DBS Flash

India: Terms of trade pressure eases, constructive BOP dynamics

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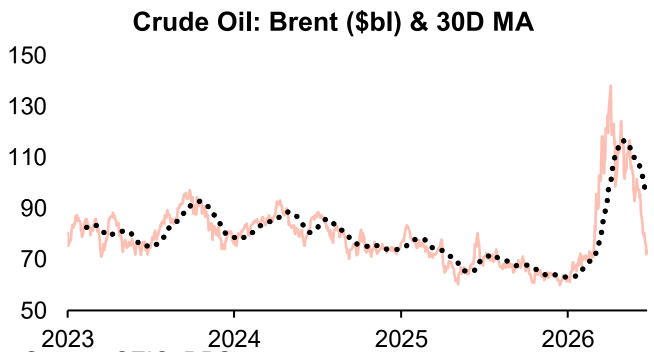
- *Global oil benchmarks are down by more than a third.*
- *This would help mitigate terms-of-trade pressures and strengthen the current account position.*
- *Host of BOP-accretive measures will help with the capital account math.*
- *Rupee is likely to benefit in the near-term, but we remain cautious further out.*
- *Monsoon watch. July-August rainfall will be important for crop output.*
- *Rate hike expectations are set to fade. We now expect an extended pause, with a downward revision in RBI CPI forecasts.*
- ***Forecast implications:** We revise macro forecasts to reflect the impact of lower oil prices.*

OIL PRICES OFF THE BOIL

Financial markets have been driven by the recent developments on the US-Iran developments, while global oil prices have beat a sharp retreat, pricing in the likelihood that peak of the geopolitical risk has passed. That said, it is too soon to conclude that conflict-related risks have been fully addressed.

A sharp drawdown in inventories, alternate fuel sources and diversion of part of the supplies from other pipeline/ port routes have helped to keep a lid on global benchmarks. Brent crude prices have retreated by about ~35% by late-Jun26, touching a four-month low, after the US-Iran signed the Memorandum of Understanding (MOU), entailing a 60-day ceasefire.



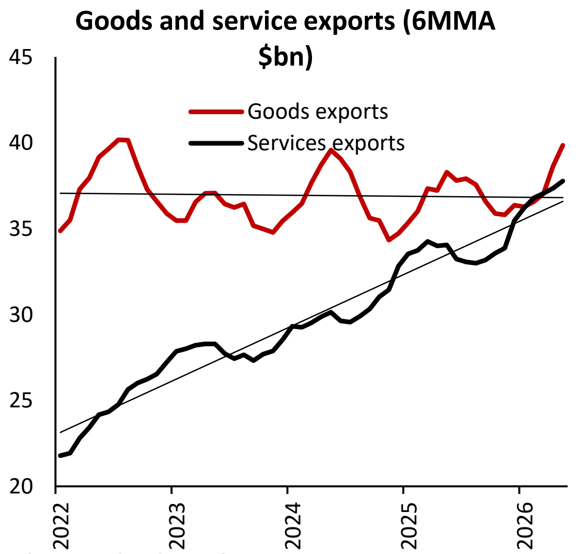
Source: CEIC, DBS

Lower oil prices have eased the terms of trade pressure on India, necessitating a relook across our macro assumptions. The key assumption behind these revisions is that the US-Iran-Middle East tensions have subsided, with oil likely to average $80-85bp in 2026, vs prevailing FY27 average at $104pb (FYTD). Any protracted re-escalation in tensions is a key risk.

REVISITING MACRO ASSUMPTIONS, CURRENT ACCOUNT RISKS EBB

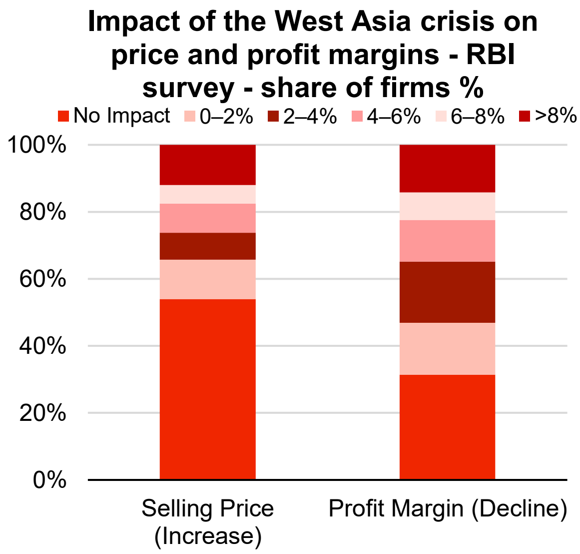
Since March 2026, the economic fallout of the Middle east crisis on overall trade has been relatively contained. Goods trade deficit between Mar26 to May26 was steady due to a combination of a sharp pick-up in nominal exports (record high in May26) helped by higher refined petroleum shipments, lower gold purchases due to duty increases and lower core imports. Diversification in export markets also played a part, with steady growth in shipments to the US and double-digit pace of increase in exports to China (25% yoy).

