NSE

Macro Review

April 3, 2022, | Vol. 4, Issue 4

Q3FY22 current account deficit widens on higher imports, external risks rising

India's current account deficit widened to a 36-quarter high of US$23bn or 2.7% of GDP in Q3FY22 vs. a deficit of US$9.9bn or 1.3% of GDP in the previous quarter. This was led by higher trade deficit thanks to a sequentially steeper surge in imports as well as higher investment income outflows. While imports continued to gain traction owing to surging commodity prices, resilient demand during the festive season in the wake of receding cases, easing restrictions, and rising pace of vaccinations domestically, targeted measures imposed by a few advanced economies in the wake of rising Omicron scare moderated export growth momentum. Capital account recorded a surplus of US$23bn—a contraction of 43% QoQ, weighed down heavily by foreign portfolio outflows. This translated into the Balance of Payment (BoP) surplus falling to a 12-quarter low of US$0.5bn in Q3FY22.

On expected lines, exports have lost momentum recently on account of slowing global demand, triggered by fading policy support and persistent supply chain issues accentuated by the Omicron-led restrictions across the globe. Escalating geopolitical tensions, that have heightened already existing stagflation concerns across the globe, is likely to turn external demand environment incrementally more unfavourable, thereby weighing on India's export momentum. A sharp spike in global commodity prices—a result of rising geopolitical uncertainty—is likely to keep import bill at elevated levels. We expect current account deficit at US$55bn or 1.7%GDP (assuming oil to avg. US$78/bbl) in FY22. 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 expect current account deficit to widen to 3.5% of GDP if oil averages at US$100/bbl. Combination of wider current account deficit and muted FPI inflows thanks to strengthened risk-off environment and rising global bond yields is likely to translate into a huge BoP deficit in FY23. This is likely to impart depreciating bias to the INR, even as the country's strong foreign exchange reserve position (US$618bn as of March 25th, 2022) and active intervention by the RBI may provide some downside support.

India's current account balance registered a deficit of US$23bn or -2.7% of GDP in Q3FY22.

- **Merchandise trade deficit (%GDP) widened to a 12-quarter high:** India's merchandise trade deficit widened to an all-time high of US$60.4bn in Q3FY22 from US$44.5bn in Q2FY22. As percentage of GDP, trade balance recorded a 12-quarter high deficit of 7.2%. This was primarily led by a 36%QoQ increase in merchandise trade deficit, thanks to a strong surge in imports (13.5%QoQ), partly offset by a modest 4% QoQ growth in exports. While imports continued to gain traction thanks to surging commodity prices, resilient demand during the festive season in the wake of receding cases, easing restrictions, and rising pace of vaccinations domestically, exports exhibited buoyancy on persistent traction in activities of advanced economies. However, targeted measures imposed by a few advanced economies in the wake of rising Omicron scare moderated export growth momentum. While oil imports rose by a strong 13% QoQ, reflecting higher crude oil prices, non-oil imports surged by 14% QoQ as demand gained traction amid festivities. On a YoY basis, imports surged by a strong 51.5% owing to a sharp 99% YoY rise in oil imports and 40% YoY in non-oil imports, albeit off a low base, indicating steady domestic consumption impulses. Exports also rose by 41% YoY, thanks to low base and strong recovery in external demand as compared to the year-ago period.

- **Uptick in invisible receipts limited widening current account deficit:** Net invisible receipts surged by 8% QoQ to US$37bn in Q3FY22, thanks to a higher net services surplus and private remittances. However, higher outflow of investment income (primary income) weighed on the category. Services surplus rose by 9% QoQ, broadly led by a surge in software services receipts (+6% QoQ to US$28bn). Primary income gap widened to US$11.7bn from US$9.9bn on account of higher net investment income outflow (-US$12.6bn in Q3FY22 vs. -US$10.7bn in Q2FY22), thereby weighing on the net invisible receipts. This was partly offset by a strong 12% QoQ surge in private transfers to an all-time high of US$21.4bn in Q3FY22.

- **BoP recorded a mild surplus in Q3FY22:** The capital account balance witnessed a significant moderation and recorded a contraction of 43%QoQ, led by net outflows of foreign investments. Higher foreign portfolio investment (FPI) outflows and subdued foreign direct investment (FDI) inflows in Q3 weighed on capital account surplus, partly offset by higher short-term credit. Net FPI outflows in Q3FY22 stood at US$5.8bn, marking the first quarter in last seven quarters to see net outflows. FDI also moderated meaningfully to a three-quarter low of US$5.1bn, reflecting streghtened risk-off environment and weakening business sentiments. External commercial borrowings also recorded net outflows of US$0.1bn vs. net inflows of US$4.3bn in the previous quarter, partly attributed to narrowing interest rate differential. On the positive side, uptick in Banking capital (US$8.2bn vs. US$0.4bn recorded in Q2FY22) due to inflows of NRI deposits limited the downside. This translated into the BoP surplus falling to a 12-quarter low of US$0.5bn in Q3FY22.

