

# Economy

## External Sector

June 27, 2025

### External sector balances remain benign; capital flows key

The 4QFY25 current account balance improved to a surplus of US\$13.5 bn (1.3% of GDP), led by the narrowing of goods trade deficit and a robust invisibles surplus. Capital flows remain weak. We maintain our FY2026E CAD/GDP at 1% (0.6% in FY2025). We pencil in USD-INR to average around 86.1 in FY2026E.

#### Current account moved to surplus in 4QFY25

The 4QFY25 current account moved to a surplus of US\$13.5 bn (1.3% of GDP) compared with a deficit of US\$11.5 bn in 3QFY25 (Exhibit 1). Goods trade deficit narrowed sharply to US\$59 bn (3QFY25: US\$79 bn), while net invisibles surplus rose to US\$73 bn (US\$68 bn), aided by a higher non-software surplus at US\$12 bn (US\$10 bn). Non-software surplus tripled in 2HFY25, driven by travel and financial services, and professional/management consulting services. Net software exports were steady at US\$41 bn (Exhibit 2).

#### Capital account deficit narrowed in 4QFY25

Capital account deficit narrowed in 4QFY25 to US\$5.6 bn (3QFY25: US\$26.6 bn), revised down from US\$26.8 bn. The narrowing was driven by a surge in ECB inflows (US\$8 bn versus US\$4 bn in 3QFY25) and a deceleration in the pace of foreign investment outflows (US\$5 bn versus US\$14 bn in 3QFY25). Net FDI inflows were muted at US\$0.4 bn. Overall, 4QFY25 BOP was in surplus at US\$9 bn (-)US\$38 bn in 3QFY25).

#### BOP turned marginally deficit in FY2025

CAD/GDP narrowed to 0.6% in FY2025 from 0.7% in FY2024. Goods trade deficit widened to US\$287 bn, while services surplus expanded to US\$189 bn, along with a steady flow from remittances. Capital account surplus weakened significantly to US\$17 bn due to a sharp drop in net FDI and FPI inflows (Exhibit 3). Overall, BOP was at (-)US\$5 bn, while FX reserves increased by US\$21.9 bn.

#### FY2026E external sector balance comfortable; INR to trade in a broad range

We maintain our FY2026E CAD/GDP estimate at 1.0% (US\$40.6 bn), led by the widening of the trade deficit and a broadly steady invisibles surplus (Exhibit 4). Notably, given the policy uncertainty in the US, we remain cautious about the robustness of the services surplus. Furthermore, we expect an improvement in capital account flows in FY2026E (green shoots in net FDI inflows visible in April 2025 at US\$3.9 bn), resulting in a marginal BOP deficit of around US\$8 bn. INR may remain under pressure from (1) volatile capital flows, (2) continued uncertainty from trade and tariff policies, (3) an asynchronous global monetary policy cycle and (4) periodic geopolitical escalations. However, we expect the uncertainty on the US exceptionalism theme to weigh on the US Dollar, providing support to the EMFX space. The two-way moves witnessed in the Indian Rupee in CY2025 signal a clear shift in the RBI's FX management policy, creating room for wide-ranging moves. We, accordingly, expect USD-INR to trade in the range of 84.00-88.00 for the rest of the year and maintain our FY2026E average at 86.1, keeping in mind the wide swings in USD-INR and the RBI's intervention as and when necessary to cap weakness (Exhibit 5).

#### Summary of key macro metrics for India

	2023	2024	2025	2026E
<b>Real economy</b>				
Real GDP growth (%)	7.6	9.2	6.5	6.2
Nominal GDP growth (%)	14.0	12.0	9.8	8.7
CPI Inflation (avg., %)	6.7	5.4	4.6	3.5
<b>Public finance</b>				
Center's GFD/GDP (%)	6.4	5.6	4.8	4.4
<b>Monetary policy</b>				
Repo Rate (% eop)	6.50	6.50	6.25	5.50
<b>External sector</b>				
Current Account Balance (% of GDP)	(2.0)	(0.7)	(0.6)	(1.0)
Brent crude oil price (avg., USD/bbl)	95.4	82.9	80.0	70.0
USD/INR (avg.)	80.3	82.8	84.6	86.1

