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EXTERNAL SECTOR OUTLOOK

Current account deficit rose to higher-than-expected US\$8.1 billion in Q4 FY2021; with second wave squeezing demand, small surplus likely in Q1 FY2022

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HIGHLIGHTS



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Current account deficit widened to US\$8.1 billion in Q4 FY2021 from US\$2.2 billion in Q3 FY2021, led by the deepening of merchandise trade deficit

After 16 years, current account posted a surplus in FY2021, of US\$24.0 billion or 0.9% of GDP

Current account expected to revert to a small, transient surplus in Q1 FY2022, following the shrinkage of domestic fuel and gold demand in May 2021 as state-wise lockdowns widened

- India's current account deficit (refer Exhibit 1 and 2) widened considerably to a seven-quarter high US\$8.1 billion (-1.0% of GDP) in Q4 FY2021 from the revised US\$2.2 billion (-0.3% of GDP) in Q3 FY2021, on account of the normalisation in import demand as well as a surge in gold imports, even as the exports recorded a robust increase in March 2021.
- The wider current account deficit in Q4 FY2021 relative to Q3 FY2021 was driven by the deepening of the merchandise trade deficit (to US\$41.7 billion from US\$34.6 billion), followed by a mild decline in the secondary income inflows (to US\$18.9 billion from US\$19.3 billion, respectively). While the inflows in net services rose marginally to US\$23.5 billion in Q4 FY2021 from US\$23.2 billion in Q3 FY2021, the outflow of the primary income narrowed to US\$8.7 billion from US\$10.1 billion, respectively.
- Relative to the marginal surplus of US\$0.6 billion in Q4 FY2020, the turnaround in the current account to a deficit in Q4 FY2021, was led by the deeper deficit in the merchandise trade account (to US\$41.7 billion in Q4 FY2021 from US\$35.0 billion in Q4 FY2020), and the rise in the primary income outflows (to US\$8.7 billion from US\$4.8 billion).
- In the financial account, there was a sharp turnaround in FPI flows to a net inflow of US\$7.3 billion in Q4 FY2021, after having recorded the record-high outflow of 13.7 billion in Q4 FY2020, following the emergence of first wave of Covid-19 in India in March 2020.
- After a gap of 16 years, India's current account balance recorded a surplus in FY2021 of US\$24.0 billion (+0.9% of GDP). This stood in contrast to the deficit of a similar magnitude of US\$24.5 billion (-0.9% of GDP) in FY2020, led primarily by a compression in the merchandise trade deficit to US\$102.2 billion from US\$157.5 billion, respectively, reflecting the moderation in domestic demand as well as the collapse in prices of various commodities in H1 FY2021.
- With the widening state level restrictions shrinking the domestic demand for fuels and gold in May 2021, ICRA expects the current account to revert to a small, transient surplus in Q1 FY2022.
- ICRA expects merchandise exports and imports to rise by ~23% and ~32%, respectively, in FY2022 to ~US\$360-365 billion, and US\$525-530 billion, respectively. As a result, the merchandise trade deficit is expected to widen to ~US\$165-170 billion in FY2022. Overall, ICRA expects India's current account balance to revert to a deficit of around US\$23-28 billion or around 0.8% of GDP in FY2022, from the surplus of US\$24.0 billion (-0.9% of GDP) in FY2021.

