ICRA
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# EXTERNAL SECTOR OUTLOOK

## Resurgent demand pushes current account to deficit of US$1.7 billion in Q3 FY2021; ICRA expects surplus of US$25-27 billion in FY2021 and deficit of US$22-27 billion in FY2022

**APRIL 2021**


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# HIGHLIGHTS

*Current account balance reverted to a deficit of US$1.7 billion in Q3 FY2021, after reporting surpluses in the last three quarters*

*Current account deficit is set to enlarge to US$5-7 billion in Q4 FY2021, led by a surge in demand for gold, and rising commodity prices*

*ICRA expects current account balance to revert to a deficit of US$22-27 billion in FY2022 from a surplus of US$25-27 billion in FY2021, as economic activity normalises and commodity prices settle at a higher level*

- India's current account balance reverted to a deficit of US$1.7 billion (-0.2% of GDP) in Q3 FY2021, after having recorded a surplus for the previous three quarters, and printed similar to our forecast.
- The turnaround in the current account balance in Q3 FY2021 from Q2 FY2021 was led by a deepening of the merchandise trade deficit to US$34.5 billion from US$14.8 billion, respectively, given pent-up and festive season demand.
- The size of the current account deficit eased in Q3 FY2021, from US$2.6 billion in Q3 FY2020, given the narrower deficit in the merchandise trade account (to US$34.5 billion in Q3 FY2021 from US$36.0 billion in Q3 FY2020), and higher inflows in the net services (to US$23.6 billion from US$21.9 billion), and secondary income (to US$19.3 billion from US$18.9 billion).
- In the financial account, there was a rise in net inflows in Q3 FY2021 relative to Q3 FY2020 of FDI (to US$17.0 billion from US$9.7 billion), FPI (to a record-high US$21.2 billion from US$7.8 billion), and NRI deposits (to US$3.0 billion from US$0.8 billion). However, there was a net outflow of external commercial borrowings of US$1.7 billion in Q3 FY2021, in contrast to the inflow of US$3.2 billion in Q3 FY2020.
- With the surge in FDI as well as FPI inflows, the accretion of foreign exchange reserves (on a BoP basis) rose multi-fold to US$32.5 billion in Q3 FY2021 from US$21.6 billion in Q3 FY2020.
- ICRA expects the size of the current account deficit to enlarge to US$5-7 billion in Q4 FY2021 from US$1.7 billion in Q3 FY2021, with the Covid-19 vaccines' rollout improving sentiment and pushing up commodity prices, as well as a resurgence in the domestic demand for gold. Accordingly, we expect an aggregate current account surplus of US$25-27 billion (1.0% of GDP) in FY2021.
- Subsequently, as the economic activity normalises, and commodity prices settle at a higher level, ICRA expects India's current account balance to revert to a deficit of around US$22-27 billion or around 0.8% of GDP in FY2022.

## OVERVIEW

Balance of Payments for Q3 FY2021: As expected, India's current account balance (refer Exhibit 1 and 2) reverted to a deficit of US$1.7 billion (-0.2% of GDP; ICRA exp: US$1.0 billion) in Q3 FY2021, after a gap of three quarters; the size of the surplus had risen from a marginal US$0.6 billion (+0.1% of GDP) in Q4 FY2020 to a high US$19.0 billion (+3.7% of GDP) in Q1 FY2021 amidst the lockdown, before easing somewhat to US$15.1 billion (+2.4% of GDP) in Q2 FY2021. The turnaround in the current account balance in Q3 FY2021, relative to Q2 FY2021 was led by a deepening of the merchandise trade deficit (to US$34.5 billion from US$14.8 billion), given pent-up and festive season demand, and to a mild extent, a rise in the net outflow of primary income, whereas the services trade surplus and net inflow of secondary income recorded an improvement.