BoP surplus fell to a 12-quarter low of US$0.5bn in Q3FY22, weighed down by higher current account deficit and lower foreign investment inflows.

- **Expect current account deficit at 1.7% of GDP in FY22:** On expected lines, exports have lost momentum recently on account of slowing global demand which in turn is triggered by fading policy support, persistent supply chain issues accentuated by the Omicron induced restrictions across the globe. Going forward, given escalating geopolitical tensions between Russia-Ukraine have heightened already existing stagflationary concerns across the globe, global demand environment is likely to turn incrementally more unfavourable, thereby weighing on India's export momentum. That said, strong fiscal support, significant progress in vaccination drives, China+1 strategy and PLI schemes announced by the Government should provide some downside support. Notwithstanding recent moderation, the ongoing trend exudes confidence that merchandise exports through the year could go past the US$400bn target. Core imports, on the other hand, are likely to bounce back and stay resilient over the coming months, aided by proactive and prompt reopening of the economy. This, along with a sharp spike in global commodity prices—a result of rising geopolitical uncertainty—is likely to keep import bill at elevated levels. For full year, we expect current account deficit at US$55bn/1.7%GDP (assuming oil to avg. US$78/bbl). 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 much lower BoP surplus this year even after considering SDR allocation.

We expect current account deficit at 1.7% of GDP in FY22, expecting it to widen to 3.5% of GDP in FY23 assuming crude averages at US$100/bbl.

- **CAD could widen to 3.5% GDP in FY23 if oil averages at US$100/bbl:** For FY23, moderating global growth prospects is likely to weigh on export growth momentum, while imports are likely to remain strong aided by strong domestic demand and surging commodity prices. We expect current account deficit to widen to 3.5% of GDP if crude oil averages at US$100/bbl. Combination of wider current account deficit and muted FPI inflows thanks to strengthened risk-off environment and rising global bond yields in the wake of faster-than-expected monetary tightening by the US Fed is likely to translate into a huge BoP deficit in FY23.

- **INR faces depreciating bias. We expect the INR to remain under pressure, weighed down by** heightened geopolitical tensions, flight of foreign capital away from EM equities including India to safe haven assets, widening trade deficit and strengthening of the dollar index on faster-than-expected rate hikes by the US Fed. That said, India's external vulnerability metrics (FX reserves, short term external debt etc.) have improved meaningfully over the last few years, thereby significantly reducing the risk of taper tantrum like situation of 2013. Additionally, India's strong foreign exchange reserve position (US$618bn as of March 25th, 2022) and active intervention by the RBI should further limit the volatility in the INR.

Table 1: Balance of Payments – Quarterly account

US$ bn	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Current account	**-2.6**	**0.6**	**19.1**	**15.3**	**-2.2**	**-8.2**	**6.4**	**-9.9**	**-23.0**
CAD/GDP (%)	-0.4	0.1	3.7	2.4	-0.3	-1.0	0.9	-1.3	-2.7
Trade balance	-36.0	-35.0	-11.0	-14.8	-34.6	-41.7	-30.7	-44.5	-60.4
Trade balance/GDP (%)	-5.0	-4.9	-2.2	-2.3	-4.7	-5.3	-4.4	-5.9	-7.2
Merchandise exports	81.2	76.5	52.2	75.6	77.2	91.3	97.4	104.8	109.0
Merchandise imports	117.3	111.6	63.2	90.4	111.8	133.0	128.2	149.3	169.4
Oil imports	31.5	33.8	13.2	18.8	21.9	28.7	30.9	38.6	43.7
Non-oil imports	85.8	77.8	50.0	71.6	89.9	104.3	97.2	110.6	125.7
Invisibles	33.4	35.6	30.0	30.1	32.4	33.6	37.1	34.6	37.4
Net services	21.9	22.0	20.8	21.1	23.2	23.5	25.8	25.6	27.8
Software earnings	21.5	21.1	20.8	22.0	23.5	23.5	25.1	26.8	28.4
Transfers	18.9	18.4	17.0	18.4	19.3	18.8	19.0	19.0	21.3
Investment income	-8.1	-5.6	-8.4	-10.2	-10.9	-9.7	-8.6	-10.7	-12.6
Other invisibles	0.7	0.7	0.7	0.7	0.8	0.9	0.9	0.7	0.9
Capital account	**23.6**	**17.4**	**1.4**	**15.9**	**34.1**	**12.3**	**25.7**	**40.4**	**23.2**
Capital acc./GDP (%)	3.3	2.4	0.3	2.5	4.6	1.6	3.7	5.3	2.8
Foreign investments	17.6	-1.8	0.1	31.4	38.6	10.0	12.2	13.4	-0.7
FDI	9.7	12.0	-0.5	24.4	17.4	2.7	11.8	9.6	5.1
FII	7.8	-13.7	0.6	7.0	21.2	7.3	0.4	3.9	-5.8
Loans	3.1	9.9	2.8	-3.9	0.3	7.7	2.8	7.8	10.2
ECBs	3.2	10.3	-1.2	-4.0	-1.1	6.1	0.6	4.3	-0.1
Banking capital	-2.3	-4.6	2.2	-11.3	-7.6	-4.4	4.1	0.4	8.2
NRI deposits	0.8	2.8	3.0	1.9	3.0	-0.5	2.5	-0.8	1.3
Others	5.2	13.8	-3.7	-0.3	2.8	-1.0	6.5	18.8	5.5
Errors & Omissions	0.6	0.9	-0.6	0.4	0.6	-0.7	-0.2	0.7	0.3
Overall balance (BoP)	**21.6**	**18.8**	**19.8**	**31.6**	**32.5**	**3.4**	**31.9**	**31.2**	**0.5**

