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Current account balance slips into deficit in Q3; BoP rises to record-high levels

India's current account balance slipped back into deficit in Q3FY21 at US$1.7bn or 0.2% of GDP after remaining in surplus for the previous three quarters. This is primarily attributed to a 133% QoQ expansion in merchandise trade deficit, thanks to a substantially higher import bill (+24% QoQ). The capital account balance, on the other hand, improved meaningfully led by record-high foreign portfolio inflows during the quarter, supported by enhanced global monetary easing and continuous normalization in economic activities. This led to the Balance of Payments (BoP) surplus rising to record-high levels of US$32.5bn in Q3FY21.

Going ahead, trade deficit is expected to widen further in Q4FY21, thanks to continued resilience in normalisation of domestic economy, translating into higher imports. The full year figure, however, 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 surplus in 17 years. Alongside, sturdy 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. However, sustenance of foreign investments on the back of easy global monetary policy stance is likely to keep BoP in a comfortable surplus position.

Emerging market currencies have come under pressure in the wake of hardening oil prices (+23% YTD), escalating US bond yields (+83bps YTD) and a stronger US macroeconomic landscape translating into dollar rally. The INR has been no different, with rising COVID infections only adding to the woes. That said, it has outperformed the broader EM pack this year due to the war chest of forex reserves (US$582bn as of March 19th, +107bn FYTD) and favorable capital flows. Continued surge in infections and rising crude oil prices are key risks to the INR stability.

- Trade deficit widened in Q3 on continued traction in domestic activities**…**: India's trade deficit widened to a three-quarter high of US$34.5bn in Q3FY21 from US$14.8bn in Q2FY21. This was primarily led by a 24% QoQ expansion in the import bill that outweighed export growth of 2% QoQ. Within imports, non-oil import growth (+26% QoQ) exceeded oil import growth (+16% QoQ), thanks to strong festive/pent-up demand even as the latter continued to suffer owing to travel restrictions. While trade deficit widened sequentially, it remained well below Dec-19 levels (-4% YoY). On a YoY basis, imports fell by 4.7% owing to a sharp 30.5% YoY dip in oil imports even as non-oil imports grew by 4.8% YoY, reflecting resilience in normalisation of economic activities. Exports, on the other hand, fell by a tad higher 4.9% YoY, as recovery in global demand suffered amid resurgence of COVID infections in several countries including the US, Europe, and UK.

After maintaining surplus over three consecutive quarters, current account balance registered a deficit of US$1.7bn or 0.2% of GDP in Q3FY21.

- **…**pushing current account balance into deficit again: Net invisible receipts witnessed a strong recovery on a sequential basis, rising by 10% QoQ to US$33bn in Q3FY21 but fell by a modest 1.8% on a YoY basis. The improvement was primarily led by a strong growth in software services receipts (+6.1%QoQ/ +8.9%YoY) and remittances (+4.7%QoQ/+1.9%YoY), partly offset by higher net investment outgo. Despite steady invisible receipts, a significant widening of trade deficit on a sequential basis pushed current account balance into deficit again of US$1.7bn in Q3FY21 vs. a surplus of US$15.1bn in the previous quarter.

- Capital account improved meaningfully leading to record-high BoP surplus: Led by robust foreign portfolio inflows on the back of continued global risk on sentiment (record-high FII inflows of US$21bn in Q3) and sequentially lower banking capital outflows, capital account surplus surged significantly to US$33.5bn in Q3FY21 from US$16bn in the previous quarter. This was partly offset by some sequential moderation in foreign direct investments (US$16.9bn vs. US$24.6bn in Q2FY21). Consquently, BoP surplus in Q3 rose to record-high levels of US$32.5bn (US$84bn in 9MFY21, +2.06x YoY).

Despite widening current account deficit, Balance of Payments (BoP) surplus rose to record-high levels of US$32.5bn in Q3FY21.

