India Flash

India’s current account deficit improves to a 3 year low in 2013

Underscoring India's strengthening external balances, the 4Q13 current account deficit (CAD) eased sharply to -0.9% of GDP (BBVA est: -1.2%), its lowest since March 2009, from -1.2% in the previous quarter and -6.5% in 4Q12. Concerted policy actions to curb non-essential imports such as gold through custom duty hikes and tighter lending norms, alongside weak domestic demand and a pick up in exports have helped improve India's 2013 current account deficit to its lowest in three years at -2.6% of GDP (BBVA est: 2.7%) from -5.0% in 2012. Meanwhile, India's balance of payments position turned positive in Q4 (+19 bn vs -10.4 bn in 3Q13) as RBI's unconventional measures, especially the special interest rate swap facility to attract dollar deposits by non-resident Indians, helped buoy the capital account (+23.8 bn vs -4.8 bn in 3Q13). Looking ahead, we expect India's CAD to moderate further in 2014 (2.5% of GDP) as global growth gains traction and domestic demand stays weak amid a tight monetary policy backdrop.

- **India’s external balance adjustment beats its ‘fragile five’ peers.** Over the past year, India has been the only 'fragile five' economy – Brazil, Indonesia, South Africa, India and Turkey – to reduce its current account deficit to sustainable levels. While India’s CAD fell by more than 200 bps, others have seen deterioration in their external balances (See chart-2). This bodes well for investor confidence and currency stability going forward.

- **Stay cautious on the rupee despite recent run up – National election outcome pose a key risk.** RBI’s tight monetary stance coupled with an improving external balance has helped achieve currency stability with the Indian rupee appreciating 8% since last September (currently 61.29 against the US dollar). Looking ahead, we maintain our near term cautious stance on the rupee (BBVA Est: 63 for March end and 62.5 for June). On the external front, while a smooth normalization of the QE taper by the US is critical, at home, we would be wary on an unclear national elections verdict, which starts April 7th. While a fractured mandate may raise fiscal deficit concerns for India and thereby dampen investor confidence, a strong verdict for a pro-reform government would boost sentiment and the currency.

Chart-1
India’s current account deficit has improved significantly over the past year

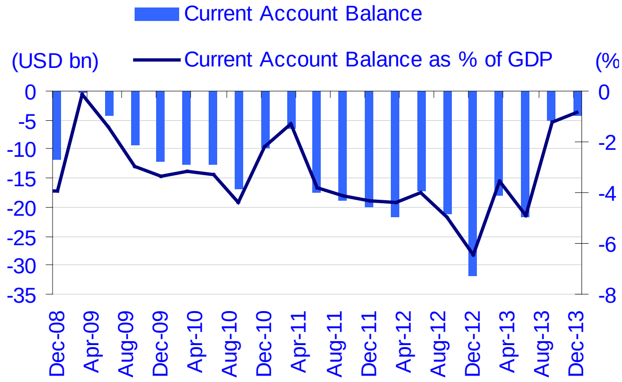
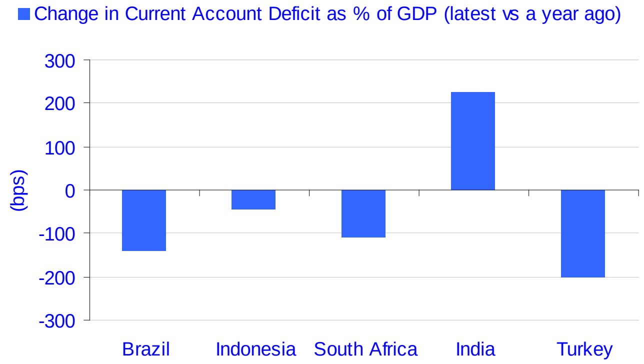


Chart-2
India has out performed its ‘fragile five’ peers in successfully reducing its external imbalances



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