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Outlook on Current Account Deficit

CAD of 1.2% of GDP in Q2 FY2025 narrower than forecast; surge in gold imports to widen it to nine-quarter high of 2.6% in Q3

DECEMBER 2024

Highlights

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India's CAD widened to $11.2 billion (-1.2% of GDP) in Q2 FY2025 from $10.2 billion (-1.1% of GDP) in Q1

This was led by a larger merchandise trade deficit in Q2 vis-à-vis Q1, which outweighed the uptick in services trade surplus

ICRA expects CAD to widen to ~2.6% of GDP in Q3 FY2025 amid larger merchandise trade deficit; CAD to print at ~1.1% of GDP in FY2025 and ~1.0% of GDP in FY2026

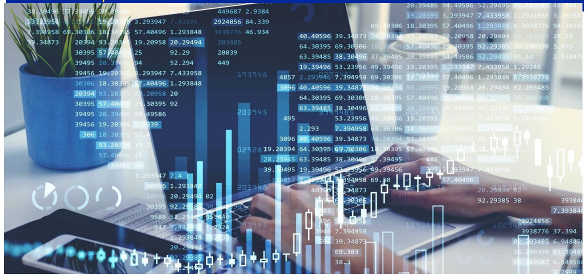
- India's current account deficit (CAD) widened slightly to $11.2 billion (-1.2% of GDP) in Q2 FY2025 from $10.2 billion (-1.1% of GDP) in Q1 FY2025. However, it printed marginally below the year-ago level (-$11.3 billion; -1.3% of GDP), and also trailed ICRA's forecast (-$17.0 billion; -1.9% of GDP).
- The sequential widening in the CAD in Q2 FY2025 was led by a larger merchandise trade deficit (to $75.3 billion in Q2 FY2025 from $65.1 billion in Q1 FY2025), which more than offset the uptick in the services trade surplus (to a three-quarter high of $44.5 billion from $39.7 billion).
- On a year-on-year (YoY) basis, the earnings from invisibles rose by ~20% YoY to $64.2 billion in Q2 FY2025 from $53.3 billion in Q2 FY2024. This offset the YoY widening in the merchandise trade deficit, thereby leading to a slightly narrower CAD in that quarter compared to Q2 FY2024.
- Net financial flows doubled to $30.5 billion in Q2 FY2025 from $14.6 billion in Q1 FY2025 led by the FPI inflows, which outpaced the widening in the CAD between these quarters, leading to a higher accretion to reserves amounting to $18.6 billion in the quarter, as against $5.2 billion seen in Q1.
- Owing to the sharp enlargement in the merchandise trade deficit in October-November FY2025, ICRA expects the CAD to widen sharply to a nine-quarter high of ~2.6% of GDP in Q3 FY2025 from 1.2% of GDP in Q2 FY2025, unless there is a meaningful revision in the gold import figures.
- Overall, ICRA projects the CAD to widen to $40-42 billion in FY2025 or 1.1% of GDP (-$26.0 billion; -0.7% of GDP in FY2024). Thereafter, it is likely to print at ~1.0% of GDP in FY2026 (baseline), even as the outlook is clouded with risks owing to the imposition of tariffs by the US.
- While the INR may weaken over the next few trading sessions, ICRA expects it to stabilise in the remainder of January 2025. With India's macros appearing favourable, ICRA expects the USD/INR pair to trade between 85 and 87 in the immediate term, amidst heightened global volatility.

Outline

1 Developments in India's Balance of Payments during Q2 FY2025

2 Preliminary October-November 2024 trends and outlook for Q3 FY2025

3 Outlook on CAD and INR



Developments in India’s BOP in Q2 FY2025

QoQ surge in net financial flows pushed up reserve asset accretion to $18.6 billion in Q2 FY2025

India's CAD widened to lower-than-expected $11.2 billion or 1.2% of GDP in Q2 FY2025

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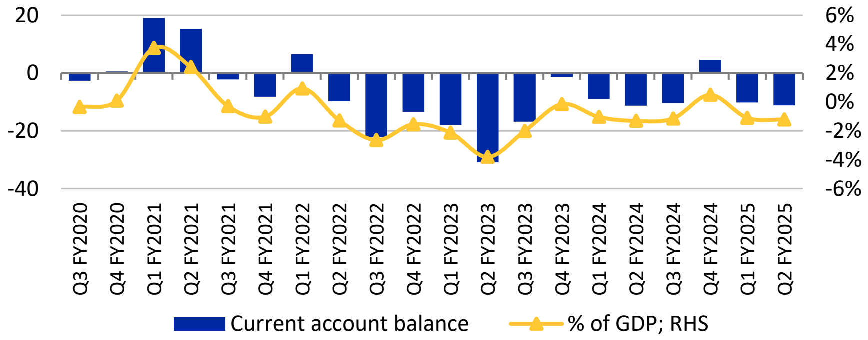
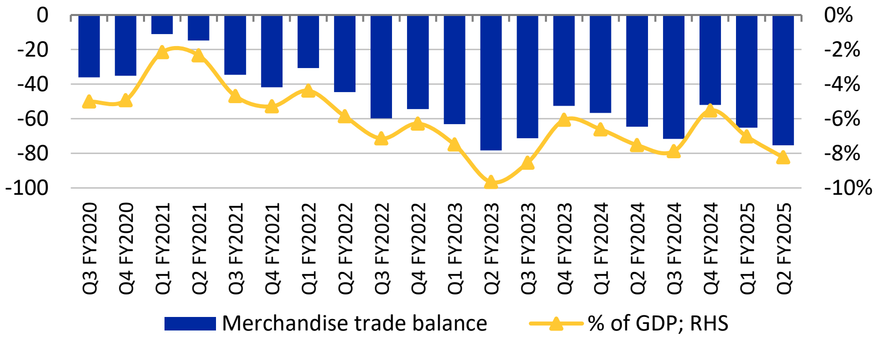
EXHIBIT: Current Account Balance – $ billion and % of GDP



"-" denotes outflows and vice versa; Source: RBI; CEIC; ICRA Research

EXHIBIT: Merchandise Trade Balance - $ billion and % of GDP



"-" denotes outflows and vice versa; Source: RBI; CEIC; ICRA Research

- India's current account deficit widened to a lower-than-expected $11.2 billion in Q2 FY2025 (-1.2% of GDP; ICRA's exp: -$17.0 billion, -1.9% of GDP) from $10.2 billion in Q1 FY2025 (-1.1% of GDP), owing to a sequential widening in the merchandise trade deficit, even as the services trade surplus rose between these quarters. The print was marginally lower than the CAD of $11.3 billion seen in Q2 FY2024 (-1.3% of GDP), with a wider merchandise trade deficit being offset by higher invisibles earnings during this period.
- On a YoY basis, the merchandise trade deficit widened sharply to $75.3 billion in Q2 FY2025 (-8.2% of GDP) from $64.5 billion in Q2 FY2024 (-7.5% of GDP), amid a contraction in exports (-4.0%), even as imports saw a YoY expansion (+3.8%).
  - The imports of petroleum, crude and products fell by a sharp 11.2% YoY in Q2 FY2025 (to $37.4 billion in Q2 FY2025 from $42.1 billion in Q2 FY2024), led by a 9.3% dip in the price of the Indian basket of crude oil. In contrast, gold imports surged by 40.1% to $17.6 billion from $12.6 billion, respectively, partly led by a spike in prices in the quarter as well as the cut in the customs duty on gold (to 6.0% in July 2024 from 15.0%) announced in the Union Budget FY2025. Moreover, non-oil non-gold imports reported an increase of 5.2% YoY in Q2 FY2025, on a BoP basis.
  - In addition, oil exports declined by a sharp 30.8% YoY in Q2 FY2025, even as exports of non-oil items saw an uptick (+3.2%; on a BoP basis) during the quarter.

