

# India Macroscope

## Beyond Swings, the New Dynamic

- **The mood swings yet again...** – Over the last year, India has been prone to mood swings between global developments and domestic economics/politics – resulting in fluctuating markets and expectations. It's global developments again - geo-politics (Ukraine, Gaza, Iraq), Fed policy and Euro Area – which seem to be taking a toll on most risk assets, and India is not an exception.
- **And dynamics are changing** – Risk on/off matters; India is not immune and there is no room for complacency, but dynamics are changing: (1) vulnerability is lower and there is better preparedness; and (2) macro stabilization is underway - growth-inflation balance, twin deficits improving. While there can be plenty of debate on pace and timing, India is on its way back to 7% growth and 6% inflation.
- **Dynamic drivers: political intent and credible Central Bank** — Yes, there's a cyclical & sentiment boost, but India is largely a 'self- help' story: There's a strong & new political will, coupled with a credible and active Central Bank. Modi – growth, execution and ambition (beginning to un-fold); Rajan – monetary frame-work and financial sector reform (executing energetically). And, as evidenced on inflation, they are working together. Pin it to personalities, but this mix is steadily changing India's dynamics.
- **Macro estimates: unchanged** — 1) **GDP**: gradual investment led upturn from 5.6% in FY15 to 6.5% in FY16. (2) **Inflation**: CPI to trend in line with the RBI's glide path of 8% by Jan 2015 and 6.5% in 2016. (3) **Rates**: subject to global monetary developments, success on government's food inflation measures could open space for easing in 2015. (4) **CAD**: to rise marginally to ~2% of GDP and the INR likely to trade in the Rs59-62 range. (5) **Fiscal**: targets challenging, but consolidation to continue.
- **There remain risks, both domestic and global** — (1) Execution and policy coordination; (2) geo-politics and (3) DM Monetary policy developments.

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**Figure 1. Statistical Snapshot (%)**

Year -end 31 March	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
Real GDP growth (%)	6.7	8.6	8.9	6.7	4.5	4.7	5.6	6.5
Agriculture growth (%)	0.1	0.8	8.6	5.0	1.4	4.7	0.5	3.0
Industry growth (%)	4.4	9.2	7.6	7.8	1.0	0.4	3.9	5.9
Services growth (%)	10.0	10.5	9.7	6.6	7.0	6.8	7.5	7.5
Fiscal Deficit (Centre+States)	-8.3	-9.3	-6.9	-8.1	-7.2	-6.9	-6.7	-6.5
Current Account Deficit (%)	-2.3	-2.8	-2.7	-4.2	-4.7	-1.7	-1.9	-2.0
CPI (Average)	9.1	12.3	10.5	8.4	10.2	9.5	8.0	6.5
INR/USD (Average)	46.0	47.4	45.6	48.1	54.0	60.4	62.0	62.0

Source: : CSO, RBI, Budget Documents, Citi Research

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 FY03 – 16E

Fiscal Year to 31 March	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
<b>National Income Indicators</b>														
Nominal GDP(Rs bn)	25,500	28,617	32,422	36,934	42,947	49,871	56,301	64,778	77,841	90,097	101,133	113,551	128,312	146,276
Nominal GDP (US\$ bn)	527	623	720	834	950	1,241	1,224	1,367	1,708	1,873	1,873	1,880	2,070	2,359
Per Capita GDP (US\$)	499	582	662	754	847	1,090	1,061	1,168	1,440	1,558	1,539	1,499	1,651	1,854
<b>Real GDP growth (%)</b>	<b>4.0</b>	<b>8.1</b>	<b>7.0</b>	<b>9.5</b>	<b>9.6</b>	<b>9.3</b>	<b>6.7</b>	<b>8.6</b>	<b>8.9</b>	<b>6.7</b>	<b>4.5</b>	<b>4.7</b>	<b>5.6</b>	<b>6.5</b>
Agriculture growth (%)	-6.6	9.0	0.2	5.1	4.2	5.8	0.1	0.8	8.6	5.0	1.4	4.7	0.5	3.0
Industry growth (%)	7.2	7.3	9.8	9.7	12.2	9.7	4.4	9.2	7.6	7.8	1.0	0.4	3.9	5.9
Services growth (%)	7.0	8.1	8.1	10.9	10.1	10.3	10.0	10.5	9.7	6.6	7.0	6.8	7.5	7.5
<b>By Demand (%YoY)</b>														
Consumption	2.3	5.4	1.9	8.7	7.7	9.4	7.7	8.4	8.2	8.9	5.2	4.7	5.6	6.8
Pvt Consumption	2.9	5.9	1.7	8.6	8.5	9.4	7.2	7.4	8.7	9.3	5.0	4.8	5.5	7.0
Public Consumption	-0.4	2.6	3.4	8.9	3.8	9.6	10.4	13.9	5.8	6.9	6.2	3.8	6.0	6.0
Gross Fixed Capital Formation	6.8	13.6	20.7	16.2	13.8	16.2	3.5	7.7	11.0	12.3	0.8	-0.1	2.5	6.5
<b>Cons; Invst, Savings * (%GDP)</b>														
Consumption	77.2	75.0	70.1	69.2	68.0	67.2	68.6	69.1	67.5	68.5	68.8	68.9	69.2	68.9
Gross Capital Formation	24.6	26.9	32.8	34.7	35.7	38.1	34.3	36.3	36.5	36.4	34.7	31.4	31.7	31.7
Gross Domestic Savings	25.4	28.7	32.4	33.4	34.6	36.8	32.0	33.7	33.7	31.3	30.1	30.5	30.8	31.0
<b>Real Indicators (%YoY)</b>														
Commercial vehicle sales	40.4	36.2	22.4	10.1	33.3	4.2	-21.4	39.2	27.0	19.5	-1.9	-20.2	-4.5	11.6
Car sales	5.3	27.2	17.8	7.7	20.7	12.1	0.3	25.7	29.2	3.9	2.4	-6.7	1.7	10.6
Two-wheelers	15.8	11.3	15.7	13.6	11.5	-7.8	2.7	25.9	25.8	13.9	2.9	7.3	10.0	10.0
Diesel consumption	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	8.0	6.7	-1.0	4.0	4.0
Mobile Tele density	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.5	66.8	75.1	79.0	87.9	78	80
<b>Monetary Indicators (% YoY)</b>														
Money supply	16.1	13.0	14.0	15.9	20.0	22.1	20.5	19.2	16.2	15.8	13.4	17.0	18.0	18.0
Inflation – WPI (Avg)	3.4	5.5	6.5	3.7	6.5	4.8	8.0	3.6	9.6	8.8	7.5	5.9	5.5	5
CPI (Avg)	4.1	3.8	3.9	4.2	6.8	6.2	9.1	12.3	10.5	8.4	10.2	9.5	8.0	6.5
Bank credit growth	23.7	15.3	30.9	37.0	28.1	22.3	17.5	16.9	21.5	17.0	14.1	15.0	15.0	15.0
Deposit growth	16.1	17.5	13.0	24.0	23.8	22.4	19.9	17.2	15.9	13.5	14.2	13.5	14.0	14.0
<b>Fiscal Indicators (% GDP)</b>														
Centre's fiscal deficit	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.5	-4.8	-5.7	-4.9	-4.5	-4.1	-4.0
State fiscal deficit	-3.5	-3.9	-3.4	-2.5	-2.1	-1.4	-2.3	-2.9	-2.1	-2.4	-2.3	-2.2	-2.6	-2.5
Combined deficit (Centre+State)	-9.2	-8.2	-7.2	-6.5	-5.4	-4.0	-8.3	-9.3	-6.9	-8.1	-7.2	-6.7	-6.7	-6.5
Off Balance Sheet Items				-0.5	-0.9	-0.6	-1.7	-0.2						
Combined liabilities ( dom+ext)	90.7	90.0	88.8	84.6	79.9	76.1	76.8	75.5	70.2	69.6	69.8	69.6	68.5	66.2
<b>External Sector (% YoY)</b>														
Exports (US\$bn)	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.4	250.5	309.8	306.6	318.6	343.8	378.2
% YoY	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.5	37.3	23.7	-1.0	3.9	7.9	10.0
Imports (US\$bn)	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	381.1	499.5	502.2	466.2	499.3	549.2
%YoY	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	26.7	31.1	0.5	-7.2	7.1	10.0
Trade deficit (US\$bn)	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.2	-130.6	-189.8	-195.7	-147.6	-155.5	-171.1
Invisibles (US\$bn)	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	84.6	111.6	107.5	115.2	116.2	123.0
Current Account Deficit (US\$bn)	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.2	-45.9	-78.2	-88.2	-32.4	-39.3	-48.1
% to GDP	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.7	-4.2	-4.7	-1.7	-1.9	-2.0
Capital Account (US\$bn)	10.8	16.7	28.0	25.5	45.2	106.6	7.4	51.6	62.0	67.8	89.3	48.8	72.4	79.4
% GDP	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.6	3.6	4.8	2.6	3.5	3.4
Forex Assets (incl gold) (US\$bn)	100.6	131.2	137.2	177.3	275.6	254.6	283.5	297.3	296.7	296.6	295.7	303.6	325.0	345.0
Months of imports	18.7	19.7	13.8	13.5	17.3	11.9	11.0	11.9	9.3	7.1	7.1	7.8	7.8	7.5
External Debt (US\$bn)	104.9	112.7	134.0	139.1	172.4	224.4	224.5	260.9	317.9	360.8	404.9	426.0	441.0	456.0
Short Term Debt (US\$bn)	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	78.2	96.7	92.7		
<b>Exchange Rate</b>														
US\$/INR - annual avg	48.4	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	48.1	54.0	60.4	62.0	62.0
% depreciation	1.5	-5.2	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	12.3	11.9	2.6	0.0

\* At current prices.

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

# Theme: Changing Dynamics

## Risk Off ... Where Does India Stand?

### RECENT SELL-OFF: LESS THEMATIC

\* If Russia/ Ukraine is the issue, one could expect higher commodity prices.

\* If Fed tightening is the issue, one should see higher yields.

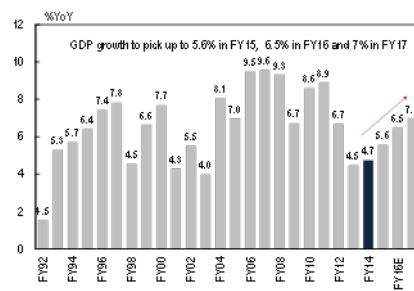
\* However, both commodity prices and US Treasury yields have come off.

Since the last month, most risk assets have been under-performing and India is no exception. Interestingly, a study by our global macro strategy team ([Observations on Risk Off](#), Jeremy Hale) indicates that the rise in risk aversion is led by DM, not EM. While there is chatter on a variety of factors including geo-politics (Gaza, Ukraine, Iraq), Fed policy and the Euro Area, our team believes that the sell-off is less thematic in nature. India's continued dependence on external capital and the warning from the RBI Governor that global markets are at "risk of a crash should investors start bailing out of risky assets created by the loose monetary policies of developed economies" warrant another look at India's fundamentals/policy directions.

## On the Path of Macro Stabilization ... But Long Way to Go

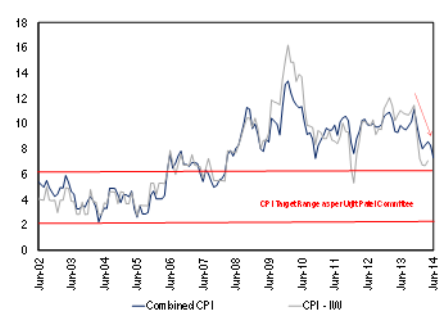
As reflected by recent macro data trends, the Indian economy stands at the cusp of a recovery. As seen in Figure 3, GDP growth bottomed out at 4.5% in FY13 and, though the recovery began to take shape in the latter half of FY14, the pace appears to have improved in the current fiscal. The good news begins, but doesn't end, with improving output. Inflation has come off from ~10% levels in FY13 and FY14 to an estimated level of 8% in FY15 and is likely to decline further towards 6.5% in FY16.

Figure 3. Trends in GDP (%YoY)



Source: CSO, Citi Research

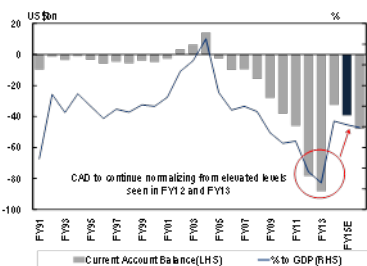
Figure 4. Trends in CPI (%YoY)



Source: CSO, Citi Research

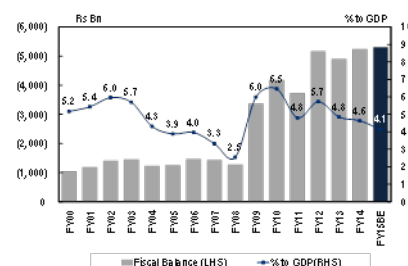
In addition to the improving growth inflation balance, there has been meaningful progress on the twin deficit front. From levels of >4% of GDP in FY12 and FY13, the current account deficit has declined to 1.7% of GDP in FY14 and is likely to remain at sub-2% levels in FY15 / FY16. As regards the fisc, while the quality may be debated, on a two-year basis, headline trends in the deficit have seen a 160bps decline. But, much of this is priced in, as echoed by the institutional investors we met across all asset classes in London (see [UK Trip Tales](#)).

