

Current account deficit narrowed y-o-y in Q1-FY26; outlook hinges on progress around the impending India-US trade deal

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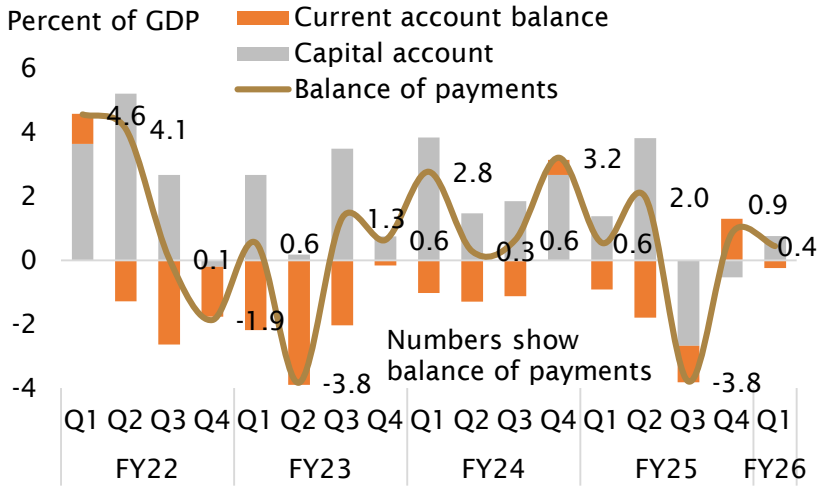
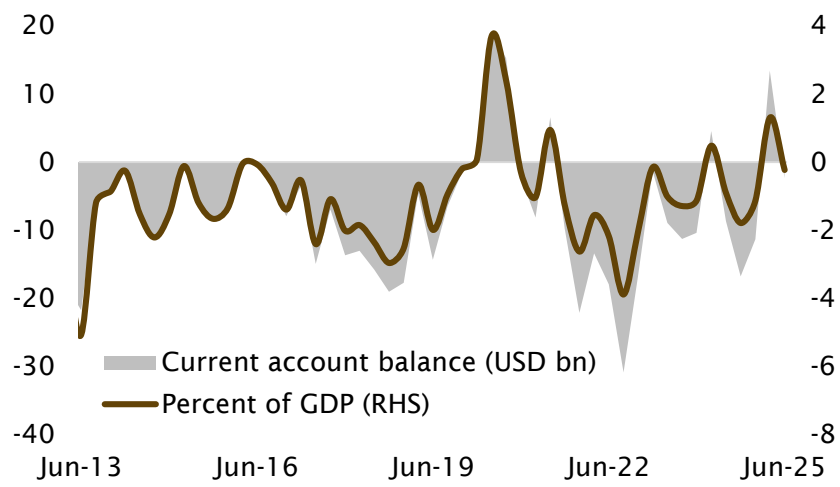
Key takeaways

- The current account deficit narrowed to 0.2% of GDP (USD2.4bn) in Q1-FY26 from 0.9% (USD8.7bn) in Q1-FY25. The steepening of deficit in goods trade and outflows under investment income were more than offset by higher surplus in services trade and increase in remittances.
- The capital account surplus eased to 0.8% of GDP (USD7.7bn) from 1.4% (USD13.1bn) in Q1-FY25. There was a moderation in FDI flows and NRI deposits, even as FPI flows improved year-on-year. The balance on banking capital, which partly captures the RBI's intervention in the foreign exchange market, remained negative for the third straight quarter, albeit to a lesser degree.
- The surplus in overall balance of payments moderated to 0.4% of GDP (USD4.5bn) from 0.6% (USD5.2bn) in Q1-FY25. Going forward, the outlook for India's external balance hinges on developments around the impending India-US trade deal.
- Recent media reports cite thawing of tensions between India and the US and resumption of trade talks. A team of US officials was slated to visit India in the last week of August to continue negotiations but talks stalled after the US administration imposed additional 25% tariff on India as penalty for importing Russian oil, taking the tariff rate to 50% that became effective on 27-Aug. To counter the impact of high US tariffs on Indian exporters, the government is reportedly working on a support package. Additionally, India is actively negotiating and signing trade deals with other economies such as the recently concluded India-UK CETA and India-EFTA TEPA. There are also ongoing talks with the EU, Peru, Chile, Oman, and New Zealand.

BoP surplus moderated y-o-y due to lower capital account surplus that failed to offset narrower current account deficit





Current account deficit narrowed y-o-y in Q1-FY26; outlook hinges on progress around the impending India-US trade deal

- The current account deficit narrowed to 0.2% of GDP (USD2.4bn) in Q1-FY26 from 0.9% (USD8.7bn) in Q1-FY25. The steepening of deficit in goods trade and outflows under investment income were offset by higher surplus in services trade and remittances. In Q4-FY25, the current account balance had posted surplus at 1.3% of GDP (USD13.4bn).

- The capital account surplus eased to 0.8% of GDP (USD7.7bn) from 1.4% (USD13.1bn) in Q1-FY25. Net FDI flows and NRI deposits moderated, while FPI flows improved. The balance on banking capital, which partly captures the RBI's intervention in FX market, stayed negative for third quarter, albeit to lesser extent, and nonetheless a reversal from positive balance in the same quarter a year ago. In Q4-FY25, capital account had posted deficit at 0.5% of GDP (USD5.4bn) due to portfolio outflows and drag from short-term external loans and banking capital.

- The surplus in overall balance of payments moderated to 0.4% of GDP (USD4.5bn) from 0.6% (USD5.2bn) in Q1-FY25. In the previous quarter, the surplus was at 0.9% of GDP (USD8.8bn). Going forward, the outlook for India's external balance hinges on developments around the impending India-US trade deal.

