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INDIA'S CURRENT ACCOUNT AND CAPITAL FLOWS IN THE POST-COVID-19 ERA: TRENDS, AND EMERGING OPPORTUNITIES: A STUDY

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ABSTRACT
India's external sector plays a crucial role in maintaining macroeconomic stability through the interaction of the current account and capital and financial flows. The COVID-19 pandemic led to an unusual external-sector adjustment, with India recording a current account surplus in 2020–21. As economic activity recovered, rising commodity prices and merchandise imports widened the current account deficit (CAD) during 2021–22 and 2022–23. The CAD subsequently narrowed due to resilient services exports, moderation in commodity prices and strong remittance inflows. This study analyses India's current account balance and capital/financial flows during the post-COVID-19 period, covering FY2020–21 to FY2024–25. The study is descriptive and analytical and relies exclusively on secondary data from the RBI, Government of India, IMF and other authoritative sources. The findings indicate considerable fluctuations in India's external-sector position during the study period. FDI emerged as a relatively stable source of external financing, while FPI remained more volatile and sensitive to global financial conditions. Strong services exports and remittances helped contain external vulnerability. However, merchandise trade deficits, crude-oil import dependence and capital-flow volatility remain key challenges. The study recommends export diversification, greater domestic value addition, energy diversification and stable long-term capital inflows to strengthen India's external-sector resilience.

KEYWORDS: *Current Account, Current Account Deficit, Capital Flows, Foreign Direct Investment, Foreign Portfolio Investment, Balance of Payments, External Sector, India, COVID-19, Foreign Exchange Reserves.*

INTRODUCTION

The Balance of Payments (BoP) systematically records a country's economic transactions with the rest of the world during a specified period. For India, the external sector is increasingly important due to its integration with global trade and financial markets. India's external position is influenced by merchandise trade, services exports, remittances, FDI, FPI and external borrowings.

The COVID-19 pandemic created an exceptional external shock, reducing domestic demand, imports and international crude-oil prices. Consequently, India recorded a current account surplus of approximately US$23.9 billion in FY2020–21. With economic recovery, rising commodity prices and increased imports, the current account shifted to a deficit of US$38.8 billion in 2021–22. The deficit widened further to approximately US$67.1 billion in 2022–23.

India's external position improved in 2023–24, with the CAD narrowing to about US$23.2 billion, supported by strong services exports and remittances. Capital and financial flows, including FDI, FPI, external commercial borrowings and banking capital, play an important role in financing the CAD. The global interest rates, geopolitical tensions, commodity-price volatility and investor sentiment create uncertainties in capital flows. FDI generally provides relatively stable long-term financing, while FPI is more sensitive to global financial conditions. Therefore, maintaining a sustainable CAD and stable capital inflows is essential for India's long-term external-sector resilience. The relationship can therefore be expressed conceptually as: **Current Account Deficit → External Financing Requirement → Capital/Financial Inflows → Foreign-Exchange Reserves and External Stability**

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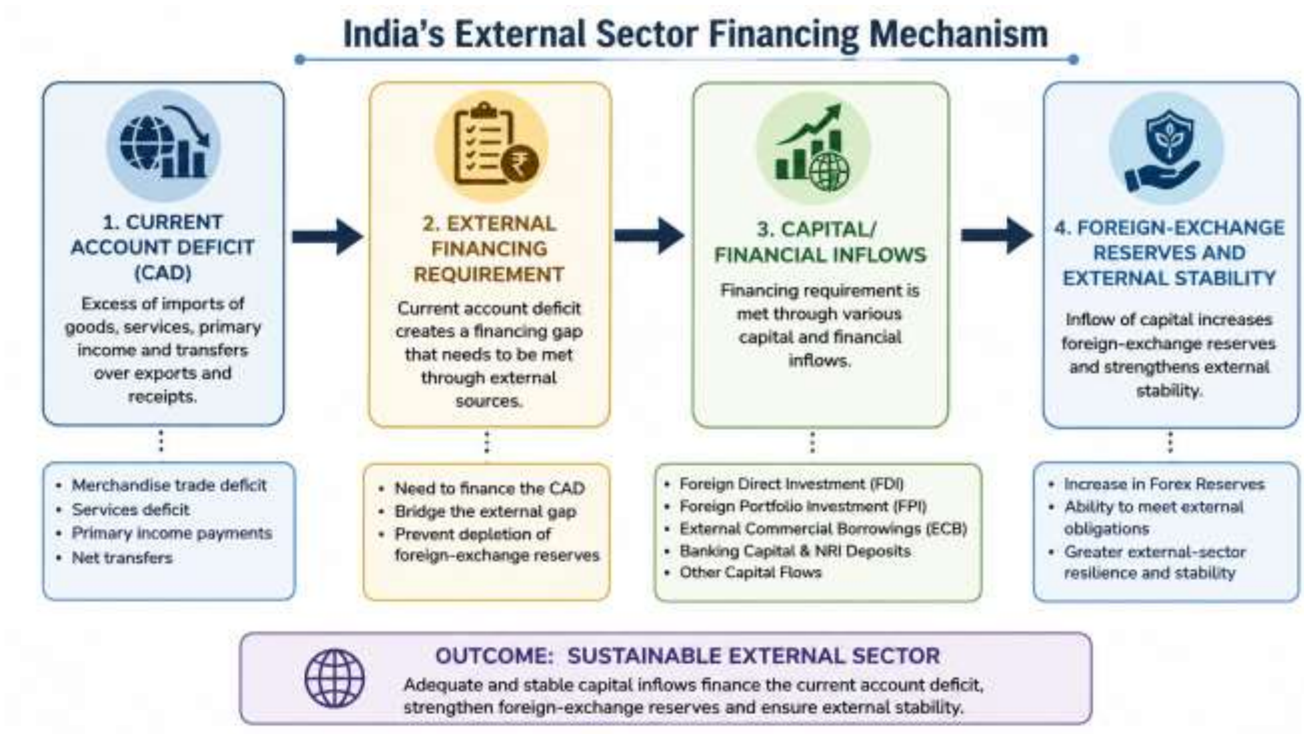

