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Current account moves into deficit in Q1; external sector outlook manageable

India's current account deficit slipped back into deficit of US$ 9.7bn (1.1% of GDP) in Q1FY25 after registering a downwardly revised surplus of US$ 4.6bn (0.5% of GDP) in the previous quarter. This is primarily on the back of widening of merchandise trade deficit (+25.2% QoQ) and lower net service receipts (four-quarter low). While growth in merchandise imports came in at a modest 1.5% QoQ, merchandise exports witnessed a sequential contraction of 8.6%, reflecting weak global demand and geopolitical tensions translating into longer shipping routes. Invisibles also declined marginally on a QoQ basis, even as the YoY growth came in at a robust 16%, higher than the last 20-year average growth of 12.5% (excluding the COVID year). Strong YoY growth in software services was partly offset by net outflows from travel-related services. The surplus in capital account nearly halved to US$ 14.4 bn, thanks to lower banking capital inflows and foreign portfolio outflows from Indian equities, weighed down by geopolitical tensions and election-led uncertainty. This was partly offset by recovery in foreign direct investment (FDI), that rose to an eight-quarter high of US$ 6.3bn. Consequently, the overall BOP surplus moderated to US$ 5.2bn in Q1, almost one-sixth of the figure reported in the previous quarter.

Notwithstanding the lingering geopolitical tensions and its implications for India's exports, the overall BOP position is likely to remain broadly stable led by buoyant services exports, benign crude oil prices, renewed foreign portfolio inflows (particularly in debt markets) and revival in FDI flows. Higher imports in this fiscal thus far (+7.1% in Apr-Aug'24), however, may see further upside led by festive season demand, even as benign crude and commodity prices is likely to keep the deficit contained. Inclusion of domestic sovereign bonds in global indices, coupled with strong macro-economic fundamentals and widening interest rate differential between the US and India, should keep foreign inflows strong. Record level of foreign exchange reserves at US$ 692.3bn as of September 20th, 2024, provides a strong buffer against external vulnerabilities. This, along with proactive intervention by the RBI, should reduce unwarranted rupee volatility amidst unfavourable global cues.

India's current account balance recorded a deficit of US$9.7 bn or 1.1% of GDP in Q1FY25.

- **Higher merchandise trade deficit led to expansion in CAD…:** India's current account moved from a downwardly revised surplus of US$ 4.6bn or 0.6% of GDP in the last quarter of FY24 to a deficit of US$ 9.7bn or 1.1% of GDP in Q1FY25. This was primarily on account of sequential widening of merchandise trade deficit (US$ 65.1bn or 7% of GDP), thanks to a steep drop in exports, as well as moderation in net services' receipts. The export bill fell by 8.6% QoQ (last 20Y avg: -0.7% QoQ), led by a broad-based moderation, with petroleum and non-petroleum exports falling by 7.2% and 8.9% QoQ respectively. On a YoY basis, exports growth came in at a modest 6%. This reflects weak global demand and geopolitical tensions translating into longer shipping routes for exporters. Imports, on the other hand, rose by 1.5% QoQ/9.1% YoY, primarily led by a strong 23% YoY growth in oil imports, even as non-oil imports—a proxy of domestic demand—grew by a marginal 0.7% QoQ/4.2% YoY.

- **…further widened by lower net services exports:** The net invisible receipts declined marginally by 2.2% QoQ to US$ 55.4bn in Q1FY25 (vs. US$56.6 bn in Q4FY24), primarily on account of lower net services receipts (US$ 39.7bn) and remittances. Net services receipts fell by 6.9% QoQ due to travel-led outflows (net) owing to seasonal effects while business and software receipts (net) were broadly flat on a sequential basis. That said, the YoY growth in invisibles came in at a robust 16%, higher than the average growth of 12.5% during this period over the last 20 years (excluding the pandemic year FY21), led by a resilient growth in software services receipts (10.4% YoY). Net remittances also dropped by 8.2% on a QoQ basis but were higher by a strong 15.4% on a YoY basis. This was partly offset by lower outgo on the investment income during the quarter.

