

Q2FY24 BoP

CAD improves on better services' exports

External Accounts

Q2FY24 Update

December 26, 2023

The sequential narrowing of the current account deficit (CAD) to USD8.3bn (1% of GDP) in Q2FY24 was despite a higher trade deficit, as net invisibles improved. However, the reversal of FPI and FDI flows led to a sharp fall in capital account surplus, with a small BoP surplus (USD2.5bn) for the quarter.

For FY24E, we maintain CAD/GDP at 1.4%, led by incrementally improving goods trade deficit vs. FY23 and solid services trade surplus. Risks from higher crude oil prices have receded. We see no risk to CAD funding currently and see FY24 BoP surplus at USD9-10bn vs. (-)USD9bn in FY23. INR will stay range-bound amid low volatility due to the RBI's two-way FX management strategy.

Q2FY24 CAD/GDP declines to 1%, led by a surge in net invisibles

CAD fell sequentially to USD8.3bn (1% of GDP – meeting our expectations) vs. the Q1FY24 deficit of USD9.2bn (1.1% of GDP) and the year-ago deficit of USD30.9bn (3.8% of GDP). The improvement was despite the increase in goods trade deficit to USD61.0bn (7.0% of GDP) from USD56.6bn (6.6% of GDP), with imports rising faster than exports. Thus, better CAD was due to a sharp rise in net invisibles, with net software exports (USD35.2bn) at the highest level on record. Non-software exports also rebounded from the previous quarter's one-year low, with an improvement in R&D and travel services exports. Net remittances rose 9% QoQ, while net investment income (-USD12.2bn) continued to be a drag amid higher global rates.

Reversal of flows depletes Q2 capital account surplus; BoP surplus falls to USD2.5bn

The decline in capital account surplus (USD10.0bn, 1.2% of GDP vs. 4.0% in Q1FY24) was led by a massive contraction in both net FPI flows (USD4.9bn vs. USD15.7bn in Q1) and net FDI flows (outflow of USD0.3bn vs. USD5.1bn of inflows in Q1). The reversal in FPI flows was led by equity (USD3.6bn vs. USD13.6bn), while debt flows moderated from a high base. Net ECBs turned negative for the first time since Q3FY23, due to higher rates abroad. Banking capital flows declined but stayed positive. Volatility in banking capital has persisted for over a year; and the trend will likely stay patchy with global rate uncertainty set to continue. Overall, Q2 BoP stayed positive but fell to USD2.5bn (vs. USD24.4bn in Q1FY24), while the basic balance (CAD+FDI), which reflects durable funding, stayed negative (-USD8.6bn vs. -USD4.1bn).

Risks recede to our FY24E CAD/GDP of 1.4%; BoP surplus to be USD9-10bn

Q3FY24 CAD/GDP is likely to worsen, with a sequentially wider goods deficit led by high imports (due to the festive season), while services will likely improve further. The upside risks to our forecast from higher crude oil prices have receded somewhat, as concerns over slowing global demand have kept Brent below USD80/bl since November, despite the ongoing conflict in the Middle East. Therefore, we maintain our FY24 CAD/GDP forecast of 1.4%, with lower risks from higher crude prices. Additionally, solid services (non-software) trade surplus will continue to partly offset the merchandise trade deficit. We reckon the broadening of services exports will likely bear long-term fruits, but it will not be immune to impending global slowdown/recession.

CAD funding so far has been quite smooth, and we believe H1CY24 could enjoy some front-loaded FPI inflows ahead of India's bond index inclusion. We also note that FPI flows have returned strongly in Q3 so far; and, thus, assuming stable and low net FDI flows and improving capital flows, we estimate BoP surplus of USD9-10bn in FY24 vs. (-)USD9bn in FY23.

INR to stay range-bound going ahead

INR has behaved relatively well in FYTD24, helped by the RBI, despite the widening trade deficit, higher Brent prices, and recent FPI equity outflows. The RBI's two-way intervention in recent months ([See: FX Strategy: Our thoughts on RBI's evolving FX management](#)) has helped in keeping INR volatility extremely low, and the currency has been range-bound as a result. Going ahead, depressed forward yields, unless corrected, will act as an impediment to INR's upside potential when USD may globally face weakness. Nevertheless, it would be difficult to take a strong directional call on the noiseless INR.

