6 November 2013 | 28 pages

Emerging Markets
Asia

India Macroscope

No Room for Complacency

- **India Has Got 'Some' Time…**In part because of (1) postponement of taper, (2) hard work on the domestic policy front and (3) compression in the current-account deficit (CAD) ahead of expectations. But tapering will come, and it could 'taper off' improved expectations. It clearly will be an important event for India.

- **The Longer Road** — India's fortunes go well beyond the taper. It lies in (1) the direction of the fiscal deficit, (2) sustained compression in the CAD, (3) monetary policy – and its ability to contain inflation and (4) the economy's response to these and other policy measures. India's economic recovery will be a long bumpy drive – but the start has been relatively smooth.

- **Mood Also Counts** — India needs risk appetite for investment, from its developers and its own consumers. This has yo-yoed in recent years; and based on the direction of markets (equity/bonds/FX–recent tailwinds), politics, and the global and domestic economies, the mood could swing either way. 'India mood' is a real risk – on the upside as well as the downside.

- **Investments Could See a Stronger Recovery** — In addition to a positive outcome on the CAD (~US$50bn or 2.7% of GDP), investments could recover strongly. There is (1) a pipeline that is cross-sectoral, (2) approvals are getting a major push and (3) financing support is coming through. This could be the 'real' surprise; the markets will accordingly react.

- **No Room for Complacency** — Tapering is an immediate risk, but the ability to trod the longer road in spite of market moods/swings will determine whether India takes advantage of the postponement of taper and the reform path it has commenced, or lets the chance slip away.

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With thanks to
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Figure 1. Statistical Snapshot (%)

Year -end 31 March	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14E
Real GDP growth (%)	9.6	9.3	6.7	8.6	9.3	6.2	5.0	4.8
Agriculture growth (%)	4.2	5.8	0.1	0.8	7.9	3.6	1.9	4.8
Industry growth (%)	12.2	9.7	4.4	9.2	9.2	3.5	2.1	1.5
Services growth (%)	10.1	10.3	10.0	10.5	9.8	8.2	7.1	6.3
Fiscal Deficit (Centre+States)	-5.4	-4.0	-8.3	-9.4	-8.0	-8.1	-7.0	-6.7
Current Account Deficit (%)	-1.0	-1.3	-2.3	-2.8	-2.7	-4.2	-4.8	-2.7
WPI (Average)	6.5	4.8	8.0	3.6	9.6	8.8	7.4	6.0
INR/USD (Average)	45.2	40.2	46.0	47.4	45.6	48.1	54.0	61.5

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

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

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Contents

Statistical Snapshot

Figure 2. India Macroeconomic Summary FY01 – 14E

Fiscal Year to 31 March	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	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	100,206	112,932
Nominal GDP (US$ bn)	478	493	528	623	720	834	950	1,241	1,224	1,367	1,710	1,866	1,856	1,836
Per Capita GDP (US$)	469	474	500	582	662	754	847	1,090	1,061	1,168	1,442	1,552	1,521	1,461
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	4.8
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	1.9	4.8
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	2.1	1.5
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	7.1	6.3
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	3.9	5.6
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	4.0	5.3
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	3.9	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	1.7	3.5
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	69.1
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	35.6	36.0
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	30.2	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	-12.0
Car sales	-5.3	3.2	5.3	27.2	17.8	7.7	20.7	12.1	0.3	25.7	29.2	3.9	2.4	0.0
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	5.0
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	16.2	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	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	9.2
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	17.2	15.9	13.5	14.3	13.5
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	-4.9	-5.0
State fiscal deficit	-3.7	-3.6	-3.5	-3.9	-3.4	-2.5	-2.1	-1.4	-2.3	-2.9	-3.2	-2.3	-2.1	-1.9
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	-7.0	-6.9
Off Balance Sheet Items						-0.5	-0.9	-0.6	-1.7	-0.2	0.0	0.0	0.0	1.0
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	306.6	323.4
% 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	-1.0	5.5
Imports (US$bn)	57.9	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	383.5	499.5	502.2	489.7
%YoY	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	27.6	30.3	0.5	-2.5
Trade deficit (US$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	-195.7	-166.2
Invisibles (US$bn)	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	79.3	111.6	107.5	115.9
Current Account Deficit (US$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	-88.2	-50.4
% to GDP	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.8	-4.2	-4.8	-2.7
Capital Account (US$bn)	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	51.6	63.7	67.8	89.3	63.6
% GDP	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.8	3.7	3.6	4.8	3.5
Forex Assets (excl gold) (US$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	264.7	277.9
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	6.3	6.8
External Debt (US$bn)	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	260.9	305.9	345.5	392.1	388.5
Short Term Debt (US$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	96.7	96.8
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	61.5
% depreciation	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	5.5	12.3	13.9

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

EM: Taper Impact Yes, But Macro Story is Key

The Unconventional Monetary Policies (UMPs) adopted by major Central Banks (the US Fed, BOE, ECB and BOJ) post the global financial crisis had a spillover impact across the world, reflected in (1) higher global asset prices and (2) increase in capital flows to emerging markets. While easy money flooded financial markets for ~five years, the May 22 testimony of Fed chairman that hinted at QE taper led to a widespread sell-off in Emerging Market (EM) assets – especially those running high CADs, e.g. Brazil, India, Indonesia, Turkey, and South Africa. Before getting into the CAD story, key to note is the broad-based slowdown in EM growth relative to the Developed Market (DM).

Figure 3. Citi 2013 Annual GDP Forecasts (%YoY)

	As of Feb-13	As of Oct-13
Industrial Economies		
United States	2.0	1.6
Japan	1.4	4.9
Euro Area	-0.5	-0.3
Emerging Markets		
Brazil	3.1	2.6
China	7.8	7.6
India	5.7	4.8
Indonesia	6.2	5.7
Mexico	3.6	1.2
South Africa	2.8	2.1
Turkey	4.0	3.5

Source: Citi Global Economics Outlook and Strategy

Deterioration in EM Growth Story: Tracing the macro story across EM, one sees an overarching trend: Slowdown in growth accompanied by concerns on rising inflation. Starting from January and leading up to Oct 2013, Citi downgraded its GDP forecast for every economy in this EM basket. Interestingly, over the last six months, we have cut our overall EM growth forecasts while lifting our DM forecasts. As highlighted by our global economics team this DM-EM divergence is a marked contrast to the pre-crisis pattern of EM upgrades and DM downgrades in 2004-08, and to the 2009-11 trend of roughly synchronised upgrades and downgrades. While EM growth continues to exceed DM growth, in terms of forecast revisions, the DM are outperformers (see monthly Global Economic Outlook and Strategy).

See: Asia Macro and Strategy Outlook; Is the Emerging Asia Growth Story Losing Its Luster?

See: Emerging Markets Macro and Strategy Outlook - Has EM growth-pessimism gone too far?

While Citi acknowledges some slowdown in EM growth– which in the near term is attributed due to recent export trends in North Asia and longer term due to (1) unfavorable demographic shifts in North Asia and (2) potential growth challenges among NIEs already at/close to the technology frontier, it believes that the "*blanket*" bearishness about Asia's growth prospects is misplaced and that the region will remain a dominant driver of global growth, though the share of the region's contribution to global growth may come down at the margin.

Key to the whole debate is to try to separate what's merely a cyclical shock facing EM, from what might be a structural problem. While EM is currently facing a cyclical shock in the form of an external shock that has primarily taken the form of a collapse in the growth rate of DM imports, there is recognition that EM export response to better DM growth may not be as strong as the past.

EM Growth Outlook

Most EM's largely hit by external shock – lower import volumes by G-10

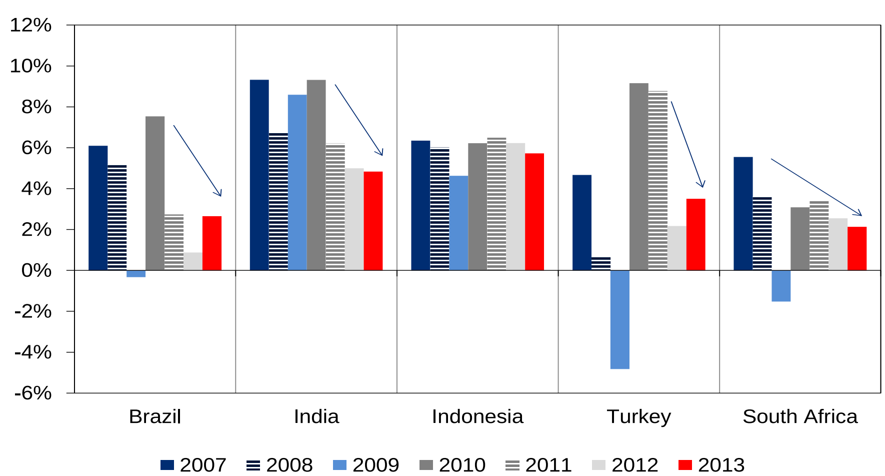
Recovery will help, but less than past due to:

(1) Unfavorable demographics playing out and

(2) Potential growth challenges

See The Global Demographic Transition—What Role Are China & Other Emerging Asian Economies Likely to Play?*

Figure 4. Trends in GDP (%YoY)

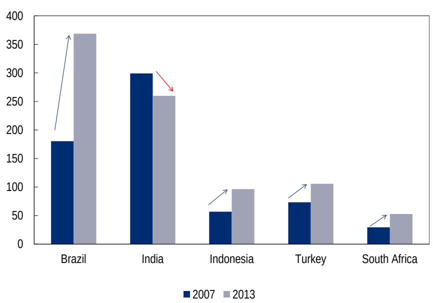


Source: Citi Global Economics Research

Impact Higher on EM with External Funding Needs

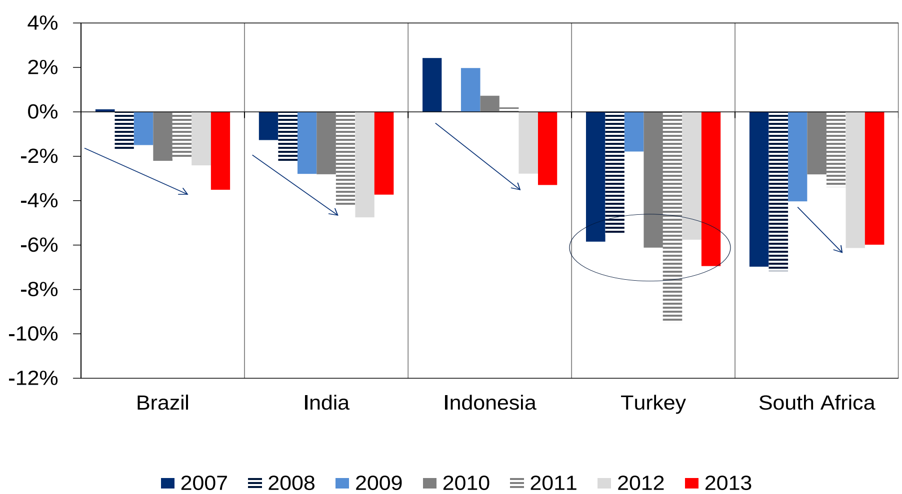
Hints of the Fed likely to ease its US$85bn monthly bond-buyback program resulted in a scurry of funds flowing out of emerging markets, taking its toll across asset classes. While our global EM team argues that history is full of episodes (2008, 1997, 1994 and 1982) when the threat of tighter US monetary policy looms, however, what makes the current situation different is the limited policy choices in the context of a weaker EM growth. Moreover, in addition to a deceleration in growth, EM also faced a widening CAD due to (1) weak import demand from G10, (2) China slowdown and lower commodity demand and (3) increased domestic consumption. In India, exceptional factors such as sticky oil, gold, and coal imports coupled with high investment income outflows were key factors behind India's record-high CADs.

Figure 5. Trends in Foreign Exchange Reserves (US$bn)



Source: Citi Global Economics Research

Figure 6. Trends in Current Account Deficit (% to GDP)



Source: Citi Global Economics Research

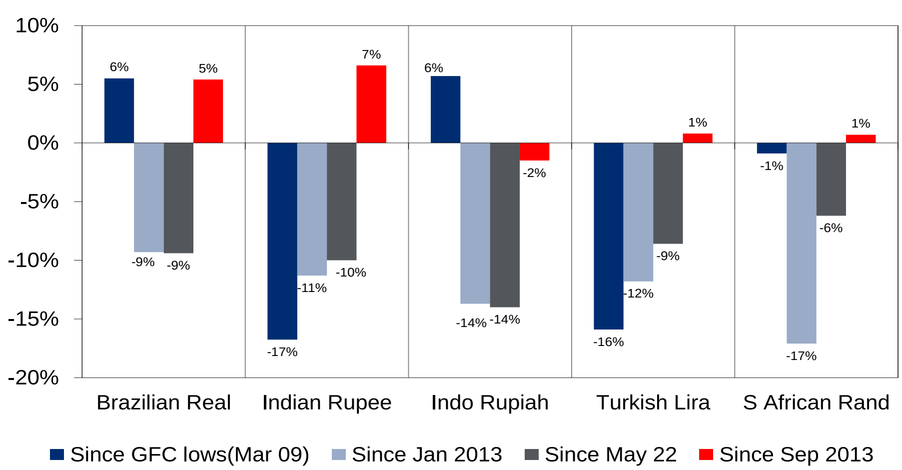
India Hit Hard, but Recovers: Among the five in this EM basket, India was hit the hardest with the rupee depreciating by 19% during May 22- Aug 28. Since September, however the unit has gained ~7%, recovering nearly half of its losses.