Relative to the year-ago quarter, the size of the current account deficit eased in Q3 FY2021, from US$2.6 billion in Q3 FY2020, given the narrower deficit in the merchandise trade account (to US$34.5 billion in Q3 FY2021 from US$36.0 billion in Q3 FY2020), and higher inflows in net services (to US$23.6 billion from US$21.9 billion), and secondary income (to US$19.3 billion from US$18.9 billion). The year-on-year (YoY) contraction of 4.9% in merchandise exports to US$77.2 billion in Q3 FY2021 from US$81.2 billion in Q3 FY2020, marginally outpaced the 4.7% fall in merchandise imports to US$111.8 billion from US$117.3 billion, respectively. Notably, net oil imports declined to US$16.4 billion in Q3 FY2021 from US$20.6 billion in Q3 FY2020, following the 28.5% fall in international crude oil prices. As per the preliminary data released by the Ministry of Commerce and Industry, non-oil non-gold imports rose by 0.8% to US$77.7 billion in Q3 FY2021 from US$77.1 billion in Q3 FY2020. Moreover, gold imports rose to US$10.0 billion in Q3 FY2021 from US$7.3 billion in Q3 FY2020, reflecting a rise in the demand for gold during the festive and marriage season.

Additionally, the services trade surplus rose to US$23.6 billion in Q3 FY2021 from US$21.9 billion in Q3 FY2020, led by earnings related to transport, which posted a net inflow of US$0.5 billion in Q3 FY2021, in contrast to the net outflow of US$1.0 billion in Q3 FY2020. Additionally, the net inflow of secondary income increased to US$19.3 billion in Q3 FY2021 from US$18.9 billion in Q3 FY2020, even though there was a decline in workers' remittances to US$13.2 billion from US$14.2 billion, respectively. Notably, the net inflow of secondary income improved sequentially from US$18.4 billion in Q2 FY2021, given the easing of global economic uncertainty and improvement in economic activity during this period. However, the outflow of primary income rose to US$10.1 billion in Q3 FY2021 from US$7.4 billion in Q3 FY2020.

In the financial account, there was a rise in net inflows in Q3 FY2021 relative to Q3 FY2020 of FDI (to US$17.0 billion from US$9.7 billion), FPI (to a record-high US$21.2 billion from US$7.8 billion), and NRI deposits (to US$3.0 billion from US$0.8 billion). In contrast, there was a net outflow of external commercial borrowings of US$1.7 billion in Q3 FY2021, in contrast to the inflow of US$3.2 billion in Q3 FY2020.

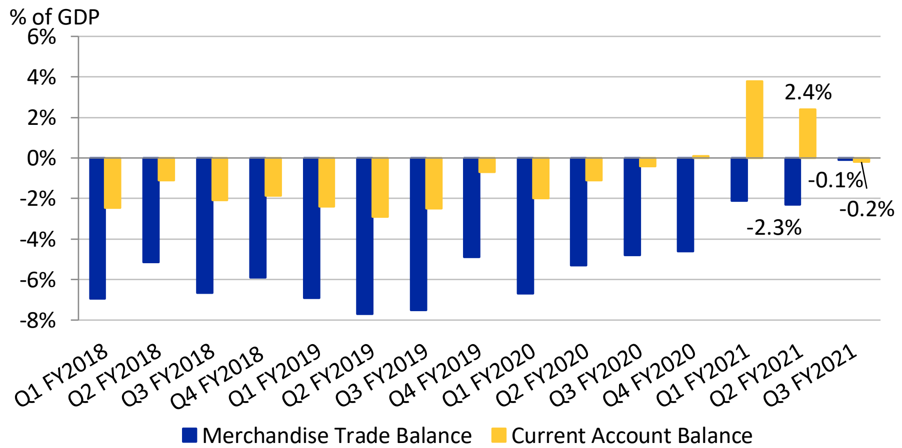
With the surge in FDI as well as FPI inflows, the accretion of foreign exchange reserves (on a BoP basis) rose multi-fold to US$32.5 billion in Q3 FY2021 from US$21.6 billion in Q3 FY2020.