Fig: Shows Current accounts deficit and Linkage between Current Account Deficit and Capital Inflows

The central concern of this study is whether India's current account deficit remains manageable and whether the country's capital inflows are sufficiently stable and productive to finance external imbalances.

Meaning of Current Account

The current account represents the component of the Balance of Payments that records a country's transactions in goods, services, primary income and secondary income with the rest of the world during a specified period. The current account records transactions relating to the exchange of goods and services, primary income and secondary income between a country and the rest of the world. In simplified form: Current Account Balance = Goods Balance + Services Balance + Primary Income Balance + Secondary Income Balance

The goods balance represents merchandise exports minus merchandise imports. The services balance records international transactions involving IT services, business services, travel, transportation, financial services and other services. Primary income includes compensation of employees and investment income, while secondary income includes transfers such as remittances. A current account surplus means that the country receives more income from current international transactions than it pays abroad. A current account deficit means that payments to the rest of the world exceed receipts.

Definition of Current Account

" The current account is the part of the Balance of Payments that records a country's exports and imports of goods and services, income earned and paid abroad, and current transfers with other countries."

According to the International Monetary Fund (IMF), the current account records transactions involving goods and services, primary income, and secondary income between residents and non-residents. The Current Account of the Balance of Payments (BoP) consists of four major components

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Tables No:1 Components of the Current Account

Sl.No	Components	Meaning	Examples
1.	Goods	Records exports and imports of physical goods	Machinery, petroleum, agricultural products, textiles
2.	Services	Records international transactions in services	Tourism, transport, banking, IT and business services
3.	Primary Income	Records income earned from factors of production across borders	Wages, interest, dividends, profits and investment income
4.	Secondary Income	Records current transfers where nothing is received in return	Workers' remittances, gifts, grants and donations

Meaning of Current Account Deficit (CAD)

A Current Account Deficit (CAD) occurs when a country's payments to the rest of the world exceed its receipts through transactions in goods, services, primary income, and secondary income during a given period. In simple terms, a country is spending more foreign exchange abroad than it is earning from abroad through current-account transactions. India has historically recorded merchandise trade deficits because imports of crude oil, electronics, machinery, gold and other goods are considerably higher than merchandise exports. India's substantial services surplus and remittance inflows partially offset the merchandise trade deficit.

"A current account deficit occurs when the value of a country's imports of goods and services, together with its net income and transfer payments abroad, exceeds the value of its exports and other current receipts."

Components of Current Account Deficit (CAD)

A Current Account Deficit (CAD) is not a separate account with different components; rather, it arises when the components of the current account collectively produce a negative balance.

Table No.2 Components of Current Account Deficit

Sl.No	Components	contributes to CAD	Examples
1.	Trade in Goods	Imports of goods exceed exports of goods	Crude oil, machinery, electronics, gold
2.	Trade in Services	Payments for imported services exceed receipts from exported services	Tourism, transport, financial services
3.	Primary Income	Income paid to foreign investors/workers exceeds income received from abroad	Interest, dividends, profits, wages
4.	Secondary Income	Transfers paid abroad exceed transfers received from abroad	Remittances, gifts, grants, donations

Capital Flows in India

Capital flows refer to the movement of financial resources between India and the rest of the world. They include foreign investment, external borrowing, banking capital, and other financial transactions that create financial claims between Indian residents and non-residents.

