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India Macroscope

Modiscope: Mandate, Mantra and More

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With thanks to
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- **A Tall Mandate** — India's New Prime Minister, Mr. Modi is standing tall – he's got a sweeping 'change' mandate, is already being compared with the world's most successful economic statesmen, and the markets are joining the celebrations. While the mandate seems surpassed only by expectations; it's throwing up opportunities (Big win…Big Possibilities), and also questions on How, What, and When.

- **Magic Mantra? – How will he do it** — Mr. Modi's 12 year Gujarat track record (which we detail) and his sharp early moves as PM suggest: a) High level of centralization & efficacy b) Bureaucratic empowerment & consolidation c) On-boarding state governments and d) 'The buck stops with me' attitude. There appear to have been few compromises on decision making – and it seems everyone is being taken along, so far at-least. It looks like it's working well – but it is the honeymoon period.

- **And a lot More - What and When** – There's a lot to be done (backlog apart) and the sooner the better. We see the July budget as the first big policy/direction day; key priorities include kick-starting the investment cycle, clearing policy imbroglio's (retro-tax, gas, environment), date-lining GST/DTC tax and measures for fiscal and macro improvement/consolidation (detailed inside).

- **Maintain Macro Estimates** — (1) **GDP:** Maintain estimates of a 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**: The political intent to address food inflation could open space for easing in early 2015. (4) **CAD:** To rise marginally to ~2% of GDP and the INR likely to trade close to its equilibrium value of Rs59-62 with a positive bias. (5**) Fiscal**: Consolidation with better quality.

- **Investors Say "(Besides Rio) India is the only party in town", but there are risks** — These include (1) Event risk in terms of El-Nino; (2) Global risk environment including geo-politics; (3) A still high inflation environment; (4) Towering expectations.

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

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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
National Income Indicators														
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
Real GDP growth (%)	4.0	8.1	7.0	9.5	9.6	9.3	6.7	8.6	8.9	6.7	4.5	4.7	5.6	6.5
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
By Demand (%YoY)														
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
Cons; Invst, Savings * (%GDP)														
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
Real Indicators (%YoY)														
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
Monetary Indicators (% YoY)														
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
Fiscal Indicators (% GDP)														
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
External Sector (% YoY)														
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		
Exchange Rate														
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: WWMD: What Will Modi Do?

What will Modi do? Many Draw Parallel to World Leaders

Figure 3. Election Results – A Snapshot

NDA	336
BJP	282
UPA	59
Congress	44
Others	148
Total	543

Source: ECI

Mr Modi and the BJP's decisive victory in the Lok Sabha elections have raised expectations and aspirations of the public. There is hope that Mr Modi's appointment as Prime Minister brings about a transformative leadership in India. The task is cut out for the BJP government: it needs to revive growth, bring down inflation, practice fiscal prudence, and ensure an investor-friendly environment. While the road ahead is unknown, given the fervor surrounding Modi, many have rushed to draw parallels between him and other world leaders, past and present, to better understand his leadership qualities and priorities in a global context:

Figure 4. Modi and Other World Leaders

Leader	Contextual Similarity with Narendra Modi
Shinzo Abe, Japan	Reflects a nation's desire for dynamic leadership that will make the economy more competitive and confident
Ronald Reagan, USA	A leader reviving self-confidence and inspiration in a period of depression following a weak leadership
Richard Nixon, USA	Modi's campaign versus the Nehru-Gandhi family is compared to that of Nixon for the Kennedys
Margaret Thatcher, Britain	A strong leader for a nation who inherited high inflation, falling growth, elevated fiscal deficits, and previously ineffective leadership
Suharto, Indonesia	Called the "Father of Development"
Barack Obama, USA	Appeal to youth voters in the 2012 US elections
Ariel Sharon, Israel	A prominent past controversy
Lee Kuan Yew, Singapore	A leader who values equity, fairness, and discipline.
Recep Tayyip Erdogan, Turkey	A bold leader with entrepreneurial ideas who wants to open the economy
Vladimir Putin, Russia	A powerful, nationalist leader

Source: Media Reports, Washington Post

While undoubtedly not all the comparisons are flattering, it appears that Narendra Modi has made the right "initial" impression. It is now up to the government to seize the momentum and restore the virtuous cycle of investment and growth.

Modi-Rajan Duo … The Next Reagan-Volcker?

CPI food inflation has averaged 11% in the last three years…

However, the political intent to bring down inflation looks strong as reflected in the BJP manifesto coupled with the game plan submitted by none other than Mr. Modi in 2011.

The political intent combined with the watchful central bank bode well for the inflation outlook, thereby potentially opening up the space for monetary easing in 2015.

Similar to the current 'Modi' optimism, late last year, the appointment of Raghuram Rajan as RBI Governor also generated a lot of optimism in the financial markets. It is but natural that the combination of Modi-Rajan has caught the imagination of many, who have compared the duo to Ronald Reagan who became president of the United States in 1981 and then Fed chairman, Paul Volcker.

The key message from Reagan-Volcker administration was that monetary policy alone cannot tackle growth-inflation dynamics; a supportive fiscal policy is also essential. To put it simply, when Reagan became president, inflation was high and the Fed had been raising interest rates. He then lowered marginal tax rates, which helped increase real economic activity. Eventually, the monetary and fiscal policy combined brought inflation down to low single digits. However, we do not expect Dr. Rajan to do a Volcker as in his own words *"if you do a Volcker, you kill the supply side, and then you are in a bad situation."*

Modi and Rajan also have a task cut out to bring down inflation and restore growth back to pre-crisis levels. Early statements indicate that the government intends to take measures related to food supply chain and through fiscal prudence. Government measures are likely to work in harmony with RBI's anti-inflationary stance on monetary policy, which has set itself a target of achieving CPI target of 8% by Jan-15 and 6% by Jan-16.

Following the Gujarat Model of Development…

Modi's successful 12-year tenure as Gujarat's chief minister has been widely used as a proxy to predict his priorities and policies as India's prime minister. The 'Gujarat Model' of development is praised for its business-friendliness and good governance and one could expect the same traits in Modi's plan for India.

Figure 5. India vs Modi's Gujarat (%)

Indicator	India	Gujarat
GDP growth (FY01-FY11)	7.7	10.1
Per Capita Income (Rs)	61,855	87,175
Agri Growth (FY01-FY11)	3	10.7
Increase in Irrigated area	+14	+57
Total Literacy Rate	74	79.3
Female Literacy Rate	65.5	70.7

Source: Narendra Modi Social Media Page

Figure 6. Gujarat's Progress during Narendra Modi's tenure as Chief Minister

Area	Gujarat's Progress
Industry Development	500,000 active SMEs/MSMEs that employ over 2.5mn people Gujarat Global Summits' have brought in big-ticket investments
Infrastructure	Power sector reform 'Jyotigram Yojana' improved power supply to farmers + rural popn 154% increase in installed power capacity from 2001 to 2012 Increase in four and six-lane roads from 394kms in 2001 to 1432 kms in 2013
Economic Growth	GSDP growth of Gujarat from FY02 to FY12 was 10.1% vs the national average of 7.7% Per Capita Income in Gujarat in FY12 reached Rs 87,175 vs national avg of Rs 61,855 Ranks as 18th in debt to GDP ratio (25.2% in 2012) and is one of the least indebted states PSUs made a profit of Rs40bn in FY13 vs losses in FY02
Agriculture Growth	Agriculture growth in Gujarat over the past decade has been 10.7% vs national avg of 3% Water tables increased to 13 m from 3 m; Irrigated area is up 57% in the past decade Foodgrain production has doubled, and oilseed production has tripled in the past decade Cotton production is up 465% in the decade; 4.2mn farmers were given 'soil health' cards
Social Indicators	Maternal and Infant mortality rate have fallen by 40% and 37% respectively Literacy rate is 79% vs all-India rate of 74%, female literacy rate is 70% vs 65% all India Sharp increase in universities, engineering + management seats, primary school teachers Malnutrition levels have more than halved from 2007 to 2011

Source: Narendra Modi's Social Media page

'Jyotirgram Yojana'. This has improved power supply to farmers and rural population through separate feeders for agriculture and domestic use.

It has benefitted rural employment, education, and rural industries.

His Agenda...The Ten Commandments

PM Modi appears to have hit the ground running, outlining a 10-point plan which puts revival of economy right at the forefront of government agenda. Through this, the government aims to create a legislative and executive environment that facilitates acceleration of economic activity. The 10-point plan puts as much emphasis on the style of governance as it does on the substance.

(see PM Modi Takes Charge: Aims for "Minimum Government, Maximum Governance" – Bodes Well for the Economy)

Figure 7. Prime Minister's 10-point Plan

1	Infrastructure and Investment reforms
2	Addressing concerns on the economy
3	Optimize the system to resolve inter-ministerial issues
4	Execute policies in a time-bound manner
5	Build up confidence in bureaucracy
6	Focus on priority areas like education, health, water, energy and roads
7	Promote transparency in governance through e auctions
8	Stability and sustainability in government policy
9	Encourage innovative ideas and give bureaucrats independence
10	Establish a people-oriented system of government; focus on people's problems

Source: Times of India; Hindustan Times

Style of Governance: Time-bound, Decisive and Accountable

Given that policy paralysis/bottlenecks on several accounts such as center-state differences, inter-ministerial conflicts, passive bureaucracy, lack of accountability etc. had led to the economic slowdown in the last three years, the PM has looked to address each of these through a new style of governance.

STYLE OF GOVERNANCE

It is intended to regain momentum on delivery of public policies, projects and programs.

The fact that Modi government is not overtly dependent on tough coalition allies or alternate high command, makes it easier to assert a new style of governance that is both business and people friendly

SUBSTANCE OF GOVERNANCE

While infrastructure and investments are key, the focus is likely to be on power, coal, roads and railways.

The NDA government has set out ambitious goals for itself in the manifesto namely 100 new cities, bullet trains and river linking project.

However, in the near term these may not be economically feasible or viable until growth picks up substantially.

– Aims to work closely with state chief ministers and allow bigger state representation in legislative/execution decisions.

– Disbanded power centers such as Group of ministers (GoMs) and Empowered GoMs (68 GoMs and 14 EGoMs constituted during UPA – 2) to increase accountability and to involve PMO in resolving inter-ministerial conflicts.

– Restore confidence in bureaucracy by encouraging new ideas / independence.

– Transparency (such as e-auctions) to reduce discretion in decision making.

As government adopts a business-friendly model, there may be a need to exercise caution such as obtaining pre-approvals from statutory bodies such as CAG/CVC etc., mostly to avoid the pitfalls that impacted the functioning of the last government.

