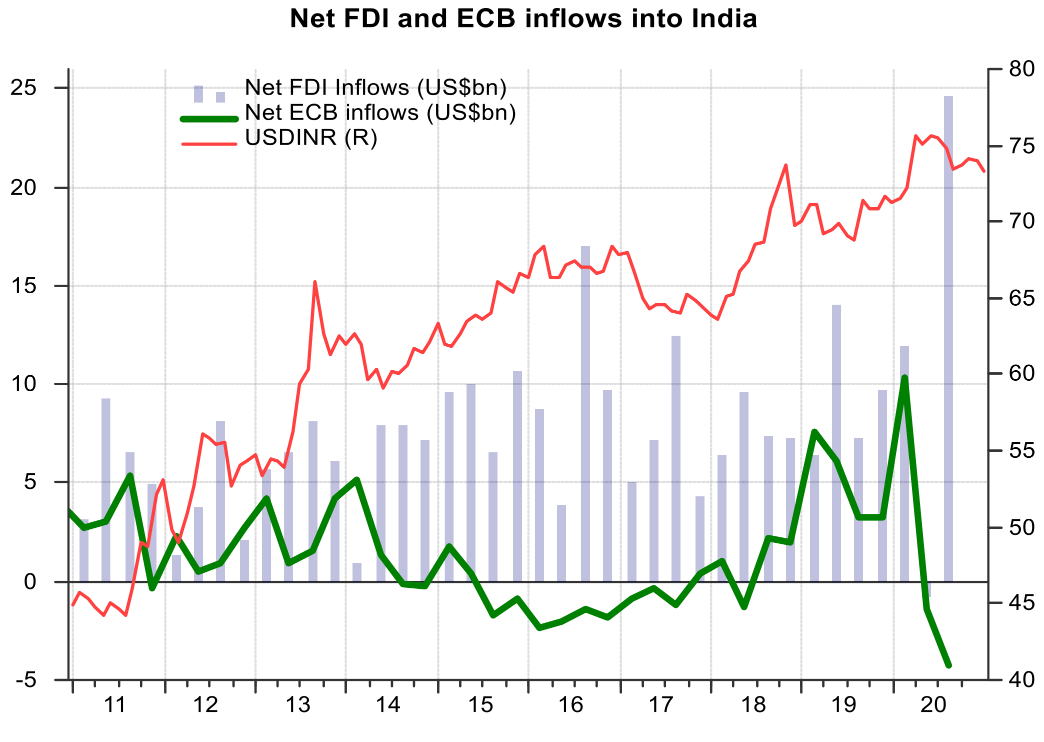
Source: RBI, CMIE Economic Outlook, NSE.

Figure 4: ...Leading to moderation of current account surplus from record-high levels



Source: Refinitiv Datastream, NSE

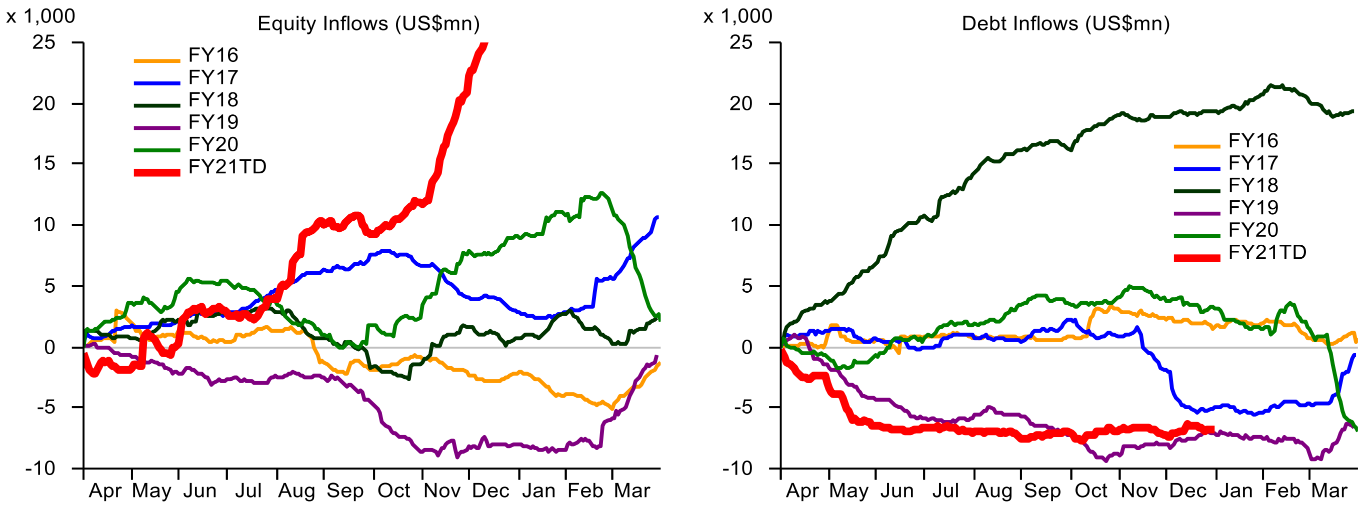
Figure 5: FDI inflows surged to record-high levels in Q2FY21 ...



