ICRA

Outlook on Current Account Deficit

Current account posted higher-than-expected surplus of 0.6% of GDP in Q4 FY2024; likely to revert to a deficit of 1.5% of GDP in Q1 FY2025

JUNE 2024

Highlights

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India's current account registered a higher-than-expected surplus of 0.6% of GDP in Q4 FY2024

The turnaround from a deficit in Q4 FY2023 was primarily on account of narrowing in merchandise trade deficit

ICRA expects India's current account to revert to a deficit in Q1 FY2025 given the higher merchandise trade deficit in April-May; the CAD is nonetheless seen at a modest ~1.0-1.2% of GDP in FY2025

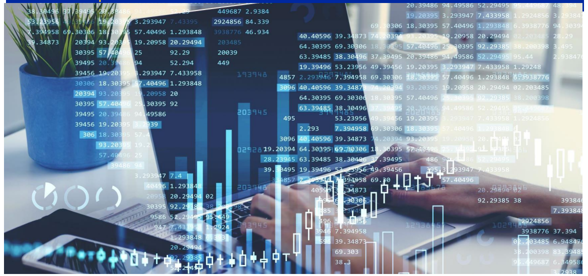
- India's current account turned to a welcome surplus in Q4 FY2024 after a gap of 10 quarters, with size of the same at $5.7 billion (0.6% of GDP) exceeding ICRA's expectations.
- The turnaround to a surplus in Q4 FY2024 from a deficit of $8.7 billion in Q3 FY2024, was primarily driven by a narrowing in the merchandise trade deficit to a 10-quarter low of $50.9 billion in Q4 FY2024 from $69.9 billion in Q3 FY2024.
- Overall, the surplus on the current account along with the quarter-on-quarter (QoQ) uptick in net financial flows in Q4 FY2024, led to a higher accretion of reserve assets amounting to $30.8 billion in that quarter (+$5.6 billion in Q4 FY2023) as against $6.0 billion in Q3 FY2024.
- The current account deficit narrowed to a seven-year low of $23.2 billion in FY2024 from $67.0 billion in FY2023, aided by a narrower merchandise trade deficit and a robust expansion in the services trade surplus. This, along with the surge in net financial flows, resulted in a reserve accretion of $63.7 billion in FY2024, in contrast to the drawdown of $9.1 billion seen in FY2023.
- ICRA expects the current account to revert to a deficit of 1.5% of GDP in Q1 FY2025, based on early trends for April and May 2024, which revealed a rise in monthly average merchandise trade deficit compared to the level seen in the year-ago period as well as Q4 FY2024.
- Overall, ICRA expects the CAD to rise slightly in FY2025, while remaining eminently manageable at ~1.0-1.2% of GDP, owing to a widening in the merchandise trade deficit in this fiscal, on the back of robust domestic demand and higher commodity prices.
- A CAD of 1.0-1.2% of GDP in FY2025 would be comfortably financed, particularly given the expectations of large FPI-debt inflows on account of the bond index inclusion starting end-June 2024. ICRA expects the USD/INR pair to trade between 82.5-84.0/$ in remainder of H1 FY2025.

Outline

1 Developments in India's Balance of Payments during Q4 FY2024

2 Preliminary April-May 2024 trends and outlook for Q1 FY2025

3 Outlook on CAD and INR for FY2025

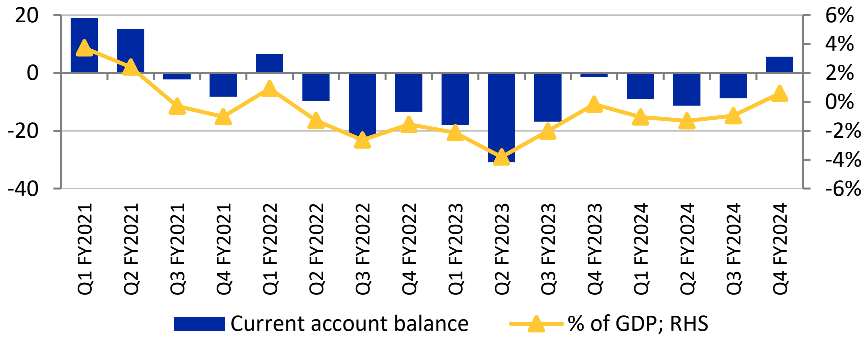


Developments in India’s BOP in Q4 FY2024

Surplus on current account and surge in financial flows led to higher accretion to reserves in Q4 FY2024 vis-à-vis Q3 FY2024

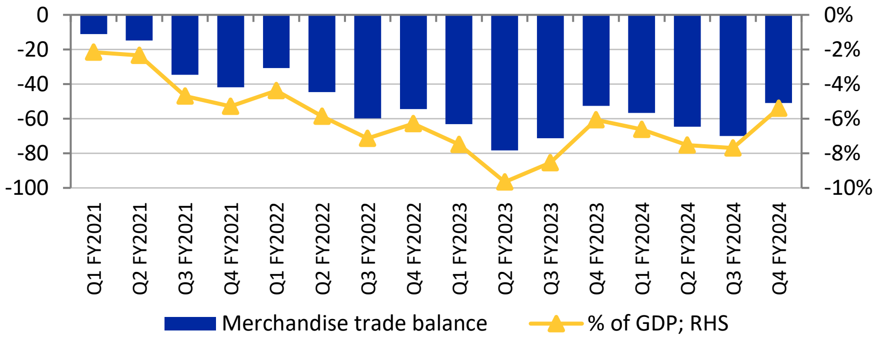
Current account turned to a surplus of $5.7 billion or 0.6% of GDP in Q4 FY2024, after a gap of 10 quarters

