

India Macro Weekly

Spotlight on Steps Taken to Counter the Naxalite Movement

- **Left Wing Extremism - Centre steps up efforts** — Faced with a rising number of violent incidents by Naxalites over recent months, in a meeting last week, the Centre proposed a unified command to improve coordination between States in anti-Naxal operations. A quick recap, after decades of dormancy, over the last few years, the Naxalite Movement¹ has emerged as the ‘single biggest internal security challenge’ for the country. Taking advantage of the hilly and dense terrain, the movement is concentrated in the ‘Red Corridor’ which spans across West Bengal to Karnataka, with the most affected states being Chhattisgarh, Jharkhand, W.Bengal and Orissa (see p. 2). Apart from a law and order concern, the movement has economic implications given that it is concentrated in the mineral-rich states in the East and is a deterrent to investment.
- **Government likely to take concrete steps to confront the threat** — At a meeting convened last week by PM Singh, the Union Home Minister P Chidambaram and senior officials from impacted states proposed to enhance support to States and carry out a number of measures. In addition to creating a unified command (i.e similar to J&K and Assam where the Army, Central para-military forces and state police operate under a common command structure) for anti-Naxal operations for the 4 most affected states, other measures include: (1) providing more helicopters for logistical support; (2) Establishment/improvement of 400 police stations in impacted districts, at a cost of Rs20mn per station; (3) Improve road connectivity in 34 districts; (4) Setting up a Special Development Plan with an emphasis on road connectivity, primary education, healthcare, drinking water. (see <http://pib.nic.in/release/release.asp?relid=63222&kwd=> for details)
- **Are measures sufficient?** The Centre’s strategy to tackle the Maoist threat is based on a two-pronged approach of development and police action. While this is positive, the Home Minister has admitted that ‘*efforts of the state governments assisted by the central paramilitary forces have met with mixed results*’. To this end, strategic intelligence firm Stratfor highlights the conundrum the govt faces in providing security without sufficient infrastructure and the difficulty in developing infrastructure without security. Moreover, as highlighted by the media, success would mean dismantling the resource generation networks, which besides using tools such as abductions, extortion, unofficial administrations to collect ‘taxes’ in rural areas, are also engaged in opium cultivation. Lastly, resolving land acquisition issues is key to quelling the movement. While there are arguments to deploy the military, a consolation is that the movement has so far remained contained within the Red Corridor.

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¹Naxalites is a term used to define Maoist groups waging a violent class struggle on behalf of landless laborers/tribal people against landlords and their agents which include the government. *Pls see India in 2010 at <https://www.citigroupgeo.com/pdf/SAP33579.pdf>*

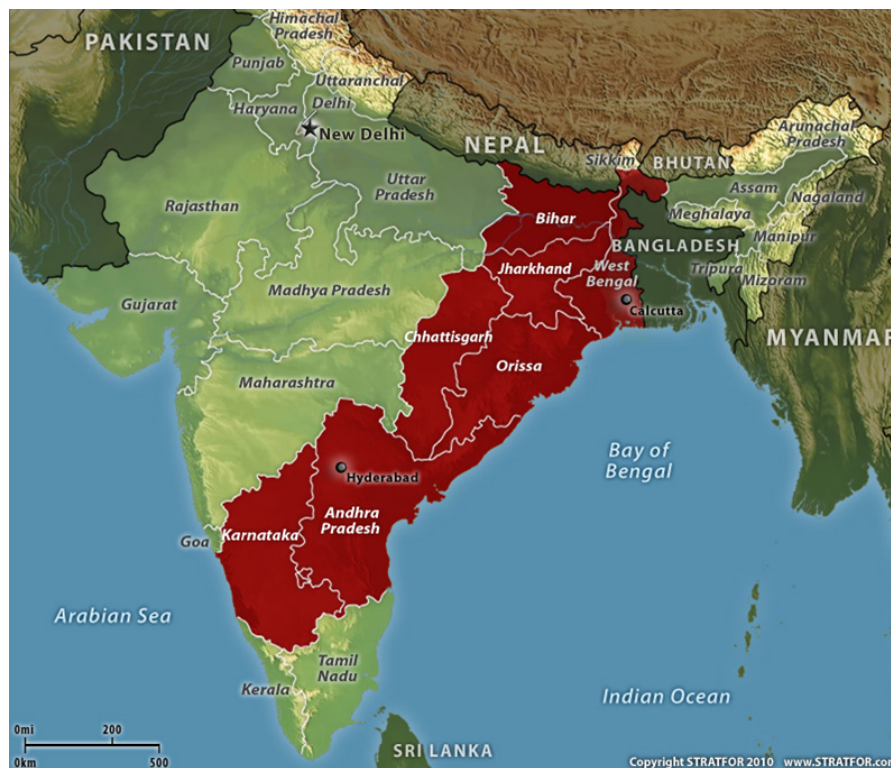
The Spread of the Naxalite Movement

The Naxalite movement spans across West Bengal to Karnataka, with the most impacted states being Chhattisgarh, Jharkhand, W. Bengal and Orissa.

