

India Macroscope

Looking Beyond Elections

- **The elections matter and already seem to be making a difference** — India's elections will continue to be primetime till the 16 May results; expectations are up, and so are equity and currency markets, which have also been buoyed by the real gains on deficit issues. There clearly is a feel-good factor in the markets.
- **But the real economy's challenges remain** — It's still tough in the economy: (1) While growth has likely bottomed, the shallow recovery is dependent on 'unlocking investments' and managing non-performing loans (NPLs). (2) Inflation may have peaked out, but structural factors, especially on the food front, need to be tackled. (3) On the fiscal deficit, targets have largely been met, but the "quality" of the deficit is questionable, and the upcoming 7th Pay Commission is key to watch.
- **Leverage concerns and unexpected shocks** — India's private-sector leverage is up, asset quality is down, and with further asset pressures ahead, there is banking system risk and 'ability-to-grow' overhang. The extent of stress and the challenge of capital will limit any economic uptick. An investor-friendly election outcome would help alleviate concerns, but any unexpected election result or new financial market weakness would add to challenges.
- **It's not called reform, but there is change happening on the ground** — The RBI and government have been hard at work. There's: a) more unlocking of investments, to the tune of 5% of GDP, by the Project Monitoring Group; b) sectoral strides – power tariffs, gas price and continued diesel price increases; and c) RBI's more aggressive efforts at recognizing and cleaning up NPLs. No single item will move the needle much – but they all add up.
- **FY15 macro estimates and risks** — Maintain estimates of a modest upturn in GDP to 5.6%, CPI inflation averaging ~8%, an extended pause on policy rates, CAD at 2.3% of GDP, and INR in the Rs60-64 range. **Risks:** Non-consensus election outcome; El-Nino impacting monsoons, renewed global risk aversion.

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With thanks to
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Figure 1. Statistical Snapshot (%)

Year -end 31 March	FY08	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E
Real GDP growth (%)	9.3	6.7	8.6	8.9	6.7	4.5	4.9	5.6
Agriculture growth (%)	5.8	0.1	0.8	8.6	5.0	1.4	4.6	3.0
Industry growth (%)	9.7	4.4	9.2	7.6	7.8	1.0	0.7	3.9
Services growth (%)	10.3	10.0	10.5	9.7	6.6	7.0	6.9	6.9
Fiscal Deficit (Centre+States)	-4.0	-8.3	-9.3	-6.9	-8.1	-7.2	-6.9	-6.7
Current Account Deficit (%)	-1.3	-2.3	-2.8	-2.7	-4.2	-4.7	-2.0	-2.3
CPI (Average)	6.2	9.1	12.3	10.5	8.4	10.2	9.6	8.3
INR/USD (Average)	40.2	46.0	47.4	45.6	48.1	54.0	61.5	63.6

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 FY02 – 15E

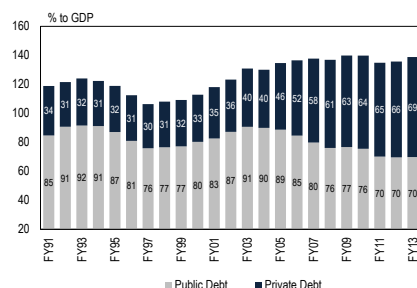
Fiscal Year to 31 March	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E
National Income Indicators														
Nominal GDP(Rs bn)	23,676	25,500	28,617	32,422	36,934	42,947	49,871	56,301	64,778	77,841	90,097	101,133	113,205	127,921
Nominal GDP (US\$ bn)	496	527	623	720	834	950	1,241	1,224	1,367	1,708	1,873	1,873	1,841	2,012
Per Capita GDP (US\$)	477	499	582	662	754	847	1,090	1,061	1,168	1,440	1,558	1,539	1,478	1,638
Real GDP growth (%)	5.5	4.0	8.1	7.0	9.5	9.6	9.3	6.7	8.6	8.9	6.7	4.5	4.9	5.6
Agriculture growth (%)	6.0	-6.6	9.0	0.2	5.1	4.2	5.8	0.1	0.8	8.6	5.0	1.4	4.6	3.0
Industry growth (%)	2.6	7.2	7.3	9.8	9.7	12.2	9.7	4.4	9.2	7.6	7.8	1.0	0.7	3.9
Services growth (%)	6.9	7.0	8.1	8.1	10.9	10.1	10.3	10.0	10.5	9.7	6.6	7.0	6.9	6.9
By Demand (%YoY)														
Consumption	5.3	2.3	5.4	1.9	8.7	7.7	9.4	7.7	8.4	8.2	8.9	5.2	4.4	5.6
Pvt Consumption	6.0	2.9	5.9	1.7	8.6	8.5	9.4	7.2	7.4	8.7	9.3	5.0	4.1	5.5
Public Consumption	2.3	-0.4	2.6	3.4	8.9	3.8	9.6	10.4	13.9	5.8	6.9	6.2	5.5	6.0
Gross Fixed Capital Formation	7.4	6.8	13.6	20.7	16.2	13.8	16.2	3.5	7.7	11.0	12.3	0.8	0.2	2.5
Cons; Invst, Savings * (%GDP)														
Consumption	78.9	77.2	75.0	70.1	69.2	68.0	67.2	68.6	69.1	67.5	68.5	68.8	69.8	70.1
Gross Capital Formation	22.3	24.6	26.9	32.8	34.7	35.7	38.1	34.3	36.3	36.5	36.4	34.7	35.3	35.7
Gross Domestic Savings	22.6	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
Real Indicators (%YoY)														
Commercial vehicle sales	-4.5	40.4	36.2	22.4	10.1	33.3	4.2	-21.4	39.2	27.0	19.5	-1.9	-25.0	-5.0
Car sales	3.2	5.3	27.2	17.8	7.7	20.7	12.1	0.3	25.7	29.2	3.9	2.4	-5.0	3.6
Two-wheelers	15.3	15.8	11.3	15.7	13.6	11.5	-7.8	2.7	25.9	25.8	13.9	2.7	5.0	10.0
Diesel consumption	-3.7	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	5.0	6.8	0.0	4.0
Mobile Tele density	0.6	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.5	66.8	75.1	79.0	87.9	89.7
Monetary Indicators (% YoY)														
Money supply	16.0	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
Inflation – WPI (Avg)	3.6	3.4	5.5	6.5	3.7	6.5	4.8	8.0	3.6	9.6	8.8	7.4	6.0	5.5
CPI (Avg)	4.3	4.1	3.8	3.9	4.2	6.8	6.2	9.1	12.3	10.5	8.4	10.2	9.6	8.3
Bank credit growth	15.3	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
Deposit growth	14.6	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
Fiscal Indicators (% GDP)														
Centre's fiscal deficit	-6.0	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.5	-4.8	-5.7	-4.9	-4.6	-4.1
State fiscal deficit	-3.6	-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
Combined deficit (Centre+State)	-9.6	-9.2	-8.2	-7.2	-6.5	-5.4	-4.0	-8.3	-9.4	-6.9	-8.1	-7.2	-6.9	-6.7
Off Balance Sheet Items					-0.5	-0.9	-0.6	-1.7	-0.2					
Combined liabilities (dom+ext)	87.2	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
External Sector (% YoY)														
Exports (US\$bn)	44.7	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.4	250.5	309.8	306.6	323.4	349.3
% YoY	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.5	37.3	23.7	-1.0	5.5	8.0
Imports (US\$bn)	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	381.1	499.5	502.2	472.1	514.6
%YoY	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	26.7	31.1	0.5	-6.0	9.0
Trade deficit (US\$bn)	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.2	-130.6	-189.8	-195.7	-148.7	-165.3
Invisibles (US\$bn)	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	84.6	111.6	107.5	111.9	118.6
Current Account Deficit (US\$bn)	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.2	-45.9	-78.2	-88.2	-36.8	-46.7
% to GDP	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.7	-4.2	-4.7	-2.0	-2.3
Capital Account (US\$bn)	8.6	10.8	16.7	28.0	25.5	45.2	106.6	7.4	51.6	62.0	67.8	89.3	50.1	63.6
% GDP	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.6	3.6	4.8	2.7	3.1
Forex Assets (excl gold) (US\$bn)	51.0	71.9	106.1	135.1	145.1	191.9	299.1	241.6	252.8	273.7	260.9	264.7	278.4	294.8
Months of imports	10.9	13.4	15.9	13.6	11.1	12.1	13.9	9.4	10.1	8.6	6.3	6.3	7.1	6.9
External Debt (US\$bn)	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	260.9	317.9	360.7	400.3	400.3	415.3
Short Term Debt (US\$bn)	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	78.2	96.7	94.8	
Exchange Rate														
US\$/INR - annual avg	47.7	48.4	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	48.1	54.0	61.5	63.6
% depreciation	4.4	1.5	-5.2	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	12.3	13.9	3.4

* At current prices.

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

Theme – Macro Delta Positive, But Worries on Leverage

Figure 3. Total Debt in India (Public+Private)



Source: RBI

One of the key takeaways from the [macro day](#) of our recent annual conference was that most investors and keynote speakers said that the delta change across macro issues – growth, inflation and the deficits – was positive. However, the nagging worry that most had was that the shallow recovery is dependent on ‘unlocking investments’ and managing non-performing loans (NPLs). There was concern that the deterioration in the banking sector’s asset quality could be an impediment to revival of the investment cycle. Before delving into the specifics of NPLs, we take a quick look into the economy’s overall debt profile.

India’s Debt Profile – Overall Debt at 139% of GDP

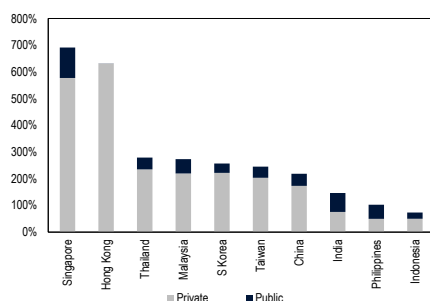
India’s total debt (private and public) currently stands at 139% of GDP – similar to the average 137% of GDP seen in the last 10 years. However, while overall debt has been stable, the composition has shifted significantly, with leverage building up in the private sector compared with declining trends in public debt.

Private sector levers up, while public debt ratios decline

Private sector: Private-sector debt has grown rapidly over the last decade and stands at ~70% of GDP in FY13 v/s 40% of GDP in FY03. The buildup in domestic private debt reflects the growing financial intermediation resulting in strong credit growth seen in scheduled banks, to the tune of average ~22%YoY in last 10 years.

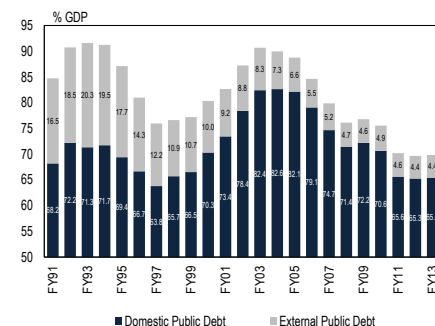
Public: By contrast, the public debt has been steadily declining and currently stands at 70% of GDP in FY13 v/s 91% in FY03. This is largely due to high nominal GDP growth that has resulted in the India public debt/GDP ratio declining.

Figure 6. Debt in India and Other EM (%GDP)



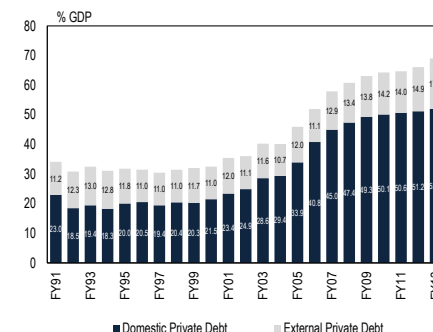
Source: Citi Research

Figure 4. Trends in Public Debt (%GDP)



Source: RBI

Figure 5. Trends in Private Debt (%GDP)



Source: RBI

India’s debt lower than in other emerging economies

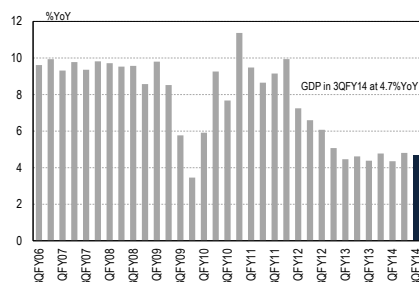
The consolidated debt in India remains much lower than in industrialized EM (Thailand, Malaysia, Taiwan, Korea, China), but higher than in the Philippines and Indonesia. As far as public debt is concerned, India’s public debt is one of the highest amongst emerging economies.

Macro Implications of High Leverage

Domestic: Prolonged Slowdown Takes a Toll – NPLs Rise

Sub-par trends in growth have resulted in asset quality in the banking sector coming under stress. Gross NPLs have risen to 3.6% in FY13 from 2.5% in the last two years. However, the picture is a bit grim if one includes restructured assets – currently at 9.4%. Furthermore, the restructuring pipeline doesn't paint a comforting picture.

Figure 7. Quarterly Trends in GDP (%YoY)



Source: CSO

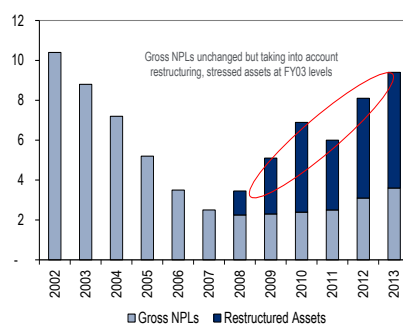
Weak growth has led to a rise in stressed assets: NPLs rose to 3.6% in FY13 from 2.5% in the prior two years, restructured assets are at 9.4%.

