NSE

Macro Review

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Current account deficit widened to a nine-quarter high in Q2 on higher imports

India's current account balance surprised on the negative (consensus estimates: US$8.9bn deficit) by recording a deficit of US$9.6bn or -1.3% of GDP in Q2FY22 vs. a surplus of US$6.6bn or +0.9% of GDP in the preceding quarter. This was primarily led by a 45%QoQ increase in merchandise trade deficit, thanks to a strong surge in imports (17%QoQ), partly offset by a decent 8% QoQ growth in exports. While imports witnessed a strong rebound thanks to rising commodity prices as well as recovery in consumer demand ahead of the festive season in the wake of receding cases, easing restrictions, and rising pace of vaccinations, exports exhibited resilience on persistent traction in economic activities of advanced economies. The Capital account recorded a substantial surplus of US$40bn, +57% QoQ, as better foreign portfolio inflows and a one-time SDR allocation of US$17.9bn by the IMF more than made up for muted foreign direct investment inflows. This translated into a Balance of Payment (BoP) surplus of US$31.2bn in Q2FY22. Excluding the SDR allocation, BoP surplus was much lower at US$13.3bn.

A sharp surge in trade deficit over the last few months, reflecting higher commodity prices and strong festive demand, may result in current account deficit widening to more than eight-year high of 3% of GDP in Q3FY22. With the Omicron strain igniting renewed concerns about global growth, exports might lose further sheen in the upcoming months, even as enhanced fiscal support and significant progress in vaccination drives may limit the downside. Strong demand and elevated commodity prices are likely to keep imports buoyant. For full year, we now expect current account deficit at US$49bn or 1.5% of GDP. This, along with moderation in foreign capital inflows in the wake of reversal in easy monetary policy conditions in the US, is expected to translate into a lower BoP surplus this year even after considering SDR allocation.

Renewed global risk aversion prompted by the emergence of 'Omicron' variant and reversal of easier monetary policy stance by important central banks including the US Fed has been weighing on the EM currencies. The INR has been no different, having seen a depreciation of nearly 3.7% from Nov-lows until mid-December. Going ahead, the Indian Rupee is most likely to face depreciating pressures on account of widening trade deficit coupled with divergent policy stance between the Fed and the RBI. However, adequate foreign exchange reserves (US$635bn as on Dec 24th, +US$58bn in FY22TD) should curtail volatility and limit depreciating bias.

India's current account balance surprised on the downside and registered a deficit of US$9.6bn or -1.3% of GDP.

- **Merchandise trade deficit widened to a nine-quarter high:** India's merchandise trade deficit widened to a nine-quarter high of US$44.4bn in Q2FY22 from US$30.7bn in Q1FY21. This was primarily led by a 17%QoQ expansion in the inbound shipments. However, continued buoyancy in external demand, as reflected by 8%QoQ rise in exports, limited merchandise trade deficit. While imports witnessed a strong rebound thanks to rising commodity prices as well as recovery in consumer demand ahead of the festive season in the wake of receding cases, easing restrictions, and rising pace of vaccinations, exports exhibited resilience on persistent traction in economic activities of advanced economies. Oil imports rose by a strong 27% QoQ, reflecting higher crude oil prices, non-oil imports surged by 13% QoQ as demand picked up ahead of the festive season. On a YoY basis, imports surged by a strong 65% owing to a sharp 108% YoY rise in oil imports and 54% YoY in non-oil imports, albeit off a low base, indicating an improvement in domestic consumption impulses. Exports also rose by 39% YoY, thanks to low base and strengthened external demand.
- **Lower invisible receipts also attributed to wider current account deficit:** Net invisible receipts fell by 7% QoQ to US$35bn in Q2FY22, thanks to a lower net services surplus and higher outflow of investment income. Services surplus fell marginally by 1% QoQ, broadly led by drop in financial & communication services receipts. Primary income gap widened to US$9.7bn from US$7.5bn on account of higher net investment income outflow (-US$10.4bn in Q2FY22 vs. -US$8.4bn in Q1FY22), thereby weighing on the net invisible receipts. On the positive side,

persistent improvement in software and business services and steady private transfers kept the downside limited for net invisible receipts.