Balance of Payments – Key highlights

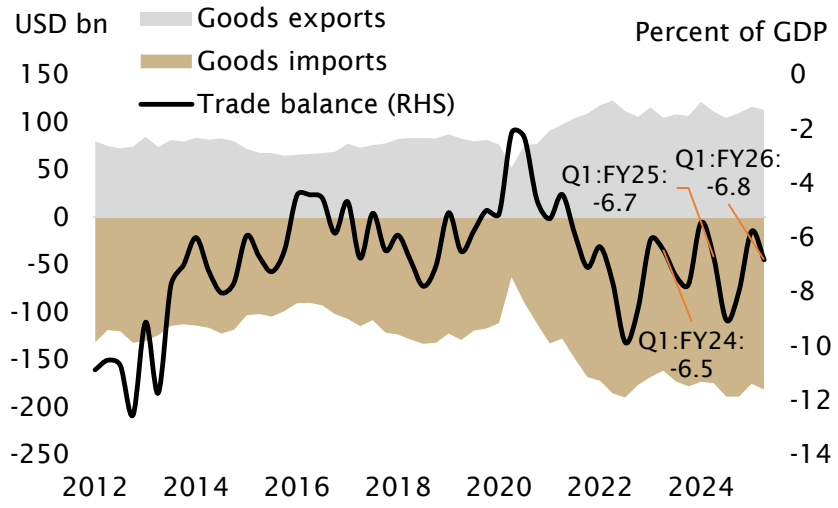
			FY25				FY26
USD bn	FY24	FY25	Q1	Q2	Q3	Q4	Q1
Current account	-26.1	-23.4	-8.7	-16.8	-11.3	13.4	-2.4
% of GDP	*-0.7*	*-0.6*	*-0.9*	*-1.8*	*-1.1*	*1.3*	*-0.2*
Trade balance	-244.9	-287.2	-63.8	-84.6	-79.3	-59.5	-68.5
Merchandise exports	441.4	441.8	111.2	104.5	109.8	116.3	113.1
Merchandise imports	686.4	729.0	175.0	189.2	189.1	175.8	181.6
Invisibles	218.8	263.9	55.1	67.8	68.0	72.9	66.1
Services	162.8	188.8	39.7	44.6	51.2	53.3	47.9
Transfers	105.8	123.4	26.3	32.4	33.2	31.5	31.0
Income	-49.7	-48.4	-10.9	-9.2	-16.4	-11.9	-12.8
Capital account	89.4	16.9	13.1	35.9	-26.6	-5.4	7.7
% of GDP	*2.5*	*0.4*	*1.4*	*3.8*	*-2.7*	*-0.5*	*0.8*
FDI	10.2	1.0	6.2	-2.8	-2.8	0.4	5.7
FPI	44.1	3.6	0.9	19.9	-11.4	-5.9	1.6
Loans	6.5	29.3	5.1	9.4	9.1	5.7	6.0
of which, ECB	-0.1	15.9	1.5	2.0	4.4	8.0	4.5
of which, ST credit	-0.8	7.2	2.2	5.3	4.0	-4.4	0.7
Banking capital	40.5	-9.8	2.9	6.1	-9.8	-9.0	-1.6
of which, NRI deposits	14.7	16.2	4.0	6.2	3.1	2.8	3.6
Others	-11.8	-7.1	-2.0	3.3	-11.7	3.4	-4.0
Errors and omissions	0.3	1.4	0.8	-0.5	0.3	0.8	-0.8
Balance of payments	63.7	-5.0	5.2	18.6	-37.7	8.8	4.5
% of GDP	*1.7*	*-0.1*	*0.6*	*2.0*	*-3.8*	*0.9*	*0.4*

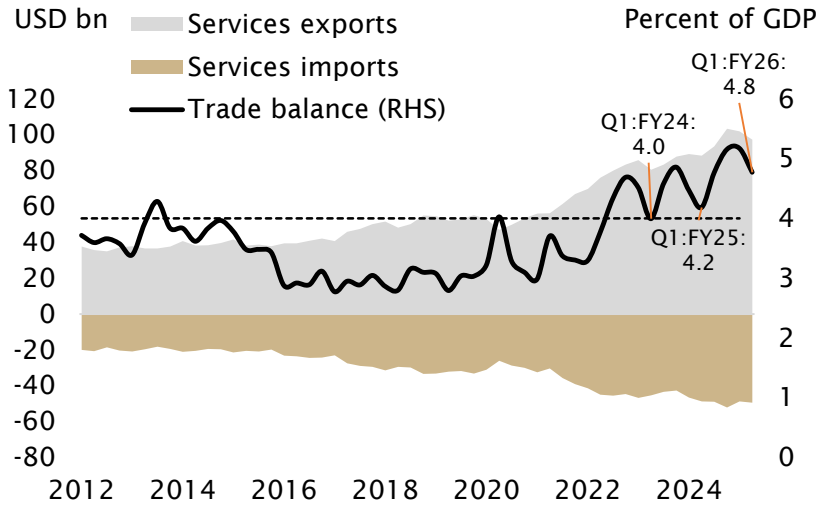
Current account continued to benefit from high services trade surplus that partly offset the y-o-y widening in goods deficit

- In Q1-FY26, merchandise trade deficit widened to USD68.5bn (6.8% of GDP) from USD63.8bn (6.7% of GDP) in Q1-FY25. The deficit was also wider sequentially from USD59.5bn (5.8% of GDP) in Q4-FY25. The year-on-year growth in both exports and imports moderated from the same quarter a year ago but imports continued to outpace exports growth.
  - Sequentially, exports fell from Q4-FY25, while imports increased quarter-on-quarter.
  - In terms of share in GDP, goods trade (exports plus imports) moderated year-on-year but increased quarter-on-quarter to 29.3% of GDP.

