ICRA

EXTERNAL SECTOR OUTLOOK

Record-high current account surplus of US$19.8 billion in Q1 FY2021, led by shrinkage of merchandise trade deficit amid Covid-19 crisis

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HIGHLIGHTS

- *India's current account balance witnessed a record-high surplus of US$19.8 billion (3.9% of GDP) in Q1 FY2021, in contrast to the deficit of US$15.0 billion (2.1% of GDP) in Q1 FY2020, primarily driven by an expected shrinkage of the merchandise trade deficit, given the sharper decline in imports relative to exports during the Covid-19 induced lockdown.*

- *The size of the current account surplus in Q1 FY2021 exceeded our expectation (+US$15.0 billion) as the fall in remittances, a major component of secondary income, was remarkably muted, despite the adverse economic conditions globally amid the ongoing pandemic.*

- *With the domestic and global lockdowns to fight Covid-19 exuding a differentiated impact on exports and imports, the merchandise trade deficit (on a BoP basis) shrunk to only US$10.0 billion in Q1 FY2021 from US$46.8 billion in Q1 FY2020.*

- *Led by FDI outflows, India's capital and financial account balance displayed a substantial outflow of US$19.3 billion in Q1 FY2021, in contrast to the inflows of US$14.6 billion in Q1 FY2020.*

- *With a merchandise trade deficit of US$11.6 billion in July-August 2020 (US$27.3 billion in July-August 2019), exceeding the US$9.1 billion recorded in Q1 FY2021 (based on data released by the Ministry of Commerce and Industry), ICRA anticipates that the size of the current account surplus would halve to around US$10 billion in Q2 FY2021.*

- *Subsequently, ICRA expects merchandise imports to stage a relatively faster recovery in H2 FY2021, with the economy slowly grinding to a new normal, the stabilisation in commodity prices and relatively sticky demand for gold closer to the festive and marriage season. Simultaneously, the fresh restrictions that may be warranted in some major trading partners to ward off rising Covid-19 infections, are likely to arrest the further normalisation in exports.*

- *Following the data released for Q1 FY2021, ICRA had revised its expectation of the size of India's current account balance in FY2021 to US$35 billion or around 1.4% of GDP.*

OVERVIEW

Balance of Payments for Q1 FY2021: India's current account balance (refer Exhibit 1 and 2) witnessed a record-high surplus of US$19.8 billion (3.9% of GDP) in Q1 FY2021, in contrast to the deficit of US$15.0 billion (2.1% of GDP) in Q1 FY2020, primarily driven by an expected shrinkage of merchandise trade deficit, given the sharper decline in imports relative to exports during the Covid-19 induced lockdown. The size of the surplus in Q1 FY2021 exceeded our expectation of US$15.0 billion, as the fall in remittances, a major component of secondary income, was remarkably muted, despite the adverse economic conditions globally amid the ongoing pandemic. In addition, the size of the current account surplus expanded multi-fold in Q1 FY2021 from the mild US$0.6 billion (0.1% of GDP) recorded in Q4 FY2020.

With the domestic and global lockdowns to fight Covid-19 exuding a differentiated impact on exports and imports, the merchandise trade deficit (on a BoP basis) shrunk to only US$10.0 billion in Q1 FY2021 from US$46.8 billion in Q1 FY2020, and was primarily driven by the net oil imports. The year-on-year (YoY) contraction of 36.8% in merchandise exports to US$52.3 billion in Q1 FY2021 from US$82.7 billion in Q1 FY2020, was outpaced by the 51.9% plunge in merchandise imports to US$62.3 billion in Q1 FY2021 from US$129.5 billion in Q1 FY2020, respectively. Net oil imports compressed to US$8.3 billion in Q1 FY2021 from US$24.2 billion in Q1 FY2020, owing to the sharp 55.4% fall in international crude oil prices amid subdued global demand. Moreover, gold imports collapsed to US$0.7 billion in Q1 FY2021 from the considerable US$11.4 billion in Q1 FY2020, reflecting constrained demand for gold during the lockdown, as well as the surge in prices during these two quarters.