Apart from law and order concerns, the movement has economic implications given that it is concentrated in mineral-rich states in the East and is a deterrent to investment.

Economic targets include mobile networks, NMDC mines, Gramin Sadak Nirman Yojana works, Essar pipelines in Chhattisgarh and Orissa, and solar plates in Bihar

Figure 1. The 'Red Corridor'



Source: Stratfor

Over the years, incidents have mounted, with attacks on policemen, railway stations and passenger trains.

According to the Ministry of Home Affairs, 500 civilians were killed each year on average during 2004-08 due to the Maoist attacks

This further increased to 591 in 2009 and in the current year so far 325 civilians have been killed of which 142 were named as 'police informers'.

Figure 2. Recent Naxalite Attacks - 2010

Date	Description	State
15-Feb	24 para-military personnel of the Eastern Frontier Rifles killed in attack by Maoist insurgents at a camp in Silda	W Bengal
6-Apr	Naxalites kill 76 CRPF members conducting a patrol in the jungles of Tarmetla	Chhattisgarh
17-May	Naxals detonate an explosive device along a road at Chingawaram in Dantewada and destroy a bus, killing 49 civilians and police officers	Chhattisgarh
28-May	Railway line in W Bengal sabotaged, de-railing a passenger train and killing 150 people	W Bengal
24-Jun	Naxals reiterate intention to drive multinational corporations (MNCs) out of India	
27-Jun	27 CRPF members killed at an encounter in Narayanpur, a few kilometers from their camp in Dhaudhai	Chhattisgarh
2-Jul	CPI (Maoist) leader Cherukuri Rajkumar, popularly known as 'Azad' killed in CRPF encounter at Adilabad	Andhra Pradesh
7-Jul	CPI-M calls a 2-day 'bandh' or strike, to protest the killing of Azad	

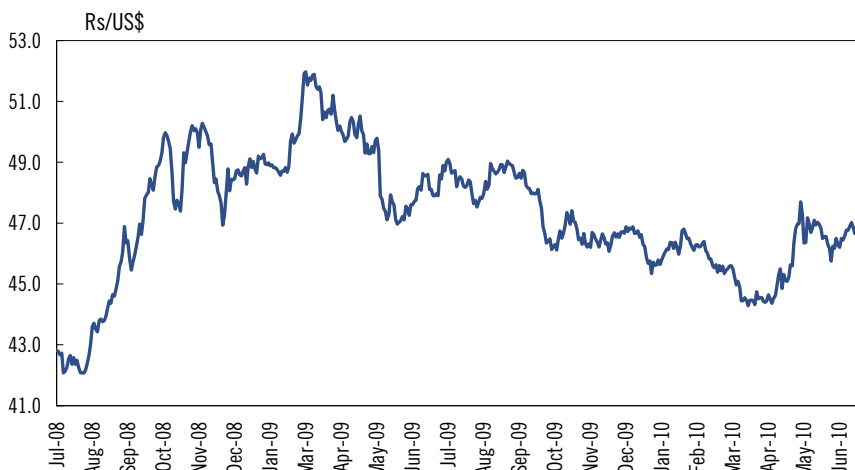
Source: IPCS, Newspaper Reports

India – Markets in Pictures

FOREX MARKETS

The rupee ended the week at Rs46.79/US\$ from Rs46.66/US\$ in the previous week, down 0.3% over the week. In addition to global trends, the main drivers of the INR were (i) defence-related demand and (ii) More activity in the NDF market

