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ECONOMIC AND MARKET ANALYSIS: INDIA

Economics

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India Macroscope

Pensions – What Lies Ahead?

- **Following the Left parties' departure, pensions is an area where the odds favour some reform**
- **With less than 13% of the working population having access to pension schemes, the passage of the Pension Bill would expand the base and have consequences for financial markets**
- **Rupee to remain weak in the near term due to global turmoil and rise in risk aversion…**
- **…but with oil coming off coupled with further likely easing of capital account norms, the long-term appreciation story holds**
- **On the macro front, while our FY09 and FY10 GDP estimates of 7.5% and 7.4% factor in single-digit investment growth from a CAGR of 17% seen during FY03 to FY08…**
- **…A sustained fall in commodity prices bodes well for inflation, rates and the fisc**

Asia Pacific

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Contents

Our theme in the September Macroscope takes stock of the Indian pension space. The passage of the Pension Bill has positive social and financial implications.

Pensions – Passage of Bill has wide ranging consequences

With less than 13% of the working population having access to formal pension schemes coupled with a rising number of people over the age of 60, the need for pension reform is imperative. With the current government getting a fresh lease of life following the departure of the Left Parties, similar to progress on the nuclear deal, the pension front is an area where the odds favour some reform. Besides giving the PFRDA more authority, its approval will permit the balance 87% of the working population currently not being covered under any social security scheme to participate in the NPS. Other pension-related reforms on the anvil are an increase in FDI limits for the sector to 49% and 26% foreign ownership in pension JVs.

Growth – Is the pain largely priced in?

The deterioration in the global and domestic macro environment has seen India Inc adapt and innovate with a clear focus on profitability. However, the adverse macro environment is having an impact on growth and expansion plans, with recent developments in Singur – the location for Tata's Nano car project – another negative. Our FY09 and FY10 GDP estimates of 7.5% and 7.4% factor in investment growth slowing to 8.6% and 6.2% from a CAGR of 17% seen during FY03 to FY08.

Implications of oil at sub US$100/bbl on rates and fisc

On the monetary front, the sharp fall in commodity prices is positive for inflationary expectations and raises the odds of the RBI keeping rates on hold despite inflation hovering around 12% levels. However, the continued buoyancy in both credit and deposits and consequent demand for government securities to meet statutory requirements raises the possibility of an SLR cut. Oil coming off to sub US$100/bbl results in four options for the government: These include a reduction in 1) retail prices 2) oil bonds, 3) net losses to companies or 4) upstream share. While the latter three would be preferable, given that it is an election year, a combination of option 1 coupled with differential diesel pricing is not ruled out.

Rupee - Near-term weakness but long-term appreciation story holds

Despite oil coming off nearly 35% in the last month, the rupee has weakened by 10% with the currency crossing Rs46/US$ levels. Given the global turmoil and adverse sentiment against the USD/INR, the rupee could weaken further. However, the key call to make is whether this is a technical move or a structural change. Given the volatile market situation, the depreciation trend is likely to continue in the near term. However, over a longer-term horizon, we maintain our rupee appreciation view. Key factors that could work in the rupee's favour are: (1) Oil at these levels would reduce the full-year Current a/c deficit (CAD) estimate from US$50bn to US$35bn. (2) Although portfolio flows will likely remain negative, FDI remains buoyant – with the latest FDI numbers indicating that gross FDI during 1QFY09 surged to US$10bn, double the US$5bn seen during the same period last year. (3) Given changed market environment from a year ago, we maintain our view of a strong possibility of the RBI further easing the norms on the capital account (ECB/NRI deposits).

Statistical Snapshot

Figure 1. India — Macroeconomic Summary, FY98-09E (Percent)

Year-end 31 March	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
National income indicators													
Nominal GDP (Rs bn)	15,272	17,512	19,520	21,023	22,790	24,546	27,546	31,494	35,803	41,458	47,131	54,578	62,394
Nominal GDP (US$ bn)	411	415	450	460	475	508	600	700	808	923	1,172	1,284	1,560
Per Capita GDP (US$)	418	409	437	440	447	471	548	639	783	881	1,023	1,104	1,322
Real GDP growth (%YoY)	4.8	6.5	6.0	4.4	5.8	3.8	8.5	7.5	9.4	9.6	9.0	7.5	7.4
Agriculture growth	-2.4	6.2	0.5	-0.2	6.3	-7.2	10.0	0.0	5.9	3.8	4.5	2.0	3.0
Industry growth	4.3	3.7	4.1	6.3	2.7	7.1	7.4	10.3	10.1	11.0	8.5	6.8	6.5
Services growth	9.8	8.4	10.8	5.7	7.2	7.5	8.5	9.1	10.3	11.1	10.8	9.6	9.2
By Demand – Real (%YoY)													
Consumption	3.5	7.0	6.5	2.8	5.5	2.2	5.3	4.8	8.2	7.0	8.1	7.5	6.9
Pvt Consumption	2.3	6.1	5.3	3.2	6.1	2.7	5.8	5.2	8.7	7.1	8.3	7.4	7.0
Public Consumption	11.2	12.2	13.1	0.9	2.3	-0.4	2.6	2.6	5.4	6.2	7.0	8.0	6.5
Gross Capital Formation	12.1	0.1	20.6	-3.5	-2.9	17.0	19.9	19.5	19.4	10.9	13.7	8.6	6.2
Cons; Invst, Savings (%GDP)													
Total Consumption	77.2	77.8	77.2	76.3	76.5	75.3	73.2	70.8	70.2	68.4	67.8	67.9	67.6
Total Investments	24.5	23.1	25.9	24.1	22.2	25.0	27.7	30.6	33.4	33.8	35.2	35.6	35.2
Gross Domestic Savings	23.6	21.9	24.8	23.7	23.5	26.4	29.8	31.8	34.3	34.8	35.0	34.0	34.0
Real indicators (%YoY)													
Cement dispatches	10.6	6.4	14.1	0.1	8.6	11.1	6.5	9.3	10.3	10.0	9.0	10.0	12.0
MHCVs	-38.2	-10.7	32.5	-21.1	1.3	36.3	40.3	25.1	4.0	33.3	-0.3	4.0	8.0
LCVs	-24.2	-11.9	6.3	4.9	-12.5	46.9	33.6	26.2	25.2	30.8	13.3	12.0	12.0
Car sales	1.1	-4.0	45.3	-5.3	3.2	5.3	34.3	19.4	7.3	20.6	11.2	10.0	12.0
Two-wheelers	2.7	11.7	9.4	0.7	15.3	15.8	12.6	16.8	15.0	12.1	-5.0	3.0	7.0
Diesel consumption	3.5	3.7	5.5	2.0	-3.5	3.0	4.5	5.5	3.0	16.2	17.2	18.2	18.0
Tele-density	1.9	2.3	2.8	3.5	4.2	5.2	7.4	9.6	13.3	19.2	26.9	35.2	43.2
Monetary indicators(%YoY)													
Money supply	18.0	19.4	15.0	16.4	14.1	14.7	16.7	12.3	21.2	21.5	20.6	20.0	18.0
10 Yr Bond Yield	NA	NA	NA	10.9	8.7	6.9	5.4	6.3	7.2	7.8	7.9	9.25	8.75
Inflation – WPI	4.4	5.9	3.3	7.1	3.6	3.4	5.5	6.5	4.4	5.4	4.7	10.5	6.0
CPI	6.9	13.1	3.4	3.7	4.3	4.1	3.8	3.9	4.2	6.8	6.2	7.0	6.0
Bank credit growth	16.4	13.8	18.2	17.3	15.3	23.7	15.3	30.9	37.0	27.6	21.0	18.0	18.0
Deposit growth	18.4	19.3	13.9	18.4	14.6	16.1	17.5	13.0	24.0	23.0	24.0	18.0	18.0
Fiscal Indicators(% GDP)													
Centre's fiscal deficit	4.8	5.1	5.4	5.6	6.2	5.9	4.5	4.0	4.1	3.4	3.0	2.5	2.3
State fiscal deficit	2.9	4.3	4.7	4.3	4.2	4.2	4.5	3.5	2.5	1.9	2.3	2.1	2.0
Combined deficit (Centre+State)	7.1	8.9	9.4	9.5	9.9	9.6	8.5	7.5	6.7	5.6	5.3	4.6	4.3
Combined domestic liabilities	61.8	62.6	66.6	71.0	76.4	80.7	81.5	82.4	80.3	77.0	77.0	73.4	70.3
Combined o/s guarantees	9.7	9.8	11.1	12.2	11.5	11.2	11.1	10.0	8.6	8.2	7.9	7.3	7.5
External Sector													
Exports (US$bn)	35.7	34.3	37.5	45.5	44.7	53.8	66.3	85.2	105.2	128.1	158.5	188.6	237.6
% YoY	4.5	-3.9	9.5	21.1	-1.6	20.3	23.3	28.5	23.4	21.8	23.7	19.0	26.0
Imports (US$bn)	51.2	47.5	55.4	57.9	56.3	64.5	80.0	118.9	157.1	191.3	248.5	315.6	358.2
%YoY	4.6	-7.1	16.5	4.6	-2.8	14.5	24.1	48.6	32.1	21.8	29.9	27.0	13.5
Trade deficit (US$bn)	-15.5	-13.2	-17.8	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-63.2	-90.1	-127.0	-120.6
Invisibles (US$bn)	10.0	9.2	13.7	9.8	15.0	17.0	27.8	31.2	42.0	53.4	72.6	76.9	88.7
Current Account Deficit (US$bn)	-5.5	-4.0	-4.1	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.8	-17.4	-50.1	-31.9
% to GDP	-1.3	-1.0	-0.9	-0.6	0.7	1.2	2.3	-0.4	-1.2	-1.1	-1.5	-3.9	-2.0
Forex reserves (excl gold) (US$bn)	26.0	29.5	35.1	39.6	51.0	71.9	106.1	135.1	145.1	191.9	300.0	305.1	326.8
Months of imports	6.1	7.5	7.6	8.2	10.9	13.4	15.9	13.6	11.1	12.0	13.5	10.9	11.1
Exchange rate													
Rs/US$ - annual avg	37.2	42.2	43.4	45.7	48.0	48.3	45.9	45.0	44.3	45.2	40.2	42.5	40.0
% depreciation	4.8	13.4	2.8	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-10.5	5.7	-5.9
Rs/US$ - year end	39.52	42.4	43.6	46.5	48.9	47.5	43.6	43.8	44.6	43.6	40.1	42.5	40.0
% depreciation	10.4	7.3	2.8	6.7	5.2	-2.9	-8.2	0.3	2.0	-2.5	-7.8	6.0	-5.9