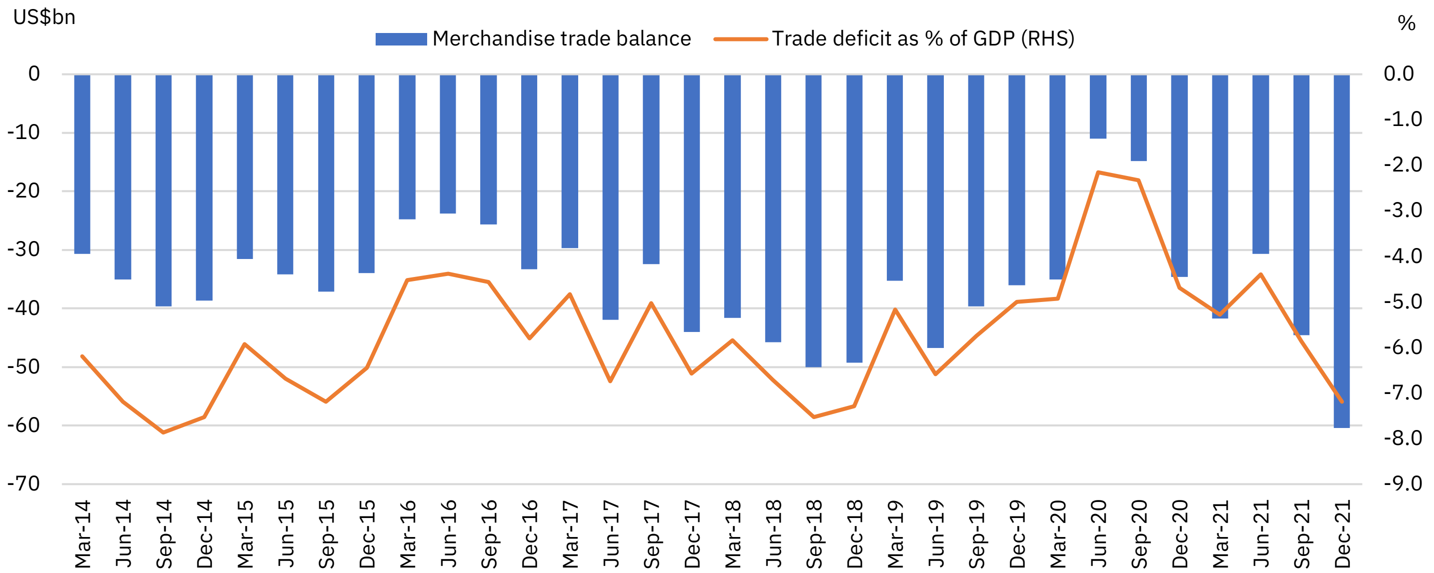
Source: RBI, CMIE Economic Outlook, NSE EPR.