Source: Refinitiv Datastream, NSE

Figure 6: **...**with strong foreign portfolio inflows during the quarter**...**

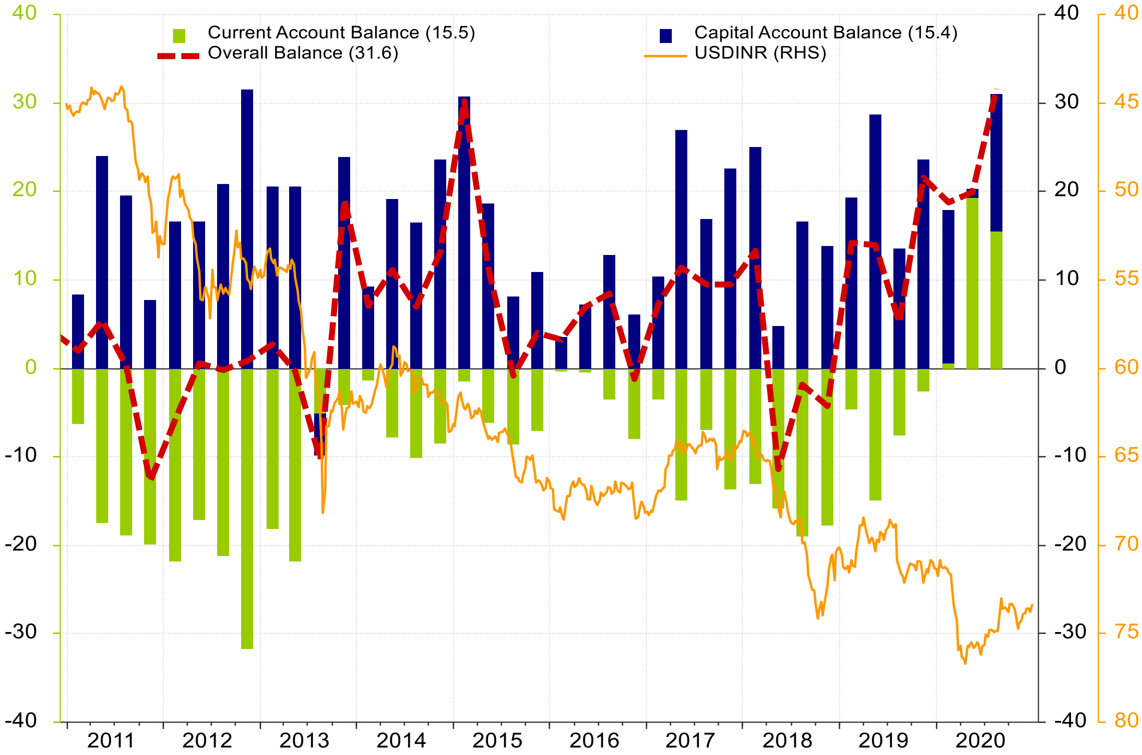
Cumulative FII net flows over last six years (FY)



Source: Refinitiv Datastream, NSE

Figure 7: **...translating into** a meaningful improvement in capital account surplus

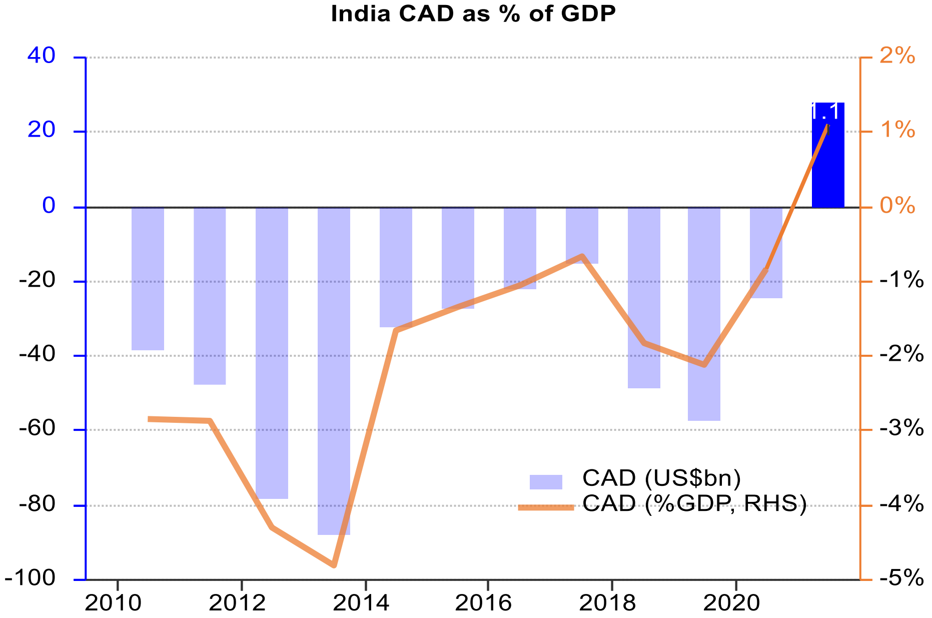
India Balance of Payments by Channel (Quarterly, US$bn)