Source: CSO, RBI, Ministry of Finance, Citi estimates

Theme: Pensions

- With less than 13% of the working population having access to formal pension schemes coupled with a rising number of people over the age of 60, the need for pension reform is imperative and well known BUT has been on the back burner for a while
- However, post the trust vote, similar to progress on the nuclear deal, the pension front is an area where the odds favour some reform
- The passage of the Pension Bill could enable the balance 87% of the workforce being covered by social security and has wide-ranging consequences for the financial markets as well

The Current Pension Scenario

India's existing pension system is based on both defined benefit (DB) and defined contribution (DC) schemes[1]. The current system can be categorized under:

The Organized Private Sector: Establishments employing more than 10 workers have to participate in the social insurance schemes managed by the Employees Provident Fund Organization (EPFO), or they can seek an exemption to manage their own funds. This is a blend of a DC scheme called the Employee Provident Fund (EPF) and a DB scheme called the Employee Pension Scheme (EPS). The EPFO has a corpus of Rs2,439bn, which covers 36mn workers and 4,71, 678 establishments.

The Public Sector: Prior to January 2004, in addition to a contributory Government Provident Fund (GPF), retirement benefits of civil servants were largely in the nature of defined benefits. However given the rising fiscal burden, the central government launched a New Pension Scheme (NPS) in January 2004,[2] which resulted in all new government employees coming under a DC scheme.

The Unorganized Sector: While there is no mandatory pension option, workers can opt to join the Public Provident Fund. This is a 15-year scheme whereby members contribute between Rs500-70,000 each fiscal year and earn an 8% return.

Figure 2. India – Pension Snapshot

	Who does it cover?	Corpus Size (Rs Bn)	Type	Equity limit	Managed by
EPFO	Non-Govt employees for organizations with over 10 people	2,439		15%*	EPFO
Employee Pension Scheme		787	DB		
Employee Provident Fund		1,584	DC		
New Pension System (NPS)	All Govt employees after 2004	>12*	DC	Two Options: (1) 100% G-Secs (2) 85% Fixed Income & 15% Equities	PFRDA
Government Provident Fund	Govt employees appointed before 2004	NA		-	
Public Provident Fund (PPF)	Unorganized sector	NA		-	Central Govt

Source: EPFO; PFRDA * While the current govt guidelines provide that upto 15% can be invested in equities, the Labour Ministry has not yet given the approval. **This is the amount transferred to the new private fund managers recently appointed. An official estimate of the total corpus is not available

[1] **Defined Benefit** plan is one where each participant receives monthly benefits that are typically linked to his/her salary or years of service. **Defined Contribution** plan is one where each participant makes contributions into an individual account. The amount received at the time of retirement would depend on the contribution made and the yield earned on it

[2] The **New Pension Scheme (NPS) -** operates on a defined contribution basis. Administration of the NPS would be carried out by a Central Record Keeping Agency (CRA). The PFRDA will appoint a number of Points of Presence (PoPs) who will be responsible for collecting funds from subscribers across the country (these could be banks and post offices).

Changes in the recent past

Over recent months there have been substantial changes in the pension space. Key changes include:

#1. Private Funds can now manage EPFO corpus

Last month, the government selected three private sector companies (HSBC, ICICI Prudential and Reliance Capital) to manage annual incremental pension funds of EPFO. *(These amounted to Rs278bn during FY07)*. The three funds are in addition to SBI, which has been the sole EPFO fund manager for 56 years! As regards the government pensions, late last year the PFRDA appointed the asset management arms of SBI, UTI and LIC to manage the NPS.

#2: Investment guidelines are liberalized

The government has revised guidelines for investment in pension funds for the private sector (i.e., those under EPFO coverage). According to new guidelines, funds can now invest up to 15% in equities and up to 55% in central/state government securities and gilt mutual funds. This is a modification from the earlier guidelines according to which funds could invest upto 5% in equities and 10% in mutual funds (these have now been clubbed together).

#3. Extending the corpus of EPFO and NPS

Another key change is that the government has extended the coverage of the EPFO scheme from private companies with more than 20 employees to those with more than 10 employees while state governments are in the process of shifting to the NPS.

Implications: All these changes will infuse much-needed competition into the sector and will allow employees to choose from yields depending on individual risk-preference. From a market perspective, it could add to liquidity given that not even 5% of the investment limit on equities has been breached.

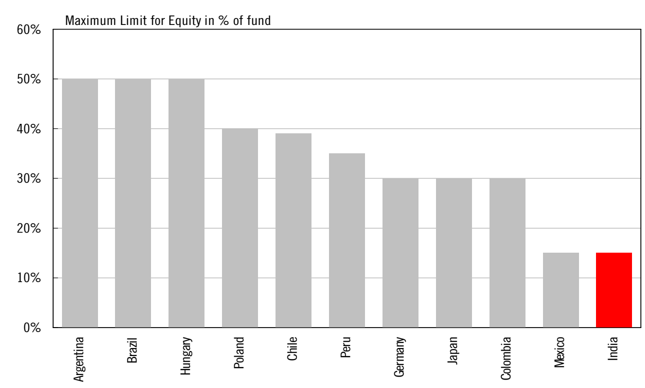
Figure 3. Pensions — Investment Guide lines in India*

	Old	New (eff Apr 2009)
Equities	**5%**	**15%**
Fixed Income	**95%**	**85%**
Centre's G-secs	25%	
State G-secs	15%	
Public FIs	25%	
Any other non-equity option	30%	

Source: MoF

* While the Ministry of Finance guidelines provide that upto 15% can be invested in equities, the Labour Ministry has not yet given the approval for funds managed by the EPFO.

Figure 4 Pensions — Limits for Equity Investment (%)



Source: 'Financial Market Implications of India's Pension Reform' , Helene Poirson; IMF, 2007

A Long Road Ahead

Passage of the PFRDA Bill – Much Overdue...

The passage of the PFRDA bill has been on the back burner since 2005 and is long overdue. Besides giving the PFRDA more authority, its approval will permit the balance 87% of the working population currently not being covered under any social security scheme to participate in the NPS. Other pension-related reforms on the anvil are an increase in FDI limits for the sector to 49% and up to 26% foreign ownership in pension joint ventures.

...As it has Social and Fiscal Implications...

Pensions in India are a ticking time bomb, from both a fiscal perspective as well as from the point of view of old-age income security. While it is true that India does currently have a demographic advantage – with amongst the youngest populations in the world, it also has a sizeable number of people over 60 who have little or no access to any pension scheme. (The number of people over 60 in India is likely to increase from 71mn currently to 113mn by 2026.)

On a fiscal basis as well, pension outgoings are categorized as non-developmental expenditure and are putting an increasing strain on revenues. The pension bill of the employees of the central and state governments has increased from Rs370bn in FY00 to Rs785bn (or 1.7% of GDP) currently. However, the introduction of the NPS in 2004 could help arrest the deterioration.

The road ahead is far from easy

While the policy is moving in the right direction, there are a couple of things worth keeping in mind.

- Firstly the decision to **extend the coverage** of the EPFO from organisations having 20 employees to 10 may not be implementable as surveys[3] have indicated that most of the population employed in 10-19 employee firms saves only 9% of their salary. Extending coverage of the EPFO[4] would imply that this section would have to save 24%, which appears difficult to achieve.
- Second is the issue on the **growing deficit** in the EPFO scheme-- EPFO currently has an unfunded gap to the tune of Rs250bn[5]. This is due to poor administration, early withdrawals and high administrative costs.
- **Equitable taxation** is another issue which needs to be looked into. While the NPS is under an EET (exempt-exempt-tax) regime where contributions and accumulations would be exempt but all withdrawals taxed as ordinary income, contributions to the PPF, GPF and EPF are under an EEE (exempt-exempt-exempt) tax regime and not taxed at any point.

[3] Based on data by Invest India Foundation, IIMS Dataworks

[4] The EPF is a defined contribution plan, whereby the employee contributes 12% of his basic salary and employer contributes 12%.

[5] See "*Pensioning off Pensioners*"; Sunil Jain, Business Standard dated July 14, 2008.

Real Indicators

- **As mentioned in our August Macroscope[6] the deterioration in the global and domestic macro environment has seen India Inc adapt and innovate with a clear focus on profitability**
- **However, the adverse macro environment is affecting growth and expansion plans, with the recent developments in Singur – the location for Tata's Nano car project – another negative[7]**
- **We thus expect investment growth to decelerate with headline growth likely to come in at 7.4% vs. 7.5% in FY09**
- **Growth would have been lower were it not for the buoyant savings, productivity gains, healthier balance sheets and the possibility of monetary easing next year**

July Industrial Production – Will the uptrend in capital goods sustain

Industrial Production in July was up 7.1% higher than expectations. The key surprise in the July industrial production numbers was capital goods production—up 22%, nearly double that of trends seen earlier this fiscal. What was encouraging was the continuation of healthy trends in consumer goods up 7.3% – led by both durables and non-durables. On a cumulative basis, industrial growth during Apr-Jul08 slowed to 5.7% vs. 9.7% in the same period last year due to the lagged impact of monetary tightening and global environment.

Implications for GDP

While the uptrend in July capital goods production could be due to lumpy orders/ backlogs being cleared, monitoring trends in capital goods is key for the investment story. The reason being that investment growth came in at sub 10% levels in 1QFY09 – the first time since FY04. Our FY09 and FY10 GDP estimates of 7.5% and 7.4% respectively factor in investment growth slowing to 8.6% and 6.2% from a CAGR of 17% seen during FY03 and FY08.