India was among the hardest hit with Rupee depreciating by 19% between May 22nd and August 28th.

Brazil and Indonesia also suffered with both Real and Rupiah sliding by close to 16% at the peak of turbulence.

In comparison, South Africa fared better in this EM sell-off with Rand depreciating by 6%, though we must note that Rand had already depreciated by close to 13% between Jan 1st and May 22nd against the dollar.

Figure 7. Currency Movement (%)

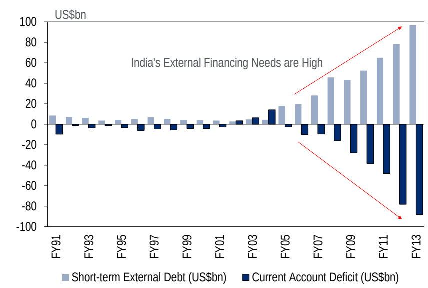


Source: Bloomberg

Indian Policy Response

As 'taper' fears took center-stage, policy makers began to respond with (1) monetary actions – hiking short term rates and tightening liquidity (2) measures to contain CAD – compression of gold, oil and non-essential imports (3) augmenting capital flows – introduction of swaps (FCNR; oil) and (4) FX intervention.

Figure 8. Current Account Deficit and Short-Term External Debt (US$bn)



Source: RBI

Figure 9. Key Policy Initiatives to Arrest Rupee Fall

Monetary Measures	
15-Jul-13	Marginal standing Facility (MSF) raised by 200bps; LAF ceiling at Rs750bn
23-Jul-13	Access to LAF by banks limited to 0.5% NDTL, Minimum daily CRR balance set at 99%
8-Aug-13	Announces Auction GoI Cash Management Bills of Rs 220bn every Monday
20-Sep-13	Daily CRR requirement cut to 95% from 99%, MSF eased by 75bps to 9.5%
7-Oct; 29-Oct	MSF eased by 50bps to 9% from 9.5% on 7 Oct; Eased Further to 8.75% on 29 Oct
Reducing Gold Imports	
13-May-13	RBI allows banks to import gold only on a consignment basis, bans Banks and NBFCs from lending against gold ETFs and MFs
13-Jun-13	Letters of credit opened by banks/ gold import agencies will be on 100% margin basis
22-Jul-13	20% of all gold imports have to be re-exported
18-Sep-13	Import duty on gold jewellery raised to 15% from 10%
Incentivize Foreign Inflows	
4-Sep-13	Overseas borrowing limit increased to 100% net Tier 1 capital, from a limit of 50%.
	Tier 1 capital borrowings can be swapped at a concession of 100bps below ongoing rate
	Special window for swapping foreign currency deposits (FCNR (B)) at fixed rate of 3.5%.
Other Measures	
28-Aug-13	Opens a Forex swap window for daily USD requirements of OMCs - IOC, HPCL, BPCL
6-Sep-13	Raised Bilateral Currency Swap Agreement with Japan to $50bn

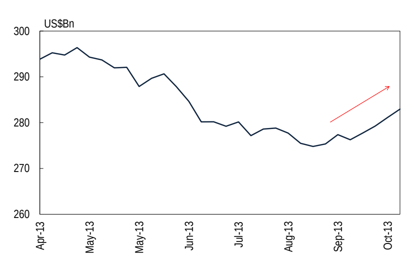
Source: RBI, SEBI, News Reports

Taper – a 6-month window

The Fed surprised the markets in its Sept 18 FOMC meeting by keeping asset purchases unchanged at US$85bn each month – US$40bn in MBS and US$45bn in Treasury Debt. This was in contrast to market expectations of the beginning of a taper of a US$10bn per month, which would result in QE ending by mid-2014. Although the Oct 30 FOMC statement was a little more hawkish than expected, the consensus view is that taper – or the first reduction in asset purchases from current levels of US$85bn per month – is likely to commence in March.

Relief Rally across Asset Classes: Currencies have strengthened further after Fed surprised markets by deferring the taper. The Brazilian Real has gained 5% since September while the Indian Rupee is up 7%. However, key to note is that even though taper fears have receded, these currencies are down by an average of 8% since May 22 while government bond yields are up by 80bps-230bps across these countries. As discussed earlier, this is a reflection of high CAD, elevated inflation and deceleration in growth resulting in some luster coming off certain segments of the EM story.

Figure 10. Trends in FX Reserves (US$bn)

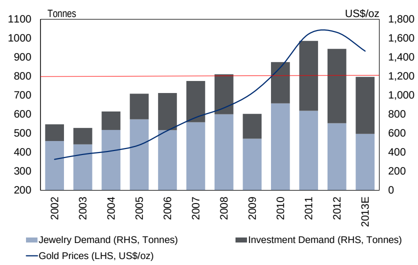


Source: RBI

Bottom Line: No Room for Complacency

While the Fed's decision not to taper caught all by surprise, policy makers across the EM world have recognized that this has just given them a short window to address macro challenges. The timing of the 'tapering' is important for countries with CADs. Thus key to monitor is the effectiveness of the measures to 'sustainably' lower the CAD and reduce external financing requirements coupled with continuation of measures to raise growth and tame inflationary expectations. As RBI Governor, Dr Raghuram Rajan stated in the Sept 20 monetary policy: *"Let us remember that the postponement of tapering is only that, a postponement".* Moreover, with elections around the corner, volatility in markets could increase.

Figure 11. Gold Demand – Jewellery and Investment and Prices (Tonnes, US$/oz)



Source: Citi Research

Figure 12. Trends in Gold Imports (US$bn)

	FY09	FY12	FY13	FY14E
Gold Imports (T)	776	1076	1006	800
Gold Prices $/oz	868	1,645	1,660	1435
Gold Imports	20.7	56.2	53.8	37.5
Jewelry Exports	28.0	44.9	43.4	43.0
Gold Exports	4.2	6.7	6.5	6.5
Net Gold Imports	16.5	49.5	47.3	31.1

Source:RBI, World Gold Council, Citi Research

External Account – On the Recovery Road; But Risks Remain

The policy measures initiated earlier have begun to bear fruit. The government's 'revised' CAD estimate of US$60bn (v/s US$70bn pegged in August) could surprise positively. In contrast to the external-led shock of slowing G-10 imports that led to a widening of CAD in most EMs, India's CAD is largely a result of oil, gold and coal imports. We expect a print of US$50bn or 2.6% of GDP with the possibility of an upside if issues related to mining and coal also get sorted out soon. This compares with the record-high US$88bn or 4.8% of GDP seen in FY13.

Impact on the INR: The INR has gained ~10% since it's all- time lows and is trading in a relatively narrow range of Rs60-62/US$. While the CAD is likely to be significantly lower, incremental capital flows remain below trend. The FX markets continue to be supported by recent RBI measures of (1) keeping oil import demand out of the market, (2) concession on FCNR swaps. Absence of the above would determine true INR stability.

Growth – Project Monitoring Group; A Delta Positive

Policy makers have taken numerous measures to resolve the bottlenecks in the investment space. These include (1) Coal India signing FSAs with IPPs, (2) gas prices are being hiked, (3) auctioning of coal blocks, (4) SEB debt restructuring, (5) permitting road developers to sell 100% stakes in projects and (6) setting up the Project Monitoring Group - *institutional mechanism* aimed at tracking stalled projects and removing bottlenecks which have resolved projects of ~Rs3,695bn. (see pg 8-9 for details) Continuation of these measures is key for a pick-up in growth from the 4.4% reading in 1QFY14 to meet our full year estimates of 4.8%.

Inflation – Monetary Policy 'taming' Expectations

In his first address on taking office, Governor Rajan re-iterated that the primary role of the central bank is monetary stability which ultimately means low and stable inflation expectations, whether that stems from domestic sources, the currency, supply constraints or demand pressures. While inflation as measured by WPI has been relatively benign, given high CPI – both headline and core and elevated expectations, the RBI has hiked policy rates – the repo – cumulatively by 50bps in two consecutive policy meetings.

While we expect another hike taking the repo rate to 8% by FY14, key to watch would be recommendations of the Urjit Patel Committee report on the monetary policy framework due later this year. Nonetheless, the continued focus of RBI to manage inflation and inflation expectations should help increase financial savings and lead to moderation in nominal yields in the longer tenor securities.

EM – No longer a Common Theme

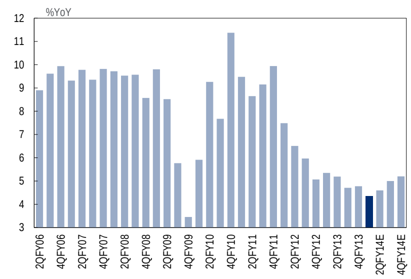
The six-month window has clearly given EM some time to address key issues. As highlighted above while policy makers have taken steps to correct macro imbalances, it is crucial that the momentum continues despite the upcoming elections. While the actual taper event could result in some volatility, the impact is expected to be lower than the July/August situation given the various steps taking by the economies. More importantly, there is no longer a common "EM" theme – markets are discerning between the 'good' and 'bad' EMs. Thus speeding up projects and tackling low hanging fruit – financial sector reform; corporate debt restructuring – would help make the India story resilient.

Real Indicators

Current Growth Trends Still Sub-Par…

India's 1QFY14 GDP came in at 4.4% - the third consecutive quarter of a sub-5% print with a continuation of decelerating trends in both consumption and investment. While consumption rose 3% led primarily by a 10.5% rise in government spending, this could moderate in the coming quarters as efforts are taken to meet budget targets. On the investment side, fixed capital formation was in the red at -1.2%. This is evident by both an increase in stalled projects and moderating new project announcements. As has been highlighted in our past publications, the accumulation/logjam of projects is due to issues like (1) obtaining environmental / forest clearances (2) land acquisition (3) ministry delays (4) fuel shortage.

Figure 13. Trends in Quarterly GDP (%)



Source: CSO: Citi Research

More recent factory output data indicate lackluster trends, while the PMI readings – both manufacturing and services remain in contraction zone. However, recent core sector data points, especially on the coal and electricity front are encouraging. (See latest PMI and Core Sector Update for more details)

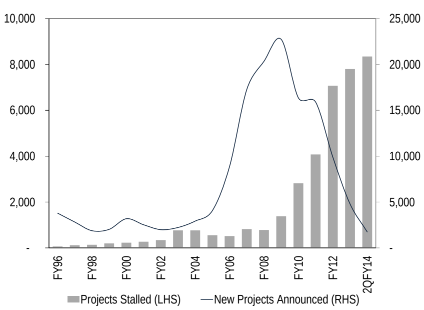
…But Investments See Rays of Light

Despite sub-par trends in growth, we have recently seen numerous measures taken by policy makers to resolve bottlenecks in the investment space. We believe these are incrementally positive and could improve the investment scenario.

Introduction of a Project Monitoring Group: While the Cabinet Committee on Investments (CCI) set up earlier this year to fast-track large projects over Rs10bn was a step forward, the lack of an institutional mechanism hampered progress. Consequently, in mid-June 2013, the government set-up "a Project Monitoring Group (PMG)", anchored in the CCI. Features of the PMG include

- It is an *institutional mechanism* aimed at tracking stalled projects and removing bottlenecks "on a fast-track basis". Private entrepreneurs / Ministries can add their project to an online portal and view its progress on a real-time basis
- The PMG monitors projects through weekly meetings with officials at both the ministry and state level, completing the functioning of the Cabinet Committee on Investments (CCI)

Figure 14. Trends in Projects Stalled vs New Projects Announced (Rs bn)



Source: www.capex.cmie.com

Since its inception in June 2013, the PMG has resolved 100 of 369 submitted projects of a total value of Rs3,695bn. Of these, ~90% are in the power sector.

Figure 15. Projects Resolved by Project Monitoring Group

	By Number		By Value (Rs bn)	
Sector	Resolved	Remaining	Resolved	Remaining
Power	79	71	3201	4610
Road Transport and Highways	4	28	45	390
Petroleum and Natural Gas	3	37	17	2268
Steel	3	23	33	3430
Railways	3	21	71	380
Shipping	2	13	17	196
Chemicals & Fertilizers	1	1	50	1
Mines	1	6	70	326
Civil Aviation	1	0	120	0
Coal	3	50	72	246
Commerce and Industry-DIPP	0	10	0	205
Commerce and Industry - Commerce	0	8	0	523
Textiles	0	1	0	13
TOTAL	100	269	3,695	12,588

Source: Cabinet Secretariat, as of 5th November 2013

Remedial Measures Being Taken: As highlighted by our infrastructure analysts, Venkatesh Balasubramaniam and Atul Tiwari, over the last few months policy makers have taken a number of steps to address the investment related bottlenecks and revive the capex cycle (see India Infrastructure for more details).

