

Current account deficit narrowed mildly to 1.2% in Q2-FY25; BoP surplus improved on capital account inflows

January 7, 2025

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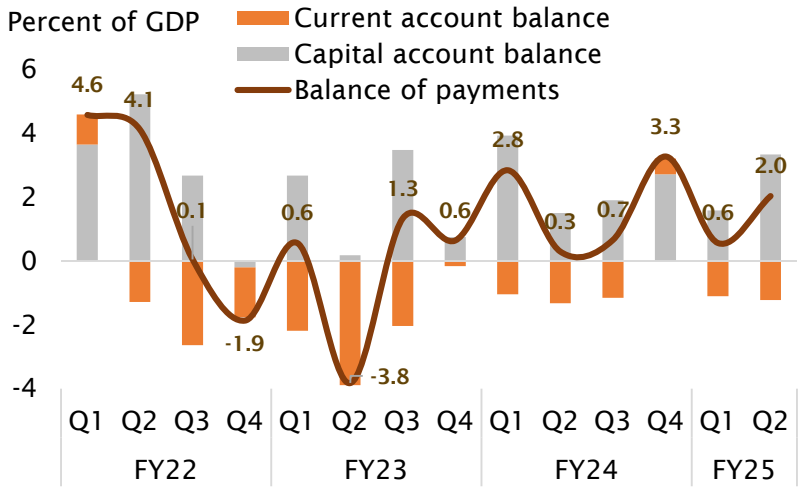
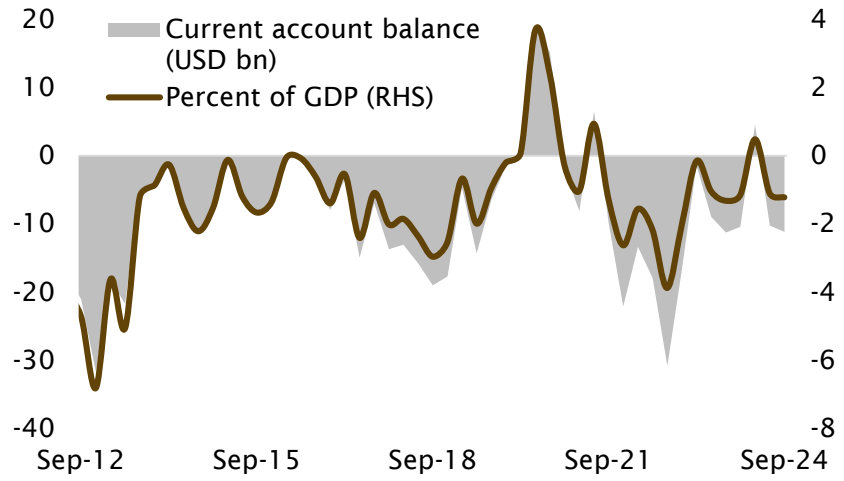
Key takeaways

- The deficit on current account narrowed fractionally to 1.2% of GDP in Q2-FY25 (USD11.2bn) from 1.3% in Q2-FY24 (USD11.3bn). There was an improvement in invisibles trade surplus, while goods trade deficit worsened. Remittances increased, while outflows under investment income moderated.
- The surplus on capital account increased to 3.3% of GDP in Q2-FY25 (USD30.5bn) from 1.5% (USD12.8bn) in Q2-FY24. FPI surged to 15-quarter high due to inflows into equities and debt. FDI recorded net outflow during the quarter, which was steeper than in Q2-FY24. There was year-on-year improvement in loans and banking account inflows. External commercial borrowings rebounded from the slump in Q2-FY24, while higher NRI deposits supported banking account surplus. The balance of payments surplus improved to 2.0% of GDP in Q2-FY25 (USD18.6bn) from 0.3% of GDP (USD2.5bn) in Q2-FY24.
- In terms of outlook, net FDI inflows remain sluggish year-to-date. The recent high frequency data shows foreign portfolio outflows in Q3, particularly from equities. The resultant pressure on the Indian rupee, among other factors driving INR weakness, could be a headwind for the import bill going forward. The widening of merchandise trade deficit to a record high in November amid a surge in gold imports does not augur well for Q3 BoP print. The recovery in goods exports remains sluggish, even as improvement in services surplus continues to offer some respite. Muted crude oil prices could be another near-term tailwind, though overall global commodity prices are starting to rise year-on-year. Also, risks continue to loom from potential global tariff wars post the US Presidential election outcome in 2024.

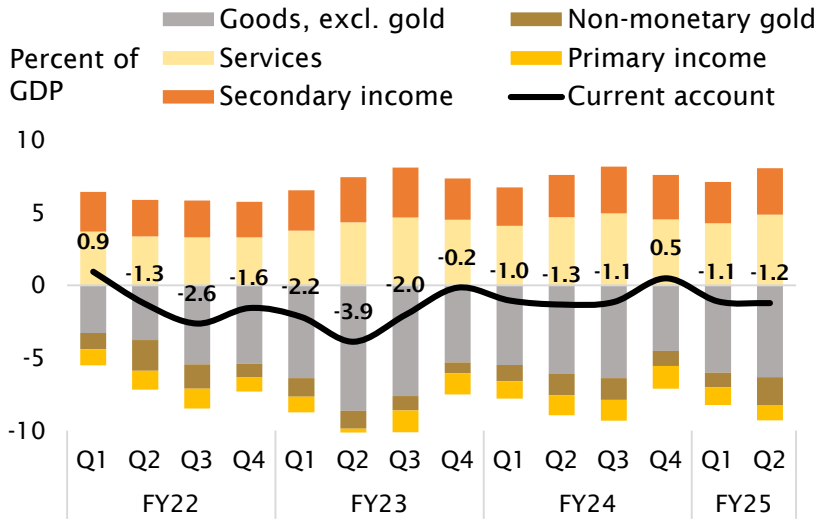
BoP surplus improved to 2% of GDP vs 0.3% in Q2-FY24; CAD narrowed mildly to 1.2% of GDP from 1.3% a year ago