YoY uptick in earnings from invisibles more than offset the larger merchandise trade deficit, leading to slightly narrower CAD in Q2

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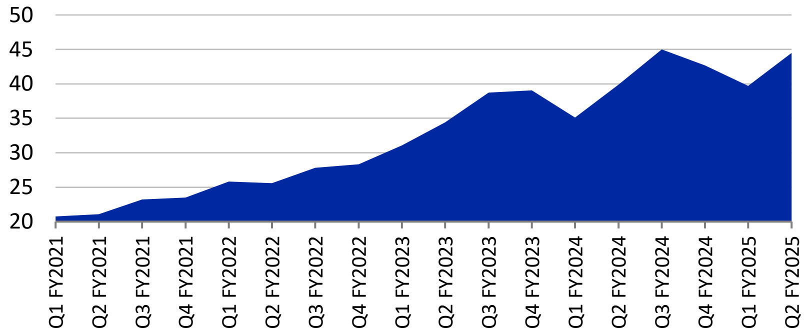
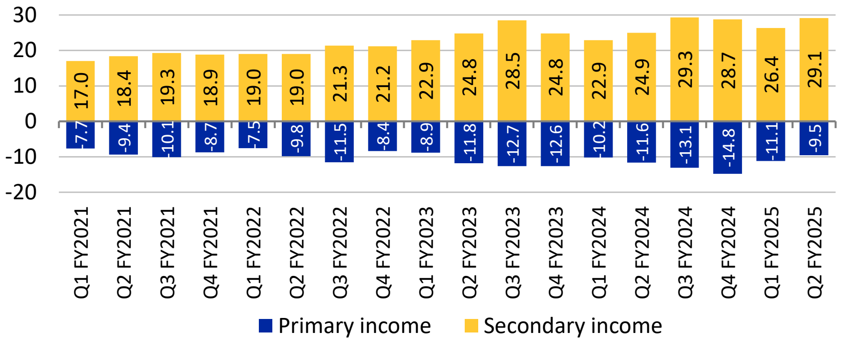
EXHIBIT: Services Trade Account - Net Flows ($ billion)



"-" denotes outflows and vice versa; Source: RBI; CEIC; ICRA Research

EXHIBIT: Secondary and Primary Income Account- Net Flows ($ billion)



"-" denotes outflows and vice versa; Source: RBI; CEIC; ICRA Research

- The services trade surplus rose to a three-quarter high of $44.5 billion in Q2 FY2025 from $39.7 billion in Q1 FY2025, while also exceeding the year-ago level of $39.9 billion in Q2 FY2024. The 11.5% YoY uptick was led by higher net earnings related to telecom, communication and information (to $39.4 billion in Q2 FY2025 from $35.6 billion in Q2 FY2024), other business services (to $9.6 billion from $7.8 billion), financial services (to $0.93 billion from $0.89 billion), and construction (to $0.31 billion from $0.28 billion), while the outflows for travel services (to -$1.7 billion from -$1.2 billion) widened between these quarters.
- Net inflows of secondary income rose by a healthy 16.8% YoY to $29.1 billion in Q2 FY2025 from $24.9 billion in Q2 FY2024, while also exceeding the Q1 FY2025 level ($26.4 billion). The YoY growth in secondary income was led by the uptick in personal transfers (to $29.3 billion from $25.3 billion). Additionally, net outflows of primary income narrowed to $9.5 billion in Q2 FY2025 (-$11.1 billion in Q1 FY2025) from $11.6 billion in Q2 FY2024, reflecting the trend for outflows of net overseas investment income (to -$11.5 billion from -$13.3 billion).
- Overall, earnings from invisibles rose by a robust 20.4% to $64.2 billion in Q2 FY2025 from $53.3 billion in Q2 FY2024 ($54.9 billion in Q1 FY2025). This has more-than-offset the YoY widening in the merchandise trade deficit, leading to a slightly narrower current account deficit in that quarter relative to Q2 FY2024.

QoQ surge in net financial flows pushed up reserve asset accretion to $18.6 billion in Q2 FY2025

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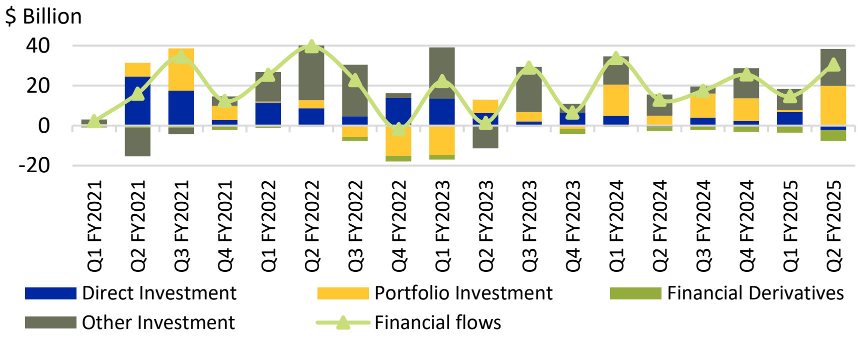
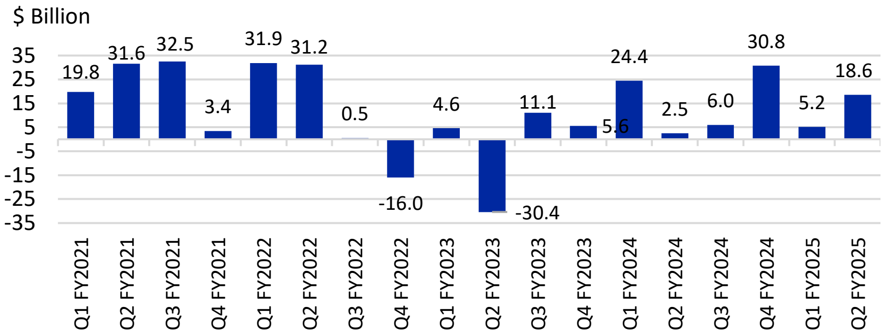
EXHIBIT: Trends in Financial flows to India ($ billion)



"-" denotes outflows and vice versa; Source: RBI; CEIC; ICRA Research

EXHIBIT: Trends in changes in India's reserve assets ($ billion)



Change in Reserve Asset [Increase (+)/Decrease (-)]; Source: RBI; CEIC; ICRA Research

- Net financial inflows to India doubled to $30.5 billion in Q2 FY2025 from $14.6 billion in Q1 FY2025, as well as $12.9 billion in Q2 FY2024.
  - On a QoQ basis, the uptick was largely driven by the surge in net FPI inflows (to a 15-quarter high +$19.9 billion in Q2 FY2025 from +$0.9 billion in Q1 FY2025, amid the inclusion of IGBs in the J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Index suite at end-June 2024), other accounts receivable/payable (to +$4.8 billion from +$2.0 billion), and NRI deposits (to $6.2 billion from $4.0 billion), even as net FDI witnessed a sharp turnaround to outflows for the first time in last three quarters in Q2 FY2025 (to -$2.2 billion from +$6.7 billion in Q1 FY2025).
  - Compared to Q2 FY2024, the improvement was largely driven by net FPI inflows (to +$19.9 billion in Q2 FY2025 from +$4.9 billion in Q2 FY2024), NRI deposits (to +$6.2 trillion from +$3.2 billion), and loans (external assistance, ECBs and banking capital; to +$3.8 billion from -$1.0 billion).
- Overall, the widening in the current account deficit was outpaced by the QoQ surge in net capital/financial flows in Q2 FY2025, leading to a sharp uptick in the accretion of reserve assets to $18.6 billion in that quarter (+$2.5 billion in Q2 FY2024) from $5.2 billion in Q1 FY2025 (on a BoP basis). This was significantly lower than the $52.9 billion increase in India's foreign exchange reserves during that quarter, with the latter partly being boosted by valuation gains during the quarter.