Capital flows are an important part of India's Balance of Payments (BoP) because they help finance the Current Account Deficit (CAD) and influence foreign-exchange reserves, exchange rates, investment, and economic growth.

Table No:3 Major Types of Capital Flows in India

Sl.No	Type of Capital inflows	Meaning	Examples
1.	Foreign Direct Investment (FDI)	Investment by foreign investors in Indian businesses with a lasting interest and significant influence	Foreign companies establishing factories or acquiring stakes in Indian companies
2.	Foreign Portfolio Investment (FPI)	Foreign investment in Indian financial securities without controlling the business	Investment in shares, bonds and other securities
3.	External Commercial Borrowings (ECBs)	Loans raised by eligible Indian companies and entities from foreign sources	Foreign currency loans and international bonds
4.	Non-Resident Deposits	Deposits maintained by non-resident Indians with Indian banks	NRE, NRO and FCNR(B) deposits
5.	Banking Capital	Cross-border financial transactions of banks	Foreign assets and liabilities of Indian banks
6.	Other Capital Flows	Other financial transactions not covered under the major categories	Trade credit, loans and other financial claims

Objectives of the Study

The study has the following objectives:

1. To examine the trend of India's current account balance during the post-COVID-19 period.
2. To examine the major components of India's current account and to analyse the role of services exports and remittances in reducing the Current Account Deficit (CAD).
3. To examine trends in FDI and FPI inflows after COVID-19.
4. To analyse the relationship between current account imbalances and capital/financial flows.
5. To suggest policy measures for maintaining sustainable external-sector stability.

Review of Literature

Holmes, Panagiotidis, and Sharma (2011) examined the long-run sustainability of India's current account using data beginning in 1950. Their analysis identified different regimes in the relationship between exports and imports, with stronger evidence of cointegration after the late 1990s, coinciding with India's economic liberalisation. The study established that the sustainability of India's external position is closely associated with the structural relationship between exports and imports.

Nabar-Bhaduri (2018) critically examined India's persistent trade and current-account deficits and argued that the merchandise trade deficit represents a structural challenge to external sustainability. The study also recognised the important contribution of services exports, remittances and capital inflows in financing India's merchandise trade deficit. However, dependence on these sources may create vulnerabilities when global economic conditions deteriorate or capital flows reverse.

Chitgupi (2019) investigated the sustainability of India's current-account deficit with particular emphasis on remittances and software-services exports. The study found that the inclusion of net invisibles improved the sustainability of the current account and highlighted the significant contribution of remittances and software-services exports to external adjustment. The findings demonstrate the importance of invisible receipts in reducing pressure arising from India's merchandise trade deficit.

Gupta and Jain (2021) analysed capital-flow volatility in India in comparison with other emerging markets. Their study highlighted the vulnerability associated with sudden reversals in capital flows and their potential effects on financial and macroeconomic stability. The authors emphasised the importance of adequate foreign-exchange reserves, exchange-rate flexibility, sustainable current-account management and a greater reliance on stable, long-term foreign investment.

Reserve Bank of India (2022) examined India's external-sector performance during the COVID-19 period. The analysis showed that the pandemic affected international trade and investment flows, while lower imports, resilient services exports and remittance receipts supported India's balance of payments. The study also highlighted the importance of foreign-exchange reserves in providing a buffer against external shocks and maintaining financial stability.

Reserve Bank of India (2023) analysed India's external-sector developments during the post-pandemic economic recovery. The analysis indicated that the widening merchandise trade deficit placed pressure on the current account, while strong services exports and private transfer receipts provided significant support. The RBI also highlighted the importance of capital flows in meeting India's external financing requirements and maintaining balance-of-payments stability.

Sahoo (2024) examined the sustainability of India's current account using the intertemporal budget constraint framework and data covering 1980–2019. The study found that exports and imports were not cointegrated over the full period and that the current-account series was not mean-reverting, indicating concerns regarding overall current-account sustainability. Importantly, the disaggregated analysis showed that the goods account was not sustainable, whereas the services account demonstrated long-run sustainability. These findings reinforce the importance of services exports in supporting India's external-sector adjustment.

Reserve Bank of India (2024) reported a significant improvement in India's external position during FY2023–24. The current-account deficit narrowed substantially, supported by an improvement in the merchandise trade balance, stronger services exports and higher secondary-income receipts. The findings demonstrate the growing contribution of services exports and remittances to India's external-sector resilience.

Dixit, Malik, Jaiswal, and Hemat (2025) examined the relationship between services trade, economic growth and India's current-account dynamics using a Balance of Payments Constrained Growth framework and cointegration techniques. The study identified insurance, construction, telecommunications, transport and travel as important service sectors with strong linkages to India's economic and external performance. The findings highlight the stabilising role of services trade in mitigating current-account pressures and emphasise the strategic importance of developing high-value service exports.

