# External Sector

***Export performance was robust during the third quarter, partly on account of the sharp depreciation in the exchange rate of the rupee and partly on account of a modest recovery in major advanced economies. The improvement in exports together with a moderation in imports, especially gold imports, contributed to a narrowing of the trade deficit to $110 billion during the period April – December 2013, i.e. 25% lower than the corresponding period last year. The reduction in trade deficit in Q2 saw the current account deficit fall to $5.2 billion (1.2%) of GDP, down from $ 21 billion in the same quarter of 2012-13. Trade data numbers from the DGCI&S for Q3 suggest the improvement seen in Q2 is likely to continue. We expect the full year CAD to fall to less than 2.5% of GDP.*** **The exchange rate has been fairly stable since mid-September 2013, despite the US Fed taper, effective January 2014.**

## E.1 Global trends

The world economy is expected to turn the corner with an expected growth of 3.7 per cent during 2014. (Table E.1).[1] The uptrend is predicted to continue with an estimated acceleration to 3.9 per cent during 2015 as compared to a relatively moderate growth of three per cent during 2013. Much of the growth impetus is due to output recovery in the high-income economies due to increase in final demand. The advanced economies are estimated to grow at 2.2 per cent during 2014 as compared with 1.3 per cent in 2013. A recovery in the advanced economies will lead to a stronger demand from the developing countries (projected to grow at a moderate rate of 5.1 per cent in 2014 as compared with 4.7 per cent during 2013). The US economy is predicted to accelerate to a growth rate of 2.8 per cent during 2014 as compared to 1.9 per cent growth during 2013. Growth prospects have improved due to lower government deficit as a result of the austerity measures. In addition, increasing industrial activity as well as employment gains during the second half of 2013 have augmented revenue collections of the government.

The Euro area is finally expected to grow at one per cent, thus showing signs of recovery from its recent recessionary phase. This growth is led by Germany while countries such as Italy and Spain are projected to post a moderate growth of 0.6 per cent each compared to the recessionary phase of 2013. While domestic demand may not be as high, exports contribute to growth prospects.

The Japanese economy responded to the fiscal stimulus with an accelerated growth of 1.7 per cent during 2013 compared with 1.4 per cent during 2012. Consumer spending increased both due to the stimulus while also benefitting from lower commodity prices during 2013). However, growth in 2014 is estimated at 1.7 per cent, mainly in view of the forthcoming rise in consumption tax due this April.

Emerging markets and developing economies are expected to grow at a slightly accelerated rate of 5.1 per cent in 2014 compared to 4.7 during 2013. However, the pattern is not uniform across countries in the region. While China is expected to slow down to 7.5 per cent, though continuing to be the regional leader, India is expected to accelerate to 5.4 per cent. The recent acceleration in investment has prompted China to restructure its growth towards consumer demand and the services sector. A decline in investment may slow down the economy. However, few other countries such as India are expected to benefit from export growth due to rising demand, including that from China, as well as from currency depreciation.

[1] The discussion is based on IMF, World Economic Outlook and World Banks, Global Economic Prospects, January 2014 release.

Commodity prices face a downward risk, particularly in the emerging markets and developing economies. In view of China's slowdown, metal prices are expected to fall. Price of agricultural commodities would be related to weather conditions. Oil prices are expected to decline in 2014 due to weaker demand from China, rising shale gas supply from the US that has turned as a net exporter as well as due to substitution with natural gas as an energy source.

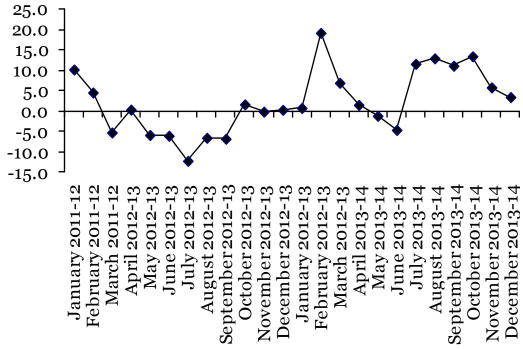
Notwithstanding the recent uptick in growth, challenges remain both in the advanced as well emerging market and developing economies. The activity level in advanced economies is still below the pre-crisis level. Developing countries face the risk of outflows of portfolio investment after the US increase in long-term interest rates on US Treasury bills, and falling terms of trade due to lower commodity prices. Attention will be required on supply-side reform as a source of growth.

