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Q4FY22 BoP slips into deficit; external situation in FY23 to worsen

India's current account deficit (CAD) narrowed to US$13.4bn or 1.5% of GDP in Q4FY22 vs. US$22.2bn or 2.6% of GDP in the previous quarter but was higher than US$8.2bn (1% of GDP) reported in the year ago period. The sequential moderation in CAD was due to lower trade deficit, thanks to a stronger growth in export bill vis-à-vis imports, as well as strong invisibles. The capital account balance, however, slipped into deficit for the first time in 34 quarters, thanks to record-high net foreign portfolio outflows and strong banking capital outflows during the quarter. Consequently, the Balance of Payments (BoP) recording a deficit of US$16bn in Q4FY22—the first deficit quarterly deficit in 13 quarters and the highest in 13 years.

Looking at annual figures, India's current account balance slipped into deficit again in FY22 after registering a surplus in the previous year and came in at US$38.8bn or 1.2% of GDP. This was led by a sharp expansion in trade deficit, attributed to higher commodity prices as well as improved demand environment in the wake of reversal of COVID-induced restrictions. Strong external loans, banking capital inflows and SDR allocation from the IMF more than compensated for record-high net foreign portfolio outflows and moderation in foreign direct investment (FDI) in FY22, translating into a BoP surplus of US$47.5bn.

Deteriorating global growth prospects is likely to weigh on export growth momentum in FY23. Imports, however, are likely to remain strong, aided by surging commodity prices. In our base case scenario, we expect current account deficit to widen to 3.1% of GDP in FY23—the highest in last 11 years—assuming average crude oil price at US$107/bbl. This, along with continued foreign capital outflows—a consequence of heightened macro and geopolitical uncertainty and tighter monetary policy setting across the globe—is expected to translate into a record BoP deficit in FY23. This is likely to continue to pose a depreciating bias on the INR, even as alignment of RBI with the US Fed in terms of rate hikes should provide some breather. Additionally, despite a drop over the last few months, India's foreign exchange reserves (US$596bn as on June 10th, 2022) remain relatively strong and should provide enough cushion to the RBI to intervene in the forex markets as and when required.

- **Lower merchandise trade deficit in Q4FY22…:** Following a sharp rise in Q3FY22, India's merchandise trade deficit dropped 8.8% QoQ to US$54.5bn in Q4FY22. This was primarily led by an 8.3% QoQ expansion in the export bill that outweighed import growth of 2.3% QoQ. Within exports, petroleum exports (+21.2% QoQ) far exceeded non-petroproduct export growth (+5.9% QoQ), thanks to a sharp surge in global oil prices. Sequential jump in imports also was solely led by oil imports, excluding which India's import bill fell by 2% QoQ—a result of moderating domestic demand and accentuated supply-side bottlenecks during the quarter. On a YoY basis, both exports and imports recorded a 29%+ growth, albeit off a low base, partly reflecting the impact of 60%+ YoY jump in crude oil prices and stronger consumption demand as compared to the year ago period. Trade deficit in FY21, however, widened by a steep 85% to a nine-year high of US$189bn led by a much stronger growth in imports, aided by higher commodity prices as well as improved demand environment in the wake of reversal of COVID-induced restrictions.

India's current account deficit declined to US$13.4bn or 1.5% of GDP in Q4FY22 vs. a deficit of US$22.2bn or 2.6% of GDP in the previous quarter.

- **…And a strong growth in invisible receipts narrowed current account deficit:** Net invisible receipts increased by 9.3% QoQ/22.3% YoY to US$41bn in Q4FY22, marking the highest QoQ and YoY expansion for the Jan-March quarter in last 11 and 10 years respectively. This was on the back of strong growth software and business service receipts during the quarter. Consequently, current account deficit narrowed sequentially to US$13.2bn or 1.5% of GDP in Q4FY22 from US$22.2bn or 2.6% of GDP in the previous quarter. Looking at the annual figures, India's current account balance slipped into deficit again in FY22 after recording a huge surplus in the previous year and came in at US$38.8bn or 1.2% of GDP, led by a sharp expansion in trade deficit, partly offset by strong growth in invisibles.

- **BoP slipped into deficit in Q4FY22 for the first time in 13 quarters but maintained a strong surplus in FY22:** The capital account balance recorded a deficit of US$1.7bn in Q4FY22—the first deficit in 34 quarters, after remaining in a strong surplus position over last several quarters. This was primarily led by record-high net foreign capital outflows of US$15.2bn and huge banking capital outflows of US$6.0bn during the March quarter. This was partly offset by a strong surge in FDI to a five-quarter high of US$13.8bn in Q4FY22 vs. US$4.6bn in the previous quarter and robust ECB inflows (US$3.4bn vs. -US$254m in Q3FY22). This led to the BoP slipping into deficit for the first time in 13 quarters to US$16bn—the highest quarterly deficit in 13 years. In FY22, strong external loans, banking capital inflows and SDR (Special Drawing Rights) allocation of US$17.9bn from the IMF more than compensated for moderation in net FDI inflows (US$35.6bn vs. US$44bn in FY21) and record-high foreign capital outflows of US$16.8bn. Consequently, capital account balance came in at a four-year high of US$85.8bn in FY22, leading to strong BoP surplus of US$47.5bn.