Main sectors with deteriorating asset quality are infrastructure, iron and steel, and power.

PSU banks are more exposed to stressed assets than private banks.

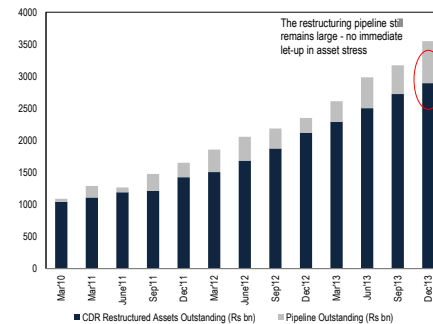
See our Banks Team note [The Asset Quality Stretch](#) for more details

Figure 8. Stressed Assets



Source: RBI

Figure 9. Rising CDRs (Rs bn)



Source: RBI, CDR Cell

Looking into the composition of non-performing loans – both in terms of the industries that are distressed and banks that are exposed – the NPL issue appears more cyclical and concentrated in a few sectors.

■ **Industrywise NPAs: Infrastructure most stressed** – As seen in Fig. 10, which details current state of restructured assets, the three largest sectors represented are infrastructure ~20%, iron & steel ~18% and power ~13%. Clearly these sectors have been impacted by the industrial slowdown and supply-side bottlenecks, and could benefit in the event of growth revival in the near term.

■ **Bankwise NPAs: Public sector banks most exposed** – Our banking analyst Aditya Narain notes that there exists PSU-private dichotomy as far as asset quality is concerned. In general, the stressed assets in PSU banks are relatively higher than the private-sector banks.

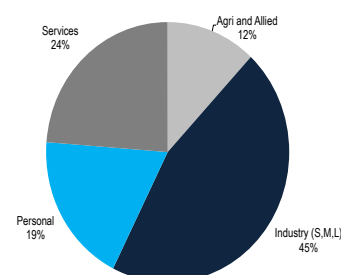
Restructuring pipeline still large: Notwithstanding a sharp increase in restructured assets, the restructuring pipeline still remains large, suggesting that there is no imminent respite.

Figure 10. Restructuring by Industries (Top 10)

Sector	No. Of Cases	Aggregate Debt (Rs bn)	% Total
Infrastructure	22	408	19.6
Iron and Steel	45	372	17.9
Power	15	263	12.7
Textiles	44	196	9.5
Telecom	5	108	5.2
NBFC	5	70	3.4
Shipping	3	68	3.25
Construction	6	66	3.2
TOTAL	259	2076	100

Source: CDR Cell

Figure 11. Bank Credit by Sector



Source: RBI, Citi Research

Figure 12. Trends in External Debt (US\$bn)

	FY11	FY12	FY13	FY14*
Multilateral	48.5	50.5	51.6	52.5
Bilateral	25.7	26.9	25.1	24.7
IMF	6.3	6.2	6.0	6.1
Trade Credit	18.6	19.0	17.8	16.6
Commercial Borrowing	100.5	120.1	131.0	129.1
NRI Deposits (> 1 year)	51.7	58.6	70.8	75.1
Rupee Debt	1.6	1.4	1.3	1.4
Total Long term debt	252.9	282.5	303.6	305.5
NRI Deposits (upto 1 yr)	-	-	-	-
FII Invest in T-Bills	5.4	9.4	5.5	2.3
Others (trade related)	58.5	65.1	86.8	87.4
Other	1.1	3.7	4.5	5.1
Total Short term debt	65.0	78.2	96.7	94.8
GROSS TOTAL	317.9	360.7	400.3	400.3
Short-term debt by Residual Maturity	88.0	99.6	172.3	168.1

Source: Ministry of Finance, RBI

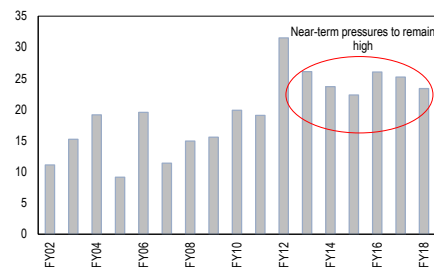
External Debt: Rise in Repayments and Servicing

While India's external debt ratios are comfortable with debt/GDP at 20%, key changes seen over the last few years include:

- **Rapid increase in private-sector debt:** Public sector debt – as reflected in multilateral/bilateral debt – has been coming off, while private-sector debt – external commercial borrowings, trade credit and NRI deposits – has been increasing. Repayments of these add to volatility in the exchange rate.
- **Growing short-term liabilities:** Short-term debt by residual maturity has been inching up over the years and now accounts for ~60% of total reserves.

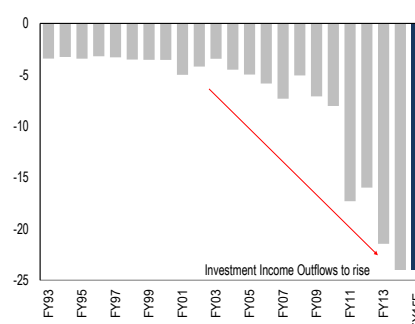
Implications: Rising private-sector debt coupled with repayments to the tune of ~US\$20bn annually make the economy vulnerable to international capital flows. In addition, it is key to note that the growing recourse to external sources of funding has resulted in a substantial increase in investment income outflows, resulting in a moderation in invisibles earnings. Thus while the real economy is largely domestic-oriented, given its dependence on capital flows, India is a high beta economy in terms of global risk appetite.

Figure 13. External Debt Servicing Projections (US\$bn)



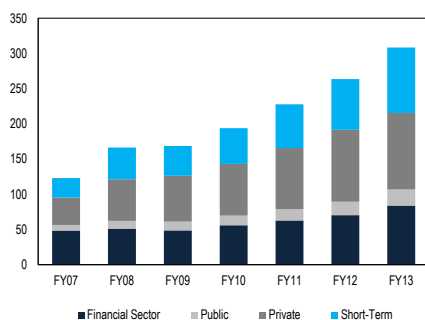
Source: Ministry of Finance, RBI

Figure 14. Investment Income Outflows (US\$bn)



Source: RBI, Citi Research

Figure 15. Non-Government External Debt (US\$bn)



Source: Ministry of Finance, RBI

What to Watch: Regulatory Framework; Unlocking Investments

On the domestic side, the stress in the credit sector is related to slow growth and could hinder a pickup in the investment cycle. Addressing the NPL issue is essential to a healthy banking sector. On the external side, changing composition and higher external debt increases vulnerability to stops in capital flows. Moreover, the rising capital requirements of public-sector banks could upset fiscal arithmetic.

Consequently, we believe there is a need to create an efficient regulatory mechanism for prevention, resolution and recovery of non-performing assets. A cyclical recovery coupled with regulatory measures to speedily resolve NPA issues could provide the much-needed relief on the stressed asset front.

Regulatory framework: What is being done?

The RBI governor has identified distressed asset management as one of the five pillars on which Reserve Bank's developmental measures will be built. Broadly he

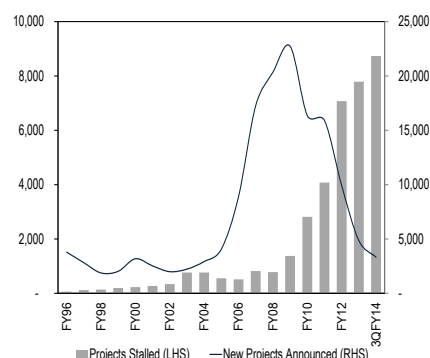
outlined a need for early recognition of financial distress, better resolution mechanisms, and a fair recovery process for lenders. Later, the RBI released a discussion paper detailing the framework for management of distressed assets, whose key implications are as follows:

Figure 16. RBI's Proposed Regulations to Tackle NPAs and Stressed Assets

For Lenders	<ul style="list-style-type: none"> - Identify and report incipient stress through common repository before a loan account turns into an NPA - In case of persistent stress, lenders to form a joint forum and agree on corrective action plan - Corrective action plan could include (1) rectification - preventive action before account slips into NPA (2) restructuring - if prima facie project is viable and borrower is not a wilful defaulter (3) recovery - if first 2 plans are not feasible - Allow lender to spread losses over 2 years, but with full disclosure
For Borrowers	<ul style="list-style-type: none"> - Tighten credit condition for non-cooperative borrowers and wilful defaulters by maintaining and sharing database of such borrowers - In case of restructuring, a borrower may be required to <ol style="list-style-type: none"> (1) transfer equity to lender (2) infuse more equity into company (3) transfer holdings to an escrow arrangement
Other Provisions	<ul style="list-style-type: none"> - Provide liberal regulatory treatment of asset sales such as <ol style="list-style-type: none"> (1) refinancing/ take out financing not to be construed as restructuring (2) allow leveraged buyouts, private equity participation in distressed markets

Source: RBI

Figure 17. Projects Announced and Projects Stalled



Source: www.capex.cmie.com

Measures to 'unlock' investments: PMG clears 288 projects

The Project Management Group (PMG) was established to complement the functioning of the Cabinet Committee on Investments (CCI). Its largest focus has been on the infrastructure sector, especially power, which is responsible for ~85% value of resolved projects. Since its inception in June 13, the PMG has resolved issues in 288 projects valued at ~US\$89bn, or ~4.8% of GDP. Still there is more to do to revive the investment climate, as the new project announcements by the private sector remains weak. Overall four developments that could aid investments in the coming months include (1) progress by the PMG, (2) headway on the Delhi-Mumbai Industrial Corridor, (3) integration of the southern grid with the national grid, and (4) Inroads into clearing the project financing pipeline.

In conclusion, debt and NPL levels are high...

Although total consolidated debt (private+public) in India at 140% of GDP is mid-ranged compared to other EMs, there is little room for complacency given: (1) Pro-cyclicality of financial sector: As debt in India is primarily financed by domestic banks, the deterioration in asset quality during slow-growth periods impacts future bank lending, which in turn negatively impacts the growth outlook further; (2) Currency vulnerability: Buildup of external private debt leads to servicing and repayment that adds to FX vulnerability; (3) Sovereign ratings: Public debt in India is relatively higher than other EMs and could cap the upside to sovereign ratings.

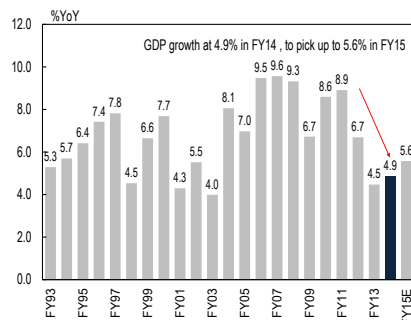
.... But not alarming if corrective actions are taken soon enough

Having highlighted the risks, we believe none of them are at alarming levels, especially if the corrective actions are implemented relatively sooner. The debt dynamics could materially improve in the private sector with (1) revival of growth/aggregate demand; (2) unlocking of investments/viable projects; and (3) regulatory mechanism for NPL issue, while public debt could come down with continued fiscal consolidation. As regards external debt, a strong chest of foreign exchange reserves ~75 % of external debt provides adequate cushion for the debt servicing, in our view.

Real Indicators

CSO Pegs FY14 GDP at 4.9%; Maintain FY15E GDP at 5.6%

Figure 18. Trends in GDP



Source: CSO, Citi Research

The government's [first GDP estimate](#) for FY14 pegs growth at 4.9%, largely in line with expectations (Citi: 4.8%; Consensus 4.7%). However, [GDP growth for first 3 quarters](#) in FY14 is at 4.6%, implying that 4Q growth would have to be 5.7% to meet the CSO's 4.9% estimate. This appears challenging, and we could see a downward bias of ~20bps when the annual estimates are revised in June.

The 4.9% estimate in FY14 is based on agriculture up 4.6%, services up 6.9% while industry is at 0.7%. On the expenditure side, the 4.6% print was primarily led by net exports which contributed ~50% to the headline number. Investments (GFCF) painted a sorry picture, up 0.2%, while consumption decelerated further to 4.4%.

Going forward for FY15, we maintain our estimate of 5.6% led by (1) Agriculture returning to its trend growth of 3%, (2) Industry growth rising to 3.9% due to mining clearances and improved electricity production, and (3) Services flat at 6.9%.

Figure 19. Trends in GDP (%YoY)

	Wts	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15E
Agriculture	13.9	5.8	0.1	0.8	8.6	5.0	1.4	4.6	3.0
Industry	27.3	9.7	4.4	9.2	7.6	7.8	1.0	0.7	3.9
Services	58.8	10.3	10.0	10.5	9.7	6.6	7.0	6.9	6.9
GDP at factor cost	100.0	9.3	6.7	8.6	8.9	6.7	4.5	4.9	5.6
Consumption	71.4	9.4	7.7	8.4	8.2	8.9	5.2	4.4	5.6
Pvt Consumption	60.1	9.4	7.2	7.4	8.7	9.3	5.0	4.1	5.5
Govt Consumption	11.2	9.6	10.4	13.9	5.8	6.9	6.2	5.5	6.0
Gross Capital Formation	38.8	18.1	-5.2	17.3	14.1	3.9	4.9	0.0	3.4
Gross Fixed Capital Formation	33.9	16.2	3.5	7.7	11.0	12.3	0.8	0.2	2.5
GDP at market prices		9.8	3.9	8.5	10.3	6.6	4.7	4.6	5.4

Source: CSO, Citi Research estimates

Recent IMF Study on Potential Growth

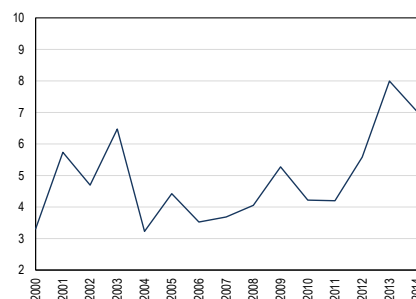
A recent study by the IMF (Rahul Anand et al, 2014) estimates that India's potential growth based on three methods, namely: (1) Statistical filters (2) Macroeconomic model-based multi-filter method, and (3) Production function approach indicates that India's trend growth peaked just before the GFC at around 8% and has recently declined to around 6-7%.