- **BoP surplus declined significantly led by higher CAD and lower foreign portfolio flows:** The capital account surplus declined significantly to a three-quarter low of US$ 14.4bn in Q1FY25 (-43.6% QoQ; 1.6% of GDP), primarily led by a notable decline in foreign portfolio flows and net banking capital flows (US$2.9bn—five quarter low). The sequential fall in foreign portfolio flows to a five-quarter low of US$ 945m) is primarily due to outflows from domestic equities, weighed down by geopolitical tensions and election-led uncertainty, partly offset by modest net inflows into debt markets, supported by expectation of inclusion of Indian government bonds in the global indices. Net loan inflows widened meaningfully to a nine-quarter high of US$ 6bn, indicating signs of revival in private investment activity, while external commercial borrowings have been broadly flat on a sequential basis but have registered a sharp decline of 70.9% YoY. Consequently, the BoP surplus moderated sharply to US$ 5.3bn from US$ 30.7bn in Q4FY24 and US$ 24.5bn in Q1FY24. Net accretion to foreign exchange reserves stood at US$ 5.2bn in Q1FY25, down from US$ 30.8bn in the previous quarter and US$ 24.4bn in Q1FY24.

- **External outlook remains comfortable:** Notwithstanding the lingering geopolitical tensions and its implications for India's exports, the overall BoP position is likely to remain stable led by buoyant services exports, benign crude oil prices, renewed foreign portfolio inflows (particularly in debt markets) and revival in FDI flows. Higher imports in this fiscal thus far (+7.1% in Apr-Aug'24), however, may see further upside led by festive season demand, even as benign crude and commodity prices is likely to keep the deficit contained. Inclusion of domestic sovereign bonds in global indices, coupled with strong macro-economic fundamentals and widening interest rate differential between the US and India, should keep foreign inflows strong. Record level of foreign exchange reserves at US$ 692.3bn as of September 20th, 2024, provides a strong buffer against external vulnerabilities. This, along with proactive intervention by the RBI, should reduce unwarranted rupee volatility amidst unfavourable global cues.

Table 1: Balance of Payments – Quarterly account

US$ bn	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25
Current account	**-18.0**	**-30.9**	**-16.8**	**-1.4**	**-8.9**	**-11.3**	**-10.4**	**4.6**	**-9.7**
CAD/GDP (%)	-2.1	-3.8	-2.0	-0.2	-1.0	-1.3	-1.1	0.5	-1.1
Trade balance	-63.1	-78.3	-71.3	-52.6	-56.7	-64.5	-71.6	-52.0	-65.1
Trade balance/GDP (%)	-7.5	-9.7	-8.6	-6.1	-6.6	-7.5	-7.9	-5.5	-7.0
Merchandise exports	122.8	111.8	105.6	115.8	104.9	108.3	106.6	121.6	111.2
Merchandise imports	185.8	190.2	176.9	168.4	161.6	172.8	178.3	173.6	176.3
Oil imports	53.2	53.4	52.0	50.8	41.9	42.1	46.0	49.6	51.5
Non-oil imports	132.7	136.7	124.9	117.6	118.2	128.2	128.4	121.0	122.0
Invisibles	45.1	47.4	54.5	51.2	47.7	53.3	61.2	56.6	55.4
Net services	31.1	34.4	38.7	39.1	35.1	39.9	45.0	42.7	39.7
Software earnings	30.7	32.7	33.5	34.4	33.9	35.2	36.3	36.6	37.4
Transfers	22.9	24.8	28.5	24.8	22.8	24.9	29.3	28.7	26.4
Investment income	-9.8	-12.6	-13.5	-13.4	-11.2	-12.5	-14.2	-15.7	-11.9
Capital account	**22.1**	**1.5**	**28.9**	**6.5**	**33.8**	**12.8**	**17.3**	**25.6**	**14.4**
Capital acc./GDP (%)	2.6	0.2	3.5	0.8	3.9	1.5	1.9	2.7	1.6
Foreign investments	-1.2	12.7	6.6	4.7	20.5	4.1	16.0	13.7	7.3
FDI	13.4	6.2	2.0	6.4	4.7	-0.8	4.0	2.3	6.3
FII	-14.6	6.5	4.6	-1.7	15.7	4.9	12.0	11.4	0.9
Loans	4.1	0.6	0.5	3.1	2.2	3.3	-2.8	3.9	6.0
ECBs	-2.8	-0.2	-2.4	1.6	5.7	-3.0	-4.5	1.7	1.7
Banking capital	19.0	-8.4	14.4	-4.1	12.9	4.3	16.4	6.9	2.9
NRI deposits	0.3	2.5	2.6	3.6	2.2	3.2	3.9	5.4	4.0
Others	0.2	-3.4	7.3	2.8	-1.7	1.1	-12.3	1.1	-1.6
Errors & Omissions	0.5	-0.9	-1.0	0.4	-0.4	1.0	-0.9	0.6	0.6
Overall balance (BoP)	**4.6**	**-30.4**	**11.1**	**5.6**	**24.4**	**2.5**	**6.0**	**30.7**	**5.3**

