

India Macro View

Europe Trip Tales – Commodities Down; Mood Up

We recently met over 40 institutional investors in Europe. The consensus view was that the delta change in sentiment across Indian asset classes - equities, rates and FX - was positive due to (1) lower commodity prices, (2) expansionary global liquidity conditions and (3) prospects of a good monsoon. However, positions remain light due to (1) concerns on politics and (2) progress on implementation of reforms.

- **Headwinds to Tailwinds...Yes** – In line with our views in our recent [Macroscope-BOP: A Welcome POP](#), investor feedback confirms that sentiment towards India is improving, with the key driver being (1) comfort on the Current Account Deficit which puts to rest fears of the USD/INR depreciating to ~58-60 levels, (2) a view that inflation will head lower in the coming months, driving more rate cuts by the RBI and (3) fiscal targets are more likely to be met, which bodes well for India's sovereign rating outlook.
- **But Fundamental Challenges Remain** – Given the drop in commodity prices, sentiment towards all Indian assets is undoubtedly positive, however, there was consensus that (1) this doesn't remove fundamental challenges and recovery in growth would be modest (FY14 Citi GDP estimate at 5.7% v/s 5% in FY13), (2) commodity prices remaining at current levels are key, (3) Political uncertainty and risk of an early election could offset the positive impact of lower commodity prices.
- **Investor Feedback on Asset Classes** — The delta change on the outlook for all asset classes is positive but political/policy risks and possibility of a re-bounce in gold remain concerns. Nonetheless, consensus view was as a regional investor summarized it "I'm always amazed... its always right at knife point. That everything just turns around". Bottom Line: While investors agreed that structural challenges still persist (see pg 6), the delta has clearly improved on a cyclical basis (see pg 2-4).
 - **Equities:** Investors referred to India as a "Tease" market, on the radar once again thanks to lower commodity prices, coupled with expansionary global monetary conditions. The consensus view was that India is among the few large markets that would welcome the inflows right now. Moreover, most felt that, if the currency holds (and the macro stabilizes), the inflows could accelerate (see pg 5).
 - **FX:** The key takeaway on the currency side was that (1) fears of the INR weakening to the Rs58-60 handle are now on the 'back-burner', (2) despite the positive impact on the CAD, dollar inflows, the unit is expected to remain range-bound in the Rs54-56 range as the RBI appears to be unwinding its forward book (~US\$13bn).
 - **Rates:** Investors continue to receive rates, with the universal view, that stable/lower commodity prices/INR will provide a leeway for monetary easing. The debate has moved to how much, rather than if, the RBI will cut rates. We expect a 25bp cut on 3 May. Guidance from this policy will help determine the extent of easing after that.

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With thanks to
Abha Agarwal

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

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Divine Intervention: Oil + Gold + Rains

OIL: +VE FOR CAD; WPI AND THE FISC

Oil = ~34% of the import bill

SENSITIVITY ANALYSIS

On CAD: a US\$1/bbl change in oil prices would affect the trade deficit by US\$900m

On losses: US\$1/bbl change = Rs40bn
USD/INR change = Rs80bn

Budget outlay on fuel subsidies for FY14 is Rs650bn; FY13 arrears are at Rs500bn.

GOLD – INVESTMENT DEMAND IS KEY

Gold = 10% of imports
Jewellery demand is ~75% while
Investment demand is ~25%

While cultural factors will likely limit the drop in jewellery demand

Key to watch is if the drop in investment demand more than offsets an increase in jewellery demand

(see p5 & 6 of the [Macroscope](#) for the detailed math)

MONSOON – WHAT'S AHEAD

The IMD's first monsoon forecast for the 2013 season is normal - at 98% of the Long Period Average (LPA)

However, the track record is not so good...

