

Capital outflows dragged balance of payments into deficit in Q3-FY25; current account gap worsened mildly

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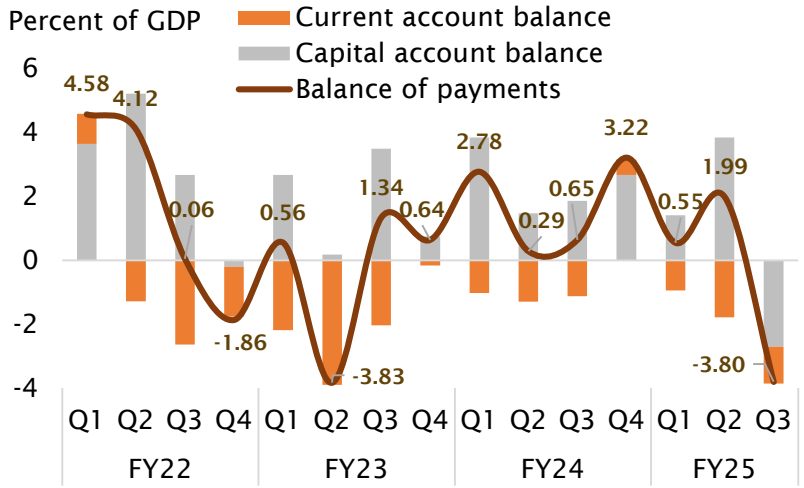
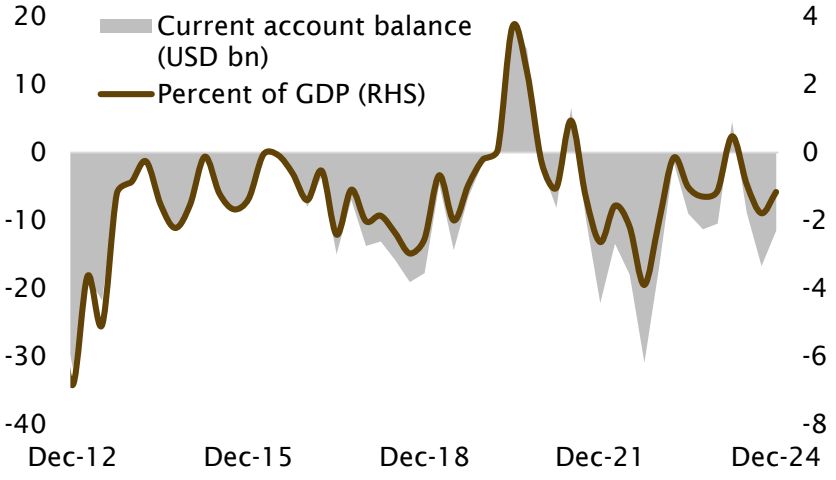
Key takeaways

- In Q3-FY25, the deficit on current account deteriorated fractionally to 1.2% of GDP (USD11.5bn) from 1.1% (USD10.4bn) in Q3-FY24. The increase in services trade surplus and higher remittances failed to offset the worsening of deficit on account of merchandise trade, and increased outflows under investment income.
- The capital account slipped into deficit after ten quarters, marking the steepest gap so far at 2.7% of GDP (USD26.8bn) due to drag from foreign investments, banking capital, and 'others' component. Both foreign portfolio and direct investments posted net outflows. Banking capital flows turned negative, partly capturing central bank intervention in foreign exchange markets.
- The overall balance of payments shifted to deficit at 3.80% of GDP (USD37.7bn) after remaining in surplus for eight straight quarters. In Q2-FY23, the quarter when the BoP was last in deficit, the gap was slightly steeper at 3.83% of GDP, though it was shallower in nominal terms at USD30.4bn.
- In the latest development on trade wars, the US administration imposed 10% tariffs across all countries, and individualized reciprocal tariffs on economies, with the tariff imposed on India at 27%. Though higher than expected, it is lower than on peer economies. While the direct impact on India's GDP is estimated to be around 0.2-0.4% of GDP in FY26, there are concerns about the indirect effects if global growth falters in coming years. To protect the domestic economy from these external headwinds, it is likely that the RBI eases more than was earlier anticipated. This raises the possibility that in addition to 25bp rate cut expected at the April meet, the RBI MPC changes the policy stance to accommodative.