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



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

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

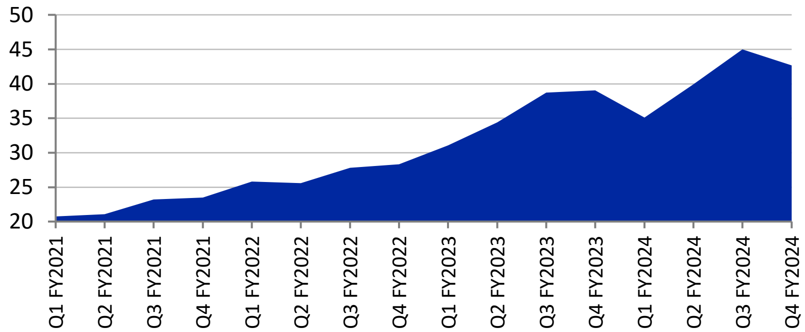


"-" denotes outflows and vice versa; Source: RBI; ICRA Research

- India's current account balance recorded a surplus, after a gap of 10 quarters, amounting to $5.7 billion in Q4 FY2024 (+0.6% of GDP; ICRA's exp: $1-3 billion, +0.2% of GDP), relative to the deficit of $8.7 billion in Q3 FY2024 (-1.0% of GDP), largely owing to a narrower merchandise trade deficit, even as the services trade surplus and secondary income inflows declined between these two quarters. The print contrasted with the current account deficit of $1.3 billion recorded in Q4 FY2023 (-0.2% of GDP), amid a narrower merchandise trade deficit and higher services trade surplus relative to the year-ago levels.
- The merchandise trade deficit narrowed to a 10-quarter low of $50.9 billion in Q4 FY2024 (-5.4% of GDP) from $52.6 billion in Q4 FY2023 (-6.1% of GDP), amidst a sharper uptick in exports (+5.0%), relative to imports (+2.5%).
  - The imports of petroleum, crude and products contracted by 2.4% YoY in Q4 FY2024 (to $49.6 billion in Q4 FY2024 from $50.8 billion in Q4 FY2023), despite a 1.6% uptick in the price of the Indian basket of crude oil. In contrast, gold imports rose by a sharp 44.7% to $9.6 billion from $6.6 billion, respectively, partly led by robust festive and marriage-season demand, as well as a low base. Non-oil non-gold imports reported an uptick of 2.1% YoY in Q4 FY2024, on a BoP basis.
  - While oil exports fell by 7.1% YoY in Q4 FY2024, exports of non-oil items rose by 8.2% (on a BoP basis) during the quarter.

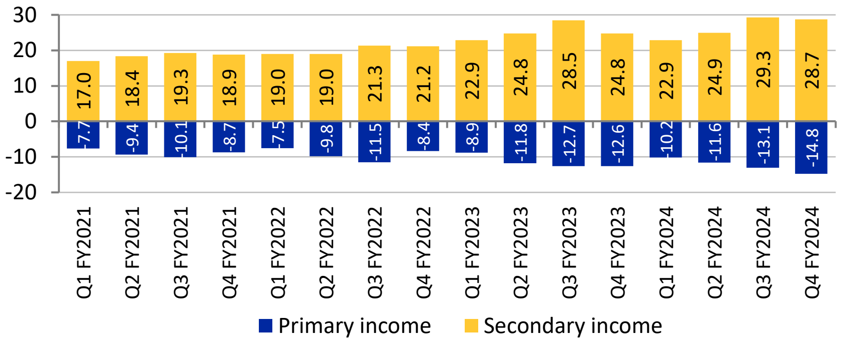
Services trade surplus rose in YoY terms in Q4 FY2024, while trailing Q3 levels; ~15% YoY uptick in earnings from invisibles led to turnaround in current account

