India Macroscope

The 5% Trap

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With thanks to
Abha Agarwal

- **Don't give me a 5%** — The macro backdrop ahead of the upcoming budget is grim. GDP growth has hit a decadal low at 5%, the fiscal deficit (centre) is above 5%, the current account could cross 5% – and both WPI and CPI are well in excess of 5%. While things do look grim, incremental policy has surpassed expectations, but the momentum needs to be sustained; that's what should get India out of the 5% trap – and instead give the economy/market a HIGH 5.

- **Upcoming Budget: The Numbers** — The Finance Minister is likely to keep his word on deficit targets (5.3% for FY13; 4.8% for FY14). To achieve this we expect (1) Reining of expenditure – both plan and non-plan (primarily subsidies); (2) Measures likely to boost revenues including – (a) higher tax collections via the imposition of a "surcharge", (b) withdrawal of pre-crisis tax benefits, and (c) focus on divestments and non-tax revenue sources. The numbers for now will likely be credible; but we would watch for supplementary pending announcements prior to the elections.

- **Incentivising Growth, Capital Raising: Also in the limelight** — As discussed in last month's Macroscope, we expect capital raising to remain key and thus could see (1) Incentives towards increasing financial savings; (2) Focus on Bond Market. We could also see (3) A roadmap towards GST; (4) Passage of key legislation - the land acquisition bill as well as FDI in more sectors in the upcoming budget session.

- **Maintain Estimates on the Macro** — (1) Maintain our 5.7% GDP estimates for FY14. This factors in a further 50bps of easing; (2) Deficits, both current account and fiscal, likely to remain elevated in FY14, keeping the INR in a Rs54-56 range; (3) Diverging trends in WPI and CPI with headline WPI expected to average 6.5%-7% and CPI forecast in the 8%-9% range.

Figure 1. Statistical Snapshot (%)

Year -end 31 March	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
Real GDP growth (%)	9.6	9.3	6.7	8.4	8.4	6.2	5.0	5.7
Agriculture growth (%)	4.2	5.8	0.1	1.0	7.0	3.6	1.8	3.0
Industry growth (%)	12.2	9.7	4.4	8.4	7.2	3.5	3.1	4.4
Services growth (%)	10.1	10.3	10.0	10.5	9.3	8.2	6.6	7.0
Fiscal Deficit (Centre+States)	-5.4	-4.1	-8.4	-9.7	-8.3	-8.4	-8.4	-8.0
Current Account Deficit	-1.0	-1.3	-2.3	-2.8	-2.7	-4.2	-4.7	-4.3
WPI (Average)	6.5	4.8	8.0	3.6	9.6	8.8	7.5	6.5-7.0
USD/INR (Average)	45.2	40.2	46.0	47.4	45.6	48.1	54.0	53.5

Source: CSO; RBI; Budget Documents: Citi Research

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Statistical Snapshot

Figure 2. Macro Economic Summary (FY01- FY14E)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E
Fiscal Year to 31 March	**FY01**	**FY02**	**FY03**	**FY04**	**FY05**	**FY06**	**FY07**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13E**	**FY14E**
National Income Indicators*														
Nominal GDP (Rs bn)	21,840	23,676	25,500	28,617	32,422	36,934	42,947	49,871	56,301	64,778	77,953	89,749	100,281	113,017
Nominal GDP (US$ bn)	478	493	528	623.5	720.5	833.7	950.2	1240.6	1223.9	1366.6	1710.2	1,866	1,857	2,112
Per Capita GDP (US$)	469	474	500	582	662	754	847	1,090	1,061	1,168	1,442	1,552	1,522	1,681
Real GDP growth (%)	4.3	5.5	4.0	8.1	7.0	9.5	9.6	9.3	6.7	8.6	9.3	6.2	5.0	5.7
Agriculture growth (%)	0.0	6.0	-6.6	9.0	0.2	5.1	4.2	5.8	0.1	0.8	7.9	3.6	1.8	3.0
Industry growth (%)	6.0	2.6	7.2	7.3	9.8	9.7	12.2	9.7	4.4	9.2	9.2	3.5	3.1	4.4
Services growth (%)	5.4	6.9	7.0	8.1	8.1	10.9	10.1	10.3	10.0	10.5	9.8	8.2	6.6	7.0
By Demand * (%YoY)														
Consumption	3.0	5.3	2.3	5.4	2.3	8.6	7.9	9.3	7.6	8.2	8.1	8.1	4.1	5.7
Pvt Consumption	3.4	6.0	2.9	5.9	2.1	8.5	8.7	9.2	7.1	7.1	8.6	8.0	4.1	5.5
Public Consumption	0.9	2.3	-0.4	2.6	3.4	8.9	3.8	9.6	10.4	13.9	5.9	8.6	4.1	7.0
Gross Fixed Capital Formation	0.0	7.4	6.8	13.6	20.7	16.2	13.8	16.2	3.5	7.7	14.0	4.4	2.5	4.0
Cons; Invst, Savings ** (%GDP)														
Consumption	78.5	78.9	77.2	75.0	70.1	69.2	68.0	67.2	68.6	69.1	67.2	68.0	68.7	69.2
Gross Capital Formation	23.8	22.3	24.6	26.9	32.8	34.7	35.7	38.1	34.3	36.3	37.0	35.4	35.3	35.7
Gross Domestic Savings	23.2	22.9	25.7	29.1	32.4	33.4	34.6	36.8	32.0	33.7	34.0	30.8	29.9	30.5
Real Indicators (%YoY)														
Cement dispatches (domestic)	-1.9	9.8	8.7	5.8	8.1	10.1	10.2	9.8	8.5	11.2	5.2	7.0	8.0	9.0
Commercial vehicle sales	-11.9	-4.5	40.4	37.5	25.5	12.3	32.2	5.8	-22.3	39.2	27.0	19.5	1.2	12.9
Car sales	-5.3	3.2	5.3	32.1	19.2	7.4	19.7	11.7	7.0	25.7	29.3	3.9	-1.4	8.0
Two-wheelers	0.7	15.3	15.8	12.6	16.8	15.0	12.1	-4.8	4.7	25.8	25.8	13.9	3.5	12.5
Diesel consumption	-3.4	-3.7	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	8.0	8.0	8.0
Mobile Tele density	0.3	0.6	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.5	66.8	75.1	79.0	80.0
Monetary Indicators (% YoY)														
Money supply	15.9	16.0	16.1	13.0	14.0	15.9	20.0	22.1	20.5	19.2	16.0	16.0	16.0	17.0
Inflation – WPI (Avg)	7.1	3.6	3.4	5.5	6.5	3.7	6.5	4.8	8.0	3.6	9.6	8.8	7.5	6.5-7
CPI (Avg)	3.7	4.3	4.1	3.8	3.9	4.2	6.8	6.2	9.1	12.3	10.5	8.4	9.0	8-8.5
Bank credit growth	17.3	15.3	23.7	15.3	30.9	37.0	28.1	22.3	17.5	16.9	21.5	17.0	16.0	15.0
Deposit growth	18.4	14.6	16.1	17.5	13.0	24.0	23.8	22.4	19.9	17.0	16.0	16.0	12.0	15.0
Fiscal Indicators (% GDP)														
Centre's fiscal deficit)	-5.4	-6.0	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.5	-4.8	-5.8	-5.9*	-5.5
State fiscal deficit	-4.0	-4.0	-3.9	-4.2	-3.3	-2.4	-1.8	-1.5	-2.4	-2.9	-2.7	-2.5	-2.5	-2.5
Combined deficit (Centre+State)	-9.2	-9.6	-9.2	-8.2	-7.2	-6.5	-5.4	-4.1	-8.4	-9.7	-8.3	-8.4	-8.4	-8.0
Off Balance Sheet Items						-0.5	-0.9	-0.6	-1.7	-0.2	0.0	0.0	0.0	0.0
Combined liabilities (dom+ext)	82.6	87.2	90.7	90.0	88.8	84.6	79.9	76.1	76.8	75.8	70.7	69.9	67.6	67.6
External Sector (% YoY)														
Exports (US$bn)	45.5	44.7	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.4	256.2	309.8	294.3	317.8
% YoY	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.5	40.4	20.9	-5.0	8.0
Imports (US$bn)	57.9	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	383.5	499.5	494.5	524.2
%YoY	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	27.6	30.3	-1.0	6.0
Trade deficit (US$bn)	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.2	-127.3	-189.8	-200.3	-206.4
Invisibles (US$bn)	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	79.3	111.6	112.4	116.5
Current Account Deficit (US$bn)	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.2	-48.1	-78.2	-87.9	-89.9
% to GDP	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.8	-4.2	-4.7	-4.3
Capital Account (US$bn)	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	51.6	63.7	67.8	86.6	87.6
% GDP	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.7	3.6	4.7	4.1
Forex Assets (excl gold) (US$bn)	39.6	51.0	71.9	106.1	135.1	145.1	191.9	299.1	241.6	252.8	273.7	260.9	259.6	257.3
Months of imports	8.2	10.9	13.4	15.9	13.6	11.1	12.1	13.9	9.4	10.1	8.6	6.3	6.3	5.9
External Debt (US$bn)	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	260.9	305.9	345.4	360.4	375.4
Short Term Debt (US$bn)	3.6	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	78.2	83.2	88.2
Exchange Rate														
US$/INR - annual avg	45.7	48.0	48.3	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	48.1	54.0	53.5
% depreciation	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	12.3	-0.9

*This could come in lower at 5.3-5.5% depending on the Telecom Re-auction and Fuel Subsidy Sharing Mechanism

** At current prices.
Source: CSO, RBI, Ministry of Finance, Citi Research Estimates

The 5% Trap

The Macro Back Drop: GDP; Deficits; Inflation

The macro backdrop ahead of the upcoming budget is grim. GDP growth has fallen to a decade low of 5%, the deficits – both fiscal (centre) and current have deteriorated with the latter likely to cross 5% for the first time ever while inflation – both WPI and CPI are well over 5%.

GDP – At a Decade Low of 5%

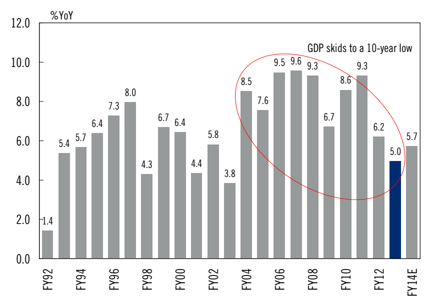
In a short span of three years, India's growth has plummeted from the 8%-9% range to 5% levels. While a weak global macro environment has added to the woes, much of the decline is due to domestic factors – centered on policy-related issues which have resulted in a near collapse in investments.

Figure 3. Trends in GDP (%)

	FY04	FY10	FY13 CSO	FY14E
Agriculture	10.0	0.8	1.8	3.0
Industry	7.4	9.2	3.1	4.4
Services	8.5	10.5	6.6	7.0
GDP	**8.5**	**8.6**	**5.0**	**5.7**

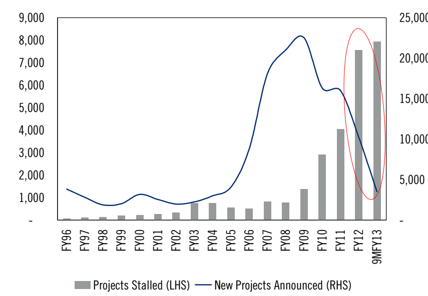
Source: CSO; Citi Research

Figure 4. Trends in GDP (%)



Source: CSO; Citi Research

Figure 5. Trends in Projects Stalled (Rs bn)



Source: CMIE; Citi Research

Deficits – Both Fiscal and Current Account Over 5%

Fiscal: While lower growth has taken a toll on revenue buoyancy, the rise in the fiscal deficit is largely structural. The cause is two-fold: (1) A large part of the expenditure is "committed" – i.e. interest, defence, wages and subsidies; and (2) A substantial part of the increase that was initially attributed to the global crisis is "irreversible" – i.e. employment guarantee scheme, pay increase etc.

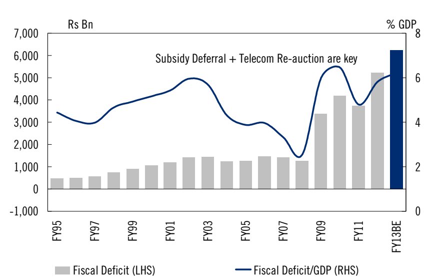
Current Account: While global demand has taken a toll on exports, imports have remained high – led by a rise in oil and gold. Furthermore, growth in invisibles has moderated due to a near doubling of investment income outflows – a result of higher recourse to external debt. (see pg 14 for details)

Figure 6. Deficit Snapshot (%)

	FY04	FY10	FY13E	FY14E
Fiscal				
Centre	-4.3	-6.5	-5.9	-5.5
State	-4.2	-2.9	-2.5	-2.5
Combined	-8.2	-9.7	-8.4	-8
Current Account	**2.3**	**-2.8**	**-4.7***	**-4.3**

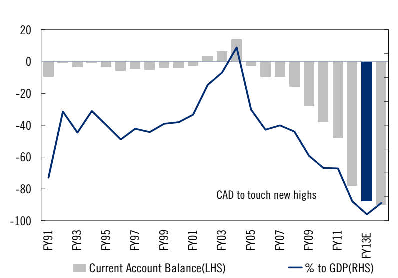
Source: Budget: RBI: Citi Research
* Could touch 5.3% if the oil import data is not revised (see pg 14)

Figure 7. Trends in Fiscal Deficit (Rsbn, %)



Source: Budget Documents; Citi Research

Figure 8. Trends in CAD (US$bn, %)



Source: RBI; Citi Research

Inflation – Likely to Stay Over 5%

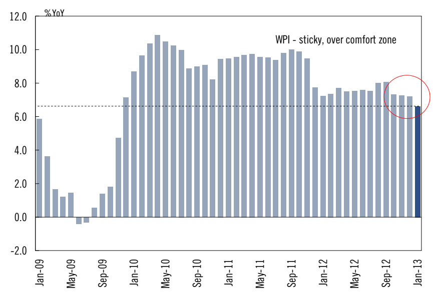
Figure 9. Average Inflation Snapshot (%)

	FY04	FY10	FY13E	FY14E
WPI	5.4	3.5	7.5	7
CPI	3.8	12.3	9	8

Source: MOSPI; Office of Econ Advisor; Citi Research

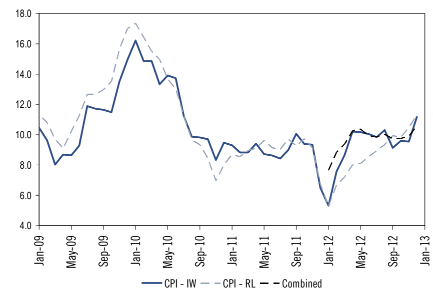
Both WPI and CPI have been well above RBI's medium term inflation target of 4%. A large part of this is sticky in nature (1) high food price inflation – a result of rising incomes and changing dietary preferences unaccompanied by any increase in agri productivity; (2) high wage inflation – a result of social welfare spending leading to high rural wages and the consequent spillover to urban wages.