Figure 3. Trends in the USD INR

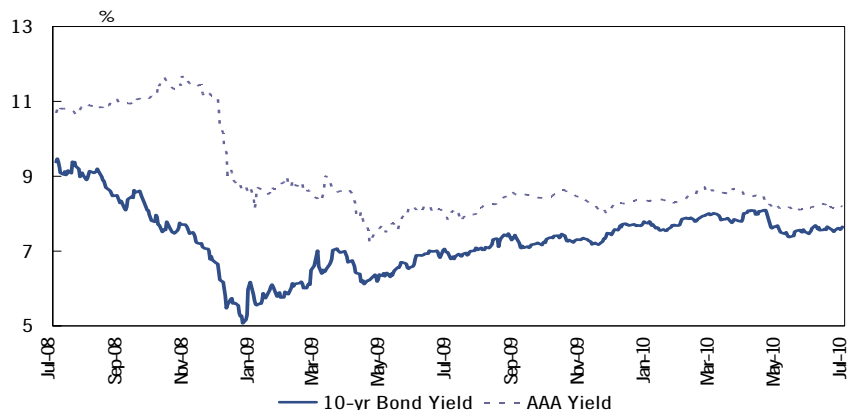


Source: RBI

BONDS

The 10-year benchmark yield traded in a narrow range of 7.62%-7.64%, while the AAA 5-year benchmark yield traded at 8.25%-8.27%. Bonds remained under pressure as concerns about tight liquidity, monetary policy and bond supplies continued to weigh on market sentiment.

Figure 4. Trends in 10-Year Bond and AAA Yields (%)



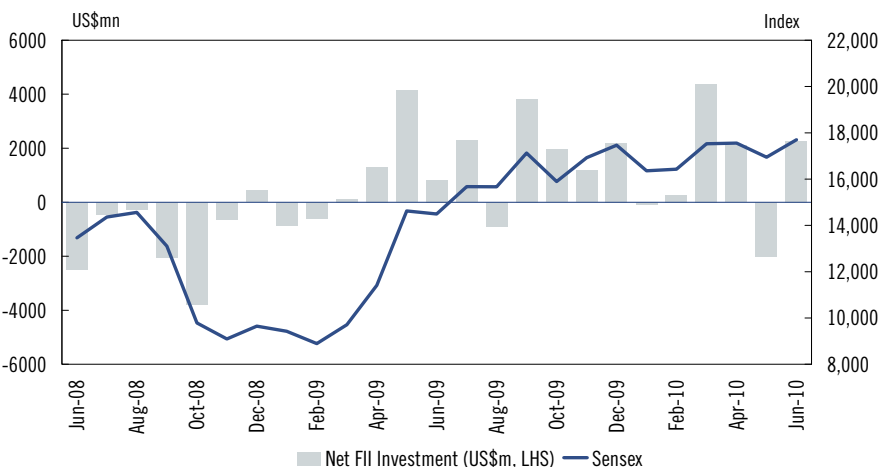
Source: RBI

While liquidity conditions remained tight with the RBI injecting Rs541bn on a daily average basis, call rates came off from 6% levels in the previous week to 5% as banks appeared to have met their funding requirements well-in-advance.

Figure 5. Trends in Institutional Flows and the Sensex (Index, US\$m)

EQUITY MKTS – From Our Trading Strategy Team

(This market commentary has been prepared by a member of the Institutional Clients Group of Citi. The information in this communication is not intended to constitute "research" as that term is defined by applicable regulations.) Indian market touched new risk rally highs, closing above 5400 for first time since Feb 8. But lower IIP growth, double-digit May inflation and muted AgBank debut in China kept bourses in check. Infosys kicked off results season on a tepid note, before AXSB, TCS and LICF posted better nos. Comments on oil subsidy sharing ended the honeymoon for PSU OMCs. FIIs bought \$740m in cash last week, DIIs sold \$470m.



Source: SEBI, BSE, Bloomberg

Other Weekly Indicators

TRENDS IN CREDIT & DEPOSITS

Incremental non-food bank credit rose by Rs920bn for the fortnight ended July 2. On a cumulative basis, credit was up Rs1576bn (vs. Rs200bn last year). This suggests that apart from telecom related funding, there appears to be a clear pick up in lending.

Deposit growth also picked up over the fortnight by Rs1152bn. On a cumulative basis, during April to July 2, deposits in FY11 were Rs1399bn v/s Rs1968bn last year. The last time that credit was more than deposits was in FY05.

