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INDIAN ECONOMY

CRISIL Insights

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Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we focus on the improvement in current account

External account and possible risks

India's macroeconomic fundamentals have seen considerable improvement in the recent years. Prominent among these is the current account, a measure of external vulnerability.

After spiking to 4.8% of GDP in fiscal 2013, current account deficit (CAD) fell to 1.1% in 2016. We expect it to decline further to around 0.9% of GDP in fiscal 2017 before rising to 1.3% of GDP in fiscal 2018.

On the road ahead, India's current account position is dependent on two risks – rising global protectionism, and higher commodity prices. While global demand has started to recover, the popular mood in advanced economies is turning against international trade. Advanced economies occupy the highest share in India's exports. Moreover, their share has increased further in the recent years. Should the protectionist policies be adopted in these advanced economies, India's exports can get severely affected. Along with merchandise exports, services exports can also take a hit. India's services exports have already been suffering in the recent years due to weak global growth.

On the other side, prices of commodities, whose fall was a crucial factor behind the decline in CAD, are expected to rise in fiscal 2018. This will put pressure on import bill, especially through rising value of oil imports, which constitute ~23% of India's imports. Since commodities have a greater share in India's imports than in exports, rising commodity prices, ceteris paribus, will widen CAD.

While protectionism, even if it plays out, will take time to impact the CAD, commodity price increases will quickly reflect in CAD.

Monetary Policy	Industrial Production	Inflation
Liquidity remains elevated	The new series gives IIP a leg-up	A new WPI series

MONETARY POLICY

- Liquidity in the banking system stayed high at Rs 4.2 trillion in April, led by high deposit growth, slack credit growth, and high government spending
- Citing inflation risks, the Monetary Policy Committee, in its review, kept the repo rate unchanged at 6.25% but trimmed the corridor by raising the reverse repo by 25 basis points (bps) to 5.75%
- This will help the Reserve Bank of India (RBI) mop up liquidity and correct the steep fall in money market rates at the short end (seen in the beginning of the month), by steering them closer to the repo rate
- Credit growth stayed tepid as demand remained weak. The appetite to lend too is hampered by large existing non-performing loans

INDUSTRIAL PRODUCTION

- The Central Statistics Office, on May 12, 2017, came out with the revised series of Index of Industrial Production (IIP) with fiscal 2012 as the base year compared with 2005 earlier
- The new series bumps up industrial growth led by manufacturing in all the years starting from 2013. However, mining growth was lower between fiscals 2013 and 2015. Growth in electricity sector remains unchanged in three of the five years
- Interestingly, in 2017, manufacturing IIP growth rose to 4.9% (from 3.0% in fiscal 2016) in the new series, whereas it declined in the old series with 2005 base. The old series shows a dip in industrial growth in the year of demonetisation, whereas the new series seems to show a contra trend for the year. However, the new series does show a slowdown in growth in the second half to 2.9% from 7% in the first half of fiscal 2017
- While this base revision brings the IIP series in sync with the GDP series (which was brought to fiscal 2012 base earlier), it may not be completely void of volatility which is essentially a characteristic of a production based series such as IIP

INFLATION

- The revised WPI series pulls down inflation by 1 percentage point for the five fiscals ended March 31, 2017. Revised commodity and weight structure, and more importantly, eliminating central excise duties from prices, is the reason behind the lower WPI figures. But lower inflation could lead to an upward revision of past real GDP growth rates, provided other factors influencing GDP remain unchanged
- CPI data for April 2017 saw inflation fall below 3%. Much of the fall was led by sharp decline in food inflation (led by higher production in fiscal 2017), moderation in fuel inflation (as the increase in global oil prices moderated) and softer core inflation (suggesting tempering of demand side pressures)
- We estimate CPI inflation to rise to 5% average in fiscal 2018, from 4.5% in fiscal 2017. There is a downward bias to this estimate.

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Interest rate	Rupee	Trade
Yields take wing on hawkish RBI stance	Rupee rallies on, uninterrupted	Trade improves on stronger demand

INTEREST RATE

- Yield on the 10-year government security (G-sec) ended April at 6.96%, up 27 bps on-month. Short-term yield or yield on the one-year G-sec rose 24 bps and reached 6.48%
- Narrowing of the policy rate corridor and citing of inflation risks by the central bank put upward pressure on G-sec yields
- The 10-year G-sec yield settled 74 bps higher at 6.83% at fiscal 2017-end compared with fiscal 2016-end. For March 2018, we expect a modest pick-up in the yield which will settle around 6.9%

RUPEE

- Robust domestic macros and the recovering risk appetite of global investors are creating the perfect conditions for the rush of foreign funds into India
- Rupee gained against the US dollar for the third successive month, backed by strong foreign capital inflows
- While the rupee remained among the best-performing emerging market currencies, advanced economies also gained significantly
- Increase in the rupee's value relative to other currencies means rupee-denominated exports have become more expensive, which can decrease external demand for India's export goods
- The rupee can face pressure hereon as domestic demand strengthens gradually in fiscal 2018, raising the import bill and, thereby, CAD. Heightened geopolitical risks can also reverse foreign capital inflows. Thus, we expect the rupee to settle at 67.5 / dollar by March 2018

TRADE

- Merchandise exports posted double-digit growth for the second month in a row, growing 27.6% on-year in March, compared with 17.5% in the previous month, due to improving global demand and rising oil prices
- Domestic demand is also gaining momentum, as evident in imports, which surged 45.3%. While its primary drivers continued to be oil and gold, imports of core consumption goods (excluding oil and gold) also rose
- Services surplus increased to $5.8 billion in February 2017 from $5.1 billion in February 2016, owing to significant deceleration in imports. While export growth moderated to 5.9% in February from 7.9% in January, import growth fell to 0.6% in February from 22.9% in January
- Due to wider trade deficit, we expect CAD to widen to 1.3% of GDP in fiscal 2018 from 0.9% of GDP in previous fiscal

Source: CRISIL Research

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