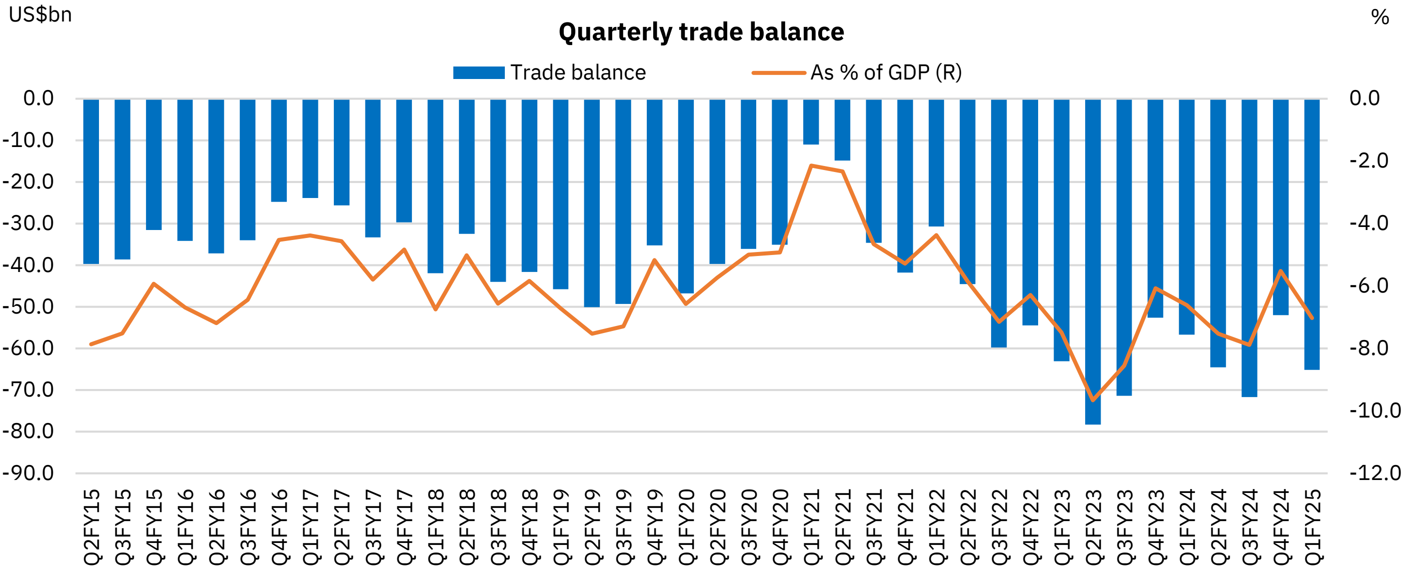
Source: RBI, CMIE Economic Outlook, NSE EPR.