Figure 5. Trends and Components of Industrial Production (% YoY)

	WTS	Feb-08	Mar-08	Apr-08	May-08	Jun08	Jul08	Jul-07	Apr-Jul FY09	Apr-Jul FY08
Sectoral Classification										
Mining	10.5	7.9	4.9	6.1	5.1	1.5	5.0	3.2	4.5	2.7
Manufacturing	79.3	9.6	5.7	6.7	4.2	6.1	7.5	8.8	6.1	10.5
Electricity	10.2	9.8	3.7	1.4	2.0	2.6	4.5	7.5	2.6	8.1
General	**100**	**9.5**	**5.5**	**6.2**	**4.1**	**5.4**	**7.1**	**8.3**	**5.7**	**9.7**
Use-based Classification										
Basic goods	35.5	7.3	3.4	4.0	3.0	2.5	5.9	8.7	3.9	9.2
Capital goods	9.7	10.7	20.3	12.4	3.4	8.3	21.9	12.3	11.3	17.2
Intermediate gds	26.4	8.5	4.9	3.1	1.6	2.5	1.6	7.7	2.2	8.9
Consumer gds	28.4	11.7	0.9	8.5	7.2	9.7	7.3	7.1	8.1	8.5
Durables	5.1	3.1	-2.0	3.2	2.6	3.7	11.2	-2.7	5.1	-1.1
Non-durables	23.3	14.3	1.9	10.0	8.7	11.7	6.1	10.5	9.1	11.9

Source: CSO

[6] **August Macroscope** "Tough Times = Innovating India" dated Aug 13, 2008 at https://www.citigroupgeo.com/pdf/SAP19196.pdf
[7] Effectively summarised by Mr **Mukesh Ambani** "A fear psychosis is being created to slow down certain projects of national importance. This will be counter productive for the country's economic growth, its global image as well as our ability to attract investments from across the world" – *Mukesh Ambani fires up in Tata's defence, ToI dated August 28, 2008*

FY10 Investments: Outlook Less Favourable

Investments have faced a double whammy with rising input costs on the one hand; and higher, more stringent borrowing constraints (both domestic and global) on the other. While companies are coping through back-to-back supply arrangements, escalation clauses and building in a buffer while bidding, the pace of growth of order books has decelerated. Due to upcoming elections in 2009, government spending has increased, but things could slow in coming months due to election uncertainty.

Consumption now comprises 66% of GDP from 75% a few years ago. Growth which has averaged 6-7% YoY is likely to sustain as the fiscal stimulus will likely offset higher rates and oil prices. On the **private** consumption side, budgetary proposals, which included increasing exemption limits for personal income tax and raising of tax slabs, have resulted in an increase in disposable incomes. The farm waiver is another offset. As regards **public** consumption, the 6th Pay Commission recommendations would further help arrest a slump.

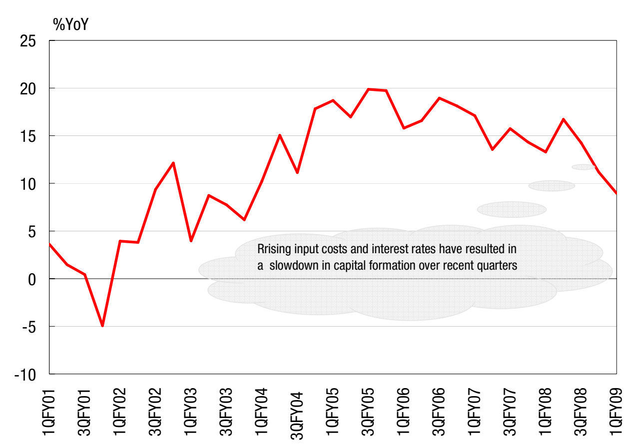
As a result of the above we expect growth in FY10 to come in marginally lower at 7.4% vs. 7.5% in FY09E. Growth would have been lower were it not for the buoyant savings, productivity gains, healthier balance sheets and the possibility of monetary easing next year.

Figure 6. Trends in GDP by Demand (%)

	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
Total Consumption (% GDP)	**75.3**	**73.2**	**64.9**	**70.2**	**68.4**	**67.8**	**67.9**	**67.6**
%YoY	2.2	5.3	4.8	8.2	7.0	8.1	7.6	6.9
Pvt Consumption (% GDP)	63.6	62.1	60.3	60.0	58.6	58.2	58.1	57.9
%YoY	2.7	5.8	5.2	8.7	7.1	8.3	7.4	7.0
Public Consumption (% GDP)	11.7	11.1	10.5	10.2	9.8	9.6	9.7	9.7
%YoY	-0.4	2.6	2.6	5.4	6.2	7.0	8.5	6.5
Gross Cap Form (% to GDP)	**25.0**	**27.7**	**30.6**	**33.4**	**33.8**	**35.2**	**35.6**	**35.2**
% YoY	17.0	19.9	19.5	19.4	10.9	13.7	8.6	6.2
Net Exports (% to GDP)	**1.5**	**0.0**	**1.7**	**-2.8**	**-4.2**	**-4.1**	**-4.5**	**-4.1**
Real GDP	**3.8**	**8.4**	**8.3**	**9.2**	**9.7**	**9.0**	**7.5**	**7.4**

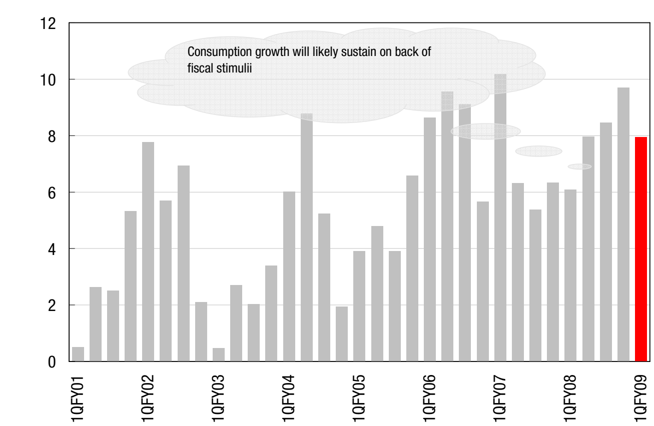
Source: CSO; Citi

Figure 7. Trends Gross Capital Formation (% YoY)



Source: CSO

Figure 8 Trends in Consumption (% YoY)



Source: CSO

Monetary Indicators

> ➤ **The continued buoyancy in both credit and deposits and consequent demand for government securities to meet statutory requirements raises the possibility of an SLR cut**
>
> ➤ **The sharp fall in commodity prices is positive for inflationary expectations and raises the odds of the RBI keeping rates on hold**

Banking Indicators

Loans and Deposits: Despite a higher rate environment, incremental credit during April-August was Rs964bn vs. Rs311bn in the same period last year. While retail lending has slowed, the higher loan off-take is partially attributed to tighter norms for overseas borrowing as well as higher off-take from the oil companies. Deposit growth remained healthy at 22.1% but lower than the 25% loan growth recorded this year. With incremental deposits in the current year at Rs1,945bn vs. Rs1,649bn, the continued demand for government securities to meet statutory requirements raises the possibility of an SLR cut.

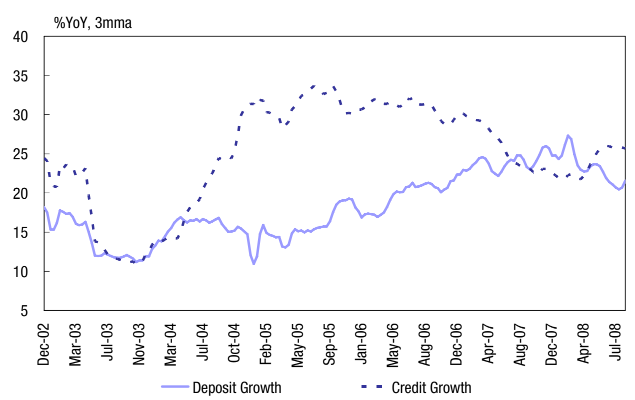
Money Supply growth continues to trend over 20% higher than the RBI's target of 17-17.5%. However, declining forex flows will likely result in a deceleration in M3 growth in the coming months. This coupled with easing inflationary expectations could result in the RBI becoming less hawkish.

Figure 9. Trends in Bank Credit and Deposits (Rupees in Billions, % YoY)

	Outstanding	Incremental to date		YoY%	Total			
	March 08	FY09	FY08		FY08	FY07	FY06	FY05
Bank Credit	**23,619**	**964**	**311**	**25.3**	**4,196**	**4,161**	**3,961**	**3,114**
Food	444	-1	-80	15.2	-17	58	7	41
Non-Food	23,175	965	392	25.5	4217	4103	3954	3074
Deposits	**31,969**	**1,945**	**1,649**	**22.1**	**5,838**	**4,852**	**3,875**	**2,807**
GOI Investments	9,717	467	1,123	12.7	1,826	747	-116	617

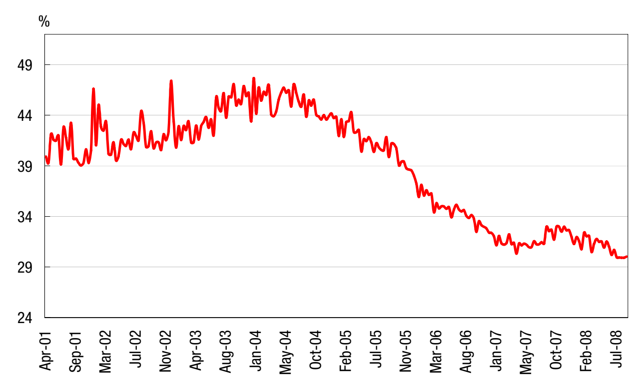
Source: RBI.