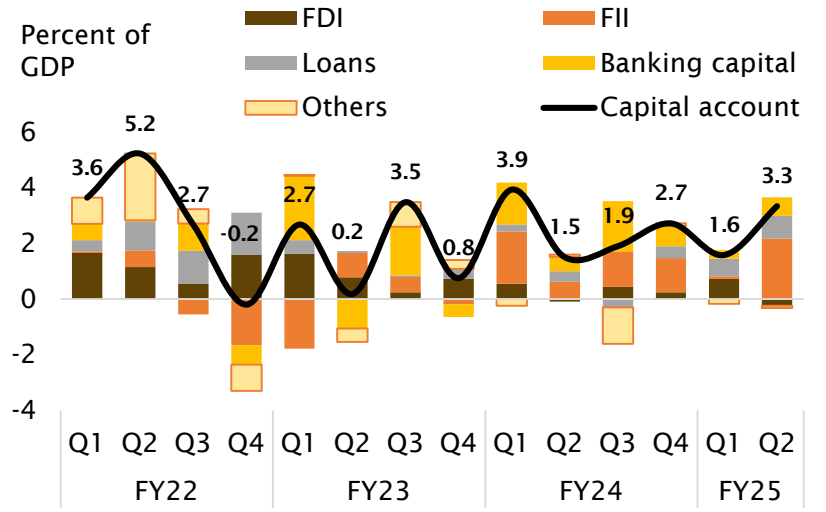


Current account deficit narrowed mildly compared to Q2-FY24

Current account balance



Capital account balance



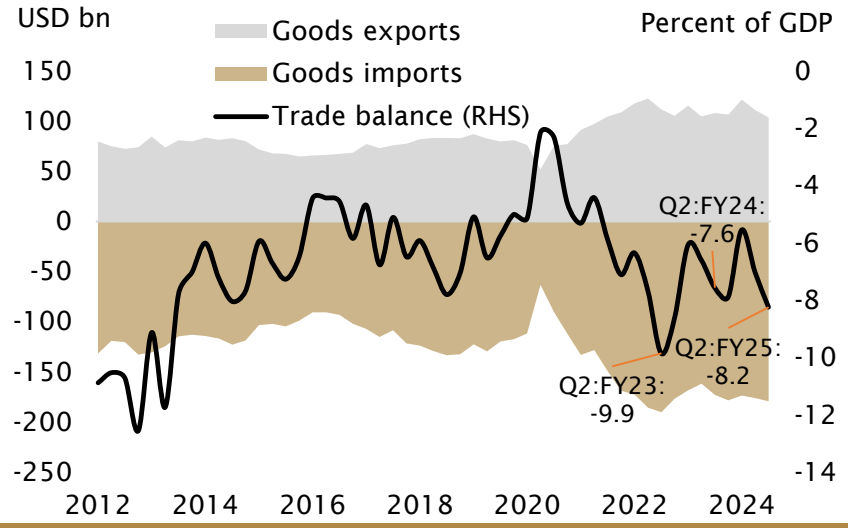
Balance of Payments – Key highlights

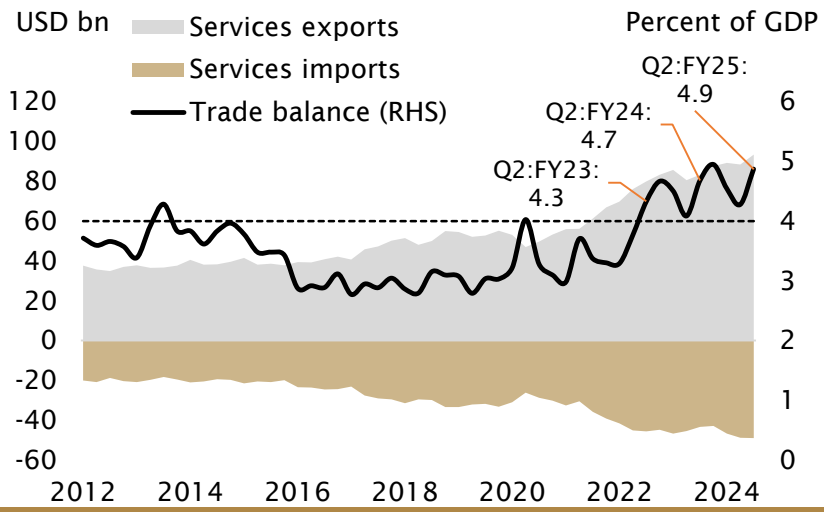
	FY24				FY25	
USD bn	Q1	Q2	Q3	Q4	Q1	Q2
Current account	-9.0	-11.3	-10.4	4.6	-10.2	-11.2
% of GDP	*-1.0*	*-1.3*	*-1.1*	*0.5*	*-1.1*	*-1.2*
Trade balance	-56.7	-64.5	-71.6	-52.0	-65.1	-75.3
Merchandise exports	104.9	108.3	106.6	121.6	111.2	104.0
Merchandise imports	161.6	172.8	178.3	173.6	176.3	179.3
Invisibles	47.7	53.3	61.2	56.6	54.9	64.1
Services	35.1	39.9	45.0	42.7	39.7	44.5
Transfers	22.8	24.9	29.3	28.7	26.4	29.1
Income	-10.2	-11.6	-13.1	-14.8	-11.1	-9.5
Capital account	33.8	12.8	17.3	25.6	14.7	30.5
% of GDP	*3.9*	*1.5*	*1.9*	*2.7*	*1.6*	*3.3*
FDI	4.7	-0.8	4.0	2.3	6.7	-2.2
FPI	15.7	4.9	12.0	11.4	0.9	19.9
Loans	2.2	3.3	-2.8	3.9	5.9	7.5
of which, ECB	5.7	-3.0	-4.5	1.7	1.6	2.0
of which, ST credit	-5.0	5.4	-1.5	0.2	2.9	3.4
Banking capital	12.9	4.3	16.4	6.9	2.9	6.1
of which, NRI deposits	2.2	3.2	3.9	5.4	4.0	6.2
Others	-1.7	1.1	-12.3	1.1	-1.6	-0.7
Errors and omissions	-0.4	1.0	-0.9	0.6	0.8	-0.7
Balance of payments	24.4	2.5	6.0	30.8	5.2	18.6
% of GDP	*2.8*	*0.3*	*0.7*	*3.3*	*0.6*	*2.0*