Current account deficit for Q1 FY2025 revised downwards, owing to higher-than-estimated primary income outflows

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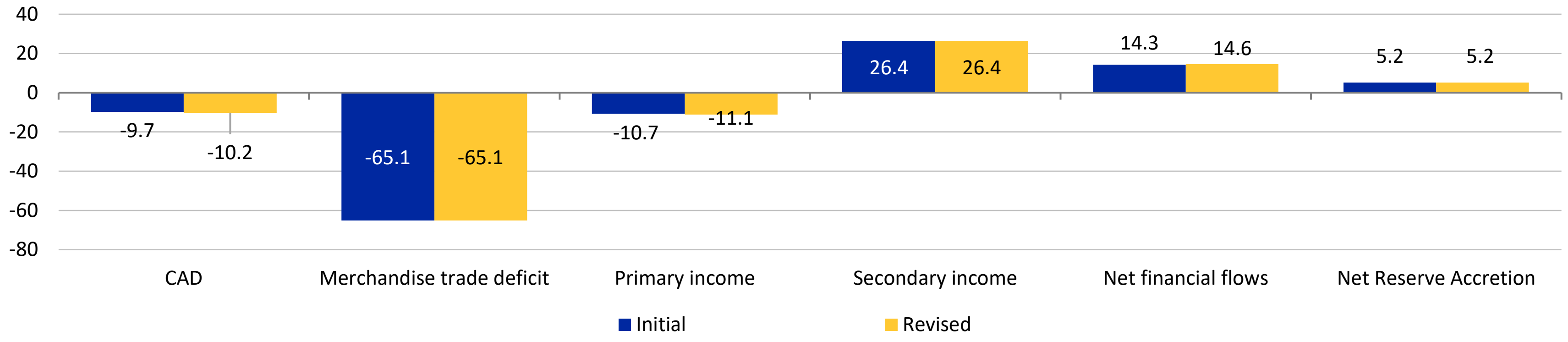
EXHIBIT: Revisions in Q1 FY2025 Balance of Payments data ($ billion)

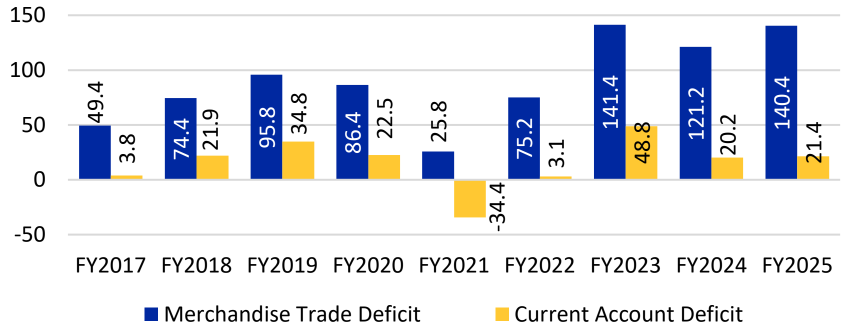


Source: RBI; CEIC; ICRA Research

- The size of current account deficit for Q1 FY2025 underwent a revision to $10.2 billion from the initial estimate of $9.7 billion, largely on account of larger-than-estimated outflows under primary income account (to -$11.1 billion from -$10.7 billion), even as the secondary income inflows and merchandise trade deficit remain unchanged at their initially reported levels.
- The quantum of financial flows in Q1 FY2025 (to +$14.6 billion from +$14.3 billion) underwent a slight upward revision, which resulted in the net reserve accretion for the quarter remaining unchanged at $5.2 billion.

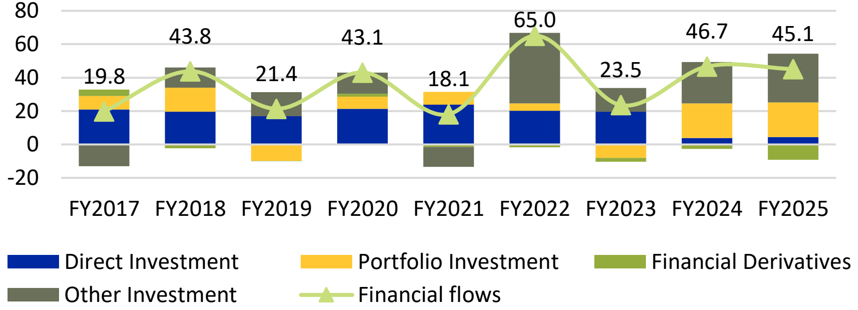
India's CAD rose modestly to $21.4 billion in H1 FY2025 from $20.2 billion in H1 FY2024

EXHIBIT: Trends in current account deficit and merchandise trade deficit in H1 FY2017-25 ($ billion)



Source: RBI; CEIC; ICRA Research

EXHIBIT: Trends in financial flows in H1 FY2017-25 ($ billion)



Source: RBI; CEIC; ICRA Research

- India's CAD widened to $21.4 billion in H1 FY2025 (-1.2% of GDP) from $20.2 billion in H1 FY2024 (-1.2% of GDP). The YoY widening in merchandise trade deficit (to -$140.4 billion from -$121.2 billion) in H1 FY2025 more-than-offset the increase in services trade surplus (to +$84.2 billion from +$75.1 billion) and net inflows on the secondary income account (to +$55.5 billion from +$47.8 billion). Besides, the net outgo under primary income (to -$20.7 billion from -$21.8 billion) moderated in H1 FY2025 compared to H1 FY2024.
- Additionally, net financial flows eased to $45.1 billion in H1 FY2025 from $46.7 billion in H1 FY2024, primarily dragged by the larger outflows under financial derivatives (to -$9.1 billion from -$2.6 billion), which was partly offset by the increase in net FDI inflows (to $4.4 billion from $3.9 billion), other investments (to $29.0 billion from $24.7 billion), and net FPI inflows (to $20.8 billion from $20.7 billion).
- Overall, the CAD was $1.2 billion larger in H1 FY2025 vis-à-vis H1 FY2024 and net financial flows eased by $1.6 billion in this period, that resulted in a lower reserve accretion (on a BoP basis) of $23.8 billion in H1 FY2025, as compared to that seen in H1 FY2024 ($27.0 billion).

