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Economics

28 November 2011 | 28 pages

India Macroscope

Tough Times = 12 Tough Tasks to Sustain Growth at ~7% in 2012

- **Tough Times Bring down the Growth Trajectory** — 2011 was tough: a cocktail of domestic macro issues (inflation, rates), policy issues (government indecision-inaction), and global (sub-par growth, advancement of debt restructuring). Tough times don't always last, but they can last long enough to do more damage to the economic structure and momentum. As a result, we have seen India growth expectations come off from 9% levels to 7%, with growing doubts on whether even a 7% rate can hold.

- **2012 will need 12 Tough Measures to Sustain Growth even at ~7%**— India is, we believe, not yet beyond repair; and the following 12 measures are key to keep to even these 7% levels. Key among them include incentivizing investments, attracting FX flows, addressing structural issues on inflation, executing proposed fiscal reform, re-vamping the current model of governance, and battling corruption along with electoral reform, etc. While one may argue that most of this has been on the agenda a while, historically India has been quick to react in difficult times. This time is no different – execution and institutionalizing project management is key *(see pages 4-7).*

- **2012 Brings Additional Vulnerabilities on FX/Funding** — India's FX dependence, the need to finance its current account deficit and meet debt repayments, remains. This needs a domestic/global market risk-on mood. An added worry in 2012 is the impact of global bank de-leveraging. To meet capital requirements, there are risks of tighter lending measures and a pull-back in bank lending. Moreover, with sub-par growth in the US, EMU and UK (jointly 43% of world GDP), export growth could splutter.

- **BUT…One could see potential gains on inflation / rates and policy making** — While global developments are likely to remain volatile. India should see inflation / interest rates peaking. We expect the RBI to begin easing rates by mid-2012. This, coupled with some determined decision-making from policymakers, could provide economic and investment gains and keep growth from falling below 7% levels.

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Figure 1. India – Macro Snapshot (%)

Year -end 31 March	FY06	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
Real GDP growth (%)	9.5	9.6	9.3	6.8	8.0	8.5	7.1	7.0
Agriculture growth (%)	5.1	4.2	5.8	-0.1	0.4	6.6	4.0	3.0
Industry growth (%)	9.7	12.2	9.7	4.4	8.0	7.9	5.1	5.3
Services growth (%)	11.0	10.1	10.3	10.1	10.1	9.4	8.9	8.8
Fiscal Deficit (Centre+States)	-6.5	-5.4	-4.1	-8.5	-9.5	-8.1	-8.3	-8.0
Current Account Deficit	-1.2	-1.0	-1.3	-2.3	-2.8	-2.6	-2.9	-3.0
WPI (Average)	3.7	6.5	4.8	8.0	3.6	8.6	9-9.5	7.5-8.0
INR/USD (Average)	44.3	45.2	40.2	46.0	47.4	45.6	48.1	49.2

Source: CSO, Budget Documents, RBI, CIRA estimates

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Statistical Snapshot

Figure 2. India – Macroeconomic Summary, FY00-13E (%)

Year to 31 March	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
National Income Indicators*														
Nominal GDP (Rs bn)	20,279	21,840	23,676	25,500	28,617	32,422	36,925	42,937	49,864	55,826	65,503	78,756	91,357	104,604
Nominal GDP (US$ bn)	467	478	493	528	624	721	834	950	1,240	1,214	1,382	1728	1,899	2,127
Per Capita GDP (US$)	467	469	474	500	582	662	754	847	1,090	1,052	1,180	1,453	1,574	1,736
Real GDP growth (%)	6.0	4.4	5.8	3.8	8.5	7.6	9.5	9.6	9.3	6.8	8.0	8.5	7.1	7.0
Agriculture growth (%)	0.5	-0.2	6.3	-7.2	10.0	1.6	5.1	4.2	5.8	-0.1	0.4	6.6	4.0	3.0
Industry growth (%)	4.6	6.4	2.7	7.1	7.4	9.4	9.7	12.2	9.7	4.4	8.0	7.9	5.1	5.3
Services growth (%)	9.5	5.7	7.2	7.5	8.5	9.4	11.0	10.1	10.3	10.1	10.1	9.4	8.9	8.8
By Demand * (%YoY)														
Consumption	7.2	3.0	5.3	2.3	5.4	1.9	8.6	7.6	9.3	8.2	8.7	8.0	6.5	7.1
Pvt Consm	6.1	3.4	6.0	2.9	5.9	1.7	8.5	8.3	9.3	7.7	7.3	8.6	6.6	6.8
Public Consm	13.2	0.9	2.3	-0.4	2.6	3.4	8.9	3.7	9.5	10.7	16.4	4.8	6.0	8.5
Gross Fixed Capital Formn	11.2	0.0	7.4	6.8	13.6	20.7	16.2	13.8	16.2	1.5	7.3	8.6	4.0	4.0
Cons; Invst, Savings ** (%GDP)														
Consumption	79.4	78.5	78.9	77.2	75.0	70.2	69.2	67.8	66.8	69.4	69.7	68.7	68.0	67.0
Capital Formation	25.3	23.8	22.3	24.6	26.9	32.8	34.7	35.7	38.2	35.4	35.8	34.8	35.5	36.0
Gross Domestic Savings	24.2	23.2	22.9	25.7	29.1	32.4	33.5	34.6	36.9	32.2	33.7	34.0	33.5	33.0
Real Indicators (%YoY)														
Cement despatches (domestic)	15.2	-1.9	9.8	8.7	5.8	8.1	10.1	10.2	9.8	8.5	11.2	4.8	8.0	9.0
Commercial vehicle sales	22.0	-11.9	-4.5	28.0	36.2	22.4	10.1	33.3	4.2	-21.4	39.2	27.0	7.0	10.0
Car sales	45.3	-5.3	3.2	7.8	27.2	17.8	7.7	20.7	12.1	0.3	25.7	29.3	4.3	17.0
Two-wheelers	9.4	0.7	15.3	17.0	11.3	15.7	13.6	11.5	-7.8	2.7	25.9	25.8	16.0	14.0
Diesel consumption	5.6	-3.4	-3.7	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	6.0	6.0
Mobile Tele density	0.2	0.3	0.6	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.9	67.9	74.9	81.6
Monetary Indicators (% YoY)														
Money supply	14.6	16.8	14.1	14.7	16.8	12.0	21.4	21.3	21.1	19.3	16.7	16.0	17.0	17.0
Inflation – WPI (Avg)	3.3	7.1	3.6	3.4	5.5	6.5	4.4	6.5	4.8	8.0	3.6	8.6	9.0-9.5	7.5-8.0
CPI (Avg)	3.4	3.7	4.3	4.1	3.8	3.9	4.2	6.8	6.2	9.1	13.0	9.5	8.0	7.0
Bank credit growth	18.2	17.3	15.3	23.7	15.3	30.9	37.0	28.1	22.3	17.5	16.7	21.4	21.0	22.0
Deposit growth	13.9	18.4	14.6	16.1	17.5	13.0	24.0	23.8	22.4	18.0	17.0	15.8	17.0	17.0
Fiscal Indicators (% GDP)														
Centre's fiscal deficit)	-5.2	-5.4	-6.0	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.4	-5.1	-5.8***	-5.5
State fiscal deficit	-4.5	-4.0	-4.1	-3.9	-4.2	-3.3	-2.4	-1.8	-1.5	-2.4	-3.3	-3.0	-2.5	-2.5
Combined deficit (Centre+State)	-9.0	-9.1	-9.5	-9.1	-8.1	-7.2	-6.5	-5.4	-4.1	-8.5	-9.5	-8.1	-8.3	-8.0
Off Balance Sheet Items	-	-	-	-	-	-	-0.5	-0.9	-0.6	-1.7	-0.2	NA	NA	NA
Combined liabilities (dom+ext)	73.8	77.1	82.0	85.5	85.4	85.2	83.0	79.3	76.1	76.7	74.0	69.4	67.2	66.8
External Sector (% YoY)														
Exports (US$bn)	37.5	45.5	44.7	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.2	250.5	298.1	357.7
% YoY	9.5	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.6	37.4	19.0	20.0
Imports (US$bn)	55.4	57.9	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	380.9	449.5	530.4
%YoY	16.5	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	26.7	18.0	18.0
Trade deficit (US$bn)	-17.8	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.4	-130.5	-151.4	-172.7
Invisibles (US$bn)	13.7	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	86.2	96.1	108.2
Current Account Deficit (US$bn)	-4.1	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.4	-44.3	-55.4	-64.6
% to GDP	-0.9	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.6	-2.9	-3.0
Capital Account (US$bn)	9.5	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	53.4	59.7	60.1	70.1
% GDP	2.0	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.9	3.5	3.2	3.3
Forex Assets (excl gold) (US$bn)	35.1	39.6	51.0	71.9	106.1	135.1	145.1	191.9	299.1	241.6	252.8	273.7	278.4	284.0
Months of imports	7.6	8.2	10.9	13.4	15.9	13.6	11.1	12.1	13.9	9.4	10.1	8.6	7.4	6.4
External Debt (US$bn)	98.3	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	261.0	306.4	316.9	331.9
Short Term Debt	3.9	3.6	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	68.5	78.5
Exchange Rate														
US$/INR - annual avg	43.4	45.7	48.0	48.3	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	48.1	49.2
% depreciation	2.8	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	2.3
US$/INR - year end	43.6	46.5	48.9	47.5	43.6	43.8	44.6	43.6	40.1	50.7	44.9	44.6	50.0	48.5
% depreciation	2.8	6.7	5.2	-2.9	-8.2	0.3	2.0	-2.3	-8.0	26.4	-11.4	-0.7	12.1	-3.0

*Using spliced data ** At current prices. ***Assuming oil at US$105/bbl and full payment of under-recoveries to oil companies
Source: CSO, RBI, Ministry of Finance and CIRA Estimates

Theme: Tough Times = Tough Tasks

Figure3. GDP Forecasts for Key Countries

%YoY	2010	2011E	2012E	2013E
United States	3.0	1.7	1.9	1.9
Japan	4.0	-0.4	1.8	1.3
Euro Area	1.8	1.5	-1.2	-0.2
Canada	3.2	2.3	1.7	2.3
Australia	2.7	1.5	3.7	4.0
New Zealand	1.7	1.4	2.6	2.6
Sweden	5.4	4.3	2.1	2.6
Switzerland	2.7	1.9	1.0	1.2
United Kingdom	1.8	0.9	0.5	1.2
Russia	4.0	4.0	2.5	4.2
China	10.4	9.1	8.4	8.6
India	**8.5**	**7.1**	**7.0**	**7.7**
Korea	6.2	3.6	3.7	4.4
South Africa	2.8	3.1	2.9	4.0
Brazil	7.5	3.2	3.5	4.5

Note: For India, 2010 = FY11. Source: Citi Investment Research and Analysis

A Year On: The Global and Domestic Overhang Continues

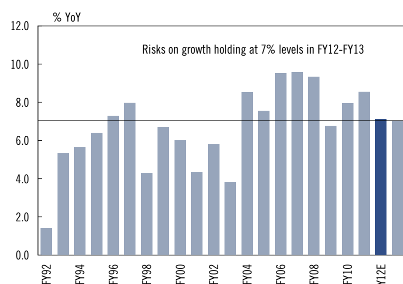
2011 has proven to be an unfortunate cocktail of domestic policy issues (high interest rates, infrastructure constraints) and a slowing global environment. As a result, we have seen growth expectations for India come off from 9% levels to 7%, with growing doubts as to whether even a 7% level can hold.

What's worrying is that prospects do not seem sunny for 2012 either. Our global team expects the hangover from the pre-recession credit boom to continue to cast a deep shadow on global growth in 2012 and beyond. Another recurring theme in the coming years is expected to be European bank deleveraging. Following shocks from the eurozone debt crisis, many EA banks have announced plans to shrink their balance sheets. Our regional economist (See Asia Macro and Strategy Outlook - Prospects for 2012) believes this could have important capital flow implications. Consequently, our team has again cut the 2012 global growth forecast, the sixth consecutive monthly downgrade, and now expect global growth will slow from 4.2% in 2010 and 3.0% in 2011 to 2.5% in 2012. (See Global Economic Outlook and Strategy - Prospects For Economies And Financial Markets In 2012 And Beyond). As regards India, in addition to global factors, domestic issues should take a toll on growth in India. Taking into account the above, ***we are further reducing our FY12 GDP estimates from 7.6% to 7.1% and for FY13 from 7.5% to 7.0%*** *(see p. 8-9 for details).*

Domestic policy would be the key supporting factor for ~7% growth

Risks to sub-7% growth: A key point to note is that, besides growth holding up on the global front, our team does not expect the euro area to break up in 2012 or the following years, nor do we expect the disorderly default of an EA sovereign. Risks to a sub-7% number could also emerge if the recent momentum on the policy front is once again derailed. Over the last fortnight, there have been a number of project announcements, steps to encourage capital flows, including cabinet approval on multi-brand retail. Given the recent deliberation over FDI, we hope that this is not another false start, similar to that seen in Apr-11, when a slew of project clearances in the mining/power sector were granted but never took off.