BoP slipped into deficit in Q4FY22 for the first time in 13 quarters to US$16bn—the highest quarterly deficit in 13 years

- **Expect FY23 CAD at 3.1% of GDP:** In FY23, deteriorating global growth prospects is likely to weigh on export growth momentum, while imports are likely to remain strong, aided by surging commodity prices. In our base case scenario, we expect current account deficit to widen to 3.1% of GDP in FY23—the highest in last 11 years—assuming average crude oil price at US$107/bbl. If crude oil price averages at around US$85/bbl in FY23, CAD would drop to 2.3% of GDP, *ceteris paribus*, and would rise to 3.8% of GDP if average crude oil price during the year surges to US$125/bbl. On the capital account side, foreign capital outflows are likely to sustain at elevated levels in the current year as well, thanks to a significant deterioration in global risk appetite—a consequence of increasing macro and geopolitical uncertainty and tightening monetary policy setting across the globe. This is likely to translate into huge BoP deficit in FY23, with our estimate in the base case scenario pegged at US$61bn.

We expect current account deficit to widen to 3.1% of GDP in our base scenario, assuming average crude oil price at US$107/bbl.

- **Depreciating bias on the INR to remain:** Emerging market currencies have come under significant pressure over the last few months. This has come on the back of heightened geopolitical uncertainty following Russia's invasion of Ukraine, leading to flight of capital from riskier asset classes. This got further accentuated by faster-than-expected pace of rate hikes by the US Fed to fight intensifying inflationary pressures. INR has been no different and has fallen by 5.3% in 2022 till date (As on June 23rd, 2022). The depreciating bias on the INR is likely to continue, even as alignment of RBI with the US Fed in terms of rate hikes should provide some breather. Additionally, despite a drop over the last few months, India's foreign exchange reserves (US$596bn as on June 10th, 2022) remain relatively strong and should provide enough cushion to the RBI to intervene as and when required**.**

Table 1: Balance of Payments – Quarterly account

US$ bn	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Current account	**0.6**	**19.1**	**15.3**	**-2.2**	**-8.2**	**6.6**	**-9.7**	**-22.2**	**-13.4**
CAD/GDP (%)	*0.1*	*3.7*	*2.4*	*-0.3*	*-1.0*	*0.9*	*-1.3*	*-2.6*	*-1.5*
Trade balance	-35.0	-11.0	-14.8	-34.6	-41.7	-30.7	-44.5	-59.7	-54.5
Trade balance/GDP (%)	*-4.9*	*-2.2*	*-2.3*	*-4.7*	*-5.3*	*-4.4*	*-5.9*	*-7.1*	*-6.2*
Merchandise exports	76.5	52.2	75.6	77.2	91.3	97.4	104.8	108.9	118.0
Merchandise imports	111.6	63.2	90.4	111.8	133.0	128.2	149.3	168.7	172.5
Oil imports	33.8	13.2	18.8	21.9	28.7	30.9	38.6	43.0	49.4
Non-oil imports	77.8	50.0	71.6	89.9	104.3	97.2	110.7	125.7	123.1
Invisibles	35.6	30.0	30.1	32.4	33.6	37.3	34.8	37.6	41.1
Net services	22.0	20.8	21.1	23.2	23.5	25.8	25.6	27.8	28.3
Software earnings	21.1	20.8	22.0	23.5	23.5	25.1	26.8	28.4	29.3
Transfers	18.4	17.0	18.4	19.3	18.8	19.0	19.0	21.3	21.1
Investment income	-5.6	-8.4	-10.2	-10.9	-9.7	-8.4	-10.5	-12.4	-9.2
Other invisibles	0.7	0.7	0.7	0.8	0.9	0.9	0.7	0.9	0.8
Capital account	**17.4**	**1.4**	**15.9**	**34.1**	**12.3**	**25.4**	**39.6**	**22.5**	**-1.7**
Capital acc./GDP (%)	*2.4*	*0.3*	*2.5*	*4.6*	*1.6*	*3.7*	*5.2*	*2.7*	*-0.2*
Foreign investments	-1.8	0.1	31.4	38.6	10.0	12.0	12.6	-1.3	-1.4
FDI	12.0	-0.5	24.4	17.4	2.7	11.6	8.7	4.6	13.8
FII	-13.7	0.6	7.0	21.2	7.3	0.4	3.9	-5.8	-15.2
Loans	9.9	2.8	-3.9	0.3	7.7	2.8	7.8	10.0	12.9
Banking capital	-4.6	2.2	-11.3	-7.6	-4.4	4.1	0.4	8.2	-6.0
NRI deposits	2.8	3.0	1.9	3.0	-0.5	2.5	-0.8	1.3	0.2
Others	13.8	-3.7	-0.3	2.8	-1.0	6.5	18.9	5.6	-7.2
Errors & Omissions	0.9	-0.6	0.4	0.6	-0.7	-0.1	1.3	0.1	-0.9
Overall balance (BoP)	**18.8**	**19.8**	**31.6**	**32.5**	**3.4**	**31.9**	**31.2**	**0.5**	**-16.0**