Surprisingly, the net inflow of secondary income eased only mildly to US$17.0 billion in Q1 FY2021 from US$18.0 billion in Q1 FY2020, with a muted decline in workers' remittances to US$11.7 billion from US$13.4 billion, respectively, despite the adverse economic conditions globally amid the ongoing pandemic. Moreover, the outflow of primary income rose to US$7.7 billion in Q1 FY2021 from US$6.3 billion in Q1 FY2020. However, the services trade surplus posted a marginal uptick to US$20.5 billion in Q1 FY2021 from US$20.1 billion in Q1 FY2020, led by earnings related to transport, which posted a net inflow of US$0.6 billion in Q1 FY2021, in contrast to the net outflow of US$0.8 billion in Q1 FY2020.

The outflow from India's capital and financial account balance widened to US$19.3 billion in Q1 FY2021 from US$1.5 billion in Q4 FY2020, and stood in contrast to the inflows of US$14.6 billion in Q1 FY2020. Following the heightened risk aversion due to the rapid escalation of the Covid-19 pandemic, foreign direct investment recorded a slippage to a net outflow of US$0.4 billion in Q1 FY2021, from the considerable inflows of US$14.0 billion and US$12.0 billion, respectively, in Q1 FY2020 and Q4 FY2020. Moreover, the net inflows of foreign portfolio investment fell to a muted US$0.6 billion in Q1 FY2021 from US$4.8 billion in Q1 FY2020. Further, financial derivative and trade, credit and advances reported a marginal net outflow of US$0.1 billion and US$0.2 billion, respectively, in Q1 FY2021, as opposed to net inflow of US$1.5 billion and US$2.0 billion, respectively, in Q1 FY2020. Moreover, the net inflow from other loans moderated to US$2.5 billion in Q1 FY2021 from US$8.0 billion in Q1 FY2020. Notably, foreign exchange reserves rose by US$19.8 billion (excluding changes in valuation) during Q1 FY2021, higher than the rise of US$14.0 billion in Q1 FY2020.

Exhibit 1: Trends in India's Balance of Payments

Figures in US$ billion	Q1 FY2020	Q3 FY2020	Q4 FY2020	Q1 FY2021	*Q2 FY2021 ICRA exp.*	FY2019	*FY2020*	*FY2021 ICRA exp.*
Merchandise Exports	82.7	81.2	76.5	52.3	*70.5*	337.2	320.4	*277.8*
Merchandise Imports	129.5	117.3	111.6	62.3	*90.3*	517.5	477.9	*365.9*
Merchandise Trade Balance	**-46.8**	**-36.0**	**-35.0**	**-10.0**	***-19.8***	**-180.3**	**-157.5**	***-88.1***
Net Services	20.1	21.9	22.0	20.5	*21.0*	81.9	84.9	*84.5*
Primary Income	-6.3	-7.4	-4.8	-7.7	*-8.0*	-28.9	-27.3	*-29.2*
Secondary Income	18.0	18.9	18.4	17.0	*17.0*	70.0	75.3	*68.0*
Current Account Balance	**-15.0**	**-2.6**	**0.6**	**19.8**	***10.2***	**-57.2**	**-24.6**	***35***
Percentage of GDP	*-2.1%*	-0.4%	0.1%	3.9%	*1.7%*	-2.1%	-0.9%	*1.4%*