**Exhibit 1: Trends in India's Balance of Payments**

| Figures in US$ billion | Q3 FY2020 | Q4 FY2020 | Q1 FY2021 | Q2 FY2021 | Q3 FY2021 | FY2019 | FY2020 | *FY2021 ICRA exp.* | *FY2022 ICRA exp.* |
|---|---|---|---|---|---|---|---|---|---|
| Merchandise Exports | 81.2 | 76.5 | 52.4 | 75.6 | 77.2 | 337.2 | 320.4 | *287 to 290* | *320-325* |
| Merchandise Imports | 117.3 | 111.6 | 63.2 | 90.4 | 111.8 | 517.5 | 477.9 | *390 to 393* | *485-490* |
| **Merchandise Trade Balance** | **-36.0** | **-35.0** | **-10.8** | **-14.8** | **-34.5** | **-180.3** | **-157.5** | ***-102 to -105*** | ***-160 to -165*** |
| Net Services | 21.9 | 22.0 | 20.5 | 20.9 | 23.6 | 81.9 | 84.9 | *89 to 91* | *93 to 95* |
| Primary Income | -7.4 | -4.8 | -7.6 | -9.4 | -10.1 | -28.9 | -27.3 | *-34.5 to -35.5* | *-35 to -37* |
| Secondary Income | 18.9 | 18.4 | 17.0 | 18.4 | 19.3 | 70.0 | 75.3 | *75 to 76* | *79 to 81* |
| **Current Account Balance** | **-2.6** | **+0.6** | **+19.0** | **+15.1** | **-1.7** | **-57.2** | **-24.6** | ***25 to 27*** | ***-22 to -27*** |
| *Percentage of GDP* | *-0.4%* | *+0.1%* | *+3.8%* | *+2.4%* | *-0.2%* | *-2.1%* | *-0.9%* | *+1.0%* | *-0.8%* |

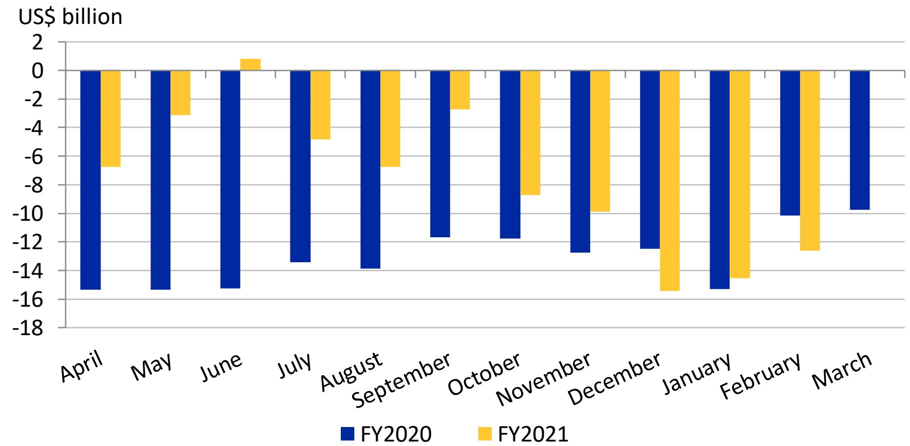
*Surplus (+)/Deficit (-); Average crude oil price of US$65/barrel is taken for FY2022 projections*
***Source**: RBI; ICRA research*