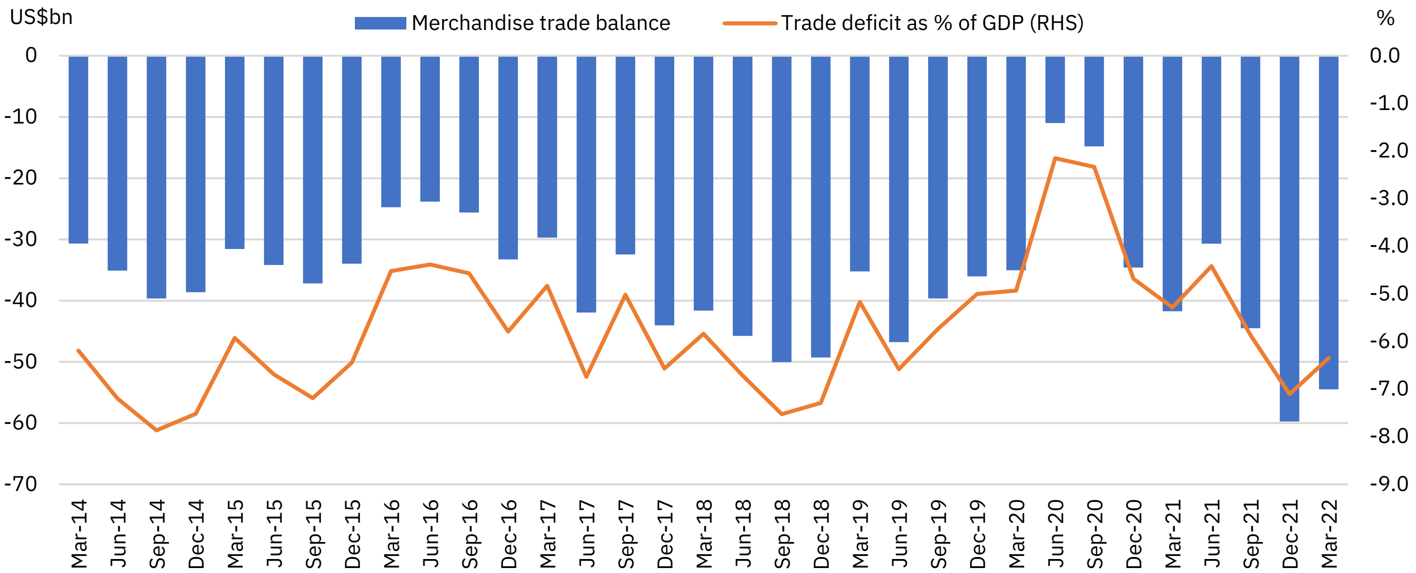
Source: RBI, CMIE Economic Outlook, NSE EPR.