Source: RBI; ICRA research

Exhibit 2: Trends in Merchandise Trade Balance and Current Account Balance

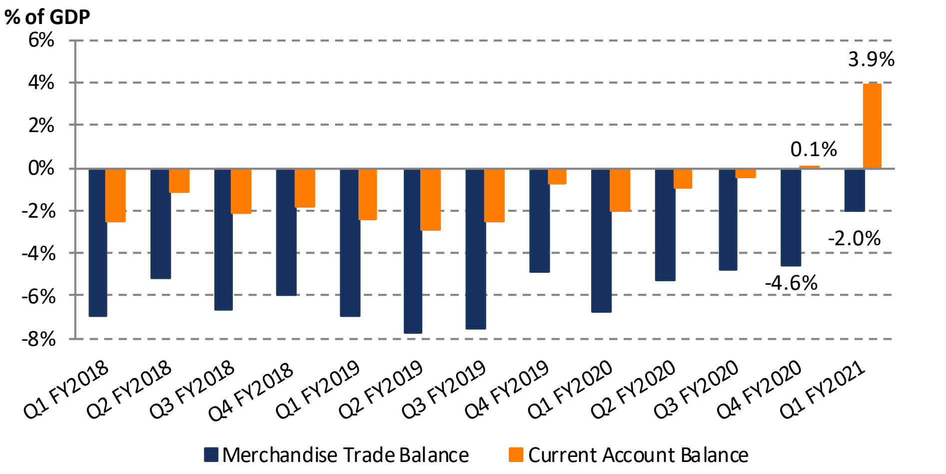
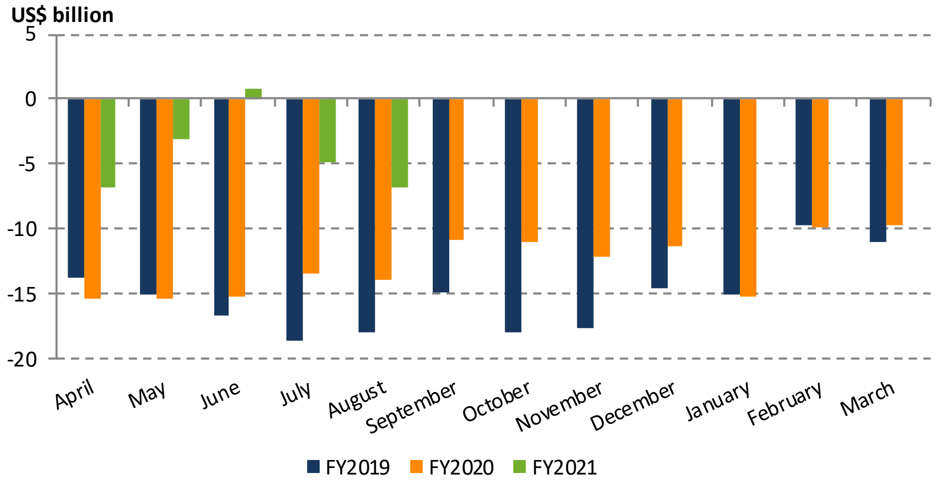


Exhibit 3: Monthly Trends in Merchandise Trade Balance



Surplus (+)/Deficit (-)

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

Exhibit 4: Monthly Trends in Merchandise Exports

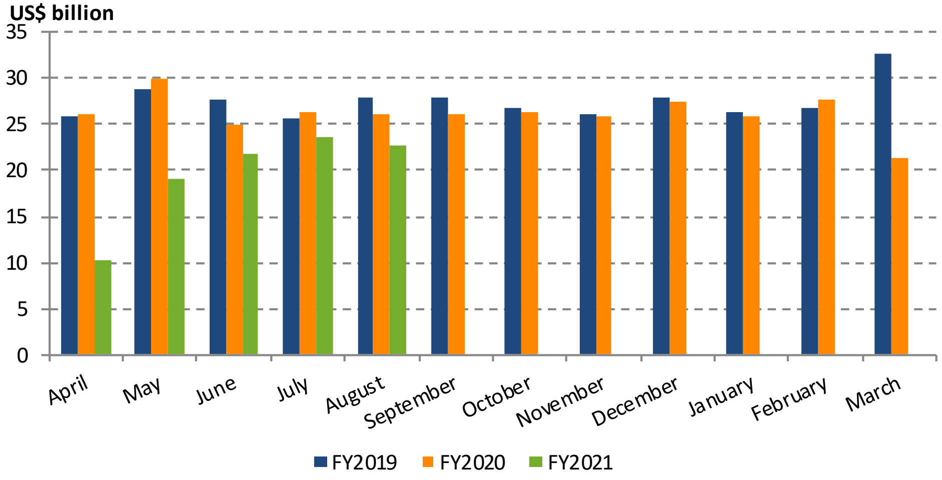
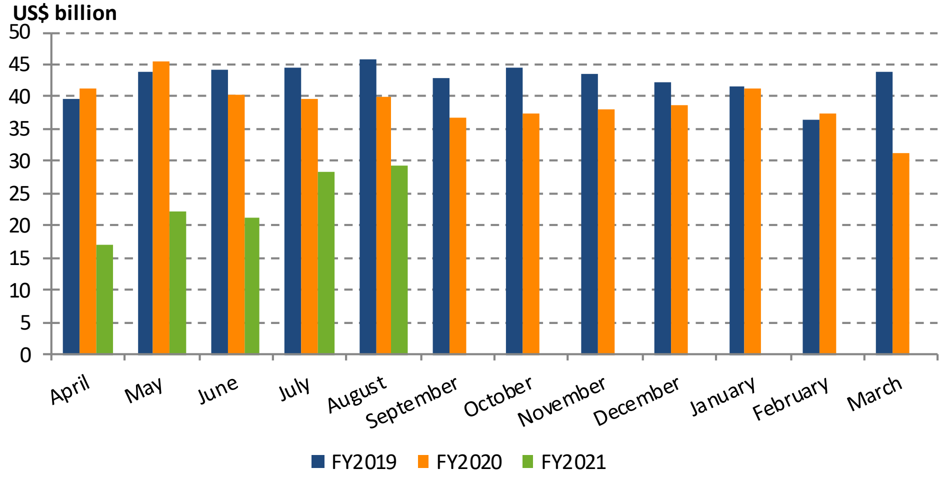