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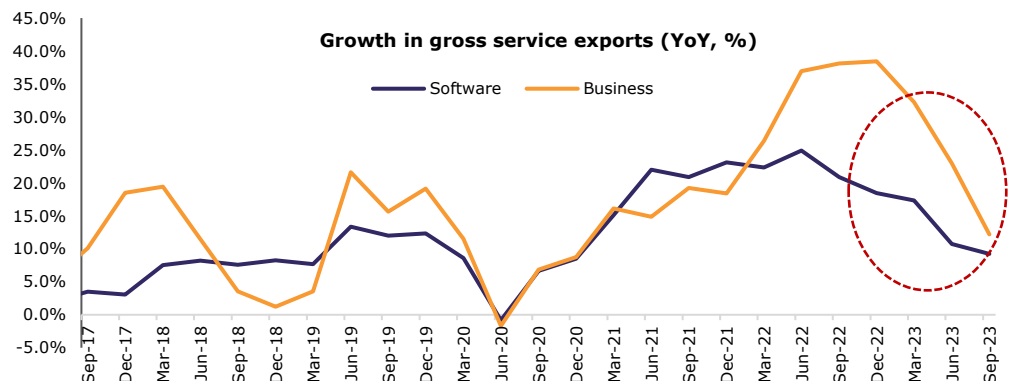
Key highlights:

- **Q2FY24 CAD/GDP at 1%; BoP surplus falls to USD2.5bn**
- **FY24E CAD/GDP at 1.4%**
- **INR to stay range-bound**

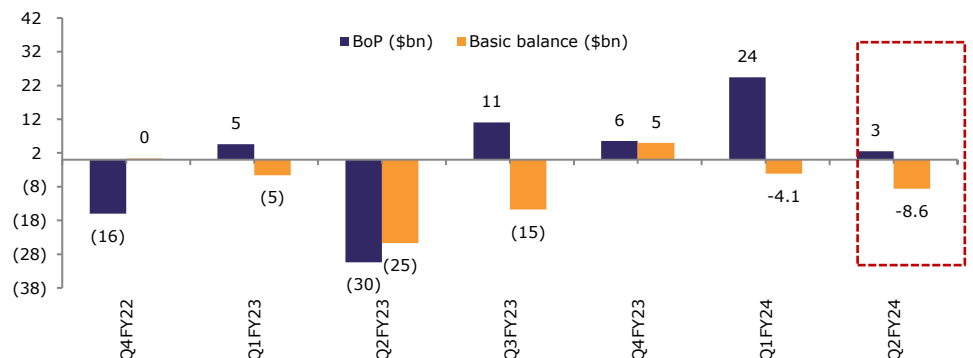
Exhibit 1: CAD improves despite higher trade deficit due to improvement in net invisibles