The study suggests that TFP growth has declined on heightened policy uncertainty, delayed project approvals and implementation, reforms setback, etc.

Productivity Declines: Potential Growth Slows to 6%-6.5%

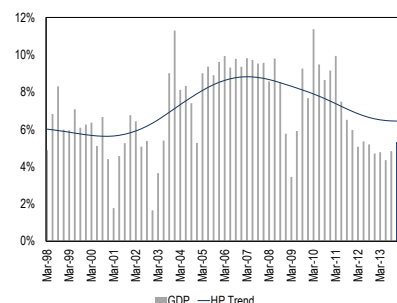
While headline trends in growth have come off sharply from ~9% levels to 4.9% in FY14, investments as a percentage of GDP have held at ~35% of GDP. As mentioned in the [savings-investment update](#), part of this can be attributed to the increase in investment in "valuables" i.e gold. However, in addition to this, part of the slowdown could be attributed to a decline in productivity of capital as reflected in the increase in the Incremental Capital Output Ratio (ICOR) from 4.2 in FY11 to ~7 in FY14. Our own assessment of potential growth based on statistical filter (Hodrick-Prescott) and production function estimates show a decline in potential growth from 8% pre-crisis to ~6.5% recently.

Figure 20. Incremental Capital Output Ratio (ICOR)



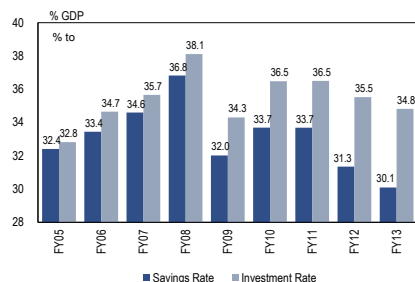
Source: CSO, Citi Research

Figure 21. Trend Growth & Output Gap (%)



Source: CSO, Citi Research

Figure 22. Trends in Savings & Investment



Source: CSO

Investments Key to a Higher Growth Trajectory

Recently released data by the CSO indicates that the deceleration in savings and investments continued for the fourth consecutive year, to 30.1% and 34.8% of GDP respectively. (India's savings and investment peaked at 36.8% and 38.1% in FY08.)

Going forward, the keys to move to a higher growth trajectory would be (1) reviving investments to pre-crisis levels, especially in the private sector through continued efforts to 'unlock' stalled investments, and (2) higher domestic savings, especially financial savings by containing inflation and positive real return.

What to Watch: Elections, Investments and Monsoons

Elections: The upcoming elections are the event to watch out for. Political pundits at our [Investor Conference](#) suggested recent opinion polls indicate the BJP-led alliance gaining ground (220+ seats). However, no one's making a hard call largely due to the likelihood of the anti-incumbency vote at the Centre being divided. All in all, we believe a stable government is key, as the business cycle remains inter-linked with politics.

El Nino Effect and Monsoons: Recently, global weather agencies have reported the possibility of increased chances of 'weak El Nino conditions' in 2014. While we await the Indian Meteorological Dept (IMD) monsoon forecast due in April, occurrence of El Nino could lead to deficient rainfall in India and consequently, pose a downward risk to agricultural output. This could affect our FY15 GDP estimate at 5.6%YoY, which is contingent on agricultural growth at 3%.

Progress made by PMG: Since its inception in June 13, the Project Monitoring Group has resolved issues in 288 projects valued at ~US\$89bn, or ~4.8% of GDP. While we believe the PMG is a positive step to improve investments, anecdotal evidence indicates that despite getting approvals, companies could be waiting for elections before commencing operations. Bottom line: A stable government post elections remains key to a capex revival, in our view.

The PMG was established to complement the functioning of the Cabinet Committee on Investments (CCI). Its largest focus has been on the power sector, which is responsible for ~85% value of resolved projects.

While the PMG is a positive step for investments, several projects were on the verge of clearance, and work on them had already commenced. Thus, these would not contribute much to "new" investment.

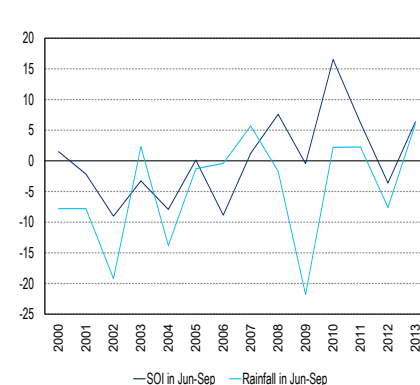
Moreover, private project announcements, the key driver behind capex, have fallen to historical lows.

Figure 23. PMG Progress on Projects So Far

Sector	No.		Value (\$bn)	
	Res	Bal	Res	Bal
Power	90	81	63	90
Road and Highways	6	29	1	7
Petroleum and Natural Gas	8	37	2	56
Steel	5	44	13	75
Railways	4	20	1	6
Shipping	5	13	1	4
Chemicals/Petrochemicals	1	1	1	1
Fertilizers	0	3	0	3
Mines	2	6	1	6
Civil Aviation	1	0	2	0
Coal	24	35	2	4
Commerce and Industry	3	18	1	11
Textiles	0	1	0	0
TOTAL	149	288	89	264

Source:
http://www.cabsec.nic.in/ccl_acceptedprojects.php

Figure 24. Rainfall and SOI Trends in Jun-Sep

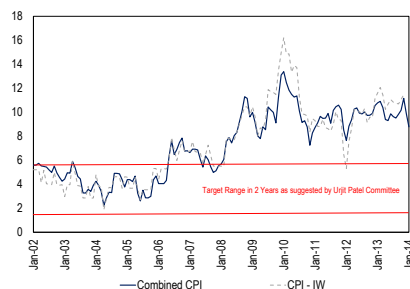


Source: IMD, Australian Meteorological Dept

Monetary Indicators

Its “CPI” for Now; Targets Likely a Parliamentary Process

Figure 25. Trends in CPI combined (%YoY)



Source: CSO, RBI

Monetary policy appears to be undergoing two major changes – a shift in focus to Consumer Price Inflation (CPI) from Wholesale Price Inflation (WPI), and a move towards inflation targeting. These changes follow the recommendations of the [Urjit Patel Committee report](#) which included: (1) Choice of Nominal Anchor: i.e CPI (2) Inflation target: set at 4% within a band of +/-2% over a 2-year time frame (8% by Jan-15, 6% by Jan-16) (3) Setting up a MPC: a 5-member Monetary Policy Committee (MPC) will be held accountable if targets are not met. We believe that the choice of a single inflation metric as well as inflation targeting are bold but risky moves – while the former bodes well for financial savings, the latter may not be suited to/ may be difficult in the current macro environment.

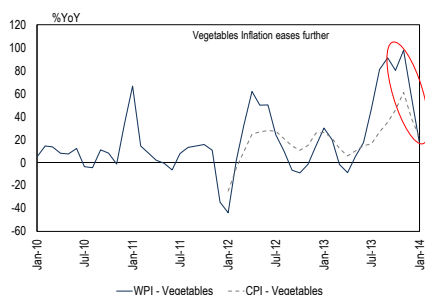
Likely to be a parliamentary process: Some of the Committee recommendations need legislative changes, government coordination and amendments to the RBI Act. In relation to this, during a media interview post the G-20 meetings in Sydney, RBI Governor Dr. Rajan said: “*What inflation target to have should be something set by the elected representatives of the people and not something the central bank decides on its own. We have certainly stayed away from setting our own inflation target. That is a process of discussion, which the finance minister and the RBI governor and perhaps Parliament might have going forward. We are not there yet. We have a committee which has set the target, but the process is consistent with the finance minister's committee.*”

Headline Inflation Eases as “Veggie” Prices Normalize

Both CPI and WPI inflation eased in the the past two months as vegetable prices normalized. To recap, rising vegetable prices had driven headline inflation higher, with WPI rising from 4.6% in May’13 to a peak of 7.5% in Nov’13 and CPI from 9.3% to a high of 11.2%. However, in the last two months, veggie prices have largely normalized, thus resulting in WPI and CPI inflation going back to the levels seen at the start of FY14.

However, core inflation remains sticky: Even though headline inflation has come off, core inflation has remained sticky. Over last four months, core CPI inflation has stayed ~8% levels and core WPI at ~3% levels. While core WPI can be considered within RBI’s comfort zone, the core CPI provides little relief as prices have been sticky for housing, clothing and miscellaneous services. Although the Patel Committee hasn’t given any explicit targets on core CPI inflation, we believe it will still play a vital role for central bank to ascertain the underlying trends in inflation.

Figure 26. Trends in Vegetable Inflation (%YoY)



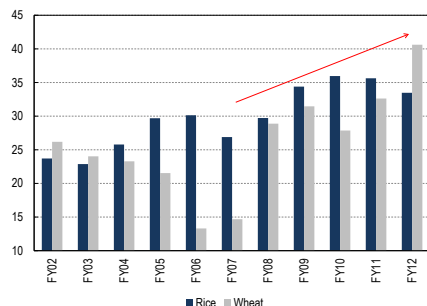
Source: CSO, Office of the Economic Advisor

Figure 27. Trends in Inflation – WPI and CPI (%)

	Wts	FY14								Apr-Jan	
		Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan-14	FY14	FY13
Headline WPI	100	5.2	5.9	7.0	7.0	7.2	7.5	6.2	5.0	6.0	7.5
Primary Articles	20.1	8.8	9.7	13.6	14.0	14.6	15.3	10.8	6.8	10.4	10.0
Fuel Index	14.9	7.5	11.4	12.7	11.7	10.5	11.1	11.0	10.0	10.1	10.6
Manufactured Products	65	2.9	2.6	2.3	2.4	2.8	2.9	2.6	2.8	2.8	5.6
Mfg Ex-Food (Core)		2.2	2.3	2.3	2.5	2.9	3.0	2.8	3.0	2.7	5.1
Overall CPI	100	9.9	9.6	9.5	9.8	10.2	11.2	9.9	8.8	9.8	10.1
Food, Beverages, Tobacco	49.7	11.7	11.0	11.0	11.3	12.4	14.5	12.0	9.9	11.5	11.6
Fuel and Light	9.5	8.6	8.4	7.5	7.7	7.0	7.0	7.0	6.5	7.6	8.6
Clothing, Bedding, footwear	4.7	9.6	9.3	8.9	9.3	9.1	8.9	9.2	9.2	9.3	10.9
Housing	9.8	10.7	10.6	10.5	10.4	10.4	10.3	10.3	10.2	10.5	11.5
Misc	26.3	6.2	6.7	7.1	7.4	6.9	6.9	7.0	7.1	6.9	7.3
Core CPI		7.7	8.0	8.2	8.4	8.0	8.0	8.1	8.1	8.0	8.7

Source: CSO, Office of the Economic Advisor

Figure 29. Foodgrain Procurement (%Production)



Source: FCI

Figure 28. Rural Wages (%YoY)



Source: RBI

Outlook – CPI Target of 8% Appears Attainable

Going forward, we maintain our view of CPI and WPI averaging 8.3% and 5.5% respectively in FY15. Key factors to watch include: (1) monsoons and the possibility of an El-Nino event, (2) government policies linked to support prices and quantum of procurement for grains, and (3) interplay of commodity prices and fx rates.

Over a medium term, we believe that the structural drivers behind high CPI inflation need to be addressed through measures other than tight monetary policy alone. Structural drivers include:

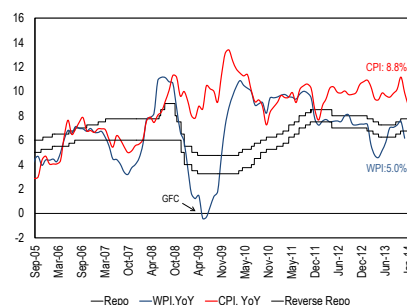
- CPI indexation of government administered wages e.g. MNREGA wages & dearness allowance, creates a positive feedback loop which aggravates inflationary impulses rather than dousing them.
- Government intervention in food supply chain (fertilizer subsidies, food procurement, MSP setting) has shifted the terms of trade towards producers, empowering them with increased pricing power.
- Prices of administered fuel such as diesel/LPG are more linked to policies rather than aggregate demand.

What to Watch: Core CPI; Rates Higher for Longer

While we do expect headline CPI inflation to come off to ~8% levels given RBI's anti-inflation bias (75bps of hikes in four months) and growth at a 10-year low, we expect rates to remain higher for longer. With the repo rate currently at 8% and taking into account that the CPI is "now" the key inflation metric, we maintain our view of an extended pause on rates through 2014.