Figure 10. Trends in Credit and Deposit Growth (%YoY, 3mma)



Source: RBI

Figure 11. Trends in the Investment Deposit Ratio (%)



Source: RBI

Inflation – Worst appears over but keep an eye on food

Inflation as measured by the WPI appears to have plateaued with the headline number coming in at 12.1% on August 30. Given the decline in commodity prices, the week-on-week numbers are likely to be benign, but the YoY numbers will remain in the double-digit range till the end of this year. While our current numbers factor in one more rate hike, the decline in commodity prices and a moderation in inflation has raised the possibility of rates being on hold.

While the decline in global commodity prices will likely ease WPI trends, the CPI (which has a larger basket of primary articles) has been edging up with the July CPI coming in at 8.3% higher than the 7.7% levels seen earlier this fiscal. What could put pressure on prices is the fact that while the monsoons have been reasonable in terms of quantum, the timing and distribution have not been as favorable. As a result crop sowing is down 3% YoY.

As on 29 Aug, crop sowing was down 3% YoY

Figure 12 Crop Sowing ***(Mn Tonnes; as on 29 August 2008)***

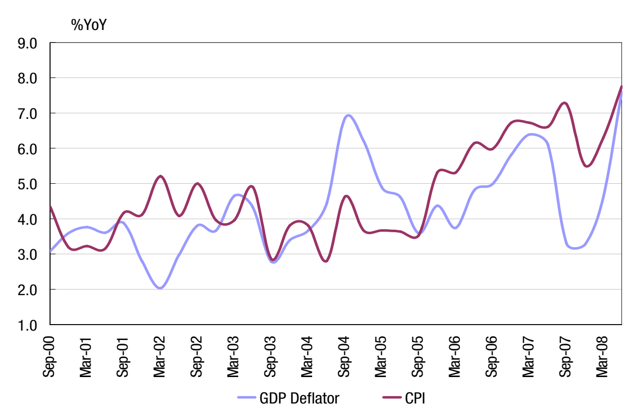
Crop	Normal Area	Area this yr 29-Aug-08	% of Normal	Area last yr 29-Aug-07	% of Normal	% change
Rice	**39.1**	**34.5**	**88.2**	**33.0**	**84.3**	**4.6**
Jowar	4.2	2.8	66.6	3.4	79.8	-16.5
Bajra	9.2	7.5	81.3	8.2	88.8	-8.6
Maize	6.4	7.0	108.6	7.3	113.6	-4.4
Total of coarse cereals	**22.7**	**19.2**	**84.4**	**20.8**	**91.6**	**-7.8**
Total Cereals	**61.8**	**53.6**	**86.8**	**53.7**	**87.0**	**-0.2**
Arhar	3.5	3.3	95.1	3.7	107.1	-11.2
Urad	2.5	2.0	79.1	2.6	104.7	-24.5
Moong	2.6	2.3	87.7	3.1	120.1	-27.0
Others	2.2	2.2	99.6	2.2	99.9	-0.3
Total of pulses	**10.8**	**9.8**	**90.5**	**11.7**	**108.2**	**-16.3**
Groundnut	5.4	5.0	93.1	5.2	95.4	-2.4
Soybean	7.3	9.5	130.4	8.7	119.2	9.4
Others	3.3	2.7	83.1	3.2	95.7	-13.1
Total of oilseeds	**15.9**	**17.3**	**108.7**	**17.0**	**107.0**	**1.6**
Cotton	8.4	8.9	106.1	9.1	108.7	-2.4
Sugarcane	4.1	4.4	107.6	5.3	129.1	-16.7
Jute	0.8	0.7	92.1	0.8	103.3	-10.8
All Crops	**101.8**	**94.8**	**93.1**	**97.7**	**96.0**	**-3.0**

Source: Ministry of Agriculture

Figure 13. Trends in the WPI (%YoY)

Source: Office of the Economic Advisor

Figure 14. Trends in CPI and the GDP Deflator (%YoY)



Source: CSO, Labor Bureau; Citi Estimates

Fiscal Indicators

- **Oil coming off sub US$100/bbl would result in four options for the government: These include a reduction in 1) retail prices, 2) oil bonds, 3) net losses to companies or 4) upstream share.**
- **While the last three would be more preferable, given that it is an election year option a combination of option 1 coupled with differential diesel pricing is a possibility.**

Fiscal Update: Budget targets on paper likely to be met

Latest fiscal data indicates that the deficit during April-July FY09 was Rs1,160bn down 10.4% YoY largely due to buoyant revenue growth and a containment in expenditure. As mentioned before, although it appears likely that the government will meet its fiscal deficit target of 2.5% of GDP on paper; this excludes the various off-balance sheet items such as oil/fertiliser bonds, farm waiver and pay commission recommendations. *(See Figure 19).* However, offsets to this could be possible divestments and revenues from the 3G license auctions.

Figure 15. Fiscal Update: April-July FY09 (Rs Bn, %)

	Jul-08	% YoY	Apr-Jul08	%YoY	FY09RE	%Ytd of B
a. Revenue receipts	356	15.2	1,179	23.7	6,030	19.5
Net tax revenues	265	18.2	1,013	26.7	5,072	20.0
Non-tax	90	7.2	166	8.0	958	17.3
b. Non-debt cap receipts	4	26.0	9	-74.1	147	5.9
c. Total receipts (a+b)	**359**	**15.3**	**1,187**	**20.4**	**6,177**	**19.2**
d. Revenue expenditure	592	32.7	2,181	22.7	6,581	33.1
e. Capital expenditure	66	85.3	166	-67.0	928	17.9
f. Total expenditure (d+e)	**658**	**36.6**	**2,347**	**2.9**	**7,509**	**31.3**
Plan Expenditure	139	16.4	760	27.1	2,434	31.2
Non- Plan Expenditure	519	43.2	1,587	-5.7	5,075	31.3
g. Fiscal deficit (f-c)	**299**	**75.6**	**1,160**	**-10.4**	**1,332**	**87.1**
h. Revenue deficit (d-a)	237	72.0	1,002	21.6	551	181.9

Source: Comptroller General of Accounts; Budget Documents

Tax Collections – Trends remain buoyant

As seen below, besides excise duties, all other tax collections are running above the government's budget estimates. This provides for cushion against a possible slow-down later this year and thus we do not expect any slippage on the revenue front.

Figure 16. Tax Collection Data: April- July FY09 (Rs Bn, %)

	Jul-08	%YoY	Apr-Jul08	%YoY	FY09RE	% of B	Budgeted Growth Rate
Corporate	66	32.8	421	41.6	2,264	18.6	21.6
Income	69	23.1	269	42.0	1,383	19.5	16.9
Customs	98	17.5	378	19.3	1,189	31.8	18.0
Excise	101	13.4	269	4.0	1,379	19.5	7.8
Others	61	21.5	194	28.5	662	29.3	26.8
Gross Taxes	**395**	**20.3**	**1,531**	**26.2**	**6,877**	**22.3**	**17.5**
Devolvement to States	128	25.5	512	25.6	1,806	28.4	17.5
Net Taxes	**265**	**18.2**	**1,013**	**26.7**	**5,071**	**20.0**	**17.5**

Source: Controller General of Accounts, Budget Documents

Impact of falling crude prices on government finances

Earlier this year when crude prices were reigning in the US$130/bbl range, the gross annual under-recoveries for the oil companies were estimated at Rs2,453bn. As per an analysis[8] by our oil analysts Rahul Singh and Saurabh Handa, if crude stays at US$105/bbl for the rest of FY09, the annual under-recoveries will come down to Rs1.55 trillion.

Figure 17. Under-recoveries for FY09 could be a lot lower if oil stays at US$105/bbl levels

Period	Months	Under-recovery (Rs bn)	Basis
Apr-Jun	3	489	Actuals
Jul-Aug	2	302	Avg. Jul-Aug (on actual prices)
Sep-Mar	7	793	On Sep prices (after crude decline)
Total (year ending Mar-09)	12	1,584	

Source: CIR

While at first glance, this appears positive, the point to note is that this exactly takes care of the Rs400bn unaccounted gap between the Finance Ministry's bonds allocation vs. the amount stated by the Petroleum Ministry[9].

Oil at sub US$100/bbl…four possibilities

Indian oil companies would break even if WTI declines to below US$85/bbl

As seen in the table below, at current levels, the subsidy equation is well balanced today – bonds of Rs950bn and upstream share of Rs450bn will leave only Rs180bn of net losses for downstream R&M to bear.

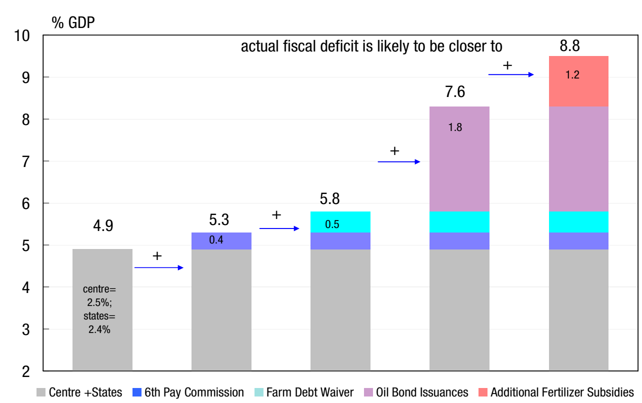
If losses decline further, the options before the government would be to 1) reduce retail prices, 2) reduce oil bonds, 3) reduce net losses to R&M companies, or 4) reduce upstream share. While the last three would be more preferable, given that it is an election year, a combination of option 1 coupled with differential diesel pricing is a possibility.

