



June 2013

CRISIL Economy First Cut

BoP: A transient respite on the current account

Overview: India's current account deficit (CAD) narrowed sharply to 3.6% of GDP in Q4FY13. The good news ends here. At 4.8 per cent of GDP for FY13, the country's foreign capital requirement to cover the CAD was alarmingly high at almost US\$90 billion. The dip in CAD in Q4FY13, we believe, is temporary and CAD will rise to settle at 4.5% of GDP for FY14. Financing CAD is a bigger challenge this year. For one, global liquidity will be stretched if the US recovery continues and as Federal Reserve starts winding up its bond purchase program in 2013-end. And second, with much weaker growth prospects vis-à-vis other emerging markets, India's attractiveness as an investment destination is waning.

CRISIL Research however, believes that the current flight of capital and sharp plunge in rupee is a short term phenomenon and largely in response to the uncertainty around the impact of the Federal Reserve's pullback of quantitative easing. Moreover, the government is pledging a slew of domestic policy reforms to shore up domestic and foreign investor sentiments. This, if successfully done, can act as a pull factor for foreign capital inflows.

- CAD fell sharply in Q4FY13 to US\$18.2 billion compared to US\$21.7 billion (or 4.4 per cent) a year ago. For FY14, CAD was at US\$88.2 billion (4.8 per cent of GDP) compared to US\$78.2 billion (4.2 per cent of GDP) in FY13.
- Lower CAD in Q4FY13 was led by a sharp fall in merchandise trade deficit. Higher growth in exports at 5.7 per cent compared to 3.8 per cent in Q4FY12 provided support to the trade account. But it was the fall in imports by 1 per cent in Q3FY14 compared to 22.8 per cent growth a year ago that dragged down trade deficit. As a per cent of GDP however, trade deficit continues to remain alarmingly high at 10.6 per cent for the full year. Moreover, a declining surplus on the invisibles' account is also adding to current account woes.
- Capital account flows during FY13 were robust enough to cover the high CAD. The balance of payments therefore, recorded a surplus of US\$3.8 billion compared to a deficit of US\$12.8 billion in FY12. However, most of the inflows were on account of higher portfolio investments and short term trade credit. To reduce volatility in the external account and to make the capital account position healthier, India must attract inflows that are more durable in nature, such as FDI.

Figure 1: Rising short term foreign inflows

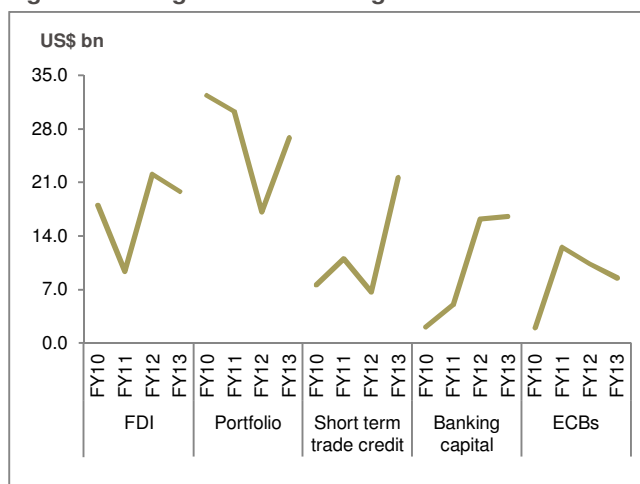
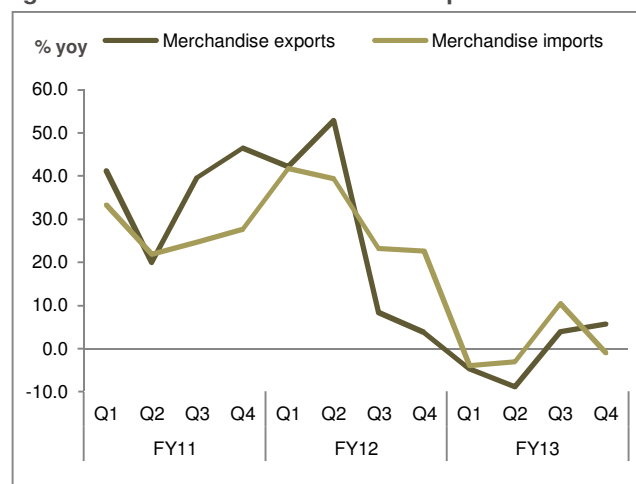