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



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

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

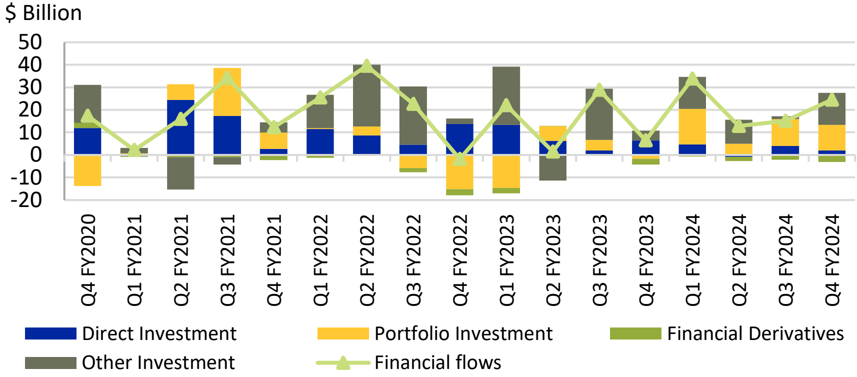


"-" denotes outflows and vice versa; Source: RBI; ICRA Research

- The services trade surplus rose by 9.2% YoY to $42.7 billion in Q4 FY2024 from $39.1 billion in Q4 FY2023, led by higher net earnings related to telecom, communication and information (to $36.4 billion in Q4 FY2024 from $34.5 billion in Q4 FY2023), other business services (to $6.2 billion from $5.9 billion) as well as travel services (to $1.9 billion from $0.7 billion). However, it moderated from $45.0 billion seen in Q3 FY2024, recording the first instance of a QoQ decline after a gap of four quarters.
- Net inflows of secondary income rose by a sharp 16.0% YoY to $28.7 billion in Q4 FY2024 from $24.8 billion in Q4 FY2023, while trailing the Q3 FY2024 level ($29.3 billion). The YoY growth in secondary income was led by the uptick in personal transfers (to $29.0 billion from $25.4 billion). However, net outflows of primary income widened to an all-time high of $14.8 billion in Q4 FY2024 (-$13.1 billion in Q3 FY2024) from $12.6 billion in Q4 FY2023, reflecting the trend for outflows of net overseas investment income (to -$16.8 billion from -$13.9 billion).
- Overall, earnings from invisibles rose by 10.4% to $56.6 billion in Q4 FY2024 from $51.3 billion in Q4 FY2023 ($61.2 billion in Q3 FY2024). This along with the YoY narrowing in the merchandise trade deficit led to a turnaround in the current account balance to a surplus in that quarter, relative to Q4 FY2023.

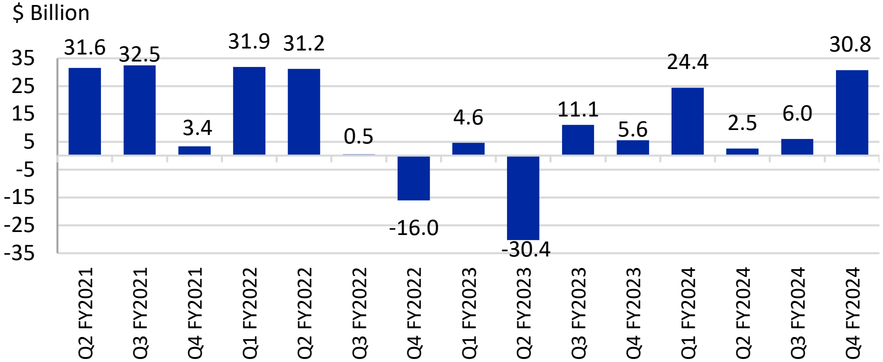
Financial flows surged to $24.5 billion in Q4 FY2024; this along with current account surplus led to higher accretion to reserves vis-à-vis that seen in Q3

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



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

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

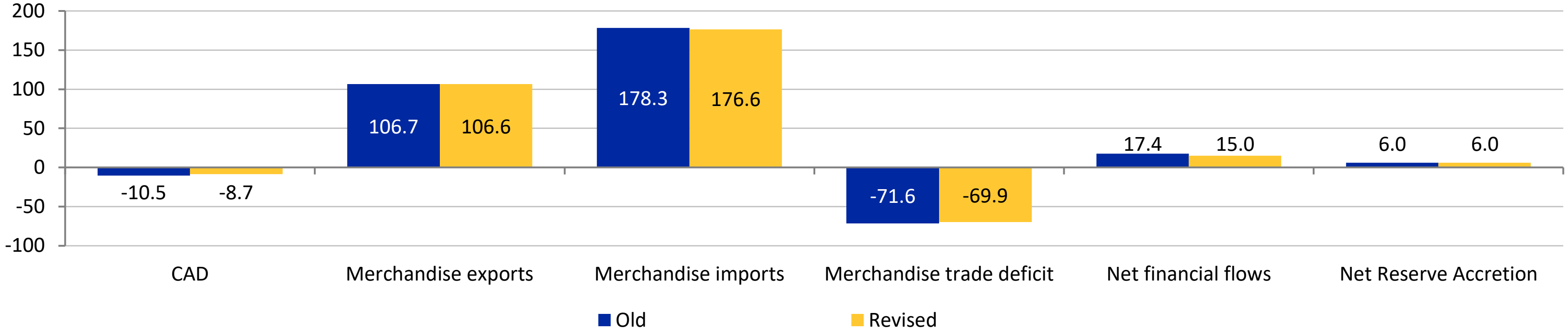


Change in Reserve Asset [Increase (+)/Decrease (-)]; Source: RBI; ICRA Research

- Financial inflows to India surged to $24.5 billion in Q4 FY2024 from $15.0 billion in Q3 FY2024, while also exceeding the year-ago level of $6.5 billion in Q4 FY2023.
  - The sequential uptick was largely driven by a turnaround in net ECBs flows (to +$1.7 billion in Q4 FY2024 from -$4.5 billion in Q3 FY2024) and other accounts receivable/payable (to +$5.6 billion from -$9.4 billion), lower outflows of trade credit (-$2.0 billion vs. -$4.4 billion), and an uptick in NRI deposit inflows (to +$5.4 billion from +$3.9 billion).
  - In contrast, both FDI (to +$2.0 billion from +$3.9 billion) and FPI (to +$11.4 billion from +$12.0 billion) inflows eased in Q4 FY2024 vis-à-vis Q3 FY2024, even as the latter remained quite elevated.
- Overall, the surplus on the current account along with the QoQ uptick in net financial flows in Q4 FY2024, led to a higher accretion of reserve assets amounting to $30.8 billion in that quarter (+$5.6 billion in Q4 FY2023) as against $6.0 billion in Q3 FY2024 (on a BoP basis). This was higher than the $22.4 billion increase in India's forex reserves during the quarter.