OVERVIEW

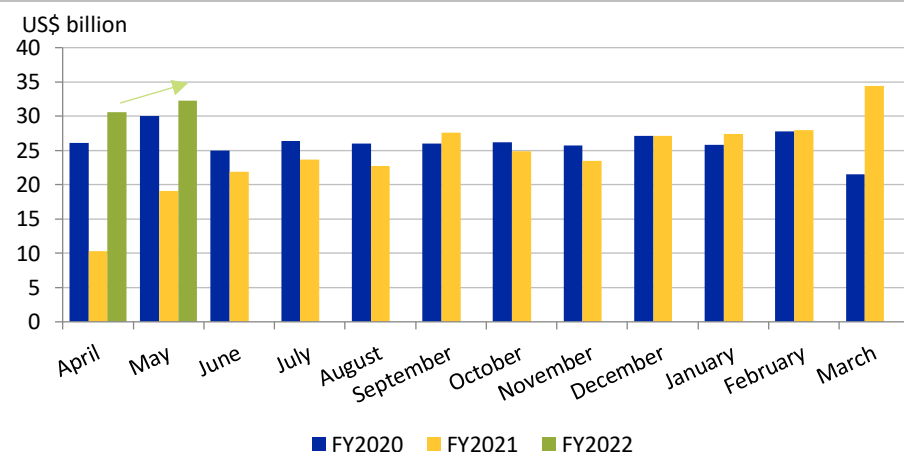
Balance of Payments for Q4 FY2021: India's current account deficit (refer Exhibit 1 and 2) widened to a seven-quarter high US\$8.1 billion (-1.0% of GDP) in Q4 FY2021 from the revised US\$2.2 billion (-0.3% of GDP) in Q3 FY2021, on account of the normalisation in import demand as well as a surge in gold imports, even as the exports recorded a robust increase in March 2021. This sequential rise in the current account deficit was led by the deepening of the merchandise trade deficit (to US\$41.7 billion from US\$34.6 billion), followed by a mild decline in the secondary income inflows (to US\$18.9 billion from US\$19.3 billion, respectively). While the inflows of net services rose marginally to US\$23.5 billion in Q4 FY2021 from US\$23.2 billion in Q3 FY2021, the outflows of primary income narrowed to US\$8.7 billion from US\$10.1 billion, respectively. **The size of the current account deficit in Q4 FY2021 exceeded our forecasts of US\$4.6 billion, led by a lower than anticipated surplus of secondary income and services trade, whereas the outflow of primary income was also modestly higher than projected.**

Relative to the marginal surplus of US\$0.6 billion in Q4 FY2020, the turnaround in the current account to a deficit in Q4 FY2021, was led by the deeper deficit in the merchandise trade account (to US\$41.7 billion in Q4 FY2021 from US\$35.0 billion in Q4 FY2020), and the rise in the primary income outflows (to US\$8.7 billion from US\$4.8 billion), even as the inflows in net services (to US\$23.5 billion from US\$22.0 billion) and secondary income (to US\$18.9 billion from US\$18.4 billion) displayed a year-on-year (YoY) improvement. The YoY expansion in merchandise exports and merchandise imports was similar at 19.3% and 19.2%, respectively, in Q4 FY2021. In absolute terms, merchandise exports rose to US\$91.3 billion in Q4 FY2021 from US\$76.5 billion in Q4 FY2020, and merchandise imports increased to US\$133.0 billion from US\$111.6 billion, respectively. As per the preliminary data released by the Ministry of Commerce and Industry, non-oil non-gold imports expanded by 18.1% to US\$84.4 billion in Q4 FY2021 from US\$71.5 billion in Q4 FY2020. Moreover, gold imports surged to US\$17.8 billion in Q4 FY2021 from US\$5.2 billion in Q4 FY2020, reflecting the massive inventory accumulation in the last two months of the fiscal following the announcement of a reduction in customs duty in the presentation of Union Budget 2021-22. However, net oil imports declined modestly to US\$20.7 billion in Q4 FY2021 from US\$24.7 billion in Q4 FY2020 (on a BoP basis).

Additionally, the net outflow of primary income widened to US\$8.7 billion in Q4 FY2021 from US\$4.8 billion in Q4 FY2020. However, the services trade surplus rose to US\$23.5 billion in Q4 FY2021 from US\$22.0 billion in Q4 FY2020, driven by the moderate ~11% increase in the earnings related to telecom, communication and information, to US\$23.7 billion from US\$21.3 billion, respectively. In addition, the net inflow of secondary income rose marginally to US\$18.9 billion in Q4 FY2021 from US\$18.4 billion in Q4 FY2020, led by the inflows in other current transfers' account of US\$0.2 billion, as opposed to the marginal outflow of US\$0.1 billion in Q4 FY2020, even though there was a decline in workers' remittances to US\$12.7 billion from US\$13.5 billion, respectively.

In the financial account, there was a sharp turnaround in the FPI flows to a net inflow of US\$7.3 billion in Q4 FY2021, from the record-high outflow of 13.7 billion in Q4 FY2020, amid the emergence of first wave of Covid-19 in India in March 2020. In contrast, there was a sizeable decline in the net inflows of FDI (to US\$2.7 billion from US\$12.0 billion), and other investments (to US\$4.6 billion from US\$16.9 billion).