Average monthly trade deficit between Mar-May26 stood at $25.7bn vs $30.9bn in Jan-Feb26. Service exports have been firm, maintaining the Jan-Feb-26 run-rate, defying early concerns over AI-related slowdown in demand for software and capability centre services. **Limited deterioration in the trade account also reflected in the current account balance in April which generated a modest surplus.**



Source: CEIC, DBS

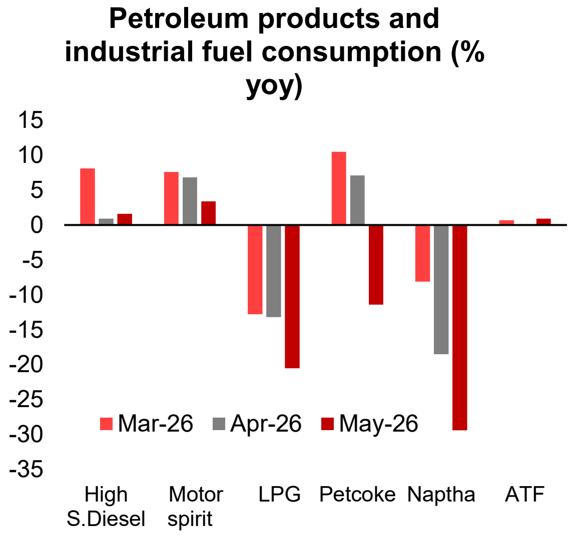
Amongst high-frequency activity indicators, the trend was mixed. PMI readings stabilised after a short-lived dip, remaining in expansionary terrain, besides resilient passenger vehicle sales, steady two-wheeler sales and firm capital production trends. PMI price sub-indices, however, pointed to an increase in producers' input costs. Results from the RBI Pulse survey – see chart – showed close to 46% of the firms surveyed witnessing an increase in selling prices.



Source: RBI, DBS

Consumption of petroleum products (LPG, transport fuels etc.) declined and industrial fuels (naptha, bitumen, petcoke etc) moderated in May. E-way bill generation and GST revenue growth also slowed, partly impacted by rationalisation moves in second half of 2025. Heatwaves and high temperatures led to a surge in power generation in 2Q26.

Meanwhile, the government plans to progress with the expansion of its strategic petroleum reserve (SPR) network, with five projects across Orissa, Madhya Pradesh, Rajasthan, Mangaluru and Padur (in Karnataka). Construction of one is likely to be awarded by end-FY27, while feasibility reports for two others might kickstart shortly.



Source: CMIE, DBS

In its sensitivity analysis, the RBI estimates that a 10% correction in oil prices, lifts growth by 15bp. With DBS baseline oil prices pointing to ~20% decrease from FYTD levels, our growth projection for FY27 stands revised up by 30bp to 6.8% yoy vs previous estimate of 6.5%. If oil prices stabilise around the lower end of our forecast range, annual growth could be closer to 7.0%.