GOVERNMENT TAKES ACTION

Coal India is signing FSAs with IPPs;

Gas prices are being hiked

Coal blocks should soon be auctioned;

SEB debt restructuring making progress

Road developers can sell 100% stakes in projects

Figure 16. Measures Announced that address Investments Issues

Issue	Steps to Resolve it	How will they help?
Fuel Shortage	Coal India signed FSAs with IPPs	Comfort to IPPs regarding fuel supply
	Auctioning of coal blocks	First times since 2009
	New gas policy –prices hiked to US$8/mmbtu	Encourage domestic gas production
Environmental / Forest Clearance	Cabinet Committee on Investments, Project Monitoring Group	Reduce Inter-ministerial delays, simplify clearance process
Land Acquisition Delays	New Land Acquisition Bill passed in Parliament	Clearer terms for the process of land acquisition
Financial Health of SEBs	Restructuring of SEB Debt	Increases ability to purchase power
	Model electricity distribution bill being formulated	To ensure financial discipline in SEB
Low Iron Ore Production	Ban on iron ore mining in Karnataka lifted, talks of lifting similar ban in Goa	Will increase iron ore mining
Roads	Continued progress on Delhi-Mumbai industrial corridor and freight corridor	Improve connectivity and freight transportation network
	Developers can sell 100% stake in projects	Free's up capital for new road projects

Source: Citi Research

Figure 17. Foodgrain Production Estimates (Mn T)

	FY13		FY14	%YoY
Crop	1st Est.	4th Est.	1st Est.	4thEst
Foodgrains	117.2	128.2	129.3	0.9
Rice	85.6	92.8	92.3	-0.5
Pulses	5.3	5.9	6.0	1.9
Coarse Cereals	26.3	29.5	31.0	5.1
Oilseeds	18.8	20.9	24.0	14.6
Sugarcane	335.3	339.0	341.8	0.8
Cotton*	33.4	34.0	35.3	3.8
Maize	14.9	16.0	17.8	11.1

* in Mn bales; Source: PIB

Some Challenges Remain – While there are clear new positives, some difficulties have re-emerged. For instance, as a consequence to the coal scam, there have been various investigations by the Central Bureau of Investigation (CBI) which are not favorable to investor sentiment and business environment.

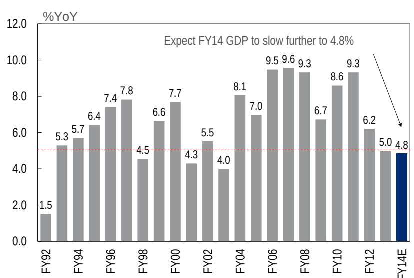
Good Harvest to Aid Agriculture

Following the optimism on monsoons and agricultural output in FY14, trends have been largely in line with our expectations. Rainfall this year was 5.6% above normal for the season vs a deficiency of 7.6% last year. Consequently, crop sowing area for this year improved to 4.4% higher than the same time last year. The combined positive agriculture input data – rainfall and sowing – point to a favorable harvest.

Bottom Line: GDP Growth Likely at 4.8%

While current data trends are a bit disappointing with 1QFY14GDP at 4.4%, we expect growth to pick up momentum in the coming quarters and average 4.8% in FY14. Key drivers of the marginal pick-up include the outcome of the good monsoons, mild export recovery and initiatives being taken to 'unlock' investments

Figure 18. Trends in Real GDP (%YoY)



Source: CSO, Citi Research

Figure 19. Trends in GDP

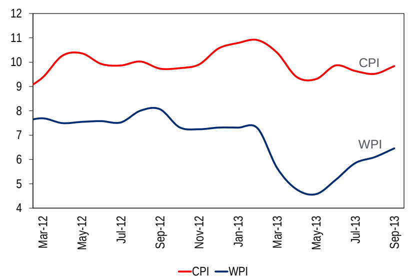
	Wts	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14E
Agriculture	13.7	4.2	5.8	0.1	0.8	7.9	3.6	1.9	4.8
Industry	26.7	12.2	9.7	4.4	9.2	9.2	3.5	2.1	1.5
Services	59.6	10.1	10.3	10.0	10.5	9.8	8.2	7.1	6.3
GDP at factor cost	100.0	9.6	9.3	6.7	8.6	9.3	6.2	5.0	4.8
Consumption	71.0	7.7	9.4	7.7	8.4	8.1	8.1	3.9	4.9
Pvt Consumption	59.6	8.5	9.4	7.2	7.4	8.6	8.0	4.0	4.5
Govt Consumption	11.3	3.8	9.6	10.4	13.9	5.9	8.6	3.9	7.0
Gross Capital Formation	39.1	13.4	18.1	-5.2	17.3	15.2	0.5	6.5	1.0
Gross Fixed Capital Formation	33.2	13.8	16.2	3.5	7.7	14.0	4.4	1.7	2.5
GDP at market prices		9.3	9.8	3.9	8.5	10.5	6.3	3.2	4.0

Source: CSO: Citi Research

Monetary Indicators

Inflation – WPI and CPI Could Inch Up Further

Figure 20. Trends in CPI and WPI (%)



Source: CSO, Office of the Economic Advisor

As seen in figure 21, 1HFY14 trends in both WPI and CPI indicate a relatively benign picture with WPI averaging 5.5% v/s 7.7% in 1HFY13 and CPI averaging 9.6% v/s 10.2% in 1HFY13. However, cumulative trends disguise the steady uptrend seen in both the inflation indices. Headline WPI inflation which had hovered at sub-5% levels at the start of fiscal, inched up with the latest reading for September coming in at 6.5% while the CPI rose from 9.4% in April to 9.8% in September. With vegetable prices remaining firm, we expect both WPI and CPI to inch up to ~7% and ~10% levels in Oct before easing in November.

Figure 21. Trends in Inflation – WPI And CPI

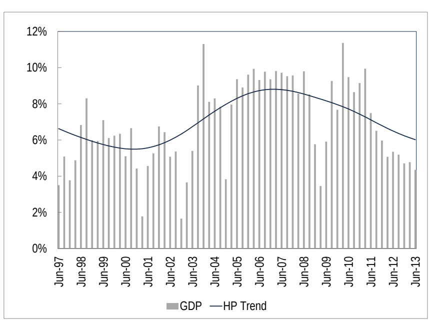
		Monthly						Apr-Sep	
	Wts	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13	FY14	FY13
Headline WPI	100	4.8	4.6	5.2	5.9	6.1	6.5	5.5	7.7
Primary Articles	20.1	5.1	5.7	8.8	9.7	11.7	13.5	9.1	10.1
Fuel Index	14.9	8.3	7.3	7.5	11.4	11.3	10.1	9.3	10.8
Manufactured Products	65	3.7	3.3	2.9	2.6	1.9	2.0	2.7	5.8
Mfg Ex-Food (Core)		3.0	2.6	2.2	2.3	1.9	2.1	2.3	5.4
Overall CPI	100	9.4	9.3	9.9	9.6	9.5	9.8	9.6	10.0
Food, Beverages, Tobacco	49.7	10.7	10.7	11.7	11.0	11.0	11.3	11.0	11.1
Fuel and Light	9.5	8.1	8.5	8.6	8.4	7.5	7.7	8.1	9.1
Clothing, Bedding, footwear	4.7	10.3	9.7	9.6	9.3	8.9	9.3	9.5	11.0
Housing	9.8	10.6	10.7	10.7	10.6	10.5	10.4	10.6	12.2
Misc	26.3	7.0	6.1	6.2	6.7	7.1	7.4	6.8	7.6
Core CPI (Ex-Food/Fuel)		8.3	7.7	7.7	8.0	8.2	8.4	8.0	9.1

Source: Office of the Economic Advisor, CSO

…Food is Key, But Other Factors Also at Play

The steady uptrend in the inflation readings was largely a result of two shocks that hit India almost simultaneously in 2QFY14, namely 1) the depreciation of the rupee and 2) a surge in vegetable prices, which contributed 180 bps to the 6.5% September reading. While the currency has reversed more than one-third of the depreciation, vegetable prices are yet to soften.

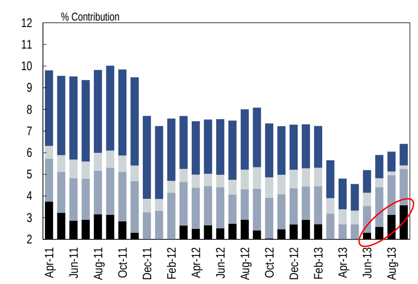
Figure 22. Trends in Output Gap and GDP (%YoY)



Source: CSO, Citi Research

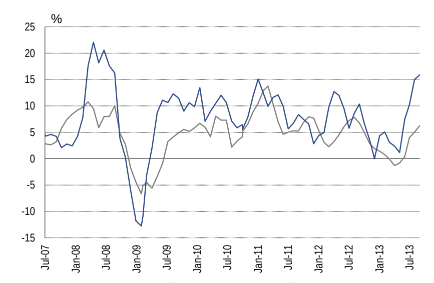
Sequential Momentum High; Building up in Core as well: **Core:** A point of concern is that the WPI momentum indicator shot up to a 5-year high of 15.9% in September. Moreover, while core WPI inflation has stayed benign in YoY terms, there has been a sharp acceleration in momentum with the 3m/3m SAAR indicator rising from negative levels in 1QFY14 to 6.2% in September. With growth remaining sub-par and consequently resulting in widening negative output gaps, we believe the rise largely reflects a cost pass-through in the wake of thinning margins and not a pick-up in aggregate demand conditions.

Figure 23. Contribution to WPI Inflation (%)



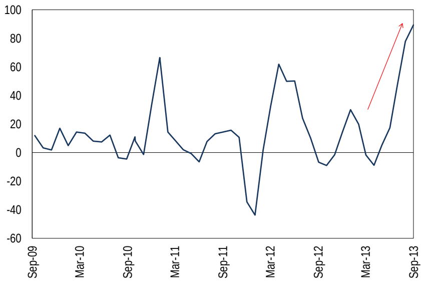
Source: Office of the Economic Advisor, CSO

Figure 24. Momentum in WPI (3m/3m SAAR)



Source: Office of the Economic Advisor, CSO

Figure 25. Trends in Vegetable Prices (%YoY)



Source: Office of the Economic Advisor

Outlook – Base Effect; Structural Issues and INR

Good Harvest Could Lower Primary Prices: The slow withdrawal of southwest monsoon took a toll on perishables which coupled with strong demand in festival season led to spiraling of vegetable prices. However, we could see swift normalization of food prices from November/December.

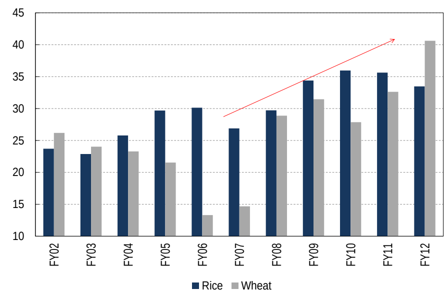
Structural Rigidities at Play: Key reasons for 'sticky' CPI levels and inflationary expectations remaining elevated are a few structural issues: (1) Agri producers armed with a MSP "put" option (increasing quantum of government food-grain procurement and at higher minimum support prices); (2) Indexation of wages to CPI inflation creates a positive feedback loop in the wake of exogenous shocks in either wages or food prices; (3) Continuation of high suppressed fuel inflation.

Figure 26. Trends in Suppressed Inflation

	Wt	Price	Loss	Inflation
LPG (Rs/cyl)	0.90%	410.5	411.9	0.9%
Kerosene (Rs/ltr)	0.70%	14.9	33.5	1.6%
Diesel (Rs/ltr)	4.67%	51.4	10.2	1.2%
Overall Impact	6.30%			3.7%

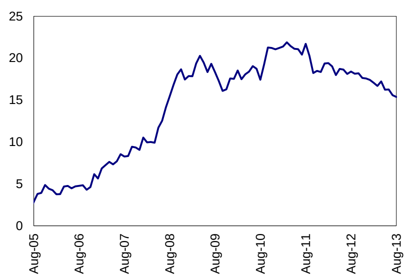
Source: Citi Research

Figure 27. Procurement as a % of Production



Source: FCI

Figure 28. Trends in Rural Wages (%YoY)



Source: Labour Bureau

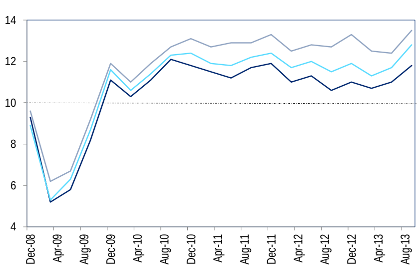
Outlook: While there are dis-inflationary factors at play – negative output gap, moderating rural wages and lower MSP increases, there are also offsetting factors. These include the INR depreciation, which, coupled with the adverse base effects, raises the odds of inflation overshooting our full-year target of 6% on WPI and 9.2% on CPI if primary prices do not ease as expected.

While not 'formally' adjusting WPI estimates, the RBI expects WPI to remain higher than current levels of 6.5%, "warranting an appropriate policy response", and CPI to remain at 9% or higher "absent" policy action

Bottom Line: Rate Hiking Cycle Not Over

The focus on maintaining monetary stability, the near term outlook on inflation and elevated household inflationary expectations suggest that following the two consecutive rate hikes of 25bps each, the rate hiking cycle may not be over yet. Going forward, we maintain our view of a further 25bps repo rate hike in FY14 to 8% but depending on how inflation unfolds, this may not necessarily be the last hike.

Figure 29. Household Inflation Expectations (%)



Source: RBI

We acknowledge that a large part of the uncertainty on the trajectory of monetary policy is eventually how much influence the new CPI (currently at ~10%) will have on monetary policy decisions. Key to watch would be recommendations of the Urjit Patel Committee report on the monetary policy framework due later this year. Using CPI inflation as nominal anchor may seem more appropriate given (1) household inflation expectations are shaped by CPI, (2) rural wages (NREGA) and other wages are indexed with CPI, (3) CPI includes pricing of services which are wage intensive, (4) decline in savings could be explained by falling real rates against CPI, and (5) it standardizes Indian policy framework with other countries.

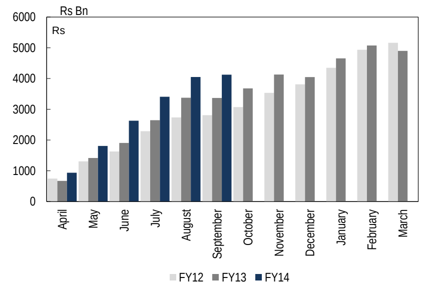
However, there are disadvantages in only using the CPI given its (1) limited data series and lack of item-wise depth and (2) disproportionately high weight of food and fuel. In light of these while RBI may aim for real interest rates higher than what is warranted over WPI, it may still not shift its focus entirely to CPI.