Preliminary trends for Oct-Nov 2024 and outlook for Q3 FY2025

Current account deficit expected to enlarge to ~2.6% of GDP in Q3 FY2025

YoY growth in merchandise imports during October-November FY2025 sharply outpaced that seen in such exports

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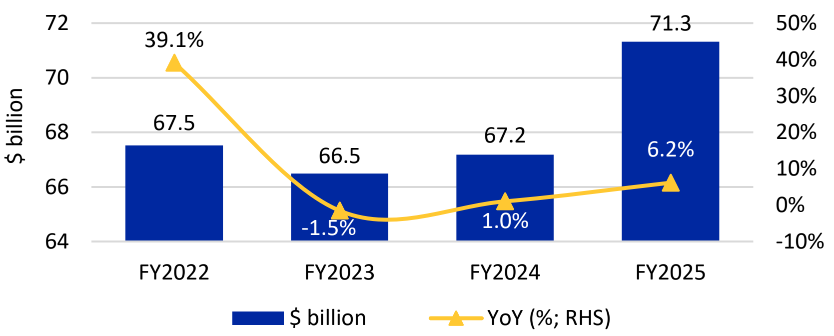
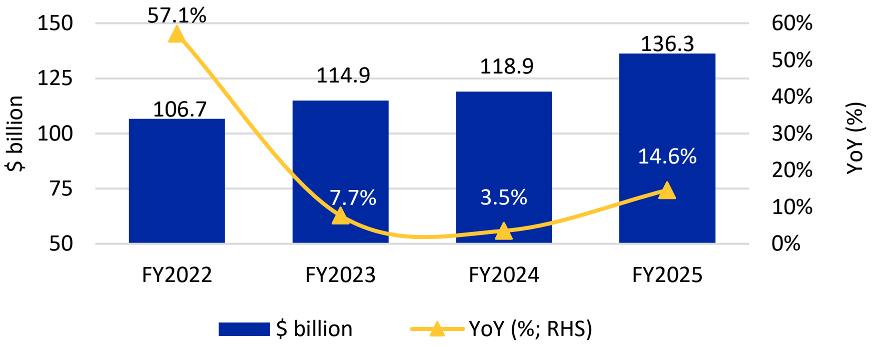
EXHIBIT: Trends in Merchandise Exports in October-November FY2022-25



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

EXHIBIT: Trends in Merchandise Imports in October-November FY2022-25



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

- As per the provisional data released by Ministry of Commerce and Industry, India's merchandise exports rose by 6.2% YoY to $71.3 billion during October-November FY2025 from $67.2 billion during October-November FY2024 (Oct 2024: +17.2%; Nov 2024: -4.8%; Q2 FY2025: -3.9%). This was entirely driven by the YoY uptick in non-oil exports (+16.9%), partly offset by the sharp contraction in petroleum crude exports (-37.4%). The uptick of $4.1 billion in non-oil exports during October-November FY2025 was driven by engineering goods (+$4.3 billion), electronic goods (+$2.3 billion), agri products (+$1.6 billion) etc. Moreover, the monthly average merchandise exports during October-November FY2025 ($35.7 billion) was only marginally higher than the levels seen in H1 FY2025 ($35.5 billion).
- Additionally, merchandise imports rose by a much higher 14.6% YoY to $136.3 billion during October-November FY2025 from $118.9 billion during October-November FY2024 (Oct: +3.9%; Nov: +27.0%; Q2: +4.0%). This was largely driven by the surge in gold imports (+106.0%; as per news reports, this could have been driven by a calculation error and may undergo a downward revision in the subsequent data releases). This was followed by a relatively lower uptick in imports of crude petroleum and products (+10.7%) and non-oil non gold articles (+3.5%). The YoY growth in non-oil non-gold imports during October-November FY2025 was largely driven by agri products (YoY: +$1.9 billion), electronic goods (+$1.7 billion), electrical and non-electrical machinery (+$0.9 billion), etc. Notably, the monthly average merchandise imports during October-November FY2025 ($68.1 billion) sharply outpaced the levels seen during H1 FY2025 ($58.4 billion).

Merchandise trade deficit likely to widen in Q3 FY2025

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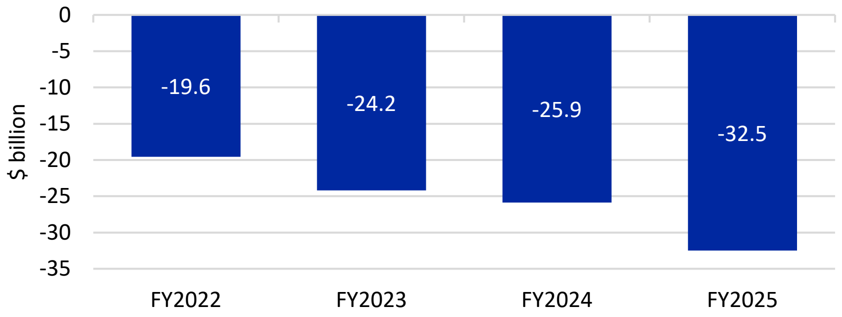
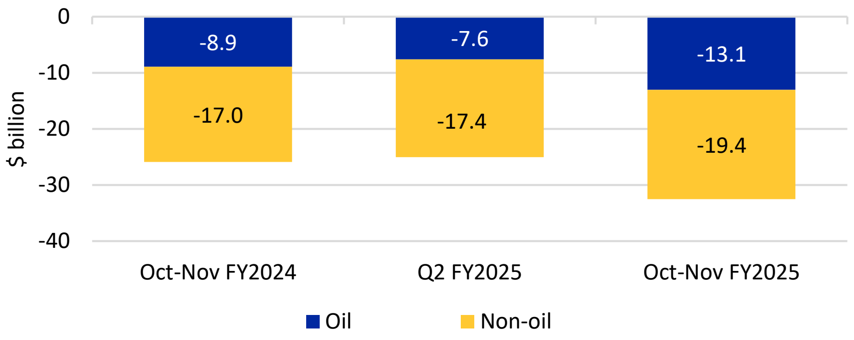
EXHIBIT: Monthly Average Trends in Merchandise Trade Balance in October-November FY2022-25



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

EXHIBIT: Monthly Average Trends in Trade Balance of Oil and Non-oil items



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

- With the pace of YoY expansion in merchandise imports (+14.6%) sharply exceeding that in such exports (+6.2%) during October-November FY2025, the average monthly trade deficit widened sharply to $32.5 billion in the period from $25.9 billion during October-November FY2024. This was driven by higher average deficits for both oil and non-oil items.
- In sequential terms, the monthly average trade deficit during October-November FY2025 was much higher than the levels seen in Q2 FY2025 ($24.7 billion), led by both non-oil (to -$19.4 billion from -$17.4 billion; amid the sharp surge in gold imports) and oil (to -$13.1 billion from -$7.6 billion) items. Moreover, the monthly average trade deficit during October-November FY2025 outpaced the levels seen during H1 FY2025 (-$22.9 billion).
- **With the $13.2 billion uptick in the merchandise trade deficit during October-November 2024 relative to the year-ago levels, based on the initial data, ICRA expects the same to widen sharply to as much as $87-89 billion in this quarter ($75.3 billion in Q2 FY2025) from $71.6 billion in Q3 FY2024 (on a BoP basis), unless there is a meaningful revision in the gold import figures.**

India's CAD to enlarge to ~2.6% of GDP in Q3 FY2025, highest level seen in two years