## E.2 India's merchandise trade

Commodity exports posted a smart acceleration during the first three quarters of 2013-14. Exports registered a growth of 5.9 per cent and have recovered from the negative growth zone observed during April-December 2012-13. Cumulative exports touched US$ 230.3 billion during April-December 2013-14 compared to US$ 217.4 billion during similar period in the past fiscal.

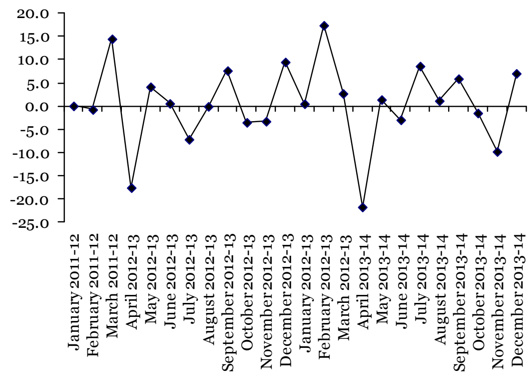
The year-on-year (y-o-y) growth in monthly exports slowed down during Q1: 2013-14, but picked up noticeably at a double-digit growth in July, the beginning of Q2: 2013-14 (Figure E.1). A double digit-growth continued over the following months till October.2013-14. Export growth over this period was mainly driven by government measures and recovery in global demand. Exports continued to expand, albeit at a lower rate, during Q3; 2013-14. This has been a period of currency depreciation that provided a boost to economic growth.

**Figure E.1: Growth in India's Total Exports (Y-o-Y)**




During the current fiscal, month-on-month (m-o-m) growth of exports has varied across a wide range that includes negative as well as positive growth (Figure E2).

**Figure E.2: Growth in India's Total Exports (M-o-M)**




Cumulative imports of goods declined by (-) 6.6 per cent during first three quarters of 2013-14. The value of imports fell to US$ 340.4 billion during April-December 2013-14 compared to US$ 364.2 billion during the comparable period, 2012-13. Growth in oil imports slowed down to 2.6 per cent compared to the earlier growth of 9.8 per cent. The slowdown in non-oil imports has been primarily due to restrictions on import of gold.

## E.3 Composition of exports

Merchandise exports are concentrated in the manufactured goods category (61.4 per cent), followed by petroleum & crude products (8.3 cent), agriculture & allied products (12.9 per cent), other commodities (3 per cent) and ores &

minerals (1.8 percent).[2] Cumulative data for the period April-November 2013-14 shows growth in each of the commodity categories with exports of ores & minerals the only exception. Ore and mineral exports declined 4.3 per cent mainly due to continued restrictions on mining activity. While total exports grew 4.8 per cent, exports of manufactured products, petroleum products, agricultural commodities, and other commodities grew 4.2, 8.3, 3.8 and 1.6 per cent, respectively. Interestingly, the manufactured goods sector has expanded due to improved export performance of many labour-intensive sectors such as textiles and readymade garments, each of which registered 15.9 per cent growth over the period. Exports of leather and manufactured items also recorded a smart growth of 15.3 per cent. Within engineering goods, export of significant items such as machinery & instruments and transport equipment grew 5.5 and 11.7 per cent, respectively. However, exports of gems & jewellery products declined in the current period. Agricultural exports have grown on the strength of stronger exports of items such as basmati rice, marine products, meat & preparations - all three of which recorded more than 40 per cent growth. Mining exports are most hit due to a fall in iron ore as well as coal exports.

## E.4 Destination of exports

Regional exports are primarily destined to Asia (49.5 per cent), followed by Europe (19.5 per cent) and Africa a (10 per cent). Exports have expanded to all these regions due to growth in these regions. Country-wise exports are led by destinations such as USA, UAE, Singapore, China and Hong Kong with 13, 9.9, 4.7, 4.5 and 4.2 per cent shares, respectively. Exports to 17 of the top 20 exporting destinations increased during April-November 2013-14. The remaining three countries include UAE, Netherlands and Brazil.

[2] Figures in parenthesis refer to shares in corresponding total merchandise trade flows (exports or imports).