Source: CEIC, Bloomberg, RBI, Kotak Economics Research estimates

#### Quick Numbers

Current account at surplus of 1.3% of GDP in 4QFY25

4QFY25 capital account deficit at US\$5.6 bn

Maintain FY2026E CAD/GDP at 1% (0.6% in FY2025)

Expect USD-INR to average 86.1 in FY2026E

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**Current account surplus at 1.3% of GDP in 4QFY25****Exhibit 1: India's quarterly balance of payments, March fiscal year-ends, 4QFY24-25 (US\$ bn)**

	4QFY24	1QFY25	2QFY25	3QFY25	4QFY25
<b>Current account</b>	<b>4.6</b>	<b>(8.7)</b>	<b>(16.8)</b>	<b>(11.3)</b>	<b>13.5</b>
GDP	959	948	936	1,007	1,018
<b>CAD/GDP (%)</b>	<b>0.5</b>	<b>(0.9)</b>	<b>(1.8)</b>	<b>(1.1)</b>	<b>1.3</b>
Trade balance	(52)	(64)	(85)	(79)	(59)
<b>Trade balance/GDP (%)</b>	<b>(5.4)</b>	<b>(6.7)</b>	<b>(9.0)</b>	<b>(7.9)</b>	<b>(5.8)</b>
- Exports	122	111	105	110	116
- oil exports	22	21	16	13	14
- non-oil exports	99	91	89	97	102
- Imports	174	175	189	189	176
- oil imports	49	52	42	48	44
- non-oil imports	125	123	148	141	131
- gold imports	10	9	9	16	18
Invisibles (net)	57	55	68	68	73
- Services	43	40	45	51	53
o/w Software	37	37	40	41	41
o/w Non-software	6	2	5	10	12
- Transfers	29	26	32	33	32
- Income (net)	(15)	(11)	(9)	(16)	(12)
<b>Capital account</b>	<b>25.5</b>	<b>13.1</b>	<b>35.9</b>	<b>(26.6)</b>	<b>(5.6)</b>
% of GDP	2.7	1.4	3.8	(2.6)	(0.5)
Foreign investment	14	7	17	(14)	(5)
- FDI	2	6	(3)	(3)	0.4
- FPI	11	1	20	(11)	(6)
- Equities	1	(1)	11	(12)	(14)
- Debt	10	2	9	0	8
Banking capital	7	3	6	(10)	(9)
- NRI deposits	5	4	6	3	3
Short-term credit	0	2	5	4	(4)
ECBs	2	2	2	4	8
External assistance	2	1	2	1	2
Other capital account items	1	(2)	3	(12)	3
E&O	1	1	(0)	0	1
<b>Overall balance</b>	<b>30.8</b>	<b>5.2</b>	<b>18.6</b>	<b>(37.7)</b>	<b>8.8</b>
<b>memo items:</b>					
Average exchange rate (US\$/Rs)	83.0	83.4	83.8	84.5	86.6
Average Brent price (US\$/bbl)	83.1	83.0	78.7	74.0	75.0

Source: RBI, Kotak Economics Research

## Increase in travel, financial services and professional and management consulting services buoyed non-software exports

Exhibit 2: Breakup of net exports in non-software services and interest income (US\$ bn)

	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
<b>Services</b>	<b>39.9</b>	<b>45.0</b>	<b>42.7</b>	<b>39.7</b>	<b>44.6</b>	<b>51.2</b>	<b>53.3</b>
- Software	35.2	36.3	36.6	37.4	39.6	41.1	41.5
- Non-software	4.7	8.7	6.0	2.2	5.0	10.2	11.8
- Transport	(0.2)	0.5	(0.1)	(0.1)	(0.4)	(0.6)	(0.2)
- Travel	(1.2)	2.4	1.9	(1.8)	(1.7)	1.7	1.2
- Construction	0.3	0.5	0.9	0.9	0.3	0.2	0.7
- Insurance and pension	0.0	(0.0)	0.3	0.3	0.1	(0.0)	0.1
- Financial	0.9	1.5	0.3	0.9	0.9	1.3	1.2
- IP charges	(2.9)	(4.2)	(3.0)	(4.1)	(3.4)	(4.0)	(4.0)
- Other business	7.8	8.6	6.2	6.4	9.6	11.4	13.2
R&D	1.6	1.7	1.5	1.5	1.6	2.2	2.5
Professional & management consulting	11.6	12.1	10.2	10.2	13.5	16.4	16.5
Technical, trade related, etc	(5.4)	(5.2)	(5.5)	(5.3)	(5.5)	(7.2)	(5.8)
- Others	0.1	(0.5)	(0.5)	(0.3)	(0.4)	0.1	(0.4)

