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UPDATE

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**CAD—wider but comfortable.** 1QFY15 CAD/GDP worsened to 1.7% with deterioration in both trade balances and net invisibles. However, capital flows were robust on account of foreign investments, thereby leading to a comfortable BOP surplus of US\$11.2 bn. For FY2015, we expect CAD/GDP at 1.7% (US\$36.1 bn), unchanged from FY2014. Even as our base case assumes a BOP surplus of US\$20.8 bn, we alter our USD/INR average to 60.50 (earlier 59.50), based on current trends and a likelihood of rapid USD appreciation globally.

#### 1QFY15 CAD widens...

CAD in 1QFY15 widened significantly to US\$7.9 bn (1.7% of GDP), as against US\$1.3 bn in 4QFY14 (0.3% of GDP). This was led by an increase in the trade deficit to US\$34.6 bn from US\$30.7 bn in 4QFY14. However, CAD was much better than the US\$50.5 bn in 1QFY14 primarily due to restriction on gold imports. Importantly, non-oil imports were higher in 1QFY15 from 4QFY14, probably signaling a rising economic growth momentum. While yoy exports growth was at 10.6%, risk to the merchandise deficit going forward is faster-than-expected domestic growth (pushing up non-oil, non-gold import growth) and slower global growth (lowering export growth).

Invisibles receipts eased in 1QFY15 with net software receipts at US\$17.0 bn and transfers at US\$16.4 bn. Net interest outgo from India continued to be a large drag on invisibles in 1QFY15 and was at (-)US\$6.8 bn.

#### ...buffered by capital flows

1QFY15 capital inflows have been much robust at US\$19.9 bn compared to US\$9.2 bn in 4QFY14. Net FDI inflows accelerated to US\$8.2 bn (mainly towards the telecom sector), net FPI was also stronger at US\$12.4 bn (election impact) against US\$9.3 bn in 4QFY14. ECB flows slowed to US\$1.7 bn while banking capital was also weaker on account of higher repayments of overseas borrowings. Overall, with capital flows remaining comfortable, BoP registered a surplus of US\$11.2 bn in 1QFY15.

#### FY2015 CAD/GDP seen at 1.7%

We see CAD/GDP for FY2015 at 1.7% with crude price at US\$107.5/bbl, with the benefit to CAD/GDP obvious if crude price is lower. The government has allowed star trading houses to import gold under the 80:20 scheme and thus we expect gold imports for the year being higher at US\$33 bn from US\$27 bn last year. However, this is unlikely to be enough to push the CAD/GDP to a risk zone with exports remaining strong on expectations of stabilizing global growth.

#### USD/INR should show near-term stability

USD/INR has stabilized now in a zone of 60-62, with RBI preventing any sharp appreciation bias by mopping up the large inflows. Building up of reserves to fight eventualities (global risk aversion or outflows on account of change in interest rate scenario in the US) is among the top priorities for RBI. Barring any tail risk of enhanced global geopolitical risks or any aggressive changes in the Fed interest rate stance, we continue to see USD/INR in a narrow range of 59-62. However, we change our view of the average USD/INR for FY2015 to 60.50 from 59.50. Since the beginning of CY2014, Dollar Index (DXY) has appreciated by approximately 2.5% and has the chance to appreciate further based on (1) risk-aversion and flight to safety owing to geopolitical concerns and (2) a hawkish Fed relative to most of its DM peers. The sharpest depreciation pressure will probably be felt in 4QFY15, as it would be the time when global markets would probably start factoring in an eventual rate-hiking cycle by the Fed.