SUBSIDY- SHARING on OIL

Providing some clarity on the subsidy-sharing formula for FY11, the oil secretary said that the upstream companies will bear 1/3rd of FY11 gross under-recoveries

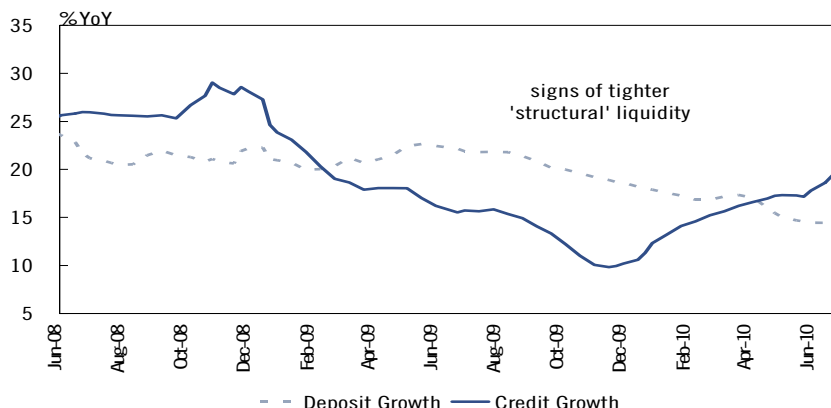
Based on these comments, and assuming oil prices at US\$75/bbl, our Oil & Gas analyst Saurabh Handa estimates that this would result in the government bearing 50% of the under-recoveries, or Rs300bn. However, it is still unclear whether this would be financed through cash or bonds.

FOREX RESERVES UP US\$365mn

Latest data indicate that foreign currency assets were up US\$1.1bn for the week ended July 9 (total reserves including gold were up US\$1.2bn).

Fiscal YTD, total reserves (including gold) were up US\$365mn and stood at US\$279.4bn (excluding gold, reserves stood at US\$253.2bn)

Figure 6. Trends in Credit and Deposit Growth (%YoY)



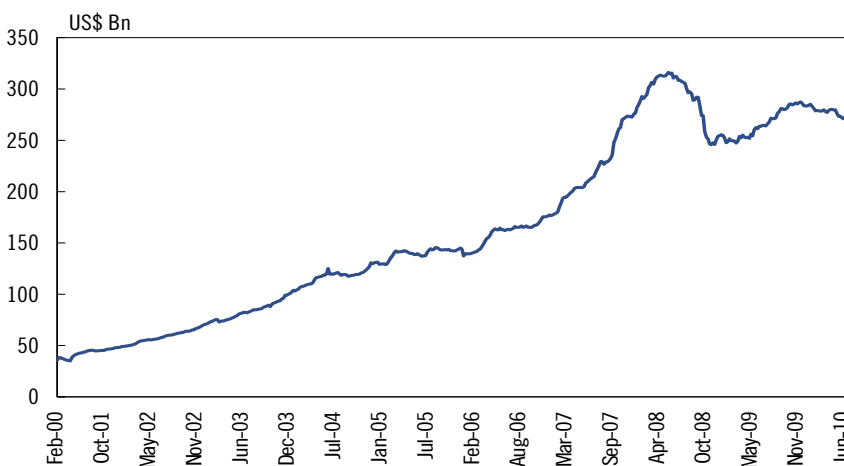
Source: RBI

Figure 7. Subsidy Sharing Mechanism

Rs bn	FY07	FY08	FY09	FY10	FY11E2
Gross under-recoveries	494	771	1,033	461	600
Petrol	20	73	52	52	20
Diesel	188	352	523	93	200
LPG	107	155	176	143	195
Kerosene	179	191	282	174	185
less: Upstream contribution	205	257	320	144	200
% share	42%	33%	31%	31%	33%
Less: Govt compensation (oil bonds/cash)	241	353	713	260	300
Net under-recovery	48	161	-	57	100
Brent (US\$/bbl)	64	82	85	70	75

Source: CIRA estimates. See note at <https://www.citigroupgeo.com/pdf/SAP38132.pdf>

Figure 8. Cumulative Forex Reserves (US\$bn)



Source: RBI

India — Market Monitor

Figure 9. India Market Monitor

	Units	Latest	Previous	1M ago	3M ago	12M ago
Interest Rates						
Overnight	%	5.10	5.65	5.35	3.30	3.30
1 year Treasury Bill	%	5.69	5.65	5.60	5.09	3.69
1 year OIS	%	5.78	5.71	5.50	4.84	4.08
1 year MIFOR	%	4.00	3.75	3.45	3.40	3.65
5 year Corporate AAA spread over GOI	%	0.67	0.56	0.71	1.06	1.26
10 year GOI	%	7.64	7.65	7.64	7.95	6.85
Currency & Reserves						
USD/INR		46.79	46.66	46.30	45.35	44.84
EUR/USD		1.30	1.27	1.24	1.38	1.33
USD/JPY		86.66	88.56	91.29	90.59	114.60
12 Month INR Forward Premium	%	3.33	3.13	2.95	2.92	2.47
FX Assets (excl gold) As On (9-Jul-10)	US\$ bn	253.3	252.1	247.2	255.7	252.9
Money & Banking						
Loan-Deposit Ratio	%	73.4	73.3	72.4	71.5	69.4
Money Supply – M3	% YoY	15.30	14.50	14.60	15.50	20.00