Table 2: Balance of Payments – Annual account

US$ bn	FY21	FY22	FY23	FY24
Current account	**23.9**	**-38.8**	**-67.1**	**-26.0**
CAD/GDP (%)	0.9	-1.2	-2.0	-0.7
Trade balance	-102.2	-189.5	-265.3	-244.9
Trade balance/GDP (%)	-3.8	-6.0	-7.9	-6.9
Merchandise exports	291.0	429.2	456.1	441.4
Merchandise imports	393.0	618.6	721.4	686.3
Oil imports	82.4	162.1	209.3	179.6
Non-oil imports	310.6	451.6	504.0	506.7
Invisibles	126.1	150.7	198.2	218.8
Net services	88.6	107.5	143.3	162.8
Software earnings	89.7	109.5	131.3	142.0
Transfers	73.5	80.4	100.9	105.8
Investment income	-39.2	-40.6	-49.2	-53.6
Capital account	**63.7**	**85.8**	**58.9**	**89.5**
Capital acc./GDP (%)	2.4	2.7	1.8	2.5
Foreign investments	80.1	21.8	22.8	54.2
FDI	44.0	38.6	28.0	10.1
FII	36.1	-16.8	-5.2	44.1
Loans	6.9	33.6	8.3	6.6
Banking capital	-20.9	7.1	21.6	40.5
NRI deposits	0.5	5.1	9.6	14.7
Others	-2.2	23.7	6.9	-11.8
Errors & Omissions	-0.3	0.5	-1.0	0.3
Overall balance (BoP)	**87.3**	**47.5**	**-9.1**	**63.8**

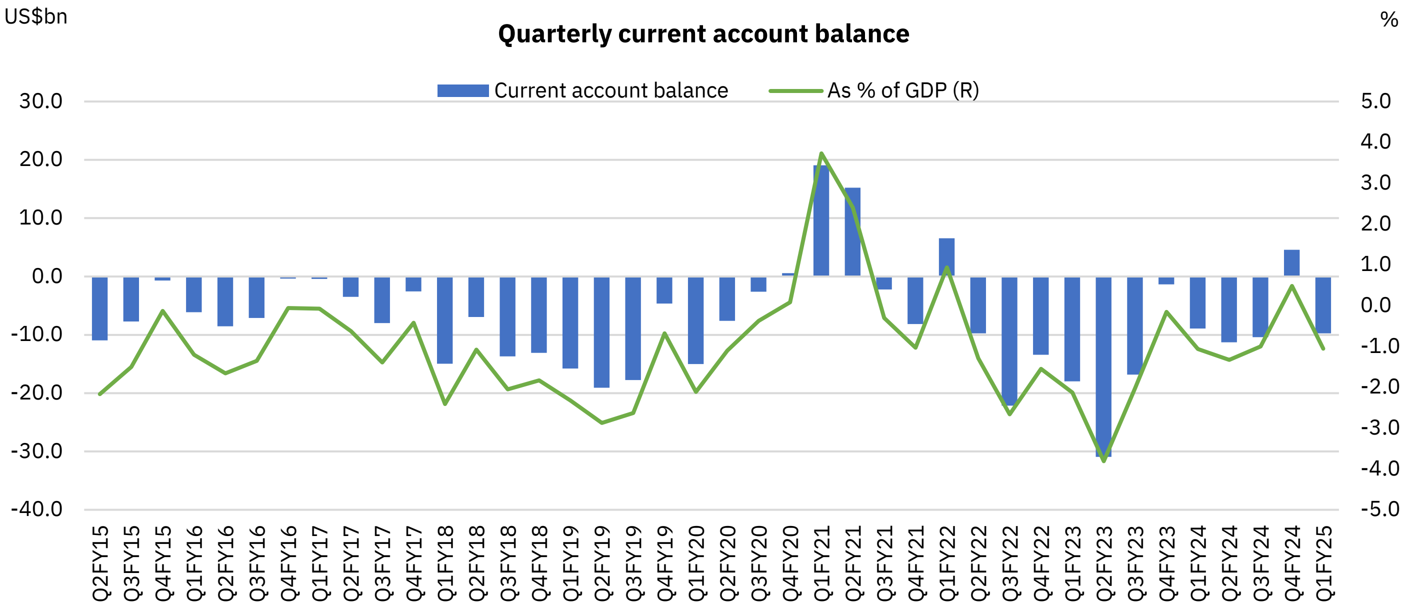
Source: RBI, CMIE Economic Outlook, NSE EPR. *Includes Investment Income.

