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FY21 Current Account: First surplus in 17 years; unlikely to continue

India's current account deficit (CAD) widened to a seven-quarter high of US$8.2bn or 1% of GDP in Q4FY21, marking the second consecutive quarter to report a deficit following a surplus in the previous three quarters. This was primarily led by a 21% QoQ/19% YoY jump in merchandise trade deficit, thanks to record-high non-oil imports during the quarter and higher crude oil prices, even as exports also registered a strong rebound amid improving global demand. Tepid foreign capital inflows and net outflows by NRIs—the first in 17 quarters—led to a sharp drop in capital account balance, partly offset by higher external commercial borrowings (ECB). Consequently, the Balance of Payments (BoP) surplus moderated sharply (-82% YoY) to a nine-quarter low of US$3.4bn.

Looking at the annual figures, **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. This was due to a sharp contraction in trade deficit, thanks to the COVID-induced nation-wide lockdown implemented earlier in the year that weighed heavily on domestic demand and therefore imports, and higher software receipts. Record-high FDI inflows and FII inflows into equities in FY21 more than compensated for ECB and banking capital outflows, translating into a BoP surplus of US$87.3bn—the highest since the Global Financial Crisis.

Strengthening external demand, aided by enhanced fiscal support and 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 assuming average crude oil prices at $65/bbl. 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 significantly lower BoP surplus this year. Deterioration in domestic growth prospects, coupled with lower BoP surplus, narrowing yield differentials amid potential global policy normalisation and a strong dollar, are likely to pose depreciating pressures on the INR. That said, adequate forex reserves (US$604bn as on June 18th, implying ~16 months of import cover), prompt policy intervention and moderate current account deficit should limit the downside.

India's current account deficit widened further to register a seven-quarter high print of US$8.2bn or 1% of GDP in Q4FY21.

FY21 reports the first ever surplus in 17 years of US$23.9bn or 0.9% of GDP

- Higher imports widened trade deficit to a seven-quarter high in Q4FY21**…**: India's trade deficit widened to a seven-quarter high of US$41.7bn in Q4FY21 from US$34.6bn in Q3FY21. This was primarily led by a 19% QoQ expansion in the import bill that outweighed export growth of 18% QoQ. Within imports, oil import growth (+31% QoQ) exceeded non-oil import growth (+16% QoQ), thanks to persistent traction in global commodity prices that surged substantially on weakening dollar index. On a YoY basis, imports surged by 19% owing to a sharp 34%YoY rise in non-oil imports, but off a low base, reflecting strong domestic demand and effective normalisation of economic activities. Exports also rose by an equivalent 19% YoY, thanks to strengthened external demand, particularly in advanced economies, aided by continued policy support and robust vaccination drive. Trade deficit in FY21, however, contracted by a sharp 35% YoY to a 13-year low of US$102bn led by a steep drop in imports—weighed down by a stringent COVID-induced nation-wide lockdown implemented earlier in the year.
- **…**But strong invisible receipts limited the downside in current account deficit: Net invisible receipts grew by 4% QoQ to US$33.6bn in Q4FY21 but fell by 6% on a YoY basis, thanks to strong steady software receipts and remittances as well as lower overseas investment income payments. This partly offset the significant widening of trade deficit in Q4FY21. Consequently, current account deficit widened to a seven-quarter high of US$8.2bn or 1% of GDP in Q4FY21, marking the second consecutive quarter to report a deficit following a surplus in the previous three quarters. Looking at the annual figures, 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, led by sharp contraction in trade deficit and higher software receipts.

- BoP surplus in Q4 shrinks to nine-quarter lows but stood at a 13-year high in FY21: The capital account balance moderated significantly to a three-quarter low of US$12bn (-64%QoQ/-29%YoY) led by tepid foreign investment inflows during the quarter, weighed down by global risk off sentiment prompted by surging global bond yields and COVID resurgence in several countries including India. Both net FPI inflows and net FDI inflows moderated significantly by 66%QoQ and 85%QoQ to US$7.3bn and US$2.7bn respectively. Among debt flows, banking capital outflows reduced to US$4.4bn in Q4 against net outflows of US$7.6bn in Q3. Net ECB flows turned positive after three quarters and stood at US$6.1bn in Q4FY21 against an outflow of US$1.1bn in the previous quarter. This led to the Balance of Payments (BoP) surplus moderating by 90%QoQ/82%YoY to a nine-quarter low of US$3.4bn in Q4FY21. In FY21, record-high FDI inflows and FII inflows into equities more than compensated for ECB and banking capital outflows, translating into a BoP surplus of US$87.3bn—the highest since the Global Financial Crisis (GFC).