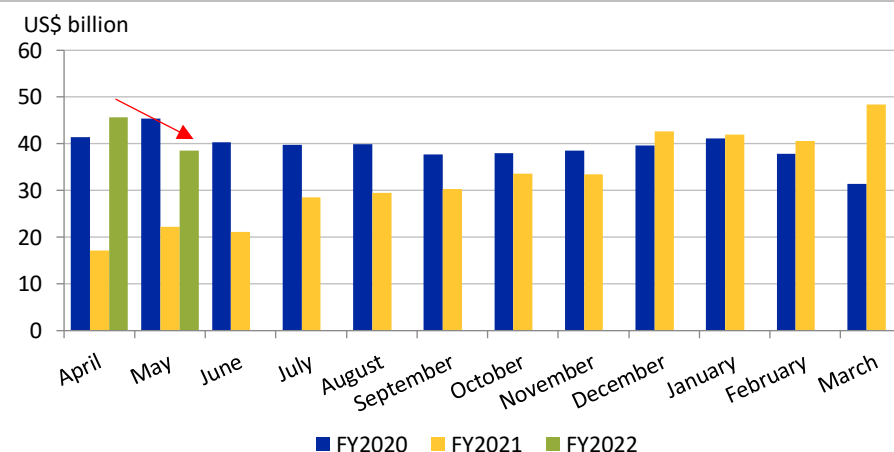
The accretion of foreign exchange reserves (on a BoP basis) declined considerably to a modest US\$3.4 billion in Q4 FY2021 from US\$18.8 billion in Q4 FY2020.

EXHIBIT 4: Monthly Trends in Merchandise Exports


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

Balance of Payments for FY2021: After a gap of 16 years, India's current account balance recorded a surplus of US\$24.0 billion (+0.9% of GDP) in FY2021. This stood in contrast to the deficit of a similar magnitude of US\$24.5 billion (-0.9% of GDP) in FY2020, driven primarily by a compression in the merchandise trade deficit to US\$102.2 billion from US\$157.5 billion, respectively, followed by an increase in net services receipts (to US\$88.6 billion from US\$84.9 billion). In contrast, there was a deepening of the net outflows in the primary income to US\$36.0 billion in FY2021 from US\$27.3 billion in FY2020 and a mild dip in the secondary income inflows to US\$73.6 billion from US\$75.3 billion, respectively.

In the financial account, the net inflows in external commercial borrowings declined sharply to a muted US\$0.2 billion in FY2021 from US\$21.7 billion in FY2020. In addition, financial derivatives posted a net outflow of US\$4.8 billion in FY2021, in contrast to net inflows of US\$4.1 billion in the previous fiscal. However, net FPI inflows surged to US\$36.1 billion in FY2021 from the subdued US\$1.4 billion in FY2020, benefitting from the record-high equity inflows in FY2021 supported by global ample liquidity and domestic economic rebound in H2 FY2021, whereas the net FDI inflows rose mildly to US\$44.0 billion from US\$43.0 billion, respectively. Significantly, foreign exchange reserves increased to a record-high US\$87.3 billion (excluding changes in valuation) in FY2021 from US\$59.5 billion in FY2020.

EXHIBIT 5: Monthly Trends in Merchandise Imports


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

Trends for April-May FY2022 for merchandise trade: The initial data released by the Ministry of Commerce and Industry indicates that merchandise exports increased by a considerable 113.8% to US\$62.9 billion on a YoY basis in April-May FY2022 from the low US\$29.4 billion in April-May FY2021. The high pace of expansion reflects a combination of the low base related to the domestic nationwide lockdown last year, and the ongoing healthy demand from advanced economies in tune with the economic revival aided by vaccines' rollout optimism, as well as elevated commodity prices. Moreover, in absolute terms, the merchandise exports rose from US\$30.6 billion in April 2021 to US\$32.3 billion in May 2021, despite the imposition of domestic state-wise restrictions and lockdowns to curb the second wave of Covid-19.