Figure 10. Trends in WPI (%)



Source: Office of the Econ Advisor: Citi Research

Figure 11. Trends in CPI (%)



Source: MOSPI; Citi Research

BUT There is Hope

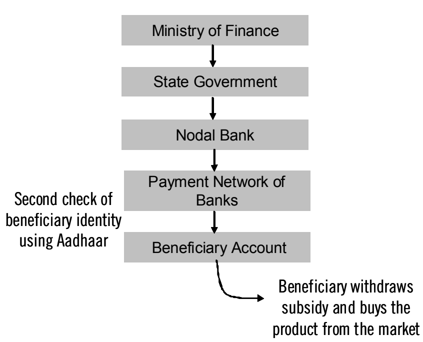
While things do look grim, the incremental policy measures announced and implemented (including politically sensitive fuel price and FDI reforms) have brought back the economy from the brink of a potential ratings downgrade. (See pg 17 for details). Encouragingly, in addition to reforms on fuel prices, FDI and divestments, the govt has also taken steps to address structural issues like the fisc and investments. However, we believe much more is needed to prop growth.

1. Fiscal Consolidation – Subsidy Reform; Revenues

On the fisc, we have seen moves towards (a) Subsidy Reform i.e. Cash Transfers and Fuel Price Measures; (b) Tax Reforms.

Subsidy Reform: Cash Transfers and Fuel Price Measures

Figure 12. Cash Transfers



Source: Ministry of Finance

- **Cash Transfers:** The Aadhaar-enabled system of direct cash transfer of subsidies and welfare payments which started on 1 January 2013 in ~20 districts is expected to cover the entire country by April 2014. The system would consist of transferring cash to a beneficiary's bank account linked to Aadhaar – a unique biometric ID issued by the government and will help reduce inefficiency due to corruption and transaction costs in the transfer of payments to beneficiaries. (For details see India Macroscope - Right Turn, but Speed is Key, dated Oct 25, 2012)

- **Fuel Price Reforms:** Diesel currently accounts for 60% of under-recoveries (losses by OMCs). The proposed implementation of a monthly hike of Rs0.5/ltr until prices reach market levels would result in a sharp fall in under-recoveries and a potential saving of 0.5% of GDP. (For details see Fuel Price Reforms).

Revenues: Steps towards GST and Divestments

- **GST:** In the past the GST has been stalled due to lack of consensus between the centre and states. On this front, the FM is taking steps to bridge this "trust deficit" and ensure smooth implementation. In recent meetings with state officials, it was decided that (1) GST would have a phased rollout - only states willing to implement GST would do so in the beginning; (2) There would be a floor rate with a narrow band as opposed to the uniform rate initially proposed; (3) It was also agreed that the Centre will provide States with ~Rs340bn as compensation for loss of central sales tax revenues.

- **Divestments:** In the current fiscal, the govt modified the divestments norms (i.e. zero % margin, indicative pricing throughout the day, and attractive terms) which enabled it to come close to its divestment target.

2. Incentivising Investments

- **Cabinet Committee on Investments:** In its first meeting on Jan 30th, the CCI reviewed key oil and gas projects which had been put on hold by the ministry of defence due to "security and strategic reasons". A decision can be expected within a month. In its next meeting, scheduled for Feb 20th, the CCI is expected to focus on coal and power issues related to clearances regarding coal mining projects. Railways are also likely to be next on the agenda.

- **Coal Price Pooling:** The govt has given an "in-principle" approval for pooling of prices of domestic and imported coal. This could help domestic power companies as domestic production is currently inadequate and cost of imported coal is high – making it difficult for power companies to pay higher prices.

- **Gas Pricing:** The govt has taken small steps towards raising natural gas prices which are currently well below market prices. Key to note is that the oil ministry has reportedly accepted the recommendations of the Rangarajan Committee and sent it to the other ministries for their comments, according to the Financial Express.

The FY14 fiscal deficit target of 4.8%, would warrant a further pruning of expenditure and a boost to revenues from their current level

So What Could One Expect in the Budget?

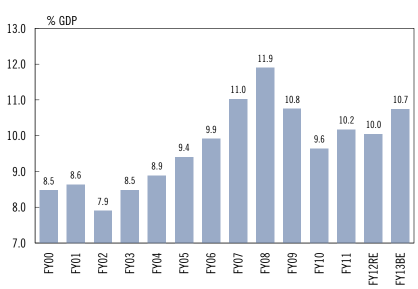
The aim of the Budget would be three-fold (1) Fiscal Consolidation – contain deficit at 4.8% GDP; (2) Encourage Investments – to boost growth; (3) Capital Raising.

Likely Measures To Boost Revenues

- **Direct Taxes**
  - **Surcharge:** In order to boost revenues and project a pro-poor bias, we could see the levy of a surcharge on the "super rich". Reasons for using the surcharge route (1) They can be interpreted as a “temporary levy” hence taxpayer feels less burdened; (2) Tax rates appear stable – basic tax rates remain the same; (3) Government does not have to share the levy with states.
  - **Incentivising Savings:** Likelihood of a rise in the tax rebate limit current at Rs1,00,000. This could aid financial savings and may help divert investments from gold towards financial products.

- **Indirect Taxes**
  - **Higher Rates:** Current tax rates are at 12%, below pre-crisis levels of 14%.
  - **Continued Duty Rationalisation:** Tariff-related measures to address duty inversion problems (i.e. raw materials are taxed more than finished products).
  - **Reduction in Exemptions:** This is an on-going exercise where-in the govt would review exemptions on excise duty and services tax.
  - **Goods and Services Tax (GST):** Announcement of a roadmap towards GST.

Figure 13. Trends in Tax-GDP Ratio (%)



Source: Budget Documents: Citi Research

- **Investment-linked incentives:** In an effort to boost economic growth, the government is expected to replace existing profit-linked tax incentives with investment-linked ones – in line with the proposed Direct Tax Code.

- **Tax Collected at Source (TCS):** This could be made mandatory for high value transactions and would help (1) transparency of a transaction; and (2) prevent flow of "unaccounted money" by keeping track of the money trail.

- **PSU/Divestments – II:** While the FY13 flows are largely attributed to use of modified norms including use of the Offer For sale (OFS), FY14 could see:

  – **New instruments** such as the Call Option Model and/or Exchange Traded Fund to enable the government meet its divestment targets.

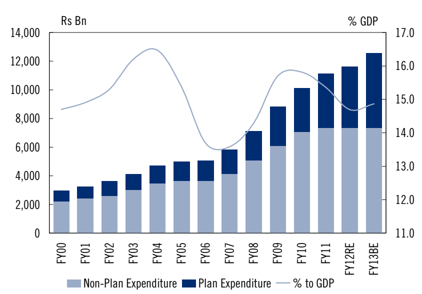
  – **Dissolution of SUUTI** (Specialized Undertaking of UTI), which would entail the govt selling its shares in key blue-chips.

  – **"Use it or lose it"** policy for cash-rich PSUs who could be asked to either invest their excess cash, or pay it as dividends to the govt.

- **What's Also Doing the Rounds:** Given the government's focus on revenues and need to project a pro-poor bias ahead of the next elections, there is chatter on (1) Commodity Transaction Tax; (2) Re-introduction of Estate Duties; and (3) Increase in Wealth Tax.

Expenditure Pruning Measures

Figure 14. Trends in Expenditure (Rsbn, %)



Source: Budget Documents; Citi Research

- **Subsidy Reduction**

  – **Cash transfers** which have come into play from Jan 1 are limited to ~20 districts and payments towards pensions and scholarships. FY14 could see this being implemented for food, fuel and fertiliser subsidies.

  – **Fertilizer Subsidies:** One could see steps towards a further rationalizing of fertilizer subsidies and paying farmers directly instead of fertilizer companies, as well as a partial decontrolling of urea and bringing it under the same subsidy regime as potash fertilizers.

- **What's Also Doing the Rounds:** On the expenditure front there is chatter of a pull-back in (1) plan expenditure and (2) defense spending.

Figure 15. Budget Arithmetic (Rs bn, %YoY)

	FY13BE		FY13E		FY14E	
	Rs bn	%YoY	Rs bn	%YoY	Rs bn	%YoY
Revenues	**9773**	**22.7**	**9381**	**17.7**	**10827**	**15.4**
Tax	7,711	20.1	7,418	15.5	8,827	19.0
Non-Tax	1,646	32	1,546	24	1,500	-3.0
Non-Debt (Divestments)	417		417		500	
Expenditures	**14,909**	**13.1**	**14,770**	**12**	**16,247**	**10.0**
Plan	5,210	22.1	4,778	12	5,256	10.0
Non-Plan	9,699	8.7	9,992	12	10,991	10.0
Fiscal Deficit	**-5,136**		**-5,389**		**-5,419**	
% to GDP	**-5.1**		**-5.4**		**-4.8**	
Nominal GDP Assumption	101,399		100,281*		113,107	

* CSO's advance estimates, Source: Budget Documents, Citi Research

Real Indicators

FY13 GDP Skids to a 10-Year Low

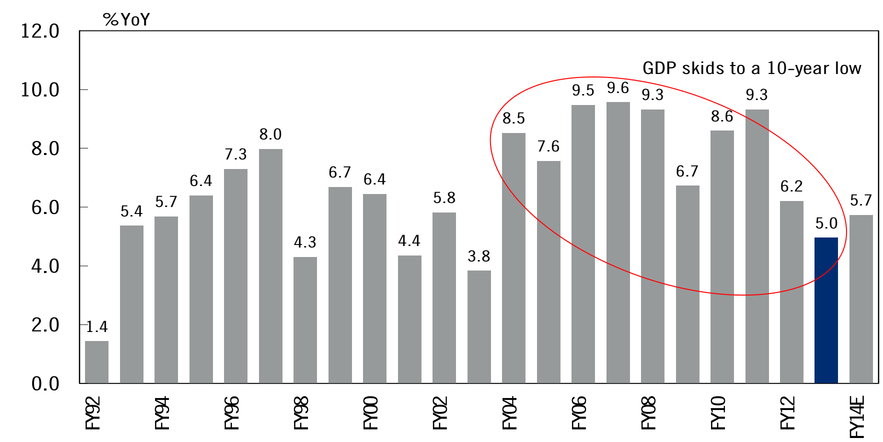
The government's first GDP estimate for FY13 pegs growth at 5%, lower than expectations of it coming in the 5.5% range. While there has been much debate on the CSO's numbers, key to note is that cumulative industrial production till Jan pegs growth at 0.8%, while the full year value add GDP numbers for industry are at 3.1%.

Figure 16. GDP Snapshot (%YoY)

	FY11	FY12	FY13 CSO	FY14E
Real GDP	**9.3**	**6.2**	**5.0**	**5.7**
Agriculture	7.9	3.6	1.8	3.0
Industry	9.2	3.5	3.1	4.4
Services	9.8	8.2	6.6	7.0
Consumption	8.1	8.1	4.1	5.7
Pvt Consumption	8.6	8.0	4.1	5.5
Govt Consumption	5.9	8.6	4.1	7.0
Gross Cap Formation	16.2	1.5	3.9	4.2
Fixed Cap Form	14.0	4.4	2.5	4.0

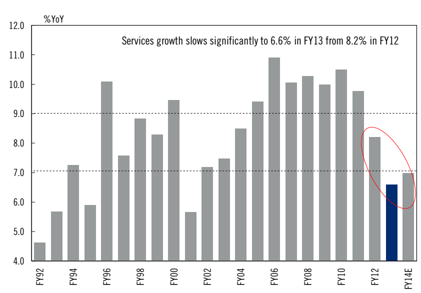
Source: CSO, Citi Research Estimates

Figure 17. Trends in GDP (%)



Source: CSO, Citi Research Estimates

Figure 18. Trends in Services (%)



Source: CSO; Citi Research

GDP by Activity: The slowdown in growth was evident in all 3 sectors: services fell to 6.6%, with industry at 3.1% and agri at 1.8%. The key reason for the lower print was a sharper than expected deceleration in services to 6.6%. This is partly cyclical and structural arising due to (1) Cyclical downturn in global trade; (2) Slowdown in banking services; and (3) Structural slowdown in communications – given that cellular penetration levels have crossed 80%. However, key to watch in FY14 is community services which could get a boost from government spending.