**EXHIBIT 2: Trends in Merchandise Trade Balance and Current Account Balance**



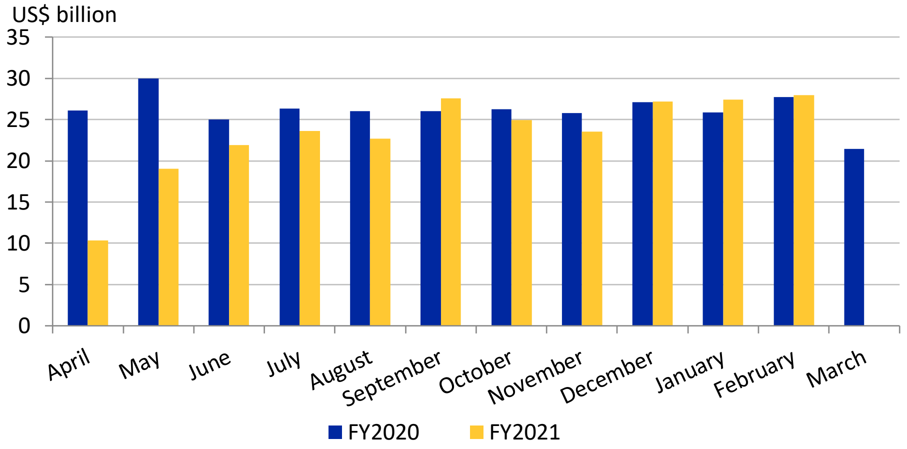

*Surplus (+)/Deficit (-); **Source:** RBI, Ministry of Commerce and Industry, GoI; ICRA research*

**EXHIBIT 3: Monthly Trends in Merchandise Trade Balance**



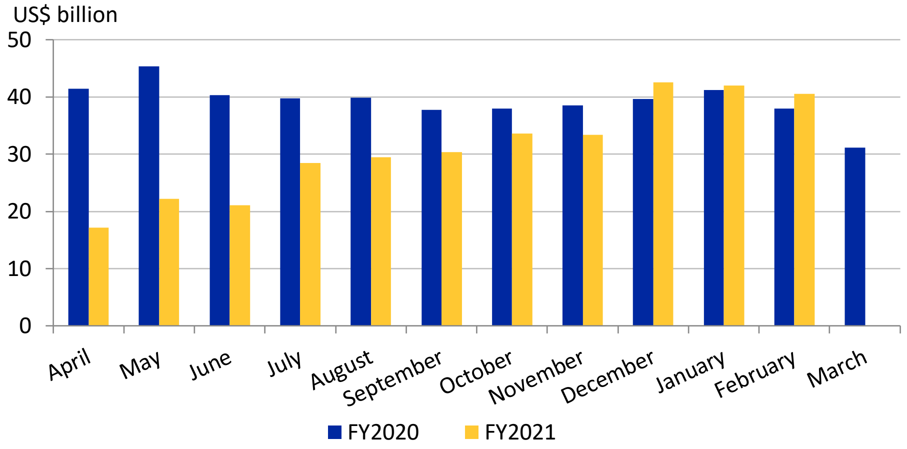

*Surplus (+)/Deficit (-); **Source:** ICRA research*

**EXHIBIT 4: Monthly Trends in Merchandise Exports**




***Source:*** *Ministry of Commerce and Industry, GoI; ICRA research*

**EXHIBIT 5: Monthly Trends in Merchandise Imports**




***Source:*** *Ministry of Commerce and Industry, GoI; ICRA research*

Trends for January-February FY2021: As per the initial data released by the Ministry of Commerce and Industry, merchandise exports and imports displayed a YoY rise in January-February FY2021, following the rollout of the Covid-19 vaccines, rise in the global and domestic demand and hardening of commodity prices. The merchandise imports recorded a modest growth of 4.4% in January-February FY2021, in contrast to the YoY decline of 5.6% in Q3 FY2021, on the back of the aforementioned factors, as well as a rise in the demand for gold. Merchandise exports grew by a relatively lower 3.3% in YoY terms, in the same period, after having contracted by 4.5% in Q3 FY2021.

The initial data released by the Ministry of Commerce and Industry indicates that merchandise exports rose by 3.3% to US$55.4 billion on a YoY basis in January-February FY2021 from US$53.6 billion in January-February FY2020, as the Covid-19 vaccine rollout gathered speed in the major trading partners. However, in monthly terms, the pace of growth in exports declined sharply to a low 0.7% in February 2021 (+3.3% in February 2020), from 6.2% in January 2021 (-2.1% in January 2020), reflecting the unfavourable base effect.