Current account deficit for Q3 FY2024 lowered by $1.8 billion, on account of downward revision in merchandise imports

EXHIBIT: Revisions in the Q3 FY2024 Balance of Payments data ($ billion)



Source: RBI; ICRA Research

- The current account deficit for Q3 FY2024 was revised to $8.7 billion from $10.5 billion, largely on account of a downward revision in the merchandise trade deficit (to -$69.9 billion from -$71.6 billion), led by merchandise imports (by -$1.7 billion).
- The revision in the CAD was more-than-offset by the downward revision in the quantum of financial flows in Q3 FY2023 (to +$15.0 billion from +$17.4 billion).
- The net reserve accretion for Q3 FY2024 was unchanged at $6.0 billion.

India's CAD narrowed to a seven-year low of $23.2 billon or 0.7% of GDP in FY2024

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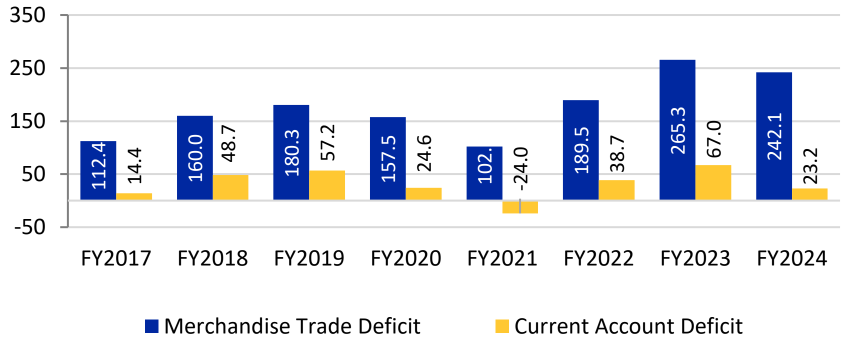
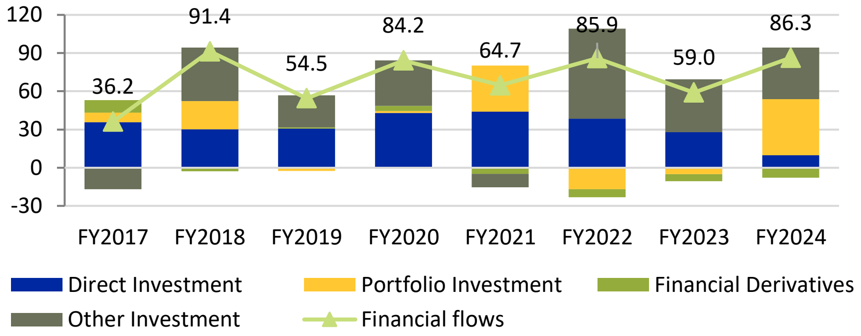
EXHIBIT: Annual trends in current account deficit and merchandise trade deficit ($ billion)



Source: RBI; CEIC; ICRA Research

EXHIBIT: Annual trends in financial flows ($ billion)



Source: RBI; CEIC; ICRA Research

- India's CAD more-than-halved to a seven-year low of $23.2 billion in FY2024 from $67.0 billion in FY2023 amidst a narrower merchandise trade deficit (to -$242.1 billion from -$265.3 billion) and a higher services trade surplus (to a record-high +$162.8 billion from +$143.3 billion). As a proportion of GDP, the CAD eased sharply to 0.7% in FY2024 from 2.0% in FY2023. Notably, the surge in the services trade surplus was largely driven by higher earnings from telecom, communication and information (to $142.7 billion from $132.5 billion) and other business services (to $29.2 billion from $20.6 billion). This was followed by a rise in net inflows of secondary income to a record-high of $105.9 billion from $100.9 billion, respectively, even as net primary income outflows widened to $49.8 billion from $45.9 billion, respectively.
- Additionally, net financial flows rose to $86.3 billion in FY2024 from $58.9 billion in FY2023, entirely on account of a turnaround in FPI inflows to a record high of $44.1 billion from outflows of $5.2 billion in the previous fiscal. In contrast, net FDI inflows (to a 13-year low $9.8 billion from $28.0 billion) and other investments (to $40.3 billion from $41.5 billion) declined in FY2024.
- Overall, the sharp narrowing in the CAD in FY2024 vis-à-vis FY2023, coupled with the rise in net financial flows, resulted in a reserve accretion (on a BoP basis) of $63.7 billion in FY2024, in contrast to the drawdown of $9.1 billion seen in FY2023.

Preliminary trends for Apr-May 2024 and ICRA’s outlook for Q1 FY2025

Current account expected to revert to a deficit of 1.5% of GDP in Q1 FY2025

Merchandise imports increased by 8.9% YoY in April-May FY2025, stronger than export growth of 5.1%