Figure 4. India - Trends in GDP (%YoY)



Source: CSO, CIRA

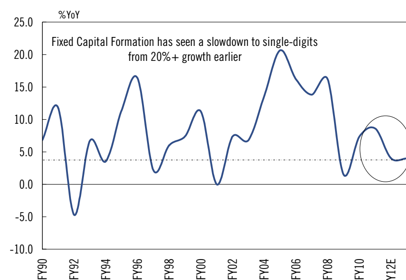
What Can Hold Growth over 7%? 12 Reforms for 2012

While global developments are out of India's control, we think there is much in today's slowing growth scenario that *is* within the reach of policy makers. Indeed, over the last year it has become a unanimously acknowledged fact that the government has fallen severely short of expectations on the reform agenda, as the current leadership framework has been challenged and corruption allegations have tainted the incumbent UPA. In addition are supply-side bottlenecks that have hindered investments. While the problems are now well-known (power and coal shortages, policy hurdles, and fiscal slippages), these issues can, and should, be remedied. As the Planning Commission points out,' *There is another urgent need to translate the large outlays provided at the Centre to enduring outcomes on the ground*'. We think implementation of reforms should be focused on execution and institutionalizing project management within specific time and cost frameworks. We find 12 varied solutions that could be a starting point to revive India through 2012:

#1. Incentivizing Investments – Resolving Power, Mining, Land Issues

The sharp deceleration in investment growth has been the key factor behind headline GDP growth expectations coming off to ~7% levels. As mentioned on pages 8-9, growing policy uncertainty/inaction, coupled with rising rates, has stifled fixed capital formation. To this end, key to reviving investments would be reforms in:

Figure 5. Trends in Fixed Capital Formation



Source: CSO, CIRA

- **Power:** Two key issues are (a) Addressing the losses of State Electricity Boards either through restructuring or fresh equity infusion by the government. To ensure that this does not become a recurring problem, necessary steps would be to ensure timely tariff revisions and improve operational efficiency. (b) Mechanisms for the passing through of prices of imported fuel. Given the current energy situation, there is a need to use more imported fuel (coal/gas/LNG). However, given the costs of imported fuel, power generated using imported fuel can not be profitably sold in market on standalone basis currently. Thus, India needs to devise a mechanism which ensures that either cost of imported fuel becomes pass-through in tariff so higher cost imported fuel and cheap domestic fuel is pooled, so that average price of power is reasonable for new projects.

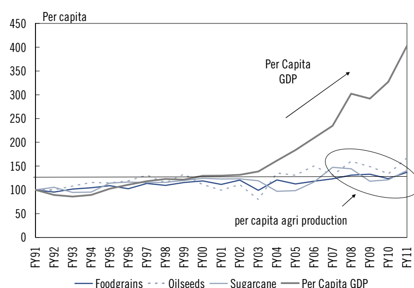
- **Mining**: Thermal coal production has grown at abysmal rates, trailing underlying demand due to (a) delays in environmental/land clearance and (b) Shortages of rakes. Given India's energy requirements, coal production growth should be increased to 5%-10% levels. The coal shortage unfortunately cannot be fully met by imports, given low power tariffs relative to seaborne coal prices and SEB losses. Coal availability issues need to be resolved indigenously by - (i) expediting clearances: environment, forest, land acquisition; (ii) improving rake availability and (iii) allocation of coal blocks through competitive bidding.

- **Land Acquisition:** Although India's land area comprises 2.4% of the world's total area, it is also among the most densely populated countries in the world. Rising industrialization has resulted in a growing struggle for land. A key step towards resolving issues related to compensation and rehabilitation would be to pass the recently tabled Land Acquisition Bill so that it becomes law.

#2. Foreign Capital – Measures to Attract Flows

Given the rise in India's external financing needs, a key issue in 2012 would be measures to augment capital flows. In addition to higher FII limits on bonds, relaxing norms on non-resident deposits and infrastructure financing would provide the right signals and be sentiment-positive. A 'big-bang' move, that was finally approved by the Cabinet recently, was permitting FDI in retail (see p. 18 for details). Our consumer analyst estimates this has potential to add US$15-20bn over the next ten years. Another positive would be FDI in insurance, which has potential to the tune of US$9-10bn over the next decade, based on the estimated incremental capital needs of the industry (with foreigners taking up 49%).

Figure 6. Trends in Per Capita GDP & Agri Production

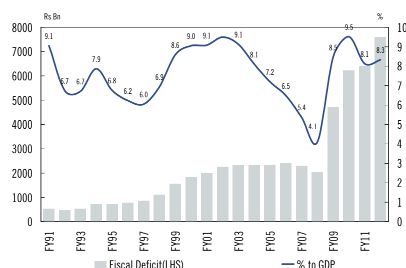


Source: Ministry of Agriculture, CSO

#3. Inflation – Addressing Structural Issues

Inflation being sticky and averaging 9.7%+ for nearly two years, despite effective monetary tightening to the tune of 525bps, is a clear indication that addressing supply-side issues is key. An acknowledged fact is that this stickiness in inflation is partly a consequence of structural changes, since agricultural production has failed to keep up with rising per capita incomes and dietary changes. The Planning Commission adopted the right approach when it called for increasing the production of pulses last year (*production has now doubled and pulse prices have been posting a contraction*). Such an approach should be adopted to improve the supply of other agri commodities. Steps could include (a) improving the logistics chain – transportation, warehousing and cold chain facilities, as almost a third of agricultural produce is wasted due to poor logistical infrastructure; (b) Raising productivity by emphasizing seed/irrigation and fertilizer related reforms; (c) unifying markets for agricultural products within the country. A key aspect of this would involve making amendments to the Agricultural Produce Marketing Commission Act (APMC) which does not allow traders to trade through the main markets and facilitates collusive pricing.

Figure 7. Trends in the Combined Deficit



Source: Ministry of Finance, CIRA

#4. Fiscal – Some Efforts towards Consolidation

Following consolidation efforts through FY02-08 that resulted in the combined deficit coming off from 9.5% of GDP to 4%, trends have seen a continued reversal. Clearly, the deficit bugbear needs to be addressed – and fast.

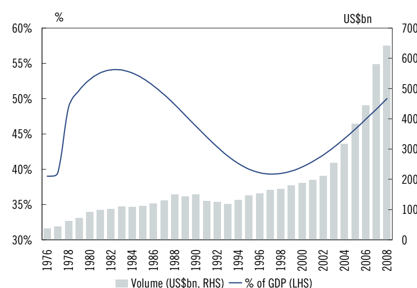
Key structural steps could be (a) Implementation of GST and the Direct Tax Code. The GST was slated for implementation in Apr-12. However, with the Constitution Amendment Bill currently pending in Parliament and no agreement on the rate/exempt commodities, this deadline is unlikely to be achieved. The Direct Taxes Code (DTC) is also scheduled to come into force from 1 April 2012 with the Finance Ministry currently awaiting the report of a parliamentary panel on the Bill. (b) Proper auditing and monitoring of social welfare programs, such as NREGA, the food distribution system, and de-regulation of diesel. To this end, the implementation of the UID (Smart Card) program for direct transfer of subsidies would the first step to sealing leakages.

#5. Politics – Current Model of Governance Needs a Revamp

The current policy gridlock is to a large extent attributed to poor governance. Recent corruption allegations have resulted in a steady slide in popularity of the incumbent UPA. There is growing awareness that the combination of Congress President Sonia Gandhi, and PM Singh, that worked well in the past, has not proven successful this time around.

Mrs. Gandhi's long absence due to a medical condition, coupled with dissent within the Congress and blemishes on PM Singh's authority, have all weakened the party's position. With major state elections approaching, there is an urgent need to either (a) appoint a popularly-elected leader, which would entail new look at the current model of governance or (b) improve momentum on reforms under the current leadership and prevent risks of a mid-term election.

Figure 8. India's Underground Economy (US$bn, % GDP)



Source: Global Financial Integrity

#6. Battling Corruption and Electoral Reform

Allegations of corruption and a growing number of scams – both corporate and political – have tainted the government and have stalled parliamentary functioning. Following the campaign for a strong '**Lokpal Bill (anti-corruption)**[1]' earlier this year, passing this bill is now likely to be topmost on the government's agenda during the ongoing winter session of parliament. Another important aspect to rooting out corruption would involve electoral reform. As per current laws, the maximum limit for election spending for parliamentary elections is Rs4m, whereas for assembly elections it is Rs1.6n (limits vary across states).

Low limits on election spending have resulted in lack of transparency, widespread corruption, and the pervasiveness of 'black money'. Indeed, a Consultation Paper to the National Commission to Review the Working of the Constitution, 2001 notes that "*Electoral compulsions for funds has become the foundation of the whole super structure of corruption*", and points out that "*the campaign expenditure by candidates is in the range of about twenty to thirty times the legal limits*".

[1] The Lokpal bill aims to create an ombudsman's office (or a Lokpal) to investigate and prosecute suspected government corruption and has been the subject of much debate and controversy given demands that it not grant immunity to even the Prime Minister

Figure 9. India's Demographic Dividend

	2005	2010	2025	2035
Total Population	1,131	1,214	1,431	1,528
% Growth*	1.6	1.4	0.9	0.6
Popn between 15-59	677	749	919	994
% Growth*	11.5	10.6	5.8	3.3
% share of total popn	59.9	61.6	64.2	65.0

* 5-Yr growth rate. Source: UN Population Prospects

Figure 10. Sectoral Share of Employment

	Sectoral Share FY07		Additional Expected (FY07-12)
	(%)	(Mns)	(Mns)
Agriculture	50.2	201.9	-4.0
Industry	20.4	81.9	50.9
Services	29.4	118.4	69.0
Total	100	402.2	116.0

Source: Planning Commission

Figure 11. NREGA Snapshot

	FY10	FY11	FY12*
Total Expenditure (Bns)	379	394	162
Works Completed (000s)	2259	259	352
Households Employed(Mns)	53	55	33
Participation of Scheduled Castes/Tribes (%)	51.7	39.8	39.9
Participation of Women (%)	49.2	51.1	50.1

*April – October. Source: NREGA

#7. Improving Data Quality and Dissemination

Poor decision-making has also been complicated by unreliable statistical data. As the RBI as well as other officials have pointed out, '*policy has been handicapped by the reliability of some of the basic data…used in policy calculations*'. In particular, data on (a) poverty ratios, (b) wage statistics, (c) trade, and (d) industrial production are most difficult to reconcile. The last in particular has been widely censured as being '*analytically bewildering*', depicting extreme volatility and counter-intuitive trends. These key issues need to be addressed in order for policy makers and observers to make well-informed decisions.

#8. Labor Reforms – Key to Avoid a Demographic Nightmare

Several instances of worker unrest seen in 2011, particularly in the autos and mining sectors, have been due to higher wage demands, consequently impacting production and taking a toll on growth. Moreover, due to rigid labor laws (i.e. high severance costs, difficulties in hiring and firing workers), many firms are now opting for contract laborers who fall outside the purview of regulation. However, this in turn is resulting in industrial unrest, as seen with Maruti's Gurgaon plant and other instances. Given that only 6% of India's total workforce of 506m is within the organized sector, this points to a need to increase the number of formal jobs and a restructuring of the current labor policy.

#9. Employment - The National Manufacturing Policy Could Help

The share of the manufacturing sector in GDP (ex-mining/construction; currently at 16%) has seen little growth over the years. To this end, the government's recently announced National Manufacturing Policy aims to create National Investment and Manufacturing Zones (NIMZ) that would function as large autonomous industrial townships. This is estimated to create 100m new jobs and boost the share of manufacturing from 16% of GDP to 25% by 2022.

#10. NREGA – More Productive Work; Putting Funding to Better Use

Although the National Employment Guarantee Act (NREGA) has been touted as one of the UPA's flagship reform programs, such a large scale social safety program does present governance challenges. While NREGA does have special monitoring and auditing mechanisms in place, key issues include (a) managing funds effectively. Reports indicate that there has been an underutilization of funds, with many states using less than 50% of the allocated amount. Efforts should be made such that unspent NREGA funding is put to effective use; (b) enhancing the scope of work could result in more long-term benefits for the economy.

#11. Urban Infrastructure – Key for Balanced Growth

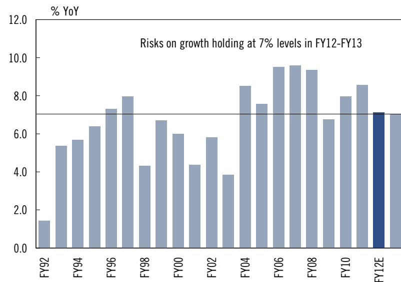
The uptrend in urbanization has resulted in growing strain on urban infrastructure. Given the fragmented nature of Urban Local bodies, the onus of development has been on the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) which was initialized in Dec 2005 for a period of seven years, with an outlay of Rs1trillion. Key to sustaining balanced growth would be higher funding, further encouraging public private partnership and upgrading ministry capacities.

#12. Vigil on NPLs – To prevent negative feedback loop

Lastly, as cautioned by the RBI, banks need to remain vigilant to the headwinds from the prevailing inflation and interest rate situation. This could affect their asset quality, as changes in the interest rate are found to have the most significant (negative) impact on the slippage ratio of the banks. This in turn could result in tighter lending standards and further dampen growth.

Real Indicators

Figure 12. Trends in GDP (%)



Source: CSO, CIRA

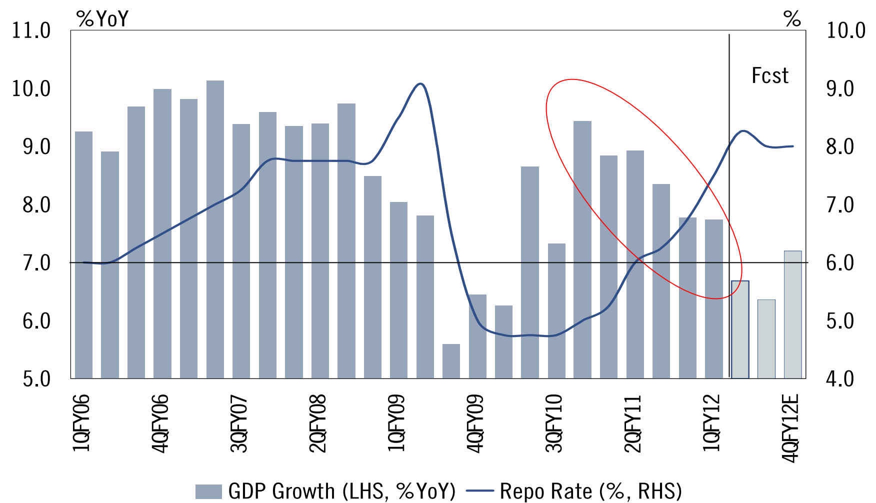
Further Cuts to GDP Forecasts: Will Trends hold over 7%?