- In Q1-FY26, services trade surplus improved year-on-year to USD47.9bn (4.8% of GDP) from USD39.7bn (4.2% of GDP) in Q1-FY25. However, the surplus was lower than USD53.3bn (5.2% of GDP) in Q4-FY25. The year-on-year growth in services exports remained in double digits for the fourth straight quarter and was higher than growth in the same quarter a year ago, amid moderation in imports growth.
  - Sequentially, services exports remained in contraction for the second consecutive quarter, while imports increased quarter-on-quarter after declining in Q4-FY25.
  - In terms of share in GDP, services trade (exports plus imports) was stable from the previous quarter at 14.6% of GDP and marked a fractional improvement from 14.5% in the same quarter a year ago.

Goods trade deficit widened year-on-year and quarter-on-quarter; services surplus stayed above 4.5% of GDP in Q1-FY26



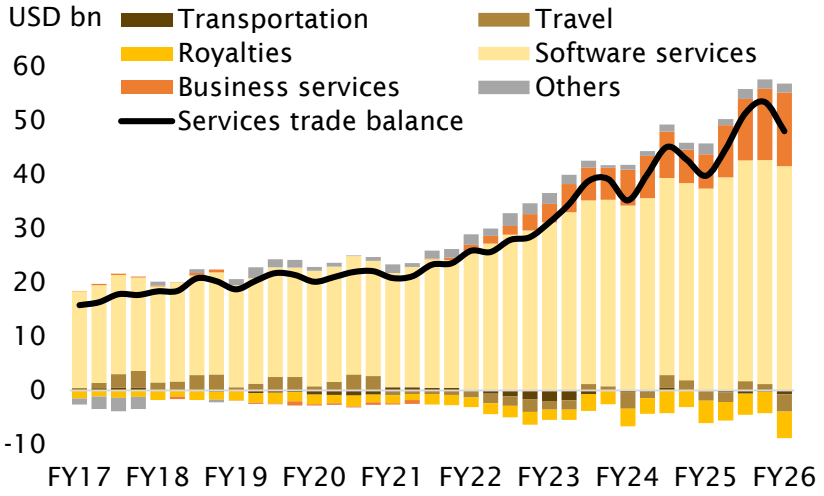


Software, business services exports drove services trade surplus higher year-on-year in Q1-FY26

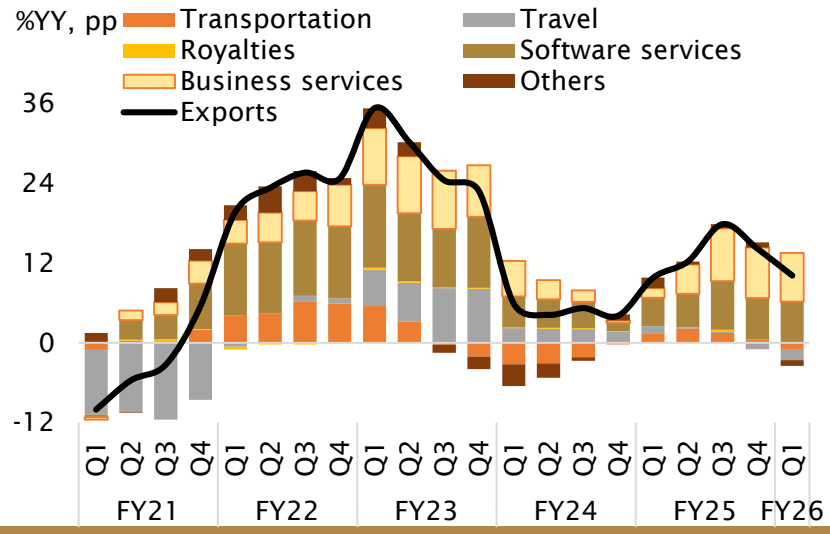
- In Q1-FY26, the improvement in year-on-year services exports growth vis-à-vis Q1-FY25 was due to increased contribution from software and business services that offset the fall in exports of travel and transportation services. In case of imports, the moderation in year-on-year growth, compared to the same quarter of Q1-FY25 was due to decline in imports of travel, transport, business and other services that offset higher imports of software services and increase in royalty payments.

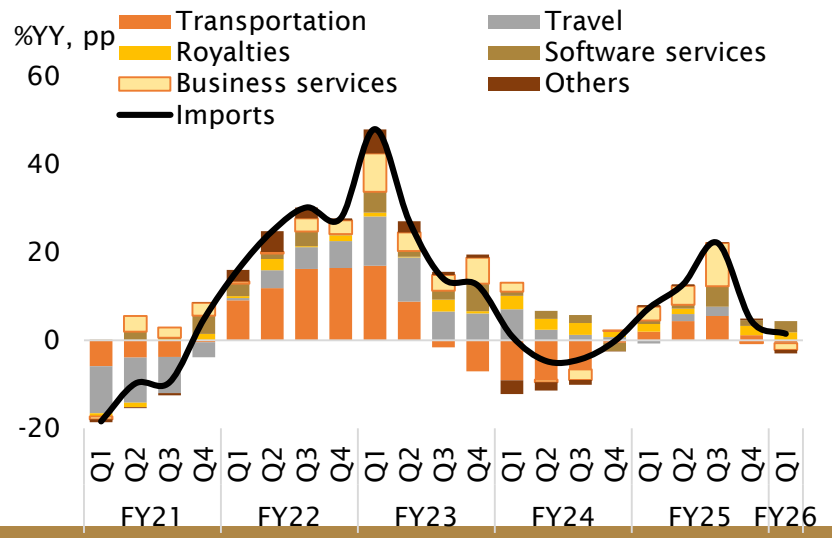
- Software and business services were also the segments that drove services surplus higher year-on-year, and offset the steepening of deficits in travel, transport and royalty payments.