Figure 1: Quarterly trade balance trend



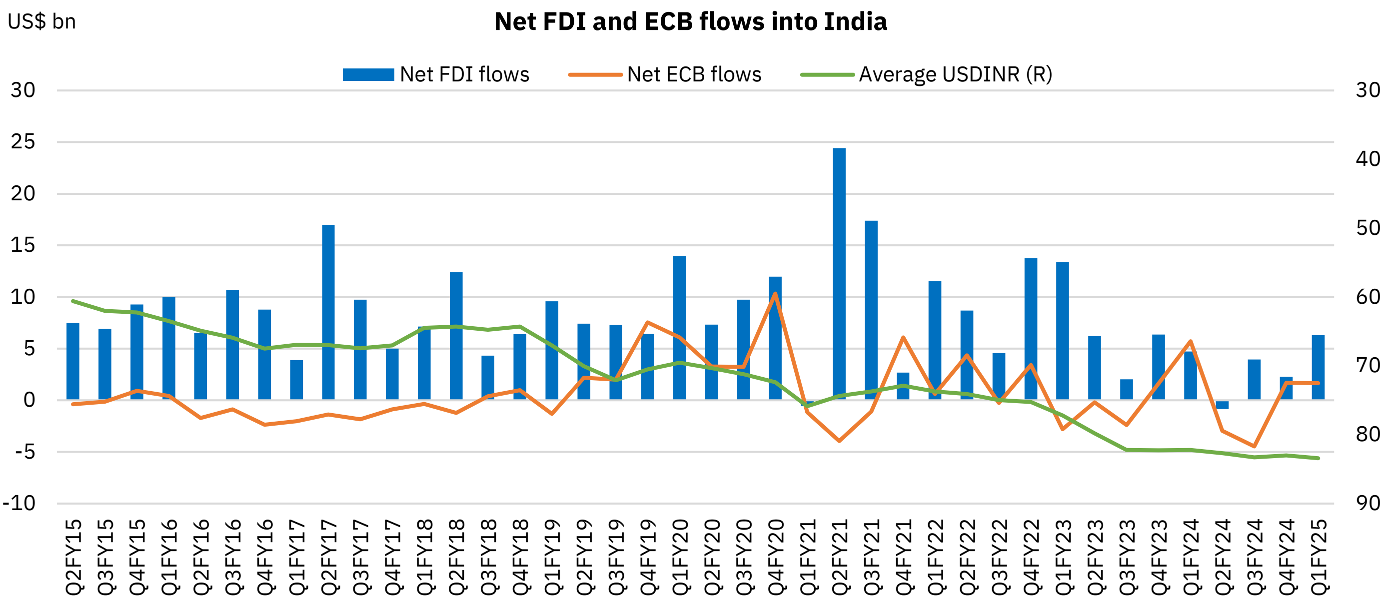
Source: RBI, CMIE Economic Outlook, NSE EPR.