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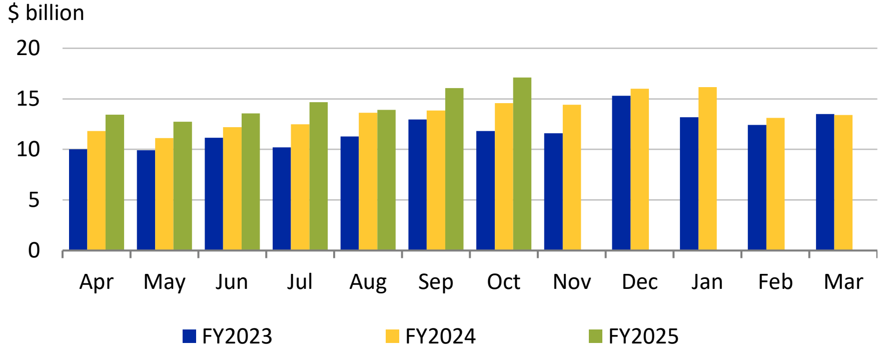
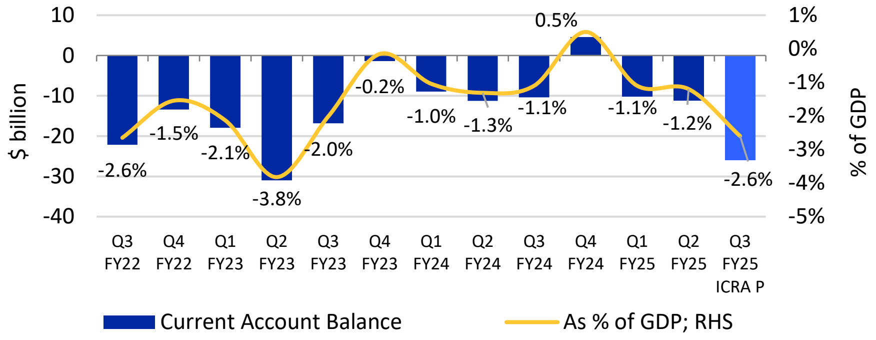
EXHIBIT: Trends in Services Trade balance



Source: RBI; ICRA Research

EXHIBIT: India's Current Account Balance ($ billion; % of GDP)



P: Projected; Data labels correspond to CAD as % of nominal GDP; ICRA's nominal GDP Proj. has been used for Q3 FY2025; Source: RBI; CEIC; ICRA Research

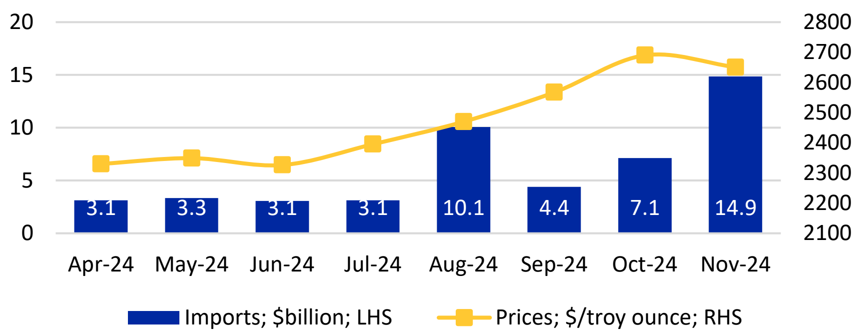
- India's services exports surged by a robust 22.3% YoY to an all-time high of $34.3 billion in October 2024 from $28.0 billion in October 2023 (Q2 FY2025: +12.2%). However, services imports grew by a sharper 27.9%, surging to a record-high of $17.2 billion in October 2024 from $13.5 billion in October 2023 (Q2: +12.5%).
- Nevertheless, the services trade surplus rose by 17.2% YoY to $17.1 billion in October 2024 from $14.6 billion in October 2023. Moreover, the surplus exceeded the monthly average of $14.9 billion/month seen during Q2 FY2025.
- **With the uptick in the services trade surplus being more-than-offset by the sharp enlargement in the merchandise trade deficit during October-November FY2025, ICRA expects the CAD to widen to a nine-quarter high of ~2.6% of GDP in Q3 FY2025 (Q3 FY2024: -1.1% of GDP) from 1.2% of GDP in Q2 FY2025.**

Outlook on CAD and INR

CAD projected at 1.1% of GDP in FY2025 and 1.0% of GDP in FY2026 (baseline); USD/INR pair to trade between 85-87/$ in immediate term

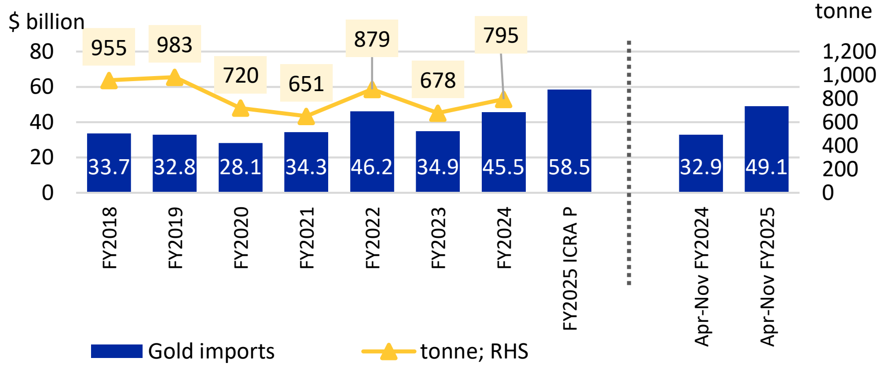
Gold imports to moderate from the initially estimated levels of November 2024; projected to grow by ~29% to $58-59 billion in FY2025

EXHIBIT: Trends in monthly gold imports and prices



Source: Ministry of Commerce and Industry; WGC; ICRA Research

EXHIBIT: Annual trends in Gold imports



Volume data for Nov 2024 is not available yet; Source: Ministry of Commerce and Industry, GoI; ICRA Research

- The value of gold imports increased considerably by 49.1% YoY to $49.2 billion during April-November FY2025. In monthly terms, such imports touched an all-time high of $14.9 billion in November 2024, vs. $3.4 billion seen in November 2023.
- The imported volume of gold rose materially to 135.9 tonne in August 2024 from an average of 43.9 tonne/month during April-July FY2025, following the sharp cut in the customs duty on gold (to 6.0% in July 2024 from 15.0%) announced in the Union Budget FY2025. Thereafter, the volume moderated to 85.7 tonne in Oct 2024.
- Gold prices scaled a monthly record of $2,690.1/troy ounce in October 2024, before easing to $2,650/troy ounce in November 2024; this may have partly boosted import volumes in the month, although the data for November 2024 is not yet available. Overall, prices have risen by a steep 26.7% YoY during April-November FY2025.
- **ICRA believes that gold imports are unlikely to sustain at such a high level in the ensuing months, even as the outlook for the rural sector appears favourable. Overall, gold imports are expected to increase by ~29% to $58-59 billion in FY2025 from $45.5 billion in FY2024.**

India's net oil import bill to widen to $110 billion in FY2025 from $95 billion in FY2024, amid a moderation in POL exports, lower discounts from Russia