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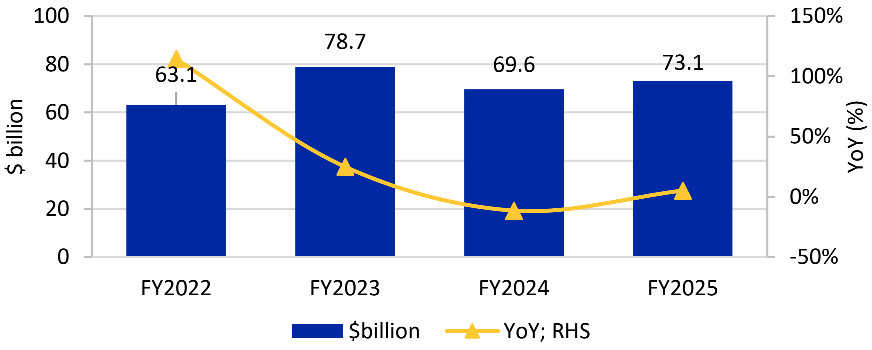
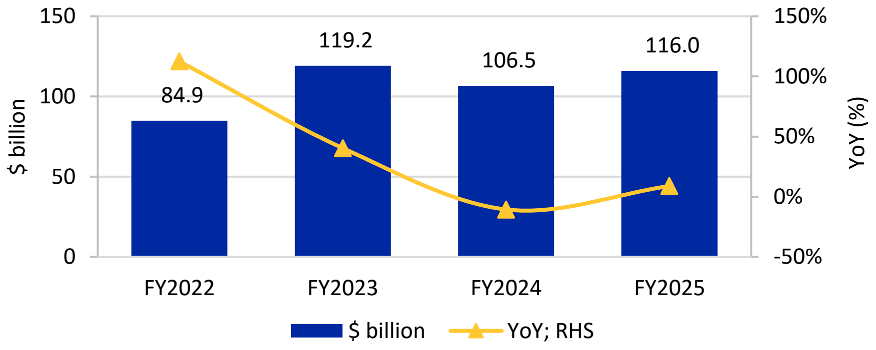
EXHIBIT: Apr-May Trends in Merchandise Exports of FY2022-25



Source: Ministry of Commerce and Industry; ICRA Research

EXHIBIT: Apr-May Trends in Merchandise Imports of FY2022-25



Source: Ministry of Commerce and Industry; ICRA Research

- As per the data released by Ministry of Commerce and Industry, India's merchandise exports have recorded a YoY growth of 5.1%, amounting to $73.1 billion in April-May FY2025. In monthly terms, exports grew by a stronger 9.1% in YoY terms in May 2024, compared to the muted 1.1% seen in April 2024. The growth in petroleum crude exports (+9.1%, amid a similar pace of rise in international crude oil prices) was sharper in April-May 2024, compared to that in non-oil items (+4.2%). Items like electronic goods (by +$1.1 billion), engineering goods (by +$0.4 billion), organic and inorganic chemicals (by +$0.4 billion), and drugs and pharmaceuticals (by +$0.4 billion) contributed as much as 95% or $2.3 billion to the overall increase of $2.4 billion in non-oil exports in April-May FY2025.
- Merchandise imports rose by a relatively stronger 8.9% YoY to $116.0 billion in April-May FY2025. This was boosted by the surge in imports of gold (+37.1%; to $6.4 billion from $4.7 billion) and crude petroleum and products (+24.4%; to $36.4 billion from $29.3 billion), even as the growth in imports of non-oil non-gold segment was tepid at 0.8% in April-May FY2025. The latter was dampened by a steep 20% YoY decline in coal imports, even as agri imports recorded a 36.8% expansion in 2M FY2025.

Average monthly deficit in April-May FY2025 trending higher than levels seen in Q4 FY2024 and April-May FY2024

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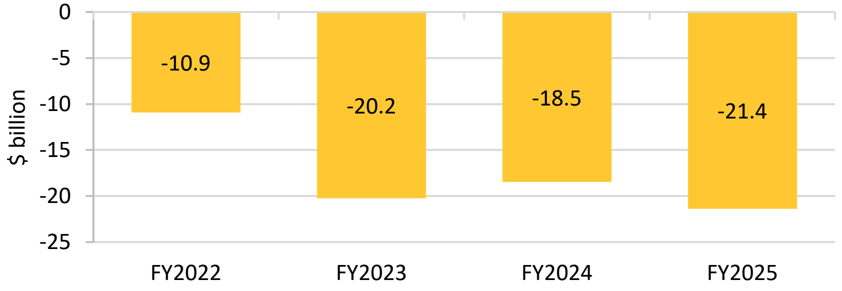
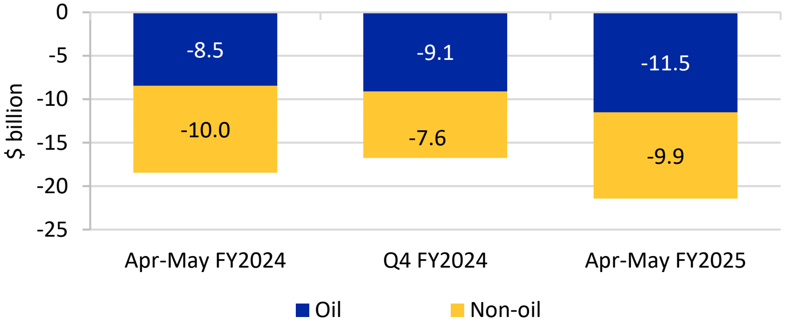
EXHIBIT: Monthly Average Trends in Merchandise Trade Balance in April-May FY2022-25