Table 2: Balance of Payments – Annual account

US$ bn	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
Current account	**-14.4**	**-48.7**	**-57.3**	**-24.7**	**23.9**	**-54.6**	**-121.2**
CAD/GDP (%)	*-0.6*	*-1.8*	*-2.1*	*-0.9*	*0.9*	*-1.7*	*-3.5*
Trade balance	-112.4	-160.0	-180.3	-157.5	-102.2	-201.3	-273.5
Trade balance/GDP (%)	*-4.9*	*-6.0*	*-6.7*	*-5.5*	*-3.8*	*-6.3*	*-8.0*
Merchandise exports	280.1	309.0	337.2	320.4	296.3	417.1	442.8
% YoY	*5.2*	*10.3*	*9.1*	*-5.0*	*-7.5*	*40.8*	*6.2*
Merchandise imports	392.6	469.0	517.5	477.9	398.5	618.3	716.3
% YoY	*-1.0*	*19.5*	*10.3*	*-7.6*	*-16.6*	*55.2*	*15.8*
Oil imports	86.9	108.7	140.9	130.6	82.7	169.0	228.0
Non-oil imports	305.6	360.3	376.6	347.4	315.8	449.3	488.3
Invisibles	98.0	111.3	123.0	132.8	176.7	146.6	152.4
Net services	68.3	77.6	81.9	84.9	88.6	106.2	111.5
Transfers	56.0	62.4	69.9	75.2	73.5	79.9	82.2
Other invisibles	-26.3	-28.7	-28.9	-27.3	14.6	-39.4	-41.4
Capital account	**36.4**	**91.4**	**54.4**	**83.2**	**63.7**	**80.4**	**81.0**
Capital account/GDP (%)	*1.6*	*3.4*	*2.0*	*2.9*	*2.4*	*2.5*	*2.4*
Foreign investments	43.2	52.4	30.1	44.4	80.1	30.4	55.0
FDI	35.6	30.3	30.7	43.0	44.0	42.4	45.0
FII	7.6	22.1	-0.6	1.4	36.1	-12.0	10.0
Loans	2.4	16.7	15.9	25.7	6.9	12.0	15.0
Banking capital	-16.6	16.2	7.4	-5.3	-21.1	8.0	5.0
NRI deposits	-12.4	9.7	10.4	8.6	7.4	5.0	12.0
Others	7.5	6.1	1.0	18.4	-2.2	30.0	6.0
Errors & Omissions	-0.5	0.9	-0.5	1.0	-0.3	0.0	0.0
Overall balance (BoP)	**21.6**	**43.6**	**-3.3**	**59.5**	**87.3**	**25.7**	**-40.2**

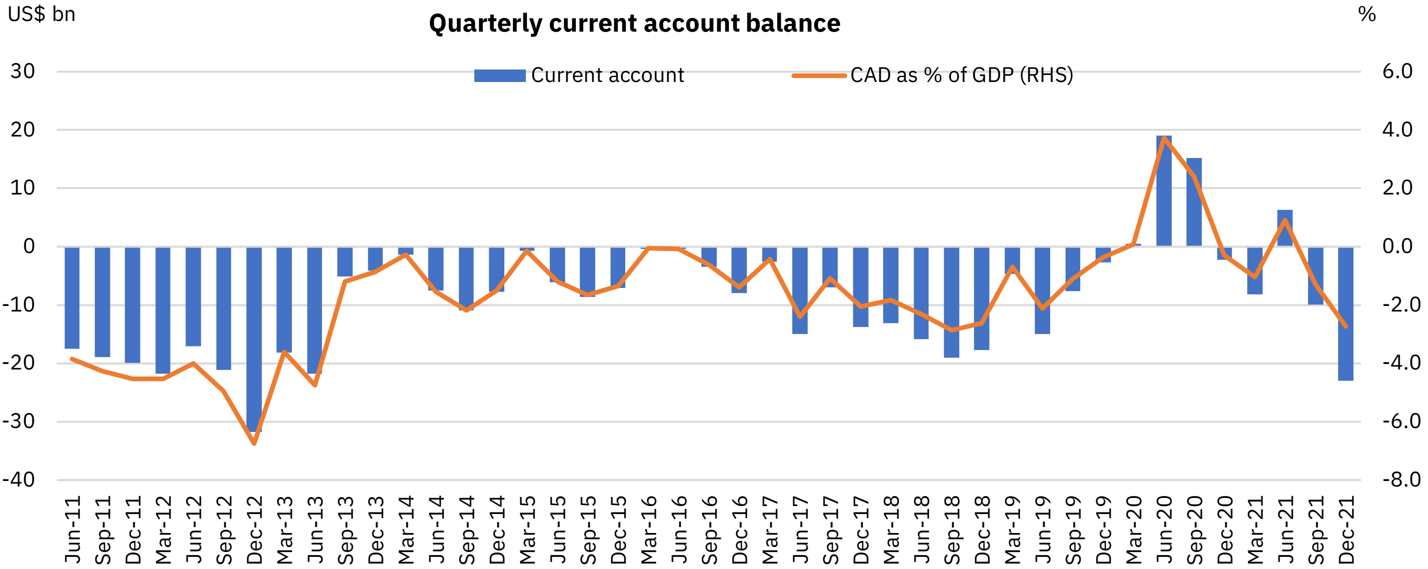
Source: RBI, CMIE Economic Outlook, NSE EPR.