Figure 18. The Govt's Subsidy Sharing Mechanism (Rs bn)

				FY09E	
Rs Bn	**FY06**	**FY07**	**FY08**	**Oil at 130**	**Oil at 100**
Gross under-recoveries	**400**	**593**	**770**	**2,453**	**1,584**
less: Oil Bonds	115	241	350	950	950
less: Upstream contrib	140	205	257	450	450
% to GDP	0.3	0.6	0.7	1.8	1.8
less: Refineries sharing	30	-	-	-	
Less: Price Hikes	-	90	8	438	
Un-accounted gap				400	
Net under-recoveries	**115**	**57**	**163**	**215**	**184**

Source: CIR

Figure 19. Trends in FY09 Deficit (Incl Off-B/S Items)



Source: Budget Documents; Citi Estimates

[8] Indian Oil & Gas – Falling Crude – Government Got Lucky…Now What at https://www.citigroupgeo.com/pdf/SAP19949.pdf

[9] At that time of the price hikes in June, there was a disconnect on the quantum of oil bonds that were likely to be issued. (The estimate by the Ministry of Petroleum was at Rs1,350bn while the Ministry of Finance had approved the issuance of Rs950bn)

External Sector

- **Monthly trade deficit numbers remain in the US$10bn range – in line with our full-year trade deficit estimates**
- **Despite oil coming off nearly 30% in the last month, the rupee has weakened by 7% crossing Rs46/US$ levels. Besides dollar strength, this is due to acute dollar shortage in the local market and limited RBI intervention**
- **Given the volatile market situation, the depreciation trend is likely to continue in the near term. However, over a longer-term horizon, we maintain our rupee appreciation view**

Trade Update: Apr-July Trade Deficit widens to US$41.2bn

Despite a 31.2% rise in exports in July, imports rose 48% YoY to US$27bn, resulting in the trade deficit coming in at a high of US$10.8bn; similar to trends seen in the first quarter. On a cumulative basis, exports were up 24.7% while imports rose 34.2% resulting in the trade deficit widening to US$41.2bn vs. US$27.4bn last year.

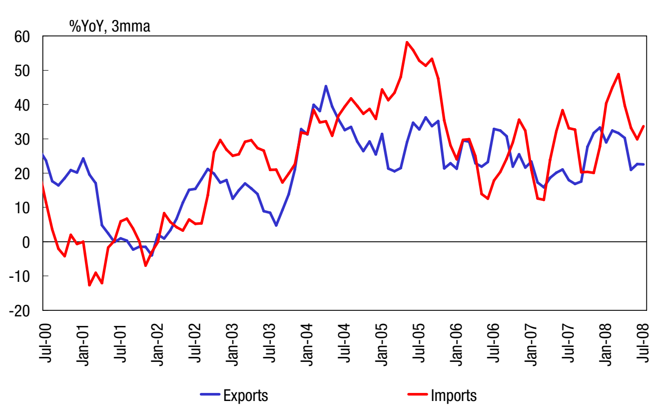
Our macro numbers take into account a widening of the customs trade deficit (*excluding defence imports*) to US$117.5bn vs. US$80.3bn in FY08. This assumes exports rising 20%; customs imports +29% and WTI at US$135/bbl. Oil prices coming off significantly from current levels would have a positive impact as every US$1/bbl change impacts the deficit by US$700mn.

Figure 20 April-July Trade Data (US$bn, %YoY)

	Jul-08	%YoY	Apr-Jul FY09	Apr-Jul FY08	%YoY	FY09E	%YoY
Exports	16.3	31.2	59.2	47.5	24.7	186.6	20.0
Imports	27.1	48.0	100.4	74.8	34.2	304.1	29.0
Oil	9.5	69.3	35.0	22.6	54.9	117.0	52.1
Non-oil	17.7	38.7	65.4	52.2	25.2	187.1	17.8
Trade Balance	-10.8		-41.2	-27.4	50.7	-117.5	

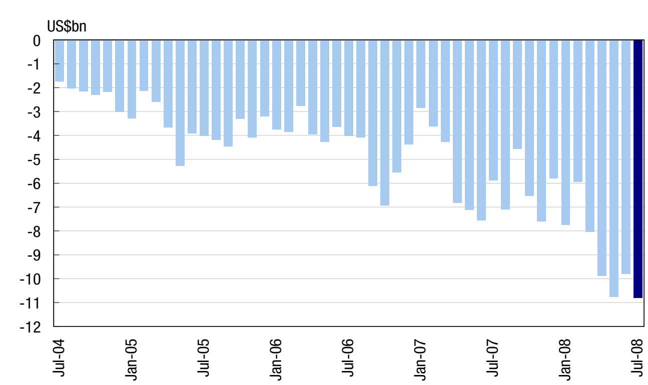
Source: DGCI&S

Figure 21. Trends in Exports and Imports (% YoY, 3mma)



Source: DGCI&S

Figure 22. Trends in Trade Deficit (% YoY, 3mma)



Source: DGCI&S

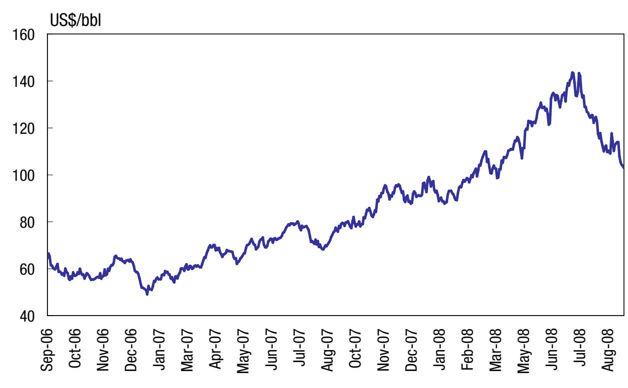
Oil breaks US$100/bbl while rupee crosses Rs46/US$

Despite oil coming off nearly 35% in the last month, the rupee has weakened by 10% with the rupee crossing Rs46/US$ levels (on a fiscal year basis, since April this year, the rupee is down 17%). While typically, one would have thought with oil coming off, the INR would benefit (*given India's import dependence and the fact that a change in oil prices would reduce the trade deficit by $700mn*), the reverse has happened.

The key reasons for the rupee move besides the dollar strength are (1) acute dollar shortage in the local market and (2) limited RBI intervention. The dollar shortage in the local markets is a result of continued portfolio outflows, demand from the oil companies, while exporters are now holding back from selling. As regards the RBI…not only has it discontinued the Special Market Operation scheme[10] (*where it provided dollars to the oil companies in lieu of oil bonds*), but intervention has been limited.

What Next? Given the adverse sentiment against the USD/INR, the rupee could weaken further (The rupee in the NDF market is trading at 46-47 levels). However, the key call to make is whether this is a technical move or a structural change. Given the volatile market situation, the depreciation trend is likely to continue in the near term. However, over a longer-term horizon, we maintain our rupee appreciation view. Key factors that could work in the rupee's favor are: (1) Oil at these levels would reduce the full-year Current a/c deficit (CAD) estimate from US$50bn to US$35bn.[11] (2) Although portfolio flows will likely remain negative, FDI remains buoyant – with the latest FDI numbers indicating that gross FDI during 1QFY09 surged to US$10bn, double the US$5bn seen during the same period last year. (3) Given changed market environment from a year ago, we maintain our view of a strong possibility of the RBI further easing the ECB norms. Lastly, the fresh issuance of oil bonds could result in a resumption of the SMOs.

Figure 23. Trends in Oil Prices (YoY, 3mma)



Source: Bloomberg

Figure 24. Trends in USD/INR

Source: Bloomberg

[10] **Special Market Operations**: Keeping in view the systemic implications of the liquidity issues faced by Public Sector Oil Companies arising due to the rise in crude oil prices, the RBI started Special Market Operations (SMOs) in June this year. Under this scheme, it conducted open market operations in oil bonds held by public sector oil marketing companies subject to an overall ceiling of Rs.15bn on any single day and provide equivalent foreign exchange to the oil companies with the aim of alleviating lumpy demand

[11] See pg 14 of the August Macroscope (https://www.citigroupgeo.com/pdf/SAP19196.pdf) for what happens if oil comes below US$100/bbl

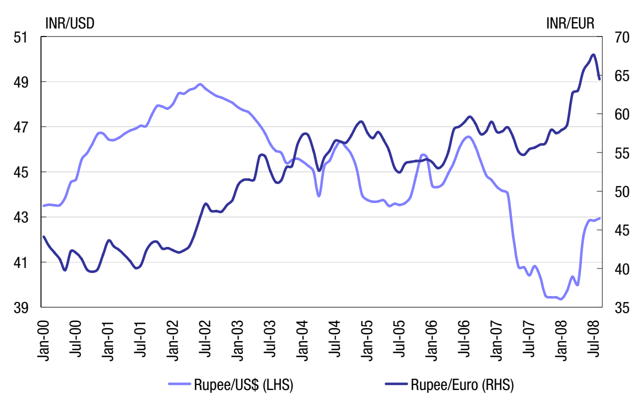
Financial Markets

- **Dollar strength, continued outflows and limited intervention have resulted in a significant weakening in the rupee.**
- **Going forward, given the global financial turmoil, the rupee is likely to trade in the Rs45-47 range but we believe this is temporary and maintain our appreciation view**
- **On rates, lower commodity prices, stabilising inflationary expectations coupled with weak growth raise the odds of the RBI keeping rates on hold**

Forex Markets

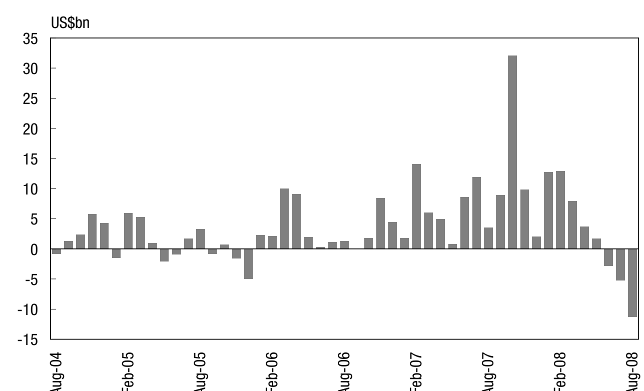
- **Forex Market:** Over the last month, the rupee has weakened by 10% with the currency crossing Rs46/US$ levels (*on a fiscal year basis, since April this year, the rupee is down 17%)*. The key reasons for the rupee move are the dollar strength and acute dollar shortage in the local market. Further exacerbating the demand-supply mismatch is the RBI intervening in the forward market via buy/sell swaps. This is resulting in premiums coming off, which further dissuades exporters from selling.
- **Outlook:** Given the turmoil in the financial markets and the adverse sentiment against the USD/INR, the rupee could weaken further. However, as mentioned on page 15 given the positive impact of oil, continuation of FDI and likely further easing of capital norms (ECB/NRI)[12]; we are maintaining our longer-term rupee appreciation view.
- **Recent Policy Changes:** The RBI has eased the norms on raising NRI deposits. The ceiling on FCNR(B) deposits is now Libor -25bps from Libor -75bps while that on NR(E)RA has been increased to Libor +50bps from Libor earlier.