The 2011 playbook of better prospects on the global front, including a delay in debt restructuring coupled with some decisive policy action on the domestic front, has not come about. Our global team now expects the hangover from the pre-recession credit boom to continue to cast a deep shadow across industrial-country growth in 2012 and beyond. In addition, domestic issues, including (1) supply-side bottlenecks in the coal and power sector and (2) the lagged impact of monetary tightening are taking a toll on domestic growth. Consequently, we are reducing our FY12 GDP estimates from 7.6% to 7.1% and for FY13 from 7.5% to 7.0%.

As mentioned earlier *(see India Macroscope - Global Contagion Risks Limited but No Room for Complacency)*, the current situation is becoming reminiscent of FY09, where we had (1) the global crisis, (2) delayed investments due to uncertainty on the election front, (3) aggressive policy tightening resulting in GDP slowing to 6% in 2HFY09 from 8%. Unfortunately, India has less maneuverability relative to the 2008 pullback given its (1) increased fiscal constraints, (2) elevated levels of inflation, and (3) government decision-making. This will likely result in weak growth, although recent policy action *(see p. 18 for details)* could help support 7% growth.

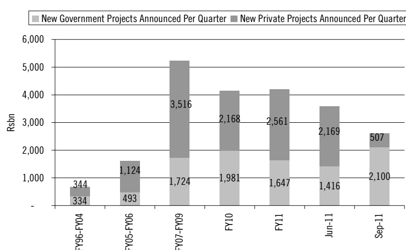
India has limited maneuverability for a big bounce-back due to increased fiscal constraints and elevated levels of inflation that prompted aggressive tightening

Figure 13. Trends in GDP and Interest Rates (%YoY)



Source: RBI, CSO, CIRA

Figure 14. New Project Announcements Per Quarter Coming Off Significantly



Source: CMIE, CIRA

Investments – No Capex Recovery in Sight

Policy uncertainty, coupled with restrictively high interest rates, has stifled fixed capital formation, with trends slowing from the 17%YoY CAGR seen during FY04-08 to low single digits in FY12. Our E&C analyst, Venkatesh Balasubramaniam[2], attributes poor investments to a confluence of a number of factors, most of which are related to a generalized policy paralysis:

1. **Lack of sufficient coal & gas:** A result of weak production by Coal India, and poor financials of State Electricity Boards (which rule out importing coal as an option).

[2] See '*Govt Projects Uptick Fails to Negate Private Projects Fall*', 11 Oct 2011

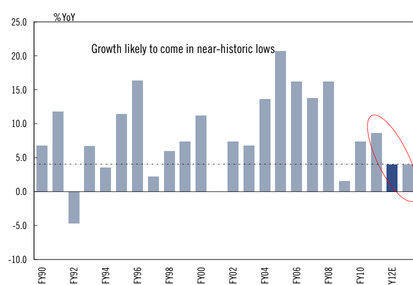
With fuel shortages coupled with policy bottlenecks hindering investments, our revised forecasts incorporate growth in fixed capital formation (FCF) slipping from 8.6%YoY in FY11 to just 4%YoY in FY12-13.

2. **High interest rates:** Corporates have been faced with restrictively high borrowing costs. While the rate cycle could turn next year, there would be a lagged impact that comes into play.

3. **Land acquisition and environmental clearance problems**. The recently tabled Land Acquisition bill may add clarity, but compensation costs may prove restrictive, resulting in failure for a number of fringe projects.

4. **Lack of major project announcements from Government**. Following the National Highways Development Program and Ultra-Mega Power Plants, there have been no major policy announcements on the infrastructure capex front. However, the Dedicated Freight Corridor could provide some thrust.

Figure 15. Trends in Fixed Capital Formation



Source: CSO, CIRA

He argues that none of these issues are likely to reverse soon. While a turn in the rate cycle, coupled with higher project announcements (in the run-up to elections), could support trends, this is insufficient to kick-start the capex cycle until FY14.

Capex growth key to a 7% GDP number: Taking into account the above, our revised forecasts incorporate growth in fixed capital formation (FCF) slipping from 8.6%YoY in FY11 to just 4%YoY in FY12-13. If FCF growth in FY13 remains flat or turns negative, headline GDP growth will likely come in the 5% to 6% range.

Consumption – Could Stay Steady due to Rural Demand, Wage Growth and Upcoming Elections

With the investment outlook remaining shaky, the key factors that could support headline GDP at ~7% levels is consumption, led by:

- **Strong rural demand**, on the back of higher agricultural incomes – a result of the government's employment scheme and an increase in minimum support prices of agricultural products. (*See Spotlight on Wages – Higher Wages Support Consumption, but Inflation Could Remain Sticky*).

GDP likely to see a lower growth trajectory due to:

(1) Recessionary global conditions

(2) Lagged impact of monetary tightening

(3) Uncertainty on domestic front

- **Major state elections next year**, in Gujarat, Punjab, UP, Uttarakhand, Manipur and Goa should fuel government spending.

- **The use of gold as collateral across income groups.** The emergence of gold financing companies has resulted in the growing use of gold loans for non-agricultural purposes and helped support consumption (*See Spotlight on Rising Gold Prices – Imports Rise and So Do Gold Loans).*

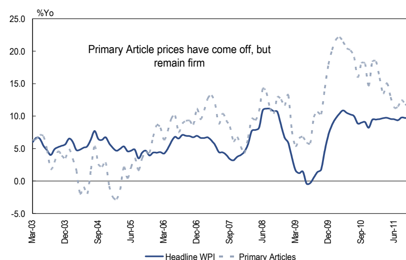
Figure 16. GDP – Trends and Components (%)

	FY06	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
Agriculture	5.1	4.2	5.8	-0.1	0.4	6.6	4.0	3.0
Industry	9.7	12.2	9.7	4.4	8.0	7.9	5.1	5.3
Services	11.0	10.1	10.3	10.1	10.1	9.4	8.9	8.8
Consumption	8.6	7.6	9.3	8.2	8.7	8.0	6.5	7.1
% to GDP	69.6	68.5	68.2	70.3	70.1	69.5	69.1	69.1
Private Consumption	8.5	8.3	9.3	7.7	7.3	8.6	6.6	6.8
Public Consumption	8.9	3.7	9.5	10.7	16.4	4.8	6.0	8.5
Gross Capital Formation	16.3	15.3	17.2	-3.1	13.8	9.3	3.4	3.4
% to GDP	34.5	36.4	38.9	35.9	37.5	37.6	36.3	35.1
Fixed Capital Formation	16.2	13.8	16.2	1.5	7.3	8.6	4.0	4.0
% to GDP	30.5	31.8	33.6	32.5	32.0	32.0	31.0	30.1
Net Exports (% to GDP)	-3.2	-3.8	-4.7	-7.2	-7.2	-5.6	-4.8	-3.7
GDP	9.5	9.6	9.3	6.8	8.0	8.5	7.1	7.0

Source: CSO, CIRA

Monetary Indicators

Figure 17. Trends in Primary Product WPI (%)



Source: Office of the Economic Advisor

Inflation – Could We See a New Tolerance Level?

Inflation remains elevated despite ~525ps of effective tightening and has averaged at 9.7% levels for the last two years. While there are cyclical factors at play, it does appear that structural factors have been playing a bigger role. This is largely due to:

- **Structural High Primary Product Inflation:** Over the last decade, per-capita income levels have gone up nearly four times, while agri output has remained stagnant – largely due to a poor investment in agriculture, and fragmentation of land holdings. With rising per capita incomes, per capita consumption of food has also been on an uptick, thus putting pressure on food prices. The issue is further exacerbated by 'nutrition transitions', with an ADB study pointing out that emerging economies are seeing shifts in dietary patterns, towards higher quality and protein-rich foods, like meat and dairy products. This, in turn, has resulted in a higher demand for grain for livestock feed *(production of 1kg of meat requires 7kg of grain).* While the recent approval for FDI in retail has been touted to bring down food inflation, there is an urgent need for steps to enhance agri productivity.

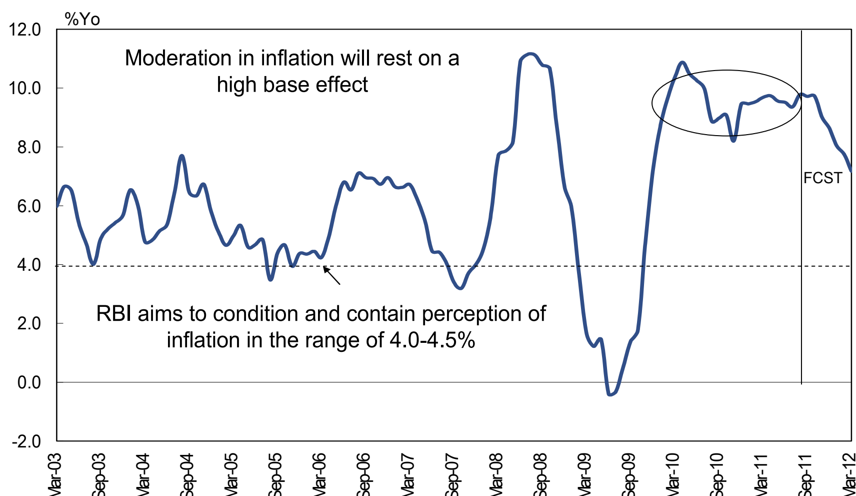
For instance between Aug08 and Mar09; the rupee depreciated 19%; but oil prices came off by 59%. This resulted in WPI moderating from 11% to 2%.

- **Commodities and Currencies:** The weight of commodities in the overall WPI is close to 60%, where prices have largely been driven by global liquidity conditions. While the RBI has been focusing on the 'non-food manufactured products' component as a measure of demand-side prices, interestingly, even in this sub-component of the WPI, more than 50% is linked to commodity prices. An important factor is the extent to which a decline in commodity prices is offset by exchange-rate depreciation. The key factors that could keep manufactured product inflation elevated are (1) Commodity prices are unlikely to collapse as much as in 2008 and (2) INR reversal is likely to be much less than that seen in 2008-09.

Outlook: Taking into account the above and a deteriorating fiscal position, we expect inflation to remain over 9% till the end of 2011 and average in 7.5-8% in 2012. This is nearly 2x the RBI's medium-term target of 4%. Another key variable to track next year will be the **new combined CPI**, which was released in Jan11 but for which no historical data are available. From Jan-12, YoY growth rates will be computable. In absolute terms, the index has moved from 106 at the start of the year to 114.2 points.

Taking into account food prices remaining structurally firm, coupled with a possible easing in commodity prices, we expect inflation to remain over 9% till end 2011 and ease to 7.5-8% in 2012

Figure 18. Likely Trajectory for the WPI (%YoY)



Source: Office of the Economic Advisor, CIRA

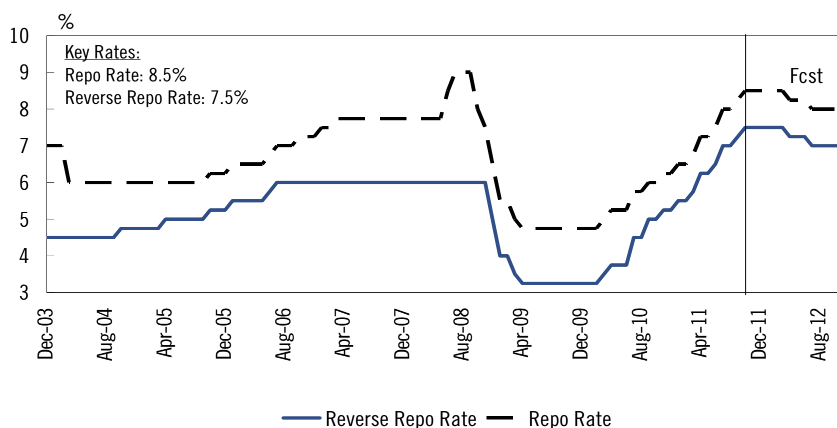
Easing Cycle – Stuck Between a Rock and a Hard Place

Despite aggressive tightening, inflation has remained strong but growth has slowed with industrial production/PMI trends at nearly-two year lows. In its latest policy, RBI stated that '*the likelihood of (further) rate action is relatively low*', however, the key issue now is its inflation tolerance level as inflation is way above its medium-term target of 4%. Given the sharp deceleration in growth, the possibility of lower commodity prices and a worsening in global macro conditions, we expect the RBI to begin its easing cycle by 2H12.

Despite 525bps of effective tightening, inflation has averaged 9.7% over the last 20+ months

With growth continuing to slow, we expect the RBI to possibly adopt a higher inflation tolerance level and begin easing rates by 2H12

Figure 19. Trends & Forecasts in Key Policy Rates (%)



Source: RBI, Ministry of Finance, CIRA

Banks' Asset Quality – A Growing Concern for 2012

Weakening growth, sharp currency depreciation and recent tightening has resulted in growing worries on the asset quality of banks

An emerging worry has been the asset quality of banks, due to weakening growth, a sharp currency depreciation that has added pressure to corporate balance sheets, and recent liquidity tightening. Concerns have been flagged with rating agency Moody's downgrading its outlook for the Indian banking system to Negative from Stable, earlier this month, due 'to *concerns that an increasingly challenging operating environment will adversely affect asset quality, capitalization, and profitability*'. This move followed close on the heels of Moody's downgrade of the rating of the State Bank of India – the largest lender.