Source: CEIC, RBI, Kotak Economics Research

## Surge in FDI outflows weigh on net inflows in FY2025

Exhibit 3: Trend in FDI flows, March fiscal year-ends, 2017-25 (US\$ bn)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gross FDI inflow into India for overseas entities	60.2	61.0	62.0	74.4	82.0	84.8	71.4	71.3	80.6
Gross FDI outflow out of India for overseas entities	(18.0)	(21.5)	(18.7)	(18.4)	(27.0)	(28.6)	(29.3)	(44.5)	(51.5)
<b>Net FDI inflow for overseas entities (a)</b>	<b>42.2</b>	<b>39.4</b>	<b>43.3</b>	<b>56.0</b>	<b>54.9</b>	<b>56.2</b>	<b>42.0</b>	<b>26.8</b>	<b>29.1</b>
Gross FDI inflow into India for Indian entities	10.6	3.5	2.8	3.4	4.3	3.4	3.9	3.6	3.6
Gross FDI outflow from India for Indian entities	(17.2)	(12.6)	(15.4)	(16.4)	(15.3)	(21.0)	(17.9)	(20.3)	(31.7)
<b>Net FDI inflow for Indian entities (b)</b>	<b>(6.6)</b>	<b>(9.1)</b>	<b>(12.6)</b>	<b>(13.0)</b>	<b>(11.0)</b>	<b>(17.6)</b>	<b>(14.0)</b>	<b>(16.7)</b>	<b>(28.2)</b>
<b>Net FDI inflow/(outflow) (a) + (b)</b>	<b>35.6</b>	<b>30.3</b>	<b>30.7</b>	<b>43.0</b>	<b>44.0</b>	<b>38.6</b>	<b>28.0</b>	<b>10.2</b>	<b>1.0</b>

Source: RBI, Kotak Economics Research

## We expect CAD/GDP at 1% in FY2026E

Exhibit 4: India's balance of payments, March fiscal year-ends, 2019-26E (US\$ bn)