Figure 25 Trends in INR/Euro and INR/USD



Source: RBI.

Figure 26. Trends in Incremental FX Reserves (US$bn)



Source: RBI.

[12] **ECB Rules:** While the overall US$500mn company ceiling remains; current ECB guidelines **limit offshore borrowing** to $50m offshore for use onshore. (For infrastructure companies this is higher at US$100mn). In addition, the all ***All-in-cost*** ceilings for overseas borrowings is capped at 200 bps for ECBs with maturities over 3 years and 350bps for ECBs over 5 years

Bond Markets

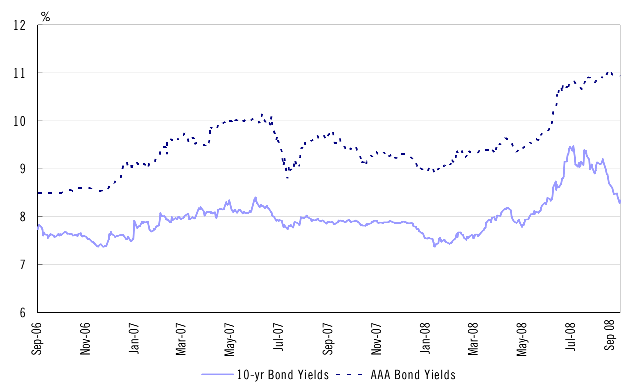
- **The 10-year benchmark bond:** In spite of tight domestic liquidity conditions and the continuation of double-digit inflation, bond yields declined from 9.4% last month to 8.2% currently. The decline in government bond yields despite a host of negative factors is largely attributed to demand-supply mismatch for long dated government securities.
- **Corporate bond yields:** The 5-year AAA bond yield rose to 11.06% from 10.92% with the spread over the 5-year GOI rising to 200 bps from 133 bps. Corporate bond yields moved in a relatively narrower range with limited trading given the absence of surplus cash.
- **Liquidity conditions:** The money market remained in deficit with call rates above 9% throughout the month resulting in the RBI injecting liquidity on a daily basis via the LAF window. Daily infusion through the repos averaged Rs200bn but rose to a high of Rs380bn mid-month.
- **Monetary Implications:** With headline inflation moderating coupled with global turmoil, the odds of RBI keeping rates on hold are rising. However, the likelihood of SLR cuts could result in yields edging higher.

Figure 27. India Market Monitor

	Units	Latest	Previous	1M ago	3M ago	12M ago
Interest Rates						
Overnight	%	6.50	9.00	6.10	6.10	6.10
1 year Treasury Bill	%	8.86	9.18	9.29	8.25	7.47
1 year OIS	%	9.34	9.25	9.24	8.18	7.09
1 year MIFOR	%	5.27	5.89	6.79	5.87	6.98
5 year Corp AAA spread over GOI	%	2.39	2.19	1.58	1.28	1.83
10 year GOI	%	8.34	8.48	8.96	8.32	7.89

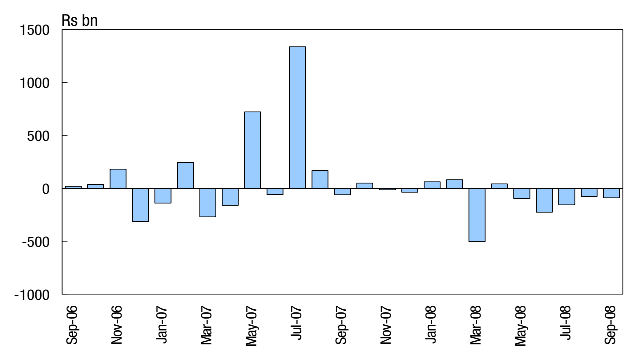
Source: RBI.

Figure 28. India — Trends in the 10-Year GOI Bond (Percent)



Source: RBI, Citi.

Figure 29. India — Trends in Reverse Repos/Repos (Rs bn)



Source: RBI, Citi.

Spotlight

Nuclear Deal – Almost Home

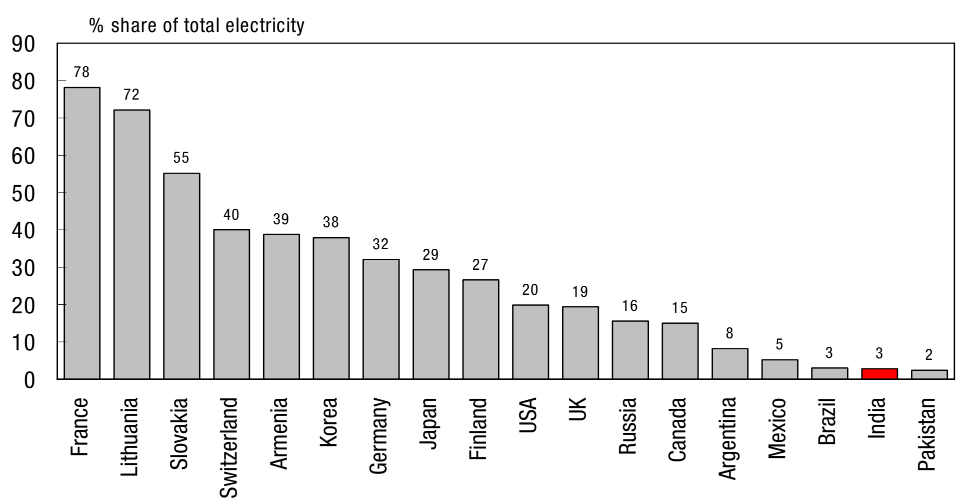
Two years of negotiations, a political imbroglio, and a vote of confidence appear to have finally paid off, with India passing the crucial 2nd stage in operationalising the nuclear deal with the 45-nation Nuclear Supplier Group (NSG) finally approving the waiver for India to engage in nuclear trade. This is particularly significant as India has not signed either the Comprehensive Test Ban Treaty (CTBT) or the Non-Proliferation Treaty (NPT). The deal once completed, will likely be touted as the ruling Congress Party's most significant achievement during its term and is a historic one for India since it marks the end of '34 years of nuclear isolation'

What next? Following successful negotiations with the IAEA on safeguards and the NSG waiver, the next step would be to get approval from the US Congress. Given all the lobbying, it appears likely that the deal will be inked during PM Singh's visit to the US. But a point worth keeping in mind is the initial need to waive the 30-day business rule, which states that the Congress needs 30 business days to study the legislation before acting on it. The ongoing Congress Session falls short of this requirement. While the NSG waiver will allow India to enter into agreements with major suppliers like Russia and France, India has said that it would await the Congress approval.

Macro-economic Impact: Besides the direct economic impact of improving India's energy security, the NSG waiver has also geo-strategic implications. This is especially positive given the gaping power shortage that India currently faces *(at present, nuclear energy accounts for less than 3% of India's electricity generation denoting the considerable potential that can be reaped).* Moreover, by making available much needed raw material, the deal would help enhance capacity utilization of India's nuclear reactors, which are currently operating at ~50-60% levels. This would benefit not only foreign companies already engaged in the nuclear space such as Areva, GE and Westinghouse but also domestic engineering companies such as L&T, BHEL, HCC, Gammon and utilities such as NTPC and NPCIL.

Figure 30. Percent Share of Nuclear Energy in Total Electricity- A Comparative View

Currently nuclear energy accounts for less than 3% of electricity generation. The Nuclear Pact should improve this ratio thus reducing dependence on other energy sources.



Source: World Nuclear Association

Monthly Monitor

Figure 31. India — Key Monthly Economics Indicators (Percent Change from a year ago unless otherwise stated)