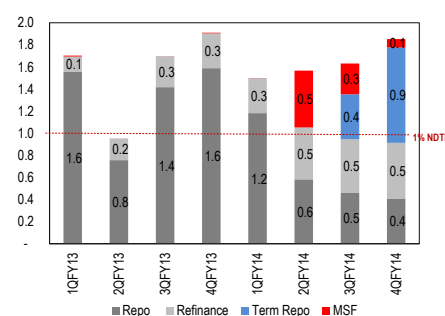
We also note that given tight liquidity conditions and due to higher reliance on term repo, the overnight call money rate (MIBOR) has remained an average 50bps above repo rate since November. The central bank has achieved stronger effective tightening by keeping liquidity tight, and we believe that RBI's action on liquidity instruments e.g. ceiling on repo, size/tenor of term repo, OMO, CRR etc. will also be guided by the inflation outlook among other factors that impact liquidity. Core CPI trends therefore will be key to watch to ascertain underlying inflationary pressure.

Figure 30. Policy Focus Shifts to CPI (%)



Source: RBI

Figure 31. Rising Importance of Term Repo (% of NDTL)



Source: RBI

Fiscal Indicators

“Interim Budget” – Targets Met, But Math Not Adding Up

Figure 32. Interim Budget Snapshot (Rs Bn)

	FY14 BE	FY14 RE	FY15 BE	Growth Rate
a. Revenue receipts	10,563	10,293	11,671	13.4
Tax revenues	8841	8360	9864	18.0
Non-tax	1723	1932	1807	-6.5
b. Non-debt cap receipts	665	366	675	84.1
Recoveries of loans	107	108	105	-2.5
Divestments	558	258	569	120.3
c. Total receipts (a+b)	11,228	10,659	12,346	15.8
d. Revenue expenditure	14,362	13,995	15,501	10.8
of which interest (1)	3,707	3,801	4,270	12.4
f. Capital expenditure	2,291	1,909	2,132	11.7
h. Plan expenditure	5,553	4,755	5,553	16.8
i. Non-plan expenditure	11,100	11,149	12,079	8.3
j. Total exp (d+f) = (h+i)	16,653	15,904	17,632	10.9
j. Fiscal Balance (c-j)	-5425	-5245	-5286	
% to GDP	-4.8	-4.6	-4.1	

Source: Budget Documents

FM Chidambaram presented the last budget of the UPA-II Government last month. Given the upcoming elections, this was an “Interim Budget” that will allow it to meet its administrative expenditure until a full budget is presented by the new government (likely in June). Contrary to fears among some in the market, (1) there have been “no” real populist schemes announced; (2) there is a push towards growth, with excise duties on cap/consumer goods having been pruned, and (3) for the second consecutive year, the finance minister restricted the fiscal deficit well within the proverbial “red line” i.e. budgeted fiscal deficit. This reflects a resolve to restore fiscal health and protect India’s investment-grade rating. Note that S&P had downgraded India’s outlook to negative (BBB-) in April 12 and warned of 1/3rd chances of a downgrade to junk rating.

FY14 deficit: pegged at 4.6% vs. target of 4.8% – For FY14, the government has proposed to cut expenditure by Rs749bn to get to its new fiscal target of Rs5,245bn or 4.6% of GDP vs. budgeted estimate of 4.8%. In our view, the estimates are optimistic as monthly fiscal data shows that [Apr-Jan fiscal deficit](#) is at Rs5,331bn, already in excess of the FY14 estimate of Rs5,245bn. However, the 4.6% target could still be met through (1) “interim” dividends from PSUs, (2) telecom revenues, and (3) subsidy rollovers.

FY15 deficit: consolidation expected to continue – The 4.1% target for FY15 is based on nominal GDP growth of 13.4%, total receipts of 15.8% and expenditures up 10.9% – all of which we believe are optimistic. Within revenues, the budget has estimated a 19% increase in gross tax collections (*corporate 14.6%, income 27.2%, excise 11.8%, customs 15% and services 31%*). Given subdued growth trends coupled with excise cuts, this seems ambitious.

Subsidy rollovers to continue

As regards expenditure, provision of subsidies is once again at the fore. For instance, the government has budgeted Rs808bn towards fuel subsidies in the revised FY14 budget and Rs573bn in its FY15 budget. Key to note is that the Rs808bn is the sum of deferred FY13 subsidies (Rs450bn) and the subsidies provided for 9MFY14 (Rs358bn). This implies that the subsidy compensation to be provided by the government for 4QFY14 (~Rs350bn) will once again be deferred to FY15, thus making available only ~Rs223bn for subsidies in FY15.

SENSITIVITY ANALYSIS on LOSSES

US\$1/bbl change = Rs40bn

USD/INR change = Rs80bn

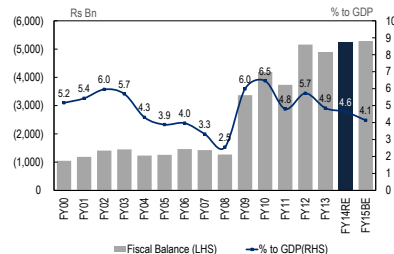
Rs1/ltr hike = Rs38bn

Figure 33. Underrecoveries in Administered Fuel Items (Rs bn)

	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E
Gross under-recoveries	1,033	461	782	1,385	1,610	1,428	983
Diesel	575	144	345	812	921	773	366
LPG	176	143	220	300	396	332	304
Kero	282	174	197	273	293	323	312
Less: upstream sharing	329	144	303	550	600	706	664
% of Total		31%	39%	40%	37%	49%	68%
Less: oil bonds/cash	713	260	410	835	1000	722	319
% of Total		56%	52%	60%	62%	51%	32%
Net under-recoveries	-9	56	69	0	10	-	-
Brent Crude (US\$/bbl)	85	71.5	87	114	111	108	106
USD/INR		47.5	45.6	47.9	54.4	61	62

Source: *Under-recoveries are calculated at fixed dollar per barrel (US\$56/bbl) Citi Research

Figure 34. Trends in Fiscal Deficit (Rs bn, % GDP)



Source: Budget Documents

Higher Redemptions Result in Rise in Borrowing Program

Based on a fiscal deficit target of Rs5286bn or 4.1% of GDP and estimated redemptions of Rs1397bn, the gross market borrowing is pegged at Rs5,970bn in FY15 v/s Rs5,639bn in FY14. Note that given the rise in fiscal deficit (from 2.5%GDP in FY08 to 5% in FY09), redemptions are likely to increase at a CAGR of 28% in the next four years and remain elevated thereafter. Taking this into account along with the 'proposed' maturity extension switch program, the gross borrowing could rise to Rs6,470bn v/sRs5,945bn in FY14

Figure 35. Borrowing Program (Rs bn)

	FY14BE	FY14RE	FY15BE
Fiscal Deficit	-5425	-5245	-5286
Net Market borrowings-dated	4840	4690	4573
PPF & special deposits	100	100	120
Small savings	58	116	82
Net external assistance	106	54	57
Others	321	135	453
Cash Drawdown	0	150	0
Total financing	5425	5245	5286
Gross dated borrowings excluding switch	5790	5639	5970
Gross dated borrowings including switch	6290	5945	6470

Source: Citi Research, Net dated borrowings adjusted after fin min press release

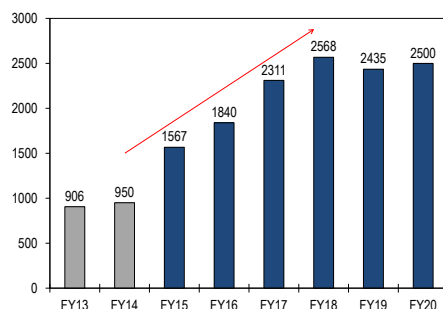
Implications:

- An increased supply of duration coupled with lower OMO demand for dated securities (Rs524bn in FY14 v/s Rs1,546bn in FY13) is likely to steepen the yield curve.
- However, also note that in addition to market borrowing, the government has been drawing down its cash balance (Rs 150bn in FY14) to fund its fiscal deficit. With the opening cash balance likely at Rs750bn in FY15, it could provide additional cushion for financing if the need arises.

Redemptions are likely to increase at a CAGR of 28% in the next four years and remain elevated thereafter.

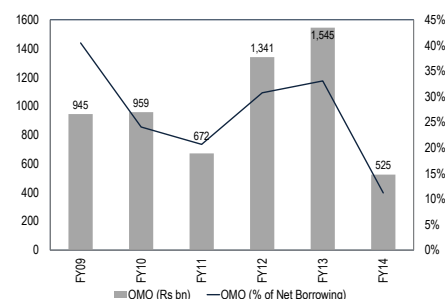
This, along with the 'proposed' maturity extension switch program, could raise gross borrowing to Rs6470bn vs Rs5945bn in FY14

Figure 36. Government Securities Redemption Schedule (Rs bn)



Source: RBI, Citi Research, As on Feb 17, 2014

Figure 37. RBI OMO as % of Borrowing Schedule (Rs bn)

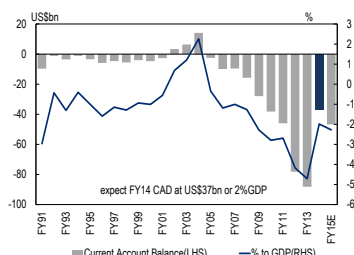


Source: RBI, Citi Research

What to Watch: Budget by New Government in June

The finance minister outlined his vision to reduce fiscal deficit to 3% of GDP by FY17, and while the actual FY15 fiscal arithmetic would depend on the new gov't and the budget it presents in June, we believe the broad theme of consolidation will continue. To revive tax buoyancy, the government may focus on tax reforms such as GST and direct taxes code, besides measures to support economic growth.

Figure 38. Trends in Current Account Deficit (US\$bn, % GDP)



Source: RBI, Citi Research

FY15 Assumptions

Exports rising by 8% and Imports up 9%

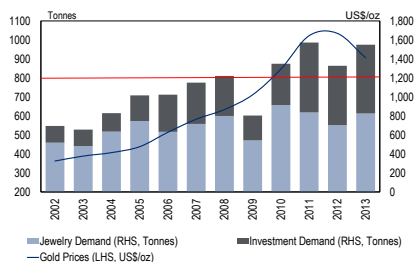
(1) gold imports at 800 tonnes vs. 640 tonnes in FY14E

(2) non-oil/non-gold imports rising 9% due to the [modest GDP upturn](#) (5.6%)

We expect the trade deficit to rise to US\$165bn v/s US\$148.7bn in FY14E

Uptrend in invisibles is likely to contain the CAD to US\$46.7bn or 2.3% of GDP.

Figure 40. Trends in Gold Price and Demand – Jewellery and Investment (Tonnes, US\$/oz)



Source: WGC

External Sector

Dissecting the Improvement in CAD; Will It Persist?

As is now well known, thanks to a series of policy measures, India's current account deficit (CAD) is likely to more than halve from US\$88.2bn in FY13 to US\$36.8bn in FY14E. A common question that we've been asked is whether the improvement in the CAD will be sustained at 2-2.5% of GDP or is this a one-off primarily due to the "squeeze" in gold imports? The short answer is yes, we expect the CAD in FY15 to be contained at US\$46.7bn or 2.3% of GDP. (See [External Sector Update](#))

The key assumptions for FY15, which we dissect below, are an 8% rise in exports and 9% in imports, with imports led by (1) gold imports at 800 tonnes vs. 640 tonnes in FY14E, (2) non-oil/non-gold imports rising 9% v/s -3.1% in FY14E due to the [modest GDP upturn](#) (5.6%) consequently resulting in the trade deficit rising marginally to US\$165bn v/s US\$149bn. However, the steady uptrend in invisibles is likely to contain the CAD to US\$46.7bn or 2.3% of GDP. Key to note, the resumption of iron ore exports and potentially lower coal/metal scrap imports should partially offset a pickup in gold and/or capital goods.

Figure 39. Trends in Current Account (US\$bn)

	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
a. Trade Balance	-91.5	-119.5	-118.2	-130.6	-189.8	-195.7	-148.7	-165.3
Exports	166.2	189.0	182.4	250.5	309.8	306.6	323.4	349.3
Imports	257.6	308.5	300.6	381.1	499.5	502.2	472.1	514.6
Of which : Gold	16.7	20.7	28.6	40.5	56.2	53.8	30.0	35.0
b. Invisibles	75.7	91.6	80.0	84.6	111.6	107.5	111.9	118.6
Services	38.9	53.9	36.0	48.8	64.1	64.9	72.1	77.8
Transfers	41.9	44.8	52.0	53.1	63.5	64.0	63.7	64.7
Investment Income	-5.1	-7.1	-8.0	-17.3	-16.0	-21.5	-24.0	-24.0
Current Account (a+b)	-15.7	-27.9	-38.2	-45.9	-78.2	-88.2	-36.8	-46.7
% GDP	-1.3	-2.3	-2.8	-2.7	-4.2	-4.7	-2.0	-2.3

Source: RBI, Citi Research estimates

Biggest Fear: What If Gold Import Curbs Are Relaxed?

Among the most effective policy measures to contain the CAD were the curbs imposed on gold imports, which had spiked to 320 tonnes in Apr-May 2013. Since then, gold imports have fallen dramatically with total imports during the period Apr-Dec at 534 tonnes or US\$23.5bn.