Substance of Governance: Infrastructure & Investments

Infrastructure and investment reforms are listed as the first item on PM's plan. To give credit where it is due, the erstwhile government had made significant progress in unlocking investments and fast tracking project approvals. We expect the current administration to build upon this and take further steps as enumerated below:

Figure 8. Key Proposals / Focus Areas for the New Government

Sector	Possible Actions
Power	- Implement electricity distribution system as per the Gujarat Model - Provide electricity from separate power feeds to reduce pilferage of power - Restructuring SEBs to reduce losses; enabling greater privatization of distribution
Railways	- Clear stalled railways projects through better coordination of CCI, PMG , states - Expedition of the Delhi-Mumbai freight corridor; Introduce high-speed bullet trains - Corporatization of railways, incentivizing private investment
Environmental Clearance	- launched an online system for environmental clearance applications - Similar initiative for forest clearance expected - Bring transparency and efficiency to the clearance process
Mining	- Revisit the "no-go" policy that restricts mining in dense forest areas - Passage of the Mines and Minerals Bill; Simplify process of mineral concession/allocation - An expert appraisal committee will revisit 28 projects in mining and steel sectors
Roads	-NHAI approves 9 roads projects for deferment of premium; potentially frees up capital - NHAI also moving to cancel and rebid projects which cannot be made viable -Clearing 50 stalled highway projects ; Managing increase in interest/escalation cost of delays
Banking	-NPA Management- strengthening NPA recovery, setting up ARC -Aiming to bring down govt. holding to 51% in most PSU banks
Taxes	-Timeline for GST/DTC implementation -Abolition of retroactive taxation - GAAR
Agriculture	-Prevent Hoarding of food items/APMC reform, -Implementing Modi Committee report on inflation Control
Capital Markets	-Liberalization in capital controls such as ECB, Outward Remittance Limits -Euroclear Settlement of Government bonds etc -Increase FDI in Defence from 26% to 49%- 100% ; Increase FDI in Insurance from 26%
Tourism	Plans to create 50 tourist circuits in Himalayas, deserts, coastal , heritage l sites
Oil and Gas	-Pricing reforms – both gas and fuel; Transparency in subsidy-sharing -Promoting gas grids and incentivizing exploration.

Source: Times of India; Hindustan Times, Financial Express, Business StandardCM

Can the Govt. Walk the Talk? Watch out for Budget in July

The first budget of the Modi government will be a key policy document - not only from the point of fiscal deficit roadmap, but would also clarify government's current position on important policy matters such as subsidies, GST roadmap, disinvestment, public welfare programs and on gold import controls etc.

His Ministers… The "Lean" Team

Minimum Government Maximum Governance

THE NEW BUZZ WORDS

"The role of a Government in businesses should be limited to that of a facilitator"

"No red tape, only red carpet, is my policy towards investors"

In contrast to the dual power center of the UPA, the BJP has a decisive governance model with Mr. Modi at the helm. Organically integrated ministries are aimed to ensure synergy across departments and speedy turnaround of key decisions/conflicts resolution. The lean cabinet coupled with the fact that Mr. Modi believes "*that the role of a Government in businesses should be limited to that of a facilitator"* are signs of a business-friendly government. Similar to the 'Gujarat' style of functioning, recent statements indicate that the PMO is likely to leverage the bureaucracy for effective implementation with accountability being key. Moreover, the objective will be to gear bureaucracy towards a business-friendly environment cutting unnecessary red tape. In Mr. Modi's words "*No red tape, only red carpet, is my policy towards investors".*

Rajya Sabha MP Arun Jaitley assumes Key Role of Finance Minister

The new finance minister will play a key role in economic turnaround, walking a tight rope between achieving fiscal consolidation and the need to support the economy. In his own words he would aim to achieve a "*fiscal rectitude*" by moving to an era of "*fiscal discipline where we can reduce the fiscal deficit, contain inflation and improve upon our growth rates*". He adds that "*short term disciplining till we reverse the present trend will give us long term benefits"*.

Figure 9. Modi's Cabinet and Ministers of State

	Cabinet Ministers			Ministers of State - Independent Charge	
1	Raj Nath Singh	Home Affairs	1	General V.K. Singh	Development of NE Region* + External Affairs+ Overseas Indian Affairs
2	Sushma Swaraj	External Affairs + Overseas Indian Affairs	2	Inderjit Singh Rao	Planning* + Statistics& Programme Implementation* + Defence
3	Arun Jaitley	Finance + Defence + Corporate Affairs	3	Santosh Kumar Gangwar	Textiles* + Parliamentary Affairs+ Water Resources, River Development and Ganga Rejuvenation
4	M. Venkaiah Naidu	Urban Development + Housing and Urban Poverty Alleviation + Parliamentary Affairs	4	Shripad Yesso Naik	Culture* + Tourism *
5	Nitin Jairam Gadkari	Road, Transport and Highways + Shipping	5	Dharmendra Pradhan	Petroleum and Natural Gas *
6	D.V. Sadananda Gowda	Railways	6	Sarbananda Sonowal	Skill Development, Entrepreneurship, Youth Affairs and Sports*
7	Uma Bharati	Water Resources, River development, Ganga rejuvenation	7	Prakash Javadekar	Information and Broadcasting* + Environment, Forest and Climate Change* + Parliamentary Affairs
8	Dr. Najma A. Heptulla	Minority Affairs	8	Piyush Goyal	Power* +Coal* + New and Renewable Energy*
9		Rural Development + Panchayati Raj+ Drinking Water and Sanitation	9	Dr. Jitendra Singh	Science and Technology* + Earth Sciences* + Prime Minister Office+ Personnel, Public Grievances & Pensions+ Department of Atomic Energy+ Department of Space
10	Ramvilas Paswan	Consumer Affairs, Food and Public Distribution	10	Nirmala Sitharaman	Commerce and Industry*+ Finance +Corporate Affairs
11	Kalraj Mishra	Micro, Small and Medium Enterprises		Ministers of State	
12	Maneka Sanjay Gandhi	Women and Child Development	1	G.M. Siddeshwara	Civil Aviation
13	Ananthkumar	Chemicals and Fertilizers	2	Manoj Sinha	Railways
14	Ravi Shankar Prasad	Communications and IT + Law and Justice	3	Nihalchand	Chemicals and Fertilizers
15	Ashok Gajapathi Raju Pusapati	Civil Aviation	4	Upendra Kushwaha	Rural Devt + Panchayati Raj + Drinking Water
16	Anant Geete	Heavy Industry and Public Enterprises	5	Radhakrishnan P	Heavy Industries and Public Enterprises
17	Harsimrat Kaur Badal	Food Processing Industries	6	Kiren Rijiju	Home Affairs
18	Narendra Singh Tomar	Mines + Steel + Labour and Employment	7	Krishan Pal	Road Transport and Highways + Shipping
19	Jual Oram	Tribal Affairs	8	Dr. Sanjeev Kumar Balyan	Agriculture + Food Processing Industries
20	Radha Mohan Singh	Agriculture	9	M.D. Vasava	Tribal Affairs
21	Thaawar Chand Gehlot	Social Justice and Empowerment	10	Raosaheb Dadarao Danve	Consumer Affairs, Food and Public Distribution
22	Smriti Zubin Irani	Human Resource and Development	11	Vishnu Deo Sai	Mines+ Steel + Labour and Employment
23	Dr. Harsh Vardhan	Health and Family Welfare	12	Sudarshan Bhagat	Social Justice and Empowerment

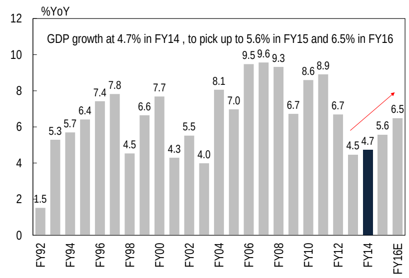
Source: Rashtrapati Bhavan Communique

Real Economy

Sub 5% Growth Trends Likely to Reverse

The new government takes charge at a time of sub-par growth, well below its average over the past decade. Following an average GDP growth of 8.1% during FY10-FY12, growth slowed to 4.5% in FY13 and 4.7% in FY14. While global factors did add to woes, much of the decline was due to domestic factors – especially policy-related issues, which led to a collapse in investments. FY14 GDP came in at 4.7%, slightly below the government's first estimate of 4.9% and 4.5% in FY13.

Figure 10. Trends in GDP (%YoY)



Source: CSO, Citi Research

FY15 Outlook & Risks: While the conclusive election outcome bodes well for consumer and business sentiment, a poor-bad monsoon could offset this. Factoring in sub-par agri growth, we retain our above consensus FY15 GDP estimate of 5.6%. This is based on (1) Agri growth of 0.5%, (2) Industry growth rising to 3.9% due to mining clearances and improved electricity production, and (3) Services at 7.5% led primarily by trade, hotels, and communication. Assuming a benign global environment, a key risk to the outlook is a full-blown El-Nino resulting in a downside of 50bps in our FY15E GDP.

Recovery likely to be visible in FY16: Going forward, we believe that the change in government is significant given the BJP's (1) Economic emphasis, (2) Stability in composition, and (3) Decisive governing structure. While the new political formation has already resulted in a much-needed change in sentiment, we expect a full-fledged recovery will be visible only in FY16/17E.

Figure 11. GDP Snapshot (%YoY)

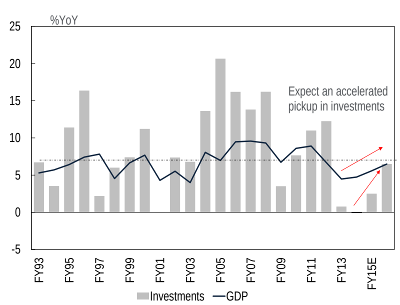
	Wts	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
Agriculture	13.9	0.1	0.8	8.6	5.0	1.4	4.7	0.5	3.0
Industry	26.1	4.4	9.2	7.6	7.8	1.0	0.4	3.9	5.9
Services	59.9	10.0	10.5	9.7	6.6	7.0	6.8	7.5	7.5
GDP at factor cost	100.0	6.7	8.6	8.9	6.7	4.5	4.7	5.6	6.5
Consumption	71.1	7.7	8.4	8.2	8.9	5.2	4.7	5.6	6.8
Pvt Consumption	60.0	7.2	7.4	8.7	9.3	5.0	4.8	5.5	7.0
Govt Consumption	11.1	10.4	13.9	5.8	6.9	6.2	3.8	6.0	6.0
Gross Capital Formation	36.0	-5.2	17.3	14.1	3.9	4.9	-2.5	4.8	5.7
Gross Fixed Capital Formation	32.3	3.5	7.7	11.0	12.3	0.8	-0.1	2.5	6.5
GDP at market prices		3.9	8.5	10.3	6.6	4.7	5.0	5.3	6.5

Source: CSO, Citi Research

'Unlocking' Investments – The Government's First Priority

The BJP emphasizes the need for India to become a global manufacturing hub. In terms of specifics, we expect it to tackle problems in sluggish sectors and create an enabling environment through (1) cutting the red tape, (2) transparency in environment clearances, (3) better co-ordination between center and states for mega projects- possibly through a single window system of clearances.

Figure 12. Trends in Investments (%YoY)



Source: CMIE

Where will the New Government start? In order to revive investments, the government is likely to implement measures that target specific sectors as well as government processes. As regards sectors, one could expect favorable measures in power, railways, and mining that will make them more efficient. On the policy front, the largest obstacle to investments is related to obtaining environmental/ forest clearances. One could expect the new government to simplify the clearance process, increase transparency and improve co-ordination among concerned ministries.

For more details on recent proposals for FDI in defense, please see our [Industrials' team's report.](#)

The new leadership has also indicated that it will give priority to defense and public sector projects. This combined with recent efforts to liberalize foreign direct investment in defense would boost domestic manufacturing. (To recap, the Department of Industrial Policy and Promotion (DIPP) has proposal to allow up to 100% foreign direct investment (FDI) in defense. Currently, only 26% FDI is allowed in defense manufacturing).