Capital account outflows dragged BoP into deficit in Q3-FY25; current account deficit worsened mildly from a year ago

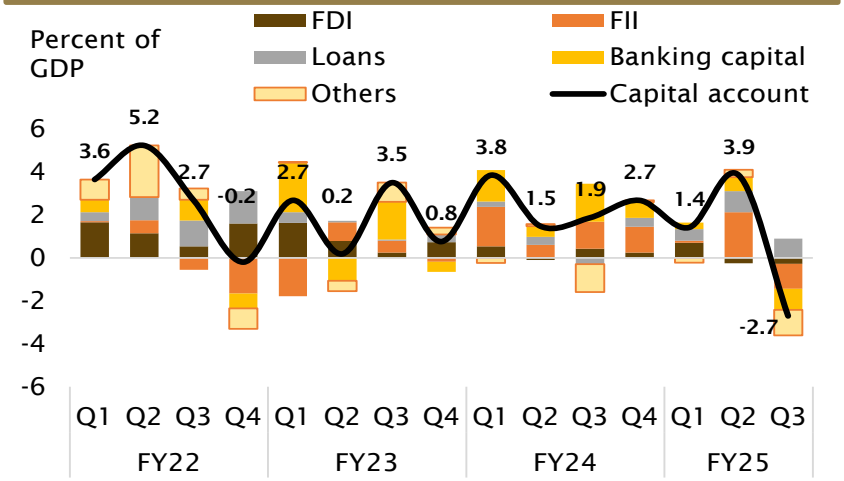




Capital account in steep deficit in Q3-FY25 amid foreign outflows

- The current account deficit deteriorated mildly to 1.2% of GDP (USD11.5bn) in Q3-FY25 from 1.1% (USD10.4bn) in Q3-FY24. In Q2-FY25, the deficit stood at 1.8% of GDP (USD16.7bn).
- The capital account slipped into deficit after ten quarters, marking the steepest gap so far at 2.7% of GDP (USD26.8bn) due to drag from portfolio outflows, banking capital, and 'others' component. In Q3-FY24, the capital account posted surplus at 1.9% of GDP (USD17.3bn). In sequential terms, the surplus was at 3.9% of GDP (USD36.1bn) in Q2-FY25.
- The overall balance of payments shifted to deficit at 3.80% of GDP (USD37.7bn) after remaining in surplus for eight straight quarters. In Q2-FY23, the quarter when the BoP was last in deficit, the gap was slightly steeper at 3.83% of GDP, though it was shallower in nominal terms at USD30.4bn.

Capital account balance



Balance of Payments – Key highlights

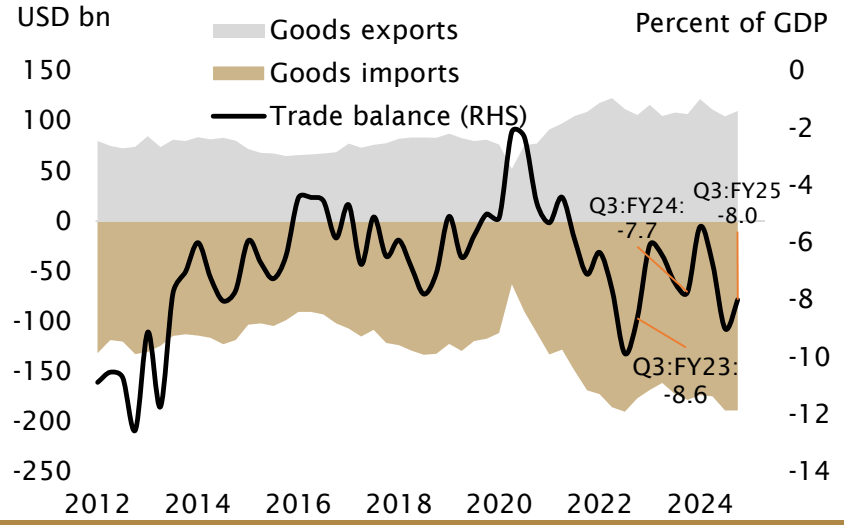
	FY24				FY25		
USD bn	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Current account	-9.0	-11.3	-10.4	4.6	-8.9	-16.7	-11.5
% of GDP	*-1.0*	*-1.3*	*-1.1*	*0.5*	*-0.9*	*-1.8*	*-1.2*
Trade balance	-56.7	-64.5	-71.6	-52.0	-63.8	-84.3	-79.2
Merchandise exports	104.9	108.3	106.6	121.6	111.2	104.6	109.8
Merchandise imports	161.6	172.8	178.3	173.6	175.0	188.8	189.0
Invisibles	47.7	53.3	61.2	56.6	54.9	67.6	67.7
Services	35.1	39.9	45.0	42.7	39.7	44.6	51.2
Transfers	22.8	24.9	29.3	28.7	26.3	32.4	33.2
Income	-10.2	-11.6	-13.1	-14.8	-11.1	-9.5	-16.7
Capital account	33.8	12.8	17.3	25.6	13.4	36.1	-26.8
% of GDP	*3.8*	*1.5*	*1.9*	*2.7*	*1.4*	*3.9*	*-2.7*
FDI	4.7	-0.8	4.0	2.3	6.6	-2.3	-2.8
FPI	15.7	4.9	12.0	11.4	0.9	19.9	-11.4
Loans	2.2	3.3	-2.8	3.9	5.1	9.2	8.9
of which, ECB	5.7	-3.0	-4.5	1.7	1.5	2.0	4.4
of which, ST credit	-5.0	5.4	-1.5	0.2	2.2	5.0	3.9
Banking capital	12.9	4.3	16.4	6.9	2.9	6.1	-9.8
of which, NRI deposits	2.2	3.2	3.9	5.4	4.0	6.2	3.1
Others	-1.7	1.1	-12.3	1.1	-2.1	3.3	-11.7
Errors and omissions	-0.4	1.0	-0.9	0.6	0.7	-0.7	0.6
Balance of payments	24.4	2.5	6.0	30.8	5.2	18.6	-37.7
% of GDP	*2.8*	*0.3*	*0.6*	*3.2*	*0.6*	*2.0*	*-3.8*

