Gunjan X Gulati/JPMCHASE
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Subject India: current account deficit better than expected

India: Current account deficit better than expected

India's current account (CA) balance posted a deficit of US$4.7 billion in April-June (JPMorgan & consensus: -US$5.7 billion). The merchandise trade deficit for the quarter was at a significant US$21.6 billion, but a sizeable surplus on the invisible balance (US$16.9 billion) limited the overall worsening of the CA deficit. The CA deficit in 2Q07 follows a seasonal surplus of US$2.6 billion in 1Q07.

Faster growth in imports relative to exports increased the merchandise trade deficit in 2Q07. As in the previous quarters, net private transfers (US$8.3 billion) and net export of software services (US$7.9 billion) pushed up the surplus on the invisible balance.

The capital account posted a surplus of US$15.3 billion in 2Q07, lower than the surplus of US$17.1 billion in the previous quarter. The surplus was primarily driven by net portfolio investment (US$7.5 billion) and external commercial borrowings (ECB) (US$7.0 billion). Net portfolio investment and net ECBs together accounted for a considerable 95% of the capital account surplus, increasing the vulnerability to any reversal in capital flows. While the restrictions on ECBs effective early August will likely limit their inflow, portfolio investment continues to be strong.

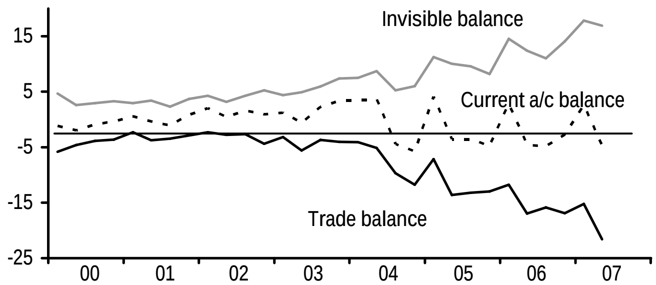
Foreign direct investment (FDI) inflows remained strong at US$6.4 billion, highlighting the positive investor sentiment. Additionally, the FDI outflows (US$6.0 billion) in 2Q07 almost kept pace with the inflows, resulting in a net inflow of only US$0.5 billion. However, net FDI inflow for the entire fiscal year (year that began April1) will likely be significant. The overall balance of payments (BoP) posted a surplus of US$11.2 billion in 2Q07 relative to the surplus of US$20.5 billion in the previous quarter.

Looking ahead, higher global crude oil prices and the recent significant INR appreciation will likely cause the CA deficit to further widen to US$13.6 billion in 2007-08 (1.2% of GDP) from US$ 9.6 billion (1.1% of GDP) in the prior year. However, strong capital inflows- especially FDI- will more than offset the shortfall in the CA. indeed, the overall BoP is poised to record another sizable surplus (US$30-35 billion) this year.

JPMorgan expects further weakness in the US dollar to increase pressure on USD/INR to appreciate to 39.5 by end-2007, and to gradually dip to 38 by 3Q2008.

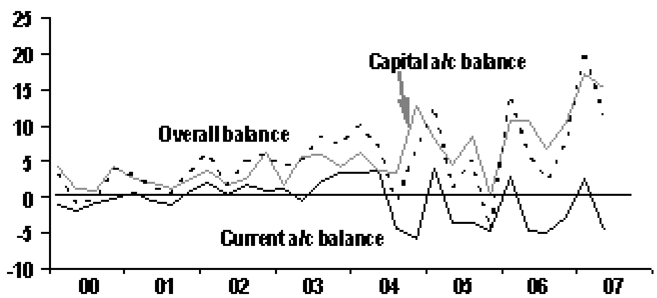
Balance of payments: current account balance

US$ billion, fiscal years beginning Apr 1



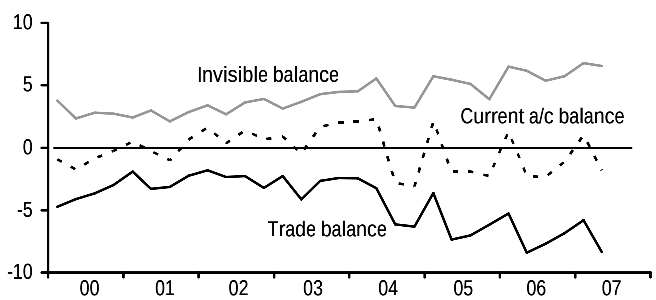
Balance of payments

US$ billion, fiscal years beginning Apr 1



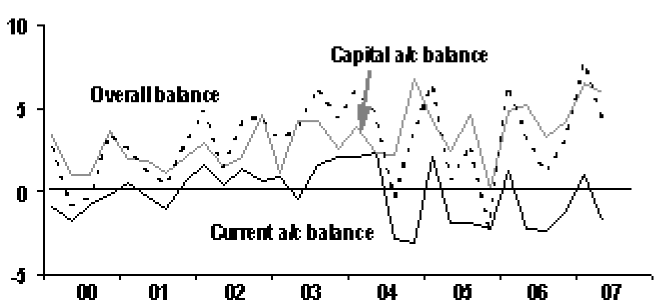
Balance of payments: current account balance

% of GDP, fiscal years beginning Apr 1



Balance of payments

% of GDP, fiscal years beginning Apr 1



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