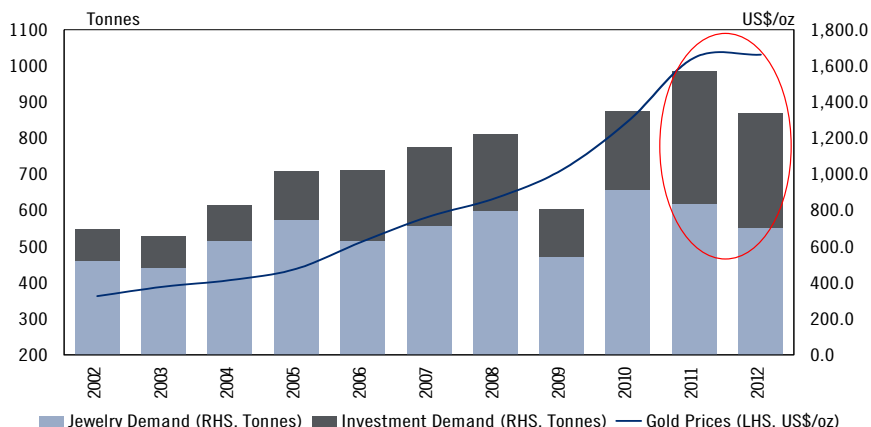
...Rainfall in 2012 was at 92% LPA vs. forecasts of 99% LPA

Figure 1. Oil – Imports, Subsidy Sharing Mechanism

Year	FY09	FY10	FY11	FY12	FY13E	FY14E
OIL IMPORTS						
Crude oil requirements (mn T)**	161.7	192.9	201.8	214.1	228.3	250.5
In Volume Terms (mn T)						
Consp of Petro products	133.6	138.2	141.8	146.3	160.8	165.6
Petroleum Product Exports	36.9	51	63.9	67.8	66.7	82.6
In Value Terms (US\$bn)						
A. Oil/ Petroleum Product Imports	95.5	89.2	106.8	159.4	158.4	158.6
B. Petroleum product exports	27.2	30.5	40	60.1	55.2	63.6
Net oil import bill (A-B)	68.3	58.7	66.8	99.3	103.2	95
Avg Oil Price (Indian basket)	89	70	80	115	107	99
SUBSIDIES						
Gross under-recoveries	1,033	461	782	1,385	1,673	1,180
Less: upstream sharing	324	144	303	550	602	637
% of total	31%	31%	39%	40%	36%	54%
Less: government's share	713	260	410	835	1,072	543
% of total	69%	56%	52%	60%	64%	46%

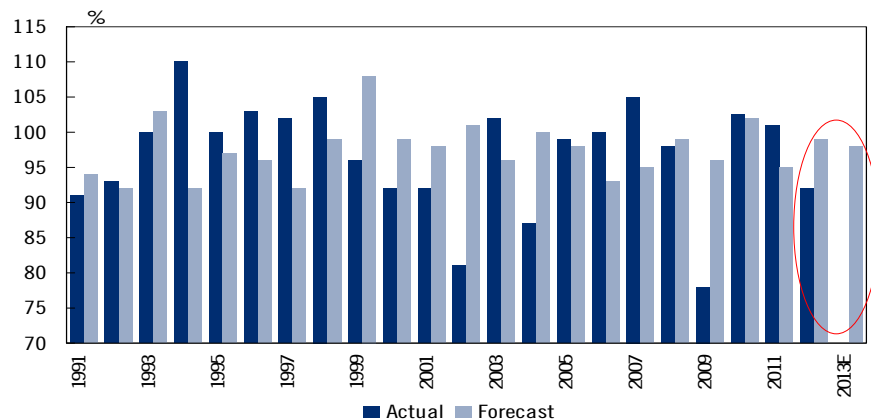
** Includes increased crude requirements as new refineries come on stream. Source: Citi Research; Crisinfac

Figure 2. Trends in Gold Demand and Prices (Tonnes, US\$/oz)



Source: World Gold Council, IMF

Figure 3. Trends in Rainfall- Actual vs. Forecast



Source: IMD

Domestic Factors Help...But More Needed

CCI – MAKES SOME HEADWAY

The CCI has taken key steps in the last two months to speed up high-value stalled projects.