(US\$bn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Current account	(22.2)	(13.4)	(18.0)	(30.9)	(16.8)	(1.4)	(9.2)	(8.3)
CAD/GDP (%)	(2.7)	(1.6)	(2.1)	(3.8)	(2.0)	(0.2)	(1.1)	(1.0)
Trade balance	(59.7)	(54.5)	(63.1)	(78.3)	(71.3)	(52.6)	(56.6)	(61.0)
Trade balance/GDP (%)	(7.2)	(6.3)	(7.4)	(9.5)	(8.4)	(6.0)	(6.6)	(7.0)
- Exports	108.9	118.0	122.8	111.9	105.6	115.8	105.0	107.4
- oil exports	17.6	21.3	26.9	23.9	22.7	23.8	19.1	16.8
- non-oil exports	91.3	96.7	95.9	87.9	82.9	92.0	86.0	90.6
- Imports	168.7	172.5	185.9	190.2	176.9	168.4	161.6	167.2
- oil imports	43.0	49.3	53.2	53.4	52.0	50.8	43.3	40.8
- non-oil imports	125.7	123.2	132.7	136.7	124.9	117.6	118.3	126.5
Net Invisibles	37.6	41.1	45.1	47.4	54.5	51.2	47.4	52.7
- Services	27.8	28.3	31.1	34.4	38.7	39.1	35.1	40.0
o/w Software	28.4	29.3	30.7	32.7	33.5	34.4	33.9	35.2
o/w Non-software	(0.5)	(0.9)	0.4	1.7	5.2	4.7	1.2	4.7
- Transfers	21.3	21.1	22.9	24.8	28.5	24.8	22.9	25.0
- Net Income	(11.5)	(8.4)	(8.9)	(11.8)	(12.7)	(12.6)	(10.6)	(12.2)
Capital account	22.5	(1.7)	22.1	1.5	28.9	6.5	34.4	10.0
% of GDP	2.7	(0.2)	2.6	0.2	3.4	0.7	4.0	1.2
Foreign investment	(1.3)	(1.4)	(1.2)	12.7	6.6	4.7	20.8	4.7
- FDI	4.6	13.8	13.4	6.2	2.0	6.4	5.1	(0.3)
- FPI	(5.8)	(15.2)	(14.6)	6.5	4.6	(1.7)	15.7	4.9
- Equities	(4.1)	(13.1)	(15.0)	6.0	5.5	(2.5)	13.6	3.6
- Debt	(0.6)	(1.2)	0.4	0.9	(1.0)	0.9	2.4	1.7
Banking capital	8.2	(6.0)	19.0	(8.4)	14.4	(4.0)	12.9	4.3
- NRI deposits	1.3	0.2	0.3	2.5	2.6	3.6	2.2	3.2
Short-term credit	9.0	6.8	5.1	0.3	1.5	(0.3)	(5.0)	3.5
ECBs	(0.3)	3.4	(2.8)	(0.2)	(2.4)	1.6	5.8	(2.9)
External assistance	1.3	2.7	1.8	0.5	1.5	1.7	1.5	0.8
Other capital account items	5.6	(7.2)	0.3	(3.4)	7.3	2.9	(1.6)	(0.4)
E&O	0.1	(0.9)	0.5	(0.9)	(1.0)	0.4	(0.7)	0.8
Overall balance	0.5	(16.0)	4.6	(30.4)	11.1	5.6	24.4	2.5

Source: RBI, CEIC, Emkay Research

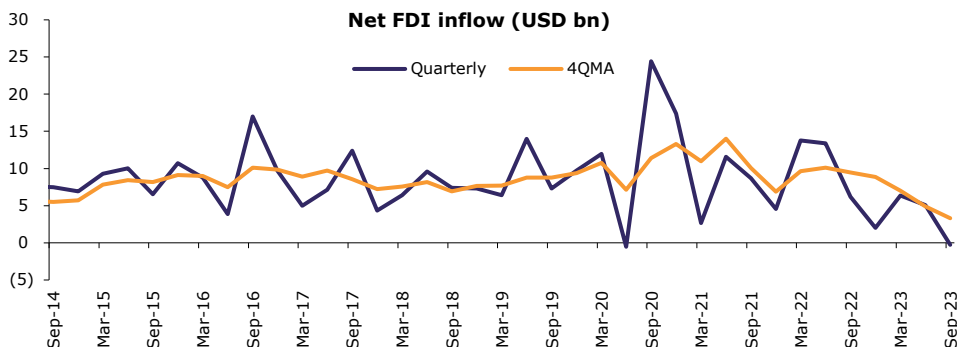
Exhibit 2: Software and business service exports growth continues to decline

Source: RBI, CEIC, Emkay Research

Exhibit 3: Basic balance stays negative due to lower FDI

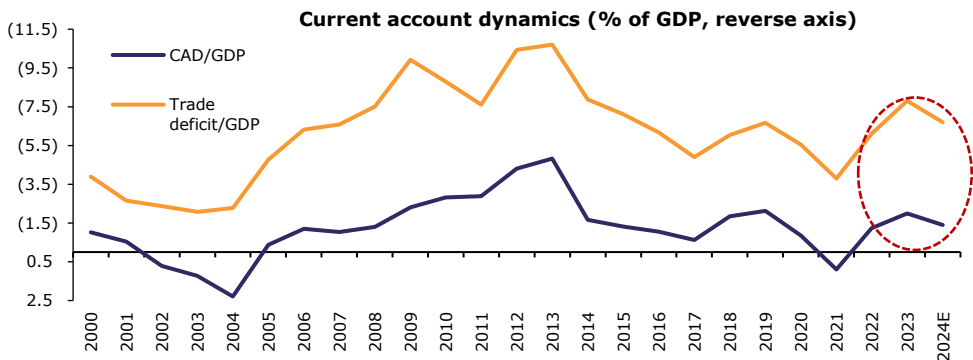
Source: RBI, CEIC, Emkay Research; Basic balance = FDI + CAD