Environmental Clearances – Crucial to Revive Key Sectors

The new environment minister believes in *"environment and development, not environment versus development"* Steps thus far include:

- shortlisted projects that can get clearances within a month

- begun consultations with mining, power, and coal industries to push high-value pending projects

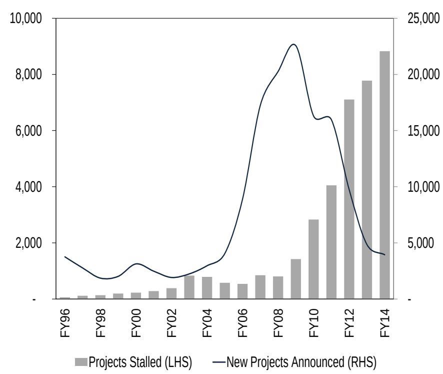
- adopt a transparent process for obtaining environmental clearances

As mentioned before, the slow, complicated environmental clearance process has been a key factor behind the accumulation of stalled projects and consequent collapse in investments. To resolve this, steps being considered include:

– The new environment minister has promised "fast and transparent clearances" as well as "time bound plans" for projects. There are currently an estimated 5,000 projects awaiting environmental clearances and until now, lack of co-ordination between multiple ministries made obtaining clearances difficult. However, going forward, the "lean" cabinet and merged ministries should help reduce delays over co-ordination, thus streamlining the clearance process.

– The ministry has launched a system for online applications for environmental clearance, to make the process transparent for authorities and industries.

Figure 13. Trends in Projects Stalled (Rsbn)



Source: CMIE

Figure 14. Project Monitoring Group Progress

	No.		Value US$bn	
Sector	Resolved	Rema -ining	Res	Rem
Power	89	77	65	85
Road and Highways	7	28	2	7
Petrol & Natural Gas	8	38	3	55
Steel	4	44	4	75
Railways	6	18	2	5
Shipping	7	11	2	4
Chemicals/Petrochem	1	1	1	1
Fertilizers	0	3	0	3
Mines	2	5	1	5
Civil Aviation	1	0	2	0
Coal	23	41	2	10
Commerce and Ind	5	17	2	10
Textiles	0	1	0	0
TOTAL	153	284	84	262

Source: http://cabsecpmg.gov.in/

Bottom line: Recovery rests on Policy Momentum

We believe a sustainable recovery would only be possible by addressing issues on the investment and infrastructure front. Given the overwhelming mandate, there is now more than ever a need to bring project execution/implementation back in focus, in our view. The pick-up in growth may be a function of (1) pace of policy de-bottlenecking, (2) investment appetite of the corporate sector, and (3) extent of the government's own role in capital formation. Furthermore, we believe in order to ensure that a pick-up in investments is financed largely by domestic savings, key would be to revive domestic financial savings.

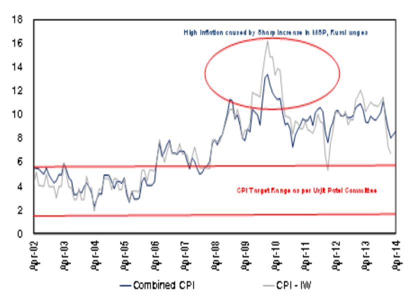
Monetary Indicators

Inflation 'Now' a Political Priority As Well

The NDA takes over at a time when inflation still remains elevated, with the latest CPI reading at 8.6%. A quick recap, since the launch of the new CPI series in 2011, headline CPI has averaged 9.7% while food inflation has averaged 11% in the past three years. The RBI has been un-equivocal in its stance on inflation stating "high inflation at both wholesale and retail levels risks entrenching inflation expectations at unacceptably elevated levels, posing a threat to growth and financial stability ".

However, interestingly, it now appears that there is also political intent to rein in inflation. This is reflected in the BJP manifesto coupled with a game plan to contain inflation submitted by none other than Mr. Modi in 2011 – both bode well for the inflation outlook. India's watchful central bank is an added positive.

Figure 15. Historical Trend in CPI Inflation (%YoY)



Source: RBI, CSO

What Can Be Done: BJP manifesto; Committee report chaired by Modi

– **Near term**: Sub-optimal food grain price and procurement policies have resulted in surplus of food grain stocks of 55mt (rice 17mt, wheat 34mt) against the buffer norm of 21mt (rice 14mt+wheat 7mt). An immediate solution could be to offload or run-down wheat inventory (10% lower wheat prices to lower CPI by 50bps). There is a possibility of re-visiting futures trading of "essential commodities."

– **Medium term:** Measures include (1) Calibrating MSP rates with market prices; (2) Setting up a Price Stabilization Fund – viz. a price spectrum band possibly similar to the 2003 scheme for plantation crops; (3) Modification of APMC Act that would enable competitive markets; and (4) Unbundling FCI operations into procurement, storage and distribution which could improve efficiency.

– **Long term:** Optimizing agri market efficiency would entail creating (1) a robust supply chain infrastructure for agri produce; (2) a single National Agriculture Market, similar to the centre-state structure being contemplated regarding 'unlocking' investments; and (3) River linking to improve irrigation capabilities.

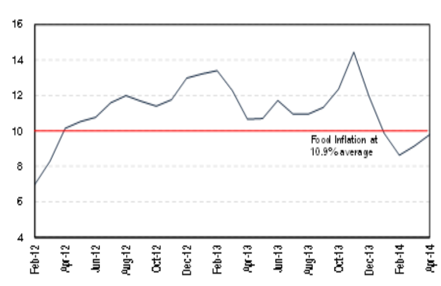
Since FY12, food inflation has averaged 11%... but this could change…

An immediate solution could be to offload or run down wheat inventory (10% lower wheat prices to lower CPI by 50bps).

Considering 1/3rd weight of wheat in the Cereals index (wt=14.6% in CPI), a 10% decline in wheat prices would lower CPI inflation by ~50bps.

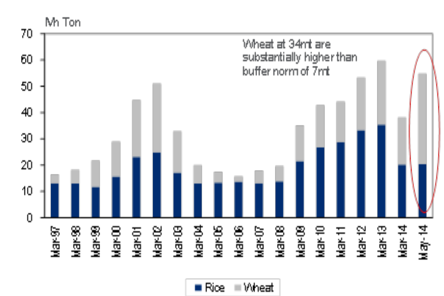
(See Reining in Food Inflation – It's Not a Distant Dream! for details)

Figure 16. New CPI Food Inflation (%YoY)



Source: CSO

Figure 17. Food Grain Stocks with FCI (mn T)



Source: FCI

CPI outlook: To come off with a lag

We maintain our view of CPI averaging 8% in FY15 and 6.5% in FY16. In the near term, the inflation reading could benefit from favorable base effect from June-onwards and could trend towards sub 7% reading by November. The easing trend could continue in FY16 as the impact of government and RBI action becomes more visible. The decline in CPI inflation would largely be in line with the "glide path" envisaged by the Patel committee report. In the immediate term, we acknowledge upside risks on inflation from (1) El Nino and (2) suppressed inflation in the fuel / energy space.

Liquidity Framework – Retooling the Target Policy Rate

Figure 18. A Recap of Liquidity Facilities

	O/N Repo (%NDTL)	Term Repo (%NDTL)	Refinance (% of export credit)
01-Apr-12	No Limit	N/A	15%
18-Jun-12	No Limit	N/A	50%
23-Jul-13	0.50%	N/A	50%
11-Oct-13	0.50%	0.25%	50%
29-Oct-13	0.50%	0.50%	50%
01-Apr-14	0.25%	0.75%	50%
03-Jun-14	0.25%	1.00%	32%

Overnight Repo and Refinance facility available at Repo rate, Term Repo at auction determined rates
Source: RBI

In line with the Urjit Patel Committee report to facilitate better monetary transmission, the RBI has been restructuring its liquidity facilities moving away from overnight repo/export refinance towards pre-dominantly term repo. A quick recap: Prior to July 13, banks could borrow unlimited liquidity through overnight repo. This has now changed with O/N repo liquidity provision limited to 0.25% of NDTL, 32% of export credit through refinance window and 1% of NDTL through term repo. It has also introduced term reverse repo to absorb liquidity as and when the need arises.

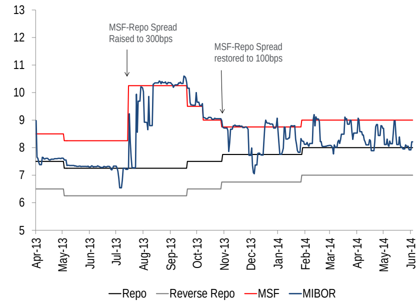
In the immediate term, the rising contribution of term repo (auctioned at rate higher than repo) has led to effective overnight rates being higher than repo rate. For example, the average daily MIBOR in current financial year has stood at 8.3% compared to 8% repo. We continue to believe that RBI's stance on liquidity augments its monetary policy stance, which among other extraneous factors such as Fx intervention, currency withdrawal, government inflows/outflows, is also shaped by evolving inflationary outlook.

The ongoing rejig in liquidity facilities is aimed at "ultimately" achieving the following objectives:

1) Developing a term structure for money markets and

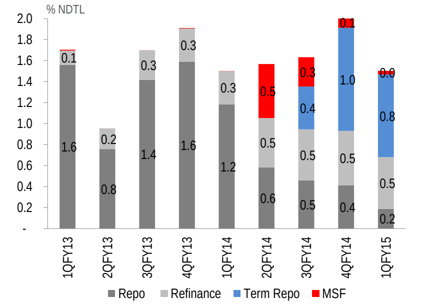
2) Moving towards a target policy rate determined by 14-day term repo cut offs

Figure 19. Effective o/n rates higher than repo(%)



Source: RBI, CEIC

Figure 20. Rising Importance of Term Repo (% of NDTL)

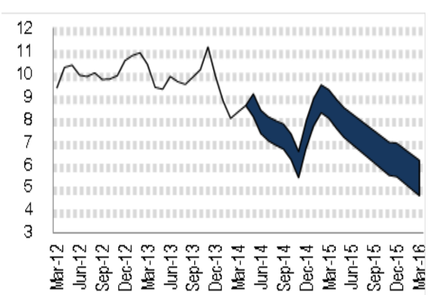


Source: RBI, Citi Research

RBI Guidance Turns Dovish

June Policy: A quick recap: In line with expectations, the RBI kept the repo rate unchanged at 8%. Similar to the April policy, it 'tweaked' liquidity norms moving further towards term repo as a pre-dominant liquidity facility. It also reduced the SLR from 23% to 22.5% of NDTL. Its macro estimates remain unchanged (GDP: 5%-6%) and CPI following the glide path (8% by Jan 15; 6% by Jan 16).

Figure 21. Projected Glide Path of CPI till FY16



Source: CSO, Citi Research

Guidance Turns Dovish: The policy guidance had a dovish undertone where-in it said the RBI *"remains committed to keep the economy on a disinflationary course taking CPI to 8% by Jan 15 and 6% by Jan 16. If the economy stays on this course, further policy tightening will not be warranted. On the other hand, if disinflation, adjusting for base effects, is faster than currently anticipated, it will provide headroom for an easing of the policy stance".*

Bottom Line: Potential Room for Monetary Easing in 2015

As regards monetary policy, we maintain our view of an extended pause on rates through 2014 as CPI inflation should roughly meet RBI's target of 8% by Jan'15 and 6% by Jan'16. In the event that the BJP government takes definite measures to improve food procurement policy, off load excess food grain stocks, calibrate MSP hikes etc. space could open up for an easing of policy rates in 2015.