- Current account surplus expected at 1.1% of GDP in FY21; FY22 to see deficit again: The monthly trade figures suggest further expansion in trade deficit in Q4FY21 as domestic demand has remained steady amid continued normalisation of domestic economy while external demand has been weighed down still high infection rate across major trading partners. 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 surplus in 17 years. Alongside, sturdy 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 as import growth is expected to outpace export growth. However, sustenance of foreign investments on the back of easy global monetary policy stance is likely to keep BoP in a comfortable surplus position.

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.

- INR likely to remain cushioned by favourable external metrics: Emerging market currencies have come under pressure in the wake of hardening oil prices (+23% YTD), escalating US bond yields (+83bps YTD) and a stronger US macroeconomic landscape translating into dollar rally. The INR has been no different, with rising COVID infections only adding to the woes. That said, it has outperformed the broader EM pack this year due to the war chest of forex reserves (US$582bn as of March 19th, +107bn FYTD) and favourable capital flows. Continued surge in infections and rising crude oil prices are key risks to the INR stability.

Figure 1: Balance of Payments – Quarterly account

US$ bn	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Current account	-17.8	-4.6	-15.0	-7.6	-2.6	0.6	19.0	15.1	-1.7
CAD/GDP (%)	*-2.7*	*-0.7*	*-2.1*	*-1.1*	*-0.4*	*0.1*	*3.8*	*2.4*	*-0.2*
Trade balance	-49.3	-35.2	-46.8	-39.7	-36.0	-35.0	-10.8	-14.8	-34.5
Trade balance/GDP (%)	*-7.4*	*-5.0*	*-6.6*	*-5.7*	*-5.0*	*-4.8*	*-2.2*	*-2.3*	*-4.7*
Merchandise exports	83.1	87.4	82.7	80.0	81.2	76.5	52.4	75.6	77.2
Merchandise imports	132.4	122.6	129.5	119.6	117.3	111.6	63.2	90.4	111.8
Oil imports	38.5	32.4	35.4	29.9	31.5	33.8	13.2	18.8	21.9
Non-oil imports	93.9	90.2	94.1	89.7	85.8	77.8	50.0	71.6	89.9
Invisibles	31.5	30.6	31.8	32.1	33.4	35.6	29.8	29.9	32.8
Net services	21.7	21.3	20.1	20.9	21.9	22.0	20.5	20.9	23.6
Software earnings	19.9	19.9	21.0	21.1	21.5	21.1	20.8	22.0	23.4
Transfers	17.4	16.2	18.0	20.0	18.9	18.4	17.0	18.4	19.3
Investment income	-8.3	-7.5	-7.0	-9.6	-8.1	-5.6	-8.3	-10.1	-10.9
Other invisibles	0.8	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.8
Capital account	13.8	19.2	28.6	13.6	23.6	17.4	1.2	16.1	33.5
Capital acc./GDP (%)	*2.1*	*2.7*	*4.0*	*1.9*	*3.3*	*2.4*	*0.2*	*2.5*	*4.5*
Foreign investments	5.2	15.9	18.8	9.8	17.6	-1.8	-0.2	31.6	38.2
FDI	7.3	6.4	14.0	7.3	9.7	12.0	-0.8	24.6	17.0
FII	-2.1	9.4	4.8	2.5	7.8	-13.7	0.6	7.0	21.2
Loans	2.9	10.3	9.6	3.1	3.1	9.9	2.7	-3.8	0.2
ECBs	2.0	7.5	6.1	3.3	3.2	10.3	-1.2	-3.9	-1.2
Banking capital	4.9	-8.1	3.4	-1.8	-2.3	-4.6	2.2	-11.3	-7.6
NRI deposits	0.1	3.4	2.8	2.3	0.8	2.8	3.0	1.9	3.0
Others	0.7	1.2	-3.2	2.5	5.2	13.8	-3.6	-0.4	2.8
Errors & Omissions	-0.3	-0.4	0.4	-0.9	0.6	0.9	-0.4	0.4	0.7
Overall balance (BoP)	-4.3	14.2	14.0	5.1	21.6	18.8	19.8	31.6	32.5