Figure 5. Current Acc Deficit (US\$bn, %GDP)



Source: RBI, Citi Research

Figure 6. Fiscal Deficit (Rs bn, % GDP)



Source: Budget Documents, Citi Research

While there is clear progress on resolving the macro-economic imbalances, key to note that the process has just begun and that it's still a long way to go for the economy. Growth remains below potential, inflation is above comfort levels; risk on capital flows and exchange rate remains present; and lastly S&P continues to maintain negative watch on India credit ratings.

Nonetheless, while the challenges remain formidable, the regime change in Delhi and Mumbai inspire confidence. We look at the vision and mechanism through which Prime Minister Modi and RBI governor Rajan could put India back on track of high growth, low inflation and sustainable deficits.

## Political Will and a Credible Central Bank

### Prime Minister Modi – Vision and Strategy

PM Modi has thus far been perceived as a pro-business leader who believes government institutions should enable economic activity, not hinder it, and that *“the role of a Government in businesses should be limited to that of a facilitator”*. This is a shift from the period of policy paralysis which characterized the last few years of the earlier regime. As reflected in the mantra *“Minimum Government, Maximum Governance”*, Modi aims to make government processes more efficient. In line with his 12-year track record in Gujarat, he has streamlined departments such that bureaucracy should cut out unnecessary red tape. In Modi's words *“No red tape, only red carpet is my policy towards investors”*

#### LABOUR REFORMS PROPOSED

\* **Factories Act (1948):** improved safety for workers, higher provisions for overtime, more favorable terms for employee benefits

\* **Apprenticeship Act (1961):** doing away with the mandate to absorb at least half of apprentices, creating equal employment opportunity

\* **Labour Laws Act (1988):** allowing companies with 10-40 employees to be exempt from labor law provisions

#### IDEAL LAND ACQUISITION POLICY

\* **Simplifies the process for land acquisition for development projects**

\* **Clears high-value projects, particularly related to roads and connectivity**

\* **Strikes a balance between farmer / landholder interests and those of industries**

Figure 7. Modi's Agenda – A Few Salient Features

Sector	Promise	Action so far
Agriculture	Increase public investment in agriculture, rural devt Raise profitability in agriculture through ensuring 50% profits over cost of production, cheaper inputs and credit, advanced technology, high yielding seeds, linking MGNREGA to agriculture Reform the APMC act	Offloading food stocks Line of credit for easier imports Budget proposes MGNREGA to be productive/asset creating
Industry and Manufacturing	Ensure a conducive, enabling environment for doing business in India Move towards a single-window system of clearances Transparent and time-bound environmental clearance Interest rate rationalization and a clear tax policy to create investor confidence Ensure power supply, undertake labour reforms	Cabinet clears labour reform amendments Merge ministries to create more efficient governance
Infrastructure	Expedite work on Freight Corridors and Industrial Corridors  National Highway construction projects will be expedited  Encourage PPP models and establish institutional framework for the same  Regulators to have greater autonomy and accountability	Preparatory work begun on industrial corridors: Amritsar – Kolkata, Chennai – Bengaluru, Bengaluru–Mumbai, Vizag – Chennai  Allocates Rs370bn for highways and roads (8500km in FY15) Proposes metro rails projects in cities with 2mn through PPP  Cabinet approves FDI in defence, railway infrastructure
Centre-State relations	Evolve a model of national development which is driven by states Place centre-state relations on an even keel through consultation	

Source: BJP Manifesto, Media Reports, Citi Research

To **revive growth**, Modi's primary focus has been on infrastructure and investments. He has expanded the role of the Project Monitoring Group, where in addition to 'unlocking projects' stalled due to lack of clearances and so on, the PMG

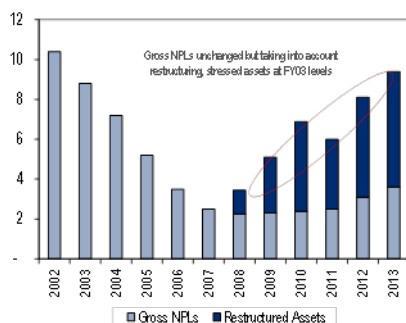
has now been asked to follow up on timelines to push timely decision making. To make the policy environment conducive for infrastructure development, government is currently working on land-acquisition issues. A balanced, transparent land policy that balances the needs of landowners as with those of industries would eliminate a major obstacle to investment.

To **improve investor sentiment** and ease of doing business, the cabinet has recently cleared labor reforms that now await parliamentary approval. The reforms are amendments to archaic labour laws. Going forward, if parliament approves these reforms, it would incentivize investment, particularly in manufacturing.

## RBI Governor Rajan – Vision and Strategy

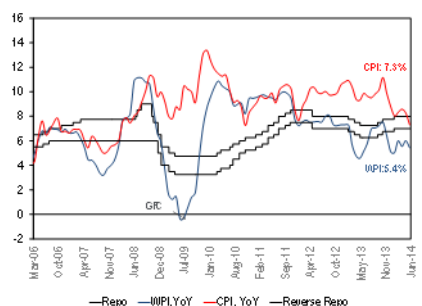
**Financial Sector Reforms can add 1%-2% of GDP growth:** Dr Rajan's vision for India's financial sector was best summarized in the following excerpt from the report titled "A Hundred Small Steps" that he submitted in Sep 2008. The report says that *"the financial sector has built capabilities such that, with appropriate policy changes, it can grow tremendously, both domestically and internationally. It can generate millions of well-paying jobs, and more important, have an enormous multiplier effect on inclusion and economic growth. Given the right environment, financial sector reforms can add between a percentage point and two to the economic growth rate"*

Figure 8. Stressed Assets (% of total Loans)



Source: RBI, Citi Research

Figure 9. Nominal Anchor Shifts to CPI (%)



Source: RBI, Citi Research

**Walking the Talk: Five Pillars of RBI:** As soon as Dr. Rajan assumed charge as RBI governor, he began implementing the regulatory and policy reforms, some of which were recommended in his 2008 report. Later, in his speeches he articulated his strategy as five pillars of RBI, namely: (1) clarifying and strengthening the monetary policy framework, (2) new entry, expansion of the banking sector, (3) market broadening and deepening, (4) financial inclusion, and (5) mechanism for debt restructuring/recovery NPA management.

Figure 10. Five Pillars of RBI – A Status Update

Pillars	Objective	Progress So Far...
Monetary Policy	Clarifying and strengthening the monetary policy framework.	RBI proposes Flexible Inflation Targeting Nominal Anchor moved from WPI to CPI Operating Framework as per Patel Committee
Banking Expansion	New entry, branch expansion, encouraging new varieties of banks	New bank license awarded to IDFC, Bandhan On-tap issue of licenses
Market Broadening	Broadening /deepening financial markets for better liquidity, pricing of risks	Long term bank Infra bonds CPI indexed bonds Proposed International Settlement of bonds
Financial Inclusion	Expanding financial access to SME, unorganized sector, and remote areas	Draft norms for small and payment banks issued as per Nachiket Mor Committee Push for Mobile based banking
Restructuring/Distress management	Mechanism to deal with corporate/FI distress and debt recovery	Refinancing infra loans under take out financing not construed as restructuring Norms for Distress asset management

**Lower inflation key to sustainable growth:** As seen in Figure 10, the RBI has already made significant progress in each of those pillars. The biggest shift has happened in the monetary policy regime where RBI has de facto shifted to CPI from WPI and proposed flexible inflation targeting with its medium target of 4% within a band of +/- 2% over a 2-year time frame (8% by Jan 2015; 6% by Jan 2016).

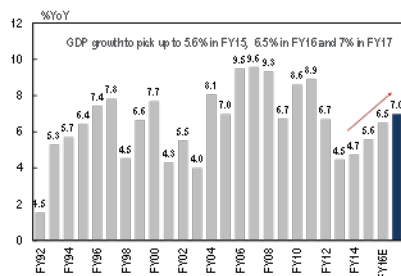
The emphasis on reining in inflation has been among the top priorities, with recent statements highlighting that *"Inflation is a disease which we have to get rid of if we want sustainable growth"*. Dr. Rajan explains high inflation not only creates a dampening effect on investment; it results in a natural tendency for currency to



depreciate and hurts the common man who does not have inflation-protected wages such as in the public sector.

## What if they get it right? FY17 GDP at 7%, CPI 6%

Figure 11. Trends in GDP (%YoY)



Source: CSO, Citi Research

**GDP growth could revive to 7%:** Investments have been the key focus area for the Modi government. Recent initiatives on the clearance process, particularly in the case of environment and forest regulations, could speed up project implementation. In addition, opening of FDI in defense/railways, higher allocation on infrastructure, cutting red-tape, expanding the role of the PMG all point to FY17 GDP growth reviving back to 7%, if not more. The expansion of financial services activity across banking and non-banking sector is likely to add a further boost to overall economic activity.

**CPI Inflation to slow to 6%:** The Central Bank stays committed to bring inflation down to 6% by Jan-16 and aims to keep it range bound between 4%-6% thereafter. The calibration of monetary policy is likely to deliver low inflation, and all the more so considering that government has joined hands with RBI in its war against food inflation. The government has acted swiftly on the inflation front by moderating MSP hikes, open market sale of food stocks and other measures on price control.

Besides, we also look at other implications of improving policy environment:

Figure 12. Trends in CPI path (%YoY)



Source: CSO, Citi Research

■ **Land reforms => Infrastructure Growth:** In order to appease to states' concerns, the government is working to manage the needs of landowners as with those of industries. With a balanced, transparent and uniform land policy in place, a major hindrance to project clearances and investments would be eliminated. For example, in the roads sector, the unions minister estimated that projects worth ~Rp600bn faced delays due to land acquisition and environmental / forest clearance issues.

■ **Labour reforms => Industrial/Manufacturing:** The reforms would amend archaic labour laws, reducing regulatory interferences in the organized sector. For the labour-intensive manufacturing sector, this would be a significant move: raising flexibility in employment planning, facilitating job creation and enhancing business productivity. The reforms would also benefit employees, with better provisions for employee benefits and safety.

■ **Stable Inflation, Rupee => Lower Cost of Capital:** The monetary policy framework as proposed by the Urjit Patel Committee that targets low and stable inflation is likely to result in lower cost of capital and contain real exchange rate volatility.

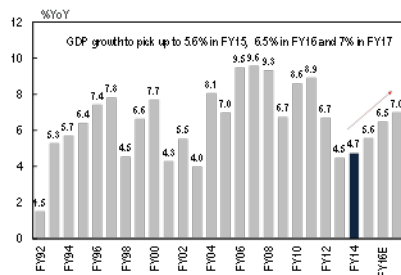
■ **Banking/NPA reforms => Investments:** New entry/on-tap licensing in the banking sector, better norms for distress/NPA management and measures to correct asset liabilities mismatches will result in more resources being available for infrastructure financing and capital intensive sectors. .

■ **Financial Inclusion => Efficiency/Productivity:** Banking in India is far from inclusive, with only 36% of population having access to bank accounts. The expansion in banking and financial services including payment services, mobile banking etc. will reduce transaction costs and improve efficiency and productivity in the real economy.

# Real Economy

## Turning a Corner

Figure 13. Trends in GDP (%YoY)



Source: CSO; Citi Research

**India an investor favorite:** Recent datapoints indicate that the Indian economy may be turning a corner. Industrial growth has picked up, exports have been rising at double digits and CPI inflation has slowed to a 30-month low. These sentiments were echoed by the ~50 institutional investors we met across all asset classes in London. The mood among investors ([UK Trip Tales](#)) was undoubtedly bullish, with India being consensus overweight vs other EMs largely due to it “now” having the (1) cleanest political story, coupled with a strong credible Central Bank; and (2) a move towards the perfect “macro” constellation of a likely pick-up in growth, lower inflation and CAD in check. Despite our above-consensus view on GDP and potential easing of rates in 2015, investors appear more bullish than us.

**However, there are still some risks:** Besides geopolitical issues, the key risk comes from execution. All eyes are on the new government and its ability to implement and deliver. Monsoons have improved recently but still remain 18% below normal, which could pose a risk to agri growth and inflation.

## Signs of Pick-up in Domestic and External Demand

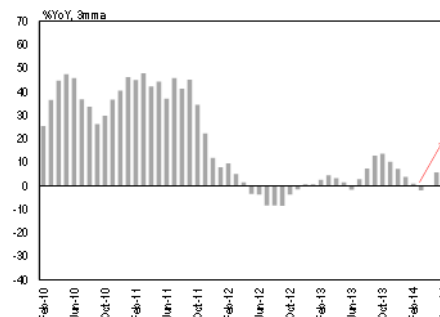
Recent macro trends are encouraging. On the domestic front, factory output in FY15 so far (Apr-May) is at 4.1%, vs a contraction of 0.1% in FY14. On the external front, export growth has bounced back to double-digits, up 10.8%YoY in 1QFY14 vs a contraction of 1.7% in the same period last year.