Exhibit 4: FDI has also begun to fall sequentially and on a 4QMA basis



Source: RBI, CEIC, Emkay Research

Exhibit 5: CAD/GDP set to improve in FY24, with lower risk from higher crude prices

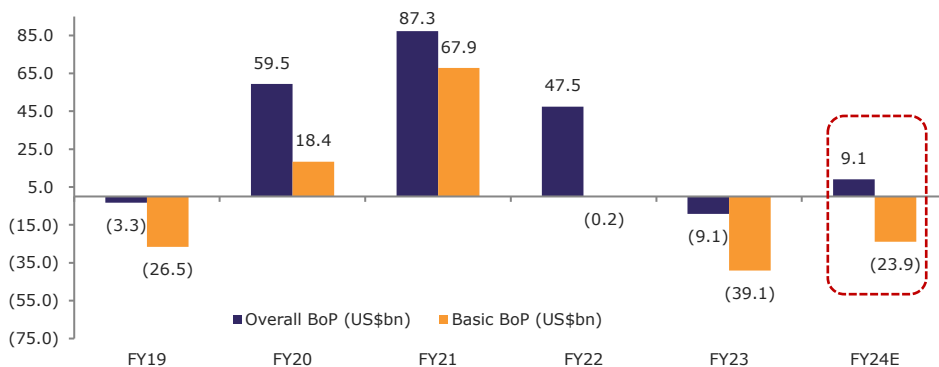


Source: CEIC, RBI, Emkay Research estimates

Exhibit 6: Overall trade deficit likely to improve, with BoP moving into surplus

	<i>Oil @70</i>	<i>Oil @61.50</i>	<i>Oil @45.8</i>	<i>Oil @79.8</i>	<i>Oil @95</i>	<i>Oil @85</i>
(US\$bn)	FY19	FY20	FY21	FY22	FY23	FY24E
Current account	(57.3)	(24.7)	23.9	(38.8)	(67)	(53)
CAD/GDP (%)	(2.1)	(0.8)	0.9	(1.2)	(2.0)	(1.4)
Trade balance	(180)	(158)	(102)	(189)	(265)	(247)
Trade balance/GDP (%)	(6.7)	(5.5)	(3.8)	(6.1)	(7.8)	(6.7)
- Exports	337	320	296	429	456	428
- oil exports	47	41	26	67	75	69
- non-oil exports	291	279	270	362	381	359
- Imports	518	478	398	619	721	675
- oil imports	141	131	83	162	209	201
- non-oil imports	377	347	316	457	512	466
Net invisibles	123	133	126	151	198	188
- Services	82	85	89	108	143	152
- software	78	85	90	110	131	140
- non-software	4	0	(1)	(2)	12	12
- Transfers	70	75	73	80	101	86
- Net Income	(29)	(27)	(36)	(37)	(46)	(50)
Capital account	54.4	83.2	63.7	85.8	82.5	62.0
% of GDP	2.0	2.9	2.4	2.7	2.4	1.7
Foreign investment	30	44	80	22	23	37
- FDI	31	43	44	39	28	29
- FPI	(1)	1	36	(17)	(5)	8
Banking capital	7	(5)	(21)	7	21	14
- NRI deposits	10	9	7	3	9	5
Short-term credit	2	(1)	(4)	20	7	10
ECBs	10	23	(0)	8	(4)	(4)
Others	1	18	(2)	24	7	-
Overall BoP	(3.3)	59.5	87.3	47.5	(9)	9

Source: RBI, CEIC, Emkay Research estimates

Exhibit 7: Basic BoP to stay negative in FY24

Source: RBI, CEIC, Emkay Research estimates

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