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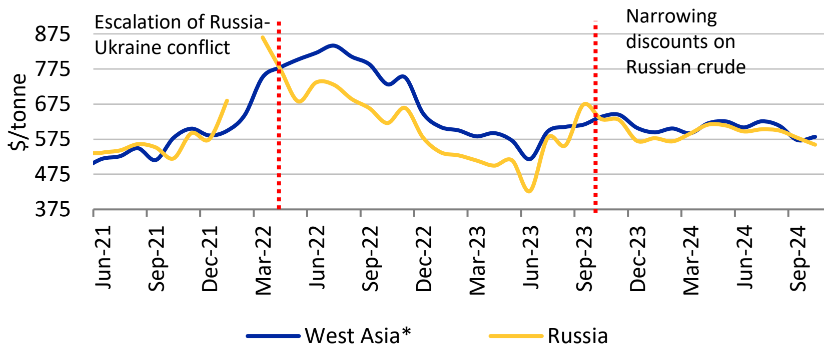
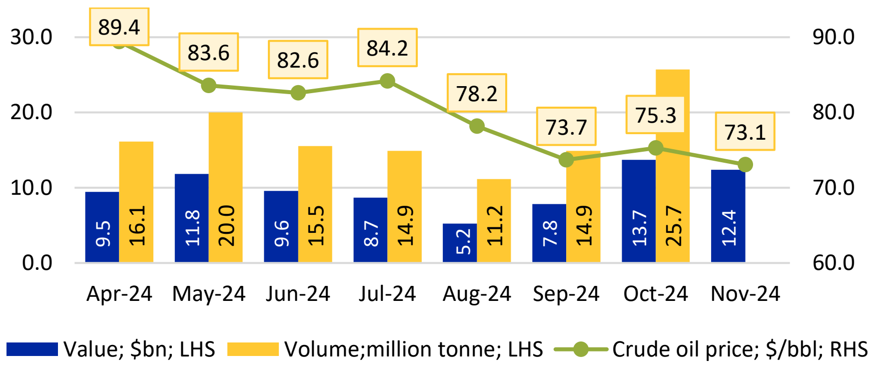
EXHIBIT: Monthly imputed prices of India's crude petroleum imports from West Asia and Russia



**West Asian countries used for our analysis: Saudi Arabia, the UAE and Kuwait; Source: CMIE; Ministry of Commerce and Industry; ICRA Research*

EXHIBIT: Trends in net POL imports-value and volume, and crude oil prices

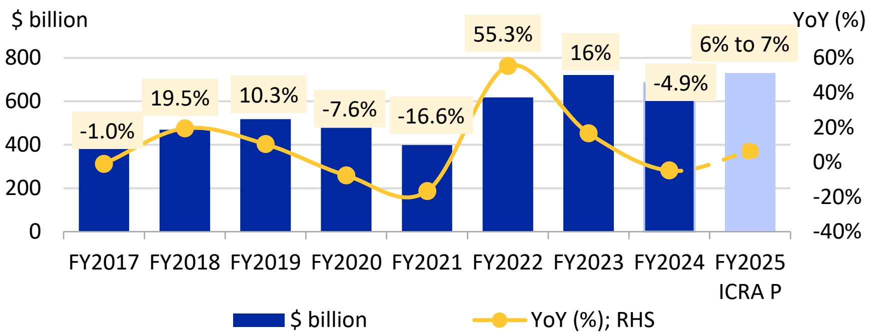


Volume data for Nov'24 is not yet available; Source: Ministry of Commerce and Industry; CEIC; ICRA Research

- The YoY growth in India's net POL imports eased to 12.2% (to $21.8 billion) in Q2 FY2025 from 35.2% in Q1 FY2025, partly owing to softening crude oil prices (-9.3% YoY to $78.7/bbl in Q2; +9.4% in Q1), amid demand concerns in the US and China, as well as the dip in imported volumes. In October-November FY2025, the net oil import bill rose sharply to $26.1 billion, from $17.8 billion in the year-ago period, amid the surge in import volumes during October 2024 (at 25.7 mn tonne), even as crude oil prices inched up only mildly to $75.3/bbl in October 2024 from $73.7/bbl in September 2024. The volumes in November 2024 may have remained high, although the data is not yet available.
- Notably, the average discount on Russian crude vis-à-vis West Asian crude grades has moderated to ~2% during April-October FY2025 from 14% seen in FY2024. In fact, the Russian crude was offered at a premium of 1% vs. West Asian crude in September 2024, before displaying a 4% discount in October 2024. Nevertheless, the share of Russian crude in India's crude petroleum imports (volume) remains sizeable at 39% in 7M FY2025, compared to 30% in the case of West Asia. **The shrinkage of discounts from Russian crude is likely to widen India's net oil import bill, even as crude oil prices may remain benign amid bleak global demand outlook.**
- **While the value of oil imports in FY2025 is likely to remain stable over the FY2024 level ($178.8 bn), that of POL exports is anticipated to moderate by 18-19% YoY. Consequently, ICRA expects the net oil import bill to widen to $110 billion in FY2025 from $94.6 billion in FY2024, which would exert some pressure on the CAD.**

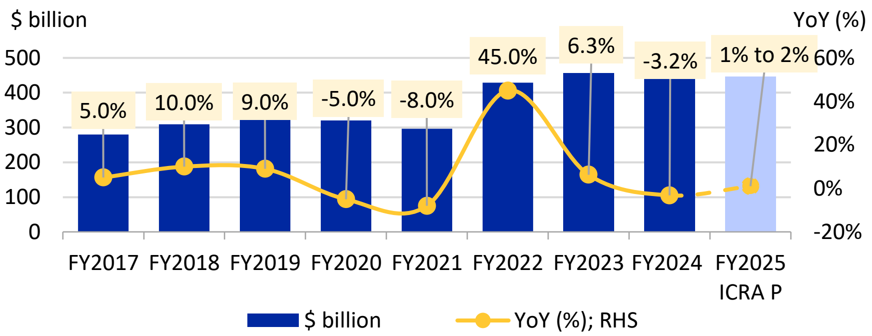
Merchandise exports to grow by a mild 1-2% in FY2025, even as such imports are projected to increase by a relatively stronger 6-7%

EXHIBIT: Trends in merchandise imports ($ billion; YoY %)



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

EXHIBIT: Trends in merchandise exports ($ billion; YoY %)

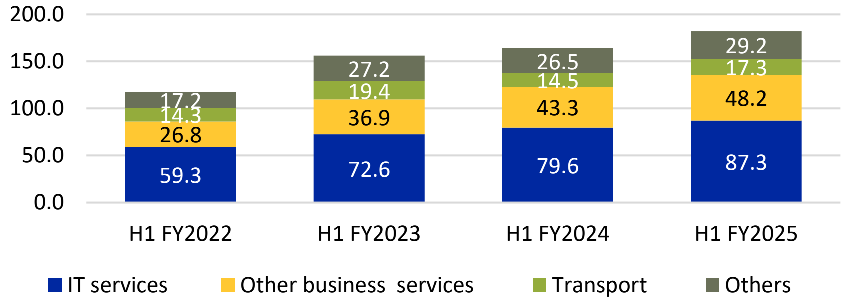


Source: Ministry of Commerce and Industry, GoI; ICRA Research

- India's merchandise imports rose by 8.3% YoY to $486.7 billion during April-November FY2025, driven by the surge in gold imports (+49.1%), followed by a relatively lower growth in crude petroleum and products (+7.2%), and non-oil non-gold (+4.4%) imports. **ICRA projects merchandise imports to grow by 6-7% in FY2025 (on BoP basis), amidst healthy domestic demand for items like gold (+49% in 8M FY2025), electronic goods (+11%), electric and non-electric machinery (+7%), as well as some agri items (+23%; led by edible oils and pulses).**
- In contrast with imports, merchandise exports increased by a muted 2.2% YoY to $284.3 billion during 8M FY2025, with the growth in exports of electronic (+28%) and engineering goods (+10%), being majorly offset by the YoY moderation in gems and jewellery (-10%), petroleum products (-22%), iron ore (-35%) and oilseeds (-2%) owing to weak demand and softening commodity prices. Based on these trends, **ICRA estimates a 1-2% growth in merchandise exports in FY2025.**
- **Overall, ICRA currently expects the merchandise trade deficit to widen sharply to $283-285 billion in FY2025 (-7.3% of GDP) from $244.9 billion in FY2024 (-6.9% of GDP).**