Fiscal Accounts

Erstwhile Govt Maintains Fiscal Consolidation Path

Figure 22. Budget Snapshot (Rs Bn)

	FY14BE	FY14RE	FY14A
a. Revenue receipts	10,563	10,293	10,153
Tax revenues	8841	8360	8,160
Non-tax	1723	1932	1992
b. Non-debt cap recpt	665	366	401
Recoveries of loans	107	108	105
Divestments	558	258	276
c. Total receipts (a+b)	11,228	10,659	10,554
d. Rev. expenditure	14,362	13,995	13,756
f. Capital expenditure	2,291	1,909	1,882
h Plan expenditure	5,553	4,755	4,530
i. Non-plan expenditure	11,100	11,149	11,108
j. Total exp (d+f) =(h+i)	16,653	15,904	15,638
j. Fiscal Balance (c-j)	-5425	-5245	-5084
% to GDP	-4.8	-4.6	-4.5

Source: CGA, Budget Documents

The new government inherits a healthy trend of fiscal consolidation, albeit still at elevated levels. Thanks to a record fiscal surplus of Rs910bn in Mar'14 achieved through a combination of (1) sharp cut in plan expenditure, (2) disinvestment/dividends overdrive, the erstwhile government restricted FY14 fiscal deficit to 4.5% of GDP, lower than its budget estimate of 4.8%. This was the second consecutive year of govt. undershooting its budget estimate, leading to a cash build-up of 615bn in two years.

…Chatter on Accounting – both revenues and expenditure

However, there has been a lot of chatter on the "cash based accounting convention" that could be somewhat obfuscating the picture. Concerns include (1) Expenditure on subsidies accrued in Q4 being pushed over to Q1 next fiscal. (2) Revenues – aggressive tax mop-up in March which gets refunded in the first quarter of next year. The net effect of this rollover could be within 1% of GDP that either has to be distributed across previous years' fisc, or more likely could be adjusted in current year's fiscal deficit number when presented in the upcoming July budget. The government may consider using an accounting method called modified cash basis that "*allows a short period of time after the year-end for settling liabilities of the year just ended (and treats this expenditure as occurring in the year just ended)*"

MODIFIED CASH BASIS ACCOUNTING

The subsidy rollovers have been possible because government follows cash basis accounting that according to a World Bank Publication "measures cash flows at the time those flows actually take place".

Given the complexity of accrual based systems, the government may consider using an accounting method namely modified cash basis that "allows a short period of time after the year-end for settling liabilities of the year just ended (and treats this expenditure as occurring in the year just ended)".

FY15 Budget Preview – Early Thoughts

Revenues – Essential to restore Buoyancy

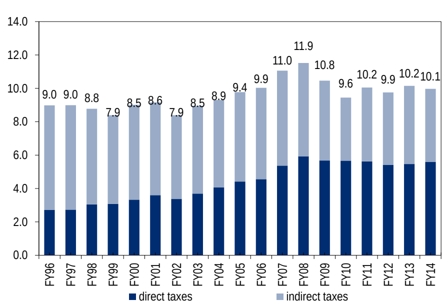
Gross tax revenues /GDP have been sticky at 10.1% of GDP. Each component of revenues (tax, non-tax, capital receipts) is below its cyclical high.

– **Taxes:** We expect some guidance on timelines for implementation of GST and Direct Tax code in order to streamline revenues and provide necessary buoyancy to both direct and indirect taxes. With a lot of groundwork already completed, the GST would be key to improve revenues and bring uniformity and efficiency to the tax mechanism. In the near term, the FM may look at withdrawing some exemptions, higher customs collection on crude, gold etc.

– **Non-tax revenues:** This includes income from telecom, dividend and profits, a turnaround in public sector units and increasing reliance on auction route for natural resources will likely prove to be supportive. Also levy of spectrum charges, coal auction etc. would help the revenue base.

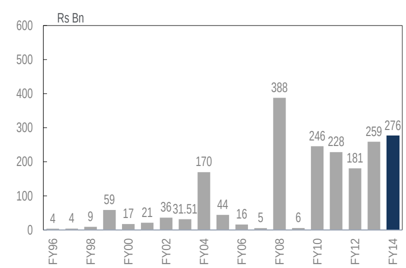
– **Capital receipts:** Given the favorable market environment, we could see higher stake sales – both PSU and SUUTI.

Figure 23. Gross Tax Revenues (% of GDP)



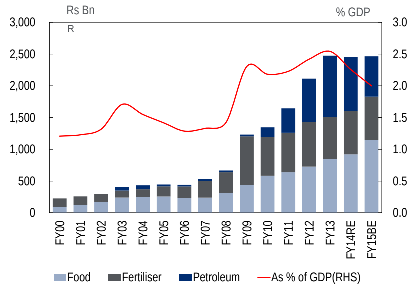
Source: CGA, Budget Documents

Figure 24. Trends in Divestments (Rs bn)



Source: CGA, Budget Documents

Figure 25. Trend in Subsidies (Rs bn, % GDP)



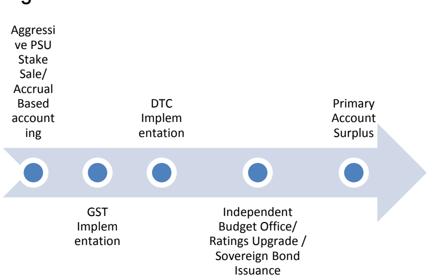
Source: CGA, Budget Documents

DIESEL DE-REGULATION COULD WIPE OUT OIL SUBSIDY

With Diesel under-recovery down to Rs 2.8/ltr, a 50 paise hike per month would reduce any losses shortly.

Assuming share of upstream oil companies to remain unchanged, the government share of oil subsidy could be reduced to negligible from FY16 i.e. ~0.1% of GDP.

Figure 27. Fiscal Reform Timeline



Source: Citi Research

Expenditure – Rationalization in Revenue Expenditure

The fiscal consolidation seen in the last two years has primarily been achieved by cutting "plan expenditure". Expenditure on subsidies has hovered around 2.2%-2.5% of GDP in last six years. However, thanks to fuel price reform, oil subsidies are likely to trend lower (see fig 27, under recovery at Rs 2.8/ltr). But, the savings on lower petroleum subsidies have been offset by higher food/fertilizer subsidies.

We expect government to target subsidies at 1.5% of GDP over two-three year time frame so as to channelize resources towards capital formation and productive sectors of the economy. The fertilizer subsidy could be brought down by increasing availability of domestic natural gas, stronger Rupee and calibrating Urea prices. A risk in the near-term could be the extent of expenditure on the 7th Pay Commission.

Figure 26. Trends in Oil Under-recoveries/ Subsidies (Rs Bn)

Year Ending Mar 31	FY11	FY12	FY13	FY14	FY15E	FY16E
Gross Under-Recoveries	782	1,385	1,610	1399	1,074	633
- Diesel	347	812	908	628	357	5
- LPG	218	300	408	465	404	359
- Kerosene	195	273	294	306	313	269
Less: Upstream sharing	303	550	600	670	674	524
% of total	39%	40%	37%	48%	63%	83%
Less: gov't compensation	410	835	1,000	708	400	109
% of total	52%	60%	62%	51%	37%	17%
Net under-recoveries	69	0	10	21	-	0

Source: Citi Research

Fiscal Consolidation Not Enough, Quality is Key

We expect the government to maintain the trends of fiscal consolidation and simultaneously aim to improve the quality of fiscal spending. In the event, the new government changes accounting norms, it may raise the fiscal deficit target marginally to 4.4% of GDP in FY15 v/s 4.1% of GDP projected in the 'interim' budget. Given that opening cash balance with govt. stood at ~Rs800bn, we do not see a risk of a big increase in dated borrowing.

Bottom Line: Reform Payoff: Better Ratings; Sovn. Bonds

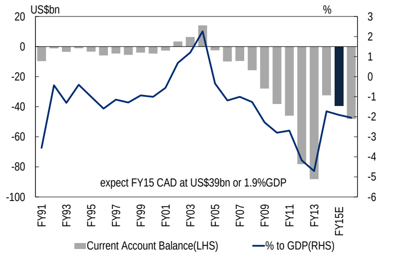
As the central government implements fiscal reforms and demonstrates fiscal discipline, the credit profile of the sovereign (S&P ratings: BBB- with a negative outlook) could likely get a boost. Over a 3-4 year horizon, we believe a potentially better rating and credible fiscal profile could create an enabling backdrop for India government to tap international markets for its capital expenditure needs.

External Sector

CAD at 5-Year Low… Favorable Start for the NDA

The Modi government has assumed charge amid CAD at a 5 year low, stable rupee and rising FX reserves. The strength of the external sector will allow the NDA government to focus on domestic priorities.

Figure 28. Trends in Current Account Deficit (US$bn, % GDP)



Source: RBI, Citi Research

FY14 CAD: A Quick Recap – After a record high current account deficit of US$88bn or 4.7% of GDP in FY13, a series of policy measures to contain the 'taper' impact last summer saw the CAD narrowing to a 5-year low of US$32.4bn or 1.7% of GDP - a reduction of US$56bn over the previous year. However, key to note is that gold accounted for less than 50% (US$25bn) of the CAD adjustment. Other factors at play include (1) Lower Non-oil/non-gold imports by US$18.5bn, and (2) Increase in goods and services exports by US$20bn.

FY15 CAD to rise, but contained at ~2% of GDP: Going forward**,** we expect the CAD to rise marginally to US$39bn, 1.9% of GDP. This factors in (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. Factors that could offset this include resumption of iron-ore exports as well as easing supply bottlenecks in coal production, thereby containing the CAD to ~2% of GDP.

Following a 1QFY14 CAD print of US$21.8bn (4.9% of GDP), a series of policy measures saw the CAD narrowing to US$5.2bn in 2Q, US$4.1bn in 3Q and US$1.2bn in 4QFY14

Figure 29. Trends in Current Account Deficit (US$bn)

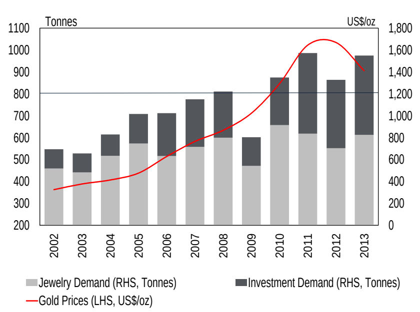
	FY14				Full Year			
	Q1	Q2	Q3	Q4	FY13	FY14	FY15E	FY16E
a.Trade Balance	-50.5	-33.3	-33.2	-30.7	-195.7	-147.6	-155.5	-171.1
Exports	73.9	81.2	79.8	83.7	306.6	318.6	343.8	378.2
Imports	124.4	114.5	112.9	114.3	502.2	466.2	499.3	549.2
Of which : Gold	16.4	3.9	3.1	5.5	53.8	28.9	35.0	37.0
b. Invisibles	28.7	28.1	29.1	29.3	107.5	115.2	116.2	123.0
Services	16.9	18.4	18.1	19.6	64.9	73.0	73.3	79.1
Transfers	16.7	16.1	16.4	16.2	64.0	65.3	66.9	67.9
Investment Income	-4.8	-6.3	-5.4	-6.4	-21.5	-23.0	-24.0	-24.0
Current Account (a+b)	-21.8	-5.2	-4.1	-1.3	-88.2	-32.4	-39.3	-48.1
% GDP	-4.9	-1.2	-0.8	-0.2	4.7	-1.7	-1.9	-2.0

Source: RBI; Citi Research estimates

Gold Restrictions – Easing Slowly, but Surely

A quick recap: In Aug 2013, the government put restrictions to contain gold imports which had risen from an average of 700tonnes prior to FY09 to ~1000 tonnes during FY10-FY13. Measures imposed include (1) Hike in customs duty, (2) Imposition of the 20:80 rule (20% to be exported, 80% for domestic use), (3) Restricted star/premium trading houses to import gold "exclusively" for exports, and (4) Notified banks to supply gold to jewellery /bullion dealers at "full upfront payment" only.