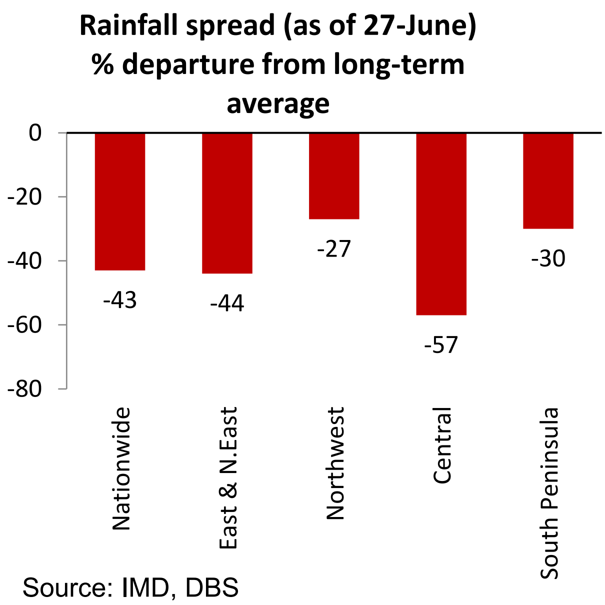
INFLATION RISKS – FUEL TO FOOD

Wholesale price index rose sharply to 9.7% yoy in May26, widening the wedge with the retail CPI inflation measure, which was at 3.9% yoy. The run-up in the WPI measure was driven by higher fuel, industrial raw materials, and manufacturing inflation, magnified by sharp depreciation in the currency, which further pushed up imported costs. While the sequential momentum will moderate, base effects and remnant cost push pressures will keep WPI inflation elevated in 2HFY27.

Retail CPI inflation has also been rising but a more modest pace since the start of the year. From average 2.1% yoy in FY26, the headline climbed to 3.9% yoy in May26, on higher food, base effects, transport/fuel and services (accommodation and restaurants). Domestic pump prices were revised by ~7% in the last month and we expect these revisions to stay to offset steep losses endured by the oil marketing companies. Improving fuel supplies, however, should have a salutary impact on LPG, LNG and fuel products.

From fuel to food. Monsoon progress will be crucial for the price outlook. IMD's updated forecast in June pointed to a 10% shortfall in this year's southwest monsoon. Yet far, the run-rate has been deficient at a nationwide deficit of 42%, with broad-based weakness across regions.

Sowing activity is keeping pace in June, although July and August trends will be key as these months account for more than two-third of the total precipitation. Adequate stock of foodgrains and satisfactory reservoir levels, also provide some comfort. As on 16-May, the rice and wheat stocks stood at 69.6mn tonnes (5.1x the buffer norm) and 46.5mn tonnes (6.2x the buffer norm), respectively. While there are ample foodgrain stocks, impact on prices/ inflation is likely to be more material in pulses, vegetables/ other perishables and oilseeds etc. **We retain our full-year inflation forecast of 4.9%.**

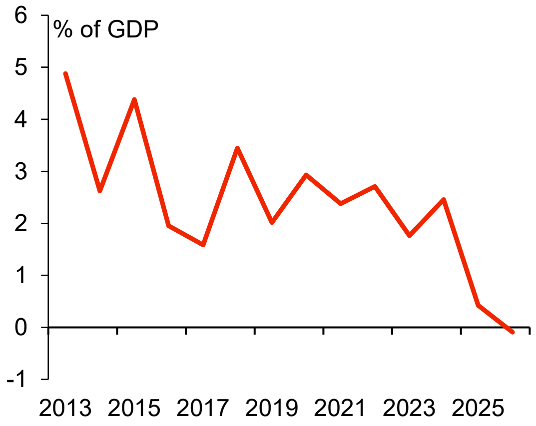


Source: IMD, DBS

CAPITAL ACCOUNT GETS A HAND FROM RBI/GOI

Weakening capital flows have been an enduring problem for the external balances for well over a year, dominated by a slowdown in foreign portfolio inflows, and narrower net FDI position. Cumulatively these had pushed the balance of payments position to a deficit in FY26, alongside a moderation in offshore borrowings.

BOP: Financing side (Capital account as % of GDP)



Source: GOI, RBI, CEIC, DBS

First quarter of FY27 proved to be a challenge as geopolitical risks and strong interest in AI-related (and value chain) stocks drew interests away from the Indian equity markets. Foreign outflows added up to -$13bn as of 24 June, while FPI debt inflows turned a corner in May-June. Net FDI stood at $6.5bn in Apr26, after totalling $6.9bn in FY26.