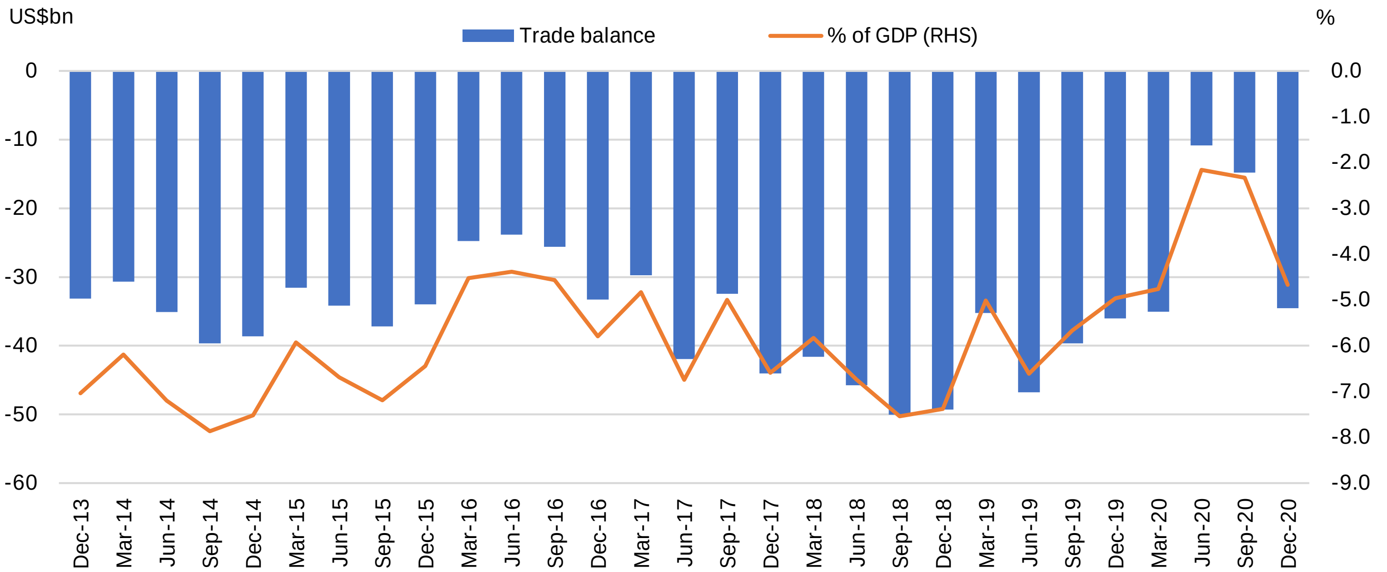
Source: RBI, CMIE Economic Outlook, NSE

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	29.0	-20.3
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	-96.0	-147.6
Trade balance/GDP (%)	*-6.2*	*-4.9*	*-6.0*	*-6.6*	*-5.5*	*-3.7*	*-5.0*
Merchandise exports	266.4	280.1	309.0	337.2	320.4	282.0	321.5
Merchandise imports	396.4	392.6	469.0	517.5	477.9	377.9	469.1
Oil imports	82.6	86.9	108.7	141.1	130.5	83.0	100.4
Non-oil imports	313.9	305.6	360.3	376.4	347.4	295.0	368.7
Invisibles	107.9	98.0	111.3	123.0	132.8	125.0	127.4
Net services	69.7	68.3	77.6	81.9	84.9	86.5	89.1
Transfers	62.6	56.0	62.4	69.9	75.2	70.8	72.2
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	90.0	79.0
Capital account/GDP (%)	*2.0*	*1.6*	*3.4*	*2.0*	*2.9*	*3.5*	*0.0*
Foreign investments	31.9	43.2	52.4	30.1	44.4	83.0	60.0
FDI	36.0	35.6	30.3	30.7	43.0	50.0	40.0
FII	-4.1	7.6	22.1	-0.6	1.4	33.0	20.0
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	119.0	58.7