The YoY increase in merchandise exports during April-May FY2022 was broad-based, led by both the non-oil (+103%; to US\$53.9 billion in Apr-May FY2022 from US\$26.5 billion in Apr-May FY2021) and oil (+212%; to US\$9.0 billion from US\$2.9 billion) segments. The YoY increase of US\$6.1 billion in oil exports in Apr-May FY2022 was driven by a surge in international crude oil prices (~160%), as well as some improvement in volumes (+18.5%) during this period. While the substantial YoY rise of US\$27.4 billion in non-oil exports in the same period was broad-based, it was led by engineering goods (absolute increase: US\$8.6 billion; YoY growth: +107%), gems and jewellery (+US\$6.3 billion; +477%), agricultural items (US\$2.1 billion; +55%), RMG of all textiles (+US\$1.8 billion; +274%), and cotton yarn/fabrics/made ups, handloom products etc. (+US\$1.6 billion; +254%).

Similarly, merchandise imports expanded by a sharp 114.3% to US\$84.3 billion in April-May FY2022 from US\$39.3 billion in April-May FY2021 (refer Exhibit 4 and 5), benefitting from the healthy domestic demand for non-oil non-gold imports, and significantly higher global commodity prices, as well as the favourable base effect of nationwide lockdown. The sizeable YoY increase of US\$45.0 billion in merchandise imports during April-May FY2022 was broad-based, mainly led by non-oil non-gold segment (+US\$25.9 billion; to US\$57.0 billion from US\$31.1 billion), followed by the imports of petroleum, crude and products (+US\$12.2 billion; to US\$20.3 billion in Apr-May FY2022 from US\$8.3 billion in Apr-May FY2021; benefitting from a YoY surge of ~160% in crude oil prices amid a decline of 9.2% in volumes), and gold (+US\$6.8 billion; to US\$6.9 billion from US\$0.1 billion; reflecting a substantial improvement in tonnage).

Within the non-oil non-gold segment, there was a healthy YoY growth during April-May FY2022 in the imports of items such as electronic goods (by +US\$4.8 billion; +107%), pearls, precious and semi-precious stones (+US\$4.3 billion; +1126%), machinery, electrical and non-electrical goods (+US\$2.4 billion; +65%), organic and inorganic chemicals (+US\$1.8 billion; +66%), agricultural commodities (+US\$1.6 billion; +93%), etc.

However, in absolute terms, merchandise imports recorded a sharp sequential decline of 15.7% to US\$38.6 billion in May 2021 from US\$45.7 billion in April 2021. With the widening state-wise restrictions amid the second Covid surge adversely impacting mobility, imports of oil eased to US\$9.5 billion in May 2021 from US\$10.9 billion in April 2021. Moreover, with stores shuttered, gold imports shrunk to US\$0.7 billion from US\$6.2 billion, even as non-oil non-gold imports remained steady at around US\$28-29 billion in these two months. As a result, the trade deficit shrank to an eight-month low US\$6.3 billion in May 2021 from US\$15.1 billion April 2021.

Trends for April-May FY2022 for services trade: Services exports and imports witnessed a YoY growth of 6.7% and 6.4%, respectively, in April 2021 (-8.9% and -18.4%, respectively, in April 2020), as per the data released by the RBI. Accordingly, the services trade surplus rose by 7.0% to US\$7.7 billion in April 2021. Subsequently, the initial estimates for May 2021 as per the [press release](#) by the Ministry of Commerce and Industry on June 3, 2021, indicate that the services trade surplus increased by 15.4% on a YoY basis to US\$7.9 billion in May 2021. Accordingly, the trade surplus is estimated to have widened to US\$15.5 billion in the first two months of FY2022 from US\$14.0 trillion in April-May FY2021.

Expectation for Q1 FY2022: As the states started unlocking in a staggered manner from June 2021, we expect the consumption of fuel to bounce back in tune with the recovery in mobility. Moreover, the demand for gold imports may revive to some extent as retail outlets start operating. Additionally, we expect the non-oil non-gold imports to remain strong. The demand from the advanced economies would continue to be robust in line with the ongoing economic rebound supported by optimism brought on by the acceleration of vaccine coverage, boosting exports. Overall, we expect the trade deficit to widen in June 2021 as compared to the low US\$6.3 billion in May 2021. However, **led by the drop in imports of crude oil and gold in May 2021, and the estimated rise in the services surplus in April-May 2021, we expect the current account balance to revert to a muted, transient surplus in Q1 FY2022.**