Figure 30. Gold Jewellery and Investment Demand and Price (Tonnes, US$/oz)



Source: WGC; RBI; Citi Research

What's New: The stabilization of the currency and gradual build-up of dollar reserves has resulted in policy makers easing restrictions on gold. For instance, late last month, the RBI allowed (1) Trading houses (star/premium) allowed to import gold under 20:80 scheme, (2) Banks now allowed to provide gold metal loans to domestic jewellery manufacturers.

What's Next? As mentioned in our earlier notes, further relaxation of gold import norms is expected including (1) Rationalization of import duty on gold/ jewellery in the upcoming July budget, (2) A gradual easing of 20:80 import restrictions. Moreover, given the relatively comfortable BoP position driven by capital inflows, we could see additional measures such as easing of external commercial borrowing and export refinance guidelines.

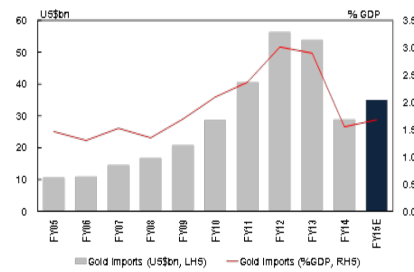
Implications: As stated in our earlier notes, while jewellery demand will likely persist, the investment demand for gold which had risen sharply during FY09-FY12 could moderate due to both falling prices and the moderation in inflation. Thus despite the likely relaxation of import curbs, we expect gold imports to be contained at 800 tonnes in FY15 v/s 640 tonnes in FY14.

Figure 31. Trends in Gold Imports

	FY12	FY13	FY14	FY15E
Gold Imports (Tonnes)	1076	1006	640	800
Gold Prices $/oz	1,645	1,669	1,330	1,250
Gold Imports*	56.2	53.8	28.9	35.0
Gems Jewelry Exports*	44.9	43.4	41.1	40.0
Gold Exports*	6.7	6.5	6.2	6.0
Net Gold Imports*	49.5	47.3	22.7	29.0

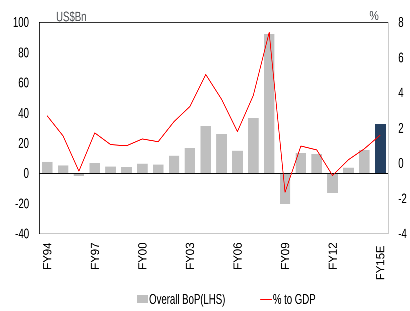
*in US$bn; Source: RBI; WGC; Citi Research

Figure 32. Trends in Gold Imports (US$bn, % GDP)



Source: RBI; Citi Research

Figure 33. Overall Balance of Payments (US$bn, %GDP)



Source: RBI, Citi Research

Strong Capital Flows → BoP Surplus, Reserve Accretion

FY14 – BoP Surplus of US$15.5bn: The series of measures to contain the CAD (US$32.4bn or 1.7% of GDP) and simultaneous measures to attract capital flows (e.g. FCNR deposits) resulted in an overall balance of payments surplus of US$15.5bn in FY14.

FY15 – BoP Surplus to rise to US$33bn: Despite incorporating a higher CAD in FY15 (US$39.3bn; 1.9% of GDP), which takes into account higher gold and non-oil imports US$32.4bn, we expect the positive change in sentiment post the elections to boost capital flows to US$72.4bn in FY15. Key delta is likely to come from portfolio flows which could pick up from US$5bn in FY14 to US$22bn in FY15. Consequently, we expect the FY15 BoP Surplus to rise to US$33bn.

Figure 34. Rupee Trades with an Appreciation bias (INR/US$)

Source: Bloomberg

Figure 35. Trends in Capital Account (US$bn)

	FY14				Full Year			
	Q1	Q2	Q3	Q4	FY13	FY14	FY15E	FY16E
c .Loans	3.6	-0.5	3.0	1.6	31.1	7.8	20.0	22.0
d. Foreign Investment	6.3	1.5	8.5	10.2	46.7	26.4	39.8	44.8
Portfolio Investments	-0.2	-6.6	2.4	9.3	26.9	4.8	22.0	22.0
FDI	6.5	8.1	6.1	0.9	19.8	21.6	17.8	22.8
e. Banking Capital Net	10.3	1.2	15.8	-1.8	16.6	25.4	12.0	12.0
Of which NRI deposits	5.5	8.2	21.4	3.7	14.8	38.9	11.0	11.0
f. Other capital	0.3	-6.9	-3.4	-0.7	-5.0	-10.8	1.0	1.0
g.Rupee debt service	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.4	-0.4
Capital Account (c:g)	20.6	-4.8	23.8	9.2	89.3	48.8	72.4	79.4
Overall Balance	-0.3	-10.4	19.1	7.1	3.8	15.5	33.0	31.2

Source: RBI; Citi Research

Bottom Line: INR to trade close to equilibrium value

On the back of improved sentiment and a supportive BoP, we expect the INR to trade in the Rs59-62 band with a positive bias. Key factors include (1) Need to rebuild reserves (currently US$313bn) given RBI's US$31bn short forward position, rise in external debt to US$426bn; (2) >10% over-valuation in terms of CPI-based REER; (3) Global risk environment; and (4) BJP's focus on domestic manufacturing.

Financial Markets

Global Backdrop Supportive for EM Assets

Most investors expected US benchmark yields to rise in 2014, instead they have fallen.

The reasons for this are certainly debatable (market positioning/bear squeeze, lower US growth expectations, Pension fund flows etc.) but what is clear is that this has led to a strong performance of the perceived EM.

For more details, see "[Global Equity Strategist - Treacherous Treasuries](#)".

UST Yields defy expectations; Supports carry in EM Currencies

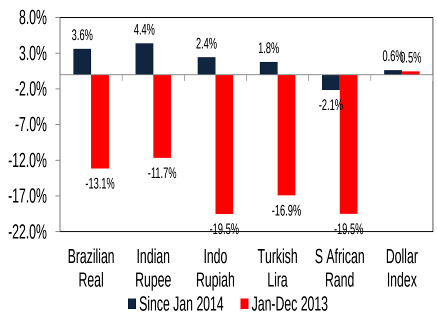
Our global team maintains its view that the US Fed is set on course to unwind its QE3 program by Sep-Oct this year. Interestingly, whilst 'taper' has been progressing in line with market expectations, yields on US treasuries have defied expectations. In the calendar year 2014, contrary to expectations of a rise of 40-50bps, yield on 10-year UST have come off by 40-50bps to 2.5%. (see figure 37)

Most EM currencies which were impacted by the taper turbulence last year have made gains since Jan14. This is on the back of a supportive risk environment coupled with steps taken to contain current account deficits. However, there is no room for complacency as although AE central banks (Fed, ECB, BoJ, BoE) are currently pursuing highly accommodative stance of monetary policies, the timing and extent of their eventual "exit" will remain a source of risk for EM currencies.

Figure 36. Trends in 10-year UST Yield (%)

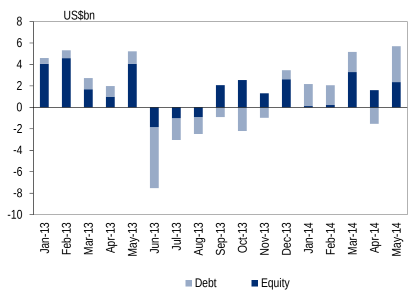
Source: Bloomberg

Figure 37. Return in EM Currencies (% YTD)



Source: Bloomberg

Figure 38. Monthly Flows in Debt & Equity (US$bn)



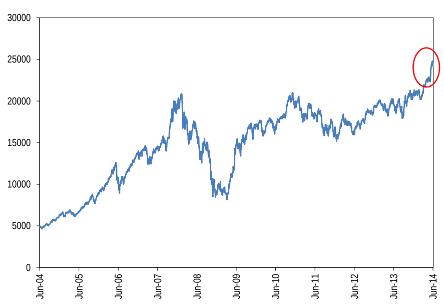
Source: SEBI

Domestic Sentiment Boost by Election Results

Equity, Credit spread rally; Rupee, G-Secs in a range…

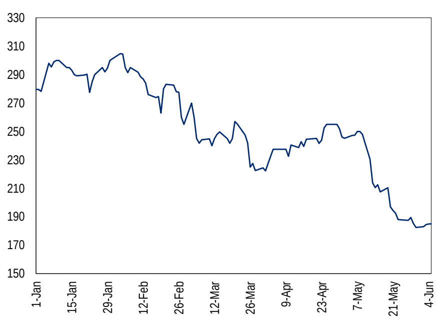
On the back of improved sentiment on the political front and a supportive global risk appetite, portfolio flows in India reached US$15bn in YTD 2014. Interestingly, the flows were almost equally divided between equity and debt at US$7.5bn each. The strong global appetite for Indian assets has fueled a sharp rally across equity and bond markets. The Equity market has been trading at record highs on elections, while CDS spreads for large Indian borrowers have also dropped significantly e.g. SBI 5yr CDS is down100bps YTD.

Figure 39. Sensex Trading at All Time Highs



Source: Bloomberg

Figure 40. 5yr CDS Spread of SBI decline (bps)

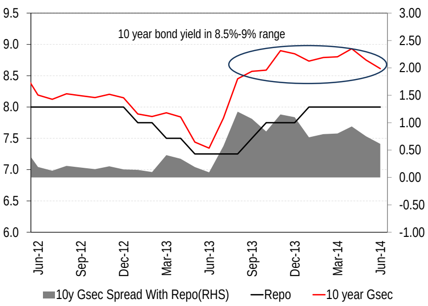


Source: Bloomberg

Bonds – Yields Likely to Soften as RBI turns Dovish

While the political change has had a significant influence on equity markets (Sensex at record high), bond yields are still above last year levels (10yr yield at 8.5% v/s 7.5% last year). This has largely been due to (1) CPI inflation above 8%; (2) Adverse supply demand dynamics amid elevated bond issuance and lack of OMO; and (3) Elevated overnight rates due to reliance on term repo (see pg 11 for details).

Figure 41. Bond Yields Likely to Soften



Source: Bloomberg, RBI, Citi Research

Expect 10-year to trend towards 8.25%-8.5%: We expect policy rates to remain unchanged in 2014. However, in the event that government takes definitive measures to improve food procurement policy, off load excess food stocks, calibrate MSP hikes etc, we maintain our view of a possibility of easing in 2015. The strengthening bias in the currency, a political will to contain food inflation and a focused monetary policy, should eventually set the stage for a "secular rally" in bonds over a medium term. Given that the term premia (spread between 10 Gsec and repo) tends to narrow as possibility of rate cuts increase (see figure 42), we expect 10-year yields to soften towards 8.25%-8.5% on dovish RBI policy stance.

In contrast to equity and corporate bond markets that have been trading at multi year highs…

… Rupee and G-secs have stayed range bound…

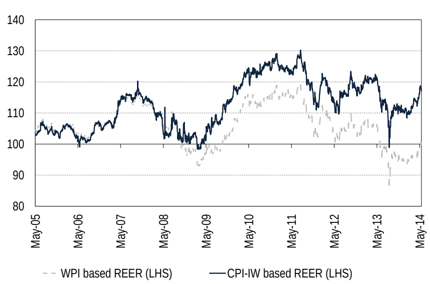
…a result of the RBI's stance on FX intervention, monetary policy and liquidity.

Fx – Appreciation Bias, but RBI Intervention to Cap gains

Thanks to subdued current account and robust capital flows, the Rupee is likely to trade with a positive bias. While the central bank has pro-actively intervened to prevent the Rupee from appreciating much below 60/US$ ahead of election results, the decisive election outcome has led to some reassessment.