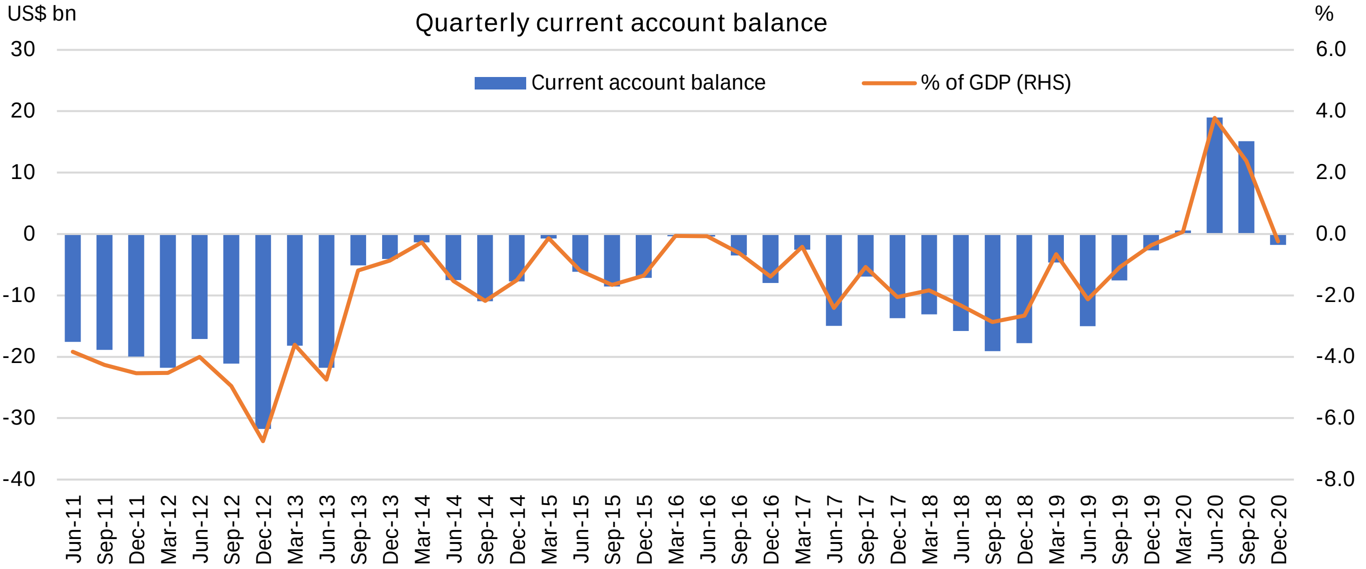
Source: RBI, CMIE Economic Outlook, NSE

Figure 3: Trade deficit widened further in Q3FY21…



Source: RBI, CMIE Economic Outlook, NSE.