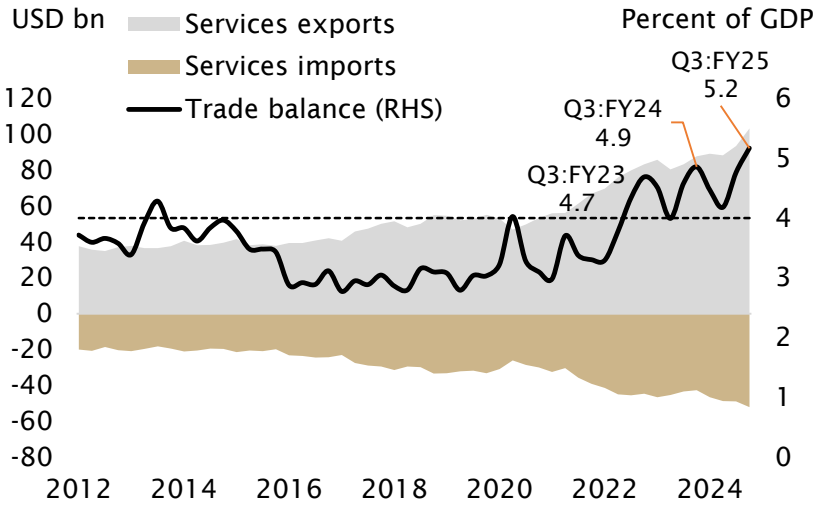
Goods deficit worsened y-o-y; services surplus above 5% of GDP

- Merchandise trade deficit worsened to USD79.2bn (8.0% of GDP) in Q3-FY25 from USD71.6bn (7.7% of GDP) a year ago but narrowed from the previous quarter's gap at USD84.3bn (9.0% of GDP). The year-on-year growth in exports and imports improved from the same quarter a year ago, with imports outpacing exports growth in the latest print. Goods trade (exports plus imports) eased sequentially and year-on-year to 30.2% of GDP.
  - Latest high frequency data for February bodes well for external balance in Q4-FY25. Goods trade deficit narrowed to the lowest level in 3.5 years, enabling surplus in total trade for the first time since Jun-2021.
  - Commodity prices, as indicated by the Bloomberg commodity index, are rising year-on-year, led by precious metals that have been rallying on safe haven demand. However, crude oil prices remain soft and are likely to remain so, which is expected to remain a tailwind for India's import bill.

- In terms of share in GDP, services trade surplus (exports minus imports) at 5.2% of GDP in Q3-FY25 marked the highest so far, up from Q2-FY25 and the recent peak of 4.9% in the same quarter a year ago. In nominal terms, services surplus stood at USD51.2bn in Q3-FY25, higher than in the same quarter a year ago and Q2-FY25 at around USD45bn. In Q3-FY25, the share of services trade (exports plus imports) in GDP rose from Q2-FY25 and also year-on-year to 15.7%.

Goods trade deficit deteriorated year-on-year but narrowed sequentially; services surplus surpassed 5% of GDP in Q3-FY25





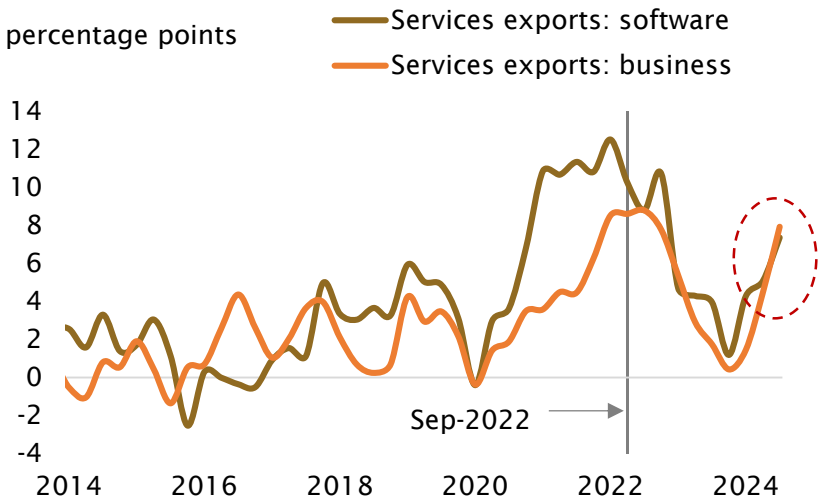
Business services added more to exports growth than software