Widening current account deficit coupled with tepid capital flows resulted in the BoP surplus falling by 90%QoQ/82%YoY to a nine-quarter low of US$3.4bn in Q4FY21.

BoP surplus in FY21 stood at a strong US$87.3bn—the highest since the GFC.

- Expect FY22 CAD at 1% of GDP: Strengthening external demand, aided by enhanced fiscal support and 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 assuming average crude oil prices at $65/bbl. 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 significantly lower BoP surplus this year.

Expect current account balance to slip into deficit again in FY22, with our estimate pegged at 1% of GDP, assuming average crude oil prices at US$65/bbl through the year.

- INR likely to face depreciating pressures: Emerging market currencies have come under pressure once again in the wake of hardening oil prices and dollar rally, thanks to a stronger US macroeconomic landscape and hawkish Fed commentary. The INR has been no different. Going ahead, deterioration in domestic growth prospects, coupled with lower BoP surplus, narrowing yield differentials amid potential global policy normalisation and a strong dollar, are likely to pose depreciating pressures on the INR. That said, adequate forex reserves (US$604bn as on June 18th, implying ~16 months of import cover), prompt policy intervention and moderate current account deficit should limit the downside.

Figure 1: Balance of Payments – Quarterly account

US$ bn	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
Current account	-4.6	-15.0	-7.6	-2.6	0.6	19.0	15.1	-1.7	-8.2
CAD/GDP (%)	*-0.7*	*-2.1*	*-1.1*	*-0.4*	*0.1*	*3.8*	*2.4*	*-0.2*	*-1.0*
Trade balance	-35.2	-46.8	-39.7	-36.0	-35.0	-10.8	-14.8	-34.5	-41.7
Trade balance/GDP (%)	*-5.0*	*-6.6*	*-5.7*	*-5.0*	*-4.8*	*-2.2*	*-2.3*	*-4.7*	*-5.4*
Merchandise exports	87.4	82.7	80.0	81.2	76.5	52.4	75.6	77.2	91.3
Merchandise imports	122.6	129.5	119.6	117.3	111.6	63.2	90.4	111.8	133.0
Oil imports	32.4	35.4	29.9	31.5	33.8	13.2	18.8	21.9	28.7
Non-oil imports	90.2	94.1	89.7	85.8	77.8	50.0	71.6	89.9	104.3
Invisibles	30.6	31.8	32.1	33.4	35.6	29.8	29.9	32.8	33.6
Net services	21.3	20.1	20.9	21.9	22.0	20.5	20.9	23.6	23.5
Software earnings	19.9	21.0	21.1	21.5	21.1	20.8	22.0	23.4	23.5
Transfers	16.2	18.0	20.0	18.9	18.4	17.0	18.4	19.3	18.8
Investment income	-7.5	-7.0	-9.6	-8.1	-5.6	-8.3	-10.1	-10.9	-9.7
Other invisibles	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.9
Capital account	19.2	28.6	13.6	23.6	17.4	1.2	16.1	33.5	12.3
Capital acc./GDP (%)	*2.7*	*4.0*	*1.9*	*3.3*	*2.4*	*0.2*	*2.5*	*4.5*	*1.6*
Foreign investments	15.9	18.8	9.8	17.6	-1.8	-0.2	31.6	38.2	10.0
FDI	6.4	14.0	7.3	9.7	12.0	-0.8	24.6	17.0	2.7
FII	9.4	4.8	2.5	7.8	-13.7	0.6	7.0	21.2	7.3
Loans	10.3	9.6	3.1	3.1	9.9	2.7	-3.8	0.2	7.7
ECBs	7.5	6.1	3.3	3.2	10.3	-1.2	-3.9	-1.2	6.1
Banking capital	-8.1	3.4	-1.8	-2.3	-4.6	2.2	-11.3	-7.6	-4.4
NRI deposits	3.4	2.8	2.3	0.8	2.8	3.0	1.9	3.0	-0.5
Others	1.2	-3.2	2.5	5.2	13.8	-3.6	-0.4	2.8	-1.0
Errors & Omissions	-0.4	0.4	-0.9	0.6	0.9	-0.4	0.4	0.7	-0.7
Overall balance (BoP)	14.2	14.0	5.1	21.6	18.8	19.8	31.6	32.5	3.4