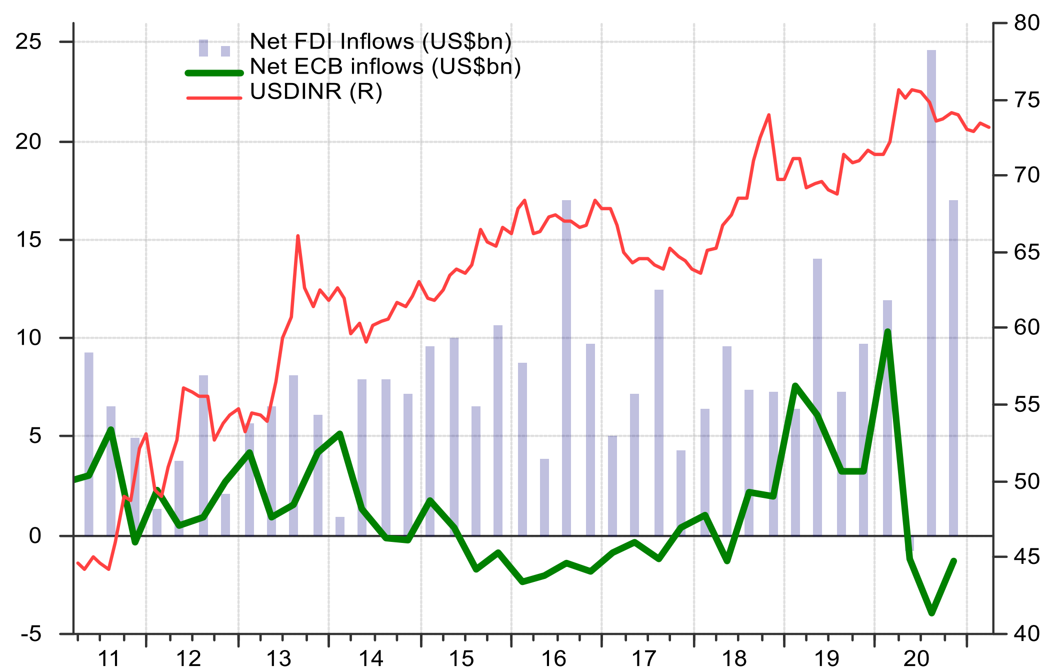
Figure 4: **...**pushing current account balance into deficit again



Source: CMIE Economic Outlook, NSE

Figure 5: After surging to record-high levels in Q2FY21, FDI inflows moderated in Q3FY21 **...**