Table 2: Balance of Payments – Annual account

US$ bn	FY19	FY20	FY21	FY22	FY23E		
					Oil @US $100/bbl	Oil @ US$85/bbl	Oil @ US$125/bbl
Current account	**-57.3**	**-24.7**	**23.9**	**-38.8**	**-108.7**	**-80.4**	**-132.1**
CAD/GDP (%)	*-2.1*	*-0.9*	*0.9*	*-1.2*	*-3.1*	*-2.3*	*-3.8*
Trade balance	-180.3	-157.5	-102.2	-189.5	-265.4	-237.1	-288.8
Trade balance/GDP (%)	*-6.7*	*-5.5*	*-3.8*	*-6.0*	*-7.6*	*-6.8*	*-8.3*
Merchandise exports	337.2	320.4	296.3	429.2	467.9	448.0	484.3
% YoY	*9.1*	*-5.0*	*-7.5*	*44.8*	*9.0*	*-4.3*	*8.1*
Merchandise imports	517.5	477.9	398.5	618.6	733.2	685.0	773.0
% YoY	*10.3*	*-7.6*	*-16.6*	*55.3*	*18.5*	*-6.6*	*12.8*
Oil imports	141.1	130.5	82.4	162.1	235.2	187.0	275.0
Non-oil imports	376.4	347.4	316.1	456.5	498.0	498.0	498.0
Invisibles	123.0	132.8	176.7	150.7	156.6	156.6	156.6
Net services	81.9	84.9	88.6	107.5	112.9	112.9	112.9
Transfers	69.9	75.2	73.5	80.4	82.9	82.9	82.9
Other invisibles*	-28.9	-27.3	-36.0	-37.3	-39.1	-39.1	-39.1
Capital account	**54.4**	**83.2**	**63.7**	**85.8**	**48.0**	**48.0**	**48.0**
Capital acc./GDP (%)	*2.0*	*2.9*	*2.4*	*2.7*	*1.4*	*1.4*	*1.4*
Foreign investments	30.1	44.4	80.1	21.8	25.0	25.0	25.0
FDI	30.7	43.0	44.0	38.6	40.0	40.0	40.0
FII	-0.6	1.4	36.1	-16.8	-15.0	-15.0	-15.0
Loans	15.9	25.7	6.9	33.6	8.0	8.0	8.0
Banking capital	7.4	-5.3	-21.1	6.7	10.0	10.0	10.0
NRI deposits	10.4	8.6	7.4	3.2	8.0	8.0	8.0
Others	1.0	18.4	-2.2	23.7	5.0	5.0	5.0
Errors & Omissions	-0.5	1.0	-0.3	0.5	0.0	0.0	0.0
Overall balance (BoP)	**-3.3**	**59.5**	**87.3**	**47.5**	**-60.7**	**-32.4**	**-84.1**

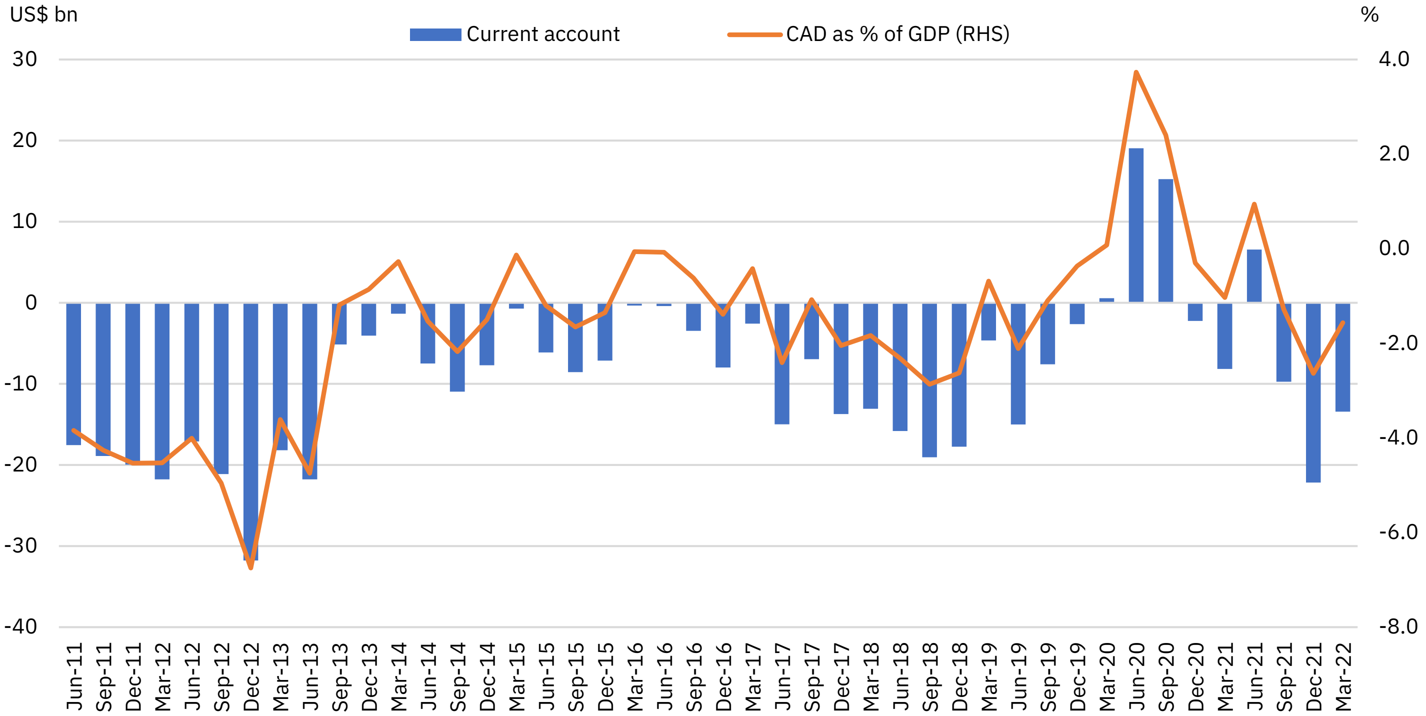
Source: RBI, CMIE Economic Outlook, NSE EPR. *Includes Investment Income.