Source: RBI, Bloomberg

Financial Market Forecasts

Figure 10. Currency Forecasts and Forwards

		Spot	Mkt Data		Forecasts			Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
			3M Fwd	12M Fwd	0-3 Mos	6-12 Mos	Long-term					
Euro	EURUSD	1.27	1.27	1.27	1.19	1.29	1.33	1.19	1.23	1.26	1.29	1.30
Japanese Yen	USDJPY	88	88	88	92	91	90	92	92	91	91	91
Chinese Renminbi	USDCNY	6.78	6.76	6.66	6.75	6.62	6.45	6.75	6.70	6.67	6.62	6.55
Indian Rupee	USDINR	46.77	46.9	47.8	45.0	43.0	40.0	45.0	44.0	43.5	42.5	41.5
Korean Won	USDKRW	1205	1208	1215	1180	1080	1040	1180	1100	1180	1060	1040

Forecasts from 'Citi Foreign Exchange: Forecasts' (June 18, 2010)

Source: Citi Investment Research and Analysis Estimates

Figure 11. Interest Rate Forecasts (% period end)

		Current	In 3M	In 6M	In 12M	3Q10	4Q10	1Q11	2Q11	3Q11
US*	Fed Fund Rate	0.25	0.25	0.25	0.75	0.25	0.25	0.25	0.50	1.00
	10-Year Treasuries	3.04	NA	NA	NA	3.45	3.65	3.65	4.00	4.20
EU*	Repo Rate	1.00	1.00	1.00	1.25	1.00	1.00	1.00	1.25	1.25
	10-Year Bunds	2.66	NA	NA	NA	2.90	2.95	3.00	3.05	3.10
JP*	Call Money	0.11	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
	10-Year JGBs	1.12	NA	NA	NA	1.30	1.40	1.40	1.40	1.40
CN	1-year deposit rate	2.25	2.52	2.52	3.06	2.52	2.52	2.79	3.06	3.33
	1-Month Shibor	2.46	2.48	2.38	2.57	2.50	2.40	2.30	2.50	2.90
	Government bond yield (5-Year)	2.57	3.30	3.32	3.52	3.30	3.30	3.40	3.50	3.60
IN	Overnight Repo Rate	5.50	5.75	6.00	6.50	5.75	6.00	6.25	6.50	6.75
	Overnight Reverse Repo Rate	4.00	4.25	4.50	5.00	4.25	4.50	4.75	5.00	5.25
	10-Year Gilt	7.59	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75

* Forecast as of Global Economic Outlook and Strategy (June 23, 2010)

Source: Datastream, CEIC Data Company Limited, Bloomberg, Reuters, and CIRA

Figure 12. Data calendar for the week of 19-23 July

Date	Day	Local Time	Country	Indicator	For	Citi Fcst	Mkt Fcst	Prev.
20-Jul	Tue	08:30	US	Housing Starts ('000)	Jun	600	580	539
		16:30	Hong Kong	Unemployment Rate (% s.a.)	Jun	4.6	4.6	4.6
		16:00	Taiwan	Export Orders (%YoY)	Jun	21.7	21.9	34.0
		15:00	Thailand	Exports - customs (%YoY)	Jun	35.2	34.3	42.1
				Imports - customs (%YoY)		32.5	34.7	55.1
				Trade Balance - customs (US\$ mn)		1578	1266	2211
21-Jul	Wed	17:00	Malaysia	CPI (%YoY)	Jun	1.8	1.7	1.6
22-Jul	Thu		EuroArea	PMI Manufacturing	Jun	55.3	55.2	55.6
		08:30	US	Initial Jobless Claims	Jul17	430	445	429
				Leading Indicators(%MoM)	Jun	-0.1	-0.3	0.5
		16:30	Hong Kong	CPI - composite (%YoY)	Jun	2.9	2.7	2.5
		16:00	Taiwan	Unemployment Rate (% s.a.)	Jun	5.1	5.2	5.2
23-Jul	Fri		UK	GDP (%QoQ)	2Q	0.8	0.6	0.3
		13:00	Singapore	CPI (%YoY)	Jun	3.1	3.5	3.2
		16:00	Taiwan	IP (%YoY)	Jun	21.6	22.6	30.7
21-27 Jul			Vietnam	CPI (%YoY)	Jul	—	—	8.7
22-28 Jul			Korea	Real GDP (%YoY)	2Q P	6.9	7.5	8.1