#### QUICK NUMBERS

- **CAD widened to US\$7.9 bn for 1QFY15; CAD/GDP at 1.7%**
- **Capital inflows at US\$19.9 bn for 1QFY15, key element being foreign investments**
- **USD/INR average for FY2015 changed to 60.50 from 59.50, factoring in recent USD firmness**

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## Exhibit 1: 1QFY15 CAD sharply up to 1.7% of GDP

India's balance of payments, March fiscal year-ends, 1QFY14-1QFY15 (US\$ bn)

	2013	2014	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15
<b>Current account</b>	<b>(88.2)</b>	<b>(32.4)</b>	<b>(21.8)</b>	<b>(5.2)</b>	<b>(4.1)</b>	<b>(1.3)</b>	<b>(7.9)</b>
GDP	1,859	1,878	456	428	484	510	476
<b>CAD/GDP (%)</b>	<b>(4.7)</b>	<b>(1.7)</b>	<b>(4.8)</b>	<b>(1.2)</b>	<b>(0.8)</b>	<b>(0.3)</b>	<b>(1.7)</b>
Trade balance	(195.7)	(147.6)	(50.5)	(33.3)	(33.2)	(30.7)	(34.6)
<b>Trade balance/GDP (%)</b>	<b>(10.5)</b>	<b>(7.9)</b>	<b>(11.1)</b>	<b>(7.8)</b>	<b>(6.8)</b>	<b>(6.0)</b>	<b>(7.3)</b>
- Exports	307	319	74	81	80	84	82
- Imports	502	466	124	115	113	114	116
o/w Oil imports	170	168	42	41	42	43	41
o/w Non-oil imports	332	298	82	74	71	72	76
Invisibles (net)	107	115	29	28	29	29	27
- Services	65	73	17	18	18	20	17
o/w Software	64	67	16	16	17	18	17
o/w Non-software	1.4	6.0	0.7	2.1	1.3	1.9	0.1
- Transfers	64	65	17	16	16	16	16
- Other invisibles	(21)	(23)	(4.8)	(6.3)	(5.4)	(6.4)	(6.7)
<b>Capital account</b>	<b>89.4</b>	<b>48.8</b>	<b>20.6</b>	<b>(4.7)</b>	<b>23.8</b>	<b>9.2</b>	<b>19.9</b>
% of GDP	4.8	2.6	4.5	(1.1)	4.9	1.8	4.2
Foreign investment	46.7	26.4	6.3	1.5	8.5	10.2	20.6
- FDI	19.8	21.6	6.5	8.1	6.1	0.9	8.2
- FPI	26.9	4.8	(0.2)	(6.6)	2.4	9.3	12.4
- Equities	23.3	13.5	4.9	(0.8)	6.2	3.3	7.5
- Debt	4.3	(8.5)	(5.4)	(5.7)	(3.7)	6.3	5.0
Banking capital	16.6	25.4	10.3	1.2	15.8	(1.8)	(0.1)
- NRI deposits	14.8	38.9	5.5	8.2	21.4	3.7	2.4
Short-term credit	21.7	(5.0)	2.5	(1.9)	(1.2)	(4.5)	0.2
ECBs	8.5	11.8	0.9	1.6	4.2	5.1	1.7
External assistance	1.0	1.0	0.3	(0.2)	(0.0)	0.9	(0.0)
Other capital account items	(5.0)	(10.8)	0.3	(6.9)	(3.4)	(0.7)	(2.5)
E&O	2.7	(0.9)	0.9	(0.4)	(0.6)	(0.7)	(0.8)
<b>Overall balance</b>	<b>3.9</b>	<b>15.6</b>	<b>(0.3)</b>	<b>(10.4)</b>	<b>19.1</b>	<b>7.1</b>	<b>11.2</b>
<b>memo items:</b>							
Average exchange rate (US\$/Rs)	54.41	60.45	55.95	62.07	61.98	61.77	59.78
Average crude price (US\$/bbl)	108.2	107.6	103.0	107.5	109.4	107.9	109.8

Source: CEIC, RBI, Kotak Economic Research

## Exhibit 2: CAD likely to remain comfortable in FY2015

India's balance of payments, March fiscal year-ends, 2013-15E (US\$ bn)

