STCI
Primary Dealer Ltd

Indian Economy - Fortnightly Update

Table 1: Balance of Payments at a glance (in $ billion)		
	Jul-Sep 2009	Jul-Sep 2010
1. Exports	43.4	54.3
2. Imports	73	89.6
3. Trade Balance (1-2)	-29.6	-35.4
4. Invisibles, net	20.4	19.6
5. Current Account Balance (3+4)	-9.2	-15.8
6. Capital Account Balance	18.6	19
7. Balance of Payments (5+6)	9.4	3.3
Source: RBI		

Table 2: Invisibles (in $ billion)		
	Jul-Sep 2009	Jul-Sep 2010
Invisibles (a+b+c)	20.4	19.6
a) Services	7.7	10.5
i) Travel	0.4	0.6
ii) Transportation	0.3	-0.2
iii) Miscellaneous	6.9	10.2
Software Services	10.8	12.2
b) Transfers	13.8	13.0
i) Private (Remittances)	13.8	13.0
c) Income	-1.1	-3.9
Source: RBI		

Table 3: Key items in Capital Account (in $ billion)		
	Jul-Sep 2009	Jul-Sep 2010
1. Foreign Direct Investment	7.5	2.5
2. Portfolio Investment	9.7	19.2
3. External Commercial Borrowings	1.2	3.7
4. NRI Deposits	1.0	1.0
5. Short-term Trade Credits	1.2	2.6
Source: RBI		

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I. Current account deficit rises further

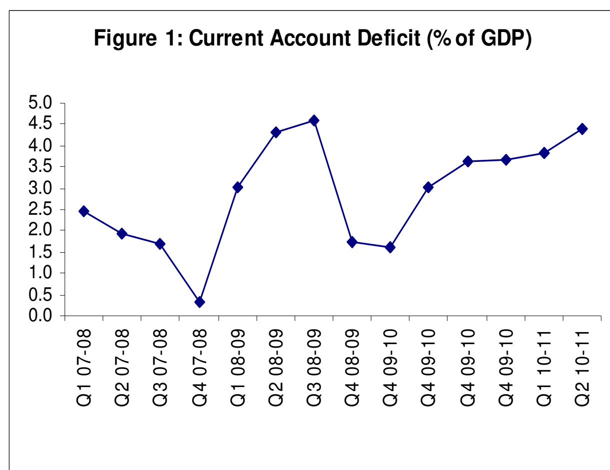
Current Account Deficit (CAD) for Jul-Sep 10 was at $ 15.8 billion (bn), rising by 72% compared to Jul-Sep 09. CAD widened on account of continued rise in imports and decline in private remittances.

The imports of goods remain higher than exports leading to a trade deficit of $ 35.4 bn, a jump of 20% compared to Jul-Sep 09 quarter. The invisibles declined by 4% compared to Jul-Sep 09 figures on account of decline in remittances from abroad. This could be because of the global crisis worsening in the same period. There was growth seen in services exports led by Travel sector. Software exports grew by 13.6% and were noted at $ 12.2 bn.

Capital account is noted at a surplus of $ 19.0 bn, higher than $ 18.6 billion in Q2 2009-10. Within capital account, FDI declined by 66.3%, FII rose by 98.3%, External Commercial Borrowings rose by 213%. Short term credit also rose by 112.3% in Jul-Sep 10 quarter. NRI deposits in Jul-Sep 10 were similar to Jul-Sep 09 quarter. Hence, capital account rose mainly because of short-term equity and debt flows. The long term flows like FDI declined from Jul-Sep 09 levels.

As current account deficit stands at $ 15.8 bn and capital account surplus at $ 19 bn. This implies Balance of Payments surplus of $ 3.3 bn. It is lower than a surplus of $ 9.4 bn noted in Q2 2009-10.

The widening of current account deficit remains a major policy concern going ahead. It is currently at 4.4% of GDP, higher than 3.8% noted in Q1 2010-11. Then managing high CAD with short-term capital flows is always seen as a dangerous strategy.



Source: RBI & CSO

The widening CAD with persistent fiscal deficit puts Indian economy into a unique club of twin deficit countries. The members of this club are not something India would want to be a member of – Greece, Ireland, Italy, Spain, Portugal, UK and US. RBI's second financial stability report said that "occurrence of both deficits poses a more serious concern". In this an economy needs both - domestic savings to manage fiscal deficit and foreign savings to manage its current account deficit. In case of a shortfall in any of the two, a crisis situation can develop.

Though in India, the situation has been manageable so far. Even if capital flows dry up, we have adequate forex reserves to manage the high CAD. Fiscal deficit is being managed as domestic savings have been high. But we cannot take these for granted.

The problem with recent crises is that once expectations set in, it becomes a case of self-fulfilling prophecy. So a country may be having sound macroeconomic fundamentals but it could still be in a crisis. Hence, there is always a need to keep a watch on the debt/deficit indicators.