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International Monetary Fund (2025) assessed India's external position and identified both strengths and vulnerabilities in the country's external sector. The analysis highlighted the importance of services exports, foreign-exchange reserves and capital flows in maintaining external stability, while also identifying global financial volatility, weakening external demand, geoeconomic fragmentation and commodity-price movements as important sources of external risk. The IMF also emphasised the need to improve the investment environment and promote policies that support sustainable foreign investment.

Reserve Bank of India (2025) provided recent evidence on India's post-COVID external-sector performance. The RBI highlighted the resilience of India's external sector, supported by strong services exports, private transfer receipts, manageable current-account deficits and substantial foreign-exchange reserves. At the same time, volatility in portfolio investment and changing global financial conditions remained important external risks. The findings demonstrate that adequate reserves and diversified foreign-exchange earnings have strengthened India's capacity to absorb external shocks and maintain macroeconomic stability.

Statement of the Problem

India's external sector faces a structural challenge arising from the coexistence of a persistent merchandise trade deficit and strong dependence on international capital and foreign-exchange earnings. The COVID-19 pandemic temporarily altered this structure by reducing imports and producing a current account surplus. However, the subsequent recovery generated strong import demand and increased the CAD.

The problem is particularly important because India's largest imports include crude oil, petroleum products, electronics, machinery and gold. International price fluctuations in these commodities can significantly affect India's import bill. At the same time, capital inflows are not uniformly stable. FDI generally provides long-term financing, whereas FPI can reverse rapidly during periods of global financial stress.

Research Gap

Based on the reviewed literature, the following research gaps are identified. First, much of the COVID-19 literature examined the immediate external-sector impact of the pandemic, whereas the post-pandemic adjustment process requires analysis over a longer period. Second, several studies examine either the current account or capital flows independently. A combined analysis provides a more comprehensive understanding of India's external-sector sustainability.

Third, the rapid growth of services exports and remittance income has fundamentally altered the capacity of India to offset merchandise trade deficits. This interaction deserves greater attention. Fourth, capital inflows should not be assessed only in terms of quantity. The composition, stability and developmental contribution of capital inflows are equally important. Finally, the post-COVID period has been characterised by geopolitical uncertainty, high global interest rates and commodity-price volatility. These factors create a new external environment that differs from the pre-pandemic period. The present study attempts to address these gaps through an integrated descriptive analysis of India's current account and capital or financial flows.

RESEARCH METHODOLOGY

Research Design

The study adopts a *descriptive and analytical research design*. The study adopts a descriptive and analytical research design to examine India’s external-sector performance during the post-COVID-19 period. It describes the trends in the current account balance, Current Account Deficit (CAD), and its major components**.** The study also analyses trends in services exports, remittances, FDI, and FPI inflows**.** Secondary data are used to identify the relationship between current account imbalances and capital/ of financial flows**.** The findings are interpreted to assess external-sector stability and provide appropriate policy suggestions for sustainable economic management**.**

Nature of Data

The study is based entirely on secondary data collected from reliable and authoritative national and international sources. The Reserve Bank of India (RBI) is the primary source for data relating to India’s Balance of Payments, current account balance, CAD, foreign-exchange reserves, FDI, and FPI. Data on international trade, exports and imports are obtained from the Ministry of Commerce and Industry and relevant government publications. Information relating to foreign investment and industrial development is sourced from the Department for Promotion of Industry and Internal Trade (DPIIT) and the Ministry of Finance, Government of India. Internationally comparable macroeconomic indicators are obtained from the International Monetary Fund (IMF) and the World Bank**.** In addition, relevant data and information are supplemented by other official reports, statistical publications, annual reports, and government documents to ensure the reliability and comprehensiveness of the analysis.

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Study Period

The study covers the period from FY 2020–21 to FY 2024–25, providing a five-year perspective on India's external-sector performance. FY 2020–21 represents the period significantly affected by the COVID-19 pandemic and the associated disruptions to economic activity and international trade. FY 2021–22 onwards reflects the phase of economic recovery, reopening, and subsequent post-pandemic adjustment. This period enables the study to examine changes in India's current account balance, Current Account Deficit (CAD), services exports, remittances, FDI, and FPI flows during and after the pandemic.

Analytical Tools

The study employs trend analysis, percentage change, ratio analysis, comparative analysis, and component-wise analysis to examine the behaviour of India's external-sector indicators. Trend analysis is used to identify changes over the study period, while percentage and ratio analysis measure the magnitude and relative performance of key indicators. Comparative and component-wise analyses are applied to assess changes in the current account and capital/financial flows. The findings are interpreted using relevant secondary macroeconomic indicators to evaluate India's external-sector performance and stability.

