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INDIAN ECONOMY

CRISIL Insights

Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In the December issue, we explain why, despite India's external vulnerability indicators looking much better, there is no room for complacency.

View of the Month: Don't uncork the bubbly yet

India's external vulnerability indicators are now among the best amongst emerging economies, a far cry from being the worst just a year ago. The country's current account deficit (CAD) is manageable, a smaller part of its external debt is short term and import cover of foreign exchange reserves has improved compared to last year. Being a net importer of oil, India has certainly benefitted from a sharp drop in global crude prices.

A more than 40% fall in oil prices since June, some tactical measures from the government like curb on gold imports and cyclical factors such as stagnancy in industry have contributed to muted growth in the import bill and have improved India's external balance. At the same time, Reserve Bank of India's (RBI) smart move to mop up long-term NRI deposits together with intervention in the forex market have helped shore up the country's war chest of foreign exchange reserves. To buttress this, a strong political mandate and growing consumer and business confidence have improved India's ability to attract foreign capital.

However one must not forget that the window of opportunity is not too wide; import restrictions cannot carry on forever and NRI deposits will become due over the next two years. Also, with the expected pick-up in GDP growth and industrial activity, the import bill will rise too. So a lot more still needs to be done. The mess in the mining sector needs to be fixed quickly. Coal and iron ore shortages led to trade deficit on mining imports rising by 60 basis points to 1.5% of GDP in fiscal 2014 compared to last fiscal.

Export competitiveness also needs to be enhanced. Over the past decade, India's inflation differential with its trading partners has risen sharply, thereby hurting price competitiveness. The good news on this front is that coordinated efforts by the government and RBI are bringing inflation down. Together with this, the innards in land, labour, power and logistics need to be cleaned up to make India's exports competitive. India is among the select few in emerging markets that are currently in a sweet spot on the external vulnerability front. But that is hardly any reason for it to be complacent.

Current account deficit	Industrial Production	Inflation
CAD shows a modest upturn in Q2	IIP growth decelerates as manufacturing output declines	Inflation falls further in November

CURRENT ACCOUNT DEFICIT

- India's current account deficit (CAD) widened to $10.1 billion (2.1% of GDP) in Q2 FY15 from $7.8 billion (1.7% of GDP) in the previous quarter and $5.2 billion (1.2% of GDP) in Q2 FY14 as exports growth slowed down and imports rose largely on account of increased gold demand.
- While exports growth in Q2 FY15 slowed down to 4.9% as compared to 11.9% a year ago, imports increased by 8.1% as opposed to a decline of 4.8% during the same period. Net gold imports rose to $7.6 billion in Q2 FY 15 from $3.8 billion a year ago. However, a larger than expected slide in oil prices is expected to keep import bill under check and CAD for FY15 as a whole is estimated at around 1.5% of GDP.

INDUSTRIAL PRODUCTION

- In October, IIP fell by 4.2% y-o-y as compared to a 2.8% growth in the previous month. This was on account of a 7.6% contraction in the manufacturing output. Mining and electricity sector, however, grew by 5.2% and 13.3% respectively. During Apr-Oct 2014, IIP growth was 1.9%.
- While the capital goods sector continued to decline (-2.3%), reflecting still weak investment demand, the largest decline was registered by consumer goods sector, where output fell by 18.6%. Output in both consumer durables and non-durable segments declined by 35.2% and 4.3% respectively, suggesting that consumer demand too remains sluggish.

INFLATION

- CPI inflation continued to glide down and was recorded at 4.4% in November, compared to 5.5% in October, largely on account of falling vegetable prices. Overall, food inflation fell by 2.4 percentage points in November to 3.14% with vegetable prices falling by 10.9%.
- CPI core inflation remained almost unchanged at 5.8% in November as compared to 5.9% in October. This is the lowest core inflation recorded since the beginning of the new CPI series. Inflation fell in household requisites for the fourth consecutive month to 2.1% and in transport and communication to 1.9% (from 2.7% in October).
- WPI inflation fell to 'zero' % in November; it was 1.8% in October. Except manufactured items, prices of which rose by about 2%, inflation of primary products and the fuel group contracted by 0.98% and 4.91% respectively.

Interest Rate	Rupee	Trade
Bond yields slide further in November	Rupee falls to a 9 month low in November	Trade deficit rises to 18 month high in November

INTEREST RATE

- The 10-year benchmark 8.40% 2024 bond edged down on a month-end basis to 8.09% in November from 8.28% in October. On a monthly average basis too yields were lower at 8.17% in November compared to 8.38% in October.
- Yield on 1 year G-sec bond also moderated on a month-end basis to 8.29% in November from 8.32% in October. On a monthly average basis too yields were lower at 8.31% in October compared to 8.50% in October.
- In the past 5 months, G-sec yields have dropped by 54 percentage points, mainly because of a sharp drop in inflation and easing liquidity conditions. Inflation has dropped from over 8% in June to 4.4% in November on the back of lower food and fuel inflation. On the other hand, slower credit off take in light of weak investment demand and availability of alternate cheaper sources such as CPs and CDs has kept the liquidity comfortable.

RUPEE

- The rupee depreciated by 0.9% in November, ending the month at a nine-month low of Rs 62 per dollar. On a monthly average basis, the rupee stood at Rs 61.7/$ in November as compared to Rs 61.3/$ in October. While net foreign institutional inflows rose during the month, high dollar demand from importers and state-owned banks kept up the pressure on the rupee.
- It is believed that state-owned banks purchased dollars in November, as India was due to make payments of around $400 million to Iran for past oil imports. The weakness in the rupee was however limited by a rise in FII flows. Net inflows from foreign institutional investors (FIIs) rose to $4.1 billion in November from $2.7 billion in October.

TRADE

- Exports in November stood at $25.96 billion, rising by 7.3% y-o-y, as compared to 5% decline in October. Imports, on the other hand, measured $ 42.82 billion displaying a strong rise of 26.8%. During Apr-Nov 2014, however, exports and imports grew by 5.0% and 4.7% respectively.
- The merchandise trade deficit widened $16.9 billion – an 18 month high – from under $10 billion a year ago despite positive exports growth and a decline of around 10% in oil imports. It was led by a surge in gold and core (non-oil non-gold imports) imports. While gold imports rose to nearly 150 tonnes ($5.6 billion) from 19 tonnes ($0.8 billion) a year ago, non-oil non gold imports – an indicator of domestic demand- grew by a 27.7% y-o-y.

Source: CRISIL Research

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