## E.5 Compositions of imports

**Commodity imports recorded a decline of 5.4 per cent during April-November 2013-14 primarily due to 9.6 per cent decline in non-pol items.**

However, oil imports registered a moderate growth of 2.9 per cent. Imports of most non-oil commodities declined through the period. Particularly, imports of significant items such as gold, chemical & related products, capital goods and edible vegetable oils declined. An increase in imports has been observed for commodities such as electronic goods, non-ferrous metals and precious pearls & semi-precious stones.

## E.6 Sources of imports

A significant proportion of India's imports is sourced from the Asian region (59.1 per cent), followed by Europe (16.7 per cent) and Africa (8.6 per cent). Imports from all these regions have slowed down during April-November 2013-14. Most significant sourcing countries for India's imports include China, Saudi Arab, UAE, USA and Iraq with shares of 11.4, 8.1, 6.7, 5 and 4.5 per cent, respectively. Imports from nearly half of the top 20 countries have slowed down. Most important among such countries is China. Notwithstanding declining imports, China continues to be the most important sourcing country for India's commodity imports.

## E.7 Balance of payments

The BoP statement for H1: April-September 2013-14 shows that merchandise exports expanded by 5.1 per cent as against merchandise imports that remained stable (Table E.2). Consequently, the deficit on merchandise trade narrowed 8.6 per cent to US$ 83.8 billion compared to US$ 91.6 billion during H1: 2012-13. Net receipts of invisibles increased 6.4 per cent. A lower merchandise trade deficit together with a rise in net invisible receipts resulted in a current account deficit (CAD) of US$ 27 billion during H1: 2013-14 as against US$

38.2 billion, i.e. lower by 29.5 per cent. Consequently the CAD-to-GDP ratio declined from 4.5 per cent to 3.1 per cent over the period.

Net inflows on the capital account declined 59.4 per cent primarily due to decline of 63.1 per cent in the net inflows of foreign investment.

**While net FDI inflows increased 11.7 per cent, net portfolio investments reduced noticeably by 217.8 per cent.**

Net inflows of both, FIIs as well as FDI fell during H1: 2013-14. Considering errors & omissions of US$ 1.1 billion, the overall balance of payments shows a deficit of US$ 10.7 billion as against a marginal surplus of US$ 0.4 billion during H1: 2012-13.

## E.8 Prognosis

The world economy is showing signs of bouncing back with accelerated growth during 2014. Advanced economies are estimated to do better The US, in particular, is in a safe zone as indicated by the withdrawal of e quantitative easing. Rising industrial output as well as household spending will encourage exports from developing countries. On the other hand, strong portfolio adjustments due to reversal of capital flows to the US have led to currency depreciation in some developing countries.

India's exports have posted acceleration both due to increasing global activity and a depreciated currency. Imports of advanced economies are poised to pick up during 2014 largely led by private consumption. This provides an opportunity for many emerging markets like India to raise incomes and break the "middle income trap". Moderation in global commodity prices as well as checks on gold imports will lower the import bill. The ability to restructure the domestic economy to address supply-side constraints and the risk of overturn in policy reforms in view of the forthcoming national elections will be crucial factors in realizing our potential.

**Box E.1: Trade facilitation measures are important for export growth**

Trade facilitation measures play a significant role in boosting a country's trade. The World Bank has acknowledged the, benefits of reduction in time and the simplification of documentation procedures for the developing countries in its Doing Business Report, 2014. India ranked 134 among 189 economies in terms of ease of doing business. This was a few ranks below its earlier rank - 131 in 2013. India's performance fell off on a number of frontiers including: starting a business, getting electricity, getting credit, protecting investors, trading across borders, and resolving insolvency; though the rank improved for tax payments. On average 12 procedures are required over 27 days for a business process. These figures are significantly high than in South Asia and OECD. Improved trade facilitation measures can help exports without additional cost to the government exchequer. The Indian government has increasingly used e-governance tools such as e-BRC (electronic bank realization certificate) system as an attempt to increase efficiency and transparency. A commitment to improve business environment will prove supportive in achieving the export target of US$ 325 billion during 2013-14.