Figure 1: Quarterly trade deficit trend



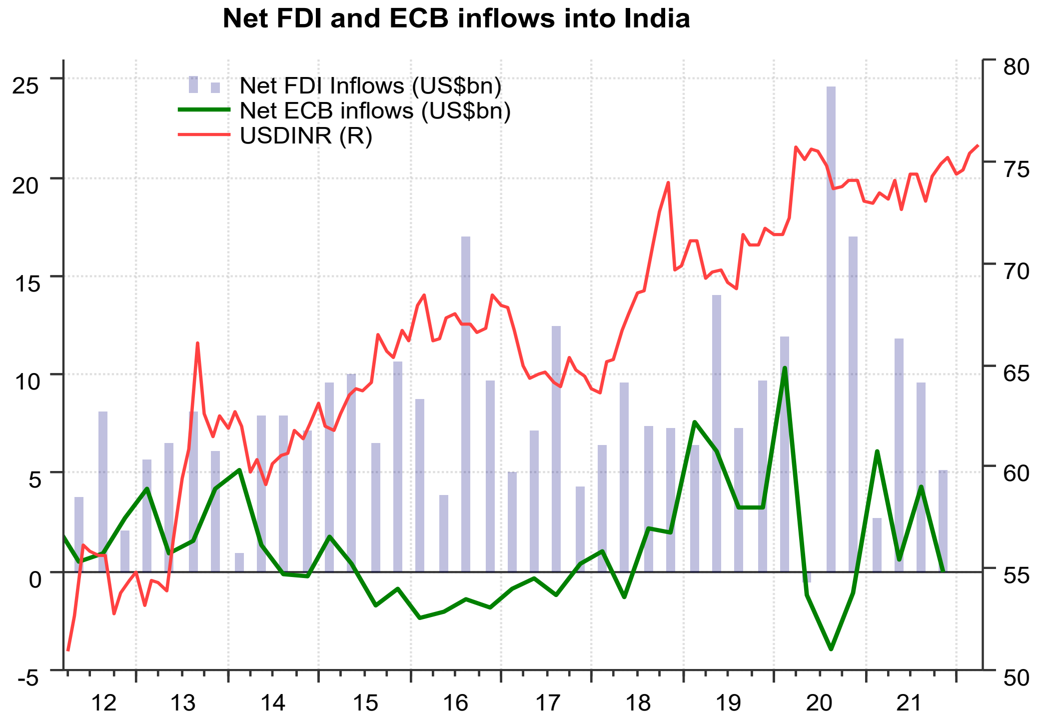
Source: RBI, CMIE Economic Outlook, NSE EPR.

Figure 2: Quarterly current account balance trend



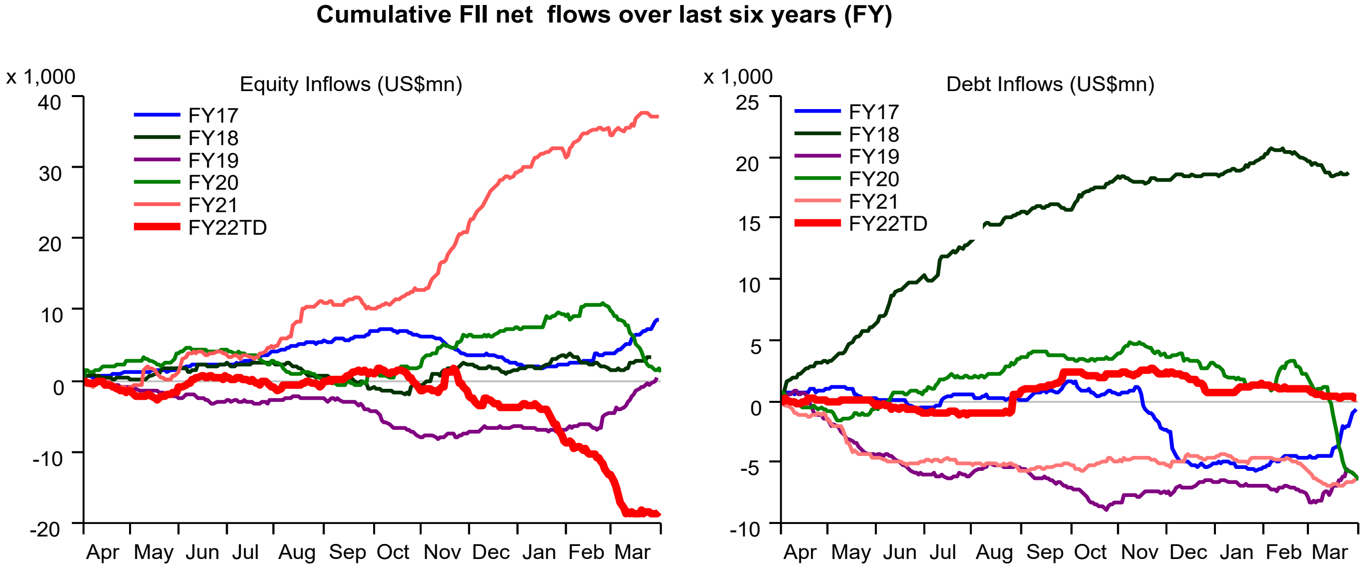
Source: CMIE Economic Outlook, NSE EPR.