Source: Refinitiv Datastream, NSE

Figure 8: Current account surplus pegged at 1.1% of GDP in FY21; expect deficit of 0.7% of GDP in FY22

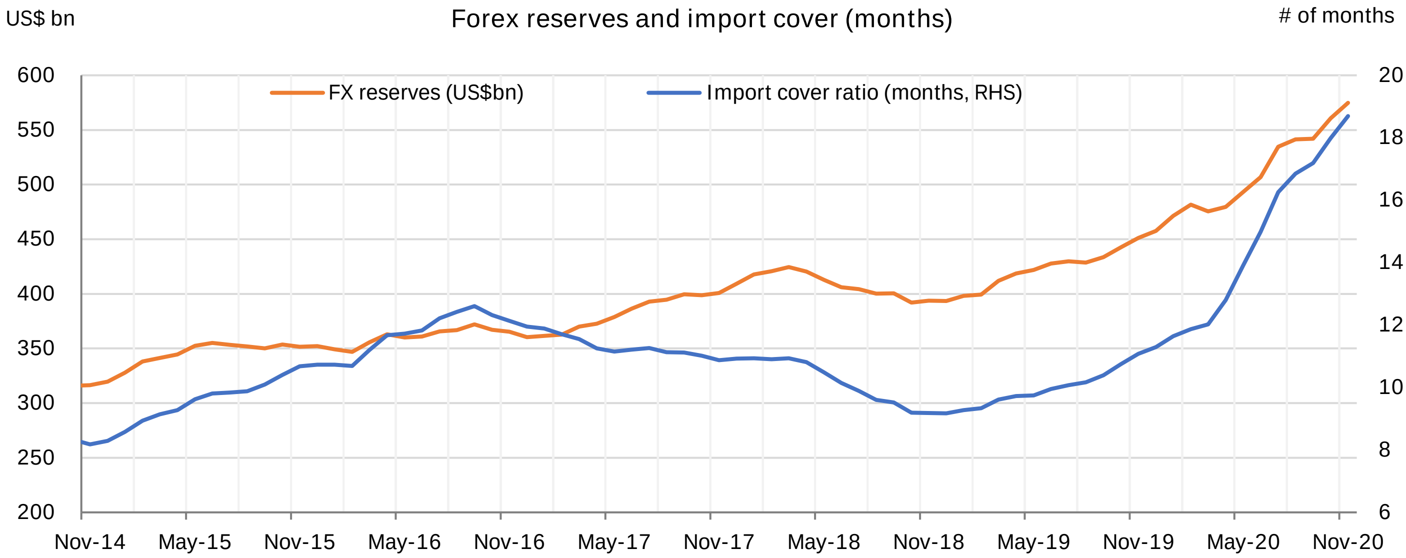
A significant contraction in trade deficit in FY21 is expected to translate into a current account surplus of 1.1% of GDP in FY21—the first surplus in 17 years, vs. a deficit of 0.9% of GDP in FY20. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 0.7% of GDP, even as expectations of sustenance of foreign investments is likely to keep BoP in a comfortable surplus position for the third year in a row.



Source: Refinitiv Datastream, NSE

Figure 9: Forex reserves are all all-time high levels, leading to a sharp rise in import cover