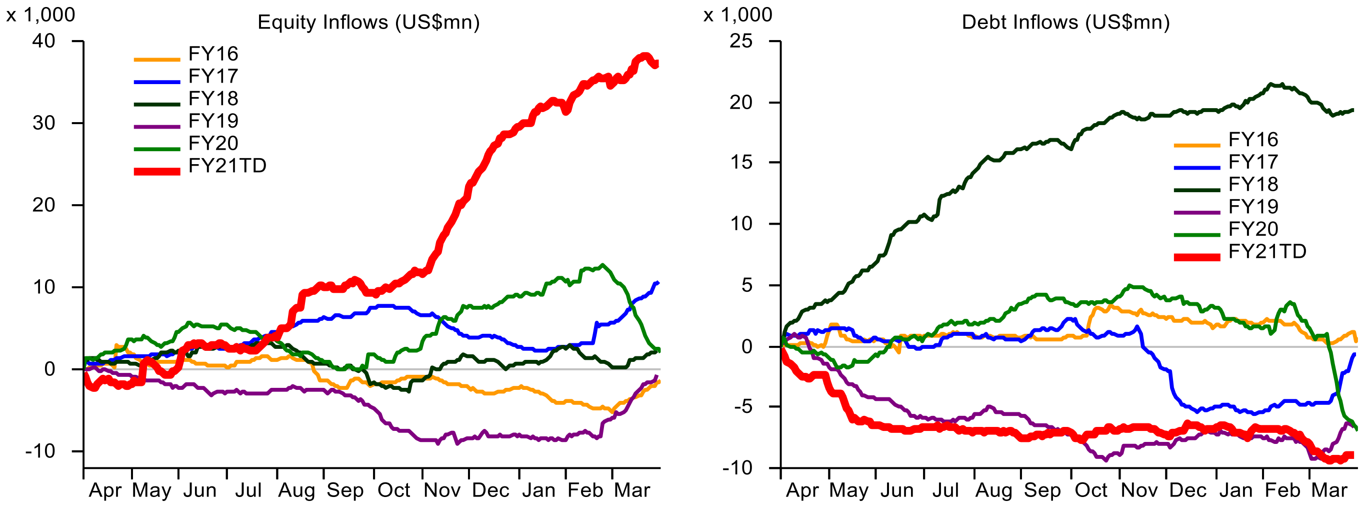
Net FDI and ECB inflows into India



Source: Refinitiv Datastream, NSE

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

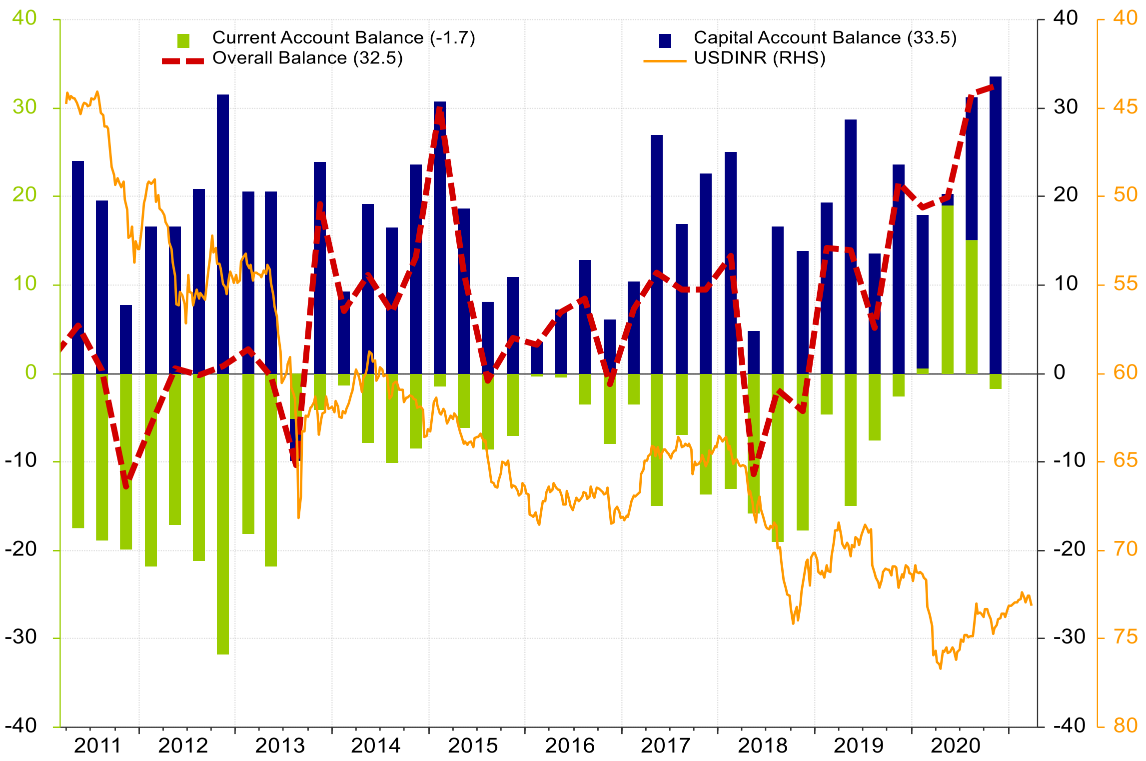
Cumulative FII net flows over last six years (FY)



Source: Refinitiv Datastream, NSE

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

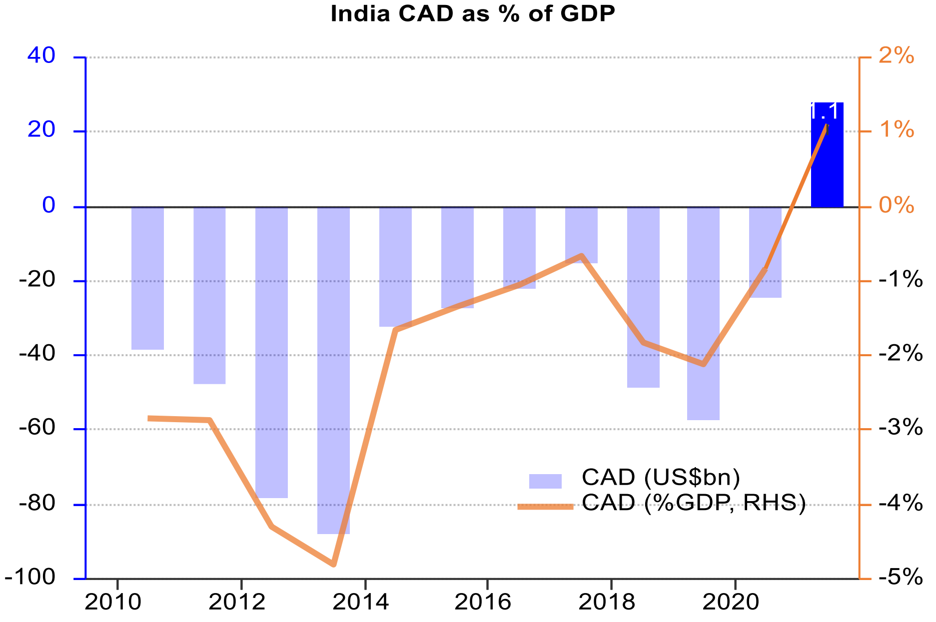
India Balance of Payments by Channel (Quarterly, US$bn)