Goods deficit worsened; services surplus stayed above 4% of GDP

- Goods trade deficit worsened to 8.2% of GDP in Q2-FY25 from 7.6% in the corresponding quarter a year ago, but remained below the recent peak of 9.9% in Q2-FY23, when crude oil prices had surged over USD120/bbl due to the Russia-Ukraine war outbreak.
  - Good exports remained in year-on-year contraction in the second quarter of both FY24 and FY25 and in fact, fell at a sharper pace of 4%YY, compared to 3.2% decline in Q2-FY24. On the other hand, imports increased 3.8%YY vis-à-vis 9.1% decrease in the same quarter a year ago.
- The deterioration in deficit in the latest print vis-à-vis a year ago was mainly due to a surge in gold imports in August post the customs duty cut announced in the Union Budget for FY25 in July. The share of deficit on account of crude oil imports was largely stable, as prices were lower year-on-year during the quarter. The share of core goods trade in deficit moderated compared to Q2-FY24.
  - Commodity prices, as indicated by the Bloomberg commodity spot index and crude oil, remained in year-on-year contraction in Q2. In Q3, even as crude oil prices remained subdued, the commodity index posted year-on-year gains, which could impinge on external balance during the quarter.
- The surplus in services trade has remained above 4% of GDP since Q2-FY23 and the latest print continued to reflect this trend. In Q2-FY25, services surplus improved to 4.9% from 4.7% in the same quarter a year ago.

Despite worsening vis-à-vis Q2:FY24, goods trade deficit was below recent peak; services surplus above 4% of GDP since Q2-FY23





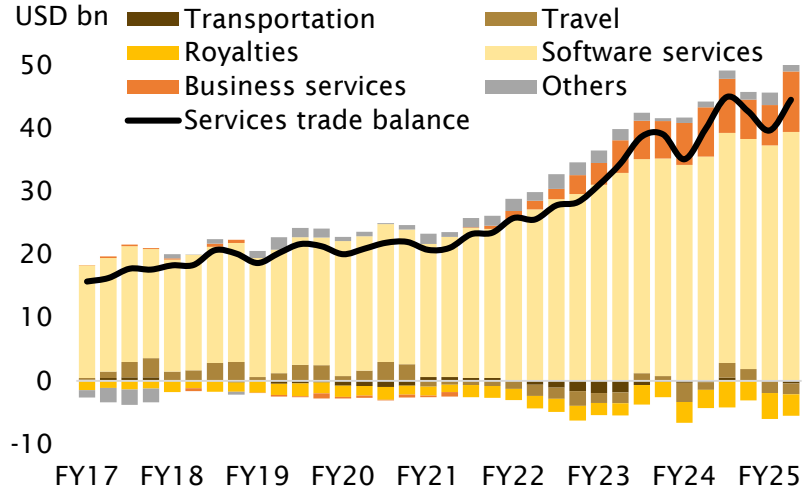
Share of business services in trade surplus continued to improve

- There was an increase in services trade surplus in Q2-FY25 compared to the respective quarter a year ago. However, the extent of improvement in the year-on-year print was less than in Q2-FY24 amid more than 12%YY surge in both services exports and imports in Q2-FY25. In Q2-FY24, services exports were up over 4%YY, while imports had declined around 5%.

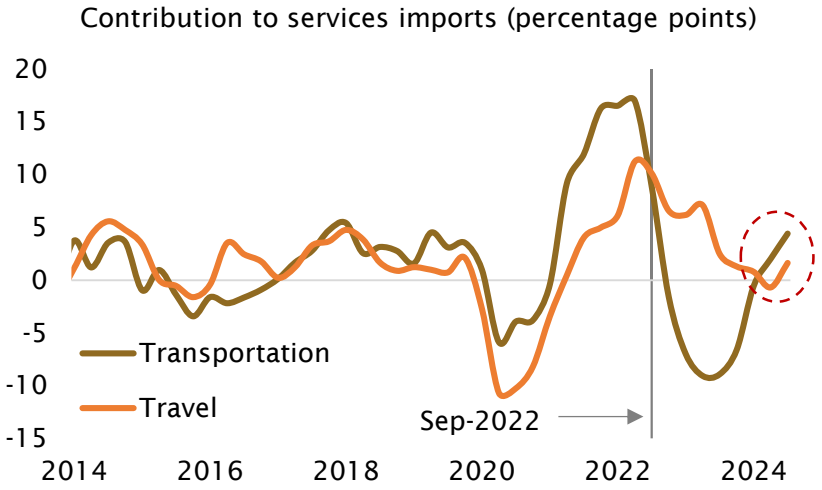
- In Q2-FY25, software and business services together continued to constitute around three-fourth share in total services exports. Particularly, software services remained the mainstay of surplus in services trade. However, in the post-pandemic period, the share of business services in this surplus has been rising. As per latest data, this share was at around 22%, up from 20% in Q2-FY24 and 15% in Q2-FY23.