Source: Ministry of Commerce and Industry; ICRA Research

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



Source: Ministry of Commerce and Industry; ICRA Research

- As per the data published by the Commerce Ministry, the growth in merchandise imports (+8.9%) outpaced that in such exports (+5.1%) in April-May FY2025, which resulted in widening in the average monthly trade deficit to $21.4 billion in the period from $18.5 billion in April-May FY2024. This was entirely driven by higher average deficit in oil items.
- In sequential terms, the monthly average deficit was significantly higher in April-May FY2025, compared to $16.8 billion seen in Q4 FY2024, entirely led by both oil (to -$11.5 billion from -$9.1 billion) and non-oil segments (to -$9.9 billion from -$7.6 billion).
- **With the merchandise trade deficit enlarging by ~US$6 billion in April-May 2024 relative to the year-ago period, ICRA expects the merchandise trade deficit to rise to $65-67 billion in this quarter from $56.7 billion in Q1 FY2024.**

India's current account likely to revert to a deficit of 1.5% of GDP in Q1 FY2025 amid widening in merchandise trade deficit

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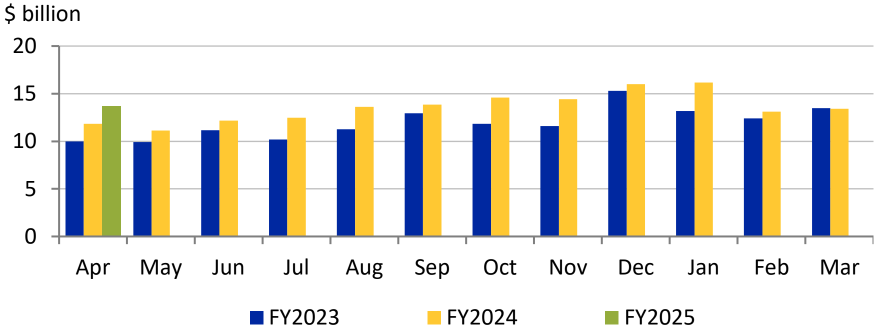
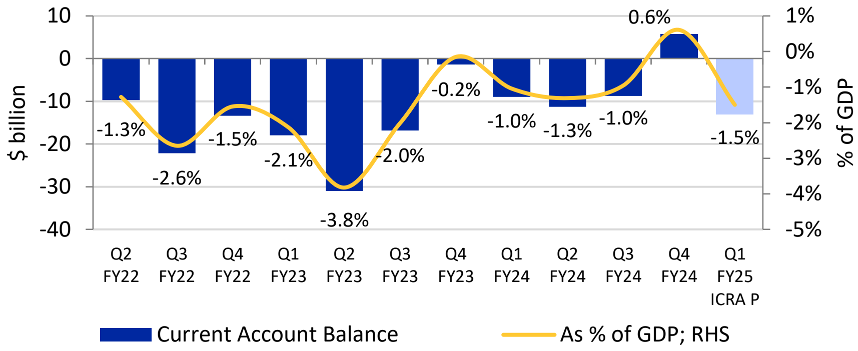
EXHIBIT: Trends in Services Trade balance



Source: RBI; ICRA Research

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



P: Projected; Data labels correspond to CAD as % of nominal GDP; ICRA's nominal GDP Proj. has been used for Q4 FY2025; Source: RBI; CEIC; ICRA Research

- In April 2024, services exports surged by 17.7% YoY to $30.3 billion (vs. monthly average of $28.4 billion in FY2024), albeit shallower than the 19.1% expansion in such imports in the month. The services trade surplus rose by ~16% YoY to $13.7 billion in April 2024 (similar to FY2024 monthly average of $13.6 billion).
- **With a widening in merchandise trade deficit in April-May FY2025 on a YoY basis, ICRA expects CAD to widen to 1.5% of GDP in Q1 FY2025 from 1.0% of GDP in Q1 FY2024. This would be in contrast with the transient surplus of 0.6% of GDP seen in Q4 FY2024.**

Outlook on CAD and INR for FY2025

CAD projected to widen to 1.0-1.2% of GDP in FY2025, while remaining manageable; INR to trade between 82.5-84.0/$ in rest of H1 FY2025

Merchandise trade deficit expected to widen in FY2025, owing to sharper uptick in imports vis-à-vis exports

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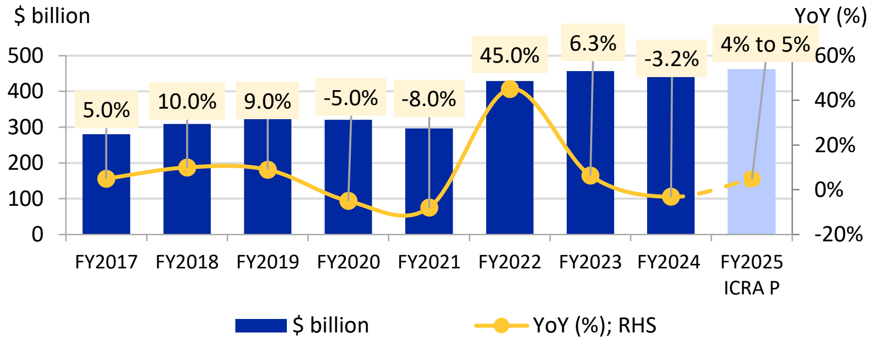
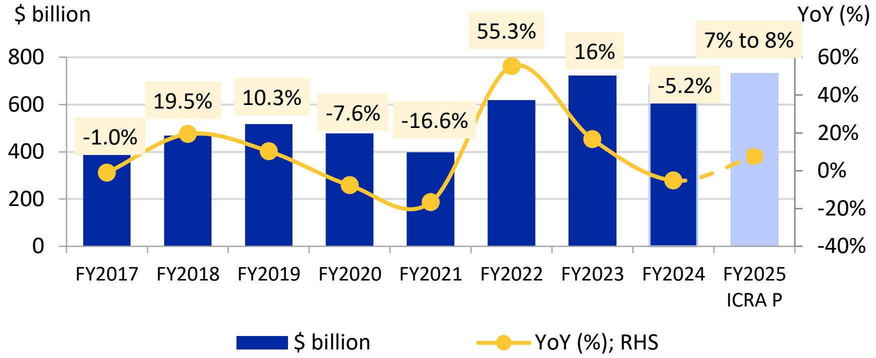
EXHIBIT: Annual trends in merchandise exports