- **BoP recorded a huge surplus, aided by higher SDR allocation:** The capital account balance gained significant traction and recorded a 57%QoQ growth, bolstered by higher SDR allocation of US$17.9bn. The IMF had increased SDF allocation for all member countries to help cope with Covid19. However, excluding the SDR allocation, capital account surplus actually dropped by 13% QoQ to US$22.2bn in Q2FY22. Pick-up in foreign portfolio investment inflows during the quarter (+US$3.9bn vs. US$0.4bn in the previous quarter), coupled with higher external commercial borrowings (US$4.1bn, up 5.5x QoQ), aided capital account surplus, making up for lower foreign direct investment flows (US$9.5bn, -19%QoQ) and banking capital due to outflows of NRI deposits. This translated into a BoP surplus of US$31.2bn in Q2FY22, broadly similar to level seen in the previous quarter. Excluding the SDR allocation, BoP surplus was much lower at US$13.3bn.

One-time SDR allocation of US$17.9bn by the IMF resulted in a huge BoP surplus of US$31.2bn in Q2FY22, excluding which BoP surplus stood much lower at US$13.3bn.

- **Expect current account deficit at 1.5% of GDP in FY22:** A sharp surge in trade deficit over the last few months, reflecting higher commodity prices and strong festive demand, is expected to result in current account deficit widening to more than eight-year high of 3% of GDP in Q3FY22. With the Omicron strain igniting renewed concerns about global growth, exports might lose further sheen in the upcoming months, even as enhanced fiscal support and significant progress in vaccination drives may limit the downside. Strong demand and elevated commodity prices are likely to keep imports buoyant. For full year, we now expect current account deficit at US$49bn or 1.5% of GDP. This, along with moderation in foreign capital inflows in the wake of reversal in easy monetary policy conditions in the US, is expected to translate into a lower BoP surplus this year even after considering SDR allocation.

We now expect current account deficit at 1.5% of GDP in FY22, higher than our previous estimate of 1.1%.

- **Policy divergences will continue to pose headwinds for EM currencies:** Renewed global risk aversion prompted by the emergence of 'Omicron' variant and reversal of easier monetary policy stance by important central banks including the US Fed has been weighing on the EM currencies. The INR has been no different, having seen a depreciation of nearly 3.7% from Nov-lows until mid-December. Going ahead, the Indian Rupee is most likely to face depreciating pressures on account of widening trade deficit coupled with divergent policy stance between the Fed and the RBI. However, adequate foreign exchange reserves (US$635bn as on Dec 24th, +US$58bn in FY22TD) is expected to curtail the volatility and limit the depreciating bias.

Table 1: Balance of Payments – Quarterly account

US$ bn	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Current account	**-7.6**	**-2.6**	**0.6**	**19.0**	**15.1**	**-1.7**	**-8.2**	**6.5**	**-9.6**
CAD/GDP (%)	*-1.1*	*-0.4*	*0.1*	*3.8*	*2.4*	*-0.2*	*-1.0*	*0.9*	*-1.3*
Trade balance	-39.7	-36.0	-35.0	-10.8	-14.8	-34.5	-41.7	-30.7	-44.4
Trade balance/GDP (%)	*-5.7*	*-5.0*	*-4.8*	*-2.2*	*-2.3*	*-4.7*	*-5.4*	*-4.4*	*-5.9*
Merchandise exports	80.0	81.2	76.5	52.4	75.6	77.2	91.3	97.4	104.8
Merchandise imports	119.6	117.3	111.6	63.2	90.4	111.8	133.0	128.1	149.3
Oil imports	29.9	31.5	33.8	13.2	18.8	21.9	28.7	30.9	39.2
Non-oil imports	89.7	85.8	77.8	50.0	71.6	89.9	104.3	97.3	110.1
Invisibles	32.1	33.4	35.6	29.8	29.9	32.8	33.6	37.2	34.8
Net services	20.9	21.9	22.0	20.5	20.9	23.6	23.5	25.8	25.6
Software earnings	21.1	21.5	21.1	20.8	22.0	23.4	23.5	25.1	26.8
Transfers	20.0	18.9	18.4	17.0	18.4	19.3	18.8	18.9	18.9
Investment income	-9.6	-8.1	-5.6	-8.3	-10.1	-10.9	-9.7	-8.4	-10.4
Other invisibles	0.7	0.7	0.7	0.7	0.7	0.8	0.9	0.9	0.7
Capital account	**13.6**	**23.6**	**17.4**	**1.2**	**16.1**	**33.5**	**12.3**	**25.8**	**40.1**
Capital acc./GDP (%)	*1.9*	*3.3*	*2.4*	*0.2*	*2.5*	*4.5*	*1.6*	*3.7*	*5.3*
Foreign investments	9.8	17.6	-1.8	-0.2	31.6	38.2	10.0	12.3	13.3
FDI	7.3	9.7	12.0	-0.8	24.6	17.0	2.7	11.9	9.5
FII	2.5	7.8	-13.7	0.6	7.0	21.2	7.3	0.4	3.9
Loans	3.1	3.1	9.9	2.7	-3.8	0.2	7.7	3.2	7.6
ECBs	3.3	3.2	10.3	-1.2	-3.9	-1.2	6.1	0.9	4.1
Banking capital	-1.8	-2.3	-4.6	2.2	-11.3	-7.6	-4.4	4.1	0.4
NRI deposits	2.3	0.8	2.8	3.0	1.9	3.0	-0.5	2.5	-0.8
Others	2.5	5.2	13.8	-3.6	-0.4	2.8	-1.0	6.3	18.8
Errors & Omissions	-0.9	0.6	0.9	-0.4	0.4	0.7	-0.7	-0.4	0.7
Overall balance (BoP)	**5.1**	**21.6**	**18.8**	**19.8**	**31.6**	**32.5**	**3.4**	**31.9**	**31.2**