The RBI has rebuilt reserves through spot market intervention, and has also recently been active in the forwards market. This is reflected in 1-year forward premiums rising ~100bps from 7.5% to 8.5%. The rising focus on forwards market could be attributed to two factors (1) to offset its US$31bn short forward position, and (2) its neutral impact on INR liquidity.

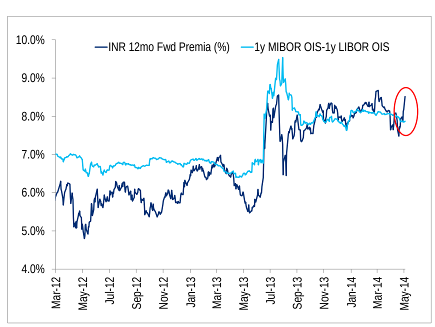
Figure 42. Trends in 6 Country REER



Source: RBI, Citi Research

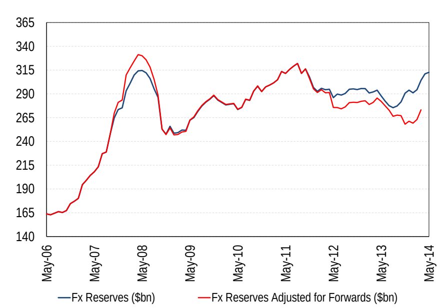
Rupee likely to trade in the Rs59-62 Range: On the back of improved sentiment and a supportive BoP, we expect the INR to trade closer to its equilibrium value in the Rs59-62 band with a positive bias. Key factors include (1) Need to rebuild reserves (currently US$312.6bn) given RBI's US$31bn short forward position, rise in external debt to US$426bn; (2) >10% over-valuation in terms of CPI-based REER; (3) Global risk environment; and (4) BJP's focus on domestic manufacturing.

Figure 43. 1 year INR Forward Premia (%)



Source: Bloomberg, Citi Research

Figure 44. Trends in Fx reserves adjusted for Forward position (US$bn)



Source: RBI, Citi Research

Politics and Policy Watch

BJP's Decisive Win…Bodes Well for the Economy

As mentioned in our post-election note "Big Win…Big Possibilities", the overwhelming election mandate implies a stable govt, significant legislative fire-power and no excuses. The government now needs to deliver and we believe it can given its economic emphasis, stable composition and decisive governing structure.

Figure 45. The New, Integrated Ministries

Departments	Head
Finance	Arun Jaitley
Corporate Affairs	
External Affairs	Sushma Swaraj
Overseas Indian Affairs	
Mines	Narendra Singh Tomar
Steel	
Road transport and highways	Nitin Gadkari
Shipping	
Power	Piyush Goyal
Coal	
New and Renewable Energy	

Source: Rashtrapati Bhavan Communique

Modi "Right" Sizes the Cabinet

Mr Modi's council of ministers consists of 45 ministers vs. 71 in the earlier administration. More-over, as seen in figure 46, there is a consolidation of some ministries. This is in line with Mr. Modi's earlier comments that "*the focus should be on Minimum Government but Maximum Governance".* Interestingly, PM Modi's Facebook page describes the model as "*eventually aiming at Smart Governance where the top layers of Govt will be downsized and there would be expansion at the grass root level*".

Decisive Governing Structure

In contrast to the dual power center of the UPA, the BJP has a decisive governance model with Mr. Modi at the helm. The focus will be on execution and implementation of the 3P's – Projects, Programs and Policies – with periodic reviews. Moreover, organically integrated ministries will likely ensure synergy across departments and speedy turnaround of key decisions/conflicts resolution. The lean cabinet coupled with the fact that Mr. Modi believes "*that the role of a Government in businesses should be limited to that of a facilitator"* are signs of a business-friendly government.

Prime Minister's Office (PMO) and the Bureaucracy; Cutting Red Tape

Similar to the 'Gujarat' style of functioning, recent statements indicate that the PMO is likely to leverage the bureaucracy for effective implementation with accountability being key. Moreover, the objective will be to gear bureaucracy towards a business-friendly environment cutting unnecessary red tape. In Mr. Modi's words "*No red tape, only red carpet, is my policy towards investors".*

INVESTORS ASK

How will the BJP's minority status in Rajya Sabha affect legislation making?

How will the Centre and States co-ordinate when there are many key non-BJP ruled states?

For more details please see our report on Post-Election Investor Concerns

There Are Concerns…But It Appears Manageable

While the results of India's 16th General Election have been unanimously viewed as positive for the economy, two commonly expressed investor concerns include 1) Pace of legislation implementation: given that the NDA is in minority in the Upper House of Parliament; and (2) Co-ordination between States and the Centre: BJP/NDA governments are in only 8 of 29 states.

Getting Legislation Passed as NDA in minority in Upper House

Although the NDA enjoys a clear majority in the Lok Sabha (Lower House), it has a mere 63 seats of 250 in the Rajya Sabha (Upper House). While the upper house minority is clearly an issue, key to note**:**

- In case of ordinary legislation (not a constitutional amendment), there is provision to call a joint sitting of the two houses where the NDA has a majority;
- In case of Money Bills (e.g. budget), the Lok Sabha enjoys pre-eminence over Rajya Sabha;
- One-third of Rajya Sabha members retire every two years which could change its composition by 2016.

Figure 46. Key Non-BJP Ruled States

State	State Ruling Party	Term Ends
Uttar Pradesh	SP	May-17
Maharashtra	INC	Dec-14
West Bengal	TMC	May-16
Bihar	JD(U)	Nov-15
Tamilnadu	AIADMK	May-16
Karnataka	INC	May-18
Odisha	BJD	Jun-18
Kerala	INC	May-16
Telangana	TRS	Jun-18
Assam	INC	Jun-16
Jharkhand	JMM	Jan-15
Haryana	INC	Oct-14
J&K	NC	Jan-15
Uttarakhand	INC	Mar-17
Himachal Pradesh	INC	Jan-18

Source: Election Commission of India

Getting Projects Off the Ground in Non-BJP ruled States

The BJP led NDA currently rules 8 states while Congress led UPA is in power in 14 states. The remaining 7 states are currently not aligned to UPA or NDA. While this could lead to some delays, key to note:

– With recent polls going in favor of growth, states would like to fall in line with pro-growth policies of the centre.

– BJP's manifesto and senior members emphasized setting up of a "Centre-State Co-ordination Committee" which could result in a formal Prime Minister – Chief Minister collaboration to resolve state level bottlenecks. In this context, Mr Modi's tenure as Gujarat CM for the last 12 years would be beneficial in understanding state-level issues.

– Some major non-BJP ruled states like Haryana, Maharashtra, also Delhi (UT) will go into polls later this year, where the composition could change.

Bottom Line: Time to Deliver

Following the past decade of policy paralysis, expectations are high and the new government brings a lot of promise. Given its overwhelming mandate and reputation for being business-friendly and pro-growth, it is expected to deliver and do so quickly.

A positive sentiment is a pre-requisite for growth to pick up and the new government has already delivered on that account. It has to further build up on the momentum, keeping in mind that the current state of economy provides little room for error.

Figure 47. Current Composition of the Lok Sabha

Party	Seats	Party	Seats
NDA	336	Opposition	207
Bharatiya Janata Party	282	Indian National Congress	44
Shiv Sena	18	AIADMK	37
Telugu Desam Party	16	All India Trinamool Congress	34
Shiromani Akali Dal	4	Biju Janata Dal	20
Lok Jan Shakti Party	6	Left Parties	14
Rashtriya Loka Samata Party	3	Telangana Rashtra Samithi	11
Apna Dal	2	YSRC	9
Pattali Makkal Katchi	1	Nationalist Congress party	6
Swabhiman Paksha	1	Ind./ others	6
All India N.R Congress	1	Samajwadi Party	5
National People's Party	1	Rashtriya Janata Dal	4
Naga People's Front	1	Aam Aadmi Party	4
		IUML	2
		INLD	2
		J&K Democratic Party	2
		Janata Dal (Secular)	2
		Janata Dal (United)	2
		JMM	2
		SDF	1
		TOTAL LOK SABHA	543

Source: Election Commission

Figure 48. Current Composition of the Rajya Sabha

Party	Seats	Party	Seats
NDA + supporting parties	63	Opposition	164
BJP	46	INC	68
TDP	6	NCP	6
Shiv Sena	3	J&K National Conf (JKNC)	2
Shiromani Akali Dal	3	Rashtriya Lok Dal(RLD)	5
Lok Janshakti Party	1	Samajwadi Party(SP)	8
NPF	1	Bahujan Samaj Party(BSP)	14
MNF	1	Rashtriya Janata Dal(RJD)	1
Kerala Congress	1	Bodoland People's Front (BPF)	1
RPI	1	Janata Dal (United)	9
		INLD	2
		BJD	6
		AIADMK	10
		Left Parties	11
		Trinamool Congress (AITC)	12
		DMK	6
		Jharkhand Mukti Morcha	1
		TRS	1
		AGP	1
		Total	164
		Nominated	10
		Others / Independents	9
		TOTAL RAJYA SABHA	246

Source: www.rajyasabha.nic.in

Monthly Monitor

Figure 49. India — Key Monthly Indicators (percent change from a year ago unless otherwise stated)