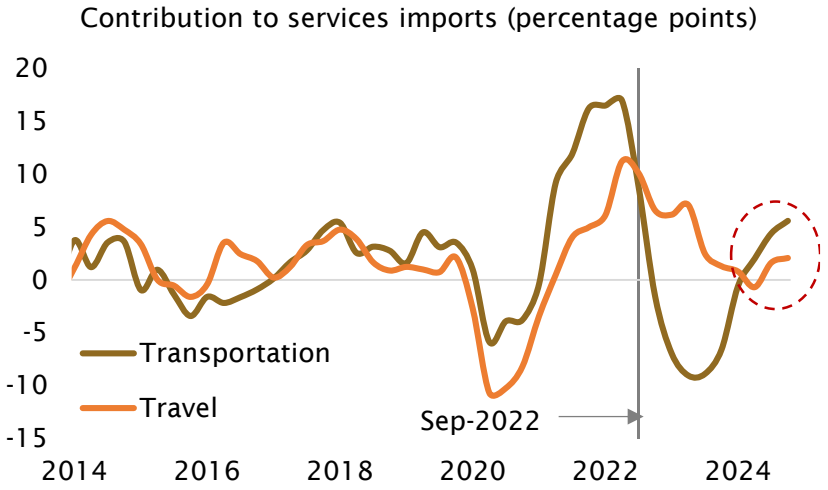
- Both exports and imports of services posted double-digit year-on-year growth in Q3-FY25 for the second straight quarter. Though imports growth outpaced the expansion in exports, in nominal USD terms, services imports at USD52.3bn remained almost half of services exports at USD103.5bn.

- The share of business services in services trade surplus remained above 20% for the second successive quarter, making continued improvement in the post-pandemic period. Though software services continue to remain the heavyweight in services exports, the share of business services has been rising, with instances of the latter contributing slightly more to exports growth than the traditional software segment. In the latest quarter data, business services added slightly more to year-on-year exports growth than software services.

- In Q3-FY25, business services continued to comprise around one-third share in services imports, followed by travel and transportation with around 16-17% share of each in total imports. Travel services that had surged in the post-pandemic period continue to normalize. Transportation services are closely linked to merchandise trade and had slumped in 2022 at the onset of the Russia-Ukraine tensions amid weak global trade flows. However, these continue to improve and are contributing more to imports growth than travel services.

Business services added more to exports growth; improvement in transport services reflects trend in goods imports





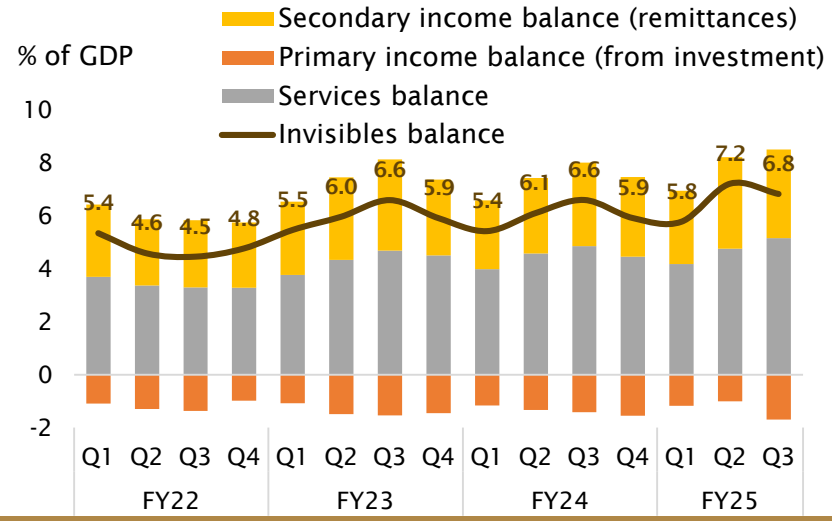
Remittances, services continued to offset primary income outgo