The YoY increase in merchandise exports during January-February FY2021 was driven by non-oil segment, which rose by a healthy 7.5% to US$50.5 billion in that period from US$47.0 billion in January-February FY2020, which is encouraging. This uptick was primarily led by engineering goods (absolute increase: US$1.0 billion; YoY growth: +7.4%), agricultural items (US$1.0 billion; +22.2%), iron ore (US$0.6 billion; +133.0%), and drugs and pharmaceuticals (US$0.5 billion; +15.6%), even as the exports of RMG of all textiles (-US$0.3 billion; -9.6%), and gems and jewellery (-US$0.4 billion; -6.3%) declined in the same period. Notably, oil exports fell by a sharp 26.2% to US$4.9 billion from US$6.6 billion, respectively, with lower volumes as well as a mild 2.5% fall in such prices.

As compared to exports, merchandise imports increased by a relatively higher 4.4% to US$82.5 billion in January-February FY2021 from US$79.1 billion in January-February FY2020 (refer Exhibit 4 and 5). The turnaround in imports in January-February FY2021 from the 5.6% contraction in Q3 FY2021, can be attributed to rise in the domestic demand with the continued economic recovery, surge in gold imports, as well as the uptrend in commodity prices. In particular, gold imports increased to US$9.3 billion in January-February FY2021 from US$3.9 billion in January-February FY2020 (led by a sharp increase in tonnage amid elevated prices), while there was a 6.8% rise in non-oil non-gold imports (to US$54.8 billion from US$51.3 billion). In contrast, oil imports contracted by a sharp 22.7% to US$18.4 billion from US$23.8 billion, respectively.

During January-February FY2021, there was a healthy growth in the imports of items such as electronic goods (by +US$2.1 billion; +26.3%), organic and inorganic chemicals (+US$0.8 billion; +26.0%), pearls, precious and semi-precious stones (+US$0.7 billion; +17.9%), and artificial resins, plastic materials, etc. (+US$0.6 billon; +22.9%), partly offset by the YoY decline in the imports of transport equipment (-US$1.1 billion; -24.2%), coal, coke and briquettes (-US$0.4 billion; -9.9%) etc. in the same period.

Overall, the merchandise trade deficit rose to US$27.1 billion in January-February FY2021 from US$25.5 billion in January-February FY2020, led by the non-oil segment (to US$13.7 billion from US$8.3 billion, respectively; refer Exhibit 3), according to the data released by the Ministry of Commerce. However, the oil trade deficit eased to US$13.5 billion from US$17.2 billion, respectively.

## EXPECTATIONS FOR Q4 FY2021 AND FY2021

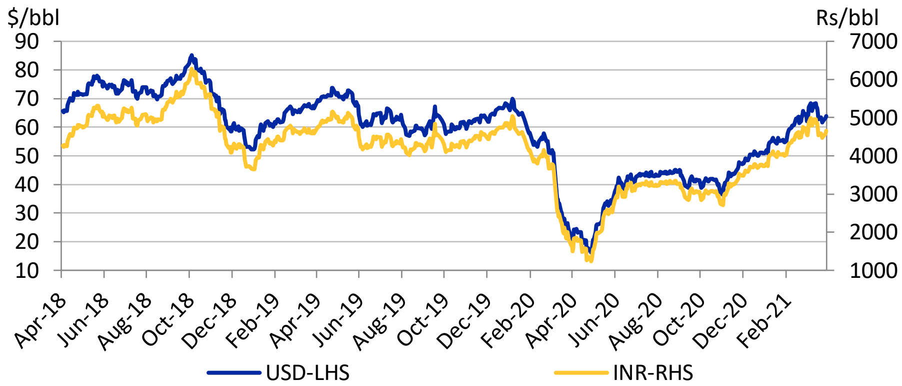
In March FY2021, ICRA expects merchandise exports and imports to record a YoY expansion of 25-30% and 35-40%, respectively, on account of a subdued base related to the restrictions and lockdowns imposed domestically as well as in major trading partners with the commencement of the Covid-19 pandemic. However, the blockage of the Suez Canal may display a transient impact on both exports and imports, with India being one of the major users of this channel (especially for imports of crude and products).