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

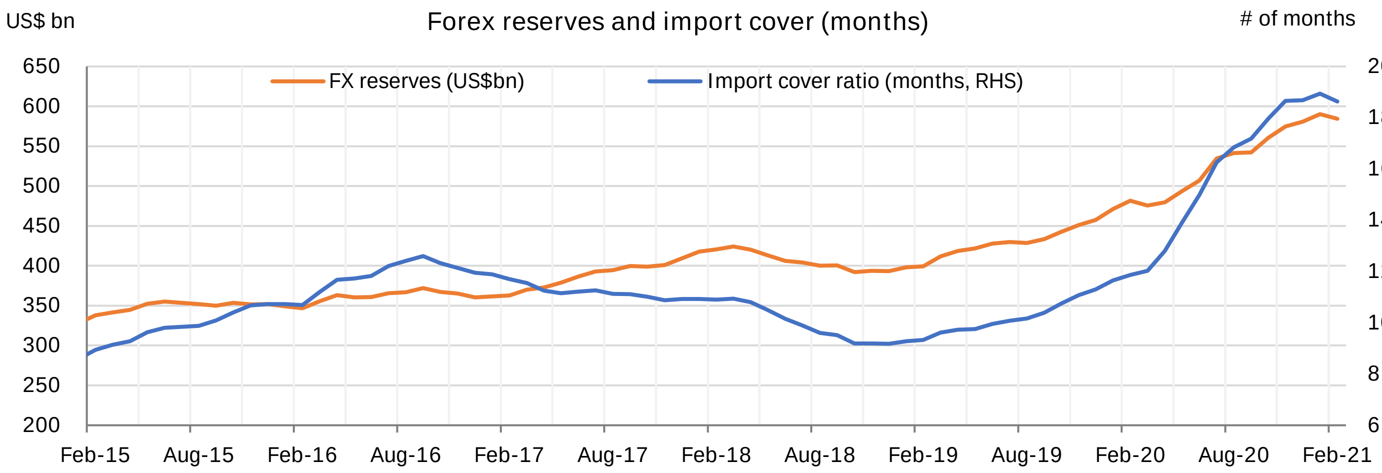
A significant contraction in trade deficit in FY21 is expected to translate into a current account surplus of 1.1% of GDP in FY21—the first surplus in 17 years, vs. a deficit of 0.9% of GDP in FY20. In FY22, we expect current account to slip into deficit again, with our estimate pegged at 0.7% of GDP, 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