- As per latest data, travel, transport and business services together comprised 70% share in total services imports. Post-pandemic, contact intensive services such as travel rebounded sharply, and are now normalizing. Transportation services, which are closely linked to trends in merchandise trade, are recovering amid recent rise in goods imports. In 2022, the outbreak of Russia-Ukraine tensions had triggered weakness in global goods trade flows, which was also reflected in muted imports of transportation services.

Business services are adding to surplus post-pandemic



Uptick in transport services amid rise in goods imports



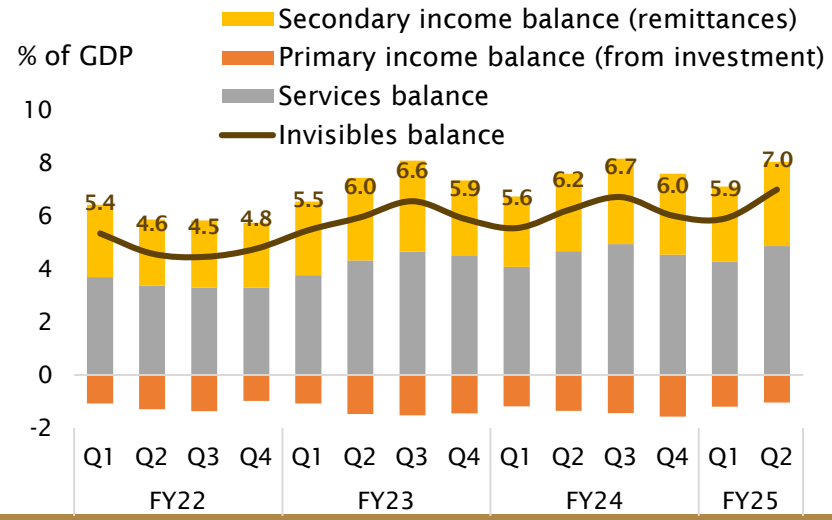
Remittances continue to remain strong post-pandemic

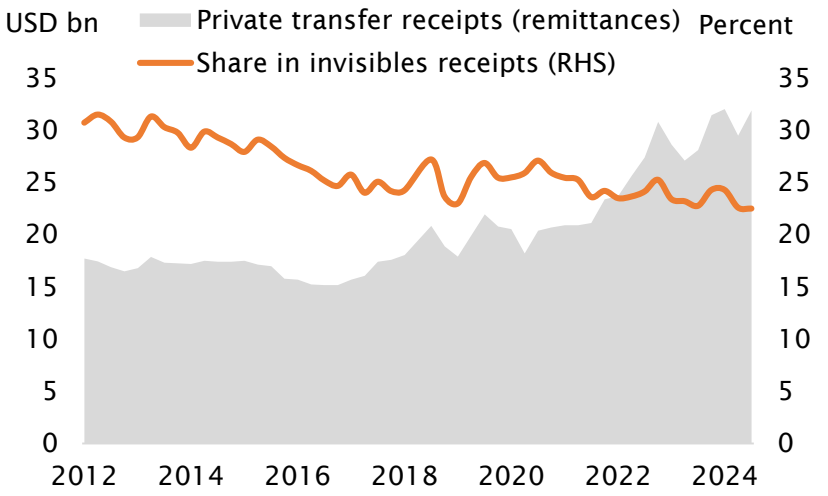
- Invisibles comprises of trade in services, primary and secondary income accounts. Primary income account mainly reflects payments of investment income, while secondary income consists of transfers, both private and official. Within this, private transfer receipts reflects remittances by Indians employed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

- In Q2-FY25, the balance on invisibles trade at USD64.1bn (7% of GDP) marked an improvement from the corresponding quarter in FY24 when the balance stood at USD53.3bn (6.2% of GDP). The improvement in balance was led by services trade and higher remittances, while net outgo under primary income account, mainly showing payments under investment income, moderated to USD9.5bn (1.0% of GDP) from USD11.6bn in Q2-FY24 (1.4% of GDP).

- Private transfer receipts or remittances increased around 13%YY to USD31.9bn from USD28.1bn in Q2-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 USD25.7 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 eased under primary income (mostly investment income); remittances continued to lift secondary income