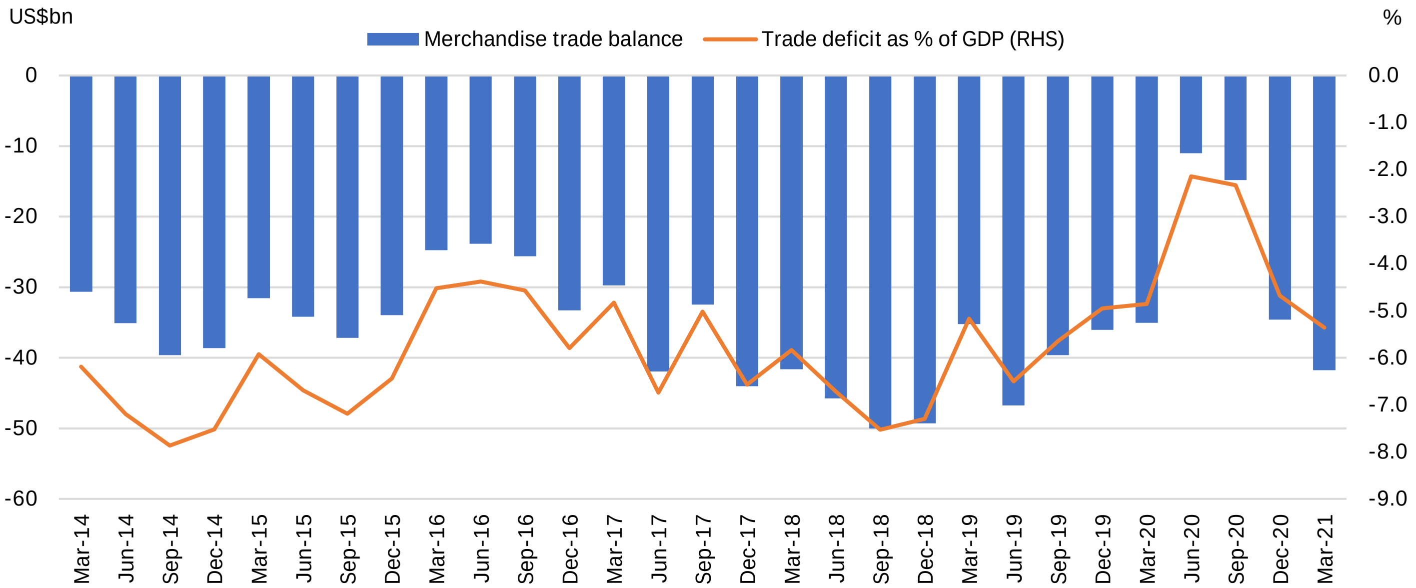
Source: RBI, CMIE Economic Outlook, NSE

Figure 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

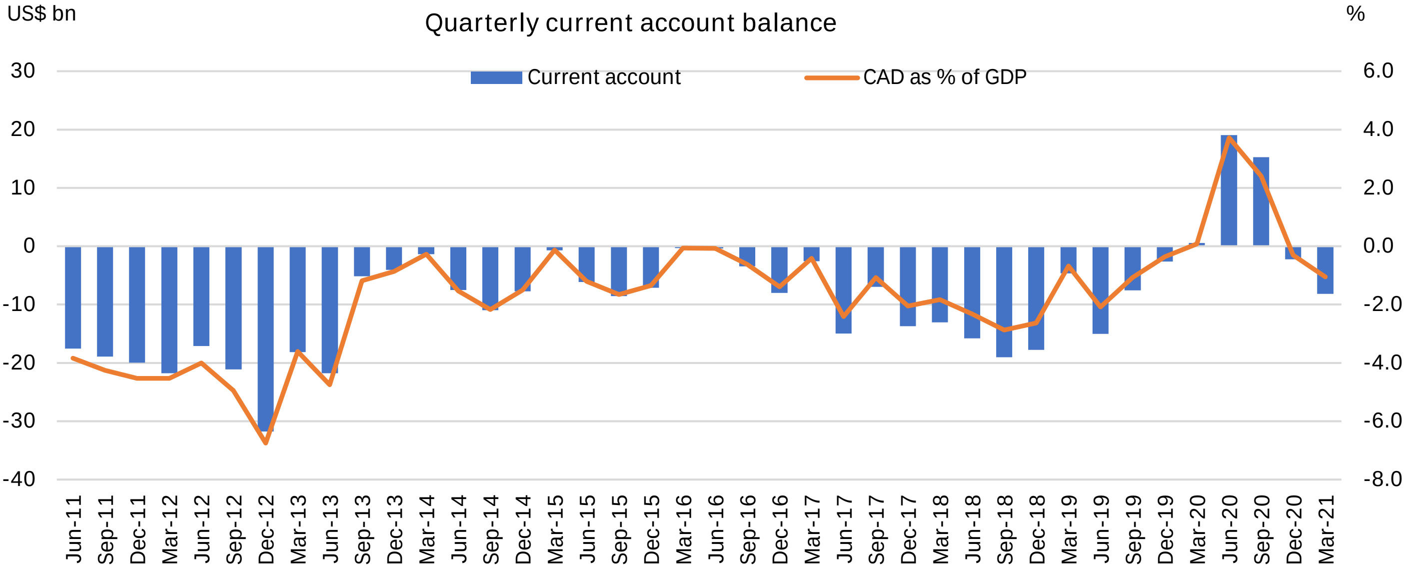
Source: RBI, CMIE Economic Outlook, NSE