Table 4: Key Indicators of Government Debt (% of BE)

		Apr- Nov 09	Apr-Nov 10
1	Total Receipts	50.9	69.3
2	Tax Receipts	49.1	55.5
3	Non Tax Receipts	52.9	121.6
4	Non Debt Capital Receipts	155.8	60.8
5	Total Expenditure	60.9	62.3
6	Fiscal Deficit	76.4	48.9
7	Revenue Deficit	91.2	50.7

Source: CGA

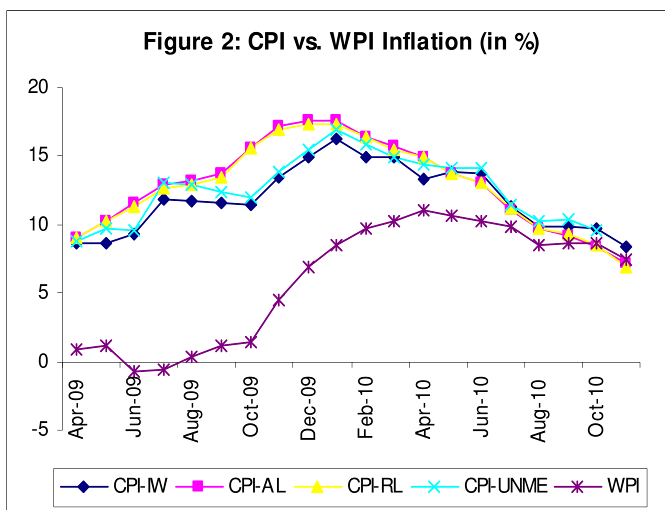
II. Fiscal deficit at 48.9% of BE

Fiscal Deficit of Central Government was noted at 48.9% of Budgeted Estimates (BE) in Apr-Nov 10, lower than 76.4% in Apr-Nov 09. Lower fiscal deficit is on account of increase in overall receipts. Till Oct-10, receipts rose on account of advanced tax flows coupled with non-tax receipts (3G and Wimax auction payments). In Nov-10, there is a rise in non-debt capital receipts as well because of disinvestment proceeds from Coal India Ltd.

The expenditure levels continue to remain higher in Apr-Nov 10 period compared to Apr-Nov 09. Market participants believe that lower government spending is the main reason for tight liquidity in the markets. However, as we have shown in previous editions as well, the government spending is in line with past trends and is actually higher than same period last year.

Table 5: CPI Inflation (YoY, in %)		
	Nov-09	Nov-10
CPI-Industrial Workers	13.51	8.33
CPI-Agricultural Labour	17.21	7.14
CPI-Rural Labour	16.99	6.95
CPI- Urban Non Manual Employees *	12	9.6

** CPI –UNME data for Oct-10 and Oct-09 respectively*
Source: Labour Burea and, CSO



Source: Labour Bureau, CSO and Commerce Ministry

In any other year, this higher spending pattern would have been criticized and markets might be saying that government expenditure might be higher than budgeted and leading to more government borrowing. But in these deficit liquidity situation, opposite concerns are being raised.

Looking at both sides of the story, there is still merit if government can spend at a faster pace to ease this persistent deficit liquidity position. Government deposits with RBI keep rising every week which could actually be spent so that liquidity situation becomes easier. In uncertain global times, persistent deficit liquidity position poses extra stress on the system.

III. CPI and WPI inflation trends continue to converge

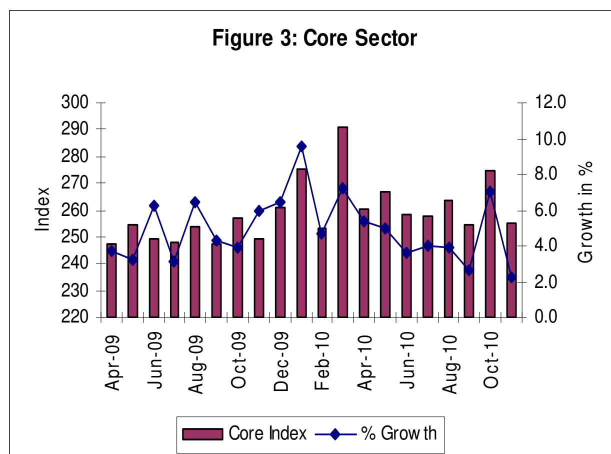
The inflation rates have come down further compared to Oct-10 levels. Earlier, only CPI-UNME remained in double digits and now it is also in single digits.

However, lower inflation trend is mainly on account of significant base-effect. CPI indices continue to increase compared to previous month levels. From Oct-10, CPI-IW, CPI-AL and CPI-RL indices increased by 1, 4 and 4 points respectively.

The convergence between the CPI and WPI Inflation numbers continues. After diverging significantly in 2009-10, the trends have been converging since Jun-10.

IV. Core industry trends volatile like IIP

Core industry index for Nov-10 was at 254.9 declining from 274.8 in Oct-10. This implied growth of 2.3%, in Nov-10 compared to 8.6% in Oct-10 (Figure for Oct-10 was revised upwards from 7% to 8.6%). The index again declined after a surprise upwards jump in Oct-10. Growth in Nov-09 was 5.9%.



Source: Commerce Ministry

In Nov-10 all the five sub-sectors except Crude Petroleum grew at a slower pace compared to Nov-09. Comparing Nov-10 from Oct-10 levels, we see rise in production of coal and crude petroleum. Production has declined in Cement, Petroleum Refinery, Electricity and Steel.

Overall, we again see sudden changes in core industry production levels compared to previous month leading to lower YoY growth rates. These volatile monthly movements are inexplicable as demand-supply does not change so rapidly in such industries. There is also a strong co-movement in core industry and IIP growth trends. Hence, we expect Nov-10 IIP growth to be lower compared to Oct-10 levels and continue to remain volatile.

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