Figure 14. Factory Output (% YoY, 3mma)



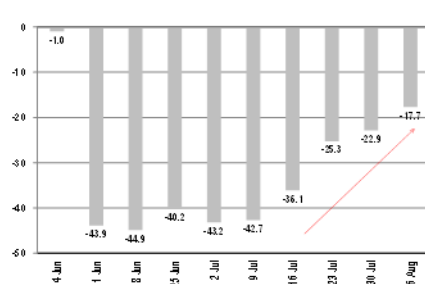
Source: CSO

Figure 15. Trends in Exports (% YoY, 3mma)



Source: DGCI&S

Figure 16. Trends in Cumulative Rainfall (%devn from normal)



Source: IMD

## Sub-Par Monsoons – An “Absorbable” Delta

While the monsoons have played truant, recent data points are encouraging.

- **Latest rainfall trends:** The rainfall deficiency so far (1 June – 10 Aug) has narrowed to 18% from 43% earlier. Moreover, the July rainfall – the crucial month for sowing – was only 11% below normal.
- **Reservoir Levels:** Water levels in reservoirs are 16% higher than the ten-year average. However, levels are 18% lower than this time last year, an improvement over last month’s trend of 30%+ lower.
- **SOI readings:** Latest SOI readings are turning relatively benign at -5.1 (sustained readings below -8 indicate El-Nino)
- **Crop sowing:** Sowing is still down, but the deviation from normal has reduced to 6.3% from 40% three weeks ago.



**Meteorological Drought indicates the deficiency of rainfall compared with normal rainfall in a particular region.**

**It occurs when the deficiency is 25% or more of LPA in a particular area.**

**However, if more than 20% of the total area of the country is drought-impacted, the year is an all-India drought year**

In addition to the above, key to note is the growing share of horticulture / forestry in the agri component of GDP. Consequently, while fears of a drought remain, we maintain our 5.6% GDP estimate, which factors in agri growth of 0.5%.

Figure 17. India's Drought Years

	Rainfall % deviation from LPA	Agri %YoY	GDP %YoY	Total Production		Kharif (summer)			Rabi (winter)		
				Mn Tons	%YoY	Mn Tons	%YoY		Mn Tons	%YoY	
FY66	-18.2	-11	-3.1	72	-19	NA	NA		NA	NA	
FY67	-13.2	-1.4	1.4	74	2.6	49	NA		25	NA	
FY69	-10.3	-0.2	2.6	94	-1.1	60	-2		34	0.4	
FY73	-23.9	-5	-0.2	97	-7.7	59	-6.9		38	-9	
FY75	-12	-1.5	1.2	100	-4.6	59	-12.9		41	10.6	
FY80	-19	-12.8	-4.8	110	-16.8	63	-19		47	-13.7	
FY83	-14.5	-0.3	3	130	-2.8	70	-11.9		60	10.6	
FY87	-12.7	-0.4	4.5	143	-4.7	80	-5.9		63	-3	
FY88	-19.4	-1.6	3.6	140	-2.1	75	-7		66	4.1	
FY03	-19.2	-7.2	4	175	-17.9	87	-22.2		88	-13.1	
FY05	-13.8	1.6	7	198	-7	103	-11.7		95	-1.2	
FY10	-21.8	0.8	8.6	218	-7	104	-12		114	-1.9	

Source: IMD, CSO, FCI, Citi Research

Figure 18. Project Management Group – Progress so far\*

Sector	Number		US\$bn	
	Resolv ed	Bala nce	Res	Bal
Power	92	78	66	85
Roads	8	27	2	7
Petrol/ Natural Gas	8	37	3	55
Steel	4	45	4	75
Railways	7	17	2	5
Shipping	7	11	2	4
Chemicals	1	1	1	1
Fertilizers	0	3	0	3
Mines	2	7	1	7
Civil Aviation	2	0	4	0
Coal	22	42	2	10
Commerce + Industry	5	18	2	11
Textiles	0	1	0	0
Urban Development	0	1	0	3
<b>TOTAL</b>	<b>158</b>	<b>288</b>	<b>89</b>	<b>265</b>

\*as of 17<sup>th</sup> July 2014; Source:

[http://cabsecpmg.gov.in/cabsec/ccj\\_acceptedprojects.php](http://cabsecpmg.gov.in/cabsec/ccj_acceptedprojects.php)

## Bottom Line: GDP to pick up 5.6% in FY15 – 7% in FY17

**FY15 GDP: Industry/Exports to Offset Sub-Par Agri:** While it's still too early to cheer, the [macro muddle](#) seen at the end of last month appears to be clearing. (1) Crude prices have come off, (2) rainfall deficiency has narrowed to 18% from 40%, (3) pro-active measures on the price front seem to be working. While fears of a drought remain, positive data surprises – factory output, car sales, and exports – indicate that a continuation of industry/service trends could offset it, prompting us to retain our 5.6% GDP estimate.

**FY16-FY17 GDP: Investments, Execution Key:** As discussed in our earlier [Macroscopic](#), investments are the key focus area for the Modi government. Supporting this are (1) recent initiatives on the clearance process, particularly in the case of environment/forest regulations, which could speed up project implementation; (2) the budget has increased allocation on infrastructure (higher outlays across roads, energy and waterways); (3) measures aimed at easier infra financing; and (4) expansion of the role of the Project Management Group (PMG) where, in addition to unlocking projects, it is also now responsible for follow-ups/timelines. Collectively, all these efforts on the policy side should help kick start investments in the upcoming years.

Figure 19. . GDP Snapshot (%YoY)

	Wts	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Agriculture	13.9	0.8	8.6	5.0	1.4	4.7	0.5	3.0	3.0
Industry	26.1	9.2	7.6	7.8	1.0	0.4	3.9	5.9	7.0
Services	59.9	10.5	9.7	6.6	7.0	6.8	7.5	7.5	7.8
<b>GDP at factor cost</b>	<b>100.0</b>	<b>8.6</b>	<b>8.9</b>	<b>6.7</b>	<b>4.5</b>	<b>4.7</b>	<b>5.6</b>	<b>6.5</b>	<b>7.0</b>
Consumption	71.1	8.4	8.2	8.9	5.2	4.7	5.6	6.8	6.8
Pvt Consumption	60.0	7.4	8.7	9.3	5.0	4.8	5.5	7.0	7.0
Govt Consumption	11.1	13.9	5.8	6.9	6.2	3.8	6.0	6.0	6.0
Gross Capital Formation	36.0	17.3	14.1	3.9	4.9	-2.5	4.8	5.7	7.5
Gross Fixed Cal Formation	32.3	7.7	11.0	12.3	0.8	-0.1	2.5	6.5	8.5
<b>GDP at market prices</b>		<b>8.5</b>	<b>10.3</b>	<b>6.6</b>	<b>4.7</b>	<b>5.0</b>	<b>5.3</b>	<b>6.5</b>	<b>6.9</b>

Source: CSO; Citi Research

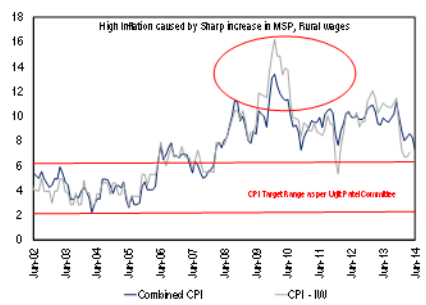
## Monetary Indicators

### CPI at 30-month low; RBI Continues Vigil on Inflation

**CPI at 30-month Low and it's not Just Base Effect:** Headline CPI inflation has eased from ~9% earlier this year with the latest print at 7.3% - a 30-month low. Thanks to the "veggie" price shock in 2013, headline trends will be helped by base effects until Nov'14. This, coupled with a stable INR (33% of CPI basket is tradable), could result in lower CPI prints in the coming months. However, key to note is that the base effect turns adverse from Dec to Feb'15 and thus reining in headline trends would be dependent on supportive supply-side measures.

**RBI Continues Vigil on Inflation and, Rightly So:** As seen in Figure 22 below, the projected glide path shows further decline and we expect CPI to average 8% in FY15 and 6.5% in FY16. However, as mentioned by the RBI in its August policy, there is uncertainty and consequently upside risks emanating from (1) geo-political and exchange rate concerns; (2) strengthening growth amid supply constraints; (3) pass-through of administered prices and (4) uncertainty over monsoon conditions.

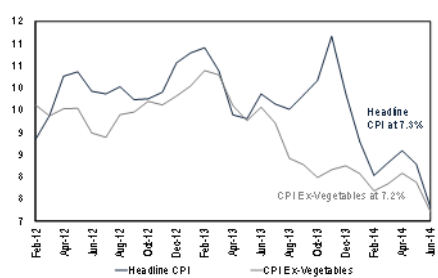
Figure 20. Trends in CPI (% YoY)



Source: CSO, Urjit Patel Committee, Citi Research

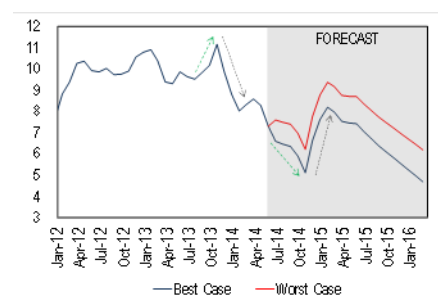
Even after excluding the volatile veggies index, CPI continues to trend down, currently at 7.2%

Figure 21. CPI: Headline & Ex-veggies (%YoY)



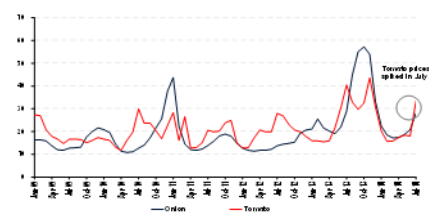
Source: CSO, Citi Research; Veggie wt in CPI: 5.4%

Figure 22. Projected CPI "Glide Path" (%YoY)



Source: CSO, Citi Research

Figure 23. Monthly Prices of Essential Vegetables (Rs/Kg)



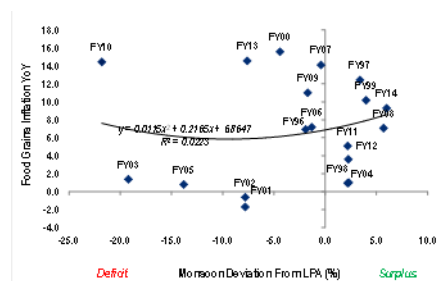
Source: Ministry of Consumer Affairs

Key to note, that excess/ unseasonal rains have had a bigger impact on perishables (fruit & vegetables) inflation than scanty rains

### Monsoons – Veg Spike a Risk; But Could it Sustain?

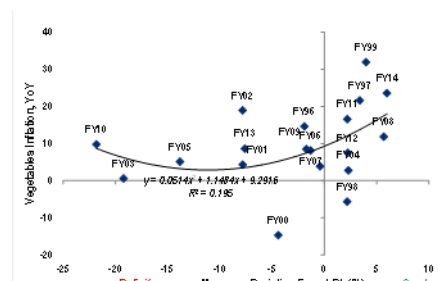
The truant rains have led to fears on the possibility of inflation spikes. As discussed earlier, while there is no clear linearity between deficient rains and food inflation (other factors e.g. MSP hikes, rural wages are key), recent trends in certain items, e.g. tomatoes, are worth watching, given that food inflation plays a role in household expectations. However, in this context, it is interesting the RBI governor remarked that "we have to be a little careful about what the surveys tell us" largely since respondents tend to extrapolate trends. Nonetheless, a late pick-up in rains could help winter crops and soften veggie prices in coming months.

Figure 24. Impact of Surplus/Deficient Rains on Food grains Inflation, YoY



Source: IMD, Office of the Economic Advisor, Citi Research, Based on WPI

Figure 25. Impact of Surplus/Deficient Rains on Vegetables Inflation, YoY



Source: IMD, Office of the Economic Advisor, Citi Research, Based on WPI

## Govt. joins hands with RBI in War against Inflation

Interestingly, in addition to the RBI's strong anti-inflation stance, the government has been taking a series of pro-active measures aimed at both short-term and structural factors behind inflation. These include:

- **Reining in Food Inflation:** Measures include moderating MSP hikes, open market sale of food stocks and other structural measures
- **Fuel & Transportation Costs:** Price calibration of diesel/railways freight aimed at reducing suppressed inflation and lowering demand supply distortions. For example, suppressed inflation in diesel has reduced to 0.1%.