It has helped resolve clearance and security issues which slowed projects in important sectors like Oil and Gas, Mining, Roads, Coal and Power...

PROJECTS COMPLETED – GOOD NEWS

Projects completed in 4QFY13 were up 27% QoQ in vs 48% QoQ in 3QFY13 – the second consecutive positive reading this fisc.

This is good news and a recovery from declining trends in Q1 and Q2

However, key to note is that there is typically a seasonal uptick in 4Qs for projects completed.

PROJECTS STALLED –THE MAIN FOCUS

New Project Announcements were up 40% QoQ in 4QFY13

But on an annual basis, stalled projects inched up in FY13, at ~Rs8,000bn vs Rs7,436bn in FY12

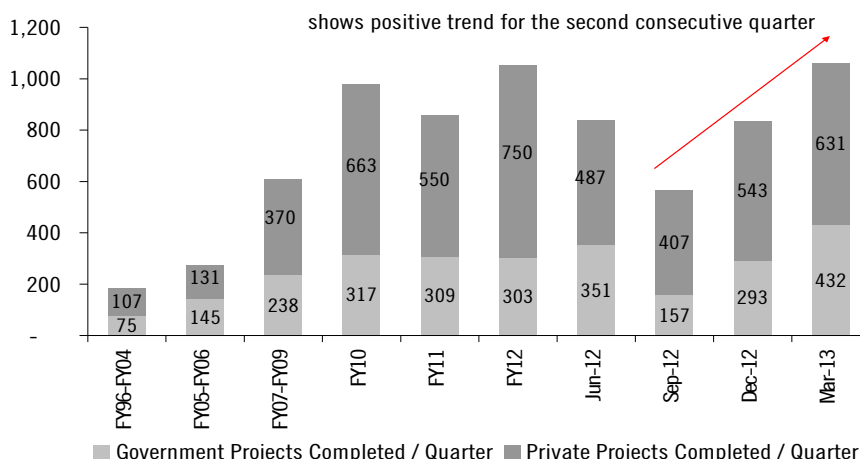
Projects stalled could see some respite in FY14 onwards due to recent reforms and continued functioning of the CCI.

Figure 4. Cabinet Committee on Investments – Progress so Far

Sector	Progress
Oil and Gas	Cleared 25 high-value oil blocks in April, and 5 in March while resolving objections by Ministry of Defense
Mining	Introduced more favorable Environmental Clearance regulations for capacity-expansion and renewal of mining lease
Roads	De-linking Environment and Forest clearances for linear projects
Coal	Working towards fast-tracking clearance approvals for 12 mining projects and fixing 1-month time-frame for processing clearance-related cases
Power	Cleared 13 power projects of ~Rs 330bn

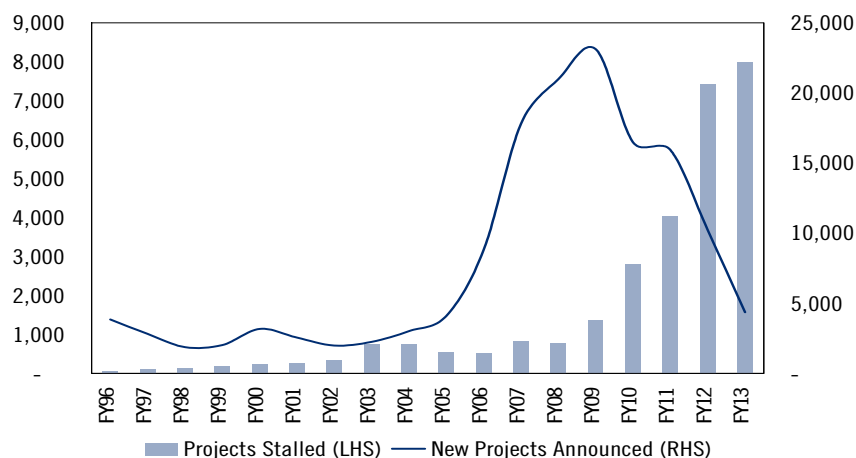
Source: PIB, News Reports

Figure 5. Trends in Projects Completed per Quarter (Rs bn)