Figure 3: Quarterly net FDI and ECB inflows vs. INR



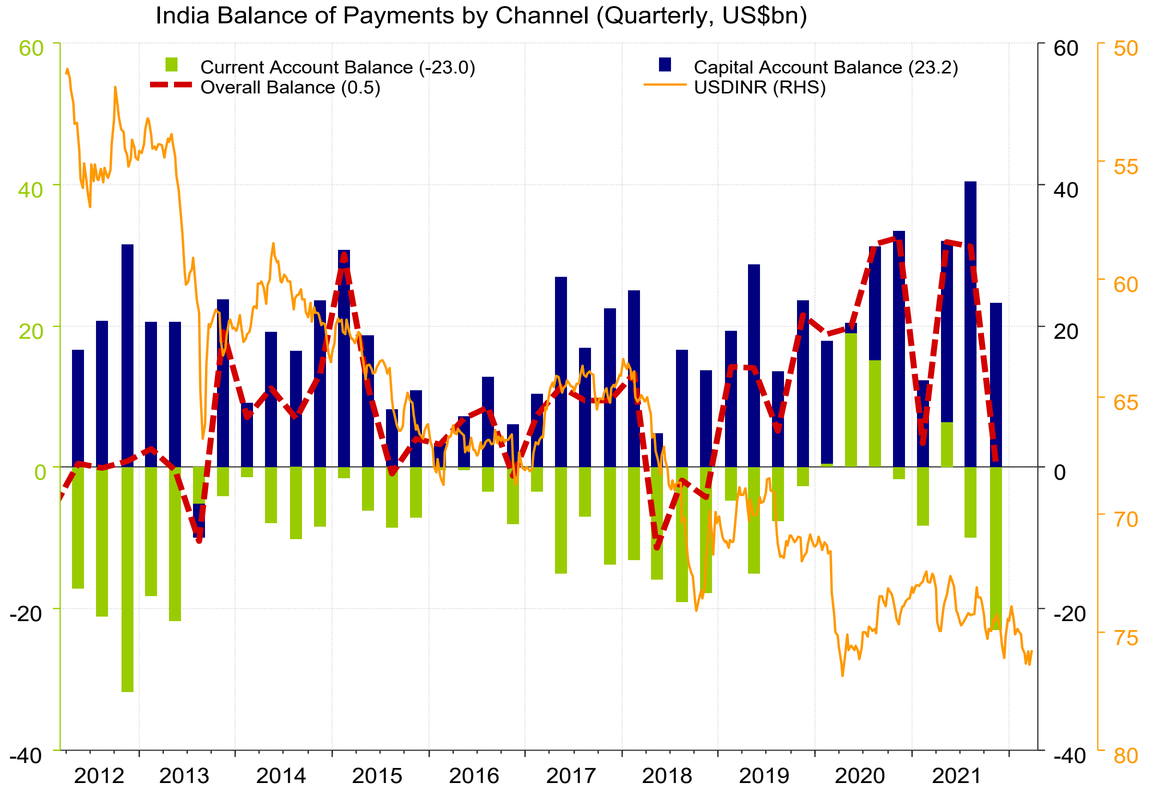
Source: Refinitiv Datastream, NSE EPR.