Soon after, the RBI warned that '*rising interest rates and substantial amount of restructuring done during the crisis period…, are likely to put further pressure on asset quality of banks…. asset quality of banks needs to be closely watched…as the sticky loan portfolio of small and medium enterprises might rise.'*

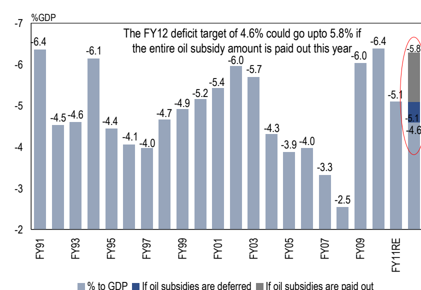
Current Trends – More Cyclical and Sector Specific

Our banks analyst Manish Chowdhary[3] points out that, unlike the wide-spread systemic concerns seen in the past cycles, in the current cycle, sectors with the most exposure include (1) Power, which comprises 7.3% of total loans. The key worry here is mounting losses of state electricity boards; (2) Real estate, which has a share of 3%; and (3) telecom, which has a share of 2.7%. Another emerging concern could be the aviation sector.

[3] *See Asset Quality – Tightening Liquidity Raises Risks*, 24 November 2011

Fiscal Indicators

Figure 20. Trends in the Fiscal Deficit (% GDP)



Source: Ministry of Finance<, CIRA

Fiscal Consolidation – Not Likely in the Near Future

FY12 slippages are factored in…On the fiscal front, progress on deficit consolidation witnessed between FY02-08 (when the centre's deficit fell from 6% of GDP to 2.5%) continues to see a reversal.

Trends this fiscal remain unchanged with revenues remaining below budget estimates while expenditures continue to overshoot. As seen in the table below, key slippages could arise from (1) Lower Tax Revenues, (2) Expenditure Overshoot, (3) Lower Divestment proceeds and (4) Higher oil under-recoveries

Possible Measures that could be used to minimize the Slippage

Taking into account the above, this would result in the deficit rising from the budgeted target of Rs4128bn to Rs5682bn – a slippage of Rs1554bn. However, it's unlikely that the final deficit figure would reflect such wide slippages. Instead, we could see the govt resort to a number of measures to bring down the deficit. These include deferring a part of total oil under-recoveries to FY13, similar to what was done last year; cushioning the shortfall in divestments appears to be topmost on the government's agenda.

Measures to meet the divestment target include (a) announcing higher dividends, (b) monetizing SUUTI (Specified Undertaking of the Unit Trust of India), which was formed by the restructuring of erstwhile UTI, (c) prompting cash-rich PSUs, such as Coal India and ONGC, to buy back the government's stake in the company, and (d) cross-purchases between various PSUs.

Figure 21. Oil Subsidy Sharing Mechanism (Rs Bn, %)

	FY11	FY12	
		Oil at US$100 /bbl	Oil at US$105/ bbl
Gross Under-recoveries	782	1,209	1,289
Less: upstream sharing	303	484	516
% of total	39%	40%	40%
Less: Govt share	410	655	704
% of total	52%	54%	55%
Net underrecoveries	69	70	70
Avg Crude (US$/bbl)	86.6	108	110

Notes (1) Oil assumptions are for 2HFY12, and INR at Rs50/$ (2) Exact Gov't and upstream share is not known for FY12 (3) Assuming net under-recoveries for OMCs stay flat yoy and upstream share stays at ~40%.Source: Citi Investment Research and Analysis

Figure 22. Expected Fiscal Slippages in FY12

	Current Run Rate	Budgeted for FY12	Assumed Slippage/Offsets (Rs Bn)
Likely Total Slippage			1,554
Tax Revenues (%YoY)	4.0%	18.0%	400
Expenditures (%YoY)	11.4%	3.4%	100
Divestments (Rs Bn)	11.5	400	350
Oil Under-recoveries (Rs Bn)	-	-	704
Possible Offsets:			754
Divestments (via buybacks, higher dividends)			350
Deferral of Oil Subsidies			404
Net Impact on Deficit			800

Source: CGA, Ministry of Finance, CIRA Estimates

Bottom Line: We expect the deficit to widen between 5.1-5.8% of GDP in FY12, depending on the extent of the payout of oil subsidies. This is higher than budgeted targets of 4.6% of GDP and thus this could result in additional funding requirements to the tune of Rs500bn over and above the recently announced extra Rs530bn borrowing program.

Emerging Pressure Points in FY13

Consolidation efforts may go awry in FY13 as well due to:

(1) SEB Losses

(2) Implementation of the Right to Food Act

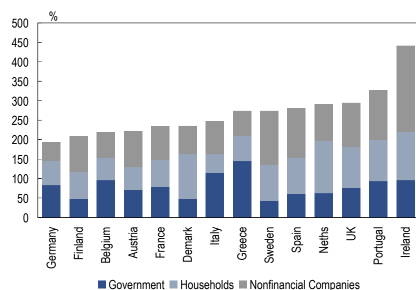
Bearing in mind state elections scheduled over the next calendar year, we do not expect to see significant consolidation on the fiscal front in FY13. Emerging risks in the coming year could arise from:

- **Losses of state electricity boards** – Total losses (without subsidies) amounted to over Rs635bn in FY11 from Rs267bn in FY07. Currently, electricity boards of five key states are making a bulk of total losses – these are Rajasthan, Tamil Nadu, Uttar Pradesh, Madhya Pradesh, and Bihar. According to Fitch, state

support to power utilities has averaged 1% of GDP, comprising mainly of subsidies, subventions, direct loans and loan guarantees.

- **Implementation of 'Right to Food' Act –** Touted as the next sweeping reform and possibly a key election plank for the Congress, the Right to Food Act, as proposed by Sonia Gandhi, would prove expensive if implemented. Estimates currently peg the additional expenditure at a minimum of Rs250bn.

Figure 23. Comparative Debt Ratios (% GDP)



Source: IMF

Debt – Higher But Sustainable

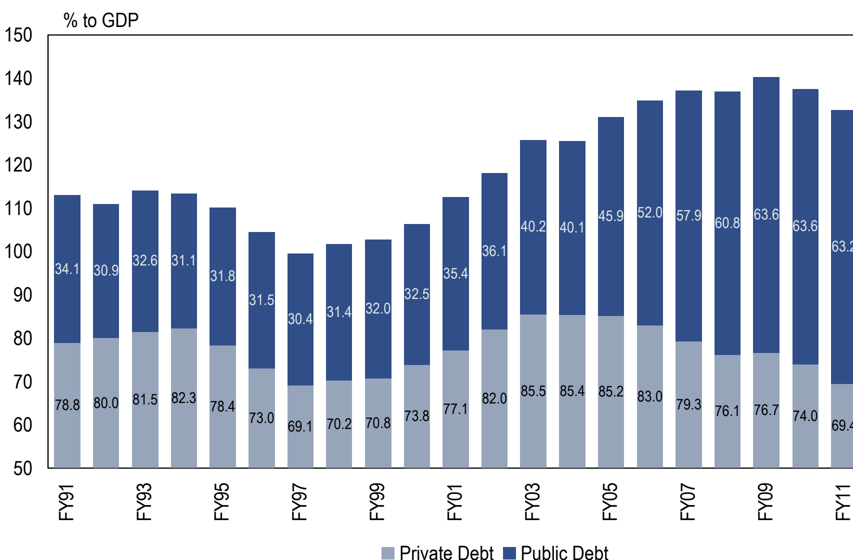
Given that India's high debt levels have flagged investor concern due to the current macro environment, we revisit the current situation. India's total debt to GDP has risen to 133% of GDP in FY11 from ~106% in FY00. This is categorized into:

- **Public Debt:** On the back of strong growth, India's public debt/GDP ratio has stabilized to 69.4% from 85%+ between FY03-05. This comprises largely of domestic public debt (65% of GDP), including rupee-denominated liabilities of both the centre and the states. External public debt has a share of 4.5% of GDP.

- **Private Sector Debt:** In contrast to public debt ratios which have been on a declining trend, India's private debt has risen from 32% of GDP in FY00 to 63% in FY11. The rise in private debt is on account of an increase in domestic debt (includes retail), as well as higher recourse to accessing cheaper funding overseas. Domestic private debt (using total bank credit as a proxy) comprises 50% of GDP, while external private sector debt has a share of 13.2% of GDP.

India's total debt is currently 133% of GDP with private debt at 63% and public debt at 69% of GDP

Figure 24. India's Total Debt – Trends and Components (% GDP)



Source: RBI, Ministry of Finance, CIRA

A key comfort factor on the debt front is that most of India's public debt is domestic in nature. Moreover, there is a large captive demand for bonds

Why India's Debt is relatively Manageable: (1) India funds its deficit through domestic sources with 95.7% of public debt being domestic. (2) It has a large captive demand for bonds through banks and insurance companies in India and (3) India's growth and rate dynamics are favorable, given that growth is higher than real interest rates. This allows flexibility in running primary deficits without leading to a rise in public debt/GDP.

External Sector

External Financing Requirements to Remain High

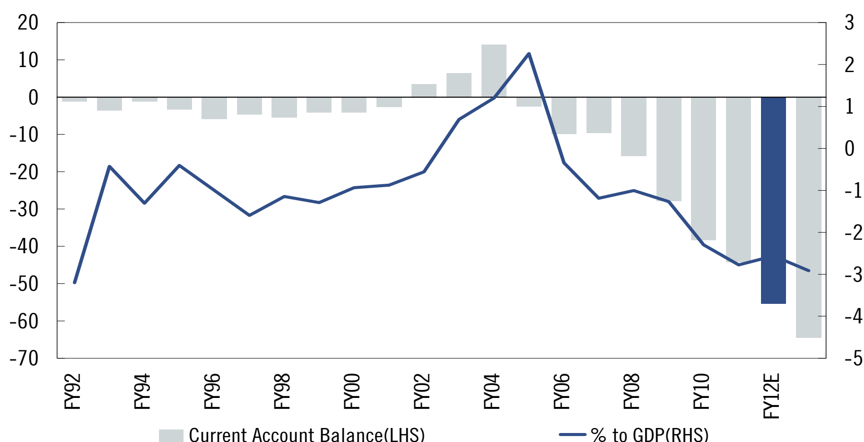
Current Account Deficit to Remain at ~3% of GDP

Despite the trade deficit likely to come in at ~8% of GDP, growth in invisibles (Software exports + remittances) is likely to keep the current account deficit (CAD) at ~3% of GDP. However, a key point to note is that, in absolute dollar terms, the CAD is now over US$55bn – twice the levels seen a few years back; thus implying that India needs to attract twice the amount of capital.

Although the current a/c deficit is likely to stay in the 3% of GDP range, in absolute numbers it's nearly double 2008 levels.

Moreover, given the current global scenario, recourse to external financing is becoming more difficult.

Figure 25. Trends in the Current Account Deficit (US$bn, % GDP)



Source: RBI, CIRA

Near-Term Debt Redemption Risks

Short-term debt by residual maturity is pegged US$137.3bn, with key pressure points being:

(1) Redemption pressures arising on ECBs/FCCBs

(2) Short-term trade credit -Rolling over trade credit could be difficult if overseas banks run out of lines on Indian banks, or if letters of credit are not renewed

Latest estimates peg India's total external debt at US$317bn. While the overall debt-GDP ratio has seen a decline and stands at a comfortable 17.4% of GDP and forex reserves are close to 100% of total external debt, a point to note is that, over last few years, there has been a rise in both short-term debt and commercial borrowings.

Figure 26. External Debt Snapshot (US$bn)

	FY07	FY08	FY09	FY10	FY11E	FY12E *
Total Long term debt	144.2	178.7	181.2	208.7	241.5	248.4
Multilateral	35.3	39.5	39.5	42.9	48.5	49.4
Bilateral	16.1	19.7	20.6	22.6	25.8	26.3
IMF	1.0	1.1	1.0	6.0	6.3	6.4
Trade Credit	7.2	10.3	14.5	16.9	18.6	18.7
Commercial Borrowing	41.4	62.3	62.5	70.8	88.9	93.2
NRI Deposits (> 1 year)	41.2	43.7	41.6	47.9	51.7	52.9
Rupee Debt*	2.0	2.0	1.5	1.7	1.6	1.6
Total Short term debt	28.1	45.7	43.3	52.3	65.0	68.5
FII Invst in T-Bills	0.4	0.7	2.1	3.4	5.4	5.9
Others (trade related)	26.0	41.9	39.9	47.5	58.5	61.5
Other	1.8	3.2	1.3	1.5	1.1	1.0
GROSS TOTAL	172.4	224.4	224.5	261.0	306.4	316.9
Short Term Debt by Residual Mty <1 Yr		82.1	93.3	107.7	129.0	137.2

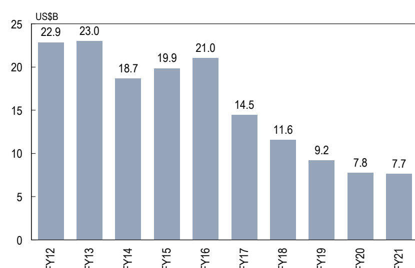
* As on June-11. Source: RBI

Figure 27. Short Term Debt by Residual Maturity <1 Year (US$bn)

	FY10	FY11	FY12*
1. NRI Deposits	38.0	40.5	43.4
2. Sovereign Debt	4.2	4.7	5.0
3. ST Debt (Original Mty)	52.5	65.0	68.5
4. Commercial Borr.	13.0	18.8	20.3
ST Debt (Residual Mty <1Yr)	107.7	129.0	137.2
Total External Debt	261.0	306.4	316.9

* As of June 11. Source: RBI

Figure 28. Debt Service Payments – Including External Assistance, ECBs & FCCBs (US$bn)



Source: Ministry of Finance, RBI

Continued current a/c deficits would result in only a modest accretion to FX reserves.

Our forecasts factor in overall accretion to reserves to the tune of US$5bn in FY12 and FY13 vs. the US$13bn rise seen in FY11

- **Short-Term Debt:** While short-term debt by original maturity stands at US$68.5bn, short-term debt by residual maturity is pegged US$137.3bn. Of this, NRI Deposits and Sovereign Debt comprising ~35% are normally rolled over. But, a key risk is short-term trade credit. Trade credit comprises 90% of total short-term debt by original maturity. Rolling over trade credit could be difficult if overseas banks run out of lines on Indian banks, or letters of credit are not renewed. This would particularly be the case for undercapitalized EA banks that have Indian counterparts.