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

EXHIBIT: Annual trends in merchandise imports

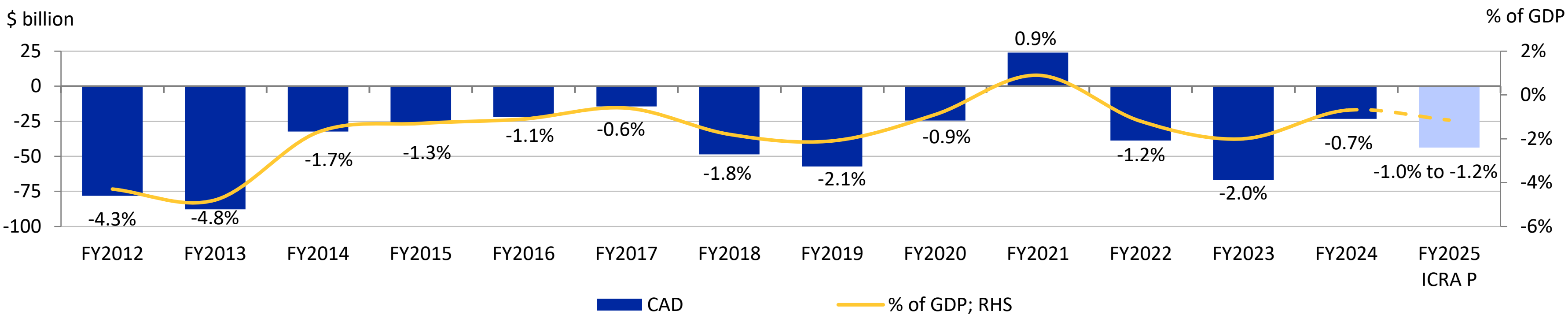


P: Projected; Source: RBI; CEIC; ICRA Research

- India's merchandise exports are projected to rise by 4-5% to $459-464 billion in FY2025 from $441.5 recorded in FY2024, amid expectations of an improvement in the latter part of the fiscal aided by a likely pick up in global demand after rate cut cycle begins in some major economies. However, an escalation of the Red sea crisis and its impact on shipping timelines and freight prices could impact India's merchandise trade, which remains a key monitorable in the near term.
- Additionally, ICRA foresees India's merchandise imports to rise by a sharper 7-8% to $731-738 billion in FY2025 from $683.5 billion seen in FY2024, partly owing to an uptick in the prices of some commodities as well as healthy domestic demand.
- **Accordingly, ICRA currently expects the merchandise trade deficit to widen to $272-275 billion in FY2025 from $242.1 billion in FY2024, based on the premise of a stronger growth in domestic demand vis-à-vis external demand, as well as higher commodity prices.**

CAD projected to rise to 1.0-1.2% of GDP in FY2025, while remaining manageable

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; Source: RBI; CEIC; ICRA Research*

- On the services front, exports of IT services may remain tepid in FY2025, amid expectations of a muted 3-5% growth in revenues in ICRA's sample set of companies, similar to that seen in FY2024, stemming from the uncertainty in key markets, resulting in pauses or deferral of non-critical projects and slowdown of discretionary IT spends by key sectors like retail, BFSI, technology and communication. However, the export performance of non-IT services may continue to remain healthy in FY2025, as was the case in the previous fiscal. Based on this, **ICRA expects the services trade surplus to rise by 6-9% to $176-178 billion in FY2025 from $162.8 billion seen in FY2024.**
- **Overall, ICRA projects the CAD to rise sharply to $40-44 billion in FY2025 from $23.2 billion in FY2024. Nevertheless, as a proportion of GDP, the CAD is likely to remain manageable at 1.0-1.2% (-0.7% in FY2024). This is likely to be comfortably financed, particularly given the expectations of large FPI-debt inflows on account of the Bond Index inclusion starting end-June 2024.**