Figure 19. Trends in GDP by Activity (%YoY)

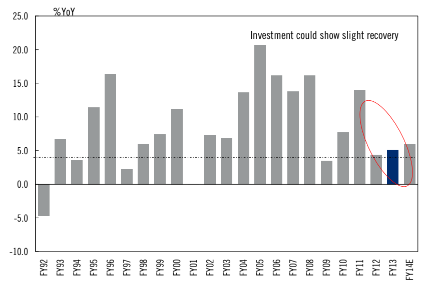
	Wts	FY07	FY08	FY09	FY10	FY11	FY12	FY13 CSO	FY14E
Agriculture	**13.7**	**4.2**	**5.8**	**0.1**	**0.8**	**7.9**	**3.6**	**1.8**	**3.0**
Industry	**27.0**	**12.2**	**9.7**	**4.4**	**9.2**	**9.2**	**3.5**	**3.1**	**4.4**
Manufacturing	15.2	14.3	10.3	4.3	11.3	9.7	2.7	1.9	3.5
Mining & quarrying	2.0	7.5	3.7	2.1	5.9	4.9	-0.6	0.4	3.0
Elect. gas & water supply	1.9	9.3	8.3	4.6	6.2	5.2	6.5	4.9	6.0
Construction	7.9	10.3	10.8	5.3	6.7	10.2	5.6	5.9	6.0
Services	**59.3**	**10.1**	**10.3**	**10.0**	**10.5**	**9.8**	**8.2**	**6.6**	**7.0**
Trade, Transport & Comm	27.5	11.6	10.9	7.5	10.4	12.3	7.0	5.2	6.0
Financing & insurance,	18.7	14.0	12.0	12.0	9.7	10.1	11.7	8.6	8.4
Community,Social Services	13.0	2.8	6.9	12.5	11.7	4.3	6.0	6.8	7.0
GDP	**100.0**	**9.6**	**9.3**	**6.7**	**8.6**	**9.3**	**6.2**	**5.0**	**5.7**

Source: CSO, Citi Research Estimates

GDP by Expenditure: While there are data issues in this series, key to note is the near halving of consumption growth which, after being steady at ~8% levels for the last 6 years, slowed to a mere 4.1%. This could be attributed to the relatively higher rate environment and the containment in govt spending seen since Sept 12. As regards investments – while gross capital formation saw a pickup to 3.9%, net investments decelerated further to 2.5%. (see FY13 GDP at a Decade Low)

Cabinet Committee on Investments – Some Hope

Figure 20. Trends in Investments (%)

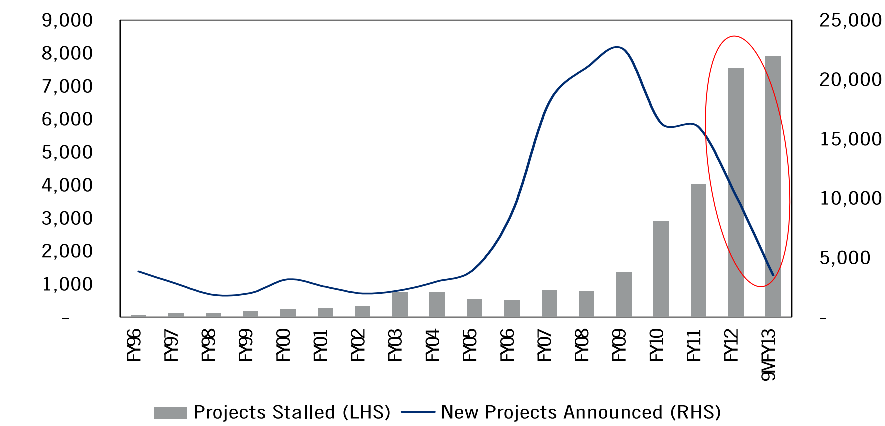


Source: CSO; Citi Research

One of the few recent rays of light on the macro front is that the Cabinet Committee on Investments (CCI) set up to intervene regarding project delays has made progress in its first few meetings. (see pg 18)

We re-iterate, that the proposed CCI appears tamer than the initially proposed National Investment Board which was supposed to have "appellate powers" and over-ride decisions made by individual ministries. However, the delta change appears positive and could help stem the current dismal project investment trends.

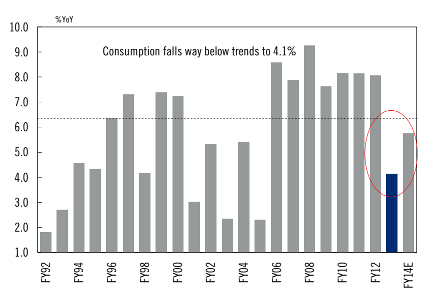
Figure 21. Projects Announced vs Projects Stalled (Rs bn)



Source: Source: http://capex.cmie.com (Centre for Monitoring Indian Economy), Citi Research

Bottom Line: FY14 Shallow Recovery Depends on Policy

Figure 22. Trends in Consumption (%)



Source: CSO; Citi Research

While the govt has taken several measures since Sept 12, continued action from all policy makers is needed to reverse the decline across all the macro variables. Assuming positive incremental policy action, we expect FY14 GDP to come in at 5.7%. This factors in: (1) The RBI easing rates by a further 50bps by 1H13; (2) A pick-up in consumption as FY14 is a pre-election year and lower rates could help; (3) A marginal uptick in investments, which rests on continued government efforts – both policy change and execution. However, if current trends in projects stall/new intentions do not improve, the headline number could be lower by ~60-80bps.

Figure 23. Trends in GDP (%)

	Wts	FY07	FY08	FY09	FY10	FY11	FY12	FY13*	FY14E
Agriculture	13.7	4.2	5.8	0.1	0.8	7.9	3.6	1.8	3.0
Industry	27.0	12.2	9.7	4.4	9.2	9.2	3.5	3.1	4.4
Services	59.3	10.1	10.3	10.0	10.5	9.8	8.2	6.6	7.0
Consumption	71.0	7.9	9.3	7.6	8.2	8.1	8.1	4.1	5.7
Private Consumption	59.7	8.7	9.2	7.1	7.1	8.6	8.0	4.1	5.5
Public Consumption	11.4	3.8	9.6	10.4	13.9	5.9	8.6	4.1	7.0
Gross Capital Formation	38.6	13.4	18.1	-5.2	16.7	16.2	1.5	3.9	4.2
Fixed Capital Formation	33.4	13.8	16.2	3.5	7.7	14.0	4.4	2.5	4.0
GDP	**100.0**	**9.6**	**9.3**	**6.7**	**8.6**	**9.3**	**6.2**	**5.0**	**5.7**

*FY13 CSO's Advance Estimates; Source: CSO; Citi Research

Monetary Indicators

Diverging Trends in WPI and CPI Likely to Continue

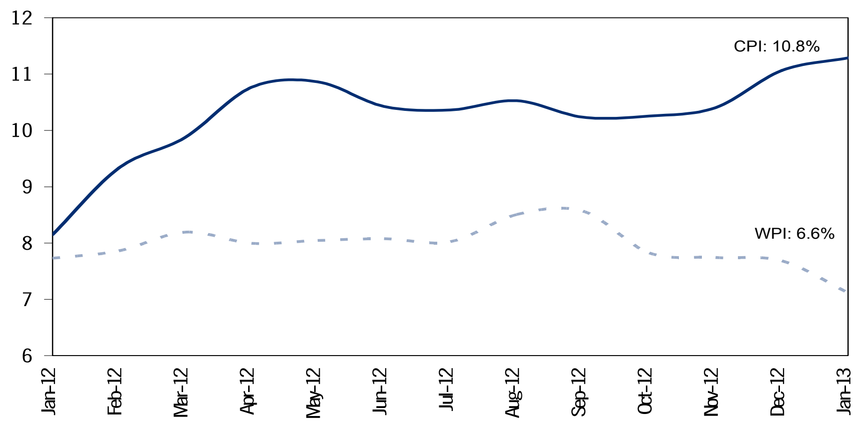
Figure 24. Trends in WPI (%)

	Wts	Nov-12	Dec-12	Jan-13
Primary Art	20.1	9.6	10.6	10.3
%MoM		0.8	-0.5	0.6
Manuf Prods	65.0	5.4	5.0	4.8
%MoM		0.1	0.0	0.2
Fuel Index	14.9	10.0	9.4	7.1
%MoM		-0.6	0.1	0.3
WPI		7.2	7.2	6.6

Source: Office of the Econ Advisor; Citi Research

WPI: India's WPI surprised positively for the fourth consecutive month with the headline print coming in at 6.6%, lower than expectations and the 7.2% reading last month. Two bits of good news: (1) Manufactured non-food product inflation (the RBI's proxy to core) came in at 4.1%, in line with the RBI's comfort zone of 4%; (2) On a seasonally-adjusted basis, headline WPI was down 0.1% MoM, while core was flat. While these numbers partially reflect the recent fuel price reforms, coal prices remain un-adjusted since Jan 12.

Figure 25. Trends in Headline WPI and Headline CPI (%)



Source: Citi Research

Figure 26. Trends in CPI (%)

	Wts	Nov-12	Dec-12	Jan-13
1. Food, Tobacco	49.7	11.8	13.0	13.2
2. Fuel and Light	9.5	7.4	8.2	8.5
3. Clothing	4.7	11.1	10.7	11.0
4. Housing	9.8	10.4	10.3	10.3
5. Miscellaneous	26.3	6.7	6.8	7.0
Headline CPI	**100**	9.9	10.6	10.8
%MoM		0.4	0.2	0.6
Rural	57.0	10.0	10.7	10.9
Urban	43.0	9.7	10.4	10.7

Source: MOSPI:

CPI: In contrast to the WPI, the headline combined CPI continued to inch higher, coming in at 10.8% vs the 10.6% reading last month. The uptrend was seen across all components, led by higher food prices up 13.2% – mainly due to veggies which rose 26%, fuel up 8.5%, clothing up 11% and housing up 10.3%. Given the across-the-board rise in prices, core CPI (Ex Food & Fuel) reversed the flattish trend seen in the last few months, edging marginally higher to 8.2%. Just a reminder, the key reason for the near ~300bps divergence in the WPI and CPI readings is the higher weight of food in the CPI vs WPI (Food wts: CPI 49.7%; WPI 20.1%).

Outlook: Relatively Benign Trends in WPI in the Near Term

Admittedly, certain elements of inflation are sticky, in particular food and the persistent rise in wage growth where latest readings peg the latter at 18%. However, given that ~57% of India's WPI basket is tradable, provided the INR doesn't depreciate beyond Rs56/$, lower/stable commodity prices bode well for near-term trends in WPI before edging up as the fuel price impact kicks in. (See Fuel Price Reforms). We thus expect the headline WPI to come in at 6%-7% in FY14 v/s the 7%-8% readings in FY13.

On an annualised basis, the implementation of the proposed Rs0.5/ltr monthly hike could have a ~60bps direct impact on WPI and an additional 30bps from second-round effects/increase in prices for bulk users

Figure 27. "Suppressed" Inflation Assuming Implementation of Monthly Hike

	Weight in WPI	Current Price	Current Losses	Required Price Hikes	Impact on Inflation
Liquefied petroleum gas	0.90%	423	490	116%	1.0%
Kerosene fuel	0.70%	15	31	207%	1.5%
High speed diesel	4.70%	51+6	3.	5.3%	0.2%
Overall impact	**6.30%**				**2.70%**

Source: Citi Research

Tough balancing act for the RBI

Growth a concern…

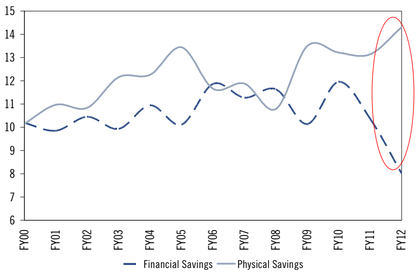
The latest GDP data indicates a near halving in consumption (FY13 GDP at a Decade Low), thus emphasizing the need for continued efforts by ALL policy makers to support growth. The RBI has acknowledged saying that "monetary policy has to increasingly shift focus and respond to the threats to growth".

…But elevated CAD and CPI to limit easing to 50bps

While growth has fallen off the cliff, the RBI is equally concerned about

- **Sharp fall in financial savings:** Recently released CSO data indicate a sharp deceleration in savings to 30.8% of GDP from 34% in FY11. An alarm bell in the savings data is the fall in financial savings, now in single digits, i.e. 8% of GDP vs 12% in FY10 – a result of high inflation and better returns on alternate assets like gold/real estate. (See Savings Update). The widening gap between household financial and physical savings has resulted in (1) Annual average gold imports rising to 850-900 tonnes from 650-700 tonnes earlier thereby resulting in a higher import bill; and (2) Tight domestic liquidity conditions as deposit growth has come off from 16%+ to 12% currently while loan growth continues to hover at 16%.

Figure 28. Trends in Savings (%)



Source: CSO

- **Double-digit CPI:** While the WPI has eased considerably, the CPI remains elevated at ~11% levels. This brings to fore the RBI's dilemma of responding to industry demands of lowering rates to boost growth vs the need to keep the interests of savers into account.

- **Level, Composition and Financing of the CAD:** After touching a record high of US$78.2bn or 4.2% of GDP in FY12, we believe India's current account deficit (CAD) is set to edge even higher to US$88bn or 4.7% in FY13E. At a recent seminar, Governor Subbarao highlighted three concerns about CAD: (1) The level of CAD; (2) Quality of CAD due to imports of oil and gold; and (3) Method of financing through increasingly volatile flows.

<u>Bottom Line</u> – Easing to be limited to 50bps

While GDP is now at a decade low and positive surprises in WPI could continue, elevated levels of the CAD and CPI would limit rate cuts. We maintain our view of a further modest 50bps easing in 2013 with a 25bps cut in the March 19 policy.