Figure 2: Trade account sees some respite



Source: RBI, CRISIL Research





- The ability of the invisibles' account to cushion the high trade deficit is going down. This is adding to the current account woes. Over the past few quarters slowdown in services' trade and workers' remittances have put pressure on the invisibles' account surplus. Invisibles surplus as a per cent of GDP fell to 5.4 per cent in Q4FY13 compared to 6 per cent a year ago.
- Higher reliance on short term foreign capital has increased the external account vulnerability to global shocks. In FY13, net FDI inflows fell to US\$19.8 billion from US\$22.1 billion in FY12. In contrast, net inflows on short term trade credit jumped to US\$21.7 billion from US\$6.7 billion in the same period. Net portfolio investment rose to US\$26.9 billion in FY13 from US\$17.2 billion in FY12. However, SEBI data shows that net portfolio investments have fallen sharply to US\$ 50 million in Q1FY14 (till date) compared to US\$11.3 billion in Q4FY13. Rupee in response has depreciated sharply against the US dollar (by nearly 10 per cent) in June 2013 vis-à-vis levels seen in March-end.
- External debt stock increased by US\$44.6 billion year-on-year and stood at US\$390 billion by March-end 2013. The rise in the external debt was primarily due to an increase in NRI deposits, commercial borrowings and short-term trade related credits. Share of short-term debt in total external debt increased to 24.8 per cent from 22.6 per cent a year ago. The foreign exchange reserve available to cover the external debt fell further to 74.9 per cent by March-end 2013, down from 85.2 per cent a year ago, indicating higher stress.

Analytical Contacts:

Dharmakirti Joshi

Chief Economist, CRISIL Research
Email: dharmakirti.joshi@crisil.com

Dipti Deshpande

Economist, CRISIL Research
Email: dipti.deshpande@crisil.com

Media Contacts:

Priyadarshini Roy

Communications and Brand Management
Email: priyadarshini.roy@crisil.com
Phone: +91 22 3342 1812

Jyoti Parmar

Communications and Brand Management
Email: jyoti.parmar@crisil.com
Phone: +91 22 3342 1835

Our Capabilities

Making Markets Function Better

Economy and Industry Research

- Largest team of economy and industry research analysts in India
- Coverage on 70 industries and 139 sub-sectors; provide growth forecasts, profitability analysis, emerging trends, expected investments, industry structure and regulatory frameworks
- 90 per cent of India's commercial banks use our industry research for credit decisions
- Special coverage on key growth sectors including real estate, infrastructure, logistics, and financial services
- Inputs to India's leading corporates in market sizing, demand forecasting, and project feasibility
- Published the first India-focused report on Ultra High Net-worth Individuals
- All opinions and forecasts reviewed by a highly qualified panel with over 200 years of cumulative experience

Funds and Fixed Income Research

- Largest and most comprehensive database on India's debt market, covering more than 15,000 securities
- Largest provider of fixed income valuations in India
- Value more than Rs.53 trillion (USD 960 billion) of Indian debt securities, comprising outstanding securities
- Sole provider of fixed income and hybrid indices to mutual funds and insurance companies; we maintain 12 standard indices and over 100 customised indices
- Ranking of Indian mutual fund schemes covering 70 per cent of assets under management and Rs.4.7 trillion (USD 85 billion) by value
- Retained by India's Employees' Provident Fund Organisation, the world's largest retirement scheme covering over 60 million individuals, for selecting fund managers and monitoring their performance

Equity and Company Research

- Largest independent equity research house in India, focusing on small and mid-cap companies; coverage exceeds 125 companies
- Released company reports on all 1,442 companies listed and traded on the National Stock Exchange; a global first for any stock exchange
- First research house to release exchange-commissioned equity research reports in India
- Assigned the first IPO grade in India

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is India's largest independent and integrated research house. We provide insights, opinions, and analysis on the Indian economy, industries, capital markets and companies. We are India's most credible provider of economy and industry research. Our industry research covers 70 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 4,500 primary sources, including industry experts, industry associations, and trade channels. We play a key role in India's fixed income markets. We are India's largest provider of valuations of fixed income securities, serving the mutual fund, insurance, and banking industries. We are the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today India's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macroeconomy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. We deliver our research through an innovative web-based research platform. Our talent pool comprises economists, sector experts, company analysts, and information management specialists.

Disclaimer

CRISIL Limited has taken due care and caution in preparing this Report. Information has been obtained by CRISIL from sources, which it considers reliable. However, CRISIL does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CRISIL Limited has no financial liability whatsoever to the subscribers / users / transmitters / distributors of this Report. The Centre for Economic Research, CRISIL (C-CER) operates independently of and does not have access to information obtained by CRISIL's Ratings Division, which may in its regular operations obtain information of a confidential nature that is not available to C-CER. No part of this Report may be published / reproduced in any form without CRISIL's prior written approval.

CRISIL Privacy Notice

CRISIL respects your privacy. We use your contact information, such as your name, address, and email id, to fulfil your request and service your account and to provide you with additional information from CRISIL and other parts of McGraw Hill Financial you may find of interest.

For further information, or to let us know your preferences with respect to receiving marketing materials, please visit www.crisil.com/privacy. You can view McGraw Hill Financial's Customer Privacy Policy at <http://www.mhfi.com/privacy>.

Last updated: May , 2013



CRISIL Limited

CRISIL House, Central Avenue, Hiranandani Business Park,
Powai, Mumbai – 400076. India

Phone: +91 22 3342 3000 | Fax: +91 22 3342 8088

www.crisil.com

CRISIL Ltd is a Standard & Poor's company