**Table E.1: Growth of World Output and Trade (% change, y-o-y)**

| | | | Projections | |
|---|---|---|---|---|
| | **2012** | **2013** | **2014** | **2015** |
| **World Output** | **3.1** | **3.0** | **3.7** | **3.9** |
| **Advanced Economies** | **1.4** | **1.3** | **2.2** | **2.3** |
| United States | 2.8 | 1.9 | 2.8 | 3.0 |
| Euro Area | -0.7 | -0.4 | 1.0 | 1.4 |
| Germany | 0.9 | 0.5 | 1.6 | 1.4 |
| France | 0.0 | 0.2 | 0.9 | 1.5 |
| Italy | -2.5 | -1.8 | 0.6 | 1.1 |
| Spain | -1.6 | -1.2 | 0.6 | 0.8 |
| Japan | 1.4 | 1.7 | 1.7 | 1.0 |
| **Emerging Market and Developing Economies 1/** | **4.9** | **4.7** | **5.1** | **5.4** |
| Central and Eastern Europe | 1.4 | 2.5 | 2.8 | 3.1 |
| Commonwealth of Independent States | 3.4 | 2.1 | 2.6 | 3.1 |
| Russia | 3.4 | 1.5 | 2.0 | 2.5 |
| Developing Asia | 6.4 | 6.5 | 6.7 | 6.8 |
| China | 7.7 | 7.7 | 7.5 | 7.3 |
| India[1] | 3.2 | 4.4 | 5.4 | 6.4 |
| ASEAN-5[2] | 6.2 | 5.0 | 5.1 | 5.6 |
| Latin America and the Caribbean | 3.0 | 2.6 | 3.0 | 3.3 |
| Brazil | 1.0 | 2.3 | 2.3 | 2.8 |
| Mexico | 3.7 | 1.2 | 3.0 | 3.5 |
| World Growth Based on Market Exchange Rates | 2.5 | 2.4 | 3.1 | 3.4 |
| **World Trade Volume (goods and services)** | **2.7** | **2.7** | **4.5** | **5.2** |
| Imports (goods and services) | | | | |
| Advanced Economies | 1.0 | 1.4 | 3.4 | 4.1 |
| Emerging Market and Developing Economies | 5.7 | 5.3 | 5.9 | 6.5 |
| **Commodity Prices (U.S. dollars)** | | | | |
| Oil[3] | 1.0 | -0.9 | -0.3 | -5.2 |
| Nonfuel (average based on world commodity export weights) | -10.0 | -1.5 | -6.1 | -2.4 |

***Source:*** WEO Update, 21 January 2014

[1] For India, data and forecasts are presented on a fiscal year basis.