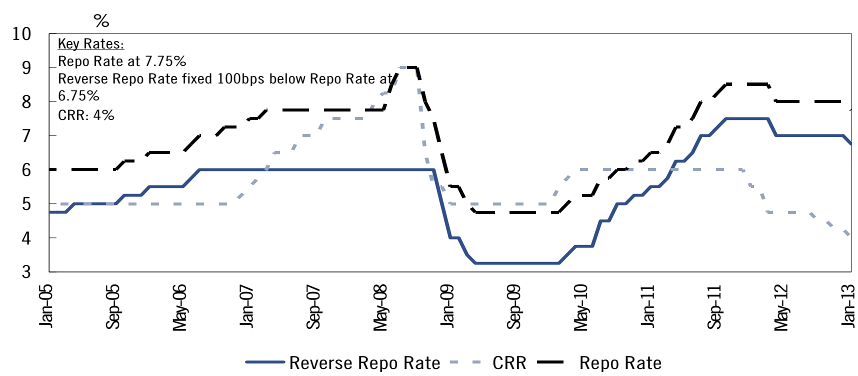
Rate Action in 2013

- **Repo Rate by 25bps to 7.75%**
- **CRR by 25bps to 4%**

Quick Recap of 2012 Policy Actions

- **CRR – cut four times to 4.25%**
- **SLR cut 100 bps to 23% (Aug)**
- **Repo Rate cut 50 bps to 8% (Apr)**

Figure 29. Trends in Policy Rates (%)

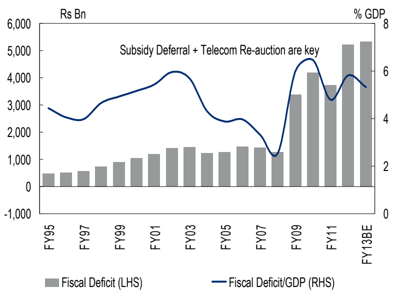


Source: RBI

Fiscal Indicators

Belt Tightening Continues

Figure 30. Centre's Deficit (Rsbn, % of GDP)



Source: Budget Documents

Latest trends in government finances on both the revenue and the expenditure front are encouraging with revenues in line with estimates and expenditures below budgeted rates thereby resulting in a marginal fiscal surplus in December. While admittedly, there is some seasonality in the December tax numbers, the key factor responsible for the improvement in government finances is a larger than expected compression in expenditure. A continuation of trends since September now makes the government's 5.3% deficit target seem more achievable. This is in contrast to trends a few months ago when expectations were of a deficit close to 5.9% levels.

Expenditure: Expenditure remained in check for the fourth consecutive month with spending in December down 9% YoY. Cumulatively, during April-December, total expenditure was Rs9,911bn, up 10.6% YoY and 67% of budget estimates. While the run-rate on expenses is below the budgeted rate of 13.1%, key points to note are: (1) The subsidy estimates in the budget have little provision for fuel subsidy in FY13; (2) Expenditure compression is largely due to plan expenditure which is up 6.9% vs a targeted rate of 22.1%.

Revenues: While tax collections have picked up last quarter, cumulative collections are well below budget estimates. We have factored in a slippage of Rs300bn on tax collections as the budget estimates are based on real GDP growth of 7.6% where-as latest government data pegs growth at 5%. While tax collections are likely to come in below budget estimates, market-based revenue items i.e. non-tax revenues as well as divestment proceeds could come close to targets.

APR-DEC FISCAL TRENDS

Revenues: were up 13.8%YoY (at Rs5.9tr) vs. budget estimates of 22.7%

Expenditures: were up 10.6% YoY (at Rs9.9tr) vs. budgeted growth of 13.1%

Fiscal Deficit: Rs4,047bn or 79% of budget estimates

Figure 31. Latest Fiscal Snapshot – April-December FY13 (Rs Bn, %)

	Dec-12	%YoY	Apr-Dec FY13	%YoY	Budget Est. FY13	% to Total Budget	Budgeted Growth Rate
a. Revenue receipts	1,247	18.0	5,705	14.5	9,357	61.0	22.0
Net tax revenues	1,146	14.6	4,842	15.2	7,711	62.8	20.1
Non-tax	102	77.2	864	10.6	1,646	52.5	32.0
b. Non-debt cap receipts	70	197.9	159	-5.8	417	38.1	40.0
c. Total receipts (a+b)	**1,317**	**21.9**	**5,864**	**13.8**	**9,773**	**60.0**	**22.7**
d. Revenue expenditure	1,033	-7.2	8,686	10.7	12,861	67.5	10.7
e. of which interest	191	41.3	2,019	12.5	3,198	63.1	16.0
f. Capital expenditure	202	11.6	1,226	9.6	2,048	59.8	30.6
g. Total expenditure (d+f)	**1,235**	**-9.0**	**9,911**	**10.6**	**14,909**	**66.5**	**13.1**
h. Plan Expenditure	525	-5.6	2,959	6.9	5,210	56.8	22.1
i. Non Plan Expenditure	710	-11.3	6,952	12.2	9,699	71.7	8.7
j. Fiscal deficit (g-c)	**(82)**	**-129.8**	**4,047**	**6.2**	**5,136**	**78.8**	
k. Revenue deficit (d-a)	(215)	-480.1	2,980	4.2	3,504	85.1	
l. Primary Deficit (j-e)	(273)	-293.5	2,028	0.6	1,938	104.6	

Source: CGA, Ministry of Finance

So how could the government meet its target?

Key items to watch in the budget statement are (1) Divestments - the new norms and pricing are making a difference; (2) Telecom Re-auction; (3) Further Expenditure Compression; and (4) Extent of Subsidy Deferral.

Expenditure Compression: On the expenditure front, as non-plan expenditure is largely "committed" expenditure – i.e. spending on interest, wages, subsidies and defense – there is little room for maneuverability. Additionally, the current run rate of 12.2% is higher than the budgeted growth rate of 8.7%. Thus, apart from a bit of "tweaking" on the non-plan side, one could see a further compression of plan expenditure to help enable the government meet its estimates. Key to note is that the Finance Ministry has directed ministries to cap spending in the Jan-Mar quarter to 33% of total funds allocated.

Figure 32. Subsidy-Sharing Mech. (Rs bn)

	FY12	FY13E	FY14E
Gross under-recoveries	**1,385**	**1,673**	**1,180**
Diesel	812	959	484
LPG	300	391	370
Kero	273	323	326
Less: upstream sharing	**550**	**609**	**640**
% of Total	40%	36%	54%
Less: oil bonds/cash	**835**	**1065**	**540**
% of Total	60%	64%	46%
Net under-recoveries	0	0	0
Brent Crude (US$/bbl)	115	110	110
USD/INR	48	54	54

Source: Ministry of Petroleum and Natural Gas, Citi Research estimates

Subsidy Deferral: Moving on to subsidies, the government had pegged the total subsidy outlay at Rs1900bn. However, as is now well known, the FY13 outlay of Rs436bn on fuel subsidies has been utilized to the tune of Rs385bn as payment of FY12 dues. Given current oil prices, losses being made by oil companies are estimated at Rs1,670bn. Similar to past trends, our base case assumes the governments share at 60% (i.e. Rs1000bn) and a 50% deferral to FY14 (Rs500bn). The deficit could be lower if the govt changes the subsidy sharing mechanism and/or defers a higher amount for FY14.

On divestments, including the recent success of OIL and NTPC, the govt has raised ~Rs230bn of its Rs300bn divestment target. The over-subscription of both PSU's was attributed to the modified "investor friendly" divestment norms (i.e. zero % margin, indicative pricing throughout the day, and attractive terms). Continuation of this could enable the success of the other upcoming issuances which would thus help the government to meet its targets.

As regards non-tax revenues, 2G Spectrum telecom revenues raised so far are Rs94bn vs an anticipated amount of Rs400bn. The government has now lowered the price and scheduled the re-auction for 11 March 2013. If it is successful, the government could raise Rs100bn and an additional Rs100bn from excess spectrum charges. Another possibility on the non-tax revenue front is higher dividend pay-outs by PSU's.

Key to note is that deficit ratios which are calculated as a percentage of nominal GDP could be impacted given the CSO's advance GDP estimates of 5% for FY13. This puts the govt's 5.3% fiscal deficit target at risk but to a lesser extent than previously expected.

MEASURES TO MEET TARGET

1. Divestment: New Norms, Attractive Pricing

2. Telecom: A Successful Re-auction

3. Subsidies Deferral

4. Expenditure Compression

Figure 33. How could the govt meet its revised "5.3%" fiscal deficit target? (Rs Bn)

Budgeted fiscal deficit for FY13	**5,136**
Fiscal deficit as % of GDP	**5.1**
Add:	
Shortfalls in tax revenues	300
Shortfalls in telecom revenues – Assumes a successful re-auction	100
Total Under-recoveries	1000
Less:	
Under-recoveries Deferred	600
Expenditure Compression	440
Food/Fertiliser Subsidies deferred	100
Total fiscal deficit	**5,396**
Nominal GDP estimate*	101,399
Fiscal deficit as % of GDP	**5.3**

*CSO's Nominal GDP pegs it at Rs100, 281bn. Source: Ministry of Finance, Citi Research estimates

Bottom Line – Rays of Light towards Fiscal Consolidation

The recent fuel price reforms, coupled with steps to contain expenses, bode well for the govt's commitment towards fiscal consolidation. This has led to rating agencies lowering the possibility of a rating downgrade. However, India cannot afford to let its guard down. Key things to watch for include (1) Budget and its assumptions due on Feb 28; (2) The implementation of the cash transfers which has started in a few districts; and (3) Measures to attract capital inflows.

Figure 34. India's Sovereign Ratings

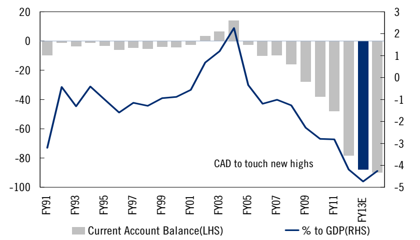
	S&P	Moody's	Fitch
LT Foreign Currency	BBB-	Baa3	BBB-
LT Local Currency	BBB-	Baa3	BBB-
Outlook (FC)	Negative	Stable	Negative

Source: Rating Agencies

External Sector

CAD – To Break Record Highs

Figure 35. Trends in CAD (US$bn, % to GDP)



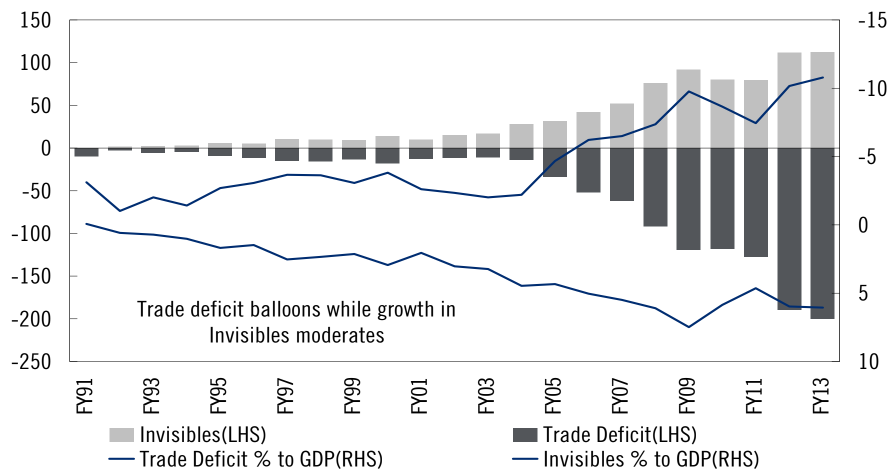
Source: RBI; Citi Research

Following a record high CAD of US$78bn or 4.2% of GDP in FY12, India's FY13 CAD is likely to edge higher to US$89bn or 4.7%. This is on the back of:

A widening trade deficit – Given the changing composition of exports, Indian exports are now more sensitive to global demand rather than a weaker INR. While January saw the first positive export reading (+0.8%), cumulatively during Apr-Jan, exports were US$240bn down -4.9%. As regards imports, despite the deceleration in GDP imports led by oil and gold remained high at US$407bn during Apr-Jan. This resulted in a widening of the trade deficit to US$167bn v/s US$155bn last year. We expect the FY13 trade deficit to widen to US$200bn vs US$190bn in FY12.

A moderation in invisibles – As highlighted earlier, while software exports and remittances remain buoyant, the factor resulting in a moderation in invisibles is the near doubling of investment income outflows. This is a result of recourse to external debt which has risen from US$224bn in FY08 to US$365bn in FY13.

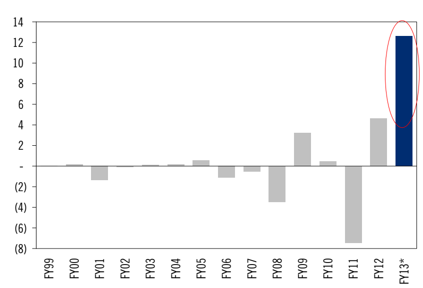
Figure 36. Trends in Trade Deficit and Invisibles (US$bn, % to GDP)



Source: RBI Citi Research

Revision in Oil Data Key to Keeping the Deficit <5% of GDP

Figure 37. Difference in Oil Import Data (US$bn)



Source: *FY13 data is for the period Apr-Dec; Ministry of Commerce, Ministry of Petroleum

A peculiarity in the FY13 import data is the substantial difference between the reporting of the oil import bill by the Commerce Ministry and that of the Petroleum Ministry. At that outset, key to note is that there is generally a difference of ~US$1.5bn, with higher numbers being reported by the Ministry of Petroleum.

However, in the current year, oil imports during Apr-Dec as reported by the Ministry of Commerce stand at US$125bn while those by the Petroleum Ministry were at US$113bn. Given that the Finance Ministry is scrutinizing all the data closely, we expect this difference of ~US10bn as reported by the Commerce Ministry to be adjusted to reflect the Ministry of Petroleum data.

However, if there is no adjustment to the data, the FY13 CAD could then touch US$99bn or 5.3% of GDP.

Capital Account – Dependence on Volatile Flows Rise

Capital flows have so far been buoyant, thus comfortably financing the rising deficit. However, a key concern as highlighted by Governor Subbarao is the composition of financing. As seen in figure 38 below, the share of FDI has been relatively static and there is growing dependence on portfolio flows, NRI deposits and recourse of overseas loans. This is a concern, especially in an oscillating risk on/off global macro environment.