	2019	2020	2021	2022	2023	2024	2025	2026E		
								Oil@60	Oil@70	Oil@80
<b>Current account balance</b>	<b>(57.3)</b>	<b>(24.7)</b>	<b>23.9</b>	<b>(38.8)</b>	<b>(67.1)</b>	<b>(26.1)</b>	<b>(23.4)</b>	<b>(22.9)</b>	<b>(40.6)</b>	<b>(58.3)</b>
GDP	2,705	2,835	2,674	3,167	3,345	3,638	3,911	4,181	4,181	4,181
<b>CAB/GDP (%)</b>	<b>(2.1)</b>	<b>(0.9)</b>	<b>0.9</b>	<b>(1.2)</b>	<b>(2.0)</b>	<b>(0.7)</b>	<b>(0.6)</b>	<b>(0.5)</b>	<b>(1.0)</b>	<b>(1.4)</b>
Trade balance	(180)	(158)	(102)	(189)	(265)	(245)	(287)	(285)	(303)	(321)
<b>Trade balance/GDP (%)</b>	<b>(6.7)</b>	<b>(5.6)</b>	<b>(3.8)</b>	<b>(6.0)</b>	<b>(7.9)</b>	<b>(6.7)</b>	<b>(7.3)</b>	<b>(6.8)</b>	<b>(7.2)</b>	<b>(7.7)</b>
<b>- Exports</b>	<b>337</b>	<b>320</b>	<b>296</b>	<b>429</b>	<b>456</b>	<b>441</b>	<b>442</b>	<b>438</b>	<b>443</b>	<b>449</b>
- oil exports	47	41	26	67	97	84	63	56	61	67
- non-oil exports	291	279	270	362	359	357	378	382	382	382
<b>- Imports</b>	<b>518</b>	<b>478</b>	<b>398</b>	<b>619</b>	<b>721</b>	<b>686</b>	<b>729</b>	<b>723</b>	<b>746</b>	<b>769</b>
- oil imports	141	131	83	162	209	179	186	157	180	203
- non-oil imports	377	347	316	457	512	508	543	566	566	566
- gold imports	33	28	35	46	35	46	75	67	67	67
<b>Invisibles (net)</b>	<b>123</b>	<b>133</b>	<b>126</b>	<b>151</b>	<b>198</b>	<b>219</b>	<b>264</b>	<b>262</b>	<b>262</b>	<b>262</b>
- Services	82	85	89	108	143	163	189	190	190	190
- software	78	85	90	110	131	142	160	160	160	160
- non-software	4	0.3	(1)	(2)	12	21	29	31	31	31
- Transfers	70	75	73	80	101	106	123	125	125	125
- Income (net)	(29)	(27)	(36)	(37)	(46)	(50)	(48)	(53)	(53)	(53)
<b>Capital account</b>	<b>54</b>	<b>83</b>	<b>64</b>	<b>86</b>	<b>59</b>	<b>89</b>	<b>17</b>	<b>33</b>	<b>33</b>	<b>33</b>
Capital account/GDP (%)	2.0	2.9	2.4	2.7	1.8	2.3	0.4	0.8	0.8	0.8
Foreign investment	30	44	80	22	23	54	5	6	6	6
<b>- FDI</b>	<b>31</b>	<b>43</b>	<b>44</b>	<b>39</b>	<b>28</b>	<b>10</b>	<b>1</b>	<b>6</b>	<b>6</b>	<b>6</b>
<b>- FPI</b>	<b>(1)</b>	<b>1</b>	<b>36</b>	<b>(17)</b>	<b>(5)</b>	<b>44</b>	<b>4</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>- Equities</b>	<b>3</b>	<b>(0)</b>	<b>39</b>	<b>(16)</b>	<b>(6)</b>	<b>25</b>	<b>(16)</b>	<b>10</b>	<b>10</b>	<b>10</b>
<b>- Debt</b>	<b>(4)</b>	<b>1</b>	<b>(0)</b>	<b>2</b>	<b>1</b>	<b>19</b>	<b>19</b>	<b>(10)</b>	<b>(10)</b>	<b>(10)</b>
Banking capital	7	(5)	(21)	7	21	41	(10)	12	12	12
- NRI deposits	10	9	7	3	9	15	16	15	15	15
Short-term credit	2	(1)	(4)	20	7	(1)	7	5	5	5
ECBs	10	23	(0)	8	(4)	(0)	16	5	5	5
External assistance	3	4	11	5	6	7	6	5	5	5
Other capital account items	1	18	(2)	24	7	(12)	(7)	—	—	—
E&O	(0)	1	(0)	—	(1)	0	2	—	—	—
<b>Overall balance</b>	<b>(3.3)</b>	<b>59.5</b>	<b>87.3</b>	<b>47.5</b>	<b>(9.1)</b>	<b>63.7</b>	<b>(5.0)</b>	<b>10.1</b>	<b>(7.6)</b>	<b>(25.3)</b>
<b>Memo items</b>										
Average USD/INR	69.9	70.9	74.2	74.5	80.3	82.8	84.6	86.1	86.1	86.1
Average Brent (US\$/bbl)	70.0	60.9	44.8	80.0	95.4	82.9	78.2	60.0	70.0	80.0

Source: RBI, Kotak Economics Research

## We expect USD-INR to range 84-88 through the rest of FY2026

Exhibit 5: Trend and estimates of average INR and major currencies against US\$, March fiscal year-ends (X)