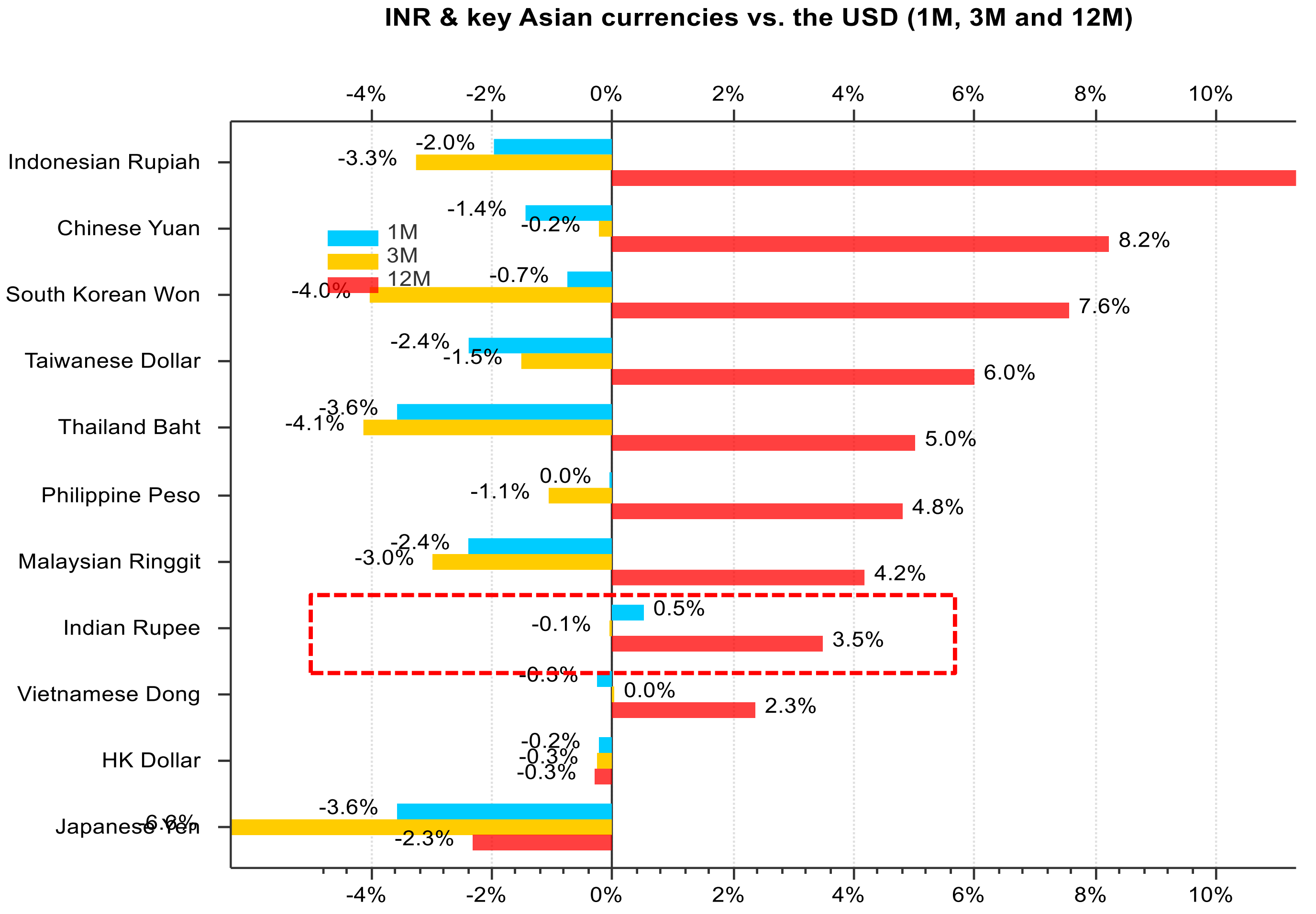
A significant accretion to forex reserves over the years, and particularly this fiscal year (+US$ 107bn in FY21 till date, as on March 19th), has resulted in a significant improvement in import cover.



Source: Refinitiv Datastream, NSE

Figure 10: INR vs. other key Asian market currencies

EM currencies have lately come under pressure in the wake of hardening oil prices, escalating US bond yields and a stronger US macroeconomic landscape translating into dollar rally. The INR is no different, having witnessed a significant volatility over the last few weeks, but has outperformed the broader EM pack.



Source: Refinitiv Datastream, NSE

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