Exhibit 5: Monthly Trends in Merchandise Imports



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

Trends for July-August FY2021: After having witnessed deep contraction in the lockdown quarter of Q1 FY2021, the performance of merchandise exports and imports improved in July-August FY2021, as per the initial data released by the Ministry of Commerce and Industry. However, the monthly performance has been mixed in Q2 FY2021. For instance, the pace YoY decline in merchandise worsened to 12.7% in August 2020 from 10.2% in July 2020. While the merchandise imports continued to recover from the April 2020 lows, the pace of the improvement lost steam, as the contraction eased only mildly to 26.0% in August 2020 from 28.4% in July 2020.

In cumulative terms, the initial data released by the Ministry of Commerce and Industry indicates that merchandise exports declined by 11.4% to US$46.3 billion in July-August FY2021 from US$52.3 billion in July-August FY2020. Oil exports nearly halved to US$3.7 billion in July-August FY2021 (-46.1% on a YoY basis) from US$6.9 billion in July-August FY2020. In addition, non-oil exports contracted by a relatively modest 6.2% to US$42.6 billion from US$45.5 billion, respectively. The YoY decline in non-oil exports was primarily driven by gems and jewellery (-US$2.9 billion; -46.3%), and to a smaller extent, textiles (-US$0.5 billion; -18.2%), electronic goods (-US$0.3 billion; -15.6%) and leather and leather products (-US$0.2 billion; -22.0%), partly on account of continued weak global demand, with rising Covid-19 infections in some major trading nations.

As compared to exports, merchandise imports declined by a relatively sharper 27.2% to US$57.9 billion in July-August FY2021 from US$79.6 billion in July-August FY2020 (refer Exhibit 4 and 5), primarily led by slower revival in the domestic demand and the moderate commodity prices (except gold). Led by lower prices, oil imports contracted by a sharp 37.1% to US$13.0 billion in July-August FY2021 from US$20.6 billion in July-August FY2020. Moreover, non-oil non-gold imports recorded a 29.4% decline to US$39.5 billion in July-August FY2021 relative to US$55.9 billion in July-August FY2020, reflecting the subdued demand for items such as machinery, electrical and non-electrical (by -US$2.5 billion; -37.4%), iron and steel (by -US$1.9 billion; -57.1%), pearls, precious and semi-precious stones (by -US$1.1 billion; -35.3%), and coal (by -US$1.8 billion; -46.4%). In contrast, gold imports expanded by 78.3% to US$5.5 billion in July-August FY2021 from US$3.1 billion in July-August FY2020, benefitted from pent-up demand as well as elevated prices during this period.

Overall, the YoY decline in the level of merchandise imports (-27.2%) in July-August FY2021 continued to outpace the same for merchandise exports (-11.4%). Given these trends, the trade deficit declined considerably to US$11.6 billion in July-August FY2021 from US$27.3 billion in July-August FY2020, largely led by non-oil segment (refer Exhibit 3), according to the data released by the Ministry of Commerce.

Expectations for FY2021: ***With a merchandise trade deficit of US$11.6 billion in July-August 2020 (US$27.3 billion in July-August 2019), exceeding the US$9.1 billion recorded in Q1 FY2021 (based on data released by the Ministry of Commerce and Industry), ICRA anticipates that the size of the current account surplus would halve to around US$10 billion in Q2 FY2021. Further, ICRA expects merchandise imports to stage a relatively faster recovery in H2 FY2021, with the economy slowly grinding to a new normal, the stabilisation in commodity prices and relatively sticky demand for gold closer to the festive and marriage season.***

Simultaneously, the fresh restrictions that may be warranted in some major trading partners to ward off rising Covid-19 infections, are likely to arrest the further normalisation in exports. Following the data release for Q1, ICRA has revised its expectation of the size of India's current account balance in FY2021 to US$35 billion or around 1.4% of GDP.

ICRA

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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