Figure 1: Quarterly trade deficit trend



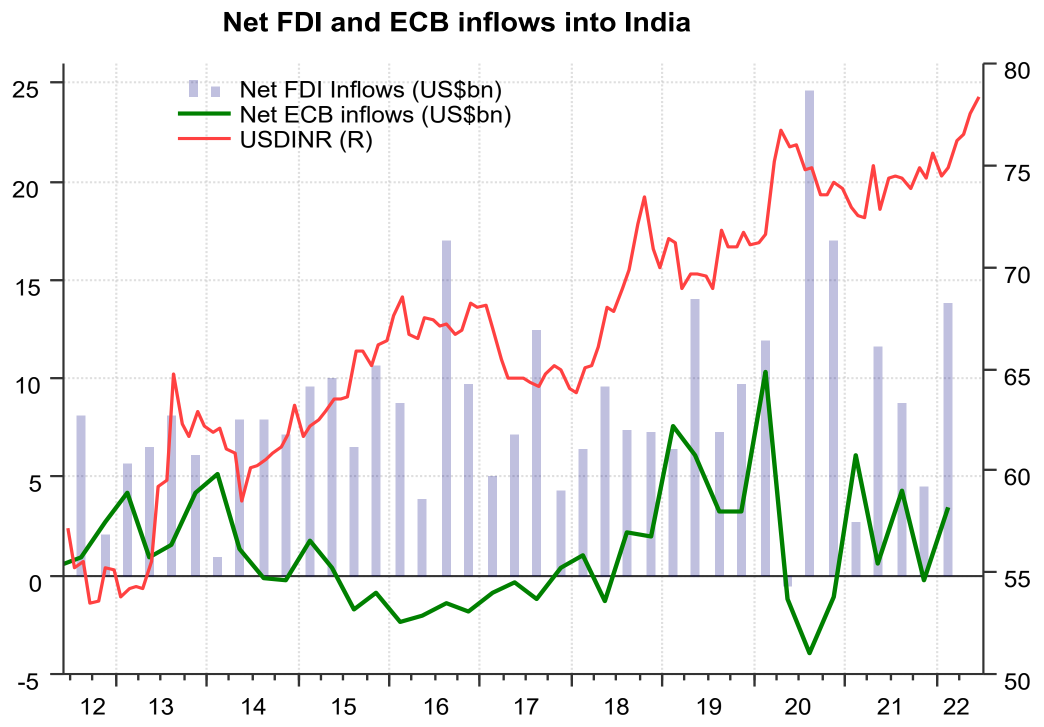
Source: RBI, CMIE Economic Outlook, NSE EPR.

Figure 2: Quarterly current account balance trend



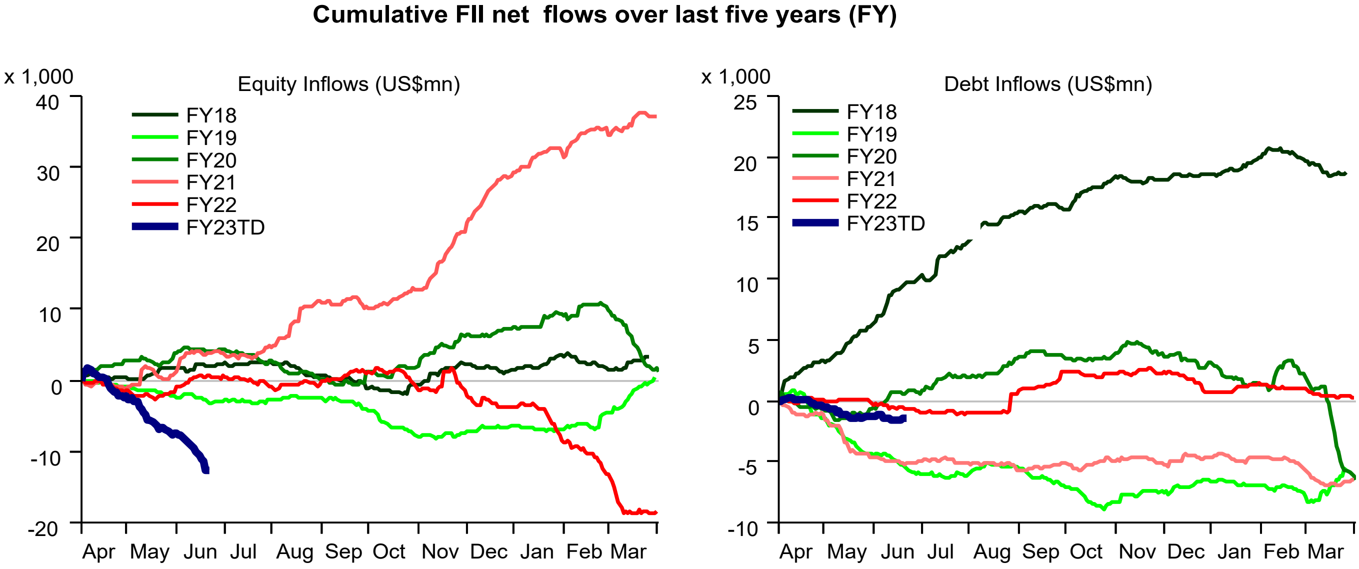
Source: CMIE Economic Outlook, NSE EPR.