Overall, we expect the merchandise trade deficit to widen to US$15-15.5 billion in March 2021, from US$9.8 billion in March 2020, widening the **trade deficit in Q4 FY2021 to US$42.2-42.7 billion from US$35.2 billion and US$34.0 billion, respectively, in Q4 FY2020 and Q3 FY2021.**

**With the rise in commodity prices, strengthening domestic demand and resurgence in gold imports, we expect the current account balance to record a deficit of US$5-7 billion in Q4 FY2021, in contrast to the mild surplus of US$0.6 billion seen in Q4 FY2020.**

**For FY2021, ICRA expects merchandise exports and imports to contract by ~10% and ~18%, respectively, on a YoY basis, to US$287-290 billion and US$390-393 billion, respectively, relative to the level recorded in FY2020 (US$320.4 billion and US$477.9 billion, respectively). As a result, the merchandise trade deficit (on a BoP basis) is expected to moderate to ~US$102-105 billion in FY2021 from US$157.5 billion in FY2020. The services trade surplus is likely to rise by ~5-6% in FY2021, whereas the outflow of primary income may increase by 25-30% relative to FY2020. The global economic uncertainty is expected to limit the growth in secondary income to below 1% in FY2021. Overall, ICRA expects a current account surplus of US$25-27 billion or around 1.0% of GDP in FY2021.**

**EXHIBIT 6: Movement in Prices of Crude Oil**




***Source:*** *PPAC, GoI; CEIC; ICRA research*

**EXHIBIT 7: Projected crude oil prices and its net imports in FY2022**

| | ICRA's expectations for FY2022 Scenarios | | | YoY growth over FY2021 | | |
|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 1 | 2 | 3 |
| Average crude oil price (US$/barrel) | 60 | 65 | 70 | 33% | 44% | 56% |
| Net Oil imports (imports-exports) * (US$ billion) | 90.0 | 97.5 | 105.0 | ~51% | ~64% | ~76% |

*Average crude price for FY2021 is estimated at US$45/barrel; net oil imports are projected at US$59-60 billion in FY2021, taken mid-point for the calculation of YoY growth rates; *Exports of petroleum products and imports of petroleum, crude and products;* ***Source:*** *PPAC; ICRA research*

## EXPECTATIONS FOR FY2022

While a low base would keep the growth rates high in Q1 FY2022 as well, the resurgence in the infection rates, and the subsequent renewed restrictions in some key states, may dampen the value of exports and imports on an absolute basis.

In January 2021, the IMF revised its estimate for global economic activity in 2021 to 5.5% from the earlier forecast of 5.2% in October 2020. This was reflected by an upward revision in the GDP growth of developed countries such as the US (to +5.1% from +3.1%), and Japan (to +3.1% from +2.3%) in January 2021 relative to the October 2020 review, following the announcement of additional fiscal support. Moreover, the rapid rollout of the Covid-19 vaccines in such major trading countries bodes well for the domestic exports as well as its growth in FY2022. **ICRA expects merchandise exports to expand by 12% to ~US$320-325 billion in FY2022.**

Expected Crude Oil Trajectory in FY2022: Commodity prices have risen appreciably with the recovery in sentiment and demand. The average price of the Indian basket of crude oil has surged from a low US$20.5 barrel in April 2020 to US$61.4/barrel in February 2021, as the OPEC+ members decided to extend the production cuts (refer Exhibit 6). Subsequently, the crude oil prices have reported a dip from an average of US$65.9/barrel during March 1-18, 2021 to an average of US$62.9/barrel in the remaining part of the month, given the rising uncertainty regarding the near-term outlook and sentiment with the resurgence in the number of new cases and renewed restrictions in many countries. Oil prices are expected to remain volatile in the immediate term, mirroring the trend in infection rates, as well as supply and demand dynamics.