Services surplus was higher year-on-year in Q1-FY26



Services exports posted double-digit year-on-year growth for fourth straight quarter; imports growth moderated





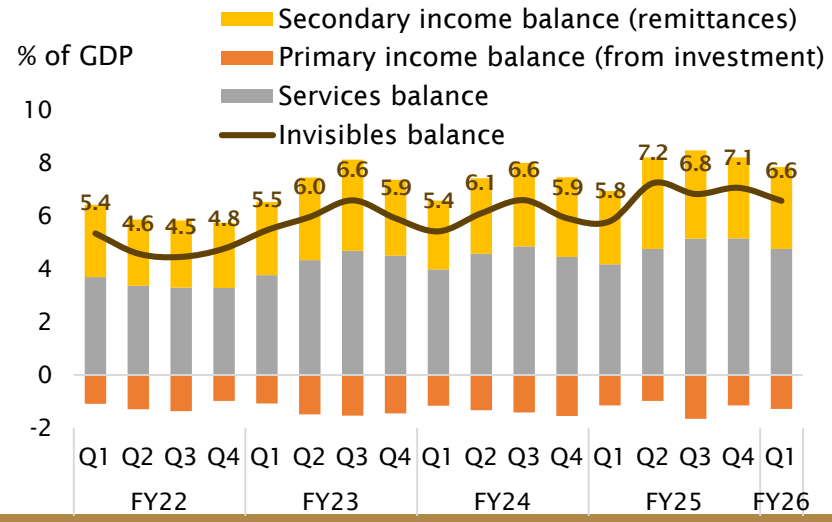
In Q1-FY26, remittances and services surplus continued to offset primary income outgo under invisibles trade balance

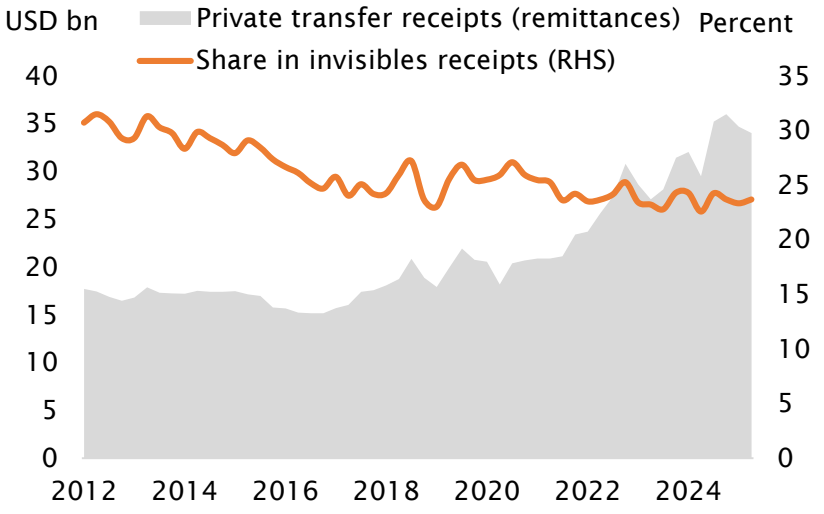
- Invisibles comprises of trade in services, primary and secondary income accounts. Primary income account mainly reflects payments of investment income, while secondary income consists of transfers, both private and official. Within this, private transfer receipts reflects remittances by Indians employed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

- In Q1-FY26, the balance on invisibles trade improved to USD66.1bn (6.6% of GDP) from USD55.1bn (5.8% of GDP) in Q1-FY25. However, compared to the previous quarter, there was a moderation in surplus from USD72.9bn (7.1% of GDP). The year-on-year increase in surplus was driven by services trade and remittances that more than offset higher net outgo under primary income or income from investments.

- Private transfer receipts or remittances increased 15.3%YY to USD34.0bn from USD29.5bn in Q1-FY25. This marked an increase from around 8%-9%YY growth in the previous quarter and in Q1-FY25. But sequentially, remittances have declined quarter-on-quarter in the past two quarters, even as they have remained in the ballpark of around USD35bn in the last four quarters. Despite the onset of ongoing tariff wars, two trends continue to persist in the post-pandemic period 1) higher remittances that have averaged around USD27bn each quarter, up from the average of around USD18bn between FY13-20 2) expansion in services trade that have dragged share of remittances in invisibles surplus 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