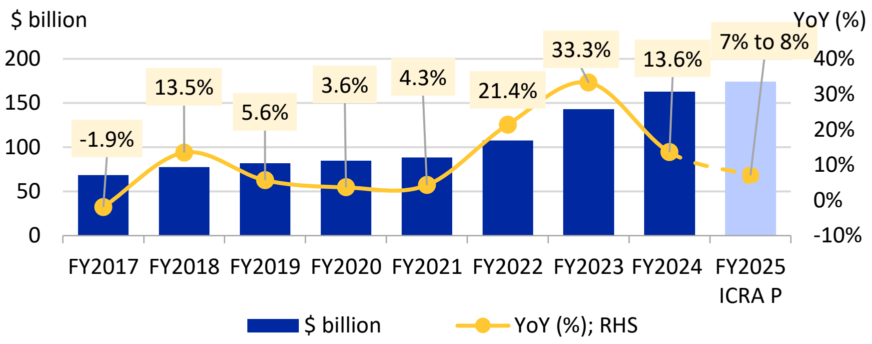
Services trade surplus expected to rise to $174-176 billion in FY2025 from $163 billion in FY2024

EXHIBIT: H1 trends in composition of services exports



P: Projected; Source: RBI; CEIC; ICRA Research

EXHIBIT: Annual trends in services trade surplus

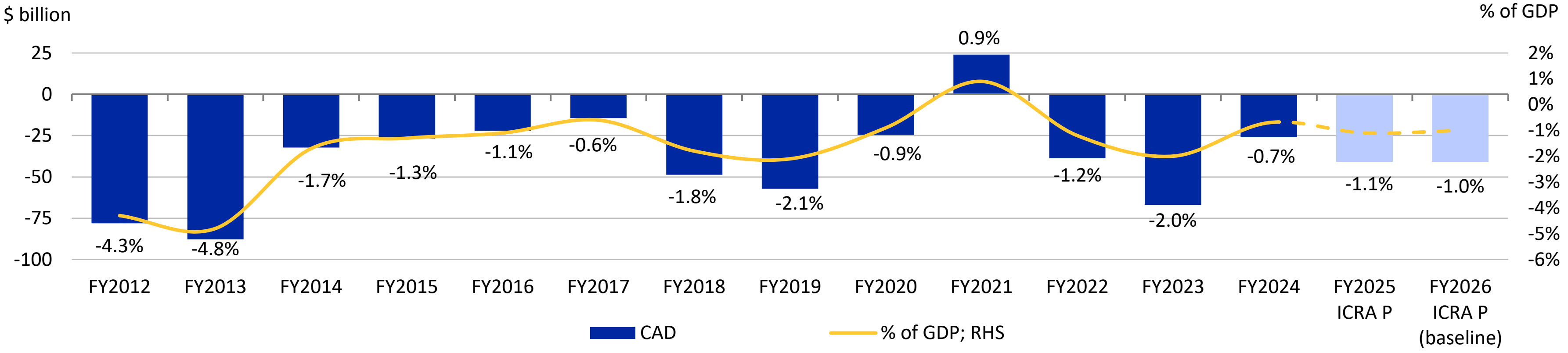


P: Projected; Source: RBI; CEIC; ICRA Research

- India's services exports have been resilient in the ongoing fiscal so far, registering a healthy growth of 12.7% to $216.3 billion during April-October FY2025 from $192.0 billion in the same period of last year (+5.8% in 7M FY2024). In monthly terms, the country witnessed the highest-ever exports of $34.3 billion in October 2024, with the YoY growth improving sharply to a 21-month high of 22.3%, from 14.6% in September 2024.
- At the same time, services imports increased by a similar 12.2% YoY to $114.8 billion during April-October FY2025. In monthly terms, the trend has been volatile, ranging from a contraction of 3.1% in June 2024 to a 26-month high 27.9% expansion in October 2024. As a result, the service trade surplus increased by a stronger 13.2% to $101.5 billion in 7M FY2025.
- **ICRA anticipates the exports of IT services to remain tepid in FY2025 amid expectations of a modest 4-6% growth in revenues in ICRA's sample set of companies (+5.5% in FY2024), despite some recovery seen in Q2. However, the export performance of non-IT services like global capability centres (GCCs) may remain healthy, as was the case in the previous fiscal. Overall, ICRA estimates the services trade surplus to rise to $174-176 billion in FY2025 from $162.8 billion in FY2024.**

India's CAD/GDP projected at 1.1% in FY2025 and 1.0% in FY2026 (baseline)

EXHIBIT: Trends in Current Account Deficit ($ billion; % of GDP)



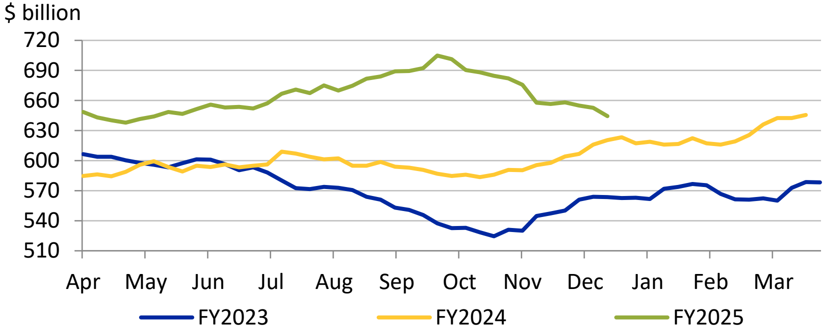
**P: Projected; Data labels correspond to CAD as % of nominal GDP; ICRA's nominal GDP Proj. has been used for FY2025-26; Source: RBI; CEIC; ICRA Research*

- In ICRA's view, high levels of gold imports seen in November 2024 are unlikely to sustain in the ensuing months, which would help to cool the upcoming merchandise trade deficit prints. Based on the initial data, **we estimate the CAD to widen to 2.6% of GDP in Q3 FY2025.**
- **Subsequently, the current account balance is expected to show a seasonal improvement to a surplus in Q4 FY2025.**
- **Overall, ICRA projects the CAD/GDP to print at ~1.1% in FY2025 (-0.7% in FY2024) and ~1.0% in FY2026 (baseline). Nevertheless, the FY2026 outlook is clouded with risks owing to the imposition of tariffs by the US.**

Valuation losses, RBI dollar sales resulted in a steep fall in forex reserves from end-September 2024 peak

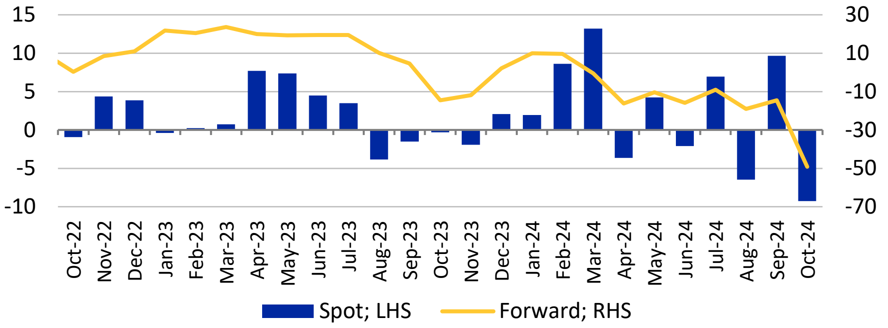
ICRA

EXHIBIT: India's Foreign Exchange Reserves



Source: RBI; ICRA Research

EXHIBIT: Net sales/purchases of $ in the spot market and outstanding net sales/purchases in forward market by the RBI ($ billion)