	Mar-13	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14
Consumption Trends														
Two-Wheelers	-7.0	0.9	1.1	-4.6	-0.1	6.7	18.4	18.0	5.6	2.3	8.9	9.7	21.2	11.7
Passenger Car Sales	-21.4	-10.4	-11.7	-10.4	-8.6	13.0	-1.0	-5.4	-9.7	-6.0	-7.6	1.4	-5.1	-10.2
Tractors	1.3	36.3	23.5	20.7	12.3	10.9	35.1	30.0	12.5	13.0	16.5	15.2	5.4	-10.7
LHCVs	9.7	4.7	-7.2	-8.9	-12.3	-14.1	-18.1	-14.4	-26.8	-24.5	-22.4	-32.6	-26.5	-27.4
MHCVs	-25.9	-6.5	-16.7	-21.3	-19.7	-38.1	-41.5	-31.6	-33.9	-27.9	-17.4	-23.8	-20.8	-17.1
Investment Trends														
Infrastructure Index	7.0	3.7	2.3	0.1	3.2	3.7	8.0	-0.6	1.7	2.1	1.6	4.5	2.5	4.3
Diesel Consumption	2.4	4.1	0.3	-2.1	-6.0	-0.1	-0.6	-1.3	0.6	-2.3	-2.6	-0.1	-1.8	-3.5
Steel Production	-2.1	4.5	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*	52.0	51.0	50.1	50.3	50.1	48.5	49.6	49.6	51.3	50.7	51.4	52.5	51.3	51.3
output	51.6	50.2	48.6	49.1	49.8	47.5	49.6	48.6	51.5	51.3	52.6	54.0	52.2	51.7
Industrial Production Index														
General	3.5	1.5	-2.5	-1.8	2.6	0.4	2.7	-1.2	-1.3	-0.2	0.8	-1.9	-0.5	
Manufacturing	4.3	1.8	-3.2	-1.7	3.0	-0.2	1.4	-1.3	-2.6	-1.2	0.0	-3.7	-1.2	
Mining	-2.1	-3.4	-5.9	-4.6	-3.0	-0.9	3.6	-2.9	1.6	0.7	1.9	1.4	-0.4	
Electricity	3.5	4.2	6.2	0.0	5.2	7.2	12.9	1.3	6.3	7.5	6.5	11.5	5.4	
Use Based Basic goods	3.2	1.4	-0.3	-1.9	1.0	0.9	6.7	-0.4	2.7	3.0	2.5	4.1	4.0	
Capital goods	9.6	-0.3	-3.7	-6.6	15.9	-2.0	-6.6	2.5	0.1	-2.5	-4.1	-17.5	-12.5	
Intermediate goods	2.1	2.5	1.1	1.3	3.2	3.8	4.4	2.7	3.7	5.2	3.6	3.7	0.6	
Consumer goods	1.8	1.7	-6.6	-1.5	-0.7	-0.9	1.0	-5.0	-8.9	-4.6	-0.5	-4.1	-0.9	
Consumer Durables	-4.9	-9.6	-18.3	-10.1	-9.6	-8.3	-10.6	-12.0	-21.7	-16.4	-8.3	-9.3	-11.8	
Consumer Non-Durables	7.3	11.3	3.8	6.2	7.4	5.4	12.0	1.9	2.2	2.8	4.6	-0.5	7.2	
Services														
Port traffic	-3.2	-6.2	0.5	2.5	4.8	6.8	4.9	-2.8	-0.6	5.8	-3.1	-1.3	7.6	8.8
Railway freight	4.7	4.2	4.9	5.3	4.5	5.7	11.5	-2.4	2.7	4.2	4.1	4.0	2.2	6.1
Tourist arrivals ('000)	640	452	384	444	524	474	436	589	718	800	720	738	669	504
Cellular subscriber Adds (Mn)**	5.6	1.5	4.1	3.4	1.4	2.0	-6.2	4.8	4.9	6.8	8.6	9.9	1.1	4.8
Banking Trends														
Money supply(M3)	13.8	12.9	13.6	12.7	12.4	12.0	12.9	13.5	14.3	14.2	14.2	14.5	13.5	13.9
Loan(Credit) growth	14.1	14.6	15.1	13.5	14.7	16.3	15.0	16.0	13.9	14.2	15.7	15.7	13.9	14.2
Deposit growth	14.2	12.8	14.2	13.5	13.1	12.6	11.5	14.3	15.6	15.4	16.2	16.6	14.1	15.4
Non-food credit	14.0	14.5	15.3	13.7	14.9	16.5	15.2	16.4	14.3	14.5	15.9	16.1	14.2	
Inflation														
CPI	10.4	9.4	9.3	9.9	9.6	9.5	9.8	10.2	11.2	9.9	8.8	8.0	8.3	8.6
WPI	5.7	4.8	4.6	5.2	5.9	7.0	7.0	7.0	7.5	6.4	5.1	5.0	5.7	5.2
Mfg products inflation	4.3	3.7	3.3	2.9	2.6	2.3	2.4	2.8	2.9	3.0	3.0	3.4	3.2	3.2
Food Products	7.4	5.1	5.7	8.8	9.7	13.6	14.0	14.6	15.3	10.8	6.8	6.3	7.7	7.1
Fuel Products	7.8	8.3	7.3	7.5	11.4	12.7	11.7	10.5	11.1	10.9	9.8	8.7	11.2	8.9
PMI - Input Prices	55.0	54.1	51.3	55.9	60.6	57.8	63.5	64.5	58.0	57.8	57.7	61.0	57.2	54.6
PMI - Output Prices	53.1	51.9	49.8	50.9	53.4	51.8	51.1	55.3	51.9	51.8	52.4	51.4	51.0	50.9
Interest rates (Average, %)														
Daily MIBOR	8.0	7.6	7.4	7.3	7.9	9.9	10.1	9.2	8.6	8.2	8.2	8.4	8.4	8.4
1 yr CD	9.0	8.6	8.3	8.3	9.1	10.3	10.1	9.2	9.2	9.3	9.3	9.7	9.5	9.2
91-day T-Bills	7.8	7.6	7.3	7.3	8.4	10.0	9.4	8.6	8.8	8.8	8.8	8.9	8.9	8.9
Corp Bond Spreads	1.1	1.1	0.9	1.0	1.2	0.9	1.2	1.0	1.2	0.9	0.9	0.8	0.8	0.8
10-year government bond	7.9	7.8	7.4	7.3	7.8	8.5	8.6	8.6	8.9	8.8	8.8	8.8	8.8	8.9
Trade - customs data														
Exports(%YoY)	5.9	1.9	-0.7	-4.8	10.6	13.5	11.7	13.2	1.9	3.5	3.8	-5.5	-3.2	5.3
Imports(%YoY)	-3.4	10.0	6.1	-0.6	-6.3	-1.2	-18.6	-14.6	-16.7	-15.2	-18.1	-17.9	-2.1	-15.0
Oil	-16.1	4.4	3.3	13.4	-7.9	17.9	-5.9	2.2	-1.0	1.0	-10.1	-3.0	17.7	-0.6
Non-oil	4.3	13.0	7.5	-6.9	-5.6	-11.2	-25.0	-23.1	-24.2	-22.9	-22.0	-25.8	-11.8	-21.5
Trade Deficit (US$bn)	-10.4	-17.7	-20.1	-12.2	-12.5	-10.6	-6.4	-10.6	-10.0	-10.1	-9.9	-8.3	-10.5	-10.1
Brent Prices ($/bbl)	109.3	102.6	103.2	103.0	107.9	110.9	111.9	109.5	108.2	110.8	107.5	108.8	107.6	107.9
Foreign investment (US$ mn)														
FII	2,741	1,992	5,220	-7,536	-3,026	-2,457	1,151	357	343	3,460	2,187	2,054	5,175	76
FDI	822	2,775	1,837	1,830	1,920	1,615	4,498	2,037	2,161	1,835	414	-60	2,908	
Exchange rate and reserves														
US$ exchange rate average	54.4	54.3	55.0	58.4	59.8	62.8	63.6	61.6	62.5	61.8	62.1	62.2	60.9	60.3
US$ exchange rate month end	54.3	54.2	56.5	59.7	61.1	66.6	62.8	61.4	62.4	61.9	62.5	62.1	60.1	60.3
Forex reserves incl.gold (US$bn)	292.6	296.4	287.9	284.6	280.2	275.5	276.3	283.0	291.3	295.7	291.1	294.4	303.7	309.9

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

Snapshot of Govt. Finances

Figure 50. India Government Finances (Rs bn)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	
a. Gross Tax Revenue	5,931	6,053	6,245	7,931	8,892	10,360	11,388	
% to GDP	11.9	10.8	9.6	10.2	9.9	10.2	10.1	Revenues : sticky at 10.1% GDP
% YoY	25.3	2.0	3.2	27.0	12.1	16.5	9.9	
Corporation tax	1,929	2,134	2,447	2,987	3,228	3,563	3,947	
Income tax	1,026	1,060	1,224	1,391	1,645	1,965	2,378	
Excise duty	1,234	1,086	1,030	1,377	1,449	1,759	1,695	
Import duty	1,041	999	833	1,358	1,493	1,653	1,721	
Service tax	513	609	584	710	975	1,326	1,546	
b. (-) Devolvement to States & UTs	1,536	1,620	1,680	2,232	2,594	2,960	3,228	
c. Net tax revenues (a-b)	4,395	4,433	4,565	5,699	6,298	7,400	8,160	
d. Non tax revenues	1,023	969	1,163	2,186	1,217	1,374	1,992	
e. Net revenue receipts (c+d)	5,419	5,403	5,728	7,885	7,514	8,776	10,153	
f. Non-debt capital receipts	439	67	332	353	369	422	401	
Recovery of loans	51	61	86	124	189	163	125	
Divestments/Other	388	6	246	228	181	259	276	
g. TOTAL REVENUES (e+f)	5,858	5,470	6,060	8,237	7,884	9,198	10,553	
%YoY	32.9	-6.6	10.8	35.9	-4.3	16.7	14.7	
h. Revenue expenditure	5,945	7,938	9,118	10,407	11,458	12,435	13,756	Expenditure
Interest (1)	1,710	1,922	2,131	2,340	2,732	3,132	3,775	
Defense	543	733	907	921	1,030	1,113	1,248***	
Subsidies	709	1,297	1,414	1,734	2,179	2,571	2,555***	Subsidies have ranged 2.2-2.5% of GDP
Pensions	243	329	561	574	612	695	741***	
Grants to States	358	382	459	498	515	480	616***	
Admin and social services	647	927	1,107	1,198	1,053	1,153	1,295***	
Plan expenditure	1,736	2,348	2,539	3,142	3,337	3,292	3,525	
i. Capital expenditure	1,182	902	1,127	1,566	1,586	1,669	1,882	
Defense	375	410	511	621	679	705	789	
Loans	493	87	121	298	120	119	88	
Plan expenditure	315	405	495	648	786	844	1,005	
j. Plan expenditure	2,051	2,752	3,034	3,790	4,124	4,143	4,531	Slow growth in plan expenditure has
k Non Plan expenditure	5,077	6,087	7,211	8,183	8,920	9,961	11,107	aided fiscal consolidation
l. TOTAL EXPENDITURE (h+i): (j+k)	7,127	8,840	10,245	11,973	13,044	14,104	15,638	
% YoY	22.2	24.0	15.9	16.9	8.9	8.1	10.9	
Deficit trends								
m. Fiscal Balance (g-l)	-1,270	-3,370	-4,185	-3,736	-5,160	-4,906	-5,085	
% to GDP	-2.5	-6.0	-6.5	-4.8	-5.7	-4.9	-4.5	
n. Revenue Balance (e-h)	-526	-2,535	-3,390	-2,523	-3,943	-3,659	-3,603	
% to GDP	-1.1	-4.5	-5.2	-3.2	-4.4	-3.6	-3.2	
o. Primary Deficit (m-1)	441	-1,448	-2,054	-1,396	-2,428	-1,774	-1,310	
% to GDP	0.9	-2.6	-3.2	-1.8	-2.7	-1.8	-1.2	
Financing the deficit								
Market borrowings (Net)	1,318	2,336	3,984	3,254	4,362	4,674	4,689	
PPF & special deposits	39	80	161	125	108	109	158	
Small savings	-113	-13	133	112	-103	86	23	
Net external assistance	93	110	110	236	124	72	66	
Others	204	418	-189	-56	828	471	257	
Cash Surplus	-271	438	-14	64	-160	-506	-109	
Total financing	1,270	3,370	4,185	3,736	5,160	4,906	5,085	
Memo items (% to GDP)								
Centre	-2.5	-6.0	-6.5	-4.8	-5.7	-4.9	-4.5	
State	-1.4	-2.3	-2.9	-2.1	-2.4	-2.3	-2.4	
Combined	-4.0	-8.3	-9.3	-6.9	-8.1	-7.2	-6.9	
Off Balance Sheet Items	-0.6	-1.7	-0.2	0.0	0.0	0.0	0.0	
Total Deficit	-4.6	-10.0	-9.5	-6.9	-8.1	-7.2	-6.9	
Combined liabilities	76.1	76.8	75.5	70.2	69.6	69.8	69.8	

* Based on CGA data released on May 30,2014; *** Number as per Interim Budget Announced on Feb 20, 2014 Source: Budget Documents, Citi Research estimates

Balance of Payments

Figure 51. 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	
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	
% 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	Oil and Gold are key as they account for 40% imports
YoY %	21.2	-5.0	28.2	32.3	0.3	-8.3	6.3	12.0	
of which: Oil	93.7	87.1	106.0	155.0	164.0	165.2	161.1	171.1	Crude price assumptions are at US$104/bbl in FY15
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	Gold imports likely to be contained at 800tonnes;
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	
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	
Difference b/w RBI and customs	-1.1	-8.6	-12.0	-6.4	-5.3	-8.9	-13.6	-5.1	Difference normally represents defense imports
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	
Investment income	-7.1	-8.0	-17.3	-16.0	-21.5	-23.0	-24.0	-24.0	Rising recourse to external funding results in outflows
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	
1. Current a/c balance (a+b)	-27.9	-38.2	-45.9	-78.2	-88.2	-32.4	-39.3	-48.1	CAD likely to be contained under 2% GDP
% 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	
External assistance	2.4	2.9	4.9	2.3	1.0	1.0	2.0	2.0	Upside potential if infrastructure and Public sector financial Institutions raise quasi sovereign bonds
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	
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	Possible upside in FDI if policies are supportive
(a) FDI - To India	41.7	33.1	25.9	33.0	27.0	30.8	32.8	37.8	
(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	
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	
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