Figure 26. Suppressed Inflation (%)

	Wt	Price	Loss	Sup. Inflation
LPG (Rs/cyl)	0.90%	414	447.87	0.9%
Kerosene (Rs/ltr)	0.70%	14.96	32.98	1.4%
Diesel (Rs/ltr)	4.67%	58.4	1.33	0.1%
<b>Overall Impact</b>				<b>2.5%</b>

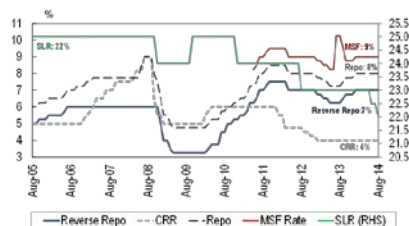
Source: Citi Research, as on 1 August

Figure 27. Recent/Proposed Government Measures to Curb Food Inflation

Announced Measures	Impact
Calibrated 0-3.8% increase in MSPs	Limit the impact of increase in procurement rates
Open market sale of food stocks as required	Counter the increase in retail price
Ban trading of Potato Futures	Reduce speculation-driven price rises / price volatility
Minimum Export Price of onions set at US\$300/ tonne	Increase domestic supply of onions
Delhi Govt to delist fruits & vegetables from APMC	Prevent hoarding and profiteering activities
Line of credit to states that import edible oils and pulses	Enable states to increase supply in case of poor rains
Considering withholding export incentives for milk	Curb the recent increase in retail price
Setting up a Price Stabilization Fund	Could be similar to 2003 scheme for plantation crops;
Prospective Measures	Impact
Reform of APMC act	Limit intermediation in food supply chain
Public Distribution System changes	Targeted subsidies for beneficiaries to curb leakages
Improve agri infrastructure, Unbundling FCI, single National agricultural market	Reduces wastage of perishable products (fruits and vegetables), strengthens the supply chain

Source: Citi Research, Budget Documents, BJP manifesto, Modi Committee report

Figure 28. Key Policy Rates (%)



Source: RBI, Citi Research

## Bottom Line: Fight against Inflation Not Over Yet ...

As stated in RBI's Aug policy, the risks of meeting its first CPI target of 8% by Jan 15 are more balanced relative to the 6% target of Jan 16. Nonetheless we believe that continuation of pro-active measures aimed at both short-term and structural factors, and in the event extraneous factors, e.g. crude, monsoons, and EM risk environment stay supportive, the window to ease rates could open in 2015.

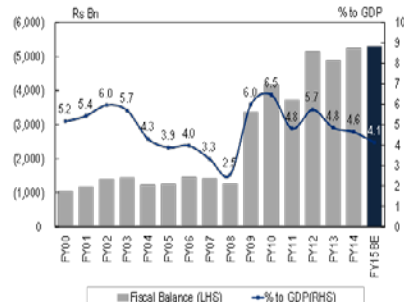
**Key Policy Determinants:** In addition to high frequency data, factors influencing policy include (1) maintaining real rates consistent with the fledgling economic growth; (2) the timing of Fed interest rate normalization (actual/expected) and its impact on global financial markets (actual/expected). Taken together, the balance of risks suggests possibility of some easing in 2015 as RBI grows confident of its 6% target. Note that the governor in media interviews after August policy said *"it is not that we have to touch 6% to cut interest rates, but have to project 6% to cut rates"*.

However, while there is two-way uncertainty, the odds at this point indicate the next move being a cut. However, the jury is still out on the timing, given the RBI statement *"Let's fight anti-inflation fight once and for all"*.

## Fiscal Indicators

### First Modi Budget – Plays Safe

Figure 29. Trends in Fiscal Deficit (% to GDP)



Source: Budget Documents

Set against a backdrop of slow growth, high inflation, a weak monsoon, elevated geopolitical risks and high market expectations, the market's first reaction to the Modi govt's maiden budget was marginally negative. Looking beyond the initial disappointment possibly due to lack of specifics on retro-tax/ date-lining GST, we believe that FM Jaitley has played it safe avoiding any politically contentious issues.

Moreover, the details appear promising where the budget has got something for everyone – for the economist it has a 4.1% fiscal deficit target, for the common man there are tax and mortgage breaks, for those who want to see India build its infrastructure, there are higher outlays and financing made easier, for the foreign investor there is more FDI in Insurance, Defense, and funding and, for industry at large, there is execution on investment allowances. For details pls see [FY15 Budget](#).

### 1QFY15 Deficit at 56% of Budget Estimates

1QFY15 fiscal deficit came in at Rs 2,978bn or 56% of full-year BE vs 48% of BE in 1Q last fiscal. As seen in Figure 30, despite the previous year's subsidy pay-out, 1QFY15 expenditure trends at 8.2% are below budgeted (BE: 12.9%). On the revenue front - overall revenues (both tax and non-tax) were down 3.1% vs BE of 18.6%, resulting in a widening of the deficit.

Figure 30. 1QFY15 Tax Collections (Rs bn)

	1QFY 15	%Yo Y	BE FY15	Bud Grow
Corporate	504	-0.6	4,510	14.6
Income	464	15.2	2,782	17.8
Customs	386	-4.9	2,018	15.2
Excise	184	-12.9	2,064	15.4
Service	266	19.5	2,160	31.0
Others	25	25.3	111	7.8
<b>Gross Taxes</b>	<b>1,830</b>	<b>3.4</b>	<b>13,645</b>	<b>17.7</b>
Devolution to States	831	11.7	3,872	19.9
<b>Net Taxes</b>	<b>991</b>	<b>-2.8</b>	<b>9,773</b>	<b>16.9</b>

Source: Budget Documents; Citi Research

**1Q Is not Necessarily a Good Predictor of Fiscal Trends:** Although the 1Q deficit at over 50% of full-year targets appears alarming, there are two points to note: (1) 1Q net tax collections usually represent only ~12-15% of full-year collections; (2) the extent of tax refunds distorts the overall picture. For example, tax collections last year (1QFY14) fell -2.5%YoY while FY14 tax registered growth of 12.7%.

Figure 31. Public Finances Snapshot – April-June (Rs Bn, %)

	Apr-Jun FY15	Apr-Jun FY14	%YoY	Budget Est FY15	% To Total Budget	Budgeted Growth
a. Revenue receipts	1,144	1,172	-2.4	11,898	9.6	15.6
Net tax revenues	991	1,019	-2.8	9,773	10.1	16.9
Non-tax	153	153	0.1	2,125	7.2	10.0
b. Non-debt cap receipts	13	22	-39.4	740	1.8	101.8
<b>c. Total receipts (a+b)</b>	<b>1,157</b>	<b>1,194</b>	<b>-3.1</b>	<b>12,638</b>	<b>9.2</b>	<b>18.6</b>
d. Revenue expenditure	3,638	3,277	11.0	15,681	23.2	12.0
e of which interest	907	615	47.5	4,270	21.2	12.3
f. Capital expenditure	498	545	-8.7	2,268	22.0	18.8
<b>g. Total expenditure (d+e)</b>	<b>4,136</b>	<b>3,822</b>	<b>8.2</b>	<b>17,949</b>	<b>23.0</b>	<b>12.9</b>
h. Plan Expenditure	1,118	1,148	-2.6	5,750	19.4	20.9
i. Non Plan Expenditure	3,018	2,674	12.9	12,199	24.7	9.4
<b>j. Fiscal deficit (g-c)</b>	<b>2,978</b>	<b>2,628</b>	<b>13.3</b>	<b>5,311</b>	<b>56.1</b>	
k. Revenue deficit (d-a)	2,494	2,105	18.5	3,783	65.9	
l. Primary Deficit (j-e)	2,071	2,013	2.9	1,041	198.9	

Source: CGA, Budget Documents

### Fiscal Targets Are Optimistic but Achievable

While the assumptions behind the govt's 4.1% fiscal deficit target of Rs5311bn are optimistic, we believe it could be achieved given (1) a likely pick-up in tax collections due to rising economic activity and better compliance; (2) a divestment target of Rs 635bn could be met if proposed stake sales on Coal India, ONGC and Hindustan Zinc go through; (3) similar to the last two years, plan expenditure could be adjusted

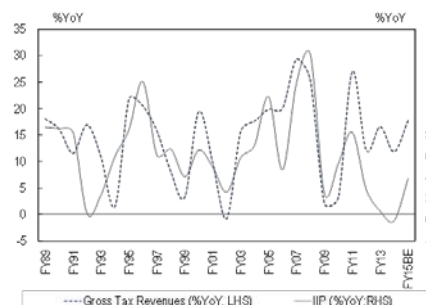
## DIVESTMENT: AMBITIOUS, BUT GOVT MAKES PROGRESS

Of the Rs634bn targeted for FY15, Rs434bn is from stake sale in PSUs, Rs150bn from non govt companies.

Stake Sales Proposed: 10% in Coal India, 5% in ONGC, 11.36% in NHPC, 5% in SAIL, 10% in SJVN, MOIL, CONCOR. Private companies include Hindustan Zinc, L&T, Axis Bank and ITC.

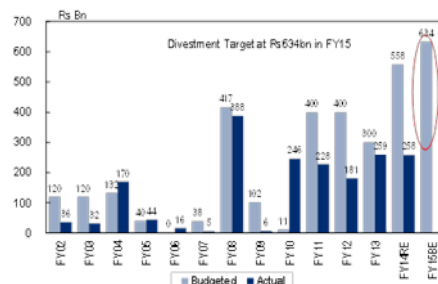
by 0.3-0.4% of GDP; and (4) a combination of benign crude, stable rupee and monthly diesel hikes to keep fuel subsidy in check.

Figure 32. Trends in Tax Revenues (% GDP)



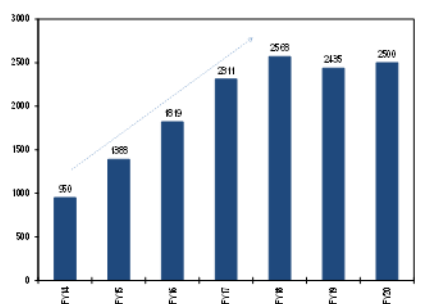
Source: Budget Documents, Citi Research

Figure 33. Trends in Divestments (Rs bn)



Source: Budget Documents, Citi Research

Figure 34. Trends in Redemption (Rs bn)



Source: RBI; Citi Research

## **Borrowing Program – Risk of Slippage Low**

Based on a fiscal deficit target of Rs5,311bn or 4.1% of GDP and estimated redemptions of Rs1,390bn, the gross market borrowing is pegged at Rs6,000bn in FY15 vs Rs5,489bn in FY14 and Rs5,970bn in the interim budget. While the budgeted cash drawdown is Rs172bn, the govt's opening cash balance (Rs1.3 trillion) provides a cushion for financing if needed.

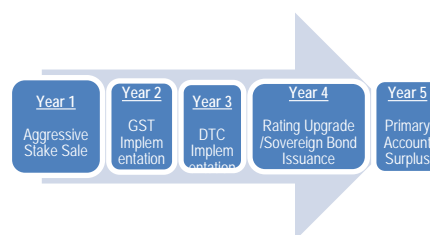
**Borrowing Program Update:** While the 1QFY15 deficit is 56% of targets, the net borrowing through market securities to mid-July is Rs 1,529bn, i.e. 33% of the BE. Data suggests that the govt has run down its cash surplus substantially. Moreover, thanks to the recent transfer of dividend (Rs 527bn), the government reduced its weekly borrowing by Rs60bn on 18 Aug.

Figure 35. Borrowing Program (Rs bn)

	FY11	FY12	FY13	FY14	FY15BE	FY15YTD
<b>Fiscal Deficit</b>	<b>-3,736</b>	<b>-5,160</b>	<b>-4,902</b>	<b>-5,245</b>	<b>-5,311</b>	<b>-2,978</b>
Net Market borrowings	3,254	4,362	4,674	4,539	4,612	1,529
Cash Drawdown	64	-160	-510	150	172	765
Redemptions	1,116	736	906	950	1,388	751
Gross dated borrowings	4,370	5,098	5,580	5,489	6,000	2,280
Maturity Ext Borrowings	0	0	0	306	500	0
Maturity Ext Buy Backs/Repayments	0	0	0	456	500	0

Source: Citi Research; FY14 borrowings adjusted for net buyback of 150bn; FY15 switch estimated at 500bn

Figure 36. Fiscal Reform - A Timeline



Source: Citi Research

## **Bottom-Line – Positioning for Ratings Upgrade**

As the government implements fiscal reforms and demonstrates fiscal discipline, the credit profile of the sovereign could likely get a boost. Over a three-to-four year horizon, we believe a potentially better rating and credible fiscal profile could create an enabling backdrop for India government to tap international markets.

Figure 37. India – Sovereign Bond Ratings

	S&P	Moody's	Fitch
LT Foreign Currency	BBB-	Baa3	BBB
Local Currency	BBB-	Baa3	BBB
<b>Sovereign outlook</b>	<b>Negative</b>	<b>Stable</b>	<b>Stable</b>

Source: Rating Agencies, Citi Research

## External Sector

### Is India prepared for the Fed Normalization?

#### THREE IMPLICATIONS OF LOWER / NEUTRAL RATES FOR EM:

- \* The search for yield tends to depress the long end of local curves, affecting the monetary transmission mechanism.
- \* It impacts exchange rates, which, as the yield curve is hampered, become the most relevant transmission mechanism and
- \* It affects the policy rates directly, forcing smoother/ lower rates than would normally have been the case.

The debate in global financial markets has shifted away from the taper to interest rate normalization. Moreover, an interesting point to note is that, unlike last year, despite chatter on Fed normalization and better data, yields remain low. Ten-year US Treasury yields have remained low at ~2.5%, while in Europe, German ten-year bonds are at 1.15%, while Italian and Spanish bonds are at sub 3%. As discussed by our global team, there is now growing adherence to the view that neutral real rates have declined, which in turn could have meaningful consequences for EMs (see [Three Implications of Lower Neutral Rates](#), Guillermo Mondino).