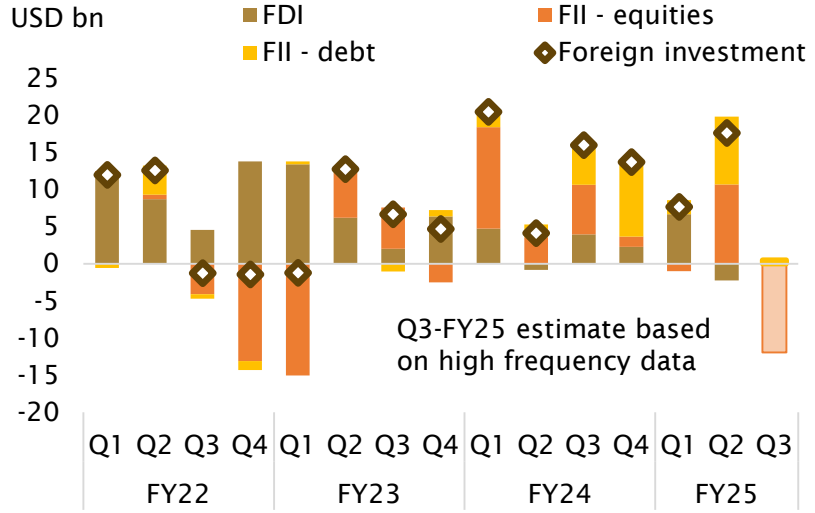




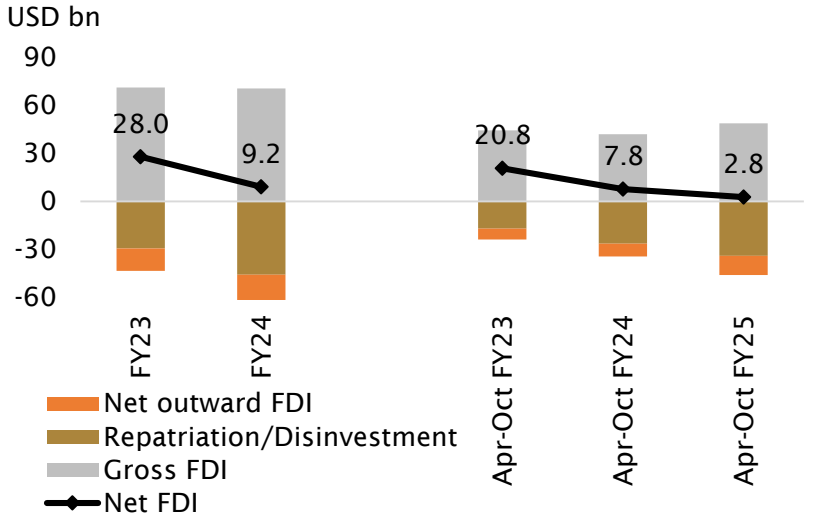
Portfolio flows improved year-on-year in Q2 amid FDI outflows

- Net foreign investment rose to USD17.6bn (1.9% of GDP) in Q2-FY25 from USD4.1bn (0.5% of GDP) in Q2-FY24. This increase was driven by improvement in net foreign institutional inflows compared to the corresponding quarter of FY24, even as foreign direct investment continued to record outflows.
  - Foreign portfolio investment increased to 15-quarter high at USD19.9bn (2.2% of GDP) in Q2-FY25 from USD4.9bn (0.6% of GDP) in Q2-FY24. Foreign direct investment recorded net outflow of USD2.2bn (0.2% of GDP), sharper than USD0.8bn (0.1% of GDP) in the corresponding quarter of FY24.
  - The year-on-year increase in net institutional flows in Q2-FY25 was both into equities and debt. The net inflows into equities amounted to USD10.7bn, up from USD3.6bn in Q2-FY24; while debt inflows stood at USD9.1bn versus USD1.7bn in the same quarter of FY24. However, high frequency data shows steep outflows in Q3-FY25, particularly from equities to the tune of around USD12bn, while inflows into debt were muted at less than USD1bn. This could dent the capital account balance in Q3, particularly in the backdrop of subdued year-to-date FDI flows.
  - Net FDI flows have continued to moderate on a year-to-date basis for the second straight fiscal year. In April-October, net FDI flows amounted to USD2.8bn from USD7.8bn in the same period of FY24. Gross FDI flows were higher year-on-year at USD48.8bn versus USD42.1bn in April-October FY24 but higher repatriation/disinvestment and net outward FDI led to the moderation in net FDI inflows in FYTD FY25.