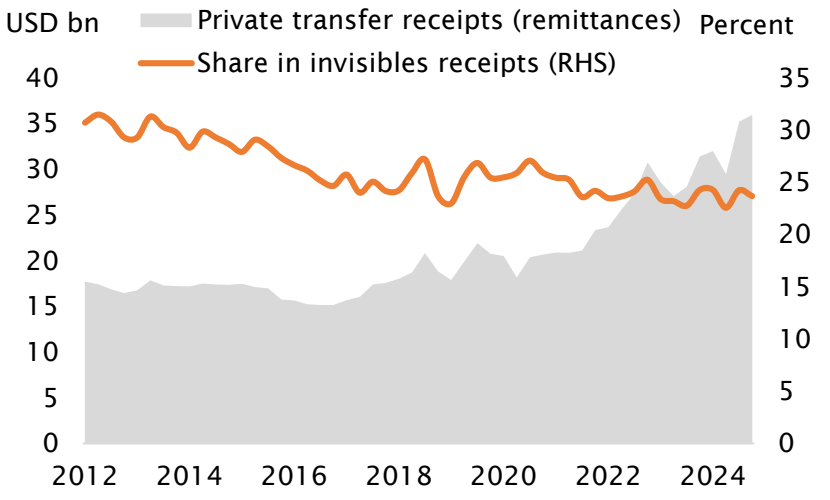
- Invisibles comprises of trade in services, primary and secondary income accounts. Primary income account mainly reflects payments of investment income, while secondary income consists of transfers, both private and official. Within this, private transfer receipts reflects remittances by Indians employed overseas.

- In Q3-FY25, the balance on invisibles trade at USD67.7bn (6.8% of GDP) marked an improvement from the corresponding quarter in FY24 when the balance stood at USD61.2bn (6.6% of GDP). The improvement in balance was led by services trade and higher remittances. However, the net outgo under primary income account, mainly showing payments under investment income, deteriorated to USD16.7bn (1.7% of GDP) from USD13.1bn in Q3-FY24 (1.4% of GDP).

- Private transfer receipts or remittances increased 14.5%YY to USD36.0bn from USD31.4bn in Q3-FY24. There has been a marked increase in remittances post-pandemic. Data for FY13-20 shows average quarterly remittance at USD17.6bn that has increased to USD26.4 post-pandemic. However, the share of remittances in invisibles receipts has slightly moderated to around 24% from 27% in the pre-pandemic period.

Net outflows rose under primary income (mostly investment income); remittances continued to lift secondary income

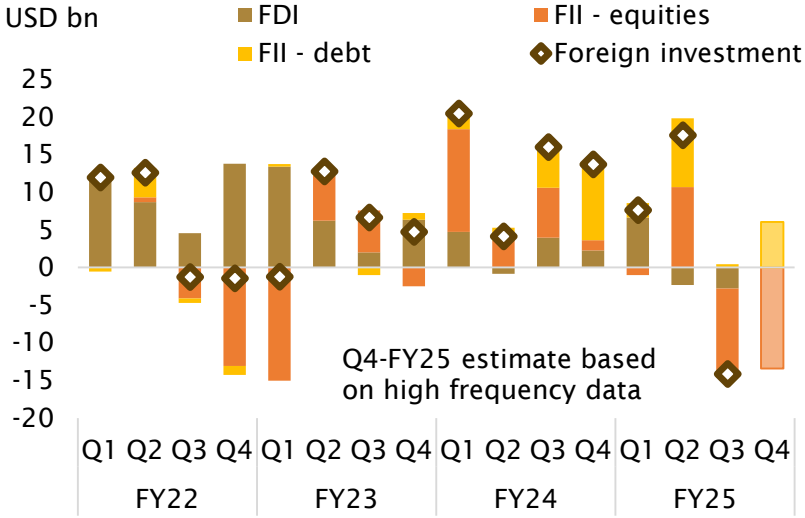




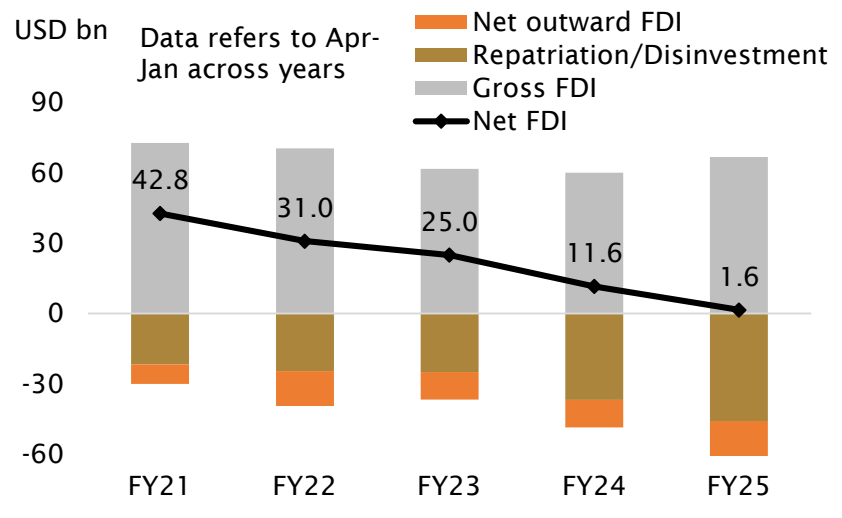
Foreign investment turned negative in Q3 amid FPI, FDI outflows