Figure 2: Quarterly current account balance trend



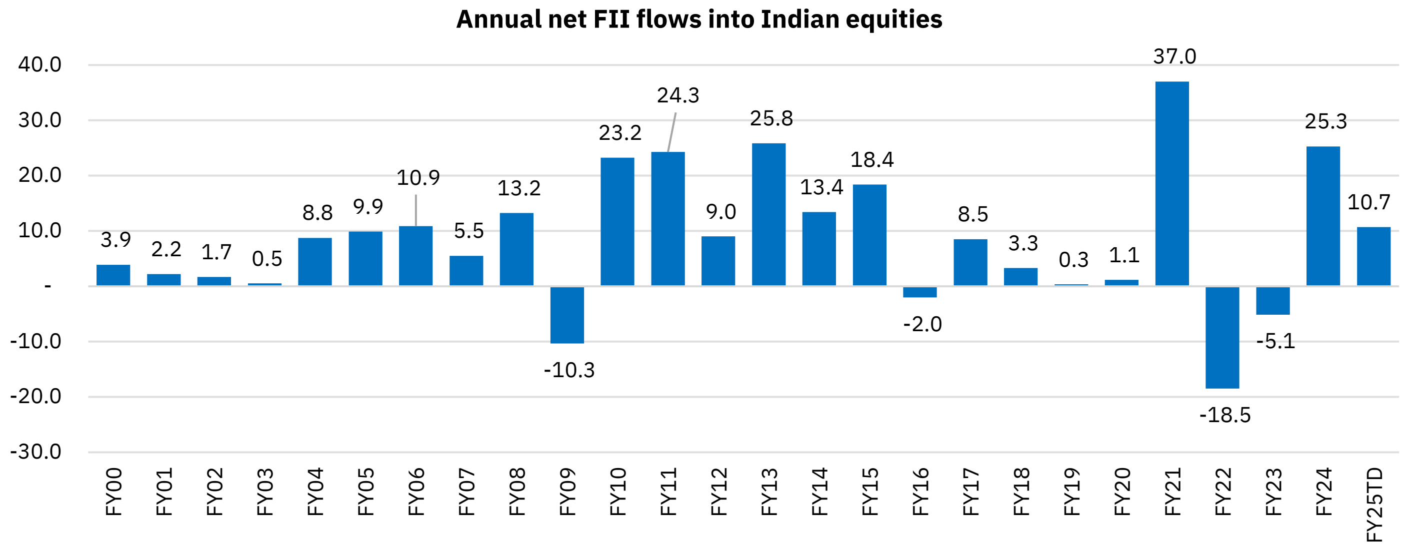
Source: CMIE Economic Outlook, NSE EPR.

Figure 3: Quarterly net FDI and ECB flows vs. INR



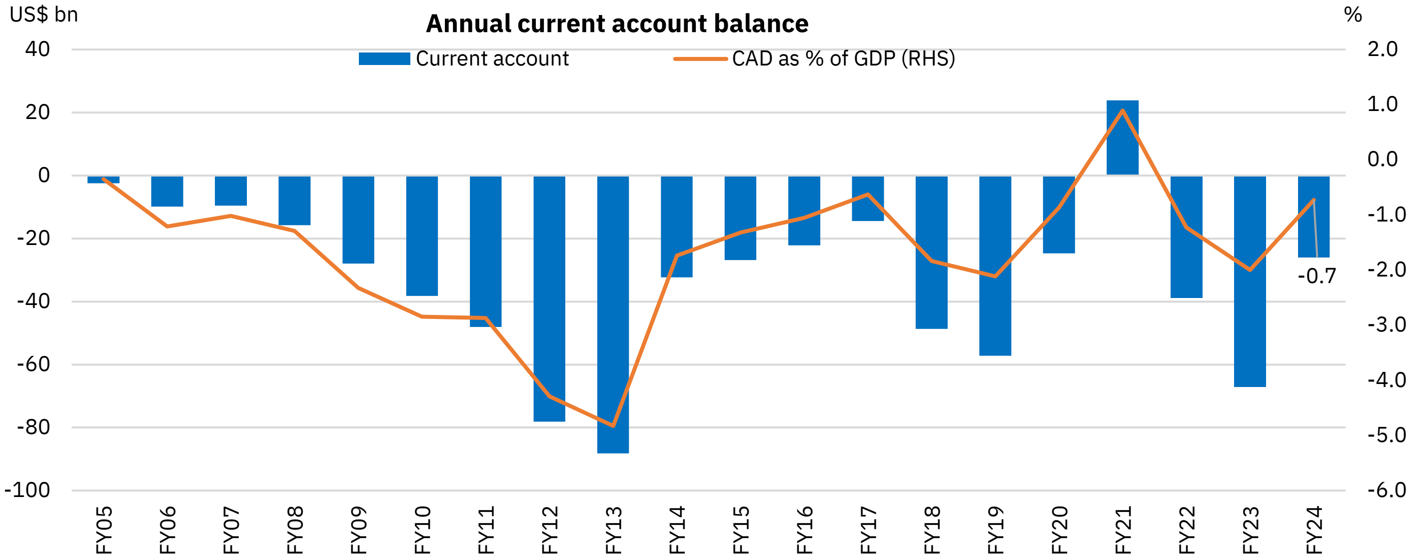
Source: CMIE Economic Outlook, NSE EPR.