Analysis of India's Current Account

India's current account position fluctuated significantly during the study period, shifting from a surplus in FY 2020–21 to a deficit thereafter. The CAD widened in FY 2022–23 but moderated substantially in the following years, indicating an improvement in India's external-sector position.

Table 4: India's Current Account Balance, 2020–21 to 2024–25

Sl.No	Financial Year	Current Account Balance (US$ billion)	CAD/Surplus as % of GDP	Broad Position
1.	2020–21	+23.9	+0.9%	Surplus
2.	2021–22	-38.8	-1.2%	Deficit
3.	2022–23	-67.1	-2.0%	Deficit
4.	2023–24	-23.2	-0.7%	Deficit
5.	2024–25	Around -23	Around -0.6%	Moderate Deficit

Source: Reserve Bank of India from 2020-25

Interpretation: India recorded a current account surplus of US$23.9 billion (0.9% of GDP) in FY 2020–21, mainly due to pandemic-related reductions in imports. The current account shifted to a deficit of US$38.8 billion in FY 2021–22 as economic activity and imports recovered. The deficit widened to US$67.1 billion (2.0% of GDP) in FY 2022–23, reflecting higher merchandise imports and global commodity-price pressures. It subsequently narrowed to US$23.2 billion (0.7% of GDP) in FY 2023–24. In FY 2024–25, the CAD remained moderate at around US$23 billion (0.6% of GDP). Overall, the trend indicates an improvement in India's external-sector position after the peak deficit in FY 2022–23, supported by services exports and remittance inflows.

Merchandise Trade and the Current Account

The Merchandise trade is a major determinant of India's current account position, as a persistent excess of merchandise imports over exports contributes significantly to the trade deficit and CAD. Higher import costs, particularly for crude oil, gold, and capital goods, can widen the current account deficit, while stronger merchandise exports help reduce it. The merchandise trade deficit is the most important structural component of India's current account.

Table 5: India's Merchandise Trade Position

Sl.No	Year	Merchandise Exports (US$ billion)	Merchandise Imports	Merchandise Trade Deficit
1.	2020–21	291.8	394.4	-102.6
2.	2021–22	422.0	613.1	-191.1
3.	2022–23	451.1	716.0	-264.9
4.	2023–24	437.1	678.2	-241.1
5.	2024–25	437.4	720.2	-282.8

Source: Ministry of Commerce and Industry; DGCI&S and Exim Bank of India.

Interpretation : India's merchandise trade deficit widened considerably from US$102.6 billion in FY 2020–21 to US$282.8 billion in FY 2024–25. Merchandise exports increased strongly after the pandemic but remained below the growth in imports, which reached US$720.2 billion in FY 2024–25. The trade deficit peaked at US$264.9 billion in FY 2022–23, narrowed slightly in FY 2023–24, and

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widened again in FY 2024–25. This persistent merchandise trade deficit remains a major source of pressure on India's current account balance**.** The trend highlights the need to strengthen export competitiveness and reduce excessive dependence on imported goods.

Role of Services Exports
The Services exports constitute one of India's major external-sector strengths and play an important role in supporting the balance of payments. India has developed strong international competitiveness in information technology, software, business, professional, and telecommunications services**.** In addition, financial services, consulting, research and development, and other knowledge-based services contribute significantly to export earnings. Strong services exports help offset the merchandise trade deficit and thereby moderate the Current Account Deficit. Consequently, the services sector has become an important source of foreign-exchange earnings and external-sector resilience. The services surplus substantially offsets the merchandise trade deficit.

Table 6: India's Services Exports, FY 2020–21 to FY 2024–25

Sl.No	Financial Year	Services Exports (US$ billion)	Annual Change (%)	Broad Trend
1.	2020–21	206.1	—	Moderate
2.	2021–22	254.5	23.5	Strong Growth
3.	2022–23	325.3	27.8	Significant Growth
4.	2023–24	341.1	4.9	Continued Growth
5.	2024–25	387.5	13.6	Strong Growth

Source: Compiled from Reserve Bank of India (RBI) and *Balance of Payments Statistics* of India from 2020-25

Interpretation : India's services exports increased substantially from US$206.1 billion in FY 2020–21 to around US$387.5 billion in FY 2024–25, demonstrating strong post-pandemic recovery. The highest growth was observed during FY 2021–22 and FY 2022–23, supported by strong demand for IT and business services. Although growth moderated in FY 2023–24, services exports continued to expand and accelerated again in FY 2024–25. The sustained services surplus has helped partly offset India's large merchandise trade deficit**.** Thus, services exports remain a major source of foreign-exchange earnings and an important stabilising factor for India's current account**.**

Major Components Supporting India's Current Account
India's current account is supported mainly by services exports and secondary income, particularly private remittances, which generate substantial foreign-exchange receipts. The services sector has consistently recorded a sizeable surplus, helping offset the persistent merchandise trade deficit. Remittance inflows further strengthen the external position, while primary income remains a net outflow. Together, these components play a crucial role in moderating India's Current Account Deficit (CAD).