	2013	2014	2015E		
			Oil@100	Oil@107.5	Oil@115
<b>Current account</b>	<b>(88.2)</b>	<b>(32.4)</b>	<b>(27.6)</b>	<b>(36.1)</b>	<b>(44.6)</b>
GDP	1,859	1,878	2,113	2,113	2,113
<b>CAD/GDP (%)</b>	<b>(4.7)</b>	<b>(1.7)</b>	<b>(1.3)</b>	<b>(1.7)</b>	<b>(2.1)</b>
Trade balance	(195.7)	(147.6)	(146.3)	(154.8)	(163.2)
<b>Trade balance/GDP (%)</b>	<b>(10.5)</b>	<b>(7.9)</b>	<b>(6.9)</b>	<b>(7.3)</b>	<b>(7.7)</b>
- Exports	307	319	332	336	340
- Imports	502	466	479	491	503
- oil imports	170	168	164	177	189
- non-oil imports	332	298	314	314	314
Invisibles (net)	107	115	119	119	119
- Services	65	73	79	79	79
- software	64	67	74	74	74
- non-software	1.4	6.0	5.0	5.0	5.0
- Transfers	64	65	67	67	67
- Income (net)	(21.5)	(23.0)	(27.0)	(27.0)	(27.0)
<b>Capital account</b>	<b>89.4</b>	<b>48.8</b>	<b>57.0</b>	<b>57.0</b>	<b>57.0</b>
Percentage of GDP	4.8	2.6	2.7	2.7	2.7
Foreign investment	46.7	26.4	50.0	50.0	50.0
- FDI	<b>19.8</b>	<b>21.6</b>	<b>25.0</b>	<b>25.0</b>	<b>25.0</b>
- FPI	<b>26.9</b>	<b>4.8</b>	<b>25.0</b>	<b>25.0</b>	<b>25.0</b>
- Equities	<b>23.3</b>	<b>13.5</b>	—	—	—
- Debt	<b>4.3</b>	<b>(8.5)</b>	—	—	—
Banking capital	16.6	25.4	8.0	8.0	8.0
- NRI deposits	14.8	38.9	10.0	10.0	10.0
Short-term credit	21.7	(5.0)	—	—	—
ECBs	8.5	11.8	8.0	8.0	8.0
External assistance	1.0	1.0	1.0	1.0	1.0
Other capital account items	(5.0)	(10.8)	(10.0)	(10.0)	(10.0)
E&O	2.7	(0.9)	—	—	—
<b>Overall balance</b>	<b>3.9</b>	<b>15.6</b>	<b>29.4</b>	<b>20.9</b>	<b>12.4</b>
<b>Memo items</b>					
Average USD/INR	54.41	60.45	60.50	60.50	60.50
<b>Average crude (US\$/bbl)</b>	<b>108.2</b>	<b>107.6</b>	<b>100.0</b>	<b>107.5</b>	<b>115.0</b>

Source: CEIC, RBI, Kotak Economic Research estimates

## Exhibit 3: USD/INR likely to average 60.5 in FY2015

USD/INR and other major currency exchange rates; appreciation/depreciation (%)

	2012	2013	2014	2015E	4QFY14	1QFY15	2QFY15E	3QFY15E	4QFY15E
<b>Average Rate</b>									
<b>USD/INR</b>	<b>47.95</b>	<b>54.41</b>	<b>60.45</b>	<b>60.50</b>	<b>61.79</b>	<b>59.76</b>	<b>60.50</b>	<b>60.50</b>	<b>61.25</b>
EUR/USD	1.38	1.29	1.34	1.33	1.37	1.37	1.34	1.32	1.30
GBP/USD	1.60	1.58	1.59	1.68	1.65	1.68	1.69	1.68	1.67
USD/JPY	79.0	83.1	100.3	103.5	102.8	102.1	103.0	104.0	105.0
<b>Depreciation (-)/appreciation (+)</b>									
<b>USD/INR</b>	<b>(5.2)</b>	<b>(13.5)</b>	<b>(11.1)</b>	<b>(0.1)</b>	<b>0.3</b>	<b>3.3</b>	<b>(1.2)</b>	<b>-</b>	<b>(1.2)</b>
EUR/USD	4.1	(6.5)	4.1	(0.6)	0.7	0.1	(2.3)	(1.5)	(1.5)
GBP/USD	2.5	(1.0)	0.7	5.7	2.2	1.8	0.3	(0.6)	(0.6)
USD/JPY	7.8	(5.1)	(20.7)	(3.3)	(2.3)	0.7	(0.8)	(1.0)	(1.0)

Source: Bloomberg, Kotak Economic Research estimates

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