Fiscal Indicators

1HFY14 Fiscal Trends – 76% of Budget Estimates

Despite sluggish tax revenues, the seasonality in non-tax revenues coupled with the continued moderation in expenditure resulted in the Sept fiscal deficit coming in at Rs74bn. On a cumulative basis, trends remain disconcerting with the Apr-Sept deficit at Rs4124bn or 76% of BE v/s 66% last year.

Figure 30. Cumulative Fiscal Deficit (Rs bn)



Source: CGA

Figure 31. Latest Fiscal Snapshot – April-September FY14 (Rs Bn, %)

	Sep-13	%YoY	Apr-Sep FY14	%YoY	Budget Est. FY14	% to Total	Budgeted Growth
a. Revenue receipts	1,374	7.2	3,899	11.1	10,563	36.9	20.2
Net tax revenues	1,239	4.3	3,076	4.7	8,841	34.8	19.3
Non-tax	135	43.8	823	44.2	1,723	47.8	25.1
b. Non-debt cap receipts	12	8.8	71	13.3	665	10.6	63.3
c. Total receipts (a+b)	1,387	7.3	3,970	11.2	11,228	35.4	22.1
d. Revenue expenditure	1,279	12.2	7,122	16.0	14,362	49.6	15.6
e. of which interest	319	83.1	1,600	22.1	3,707	43.2	18.8
f. Capital expenditure	182	24.4	972	21.7	2,291	42.4	37.0
g. Total expenditure (d+f)	1,461	13.6	8,094	16.6	16,653	48.6	18.1
h. Plan Expenditure	530	-3.2	2,361	16.5	5,553	42.5	34.0
i. Non Plan Expenditure	931	26.0	5,732	16.7	11,100	51.6	11.5
j. Fiscal deficit (g-c)	74	-1273.0	4,124	22.4	5,425	76.0	10.7
k. Revenue deficit (d-a)	(96)	-32.5	3,223	22.4	3,798	84.8	4.5
l. Primary Deficit (j-e)	(244)	35.4	2,524	22.6	1,718	146.9	(3.5)

Source: CGA, Ministry of Finance

Revenue Pressure – Tax Collections; Divestments

Figure 32. Tax Collection in FY14 (Rs bn)

	Apr-Sep FY14	%YoY	Budgeted Growth
Corporate	1,537	7.5	17.7
Income	978	18.4	22.4
Customs	830	5.7	13.0
Excise	619	-8.2	11.9
Service	571	16.3	36.0
Others	46	8.5	19.7
Gross Taxes	4,582	7.8	19.2
Devolvement	1,487	14.9	19.0
Net Taxes	3,084	4.7	19.3

Source: CGA, Budget Documents

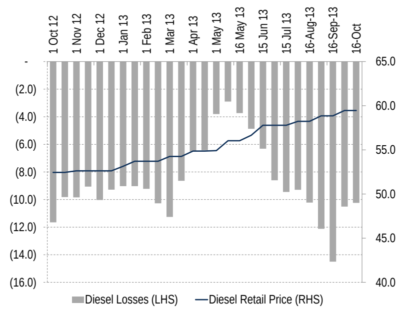
Tax Collections: Sub-par growth trends have taken a toll on tax collections with the current run-rate below budget estimates (BE) across components. On the indirect tax front, customs and service revenues were up 5.7% and 16% v/s budget estimates of 13% and 36% respectively. Excise remained in the red at -8.2% v/s 11.9% BE. Relative to indirect taxes, direct taxes appear to be doing better with income and corporate tax collections up 18.4% and 7.5% v/s the budgeted growth of 22.4% and 17.7%. Consequently, cumulative gross collections stood at Rs4582bn, up 7.8% v/s the budgeted growth rate of 19.2%. Higher devolvement to states has resulted in net tax collections at Rs3084bn, up 4.7% v/s budget estimates of 19%.

Divestments: The overall revenue estimates in FY14 assume a divestment target of Rs558bn in FY14 – significantly higher than the Rs259bn achieved in FY13. While this appears optimistic at first, key to note is that the government is looking at not only vanilla divestments, but at a variety of measures to meet targets. Measures under consideration to achieve divestment targets include (1) partial dissolution of SUUTI (specialized undertaking of UTI) wherein the govt would sell its shares in key blue-chips and (2) "Use it or lose it" policy for cash-rich PSUs which could be asked to invest excess cash or pay it as dividends to the govt.

Expenditure – Subsidy Rollovers; Austerity to Help

Expenditures: Within Targets —The moderation in expenditure seen since July has contained it well within budget targets with cumulative trends at Rs8094bn, up 16.6% v/s budget estimates of 18.1%. As seen in figure 31, the current run-rate of plan expenditure is 16.5% v/s BE of 34% while non-plan expenditure is up 16.7% v/s BE of 11.5%. We believe plan expenditure could remain below estimates for the govt to meet its fiscal target.

Figure 33. Diesel Price and Under-Recoveries (Rs/ltr)



Source: PIB

SENSITIVITY ANALYSIS on LOSSES

US$1/bbl change = Rs40bn

USD/INR change = Rs80bn

Rs1/ltr hike = Rs38bn

Fuel Subsidy Rollovers: The incremental fuel price reform momentum seen since Sept 12 has seen oil marketing companies (OMCs) continuing to raise diesel prices by Rs0.5/ltr per month. As seen in Figure 33, while under-recoveries had come down to Rs3/ltr, the INR depreciation has resulted in it rising to Rs10/ltr. Citi's oil analyst, Saurabh Handa, currently estimates gross under-recoveries at Rs1390bn in FY14, of which the government's share is Rs711bn. However, key to note is that while the FY14 budget has estimated oil subsidies at Rs650bn, arrears for FY13 are Rs450bn. In the current fiscal year, the government has announced subsidy payments to the tune of Rs80bn for losses, and similar to the past, we expect to see a rollover of the fuel subsidy bill to FY15.

Figure 34. Subsidy Sharing Mechanism (Rs bn)

	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E
Gross under-recoveries	1,033	461	782	1,385	1,610	1,390	890
Diesel	575	144	345	812	921	681	208
LPG	176	143	220	300	396	369	361
Kero	282	174	197	273	293	340	321
Less: upstream sharing	329	144	303	550	600	679	662
% of Total		31%	39%	40%	37%	49%	74%
Less: govt's share	713	260	410	835	1000	711	229
% of Total		56%	52%	60%	62%	51%	26%
Brent Crude (US$/bbl)	85	71.5	87	114	111	102	96
USD/INR		47.5	45.6	47.9	54.4	60	63

Source: Citi Research, Estimates as of 23rd September 2013

Austerity Measures – A quick recap: In mid-August, the government announced a series of measures to contain expenditure. These include a 10% cut in non-plan expenditure (excluding interest, debt repayments, defence, capex), lower budgetary allocations for conferences, travel related restrictions, freeze on hiring: relating to new posts and suspension of purchase of new vehicles. Further, it has enforced a "balanced pace of expenditure", wherein not more than 33% of BE is to be spent in the Jan-Mar quarter and expenditure in March is to be limited to 15% of BE.

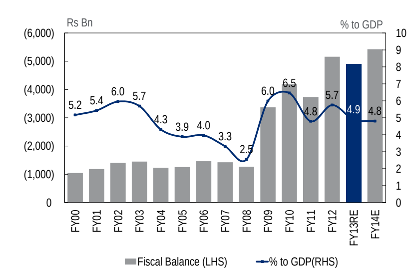
Government Borrowing Update — Latest available data indicate that the government has finished more than 60% or Rs3,103bn of its net borrowing requirement of Rs5,038bn. In terms of gross borrowings, it also translates to 60% of full-year borrowing if we include the proposed Rs500bn switch from the govt.

Figure 36. Borrowing Program Update

	FY13A	FY14BE	FY14YTD
Fiscal Deficit*	4,900	5,425	4,124
Net Market Borrowings**	5,131	5,038	3,103
Net Market Borrowings Dated**	4,674	4,840	2,993
Net Market Borrowings – Bills**	457	198	110
Repayments (includes switch for FY14)	906	1,450	747
Gross Dated Borrowings	5,580	6,290	3,740

Source: Bloomberg; Citi Research

Figure 35. Trends in Fiscal Deficit (Rs bn, %GDP)



Source: Budget Documents

Bottom-Line: Fiscal Deficit Red Line; a Tight Rope

Assuming the roll-over of fuel subsidy to FY15, the moderation in expenditure coupled with the austerity measures bodes well for expenditure being contained within budgeted targets. However, trends in revenues, both tax and non-tax (divestment target of Rs558bn) appear challenging at this juncture. This would be crucial to adhere to the fiscal 'red-line' of 4.8% of GDP. Revenue shortfall could result in a slippage to 5% of GDP.

External

Current Account Deficit Could Come in at Sub ~US$50bn

Figure 37. Trends in Trade Deficit (US$bn)

	QUARTERLY		Apr-Sep	
	1QFY14	2QFY14	FY14	FY13
Exports ($ bn)	72.3	79.1	152.1	144.7
%YoY	-1.6	11.2	5.1	
Imports ($ bn)	122.7	109.4	232.2	236.5
%YoY	5.2	-8.5	-1.8	
Oil ($ bn)	41.9	41.0	82.9	80.0
%YoY	7.0	1.4	3.6	
Gold ($ bn)	16.3	4.1	20.4	20.2
%YoY	69.0	-63.7	0.8	
Non-oil Non-gold	64.4	64.3	128.7	136.3
%YoY	-5.2	-5.6	-5.5	
Trade Deficit ($bn)	-50.3	-30.3	-80.1	-91.8
%YoY	16.7	-37.1	-12.7	

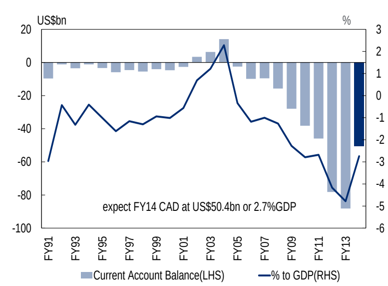
Source: DGCI&S

Quick Re-cap of Recent Developments: Fears of Fed tapering and its impact on EM assets especially those countries with a large CAD prompted policy makers to announce a series of measures to contain the CAD at US$70bn or 3.7% of GDP v/s US$88bn or 4.8% of GDP in FY13. Measures announced include a compression in imports of gold, oil and non-essential items. Earlier this month, the government revised its CAD estimate to US$60bn.

Trends so far: India's 1QFY14 CAD remained elevated at US$21.8bn or 4.9% of GDP. However, this was no surprise as it was largely due to the widening of the trade deficit to US$50.5bn in the April-June quarter. As seen in fig 37, this was primarily on account of a sharp increase in gold imports. However, in 2QFY14 (July-Sept), India's trade deficit has narrowed sharply to US$30bn with the September deficit coming in at US$6.7bn. This is on account of (1) a stronger than expected export recovery due to the INR depreciation and partner country growth, (2) a compression in imports primarily due to lower gold demand, sub-par trends in growth, curbs on non-essential imports and impact of INR depreciation.

Outlook: Going forward, we expect the FY14 CAD to be contained at US$50bn or 2.7% of GDP. Key assumptions behind our estimates are: (1) export growth at 5.5%; (2) gold imports contained at ~800 tonnes (a quick re-cap, gold imports stood at 375 tonnes during 1HFY13); (3) oil prices averaging US$107/bbl; (4) non-oil/non-gold imports at 1.3%; (5) positive trends in invisibles – remittances and software exports more than offsetting the rise in investment income outflows.

Figure 38. CAD (US$bn, %GDP)



Source: RBI; Citi Research

Factors that could result in further improvement include (1) revival of iron-ore exports which has fallen from 100MT FY11 to 16MT in FY13, (2) lower imports of ores and metal scrap which have risen from US$9.7bn to US$15bn in FY13 and (3) lower coal imports which have risen from 69MT in FY11 to 135MT in FY13.

Figure 39. Trends in Current Account Deficit (US$bn, %)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14E
a.Trade Balance	-91.5	-119.5	-118.2	-130.6	-189.8	-195.7	-166.2
Exports	166.2	189.0	182.4	250.5	309.8	306.6	323.4
%YoY	29.0	13.7	-3.5	40.5	21.8	-2.1	5.5
Imports	257.6	308.5	300.6	381.1	499.5	502.2	489.7
%YoY	35.1	19.8	-2.6	26.7	31.1	0.5	-2.5
Oil	79.6	93.7	87.1	106.0	155.0	169.3	171.2
Gold	16.7	20.7	28.6	40.5	56.2	53.8	37.5
b. Invisibles	75.7	91.6	80.0	84.6	111.6	107.5	115.9
Services	38.9	53.9	36.0	48.8	64.1	64.9	72.1
Transfers	41.9	44.8	52.0	53.1	63.5	64.0	67.7
Investment Income	-5.1	-7.1	-8.0	-17.3	-16.0	-21.5	-24.0
Current Account (a+b)	-15.7	-27.9	-38.2	-45.9	-78.2	-88.2	-50.4
%GDP	-1.3	-2.3	-2.8	-2.7	-4.2	-4.8	-2.7

Source: RBI, Citi Research

Capital Account – FCNR Deposits a Key Driver

Measures Announced: Complementing the measures to contain the CAD at US$70bn or 3.7% of GDP, policy makers under-took a host of measures to augment capital flows. These include (1) allowing public sector financial institutions to raise quasi-sovereign bonds to finance long-term infrastructure, (2) liberalizing ECB guidelines, (3) allowing PSU oil companies to raise additional funds, and (4) liberalizing NRE and FCNR deposit schemes.