Figure 38. Trends and Composition of the Capital Account (US$bn)

	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
I. Current A/c	**-9.6**	**-15.7**	**-27.9**	**-38.2**	**-48.1**	**-78.2**	**-87.9**	**-89.9**
II. Capital A/c								
a. Borrowings	**24.5**	**40.7**	**8.3**	**12.4**	**29.1**	**19.3**	**21.0**	**20.0**
External Assistance	1.8	2.1	2.4	2.9	4.9	2.3	2.0	2.0
Commercial Borrowings	16.1	22.6	7.9	2.0	12.2	10.3	12.0	12.0
Short-term credit	6.6	15.9	-2.0	7.6	12.0	6.7	7.0	6.0
b. FDI (Net)	**7.7**	**15.9**	**19.8**	**18.0**	**11.8**	**22.1**	**23.0**	**28.0**
c. Portfolio Invst	**7.1**	**27.4**	**-14.0**	**32.4**	**30.3**	**17.2**	**25.0**	**23.0**
d. Banking Capital	1.9	11.8	-3.2	2.1	5.0	16.2	17.0	16.0
Commercial Banks (Net)	-2.4	11.6	-2.8	1.9	4.4	16.0	1.0	1.0
NRI Deposits	**4.3**	**0.2**	**4.3**	**2.9**	**3.2**	**11.9**	**16.0**	**15.0**
e. Rupee Debt Service	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4
f. Other capital	4.2	11.0	-4.0	-13.2	-12.4	-6.9	1.0	1.0
II. Total Capital A/c (Sum a:f)	**45.2**	**106.6**	**6.8**	**51.6**	**63.7**	**67.8**	**86.6**	**87.6**
Overall BOP I + II	**36.6**	**92.2**	**-20.1**	**13.4**	**12.7**	**-12.8**	**-1.3**	**-2.3**

Source: RBI, Citi Research

Bottom Line — CAD Pressure Rises Substantially

Policy makers are aware of the gravity of the problem as reflected in Governor Subbarao's recent comments on the level, the quality and financing of the CAD.

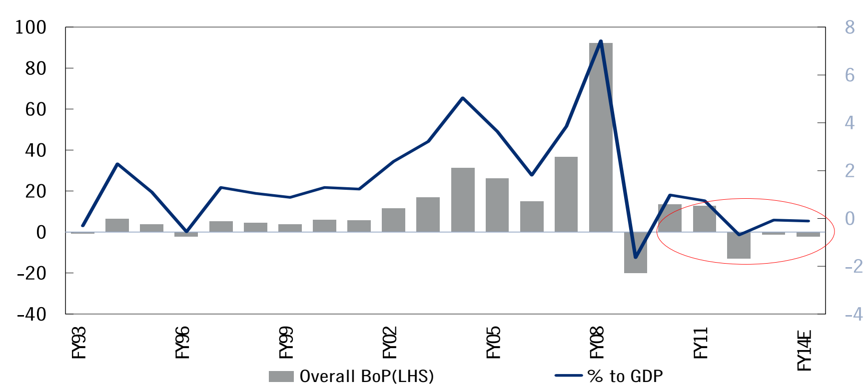
Over the last few months, officials have taken several steps to boost dollar inflows including (1) de-regulating NRI deposit rates, (2) relaxing ECB norms, (3) increasing FII debt limits, (4) liberalization of FDI, (5) postponement of GAAR, and (6) higher duties on gold. Given India's rising external financing requirements, we expect capital raising to be a key priority in 2013. Pls see pg 4-7 of India Macroscope –The Capital Question for details.

Figure 39. Trends in External Debt (US$bn)

India's external debt	FY08	FY12	FY13 *
Multilateral	39.5	50.5	50.7
Bilateral	19.7	26.7	27.6
IMF	1.1	6.2	6.1
Trade Credit	10.3	19.0	19.0
Commercial Borrowing	62.3	104.9	109.0
NRI Deposits (> 1 year)	43.7	58.6	67.0
Rupee Debt*	2.0	1.4	1.3
Total Long term debt	**178.7**	**267.2**	**280.8**
NRI Deposits (1 yr)	-	-	-
FII Invst in T-Bills	0.7	9.4	8.2
Others (trade related)	41.9	65.1	74.5
Other	3.2	3.7	1.8
Total Short term debt	**45.7**	**78.2**	**84.5**
GROSS TOTAL DEBT	**224.4**	**345.4**	**365.3**

Source: RBI; MOF: Citi Research

Figure 40. Trends in Overall Balance of Payments (US$bn, % to GDP)



Source: RBI; Citi Research

Financial Markets

INR Likely to Remain Under Pressure

Figure 41. Trends in USD/INR

Source: Bloomberg

Trends So Far/Outlook: The rupee has been trading in the Rs53-55 range in 2013. On a 6 month perspective, taking into account the relative growth story and capital inflows being close to financing the CAD, we maintain our view of the unit trading in the Rs54-56 range. Given the elevated levels of CAD, we do not expect the unit to retrace back to 2011 levels.

Factors Supporting Current Trading Range: While the macro is clearly far from comfortable, at current USD/INR levels, the risks look priced in. More-over, the RBI appears to have enough ammunition to attract capital flows including further liberalizing the window under external commercial borrowings and increasing FII debt limits for bonds. Lastly, given the commodity outlook, the INR should be supported by falls in oil prices.

What Could Change the Picture?

- **Global Liquidity Conditions:** The current easy global liquidity environment has led to higher inflows despite a poor macro backdrop. Fiscal YTD, portfolio flows including debt stand at US$23bn. Given the economy's dependence on capital flows, the unit has a high beta in terms of global risk appetite.

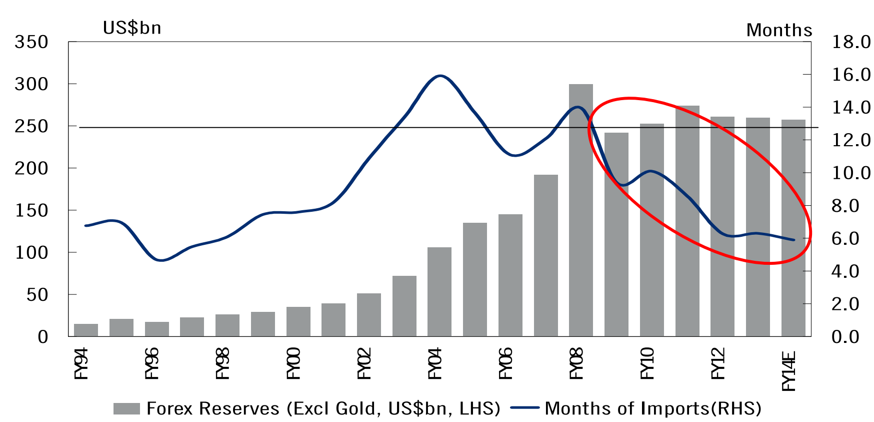
- **Higher Oil Prices:** In contrast to expectations, oil prices have moved up in 2013. India is one of the EM's that is more severely impacted as it imports 70% of its crude oil requirements. Oil imports comprise 30% of the import bill and every US$1/bbl change in prices impacts the deficit by US$900mn.

- **Domestic Factors:** The reforms seen since Sept 12 have increased investor appetite. Uncertainty in the run up to elections could impact the reform momentum, which could in turn temper investor interest.

- **Ratings Downgrade:** The probability of a ratings downgrade has considerably reduced following government measures. However, agencies continue to watch India closely.

Bottom Line: Given India's elevated CAD and declining import cover ratio, the risks of a weaker rupee are more than that of the unit retracing back to its 2011 levels.

Figure 42. Trends in Forex Import Cover (US$bn, Months of Imports)



Source: RBI, Citi Research

Policy Watch

Takeaways from the FM's Road show

Citi, among other investment banks, hosted the Finance Minister in most of the global financial centres. The key takeaway was his openness and willingness to take in audience feedback and suggestions. The FM was both clear and confident – of what needs to be done, how and when it will be done, and timelines. This is across a spectrum of issues (Fiscal, Growth, Investments, CAD, FII taxation / regulations and GST), and in meeting near-term targets. (See FM Road show)

Figure 43. Upcoming Elections

State	Ruling Party	Seats LS	Seats RS	Date
Meghalaya	Congress	2	1	Mar-13
Tripura	CPI(M)	2	1	Mar-13
Nagaland	NPF	1	1	Mar-13
Karnataka	BJP	28	12	Jun-13
Madhya Pradesh	BJP	29	11	Dec-13
Mizoram	Congress	1	1	Dec-13
NCT Delhi	Congress	7	3	Dec-13
Rajasthan	Congress	25	10	Dec-13
Chattisgarh	BJP	11	5	Jan-14

Source: PRS, Election Commission

Figure 44. The Finance Minister's comments on key issues

Issue	Comment
GDP target	FY14: 6.5-7%. FY15: ~8%
Fiscal consolidation	Top priority. Curtailing expenditure in the short-term. In the medium run, aiming to cut fiscal deficit by 60bps per year and reduce it to 3% in 4 years from 5.3% in FY13E. Long-term goal is to increase revenues, not by raising taxes, but by simplifying tax processes and increasing tax base.
Current account deficit	CAD is likely to remain high even in FY14. However, capital flows (portfolio and FDI) should be sufficient to plug the gap.
Rating downgrade threat	Very confident that rating downgrade will not happen.
GAAR	Has been postponed till April 2016.
GST	Targeting to introduce the bill in the August session of the parliament and get it passed by December. All states are already on board.
Cabinet Committee on Investments	First meeting at Jan end. Will resolve inter-ministerial frictions on projects, with key focus on infrastructure projects.
Infrastructure development funds	3 such funds have been approved and another 6 are in pipeline. Banks can sell loans to these funds projects that have been running for over a year.
Debt limits for FIIs	The ceiling for Govt. bonds holdings would be raised from \$10bn to \$15bn, with no residual maturity constraint. Limit for corporate bonds holdings would be increased from \$20bn to \$25bn. Lock-in period for Infra bonds would be done away with.
KYC norms	A committee set up to simplify KYC norms

Source: Citi Research

…But In Politics – Never, say Never

India's politics has been a key swing element in some recent challenges - as also in the turn-around since July 12. The FM was quite confident on the policy turnaround, and said that most political parties are on board and more would have been done if the Winter parliament session had been longer. The budget session of parliament would most likely see further legislation being passed (see Figure 47). Thereafter, we would be a bit cautious, given the upcoming elections.

Figure 45. Current Composition of Lok Sabha

Party	Seats	Party	Seats
Indian National Congress(INC)	205	Bharatiya Janata Party(BJP)	114
Dravida Munnetra Kazhagam(DMK)	18	Janata Dal (United) (JD(U))	20
Nationalist Congress Party(NCP)	9	Shiv Sena(SS)	11
J&K National Conference(JKNC)	3	Shiromani Akali Dal(SAD)	4
Indian Union Muslim League (IUML)	2	Telangana Rashtra Samithi(TRS)	2
Rashtriya Lok Dal(RLD)	5	Biju Janata Dal(BJD)	14
Others/ Independents	13	AIADMK	9
UPA	**255**	Telugu Desam Party(TDP)	6
Supporting Parties		Janata Dal (Secular) (JD(S))	3
Samajwadi Party(SP)	22	All India Trinamool Congress TMC	19
Bahujan Samaj Party(BSP)	21	Jharkhand Vikas Morcha JVM (P)	2
Rashtriya Janata Dal(RJD)	4	Left Demo. Front	25
Total:	**47**	Others	11
		Total Opposition	**240**
UPA Incl. Outside Support:	**302**	**TOTAL LOK SABHA**	**542**

Source: www.loksabha.nic.in

Figure 46. Current Composition of Rajya Sabha

Party	Seats	Party	Seats
Indian National Congress(INC)	70	Bharatiya Janata Party(BJP)	49
DMK	7	Janata Dal (United) (JD(U))	9
Nationalist Congress Party (NCP)	7	Shiv Sena(SS)	4
J&K National Conf (JKNC)	2	Shiromani Akali Dal(SAD)	3
Rashtriya Lok Dal(RLD)	5	India National Lok Dal (INLD)	1
UPA	**91**	Biju Janata Dal(BJD)	7
Supporting Parties		Asom Gana Parishad (AGP)	2
Samajwadi Party(SP)	9	Telugu Desam Party (TDP)	5
Bahujan Samaj Party(BSP)	15	AIADMK	5
Rashtriya Janata Dal(RJD)	2	Left Parties	12
Bodoland People's Front (BPF)	1	All India Trinamool Congress TMC	9
Lok Janasakti Party (LJP)	1	**Total Opposition**	**106**
Mizo National Front (MNF)	1		
Nagaland People's Front (NPF)	1	Nominated	10
Total:	**30**	Other Parties/ Independents	7
UPA Incl. Outside Support:	**121**	**TOTAL RAJYA SABHA**	**244**

Source: www.rajyasabha.nic.in

Reforms – Incrementally Positive

Since Sept 12, the govt and the FM have delivered significantly on policy reforms (in absolute terms, and against low expectations) – and the markets have responded warmly.

Fuel Price Changes: A Good Sign

The incremental fuel price reform momentum seen since Sept 2012 has been significantly better than expectations. Following the 12% hike in diesel prices last Sept, the govt has authorized oil marketing companies (OMCs) to raise diesel prices by Rs0.5/ltr per month till losses are nullified. It is encouraging that two monthly hikes (Jan and Feb) have come into effect. As discussed in our note (see Fuel Price Reforms), we estimate that implementation of a monthly hike could result in a saving of 0.5% of GDP.

Cabinet Committee on Investments

In its first meeting on Jan 30th, the CCI reviewed key oil and gas projects which had been put on hold by the ministry of defence due to "security and strategic reasons". A decision can be expected within a month. In its next meeting, scheduled for Feb 20th, the CCI is expected focus on coal and power issues related to clearances regarding coal mining projects. Railways are also likely to be next on the agenda.