- Net foreign investment turned negative in Q3-FY25 to the tune of (-)USD14.1bn (-1.4% of GDP) versus inflow of USD16.0bn (1.7% of GDP) in Q3-FY24. Both net foreign institutional and direct investment posted net outflows in the latest quarter, compared to inflows recorded by both the categories in Q3-FY24.
  - Foreign portfolio investment turned negative after six quarters to (-)USD11.4bn (-1.1% of GDP) versus the inflow of USD12.0bn (1.3% of GDP) in Q3-FY24. Foreign direct investment posted net outflow of (-) USD2.8bn (-0.3% of GDP) versus the inflow of USD4.0bn (0.4% of GDP) in the respective quarter of FY24.
  - In Q3-FY25, there were outflows from equities and continued inflows into debt. The net outflow from equities amounted to (-)USD11.9bn, compared to inflows of USD6.7bn in Q3-FY24. Debt inflows eased to USD0.4bn from USD5.0bn in Q3-FY24. High frequency data shows that the selloff in equities was sharper in Q4-FY25 to the tune of USD13.4bn, though debt inflows improved quarter-on-quarter to USD6.0bn, which could partly offset the impact of outflows from equities. Nonetheless, these trends in portfolio flows and subdued year-to-date FDI flows could continue to weigh on capital account balance in Q4.
  - Net FDI flows have continued to moderate on a year-to-date basis for the fourth straight fiscal year. In Apr-Jan, net FDI flows amounted to USD1.6bn from USD11.6bn in the same period of FY24. Gross FDI flows were higher year-on-year at USD66.9bn versus USD60.2bn in Apr-Jan FY24 but higher repatriation/disinvestment and net outward FDI led to the moderation in net FDI inflows in FYTD FY25.

Net foreign investment turned negative in Q3



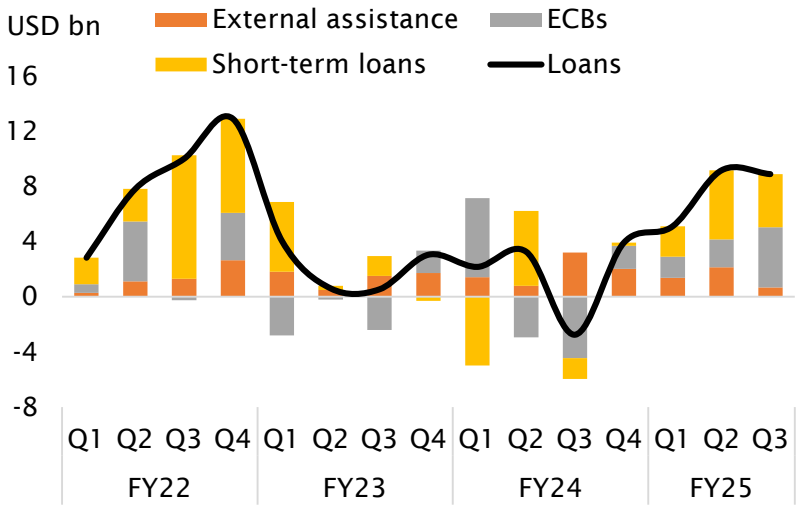
Net FDI flows continued to moderate FYTD



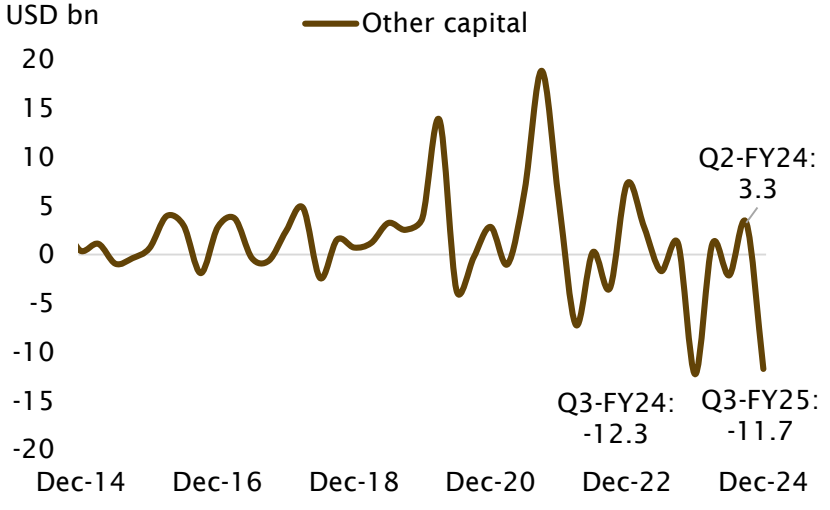
‘Other’ component also dragged down capital account balance