Table 7: Major Components Supporting India's Current Account
FY 2020–21 to FY 2024–25

Sl.No	Financial Year	Services Exports	Services Balance	Secondary Income / Transfers	Primary Income Balance
1.	**2020–21**	206.1	+88.6	+74.4	−36.0
2.	**2021–22**	254.5	+107.5	+81.2	−37.3
3.	**2022–23**	325.3	+143.3	+101.8	−45.9
4.	**2023–24**	341.1	+162.8	+105.9	−49.8
5.	**2024–25**	383.5	+188.6	—	—

Source: Compiled from Reserve Bank of India (RBI), *Balance of Payments Statistics and Annual Reports* and India's official external-sector data from 2020-2025.

Interpretation : The table shows a strong and sustained increase in India's **services surplus**, from US$88.6 billion in FY 2020–21 to about US$188.6 billion in FY 2024–25. This substantial surplus, together with strong remittance/transfer receipts, has provided an important cushion against the merchandise trade deficit and helped contain the CAD.

Role of Remittances
Remittances are a major source of foreign-exchange earnings for India and are recorded under secondary income in the Balance of Payments. They support household consumption, savings, and investment**,** particularly among recipient families. Strong remittance inflows enhance foreign-exchange availability and help partially offset the merchandise trade deficit**.** They therefore contribute to strengthening the current account position and reducing external financing pressures**.** Together, services exports and remittances represent key strengths of India's external sector and support overall external stability.

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Foreign Direct Investment (FDI)

Foreign Direct Investment represents one of the most important forms of long-term capital inflow into India and plays a significant role in strengthening the productive capacity of the economy. FDI contributes to capital formation and employment generation by supporting new businesses, industries, and infrastructure. It also facilitates the transfer of advanced technology, managerial skills, and international business practices to domestic enterprises. Furthermore, foreign investment can enhance India's export capacity and participation in global value chains, thereby improving international competitiveness. Thus, FDI provides relatively stable external financing while contributing to economic growth, productivity, and long-term external-sector stability**.** The following table uses RBI's net FDI measure**,** which is particularly relevant for analysing the external sector because it accounts for inward FDI, repatriation/disinvestment and outward FDI. RBI reports net FDI of US$44.0 billion in 2020–21, US$38.6 billion in 2021–22, US$28.0 billion in 2022–23, US$10.1 billion in 2023–24 and US$0.4 billion in 2024–25

Table 8: FDI and India's External Sector, FY2020–21 to FY2024–25

Sl.No	Financial Year	Gross FDI Inflows (US$ bn)	Net Inward FDI (US$ bn)	Net FDI (US$ bn)	External-Sector Implication
1.	**2020–21**	82.0	54.9	44.0	Strong capital inflow
2.	**2021–22**	84.8	56.2	38.6	Continued support
3.	**2022–23**	71.4	42.0	28.0	Moderate support
4.	**2023–24**	71.3	26.8	10.1	Reduced net contribution
5.	**2024–25**	81.0	29.6	0.4	Very limited net

Source: Reserve Bank of India & Annual Reports 2020-2025.

Interpretation: FDI remained an important source of external financing throughout the post-COVID period, although its **net contribution declined considerably** over time. Gross FDI inflows increased from US$82.0 billion in FY2020–21 to US$84.8 billion in FY2021–22 and recovered to US$81.0 billion in FY2024–25. However, net FDI declined from US$44.0 billion to only US$0.4 billion during the study period, mainly because of higher disinvestment and outward FDI. Therefore, FDI remains strategically important for capital formation, technology transfer, productivity and export capacity, but its declining net inflow highlights the need to improve investment retention, policy stability and the attractiveness of India as a long-term investment destination.

Foreign Portfolio Investment

Foreign Portfolio Investment (FPI) represents foreign investment in financial assets such as equities, government securities, corporate bonds and other marketable instruments. Unlike FDI, FPI does not generally involve long-term managerial control over enterprises and is therefore more sensitive to changes in international financial conditions. Portfolio flows are influenced by global interest rates, US monetary policy, exchange-rate expectations, geopolitical developments, domestic economic performance and global investor risk factors. Strong FPI inflows can provide foreign-exchange resources, deepen domestic capital markets and support the financing of external-sector requirements. Thus, FPI provides an important but relatively volatile component of India's financial account.