Figure 47. Govt. Actions and Reforms since September 2012– Announced / Pipeline

Announced / Passed Reforms	Key Features
Fuel Price Hike	Diesel price raised by Rs 5/ltr, Subsidised LPG cylinders capped at 6/household
Fuel Price Hike pt II	Bulk users to pay market price, phased hike proposed, LPG cap raised to 9
FDI	
Multi-Brand Retail	51% FDI permitted subject to State approval
Single- Brand Retail	FDI beyond 51% requires 30% sourcing locally from MSMEs, cottage industries etc.
Broadcasting Services	74% FDI allowed in teleports, mobile TV and sky broadcasting services
Power Exchanges	49% FDI allowed
Civil Aviation	49% FDI in scheduled and non-scheduled air transport services
Divestment in PSUs	Divestment proceeds of approximately Rs 150 bn
Competition Bill	All sectors under the purview of competition law, merger of weak/ failing banks excluded
Enforcement of Security Interest and Debt Recovery Bill	Amends the process for recovery of secured loans
Banking Laws (Amendment) Bill	Addresses issues on capital raising, voting rights, mandatory approval from RBI for acquiring 5% + stake
SEB loan restructuring	US$38bn of loans restructured/ converted to state debt
Overseas Loans	Withholding tax lowered from 20% to 5%
Companies Bill (Amendments)	Ensures more transparent corporate governance
Urea Price Hike	Price raised by Rs 50pmt.
Govt. UTI sale in select Stocks	Stock sales could raise a total holding ~Rs 440bn
Rail hike	Across the board hike in Passenger fares
Import duty on gold & platinum	Import duty on gold and platinum hiked to 6%
Pending Reforms	**Key Features**
Land Acquisition Bill	For commercial land acquisition, and rehabilitation
National Food Security Bill, 2011	Provides for food and nutritional security by providing specific entitlements to certain groups
Public Procurement Bill, 2012	Regulate public procurement to further transparency, accountability, and probity in the procurement process
Mines and Minerals Bill, 2011	Consolidates and amends the law relating to the scientific development and regulation of mines and minerals
Goods and Services Tax (GST)	Landmark Change - for efficiency, GDP and tax collections
Direct Taxes Code (DTC)	A simplified Tax platform
FDI	
Insurance	49% FDI allowed, public sector insurance cos can get listed w government stake at least 51%
Pension	49% FDI, has one term 'return scheme' action, gives statutory power to regulatory authority

Source: News Reports: Citi Research

Monthly Monitor

Figure 48. India — Key Monthly Indicators (percent change from a year ago unless otherwise stated)

	Nov11	Dec11	Jan12	Feb12	Mar12	Apr12	May12	Jun12	Jul12	Aug12	Sept12	Oct12	Nov12	Dec12
Consumption Trends														
Two-Wheelers	25.0	8.5	13.6	12.0	8.0	10.8	11.2	9.2	7.2	-4.8	-13.3	12.0	1.0	4.1
Passenger Car Sales	6.0	7.2	6.3	11.8	18.4	3.4	2.8	8.6	7.3	-18.2	-5.1	24.5	-7.5	-11.4
Commercial Vehicle Sales	37.2	16.7	15.0	20.0	16.4	5.6	10.1	4.7	1.2	3.9	0.1	8.0	-7.3	-13.0
LCV	52.4	23.0	16.9	34.0	35.6	18.2	26.5	19.3	12.7	13.3	11.6	31.9	9.4	5.9
MHCV	18.8	9.1	12.7	5.3	-1.3	-11.6	-10.6	-13.4	-14.6	-8.8	-14.6	-22.9	-33.1	-38.3
Investment Trends														
Infrastructure Index	7.8	4.9	0.7	6.9	2.3	3.2	4.0	3.8	1.1	2.3	5.0	6.5	1.8	2.7
Cement Dispatches	19.0	13.8	9.9	10.7	7.2	6.2	12.8	8.7	1.1					
Diesel Consumption	16.4	6.0	7.5	11.7	10.8	7.9	9.3	13.7	13.1	10.4	7.5	6.9	1.7	4.4
Steel Production	2.2	4.5	1.5	0.0	11.0	5.2	3.5	5.9	-1.2	7.9	-2.9	2.7	4.1	4.8
Manufacturing PMI*	51.0	54.2	57.5	56.6	54.7	54.9	54.8	55.0	52.9	52.8	52.8	52.9	53.7	54.7
Output	50.5	55.8	62.9	60.5	56.3	56.1	56.4	58.5	54.7	52.7	53.2	52.7	55.4	57.7
New Orders	52.8	57.9	62.2	62.8	58.1	61.1	59.6	58.5	54.9	54.3	54.4	54.9	55.8	58.0
Industrial Production Index														
General	6.0	2.7	1.0	4.3	-2.8	-1.3	2.5	-2.0	-0.1	2.3	-0.7	8.3	-0.1	-0.6
Manufacturing	6.6	2.8	1.1	4.1	-3.6	-1.8	2.6	-3.2	0.0	2.4	-1.5	9.8	0.3	-0.7
Mining	-3.5	-3.3	-2.1	2.3	-1.1	-2.8	-0.7	-1.1	-3.5	1.9	2.3	0.0	-5.5	-4.0
Electricity	14.6	9.1	3.2	8.0	2.7	4.6	5.9	8.8	2.8	1.9	3.9	5.5	2.4	5.2
Use Based Basic Goods	6.5	5.5	1.9	7.6	1.1	1.9	4.4	3.6	1.0	3.4	2.8	4.1	1.7	2.6
Capital goods	-4.7	-16.0	-2.7	10.5	-20.1	-21.5	-8.6	-27.7	-5.8	-3.4	-12.9	7.5	-7.7	-0.9
Intermediate goods	1.3	-1.5	-2.5	1.0	0.0	-1.8	3.4	0.9	0.1	2.7	1.7	9.3	-1.1	-0.1
Consumer goods	12.8	10.1	2.5	-0.4	1.1	3.7	4.4	3.7	0.7	3.3	-0.1	13.7	1.0	-4.2
Consumer Durables	10.4	5.1	-7.5	-6.2	1.2	5.4	9.7	9.1	0.8	0.6	-1.7	16.9	1.9	-8.2
Consumer Non-Durables	15.0	13.8	10.6	4.4	1.0	2.3	-0.1	-0.5	0.6	5.8	1.6	10.7	0.3	-1.4
Services														
Major Port traffic	-0.7	-6.5	-5.7	-6.2	-8.5	-6.5	-5.7	-5.0	-3.0	2.6	-2.0	0.1	-3.3	-4.9
Railway freight	5.9	8.7	5.4	9.0	5.6	3.5	5.6	5.3	3.1	3.5	8.2	8.0	0.8	1.6
Tourist arrivals ('000)	637	715	681	677	623	452	372	432	525	456	415	576	690	750
Cellular subscriber Adds (Mn)	3.7	9.2	9.9	8.6	8.1	6.8	8.4	-0.3	-20.6	-5.0	-2.1	-1.8	-13.6	-25.9
Banking Trends														
Money supply(M3)	15.6	15.9	14.7	13.7	12.9	13.0	13.3	15.6	13.7	13.9	13.4	13.1	13.4	11.3
Loan(Credit) growth	18.0	16.9	16.7	15.6	16.6	18.0	18.3	18.6	17.2	16.7	15.7	16.2	17.9	15.1
Deposit growth	16.9	17.4	16.4	14.6	13.6	13.6	14.1	16.0	13.8	14.1	13.8	13.8	13.8	11.0
Non-food credit	17.6	15.8	16.1	15.4	16.8	16.8	17.2	18.3	16.9	17.4	15.4	13.8	17.5.	14.9
Inflation														
CPI –Industrial Workers	9.3	6.5	7.6	8.8	9.4	10.3	10.4	9.9	9.9	10.0	9.7	9.8	9.9	10.6
WPI	9.5	7.7	6.9	7.4	7.7	7.5	7.5	7.6	7.5	8.0	8.1	7.5	7.2	7.2
Manufactured Products	8.2	7.6	6.7	5.8	5.2	5.3	5.2	5.4	5.9	6.4	6.5	5.9	5.4	5.0
Primary Products	8.9	3.6	2.8	7.1	10.4	9.6	10.3	9.7	10.5	11.2	9.2	8.2	9.4	10.6
Fuel Index	15.5	15.0	14.6	13.6	12.8	12.1	11.5	10.3	8.4	8.7	12.0	11.7	10.0	9.4
Interest rates (Average, %)														
Call money rate	8.3	8.5	8.8	9.0	8.8	8.6	8.6	8.07	8.0	8.0	7.9	8.04	8.02	8.31
91-day T-Bills	8.8	8.5	8.7	9.1	9.0	8.4	8.4	8.3	8.2	8.0	7.9	8.1	8.2	8.2
Corp Bond Spreads (5y GOI-AAA)	0.7	0.8	1.0	0.9	0.9	0.8	0.9	1.1	1.4	1.2	1.3	1.1	0.9	1.0
10-year government bond	8.9	8.5	8.3	8.2	8.4	8.6	8.6	8.2	8.13	8.21	8.18	8.2	8.2	8.1
Trade - customs data														
Exports(%YoY)	8.3	6.7	10.1	4.3	-5.7	3.2	-4.3	-5.4	-14.8	-9.7	-10.8	-1.6	-4.2	-1.9
Imports(%YoY)	35.6	19.8	20.3	20.6	24.3	3.8	-7.2	-13.5	-7.6	-5.1	5.1	7.4	6.4	6.3
Oil	59.6	26.1	26.8	39.5	32.4	7.0	14.0	-4.4	-5.5	3.0	30.7	31.6	16.8	23.6
Non-oil	26.7	26.2	17.6	13.5	19.9	2.1	-15.9	-17.8	-8.6	-8.7	-4.5	-1.7	1.5	-0.9
Trade Deficit (US$bn)	-15.8	-12.7	-14.8	-15.2	-13.9	-13.5	-16.3	-10.3	-15.5	-15.6	-18.1	-21.0	-19.3	-17.7
Brent Prices ($/bbl)	110.3	107.7	111.6	119.1	124.4	120.5	110.2	95.9	103.1	113.4	113.7	112.0	109.6	109.7
Foreign investment (US$ mn)														
FII	-586	4,195	5,087	7,164	387	-927	597	209	2,463	1,996	3,682	3,646	1,805	4,905
FDI	1,647	780	871	484	244	1,614	1,137	1,222	1,569	3,024	4,237	1,646	1,219	1,533
Exchange rate and reserves														
US$ exchange rate average	50.9	52.6	51.3	49.2	50.4	51.9	54.5	56.0	55.4	55.6	54.4	53.1	54.8	54.7
US$ exchange rate month end	52.2	53.1	49.5	49.0	50.9	52.7	56.1	55.6	55.7	55.5	52.9	53.8	54.3	54.8
Forex reserves incl.gold (US$bn)	304.4	296.7	293.9	295.0	294.4	295.4	288.3	290.0	288.6	290.5	294.8	295.3	294.5	296.6

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

Balance of Payments

Figure 49. India – Trends and Forecasts in the Balance of Payments (US$Bn, %)

	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	Comments
CURRENTACCOUNT								
Exports(RBI)	**166.2**	**189.0**	**182.4**	**256.2**	**309.8**	**294.3**	**317.8**	
Y/Y%	28.9	13.7	(3.5)	40.4	20.9	(5.0)	8.0	While a weak currency helps exports, the impact is muted
% of GDP	13.4	15.4	13.3	15.0	16.6	15.8	15.0	Due to changing composition and global slowdown
Exports–Customs*	**162.9**	**185.3**	**178.8**	**251.1**	**303.7**	**288.5**	**317.4**	
Y/Y%	28.9	13.8	(3.5)	40.5	20.9	(5.0)	10.0	
Imports(RBI)	**257.6**	**308.5**	**300.6**	**383.5**	**499.5**	**494.5**	**524.2**	
Y/Y%	35.1	19.8	-2.6	27.6	30.3	-1.0	6.0	
%to GDP	20.8	25.2	22.0	22.4	26.8	26.6	24.8	
Imports-Customs*	**251.4**	**310.3**	**288.3**	**369.7**	**488.6**	**489.7**	**521.6**	
Y/Y%	35.4	23.4	-7.1	28.2	32.2	0.2	6.5	Crude at US$111/bbl in FY12, US$108/bbl in FY13,US$96/bbl
Of which Oil	79.6	93.7	87.1	103.9	155.6	170.0	170.0	in FY14
Y/Y%	39.9	17.6	-7.0	19.3	49.8	9.3	0.0	**ΔUS$1/bbl in oil prices=US$900m impact on deficit**
Non-Oil	171.8	216.6	201.2	265.8	333.0	319.7	351.6	
Y/Y%	33.4	26.1	-7.1	32.1	25.3	-4.0	10.0	
Of which Gold	16.7	20.7	28.6	40.5	56.2	50.0	45.0	
Y/Y%	15.6	23.9	38.2	41.6	38.7	-11.1	-10.0	
a. Trade balance (RBI)	**-91.5**	**-119.5**	**-118.2**	**-127.3**	**-189.8**	**-200.3**	**-206.4**	Oil and Gold are key as they account for 40% of imports
% of GDP	-7.4	-9.8	-8.6	-7.4	-10.2	-10.8	-9.8	
Trade Balance(Customs)	-88.5	-125.0	-109.6	-118.6	-184.9	-201.2	-204.3	
Difference bet. RBI and Customs Data	-2.9	5.5	-8.6	-8.7	-4.9	0.9	-2.1	Difference normally represents defense imports.
b. Invisibles	**75.7**	**91.6**	**80.0**	**79.3**	**111.6**	**112.4**	**116.5**	
Non-factor services	38.9	53.9	35.8	44.1	64.1	62.0	64.1	
Of which: Software Services	36.9	43.5	48.2	50.9	61.0	64.0	69.1	
Non-Software Services	1.9	10.4	-12.5	-6.8	3.1	-2.0	-5.0	
Investment income	-5.1	-7.1	-8.0	-18.0	-16.0	-17.0	-17.0	
Remittances**	41.7	44.6	52.1	53.1	63.5	67.0	69.0	
Official transfers	0.2	0.2	0.3	0.0	0.0	0.4	0.4	
1.Current a/c balance (a+b)	**-15.7**	**-27.9**	**-38.2**	**-48.1**	**-78.2**	**-87.9**	**-89.9**	
% of GDP	-1.3	-2.3	-2.8	-2.8	-4.2	-4.7	-4.3	Current a/c to remain elevated
CAPITALACCOUNT								
c. Loans	**40.7**	**8.3**	**12.4**	**29.1**	**19.3**	**21.0**	**20.0**	Global developments could impact bank loans
External assistance	2.1	2.4	2.9	4.9	2.3	2.0	2.0	
Commercial borrowings***	22.6	7.9	2.0	12.2	10.3	12.0	12.0	
Short-term credit	15.9	-2.0	7.6	12.0	6.7	7.0	6.0	
d. FDI(Net=a-b)	**15.9**	**19.8**	**18.0**	**11.8**	**22.1**	**23.0**	**28.0**	Policy clarity will help FDI in FY14
(a)FDI-To India	34.7	37.7	33.1	29.0	33.0	35.0	43.0	
(b)FDI-Abroad	-18.8	-17.9	-15.1	-17.2	-10.9	-12.0	-15.0	
e. Portfolio Invst(FII+ADRs/GDRs)	**27.4**	**-14.0**	**32.4**	**30.3**	**17.2**	**25.0**	**23.0**	Recent reforms bode well for flows
f. Banking Capital	**11.8**	**-3.2**	**2.1**	**5.0**	**16.2**	**17.0**	**16.0**	
Of which NRI deposits	0.2	4.3	2.9	3.2	11.9	16.0	15.0	
g. Rupee debt service	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.4**	**-0.4**	
h. Other capital****	**11.0**	**-4.0**	**-13.2**	**-12.4**	**-6.9**	**1.0**	**1.0**	
2.Capital a/c (c+d+e+f+g+h)	**106.6**	**6.8**	**51.6**	**63.7**	**67.8**	**86.6**	**87.6**	
Errors & Omissions	1.3	1.1	0.0	-3.0	-2.4	0.0	0.0	
Overall balance (1+2)	**92.2**	**-20.1**	**13.4**	**12.7**	**-12.8**	**-1.3**	**-2.3**	
Forex								
Forex assets	299.1	241.6	252.8	273.7	260.9	259.6	257.3	
FCA to months of imports	13.9	9.4	10.1	8.6	6.3	6.3	5.9	
Exchange rate								
Rs/US$-annual avg	40.2	46.0	47.4	45.6	48.1	54.0	53.5	
%depreciation	-11.1	14.4	3.0	-3.8	5.5	12.3	-0.9	