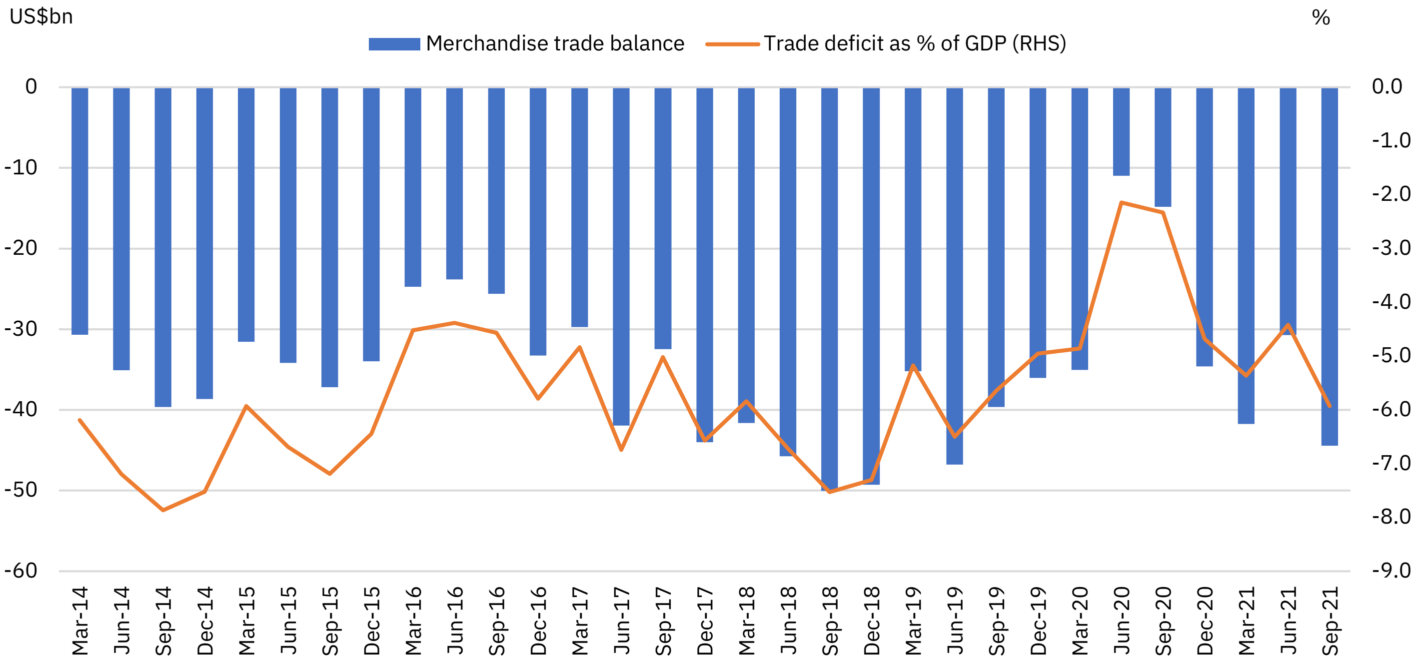
Source: RBI, CMIE Economic Outlook, NSE

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**	**-49.2**
CAD/GDP (%)	*-1.1*	*-0.6*	*-1.8*	*-2.1*	*-0.9*	*0.9*	*-1.5*
Trade balance	-130.1	-112.4	-160.0	-180.3	-157.5	-102.2	-197.4
Trade balance/GDP (%)	*-6.2*	*-4.9*	*-6.0*	*-6.6*	*-5.5*	*-3.8*	*-6.2*
Merchandise exports	266.4	280.1	309.0	337.2	320.4	296.3	408.4
% YoY	*-15.9*	*5.2*	*10.3*	*9.1*	*-5.0*	*-7.5*	37.8
Merchandise imports	396.4	392.6	469.0	517.5	477.9	398.5	605.8
% YoY	*-14.1*	*-1.0*	*19.5*	*10.3*	*-7.6*	*-16.6*	52.0
Oil imports	82.6	86.9	108.7	141.1	130.5	82.7	156.0
Non-oil imports	313.9	305.6	360.3	376.4	347.4	315.8	449.8
Invisibles	107.9	98.0	111.3	123.0	132.8	126.1	148.2
Net services	69.7	68.3	77.6	81.9	84.9	88.6	102.8