Source: CMIE

Figure 6. Trends in Projects Announced and Projects Stalled (Rs bn)



Source: CMIE

Reform Implementation – High on Investors' Radar

The slew of reforms announced since Sep 12 address vital, longstanding issues on the macro front, and thus have been well-received by markets.

However, these reforms have been repeatedly hindered by political disputes over the coal and telecom controversies that result in unproductive parliament sessions. Implementation of these policies would be more efficient if focus shifted away from political motives towards economic necessities.

Bottom Line: While there have been some disappointments e.g. coal price pooling etc, nonetheless, the incremental delta change has clearly been positive.

Figure 7. Reforms – What's Announced / Passed

Announced Reforms	Key Features	Status of Reform
Fuel Price Hike	Diesel price raised by Rs 5/ltr in 2012. Proposed Rs0.5/ltr hike per month in 2013. Subsidised LPG cylinders capped at 6/household	Rs5/ltr hike implemented in 2012 Price hiked in Jan, Feb, Mar, but the ministry pushed back the monthly Re 0.5/ltr diesel hike in April
Fuel Price Hike pt II	Bulk users to pay market price, phased hike proposed, LPG cap raised to 9	Implemented
FDI		
Multi-Brand Retail	51% FDI permitted subject to State approval	Work in Progress but seeking clarity on regulations
Single- Brand Retail	FDI beyond 51% requires 30% sourcing locally from MSMEs cottage industries etc.	CCEA expected to review IKEA's Rs105bn project next week, some firms seeking clarity on regulations
Broadcasting Services	74% FDI allowed in teleports, mobile tv and sky broadcasting services	
Power Exchanges	49% FDI allowed	
Civil Aviation	49% FDI in scheduled and non-scheduled air transport services	Air Asia/Tata JV– In advanced stage Jet Airways and Etihad form an alliance
Divestment in PSUs	Divestment proceeds of approx Rs 150 bn	Completed
Competition Bill	All sectors under the purview of competition law, merger of weak/ failing banks excluded	
Enforcement of Security Interest and Debt Recovery Bill	Amends the process for recovery of secured loans	Passed by both houses of Parliament
Banking Laws (Amendment) Bill	Addresses issues on capital raising, voting rights, mandatory approval from RBI for acquiring 5% + stake	Passed by both houses of Parliament
SEB loan restructuring	US\$38bn of loans restructured/ converted to state debt	UP, Rajasthan and Tamil Nadu accept restructure plan
Overseas Loans	Withholding tax lowered from 20% to 5%	Reduced for Infrastructure; Awaiting other sectors
Companies Bill (Amendments)	Ensures more transparent corporate governance	likely to be introduced in the Rajya Sabha this week
Urea Price Hike	Price raised by Rs 50pmt.	Implemented
Govt. UTI sale in select Stocks	Stock sales could raise a total holding –Rs 440bn	
Rail hike	Across the board hike in Passenger fares	Implemented
Import duty on gold & platinum	Import duty on gold and platinum hiked to 6%	Implemented
Sugar decontrol	Sugar mills given freedom to sell sugar in open market; no longer need sell sugar to Govt. at controlled prices.	Implemented