Direction and Composition of Trade

Figure 52. India — Composition of Imports (US$bn, %)

	FY09	FY10	FY11	FY12	FY13	FY14
Petroleum (Crude+Products)	93.7	87.1	106.0	155.0	165.1	165.1
%YoY	17.5	-7.0	21.6	46.2	6.5	0.7
% Total	30.8	30.2	28.7	31.7	33.7	36.7
Electronic Goods	23.5	21.0	26.6	32.7	31.4	31.0
%YoY	15.4	-10.9	26.8	23.2	-4.0	-1.4
% Total	7.7	7.3	7.2	6.7	6.4	6.9
Gold	21.3	28.8	40.7	56.5	53.8	28.9
%YoY	29.7	35.1	41.1	39.0	-4.7	-46.3
% Total	7.0	10.0	11.0	11.5	11.0	6.4
Pearls, precious, semiprecious stones	16.8	16.3	34.6	29.4	22.7	24.0
%YoY	111.6	-3.2	112.4	-15.1	-22.9	5.9
% Total	5.5	5.7	9.4	6.0	4.6	5.3
Machinery (ex electric)	21.8	19.7	23.9	30.2	27.7	23.7
%YoY	9.7	-9.8	21.0	26.6	-8.4	-14.3
% Total	7.2	6.8	6.5	6.2	5.6	5.3
Coal, Coke, Briquettes	10.1	9.0	9.8	17.5	16.4	16.4
%YoY	56.7	-11.0	9.1	79.1	-6.2	-3.3
% Total	3.3	3.1	2.6	3.6	3.4	3.7
Organic Chemicals	7.8	8.6	11.6	13.4	14.5	15.8
%YoY	7.8	11.2	34.2	15.2	8.5	9.2
% Total	2.6	3.0	3.1	2.7	3.0	3.5
Metalliferrous ores, Metal Scraps	8.1	7.7	9.7	13.4	15.0	15.0
%YoY	2.2	-4.4	26.0	37.6	12.0	-12.9
% Total	2.7	2.7	2.6	2.7	3.1	3.3
Transport Equipment	13.2	11.7	11.5	13.9	15.7	13.5
%YoY	70.9	-11.8	-2.0	21.5	13.0	-10.1
% Total	4.4	4.1	3.1	2.8	3.2	3.0
TOTAL IMPORTS	303.7	288.4	369.8	489.3	489.7	450.1
% YoY	27.2	-5.1	28.2	32.3	0.1	-8.3

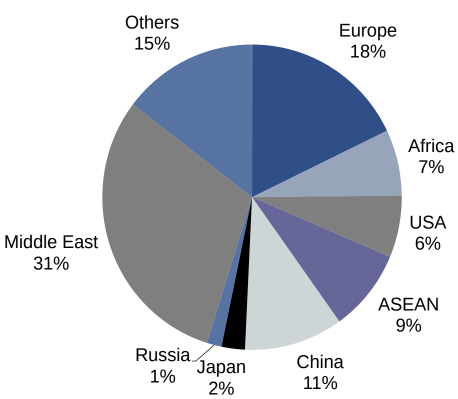
Source: DGCI&S, RBI

Figure 53. India — Composition of Exports (US$bn, %)

	FY09	FY10	FY11	FY12	FY13	FY14
Petroleum Crude & Products	27.5	28.2	41.5	55.9	60.8	62.7
%YoY	4.5	2.3	47.2	34.8	8.7	3.0
%Total	14.9	15.8	16.8	18.3	20.3	20.1
Gems and Jewellery	28.4	29.1	37.9	45.3	43.3	41.1
%YoY	44.1	2.4	30.5	19.5	-4.4	-5.2
%Total	15.3	16.3	15.4	14.8	14.4	13.2
Transport Equipment	11.2	9.8	16.7	21.4	18.5	21.4
%YoY	66.0	-12.9	70.1	28.2	-13.6	16.5
%Total	6.1	5.5	6.7	7.0	6.2	6.9
Machinery, Instruments	11.0	9.6	11.9	14.3	15.2	16.2
%YoY	23.4	-13.3	24.2	20.8	6.4	5.9
%Total	5.9	5.4	4.8	4.7	5.1	5.2
Pharmaceuticals, Chemicals	8.8	9.0	10.6	13.2	14.6	15.0
%YoY	19.4	2.1	18.6	24.1	10.7	2.6
%Total	4.7	5.0	4.3	4.3	4.9	4.8
Manufacture of Metals	7.6	5.5	8.6	9.5	10.0	9.7
%YoY	9.4	-27.2	56.3	10.4	5.3	-3.7
%Total	4.1	3.1	3.5	3.1	3.3	3.1
Cotton yarn, Fabrics, etc	4.2	3.7	5.7	6.8	7.5	9.1
%YoY	-6.9	-11.1	54.6	19.0	10.4	7.7
%Total	2.2	2.1	2.3	2.2	2.5	2.9
Readymade Garments	10.1	9.9	10.6	12.5	11.5	8.9
%YoY	14.9	-1.8	6.9	17.6	-7.9	18.1
%Total	5.4	5.6	4.3	4.1	3.8	2.8
Electronic Goods	7.2	5.6	8.5	9.4	8.4	7.6
%YoY	105.5	-21.5	51.7	9.8	-9.8	-5.3
%Total	3.9	3.2	3.5	3.1	2.8	2.4
TOTAL EXPORTS	185.3	178.5	247.0	305.4	300.0	312.6
% YoY	16.9	-3.7	38.4	23.7	-1.8	4.1

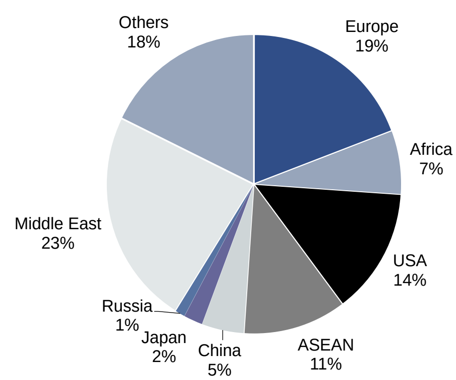
Source: DGCI&S, RBI

Figure 54. Direction of Imports FY13



Source: DGCI&S, CMIE

Figure 55. Direction of Exports FY13



Source: DGCI&S, CMIE

Global Economic and Financial Forecasts

Figure 56. 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
Global	2.5	3.0	3.5	3.7	3.6	2.6	2.9	3.1	3.4	3.4	2.14	2.36	2.49	2.88	3.36
Industrial Countries	1.2	2.0	2.4	2.5	2.3	1.3	1.5	1.7	1.6	1.5	0.46	0.37	0.56	1.15	1.84
United States	1.9	2.3	3.1	3.2	2.7	1.1	1.5	1.8	2.2	2.3	0.25	0.25	0.50	1.65	3.00
Japan	1.6	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	1.2	1.8	1.9	1.9	1.4	0.6	0.9	1.2	1.3	0.50	0.16	0.10	0.11	0.42
Emerging Markets	4.5	4.5	5.0	5.4	5.5	4.7	5.0	5.2	5.1	5.1	4.78	5.32	5.37	5.48	5.58
China	7.7	7.3	7.0	7.5	7.3	2.6	2.6	3.2	3.8	4.0	3.00	3.00	3.00	3.13	3.50
India	4.9	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	5.3	5.5	5.6	5.8	6.4	6.5	6.7	5.4	5.3	4.65	5.81	6.00	6.00	6.00
Turkey	4.0	2.2	3.5	3.8	4.0	7.5	8.6	7.9	7.3	7.1	6.16	10.69	10.63	9.75	9.50
South Africa	1.9	2.3	2.9	3.3	4.0	5.8	6.5	5.8	5.5	5.9	5.00	5.79	6.42	7.92	8.00
Brazil	2.3	1.3	1.8	2.5	3.0	6.2	6.4	6.3	5.9	5.5	8.44	10.92	12.33	12.00	11.50
Mexico	1.1	3.0	4.0	4.4	4.5	3.8	4.0	3.6	3.6	3.6	3.94	3.50	3.75	4.90	5.17

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, 21st May 2014*

Figure 57. 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
Global	0.7	0.8	0.7	0.3	0.1	-4.1	-3.6	-3.2	-2.9	-2.7	88	86	86	85	84
Industrial Countries	-0.2	0.1	0.2	0.1	0.1	-5.5	-4.6	-3.7	-3.3	-3.0	115	113	113	112	111
United States	-2.3	-2.0	-1.5	-1.8	-1.7	-7.3	-6.4	-5.6	-5.6	-5.4	105	106	106	106	106
Japan	0.7	-0.2	-0.2	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	2.9	2.8	2.6	-3.0	-2.6	-2.0	-1.5	-1.1	95	97	97	96	94
Emerging Markets	1.8	1.9	1.2	0.6	0.1	-2.0	-2.2	-2.4	-2.2	-2.3	45	45	45	45	44
China	2.0	2.0	1.5	0.8	0.5	-1.9	-2.1	-2.0	-2.0	-2.0	54	54	53	52	51
India	-1.7	-1.9	-2.0	-2.4	-2.5	-6.9	-6.7	-6.5	-6.2	-5.9	70	68	66	65	63
Indonesia	-3.3	-2.4	-2.1	-1.7	-1.5	-2.2	-2.3	-1.7	-1.9	-2.0	24	26	25	25	25
Turkey	-7.9	-5.2	-5.3	-4.9	-4.9	-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	-4.3	-4.2	-4.2	-3.7	-3.0	46	47	48	49	49
Brazil	-3.7	-3.8	-3.8	-3.8	-3.8	-3.3	-3.9	-3.4	-3.3	-3.2	57	57	58	58	58
Mexico	-1.8	-2.1	-1.8	-1.4	-1.5	-2.4	-3.5	-2.5	-2.0	-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, 21st May 2014*

Figure 58. 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	3.00	3.50	3.75	4.10	NA	NA	NA	NA	NA
Japan	0.71	0.65	0.90	1.25	1.50	98	102	107	111	113
Euro Area	1.60	1.63	1.75	2.00	2.25	1.33	1.38	1.37	1.41	1.41
China	3.68	4.41	4.33	4.45	4.83	6.15	6.21	6.05	6.01	6.03
India	8.25	8.50	8.50	8.00	7.50	58.57	60.20	62.40	62.11	59.17
Indonesia	6.97	8.34	8.75	8.75	8.75	10449	11617	11981	11592	10842
Turkey	NA	NA	NA	NA	NA	1.91	2.13	2.28	2.39	2.38
South Africa	7.20	8.00	8.04	8.14	8.38	9.65	10.61	10.98	10.78	10.68
Brazil	9.98	12.71	13.66	13.08	12.25	2.16	2.34	2.56	2.68	2.80
Mexico	5.67	6.63	7.60	7.66	7.65	12.8	13.0	12.9	12.7	12.5

Source: Citi Research estimates; *Global Economic Outlook and Strategy, 21st May 2014*

Appendix A-1

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