Figure 3: Trade deficit widened further in Q4FY21…



Source: RBI, CMIE Economic Outlook, NSE.

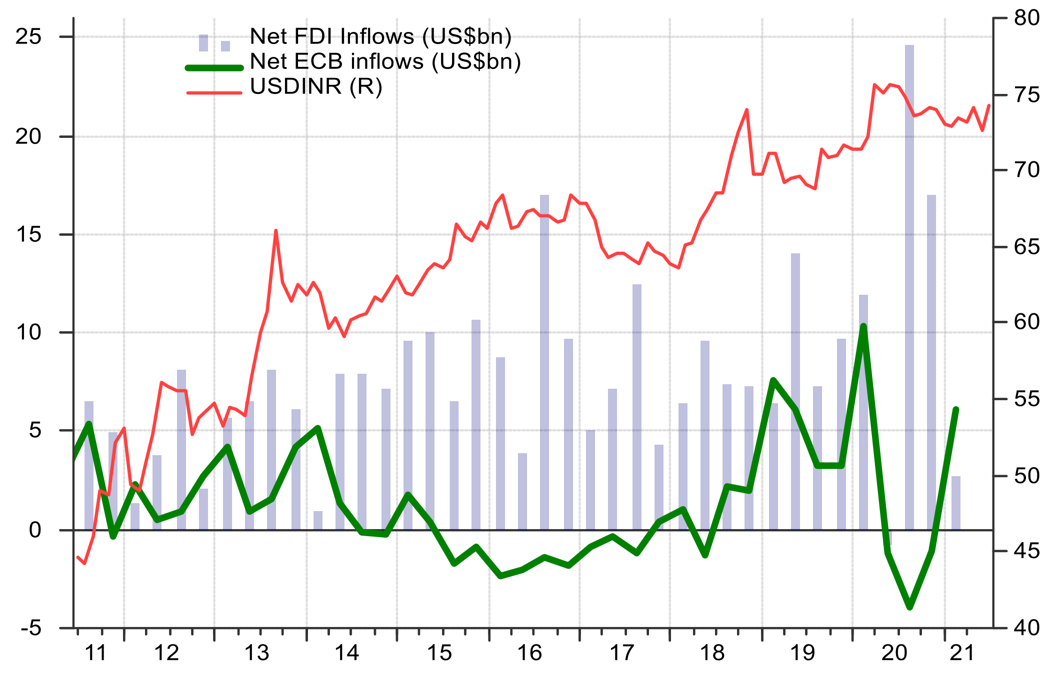
Figure 4: ...pushing current account deficit to a seven-quarter high