- Within the capital account, net inflows from loans rebounded to USD8.9bn in Q3-FY25, compared to net outflows recorded in the corresponding quarter of FY24 at (-)USD2.8bn. The recovery was led by external commercial borrowings (ECBs) and short term loans. ECBs posted net inflows of USD4.4bn versus outflow of (-)USD4.5bn in Q3-FY24. Short-term loans also recorded positive flows, implying that disbursements exceeded repayments. These amounted to USD3.9bn in Q3-FY25, compared to net outflow of (-)USD1.5bn in Q3-FY24. However, net inflows from external assistance eased to USD0.7bn from USD3.2bn in Q3-FY24.
  - The disbursements of loans up to six months duration increased, while repayments were higher than disbursements for loans exceeding six months duration, though to a lesser extent than in Q3-FY24.
  - Data on ECB registrations for Apr-Jan FY25 showed that NBFCs topped the list in terms of amount raised, displacing manufacturing and infrastructure that were leading in Apr-Jan FY24.
- Though there was an improvement in inflows from loans, all other major components of capital account recorded net outflows that cumulatively tipped the balance into negative. In addition to foreign investment flows evaluated in the previous slide, and banking capital assessed in the next slide, the ‘other’ component of capital account also turned sharply negative in Q3-FY25 vis-à-vis the previous quarter, though to a slightly shallower extent compared to Q3-FY24. The ‘other’ component captures the leads and lags in exports receipts, and transactions not included elsewhere.

Net balance on loans rebounded in Q3-25 vs. Q3-24



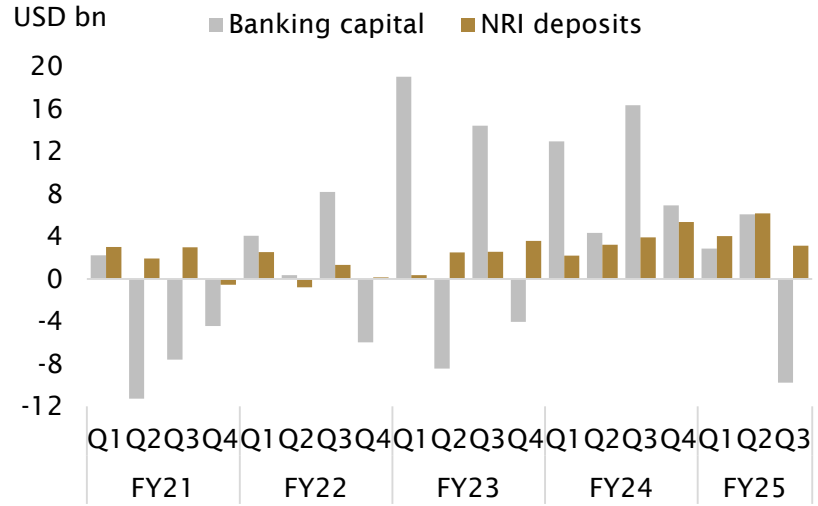
‘Other’ component also weighed on capital account



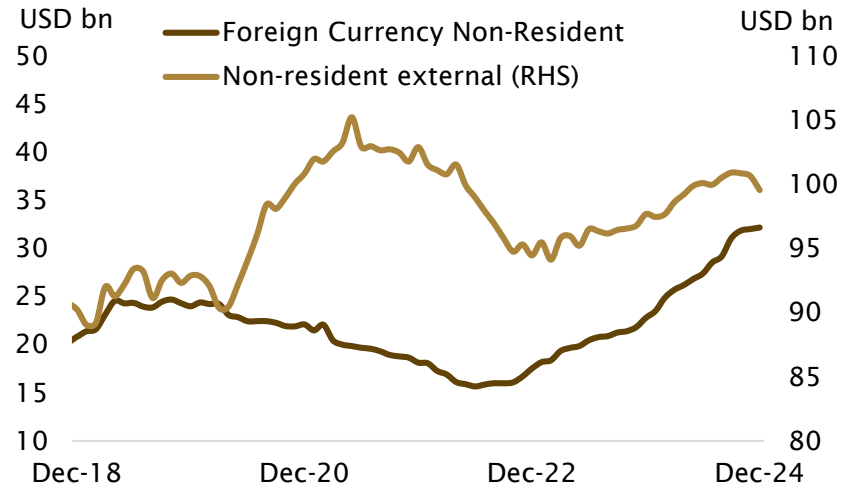
Banking capital flows turned negative on likely FX intervention