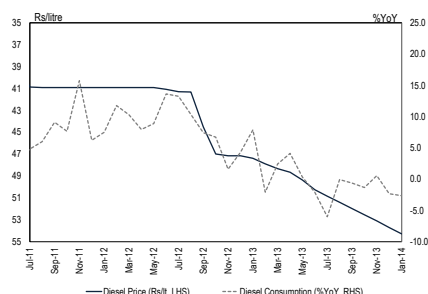
While we clearly expect the curbs to be partially relaxed in the coming months, we do believe a combination of domestic (efforts to rein in inflation) and global factors (prices) will likely contain gold imports at ~US\$800 tonnes. Key to note is that while jewellery demand will likely persist, the investment demand for gold which had risen sharply during FY09-FY12 could moderate due to both falling prices and the moderation in inflation.

Figure 41. Trends in Gold Imports

	FY08	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E
Gold Imports (Tonnes)	703	776	867	976	1076	1006	640	800
Gold Prices \$/oz	765	868	1,025	1,295	1,645	1,669	1,330	1,250
Gold Imports (US\$bn)	16.7	20.7	28.6	40.5	56.2	53.8	30.0	35.0
Gems Jewellery Exports (US\$bn)	19.7	28.0	29.0	40.5	44.9	43.4	40.0	40.0
Gold Exports (US\$bn)	3.0	4.2	4.3	6.1	6.7	6.5	6.0	6.0
Net Gold Imports (US\$bn)	13.8	16.5	24.3	34.5	49.5	47.3	24.0	29.0

Source: RBI, WGC, Citi Research

Figure 42. Fuel Price Reforms Slow Diesel Consumption (Rs/ltr, %YoY)



Source: PPAC

Oil – Fuel Reforms to Help Contain Import Bill

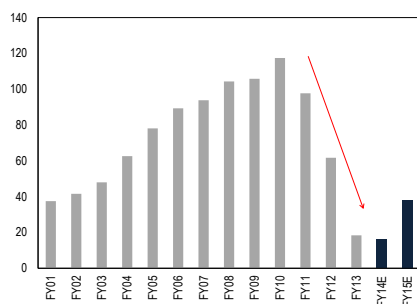
A quick re-cap: India imports 80% of its crude oil requirements, with oil comprising over 30% of its import bill. Taking into account petro product exports, a US\$1/bbl increase in oil prices would increase the trade deficit by US\$900m. Given the moderation in crude prices and a likely moderation in demand due to recent fuel price reforms, we expect the "net" oil import bill to come in ~10% lower in FY15E.

Figure 43. Trends in Oil Imports

	FY08	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E
A. Crude oil production (Mn T)	34.1	33.5	33.7	37.7	37.9	37.8	38.9	41.1
B. Crude oil Imports (Mn T)	121.7	132.8	159.3	163.6	171.7	184.8	197.1	195.0
Crude Oil Requirements (A+B)	155.8	166.3	193.0	201.3	209.6	222.6	236.1	236.1
In Volume Terms (Mn T)								
Consumption of Petrol Products	128.9	133.6	137.8	141.0	148.1	156.5	159.4	165.8
Petro Product Exports (Mn T)	40.8	38.9	51.0	59.1	60.8	63.4	75.2	68.8
In Value Terms (US\$bn)								
C. Total Imports (US\$bn)	79.7	93.7	87.1	106.0	155.0	169.3	165.6	159.6
D. Petro Product Exports (US\$bn)	26.4	27.5	28.2	41.5	55.9	60.1	63.0	64.0
Net Oil Import Bill (C-D)	53.4	66.1	58.9	64.5	99.0	109.2	102.6	95.6
Average Oil Price (Indian Basket)	79.2	83.6	69.8	85.1	111.9	108.0	107.0	104.0

Source: PPAC, DGCI&S, Citi Research

Figure 44. Iron Ore Exports (Mn T)



Source: Ministry of Commerce, Citi Research

Coal & Iron Ore – Easing Bottlenecks to Plug Trade Deficit

Two key commodities which could influence external trade in FY15 are likely to be coal and iron ore. As regards iron ore, due to the imposition of production restrictions, iron-ore exports have dropped from 100MT in FY11 to 16MT in FY13. This has resulted in (a) a fall in iron-ore exports from US\$4.7bn in FY11 to US\$1.6bn in FY13 and (b) an increase in imports of ores and metal scrap from US\$9.7bn in FY11 to US\$15bn in FY13.

As far as coal is concerned, supply-side constraints have led to coal imports rising from 69 MT in FY11 to 135 MT in FY13, consequently resulting in the coal import bill rising from US\$9.8bn in FY11 to US\$15.4bn in FY13. Easing of some constraints (including availability of rakes) could help lower coal imports.

What to Watch: Capital Flows in Absence of FCNR Boost

Thanks to the FCNR swap scheme, capital flows in FY14 are likely to come in at ~US\$50bn resulting in an overall BoP surplus of US\$13bn. Our US\$63bn estimate for capital flows in FY15 rests on a stable political outcome. This in turn, could have a positive influence on growth and foreign investment – FDI and portfolio.

Figure 45. Trends in Capital Flows (US\$bn)

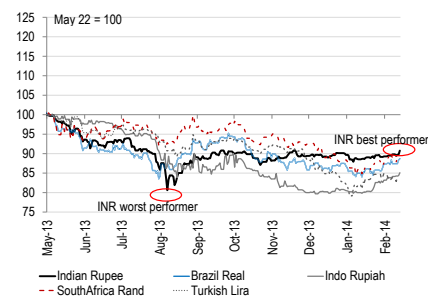
	FY08	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E
c.Loans	40.7	8.3	12.4	28.4	19.3	31.1	10.0	20.0
d.Foreign Investment	43.3	8.3	50.4	39.7	39.2	46.7	23.0	31.0
Portfolio Investments	15.9	22.4	18.0	9.4	22.1	19.8	20.0	18.0
FDI	27.4	-14.0	32.4	30.3	17.2	26.9	3.0	13.0
e.Banking Capital Net	11.8	-3.2	2.1	5.0	16.2	16.6	29.5	12.0
of which NRI deposits	0.2	4.3	2.9	3.2	11.9	14.8	28.0	11.0
f. Other capital	11.0	-5.9	-13.2	-11.0	-6.9	-5.0	-12.0	1.0
Capital Account (c:f)	106.6	7.4	51.6	62.0	67.8	89.3	50.1	63.6
Overall Balance	92.2	-20.1	13.4	13.1	-12.8	3.8	13.3	16.8

Source: RBI, Citi Research

Financial Markets

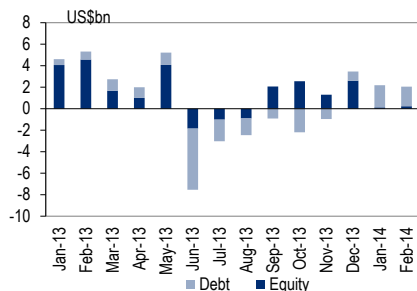
Rupee – No Longer the Weakest Link

Figure 46. Rupee Outperforms “Fragile Five”



Source: Bloomberg

Figure 47. Foreign portfolio flows (\$bn)



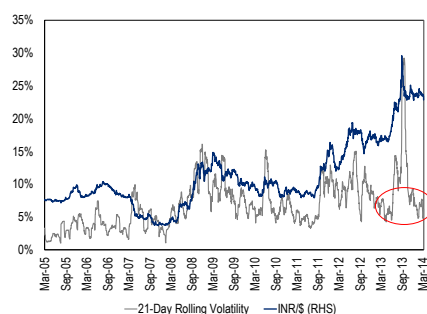
Source: SEBI

Fed Taper now at US\$20bn; monetary conditions still easy – The Fed reduced its monthly asset purchases by another US\$10bn in Feb, bringing its monthly purchases down to US\$65bn (US\$35bn treasury + US\$30bn MBS) from US\$85bn in Dec. Our global team expects tapering to continue in the coming months leading to a complete wind down of QE by Sep-Oct 2014 (see [Global Economics Update](#)).

Brief EM turmoil in Jan/Mar, Asia outperforms – Three events early this year reignited the fears of another bout of EM volatility: (1) Argentine peso underwent step depreciation by ~15% during the week Jan 20-24 in the official markets; (2) Turkey shocked markets by hiking rates by 425-450bps on Jan 29th; and (3) Ukraine/Russia standoff led to worries about credit risk. In the selloff post the Argentina/Turkey events, Asia (including INR) outperformed the rest of emerging markets. Interestingly, EM currencies have been weak despite 10-year UST yield sliding more than 25bps in 2014, suggesting a move to safe-haven assets and diminishing role of yield differential in currency behavior. (see [Emerging Markets - A Comment on the Turmoil](#) by David Lubin)

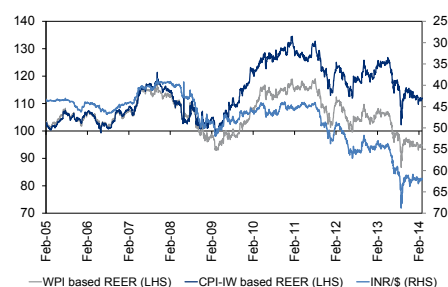
Rupee stays in 61-63.7 range for last 5 months, volatility dips – Thanks to a rapid adjustment in CAD (US\$36.5bn in FY14 v/s US\$88bn in FY13) and a pickup in capital flows (portfolio+FCNR), the rupee has recovered from the historic lows of 68.8 in Sep to 61.2 currently. Moreover, 21-day rolling volatility has reduced from a peak of 29% (ann) to ~6% currently. In terms of REER, the unit trades at ~5% discount to fair value based on WPI inflation, but a premium of 10% based on CPI-IW inflation. However, factoring in the Balassa-Samuelson effect, the INR appears fairly valued at current levels.

Figure 48. 21-day Rupee Realized Volatility (% annualized)



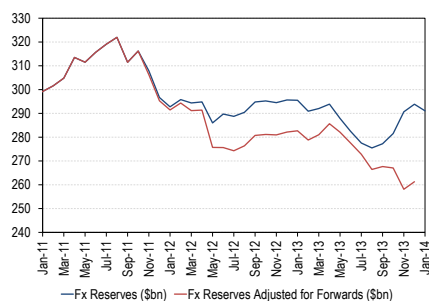
Source: RBI

Figure 49. Real Effective Exchange Rate (2004-2005=100)



Source: RBI

Figure 50. RBI Fx Reserves Adj. for Forwards (US\$bn)

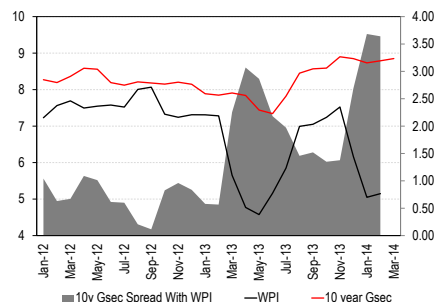


Source: RBI, Citi Research

Outlook: Volatility to Increase heading into elections – While domestic policy actions have been effective in containing rupee volatility against broad EM weakness, the upcoming general elections are an important event to watch. A quick recap: INR appreciated by ~3.5% in a month after 2009 election results.

While a positive election outcome could result in higher dollar inflows, we expect the INR to be capped at ~Rs60/US\$ levels. The reason being a need to rebuild reserves, thereby increasing FX import cover. Moreover, key to note is the US\$33bn of RBI's forward short position – mostly due to FCNR(B) swaps. Thus despite a favorable BoP situation, the RBI's dollar demand to meet future liabilities will likely cap the INR appreciation, and we maintain our view of the unit trading in the Rs60-64 range in FY15.

Figure 51. 10 year G-sec yield with WPI (%)



Source: RBI, Office of the Economic Advisor, WPI estimate for Feb

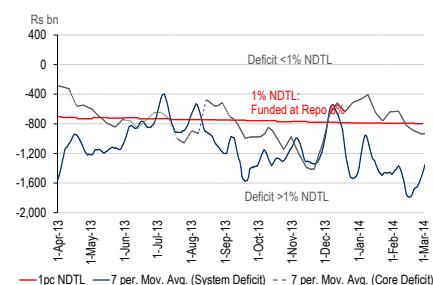
Bonds – Rally on Hold

Bond market loses WPI focus, narrative shifts to CPI – Following the release of the Urjit Patel Committee report and the ‘apparent’ shift to CPI, yields have edged higher with the 10-year trading at 8.8%. Markets now appear to have discounted WPI-based inflation. The spread between 10-year g-sec yield (8.8% currently) and headline WPI inflation (5.0%) has reached a post financial crisis high of 380bps.

However, the Urjit Patel recommendations appear to be getting more resistance than expected. As highlighted during our India conference, while there is acknowledgment of the positive aspects of having a clear nominal anchor to influence expectations, most believe that India is not yet ready to adopt an inflation targeting framework. Additional concerns include (a) conceptual issues (the economy is still too fragmented for RBI to adopt an integrated approach) and (b) methodical matters (the suggestion to splice the old CPI-IW series with the new CPI for modeling purposes appears flawed).

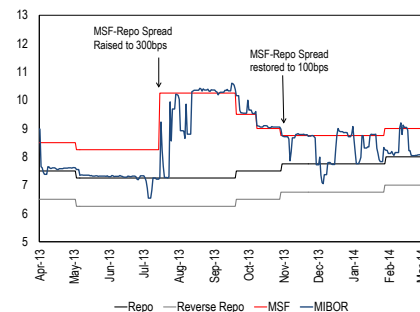
Operating rate higher than repo rate of 8% – A quick recap on liquidity: The RBI imposed a ceiling of 1% of NDTL on overnight repo and widened the MSF-repo spread to 300bps in mid-July to stem the depreciation in the rupee. As the INR stabilized, the RBI restored MSF-Repo spread to 100bps. However, it maintained the 1% ceiling on overnight repo and simultaneously introduced term repo instruments of 7/14/28 day maturity. While term repos have reduced the dependency on the penal MSF window, it hasn’t eliminated the occasional borrowing from MSF. As a result the “operating rate” or MIBOR has been on an average 50bps higher than the repo rate since November.