Source: PRS, News reports

Implications for the Macro

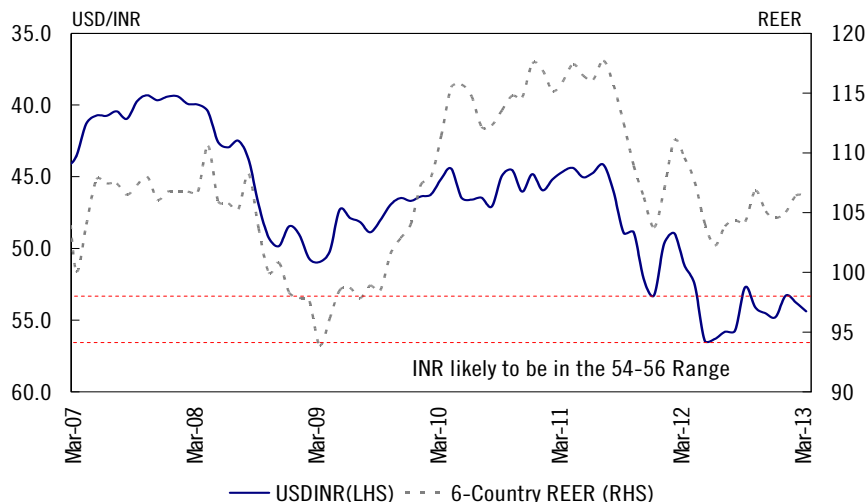
PRESSURE EASES ON THE RUPEE

The INR is likely to remain in the 54-56 range

Despite the positive impact on the CAD and improved outlook on dollar inflows, the unit is expected to remain range-bound as the RBI appears to be unwinding its forward book (~US\$13bn).

However, fears of the INR depreciating to the Rs58-60 handle have subsided.

Figure 8. Trends in USD/INR and REER



Source: RBI

WPI + COMMODITY PRICES

WPI trends show moderation, with the latest reading in March at 5.96% - a two-year low.

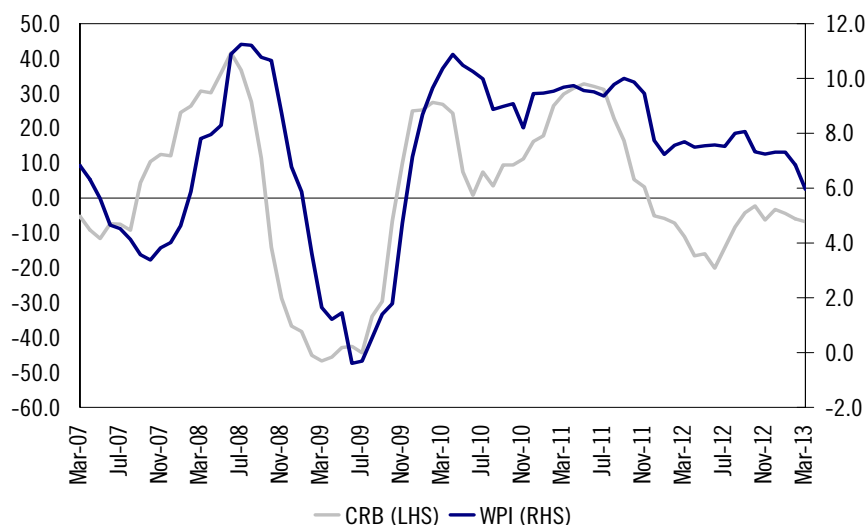
Easing commodity prices would further ease inflation – since ~57% of the WPI is tradables

This would provide leeway for more monetary easing....

.... We thus expect a 25bps rate cut in the RBI policy on May 3

Guidance from the policy will help determine the extent of easing later in the year

Figure 9. Trends in WPI and CRB (%YoY)



Source: Office of the Economic Advisor, Bloomberg

REDUCED RISK OF RATINGS DOWNGRADE

Positive news on both the external and domestic front reduces probability (30%) of a ratings downgrade.

Agencies continue to watch India closely.