Monthly Macro Snapshot

	Jun07	Jul07	Aug07	Sept07	Oct07	Nov07	Dec07	Jan08	Feb08	Mar08	Apr08	May08	Jun08	Jul08	Aug08
Consumption Trends															
Two-Wheelers	-8.0	-6.6	-1.3	-11.3	-0.8	0.9	-3.9	-6.8	-7.1	2.2	12.7	8.9	9.4	20.0	17.2
Passenger Car Sales	12.7	13.9	15.7	8.7	14.0	16.0	6.6	10.8	6.4	14.6	24.2	18.0	11.6	5.7	5.1
Commercial Vehicle Sales	7.0	2.0	4.1	1.4	14.0	0.9	2.8	1.7	3.6	15.2	3.1	7.1	10.7	3.5	-3.3
Investment Trends															
Infrastructure Index	5.2	8.8	10.9	7.0	12.2	4.9	8.0	6.2	8.6	3.9	7.0	3.5	3.5	4.3	
Cement Dispatches	4.6	11.3	13.8	3.7	8.4	3.1	4.2	4.6	12.9	8.6	6.5	4.5	9.0	8.6	
Diesel Consumption	19.9	14.0	5.7	3.0	17.4	10.6	11.0	16.7	19.0	9.5	13.2	17.1	3.3	10.4	
Steel Production	5.1	6.6	8.5	8.6	4.9	3.7	0.6	1.1	4.3	1.2	3.9	5.2			
Aluminum Production	16.3	12.0	9.9	7.9	5.5	3.6	2.3	4.8	6.2	4.4	2.9	2.1	1.8		
Ind. Production Index															
General	8.9	8.3	10.9	7.0	12.2	4.9	8.0	6.2	9.5	5.5	6.2	4.1	5.4	7.1	
Manufacturing	9.7	8.8	10.7	7.4	13.8	4.7	8.6	6.7	9.6	5.7	6.7	4.2	6.1	7.5	
Basic Goods	9.2	8.7	12.7	6.5	6.5	5.2	3.4	3.6	7.3	3.4	4.0	3.0	2.5	5.9	
Capital Goods	23.1	12.3	30.8	20.9	20.9	24.2	17.6	2.6	10.7	20.3	12.4	3.4	8.3	21.9	
Intermediate Goods	8.6	7.7	13.8	10.1	13.9	5.5	7.6	8.0	8.5	4.9	3.1	1.6	2.5	1.6	
Consumer Goods	3.6	7.1	0.0	-0.2	13.7	-2.9	8.7	8.4	11.7	0.9	8.5	7.2	9.7	7.3	
Services															
Port Traffic	7.6	16.4	11.5	11.3	14.7	8.9	7.6	7.1	15.0	9.9	14.7	7.5	6.1		
Railway Freight	3.9	7.7	11.7	9.0	12.4	7.5	10.1	10.1	14.4	8.4	10.9	9.4	7.8		
Tourist Arrivals ('000)	310	377	361	326	441	511	575	561	542	384	301	340	429	391	
Cellular Sub Adds (Mils.)	7.6	8.0	8.2	8.1	8.0	8.2	8.0	8.6	8.4	9.9	8.2	8.6	8.9	9.2	
Banking Trends															
Money Supply	21.3	21.6	20.6	20.7	22.1	23.3	22.1	23.1	22.2	20.9	21.2	22.2	21.0	20.3	20.1
Loan Growth	24.6	23.7	23.1	22.6	22.9	23.0	22.3	21.8	22.2	21.7	23.3	25.1	26.0	25.7	25.9
Deposit Growth	23.7	24.8	23.3	23.7	25.4	25.7	24.3	27.3	25.6	22.6	23.1	23.7	21.9	20.7	21.3
Non-Food Credit	25.1	24.1	25.0	22.1	23.0	24.0	23.0	23.1	24.7	22.6	24.0	25.0	26.2	26.0	26.2
Inflation															
CPI (IW)	5.7	6.5	7.3	6.4	5.5	5.5	5.5	5.5	5.5	7.9	7.8	7.8	7.7	8.3	
WPI	4.5	4.7	4.1	3.5	3.1	3.3	3.8	4.5	5.3	7.5	8.0	8.5	11.4	11.9	12.4
Mfg Products Inflation	5.4	5.2	4.8	5.2	4.6	4.3	4.3	4.9	4.5	7.0	8.7	9.0	10.0	10.8	11.0
Interest Rates (Avg, %)															
Call Money Rate	2.3	0.6	6.4	6.1	6.0	7.1	7.4	6.6	6.9	7.1	6.0	6.6	7.7	5.3	6.3
91-Day T-Bills	7.3	5.1	6.7	7.1	7.3	7.5	7.4	7.3	7.4	7.2	7.4	7.5	8.7	9.4	9.1
10-Year Government Bond	8.2	7.9	7.9	7.9	7.9	7.9	7.9	7.6	7.5	7.7	8.0	8.0	8.4	9.2	9.0
Trade - Customs Data															
Exports	14.1	18.2	18.2	16.1	48.8	30.3	20.9	35.7	40.7	18.6	31.5	12.9	23.5	31.3	
Imports	38.3	26.1	33.6	1.1	26.3	32.8	24.3	63.9	46.7	36.0	36.6	27.1	25.9	48.0	
Oil	14.2	20.6	19.5	8.0	14.6	16.7	23.8	60.8	100.0	76.6	46.2	50.8	53.4	69.3	
Non-Oil	52.3	28.6	40.9	-1.9	31.8	40.5	24.5	65.6	21.9	19.7	32.3	17.4	13.9	38.7	
Brent Prices ($/bbl)	71.8	77.9	71.5	78.1	82.8	93.0	91.3	92.5	95.8	104.3	108.8	122.6	132.0	132.8	113.9
Foreign Invstmnt (US$ Mils.)															
FII	401	5,855	-1,922	3,957	5,067	-1,450	1,383	-3,232	430	-32	267	-1,242	-2,503	-455	-300
FDI Inflows	1,238	705	831	713	2,027	1,864	1,558	1,767	5,670	4,438	3,749	3,932	2,392	2,247	
Exch. Rate and Reserves															
US$ Exchange Rate Average	40.8	40.4	40.8	40.3	39.5	39.5	39.5	39.4	39.8	40.3	40.1	42.2	42.8	42.8	43.0
US$ Exch Rate Mnth End	40.7	40.4	40.9	39.8	39.3	39.6	39.4	39.4	40.0	40.1	40.5	42.5	43.0	42.6	43.9
Forex Res Inc.Gold (US$ Bn.)	213.5	225.4	228.8	247.8	262.5	272.3	275.6	288.3	301.2	309.2	312.9	314.6	311.8	306.6	295.3

Source: CSO; CMIE, RBI, DGCI&S; CMA; SIAM.

Summary of Balance of Payments

Figure 32. Trends and Forecasts in the Balance of Payments (US$Mn, %)

	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	COMMENTS
Exports (RBI)	**66,285**	**85,206**	**105,152**	**128,083**	**158,461**	**188,569**	**237,596**	UPSIDE if currency weakens
Y/Y %	23.3	28.5	23.4	21.8	23.7	19.0	26.0	Includes Petro-Product exports
% of GDP	11.0	12.2	13.0	13.9	13.5	14.7	15.0	
Imports (RBI)	**80,003**	**118,908**	**157,056**	**191,254**	**248,521**	**315,622**	**358,231**	
Y/Y %	24.1	48.6	32.1	21.8	29.9	27.0	13.5	
% to GDP	13.3	17.0	19.4	20.7	21.2	24.6	23.0	
Imports-Customs	78,200	106,700	140,200	185,700	235,770	304,149	350,836	
Y/Y %	27.4	36.4	31.4	32.5	27.0	29.0	15.3	
Of which: Oil	20,600	29,900	43,800	56,900	76,900	117,000	125,000	DOWNSIDE if WTI crosses US$135/bbl
Y/Y %	16.5	45.1	46.5	29.9	35.1	52.1	11.1	
Non-Oil	57,600	76,800	96,400	128,800	158,870	187,149	220,836	
Y/Y %	31.8	33.3	25.5	33.6	23.3	17.8	18.0	
a. Trade balance (RBI)	**-13,718**	**-33,702**	**-51,904**	**-63,171**	**-90,060**	**-127,053**	**-120,634**	
% of GDP	-2.3	-4.8	-6.4	-6.8	-7.7	-9.9	-7.7	
Trade Balance (Customs)	-14,357	-26,000	-39,600	-59,300	-80,258	-117,534	-110,700	
Difference	639	-7,702	-12,304	-3,871	-9,802	-9,519	-9,900	Diff bet RBI & customs= proxy for defense imports
b. Invisibles	**27,801**	**31,232**	**42,002**	**53,405**	**72,657**	**76,900**	**88,698**	
Non-factor services	10,144	15,426	23,170	31,810	37,550	45,000	53,798	Assumes 21% growth v/s 27%-30% seen earlier
Of which: Software Services	11,750	16,400	22,742	29,033	37,051	44,832	53,798	UPSIDE IF currency weakens, US strong
Investment income	-4,505	-4,979	-5,855	-6,573	-5,910	-5,500	-5,500	
Remittances*	21,608	20,525	24,493	27,941	40,778	37,000	40,000	COULD VARY Depending on Invst Opportunities
Official transfers	554	260	194	227	239	400	400	
1. Current a/c balance (a+b)	**14,083**	**-2,470**	**-9,902**	**-9,766**	**-17,403**	**-50,153**	**-31,936**	Due to a widening trade deficit and moderation in invisibles, CAD could widen to 3.9% of GDP
% of GDP	2.3	-0.4	-1.2	-1.1	-1.5	-3.9	-2.0	
c. Loans	**-4,364**	**10,909**	**7,909**	**24,534**	**41,962**	**27,000**	**21,000**	
External assistance	-2,858	1,923	1,702	1,767	2,114	1,000	1,000	
Commercial borrowings	-2,925	5,194	2,508	16,155	22,165	14,000	14,000	UPSIDE if RBI liberalizes norms further
Short-term credit	1,419	3,792	3,699	6,612	17,683	12,000	6,000	
d. FDI (Net = a-b)	**2,388**	**3,713**	**3,034**	**8,479**	**15,545**	**15,000**	**16,000**	
(a) FDI - To India	4,322	5,987	8,901	21,991	32,327	32,000	34,000	
(b) FDI - Abroad	-1,934	-2,274	-5,867	-13,512	-16,782	-17,000	-18,000	
e. Portfolio Inst (FII//GDRs)	**11,356**	**9,287**	**12,494**	**7,062**	**29,261**	**5,000**	**10,000**	DOWNSIDE Risk if global environment worsens
f. Banking Capital	**6,033**	**3,874**	**1,373**	**1,913**	**11,757**	**6,500**	**6,000**	
Commercial Banks (Net)	2,391	4,838	-1,416	-2,408	11,578	4,000	3,500	UPSIDE if RBI raises limit to 50% of Tier 1 capital
NRI deposits	3,642	-964	2,789	4,321	179	2,500	2,500	UPSIDE if RBI makes NRI deposits attractive
g. Rupee debt service	**-376**	**-417**	**-572**	**-162**	**-121**	**-400**	**-400**	
h. Other capital**	**1,699**	**656**	**1,232**	**3,953**	**9,627**	**3,000**	**1,000**	
2.Capital a/c (c+d+e+f+g+h)	**16,736**	**28,022**	**25,470**	**45,779**	**108,031**	**56,100**	**53,600**	
Errors & Omissions	602	607	-516	593	1,536	0	0	
Overall balance (1+2)	**31,421**	**26,159**	**15,052**	**36,606**	**92,164**	**5,947**	**22,627**	
Forex								
Forex assets	106.1	135.1	145.1	191.9	299.1	305.1	327.7	FX Assets@ US$302bn are a strong cushion
FCA to months of imports	15.9	13.6	11.1	12.0	13.5	10.9	11.1	
Exchange rate								
Rs/US$ - annual avg	45.9	45.0	44.3	44.9	40.2	42.5	40.0	
% depreciation	-5.0	-2.0	-1.6	1.4	-10.5	5.7	-5.9	
Rs/US$ - year end	43.6	43.8	44.6	43.5	39.0	42.5	40.0	
% depreciation/(-) app	-8.2	0.3	2.0	-2.5	-10.3	6.0	-5.9	

* **Remittances** - 50% are for family maintenance; balance is local withdrawal from NRI rupee deposits ** **other capital** refers to leads and lags in exports, advances received pending issue of shares, funds held abroad Source: RBI; Citi Estimate*Includes US$4.1bn of the Resurgent Bond Issue repaid in September 2003 and repayment of India Millennium Bonds in FY06. ** Includes delayed export receipts, advance payments against imports. Source: RBI, Citi estimates.

