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BALANCE OF PAYMENTS OUTLOOK FOR 2006/07 - UPDATE

I. Update on BoP

1. In its Economic Outlook 2006/2007 (September 2006), the EAC had also looked at the external sector and projected a current account deficit (CAD) for 2006/07 of US$ 11.1 billion or 1.2% of expected GDP for the year. This note presents an update on the BoP outlook based on the date released by the RBI for the first half of the year (April-September 2006) and the traded data released by DGCI&S as up to end-November 2006.

II. Divergence between RBI and DGCIS Data on Trade

2. The data of both RBI and DGCIS reflect revisions of past period data as is the common practice. The Council has, on several occasions, underscored the need to bring the merchandise trade deficits reported by the two agencies into closer alignment than has been the case in recent years. A positive consequence of the revisions made is that the extent of deviation between the merchandise trade deficits reported by the two agencies has greatly reduced. Following on the latest revisions, the difference between the merchandise trade deficit on BoP and DGCI&S data has come down to US$ 5.76 billion in 2005/06 and US$ 5.72 billion in 2004/05 from nearly twice these levels reported earlier. For both of these years now the BoP imports are about US$ 8 billion greater, and exports about US$ 2 billon more than the counterpart DGCI&S data. This order of difference is within what may be reasonably expected given the somewhat different basis of gathering of statistics.

III. Data Revisions

3. The BoP data released at the end of December 2006 for the first half of 2006/07 indicates that the merchandise trade deficit had risen by 30% to US$ 35.1 billion, while net invisibles had risen by 18%, resulting in an increase by 63% of the CAD to US$ 11.7 billion. This level of CAD amounts to 2.6% of expected GDP in the first half of 2006/07, if the GDP figure is annualised. However, it must be noted that the preliminary revisions to the first quarter (April-June 2006) show a large reduction of the CAD from US$ 6.10 to US$ 4.76 billion (28% reduction). The revision was almost wholly on account of an increase in the value of BoP exports leading to a reduction in the BoP merchandise trade deficit by US$ 1.3

billion. The revisions made to earlier quarters have been more considerable, as for instance that for the first half of 2005/06 where the latest CAD is now understood to be US$ 7.2 billion as against the initial estimate of US$ 13.9 billion. There is therefore sufficient reason to expect that the current estimates of CAD for the first and second quarter will both be eventually restated at lower levels. The situation for the past 26 quarters is placed at Table-1. The "provisional" estimate is the first estimate released of the CAD and the "latest" figure is the revised data as per the most recent releases. A graphic representation of the same is at Chart-1.

Table 1: Revisions in the Estimates of CAD

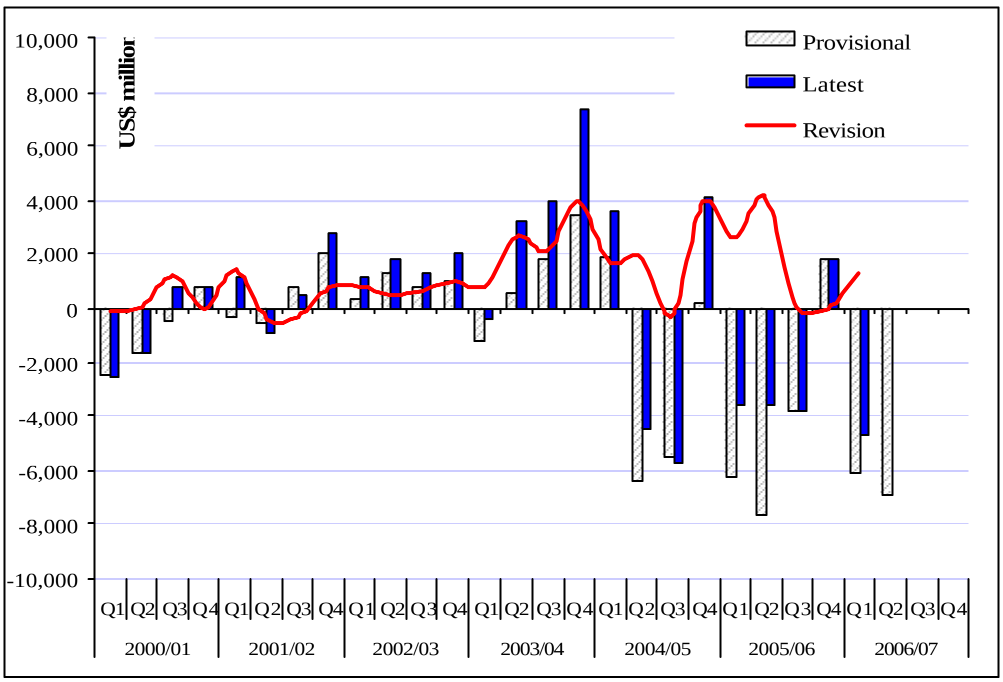
(US$ million)