Figure 4: Annual net FII inflows trend



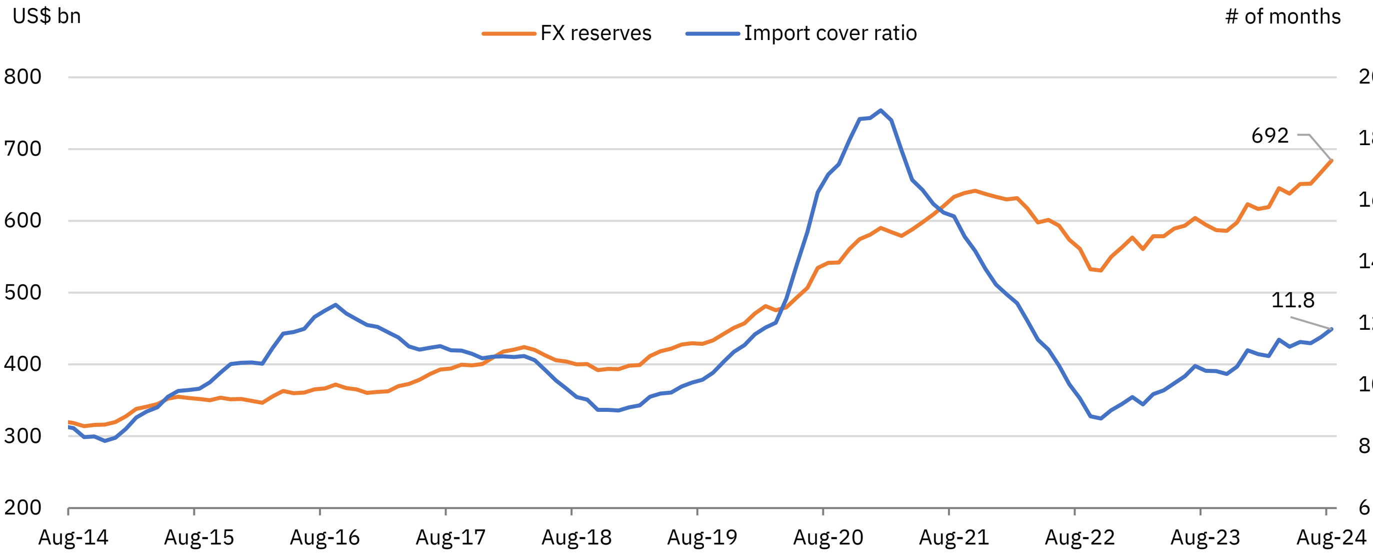
Source: LSEG Workspace, NSE EPR. Data for FY25 is as of September 27th, 2024.