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



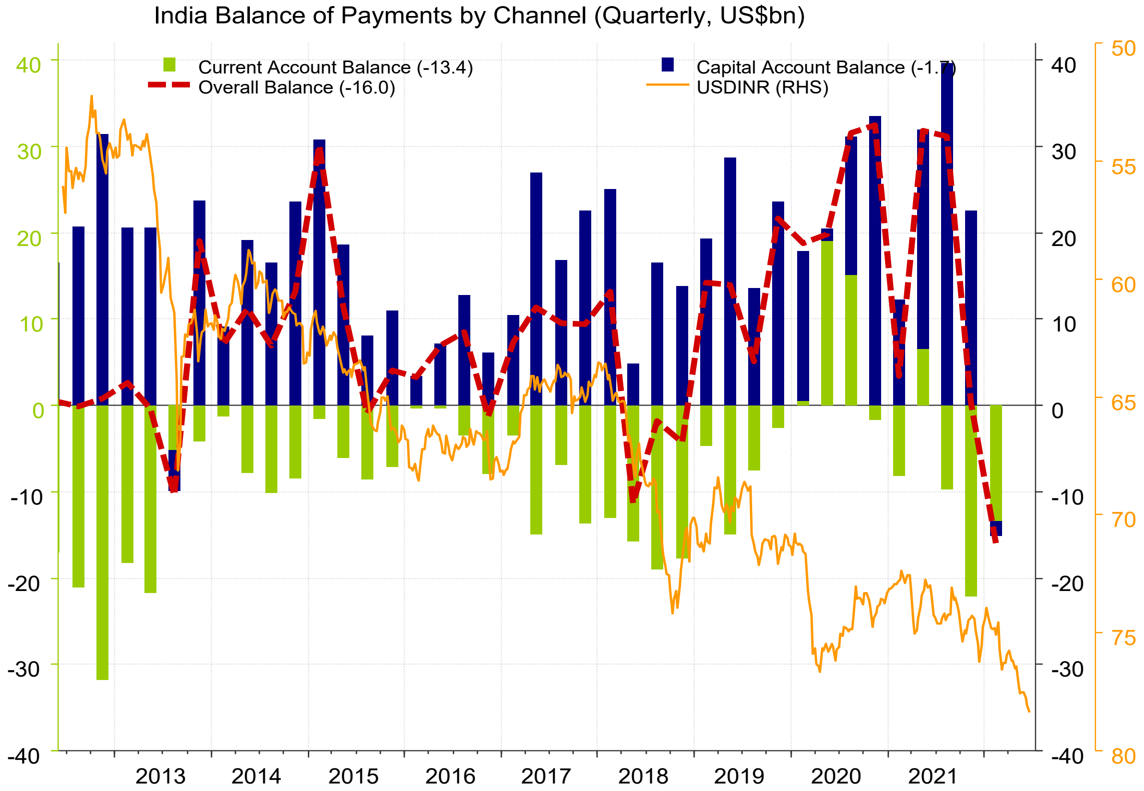
Source: Refinitiv Datastream, NSE EPR.

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



Source: Refinitiv Datastream, NSE EPR.