Net foreign investment improved in Q2 due to FII flows



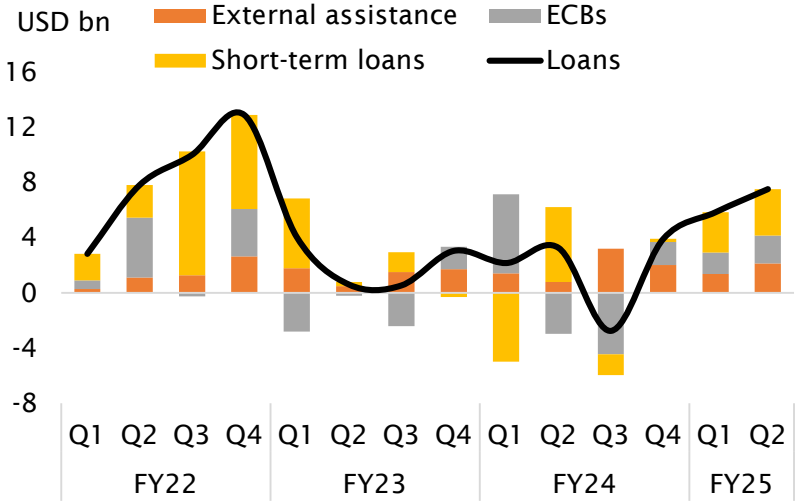
Net FDI flows continue to moderate FYTD



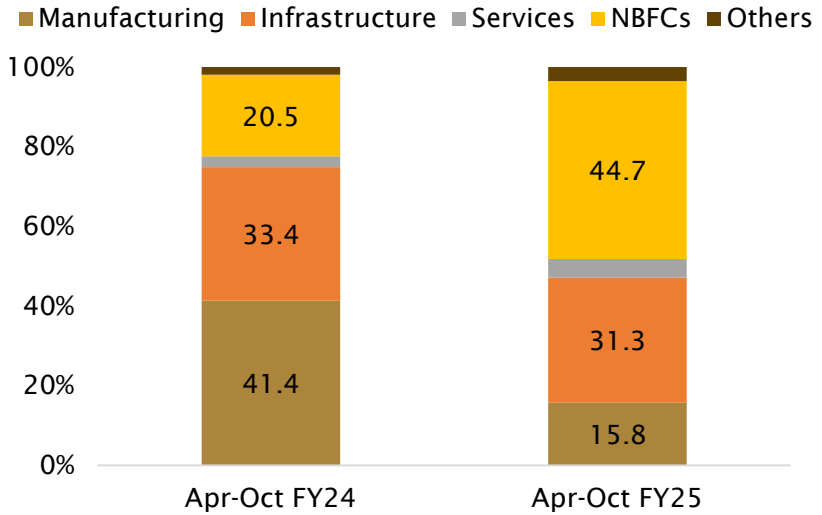
Higher inflows from loans contributed to capital account surplus

- Within the capital account, net inflows from loans increased year-on-year to USD7.5bn in Q2-FY25 from USD3.3bn in Q2-FY24 amid higher external assistance and a rebound in external commercial borrowings (ECBs). Short-term loans also recorded positive flows, implying that disbursements exceeded repayments. There was a moderation in short-term loans in nominal terms compared to the same quarter a year ago, though these continued to account for the largest share among categories of external loans in Q2-FY25.
  - The balance on external assistance increased to USD2.1bn from less than a billion USD in Q2-FY24.
  - In Q2-FY25, ECB net inflows amounted to USD2bn, compared to outflow or repayments of USD3bn in Q2-FY24. On a fiscal year-to-date basis until October, there was year-on-year surge in ECB registration amount by NBFCs, displacing manufacturing that accounted for the largest share in Apr-Oct FY24. This could be partly attributable to the increase in risk weights by the RBI on bank loans to NBFCs for certain categories announced in November 2023 that could have prompted these entities to diversify their funding sources.
  - The moderation in short-term loans was in the category of loans exceeding six months duration, with its share easing to 20% from more than 60% in Q2-FY24. At the same time, loans of up to six months recorded year-on-year improvement in terms of both amount and share in short-term loans.

Net balance on loans within capital account



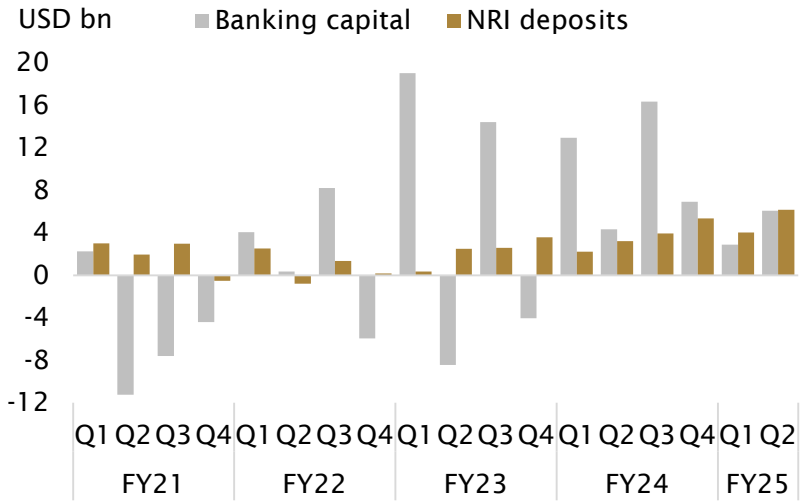
Share in ECB registration amount by borrower category



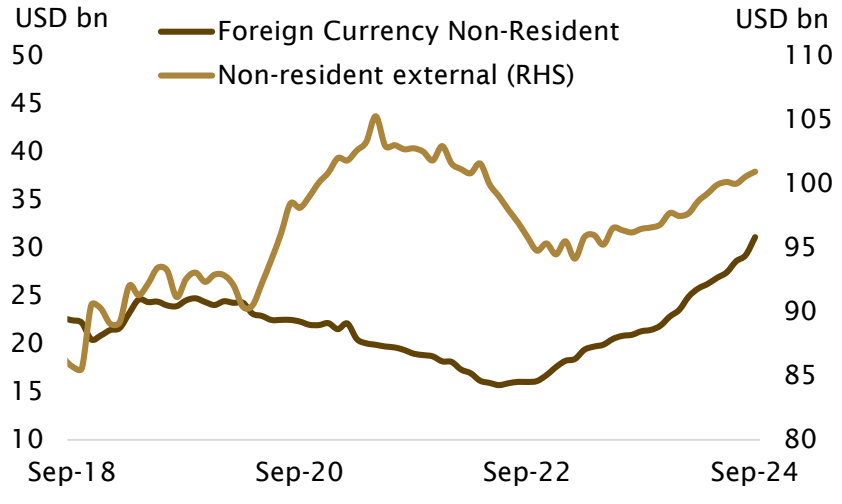
Banking capital flows improved, aided by NRI deposits

- 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 Q2-FY25, banking capital was stable compared to the previous quarter at around 20% of capital account balance but there was an improvement in nominal terms to USD6.1bn from USD2.9bn in Q1-FY25, along with an increase in overall capital account surplus. In Q2-FY24, net banking capital stood at USD4.3bn (34% of capital account balance).
- In Q2-FY25, the balance on commercial banks' foreign assets remained negative for the third consecutive quarter. A part of this could be attributable to intervention in the forex market during April-September when the RBI was net seller of USD in the forward segment.
- NRI deposit flows have been strong, exceeding USD2bn every quarter since Q2-FY23. In Q2-FY25, NRI deposit flows stood at USD6.2bn, greater than USD3.2bn in Q2-FY24. Despite these strong accretions on the liabilities side, dwindling assets continue to act as a drag on overall banking capital flows. As part of developmental and regulatory policy measures announced at the December RBI MPC meeting, the central bank raised interest rate ceilings on FCNR(B) deposits, effective December 6, 2024 to March 31, 2025, yielding scope for NRI deposits to further improve in Q3 and Q4 of current financial year.