Figure 5: Annual current account deficit trend



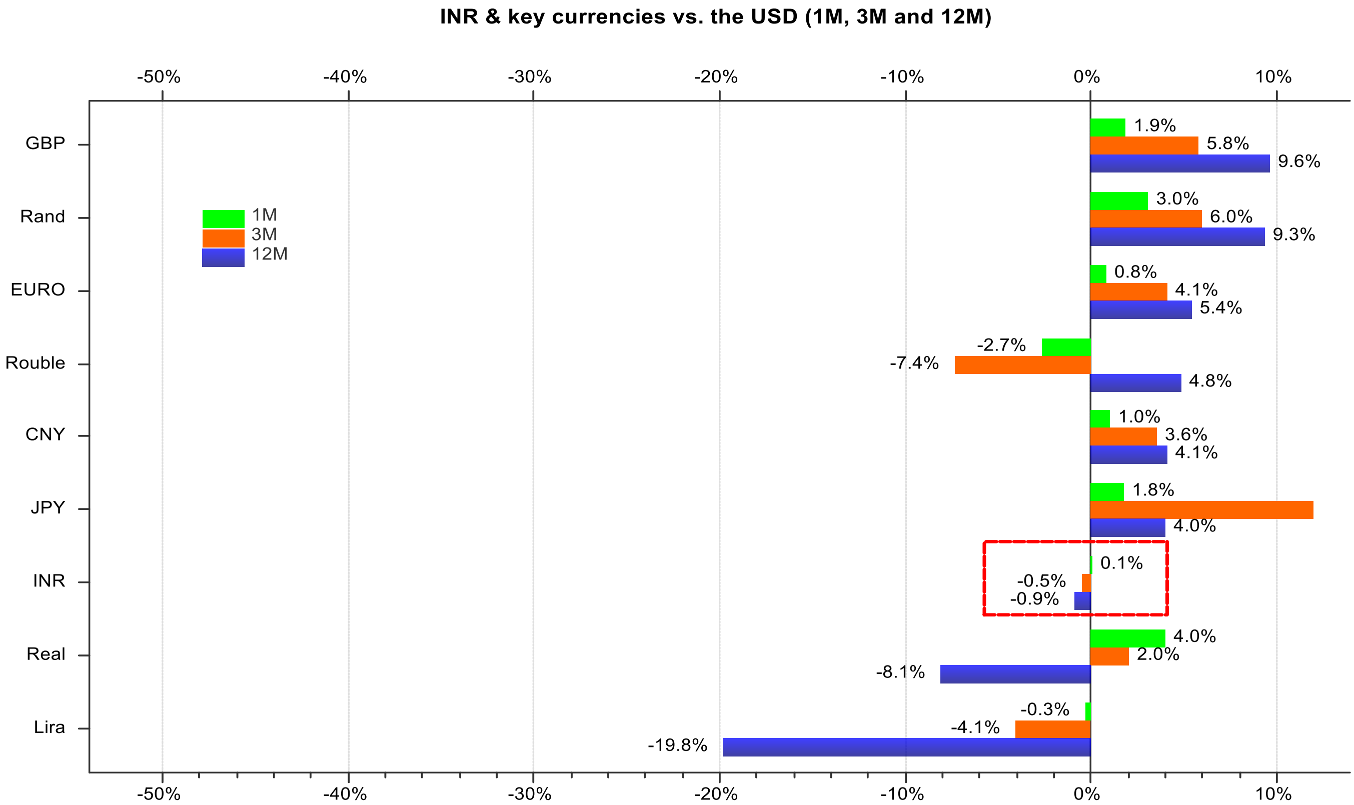
Source: CMIE Economic Outlook, NSE EPR.

Figure 6: Foreign exchange reserves and import cover



Source: CMIE Economic Outlook, NSE EPR; Data for foreign exchange reserves pertains to the week ending September 20th, 2024

Figure 7: Change in INR vs other major currencies



Source: LSEG Datastream, NSE EPR (Data as of September 30th, 2024)

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