Transfers	62.6	56.0	62.4	69.9	75.2	73.5	78.6
Other invisibles	-24.4	-26.3	-28.7	-28.9	-27.3	-36.0	-33.2
Capital account	**41.1**	**36.4**	**91.4**	**54.4**	**83.2**	**63.7**	**97.2**
Capital account/GDP (%)	*2.0*	*1.6*	*3.4*	*2.0*	*2.9*	*2.4*	**3.1**
Foreign investments	31.9	43.2	52.4	30.1	44.4	80.1	47.2
FDI	36.0	35.6	30.3	30.7	43.0	44.0	42.2
FII	-4.1	7.6	22.1	-0.6	1.4	36.1	5.0
Loans	-4.6	2.4	16.7	15.9	25.7	6.9	12.0
Banking capital	10.6	-16.6	16.2	7.4	-5.3	-21.1	8.0
NRI deposits	16.1	-12.4	9.7	10.4	8.6	7.4	5.0
Others	3.2	7.5	6.1	1.0	18.4	-2.2	30.0
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**	**48.0**

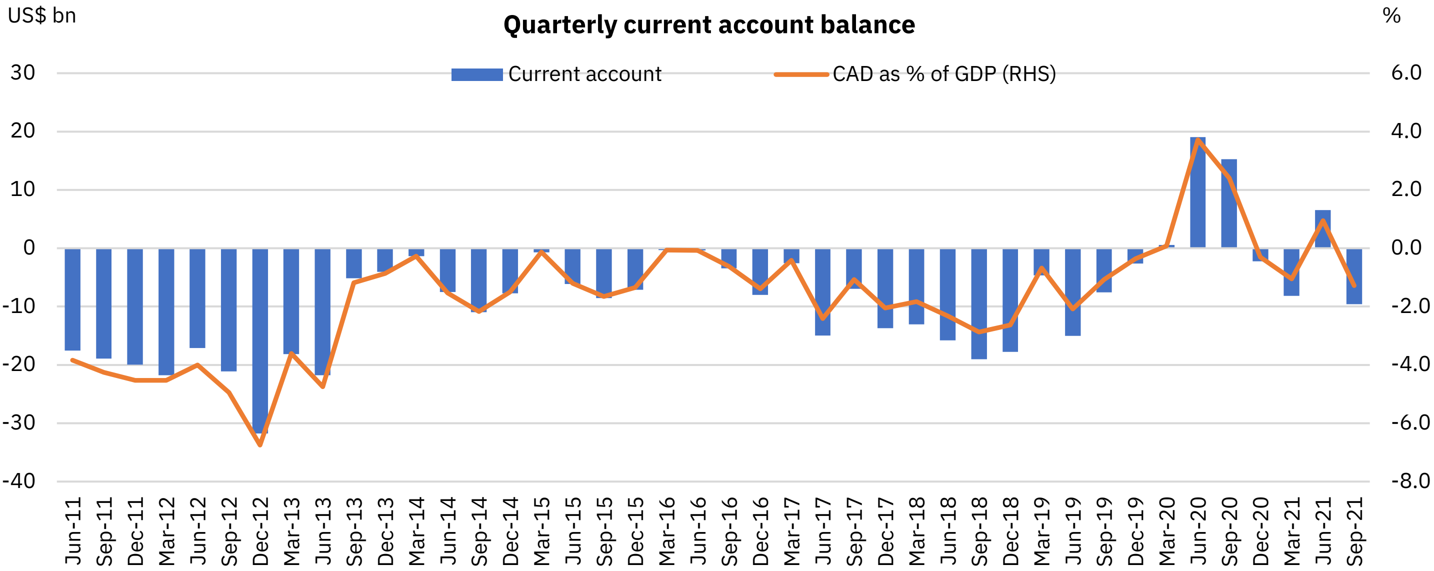
Source: RBI, CMIE Economic Outlook, NSE

Figure 1: Trade deficit widened substantially in Q2FY22...