While last year's taper tantrums took a toll on most EMs, with India among the most affected, resulting in outflows to the tune of US\$13bn, the situation today is far different. As discussed earlier, India is well on the path toward macro-stabilization, with deficits being contained and the growth-inflation imbalance being corrected. Nonetheless, there is no room for complacency

Figure 38. Trends in Fed Target Rate (%)

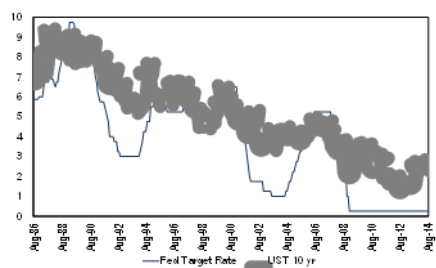
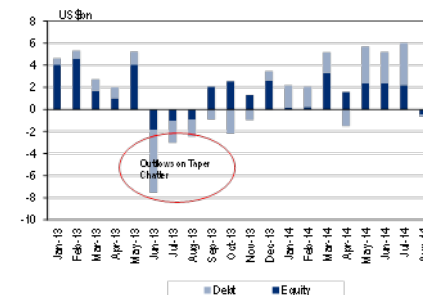


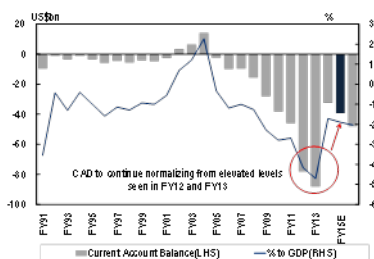
Figure 39. Trends in Portfolio Flows (US\$bn)



Source: Bloomberg, Citi Research

Source: SEBI, Citi Research

Figure 40. Trends in Current Account Deficit (US\$bn, %GDP)



Source: RBI, Citi Research

### CAD in check; Back to Sustainable levels

As seen in Figure 40, India's CAD, which had been in the 2-2.5% of GDP range, crossed 4% for two consecutive years – i.e. US\$78bn (4.2% of GDP) in FY12 and US\$88bn or 4.7% of GDP in FY13. A series of policy measures in the summer of 2013 resulted in the CAD narrowing sharply to a 5-year low of US\$32.4bn or 1.7% of GDP in FY14. **Looking Ahead** : it's important to note that record-high CAD was seen during the period when GDP was sub-5%. Moreover, gold demand is also a function of high domestic inflation and commodity prices. This suggests that a growth recovery poses limited upside risk to CAD going forward.

#### FY15 FORECASTS:

1QFY15 Trade Deficit indicates that the CAD is likely to be ~US\$7bn or 1.4% of GDP. We maintain our FY15 CAD estimate of US\$39bn or 1.9% of GDP in FY15 based on:

- (1) Higher gold imports - 800 tonnes in FY15 vs. 640 tonnes in FY14,
- (2) Capex-led recovery resulting in 11% increase in non-oil/non-gold imports.

Figure 41. Trends in Current Account (US\$bn)

	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
<b>a. Trade Balance</b>	-119.5	-118.2	-130.6	-189.8	-195.7	-147.6	-155.5	-171.1
Exports	189.0	182.4	250.5	309.8	306.6	318.6	343.8	378.2
Imports	308.5	300.6	381.1	499.5	502.2	466.2	499.3	549.2
Of which : Gold	20.7	28.6	40.5	56.2	53.8	28.9	35.0	37.0
Oil	93.7	87.1	106.0	155.0	164.0	165.2	161.1	171.1
Non-Oil Non-Gold	189.3	172.6	223.3	278.1	272.9	254.4	282.3	327.9
<b>b. Invisibles</b>	91.6	80.0	84.6	111.6	107.5	115.2	116.2	123.0
Services	53.9	36.0	48.8	64.1	64.9	73.0	73.3	79.1
Transfers	44.8	52.0	53.1	63.5	64.0	65.3	66.9	67.9
Investment Income	-7.1	-8.0	-17.3	-16.0	-21.5	-23.0	-24.0	-24.0
<b>1. Current Account (a+b)</b>	-27.9	-38.2	-45.9	-78.2	-88.2	-32.4	-39.3	-48.1
% GDP	-2.3	-2.8	-2.7	-4.2	-4.7	-1.7	-1.9	-2.0

Source: RBI, Citi Research



## Capital Account: Further Liberalization Likely

While current account deficit remains stable, the capital account could become a source of concern in the event that there is widespread risk aversion on Fed normalization. A sentiment boost on political change, growth rebound and slowing inflation has led to a pick-up in capital flows (portfolio flows higher by US\$20bn in the first four months of FY15 vs FY14). Going forward, we expect government & RBI to further liberalize bond markets (FII limit relaxation, EM bond index listing, Clearing & Settlement on offshore exchanges, e.g. Euroclear; Clearstream), in order to facilitate inflows if needed.

Overall while the risk to capital flows couldn't be understated in light of Fed rate expectations, we believe that improving macro, liberalization in capital account etc. is likely to blunt the impact, if any.

Figure 42. Trends in Capital Account (US\$bn)

	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
c.Loans	8.3	12.4	28.4	19.3	31.1	7.8	20.0	22.0
d.Foreign Investment	8.3	50.4	39.7	39.2	46.7	26.4	39.8	44.8
Portfolio Investments	-14.0	32.4	30.3	17.2	26.9	4.8	22.0	22.0
FDI	22.4	18.0	9.4	22.1	19.8	21.6	17.8	22.8
e.Banking Capital Net	-3.2	2.1	5.0	16.2	16.6	25.4	12.0	12.0
of which NRI deposits	4.3	2.9	3.2	11.9	14.8	38.9	11.0	11.0
f. Other capital	-5.9	-13.2	-11.0	-6.9	-5.0	-10.8	1.0	1.0
g.Rupee debt service	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4
<b>Capital Account (c:g)</b>	<b>7.4</b>	<b>51.6</b>	<b>62.0</b>	<b>67.8</b>	<b>89.3</b>	<b>48.8</b>	<b>72.4</b>	<b>79.4</b>
Overall Balance	-20.1	13.4	13.1	-12.8	3.8	15.5	33.0	31.2

Source: RBI, Citi Research

## Bottom Line: No Room for Complacency

The fact that the current account deficit is now within 2% of GDP, and that foreign exchange reserves are close to an all-time high, provides some comfort on the external front. Also, the RBI's aim to bring down inflation, and thus the interest rate differential with other countries, bodes well in the medium term. However, there is no room for complacency as external debt remains elevated, and India remains vulnerable to capital stops.

### EXTERNAL DEBT RISES TO US\$440BN IN FY14

At US\$440bn, external debt remains one of the sources of vulnerability on two fronts:

1. Debt servicing has led to widening in current account

2. Repayment schedule exposes to risk of sudden stops.

Figure 43. Trends in External Debt (US\$bn)

	FY09	FY10	FY11	FY12	FY13	FY14
Multilateral	39.5	42.9	48.5	50.5	51.6	53.3
Bilateral	20.6	22.6	25.7	26.9	25.2	24.8
IMF	1.0	6.0	6.3	6.2	6.0	6.2
Trade Credit	14.5	16.8	18.6	19.0	17.7	15.3
Commercial Borrowing	62.5	70.7	100.5	120.1	140.2	146.5
NRI Deposits (Beyond 1 year)	41.6	47.9	51.7	58.6	70.8	103.8
Rupee Debt*	1.5	1.7	1.6	1.4	1.3	1.5
<b>A. Total Long term debt</b>	<b>181.2</b>	<b>208.6</b>	<b>252.9</b>	<b>282.6</b>	<b>312.7</b>	<b>351.4</b>
FII Invst in T-Bills	2.1	3.4	5.4	9.4	5.5	3.2
Others (trade related)	39.9	47.5	58.5	65.1	86.8	81.7
Other	1.3	1.5	1.1	3.7	4.5	4.3
<b>B. Total Short term debt</b>	<b>43.3</b>	<b>52.3</b>	<b>65.0</b>	<b>78.2</b>	<b>96.7</b>	<b>89.2</b>
% Total reserves	17.9	20.7	23.7	30.1	37.2	32.3
<b>GROSS TOTAL (A+B)</b>	<b>224.5</b>	<b>260.9</b>	<b>317.9</b>	<b>360.8</b>	<b>409.4</b>	<b>440.6</b>
Short-Term Debt Residual Maturity (1+2)	57.5	65.3	88.0	99.6	172.3	164.9

Source: RBI, Ministry of Finance

# Financial Markets

## Backdrop: A Mix of Low Volatility and Fine Carry

For the global macro backdrop, please refer to July's GEOS:

[Global Economic Outlook and Strategy](#)

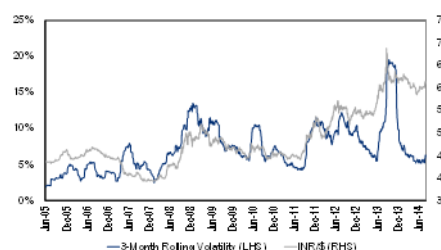
As QE-III comes closer to an end, the debate has shifted towards the timing of Fed rate action. While the Fed has been reducing its purchases by US\$10bn in each of its last six meetings, as seen in Figure 44 below, price action on 10yr UST have been muted so far (~2.4% currently). This, coupled with the relatively subdued impact of geopolitical risks so far (Russia, Iraq, Israel, Syria etc.), has resulted in Indian assets delivering a desirable mix of high returns and low FX volatility. However, with political change now priced in, we believe the path forward will be guided by economic recovery (corporate earnings, macro data).

Figure 44. Trends in US Treasury Yield (%)



Source: Bloomberg, Citi Research

Figure 45. INR- 3 Month Realized Volatility (%)



Source: Bloomberg, Citi Research

## INR: To trade in 59-62 range; FX intervention caps gains

Figure 46. RBI's Foreign Exchange Reserves and Outstanding Forward Position (US\$bn)

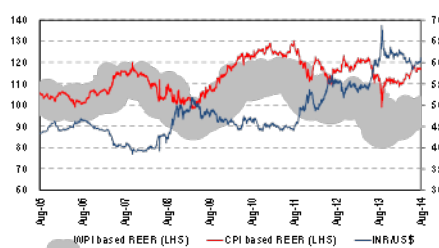
	Fx Reserves	O/S Forwards		
		<1yr Mat	>1yr Mat	Total
Apr-13	293.9	-8.2	0.0	-8.2
May-13	287.9	-5.8	0.0	-5.8
Jun-13	282.5	-4.9	0.0	-4.9
Jul-13	277.6	-4.7	0.0	-4.7
Aug-13	275.5	-9.1	0.0	-9.1
Sep-13	277.2	-7.7	-1.9	-9.6
Oct-13	281.5	-5.9	-8.5	-14.5
Nov-13	290.7	-6.4	-26.1	-32.5
Dec-13	293.9	-6.6	-26.0	-32.6
Jan-14	291.1	-5.9	-26.0	-31.8
Feb-14	294.4	-5.3	-26.0	-31.3
Mar-14	304.2	-5.1	-26.0	-31.0
Apr-14	311.0	-6.1	-26.0	-32.1
May-14	312.2	14.5	-26.0	-11.5
Jun-14	315.8	25.8	-26.0	-0.2
Jul-14	320.0			

Source: RBI, Citi Research

Following an overall BoP surplus of US\$15.5bn in FY14, we expect the BoP surplus to rise to US\$33bn. This is thanks to the CAD likely to be contained under than 2% of GDP and robust capital flows. Key to note that in a bid to re-build dollar reserves, the RBI has been intervening in both the spot and forward markets with FX reserves close to all-time highs (US\$320bn) and its short forward position now fully covered (see Figure 46). However, despite the improved sentiment and a supportive BoP, we expect the INR to trade in the Rs59-62 band with a positive bias given:

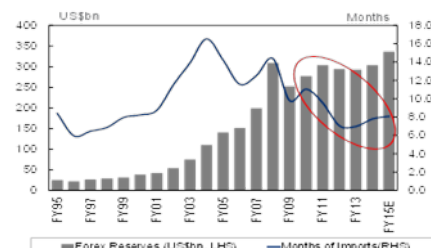
- **Real effective exchange rate (CPI based):** The rupee appears overvalued by ~16% in real terms (six-country 2004-05 base) but after adjusting for productivity, the rupee at 61.1 is within its equilibrium value of 60-62.
- **Reserves Adequacy (Import Cover/ external debt):** As stated in the Urjit Patel report, there is a need to build reserves not just in terms of existing metrics but also intervention requirements set by past experience with external shocks.
- **Cost of Intervention (banking liquidity, rate diff):** Given the core liquidity need of ~US\$20bn annually in the banking system, FX intervention up to US\$20bn need not be sterilized.