- Banking capital mainly consists of foreign assets (includes foreign currency holdings and rupee overdrafts to non-resident banks) and foreign liabilities of commercial banks (includes non-resident deposits).
- In FY23 and FY24, banking capital contributed to capital account surplus, amounting to USD21bn (36% of capital account balance) and USD41bn (45%), respectively. In Q3-FY25, the balance on banking capital turned negative after a gap of six quarters to (-)USD9.8bn versus USD16.4bn in Q3-FY24. The balance on commercial banks' assets and liabilities turned sharply negative, and NRI deposit flows moderated.
- The balance on commercial banks' foreign assets remained negative for the fourth consecutive quarter, but the extent was steeper in Q3-FY25. A part of this could be attributable to intervention in the forex market during Oct-Dec when the RBI was net seller of USD in both the spot and forward markets.
- In Q3-FY25, NRI deposit flows eased to USD3.1bn from USD3.9bn in Q3-FY24 and were almost half of the recent peak of USD6.2bn in the previous quarter (Q2-FY25). Despite moderation in the latest print, NRI deposit flows remain strong, exceeding USD2bn every quarter since Q2-FY23.
- As part of developmental and regulatory policy measures announced at the Dec-2024 RBI MPC meeting, the central bank had raised interest rate ceilings on FCNR(B) deposits, effective December 6, 2024 to March 31, 2025, suggesting that there is still scope for NRI deposits to improve in Q4-FY25, though there does not seem to have been any notable effect in Q3.

Banking capital turned negative in Q3-FY25



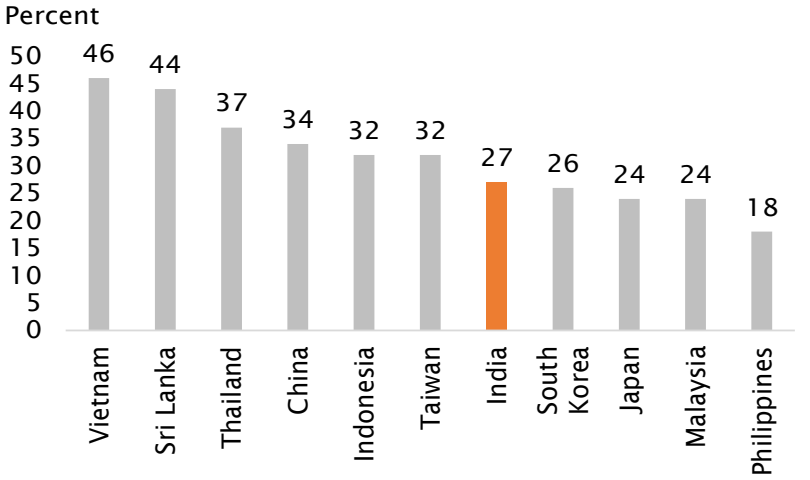
Despite easing in Q3, o/s NRI deposits remain strong



US reciprocal tariffs could impel the RBI towards more easing

- In the latest development on trade wars, the US administration has imposed 10% tariffs across all countries (effective Apr-5), and reciprocal higher tariffs on economies with which the US has the largest trade deficits (effective Apr-9). Under the latter, the tariff imposed on India stands at 27%. Though higher than expected, it is lower than on peer economies such as Vietnam (46%), China (34%), and Thailand (37%). Among advanced economies, the European Union faces 20% reciprocal tariffs, and Switzerland 32%.
- There are certain goods that will not be subject to reciprocal tariffs. These include 1) steel/aluminium articles, and autos/auto parts that are already subject to tariffs 2) copper, pharmaceuticals, semiconductors, and lumber articles 3) articles that may become subject to future Section 232 tariffs (on grounds of national security) 4) bullion 5) energy and other certain minerals that are not available in the US.
- While the direct impact on India's GDP is estimated to be around 0.2-0.4% of GDP in FY26, there are concerns about the indirect effects if global growth falters in coming years. In its outlook note published in Oct-2024, the IMF noted that global rise in tariffs and greater trade uncertainty would lower global growth by 0.8% in 2025 and 1.3% in 2026. US GDP would fall by about 1% relative to the baseline in 2025.
- India is working on negotiating a trade deal with the US (to be finalized by fall 2025), but experts caution that the scope of the deal could extend beyond tariffs. The White House factsheet on reciprocal tariffs notes "India imposes their own uniquely burdensome and/or duplicative testing and certification requirements in sectors such as chemicals, telecom products, and medical devices that make it difficult or costly for American companies to sell their products in India. If these barriers were removed, it is estimated that US exports would increase by at least USD5.3bn annually." These issues were noted in the annual report by the USTR on non-tariff barriers faced by the US across economies, including India.
- To protect the domestic economy from these external headwinds, it is likely that the RBI leans towards easing more than was earlier anticipated in the current rate cut cycle. This raises the possibility that in addition to 25bp rate cut expected at the April meet, the RBI MPC changes the policy stance to accommodative.

US reciprocal tariffs – Asian economies



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1101, Naman Centre, Bandra Kurla Complex, Bandra (E), Mumbai -400 051, Maharashtra.

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