Banking capital flow improved to USD6.1bn in Q2-FY25



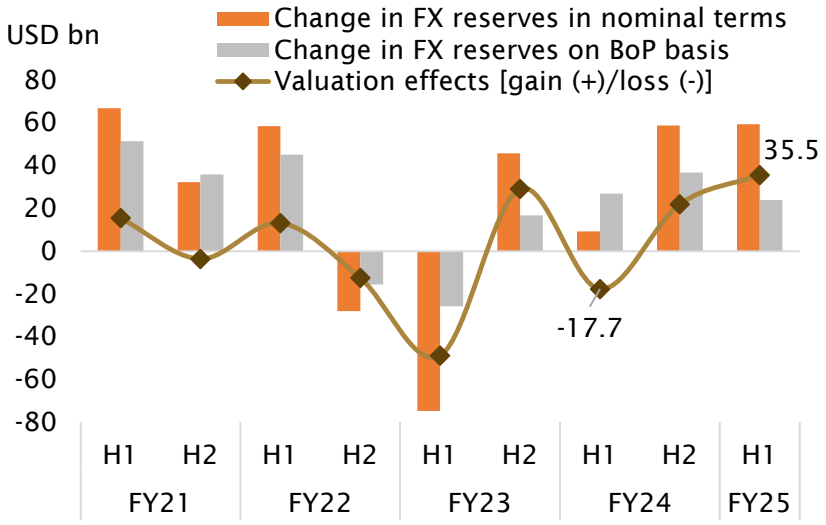
NRI deposits outstanding on an uptrend since Sep-22



Gold prices, weak USD drove valuation gains in FX reserves in H1

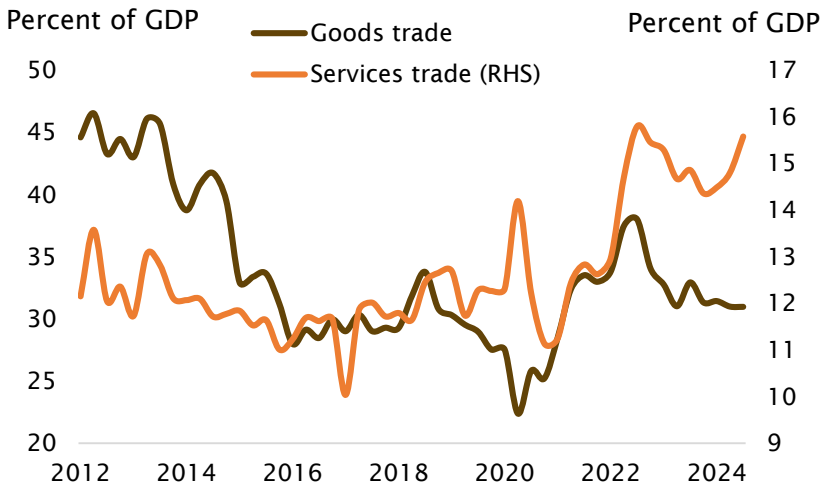
- On a balance of payment basis, which excludes valuation effects, foreign exchange reserves increased by USD23.8bn in H1-FY25 (Apr-Sep), lower than the accretion of USD27bn in H1-FY24. In nominal terms, which includes valuation effects, FX reserves surged by USD59.4bn, compared to the increase of USD9.3bn in H1-FY24. This amounted to a valuation gain of USD35.5bn versus a valuation loss of USD17.7bn in H1-FY24, with the gain largely reflecting higher gold prices and USD depreciation against major currencies.

Valuation gains on FX reserves in H1-FY25

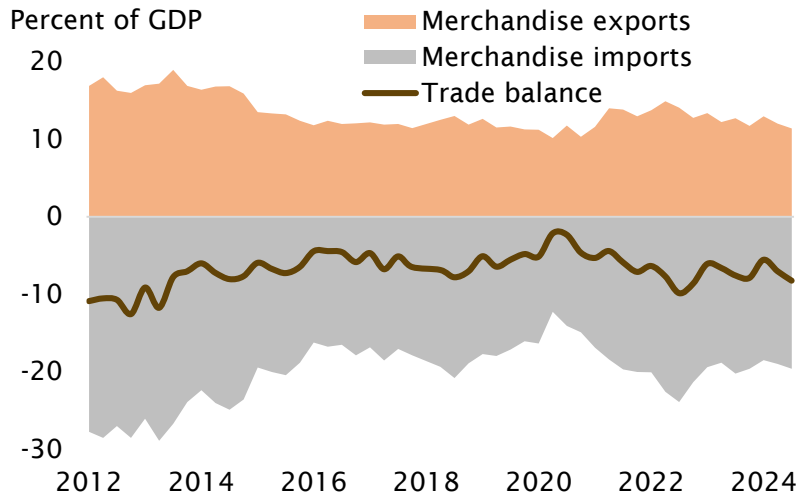


Appendix

Recovery in goods trade remains sluggish..