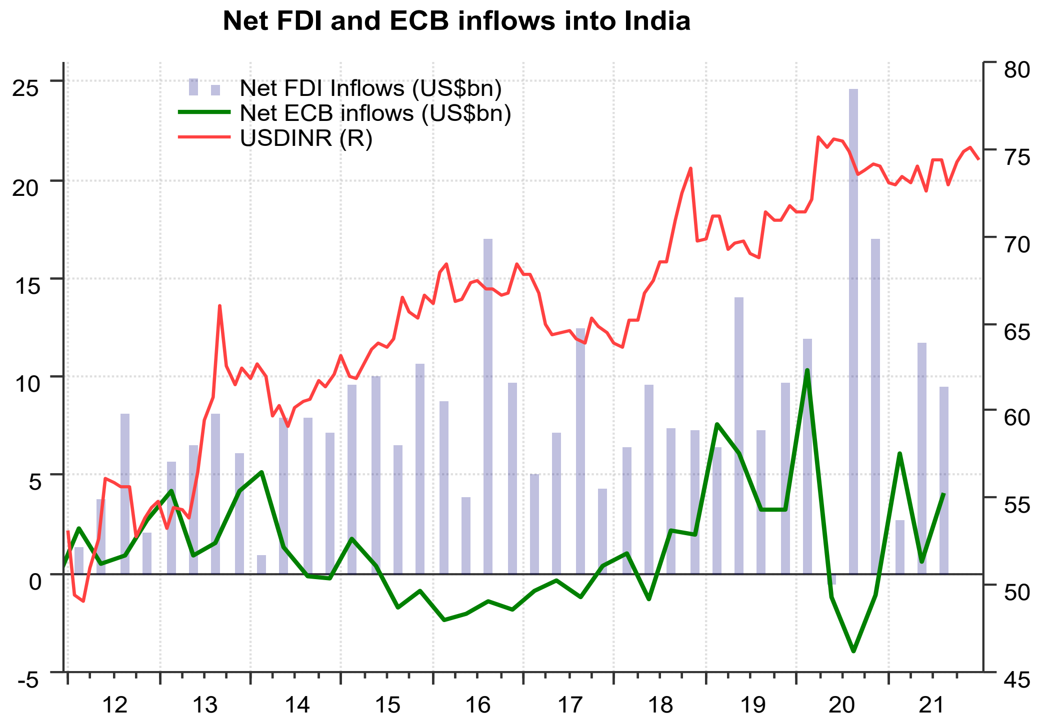
Source: RBI, CMIE Economic Outlook, NSE.

Figure 2: ...taking current account deficit to a nine-quarter high



Source: CMIE Economic Outlook, NSE

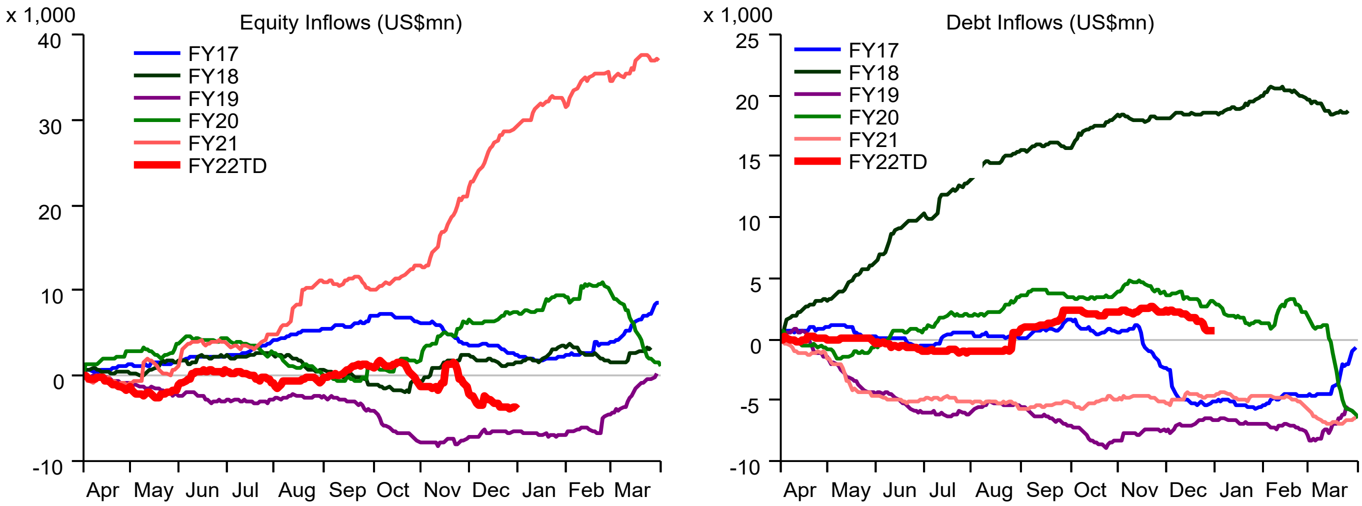
Figure 3: While Net FDI inflows moderated by 19%QoQ, net ECB inflows surged by 549%QoQ