Figure 4: Cumulative FII net inflows into Indian equity and debt markets



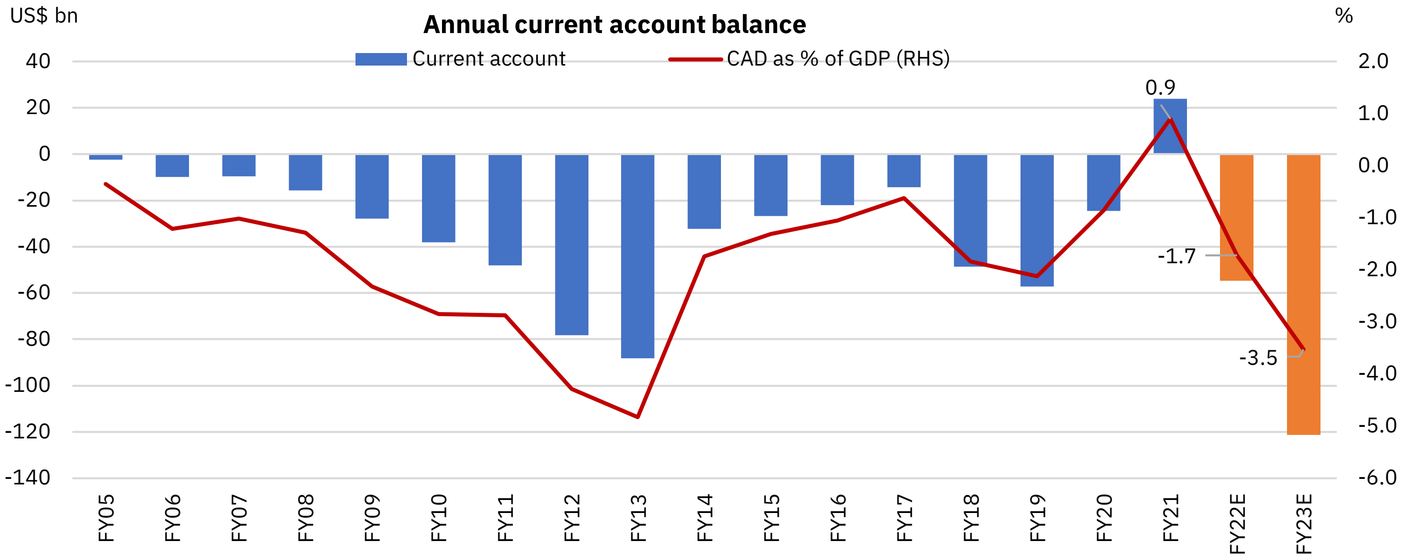
Source: Refinitiv Datastream, NSE EPR.

Figure 5: Quarterly Balance of Payments trend by channels



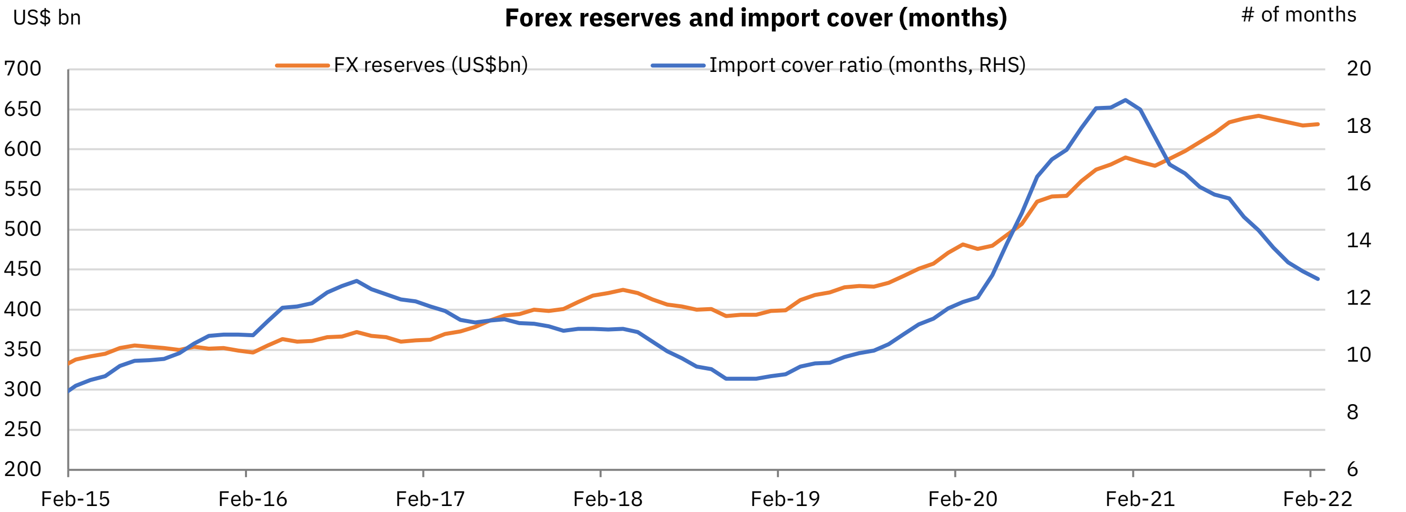
Source: Refinitiv Datastream, NSE EPR.