		Provisional	Latest	Revision *	
2000/01	Q1	–2,454	–2,563	–109	4%
	Q2	–1,673	–1,631	42	–3%
	Q3	–469	755	1,224	162%
	Q4	772	773	1	0%
2001/02	Q1	–332	1,127	1,459	129%
	Q2	–606	–965	–359	37%
	Q3	785	475	–310	–65%
	Q4	2,017	2,763	746	27%
2002/03	Q1	325	1,129	804	71%
	Q2	1,341	1,815	474	26%
	Q3	721	1,354	633	47%
	Q4	1,031	2,047	1,016	50%
2003/04	Q1	–1,204	–422	782	–185%
	Q2	524	3,186	2,662	84%
	Q3	1,819	3,962	2,143	54%
	Q4	3,439	7,357	3,918	53%
2004/05	Q1	1,904	3,608	1,704	47%
	Q2	–6,419	–4,430	1,983	–45%
	Q3	–5,470	–5,754	–284	5%
	Q4	159	4,106	3,947	96%
2005/06	Q1	–6,201	–3,582	2,619	–73%
	Q2	–7,660	–3,578	4,082	–114%
	Q3	–3,854	–3,826	28	–1%
	Q4	1,815	1,815	0	0%
2006/07	Q1	–6,099	–4,755	1,344	–28%
	Q2	–6,928		6,928	

Note: Highlighted sections indicates quarters where the revision has exceeded US$1 billion
* Expressed as a proportion of the final value, not the provisional value.

4. The magnitude of the revisions is brought out by the value of the standard deviation of the revision which is 75%; ignoring signs the standard deviation of the absolute values of the revision is 50% and it would be reasonable to expect therefore that the final value of the CAD in the first half of 2006/07 will also be found to have been reduced in magnitude to the extent of 50%. That basically means that on average it will be expected that the CAD for the first quarter of 2006/07 will be further revised to somewhere closer to US$ 3.0 billion, while that of the second quarter is likely to eventually be found to be closer to US$ 3.5 billion.

Chart 1
Extent of revision of the CAD in previous quarters



5. Chart-1 shows that the revision to the CAD has largely had a positive value – that is resulting in an increase in the current account surplus or a reduction in the current account deficit; in recent quarters the order of revision has been as large as US$ 2 to US$ 4 billion.

IV. BoP Update based on Latest Data

6. The earlier estimates of the Council had been made on the basis that (a) gold imports in the current year (2006/07) would be at about the same level as that of the previous year; (b) the value of crude petroleum imports, after taking into account restoration of Bombay High output, would increase by 33% over the previous year; (c) non-oil, non-gold imports would increase by 17%; and (d) exports would increase by 17%. On the basis of these assumptions, the merchandise trade deficit (conforming to the DGCI&S reporting) would be $53 billion. The difference between the BoP and DGCI&S trade deficit had been US$ 12 billion in 2005/06 (at that time, i.e. August 2006) and this was expected to reduce a bit to USD $10 billion – thus yielding the estimate of a BoP merchandise trade deficit of US $ 63 billion.

7. The BoP merchandise trade deficit during the first half of 2006/07 (April-September) was US$ 35.14 billion, while the DGCI&S trade deficit for the same period was US$ 24.67. Almost all of the difference was on account of imports. We have seen that in previous periods the DGCI&S data has tended to under-estimate imports and to a lesser extent exports, while in the case of the BoP data, exports have been raised and on occasion the import numbers have been revised downward. On balance, going by the previous experience it is likely that there will be both a reduction in the BoP merchandise trade deficit and an increase in the DGCI&S trade deficit.

8. The DGCI&S trade data (provisional) is available up to the end of November 2006. There seems to have been a small reduction in the level of exports in October and November 2006. Between May and September 2006, in every month the level of exports was comfortably in excess of US$ 10 billion. In both October and November 2006, exports have been under US$ 9.7 billion. This could be a temporary situation, but there is some ground to expect a little moderation in export growth in the balance months of 2006/07. Thus, export growth has averaged little under 25% in the first half, 22.5% in October and November and may be expected to average 21% for the second half of the year.

9. Import growth in the first half of 2006/07 has been strong, averaging nearly 24%, while it was higher at nearly 40% in October and November. Oil imports have risen by 40.5% during the first eight months (April-November) of 2006/07, while the value of gold imports had declined till August before rising sharply in September 2006. Overall the value of gold and silver imports are slightly above the level for the comparable period in the previous year, and a similar increase is projected for the remaining months of 2006/07. Non-oil, non-gold imports appear to have risen by over 25% during the period April-November 2006/07. However, there is some indication of a significant acceleration in the import of non-oil, non-gold imports in the third quarter of 2006/07 to nearly 40%, while in the first half the average was little over 18%. Under the circumstances it will not be unreasonable to expect that the higher level of expansion in non-oil, non-gold imports is likely to extend, at least to an extent,

into the last quarter of the year – at over 28%. In consequence the expansion of non-oil, non-gold imports in the second half of 2006/07 is expected to show an increase of 34%. Crude oil prices have eased considerably, notwithstanding the OPEC initiated production cut-backs. Under the circumstances we project only a modest increase in the oil import bill during the last quarter of the fiscal year.