- **Commercial Borrowings: Redemption Pressures on ECB/FCCBs:**

  - **Redemptions of Commercial Borrowings:** Over the last few years due to growing interest rate differentials, corporates have been accessing the overseas borrowing route. In addition to repayments, borrowers would also have to bear exchange rate risks associated with a falling rupee.

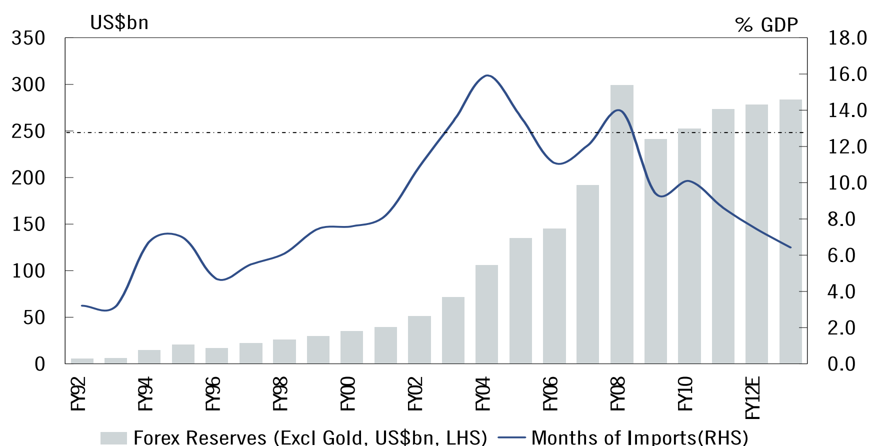
  - **FCCB Conversion Risks:** FCCBs worth over US$7bn are maturing in Mar-13, but most of them are out of the money and may not get converted. This would be negative for corporates (refinance – leading to higher interest costs or dilution of equity base) and for the macro (higher external financing).

Risk Aversion Likely to Result in Lower Forex Accretion

Risk-off environments normally result in lower flows to countries with twin deficits. Consequently, while flows are likely to remain sufficient to finance the CAD *(see pg 20)*, reserve accretion is likely to be lower due to the rise in external financing requirements. As seen below, reserves have barely inched up over the last three years. As a result, India's forex import cover has come off significantly.

Risks from deleveraging by European banks: Following shocks from the eurozone debt crisis, many euro area banks have announced plans to shrink their balance sheets. Consequently, cross-border funding will likely be the most vulnerable.[4] Given its high current account deficit, India could be relatively more impacted within the region. This again re-iterates the need for India to attract more foreign inflows.

Figure 29. Trends in Forex Reserves and Months of Import Cover (US$bn, Months)

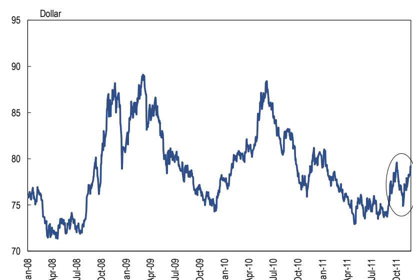


Source: RBI, Ministry of Finance, CIRA

[4] See R. Ghose et al. Half the World – *Global Implications of European Bank Deleveraging* (11 Nov 2011).

Financial Markets

Figure 30. Dollar Index



Source: Bloomberg

Global Back drop – Further USD gains

- **Global FX:** Our global strategists maintain their view that the EMU crisis, and elevated risk aversion, will generate further USD gains over the short to medium term. However, they have highlighted that a possible move to QE3 in the US will temper appreciation. Our team forecasts that EUR/USD will drop into a 1.25-1.30 range. They expect further near-term USD gains vs. commodity backed G10 currencies as commodity prices ease, with the NZD the worst performing

- **EM FX:** Our team expects uncertainties to continue for the three chief areas of the global economy that drive asset markets – Europe, China, and the US. Against this finely-balanced backdrop, our team forecasts that reserve-rich Asian currencies should do best, and EMEA, which is ultra-sensitive to Europe and surprisingly reserve-light, perform the worst. Latam, with highly dispersed sensitivities to the US and China and generally good reserve firepower, runs a middle course. The INR by contrast continues to grapple with twin deficits on the current and fiscal accounts, in an increasingly "stagflationary" domestic setting. India is in "industrial recession" with two successive quarters of falling production, and weaker leading/monetary data.

Figure 31. Quarterly FX Forecasts

	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Euro	1.33	1.30	1.28	1.26	1.26	1.27	1.28
Japanese Yen	76.00	75.00	75.00	76.00	76.00	77.00	77.00
British Pound	1.58	1.57	1.55	1.53	1.54	1.57	1.60
Swiss Franc	0.93	0.96	0.97	0.98	0.99	1.00	1.02
Australian Dollar	0.98	0.96	0.96	0.95	0.95	0.95	0.95
Brazilian Real	1.79	1.78	1.75	1.72	1.70	1.70	1.70
EM Asia							
Chinese Renminbi	6.30	6.24	6.18	6.12	6.05	6.00	5.93
HK Dollar	7.78	7.77	7.77	7.76	7.76	7.75	7.75
Indonesian Rupiah	9300	9200	9000	8900	8800	8750	8700
Indian Rupee	51.00	50.00	49.80	49.50	49.00	48.50	48.00
Korean Won	1130	1110	1095	1080	1050	1040	1020
Malaysian Ringgit	3.20	3.11	3.09	3.06	3.00	2.96	2.94
Philippine Peso	43.70	43.50	43.00	42.80	42.00	42.00	41.5
Singapore Dollar	1.29	1.26	1.25	1.24	1.22	1.21	1.19
Thai Baht	30.90	30.80	30.70	30.50	30.30	30.00	29.9
Taiwan Dollar	30.20	30.20	29.80	29.50	29.20	28.80	28.5

Source: *Citi Foreign Exchange Forecasts* dated Nov 18, 2011

Figure 32. Comparative Currency Trends

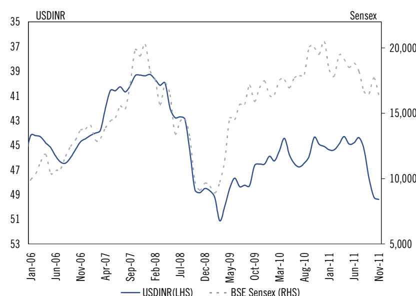
	Aug-08	Mar-09*	Jul-11	Latest**
EURO	1.47	1.26	1.44	1.32
JPY	108.80	98.16	76.76	77.74
GBP	1.82	1.41	1.64	1.54
CHF	1.10	1.18	0.79	0.93
CNY	6.84	6.84	6.44	6.37
IDR	9148	12100	8506	9215
INR	43.95	51.97	44.20	52.24
KRW	1089	1552	1054	1163
BRL	1.63	2.42	1.56	1.89

Source: * 3-Mar-09. **25-Nov-11. Source: Bloomberg

The Rupee – Trends, Triggers, Implications and Outlook

- **Trends: The Rupee has been the worst performing currency in the region** — Following the US downgrade and escalation problems in the euro area, rising risk aversion has resulted in the INR breaking out of its nearly two-year long trading range of Rs44-Rs46/US$. Since August the INR has weakened ~16%, touching an all-time low of Rs52.7/US$ on 22 November. Recent RBI intervention has resulted in a marginal recovery to 52.2/$. However, given global/domestic factors, we expect the INR to remain weak over the next few months.

Figure 33. Trends in the INR vs. the BSE Sensex



Source: RBI, BSE

- **Triggers: Both Global and Local** — While oil payments to Iran in August 2011 and risk aversion acted as initial catalysts, the deterioration on the domestic macro front accompanied by lower inflows have resulted in a sustained fall in the currency.
  - **Risk Aversion:** In times of risk aversion, India immediately comes on the radar due to its external financing requirements arising due its current account deficits, redemption pressures on its borrowings and rise in short-term debt.
  - **Domestic Fundamentals have taken a turn for the worse:** These include the (1) domestic policy gridlock, (2) elevated levels of inflation despite 525bps of effective tightening, (3) likelihood of a near 1%+ fiscal slippage, (4) October's record-high US$20bn trade deficit and (5) growth expectations coming off significantly. This has resulted in equity flows slowing to US$1.2bn so far this fiscal vs US$24.4bn last year.
- **Implications** — Apart from a higher import bill, rupee depreciation is likely to complicate macro management: (1) Inflation is likely to remain elevated as input costs across all components could see an increase. (2) This would also be a drag on the fiscal situation, as every Rs1 depreciation increases oil under-recoveries by Rs80bn.
- **RBI Steps In** — The RBI has stepped in to curb volatility, and announced a special window to sell USD to state-run oil importers (which would relieve market buying by ~USD350m per day). It has also removed the US$100m limit on net FX supply through rupee swaps. While there is unlikely to be a large intervention for fear of eroding reserves, we could see measures to encourage inflows via higher FDI limits, NRI deposits, and dollar swap-lines.
- **Outlook** — Our forecasts factor in continued near-term weakness and a modest medium-term bounce by mid-2012 on account of relatively higher domestic growth, favorable composition of external debt and a domestically financed fiscal deficit. However, a key point to note is that, unlike the sharp reversal one saw post the 2008 crisis (*the unit reversed from a low of Rs52.2/US$ to Rs47/$ levels in a few months*), this time around we expect a modest bounce-back; as forex accretion is likely to remain muted due to an increase in external financing requirements. Our forecasts are for the INR to bounce back to Rs50/US$ by March 12 and Rs48.5/US$ by Mar13.

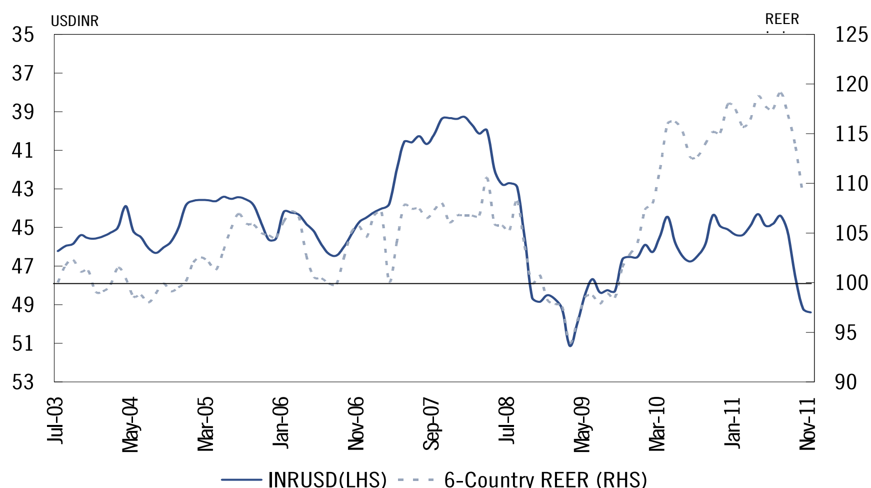
CATCH-UP TO FUNDAMENTALS?

In a sense, the current round of INR depreciation can be viewed as a catch-up to fundamentals.

The six-country Trade-based REER, available till Oct 28 is at 108.7 (Base 2004-05) and 106.5 (Base 2009-10)

The six-country REER is the weighted average of bilateral exchange rates, adjusted for relative inflation rates. Comprises (1) US dollar (2) Euro-zone (Euro) (3) UK (Pound Sterling), (4) Japan (Yen), (5) China (Yuan) and (6) Hong Kong (Dollar).

Figure 34. Trends in the INR vs. the REER (Six- Country Trade Weighted, 2004-5=100)



Source: RBI

Policy Watch

FDI in Multi-Brand Retail – Hopefully Approved

The Union Cabinet has approved 51% FDI in multi-brand retail and raised the limit for FDI in single-brand retail from 51% to 100%. The move, if accepted, will help improve competition in the organized sector through the entry of several players such as Carrefour, Wal-Mart, and Tesco, which have been waiting on the sidelines, and enhance expertise in logistics, supply chain management from multinationals.

Ass seen in the case of China, which opened up FDI in retail trade in 2004, investments may gather steam over a few years as companies typically begin pumping in investments over time

While there are some conditions attached, this would also help enhance the share of the organized sector, which is currently just ~6% in India's US$470bn retail market. Our consumer analyst Jamshed Dadabhoy estimates that the potential FDI that could come in through this channel could be US$15-20bn.

RBI Begins to Move + Further Possible Steps

Given the recent sharp movement in the Rupee, coupled with continued risk aversion, we expect the RBI to remain proactive in the coming months. Over the last few days, we have already seen a number of measures taken by the government/RBI to encourage foreign inflows and curb INR volatility, including (1) Announcing a special window to sell USD to **state-run oil importers** (which would relieve market buying by ~USD350m per day) and (2) Removing the US$100m limit on **net FX supply** through rupee swaps. As seen below, other measures include:

Figure 35. Key Measures Taken to Encourage Foreign Inflows

Instrument	Measure
ECBs	Loans with a maturity between 3-5 years can now be raised at a spread of Libor+350bps from Libor +300bps previously. Moreover, funds raised must be brought back into India immediately
NRI Deposits	Rates on Non-Resident (External) Rupee (NRE) Term Deposits for 1-3 years maturity have been raised to Libor +275bps, from Libor + 175bps earlier. Rates on Foreign Currency Non-Resident (Banks) (FCNR(B)) deposits have been raised to Libor +125bps from Libor + 100bps earlier

Source: RBI

Further Possible Measures include opening FDI to more sectors, the possibility of a commercial dollar bond issue, measures to bring in accounted money parked overseas, dollar swap-lines, and permitting FCCB buybacks.

Winter Session of Parliament

New bills to be tabled include the National Food Security Bill, and Mines and Minerals Bill.