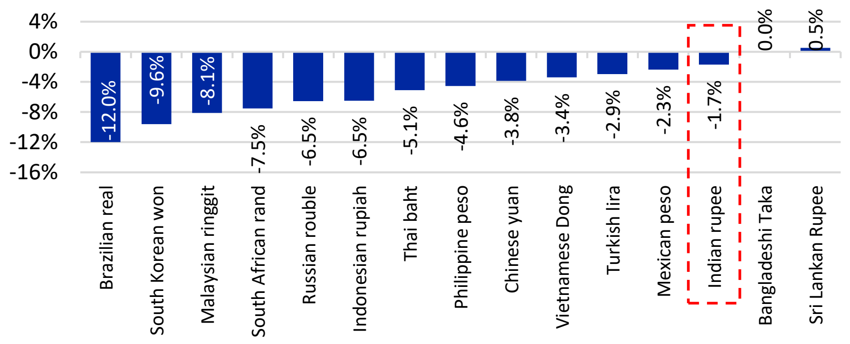


**Net Purchase (+)/ Sale (-); Source: RBI; ICRA Research*

- India's foreign exchange reserves had surged to a record-high of $704.9 billion at end-September 2024 from $652.0 billion at end-June 2024, crossing the $700 billion mark for the first time. Thereafter, reserves declined sharply by ~$60 billion to $644.4 billion as on December 20, 2024.
- A part of this decline is likely due to valuation losses, amid the sharp rally in the DXY (to 107.6 as on December 20, 2024 from 100.8 at end-September 2024) and the rise in UST yields (to 4.52% from 3.80%) during this period, apart from the RBI's intervention in the forex market to support the INR, amid FPI outflows and the surge in the merchandise trade deficit in November 2024.
- The Central Bank sold dollars amounting to $9.3 billion in October 2024 in the spot market on a net basis. Additionally, its outstanding net sales in the forward market widened sharply to $49.2 billion at end-October 2024 from $14.6 billion at end-September 2024, of which $28.2 billion was due to mature within a month and $21.0 billion was set to mature within 1-3 months. This is likely to have exerted downward pressure on foreign exchange reserves in November and December 2024.

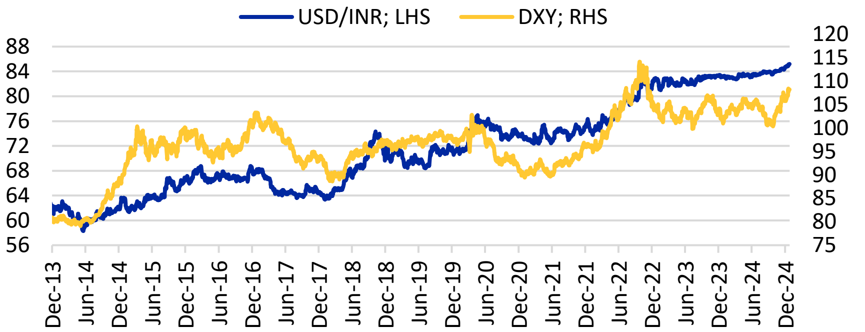
USD/INR pair to trade between 85 and 87 in immediate term

EXHIBIT: Exchange Rate Movements of Various Currencies Relative to the $ as on December 26, 2024 relative to end-September 2024



Negative values indicate depreciation against the $; Source: Refinitiv, ICRA Research

EXHIBIT: Trends in USD/INR and DXY



Data for FY2025 is up to December 26, 2024; Source: Refinitiv; ICRA Research

- Following the uptick in dollar index after hawkish commentary by the US Fed, the USD/INR pair crossed the 85-mark for the first time and peaked at 85.07 on December 19, 2024. Thereafter, it fell to a record intra-day low of 85.8 on December 27. Overall, the pair has depreciated by 0.8% in December 1-26, relative to the prior month.
- In a matter of less than three months, i.e. between end-September 2024 and December 26, 2024, the INR has depreciated by 1.7% against the $. Nevertheless, it has still outperformed as many as 12 of the 14 EM currencies, including the Chinese Yuan (-3.8%) during this period. On a fiscal year basis, the INR has depreciated by 2.2% against the $ in FY2025 so far (till December 26, 2024), outperforming eight of the 14 EM currencies in ICRA's set.
- **Prior episodes wherein the currency was under pressure, such as the taper tantrum, US-China trade war, and Russia-Ukraine war, suggest that healthy macroeconomic fundamentals are paramount to limit adverse currency outcomes. While thin volumes may lead to a further weakening in the INR over the next few trading sessions, we expect it to stabilise in the remainder of January 2025. Amidst heightened global volatility, the USD/INR pair may trade between 85 and 87 in immediate term.**

Annexure

EXHIBIT: Trends in India's Current account

Figures in $ billion	Q2 FY2024	Q3 FY2024	Q4 FY2024	Q1 FY2025	Q2 FY2025	Q3 FY2025 ICRA P	FY2021	FY2022	FY2023	FY2024	FY2025 ICRA P
Merchandise Exports	108.3	106.6	121.6	111.2	104.0	110 to 112	296.3	429.2	456.1	441.4	445 to 448
Merchandise Imports	172.8	178.3	173.6	176.3	179.3	198 to 200	398.5	618.6	721.4	686.3	728 to 731
Merchandise Trade Balance	***-64.5***	***-71.6***	***-52.0***	***-65.1***	***-75.3***	***-87 to -89***	*-102.2*	*-189.5*	*-265.3*	-244.9	**-283 to -285**
Net Services	**39.9**	**45.0**	**42.7**	**39.7**	**44.5**	**44 to 46**	88.6	107.5	143.3	162.8	**174 to 176**
Primary Income	**-11.6**	**-13.1**	**-14.8**	**-11.1**	**-9.5**	**-12 to -14**	-36.0	-37.3	-45.9	-49.8	**-45 to -47**
Secondary Income	**24.9**	**29.3**	**28.7**	**26.4**	**29.1**	**29 to 31**	73.6	80.5	100.9	105.9	**114 to 116**
Current Account Balance	***-11.3***	***-10.4***	***4.6***	***-10.2***	***-11.2***	***-25 to -27***	*+24.0*	*-38.7*	*-67.0*	-26.0	**-40 to -42**
Percentage of GDP	**-1.3%**	**-1.1%**	**+0.5%**	**-1.1%**	**-1.2%**	**-2.6%**	+0.9%	-1.2%	-2.0%	-0.7%	**-1.1%**

EXHIBIT: Trends in India's Financial flows

Figures in $ billion	Q2 FY2024	Q3 FY2024	Q4 FY2024	Q1 FY2025	Q2 FY2025	FY2021	FY2022	FY2023	FY2024
Financial flows	**12.9**	**17.4**	**25.5**	**14.6**	**30.5**	**64.7**	**85.9**	**59.0**	**89.5**
Direct investment	-0.8	4.0	2.3	6.7	-2.2	44.0	38.6	28.0	10.1
Portfolio investment	4.9	12.0	11.4	0.9	19.9	36.1	-16.8	-5.2	44.1
Financial derivatives	-1.9	-2.1	-3.2	-3.6	-5.5	-4.8	-6.4	-5.4	-7.9
Other investment*	10.6	3.5	15.0	10.6	18.4	-10.6	70.5	41.5	43.2

**other investments include ECBs, banking capital, trade credit and advances, other accounts receivable/payable, etc.; P: Projected; ICRA's nominal GDP forecast has been used for FY2025; Source: RBI; CEIC; ICRA Research*

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Thank You!