Source: CMIE Economic Outlook, NSE

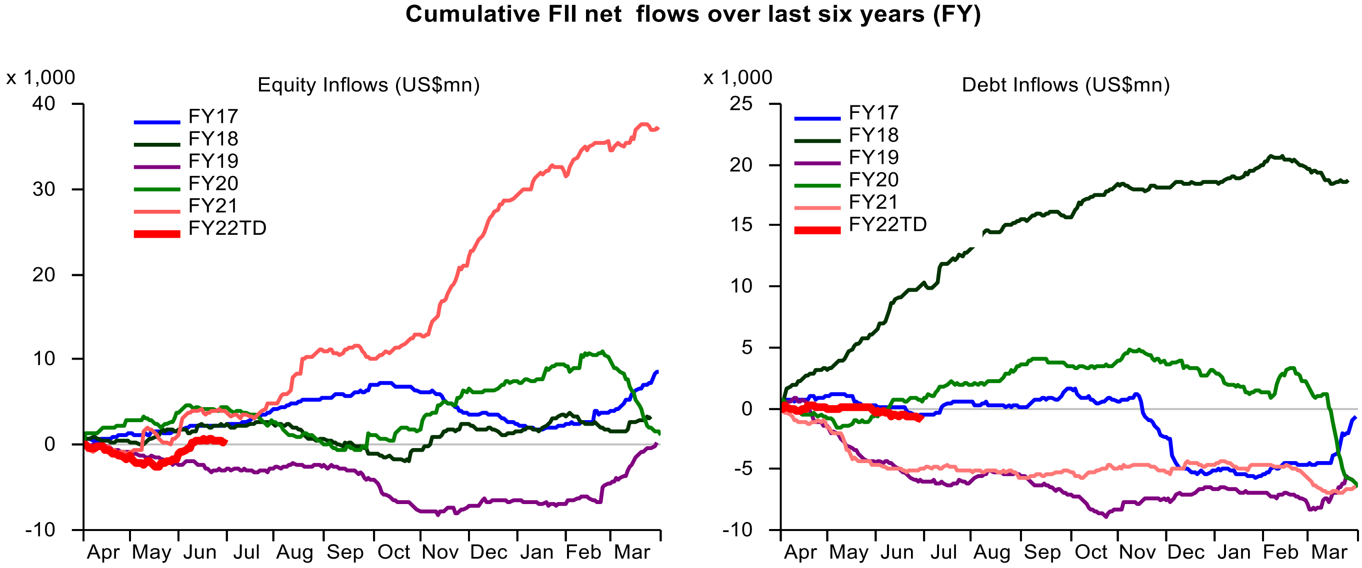
Figure 5: After surging to record-high levels in Q2FY21, FDI inflows have been moderating since then