Figure 47. Real Effective Exchange Rates



Source: RBI; Citi Research

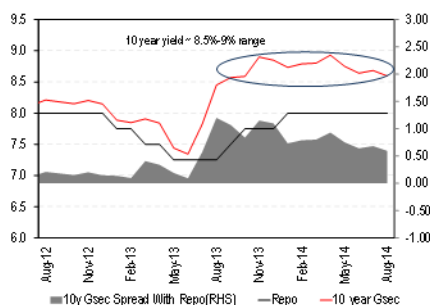
Figure 48. Import Cover (in months)



Source: RBI; Citi Research

## Bonds – 10yr Yields to Soften to 8.25-8.5%

Figure 49. Trend in bond yields (%)



Source: Citi Research

As seen in Figure 49, over the last 12 months, 10-year bond yields have traded in the 8.5%-9% range. This is despite a significant change in the inflation and currency outlook in this period. Key reasons for 10-year yields remaining elevated include (1) cautious outlook on policy rates, (2) high funding rates and (3) supply-demand dynamics e.g. lack of OMO, SLR cuts etc. However, factors that could result in yields edging lower include (1) the recent rejig in FII investment limits by US\$5bn, (2) funding costs coming off – aided by unsterilized FX intervention and possible modifications in term repo (frequency, maturity, timing, etc), (3) possibility of rates being eased if pro-active measures to contain inflation continue.

Figure 50. Utilization of Govt. bond limits

	Limit US\$bn	Limit Rs bn	Invst Rs bn	% limits used
<b>Government Debt</b>	<b>30</b>	<b>1,535</b>	<b>1,173</b>	<b>76.4%</b>
Auction Route	25	1244	1041	83.7%
On Tap*	5	291	132	45.4%
<b>Corporate Debt</b>	<b>51</b>	<b>2,443</b>	<b>998</b>	<b>40.8%</b>
Commercial Papers	2	100	100	100.2%
<b>Total</b>	<b>81</b>	<b>3978</b>	<b>2,171</b>	<b>54.6%</b>

Source: Applicable for Sovereign funds/ Multilateral agencies/ Endowment/ Insurance/ Pension funds/ Foreign central banks Source: <https://nsdl.co.in/FII/FII.php>, as of 1 August

## Liquidity: Term repo, Sept. advance tax in Focus

The benchmark overnight MIBOR has averaged 8.5% in 2QFY15 as compared to 8.2% in 1Q. As the banking system heads into the advance tax outflow season of September (~1% of NDTL), the system could come into further stress. However, the RBI's dividend transfer (Rs 527bn in FY15 v/s Rs330bn) is liquidity-positive as govt spending takes place. Going forward, the RBI could possibly look at reducing the daily CRR floor from currently 95% of the daily prescribed limit. These measures in addition to a tweaking of repo timing, frequency, maturity are likely to ensure an overnight borrowing rate anchored around the repo rate.

### CURRENT LAF LIMITS (% NDTL)

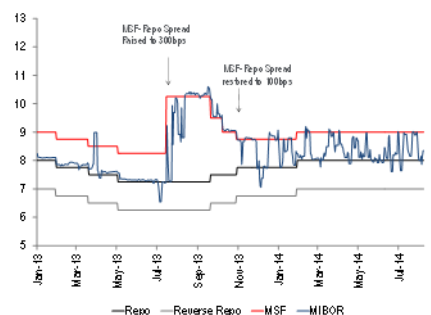
- \* **Overnight Repo: 0.25%**
- \* **Term Repo: 0.75%**
- \* **Refinance: 32% of eligible credit**
- \* **MSF: Up to 2%**

**Current Rates:** Overnight rates moved up from 8.2% in 1QFY15 to 8.5% in 2Q, despite no change in policy rate

**Outlook:** to narrow the spread on overnight/term repo rates, governor in his media interview hinted at upcoming liquidity measures on term repos such as

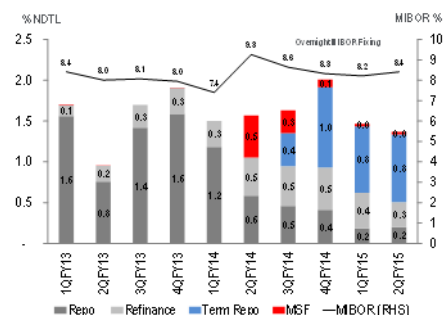
- \* **reduced maturity,**
- \* **increased frequency,**
- \* **change in timing**

Figure 51. Trends in Overnight MIBOR (%)



Source: RBI, Citi Research

Figure 52. Liquidity Conditions (% NDTL)



Source: RBI, Citi Research

## Bottom Line: Indian Assets an Attractive Investment

Given a stable outlook for the exchange rate and considering that the rate cycle has likely peaked in India, fixed-income assets continue to appear attractive on a medium-term investment horizon.

# Monthly Monitor

Figure 53. India — Key Monthly Indicators (percent change from a year ago unless otherwise stated)

	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14
<b>Consumption Trends</b>														
Two-Wheelers	1.1	-4.6	-0.1	6.7	18.4	18.0	5.6	2.3	8.9	9.7	21.2	11.7	16.3	13.0
Passenger Car Sales	-11.7	-10.4	-8.6	13.0	-1.0	-5.4	-9.7	-6.0	-7.6	1.4	-5.1	-10.2	3.1	14.8
Tractors	23.5	20.7	12.3	10.9	35.1	30.0	12.5	13.0	16.5	15.2	5.4	-10.7	0.1	5.5
LHCVs	-7.2	-8.9	-12.3	-14.1	-18.1	-14.4	-26.8	-24.5	-22.4	-32.6	-26.5	-27.4	-17.7	-12.5
MHCVs	-16.7	-21.3	-19.7	-38.1	-41.5	-31.6	-33.9	-27.9	-17.4	-23.8	-20.8	-17.1	-10.5	-2.1
<b>Investment Trends</b>														
Infrastructure Index	2.3	0.1	3.2	3.7	8.0	-0.6	1.7	2.1	1.6	4.5	2.5	4.3	2.3	7.2
Diesel Consumption	0.3	-2.1	-6.0	-0.1	-0.6	-1.3	0.6	-2.3	-2.6	-0.1	-1.8	-3.6	1.3	3.4
Steel Production	1.7	5.5	0.7	12.1	12.8	0.8	4.2	5.0	-5.2	8.0	4.3	3.3		
Manufacturing PMI*	50.1	50.3	50.1	48.5	49.6	49.6	51.3	50.7	51.4	52.5	51.3	51.3	51.4	51.5
output	48.6	49.1	49.8	47.5	49.6	48.6	51.5	51.3	52.6	54.0	52.2	51.7	51.7	52.4
<b>Industrial Production Index</b>														
General	-2.5	-1.8	2.6	0.4	2.7	-1.2	-1.3	-0.2	0.8	-1.9	-0.5	3.4	4.7	
Manufacturing	-3.2	-1.7	3.0	-0.2	1.4	-1.3	-2.6	-1.2	0.0	-3.7	-1.2	2.5	4.8	
Mining	-5.9	-4.6	-3.0	-0.9	3.6	-2.9	1.6	0.7	1.9	1.4	-0.4	2.6	2.7	
Electricity	6.2	0.0	5.2	7.2	12.9	1.3	6.3	7.5	6.5	11.5	5.4	11.9	6.3	
Use Based Basic goods	-0.3	-1.9	1.0	0.9	6.7	-0.4	2.7	3.0	2.5	4.1	4.0	7.3	6.3	
Capital goods	-3.7	-6.6	15.9	-2.0	-6.6	2.5	0.1	-2.5	-4.1	-17.5	-12.5	14.3	4.5	
Intermediate goods	1.1	1.3	3.2	3.8	4.4	2.7	3.7	5.2	3.6	3.7	0.6	3.4	2.7	
Consumer goods	-6.6	-1.5	-0.7	-0.9	1.0	-5.0	-8.9	-4.6	-0.5	-4.1	-0.9	-4.7	3.7	
Consumer Durables	-18.3	-10.1	-9.6	-8.3	-10.6	-12.0	-21.7	-16.4	-8.3	-9.3	-11.8	-7.8	3.2	
Consumer Non-Durables	3.8	6.2	7.4	5.4	12.0	1.9	2.2	2.8	4.6	-0.5	7.2	-2.5	3.9	
<b>Services</b>														
Port traffic	0.5	2.5	4.8	6.8	4.9	-2.8	-0.6	5.8	-3.1	-1.3	7.6	8.8	0.9	3.7
Railway freight	4.8	5.7	4.5	5.7	11.5	-2.4	2.7	4.2	4.1	4.0	2.2	6.1	4.0	2.6
Tourist arrivals ('000)	417	451	506	486	454	598	734	822	720	738	669	504	421	492
Cellular subscriber Adds (Mn)**	4.1	3.4	1.4	2.0	-6.2	4.8	4.9	6.8	8.6	10.3	8.3	5.0	6.2	6.5
<b>Banking Trends</b>														
Money supply(M3)	13.6	12.7	12.4	12.0	12.9	13.5	14.3	14.2	14.2	14.5	13.5	13.7	13.5	12.2
Loan(Credit) growth	15.1	13.5	14.7	16.3	15.0	16.0	13.9	14.2	15.7	15.7	13.9	13.8	12.5	12.8
Deposit growth	14.2	13.5	13.1	12.6	11.5	14.3	15.6	15.4	16.2	16.6	14.1	15.4	13.4	11.7
Non-food credit	15.3	13.7	14.9	16.5	15.2	16.4	14.3	14.5	15.9	16.1	17.0	14.2	12.8	13.0
<b>Inflation</b>														
CPI	9.3	9.9	9.6	9.5	9.8	10.2	11.2	9.9	8.8	8.0	8.3	8.6	8.3	7.3
WPI	4.6	5.2	5.9	7.0	7.0	7.2	7.5	6.4	5.1	5.0	6.0	5.5	6.0	5.4
Mfg products inflation	3.3	2.9	2.6	2.3	2.4	2.8	2.9	3.0	3.0	3.4	3.7	3.7	3.5	3.6
Food Products	5.7	8.8	9.7	13.6	14.0	14.6	15.3	10.8	6.8	6.3	7.3	7.0	8.6	6.8
Fuel Products	7.3	7.5	11.4	12.7	11.7	10.5	11.1	10.9	9.8	8.7	11.8	9.3	10.5	9.0
PMI - Input Prices	51.3	55.9	60.6	57.8	63.5	64.5	58.0	57.8	57.7	61.0	57.2	54.6	54.0	55.8
PMI - Output Prices	49.8	50.9	53.4	51.8	51.1	55.3	51.9	51.8	52.4	51.4	51.0	50.9	51.1	52.5
<b>Interest rates (Average, %)</b>														
Daily MIBOR	7.4	7.3	7.9	9.9	10.1	9.2	8.6	8.2	8.3	8.4	8.4	8.4	8.2	8.2
1 yr CD	8.3	8.3	9.1	10.3	10.1	9.2	9.2	9.3	9.3	9.7	9.5	9.2	9.1	8.9
91-day T-Bills	7.3	7.3	8.4	10.0	9.4	8.6	8.8	8.8	8.7	8.9	8.9	8.9	8.8	8.6
Corp Bond Spreads	0.9	1.0	1.2	0.9	1.2	1.0	1.2	0.9	0.9	0.8	0.8	0.8	0.8	0.6
10-year government bond	7.4	7.3	7.8	8.5	8.6	8.6	8.9	8.8	8.7	8.8	8.8	8.9	8.8	8.6
<b>Trade - customs data</b>														
Exports(%YoY)	-0.7	-4.8	10.6	13.5	11.7	13.2	1.9	3.5	3.8	-5.5	-3.2	5.3	12.4	10.2
Imports(%YoY)	6.1	-0.6	-6.3	-1.2	-18.6	-14.6	-16.7	-15.2	-18.1	-17.9	-2.1	-15.0	-11.4	8.3
Oil	3.3	13.4	-7.9	17.9	-5.9	2.2	-1.0	1.0	-10.1	-3.0	17.7	-0.6	2.4	10.9
Non-oil	7.5	-6.9	-5.6	-11.2	-25.0	-23.1	-24.2	-22.9	-22.0	-25.8	-11.8	-21.5	-17.9	7.0
Trade Deficit (US\$bn)	-20.1	-12.2	-12.5	-10.6	-6.4	-10.6	-10.0	-10.1	-9.9	-8.3	-10.5	-10.1	-11.2	-11.8
Brent Prices (\$/bbl)	103.2	103.0	107.9	110.9	111.9	109.5	108.2	110.8	107.5	108.8	107.6	107.9	109.7	111.3
<b>Foreign investment (US\$ mn)</b>														
FII	5,220	-7,536	-3,026	-2,457	1,151	357	343	3,460	2,187	2,054	5,175	76	5,701	5,188
FDI	1,866	1,835	1,930	1,661	4,511	2,040	2,165	1,861	-559	-666	2,133	2,006	4,753	
<b>Exchange rate and reserves</b>														
US\$ exchange rate average	55.0	58.4	59.8	62.8	63.6	61.6	62.5	61.8	62.1	62.2	60.9	60.3	59.3	59.7
US\$ exchange rate month end	56.5	59.7	61.1	66.6	62.8	61.4	62.4	61.9	62.5	62.1	60.1	60.3	59.0	60.1
Forex reserves incl.gold (US\$bn)	287.9	284.6	280.2	275.5	276.3	283.0	291.3	295.7	291.1	294.4	303.7	309.9	312.4	315.8

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

## Balance of Payments

Figure 54. Balance of Payments Snapshot (US\$bn)