Figure 52. Banking System Liquidity (Rs Bn)



Source: RBI

Figure 53. O/N Rate Higher Than Repo (%)



Source: RBI

Steepening of yield curve likely

Increased supply of government securities (higher redemptions and proposed switch) coupled with lower OMO demand for dated securities is likely to steepen the yield curve further.

Outlook: rally on hold – Given RBI’s stringent goal for CPI inflation, rates are expected to stay higher for longer. In line with our policy view of an extended pause, and factoring in an increase in supply (a result of higher redemptions/switch) and lower OMOs, we expect 10-year bond yield to trade in 8.7%-9% levels. Increasingly, we see core CPI playing a key role in guiding the bond markets, as swings in food inflation prove transitory.

What to Watch: Stable FX, Higher Bond Yields

Overall, while a stable political outcome will be instrumental for equity and exchange rate markets, the inflation dynamics remains central for bond yield movement. As regards sovereign ratings outlook, we expect no negative action as long as the new government stays on a fiscal consolidation path when it presents its final budget in June.

Politics – Elections Are Here!

Upcoming Elections – What's New and Noteworthy?

Figure 54. Election Schedule 2014

Date	No. Of States + Union Territories	No. Of Constituencies
7th Apr	2	6
9th Apr	5	7
10th Apr	14	92
12th Apr	3	5
17th Apr	13	122
24th Apr	12	117
30th Apr	9	89
7th May	7	64
12th May	3	41
Total Constituencies		543

Source: ECI

The remaining states and Union Territories have only 1-2 seats in parliament and include Arunachal Pradesh, Goa, Manipur, Meghalaya, Tripura, etc.

The Election Commission has announced the dates for India's 16th General Election. Polling is scheduled in nine phases beginning 7 April, with the ninth and last phase ending on 12 May. Counting and results will be on 16 May and a new house will be constituted by 31 May. Based on recent assembly elections and trends in opinion polls, many believe that the anti-incumbency factor is strong and there exists a high possibility of BJP victory (220+ seats)...more so, since the BJP has made significant progress in battleground states such as UP and Bihar, which represent 120 seats of the total 543.

However, few are making a hard call for several reasons: (1) anti-incumbency votes may get divided in the wake of new frontiers such as AAP (a new party) and Third Front (a coalition of 11 regional parties), and (2) opinion polls may have failed to adequately capture the better mood in rural areas and could underestimate Congress's chances. In any case, we believe consensus exists for the need of a stable formation at the centre which could revive the investment climate and growth.

Figure 55. A Look at 2009 Election Results in Key States

State	Members	2009 Election Results	Winning Party
Uttar Pradesh	80	SP:23; INC:21; BSP:20; BJP:10	Samajwadi Party
Maharashtra	48	INC:17; SS:11; BJP:9; NCP:8	Congress
Andhra Pradesh	42	INC:33; TDP:6; TRS:2	Congress
West Bengal	42	AITC:19; CPI(M):9; INC:6	Trinamool Congress
Bihar	40	JD(U):20; BJP:12; RJD:4; INC:2	Janata Dal (U)
Tamil Nadu	39	DMK:18; AIADMK:9; INC:8	DMK
Madhya Pradesh	29	BJP:16; INC:12	BJP
Karnataka	28	BJP:19; INC:6; JD(S):3	BJP
Gujarat	26	BJP:15; INC:11	BJP
Rajasthan	25	INC:20; BJP:4	Congress
Odisha	21	BJD:14; INC:6	BJD
Kerala	20	INC:13; CPI(M):4	Congress
Assam	14	INC:7; BJP:4; Others:3	Congress
Jharkhand	14	BJP:8; JMM:2; Ind:2; INC:1	BJP
Punjab	13	INC:8; SAD:4; BJP:1	Congress
Chhattisgarh	11	BJP:10; INC:1	BJP
Haryana	10	INC:9	Congress
Delhi	7	INC:7	Congress
Jammu and Kashmir	6	J&KNC:3; INC:2	J&KNC
Uttarakhand	5	INC:5	Congress
Himachal Pradesh	4	BJP:3; INC:1	BJP
Total Seats	524	INC:196; BJP:111; Others:217	

Source: ECI

Figure 56. Electorate Distribution – by State

State	Electors Mn	% Total Electorate
Uttar Pradesh	134.3	16.5
Maharashtra	79.0	9.7
West Bengal	62.5	7.7
Andhra Pradesh	62.4	7.7
Bihar	62.1	7.6
Tamil Nadu	53.8	6.6
Madhya Pradesh	47.5	5.8
Karnataka	44.7	5.5
Rajasthan	42.6	5.2
Gujarat	39.9	4.9

Source: Election Commission of India

Electorate – New Voters Shift Election Sentiment

India's demographic landscape has changed since the last general election in 2009. There has been a 13.5% increase in the number of voters, and the growth is naturally in the youth and middle-class segments. Several political commentators emphasize that, contrary to the 2009 elections which were driven by an "income deficit", the 2014 elections will revolve around an "aspiration deficit" – largely influenced by the growth in middle-class and youth voters. Consequently, we expect voters are more likely to prefer a party that addresses 'aspirations' over 'poverty.'

To put this in perspective, the total Indian electorate has 97mn new voters as compared to the 2009 elections. On a state-wise basis, highest growth in electorates was seen in Tamil Nadu (+29%), Haryana (+28%), Madhya Pradesh (+25%), and West Bengal (19%).

AAP, Third Front – Add to Election Uncertainty

Figure 57. Third Front Parties

Party	Lok Sabha Members
Samajwadi Party	22
Janata Dal (United)	19
Communist Party of India (Marxist)	16
Biju Janata Dal	14
AIADMK	9
Communist Party of India	4
All India Forward Bloc	2
Jharkhand Vikas Morcha (Prajantrik)	2
Revolutionary Socialist Party	2
Asom Gana Parishad	1
Janata Dal (Secular)	1
Total	92

Source: www.loksabha.nic.in

The AAP, in an industry body meet, detailed some aspects of its economic policy based on (1) security (2) justice (3) corruption-free governance. It suggested the economy would become more efficient by privatizing sectors with more competition, by ensuring good governance, and by deregulating agriculture prices.

Election dynamics are in a state of flux, and recent events have added to the uncertainty. Firstly, there is emergence of the AAP. The AAP victory in Delhi state assembly elections surpassed expectations. Following the AAP victory, party leader Arvind Kejriwal became the chief minister of Delhi and also resigned within weeks of forming the government on anti-corruption agenda.

Secondly, there are talks of formation of a 'Third Front' – a non-BJP, non-Congress led alliance. The Third Front currently consists of 11 parties – 4 Left parties and 7 regional parties including the AIADMK, JD(U), JD(S), SP and BJD. It excludes key non-BJP, non-UPA parties such as the Trinamool Congress and BSP. History shows that a Third Front has had little success in India – the United Front formed a coalition government of 13 parties in 1996 that collapsed and resulted in another election in 1998. Already, some fissures have begun to appear in the Third Front.

What to Watch: Political Parties' Economic Vision

The BJP is generally perceived to be more pro-market and pro-economic growth and its 'vision' focuses on building infrastructure and technology for the 'three pillars' of growth: agriculture, manufacturing and services. It also emphasizes urbanization. The Congress has flagship programs such as food security bill and MGNREGA that are populist, but the party has also undertaken ambitious measures such as Delhi Mumbai Industrial Corridor, direct cash transfers, fuel reforms, FDI reforms, etc.

Regardless of which party comes to power, stable government is crucial. There are broad policies, especially tax reforms such as GST and DTC, which would benefit the economy and for which significant groundwork has been done.

Figure 58. Congress and BJP Economic Views

Agenda	Congress	BJP
Foreign Investment	- No room for aversion to foreign investment as it is the only way to finance the CAD	- Transparent, stable policies to encourage foreign investment
Price Stability & Growth	- RBI must strike a balance between price stability and growth while formulating monetary policy	- Set up a Price Stabilisation Fund - Special courts for black marketeers - Make agri sector more productive
Reforms	- FSLRC recommendations that do not require change in legislation should be implemented immediately - Form a timetable for passing legislations	- Says it will support GST - Focus on "economic diplomacy" for friendly trade policies - Professionalize PSUs
Infrastructure	- Every proven infrastructure model should be adopted, and PP model should be used more - New financing structures for long-term investment are key	- Focus on public investment in Agriculture investment and technology - Bullet trains and interlinking rivers
Manufacturing	- Focus on manufacturing for export; proposes all taxes into an export product should be waved / rebated - Suggests a minimum tariff protection to incentivize manufacturing goods in India rather than importing them	- Manufacturing should account for a third of GDP - Focus on manufacturing should reduce dependence on imports - Make hubs where labor and infrastructure for manufacturing are not a problem
Urbanisation	- Should use the wealth and resources in cities to rebuild a new model of governance	- Set up 100 'smart' cities - Develop twin city concept and set up satellite cities
Education, Skill Development	- Should be a priority alongside secondary and university education, sanitation, healthcare, etc	- IITs, IIMs, AIIMs in all states - Skill development key to benefiting from demographic dividend
States and Centre	- States should willingly bear reasonable proportion of financial costs of implementing flagship programmes so that the Centre can allocate its resources towards exclusive responsibilities like defence, railways, etc	- States should have a larger role in development - "Equal Development" for Northeastern States
Fiscal Consolidation	- Achieve fiscal deficit target of 3% GDP by 2016-17, and always remain below this level	

Source: FM Speech, BJP Vision Document

Monthly Monitor

Figure 59. India — Key Monthly Indicators (percent change from a year ago unless otherwise stated)