Source: Refinitiv Datastream, NSE

Figure 4: FPI flows surged by 864%QoQ in Q2FY22 even as they have dropped meaningfully in Q3FY22

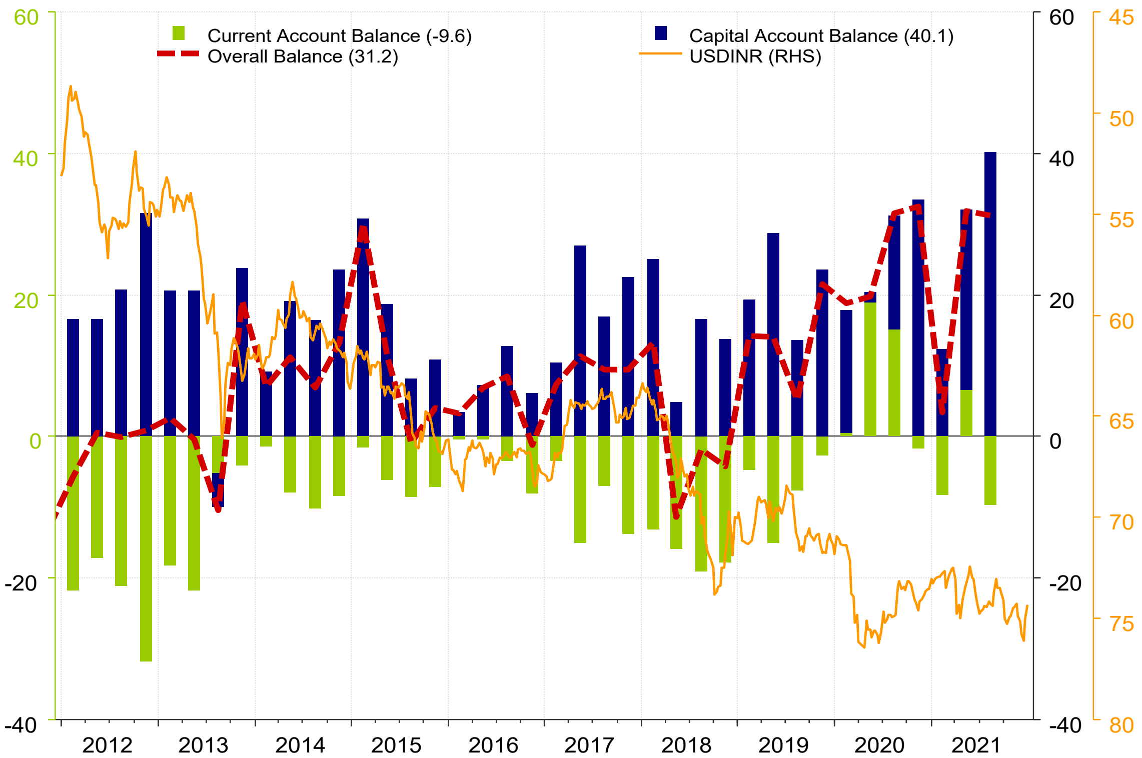
Cumulative FII net flows over last six years (FY)



Source: Refinitiv Datastream, NSE

Figure 5: Notwithstanding wider current account deficit, BoP surplus remained robust at US$31.2bn which was partly due to one-time SDR allocation (US$17.9bn) by the IMF. Excluding SDR allocation, BoP surplus is actually lower at US$13.3bn.