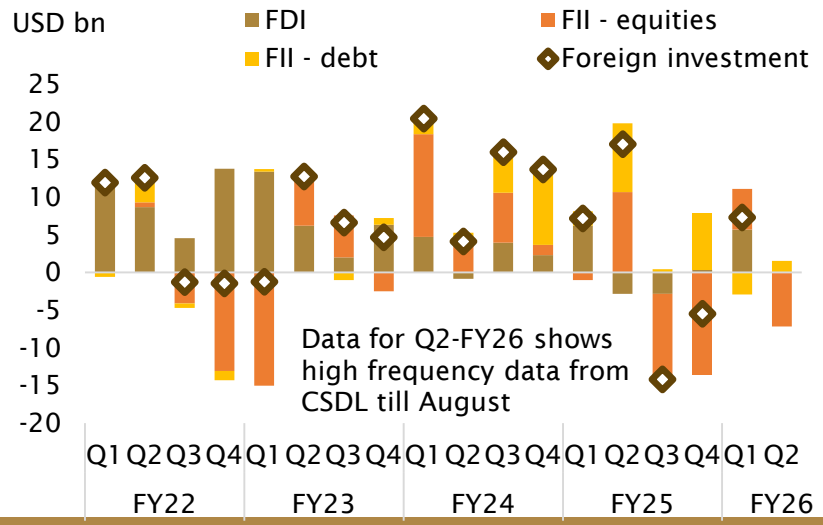


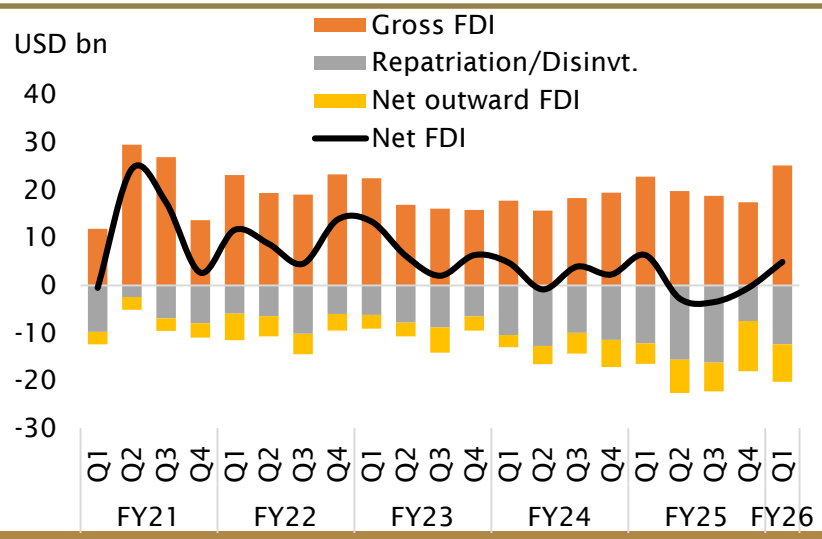


Net foreign investment turned positive in Q1 amid net equity inflows, positive FDI flows that offset outflows from debt

- Net foreign investment turned positive in Q1-FY26 after posting outflows for two quarters. Net inflows stood at USD7.3bn (0.7% of GDP), compared to USD7.2bn (0.8% of GDP) in Q1-FY25. Net inflows of institutional and direct investment were positive in Q1, but net FDI inflows moderated year-on-year, while FPI inflows increased.
  - Foreign portfolio investment turned positive after two quarters to USD1.6bn (0.2% of GDP), up from USD0.9bn in Q1-FY25 (0.1% of GDP). Net FDI improved from the previous quarter, though marked a moderation to USD5.7bn (0.6% of GDP) in Q1-FY26 from USD6.2bn (0.7% of GDP) in Q1-FY25.
  - In Q1-FY26, there were inflows into equities after two straight quarters of selloff, but outflows from debt for the first time in 10 quarters. The net inflows into equities were USD5.4bn, compared to net outflows of USD1.0bn in Q1-FY25. Debt outflows amounted to USD2.9bn in Q1-FY26 versus inflows of USD1.9bn in the same quarter of FY25. High frequency data for Q2-FY26 till August shows that there were outflows from equities and inflows into debt. The ongoing tariff-related uncertainties could continue to weigh on sentiment for foreign investment flows, though increased net FDI inflows in Q1 offered some respite.
  - High frequency data on FDI from the RBI shows that even as net FDI was positive but lower year-on-year in Q1, gross FDI increased to USD25.2 from USD22.8 in Q1-FY25. The moderation in net inflows was due to repatriation and net outward FDI. The extent of disinvestment was similar to last year's level in Q1 at around USD12bn, so that the decrease in net FDI inflow was driven by higher net outward FDI.

Net foreign investment was positive in Q1 due to net equity inflows, positive FDI flows that offset outflows from debt