To support the capital account, **the RBI and government undertook a host of measures in June 2026 to shore up inflows, which included (see table):**

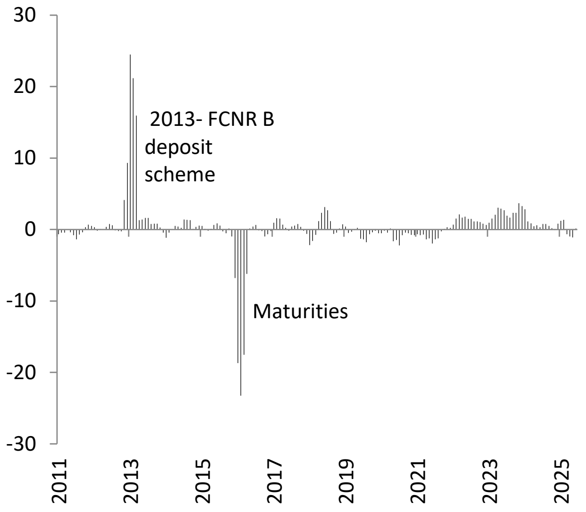
- **Expansion of FAR securities**: Universe of eligible securities under the Fully Accessible Route (FAR) was widened to include all new issuances of 15Y, 30Y, and 40Y G-secs. In addition, limits pertaining to short-term investment, concentration and individual securities on investment under the General Route were also removed.
- **FPI tax liberalisation**: Withholding tax (of 20%) and long-term capital gains tax on debt investors into FPI debt will be lifted, thereby drawing in more FPI inflow into Gsecs. This also paves the way for inclusion into other global FI benchmarks as well as adoption into the Euroclear platform.
- **Boost investment inflows from non-residents**: Limits for investment by NRIs and OCIs in equity instruments traded on the stock market without SEBI registration are being increased. This same facility was also extended to all individual Persons Resident Outside India (PROIs). This formalises changes announced by the government in the Budget.
- Concessional forex swap will be provided till 30th September 2026 to **incentivize ECBs** by public sector entities. Details on the final pricing is being awaited. Industry watchers peg the share of PSUs in outstanding ECBs at 35-40%.
- **FCNR (B) deposits**. Facility under which full hedging costs will be provided (by the RBI) till Sep26 for Authorised dealers (ADs) to raise fresh 3–5-year FCNR (B) deposits. This scheme mirrors the move back in 2013 (discounted swap; attracted $26bn in deposits and $34bn on wider concessional swap facilities) to draw in non-resident deposits but will necessitate a higher subsidy by the RBI in the context of higher US rates currently vs 2013. Arbitrage is attractive (spread between USD & INR is at ~250bp), despite being lower than past cycle. These will be exempt from CRR/ SLR, and leverage will be permitted.
- **Export realisation timeline**: Restore the time for realisation of export proceeds to nine months, from 15 months earlier. This will draw dollar flows by the exporters, helping to make trade-related flows more balanced and limit one-sided pressure on the rupee.

Measure	By	Estimated Size
FPI liberalisation	GOI	$20-25bn potential if added into global benchmarks; impact more likely in FY28
Expansion of Fully Accessible Route (FAR) to additional long-dated G-Secs	RBI	~$10–20bn over 12–24 months
Incentives for FCNR(B) deposits and NRI deposits	RBI	~$40-50bn
Concessional FX swap facility – ECBs to PSUs	RBI	~$10-15bn incremental inflows
Export realisation timeline	RBI	~$10–20 bn
Relaxation of investment norms for non-residents	RBI/GOI	~$3-$5bn

Source: RBI, DBS

To be sure, fresh deposits into the FCNR (B) deposits had been modest before this scheme (see chart). **By various yardsticks, there is reason to be optimistic at the scale of fresh dollar flows under the deposit and ECB schemes**. In 2013, when a similar FCNR (B) and overseas borrowing program were introduced, total inflows amounted to ~12.8% of FX reserves and ~2% of GDP. Assuming the same scale this year, total inflows could amount to ~$70-$75bn. With US rates, however, being higher this time around than 2013 and consequently narrower spreads, we are opting to be conservative with an assumption of $40-$50bn worth inflows. Debt-FAR category has, meanwhile, attracted strong foreign inflows of ~$5bn+ in June 2026 alone, on likely front-running flows i.e., expectations that India's eligible papers will be included in Bloomberg's Global aggregate indices in the upcoming review. Tax breaks have also been a strong draw.

FCNR B deposits ($bn)



Source: CEIC, DBS

Inflows from the FCNR(B) scheme (open till Sep26) and increase in ECBs will have **second-derivative impact on the domestic financial system**. While the FX swap makes the transaction (of incoming dollars), neutral on INR spot, rupee borrowing costs to ease, decrease in ECB funding costs for PSUs (and spillover benefits to rest), and liquidity surplus to widen, necessitating nimble market operations by the central bank. A host of institutions have also raised dollar bonds in the past fortnight, though the supply surge has led to a temporary widening in yields, resulting in a scaled back pipeline.