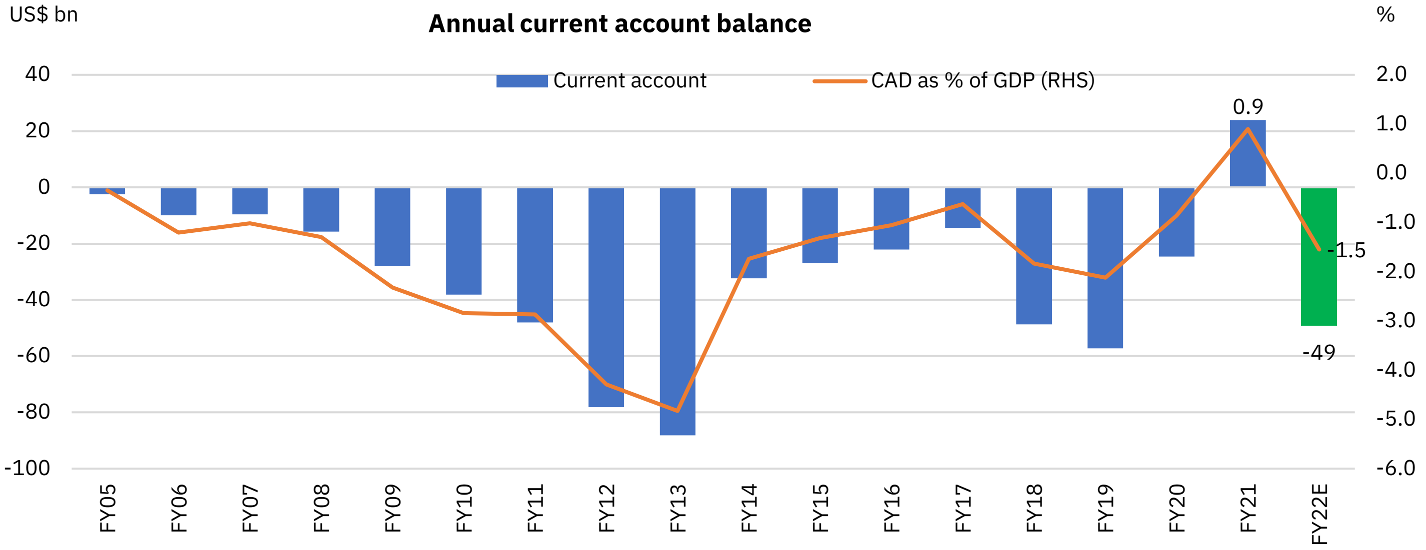
India Balance of Payments by Channel (Quarterly, US$bn)



Source: Refinitiv Datastream, NSE

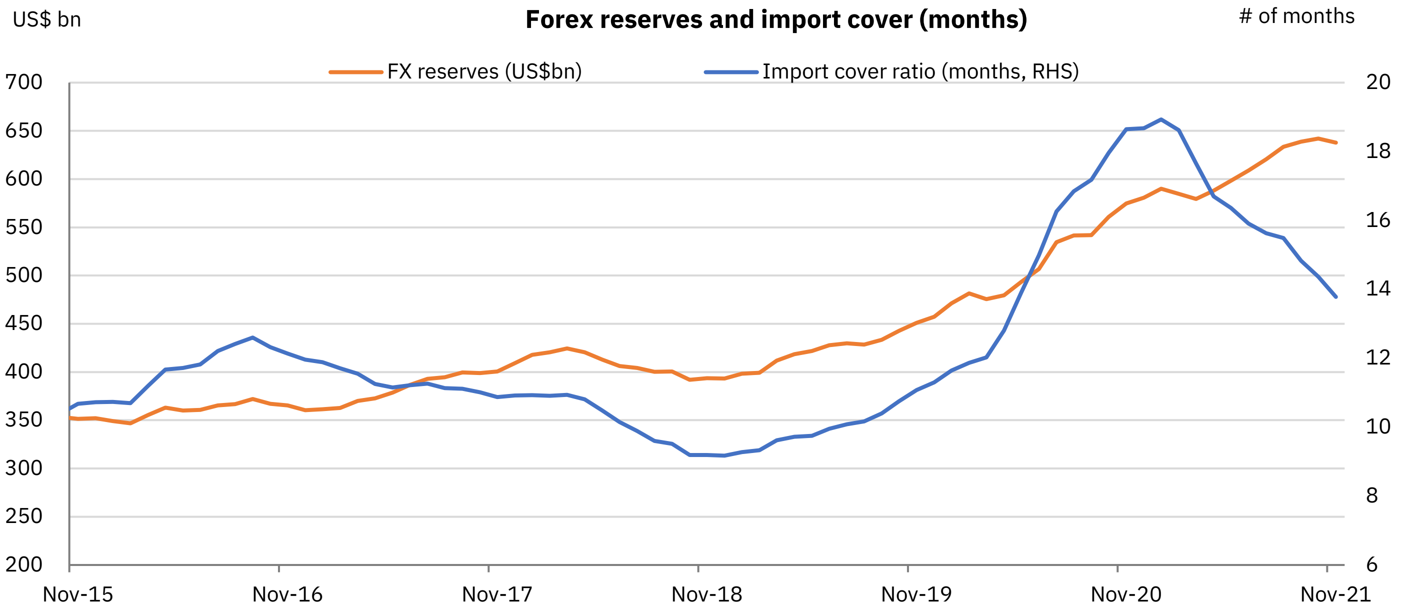
Figure 6: Expect current account deficit at 1.5% of GDP in FY22

A sharp surge in trade deficit over the last few months, reflecting higher commodity prices and strong festive demand, is expected to result in current account deficit widening to more than eight-year high of 3% of GDP in Q3FY22. For the full year, we now expect current account deficit at US$49.2bn or 1.5% of GDP vs. our earlier estimate of 1.1% of GDP.