The winter session of parliament, scheduled during 22 Nov - 21 Dec 2011 initially got off to a stormy start. While the Cabinet has approved FDI in retail and the Companies Bill, the former is still under debate. Moreover, there are several pending bills due for consideration. New bills to be tabled include the National Food Security Bill, and Mines and Minerals Bill. However, bills on Land Acquisition, Direct Tax Code, and Banking and Insurance have been postponed for consideration.

Figure 36. Key Bills Due for Consideration and Passing in the Winter Session

Title	Comments
The Lokpal Bill, 2011	Aims to institute a Lokpal to enquire into allegations of corruption against public functionaries
The Public Interest Disclosure and Protection to Persons Making the Disclosures Bill, 2010	Aims to set up a mechanism to receive corruption complaints against public servants
The Pension Fund Regulatory and Development Authority Bill, 2011	Gives statutory status to the PFRDA
The Judicial Standards and Accountability Bill, 2010	Seeks to enhance accountability of judges and establish mechanisms for misbehavior/incapacity of SC/HC judges
The Petroleum and Minerals Pipelines Amendment Bill, 2010	Seeks to amend the Petroleum and Mineral Pipelines Act, which provides for acquisition of right of user in land for laying pipelines.

Source: PRS Legislative Research

Figure 37. India — Key Monthly Indicators (percent change from a year ago unless otherwise stated)

	Sept10	Oct10	Nov10	Dec10	Jan11	Feb11	Mar11	Apr11	May11	Jun11	Jul11	Aug11	Sept11	Oct11
Consumption Trends														
Two-Wheelers	19.9	50.3	17.7	31.1	17.5	22.0	19.1	22.0	14.5	14.8	12.6	16.1	22.7	1.8
Passenger Car Sales	30.4	38.0	20.8	29.0	26.3	22.9	24.8	13.1	7.0	1.5	-15.8	-10.1	-1.9	-24.3
Commercial Vehicle Sales	30.8	19.4	18.3	27.3	13.7	10.4	15.3	8.5	15.9	18.8	24.8	23.5	18.8	21.6
LCV	17.8	25.0	22.7	36.4	20.4	9.7	13.5	14.9	22.4	31.2	37.9	36.1	36.6	19.8
MHCV	46.2	12.7	13.4	18.0	6.6	11.2	17.0	0.9	8.6	6.2	10.4	9.8	1.8	23.9
Investment Trends														
Infrastructure Index	3.3	7.2	3.6	6.2	6.4	5.2	6.3	4.6	5.6	5.5	7.8	3.7	2.3	
Cement Dispatches	6.9	18.7	-5.4	-3.1	1.4	7.2	5.5	-0.2	-0.1	1.6	10.4	6.1	1.3	
Diesel Consumption	1.7	4.0	3.9	9.6	6.2	5.5	5.8	1.4	10.7	2.9	5.3	6.4	9.8	
Steel Production	7.6	0.9	2.6	6.7	9.3	NA	6.9	4.8	5.4	14.4	7.2	17.3	6.7	5.4
Manufacturing PMI*	55.1	57.2	58.4	56.7	56.8	57.9	57.9	58.0	57.5	55.3	53.6	52.6	50.4	52.0
Output	58.4	62.8	63.7	61.4	62.6	62.7	62.6	63.9	63.2	58.4	57.2	56.0	51.1	52.7
New Orders	58.7	60.6	62.2	59.3	60.7	62.4	64.2	63.1	62.4	60.1	54.5	53.1	51.3	53.7
Industrial Production Index														
General	6.1	11.3	6.4	8.2	7.5	6.7	9.4	5.3	6.1	9.5	3.8	3.6	1.9	
Manufacturing	6.9	12.4	6.5	8.7	8.1	7.5	11.0	5.7	6.3	11.2	3.2	4.0	2.1	
Mining	4.3	6.1	6.9	5.9	1.7	1.2	0.4	1.6	1.8	-1.4	1.5	-4.1	-5.6	
Electricity	1.8	8.8	4.6	6.0	10.5	6.8	7.2	6.4	10.3	7.9	13.1	9.5	9.0	
Use Based Basic Goods	3.5	9.8	5.7	7.8	7.7	5.6	6.4	7.1	7.5	7.8	9.5	5.2	4.5	
Capital goods	7.2	21.0	25.7	20.2	5.3	-5.7	14.5	6.7	6.2	38.7	-13.8	4.0	-6.8	
Intermediate goods	4.6	9.7	4.3	8.1	7.4	6.3	3.0	3.9	0.1	1.6	-0.6	1.9	1.5	
Consumer goods	9.7	9.3	0.7	3.6	8.2	13.4	13.2	3.2	7.2	3.1	7.7	2.2	3.5	
Consumer Durables	14.2	14.3	7.2	7.8	12.5	18.2	14.9	1.6	5.1	1.6	9.0	5.5	8.7	
Consumer Non-Durables	5.8	5.1	-4.4	0.7	5.0	9.7	11.9	4.6	9.0	4.4	6.5	-0.5	-1.3	
Services														
Major Port traffic	4.4	4.3	-4.9	3.2	0.9	1.4	3.9	6.1	3.7	5.4	3.7			
Railway freight	2.3	7.1	5.2	2.1	5.4	5.9	5.1	7.4	7.4	6.2	7.4			
Tourist arrivals ('000)	369	487	606	655	538	692	507	417	369	396	498	402	401	563
Cellular subscriber Adds (Mn)	17.2	19.0	23.2	22.5	19.1	20.2	20.0	15.9	13.0	11.4	7.0	7.5	6.5	7.1
Banking Trends														
Money supply(M3)	14.9	16.2	16.0	15.6	16.4	16.7	16.6	17.3	16.9	17.2	16.7	17.0	16.3	15.3
Loan(Credit) growth	19.4	21.1	22.4	23.7	23.4	23.5	23.2	21.5	22.1	20.4	19.2	20.4	18.9	18.9
Deposit growth	14.5	16.9	15.0	15.4	16.2	16.7	16.6	17.0	16.9	18.0	15.9	18.1	16.6	15.4
Non-food credit	19.5	20.6	22.3	23.6	23.2	23.4	22.3	22.1	20.3	18.2	20.1	20.2	19.7	19.3
Inflation														
CPI	9.8	9.7	8.3	9.5	9.3	8.8	8.8	9.4	8.7	8.6	8.4	9.0	10.1	
WPI	9.0	9.1	8.2	9.4	9.5	9.5	9.7	9.7	9.6	9.5	9.4	9.8	9.7	9.7
Manufactured Products	5.0	5.1	5.0	5.4	5.3	6.3	7.4	6.8	7.4	7.9	7.7	7.9	7.7	7.7
Primary Products	18.2	18.1	14.7	18.4	18.4	15.9	13.4	15.1	12.9	11.3	11.5	12.5	11.8	11.4
Fuel Index	11.1	11.0	10.3	11.3	11.4	12.4	12.5	13.0	12.3	12.8	12.0	12.9	14.1	14.8
Interest rates (Average, %)														
Call money rate	5.5	6.2	6.7	6.7	6.5	6.7	7.2	6.6	7.2	7.3	7.6	8.0	8.1	8.3
91-day T-Bills	6.3	6.9	6.9	7.2	7.2	7.1	7.3	7.5	8.1	8.2	8.4	8.4	8.4	8.7
Corp Bond Spreads (5y GOI-AAA)	0.6	0.6	0.6	0.8	0.9	1.0	1.0	1.0	0.9	1.1	0.9	0.9	0.9	0.8
10-year government bond	7.9	8.1	8.0	8.0	8.2	8.1	8.0	8.0	8.3	8.3	8.3	8.3	8.3	8.7
Trade - customs data***														
Exports(%YoY)	24.5	21.4	44.1	60.0	57.6	75.7	51.9	34.7	67.8	46.4	81.8	44.3	36.4	10.8
Imports(%YoY)	37.1	12.4	5.4	2.6	23.8	24.7	19.1	20.5	69.9	42.5	51.5	38.9	17.2	21.7
Oil	22.7	-3.9	-1.0	2.5	13.9	12.9	56.7	37.5	53.3	30.1	37.0	43.6	14.6	14.3
Non-oil	43.4	20.2	8.1	2.7	28.8	30.1	3.5	12.7	77.7	47.8	58.1	37.3	18.2	43.7
Trade Deficit (US$bn)	-11.3	-11.2	-4.8	-2.6	-6.7	-4.9	-4.5	-12.3	-17.3	-7.7	-11.1	-14.0	-9.8	-19.6
Brent Prices ($/bbl)	78.4	83.4	86.2	91.8	97.0	104.3	114.7	123.0	114.5	113.7	116.6	110.0	109.8	108.8
Foreign investment (US$ mn)														
FII	5,428	6,421	4,117	450	-1,054	-1,007	1,097	1,618	-1,480	1,014	1,807	-2,394	7	347
FDI	2,118	1,392	1,628	2,014	1,042	1,274	1,075	3,121	4,664	5,656	1,099	2,830	1,765	
Exchange rate and reserves														
US$ exchange rate average	46.0	44.4	45.0	45.1	45.4	45.4	45.0	44.4	44.9	44.8	44.2	45.3	47.7	49.2
US$ exchange rate month end	45.0	44.4	45.9	44.7	45.9	45.3	44.6	44.2	45.1	44.7	44.4	46.1	49.0	48.7
Forex reserves incl.gold (US$bn)	287.7	298.0	294.0	297.3	299.2	300.8	303.5	313.5	310.2	309.0	319.1	319.2	311.5	320.4

* Values over 50 indicate expansion. ** Only GSM subscribers available. *** Provisional. Source: CSO, RBI, Ministry of Finance, Markit

Balance of Payments

Figure 38. India – Trends and Forecasts in the Balance of Payments (US$B, %)

	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E	Comments
CURRENTACCOUNT								
Exports(RBI)	128.9	166.2	189.0	182.2	250.5	298.1	357.7	
Y/Y%	22.6	28.9	13.7	(3.6)	37.4	19.0	20.0	Export growth is likely to moderate to 19% levels in FY12
% of GDP	13.6	13.4	15.6	13.2	14.5	15.7	16.8	Latest Data Oct11 Exports +10.8%YoY; Imports up
Exports–Customs*	126.4	162.9	182.8	178.8	254.4	302.7	363.3	21.7%YoY
Y/Y%	22.6	28.9	12.2	(2.2)	42.3	19.0	20.0	
Imports(RBI)	190.7	257.6	308.5	300.6	380.9	449.5	530.4	
Y/Y%	21.4	35.1	19.8	-2.6	26.7	18.0	18.0	
%to GDP	20.1	20.8	25.4	21.8	22.0	23.7	24.9	
Imports-Customs*	185.7	251.4	298.8	288.3	352.6	430.7	490.1	
Y/Y%	24.5	35.4	18.8	-3.5	22.3	22.1	13.8	
Of which Oil	56.9	79.6	93.7	87.1	106.1	137.3	138.1	Indian crude at US$102bbl in FY12; US$95/bbl in FY13
Y/Y%	29.5	39.9	17.6	-7.0	21.8	29.5	0.5	∆US$1/bbl in oil prices=US$800m impact on deficit
Non-Oil	128.8	171.8	205.2	201.2	246.5	293.3	352.0	
Y/Y%	22.4	33.4	19.4	-1.9	22.5	19.0	20.0	
a. Trade balance (RBI)	-61.8	-91.5	-119.5	-118.4	-130.5	-151.4	-172.7	Latest Data: April-Oct Trade deficit at US$91.7bn
% of GDP	-6.5	-7.4	-9.8	-8.6	-7.6	-8.0	-8.1	vs.US$72bn last year
Trade Balance(Customs)	-59.3	-88.5	-116.0	-109.6	-98.2	-127.9	-126.8	
Difference bet. RBI and Customs Data	-2.5	-2.9	-3.5	-8.8	-32.3	-23.5	-46.0	Difference normally represents defense imports. FY11
b. Invisibles	52.2	75.7	91.6	80.0	86.2	96.1	108.2	numbers could see a revision thus impacting FY12 fcsts
Non-factor services	29.5	38.9	53.9	35.7	47.7	55.9	65.8	
Of which: Software Services	29.0	36.9	43.5	48.2	56.8	65.9	75.8	
Non-Software Services	0.4	1.9	10.4	-12.5	-9.1	-10.0	-10.0	
Investment income	-7.3	-5.1	-7.1	-8.0	-14.9	-14.0	-14.0	
Remittances**	29.8	41.7	44.6	52.1	53.4	54.0	56.0	
Official transfers	0.3	0.2	0.2	0.3	0.0	0.2	0.4	
1.Currenta/cbalance (a+b)	-9.6	-15.7	-27.9	-38.4	-44.3	-55.4	-64.6	
% of GDP	-1.0	-1.3	-2.3	-2.8	-2.6	-2.9	-3.0	Current a/c to widen to 2.9 % of GDP in FY12
CAPITALACCOUNT								
c. Loans	24.5	40.7	8.3	13.3	27.9	27.5	20.0	Latest Data: ECBs during Apr-Sept at US$18.3bn vs.
External assistance	1.8	2.1	2.4	2.9	4.9	4.5	2.0	US$10.7b last yr. Recent liberalization in ECB norms
Commercial borrowings***	16.1	22.6	7.9	2.8	11.9	16.0	12.0	and interest rate differentials could support flows.
Short-term credit	6.6	15.9	-2.0	7.6	11.0	7.0	6.0	
d. FDI(Net=a-b)	7.7	15.9	19.8	18.8	7.1	20.0	25.0	Latest Data: FDI during Apr-Sept at US$19.1b vs.
(a)FDI-To India	22.7	34.7	37.7	33.1	23.4	35.0	37.0	US$11bn last yr. FDI in retail, BP – Reliance Deal
(b)FDI-Abroad	-15.0	-18.8	-17.9	-14.4	-16.2	-15.0	-12.0	expected to boost inflows
e. Portfolio Invst(FII+ADRs/GDRs)	7.1	27.4	-14.0	32.4	30.3	5.0	20.0	Latest Data: FII equity inflows during Apr-Nov at
f. Banking Capital	1.9	11.8	-3.2	2.1	5.0	7.0	4.5	US$1.2bn vs. US$24.4bn last year
Of which NRI deposits	4.3	0.2	4.3	2.9	3.2	4.0	3.5	Latest Data: NRI deposits during Apr-Oct FY12
g. Rupee debt service	-0.2	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4	US$2.4bn , flat from last year
h. Other capital****	4.2	11.0	-4.0	-13.0	-10.4	1.0	1.0	
2.Capitala/c(c+d+e+f+g+h)	45.2	106.6	6.8	53.4	59.7	60.1	70.1	
Errors & Omissions	1.0	1.3	1.1	-1.6	-2.4	0.0	0.0	
Overall balance(1+2)	36.6	92.2	-20.1	13.4	13.1	4.7	5.5	
Forex								
Forex assets	191.9	299.1	241.6	252.8	273.7	278.4	297.5	
FCA to months of imports	12.1	13.9	9.4	10.1	9.0	7.4	6.9	
Exchange rate								
Rs/US$-annual avg	45.2	40.2	46.0	47.4	45.6	48.1	49.2	
%depreciation	2.0	-11.1	14.4	3.0	-3.8	5.5	2.3	
Rs/US$-yearend	43.6	40.1	50.7	44.9	44.6	50.0	48.5	
%depreciation/(-)appreciation	-2.3	-8.0	26.4	-11.4	-0.7	12.1	-3.0	