Figure 6: Annual current account deficit trend and expectations



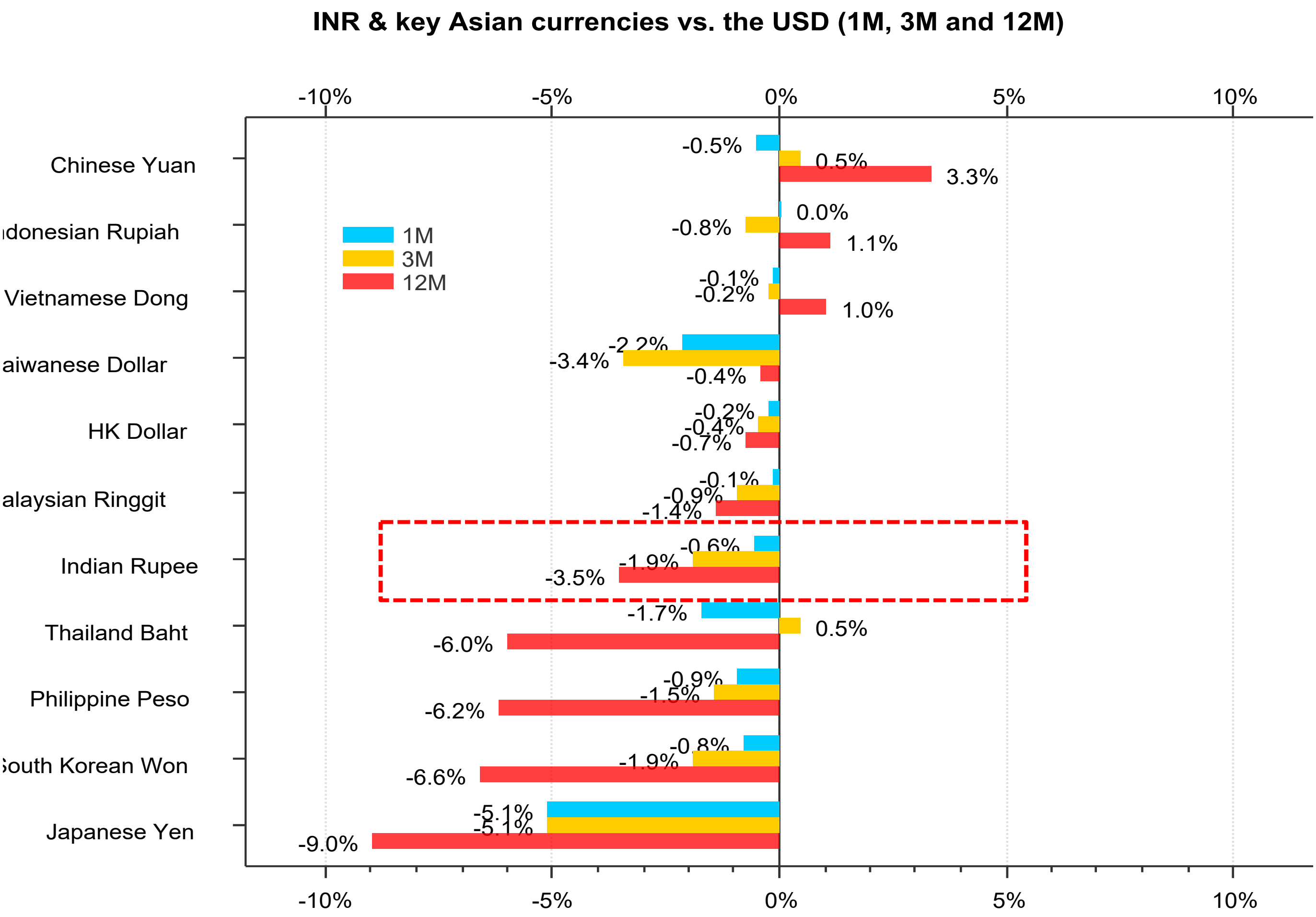
Source: Refinitiv Datastream, NSE EPR.

Figure 7: Foreign exchange reserves and import cover



Source: Refinitiv Datastream, NSE EPR.

Figure 8: INR vs. other key Asian market currencies



Source: Refinitiv Datastream, NSE EPR.

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