Figure 40. Capital Flows (US$bn)

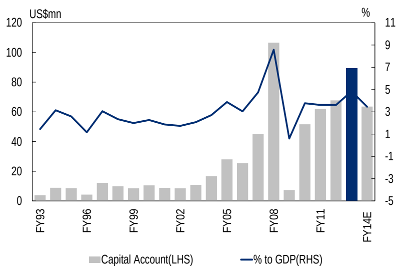
	FY14	FY13
FDI (Apr-Aug)	13.0	13.1
ECBs (Apr-Aug)	11.5	11.5
NRI Deposits (Apr-Aug)	8.0	8.3
FIIs (Apr – Oct)	-4.3	11.7
FII debt	-10.2	2.5
FII equity	5.9	9.2

Source: RBI, SEBI

Trends so far: On the capital account side, RBI's concessional swap scheme against mobilization of FCNR deposits and banks borrowing overseas has proved to be most effective. Inflows into the scheme currently stand at US$$14bn. Hidden caveats include the possibility of it leading to lower remittances. Nonetheless, incremental foreign capital received through this channel offsets the dollar outflow towards oil importers demand. The RBI currently provides dollars directly to state oil companies via a sell/buy swap

A look at the other components of flows indicates that while FDI and debt flows remained resilient, the sharpest swing was seen in debt portfolio flows this financial year. The debt market saw an outflow of US$10.1bn in the April-Oct period compared to an inflow of US$2.5bn last year. To arrest the volatility in debt flows, the government has been exploring ways to enter into the leading global EM debt indices. The inclusion of India G-Secs into the index could lead to stability of debt flows, but will likely co-integrate India's rates market to EM dynamics.

Figure 42. Capital Flows (US$bn, %GDP)



Source: RBI

Figure 41. Trends in Capital Account (US$bn)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14E
I. Current A/c	-15.7	-27.9	-38.2	-45.9	-78.2	-88.2	-50.4
II. Capital A/c							
a. Borrowings	40.7	8.3	12.4	28.4	19.3	31.1	17.0
External Assistance	2.1	2.4	2.9	4.9	2.3	1.0	2.0
Commercial Borrowings	22.6	7.9	2.0	12.5	10.3	8.5	10.0
Short-term credit	15.9	-2.0	7.6	11.0	6.7	21.7	5.0
b. FDI (Net)	15.9	22.4	18.0	9.4	22.1	19.8	21.0
c. Portfolio Invst	27.4	-14.0	32.4	30.3	17.2	26.9	5.0
d. Banking Capital	11.8	-3.2	2.1	5.0	16.2	16.6	23.0
of which NRI Deposits	0.2	4.3	2.9	3.2	11.9	14.8	20.0
f. Other capital	11.0	-5.9	-13.2	-11.0	-6.9	-5.0	-2.0
Total Capital A/c	106.6	7.4	51.6	62.0	67.8	89.3	63.6
Overall Balance (I + II)	92.2	-20.1	13.4	13.1	-12.8	3.8	13.2

Source: RBI, Citi Research

External Debt: Lower due to Valuation Gains

Valuation gains saw India's external debt declining by US$3.6bn in 1QFY14 to US$388.5bn. Excluding the valuation gains, the outstanding external debt would have increased by US$5.9bn instead. The improvement was also seen in the short-term debt profile with outstanding debt by residual maturity of less than 1 year having declined to US$170.1bn in June from US$172.3bn in end March.

Figure 43. External Debt (US$bn)

	FY11	FY12	FY13	FY14*
Multilateral	48.5	50.5	51.6	51.7
Bilateral	25.7	26.9	25.2	24.8
IMF	6.3	6.2	6.0	6.0
Trade Credit	18.6	19.1	17.9	17.5
Commercial Borrowing	88.5	105.1	122.7	119.4
NRI Deposits (> 1 year)	51.7	58.6	70.8	71.1
Rupee Debt	1.6	1.4	1.3	1.2
Total Long term debt	240.9	267.6	295.4	291.8
NRI Deposits (upto 1 yr)	-	-	-	-
FII Invst in T-Bills	5.4	9.4	5.5	3.1
Others (trade related)	58.5	65.1	86.8	89.2
Other	1.1	3.7	4.5	4.4
Total Short term debt	65.0	78.2	96.7	96.8
GROSS TOTAL	305.9	345.8	392.1	388.5
Short-term debt by Residual Maturity	88.0	99.6	172.3	170.1

*Apr-Jun'13 ; Source: RBI

<u>Bottom Line:</u> External Imbalances on the Recovery Road

The policy measures initiated earlier have begun to bear fruit. The government's 'revised' CAD estimate of US$60bn (v/s US$70bn pegged in August) is likely to surprise positively. We expect a print of US$50bn or 2.7% of GDP with the possibility of an upside if issues related to mining and coal also get sorted out soon.

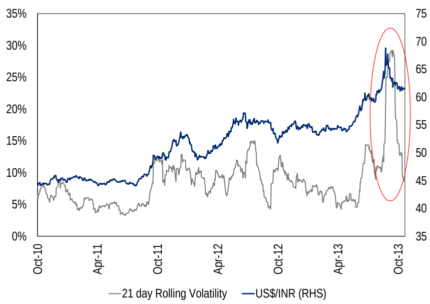
The INR has gained ~10% since its all-time lows and is trading in a relative narrow range of Rs60-62/US$. While the CAD is likely to narrow substantially, the FX markets continue to be supported by the concessional swap facilities and oil import demand out of the market. Nonetheless, forex reserves have reversed their declining trend and are currently up ~US$7bn in October.

Financial Markets

Forex – Rupee Partially Recovers but Don't Cheer Yet

INR amongst the Hardest Hit: The May 22nd testimony of Fed chairman in which he hinted at QE taper led to a widespread sell-off in EM assets – especially those running high current account deficits. India saw portfolio outflows to the tune of US$13bn (Debt $9.2bn: Equity $3.8bn) during June-August which took a toll on the currency. The INR was amongst the more impacted currencies with the unit touching Rs68.8/US$ due to fears on its external financing requirements (CAD + residual short-term debt) coupled with macro imbalances of high inflation and slowing growth.

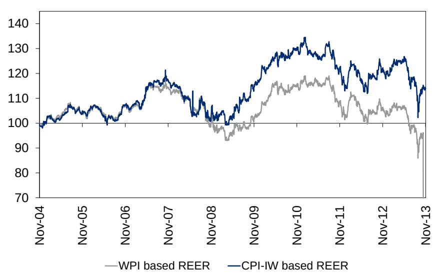
Figure 44. INR Monthly Rolling Volatility



Source: CEIC, Citi Research

Relief rally and improvements in deficit = INR gains: The surprise postponement of 'taper' resulted in a relief rally across markets. This coupled with improvements on India's external account (monthly trade deficits averaged under US$10bn v/s US$20bn in the beginning of the fiscal) resulted in the rupee reversing some of its weakness and stabilizing at Rs61-62/US$ levels. While the CAD is likely to narrow substantially, key to note is that incremental capital flows remain below trend. The FX markets continue to be supported by RBI's accommodation by (1) keeping oil import demand out of the market (2) Concession on FCNR swaps. Absence of the above would determine true INR stability.

Figure 45. Trends in REER



Source: RBI, Citi Research

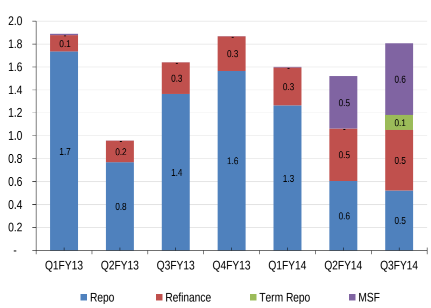
Outlook: With two event risks in 1QCY14 (taper + elections), we are more constructive on INR over a 6-12 month horizon. In addition to a lower CAD is the likelihood of augmentation of flows via sovereign wealth funds and possibility of including India government bonds in the EM benchmark indices. This could lead to some portfolio rebalancing in favor of INR. Further, the attractive valuation of INR in real terms is also likely to help, with the unit currently under-valued in REER terms.

FX Reserves – Downtrend Reverses: Latest data on reserves indicate that reserves as on Oct 25 were US$282.9bn while forex assets (excluding gold) were US$254.5bn. While still ~US$5bn lower than levels at the beginning of this fiscal, forex assets have risen ~US$7bn in October compared to a ~US$11bn fall during April-Sept. In addition to revaluation gains, the rise is attributed to the swap window (FCNR-B and banks) and equity inflows. The net forward book has also seen an improvement with the latest available data (Sept end) at US$ -7.7bn v/s the peak of -US$9.1bn seen in August.

Bonds – Shifting Dynamics of Reserve Money

Earlier Framework: An RBI working group in March 2011 recommended an optimal liquidity deficit of 1% of NDTL to achieve effective policy transmission and stable money market rates. However, given the ~6% overhang of excess SLR in the banking system (statutory requirement = 23% of NDTL) plus export re-finance available for 50% of INR exports effectively meant that money markets could function smoothly even though system deficit exceeded 1.5% of NDTL.

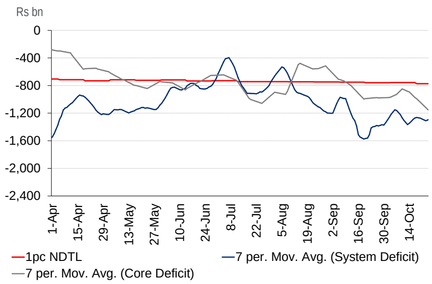
Figure 46. Shifting Composition of LAF



Source: Citi Research

Exceptional Liquidity Measures Taken during July: In a bid to raise short term rates and discourage speculative currency behavior, the RBI (1) hiked the Marginal Standing Facility (MSF) by 200bps to10.25% and (2) capped the Liquidity Adjustment Facility (LAF) limit to 0.5% of NDTL for each bank. This resulted in short- term rates rising ~300bps with daily MIBOR fixing rising from 7.25% to 10.25% as MSF became the operative rate. In addition to the repo window, the system was able to fund up to ~Rs400bn (0.5% of NDTL) through the refinance window at repo rate.

Figure 47. Banking System Liquidity Deficit



Source: CEIC, Citi Research

Figure 48. Open Market Purchases (Rs Bn)

	1H	2H	Total
FY10	940	19	959
FY11	0	672	672
FY12	0	1341	1341
FY13	820	726	1546
FY14*	264	100	364

Source: Citi Research, 2HFY14 data is YTD

POLICY ACTION

July 15: MSF hiked by 200bps to 10.25%. Repo unchanged at 7.25%. Corridor widens to 300bps

Sept 20: MSF cut by 75bps to 9.5%. Repo hiked by 25bps to 7.5%

Oct 7: MSF cut by 50bps to 9%.

Oct 29: MSF cut to 8.75%; Repo hiked by 25bps to 7.75%. Corridor between Repo and MSF normalized to 100bps

Unwind of Exceptional Liquidity Measures With a Twist: As FX markets stabilized, the central bank restored the MSF-Repo spread to 100bps but didn't remove the ceiling on repo. However, it introduced an auction-based term repo of 7-day and 14-day maturity with a current limit of 0.5% of NDTL. The liquidity provided at repo, term repo and refinance window totaled 1.5% of NDTL which is currently closer to system deficit. Due to this, the MSF window becomes a frictional source of liquidity in the near term.

..Impacts Markets in Multiple Ways

In our view, the shifting composition of reserve money has further strengthened the operating framework. Key implications:

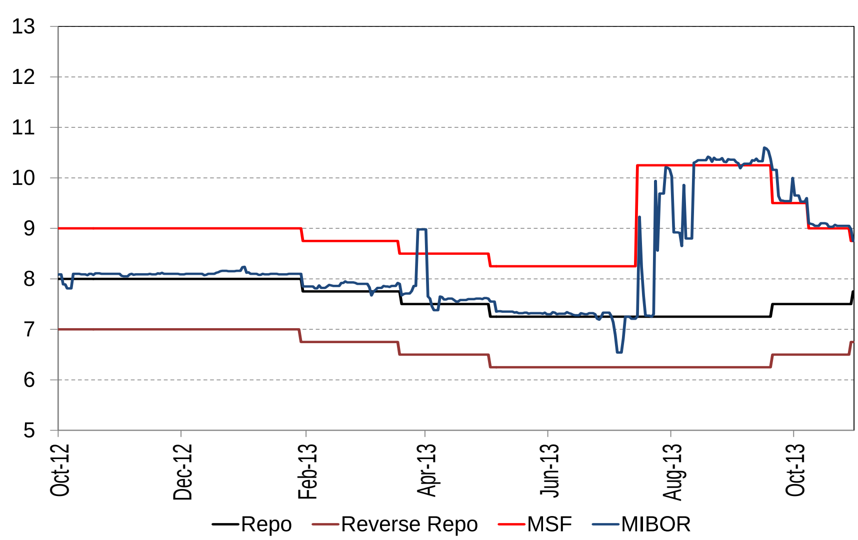
Funding Rates: Before July, the repo rate was the key funding rate for government securities as well as for the Overnight Index Swaps (OIS) market. It was thus considered the sole operative rate. This has now changed given the funding available across repo, term repo and the MSF window. The operative rate for swap markets i.e. call rate or MIBOR is likely to be higher than the operative rate for government securities market - i.e. weighted average rate of borrowing from RBI. Effectively this could impact the spread between these two rate instruments, especially when the system deficit is close to 1.5% of NDTL.