Net FDI and ECB inflows into India



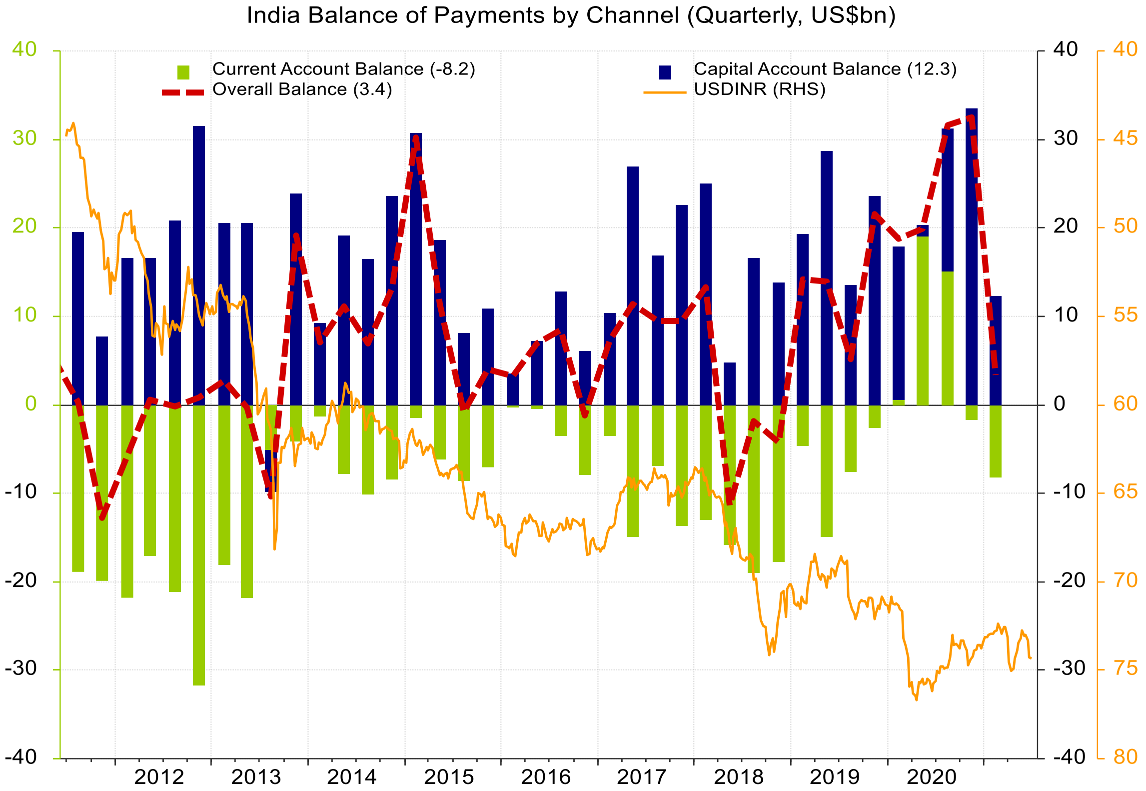
Source: Refinitiv Datastream, NSE

Figure 6: While FPI flows moderated in Q4FY21, cumulative flows into Indian equities where the highest ever in FY21



Source: Refinitiv Datastream, NSE

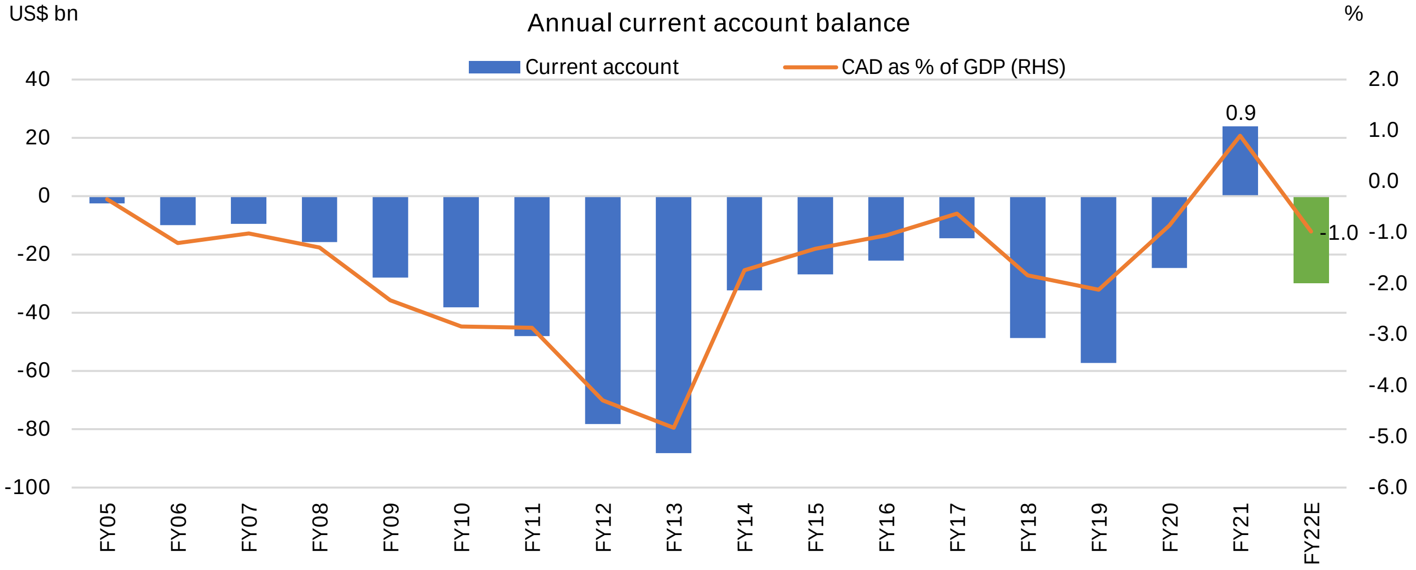
Figure 7: BoP surplus moderated sharply in 4QFY21 on widened trade deficit and tepid capital flows