USD/INR pair to trade between 82.5-84.0/$ in remainder of H1 FY2025

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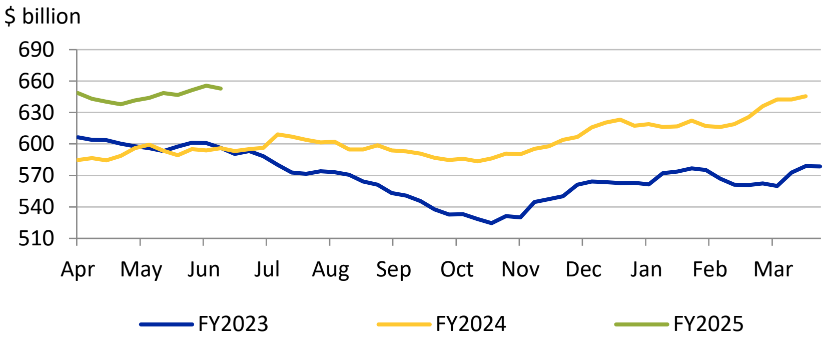
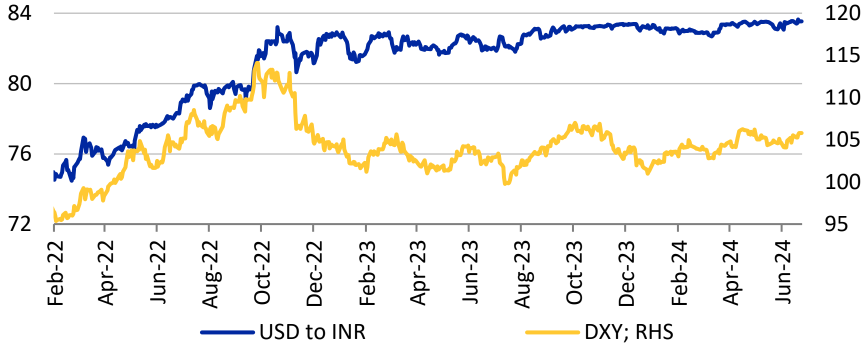
EXHIBIT: India's Foreign Exchange Reserves



Source: RBI; ICRA Research

EXHIBIT: Movement in USD/ INR reference rate and DXY



Source: RBI; FBIL; CEIC; ICRA Research

- India's foreign exchange reserves rose to $652.9 billion as on June 14, 2024 from $645.6 billion as on March 29, 2024. This translates to an increase of $7.3 billion in FY2025 so far, marginally higher than the increase of $7.0 billion recorded in the corresponding period of FY2024. Additionally, the build up in reserves in Q1 FY2025 (up to June 14, 2024) is also likely to have been impacted by valuation losses with the DXY (rising to 105.55 on June 14 from 104.49 on Mar 29) and the 10-year UST (to 4.22% from 4.20%) witnessing a marginal rise during the quarter. This suggests that financial flows may have risen sufficiently to finance the CAD, which is expected to widen sharply in the quarter.
- The USD/INR pair fell to a record-low of 83.65/$ as on June 20, 2024, while averaging at 83.42/$ in Q1 FY2025 so far (up to June 24; 83.04/$ in Q4 FY2024), amidst the uptrend seen in the DXY as well as FPI equity outflows recorded in the ongoing quarter so far.
- ICRA expects the INR to trade between 82.5-84.0/$ in the rest of H1 FY2025, with the inclusion of Indian bonds in J.P. Morgan's GBI-EM Global Index from end-June 2024 auguring favourably for the USD/INR pair. However, any untoward depreciation in EM currencies in the event of an escalation in geopolitical conflicts could exert some pressure on the Indian currency. Nevertheless, we believe that the extent of volatility in the USD/INR pair is likely to remain contained, as witnessed over the last few quarters.

Annexure

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EXHIBIT: Trends in India's Current account

Figures in $ billion	Q4 FY2023	Q1 FY2024	Q2 FY2024	Q3 FY2024	Q4 FY2024	Q1 FY2025 ICRA P	FY2021	FY2022	FY2023	FY2024	FY2025 ICRA P
Merchandise Exports	115.8	104.9	108.3	106.6	121.7	110 to 112	296.3	429.2	456.1	441.5	459 to 464
Merchandise Imports	168.4	161.6	172.8	176.6	172.5	175 to 177	398.5	618.6	721.4	683.5	731 to 738
Merchandise Trade Balance	***-52.6***	***-56.7***	***-64.5***	***-69.9***	***-50.9***	***-65 to -67***	*-102.2*	*-189.5*	*-265.3*	-242.1	**-272 to -275**
Net Services	**39.1**	**35.1**	**39.9**	**45.0**	**42.7**	**41 to 43**	88.6	107.5	143.3	162.8	**176 to 178**
Primary Income	**-12.6**	**-10.2**	**-11.6**	**-13.1**	**-14.8**	**-11 to -13**	-36.0	-37.3	-45.9	-49.8	**-53 to -55**
Secondary Income	**24.8**	**22.9**	**24.9**	**29.3**	**28.7**	**23 to 24**	73.6	80.5	100.9	105.9	**109 to 110**
Current Account Balance	***-1.3***	***-8.9***	***-11.3***	***-8.7***	***5.7***	***-13 to -14***	*+24.0*	*-38.7*	*-67.0*	-23.2	**-40 to -44**
Percentage of GDP	**-0.2%**	**-1.0%**	**-1.3%**	**-1.0%**	**0.6%**	**-1.5%**	+0.9%	-1.2%	-2.0%	-0.7%	**-(1.0 to 1.2)%**

EXHIBIT: Trends in India's Financial flows

Figures in $ billion	Q4 FY2023	Q1 FY2024	Q2 FY2024	Q3 FY2024	Q4 FY2024	FY2021	FY2022	FY2023	FY2024
Financial flows	**6.5**	**33.9**	**12.9**	**15.0**	**24.5**	**64.7**	**85.9**	**58.9**	**86.2**
Direct investment	6.4	4.7	-0.8	3.9	2.0	44.0	38.6	28.0	9.8
Portfolio investment	-1.7	15.7	4.9	12.0	11.4	36.1	-16.8	-5.2	44.1
Financial derivatives	-2.7	-0.7	-1.9	-2.1	-3.2	-4.8	-6.4	-5.4	-7.9
Other investment*	4.5	14.2	10.6	1.2	14.3	-10.6	70.5	41.5	40.3

**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; ICRA Research*

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Thank You!