Open Market Operations: Due to scalability of these measures (through expansion of ceiling), we believe the term repo could become a key instrument of liquidity injection. As dependence on daily borrowing reduces, it may also provide additional flexibility on Open Market Operations (RBI purchased an average ~Rs1200bn through OMO in last three years) and could result in lower OMO's in FY14.

Bottom Line: Volatility in Operative Rates

Even though Repo-MSF spread has been restored to 100bps, the operative rate is likely to remain volatile within the band due to multiple pricing. Thus rate instruments going forward will have to factor in the volatility of money market rates with a keen eye on system liquidity and RBI actions.

Figure 49. Spread between Repo and MSF Normalized to 100bps with INR stability



Source: RBI

Politics and Policy Watch

Figure 50. Upcoming State Elections

State	Election Date	Current Ruling Party	Lok Sabha Seats
Chhattisgarh	4-Apr-14	BJP	11
Madhya Pradesh	12-Dec-13	BJP	29
Mizoram	15-Dec-13	Congress	1
Rajasthan	31-Dec-13	Congress	25
Delhi	17-Dec-13	Congress	7

Source: PIB, PRS

On Politics, the key development is that the main opposition, the BJP, has officially announced Narendra Modi as its Prime Ministerial candidate for the general election in May 2014. This announcement comes right before important state elections in Delhi, Rajasthan, Madhya Pradesh, and Chhattisgarh. As a political leader, Narendra Modi is perceived to be supportive of business activity and economic growth. His reputation as the chief minister of Gujarat during whose tenure the state saw double-digit growth is evidence of this trait.

As regards reforms, the latest parliament session showed notable progress. Key bills passed were the Land Acquisition Bill, the Companies Bill, the Food Security Bill, and the Pension Bill. These will directly impact infrastructure investments, business environment, the fisc, and FDI respectively. While the food security bill is characteristic of the incumbent government's populist stance, it is important to note that some of these reforms were the most controversial and debated about since reform momentum initiated in September 2012. This shows that, leading up to the elections, the government is prepared to take big policy decisions.

Figure 51. Reforms – What's Announced

Announced Reform	Key Features	Status of Reform
Fuel Price Hike	Diesel price raised by Rs 5/ltr in 2012.	Rs5/ltr hike implemented in 2012
	Proposed Rs0.5/ltr hike per month in 2013, Bulk users pay market price;	Monthly price hikes being implemented.
FDI		
Multi-Brand Retail	51% FDI permitted subject to State approval	Work in Progress but firms seeking clarity on regulations
Single- Brand Retail	FDI beyond 51% requires 30% sourcing locally from MSMEs	Work in Progress, but 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	(1) Air Asia/Tata JV (2)Jet Airways/Etihad
Telecom	permitted up to 100%, through FIPB route	
Defence	FDI above 26% allowed on a case-by-case basis	
Divestment in PSUs	Divestment is public sector undertakings	On-going
Competition Bill	All sectors under competition law, merger of weak/ failing banks excluded	
Security Interest/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,	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 All Loans
Companies Bill (Amendments)	Ensures more transparent corporate governance	Passed by both houses of Parliament
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 10%	Implemented
Sugar decontrol	Sugar mills no longer need sell sugar to Govt. at controlled prices.	Implemented
Gas Price Hike	Gas price increased to $8.4 per mBtu from $4.2 a mBtu	in effect from April 2014
Interest Subsidy Hike	Interest Subsidy raised to 3% from 2%, also includes more items	Implemented
Land Acquisition Bill	For commercial land acquisition, and rehabilitation	Passed by both houses of Parliament
National Food Security Bill, 2011	Provides food security by providing specific entitlements to certain groups	Passed by both houses of Parliament
PFRDA- Pension Bill	Better regulation of pension sector, FDI in pensions up to 26% allowed	Passed by both houses of Parliament

Source: PIB, News Reports, Citi Research

Monthly Monitor

Figure 52. India — Key Monthly Indicators (percent change from a year ago unless otherwise stated)

	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13
Consumption Trends														
Two-Wheelers	-4.8	-13.3	12.0	1.0	4.1	8.4	-2.8	-7.0	0.9	1.1	-4.6	-0.1	6.7	18.4
Passenger Car Sales	-18.2	-5.1	24.5	-7.5	-11.4	-11.5	-25.0	-21.4	-10.4	-11.7	-10.4	-8.6	13.0	-1.0
Tractors	-14.8	-17.1	0.4	19.1	-6.1	-6.2	-0.4	1.3	36.3	23.5	20.7	12.3	10.9	35.1
LHCVs	13.3	11.6	31.9	9.4	5.9	14.2	6.6	9.7	4.7	-7.2	-8.9	-12.3	-14.1	-18.1
MHCVs	-8.8	-14.6	-22.9	-33.1	-38.3	-38.9	-34.7	-25.9	-6.5	-16.7	-21.3	-19.7	-38.1	-41.5
Investment Trends														
Infrastructure Index	6.1	8.3	4.5	2.2	2.9	3.7	-2.4	3.2	2.2	2.3	0.1	3.2	3.7	8.0
Diesel Consumption	10.9	7.4	6.8	1.6	4.3	7.9	-2.4	2.5	4.1	0.0	-2.1	-6.8	-0.6	-0.5
Steel Production	7.9	-2.9	2.7	4.1	4.8	13.4	-7.8	-2.1	4.5	1.7	5.5	0.7	12.1	12.8
Manufacturing PMI*	52.8	52.8	52.9	53.7	54.7	53.2	54.2	52.0	51.0	50.1	50.3	50.1	48.5	49.6
output	52.7	53.2	52.7	55.4	57.7	54.0	56.3	51.6	50.2	48.6	49.1	49.8	47.5	49.6
Industrial Production Index														
General	2.0	-0.7	8.4	-1.0	-0.6	2.5	0.6	3.5	1.5	-2.5	-1.8	2.8	0.6	
Manufacturing	2.4	-1.6	9.9	-0.8	-0.8	2.7	2.1	4.3	1.8	-3.2	-1.7	3.2	-0.1	
Mining	-0.3	2.2	-0.2	-5.5	-3.1	-1.8	-7.7	-2.1	-3.4	-5.9	-4.3	-2.5	-0.2	
Electricity	1.9	3.9	5.5	2.4	5.2	6.4	-3.2	3.5	4.2	6.2	0.0	5.2	7.2	
Use Based Basic goods	3.0	2.7	4.3	1.1	2.2	3.7	-1.8	3.2	1.4	-0.3	-1.5	1.5	1.5	
Capital goods	-4.4	-13.3	7.0	-8.5	-1.1	-2.5	9.1	9.6	-0.3	-3.7	-5.8	15.6	-2.0	
Intermediate goods	2.7	1.7	9.6	-1.4	-0.2	3.5	-0.8	2.1	2.5	1.1	1.3	3.1	3.6	
Consumer goods	3.6	0.0	13.8	-0.3	-3.6	2.5	0.8	1.8	1.7	-6.6	-1.9	-0.5	-0.8	
Consumer Durables	1.0	-1.5	16.7	1.1	-8.1	-0.7	-2.6	-4.9	-9.6	-18.3	-10.4	-8.9	-7.6	
Consumer Non-Durables	6.0	1.4	11.2	-1.5	-0.5	4.6	3.2	7.3	11.3	3.8	5.7	7.0	5.0	
Services														
Port traffic	2.0	-2.1	0.1	-3.3	-4.9	-1.0	1.0	-3.2	-6.2	0.5	2.5	4.8	6.8	4.9
Railway freight	3.4	8.1	8.0	0.9	1.6	6.4	-0.2	-0.6	3.9	4.5	5.3	4.9	6.0	11.8
Tourist arrivals ('000)	446	412	576	690	750	699	688	640	452	384	444	524	474	436
Cellular subscriber Adds (Mn)**	-5.0	-2.1	-1.8	-13.6	-25.9	-2.3	-1.5	5.6	1.5	4.1	3.4	1.4	1.9	4.6
Banking Trends														
Money supply(M3)	14.1	13.6	13.3	13.6	11.2	13.0	12.7	13.8	12.7	13.6	12.8	12.5	12.2	13.0
Loan(Credit) growth	17.6	15.7	16.2	17.9	15.0	16.1	16.3	14.1	14.6	15.1	13.5	14.9	16.1	15.0
Deposit growth	15.1	13.6	13.8	13.7	11.0	13.1	12.8	14.2	12.8	14.2	13.5	13.4	12.1	10.6
Non-food credit	17.4	15.4	15.5	17.5	14.8	15.8	16.1	14.0	14.5	15.3	13.7	15.1	16.4	15.1
Inflation														
CPI	10.0	9.7	9.8	9.9	10.6	10.8	10.9	10.4	9.4	9.3	9.9	9.6	9.5	9.8
WPI	8.0	8.1	7.3	7.2	7.3	7.3	7.3	5.7	4.8	4.6	5.2	5.9	6.1	6.5
Mfg products inflation	6.4	6.5	5.9	5.4	5.0	4.9	4.8	4.3	3.7	3.3	2.9	2.6	1.9	2.0
Food Products	11.2	9.2	7.8	9.6	10.6	11.4	10.5	7.4	5.1	5.7	8.8	9.7	11.7	13.5
Fuel Products	8.7	12.0	11.6	10.0	10.2	9.3	10.6	7.8	8.3	7.3	7.5	11.4	11.3	10.1
PMI - Input Prices	60.7	62.3	58.5	60.0	59.6	58.9	58.9	55.0	54.1	51.3	55.9	60.6	57.8	63.5
PMI - Output Prices	59.1	56.8	52.9	56.0	55.9	55.0	57.9	53.1	51.9	49.8	50.9	53.4	51.8	51.1
Interest rates (Average, %)														
Daily MIBOR	8.0	8.0	8.1	8.1	8.1	8.1	7.9	8.0	7.6	7.4	7.3	7.9	9.9	10.1
1 yr CD	9.1	9.0	8.6	8.7	8.8	8.7	9.3	9.0	8.6	8.3	8.3	9.1	10.3	10.1
91-day T-Bills	8.1	8.0	8.0	8.1	8.0	7.8	7.9	7.8	7.6	7.3	7.3	8.4	10.0	9.4
Corp Bond Spreads	1.2	1.3	1.1	0.9	1.0	1.2	1.1	1.1	1.1	0.9	1.0	1.2	0.9	1.2
10-year government bond	8.2	8.2	8.2	8.2	8.1	7.9	7.8	7.9	7.8	7.4	7.3	7.8	8.5	8.6
Trade - customs data														
Exports(%YoY)	-6.6	-6.2	1.7	-0.1	0.6	1.2	2.3	5.9	1.7	-0.9	-5.5	9.5	13.0	11.2
Imports(%YoY)	-6.7	5.8	8.5	5.7	8.3	6.3	2.8	-3.4	10.3	6.0	-0.8	-6.6	-0.7	-18.1
Oil	2.4	30.1	40.3	13.9	25.5	8.2	15.7	-16.1	4.4	3.3	13.4	-7.9	17.9	-5.9
Non-oil	-10.8	-3.3	-3.5	1.9	1.2	5.3	-3.4	4.3	13.5	7.5	-7.3	-6.0	-10.4	-24.2
Trade Deficit (US$bn)	-14.2	-17.1	-20.6	-18.1	-17.8	-20.0	-15.5	-10.4	-17.9	-20.1	-12.3	-12.6	-10.9	-6.8
Brent Prices ($/bbl)	113.4	113.8	112.0	109.6	109.7	112.8	116.7	109.3	102.6	103.2	103.0	107.9	110.9	111.9
Foreign investment (US$ mn)														
FII	1,996	3,682	3,646	1,805	4,905	4,610	5,318	2,741	1,992	5,220	-7,536	-3,026	-2,457	1,151
FDI	2,399	4,147	1,213	439	453	2,701	2,210	822	2,784	1,860	1,828	1,696	1,616	
Exchange rate and reserves														
US$ exchange rate average	55.6	54.4	53.1	54.8	54.7	54.2	53.8	54.4	54.3	55.0	58.4	59.8	62.8	63.6
US$ exchange rate month end	55.5	52.9	53.8	54.5	54.8	53.3	53.8	54.3	54.2	56.5	59.7	61.1	66.6	62.8
Forex reserves incl.gold (US$bn)	290.5	294.8	295.3	294.5	296.6	295.7	291.9	292.6	293.9	294.9	295.9	296.9	297.9	298.9

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

Balance of Payments

Figure 53. Balance of Payments Snapshot (US$bn)