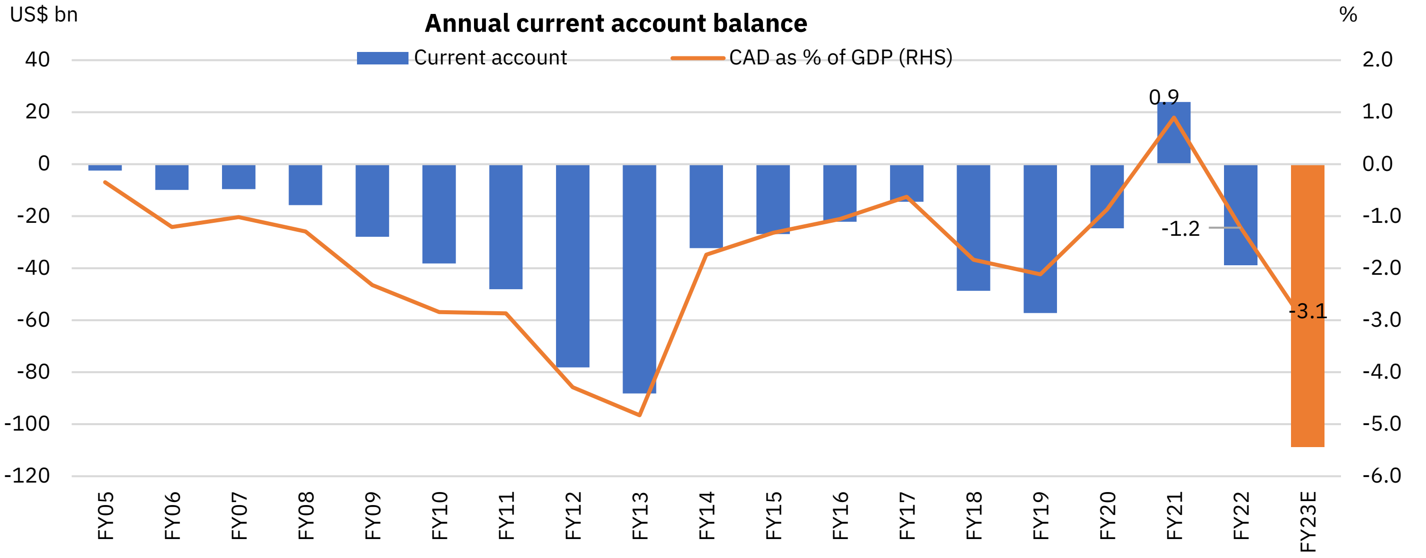
Figure 5: Quarterly Balance of Payments trend by channels



Source: Refinitiv Datastream, NSE EPR.

Figure 6: Annual current account deficit trend and expectations

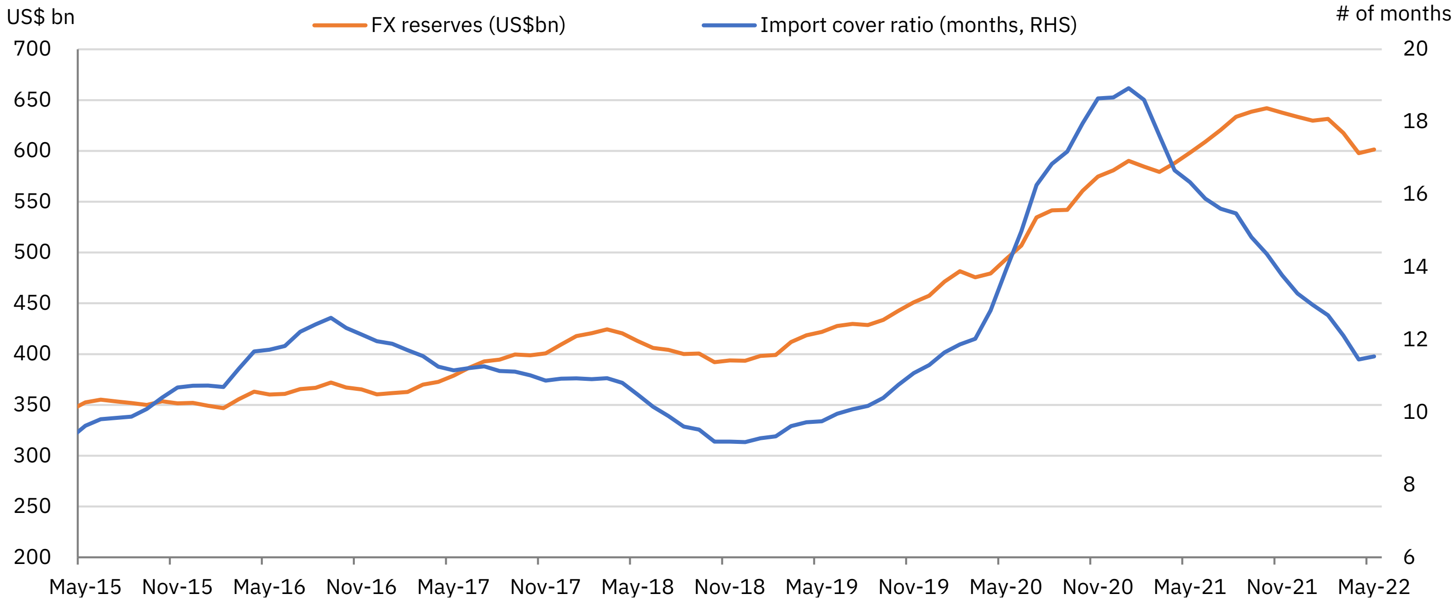
In our base case scenario, we expect current account deficit to widen to 3.1% of GDP in FY23 assuming average crude oil price at US$107/bbl. This is the highest current account deficit as a % of GDP in last 11 years.