Table 9: Foreign Portfolio Investment and India's External Sector

Sl.No	Financial Year	Net Portfolio Investment (US$ billion)	External-Sector Position
1.	**2020–21**	**36.1**	Strong inflow
2.	**2021–22**	**−16.8**	Significant outflow
3.	**2022–23**	**−5.2**	Moderate outflow
4.	**2023–24**	**44.1**	Strong inflow
5.	**2024–25**	**1.7**	Marginal inflow

Source: Reserve Bank of India, Balance of Payments and Annual Reports.

Interpretation : A strong inflow of US$36.1 billion in FY2020–21 was followed by substantial outflows in FY2021–22 and FY2022–23. FPI recovered sharply in FY2023–24, recording an inflow of US$44.1 billion and strengthening India's financial account. However, inflows moderated to about US$1.7 billion in FY2024–25 amid global uncertainty and risk aversion. Overall, FPI provides valuable external financing but remains highly sensitive to global financial conditions and can create exchange-rate and capital-flow volatility.

Capital Flows and External Financing

Capital flows provide an important source of external financing for India, particularly when the current account records a deficit. They include FDI, FPI, external borrowings, banking capital and other financial flows that help meet external financing requirements. Stable and adequate capital inflows support the balance of payments, foreign-exchange reserves and overall external-sector stability.

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Table 10: Capital Flows and External Financing in India

Sl.No	Financial Year	Net Capital Flows (US$ billion)	Net Capital Flows (% of GDP)	External Financing Position
1.	2020–21	63.7	2.7%	Strong
2.	2021–22	—	1.8%	Moderate
3.	2022–23	68.1	1.8%	Moderate
4.	2023–24	25.7	2.5%	Improved
5.	2024–25	21.7	—	Moderate

Source: Reserve Bank of India, Annual Reports and Balance of Payments data.

Current Account and Capital Account Relationship

India's current account reflects the net position arising from goods, services, primary income and secondary income, while the capital and financial account records cross-border investment and financing flows. A current account deficit generally requires adequate capital and financial inflows to meet the external financing requirement.

Table11 : Current Account and Capital Account Relationship, India

Sl.No	Financial Year	Current Account Balance (% of GDP)	Net Capital Flows (% of GDP)	External Position
1.	2020–21	**+0.9%**	**2.7%**	Current account surplus
2.	2021–22	**−1.2%**	**1.8%**	Deficit financed by capital flows
3.	2022–23	**−2.0%**	**1.8%**	Higher external financing requirement
4.	2023–24	**−1.2%**	**2.5%**	CAD moderated
5.	**2024–25**	**−1.2%**	**2.5%**	**Moderate CAD with adequate financing**

Source: Reserve Bank of India, *Annual Report 2024–25*, External Sector indicators.

Interpretation : India's current account shifted from a surplus of 0.9% of GDP in FY2020–21 to a deficit thereafter. The CAD reached 2.0% of GDP in FY2022–23 before moderating to 1.2% in FY2024–25. Net capital flows remained positive at 2.5% of GDP in FY2024–25, exceeding the current account deficit. This indicates that capital and financial inflows provided adequate financing for the external deficit. Overall, the relationship demonstrates the important role of capital flows in maintaining India's external-sector stability

Foreign-Exchange Reserves

Foreign-exchange reserves are a crucial external-sector buffer that helps India meet international payment obligations and manage exchange-rate volatility.

They strengthen investor confidence and provide protection against sudden capital outflows and external financial shocks.

Table 12: India's Foreign-Exchange Reserves

Sl.No	Financial Year	Foreign-Exchange Reserves (US$ billion)	Broad Position
1.	2020–21	577.0	Strong
2.	2021–22	606.5	Increased
3.	2022–23	578.4	Moderate decline
4.	2023–24	646.4	Strong increase
5.	2024–25	668.3	Highest level

Source: Reserve Bank of India; Government of India, *Monthly Economic Review, March 2025* & RBI reports 2025.

Interpretation : India's foreign-exchange reserves increased from US$577.0 billion in FY2020–21 to US$668.3 billion in FY2024–25. Reserves declined temporarily in FY2022–23 but recovered strongly during FY2023–24 and FY2024–25. The accumulation of reserves reflects favourable balance-of-payments conditions and capital inflows. At end-March 2025, reserves provided approximately 11 months of import cover, strengthening external resilience. Overall, India's substantial reserves provide an important cushion against global financial uncertainty, exchange-rate volatility and sudden external shocks.