	Dec-12	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14
Consumption Trends														
Two-Wheelers	4.1	8.4	-2.8	-7.0	0.9	1.1	-4.6	-0.1	6.7	18.4	18.0	5.6	2.3	8.9
Passenger Car Sales	-11.4	-11.5	-25.0	-21.4	-10.4	-11.7	-10.4	-8.6	13.0	-1.0	-5.4	-9.7	-6.0	-7.6
Tractors	-6.1	-6.2	-0.4	1.3	36.3	23.5	20.7	12.3	10.9	35.1	30.0	12.5	13.0	16.5
LHCVs	5.9	14.2	6.6	9.7	4.7	-7.2	-8.9	-12.3	-14.1	-18.1	-14.4	-26.8	-24.5	-22.4
MHCVs	-38.3	-38.9	-34.7	-25.9	-6.5	-16.7	-21.3	-19.7	-38.1	-41.5	-31.6	-33.9	-27.9	-17.4
Investment Trends														
Infrastructure Index	7.5	3.7	-2.4	3.2	2.2	2.3	0.1	3.2	3.7	8.0	-0.6	1.7	2.1	1.6
Diesel Consumption	4.3	7.9	-2.2	2.4	4.1	0.3	-2.1	-6.0	-0.1	-0.6	-1.3	0.6	-2.3	-2.6
Steel Production	4.8	13.4	-7.8	-2.1	4.5	1.7	5.5	0.7	12.1	12.8	0.8	4.2	5.0	-5.0
Manufacturing PMI*	54.7	53.2	54.2	52.0	51.0	50.1	50.3	50.1	48.5	49.6	49.6	51.3	50.7	51.4
output	57.7	54.0	56.3	51.6	50.2	48.6	49.1	49.8	47.5	49.6	48.6	51.5	51.3	52.6
Industrial Production Index														
General	-0.6	2.5	0.6	3.5	1.5	-2.5	-1.8	2.6	0.4	2.7	-1.6	-1.3	-0.6	
Manufacturing	-0.8	2.7	2.1	4.3	1.8	-3.2	-1.7	3.0	-0.2	1.4	-1.8	-2.7	-1.6	
Mining	-3.1	-1.8	-7.7	-2.1	-3.4	-5.9	-4.6	-3.0	-0.9	3.6	-3.2	1.7	0.4	
Electricity	5.2	6.4	-3.2	3.5	4.2	6.2	0.0	5.2	7.2	12.9	1.3	6.3	7.5	
Use Based Basic goods	2.2	3.7	-1.8	3.2	1.4	-0.3	-1.9	1.0	0.9	6.7	-1.4	2.7	2.4	
Capital goods	-1.1	-2.5	9.1	9.6	-0.3	-3.7	-6.6	15.9	-2.0	-6.6	2.4	-0.1	-3.0	
Intermediate goods	-0.2	3.5	-0.8	2.1	2.5	1.1	1.3	3.2	3.8	4.4	2.2	3.4	4.5	
Consumer goods	-3.6	2.5	0.8	1.8	1.7	-6.6	-1.5	-0.7	-0.9	1.0	-4.9	-8.8	-5.3	
Consumer Durables	-8.1	-0.7	-2.6	-4.9	-9.6	-18.3	-10.1	-9.6	-8.3	-10.6	-12.1	-21.5	-16.2	
Consumer Non-Durables	-0.5	4.6	3.2	7.3	11.3	3.8	6.2	7.4	5.4	12.0	2.2	2.1	1.6	
Services														
Port traffic	-4.9	-1.0	1.0	-3.2	-6.2	0.5	2.5	4.8	6.8	4.9	-2.8	-0.6	5.8	-3.1
Railway freight	1.6	6.4	-0.2	-0.6	3.9	4.5	5.3	4.9	6.0	11.8	-2.0	3.1	4.5	4.1
Tourist arrivals ('000)	753	699	688	640	452	384	444	524	474	436	589	718	800	720
Cellular subscriber Adds (Mn)**	-25.9	-2.3	-1.5	5.6	1.5	4.1	3.4	1.4	2.0	-6.2	4.8	4.9	6.8	8.6
Banking Trends														
Money supply(M3)	11.2	13.0	12.7	13.8	12.9	13.6	12.7	12.4	12.0	12.9	13.6	15.1	14.9	14.5
Loan(Credit) growth	15.0	16.1	16.3	14.1	14.6	15.1	13.5	14.7	16.3	15.0	16.0	13.9	14.5	16.1
Deposit growth	11.0	13.1	12.8	14.2	12.8	14.2	13.5	13.1	12.6	11.5	14.3	15.6	15.9	16.6
Non-food credit	14.9	15.8	16.1	14.0	14.5	15.3	13.7	14.9	16.5	15.2	16.4	14.2	14.8	
Inflation														
CPI	10.6	10.8	10.9	10.4	9.4	9.3	9.9	9.6	9.5	9.8	10.2	11.2	9.9	8.8
WPI	7.3	7.3	7.3	5.7	4.8	4.6	5.2	5.9	7.0	7.0	7.2	7.5	6.2	5.0
Mfg products inflation	5.0	4.9	4.8	4.3	3.7	3.3	2.9	2.6	2.3	2.4	2.8	2.9	2.6	2.8
Food Products	10.6	11.4	10.5	7.4	5.1	5.7	8.8	9.7	13.6	14.0	14.6	15.3	10.8	6.8
Fuel Products	10.2	9.3	10.6	7.8	8.3	7.3	7.5	11.4	12.7	11.7	10.5	11.1	11.0	10.0
PMI - Input Prices	59.6	58.9	58.9	55.0	54.1	51.3	55.9	60.6	57.8	63.5	64.5	58.0	57.8	57.7
PMI - Output Prices	55.9	55.0	57.9	53.1	51.9	49.8	50.9	53.4	51.8	51.1	55.3	51.9	51.8	52.4
Interest rates (Average, %)														
Daily MIBOR	8.1	8.1	7.9	8.0	7.6	7.4	7.3	7.9	9.9	10.1	9.2	8.6	8.2	8.3
1 yr CD	8.8	8.7	9.3	9.0	8.6	8.3	8.3	9.1	10.3	10.1	9.2	9.2	9.3	9.3
91-day T-Bills	8.0	7.8	7.9	7.8	7.6	7.3	7.3	8.4	10.0	9.4	8.6	8.8	8.8	8.7
Corp Bond Spreads	1.0	1.2	1.1	1.1	1.1	0.9	1.0	1.2	0.9	1.2	1.0	1.2	0.9	0.9
10-year government bond	8.1	7.9	7.8	7.9	7.8	7.4	7.3	7.8	8.5	8.6	8.6	8.9	8.8	8.7
Trade - customs data														
Exports(%YoY)	0.4	1.6	2.3	5.9	1.9	-0.7	-4.8	10.6	13.5	11.7	13.2	1.9	3.5	3.8
Imports(%YoY)	7.5	4.2	2.8	-3.4	10.0	6.1	-0.6	-6.3	-1.2	-18.6	-14.6	-16.7	-15.2	-18.1
Oil	17.8	-1.4	15.7	-16.1	4.4	3.3	13.4	-7.9	17.9	-5.9	2.2	-1.0	1.0	-10.1
Non-oil	3.3	7.1	-3.4	4.3	13.0	7.5	-6.9	-5.6	-11.2	-25.0	-23.1	-24.2	-22.9	-22.0
Trade Deficit (US\$bn)	-17.6	-19.0	-15.5	-10.4	-17.7	-20.1	-12.2	-12.5	-10.6	-6.4	-10.6	-10.0	-10.1	-9.9
Brent Prices (\$/bbl)	109.7	112.8	116.7	109.3	102.6	103.2	103.0	107.9	110.9	111.9	109.5	108.2	110.8	107.5
Foreign investment (US\$ mn)														
FII	4,905	4,610	5,318	2,741	1,992	5,220	-7,536	-3,026	-2,457	1,151	357	343	3,460	2,187
FDI	453	2,701	2,210	822	2,772	1,843	1,826	1,925	1,618	4,502	1,847	2,381	2,133	
Exchange rate and reserves														
US\$ exchange rate average	54.7	54.2	53.8	54.4	54.3	55.0	58.4	59.8	62.8	63.6	61.6	62.5	61.8	62.1
US\$ exchange rate month end	54.8	53.3	53.8	54.3	54.2	56.5	59.7	61.1	66.6	62.8	61.4	62.4	61.9	62.5
Forex reserves incl.gold (US\$bn)	296.6	295.7	291.9	292.6	296.4	287.9	284.6	280.2	275.5	276.3	283.0	291.3	295.7	291.1

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

Government Finances

Figure 60. Snapshot of Indian Government Finances (Rs bn)

	FY09	FY10	FY11	FY12	FY13	FY14RE	FY15BE	Interim Budget Estimates
a. Gross Tax Revenue	6,053	6,245	7,931	8,892	10,360	11,589	13,792	Revenues
% to GDP	10.8	9.6	10.2	9.9	10.2	10.2	10.8	Key Assumptions
% YoY	2.0	3.2	27.0	12.1	16.5	11.9	19.0	Income Tax +27.2%
Corporation tax	2,134	2,447	2,987	3,228	3,563	3,937	4,510	Corporate: +14.6%; Customs +15%
Income tax	1,060	1,224	1,391	1,645	1,965	2,362	3,005	Excise: +11.8%; Service: +30.7%
Excise duty	1,086	1,030	1,377	1,449	1,759	1,788	1,998	
Import duty	999	833	1,358	1,493	1,653	1,751	2,013	
Service tax	609	584	710	975	1,326	1,649	2,155	
b. (-) Devolvement to States & UTs	1,620	1,680	2,232	2,594	2,960	3,229	3,928	
c. Net tax revenues (a-b)	4,433	4,565	5,699	6,298	7,400	8,360	9,864	
d. Non tax revenues	969	1,163	2,186	1,217	1,374	1,932	1,807	
e. Net revenue receipts (c+d)	5,403	5,728	7,885	7,514	8,776	10,293	11,671	
f. Non-debt capital receipts	67	332	353	369	422	366	675	
Recovery of loans	61	86	124	189	163	108	105	
Divestments/Other	6	246	228	181	259	258	569	
g. TOTAL REVENUES (e+f)	5,470	6,060	8,237	7,884	9,198	10,659	12,346	
%YoY	-6.6	10.8	35.9	-4.3	16.7	15.9	15.8	
h. Revenue expenditure	7,938	9,118	10,407	11,458	12,435	13,995	15,501	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	2,557	Food: Rs1150bn; Fuel: Rs634bn; Fert: Rs680bn
Pensions	329	561	574	612	695	741	810	
Grants to States	382	459	498	515	480	616	694	
Admin and social services	927	1,107	1,198	1,053	1,153	1,316	1,402	
Plan expenditure	2,348	2,539	3,142	3,337	3,292	3,719	4,423	
i. Capital expenditure	902	1,127	1,566	1,586	1,669	1,909	2,132	
Defense	410	511	621	679	705	789	896	
Loans	87	121	298	120	119	83	105	
Plan expenditure	405	495	648	786	844	1,037	1,130	
j. Plan expenditure	2,752	3,034	3,790	4,124	4,143	4,755	5,553	Plan expenditure to rise 16.8%
k Non Plan expenditure	6,087	7,211	8,183	8,920	9,961	11,149	12,079	Non-plan expenditure to rise 8.3%
l. TOTAL EXPENDITURE (h+i): (j+k)	8,840	10,245	11,973	13,044	14,104	15,904	17,632	
% YoY	24.0	15.9	16.9	8.9	8.1	12.8	10.9	
Deficit trends								
m. Fiscal Balance (g-l)	-3,370	-4,185	-3,736	-5,160	-4,906	-5,245	-5,286	FY14 fiscal deficit contained at 4.6% GDP vs estimates of 4.8%
% to GDP	-6.0	-6.5	-4.8	-5.7	-4.9	-4.6	-4.1	
n. Revenue Balance (e-h)	-2,535	-3,390	-2,523	-3,943	-3,659	-3,703	-3,829	
% to GDP	-4.5	-5.2	-3.2	-4.4	-3.6	-3.3	-3.0	
o. Primary Deficit (m-1)	-1,448	-2,054	-1,396	-2,428	-1,774	-1,445	-1,016	
% to GDP	-2.6	-3.2	-1.8	-2.7	-1.8	-1.3	-0.8	
Financing the deficit								
Market borrowings (Net)	2,336	3,984	3,254	4,362	4,674	4,233	4,073	
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	592	953	
Cash Surplus	438	-14	64	-160	-506	150	0	
Total financing	3,370	4,185	3,736	5,160	4,906	5,245	5,286	
Memo items (% to GDP)								
Centre	-6.0	-6.5	-4.8	-5.7	-4.9	-4.6	-4.1	
State	-2.3	-2.9	-2.1	-2.4	-2.3	-2.2	-2.6	
Combined	-8.3	-9.4	-6.9	-8.1	-7.2	-6.9	-6.7	
Off Balance Sheet Items	-1.7	-0.2	-	-	-	-	-	
Total Deficit	-10.0	-9.5	-8.0	-8.1	-7.0	-6.7	-5.7	
Combined liabilities	76.8	75.5	70.2	69.6	69.8	69.6	68.5	

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

Balance of Payments

Figure 61. Balance of Payments Snapshot (US\$bn)

	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E	Comments
CURRENT ACCOUNT								
Exports (RBI)	189.0	182.4	250.5	309.8	306.6	323.4	349.3	Exports likely to pick up due to partner country growth A weak rupee also helps
YoY %	13.7	(3.5)	37.3	23.7	(1.0)	5.5	8.0	
% of GDP	15.4	13.3	14.7	16.5	16.4	17.6	17.4	
Exports (Customs)	185.3	178.8	251.1	306.0	299.5	316.3	341.6	
YoY %	13.7	(3.5)	40.5	21.8	(2.1)	5.6	8.0	
Imports (RBI)	308.5	300.6	381.1	499.5	502.2	472.1	514.6	
YoY %	19.8	-2.6	26.7	31.1	0.5	-6.0	9.0	
% to GDP	25.2	22.0	22.3	26.7	26.8	25.6	25.6	
Imports-Customs	303.7	288.4	369.8	489.3	491.2	455.6	497.5	Oil and Gold are key as they account for 40% imports
YoY %	21.2	-5.0	28.2	32.3	0.4	-7.3	9.2	
of which: Oil	93.7	87.1	106.0	155.0	169.3	165.6	180.0	Crude price assumptions are at US\$107/bbl in FY14
YoY %	17.6	-7.0	21.6	46.2	9.3	-2.2	8.7	
Gold	20.7	28.6	40.5	56.2	53.8	30.0	35.0	Gold imports likely to be contained at 800tonnes;
YoY %	23.9	38.2	41.6	38.7	-4.3	-44.3	16.7	
Non-oil Non-gold	189.3	172.6	223.3	278.1	268.3	260.0	282.5	
YoY%	22.1	-8.8	29.4	24.6	-3.5	-3.1	8.7	
a. Trade balance (RBI)	-119.5	-118.2	-130.6	-189.8	-195.7	-148.7	-165.3	
% of GDP	-9.8	-8.6	-7.6	-10.1	-10.4	-8.1	-8.2	
Trade Balance (Customs)	-118.4	-109.6	-118.6	-183.4	-191.7	-139.3	-155.9	
Difference b/w RBI and customs	-1.1	-8.6	-12.0	-6.4	-4.0	-9.4	-9.3	Difference normally represents defense imports 9MFY14 Invisibles at US\$86bn
b. Invisibles	91.6	80.0	84.6	111.6	107.5	111.9	118.6	
Non-factor services	53.9	36.0	48.8	64.1	64.9	72.1	77.8	Rising recourse to external funding results in outflows
Investment income	-7.1	-8.0	-17.3	-16.0	-21.5	-24.0	-24.0	
Remittances**	44.6	51.8	53.1	63.5	64.3	63.3	64.3	
Official transfers	0.2	0.3	0.0	0.0	-0.3	0.4	0.4	
1. Current a/c balance (a+b)	-27.9	-38.2	-45.9	-78.2	-88.2	-36.8	-46.7	
% of GDP	-2.3	-2.8	-2.7	-4.2	-4.7	-2.0	-2.3	9MFY14 CAD at US\$31bn
CAPITAL ACCOUNT								
c. Loans	8.3	12.4	28.4	19.3	31.1	10.0	20.0	9MFY14 Loans are at US\$6.2bn
External assistance	2.4	2.9	4.9	2.3	1.0	1.0	2.0	Upside if infrastructure and Public sector financial Institutions raise quasi -sovereign bonds
Commercial borrowings	7.9	2.0	12.5	10.3	8.5	6.5	12.0	
Short-term credit	-2.0	7.6	11.0	6.7	21.7	2.5	6.0	
d. FDI (Net = a-b)	22.4	18.0	9.4	22.1	19.8	20.0	18.0	9MFY14 FDI is at US\$20.7bn
(a) FDI - To India	41.7	33.1	25.9	33.0	27.0	31.0	33.0	
(b) FDI - Abroad	-19.4	-15.1	-16.5	-10.9	-7.1	-11.0	-15.0	
e. Portfolio invst (-14.0	32.4	30.3	17.2	26.9	3.0	13.0	9MFY14 portfolio flows are at US\$-4.4bn
f. Banking Capital	-3.2	2.1	5.0	16.2	16.6	29.5	12.0	
NRI deposits	4.3	2.9	3.2	11.9	14.8	28.0	11.0	9MFY14 NRI deposits are at US\$35.1bn
g. Rupee debt service	-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	-12.0	1.0	
2.Capital a/c (c+d+e+f+g+h)	7.4	51.6	62.0	67.8	89.3	50.1	63.6	
Errors & Omissions	0.4	0.0	-3.0	-2.4	2.7	-	-	
Overall balance (1+2)	-20.1	13.4	13.1	-12.8	3.8	13.3	16.8	
Forex								
Forex assets	241.6	252.8	273.7	260.9	264.7	278.0	294.8	
FCA to months of imports (Rhs)	9.4	10.1	8.6	6.3	6.3	7.1	6.9	
Exchange rate								
Rs/US\$ - annual avg	46.0	47.4	45.6	48.1	54.0	61.5	63.6	
% depreciation	14.4	3.0	-3.8	5.5	12.3	13.9	3.4	