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, Citi Research

Composition and Direction of Trade

Figure 50. India — Composition of Imports (US$bn, %)

	FY08	FY09	FY10	FY11	FY12	FY13*
Petroleum crude& products	79.7	91.5	86.8	105.8	154.9	110.8
% to total	31.9	30.6	30.2	28.6	31.7	34.6
% YoY	39.6	14.8	-5.1	21.9	44.6	
Capital goods	49.8	48.5	44.5	51.7	66.1	39.2
% to total	20.0	16.2	15.5	14.0	13.5	12.3
% YoY	61.9	-2.8	-8.2	16.3	20.9	
Gold & Silver	17.9	22.8	29.6	42.5	61.3	33.5
% to total	7.1	7.6	10.3	11.5	12.5	10.5
% YoY	22.1	27.8	29.8	43.4	54.1	
Pearls precious stones	7.3	16.6	16.2	34.6	30.5	14.7
% to total	2.9	5.5	5.6	9.4	6.2	4.6
% YoY	-2.0	126.5	-2.6	113.8	0.6	
Chemicals, related products	18.7	29.2	23.5	28.3	36.7	24.7
% to total	7.5	9.8	8.2	7.7	7.5	7.7
% YoY	34.8	56.7	-19.7	20.7	25.4	
Electronic Goods	20.2	23.4	21.0	26.6	32.6	20.8
% to total	8.1	7.8	7.3	7.2	6.7	6.5
%YoY	26.7	15.8	-10.3	26.6	24.2	
Food & related items	5.3	5.8	10.0	10.1	13.2	10.3
% to total	2.1	1.9	3.5	2.7	2.7	3.2
% YoY	8.8	8.3	72.9	1.4	30.1	
Other non-POL items	42.7	52.2	46.8	57.6	78.7	51.3
% to total	17.1	17.4	16.3	15.6	16.1	16.1
% YoY	26.2	22.4	-10.4	22.9	36.7	
Other commodities	5.8	6.8	6.7	9.0	11.4	12.0
% to total	2.3	2.3	2.3	2.4	2.3	3.7
% YoY	28.3	17.3	-0.5	33.8	18.0	
TOTAL IMPORTS	249.8	299.3	287.6	369.4	489.3	319.7
% YoY	35.0	19.8	-3.9	28.4	32.4	

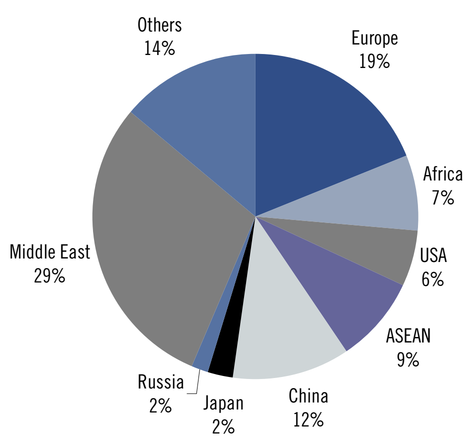
* Apr-Nov12 Source: CMIE ,RBI

Figure 51. Composition of Exports (US$bn, %)

	FY08	FY09	FY10	FY11	FY12	FY13*
Engineering goods	37.2	47.0	38.1	58.1	66.9	41.6
% to total	22.8	25.7	21.4	23.1	22.0	22.3
%YoY	26.4	26.3	-18.9	52.3	13.9	
Petroleum, crude prods	28.4	26.9	28.0	41.4	55.4	34.7
% to total	17.4	14.7	15.7	16.5	18.2	18.6
%YoY	52.0	-5.3	4.3	47.8	51.8	
Gems & Jewellery	19.7	28.0	29.0	40.5	46.9	28.7
% to total	12.1	15.3	16.3	16.1	15.4	15.4
%YoY	23.3	42.2	3.6	39.5	46.9	
Agri, allied products	18.4	17.6	17.7	24.2	37.4	26.1
% to total	11.3	9.6	10.0	9.7	12.3	14.0
%YoY	45.5	-4.8	1.1	36.4	53.0	
Chemicals & related	15.6	17.3	17.4	21.3	26.9	18.8
% to total	9.5	9.5	9.7	8.5	8.8	10.1
%YoY	28.3	11.3	0.4	22.7	27.9	
Textiles (incl RMG)	19.4	20.0	19.9	24.2	28.0	17.1
% to total	11.9	10.9	11.1	9.7	9.2	9.2
%YoY	11.9	3.2	-0.9	21.9	22.7	
Ores & minerals	9.1	7.8	8.7	8.6	8.1	3.6
% to total	5.6	4.3	4.9	3.4	2.7	1.9
%YoY	30.4	-14.4	11.0	-0.4	-18.4	
Other manuf goods	7.6	7.4	7.5	10.0	13.2	8.9
% to total	4.7	4.0	4.2	4.0	4.3	4.8
%YoY	9.8	-2.8	1.6	32.7	32.4	.
Other commodities	4.0	7.5	8.6	18.6	16.7	4.0
% to total	2.5	4.1	4.8	7.4	5.5	2.2
%YoY	30.5	86.9	15.2	115.0	-10.2	
TOTAL EXPORTS	163.0	183.1	178.3	250.8	304.3	186.7
% YoY	29.1	12.3	-2.6	40.6	21.3	

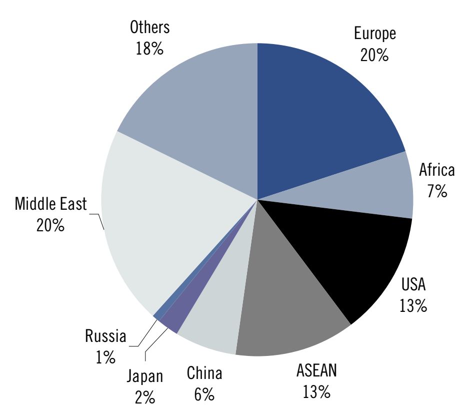
* Apr-Nov12 Source: CMIE, RBI

Figure 52. Direction of Imports FY12



Source: DGCI&S, CMIE

Figure 53. Direction of Exports FY12



Source: DGCI&S, CMIE

Snapshot of Government Finances

Figure 54. India Government Finances

	FY07	FY08	FY09	FY10	FY11	FY12RE	FY13BE	BUDGET FY13– KEY HIGHLIGHTS
a. Gross Tax Revenue	**4,735**	**5,931**	**6,053**	**6,245**	**7,931**	**9,017**	**10,776**	
% to GDP	11.0	11.9	10.8	9.7	10.3	10.1	10.6	**Revenues**
% YoY	29.3	25.3	2.0	3.2	27.0	13.7	19.5	Key Assumptions: Income Tax +13.9%,
Corporation tax	1,443	1,929	2,134	2,447	2,987	3,277	3,732	Customs +22%, Excise +29.1%,
Income tax	751	1,026	1,060	1,224	1,391	1,667	1,899	Corporate +13.9%, Service +30.5%
Excise duty	1,176	1,234	1,086	1,030	1,377	1,501	1,937	
Import duty	863	1,041	999	833	1,358	1,530	1,867	Increase in service taxes from 10% to
Service tax	376	513	609	584	710	950	1,240	12%, negative list introduced
b. (-) Devolvement to States & UTs	**1,223**	**1,536**	**1,620**	**1,680**	**2,232**	**2,594**	**3,065**	Excise duties also raised from 10% to
c. Net tax revenues (a-b)	3,512	4,395	4,433	4,565	5,699	6,423	7,711	12%
d. Non tax revenues	832	1,023	969	1,163	2,186	1,247	1,646	
e. Net revenue receipts (c+d)	**4,344**	**5,419**	**5,403**	**5,728**	**7,885**	**7,670**	**9,357**	
f. Non-debt capital receipts	**64**	**439**	**67**	**332**	**353**	**298**	**417**	Divestment targets appear more realistic
Recovery of loans	59	51	61	86	124	143	117	
Divestments/Other	5	388	6	246	228	155	300	
g. TOTAL REVENUES (e+f)	**4,408**	**5,858**	**5,470**	**6,060**	**8,237**	**7,967**	**9,773**	
%YoY	22.7	32.9	-6.6	10.8	35.9	-3.3	22.7	
h. Revenue expenditure	**5,146**	**5,945**	**7,938**	**9,118**	**10,407**	**11,619**	**12,861**	**Expenditures**
Interest (1)	1,503	1,710	1,922	2,131	2,340	2,756	3,198	
Defense	517	543	733	907	921	1,048	1,138	
Subsidies	571	709	1,297	1,414	1,734	2,163	1,900	Fuel subsidies appear understated
Pensions	221	243	329	561	574	562	632	
Grants to States	357	358	382	459	498	553	642	
Admin and social services	553	647	927	1,107	1,198	1,075	1,146	
Plan expenditure	1,424	1,736	2,348	2,539	3,142	3,462	4,205	
i. Capital expenditure	**688**	**1,182**	**902**	**1,127**	**1,566**	**1,568**	**2,048**	
Defense	338	375	410	511	621	661	796	
Loans	75	493	87	121	298	102	247	
Plan expenditure	274	315	405	495	648	804	1,005	
j. Plan expenditure	**1,699**	**2,051**	**2,752**	**3,034**	**3,790**	**4,266**	**5,210**	Plan exp budgeted to rise 22.1%YoY
k Non Plan expenditure	**4,135**	**5,077**	**6,087**	**7,211**	**8,183**	**8,921**	**9,699**	Non-plan exp slated to rise 8.7%
l. TOTAL EXPENDITURE (h+i): (j+k)	**5,834**	**7,127**	**8,840**	**10,245**	**11,973**	**13,187**	**14,909**	
% YoY	15.4	22.2	24.0	15.9	16.9	10.1	13.1	
Deficit trends								
m. Fiscal Balance (g-l)	**-1,426**	**-1,270**	**-3,370**	**-4,185**	**-3,736**	**-5,220**	**-5,136**	**Revised Budget Deficit at 5.3%**
% to GDP	-3.3	-2.5	-6.0	-6.5	-4.9	-5.9	-5.1	**Expect a 4.8% Target for FY14**
n. Revenue Balance (e-h)	**-802**	**-526**	**-2,535**	**-3,390**	**-2,523**	**-3,950**	**-3,504**	
% to GDP	-1.9	-1.1	-4.5	-5.2	-3.3	-4.4	-3.4	
o. Primary Deficit (m-1)	**77**	**441**	**-1,448**	**-2,054**	**-1,396**	**-2,464**	**-1,938**	
% to GDP	0.2	0.9	-2.6	-3.2	-1.8	-2.8	-1.9	
Financing the deficit								
Market borrowings (Net)	1,104	1,318	2,336	3,984	3,254	4,364	4,790	
PPF & special deposits	52	39	80	161	125	100	120	
Small savings	0	-113	-13	133	112	-103	12	
Net external assistance	85	93	110	110	236	103	101	
Others	140	204	418	-189	-56	1,000	112	
Cash Surplus	45	-271	438	-14	64	-245	0	
Total financing								
Memo items (% to GDP)								
Centre	-3.3	-2.5	-6.0	-6.5	-4.9	-5.5	-5.1	
State	-1.8	-1.5	-2.4	-3.3	-2.5	-2.5	-2.5	
Combined	**-5.4**	**-4.1**	**-8.4**	**-9.6**	**-8.3**	**-8.0**	**-7.7**	
Off Balance Sheet Items	-0.9	-0.6	-1.7	-0.2	1.0			
Total Deficit	**-6.3**	**-4.7**	**-10.1**	**-9.8**	**-7.3**	**-8.0**	**-7.7**	
Combined liabilities	79.3	76.1	76.1	75.0	71.3	70.0	69.0	

*Includes proceeds of transfer of RBI's stake in SBI. RE: Revised Estimates; BE: Budgeted Estimates, based on the government's nominal GDP forecast of Rs101599bn or 14%YoY. Source: Budget Documents, Citi Research estimates