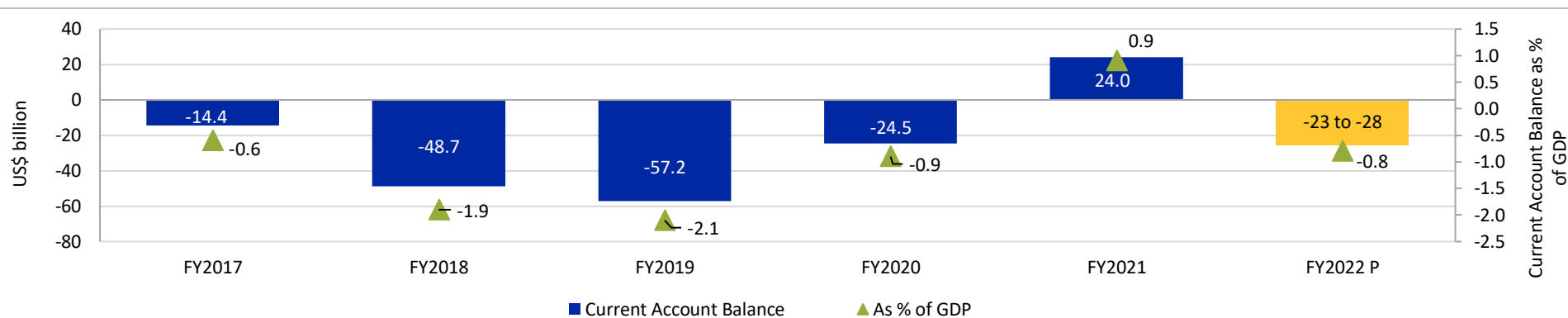
Expectation for FY2022: In April 2021, the IMF revised its global growth projections upwards for CY2021 (to 6.0% from the earlier estimate of 5.5%) and CY2022 (to 4.4% from the earlier estimate of 4.2%). This revision reflects additional fiscal support in a few large economies, the anticipated vaccine-driven recovery in H2 CY2021, and continued adaptation of economic activity to subdued mobility. Consistent with the recovery in global activity, global trade volumes are expected to rise in 2021. Services trade is expected to recover more slowly than merchandise volumes, with subdued cross-border tourism and business travel until the vaccine rollout gathers pace globally. **With a global economic recovery and associated rise in commodity prices, we expect merchandise exports to rise by ~23% to US\$360-365 billion 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 to US\$67.4/barrel in Q1 FY2022 so far (till June 29, 2021) from US\$44.6/barrel in FY2021, supported by the strengthening of demand and favourable prospects of a global economic rebound brought on by the vaccine rollout optimism, combined with the depletion of inventory levels in the United States. We expect the Indian basket of crude oil to average US\$70/barrel in FY2022, assuming the vaccine rollout sustains the global sentiment and demand recovery. Accordingly, **net oil imports are projected to increase to ~US\$100 billion in FY2022 from US\$82.4 billion in FY2021.**

Global gold prices recorded a correction of 6.0% as on June 25, 2021 relative to May 31, 2021, following the strengthening of US dollar supported by economic optimism and the US Federal Reserve's hawkish stance on the key interest rates in its recent policy meeting. In FY2022 so far, domestic gold prices have declined by a mild 1.0% till June 25, 2021. With the spread of Covid-19 infections in the rural areas, we have tempered our forecasts of the uptick in gold volumes in FY2022. Moreover, the extent of the improvement in urban demand will take a cue from the level of prices. With substantial inventory having been built up during Feb 2021- Apr 2021, **ICRA expects the value of gold imports to ease to ~US\$30-32 billion in FY2022 from US\$34.6 billion in FY2021.**

The elevated commodity prices, cautiously optimistic domestic consumption and back-ended pick-up in investment activity 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 27% to ~US\$340-345 billion in FY2022 from US\$272.2 billion in FY2021.**

ICRA expects merchandise exports and imports to rise by ~23% and ~32%, respectively, in FY2022 to ~US\$360-365 billion, and US\$525-530 billion, respectively. As a result, the merchandise trade deficit is expected to widen to ~US\$165-170 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\$23-28 billion or around 0.8% of GDP in FY2022, from the surplus of US\$24.0 billion (-0.9% of GDP) in FY2021 (refer Exhibit 6).

EXHIBIT 6: Current Account Balance (absolute and as % of GDP) and ICRA's expectations for 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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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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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