	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	Comments
CURRENT ACCOUNT									
Exports (RBI)	189.0	182.4	250.5	309.8	306.6	318.6	343.8	378.2	Exports likely to pick up due to partner country growth
YoY %	13.7	(3.5)	37.3	23.7	(1.0)	3.9	7.9	10.0	
% of GDP	15.4	13.3	14.7	16.5	16.4	17.0	16.7	16.1	
Exports (Customs)	185.3	178.8	251.1	306.0	300.4	311.5	336.4	370.0	Oil and Gold are key as they account for 40% imports
YoY %	13.7	(3.5)	40.5	21.8	(1.8)	3.7	8.0	10.0	
Imports (RBI)	308.5	300.6	381.1	499.5	502.2	466.2	499.3	549.2	
YoY %	19.8	-2.6	26.7	31.1	0.5	-7.2	7.1	10.0	Crude price assumptions are at US\$104/bbl in FY15
% to GDP	25.2	22.0	22.3	26.7	26.8	24.9	24.2	23.4	
Imports-Customs	303.7	288.4	369.8	489.3	490.7	450.2	478.4	536.0	
YoY %	21.2	-5.0	28.2	32.3	0.3	-8.3	6.3	12.0	Gold imports likely to be contained at 800tonnes;
of which: Oil	93.7	87.1	106.0	155.0	164.0	165.2	161.1	171.1	
YoY %	17.6	-7.0	21.6	46.2	5.9	0.7	-2.5	6.2	
Gold	20.7	28.6	40.5	56.2	53.8	28.9	35.0	37.0	Difference normally represents defense imports
YoY %	23.9	38.2	41.6	38.7	-4.3	-46.3	21.1	5.7	
Non-oil Non-gold	189.3	172.6	223.3	278.1	272.9	254.4	282.3	327.9	
YoY%	22.1	-8.8	29.4	24.6	-1.9	-6.8	11.0	16.2	Rising recourse to external funding results in outflows
a. Trade balance (RBI)	-119.5	-118.2	-130.6	-189.8	-195.7	-147.6	-155.5	-171.1	
% of GDP	-9.8	-8.6	-7.6	-10.1	-10.4	-7.9	-7.5	-7.3	
Trade Balance (Customs)	-118.4	-109.6	-118.6	-183.4	-190.3	-138.7	-142.0	-166.0	CAD likely to be contained under 2% GDP
Difference b/w RBI and customs	-1.1	-8.6	-12.0	-6.4	-5.3	-8.9	-13.6	-5.1	
b. Invisibles	91.6	80.0	84.6	111.6	107.5	115.2	116.2	123.0	
Non-factor services	53.9	36.0	48.8	64.1	64.9	73.0	73.3	79.1	Possible upside in FDI if policies are supportive
Investment income	-7.1	-8.0	-17.3	-16.0	-21.5	-23.0	-24.0	-24.0	
Remittances**	44.6	51.8	53.1	63.5	64.3	65.5	66.5	67.5	
Official transfers	0.2	0.3	0.0	0.0	-0.3	-0.2	0.4	0.4	Upside potential if infrastructure and Public sector financial Institutions raise quasi sovereign bonds
1. Current a/c balance (a+b)	-27.9	-38.2	-45.9	-78.2	-88.2	-32.4	-39.3	-48.1	
% of GDP	-2.3	-2.8	-2.7	-4.2	-4.7	-1.7	-1.9	-2.0	
CAPITAL ACCOUNT									
c. Loans	8.3	12.4	28.4	19.3	31.1	7.8	20.0	22.0	Possible upside in FDI if policies are supportive
External assistance	2.4	2.9	4.9	2.3	1.0	1.0	2.0	2.0	
Commercial borrowings	7.9	2.0	12.5	10.3	8.5	11.8	12.0	14.0	
Short-term credit	-2.0	7.6	11.0	6.7	21.7	-5.0	6.0	6.0	Upside potential if infrastructure and Public sector financial Institutions raise quasi sovereign bonds
Foreign Investment (d+e)	8.3	50.4	39.7	39.2	46.7	26.4	39.8	44.8	
d. FDI (Net = a-b)	22.4	18.0	9.4	22.1	19.8	21.6	17.8	22.8	
(a) FDI - To India	41.7	33.1	25.9	33.0	27.0	30.8	32.8	37.8	Possible upside in FDI if policies are supportive
(b) FDI - Abroad	-19.4	-15.1	-16.5	-10.9	-7.1	-9.2	-15.0	-15.0	
e. Portfolio invst	-14.0	32.4	30.3	17.2	26.9	4.8	22.0	22.0	
f. Banking Capital	-3.2	2.1	5.0	16.2	16.6	25.4	12.0	12.0	Possible upside in FDI if policies are supportive
NRI deposits	4.3	2.9	3.2	11.9	14.8	38.9	11.0	11.0	
g. Rupee debt service	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4	
h. Other capital***	-5.9	-13.2	-11.0	-6.9	-5.0	-10.8	1.0	1.0	Possible upside in FDI if policies are supportive
2.Capital a/c (c+d+e+f+g+h)	7.4	51.6	62.0	67.8	89.3	48.8	72.4	79.4	
Errors & Omissions	0.4	0.0	-3.0	-2.4	2.7	-0.9	0.0	0.0	
Overall balance (1+2)	-20.1	13.4	13.1	-12.8	3.8	15.5	33.0	31.2	
Forex									
Forex Reserves (incl gold)	283.5	297.3	296.7	296.6	295.7	303.6	325.0	345.0	
FCA to months of imports (Rhs)	11.0	11.9	9.3	7.1	7.1	7.8	7.8	7.5	
Exchange rate									
Rs/US\$ - annual avg	46.0	47.4	45.6	48.1	54.0	60.4	62.0	62.0	
% depreciation	14.4	3.0	-3.8	5.5	12.3	11.9	2.6	0.0	

\*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.. \*\*\* Other capital refers to leads and lags in exports, advances received pending issue of shares, funds held abroad.

Source: RBI; Citi Research estimates

## Composition of Trade

Figure 55. India — Composition of Imports (US\$bn, %)

	FY10	FY11	FY12	FY13	FY14	FY15*
Petroleum (Crude+Products)	87.1	106.0	155.0	165.1	165.1	40.8
%YoY	-7.0	21.6	46.2	6.5	0.7	4.3
% Total	30.2	28.7	31.7	33.7	36.7	36.0
Electronic Goods	21.0	26.6	32.7	31.4	31.0	8.4
%YoY	-10.9	26.8	23.2	-4.0	-1.4	2.7
% Total	7.3	7.2	6.7	6.4	6.9	7.4
Gold	28.8	40.7	56.5	53.8	28.9	7.1
%YoY	35.1	41.1	39.0	-4.7	-46.3	-56.2
% Total	10.0	11.0	11.5	11.0	6.4	6.2
Pearls, precious, semiprecious stones	16.3	34.6	29.4	22.7	24.0	6.5
%YoY	-3.2	112.4	-15.1	-22.9	5.9	-6.1
% Total	5.7	9.4	6.0	4.6	5.3	5.8
Machinery (ex electric)	19.7	23.9	30.2	27.7	23.7	
%YoY	-9.8	21.0	26.6	-8.4	-14.3	
% Total	6.8	6.5	6.2	5.6	5.3	
Coal, Coke, Briquettes	9.0	9.8	17.5	16.4	16.4	4.2
%YoY	-11.0	9.1	79.1	-6.2	-3.3	-0.8
% Total	3.1	2.6	3.6	3.4	3.7	3.7
Organic Chemicals	8.6	11.6	13.4	14.5	15.8	
%YoY	11.2	34.2	15.2	8.5	9.2	
% Total	3.0	3.1	2.7	3.0	3.5	
Metalliferous ores, Metal Scraps	7.7	9.7	13.4	15.0	15.0	1.9
%YoY	-4.4	26.0	37.6	12.0	-12.9	-25.5
% Total	2.7	2.6	2.7	3.1	3.3	1.7
Transport Equipment	11.7	11.5	13.9	15.7	13.5	3.2
%YoY	-11.8	-2.0	21.5	13.0	-10.1	-24.2
% Total	4.1	3.1	2.8	3.2	3.0	2.8
<b>TOTAL IMPORTS</b>	<b>288.4</b>	<b>369.8</b>	<b>489.3</b>	<b>489.7</b>	<b>450.1</b>	<b>113.2</b>
% YoY	-5.1	28.2	32.3	0.1	-8.3	-6.6

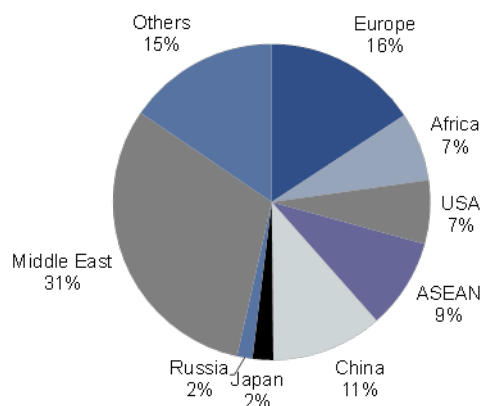
\*(Apr-Jun) Source: DGCI&S, RBI

Figure 56. India — Composition of Exports (US\$bn, %)

	FY10	FY11	FY12	FY13	FY14	FY15*
Petroleum Crude & Products	28.2	41.5	55.9	60.8	62.7	17.2
%YoY	2.3	47.2	34.8	8.7	3.0	21.9
%Total	15.8	16.8	18.3	20.3	20.1	21.5
Gems and Jewellery	29.1	37.9	45.3	43.3	41.1	10.0
%YoY	2.4	30.5	19.5	-4.4	-5.2	-3.9
%Total	16.3	15.4	14.8	14.4	13.2	12.5
Transport Equipment	9.8	16.7	21.4	18.5	21.4	
%YoY	-12.9	70.1	28.2	-13.6	16.5	
%Total	5.5	6.7	7.0	6.2	6.9	
Machinery, Instruments	9.6	11.9	14.3	15.2	16.2	
%YoY	-13.3	24.2	20.8	6.4	5.9	
%Total	5.4	4.8	4.7	5.1	5.2	
Pharmaceuticals, Chemicals	9.0	10.6	13.2	14.6	15.0	3.9
%YoY	2.1	18.6	24.1	10.7	2.6	6.8
%Total	5.0	4.3	4.3	4.9	4.8	4.9
Manufacture of Metals	5.5	8.6	9.5	10.0	9.7	
%YoY	-27.2	56.3	10.4	5.3	-3.7	
%Total	3.1	3.5	3.1	3.3	3.1	
Cotton yarn, Fabrics, etc	3.7	5.7	6.8	7.5	9.1	
%YoY	-11.1	54.6	19.0	10.4	7.7	
%Total	2.1	2.3	2.2	2.5	2.9	
Readymade Garments	9.9	10.6	12.5	11.5	8.9	4.2
%YoY	-1.8	6.9	17.6	-7.9	18.1	17.8
%Total	5.6	4.3	4.1	3.8	2.8	5.3
Electronic Goods	5.6	8.5	9.4	8.4	7.6	1.6
%YoY	-21.5	51.7	9.8	-9.8	-5.3	-11.6
%Total	3.2	3.5	3.1	2.8	2.4	2.0
<b>TOTAL EXPORTS</b>	<b>178.5</b>	<b>247.0</b>	<b>305.4</b>	<b>300.0</b>	<b>312.6</b>	<b>80.1</b>
% YoY	-3.7	38.4	23.7	-1.8	4.1	9.4

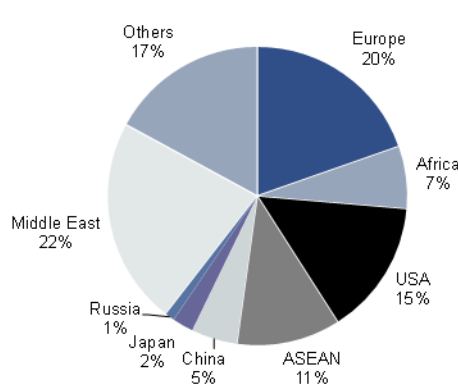
\*(Apr-Jun) Source: DGCI&S, RBI

Figure 57. Direction of Imports FY14



Source: DGCI&S, CMIE

Figure 58. Direction of Exports FY14



Source: DGCI&S, CMIE



# Government Finances

Figure 59. Snapshot of Indian Government Finances (Rs bn)