Figure 10. India Ratings Snapshot

	S&P	Moody's	Fitch
Long term Foreign Currency	BBB-	Baa3	BBB-
Long term Local Currency	BBB-	Baa3	BBB-
Sovereign outlook	Negative	Stable	Negative

Source: Rating Agencies

Projects, Policies & Politics – Still a Concern

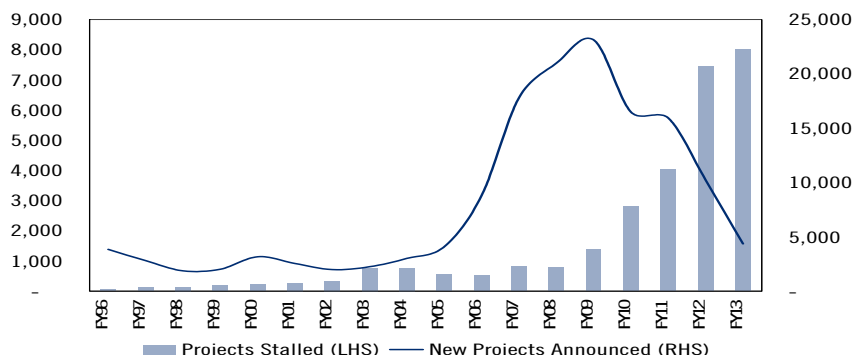
PROJECTS STALLED – STILL A WORRY

Stalled projects inched up in FY13, at ~Rs8000bn vs Rs7436bn in FY12

This is largely due to execution-related challenges

Additionally, new project announcements declined by 75% YoY in 4QFY13

Figure 11. Projects Announced vs. Projects Stalled (Rs bn)



Source: CMIE

PENDING REFORMS – STILL CRUCIAL

The key reforms pending are crucial to -

- **Incentivizing investments:** Land acquisition bill, mines and minerals

- **Fiscal Consolidation:** GST, DTC

- **Improving Dollar Inflows:** FDI in pension and insurance

However, they all require parliamentary approval, and thus depend on progress during parliament sessions.

Figure 12. Pending Reforms

Reforms	Key Features
Land Acquisition Bill	For commercial land acquisition, and rehabilitation
Food Security Bill	Provides for food and nutritional security by providing specific entitlements to certain groups
Public Procurement Bill	Regulate public procurement to further transparency, accountability, and probity in the procurement process
Mines and Minerals Bill	Consolidates and amends the law relating to the scientific development and regulation of mines and minerals
Goods and Services Tax (GST)	Landmark Change - for efficiency, GDP and tax collections
Direct Taxes Code (DTC)	A simplified Tax platform
FDI	
Insurance	49% FDI allowed, public sector insurance cos can get listed w government stake at least 51%
Pension	49% FDI, has one term 'return scheme' action, gives statutory power to regulatory authority

Source: PRS, News Reports

POLITICS – STILL THE MAIN RISK

The political landscape has seen many instances of uncertainty and instability:

1. Key allies DMK+TMC withdrew support from the UPA govt.

2. Talks of early elections and formation of a Third Front

3. Both BJP and Congress face threats of losing allies, neither seems likely to have majority support

4. Indecision over most suitable PM candidate for 2014 elections

Collectively, these political uncertainties slow down reform momentum, and thus adversely affect growth.

Figure 13. Composition of the Lok Sabha

UPA		OPPOSITION	
Party	Seats	Party	Seats
Indian National Congress(INC)	203	Bharatiya Janata Party(BJP)	115
Nationalist Congress Party(NCP)	9	Janata Dal (United) (JD(U))	20
J&K National Conference(JKNC)	3	Shiv Sena(SS)	11
Indian Union Muslim League(IUML)	2	Shiromani Akali Dal(SAD)	4
Rashtriya Lok Dal(RLD)	5	Telangana Rashtra Samithi(TRS)	2
Others/ Independents	13	Biju Janata Dal(BJD)	14
A. UPA (Excl DMK)	235	AIADMK	9
		Telugu Desam Party(TDP)	6
Supporting Parties		Janata Dal (Secular)(JD(S))	3
Samajwadi Party(SP)	22	Trinamool Congress (TMC)	19
Bahujan Samaj Party(BSP)	21	DMK	18
Rashtriya Janata Dal(RJD)	3	Jharkhand Vikas Morcha (JVM (P))	2
B. Total Outside Support	46	Left Demo. Front	25
		Others	11
UPA incl. Outside Support (A+B)	281	Total Opposition	259
Seats needed for majority	271	TOTAL LOK SABHA	540