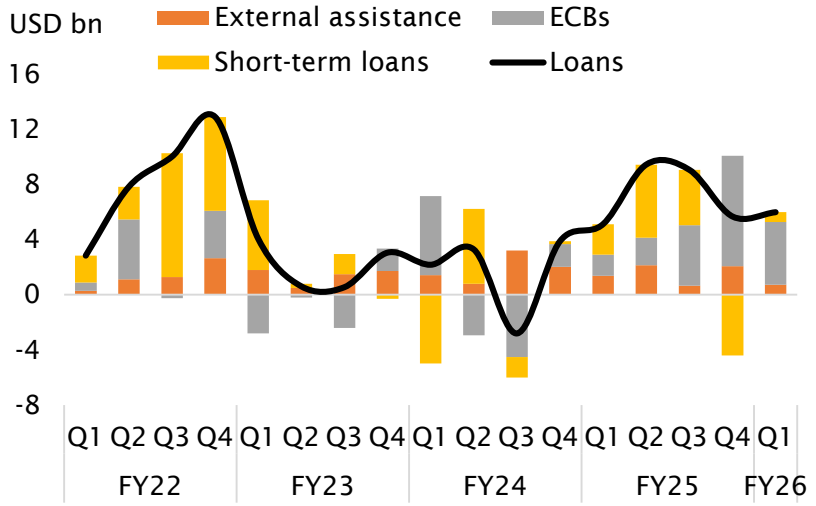


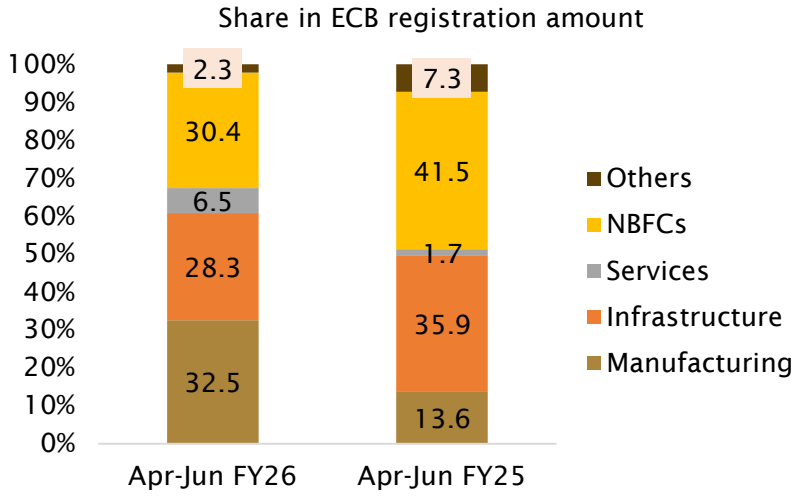


Net inflows from external loans increased year-on-year and quarter-on-quarter in Q1-FY26

- In Q1-FY26, net inflows from external loans within the capital account were up year-on-year and quarter-on-quarter. These amounted to USD6.0bn versus USD5.1bn in Q1-FY25. The increase was led by external commercial borrowings (ECBs) that offset moderate inflows from external assistance and short-term loans. Even as ECBs increased year-on-year to USD4.5bn in Q1, they eased from 20-quarter high of USD8bn in the previous quarter. Despite being lower year-on-year, the positive inflows of short-term loans in Q1 implied that disbursements exceeded repayments, a reversal from the trend in the previous quarter.
  - Data on ECB registrations for Q1-FY26 showed that manufacturing firms topped the share in amount raised. This was followed by NBFCs and infrastructure firms that saw year-on-year fall in share.
  - In case of short-term loans for trade, there were repayments in case of loans of up to six months' and no disbursements or credit extended by overseas suppliers for imports into India. This drove the year-on-year moderation in short-term loans to India. In case of loans over six months' duration, disbursements exceeded repayments, in line with the trend in Q1-FY25, but by a higher amount.
- In Q1-FY26, the year-on-year moderation in capital account surplus was due to 1) lower net FDI inflows 2) lesser short-term external loans 3) outflows under banking capital account (assessed in the next slide) 4) higher outflows under 'other' capital account that captures the leads and lags in exports receipts, and transactions not included elsewhere. In Q4-FY25, there were net inflows under the 'other' component.

In Q1-FY26, external loans rose y-o-y and q-o-q; manufacturing and NBFCs topped share in ECB registration amount

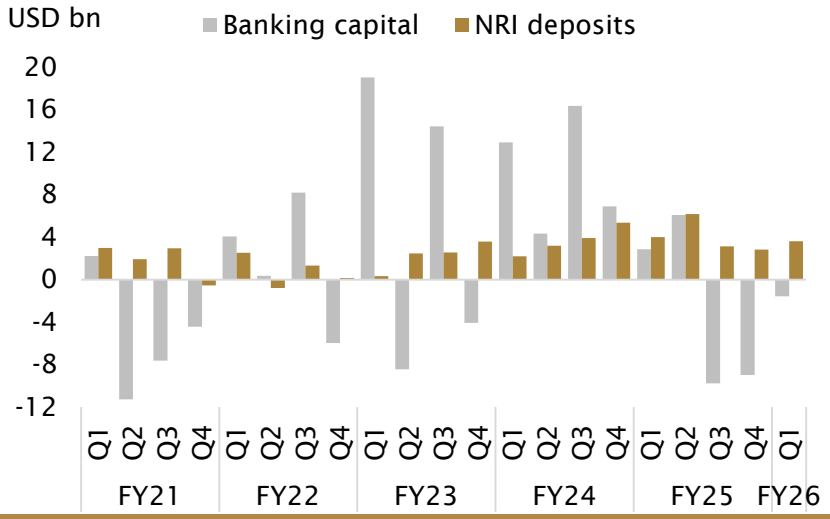


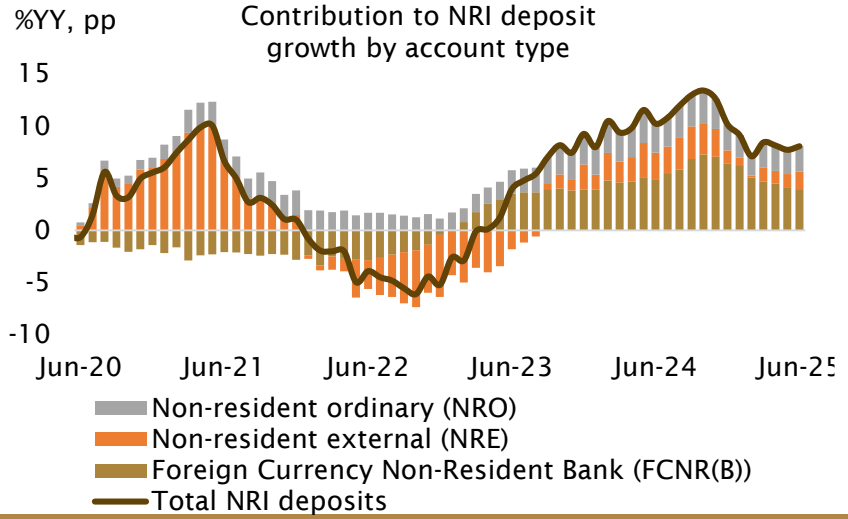


Banking capital flows remained negative on likely FX intervention, though to a lesser extent; NRI deposits remained firm