*Data on exports and imports differ from those given by DGCI&S on account of differences in coverage, valuation and timing (e.g. RBI data on imports includes defence).** Remittances - 50% are for family maintenance; balance is local withdrawal from NRI rupee deposits. ***Commercial Borrowings include US$4.1bn of the Resurgent Bond Issue repaid in September 2003 and repayment of India Millennium Bonds in FY06. **** Other capital refers to leads and lags in exports, advances received pending issue of shares, funds held abroad. Source: RBI, CIRA Estimates.

Direction and Composition of Trade

Figure 39. India — Composition of Imports (US$bn, %)

	FY06	FY07	FY08	FY09	FY10	FY11
Petroleum crude& products	44.0	57.1	79.7	91.5	86.8	105.9
% to total	29.5	30.8	31.9	30.6	30.2	30.1
% YoY	47.3	29.8	39.6	14.8	-5.1	22.0
Capital goods	24.3	30.8	49.8	48.5	44.5	49.9
% to total	16.3	16.6	20.0	16.2	15.5	14.2
% YoY	61.0	26.8	61.9	-2.8	-8.2	12.2
Gold & Silver	11.3	14.6	17.9	22.8	29.6	35.6
% to total	7.6	7.9	7.1	7.6	10.3	10.1
% YoY	1.5	29.1	22.1	27.8	29.8	20.2
Pearls precious stones	9.1	7.5	7.3	16.6	16.2	31.3
% to total	6.1	4.0	2.9	5.5	5.6	8.9
% YoY	-3.0	-18.1	-2.0	126.5	-2.6	93.3
Chemicals, related products	11.4	13.8	18.7	29.2	23.5	27.4
% to total	7.6	7.5	7.5	9.8	8.2	7.8
% YoY	30.6	21.6	34.8	56.7	-19.7	16.8
Electronic Goods	13.2	15.9	20.2	23.4	21.0	21.5
% to total	8.9	8.6	8.1	7.8	7.3	6.1
%YoY	32.5	20.3	26.7	15.8	-10.3	2.5
Food & related items	3.3	4.9	5.3	5.8	10.0	10.0
% to total	2.2	2.7	2.1	1.9	3.5	2.8
% YoY	-7.2	50.5	8.8	8.3	72.9	-0.3
Other non-POL items	24.6	33.8	42.7	52.2	46.8	56.1
% to total	16.5	18.3	17.1	17.4	16.3	15.9
% YoY	37.0	37.3	26.2	22.4	-10.4	19.9
Other commodities	7.9	6.6	8.2	9.3	9.3	14.6
% to total	5.3	3.6	3.3	3.1	3.2	4.1
% YoY	37.1	-16.5	24.1	13.4	-0.4	56.9
TOTAL IMPORTS	149.1	185.1	249.8	299.3	287.6	352.3
% YoY	33.8	24.1	35.0	19.8	-3.9	22.5

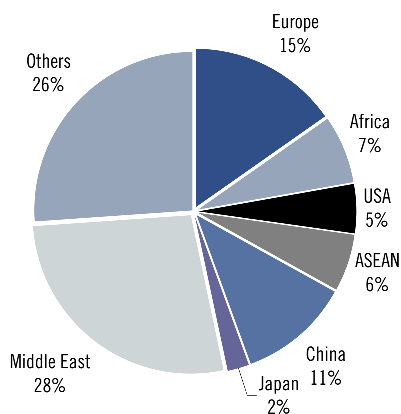
Source: CMIE ,RBI

Figure 40. Composition of Exports (US$bn, %)

	FY06	FY07	FY08	FY09	FY10	FY11
Engineering goods	21.6	29.5	37.2	47.0	38.1	68.8
% to total	21.0	23.3	22.8	25.7	21.4	27.3
%YoY	25.1	36.3	26.4	26.3	-18.9	80.5
Petroleum, crude prods	11.6	18.7	28.4	26.9	28.0	42.0
% to total	11.3	14.8	17.4	14.7	15.7	16.7
%YoY	66.6	60.4	52.0	-5.3	4.3	49.9
Gems & Jewellery	15.5	16.0	19.7	28.0	29.0	36.6
% to total	15.1	12.6	12.1	15.3	16.3	14.5
%YoY	12.9	2.8	23.3	42.2	3.6	26.2
Agri, allied products	10.2	12.7	18.4	17.6	17.7	24.7
% to total	9.9	10.0	11.3	9.6	10.0	9.8
%YoY	20.6	24.1	45.5	-4.8	1.1	39.2
Chemicals & related	10.3	12.1	15.6	17.3	17.4	21.5
% to total	10.0	9.6	9.5	9.5	9.7	8.5
%YoY	28.4	18.1	28.3	11.3	0.4	23.7
Textiles (incl RMG)	16.4	17.4	19.4	20.0	19.9	23.4
% to total	15.9	13.7	11.9	10.9	11.1	9.3
%YoY	21.0	5.9	11.9	3.2	-0.9	17.6
Ores & minerals	6.2	7.0	9.1	7.8	8.7	10.7
% to total	6.0	5.5	5.6	4.3	4.9	4.2
%YoY	21.4	13.6	30.4	-14.4	11.0	23.0
Other manuf goods	6.0	6.9	7.6	7.4	7.5	10.0
% to total	5.9	5.5	4.7	4.0	4.2	4.0
%YoY	6.0	14.8	9.8	-2.8	1.6	33.4
Other commodities	2.5	3.1	4.0	7.5	8.6	10.5
% to total	2.4	2.4	2.5	4.1	4.8	4.2
%YoY	11.0	22.5	30.5	86.9	15.2	21.1
TOTAL EXPORTS	103.1	126.3	163.0	183.1	178.3	252.0
% YoY	23.4	22.5	29.1	12.3	-2.6	41.3

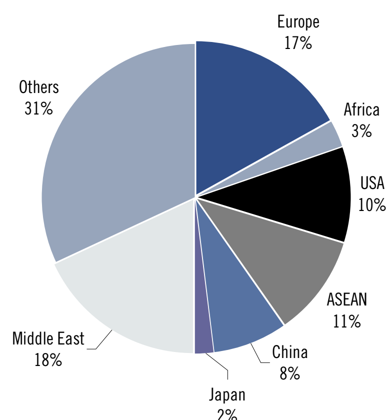
Source: CMIE, RBI

Figure 41. Direction of Imports FY11



Source: DGCI&S, CMIE

Figure 42. Direction of Exports FY11



Source: DGCI&S, CMIE

Snapshot of Government Finances

Figure 43. India — Snapshot of Central Government Finances (Rs Bn, %)

	FY06	FY07	FY08	FY09	FY10	FY11RE	FY12BE	BUDGET FY12– KEY HIGHLIGHTS
a. Gross Tax Revenue	3,662	4,735	5,931	6,053	6,245	7,869	9,324	
% to GDP	9.9	11.0	11.9	10.8	9.5	10.0	10.4	Revenues
% YoY	20.1	29.3	25.3	2.0	3.2	26.0	18.5	Key Assumptions: Income Tax +16.2%,
Corporation tax	1,013	1,443	1,929	2,134	2,447	2,964	3,600	Customs +15.1%, Excise +19.2%,
Income tax	560	751	1,026	1,060	1,224	1,416	1,645	Corporate +21.5%, Service +18.2%
Excise duty	1,112	1,176	1,234	1,086	1,030	1,373	1,636	
Import duty	651	863	1,041	999	833	1,318	1,517	Apr-Sept Trends
Service tax	231	376	513	609	584	694	820	Income Tax +17.3%; Customs +22.5%
b. (-) Devolvement to States & UTs	972	1,223	1,536	1,620	1,680	2,232	2,680	Excise +13.9%, Corporate: -6%
c. Net tax revenues (a-b)	2,689	3,512	4,395	4,433	4,565	5,637	6,645	Service +37.5%
d. Non tax revenues	768	832	1,023	969	1,163	2,201	1,254	
e. Net revenue receipts (c+d)	3,471	4,344	5,419	5,403	5,728	7,838	7,899	
f. Non-debt capital receipts	122	64	439	67	332	317	550	Divestment targets unlikely to be met
Recovery of loans	106	59	51	61	86	90	150	
Divestments/Other	16	5	388	6	246	227	400	
g. TOTAL REVENUES (e+f)	3,593	4,408	5,858	5,470	6,060	8,156	8,449	Apr- Sept Revenues down 24% or 36% of
%YoY	-3.5	22.7	32.9	-6.6	10.8	34.6	3.6	budgeted targets
h. Revenue expenditure	4,394	5,146	5,945	7,938	9,118	10,537	10,972	Expenditures
Interest (1)	1,326	1,503	1,710	1,922	2,131	2,408	2,680	
Defense	482	517	543	733	907	907	952	
Subsidies	475	571	709	1,297	1,414	1,642	1,436	Food, fuel subsidies appear understated
Pensions	203	221	243	329	561	533	545	
Grants to States	305	357	358	382	459	526	663	
Admin and social services	484	553	647	927	1,107	1,252	1,060	Lower social exp could be due to absence of
Plan expenditure	1,119	1,424	1,736	2,348	2,539	3,269	3,636	Farm debt waiver
i. Capital expenditure	664	688	1,182	902	1,127	1,629	1,606	
Defense	323	338	375	410	511	608	692	
Loans	52	75	493	87	121	340	134	
Plan expenditure	288	274	315	405	495	681	779	
j. Plan expenditure	1,406	1,699	2,051	2,752	3,034	3,950	4,415	Plan exp up 4.8% during Apr-Sept
k Non Plan expenditure	3,651	4,135	5,077	6,087	7,211	8,215	8,162	Non-plan exp up 14.4% during Apr-Sept
l. TOTAL EXPENDITURE (h+i): (j+k)	5,057	5,834	7,127	8,840	10,245	12,166	12,577	Apr-Sept Expenditures up 11.4% or 47.6% of
% YoY	1.5	15.4	22.2	24.0	15.9	18.7	3.4	budgeted targets
Deficit trends								
m. Fiscal Balance (g-l)	-1,464	-1,426	-1,270	-3,370	-4,185	-4,010**	-4,128	**Actual Fisc Deficit for FY11 was Rs3.7tr
% to GDP	-4.0	-3.3	-2.5	-6.0	-6.4	-5.1	-4.6	or 4.7% of GDP *(see below for details)*
n. Revenue Balance (e-h)	-923	-802	-526	-2,535	-3,390	-2,698	-3,073	We expect a print of 5.8% for FY12
% to GDP	-2.5	-1.9	-1.1	-4.5	-5.2	-3.4	-3.4	
o. Primary deficit (m-1)	-138	77	441	-1,448	-2,054	-1,602	-1,448	Deficit widened to Rs2.9trillion during Apr-
% to GDP	-0.4	0.2	0.9	-2.6	-3.1	-2.0	-1.6	Sept vs. Rs1.3tn last year
Financing the deficit								
Market borrowings (Net)	953	1,104	1,318	2,336	3,984	3,554	3,430	
PPF & special deposits	60	52	39	80	161	100	100	
Small savings	0	0	-113	-13	133	178	242	
Net external assistance	75	85	93	110	110	223	145	
Others	584	140	204	418	-189	105	11	
Cash Surplus	-209	45	-271	438	-14	-150	200	
Total financing	1,464	1,426	1,270	3,370	4,185	4,010	4,128	
Memo items (% to GDP)								
Centre	-4.0	-3.3	-2.5	-6.0	-6.4	-5.1	-5.8	
State	-2.4	-1.8	-1.5	-2.4	-3.3	-2.5	-2.5	
Combined	-6.5	-5.4	-4.1	-8.5	-9.5	-8.1	-8.3	
Off Balance Sheet Items	-0.5	-0.9	-0.6	-1.7	-0.2	0.0	0.0	
Total Deficit	-7.0	-6.3	-4.7	-10.2	-9.7	-8.1	-8.3	
Combined liabilities	83.0	79.3	76.1	76.7	74.0	69.4	67.2	
Combined o/s guarantees	8.3	6.2	5.6	5.5	5.5			

*Includes proceeds of transfer of RBI's stake in SBI. ** Actual Deficit for FY11 was Rs3.7tr with total revenues at Rs8.3tr and total expenditures at Rs12tr.
RE: Revised Estimates; BE: Budgeted Estimates, based on the govt's nominal GDP forecast of Rs89,809bn or 14%YoY
Source: Budget Documents, CIRA