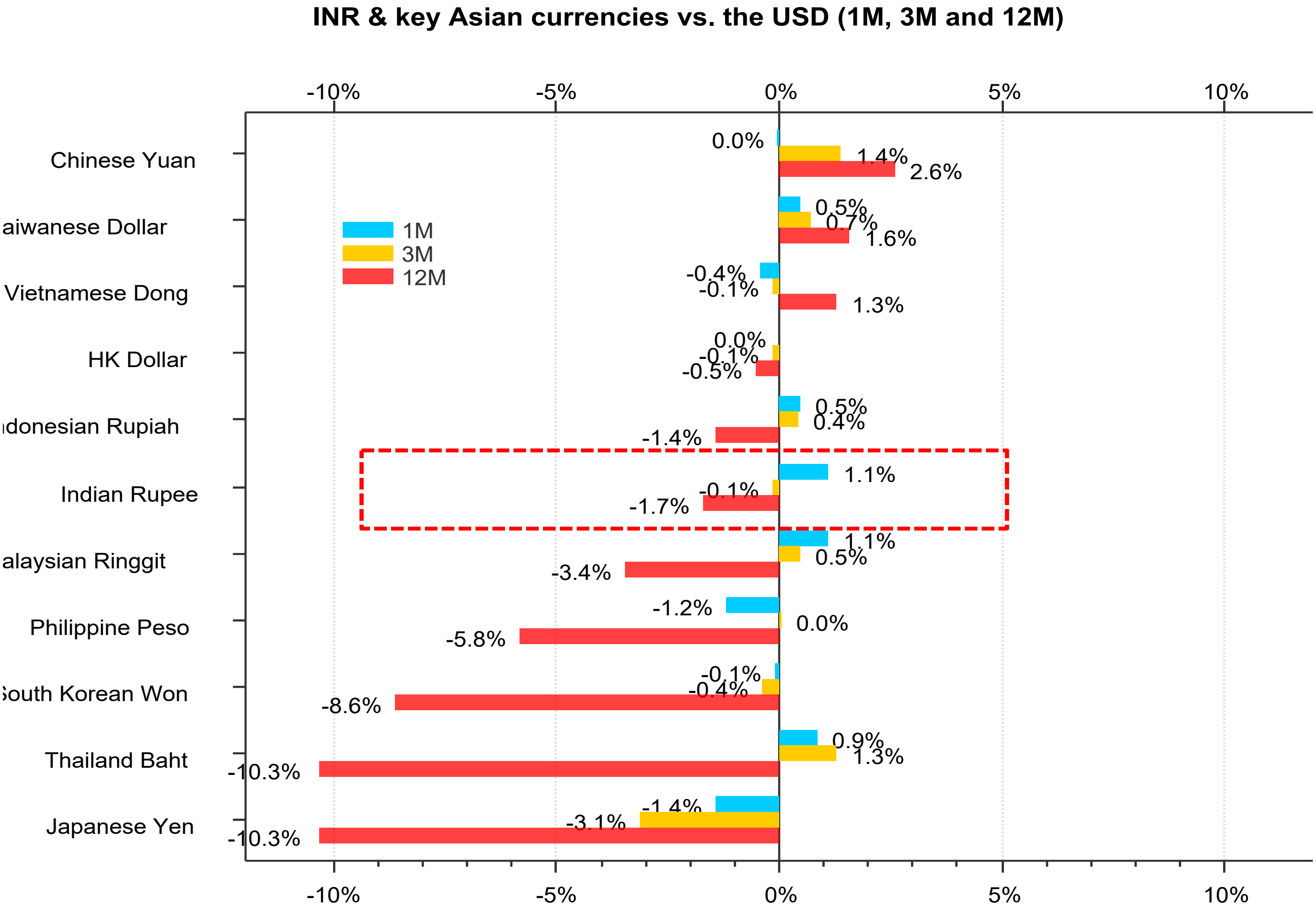
Source: Refinitiv Datastream, NSE

Figure 7: Accretion to foreign exchange reserves continue



Source: Refinitiv Datastream, NSE

Figure 8: INR vs. other key Asian market currencies (As on December 31st, 2021)



Source: Refinitiv Datastream, NSE

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