10. The BoP merchandise trade deficit comes to US$ 65.9 billion which is somewhat larger than our earlier estimate of US$ 63.0 billion – reflecting for the most part the higher growth of non-oil, non-gold imports. Net invisible earnings are expected to be US$ 52.5 billion, marginally above our previous estimate. This is on account of a combination of little lower expected software and other service export earnings, marginally higher remittances and lower (negative) investment income. The new estimate of the current account deficit for the fiscal year 2006/07 is US$ 13.4 billion which is 1.5% of expected GDP for the year.

11. Export of Information Technology Enabled Services (ITES – software & business process outsourcing) is reported to have been US$ 26.5 billion during calendar (Jan-Dec) 2006. Reducing this amount by the ITES earnings of the last quarter of 2005/06 (Jan-Mar) we get the earnings during the first nine months of 2006/07. After projecting that for the last quarter of 2006/07 (Jan-Mar) on the basis of 30% year-on-year growth and adding the result to the nine-month total, we arrive at an estimate of US$ 28.5 billion for the year as a whole.

12. The summary of the Balance of Payment statements are presented at Table-2. It may be observed from the table that the larger change as compared to our previous estimate is on the capital account side.

13. Mostly on account of higher banking capital inflows (including NRI deposits), higher foreign investment and commercial loan inflows, the expected capital account surplus has been re-estimated at US$ 35 billion in 2006/07, resulting in the need to absorb US$ 22.6 billion in the reserve foreign currency assets. This is an increase of US$ 8.2 billion as compared to our previous estimate. It is pertinent to note that of this projected increment to reserves of US$ 22.6 billion absorption, US$ 8.6 billion has already been absorbed in the first half, leaving US$ 14 billion to be absorbed in the second half of this fiscal. We estimate that in the third quarter (October to December 2006) another US$ 7 to 8 billion was the increment to the RBI's foreign currency assets, implying that in the last quarter (January to March 2007) there is likely to be a further increment to reserves of US$ 6 to US$ 7 billion.

Table 2
Summary Balance of Payments - Actual and Projected for 2006/07

US $ billion except where indicated otherwise

US$ billion	Reported			Projected 2006/07	
	2004/05	**2005/06**	**H-1 2006/07**	**As estimated in Aug 2006**	**As estimated in Jan 2007**
Current Account					
Merchandise Exports	82.2	105.2	60.6	119.7	128.4
Merchandise Imports	118.8	157.0	95.7	182.8	194.3
Merchandise Trade Balance	–36.6	–51.8	–35.1	–63.1	–65.1
Percent of GDP	(–5.3%)	(–6.5%)	(–7.8%)	(–7.0%)	(–7.3%)
Net Invisibles	31.2	42.7	23.5	52.0	52.5
o/w Software	16.5	22.6	12.1	29.3	28.5
Remittances	20.3	24.1	11.2	27.5	26.5
Investment Income	–2.7	–4.9	–1.8	–4.1	–3.5
Current Account Balance	–5.4	–9.2	–11.7	–11.1	–13.4
Percent of GDP	(–0.8%)	(–1.2%)	(–2.6%)	(–1.2%)	(–1.5%)
Capital Account					
Foreign Investment	12.1	17.2	5.8	13.5	16.0
o/w FDI (net)	3.2	4.7	4.2	8.5	9.0
Portfolio capital	8.9	12.5	1.6	5.0	7.0
Loans	10.8	6.1	7.4	12.0	14.0
Banking capital	3.9	1.4	3.2	1.0	4.0
Other capital	4.7	–0.7	3.0	1.0	1.0
Capital Account Balance	31.0	23.4	19.3	27.5	35.0
Percent of GDP	(4.5%)	(2.9%)	(4.3%)	(3.0%)	(3.9%)
Errors & Omissions	0.5	0.8	1.0	0.0	1.0
Accretion to Reserves	26.2	15.1	8.6	16.4	22.6
Memo item					
GDP mp (Rs crore)	3,121,414	3,530,319	1,994,630	3,989,260	3,989,260
GDP mp (US$ billion)	695	798	451	902	902

Note: Figures in parentheses refer to the proportion to GDP; for half-year periods it is the proportion to GDP assuming equal distribution of GDP at market prices for the two halves of the year.