	FY09	FY10	FY11	FY12	FY13	FY14RE	FY15BE	
<b>a. Gross Tax Revenue</b>	<b>6,053</b>	<b>6,245</b>	<b>7,931</b>	<b>8,892</b>	<b>10,359</b>	<b>11,589</b>	<b>13,645</b>	Revenues
% to GDP	10.8	9.6	10.2	9.9	10.2	10.2	10.6	Key Assumptions
% YoY	2.0	3.2	27.0	12.1	16.5	11.9	17.7	Income Tax: +17.8%
Corporation tax	2,134	2,447	2,987	3,228	3,563	3,936	4,510	Corporate: +14.6%; Customs +15.2%
Income tax	1,060	1,224	1,391	1,645	1,965	2,362	2,782	Excise: +15.4%; Service: +31%
Excise duty	1,086	1,030	1,377	1,449	1,758	1,788	2,064	
Import duty	999	833	1,358	1,493	1,653	1,751	2,018	
Service tax	609	584	710	975	1,326	1,649	2,160	
<b>b. (-) Devolvement to States &amp; UTs</b>	<b>1,620</b>	<b>1,680</b>	<b>2,232</b>	<b>2,594</b>	<b>2,944</b>	<b>3,229</b>	<b>3,872</b>	
<b>c. Net tax revenues (a-b)</b>	<b>4,433</b>	<b>4,565</b>	<b>5,699</b>	<b>6,298</b>	<b>7,415</b>	<b>8,360</b>	<b>9,773</b>	
<b>d. Non tax revenues</b>	<b>969</b>	<b>1,163</b>	<b>2,186</b>	<b>1,217</b>	<b>1,374</b>	<b>1,932</b>	<b>2,125</b>	
<b>e. Net revenue receipts (c+d)</b>	<b>5,403</b>	<b>5,728</b>	<b>7,885</b>	<b>7,514</b>	<b>8,792</b>	<b>10,292</b>	<b>11,898</b>	
<b>f. Non-debt capital receipts</b>	<b>67</b>	<b>332</b>	<b>353</b>	<b>369</b>	<b>410</b>	<b>366</b>	<b>740</b>	
Recovery of loans	61	86	124	189	151	108	105	
Divestments/Other	6	246	228	181	259	258	634	
<b>g. TOTAL REVENUES (e+f)</b>	<b>5,470</b>	<b>6,060</b>	<b>8,237</b>	<b>7,884</b>	<b>9,202</b>	<b>10,659</b>	<b>12,638</b>	
%YoY	-6.6	10.8	35.9	-4.3	16.7	15.8	18.6	
<b>h. Revenue expenditure</b>	<b>7,938</b>	<b>9,118</b>	<b>10,407</b>	<b>11,458</b>	<b>12,435</b>	<b>13,995</b>	<b>15,681</b>	Expenditures
Interest (1)	1,922	2,131	2,340	2,732	3,132	3,801	4,270	
Defense	733	907	921	1,030	1,113	1,248	1,344	
Subsidies	1,297	1,414	1,734	2,179	2,571	2,555	2,607	Food: Rs1150 bn; Fuel: Rs730bn; Fert: Rs634bn
Pensions	329	561	574	612	695	741	820	
Grants to States	382	459	498	515	480	616	699	
Admin and social services	927	1,107	1,198	1,053	1,153	1,315	1,406	
Plan expenditure	2,348	2,539	3,142	3,337	3,292	3,719	4,535	
<b>i. Capital expenditure</b>	<b>902</b>	<b>1,127</b>	<b>1,566</b>	<b>1,586</b>	<b>1,669</b>	<b>1,909</b>	<b>2,268</b>	
Defense	410	511	621	679	705	789	946	
Loans	87	121	298	120	119	83	107	
Plan expenditure	405	495	648	786	844	1,037	1,215	
<b>j. Plan expenditure</b>	<b>2,752</b>	<b>3,034</b>	<b>3,790</b>	<b>4,124</b>	<b>4,136</b>	<b>4,755</b>	<b>5,750</b>	Plan expenditure to rise 20.9%
<b>k Non Plan expenditure</b>	<b>6,087</b>	<b>7,211</b>	<b>8,183</b>	<b>8,920</b>	<b>9,967</b>	<b>11,149</b>	<b>12,199</b>	Non-plan expenditure to rise 8.3%
<b>l. TOTAL EXPENDITURE (h+i): (j+k)</b>	<b>8,840</b>	<b>10,245</b>	<b>11,973</b>	<b>13,044</b>	<b>14,104</b>	<b>15,904</b>	<b>17,949</b>	
% YoY	24.0	15.9	16.9	8.9	8.1	12.8	12.9	
<b>Deficit trends</b>								
<b>m. Fiscal Balance (g-l)</b>	<b>-3,370</b>	<b>-4,185</b>	<b>-3,736</b>	<b>-5,160</b>	<b>-4,902</b>	<b>-5,245</b>	<b>-5,311</b>	FY15 fiscal deficit contained at 4.1% GDP vs. estimates of 4.5% in FY14
% to GDP	-6.0	-6.5	-4.8	-5.7	-4.8	-4.6	-4.1	
<b>n. Revenue Balance (e-h)</b>	<b>-2,535</b>	<b>-3,390</b>	<b>-2,523</b>	<b>-3,943</b>	<b>-3,643</b>	<b>-3,703</b>	<b>-3,783</b>	
% to GDP	-4.5	-5.2	-3.2	-4.4	-3.6	-3.3	-2.9	
<b>o. Primary Deficit (m-1)</b>	<b>-1,448</b>	<b>-2,054</b>	<b>-1,396</b>	<b>-2,428</b>	<b>-1,770</b>	<b>-1,444</b>	<b>-1,041</b>	
% to GDP	-2.6	-3.2	-1.8	-2.7	-1.8	-1.3	-0.8	
<b>Financing the deficit</b>								
Market borrowings (Net)	2,336	3,984	3,254	4,362	4,674	4,539	4,612	
PPF & special deposits	80	161	125	108	109	100	120	
Small savings	-13	133	112	-103	86	116	82	
Net external assistance	110	110	236	124	72	54	57	
Others	418	-189	-56	828	471	286	268	
Cash Drawdown	438	-14	64	-160	-510	150	172	
<b>Total financing</b>	<b>3,370</b>	<b>4,185</b>	<b>3,736</b>	<b>5,160</b>	<b>4,902</b>	<b>5,245</b>	<b>5,311</b>	
<b>Memo items (% to GDP)</b>								
Centre	-6.0	-6.5	-4.8	-5.7	-4.8	-4.6	-4.1	
State	-2.3	-2.9	-2.1	-2.4	-2.3	-2.2	-2.6	
<b>Combined</b>	<b>-8.3</b>	<b>-9.3</b>	<b>-6.9</b>	<b>-8.1</b>	<b>-7.2</b>	<b>-6.9</b>	<b>-6.7</b>	
Off Balance Sheet Items	-1.7	-0.2	0.0	0.0	0.0	0.0	0.0	
<b>Total Deficit</b>	<b>-10.0</b>	<b>-9.5</b>	<b>-6.9</b>	<b>-8.1</b>	<b>-7.2</b>	<b>-6.9</b>	<b>-6.7</b>	
Combined liabilities	76.8	75.5	70.2	69.6	69.8	69.8	69.8	

\*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. Source: Budget Documents, Citi Research estimates

## Global Forecasts

Figure 60. Selected Countries — Economic Forecast Overview (Percent) 2013F-2017F

	GDP Growth					CPI					Short Term Interest Rates				
	2013	2014F	2015F	2016F	2017F	2013	2014F	2015F	2016F	2017F	2013	2014F	2015F	2016F	2017F
<b>Global</b>	2.6	2.9	3.5	3.6	3.6	2.6	2.9	3.0	3.2	3.2	2.14	2.35	2.45	2.74	3.09
<b>Industrial Countries</b>	1.3	1.9	2.5	2.5	2.3	1.3	1.6	1.7	1.5	1.5	0.46	0.37	0.54	1.05	1.61
United States	2.2	2.1	3.2	3.2	2.7	1.2	1.6	1.8	2.2	2.3	0.25	0.25	0.48	1.46	2.48
Japan	1.5	1.4	0.9	1.2	1.2	0.4	2.8	1.7	1.6	0.7	0.10	0.10	0.10	0.10	0.10
Euro Area	-0.4	1.1	1.7	1.9	1.9	1.4	0.5	0.9	1.2	1.5	0.50	0.19	0.15	0.16	0.42
<b>Emerging Markets</b>	4.6	4.5	5.0	5.1	5.4	4.7	4.9	5.0	4.7	4.8	4.78	5.29	5.27	5.24	5.25
China	7.7	7.5	7.1	6.7	7.1	2.6	2.3	2.6	2.9	3.3	3.00	3.00	2.84	2.63	2.75
<b>India</b>	4.7	5.6	6.5	7.0	7.1	9.5	8.0	6.5	6.5	6.5	7.75	8.00	8.00	7.50	7.00
Indonesia	5.8	5.1	5.2	5.4	5.5	6.4	6.5	6.7	6.0	5.3	4.65	5.81	6.00	6.00	6.00
Turkey	4.0	3.5	3.5	3.8	4.0	7.5	8.8	7.4	7.0	6.8	6.16	9.34	10.75	9.88	9.50
South Africa	1.9	2.0	2.8	3.3	4.3	5.8	6.5	5.8	5.5	5.9	5.00	5.71	6.42	7.92	8.00
Brazil	2.3	0.9	1.2	2.5	3.0	6.2	6.4	6.4	5.9	5.5	8.44	10.92	12.33	12.00	11.50
Mexico	1.1	2.7	3.9	4.4	4.5	3.8	3.9	3.4	3.6	3.6	3.94	3.21	3.25	4.19	4.67

Note: For inflation, we use the PCE deflator in the US, wholesale price index in India, GDP deflator in Ireland. For Indonesia we refer to the FasBI rate to reflect actual money market rates.

Source: Citi Research estimates, *Global Economic Outlook and Strategy*, 30<sup>th</sup> July 2014

Figure 61. Selected Countries — Economic Forecast Overview (Percent) 2013F-2017F

	Current Balance (Pct of GDP)					Fiscal Balance (Pct of GDP)					Government Debt (Pct of GDP)				
	2013	2014F	2015F	2016F	2017F	2013	2014F	2015F	2016F	2017F	2013	2014F	2015F	2016F	2017F
<b>Global</b>	0.7	0.7	0.5	0.4	0.2	-4.1	-3.7	-3.3	-2.9	-2.7	88	86	86	86	84
<b>Industrial Countries</b>	-0.2	-0.1	-0.1	0.1	0.1	-5.5	-4.6	-3.8	-3.4	-3.0	115	113	113	112	111
United States	-2.4	-2.5	-2.3	-1.8	-1.7	-7.4	-6.4	-5.6	-5.6	-5.4	105	107	107	107	106
Japan	0.7	-0.1	0.0	0.0	0.2	-9.8	-8.0	-6.2	-5.8	-5.4	241	243	247	248	251
Euro Area	2.4	2.9	3.0	2.9	2.8	-3.0	-2.7	-2.4	-1.8	-1.4	95	97	97	96	94
<b>Emerging Markets</b>	2.0	1.9	1.5	0.8	0.3	-2.1	-2.3	-2.5	-2.3	-2.3	45	45	45	45	45
China	2.0	2.0	2.0	1.5	1.0	-1.9	-2.1	-2.0	-2.0	-2.0	54	54	54	53	53
<b>India</b>	-1.7	-1.9	-2.0	-2.0	-2.0	-6.9	-6.7	-6.5	-6.2	-5.9	69	68	66	65	63
Indonesia	-3.3	-3.0	-2.5	-2.7	-2.4	-2.2	-2.4	-2.2	-1.9	-2.0	24	26	25	25	25
Turkey	-7.9	-5.4	-5.8	-5.5	-5.3	-1.2	-2.8	-3.2	-3.3	-3.3	39	38	37	36	35
South Africa	-5.8	-4.9	-4.2	-3.4	-3.1	-4.1	-4.0	-4.0	-3.6	-2.8	46	47	48	49	49
Brazil	-3.7	-3.7	-3.9	-3.9	-3.9	-3.3	-3.9	-3.4	-3.4	-3.3	57	57	58	58	58
Mexico	-2.0	-1.7	-1.7	-2.1	-2.4	-2.3	-3.5	-3.0	-2.2	-2.0	38	38	38	37	37

Note: US debt and deficit figures are for Fed govt only. All other countries are general government debt and deficits. Source: Citi Research estimates, *Global Economic Outlook and Strategy*, 30<sup>th</sup> July 2014

Figure 62. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent) 2013F-2017F

	10-Year Yields					Exchange Rates Versus U.S. Dollar*				
	2013	2014F	2015F	2016F	2017F	2013F	2014F	2015F	2016F	2017F
United States	2.35	2.70	3.10	3.20	3.35	NA	NA	NA	NA	NA
Japan	0.71	0.57	0.78	1.25	1.50	98	104	109	110	107
Euro Area	1.60	1.46	1.55	1.80	2.05	1.33	1.35	1.35	1.40	1.42
China	3.68	4.11	3.97	4.08	4.20	6.15	6.17	6.03	6.01	6.02
<b>India</b>	8.25	8.50	8.50	8.00	7.50	58.57	60.36	62.21	62.45	59.75
Indonesia	6.97	8.14	8.75	8.75	8.75	10449	11693	12009	11704	10989
Turkey	NA	NA	NA	NA	NA	1.91	2.14	2.25	2.38	2.38
South Africa	7.20	8.08	8.04	8.14	8.38	9.65	10.70	11.01	10.81	10.69
Brazil	9.98	11.83	11.91	12.21	12.25	2.16	2.30	2.53	2.66	2.77
Mexico	5.67	6.12	6.95	7.35	7.65	12.8	13.0	13.0	12.7	12.6

Source: Citi Research estimates; *Global Economic Outlook and Strategy*, 30<sup>th</sup> July 2014





## Appendix A-1

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