ICICI Bank Global Markets

India Q4 FY2021 BoP: Current Account deficit widened; subdued capital flows weighed on capital account surplus

- **The Current Account Deficit (CAD) has widened sharply in Q4 on account of a higher trade deficit, as the economy gradually recovered**
- **For FY2021 as a whole, the compressed trade deficit offsets a fall in the invisible receipts, leading to a Current Account surplus of ~0.9% of GDP in FY2021. The robust net capital inflows, along with the Current Account surplus, led to a large balance of payments surplus**
- **The Current Account is likely to pose a deficit this fiscal, amid elevated oil prices and import recovery. We expect the Current Account to clock a deficit of USD 25-30 billion (~0.8-1% of GDP) in FY2022, accompanying a lower balance of payments surplus, as compared to FY2021.**

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Current Account Deficit (CAD) widened sharply, as imports made a sharper rebound

- CAD widened sharply on account of a higher trade deficit that largely reflected an adverse shift in terms of trade, as import made a sharper rebound in Q4, aided by an uptrend in the international crude oil and commodity prices and a strong domestic industrial demand. The CAD increased on a sequential basis to USD 8.1 billion (1% of GDP) in Q4 from USD 2.2 billion (0.3 % of GDP) in Q3 FY2021, and USD 0.6 billion (0.1% of GDP), seen in Q4 FY2020. **On an annual basis, the sizeable contraction in imports, relative to exports, compressed the trade deficit. The compressed trade deficit coupled with higher services surplus, overshadowed the fall in the invisible receipts, due to higher investment payments and lower remittances, and translated into Current Account surplus of USD 23.9 billion (0.9% of GDP) in FY2021 from a deficit of USD 24.6 billion (0.9% of GDP) in FY2020**
- Exports rose to a quarterly high level in Q4, while imports rebounded sharply on account of higher oil and gold imports. As a result, the trade deficit widened by a considerable ~USD 7 billion, sequentially
- Net services receipts stayed flat in Q4, in line with the print in Q3. Receipts from software services remained largely at par with Q3, while receipts from transport and business services improved on a year-on-year basis. Going forward, the scope of expansion in services trade, especially software, business and financial services has further widened, as economies are transitioning towards digitalisation. Travel services would take a hit, due to restrictions imposed amid the second wave. Easing of H-1B Visa norms and a strong performance of the Banking, Financial Services and Insurance (BFSI) sector could play out in the near term
- Transfer receipts, mainly representing remittances by Indians employed overseas, increased slightly in Q4 to USD 18.8 billion, on the back of increase in international crude oil prices and improved nominal income conditions on the prospect of economic recovery in the US and UK.

Capital Account surplus in Q4 plummeted on subdued capital flows

- The overall Capital Account surplus (including errors and omission) plummeted to USD 11.6 billion in Q4 FY2021, as FDI flows were muted after several big ticket deals, in the previous quarter. Sharply higher loans aided this account, substantially. For FY2021 as a whole, the Capital Account remained in surplus, fuelled by the foreign investment flows. The Foreign Portfolio Investment (FPI) investment rose to a record high to USD 36 billion in FY2021, despite the pandemic. Higher returns, coupled with ample global liquidity, kept investors attracted to Indian equities
- Portfolio inflows fell sequentially in Q4 to USD 7.3 billion as foreign investors booked profit, given the lucrative returns offered in the Indian equity market. However, Foreign Direct Investment (FDI) related flows stayed muted in the last quarter of FY2021

- For the fiscal as a whole, India's FDI performance was in sharp contrast to the global FDI trends. India remained an attractive investment destination registering a new high in FY2021, with Gross FDI amounting to USD 80.9 billion. Meanwhile, the World Investment Report 2021 by the United Nations Conference On Trade and Development (UNCTAD), states that India was the fifth largest FDI recipient in the world in 2020, owing to a robust investment in ICT (software and hardware) and construction. Other domestic factors, such as an FDI limit increase in insurance, proposed PLI scheme and forward growth trajectory provided optimism for the medium term. FPI inflows witnessed a record surge during 2020-21, aided by ultra-accommodative monetary policy stances of advanced economies, weaker dollar and a better return, domestically
- The Loan Account saw a multi-quarter high in Q4, while banking capital printed a net deficit in that quarter. While the former was due to a swelling commercial borrowing and external assistance to India, the latter was led by a substantial decline in the commercial banks' assets. The net receipt on the account of non-resident deposits fell sharply in Q4.

Overall, the balance of payments clocked a USD 3.4 billion surplus in Q4, indicating capital flows were sufficient to cover the CAD, despite a higher trade deficit. The Balance of Payment (BoP) clocked a healthy surplus of USD 87.3 billion in FY2021, as compared to a surplus of USD 59.5 billion in FY2020. The external sector remained ebullient, throughout the year.

The external sector looks good, but import bill and lower flows could weigh in on the margin

Exports have seen a robust performance over the past three months, as major trading partners have resumed activity on the back of swift vaccinations. Imports are currently seeing modest headwinds, but wide-scale opening up over the next few months will imply a normalisation, over time. The Current Account is likely to pose a deficit this fiscal, amid elevated oil prices and import recovery to the pre-pandemic levels. We expect the Current Account to clock a deficit of USD 25-30 billion (~0.8-1% of GDP) in FY2022, with balance of payments displaying a surplus of ~USD 45-50 billion. On the capital inflows front, FPIs have been modest so far, however, a rebound is already in place as the second wave infections continue to ebb, while the US rates hike concerns and tapering of purchases may pose downside risks. FDI inflows are expected to continue their momentum. We retain our expectation of a mild depreciation bias in the medium term for the Rupee. Elevation in the oil and commodity prices, the recent change in tone by the Federal Reserve indicating possibly a quicker withdrawal of accommodation, other Central Banks following suit, could play out in the near to medium term.

BOP details

(USD bn)	Q1 FY2021	Q2 FY2021	Q3 FY2021	Q4 FY2021	FY2021
Merchandise	-11.0	-14.8	-34.6	-41.7	-102.2
- Exports	52.2	75.6	77.2	91.3	296.3
- Imports	63.2	90.4	111.8	133.0	398.5
Invisibles	30.0	30.1	32.4	33.6	126.1
- Services	20.8	21.1	23.2	23.5	88.6
- Transfers	17.0	18.4	19.3	18.8	73.5
- Income	-7.7	-9.4	-10.1	-8.7	-36.0
Current Account	19.1	15.3	-2.2	-8.2	23.9
Foreign Investment	0.1	31.4	38.6	10.0	80.1
- FDI	-0.5	24.4	17.4	2.7	44.0
- Portfolio Investment	0.6	7.0	21.2	7.3	36.1
Loans	2.8	-3.9	0.3	7.7	6.9
Banking Capital	2.2	-11.3	-7.6	-4.4	-21.1
Other capital	-3.7	-0.3	2.8	-1.0	-2.1
Capital Account*	0.8	16.3	34.7	11.6	63.4
Overall BoP	19.8	31.6	32.5	3.4	87.3

(includes errors and omissions)*

Source: Reserve Bank of India, ICICI Bank Research

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