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Major Findings of the Study

1. **Current account fluctuations:** India's current account moved from a surplus of 0.9% of GDP in FY2020–21 to deficits in subsequent years. The CAD reached about 2.0% of GDP in FY2022–23 before moderating, reflecting an improvement in the external-sector position.
2. **Persistent merchandise trade deficit:** The merchandise trade deficit remained the major structural pressure on the current account. Higher imports of crude oil, gold, machinery and other goods continued to exceed merchandise export earnings.
3. **Strong services exports:** Services exports emerged as one of India's strongest external-sector components. The services surplus increased from US$88.6 billion in FY2020–21 to US$162.8 billion in FY2023–24, substantially offsetting the merchandise trade deficit.
4. **Important role of remittances:** Private transfer receipts, mainly workers' remittances, provided a significant and relatively stable source of foreign-exchange earnings and helped moderate the CAD.
5. **FDI remained strategically important:** India continued to attract substantial gross FDI, supporting capital formation, employment, technology transfer and export capacity. However, net FDI moderated because of higher repatriation and outward investment.
6. **High volatility in FPI:** Portfolio flows were considerably more volatile than FDI. India recorded a strong FPI inflow of US$44.1 billion in FY2023–24, while net FPI inflows moderated to US$1.7 billion in FY2024–25, supported mainly by debt inflows as the equity segment experienced outflows.
7. **Capital flows financed external requirements:** Capital and financial inflows played an important role in financing current account deficits. However, the composition and stability of these flows varied considerably across years.
8. **Foreign-exchange reserves strengthened resilience:** India maintained a substantial foreign-exchange reserve buffer. RBI reported that reserves increased by 3.4% during FY2024–25, while reserves at end-March 2025 provided around 11 months of merchandise-import cover.
9. **Overall external-sector resilience:** Despite global monetary tightening, geopolitical uncertainty, commodity-price pressures and volatile portfolio flows, India's external sector remained broadly resilient because of strong services exports, remittances, adequate capital inflows and large foreign-exchange reserves.

Suggestions

1. **Strengthen merchandise export competitiveness:** India should diversify its export basket and markets, improve product quality, reduce logistics costs and enhance integration into global value chains.
2. **Reduce excessive import dependence:** Greater domestic production of crude-alternative energy, electronics, critical minerals, machinery and other strategic products can reduce vulnerability to external price shocks.
3. **Expand high-value services exports:** India should move beyond traditional IT services towards artificial intelligence, fintech, professional services, research and development, healthcare, education and other knowledge-intensive sectors.
4. **Promote stable FDI:** Policies should focus not only on attracting FDI but also on retaining investment through a predictable regulatory environment, faster approvals, infrastructure development and improved ease of doing business.
5. **Manage volatile portfolio flows:** Greater emphasis should be placed on long-term institutional investment and diversified sources of capital to reduce vulnerability to sudden FPI reversals caused by global interest-rate and risk-appetite changes.
6. **Strengthen remittance channels:** India should maintain efficient, low-cost and transparent remittance mechanisms while encouraging remittances to contribute to productive savings and investment.
7. **Maintain adequate foreign-exchange reserves:** Continued accumulation of adequate reserves is necessary to provide protection against exchange-rate volatility, commodity-price shocks and sudden capital outflows.
8. **Improve external-sector monitoring:** Regular monitoring of CAD, external debt, capital flows, reserve adequacy and short-term external liabilities should be strengthened to identify emerging vulnerabilities at an early stage.
9. **Promote renewable energy:** Accelerating the transition towards renewable energy can reduce India's dependence on imported fossil fuels and consequently lower pressure on the merchandise trade balance.
10. **Maintain policy coordination:** Monetary, trade, investment and exchange-rate policies should be coordinated to ensure that current account imbalances remain manageable without compromising economic growth.

Conclusion

India's external sector demonstrated considerable resilience during the post-COVID period, although significant structural challenges remained. The study shows that the persistent merchandise trade deficit continues to be the principal source of pressure on the current account, while the growing surplus in services and strong remittance receipts provide important counterbalancing support. India's services exports have therefore emerged as a major source of foreign-exchange earnings and an important strength of the balance of payments. The analysis also indicates that FDI and FPI play different but complementary roles in external financing. FDI provides relatively longer-term capital and contributes to productive capacity, whereas FPI is more sensitive to global financial conditions and can generate significant volatility. In FY2024–25, net FPI inflows were only about US$1.7 billion, while net FDI was also considerably moderated by repatriation and outward investment.

Overall, India's external position remained manageable, supported by diversified foreign-exchange earnings and a strong reserve buffer. Going forward, strengthening export competitiveness, reducing import dependence, attracting stable FDI and maintaining adequate reserves will be essential for sustained external-sector stability. A balanced combination of trade, investment and macroeconomic policies is therefore crucial for achieving long-term and sustainable external-sector resilience.

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