India Q1 FY2022 BoP: Current Account reverts to surplus; Capital Account shines on strong investment inflows

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- **Moderation in trade deficit translated into the Current Account surplus, while the Capital Account posted a healthy surplus on account of higher foreign investment**
- **FY2022 is expected to end with a Current Account deficit of ~0.6% of GDP, with an accompanying healthy BoP surplus of USD 60 billion**
- **Going ahead, higher oil prices coupled with imports, catching up to the pre-COVID levels will flip the Current Account back to a modest deficit, while the accompanying BoP surplus will likely be sharply lower than that seen in FY2021.**

Current Account back to surplus; exports picked up sharply and imports normalised to pre-pandemic level, while higher surplus on the invisible front cushioned the Current Account:

- The Current Account posted a surplus of USD 6.5 billion (0.9% of GDP) in Q1 FY2022 versus a deficit of USD 8.1 billion (1.0% of GDP) in Q4 FY2021 and a surplus of USD 19.1 billion (3.7% of GDP) a year ago. Moderation in trade deficit, on account of stellar exports growth, drove the Current Account into surplus. India's net services exports increased substantially, while remittances remained stable, during the quarter. Consequently, the surplus on the invisibles front rose to USD 37.2 billion from USD 33.6 billion, in the previous quarter
- Exports showed an impressive growth during Q1 FY2022. It rose to a quarterly high figure to USD 97.4 billion on the back of economic recovery, across major trading partners. On the other hand, imports tapered slightly on a sequential basis, as domestic economic activities remained muted and mobility was restricted amid the second wave. Gold imports plunged sharply, while higher crude oil prices kept oil imports bill elevated, during Q1 FY2022. As a result, the trade deficit narrowed to USD 30.7 billion in Q1 FY2022 from USD 41.7 billion in Q4 FY2021 fueling the Current Account to record a surplus
- Net services receipts increased both on a sequential basis and an annual basis, aided by a sharp rise in the net exports of software and business services. The receipt from transportation, communication and financial services witnessed a sequential uptick, while travel services remained muted
- Transfer receipts remained buoyant as private transfers ballooned on higher worker remittances. The foremost factors driving the transfers included prospects of economic recovery abroad, gradual pickup in employment, relatively higher oil prices and Dollar's depreciation bias
- Income-related outflows, mainly reflecting the net overseas investment income payments fell sharply on an annual basis in Q1. Meanwhile, the net external liabilities (net IIP) declined by USD 24.3 billion during April-June 2021 to USD 327.0 billion. Further moderation in income payments is due ahead.

Capital account surplus more than doubled, aided by strong FDI flows:

- The overall Capital Account surplus (including errors and omission) rose sharply in Q1 FY2022 to USD 25.4 billion (more than double the previous quarter). FDI recorded robust inflows, however, FPIs remained volatile. External commercial borrowings (ECB) increased sharply in Q1, reflecting an improvement in the domestic business environment. Short-term credit surged, amid the global trade momentum. However, non-resident deposit flows have moderated in Q1 FY2022

- **Robust foreign investment flows led to a higher Capital Account surplus.** FDI remained robust in Q1 FY2022 owning to several big-ticket deals in e-commerce and IPO listing. FDI inflows jumped to USD 11.9 billion as compared to a mere USD 2.7 billion in Q4 FY2021. On the other hand, FPI flows turned bearish as India witnessed the second wave of infections, which undermined the investors' confidence. In addition, a dovish commentary from Fed officials and concerns on sooner than expected tapering of US bond purchases, led to the withdrawal of FPI investments from Indian equities. **FDI is likely to carry the momentum, while FPI inflows could be challenged to an extent going ahead, considering rising US yields and concerns over the US policy rate hike. While global bond inclusion, could also pose tailwinds. However, the overall outlook for foreign investment inflows remains positive**
- **External borrowings improved on a sequential basis.** The approvals and disbursements of External Commercial Borrowings (ECB) to India recorded a sharp increase in Q1 FY2022, reflecting an improvement in the domestic business environment. Short-term loans to India increased somewhat, especially for the category of suppliers credit up to 180 days, due to global trade momentum
- **Banking capital printed surplus led by a substantial increase in commercial bank assets.** However, non-resident deposit flows have moderated with net accretions to the tune of USD 2.5 billion in Q1 FY2022 as compared to USD 3.0 billion a year ago.

Overall, given the huge Capital Account surplus and the marginal surplus in the Current Account, the Balance of payments clocked a surplus of USD 31.8 billion in Q1 FY2022 as compared to USD 3.4 billion, in the previous quarter.

External sector looks comfortable this year, but higher oil import bills and lower flows could weigh on the margin:
Exports may benefit incrementally, as global trade picks up steam, while the recovery seen across major trading partners should continue to support the trade momentum, going ahead. As Indian exports, have a higher income elasticity (an effect of global demand) as compared to price elasticity (an effect of a weaker Rupee), the global trade recovery is likely to drive the export momentum further. Normal monsoon and sturdy rural demand could boost the demand for gold, over FY2022. Higher oil prices need to be watched as a possible headwind.

On the Capital inflows front, FPIs have been modest so far, however, a rebound is already in place as the second wave continues to ebb, while the US rates hike concerns and tapering of purchases may pose downside risks. FDI inflows are expected to continue their momentum.

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 18 billion (~0.6% of GDP) in FY2022, with the Balance of payments displaying a surplus of ~USD 60 billion.

We see the USD/INR pair trading in the 73.50-74.50 range in the near term with an upside bias of 74.80. Over the medium-term, we see more upside potential in the pair, reflecting a tightening global monetary policy environment led by the Federal Reserve.

BOP details

(USD bn)	Q1 FY2021	Q2 FY2021	Q3 FY2021	Q4 FY2021	Q1 FY2022
Merchandise	-11.0	-14.8	-34.6	-41.7	-30.7
- Exports	52.2	75.6	77.2	91.3	97.4
- Imports	63.2	90.4	111.8	133.0	128.1
Invisibles	30.0	30.1	32.4	33.6	37.2
- Services	20.8	21.1	23.2	23.5	25.8
- Transfers	17.0	18.4	19.3	18.8	18.9
- Income	-7.7	-9.4	-10.1	-8.7	-7.5
Current Account	19.1	15.3	-2.2	-8.2	6.5
Foreign Investment	0.1	31.4	38.6	10.0	12.3
- FDI	-0.5	24.4	17.4	2.7	11.9
- Portfolio Investment	0.6	7.0	21.2	7.3	0.4
Loans	2.8	-3.9	0.3	7.7	3.2
Banking Capital	2.2	-11.3	-7.6	-4.4	4.1
Other capital	-3.7	-0.3	2.8	-1.0	6.3
Capital Account*	0.8	16.3	34.7	11.6	25.4
Overall BoP	19.8	31.6	32.5	3.4	31.9

(includes errors and omissions)*

Source: Reserve Bank of India, ICICI Bank Research

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