Source: Refinitiv Datastream, NSE EPR.

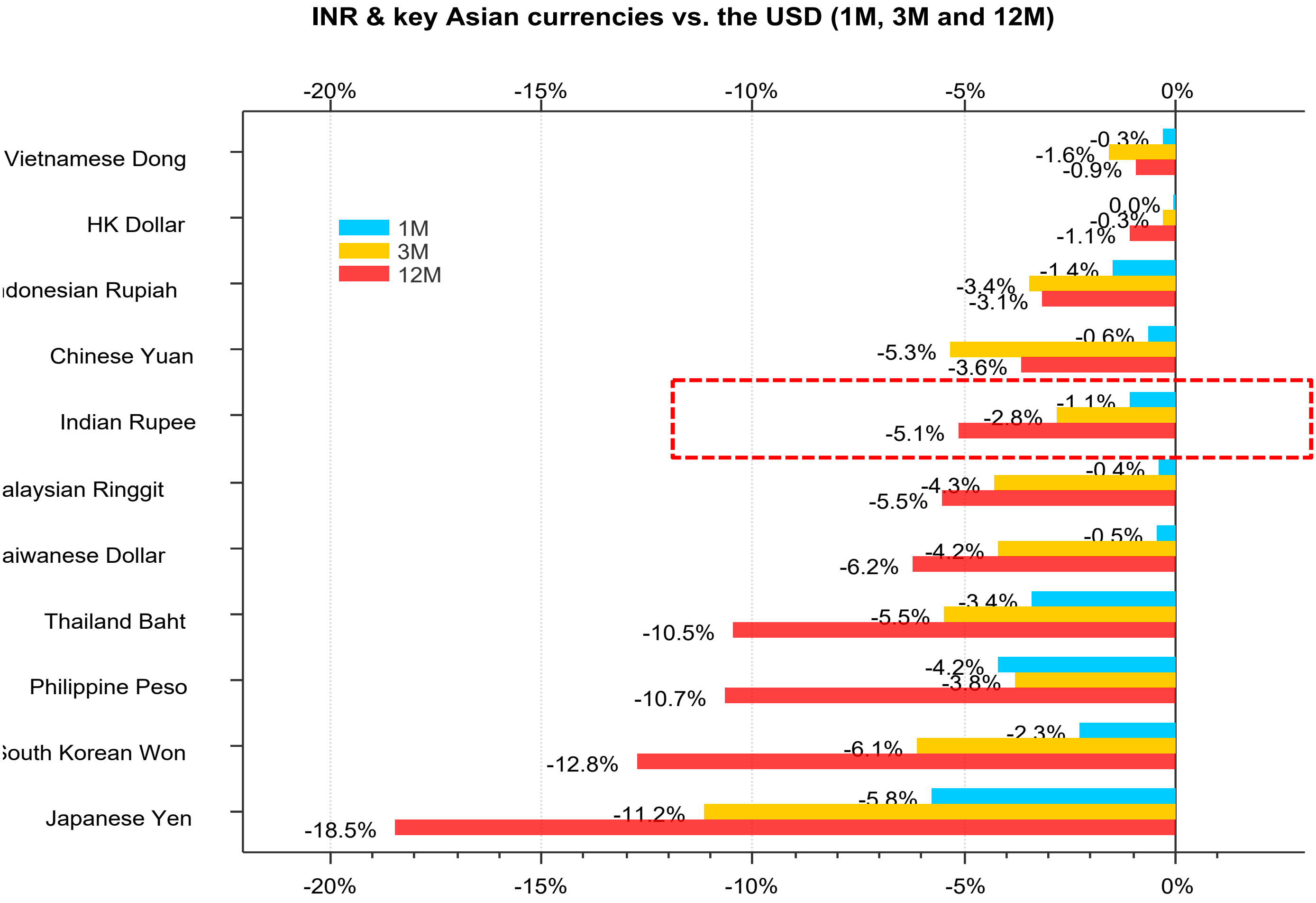
Figure 7: Foreign exchange reserves and import cover

Foreign exchange reserves remain quite strong at ~US$600bn despite the recent drop, providing sufficient cushion to the RBI to intervene in the forex markets as and when required.



Source: Refinitiv Datastream, NSE EPR.

Figure 8: INR vs. other key Asian market currencies



Source: Refinitiv Datastream, NSE EPR.

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