Source: www.loksabha.nic.in

Statistical Snapshot

Figure 14. India – Macroeconomic Summary (FY01-FY14E)

Fiscal Year to 31 March	2000 FY01	2001 FY02	2002 FY03	2003 FY04	2004 FY05	2005 FY06	2006 FY07	2007 FY08	2008 FY09	2009 FY10	2010 FY11	2011 FY12	2012 FY13E	2013E FY14E
National Income Indicators*														
Nominal GDP (Rs bn)	21,840	23,676	25,500	28,617	32,422	36,934	42,947	49,871	56,301	64,778	77,953	89,749	100,281	113,017
Nominal GDP (US\$ bn)	478	493	528	623	720	834	950	1,241	1,224	1,367	1,710	1,866	1,857	2,055
Per Capita GDP (US\$)	469	474	500	582	662	754	847	1,090	1,061	1,168	1,442	1,552	1,522	1,635
Real GDP growth (%)	4.3	5.5	4.0	8.1	7.0	9.5	9.6	9.3	6.7	8.6	9.3	6.2	5.0	5.7
Agriculture growth (%)	0.0	6.0	-6.6	9.0	0.2	5.1	4.2	5.8	0.1	0.8	7.9	3.6	1.8	3.0
Industry growth (%)	6.0	2.6	7.2	7.3	9.8	9.7	12.2	9.7	4.4	9.2	9.2	3.5	3.1	4.4
Services growth (%)	5.4	6.9	7.0	8.1	8.1	10.9	10.1	10.3	10.0	10.5	9.8	8.2	6.6	7.0
By Demand * (%YoY)														
Consumption	3.0	5.3	2.3	5.4	2.3	8.6	7.9	9.3	7.6	8.2	8.1	8.1	4.1	5.7
Pvt Consumption	3.4	6.0	2.9	5.9	2.1	8.5	8.7	9.2	7.1	7.1	8.6	8.0	4.1	5.5
Public Consumption	0.9	2.3	-0.4	2.6	3.4	8.9	3.8	9.6	10.4	13.9	5.9	8.6	4.1	7.0
Gross Fixed Capital Formation	0.0	7.4	6.8	13.6	20.7	16.2	13.8	16.2	3.5	7.7	14.0	4.4	2.5	4.0
Cons; Invst, Savings ** (%GDP)														
Consumption	78.5	78.9	77.2	75.0	70.1	69.2	68.0	67.2	68.6	69.1	67.2	68.0	68.7	69.2
Gross Capital Formation	23.8	22.3	24.6	26.9	32.8	34.7	35.7	38.1	34.3	36.3	37.0	35.4	35.3	35.7
Gross Domestic Savings	22.8	22.6	25.4	28.7	32.4	33.4	34.6	36.8	32.0	33.7	34.0	30.8	29.9	30.5
Real Indicators (%YoY)														
Cement dispatches (domestic)	-1.9	9.8	8.7	5.8	8.1	10.1	10.2	9.8	8.5	11.2	5.2	7.0	8.0	9.0
Commercial vehicle sales	-11.9	-4.5	40.4	36.2	22.4	10.1	33.3	4.2	-21.4	39.2	27.0	19.5	-1.9	12.9
Car sales	-5.3	3.2	5.3	27.2	17.8	7.7	20.7	12.1	0.3	25.7	29.3	3.9	2.4	8.0
Two-wheelers	0.7	15.3	15.8	11.3	15.7	13.6	11.5	-7.8	2.7	25.9	25.8	13.9	2.7	12.5
Diesel consumption	-3.4	-3.7	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	8.0	8.0	8.0
Mobile Tele density	0.3	0.6	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.5	66.8	75.1	79.0	80.0
Monetary Indicators (% YoY)														
Money supply	15.9	16.0	16.1	13.0	14.0	15.9	20.0	22.1	20.5	19.2	16.0	15.8	13.4	17.0
Inflation – WPI (Avg)	7.1	3.6	3.4	5.5	6.5	3.7	6.5	4.8	8.0	3.6	9.6	8.8	7.4	5.5%-6
CPI (Avg)	3.7	4.3	4.1	3.8	3.9	4.2	6.8	6.2	9.1	12.3	10.5	8.4	10.2	8.5-9
Bank credit growth	17.3	15.3	23.7	15.3	30.9	37.0	28.1	22.3	17.5	16.9	21.5	17.0	14.1	15.0
