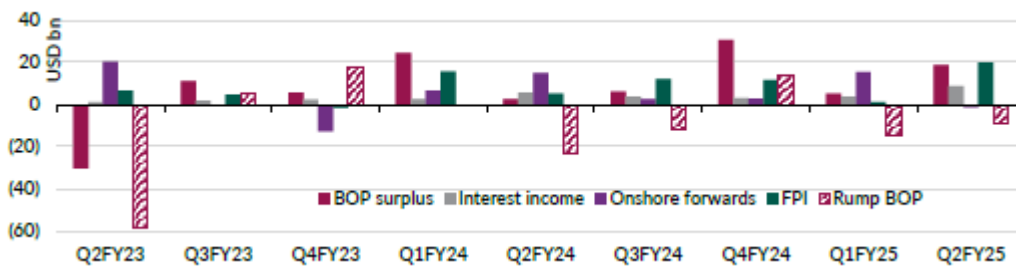


Likely 4Q improvement, but risks skewed against longer term

India's 2Q current account deficit at 1.2% of GDP was largely steady, with higher gold imports offset by services, remittances and interest inflows. Strong FPI flows allowed for reserve accumulation, but a closer look at BOP dynamics after stripping out interest on reserves, sterilization and FPI flows shows trends have been negative for some time. While there is some reason to expect a reversal in Q4, longer-term CAD is sensitive to improved growth while financial inflows depend on global savings. As we had outlined last month, increased volatility is the most likely outcome.

Exhibit: India BOP – stripping out volatile/management flows - weak



Source: Axis Bank Business and Economic Research

India 2Q current account deficit at USD 11.2 bn (1.2% of GDP)

The current account deficit printed largely steady at USD 11.2 bn (1Q 10.2 bn, 2QFY24 11.3 bn), despite widening of the merchandise trade deficit by USD 10 bn QoQ to 75.3 bn (on an increase in gold imports after duty cuts, in net electronics imports). This was largely offset by increased exports in software and other GCC services, lower royalty payments and rebound in remittances (weaker INR). The larger merchandise deficit was offset by seasonal increase in interest income to FX reserves. The merchandise deficit for Q3 so far has also been large, but this has been partly on miscalculation of gold imports – were this to normalise, 3Q CAD would also likely be stable, with 4Q numbers approaching a seasonal surplus keeping the annual CAD print below 1% of GDP.

Capital and financial account supported by FPI, but this masks far weaker trends

The financial and capital account (ex FX reserves) surplus was the largest in 6 quarters at USD 30.5 bn, with FPI flows making up 19.8 bn of this. Indications of heavy buildup of offshore shorts (unquantifiable) likely contributed to a chunk to financial inflows. Stripping out known sterilisation flows (not including those offshore), interest on FX reserves and FPI, the rump of stable BOP was negative – as with 4 of the past 5 quarters. Underlying this weakness is repatriation of past FDI with maturation of investments, and a skew of fresh FDI towards developed markets – with overall FDI also held back by the absence of QE and consumption-boosting fiscal spending across countries.

Potential reversal of positioning in Q4, but risks skewed against long-term

A look at NDF levels shows the presence of offshore positioning, with potential participation to hedge future outflows as well as likely trading positions. 4Q is seasonally positive from this standpoint, as well from one of a much smaller CAD. However, creation of global savings will likely be limited by trade barriers, absence of QE and fiscal stimulus, making long-term inflows unlikely – as we outlined in our note (link), an increase in volatility is the most logical path forward, and has been borne out so far.

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