Source: Refinitiv Datastream, NSE

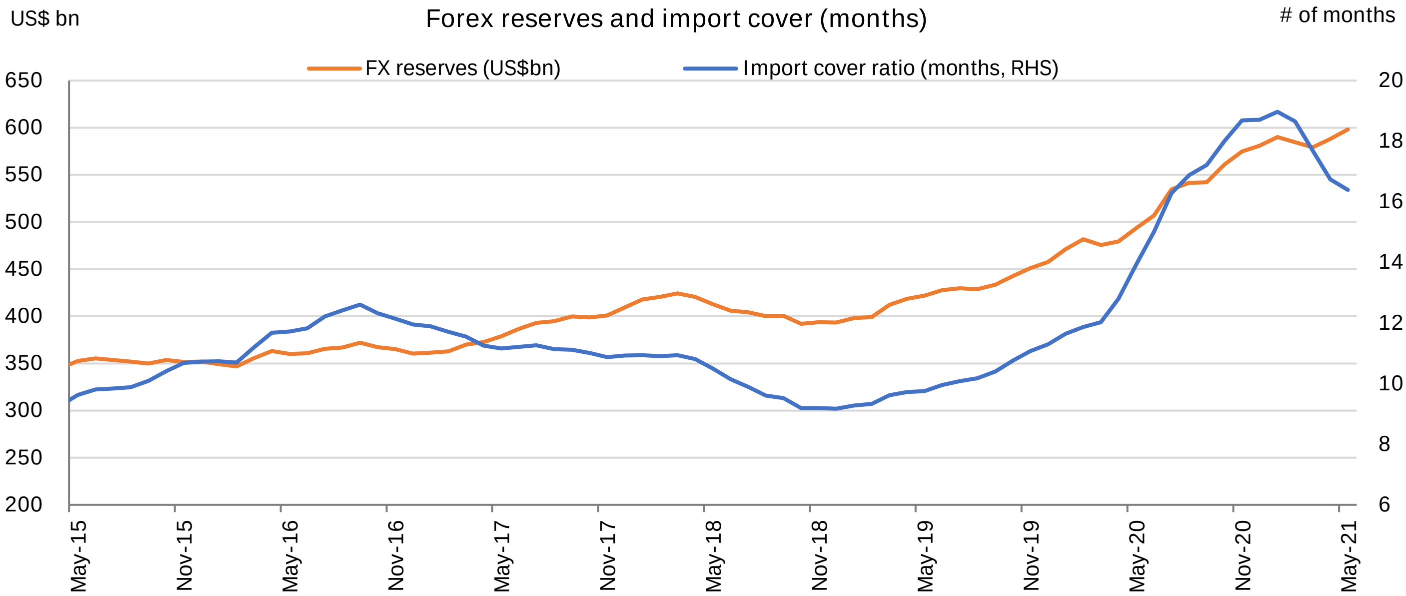
Figure 8: Current account surplus came in at 0.9% of GDP in FY21; expect deficit of 1.0% of GDP in FY22