- 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).
- The balance on banking capital remained negative for the third successive quarter in Q1-FY26, though to a lesser extent of (-)USD1.6bn, compared to the average level of (-)USD9.4bn in the previous two quarters. In Q1-FY25, banking capital account had posted surplus of USD2.9bn. The balance on commercial banks' assets stayed negative for the sixth consecutive quarter, partly reflecting RBI intervention in the foreign exchange market to curb excessive volatility in the INR.
- NRI deposit flows moderated year-on-year to USD3.6bn in Q1-FY26 from USD4.0bn in Q1-FY25. But there was a sequential increase from USD2.8bn in the previous quarter. High frequency monthly data from the RBI shows that by account type, NRE account continued to comprise the largest portion of total NRI deposits in Q1 at over 60%, while the other two types constituted around 20% share each. But the contribution to year-on-year growth in total deposits remained the strongest from the FCNR(B) account due to high growth rate.

Banking capital stayed negative for third straight quarter; FCNR(B) account added the most to NRI deposit growth in Q1



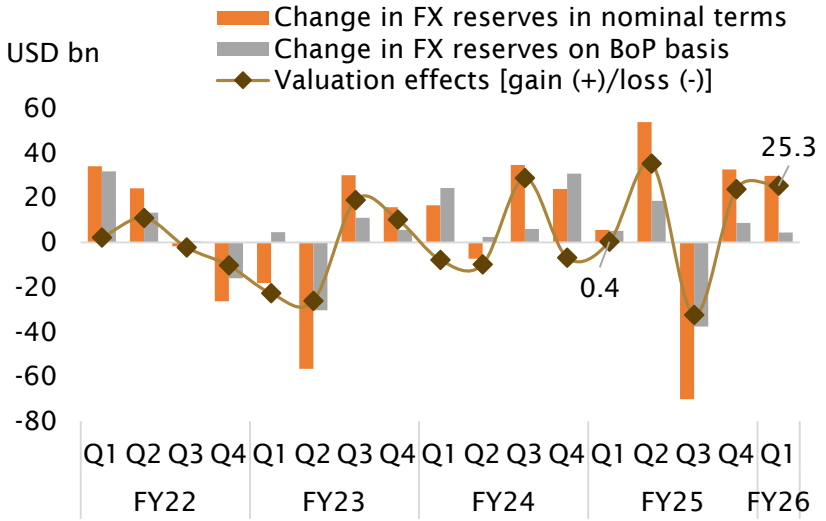


High gold prices, weak USD continued to drive valuation gains in FX reserves in Q1-FY26

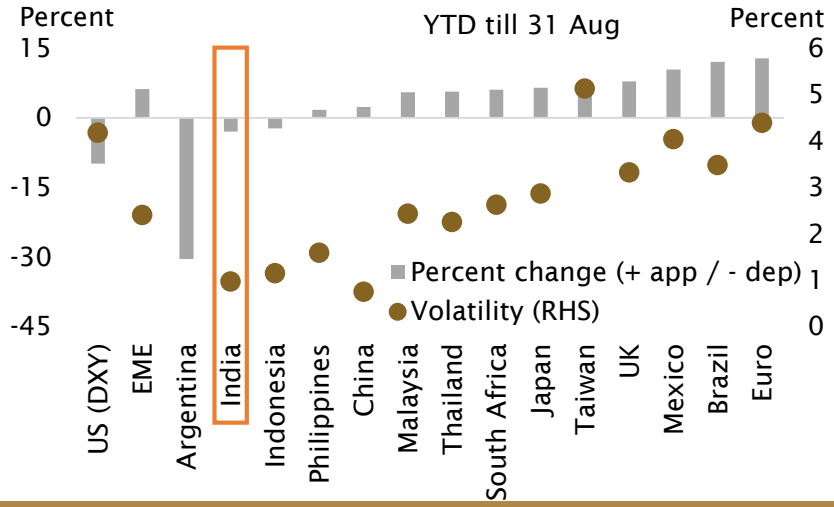
- On a balance of payment basis, which excludes valuation effects, foreign exchange reserves increased by USD4.5bn in Q1-FY26, compared to USD5.2bn in Q1-FY25. In nominal terms, which includes valuation effects, FX reserves rose by USD29.8bn, greater than the increase of USD5.6bn in the same quarter of FY25. The valuation gain of USD25.3bn, higher than USD0.4bn in Q1-FY25 mainly reflected the depreciation of USD against major currencies and higher price of gold.