Global Financial Forecasts

Figure 55. Selected Countries — Economic Forecast Overview (Percent) 2012F-2016F

	GDP Growth					CPI					Short Term Interest Rates				
	2012F	2013F	2014F	2015F	2016F	2012F	2013F	2014F	2015F	2016F	2012F	2013F	2014F	2015F	2016F
Global	**2.5**	**2.6**	**3.2**	**3.6**	**3.8**	**2.8**	**2.8**	**3.0**	**2.9**	**2.9**	**2.34**	**2.20**	**2.38**	**2.78**	**3.19**
Based on PPP weights	*3.1*	*3.2*	*3.7*	*4.0*	*4.3*	*3.2*	*3.2*	*3.3*	*3.3*	*3.3*	*2.93*	*2.78*	*2.96*	*3.35*	*3.71*
Industrial Countries	**1.2**	**1.0**	**1.6**	**2.2**	**2.5**	**1.9**	**1.6**	**1.9**	**1.7**	**1.7**	**0.62**	**0.46**	**0.49**	**0.87**	**1.35**
United States	2.2	1.9	3.1	3.5	4.0	1.7	1.5	2.1	2.1	2.1	0.25	0.25	0.25	1.10	2.10
Japan	2.0	1.3	1.2	1.5	1.2	0.0	-0.3	1.9	0.5	0.2	0.07	0.07	0.13	0.10	0.10
Euro Area	-0.5	-0.6	-0.4	0.7	1.0	2.5	1.8	1.5	1.5	1.4	0.88	0.44	0.25	0.25	0.31
Australia	3.6	2.4	3.0	3.5	3.6	1.8	2.9	2.5	2.8	2.5	3.56	3.00	3.50	4.00	4.75
United Kingdom	0.1	0.4	0.7	1.3	1.5	2.8	2.9	2.3	2.1	2.0	0.50	0.50	0.50	0.50	0.50
Emerging Markets	**4.7**	**5.2**	**5.5**	**5.5**	**5.6**	**4.4**	**4.6**	**4.7**	**4.7**	**4.6**	**5.20**	**4.91**	**5.16**	**5.51**	**5.72**
China	7.8	7.8	7.3	7.0	7.5	2.6	2.8	3.6	3.8	3.8	3.25	3.13	3.50	3.75	3.88
Taiwan	1.1	3.0	3.8	4.0	4.5	1.9	2.0	1.8	1.8	1.8	1.88	1.88	1.97	2.38	2.88
India	**5.0**	**5.7**	**6.4**	**7.2**	**7.3**	**7.5**	**7.0**	**6.0**	**6.0**	**6.0**	**7.80**	**7.50**	**7.50**	**7.50**	**7.50**
Indonesia	6.2	6.1	6.3	6.5	6.5	4.3	4.7	4.7	5.7	5.4	3.90	4.19	4.50	4.63	5.13
Korea	2.1	3.2	4.1	4.3	4.2	2.2	2.6	3.0	3.2	3.1	3.06	2.56	3.31	3.75	4.13
Czech Republic	-1.1	-0.2	0.9	2.0	2.3	3.3	2.0	1.2	2.2	1.8	0.51	0.05	0.08	0.79	1.63
Hungary	-1.7	0.2	1.3	0.9	1.3	5.7	3.5	3.6	3.9	3.5	6.77	5.06	5.00	4.94	4.50
Poland	1.9	1.3	2.8	3.3	3.3	3.7	2.1	2.4	2.5	2.5	4.61	3.50	3.29	4.15	4.73
Russia	3.5	3.0	3.7	3.3	3.3	5.1	6.5	5.7	4.9	5.0	8.07	8.10	7.50	7.00	7.00
Turkey	2.8	4.0	4.3	4.6	4.5	8.9	7.4	7.3	6.9	6.4	5.69	5.19	6.88	8.00	8.00
Nigeria	7.4	6.8	7.2	6.9	7.2	12.2	10.3	9.2	12.2	10.8	12.00	11.00	10.50	12.50	11.00
South Africa	2.4	2.8	3.1	4.0	4.2	5.8	6.0	5.3	5.5	5.6	5.25	5.00	5.08	6.17	6.50
Argentina	1.9	3.0	3.0	2.0	-2.0	10.0	12.6	14.5	15.0	50.0	13.89	17.74	20.83	22.00	22.00
Brazil	0.9	3.1	4.2	3.5	3.5	5.4	6.1	5.5	5.4	4.8	8.46	6.69	6.50	8.00	9.25
Mexico	3.9	3.6	3.8	4.0	3.8	4.1	3.8	3.7	3.6	3.6	4.50	4.50	4.65	5.46	6.42
Venezuela	5.2	2.0	2.0	2.1	2.5	21.1	24.2	24.3	26.4	24.3	14.40	14.40	14.40	14.80	14.80

Source: Citi Research estimates, *Global Economic Outlook and Strategy*, 23 January 2013; India Numbers revised on Feb 8.

Figure 56. Selected Countries — Economic Forecast Overview (Percent) 2011-2015F

	Current Balance (Pct of GDP)					Fiscal Balance (Pct of GDP)					Government Debt (Pct of GDP)				
	2012F	2013F	2014F	2015F	2016F	2012F	2013F	2014F	2015F	2016F	2012F	2013F	2014F	2015F	2016F
Global	**0.3**	**0.3**	**0.1**	**0.0**	**-0.2**	**-4.4**	**-4.0**	**-3.2**	**-2.7**	**-2.4**	**88**	**90**	**89**	**88**	**87**
Based on PPP weights	0.1	0.1	0.0	-0.2	-0.3	-4.3	-3.9	-3.3	-2.8	-2.5	79	80	79	78	77
Industrial Countries	**-0.8**	**-0.4**	**-0.3**	**-0.2**	**-0.2**	**-5.9**	**-5.3**	**-3.9**	**-3.0**	**-2.7**	**117**	**122**	**122**	**123**	**123**
United States	-3.0	-2.7	-2.6	-2.7	-2.8	-8.3	-7.2	-5.0	-4.0	-4.0	106	110	112	112	112
Japan	1.0	0.4	1.6	1.5	1.5	-10.7	-9.8	-7.0	-6.2	-5.8	237	245	246	250	254
Euro Area	1.0	2.4	2.1	2.1	2.1	-3.2	-2.8	-2.4	-1.4	-1.0	94	97	95	95	93
Australia	-3.9	-4.8	-5.4	-3.5	-3.2	-3.0	-0.8	0.0	0.2	0.3	29	30	28	26	24
United Kingdom	-3.7	-3.2	-2.9	-2.6	-2.2	-5.4	-6.9	-6.7	-6.1	-5.1	90	95	99	102	103
Emerging Markets	**2.0**	**1.2**	**0.7**	**0.2**	**-0.1**	**-1.9**	**-2.0**	**-2.2**	**-2.2**	**-2.0**	**41**	**41**	**40**	**39**	**38**
China	2.5	2.0	1.5	1.0	0.7	-2.4	-2.0	-2.0	-2.0	-1.5	44	43	41	39	37
Taiwan	8.7	8.4	8.0	8.0	8.0	-1.6	-1.2	-1.3	-1.0	-0.7	39	40	42	43	44
India	**-4.7**	**-4.3**	**-3.6**	**-3.6**	**-3.6**	**-8.5**	**-8.0**	**-7.5**	**-7.0**	**-6.5**	**68**	**67**	**66**	**65**	**64**
Indonesia	-2.6	-2.0	-1.5	-1.2	-0.9	-1.8	-1.5	-1.4	-1.0	-0.5	24	22	21	21	20
Korea	3.7	2.2	1.8	0.8	0.1	1.4	1.1	1.4	2.5	2.7	34	33	31	29	27
Czech Republic	-2.0	-2.3	-3.4	-2.6	-2.2	-4.8	-3.1	-2.7	-2.2	-1.5	46	49	50	50	49
Hungary	2.2	3.4	4.8	5.7	6.5	-2.8	-2.9	-3.6	-3.0	-2.8	80	81	81	80	80
Poland	-3.3	-3.0	-3.6	-4.0	-4.5	-3.5	-3.5	-2.8	-2.5	-2.4	52	53	51	51	50
Russia	4.2	2.2	-0.1	-1.7	-3.0	-0.4	-1.2	-2.1	-2.3	-2.3	9	10	11	12	13
Turkey	-6.4	-6.8	-7.0	-6.7	-6.2	-2.0	-2.2	-2.7	-2.7	-3.0	38	37	36	36	36
Nigeria	2.4	3.7	3.3	2.0	1.4	-2.8	-2.6	-2.8	-3.2	-2.7	NA	NA	NA	NA	NA
South Africa	-6.0	-5.6	-5.3	-4.5	-3.3	-4.7	-5.0	-4.6	-4.2	-3.7	40	42	42	42	41
Argentina	0.7	0.4	0.2	0.2	3.0	-2.4	-2.7	-2.9	-3.8	0.0	39	40	42	44	42
Brazil	-2.4	-2.6	-2.7	-2.9	-3.0	-2.6	-2.4	-2.2	-1.8	-2.0	57	57	57	57	58
Mexico	-0.8	-1.6	-1.8	-2.5	-2.7	-2.2	-2.1	-2.0	-2.0	-2.0	40	38	38	38	37
Venezuela	5.0	4.8	6.0	6.2	5.5	-5.0	-4.0	-4.0	-4.8	-4.6	42	44	42	43	44

Note: US debt and deficit figures are for the Federal government only. All other countries are general government debt and deficits.
Source: Citi Research estimates, *Global Economic Outlook and Strategy,* 23 January 2013; India Numbers revised on 8 Feb.

Figure 57. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent) 2011-2015F

	10-Year Yields					Exchange Rates Versus U.S. Dollar*				
	2012F	2013F	2014F	2015F	2016F	2012F	2013F	2014F	2015F	2016F
Industrial Countries										
United States	1.80	2.10	2.80	3.25	3.50	NA	NA	NA	NA	NA
Japan	0.85	0.91	1.00	1.38	1.50	81	95	92	88	86
Euro Area	1.57	1.59	1.44	1.50	2.00	1.28	1.33	1.31	1.32	1.35
Australia	3.28	3.16	3.90	4.20	5.00	1.03	1.03	0.98	0.95	0.94
United Kingdom	1.85	1.90	1.75	1.75	2.50	1.59	1.61	1.62	1.65	1.69
Emerging Markets										
China	3.33	3.58	3.83	4.08	4.21	6.31	6.13	6.07	6.05	6.06
Taiwan	1.21	1.24	1.36	1.50	1.70	29.57	28.59	28.30	28.20	28.20
India	**8.25**	**8.25**	**8.25**	**8.25**	**8.25**	**53.38**	**53.68**	**54.33**	**53.64**	**52.14**
Indonesia	5.90	5.73	6.10	6.30	6.60	9361	9845	9708	9629	9576
Korea	3.24	2.89	3.76	4.48	5.00	1127	1035	1007	994	991
Czech Republic	2.75	2.17	2.93	3.57	3.80	19.5	19.5	19.4	18.5	17.4
Hungary	7.91	6.45	6.20	5.89	5.60	225	227	225	219	211
Poland	5.05	4.79	5.19	5.40	5.34	3.25	3.19	3.09	2.96	2.89
Russia	NA	NA	NA	NA	NA	31.1	30.8	32.5	32.5	31.5
Turkey	NA	NA	NA	NA	NA	1.80	1.82	1.88	1.90	1.91
Nigeria	NA	NA	NA	NA	NA	159	161	164	168	171
South Africa	7.15	7.19	8.15	9.15	9.20	8.21	9.03	9.36	9.59	9.74
Argentina	NA	NA	NA	NA	NA	4.54	5.46	6.74	8.72	13.45
Brazil	9.31	7.96	8.39	8.66	8.25	1.95	2.07	2.07	2.00	1.92
Mexico	5.70	5.96	6.76	7.22	7.51	13.2	12.4	12.5	12.6	12.8
Venezuela	11.40	11.55	11.85	15.50	15.50	4.29	5.58	6.50	9.75	10.50

* Per USD except Euro Area, Australia, United Kingdom. Source: Citi Research estimates, *Global Economic Outlook and Strategy*, 23 January 2013

Figure 58. Foreign Exchange Forecasts (End of Period), as of 23 January 2013

	vs. USD						vs. EUR					
	Current	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Current	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14
United States	NA	NA	NA	NA	NA	NA	1.33	1.35	1.34	1.32	1.32	1.31
Japan	90	94	95	96	95	94	120	127	127	127	125	123
Euro Area	1.33	1.35	1.34	1.32	1.32	1.31	NA	NA	NA	NA	NA	NA
Canada	0.99	0.98	0.97	0.97	0.97	0.97	1.32	1.32	1.30	1.28	1.28	1.27
Australia	1.05	1.06	1.04	1.02	1.01	1.00	1.27	1.27	1.28	1.29	1.30	1.31
New Zealand	0.84	0.85	0.84	0.83	0.81	0.79	1.60	1.60	1.59	1.59	1.62	1.66
Norway	5.59	5.52	5.54	5.56	5.57	5.57	7.45	7.47	7.42	7.36	7.33	7.31
Sweden	6.50	6.40	6.42	6.44	6.44	6.45	8.67	8.67	8.59	8.51	8.48	8.46
Switzerland	0.93	0.92	0.91	0.91	0.92	0.94	1.24	1.24	1.22	1.20	1.22	1.24
United Kingdom	1.59	1.60	1.61	1.61	1.61	1.62	0.84	0.84	0.83	0.82	0.82	0.81
China	6.22	6.17	6.14	6.11	6.09	6.08	8.3	8.3	8.2	8.1	8.0	8.0
India	**53.7**	**53.2**	**53.5**	**53.9**	**54.1**	**54.2**	**71.6**	**72.0**	**71.7**	**71.3**	**71.2**	**71.1**
Korea	1057	1047	1039	1031	1024	1017	1410	1416	1390	1365	1349	1336
Poland	3.10	3.12	3.18	3.24	3.22	3.17	4.14	4.22	4.25	4.29	4.24	4.16
Russia	30.3	29.6	30.5	31.3	31.7	32.0	40.4	40.1	40.8	41.4	41.8	42.1
South Africa	8.91	8.89	8.99	9.08	9.16	9.24	11.89	12.03	12.03	12.01	12.07	12.14
Turkey	1.76	1.77	1.80	1.84	1.86	1.87	2.35	2.39	2.41	2.44	2.45	2.45
Brazil	2.04	2.04	2.07	2.09	2.09	2.08	2.73	2.76	2.77	2.77	2.75	2.73
Mexico	12.6	12.4	12.4	12.5	12.5	12.5	16.8	16.7	16.6	16.5	16.5	16.4

Source: Citi Research estimates, *Global Economic Outlook and Strategy, 23 January 2013*

Appendix A-1

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