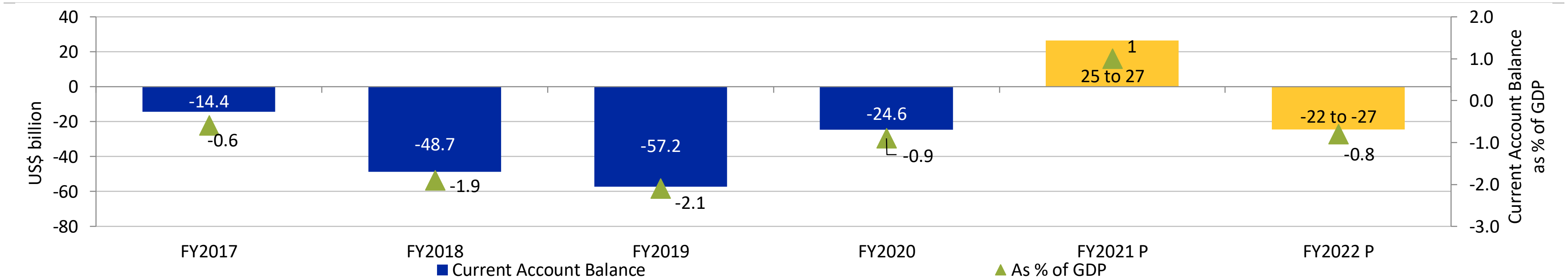
At present, we expect the Indian basket of crude oil to average US$65/barrel in FY2022 (Scenario 2), barring a double-dip recession that leads to a decline in commodity prices. Accordingly, net oil imports are projected to increase by 64% to US$97.5 billion in FY2022 from US$59-60 billion in FY2021, on the back of a low base (refer Exhibit 7). If OPEC+ members decided to continue to extend the production cuts up to May 2021, and if the vaccine rollout accelerates the sentiment and demand recovery, crude oil prices may average closer to US$70/barrel in FY2022. In this case, the net oil imports are likely to increase to US$105 billion in that fiscal, ~76% higher than the expected level for FY2021. If prices average a lower ~US$60/barrel in FY2022, net oil imports are estimated at US$90 billion, a YoY expansion of ~51% over the expected level for FY2021. In our view, every rise of US$5/barrel in average crude oil prices in FY2022, will bloat net imports by US$7.5 billion in year as a whole.

Gold imports in FY2022: Domestic gold prices have moderated in the recent months, reflecting the easing in the global prices, a downward move in the USD/INR pair, and the announcement made in the Union Budget about the rationalizing of gold duties for FY2022. After a sequential decline of 3.2% in February 2021, on average, gold prices have corrected further by 4.8% in March 2021 (up to March 26, 2021), relative to the previous month, following the risk-on sentiment which has also boosted US Treasury yields. While domestic demand is broadly expected to improve in FY2022 relative to FY2021, the extent of the pick-up will be a function of how much global prices correct as the pandemic recedes. **ICRA expects the value of gold imports to rise mildly to ~US$30-32 billion in FY2022 from US$28-29 billion in FY2021.**

Non-oil Non-gold imports in FY2022: Normalisation in domestic consumption and some traction in investment activity, in addition to the rise in commodity prices, are expected to boost non-oil non-gold imports in FY2022. **Reflecting the low base effect, ICRA expects non-oil non-gold imports to increase by a substantial 19% to ~US$320-325 billion in FY2022 from US$270-275 billion in FY2021. Overall, ICRA expects merchandise imports to rise by ~24% in FY2022 to US$485-490 billion from US$477.9 billion in FY2020.**

**The merchandise trade deficit is expected to widen to ~US$160-165 billion in FY2022. The global economic recovery is expected to boost the secondary income by 6-7% and the services trade surplus by ~5% in FY2022, whereas the outflow of primary income may increase by 3% relative to FY2021. Overall, ICRA expects India's current account balance to revert to a deficit of around US$22-27 billion or around 0.8% of GDP in FY2022, in contrast to the expected surplus of US$25-27 billion (1.0% of GDP) in FY2021 (refer Exhibit 8).**

**EXHIBIT 8: Current Account Balance (absolute and as % of GDP) and ICRA's expectations for FY2021 and FY2022**




*Deficit (-)/Surplus (+); P: Projected; **Source:** RBI; ICRA research*

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# ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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