*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

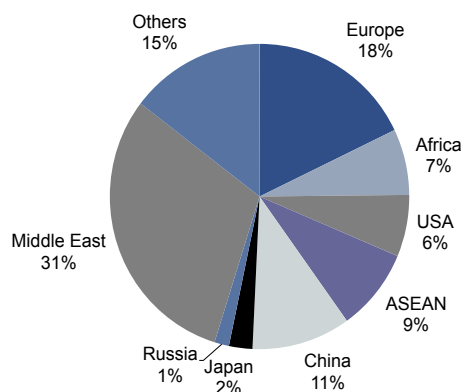
Direction and Composition of Trade

Figure 62. India — Composition of Imports (US\$bn, %)

	FY09	FY10	FY11	FY12	FY13	FY14*
Petroleum (Crude+Products)	93.7	87.1	106.0	155.0	169.3	125.2
%YoY	17.5	-7.0	21.6	46.2	9.2	2.7
% Total	30.8	30.2	28.7	31.7	34.2	36.7
Electronic Goods	23.5	21.0	26.6	32.7	31.4	23.7
%YoY	15.4	-10.9	26.8	23.2	-4.0	1.3
% Total	7.7	7.3	7.2	6.7	6.4	7.0
Gold	21.3	28.8	40.7	56.5	53.8	23.4
%YoY	29.7	35.1	41.1	39.0	-4.7	-38.5
% Total	7.0	10.0	11.0	11.5	10.9	6.9
Pearls, precious, semiprecious stones	16.8	16.3	34.6	29.4	22.7	18.3
%YoY	111.6	-3.2	112.4	-15.1	-22.9	16.4
% Total	5.5	5.7	9.4	6.0	4.6	5.4
Machinery (ex electric)	21.8	19.7	23.9	30.2	27.6	17.7
%YoY	9.7	-9.8	21.0	26.6	-8.5	-14.9
% Total	7.2	6.8	6.5	6.2	5.6	5.2
Coal, Coke, Briquettes	10.1	9.0	9.8	17.5	16.5	12.1
%YoY	56.7	-11.0	9.1	79.1	-5.9	-7.5
% Total	3.3	3.1	2.6	3.6	3.3	3.6
Organic Chemicals	7.8	8.6	11.6	13.4	14.5	11.9
%YoY	7.8	11.2	34.2	15.2	8.5	9.9
% Total	2.6	3.0	3.1	2.7	2.9	3.5
Metalliferous ores, Metal Scraps	8.1	7.7	9.7	13.4	15.0	10.4
%YoY	2.2	-4.4	26.0	37.6	12.0	-2.8
% Total	2.7	2.7	2.6	2.7	3.0	3.1
Transport Equipment	13.2	11.7	11.5	13.9	15.6	9.7
%YoY	70.9	-11.8	-2.0	21.5	11.8	-22.6
% Total	4.4	4.1	3.1	2.8	3.1	2.8
TOTAL IMPORTS	303.7	288.4	369.8	489.3	494.9	340.6
% YoY	27.2	-5.1	28.2	32.3	1.1	-6.5

*FY14 numbers are from Apr-Dec ; Source: DGCI&S, RBI

Figure 64. Direction of Imports FY13



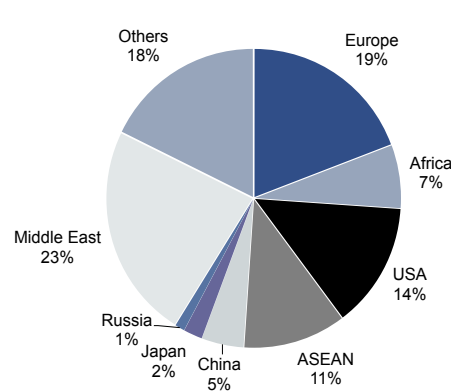
Source: DGCI&S, CMIE

Figure 63. India — Composition of Exports (US\$bn, %)

	FY09	FY10	FY11	FY12	FY13	FY14*
Petroleum Crude & Products	27.5	28.2	41.5	55.9	60.1	47.2
%YoY	4.5	2.3	47.2	34.8	7.4	5.5
%Total	14.9	15.8	16.8	18.3	20.1	20.6
Gems and Jewellery	28.4	29.1	37.9	45.3	43.4	29.3
%YoY	44.1	2.4	30.5	19.5	-4.3	-6.4
%Total	15.3	16.3	15.4	14.8	14.5	12.8
Transport Equipment	11.2	9.8	16.7	21.4	18.4	15.2
%YoY	66.0	-12.9	70.1	28.2	-14.1	11.4
%Total	6.1	5.5	6.7	7.0	6.1	6.6
Machinery, Instruments	11.0	9.6	11.9	14.3	15.3	11.8
%YoY	23.4	-13.3	24.2	20.8	6.5	5.9
%Total	5.9	5.4	4.8	4.7	5.1	5.1
Pharmaceuticals, Chemicals	8.8	9.0	10.6	13.2	14.6	11.1
%YoY	19.4	2.1	18.6	24.1	10.6	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	7.1
%YoY	9.4	-27.2	56.3	10.4	5.3	-6.2
%Total	4.1	3.1	3.5	3.1	3.4	3.1
Cotton yarn, Fabrics, etc	4.2	3.7	5.7	6.8	7.5	6.5
%YoY	-6.9	-11.1	54.6	19.0	10.4	22.0
%Total	2.2	2.1	2.3	2.2	2.5	2.8
Readymade Garments	10.1	9.9	10.6	12.5	11.5	6.4
%YoY	14.9	-1.8	6.9	17.6	-7.9	8.4
%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	5.8
%YoY	105.5	-21.5	51.7	9.8	-9.8	-5.3
%Total	3.9	3.2	3.5	3.1	2.8	2.5
TOTAL EXPORTS	185.3	178.5	247.0	305.4	299.6	229.5
% YoY	16.9	-3.7	38.4	23.7	-1.9	5.6

*FY14 numbers are from Apr-Dec ; Source: DGCI&S, RBI

Figure 65. Direction of Exports FY13



Source: DGCI&S, CMIE

Global Forecasts

Figure 66. Selected Countries — Economic Forecast Overview (Percent) 2013F-2017F

	GDP Growth					CPI					Short Term Interest Rates				
	2013F	2014F	2015F	2016F	2017F	2013	2014F	2015F	2016F	2017F	2013	2014F	2015F	2016F	2017F
Global	2.5	3.1	3.4	3.6	3.5	2.6	3.0	3.1	3.4	3.4	2.22	2.39	2.66	3.09	3.55
Industrial Countries	1.2	2.0	2.3	2.4	2.1	1.3	1.6	1.6	1.5	1.4	0.46	0.36	0.51	1.06	1.70
United States	1.9	2.6	3.1	3.2	2.7	1.1	1.5	1.7	2.2	2.3	0.25	0.25	0.40	1.50	2.70
Japan	1.6	1.2	1.0	1.2	1.2	0.4	2.8	1.6	1.6	0.7	0.10	0.10	0.10	0.10	0.10
Euro Area	-0.4	1.1	1.3	1.5	1.6	1.4	0.7	0.7	1.0	1.2	0.50	0.13	0.10	0.11	0.42
Emerging Markets	4.5	4.7	5.0	5.3	5.4	4.7	5.0	5.4	5.1	5.1	4.99	5.46	5.86	6.10	6.22
China	7.7	7.3	7.0	7.5	7.3	2.6	3.2	3.7	3.8	4.0	3.00	3.03	3.63	3.88	4.25
India	4.9	5.6	6.2	6.6	6.9	9.6	8.3	7.5	7.0	6.5	7.75	8.00	8.00	7.50	7.00
Indonesia	5.8	5.3	5.5	5.7	5.9	6.4	6.5	5.7	5.4	5.3	4.65	6.00	6.44	6.25	6.00
Turkey	4.0	2.3	3.5	3.9	4.1	7.5	7.7	7.4	6.8	6.5	6.16	11.05	10.63	9.75	9.50
South Africa	1.9	2.4	2.9	3.2	3.4	5.8	6.1	5.7	5.9	6.2	5.00	6.17	6.79	7.00	7.00
Brazil	2.1	1.3	1.8	2.5	3.0	6.2	6.0	6.0	5.5	5.5	8.44	10.73	11.90	11.50	11.00
Mexico	1.1	3.8	4.0	4.4	4.5	3.8	4.3	3.7	3.6	3.6	3.94	3.50	3.94	5.40	6.42

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*, 26th February 2014

Figure 67. Selected Countries — Economic Forecast Overview (Percent) 2013F-2017F

	Current Balance (Pct of GDP)					Fiscal Balance (Pct of GDP)					Government Debt (Pct of GDP)				
	2013F	2014F	2015F	2016F	2017F	2013F	2014F	2015F	2016F	2017F	2013F	2014F	2015F	2016F	2017F
Global	0.7	0.8	0.6	0.3	0.1	-3.7	-3.0	-2.5	-2.4	-2.3	89	87	87	86	85
Industrial Countries	-0.2	0.0	0.2	0.2	0.2	-4.8	-3.5	-2.7	-2.6	-2.4	116	114	115	114	114
United States	-2.2	-2.0	-1.5	-1.8	-1.7	-5.7	-3.9	-3.0	-3.4	-3.4	105	107	106	106	106
Japan	0.6	0.2	0.1	0.8	1.0	-9.8	-8.0	-6.2	-5.8	-5.4	244	246	251	255	258
Euro Area	2.2	2.5	2.6	2.6	2.5	-2.9	-2.4	-2.1	-1.7	-1.5	96	97	97	97	96
Emerging Markets	2.0	1.8	1.2	0.5	0.1	-2.1	-2.3	-2.2	-2.0	-2.1	45	45	44	44	43
China	2.2	2.0	1.5	0.8	0.5	-2.0	-2.0	-1.5	-1.5	-1.5	54	54	52	51	49
India	-2.0	-2.3	-2.2	-2.2	-2.3	-6.9	-6.7	-6.5	-6.2	-5.9	70	68	66	65	63
Indonesia	-3.3	-2.5	-2.1	-1.7	-1.5	-2.2	-2.2	-1.7	-1.9	-2.0	24	26	25	25	25
Turkey	-7.8	-5.2	-5.3	-5.5	-5.4	-1.2	-2.8	-3.2	-3.3	-3.3	37	37	37	36	35
South Africa	-5.8	-4.7	-4.2	-3.7	-3.1	-4.2	-4.2	-4.3	-3.8	-3.0	46	47	49	50	49
Brazil	-3.7	-3.9	-3.8	-3.8	-3.7	-3.3	-3.7	-2.8	-3.1	-3.1	57	58	57	58	58
Mexico	-1.7	-2.0	-1.7	-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*, 26th February 2014

Figure 68. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent) 2013F-2017F

	10-Year Yields					Exchange Rates Versus U.S. Dollar*				
	2013F	2014F	2015F	2016F	2017F	2013F	2014F	2015F	2016F	2017F
United States	2.35	2.90	3.40	3.75	4.10	NA	NA	NA	NA	NA
Japan	0.71	0.68	1.06	1.25	1.50	98	106	112	115	115
Euro Area	1.60	1.71	1.90	2.15	2.40	1.33	1.39	1.41	1.41	1.41
China	3.68	4.68	5.11	5.49	5.86	6.15	6.02	6.00	6.01	6.03
India	8.25	8.50	8.50	8.00	7.50	58.57	63.0	63.5	61.5	58.5
Indonesia	6.97	8.58	8.75	8.75	8.75	10449	12108	12083	11598	10765
Turkey	NA	NA	NA	NA	NA	1.91	2.36	2.46	2.42	2.25
South Africa	7.20	7.83	8.04	8.14	8.38	9.65	11.48	11.58	11.23	10.66
Brazil	9.98	13.44	15.13	13.56	11.75	2.16	2.59	2.79	2.75	2.54
Mexico	5.67	6.75	7.38	7.60	7.95	12.8	13.2	12.9	12.6	12.5

Source: Citi Research estimates; *Global Economic Outlook and Strategy*, 26th February 2014

Appendix A-1

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