Source: Bloomberg, CEIC Data Company Ltd and CIRA estimates

Monsoon Monitor

Monsoon Update

- Rainfall dipped back into the red for the w/e 14th July, coming in at 24% below normal (vs. 2% above normal the previous week). On a cumulative basis, rainfall during 1 Jun-14 July was 13% below normal.
- As a result of weak rainfall, the water level in reservoirs was 32% below the last 10-year average as on July 15. Total water stock in 79 of the 81 reservoirs monitored by the Central Water Commission stood at 25.5bcm, or 17% of live storage capacity. However, this is still higher than last year's storage of 20.9bcm .
- Encouragingly, crop sowing data available until Jul 9 indicate an across-the-board increase in acreage under crops such as rice, coarse cereals, oilseeds, sugarcane and cotton. However, pulse sowing continues to remain in the red

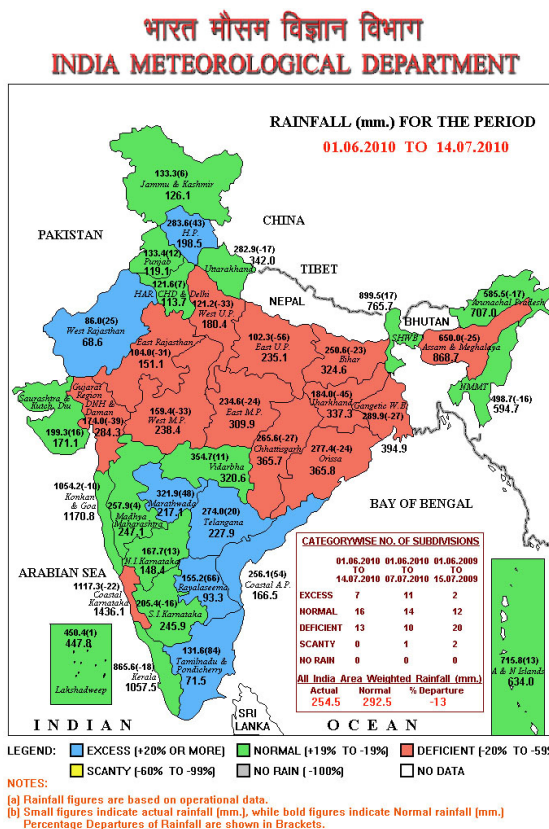
Figure 13. Crop Sowing as on 9 July

	Normal Area	Area Sown 9-Jul-10	% of Normal	% YoY
I. Total Foodgrains(1+2+3+4)	72.5	13.8	19.1	6.2
1. Rice	39.5	7.2	18.2	4.8
2. Coarse cereals	22.2	5.8	26.2	9.2
3. Total Cereals (1+2)	61.7	13.0	21.1	6.8
4. Pulses	10.8	0.8	7.6	-2.3
II. Non-Foodgrains	31.9	17.9	56.2	16.6
Oilseeds	17.5	5.8	33.3	2.9
Cotton	9.1	6.6	72.6	36.4
Sugarcane	4.5	4.7	105.3	13.4
Jute	0.8	0.8	93.8	8.9
III. All Crops (I + II)	104.4	31.8	30.4	11.8

Figure 14. Water Reservoir Levels as on July 15th

River basin	This year	Average of last 10 years	% departure
Ganga	2.4	4.4	-45.6
Indus	3.0	4.5	-33.1
Narmada	1.3	2.2	-39.3
Tapi	1.3	2.1	-40.2
Mahi	0.6	1.1	-46.7
Sabarmati	0.0	0.1	-89.4
Rivers of Kutch	0.1	0.2	-68.7
Godavari	1.0	2.2	-54.4
Krishna	8.7	10.3	-15.5
Mahanadi & east-flowing rivers	1.7	3.3	-49.6
Cauvery & east -flowing rivers	2.6	2.9	-11.3
West flowing rivers of south	3.0	4.3	-31.2
Total	25.5	37.6	-32.1

Figure 15. Seasonal Rainfall : 1 June - 14 July: 13% BELOW Normal



Source: IMD, CWC

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Appendix A-1

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