	FY08	FY09	FY10	FY11	FY12	FY13A	FY14E	Comments
CURRENT ACCOUNT								
Exports (RBI)	166.2	189.0	182.4	250.5	309.8	306.6	323.4	Exports likely to pick up due to partner country growth
YoY %	28.9	13.7	(3.5)	37.3	23.7	(1.0)	5.5	A weak rupee also helps
% of GDP	13.4	15.4	13.3	14.6	16.5	16.6	17.6	
Exports (Customs)	163.0	185.3	178.8	251.1	306.0	299.5	316.2	
YoY %	29.0	13.7	(3.5)	40.5	21.8	(2.1)	5.6	
Imports (RBI)	257.6	308.5	300.6	381.1	499.5	502.2	489.7	
YoY %	35.1	19.8	-2.6	26.7	31.1	0.5	-2.5	
% to GDP	20.7	25.2	22.0	22.2	26.6	27.2	26.7	
Imports-Customs	250.5	303.7	288.4	369.8	489.3	493.7	480.5	Oil and Gold are key as they account for 40% imports
YoY %	34.9	21.2	-5.0	28.2	32.3	0.9	-2.7	
of which: Oil	79.6	93.7	87.1	106.0	155.0	169.3	171.2	Crude price assumptions are at US$107/bbl in FY14
YoY %	39.9	17.6	-7.0	21.6	46.2	9.3	1.1	
Gold	16.7	20.7	28.6	40.5	56.2	53.8	37.5	Gold imports likely to be contained at 800tonnes;
YoY %	15.6	23.9	38.2	41.6	38.7	-4.3	-30.3	Average prices at US$1435/oz
Non-oil Non-gold	155.1	189.3	172.6	223.3	278.1	268.3	271.8	
YoY%	35.6	22.1	-8.8	29.4	24.6	-3.5	1.3	
a. Trade balance (RBI)	-91.5	-119.5	-118.2	-130.6	-189.8	-195.7	-166.2	
% of GDP	-7.4	-9.7	-8.6	-7.6	-10.1	-10.6	-9.1	
Trade Balance (Customs)	-87.5	-118.4	-109.6	-118.6	-183.4	-194.3	-164.3	
Difference b/w RBI and customs	-4.0	-1.1	-8.6	-12.0	-6.4	-1.4	-2.0	Difference normally represents defense imports
b. Invisibles	75.7	91.6	80.0	84.6	111.6	107.5	115.9	
Non-factor services	38.9	53.9	36.0	48.8	64.1	64.9	72.1	
Of which: Software Services	36.9	43.7	48.2	53.3	61.0	63.5	71.1	
Non- Software Services	1.9	10.2	-12.2	-4.4	3.1	1.4	1.0	
Investment income	-5.1	-7.1	-8.0	-17.3	-16.0	-21.5	-24.0	Rising recourse to external funding results in outflows
Remittances**	41.7	44.6	51.8	53.1	63.5	64.3	67.3	
Official transfers	0.2	0.2	0.3	0.0	0.0	-0.3	0.4	
1. Current a/c balance (a+b)	-15.7	-27.9	-38.2	-45.9	-78.2	-88.2	-50.4	CAD could surprise coming in at sub US$50bn
% of GDP	-1.3	-2.3	-2.8	-2.7	-4.2	-4.8	-2.7	If coal; iron-ore issues are resolved
CAPITAL ACCOUNT								
c. Loans	40.7	8.3	12.4	29.5	19.3	31.1	17.0	Upside if infrastructure and Public sector financial
External assistance	2.1	2.4	2.9	4.9	2.3	1.0	2.0	Institutions raise quasi sovereign bonds
Commercial borrowings	22.6	7.9	2.0	12.5	10.3	8.5	10.0	
Short-term credit	15.9	-2.0	7.6	12.0	6.7	21.7	5.0	
d. FDI (Net = a-b)	15.9	22.4	18.0	9.4	22.1	19.8	21.0	
(a) FDI - To India	34.7	41.7	33.1	25.9	33.0	27.0	31.0	
(b) FDI - Abroad	-18.8	-19.4	-15.1	-16.5	-10.9	-7.1	-10.0	
e. Portfolio invst (	27.4	-14.0	32.4	30.3	17.2	26.9	5.0	
f. Banking Capital	11.8	-3.2	2.1	5.0	16.2	16.6	23.0	RBI's concessional swap scheme against mobilization
NRI deposits	0.2	4.3	2.9	3.2	11.9	14.8	20.0	of FCNR deposits and banks borrowing overseas to
g. Rupee debt service	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	help banking capital flows
h. Other capital***	11.0	-5.9	-13.2	-11.0	-6.9	-5.0	-2.0	
2.Capital a/c (c+d+e+f+g+h)	106.6	7.4	51.6	63.0	67.8	89.3	63.6	
Errors & Omissions	1.3	1.1	0.0	-3.0	-2.4	2.7	0.0	
Overall balance (1+2)	92.2	-19.5	13.4	14.1	-12.8	3.8	13.2	
Forex								
Forex assets	299.1	241.6	252.8	273.7	260.9	264.7	277.9	
FCA to months of imports (Rhs)	13.9	9.4	10.1	8.6	6.3	6.3	6.8	
Exchange rate								
Rs/US$ - annual avg	40.2	46.0	47.4	45.6	48.1	54.0	61.5	
% depreciation	-11.1	14.4	3.0	-3.8	5.5	12.3	13.9	

*Data on exports and imports differ from those given by DGCI&S on account of differences in coverage, valuation and timing (e.g. RBI data on imports includes defence).** Remittances - 50% are for family maintenance; balance is local withdrawal from NRI rupee deposits.. *** Other capital refers to leads and lags in exports, advances received pending issue of shares, funds held abroad.

Source: RBI; Citi Research

Direction and Composition of Trade

Figure 54. India — Composition of Imports (US$bn, %)

	FY09	FY10	FY11	FY12	FY13	FY14*
Petroleum crude& products	91.5	86.8	105.8	154.9	169.0	54.7
% to total	30.6	30.2	28.6	31.7	34.5	34.1
% YoY	14.8	-5.1	21.9	44.6	9.1	
Capital goods	48.5	44.5	51.7	66.1	60.5	17.7
% to total	16.2	15.5	14.0	13.5	12.3	11.0
% YoY	-2.8	-8.2	16.3	20.9	-8.5	
Gold & Silver	22.8	29.6	42.5	61.3	55.6	21.3
% to total	7.6	10.3	11.5	12.5	11.3	13.3
% YoY	27.8	29.8	43.4	54.1	-9.2	
Pearls precious stones	16.6	16.2	34.6	30.5	22.6	9.5
% to total	5.5	5.6	9.4	6.2	4.6	5.9
% YoY	126.5	-2.6	113.8	0.6	-25.9	
Chemicals, related products	29.2	23.5	28.3	36.7	35.4	11.5
% to total	9.8	8.2	7.7	7.5	7.2	7.2
% YoY	56.7	-19.7	20.7	25.4	-3.6	
Electronic Goods	23.4	21.0	26.6	32.6	31.4	10.4
% to total	7.8	7.3	7.2	6.7	6.4	6.5
%YoY	15.8	-10.3	26.6	24.2	-3.6	
Food & related items	5.8	10.0	10.1	13.2	15.9	4.5
% to total	1.9	3.5	2.7	2.7	3.2	2.8
% YoY	8.3	72.9	1.4	30.1	19.6	
Other non-POL items	52.2	46.8	57.6	78.7	76.6	24.7
% to total	17.4	16.3	15.6	16.1	15.6	15.4
% YoY	22.4	-10.4	22.9	36.7	-2.7	
Other commodities	6.8	6.7	9.0	11.4	19.4	4.9
% to total	2.3	2.3	2.4	2.3	4.0	3.0
% YoY	17.3	-0.5	33.8	18.0	70.1	
TOTAL IMPORTS	299.3	287.6	369.4	489.3	490.3	160.4
% YoY	19.8	-3.9	28.4	32.4	0.2	

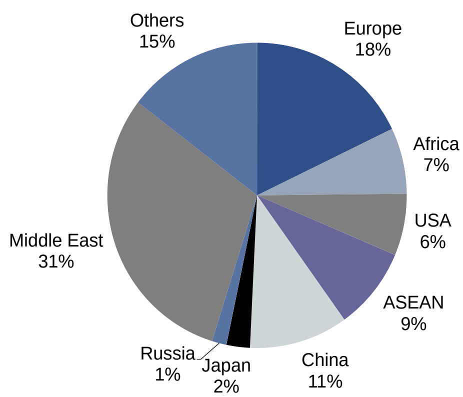
*FY14 numbers are from Apr-Jul ; Source: CMIE ,RBI

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

	FY09	FY10	FY11	FY12	FY13	FY14*
Engineering goods	47.0	38.1	58.1	66.9	64.9	20.6
% to total	25.7	21.4	23.1	22.0	21.6	21.3
%YoY	26.3	-18.9	52.3	13.9	-3.1	
Petroleum, crude prods	26.9	28.0	41.4	55.4	60.2	19.4
% to total	14.7	15.7	16.5	18.2	20.0	20.1
%YoY	-5.3	4.3	47.8	51.8	8.6	
Gems & Jewellery	28.0	29.0	40.5	46.9	43.4	13.2
% to total	15.3	16.3	16.1	15.4	14.5	13.7
%YoY	42.2	3.6	39.5	46.9	-7.4	
Agri, allied products	17.6	17.7	24.2	37.4	40.6	13.0
% to total	9.6	10.0	9.7	12.3	13.5	13.5
%YoY	-4.8	1.1	36.4	53.0	8.6	
Chemicals & related	17.3	17.4	21.3	26.9	29.5	9.5
% to total	9.5	9.7	8.5	8.8	9.8	9.8
%YoY	11.3	0.4	22.7	27.9	9.6	
Textiles (incl RMG)	20.0	19.9	24.2	28.0	27.3	9.9
% to total	10.9	11.1	9.7	9.2	9.1	10.3
%YoY	3.2	-0.9	21.9	22.7	-2.4	
Ores & minerals	7.8	8.7	8.6	8.1	5.6	1.8
% to total	4.3	4.9	3.4	2.7	1.9	1.8
%YoY	-14.4	11.0	-0.4	-18.4	-31.8	
Other manuf goods	11.0	10.9	13.9	18.0	18.5	4.4
% to total	6.0	6.1	5.5	5.9	6.2	4.6
%YoY	-1.4	-0.7	27.6	29.6	2.9	
Other commodities	7.5	8.6	18.6	16.7	10.3	3.0
% to total	4.1	4.8	7.4	5.5	3.4	3.1
%YoY	86.9	15.2	115.0	-10.2	-38.3	
TOTAL EXPORTS	183.1	178.3	250.8	304.3	300.2	96.5
% YoY	12.3	-2.6	40.6	21.3	-1.4	

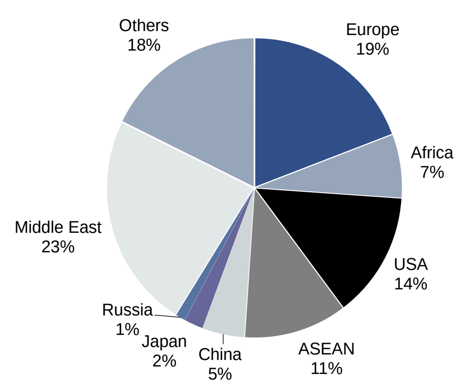
*FY14 numbers are from Apr-Jul ; Source: CMIE ,RBI

Figure 56. Direction of Imports FY13



urce: DGCI&S, CMIE

Figure 57. Direction of Exports FY13



Source: DGCI&S, CMIE

Snapshot of Government Finances

Figure 58. Snapshot of Government Finances

	FY08	FY09	FY10	FY11	FY12	FY13RE*	FY14BE	
a. Gross Tax Revenue	5,931	6,053	6,245	7,931	8,892	10,366	12,359	
% to GDP	11.9	10.8	9.6	10.2	9.9	10.3	10.9	Revenues
% YoY	25.3	2.0	3.2	27.0	12.1	16.6	19.2	Key Assumptions: Income Tax + 22%,
Corporation tax	1,929	2,134	2,447	2,987	3,228	3,563	4,195	Corporate: +17.7%, Customs +13%
Income tax	1,026	1,060	1,224	1,391	1,645	1,968	2,409	Excise: +11.9%, Service + 35.9%
Excise duty	1,234	1,086	1,030	1,377	1,449	1,759	1,968	
Import duty	1,041	999	833	1,358	1,493	1,658	1,873	
Service tax	513	609	584	710	975	1,325	1,801	
b. (-) Devolvement to States & UTs	1,536	1,620	1,680	2,232	2,594	2,956	3,518	
c. Net tax revenues (a-b)	4,395	4,433	4,565	5,699	6,298	7,410	8,841	
d. Non tax revenues	1,023	969	1,163	2,186	1,217	1,377	1,723	
e. Net revenue receipts (c+d)	5,419	5,403	5,728	7,885	7,514	8,788	10,563	
f. Non-debt capital receipts	439	67	332	353	369	407	665	
Recovery of loans	51	61	86	124	189	148	107	
Divestments/Other	388	6	246	228	181	259	558	
g. TOTAL REVENUES (e+f)	5,858	5,470	6,060	8,237	7,884	9,195	11,228	
%YoY	32.9	-6.6	10.8	35.9	-4.3	16.6	22.1	
h. Revenue expenditure	5,945	7,938	9,118	10,407	11,458	12,423	14,362	Expenditures
Interest (1)	1,710	1,922	2,131	2,340	2,732	3,119	3,707	
Defense	543	733	907	921	1,030	1,089**	1,169	
Subsidies	709	1,297	1,414	1,734	2,179	2,577**	2,311	
Pensions	243	329	561	574	612	638**	707	
Grants to States	358	382	459	498	515	579**	770	Assume FY14 Fuel Subsidy at Rs650 bn
Admin and social services	647	927	1,107	1,198	1,053	987	1,265	vs Rs 969bn in FY13
Plan expenditure	1,736	2,348	2,539	3,142	3,337	3,434**	4,433	
i. Capital expenditure	1,182	902	1,127	1,566	1,586	1,672	2,291	
Defense	375	410	511	621	679	696**	867	
Loans	493	87	121	298	120	127**	303	
Plan expenditure	315	405	495	648	786	849**	1,121	
j. Plan expenditure	2,051	2,752	3,034	3,790	4,124	4,143	5,553	Plan Expenditure estimated to rise 34%
k Non Plan expenditure	5,077	6,087	7,211	8,183	8,920	9,952	11,100	Non-plan expenditure to rise 11.5%
l. TOTAL EXPENDITURE (h+i): (j+k)	7,127	8,840	10,245	11,973	13,044	14,095	16,653	
% YoY	22.2	24.0	15.9	16.9	8.9	8.1	18.1	
Deficit trends								
m. Fiscal Balance (g-l)	-1,270	-3,370	-4,185	-3,736	-5,160	-4,900	-5,425	
% to GDP	-2.5	-6.0	-6.5	-4.8	-5.7	-4.9	-4.8	
n. Revenue Balance (e-h)	-526	-2,535	-3,390	-2,523	-3,943	-3,635	-3,798	
% to GDP	-1.1	-4.5	-5.2	-3.2	-4.4	-3.6	-3.4	
o. Primary Deficit (m-1)	441	-1,448	-2,054	-1,396	-2,428	-1,781	-1,718	
% to GDP	0.9	-2.6	-3.2	-1.8	-2.7	-1.8	-1.5	
Financing the deficit								
Market borrowings (Net)	1,318	2,336	3,984	3,254	4,362	4,674	4,840	
PPF & special deposits	39	80	161	125	108	98	100	
Small savings	-113	-13	133	112	-103	-13	58	
Net external assistance	93	110	110	236	124	38	106	
Others	204	418	-189	-56	828	407	321	
Cash Surplus	-271	438	-14	64	-160	-303	0	
Total financing	1,270	3,370	4,185	3,736	5,160	4,900	5,425	
Memo items (% to GDP)								
Centre	-2.5	-6.0	-6.5	-4.8	-5.7	-4.9	-4.8	
State	-1.4	-2.3	-2.9	-3.2	-2.3	-2.1	-1.9	
Combined	-4.0	-8.3	-9.4	-8.0	-8.1	-7.0	-6.7	
Off Balance Sheet Items	-0.6	-1.7	-0.2	0.0	0.0	0.0	0.0	
Total Deficit	-4.6	-10.0	-9.5	-8.0	-8.1	-7.0	-6.7	
Combined liabilities	76.1	76.8	75.5	69.6	69.1	68.3	67.7	