Snapshot of Government Finances

Figure 33 India's Central Government Finances (Rupees in Billions, Percent to GDP)

Rs Bn, % GDP	FY04	FY05	FY06	FY07	FY08RE	FY09BE	COMMENTS
a. Gross Tax Revenue	**2,543**	**3,050**	**3,662**	**4,735**	**5,911**	**6,877**	
% to GDP	9.2	9.7	10.2	11.4	12.5	13.0	The 17.5% Gross tax assumptions appear realistic
Corporation tax	636	827	1,013	1,443	1,895	2,264	
Income tax	414	493	560	751	1,057	1,383	Higher exemption limits and tax slabs will help
Excise duty	908	991	1,112	1,176	1,233	1,379	Export bans/ import duty reductions to curb inflation could
Import duty	486	576	651	863	1,029	1,189	hurt growth in excise/import duties
Service tax	100	163	326	502	697	662	
b. (-) Devolvement to States & UTs	674	802	972	1,223	1,518	1,806	
c. Net tax revenues (a-b)	1,870	2,248	2,689	3,512	4,375	5,072	
d. Non tax revenues	769	812	768	832	1,024	958	
e. Net revenue receipts (c+d)	**2,639**	**3,060**	**3,458**	**4,344**	**5,396**	**6,029**	
f. Non-debt capital receipts	841	665	122	64	439	147	
Recovery of loans	672	620	106	59	51	45	
Privatisation	170	44	16	5	388	102	
g. TOTAL REVENUES (e+f)	**3,480**	**3,725**	**3,580**	**4,408**	**5,838**	**6,176**	
% YoY	29.8	7.0	-3.9	23.1	32.4	5.8	
h. Revenue expenditure	**3,621**	**3,843**	**4,394**	**5,146**	**5,954**	**6,581**	Expenditure Targets do not take into account off-balance
Interest (1)	1,241	1,269	1,326	1,503	1,715	1,908	sheet items. These include:
Defence	432	439	482	517	548	576	1. Oil Bonds: Estimated at Rs964bn-1350bn in FY09
Subsidies	443	460	475	571	697	**714**	2. Additional Fertilizer Subsidies: c.Rs650bn
Pensions	159	183	203	221	242	251	3. Farm Loan Waiver
Grants to States	137	148	305	357	364	433	4. 6th Pay Commission Recommendations
Admin and social services	422	470	484	553	558	601	These items understate expenditure targets
Plan expenditure	786	875	1,119	1,424	1,756	2,098	
i. Capital expenditure	**1,092**	**1,139**	**664**	**688**	**1,182**	**928**	
Defence	169	320	323	338	377	480	
Loans	487	371	52	75	512	111	
Plan expenditure	436	448	288	274	319	336	
j. Plan exp on rev & cap a/c	1,223	1,323	1,406	1,699	2,056	2,434	
k Non Plan expen on rev & cap a/c	3,490	3,660	3,651	4,135	5,080	5,075	
l. TOTAL EXPENDITURE (h+i) = (j+k)	**4,713**	**4,983**	**5,057**	**5,834**	**7,136**	**7,509**	
% YoY	14.0	5.7	1.5	15.4	22.3	5.2	
Deficit trends							
m. Fiscal deficit (l-g)	**1,233**	**1,258**	**1,478**	**1,426**	**1,298**	**1,333**	On paper, FD is in line with FRBM Targets
% to GDP	4.5	4.0	4.1	3.4	2.8	2.5	Including off-balance sheet items to 6.5% of GDP
n. Revenue deficit (h-e)	**982**	**783**	**936**	**802**	**555**	**552**	
% to GDP	3.6	2.5	2.6	1.9	1.4	1.0	
o. Primary deficit (m-1)	**-8**	**-12**	**137**	**-77**	**-417**	**-575**	
% to GDP	0.0	0.0	0.4	-0.2	-0.9	-1.1	
Financing the deficit							
Market borrowings	889	460	953	1,104	1,107	1,006	
PPF & special deposits	50	-4	60	52	48	48	
Small savings	0	0	0	0	-18	99	
Net external assistance	-135	148	75	85	100	110	
Others	468	736	584	140	382	-2	
Cash Surplus	-39	-82	-195	45	-182	72	
Total financing	**1,233**	**1,258**	**1,478**	**1,426**	**1,437**	**1,333**	
Memo items (% to GDP)							
Centre	4.5	4.0	4.1	3.4	3.0	2.5	
State	4.5	3.5	2.5	1.9	2.3	2.1	
Combined	8.5	7.5	6.7	5.6	5.3	4.6	

BE- Budgeted Estimated; RE- Revised Estimates. Source: Budget Documents.

Global Forecasts

	GDP Growth (%YoY)			CPI Inflation (%YoY)			Current Balance (% GDP)			Fiscal balance (% GDP)		
	2007	2008F	2009F	2007	2008F	2009F	2007	2008F	2009F	2007	2008F	2009F
Global	**3.9**	**3.0**	**2.6**	**3.1**	**5.3**	**3.9**	**0.3**	**0.3**	**0.2**	**-0.5**	**-1.2**	**-1.6**
Based on PPP weights	4.9	3.9	3.5	3.6	6.1	4.4	1.0	0.7	0.6	-0.5	-1.2	-1.7
Industrial Countries	**2.5**	**1.5**	**1.2**	**2.1**	**3.7**	**2.7**	**-1.4**	**-1.2**	**-1.0**	**-0.9**	**-2.0**	**-2.3**
United States	2.0	1.9	1.9	2.9	4.6	2.8	-5.3	-5.1	-4.7	-1.1	-3.0	-3.4
Japan	2.1	0.8	0.6	0.0	1.7	2.1	4.8	3.7	4.0	-3.3	-4.3	-4.1
Euro Area	2.7	1.4	0.5	2.1	3.6	2.6	0.1	-0.1	-0.1	-0.6	-1.1	-1.5
Canada	2.7	0.8	2.3	2.1	2.4	1.8	0.9	1.4	0.4	0.2	0.1	0.1
Australia	4.3	2.5	2.8	2.3	4.6	3.5	-6.1	-4.1	-3.5	1.6	1.5	1.8
Germany	2.6	1.6	0.6	2.3	2.8	2.3	7.6	6.3	3.5	0.0	-0.5	-1.2
France	2.1	1.0	0.5	1.5	3.3	2.1	-1.4	-2.3	-2.4	-2.7	-3.2	-3.6
Italy	1.4	0.2	0.5	2.2	3.5	2.0	-2.0	-2.5	-2.8	-2.3	-3.2	-3.5
Spain	3.8	1.2	-0.2	2.8	4.5	3.0	-10.2	-10.7	-8.8	2.2	-0.6	-3.0
United Kingdom	3.5	2.2	0.8	1.6	2.4	2.7	6.1	5.7	5.4	0.4	0.3	0.4
Emerging Markets	**3.0**	**1.2**	**0.1**	**2.3**	**3.8**	**3.5**	**-4.3**	**-1.5**	**-0.4**	**-2.7**	**-3.6**	**-4.5**
China	7.4	6.3	6.0	5.3	8.7	6.6	4.3	4.4	3.9	0.7	0.5	-0.1
India (Infl is WPI)	11.9	9.8	9.4	4.8	6.8	4.3	10.8	8.4	7.3	0.3	-0.3	-0.9
Korea	9.0	7.7	7.9	4.5	10.0	6.0	-1.5	-3.9	-2.0	-6.0	-5.8	-5.2
Poland	5.0	4.2	3.6	2.5	5.0	3.8	0.6	-1.0	-0.5	3.8	1.5	0.7
Russia	6.6	5.1	4.3	2.5	4.4	3.6	-3.7	-4.7	-4.8	-1.4	-1.6	-1.3
South Africa	8.1	7.3	7.1	9.0	14.2	12.8	6.0	6.0	1.7	5.4	4.6	1.4
Turkey	5.1	3.3	3.0	7.2	11.5	6.4	-7.3	-8.2	-7.6	0.8	0.3	0.2
Brazil	4.5	3.8	3.9	8.8	10.8	9.0	-5.7	-6.8	-7.1	-1.9	-2.4	-3.1

Source: Citi estimates

Long-Term Forecasts

	GDP Growth(%)					Exchange Rates(Average)					Long-term Rates(%)				
	2008	2009	2010	2011	2012	2008	2009	2010	2011	2012	2008	2009	2010	2011	2012
United States	1.9	1.4	2.7	2.7	2.7	NA	NA	NA	NA	NA	3.95	4.30	4.75	5.00	5.00
Japan	1.4	0.8	1.5	2.0	1.2	105	104	108	103	98	1.55	1.63	1.75	2.25	1.75
Euro Area	1.4	0.7	1.5	2.0	2.0	1.56	1.50	1.40	1.30	1.30	4.50	4.50	4.60	4.75	4.75
China	9.8	9.7	10.5	10.8	10.0	6.90	6.50	5.95	5.60	5.45	4.1	4.0	4.0	4.5	5.0
India	**7.5**	**7.4**	**8.3**	**8.7**	**8.8**	**42.5**	**40.0**	**38.0**	**36.0**	**34.0**	**9.50**	**8.5**	**8.5**	**8.5**	**8.5**

Source: Citi estimates

Disclosure Appendix A1

ANALYST CERTIFICATION

We, Rohini Malkani, Anushka Shah, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. [I(We)] also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views in this report.

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