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

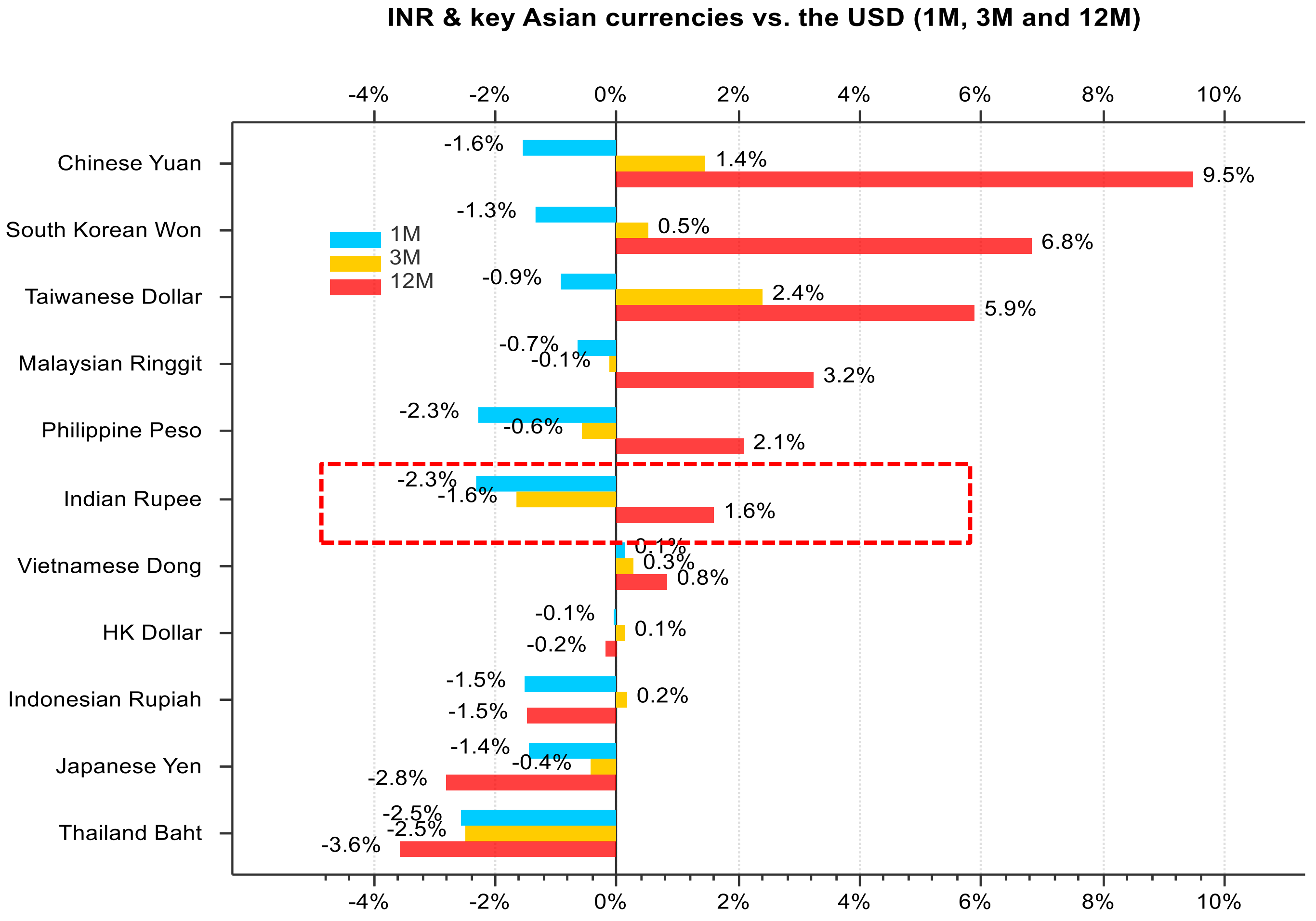
Figure 9: Forex reserves remain at more-than-adequate levels despite the recent drop



Source: Refinitiv Datastream, NSE

Figure 10: INR vs. other key Asian market currencies

Emerging market currencies have come under pressure once again in the wake of hardening oil prices and a stronger US macroeconomic landscape accompanied with hawkish Fed commentary, that has translated into dollar rally again. The INR has been no different. We expect INR to trade with a depreciating bias in the near future.



Source: Refinitiv Datastream, NSE

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