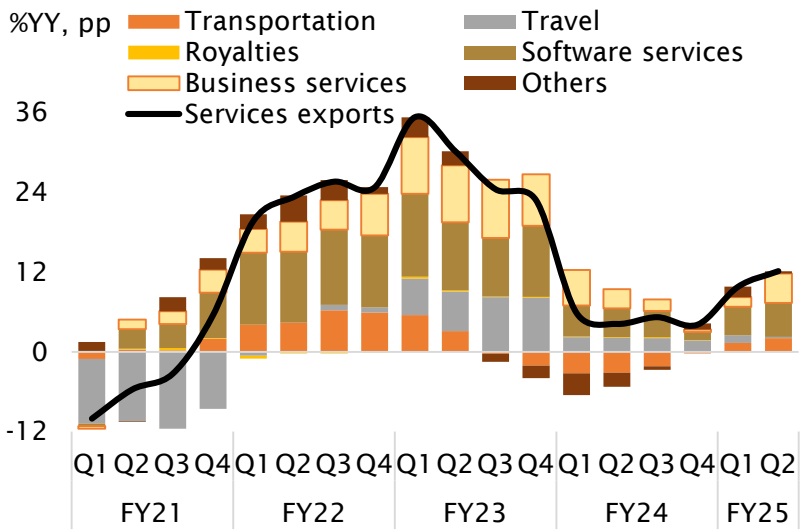


..with exports at 15-quarter low of 11.4% of GDP in Q2

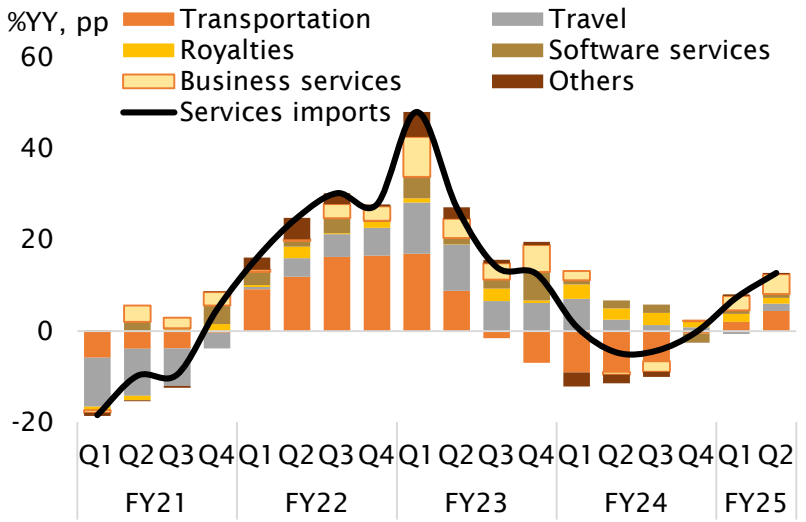


Appendix (Continued)

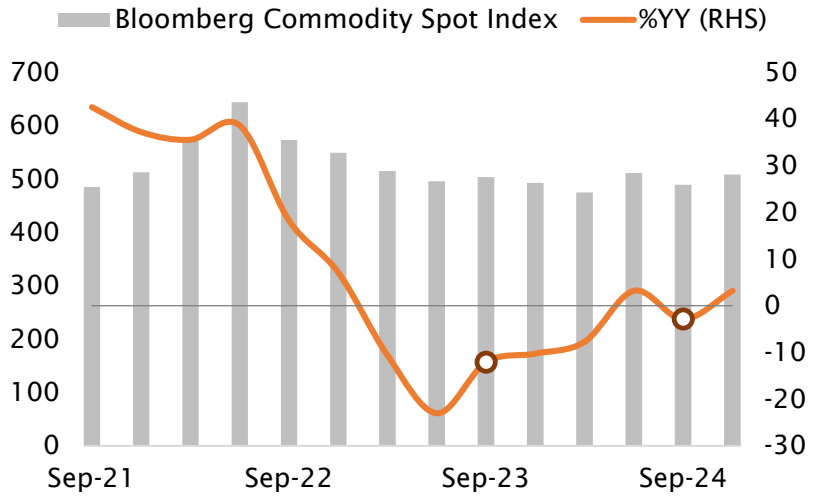
Contribution to services exports



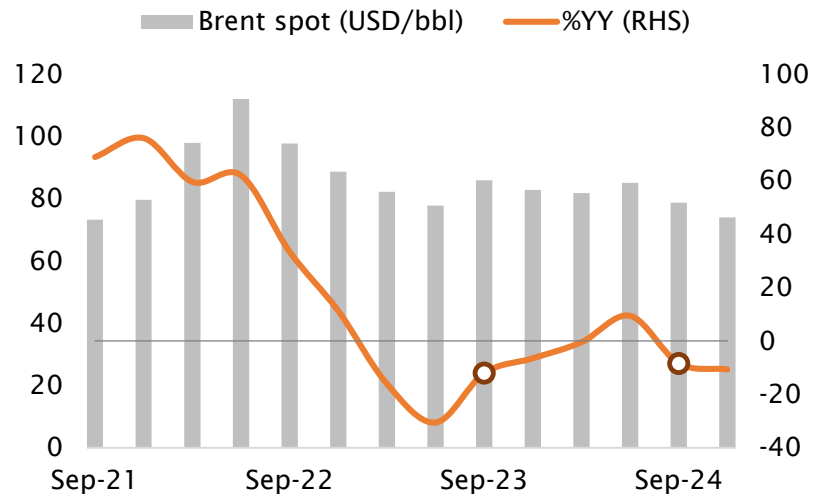
Contribution to services imports



Commodity prices are slowly rising year-on-year



Crude oil prices subdued, could act as tailwind in Q3



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