Deposit growth	18.4	14.6	16.1	17.5	13.0	24.0	23.8	22.4	19.9	17.0	16.0	13.5	14.3	15.0
Fiscal Indicators (% GDP)														
Centre's fiscal deficit	-5.4	-6.0	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.5	-4.8	-5.7	-5.2	-4.8
State fiscal deficit	-4.0	-4.0	-3.9	-4.2	-3.3	-2.5	-2.1	-1.4	-2.3	-2.9	-3.2	-2.3	-2.1	-2.2
Combined deficit (Centre+State)	-9.2	-9.6	-9.2	-8.2	-7.2	-6.5	-5.4	-4.0	-8.3	-9.4	-8.0	-8.1	-7.3	-7.0
Off Balance Sheet Items						-0.5	-0.9	-0.6	-1.7	-0.2				
Combined liabilities (dom+ext)	82.6	87.2	90.7	90.0	88.8	84.6	79.9	76.1	76.8	75.5	69.6	69.1	68.3	68.3
External Sector (% YoY)														
Exports (US\$bn)	45.5	44.7	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.4	256.2	309.8	303.6	333.9
% YoY	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.5	40.4	20.9	-2.0	10.0
Imports (US\$bn)	57.9	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	383.5	499.5	507.0	527.3
%YoY	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	27.6	30.3	1.5	4.0
Trade deficit (US\$bn)	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.2	-127.3	-189.8	-203.4	-193.4
Invisibles (US\$bn)	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	79.3	111.6	108.2	108.5
Current Account Deficit (US\$bn)	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.2	-48.1	-78.2	-95.2	-84.9
% to GDP	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.8	-4.2	-5.1	-4.1
Capital Account (US\$bn)	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	51.6	63.7	67.8	92.6	91.6
% GDP	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.7	3.6	5.0	4.5
Forex Assets (excl gold) (US\$bn)	39.6	51.0	71.9	106.1	135.1	145.1	191.9	299.1	241.6	252.8	273.7	260.9	258.2	264.9
Months of imports	8.2	10.9	13.4	15.9	13.6	11.1	12.1	13.9	9.4	10.1	8.6	6.3	6.1	6.0
External Debt (US\$bn)	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	260.9	305.9	345.5	376.3	391.3
Short Term Debt (US\$bn)	3.6	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	78.2	91.9	96.9
Exchange Rate														
US\$/INR - annual avg	45.7	48.0	48.3	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	48.1	54.0	55.0
% depreciation	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	12.3	1.9
US\$/INR – Year end	46.5	48.9	47.5	43.6	43.8	44.6	43.6	40.1	50.7	44.9	44.6	50.3	54.3	56.3
% depreciation	6.7	5.2	-2.9	-8.2	0.3	2.0	-2.3	-8.0	26.4	-11.4	-0.7	12.8	8.0	3.7

** At current prices.

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

Appendix A-1

Analyst Certification

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