Global Forecasts

Figure 44. Selected Countries — Economic Forecast Overview (Percent) 2011-2015F

	GDP Growth					CPI					Short Term Interest Rates				
	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
Global	3.0	2.5	3.1	3.5	3.8	3.9	3.0	2.9	2.9	3.0	2.7	2.7	2.7	2.9	3.3
Based on PPP weights	3.7	3.0	3.6	3.8	4.1	4.4	3.5	3.3	3.3	3.3					
Industrial Countries	1.4	0.9	1.2	2.0	2.4	2.6	1.6	1.3	1.4	1.5	0.8	0.6	0.6	0.8	1.2
United States	1.7	1.9	1.9	2.8	3.5	3.2	1.8	1.7	2.0	2.3	0.3	0.3	0.3	0.4	1.2
Japan	-0.4	1.8	1.3	1.5	1.5	-0.3	-0.3	-0.1	0.1	0.3	0.1	0.1	0.1	0.1	0.5
Euro Area	1.5	-1.2	-0.2	1.0	1.2	2.7	2.0	1.1	0.8	0.8	1.2	0.8	0.5	0.5	0.5
Australia	1.5	3.7	4.0	4.3	3.8	3.5	2.4	3.1	2.9	2.7	4.5	4.5	4.8	5.3	5.3
United Kingdom	0.9	0.5	1.2	1.6	2.4	4.5	2.7	2.4	2.3	2.2	0.5	0.5	0.5	0.5	1.0
Emerging Markets	6.0	5.1	6.0	5.8	5.8	6.2	5.3	5.3	5.1	5.1	6.0	6.0	6.0	6.2	6.2
China	9.1	8.4	8.6	7.6	7.5	5.5	4.1	4.3	4.9	5.0	3.2	3.7	3.9	4.3	4.6
Hong Kong	5.0	3.5	4.2	4.0	4.0	5.3	3.8	3.1	3.3	3.5	0.9	0.5	0.9	1.2	2.0
India	7.1	7.0	7.7	8.2	8.3	9.5	7.5	7.0	6.0	6.0	8.2	8.1	8.0	7.5	7.5
Indonesia	6.5	6.3	6.5	6.7	7.0	5.5	5.7	5.6	5.5	5.8	6.5	5.5	5.5	5.6	5.9
Korea	3.6	3.7	4.4	4.5	4.1	4.4	3.3	3.2	3.1	3.0	3.5	3.6	4.2	4.5	5.0
Czech Republic	1.8	0.0	2.1	2.8	3.6	1.9	2.7	2.0	2.7	2.0	0.8	0.8	1.2	2.0	2.9
Hungary	1.2	0.1	1.7	2.6	2.0	3.9	5.2	3.4	3.5	3.1	6.0	6.7	6.1	5.7	5.5
Poland	4.0	1.9	2.8	3.1	3.4	4.2	2.9	2.6	2.5	2.5	4.3	4.1	3.8	4.4	4.8
Russia	4.0	2.5	4.2	4.0	4.0	8.6	6.2	6.1	5.5	5.5	8.3	7.5	6.0	6.0	5.5
Turkey	7.7	2.5	4.3	4.4	4.5	6.3	8.1	6.6	6.2	5.7	5.8	5.8	7.3	8.0	7.5
Nigeria	7.1	6.7	6.5	6.9	7.2	10.9	10.9	10.4	10.3	9.5	9.0	14.0	12.5	10.5	10.0
South Africa	3.1	2.9	4.0	4.4	4.3	5.0	5.8	5.8	5.6	5.5	5.5	5.8	7.3	8.5	8.8
Argentina	8.5	5.0	5.0	3.5	3.5	9.8	9.6	12.2	15.0	15.0	14.0	19.5	18.2	16.0	14.0
Brazil	3.2	3.5	4.5	4.5	4.5	6.6	5.6	5.2	4.5	4.0	11.7	9.7	9.5	9.5	9.0
Mexico	3.8	3.0	3.4	3.7	3.8	3.3	3.6	3.7	3.9	3.8	4.5	4.5	5.4	7.0	7.0
Venezuela	3.5	3.0	3.4	4.0	3.0	27.0	26.3	28.0	25.0	28.0	14.6	14.5	14.5	14.5	14.5

Source: Citi Investment Research and Analysis estimates, Global Economic Outlook and Strategy, 28 Nov 2011

Figure 45. Selected Countries — Economic Forecast Overview (Percent) 2011-2015F

	Current Balance (Pct of GDP)					Fiscal Balance (Pct of GDP)					Government Debt (Pct of GDP)				
	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
Global	0.2	0.0	0.3	0.3	0.3	-5.2	-4.7	-3.7	-3.2	-2.8	75	75	76	75	74
Based on PPP weights	0.4	0.0	0.4	0.3	0.3	-4.5	-4.4	-3.5	-3.1	-2.8					
Industrial Countries	-0.8	-0.5	-0.3	-0.3	-0.2	-7.0	-6.0	-4.7	-4.1	-3.5	107	111	114	115	116
United States	-3.0	-2.5	-2.4	-2.5	-2.7	-9.3	-7.3	-6.2	-5.5	-5.0	99	104	108	110	111
Japan	2.3	2.5	2.7	2.8	2.8	-10.8	-11.0	-8.5	-8.2	-7.8	233	242	248	252	256
Euro Area	-0.7	-0.9	-0.7	-0.6	-0.4	-4.5	-4.2	-3.1	-2.7	-2.0	89	94	94	94	94
Australia	-2.2	-1.7	-4.2	-4.9	-3.5	-3.4	-1.8	0.2	0.3	1.2	6	7	7	6	6
United Kingdom	-0.2	1.6	2.9	3.4	3.6	-8.9	-8.6	-7.5	-6.3	-5.3	82	88	93	96	97
Emerging Markets	1.9	0.9	1.4	1.1	1.1	-1.9	-2.6	-2.1	-1.9	-1.8	16	16	16	15	16
China	3.0	2.0	2.0	1.0	1.0	-1.0	-2.0	-2.0	-2.0	-2.0	16	16	16	17	17
Hong Kong	7.0	10.3	12.4	10.0	10.0	2.7	2.2	2.5	1.9	3.4	1	2	2	3	3
India	-2.9	-3.0	-2.5	-2.1	-1.8	-8.3	-8.0	-7.5	-6.0	-6.0	67	67	66	64	62
Indonesia	0.3	-0.3	-0.5	-0.7	-0.6	-0.8	-1.0	-0.7	-0.3	-0.5	26	25	24	23	23
Korea	1.7	1.2	0.9	0.7	-0.4	0.5	0.7	1.2	1.5	1.4	35	35	34	32	31
Czech Republic	-4.1	-3.3	-4.2	-3.3	-3.8	-4.5	-4.0	-3.5	-2.3	-1.5	39	42	44	46	46
Hungary	2.9	2.6	2.5	2.0	2.2	1.9	-3.0	-3.0	-3.3	-2.9	80	74	74	71	71
Poland	-4.6	-3.5	-4.1	-5.3	-5.5	-5.2	-4.0	-2.9	-2.3	-2.1	53	53	53	52	50
Russia	4.7	1.9	1.4	-1.0	-1.0	-1.4	-3.1	-2.7	-2.3	-1.9	8	9	11	12	13
Turkey	-10.2	-8.5	-7.4	-6.6	-5.9	-1.7	-1.8	-2.2	-2.5	-2.7	43	40	38	36	35
Nigeria	5.9	5.3	6.0	4.7	3.7	-3.2	-2.8	-2.0	-2.4	-2.8	NA	NA	NA	NA	NA
South Africa	-3.4	-4.4	-6.2	-6.6	-6.4	-5.3	-5.2	-4.7	-4.7	-4.3	35	39	43	44	45
Argentina	0.4	0.4	0.2	-0.5	-0.5	-0.9	-0.4	0.4	2.0	2.0	49	49	49	52	53
Brazil	-2.3	-2.9	-2.4	-2.6	-2.9	-2.7	-2.5	-2.3	-1.8	-1.2	63	63	63	63	70
Mexico	-1.4	-2.8	-2.5	-2.6	-2.7	-2.5	-2.2	-2.0	-1.9	-1.9	40	40	40	38	42
Venezuela	12.1	5.9	9.0	8.1	8.8	-5.0	-5.0	-4.0	-5.2	-5.0	39	41	36	35	36

Note: US debt and deficit figures are for the Federal government only. All other countries are general government debt and deficits.
Source: Citi Investment Research and Analysis estimates, Global Economic Outlook and Strategy, 28 Nov 2011

Figure 46. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent) 2011-2015F

	10-Year Yields					Exchange Rates Versus U.S. Dollar*				
	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
Industrial Countries										
United States	2.80	2.20	2.70	3.05	3.35	NA	NA	NA	NA	NA
Japan	1.12	1.16	1.50	1.50	1.75	79	76	78	80	83
Euro Area	2.71	1.50	1.50	1.80	2.20	1.39	1.27	1.29	1.31	1.33
Australia	4.63	4.00	4.90	5.20	5.50	1.01	0.95	0.95	0.93	0.90
United Kingdom	3.71	1.76	1.50	1.75	2.50	1.59	1.55	1.61	1.67	1.69
Emerging Markets										
China	3.65	4.05	4.30	4.55	4.93	6.45	6.15	5.90	5.85	5.75
Hong Kong	1.17	1.05	1.58	1.85	2.20	7.78	7.77	7.75	7.75	7.75
India	**8.25**	**8.25**	**8.25**	**8.25**	**8.25**	**48.10**	**49.56**	**47.75**	**45.00**	**45.00**
Indonesia	7.25	6.75	7.00	7.13	7.25	8866	8975	8675	8650	8625
Korea	3.83	3.66	4.54	5.45	5.60	1118	1084	1018	1005	985
Czech Republic	3.71	3.85	3.39	3.25	3.36	17.9	19.8	18.9	18.2	17.4
Hungary	7.41	7.79	7.61	7.10	6.09	206	252	230	221	215
Poland	5.56	5.24	5.43	5.57	5.56	3.05	3.44	3.15	3.03	2.97
Russia	8.24	7.57	7.59	7.60	7.60	30.0	33.5	33.0	32.0	31.2
Turkey	NA	NA	NA	NA	NA	1.72	1.86	1.82	1.75	1.69
Nigeria	NA	NA	NA	NA	NA	155	160	163	163	165
South Africa	8.27	8.33	9.50	9.25	9.20	7.45	8.35	8.72	9.08	9.47
Argentina	NA	NA	NA	NA	NA	4.16	5.31	5.97	6.79	7.54
Brazil	11.97	11.59	11.48	10.24	8.75	1.66	1.74	1.70	1.72	1.76
Mexico	6.87	6.45	7.50	8.10	8.00	12.4	13.2	12.5	12.4	12.7
Venezuela	13.65	13.55	13.53	13.50	13.50	4.30	4.30	4.80	4.80	5.30

Source: Citi Investment Research and Analysis estimates, Global Economic Outlook and Strategy, 28 Nov 2011

Figure 47. Foreign Exchange Forecasts (End of Period), as of 28 Nov 2011

	vs. USD						vs. EUR					
	Current	Mar 12	Jun 12	Sept12	Dec12	Mar13	Current	Mar 12	Jun 12	Sept12	Dec12	Mar13
United States	NA	NA	NA	NA	NA	NA	1.35	1.30	1.28	1.26	1.26	1.27
Japan	77	75	75	76	76	77	104	98	97	96	96	97
Euro Area	1.35	1.30	1.28	1.26	1.26	1.27	NA	NA	NA	NA	NA	NA
Canada	1.03	1.06	1.06	1.07	1.06	1.03	1.39	1.38	1.36	1.35	1.33	1.30
Australia	1.00	0.96	0.96	0.95	0.95	0.95	1.35	1.36	1.34	1.32	1.32	1.33
New Zealand	0.76	0.73	0.72	0.71	0.69	0.67	1.78	1.79	1.79	1.79	1.82	1.88
Norway	5.78	6.06	6.13	6.20	6.20	6.12	7.81	7.88	7.85	7.82	7.79	7.76
Sweden	6.78	7.16	7.20	7.25	7.22	7.09	9.17	9.31	9.23	9.14	9.06	8.99
Switzerland	0.92	0.96	0.97	0.98	0.99	1.00	1.24	1.25	1.24	1.23	1.24	1.27
United Kingdom	1.58	1.57	1.55	1.53	1.54	1.57	0.86	0.83	0.83	0.82	0.82	0.81
China	6.36	6.24	6.18	6.12	6.05	6.00	8.6	8.1	7.9	7.7	7.6	7.6
India	**51.3**	**50.0**	**49.8**	**49.5**	**49.0**	**48.5**	**69.4**	**65.0**	**63.7**	**62.4**	**61.5**	**61.5**
Korea	1139	1110	1095	1080	1050	1040	1540	1444	1403	1362	1319	1319
Poland	3.27	3.47	3.46	3.45	3.39	3.28	4.43	4.51	4.43	4.34	4.25	4.15
Russia	30.9	32.7	33.3	33.9	34.0	33.6	41.7	42.6	42.6	42.7	42.7	42.6
South Africa	8.20	8.16	8.29	8.43	8.54	8.61	11.09	10.62	10.62	10.63	10.72	10.92
Turkey	1.83	1.85	1.86	1.87	1.86	1.84	2.47	2.41	2.38	2.35	2.34	2.34
Brazil	1.78	1.78	1.75	1.72	1.70	1.70	2.41	2.32	2.24	2.17	2.14	2.16
Mexico	13.7	13.2	13.2	13.2	13.1	12.8	18.5	17.2	16.9	16.6	16.4	16.3

Source: Citi Investment Research and Analysis estimates, Global Economic Outlook and Strategy, 28 Nov 2011

Appendix A-1

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