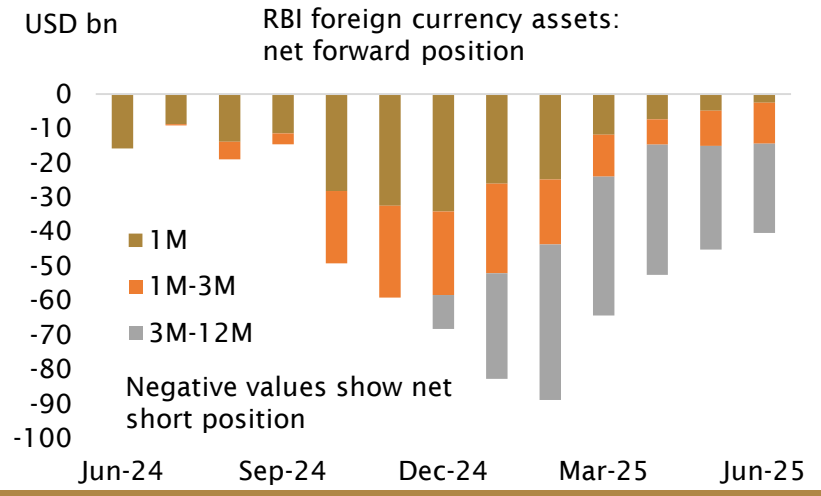
- In Q1, the RBI pruned its USD net short forward book and turned into a net buyer of USD (combined spot and forward positions) after remaining a net seller between Oct-Feb FY25. On calendar year-to-date basis, the USDINR continues to underperform relative to its peers.

Valuation gain in Q1-FY26 higher year-on-year



In calendar year-to-date terms, the USDINR has underperformed compared to peers; RBI partly unwound short USD positions in Q1-FY26 after being net USD seller between Oct-Feb FY25

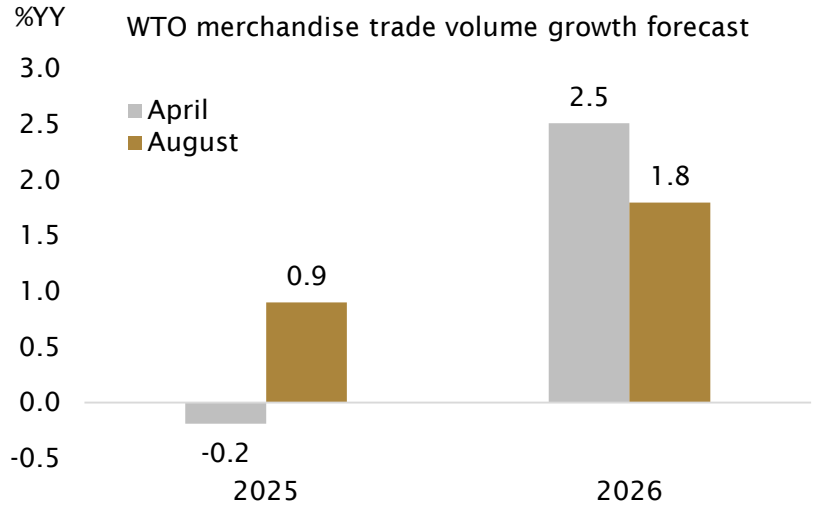




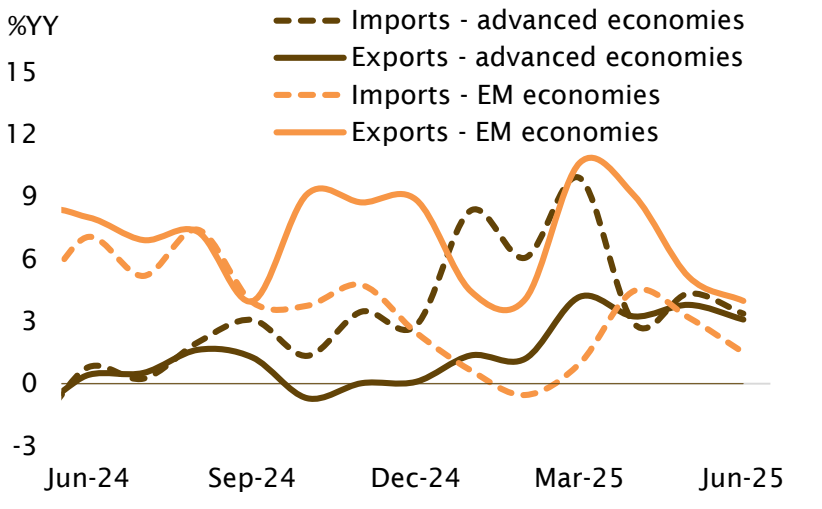
Beyond the frontloading of trade ahead of US tariffs implementation, global trade outlook for 2026 remains weak

- In its interim forecast update published in August, the WTO raised 2025 global merchandise trade volume growth forecast to 0.9% from the decline of (-)0.2% expected earlier in its April update. The key reason for the upgrade was frontloading of imports and inventory accumulation in the US. But the agency lowered forecast for 2026 to 1.8% from 2.5%, as US reciprocal tariffs, effective August 7, are expected to weigh on global trade in H2-2025 and in 2026. Data till June shows that export volume growth from emerging market economies moderated post Mar-2025, and is also reflected in lower import volume of advanced economies.
- A team of US officials was slated to visit India in the last week of August to continue negotiations for a trade deal between the two economies but talks stalled after the US administration imposed additional 25% tariff on India as penalty for importing Russian oil, taking the tariff rate to 50% that became effective on 27-Aug. Recent media reports cite thawing of tensions between the two economies and resumption of trade talks. To counter the impact of high US tariffs, Union Minister of Finance Smt. Nirmala Sitaraman noted in a recent television interview the government is working on a support package for Indian exporters hit by US tariffs. Media reports cite that for this purpose, the government could use a portion of Rs.2,250 crore earmarked for Export Promotion Mission under the Department of Commerce in the Union Budget for FY26. Among other steps to counter global trade uncertainties, India is actively signing trade deals with other economies such as the recently concluded India-UK CETA and India-EFTA TEPA. There are also ongoing talks with the EU, Peru, Chile, Oman and New Zealand.

WTO raised trade forecast for 2025; cut for 2026



EM export, AE import volume growth has eased



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