[2] Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

**Table E.2: Overall Balance of Payment in India ($ billion)**

| | April-September 2012 PR | | | April-September 2013 P | | |
|---|---|---|---|---|---|---|
| | Credit | Debit | Net | Credit | Debit | Net |
| **A. CURRENT ACCOUNT** | | | | | | |
| **I. MERCHANDISE** | **147.6** | **239.2** | **-91.6** | **155.2** | **238.9** | **-83.8** |
| **II. INVISIBLES (a+b+c)** | **110.2** | **56.8** | **53.4** | **114.2** | **57.3** | **56.8** |
| **a) Services** | 70.8 | 39.5 | 31.3 | **73.2** | **37.9** | **35.2** |
| i) Travel | 7.5 | 6.1 | 1.4 | 7.8 | 6.1 | 1.7 |
| ii) Transportation | 8.5 | 7.8 | 0.7 | 8.3 | 7.2 | 1.1 |
| iii) Insurance | 1.1 | 0.6 | 0.5 | 1.1 | 0.5 | 0.5 |
| iv) G.n.i.e. | 0.3 | 0.3 | 0.0 | 0.2 | 0.6 | -0.3 |
| v) Miscellaneous of which : | 53.5 | 24.7 | 28.8 | 55.8 | 23.6 | 32.2 |
| Software Services | 31.7 | 1.2 | 30.5 | 33.5 | 1.0 | 32.4 |
| Business Services | 14.7 | 15.0 | -0.2 | 14.7 | 13.7 | 1.0 |
| Financial Services | 2.7 | 2.5 | 0.1 | 3.6 | 3.4 | 0.2 |
| Communication Services | 0.9 | 0.2 | 0.6 | 1.2 | 0.6 | 0.6 |
| b) Transfers | 34.4 | 1.8 | 32.6 | 35.3 | 2.6 | 32.7 |
| i) Official | 0.1 | 0.4 | -0.3 | 0.2 | 0.5 | -0.3 |
| ii) Private | 34.3 | 1.5 | 32.9 | 35.2 | 2.1 | 33.1 |
| c) Income | 5.0 | 15.4 | -10.5 | 5.6 | 16.8 | -11.2 |
| i) Investment Income | 3.5 | 14.4 | -11.0 | 4.1 | 15.5 | -11.4 |
| ii) Compensation of Employees | 1.5 | 1.0 | 0.5 | 1.6 | 1.3 | 0.2 |
| **Total Current Account (I+II)** | **257.8** | **296.0** | **-38.2** | **269.3** | **296.3** | **-27.0** |
| **B. CAPITAL ACCOUNT** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| **1. Foreign Investment (a+b)** | **95.5** | **77.7** | **17.8** | **124.5** | **117.9** | **6.6** |
| a) Foreign Direct Investment (i+ii) | 20.5 | 8.5 | 12.0 | 20.3 | 6.9 | 13.4 |
| i. In India | 18.2 | 2.7 | 15.4 | 16.7 | 2.7 | 14.0 |
| *Equity* | 12.8 | 2.4 | 10.4 | 11.8 | 2.4 | 9.4 |
| *Reinvested Earnings* | 4.6 | 0.0 | 4.6 | 4.1 | 0.0 | 4.1 |
| *Other Capital* | 0.9 | 0.4 | 0.5 | 0.7 | 0.3 | 0.4 |
| ii. Abroad | 2.3 | 5.8 | -3.5 | 3.6 | 4.2 | -0.6 |
| *Equity* | 2.3 | 2.9 | -0.6 | 3.6 | 1.8 | 1.8 |
| *Reinvested Earnings* | 0.0 | 0.6 | -0.6 | 0.0 | 0.6 | -0.6 |
| *Other Capital* | 0.0 | 2.2 | -2.2 | 0.0 | 1.8 | -1.8 |
| b) Portfolio Investment | 75.0 | 69.2 | 5.8 | 104.2 | 111.0 | -6.8 |
| *In India* | 74.1 | 67.7 | 6.4 | 103.6 | 110.6 | -7.0 |
| *FIIs* | 73.9 | 67.7 | 6.2 | 103.5 | 110.6 | -7.0 |
| *Equity* | 56.4 | 50.9 | 5.5 | 81.6 | 77.5 | 4.0 |
| *Debt* | 17.6 | 16.9 | 0.7 | 22.0 | 33.0 | -11.1 |
| *ADRs/GDRs* | 0.2 | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 |

| | | | | | | |
|---|---|---|---|---|---|---|
| *Abroad* | 0.9 | 1.4 | -0.6 | 0.6 | 0.4 | 0.2 |
| **2.Loans** | **71.1** | **60.0** | **11.1** | **70.9** | **67.7** | **3.2** |
| a) External Assistance | 2.0 | 1.9 | 0.1 | 1.8 | 1.7 | 0.1 |
| i) By India | 0.0 | 0.2 | -0.1 | 0.0 | 0.1 | -0.1 |
| ii) To India | 2.0 | 1.7 | 0.3 | 1.8 | 1.6 | 0.2 |
| b) Commercial Borrowings (ST, MT&LT) | 69.1 | 58.1 | 11.0 | 69.1 | 66.0 | 3.0 |
| **3. Banking Capital** | **45.6** | **30.7** | **14.9** | **50.1** | **38.1** | **12.0** |
| **4. Rupee Debt Service** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| **5. Other Capital** | **6.6** | **13.1** | **-6.5** | **9.5** | **16.1** | **-6.5** |
| **Total Capital Account (1 to 5)** | **218.7** | **181.4** | **37.3** | **255.0** | **239.9** | **15.1** |
| **C. Errors & Omissions** | **1.3** | **0.0** | **1.3** | **1.1** | **0.0** | **1.1** |
| **D. Overall Balance (A+B+C)** | **477.7** | **477.4** | **0.4** | **525.4** | **536.1** | **-10.7** |
| **E. Monetary Movements (i+ii)** | **0.0** | **0.4** | **-0.4** | **10.7** | **0.0** | **10.7** |
| i) I.M.F. | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| ii) Foreign Exchange Reserves (Increase - / Decrease +) | 0.0 | 0.4 | -0.4 | 10.7 | 0.0 | 10.7 |

PR: Partially Revised. P: Preliminary.
***Source:*** RBI, Monthly Bulletin January, 2014 and Press Release, 2 December 2013