BOP implications

In midst of the US-Iran conflict, India's balance of payments was on course to register a third consecutive annual deficit in FY27, a first. The scale of the gap hinged on the underlying oil price assumption and risk sentiments. Prior to the cessation in tensions, our baseline forecast was for a -$65bn BOP deficit, which could potentially widen to >-$80bn if the conflict dragged on. **With the ceasefire in place and oil prices having corrected sharply, we revisit our current account (to account for lower oil, gold curbs) and capital account (RBI/GOI measures)**. We now expect a BOP surplus as highlighted in the table below.

Balance of payments (USDbn)

	FY26	FY27E (Conflict)	FY27E (Revised)
a. Current account	31.8	*80.0*	*45.0*
as % of GDP	*0.8*	*2.0*	*1.1*
Merchandise	337.0	360.0	335.0
Invisibles	312.0	280.0	290.0
b. Capital account	1.9	*9.9*	*67.0*
as % of GDP	0.0	0.2	1.7
BOP (-ve in red)	35.5	65.0	22.0

Source: RBI, DBS; Annual (-ve values in red)

FISCAL AND MARKET IMPLICATIONS

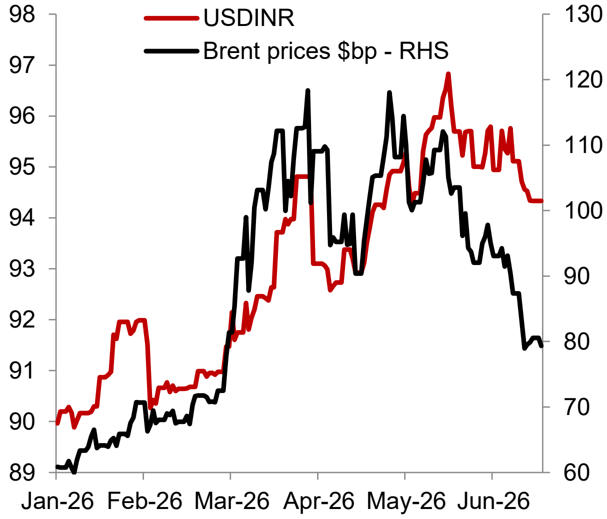
The need to accommodate higher subsidies and lower revenue growth is likely to result in a modestly wider fiscal deficit in FY27.

While a pullback in energy costs lowers the potential burden on the exchequer, we expect subsidy support to stay elevated due to the need to pick additional costs from 1QFY27 as well as offset potential impact on the rural economy from a strong El Nino development.

Factoring in a) economic stabilisation fund buffer (+0.25% of GDP), higher non-tax revenue and slightly higher nominal GDP growth, on one hand; b) on the other hand, cost of excise duty cut and higher subsidies to **result in ~0.3% of GDP slippage risk vs budgeted -4.3% of GDP**. Markets and rating agencies are likely to look past this modest slippage, factoring in the broader positive track record of fiscal consolidation at the centre in recent years.

Risk sentiment towards asset markets of oil-dependent economies benefited significantly on the US-Iran peace deal announcement. India's equity, bonds, and rupee have gained ground this month, further fuelling a turnaround that was already underway since the RBI announced BOP-supportive measures on 5-June

USDINR and Brent prices



Source: CEIC, DBS

In the near-term, there is scope for further downside in the USDINR on expectations of these flows and lower commodity prices. Further out., we expect authorities to prefer absorbing incremental dollar flows to boost the reserves position, paving the way for a gradual rise in the USDINR.

Benchmark bond yields are likely to stay capped at the short-end and 10Y part of the curve as lower oil prices lead to a reassessment in associated macroeconomic risks. Rate hike expectations have been scaled back after the June MPC minutes and recent comments from the RBI Governor where he said that rate hike talks were premature and any such intention would have pre-empted by a shift to a tightening stance in June. For inflation, geopolitics were a bigger worry rather monsoon for the central bank, in our view. **We remove our rate hike forecast for FY27** and see downside to our end-year forecast for 10Y yield forecast of 6.9%.

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