	2020	2021	2022	2023	2024	2025	2026E	1QFY25	2QFY25	3QFY25	4QFY25	1QFY26E	2QFY26E	3QFY26E	4QFY26E
<b>Average Rate</b>															
<b>USD/INR</b>	<b>70.9</b>	<b>74.2</b>	<b>74.5</b>	<b>80.4</b>	<b>82.8</b>	<b>84.6</b>	<b>86.1</b>	<b>83.4</b>	<b>83.8</b>	<b>84.5</b>	<b>86.6</b>	<b>85.6</b>	<b>86.0</b>	<b>86.3</b>	<b>86.5</b>
EUR/USD	1.11	1.14	1.16	1.04	1.08	1.07	1.16	1.08	1.10	1.07	1.05	1.13	1.16	1.18	1.18
GBP/USD	1.27	1.31	1.37	1.21	1.26	1.27	1.36	1.26	1.30	1.28	1.22	1.33	1.36	1.38	1.38
USD/JPY	108.7	106.0	112.4	135.6	144.6	152.5	141.1	155.8	149.0	152.5	152.7	144.5	142.0	140.0	138.0
<b>Depreciation (-)/appreciation (+) against USD (%)</b>															
<b>INR</b>	<b>(1.4)</b>	<b>(4.5)</b>	<b>(0.4)</b>	<b>(7.3)</b>	<b>(2.9)</b>	<b>(2.1)</b>	<b>(1.8)</b>	<b>(0.5)</b>	<b>(0.4)</b>	<b>(0.8)</b>	<b>(2.5)</b>	<b>1.2</b>	<b>(0.5)</b>	<b>(0.3)</b>	<b>(0.3)</b>
EUR	(4.1)	2.8	1.7	(10.3)	4.0	(1.1)	8.3	(0.8)	2.1	(3.0)	(1.5)	7.9	2.3	1.7	(0.4)
GBP	(3.2)	2.9	4.5	(11.7)	4.2	0.7	7.4	(0.5)	3.1	(1.5)	(4.8)	9.4	1.5	1.5	0.0
JPY	1.9	2.5	(5.6)	(17.1)	(6.2)	(5.2)	8.1	(4.7)	4.6	(2.3)	(0.2)	5.7	1.8	1.4	1.4

Source: Bloomberg, Kotak Economics Research

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**ADD.** We expect this stock to deliver 5-15% returns over the next 12 months.

**REDUCE.** We expect this stock to deliver -5+5% returns over the next 12 months.

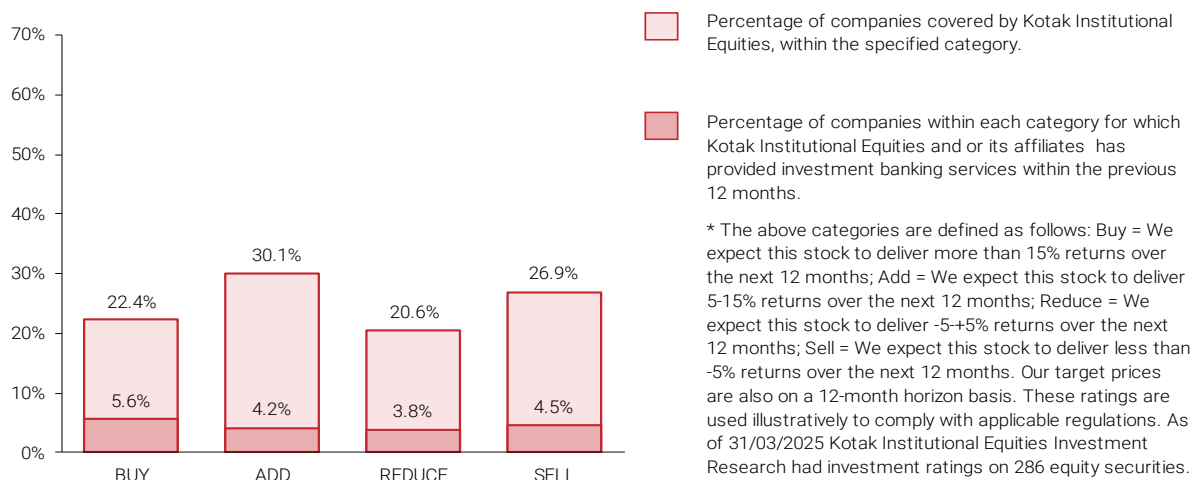
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Source: Kotak Institutional Equities

As of March 31, 2025

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