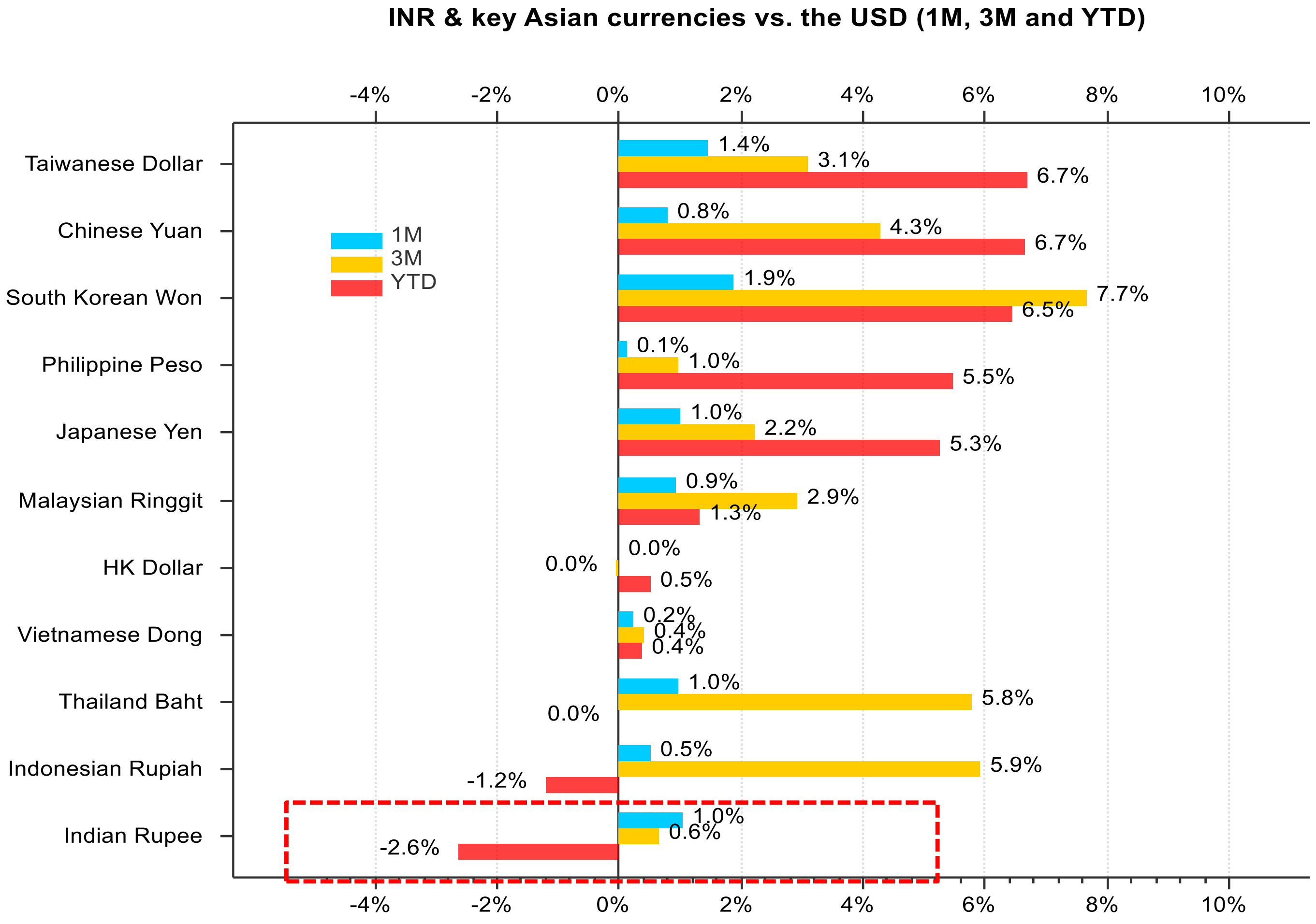
A significant accretion to forex reserves over the years, and particularly this fiscal year (+US$ 69bn in FY21 till date), has resulted in a significant improvement in import cover, further supported by moderation in domestic demand. After falling to eight months in 2014, India's import cover has improved sharply to nearly 19 months now, thereby significantly reducing India's external vulnerability.



Source: Refinitiv Datastream, NSE

Figure 10: Aggressive RBI intervention has weighed on the INR this year

Even as strong foreign capital inflows and a comfortable current account bodes well for the INR, aggressive dollar purchases by the RBI—reflected in record-high FX reserves—have constrained gains on the INR. The INR is the worst performing currency among major Asian currencies in 2020.



Source: Refinitiv Datastream, NSE

Economic Policy & Research

Tirthankar Patnaik, PhD	tpatnaik@nse.co.in	+91-22-26598149
Prerna Singhvi, CFA	psinghvi@nse.co.in	+91-22-26598316
Runu Bhakta, PhD	rbhakta@nse.co.in	+91-22-26598163
Ashiana Salian	asalian@nse.co.in	+91-22-26598163
Simran Keswani	skeswani@nse.co.in	+91-22-26598163

Disclaimer

This report is intended solely for information purposes. This report is under no circumstances intended to be used or considered as financial or investment advice, a recommendation or an offer to sell, or a solicitation of any offer to buy any securities or other form of financial asset. The Report has been prepared on best effort basis, relying upon information obtained from various sources, but we do not guarantee the completeness, accuracy, timeliness or projections of future conditions provided herein from the use of the said information. In no event, NSE, or any of its officers, directors, employees, affiliates or other agents are responsible for any loss or damage arising out of this report. All investments are subject to risk, which should be considered prior to making any investment decisions. Consult your personal investment advisers before making an investment decision.