Includes proceeds of transfer of RBI's stake in SBI. RE: Revised Estimates announced on May 31; BE: Budgeted Estimates, based on the government's nominal GDP forecast of Rs101599bn or 14%YoY. ** Revised Estimates as of FY14 Budget in Feb'13; Source: Budget Documents, Citi Research estimates

Global Forecasts

Figure 59. Selected Countries — Economic Forecast Overview (Percent) 2012-2016F

	GDP Growth					CPI					Short Term Interest Rates				
	2012	2013F	2014F	2015F	2016F	2012	2013F	2014F	2015F	2016F	2012	2013F	2014F	2015F	2016F
Global	2.6	2.5	3.2	3.4	3.6	2.9	2.6	2.9	3.3	3.2	2.31	2.21	2.32	2.57	3.05
Based on PPP weights	3.1	2.9	3.6	3.9	4.1	3.4	3.1	3.3	3.8	3.7	2.90	2.77	2.90	3.22	3.67
Industrial Countries	1.4	1.1	2.0	2.2	2.3	1.9	1.3	1.8	1.6	1.6	0.57	0.48	0.48	0.64	1.23
United States	2.8	1.6	2.6	3.2	3.2	1.8	1.2	1.9	2.1	2.1	0.25	0.25	0.25	0.50	1.60
Japan	2.0	1.9	1.8	1.0	1.2	0.0	0.1	2.1	1.5	1.5	0.10	0.10	0.10	0.10	0.10
Euro Area	-0.6	-0.3	0.8	1.0	1.3	2.5	1.4	1.3	1.4	1.4	0.88	0.56	0.50	0.50	0.56
Australia	3.7	2.5	3.0	3.0	3.0	1.8	2.4	3.0	2.5	2.3	3.56	2.69	2.69	3.63	4.75
United Kingdom	0.1	1.4	3.0	3.2	2.7	2.8	2.6	2.2	2.2	2.1	0.50	0.50	0.50	0.54	1.29
Emerging Markets	4.6	4.6	5.0	5.2	5.4	4.6	4.7	4.6	4.8	4.6	5.20	4.95	5.10	5.50	5.74
China	7.7	7.6	7.2	7.0	7.5	2.6	2.7	3.0	3.7	3.8	3.25	3.00	3.03	3.63	3.88
Taiwan	1.3	2.6	3.8	4.0	4.5	1.9	1.2	1.7	2.0	1.8	1.88	1.88	1.97	2.38	2.88
India	5.0	4.8	5.6	6.7	7.3	7.3	6.0	5.0	5.0	5.0	7.80	7.50	7.75	7.75	7.75
Indonesia	6.2	5.7	5.3	5.5	5.9	4.3	7.1	6.6	5.7	5.4	3.90	4.88	6.00	6.00	5.50
Korea	2.0	2.9	3.7	3.9	3.9	2.2	1.3	2.4	3.2	3.1	3.06	2.56	2.50	3.13	3.75
Russia	3.4	1.4	2.8	3.2	3.2	5.1	6.7	5.4	5.0	5.0	8.07	8.25	7.90	7.13	7.00
Turkey	2.2	3.5	4.0	4.2	4.2	8.9	7.3	7.3	6.9	6.4	5.69	4.75	5.00	7.25	7.50
South Africa	2.5	2.1	2.9	3.4	3.9	5.7	5.9	5.5	5.6	5.7	5.28	5.00	5.00	5.46	6.00
Brazil	0.9	2.6	2.0	2.0	2.5	5.4	6.2	5.9	5.7	5.5	8.46	8.44	10.25	10.75	10.63
Mexico	3.8	1.2	3.8	4.0	3.8	4.1	3.8	3.5	3.7	3.6	4.50	3.94	3.50	3.94	5.40

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 FasB1 rate to reflect actual money market rates. Source: Citi Research, *Global Economic Outlook and Strategy, 23rd October 2013*

Figure 60. Selected Countries — Economic Forecast Overview (Percent) 2012-2016F

	Current Balance (Pct of GDP)					Fiscal Balance (Pct of GDP)					Government Debt (Pct of GDP)				
	2012	2013F	2014F	2015F	2016F	2012	2013F	2014F	2015F	2016F	2012	2013F	2014F	2015F	2016F
Global	0.5	0.7	0.7	0.4	0.1	-4.4	-3.5	-3.0	-2.6	-2.4	86	88	86	86	86
Based on PPP weights	0.3	0.4	0.4	0.1	-0.2	-4.2	-3.4	-3.1	-2.7	-2.5	78	79	79	79	78
Industrial Countries	-0.5	0.0	0.0	-0.1	-0.2	-6.0	-4.4	-3.6	-2.9	-2.6	112	116	114	115	115
United States	-2.7	-2.5	-2.6	-2.7	-2.7	-8.1	-4.8	-4.3	-3.8	-3.8	103	106	108	109	109
Japan	1.1	1.5	2.4	1.8	1.5	-10.7	-9.8	-8.0	-6.2	-5.8	237	244	246	251	255
Euro Area	1.3	2.6	2.5	2.5	2.5	-3.7	-2.8	-2.3	-1.8	-1.4	93	96	97	96	96
Australia	-3.7	-2.4	-3.3	-3.3	-3.3	-2.9	-1.2	-2.5	-1.5	-0.3	29	30	32	32	30
United Kingdom	-3.7	-3.8	-2.9	-2.9	-2.8	-6.1	-6.9	-5.6	-4.5	-2.9	89	93	96	97	97
Emerging Markets	2.1	1.9	1.6	1.0	0.4	-1.6	-2.0	-2.1	-2.0	-2.0	43	42	42	42	41
China	2.3	2.2	2.0	1.5	0.8	-2.0	-2.0	-2.0	-1.5	-1.5	45	45	45	44	43
Taiwan	10.5	10.1	9.0	8.0	8.0	-1.6	-1.2	-1.3	-1.0	-0.7	41	41	41	42	43
India	-4.8	-2.7	-2.4	-1.9	-1.7	-7.0	-6.7	-6.4	-6.2	-5.9	68	67	66	65	64
Indonesia	-2.8	-3.3	-2.7	-2.0	-1.9	-1.9	-2.1	-1.8	-1.7	-1.9	24	25	26	25	24
Korea	3.8	5.1	3.2	2.0	1.4	1.5	0.9	2.3	2.3	2.6	33	35	33	31	29
Russia	3.6	2.8	0.9	-1.7	-3.1	-0.7	-2.0	-4.2	-4.6	-3.2	8	8	10	13	15
Turkey	-5.8	-6.9	-6.6	-6.3	-5.6	-2.0	-1.2	-2.7	-2.7	-3.0	39	37	37	36	36
South Africa	-6.1	-6.0	-5.6	-5.1	-4.2	-4.4	-5.0	-4.8	-4.4	-3.7	41	43	45	44	44
Brazil	-2.4	-3.5	-3.2	-3.0	-3.0	-2.5	-3.8	-3.7	-2.6	-3.1	59	59	60	60	60
Mexico	-1.2	-1.8	-2.0	-1.8	-3.3	-2.6	-2.4	-3.5	-2.5	-2.0	40	38	38	38	37

Note: US debt and deficit figures are for the Federal government only. All other countries are general government debt and deficits.
Source: Citi Research, *Global Economic Outlook and Strategy, 23rd October 2013*

Figure 61. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent) 2012-2016F

	10-Year Yields					Exchange Rates Versus U.S. Dollar*				
	2012	2013F	2014F	2015F	2016F	2012	2013F	2014F	2015F	2016F
Industrial Countries										
United States	1.80	2.30	3.00	3.50	3.75	NA	NA	NA	NA	NA
Japan	0.85	0.72	0.60	0.90	1.25	81	98	104	105	105
Euro Area	1.57	1.62	1.83	2.00	2.25	1.28	1.33	1.40	1.40	1.40
Australia	3.28	3.65	4.30	4.75	5.50	1.02	0.97	0.95	0.93	0.93
United Kingdom	1.85	2.34	3.08	3.60	3.80	1.59	1.58	1.71	1.74	1.75
Emerging Markets										
China	3.33	3.90	4.02	4.40	4.77	6.31	6.14	6.08	6.02	6.02
Taiwan	1.21	1.51	1.97	1.50	1.70	29.57	29.65	29.03	28.99	28.78
India	8.25	8.20	8.25	8.25	8.25	53.38	59.41	62.08	58.83	56.84
Indonesia	5.90	7.18	7.81	8.25	8.50	9361	10588	11529	11101	10586
Korea	3.24	3.03	3.59	4.03	4.30	1127	1095	1029	1001	993
Russia	NA	NA	NA	NA	NA	31.1	32.0	32.5	32.6	32.6
Turkey	NA	NA	NA	NA	NA	1.80	1.94	2.04	2.07	2.05
South Africa	7.23	7.34	8.00	9.00	9.20	8.21	9.77	10.05	10.41	10.56
Brazil	9.31	9.48	12.25	12.75	11.38	1.95	2.17	2.29	2.34	2.31
Mexico	5.70	5.67	6.73	7.16	7.46	13.2	12.7	12.4	12.3	12.3

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

Figure 62. Foreign Exchange Forecasts (End of Period), as of 23 October 2013

	vs. USD						vs. EUR					
	Current	Dec 13	Mar14	Jun 14	Sep14	Dec14	Current	Dec 13	Mar14	Jun 14	Sep14	Dec14
United States	NA	NA	NA	NA	NA	NA	1.37	1.38	1.39	1.40	1.40	1.40
Japan	98	99	102	104	105	105	134	137	142	146	147	147
Euro Area	1.37	1.38	1.39	1.40	1.40	1.40	NA	NA	NA	NA	NA	NA
Canada	1.03	1.04	1.05	1.06	1.06	1.07	1.41	1.43	1.46	1.48	1.49	1.49
Australia	0.97	0.97	0.96	0.95	0.95	0.94	1.42	1.42	1.44	1.47	1.48	1.49
New Zealand	0.85	0.87	0.86	0.85	0.84	0.84	1.61	1.60	1.62	1.64	1.66	1.68
Norway	5.91	5.84	5.78	5.73	5.66	5.58	8.09	8.08	8.05	8.01	7.92	7.82
Sweden	6.40	6.41	6.40	6.39	6.37	6.34	8.76	8.87	8.90	8.94	8.92	8.88
Switzerland	0.90	0.90	0.90	0.89	0.90	0.90	1.23	1.25	1.25	1.25	1.26	1.26
United Kingdom	1.62	1.67	1.69	1.70	1.71	1.72	0.84	0.83	0.82	0.82	0.82	0.81
China	6.10	6.08	6.09	6.10	6.08	6.06	8.3	8.4	8.5	8.5	8.5	8.5
India	61.3	61.4	62.1	62.9	62.2	61.2	83.9	84.9	86.4	87.9	87.1	85.7
Korea	1062	1051	1041	1032	1024	1017	1453	1454	1448	1443	1434	1424
Russia	31.9	31.8	32.2	32.6	32.6	32.6	43.6	44.0	44.7	45.5	45.7	45.7
South Africa	9.77	9.92	9.95	9.99	10.08	10.18	13.37	13.72	13.85	13.97	14.11	14.25
Turkey	1.97	1.99	2.02	2.04	2.05	2.06	2.69	2.76	2.81	2.86	2.87	2.88
Brazil	2.15	2.22	2.25	2.29	2.31	2.32	2.95	3.07	3.14	3.21	3.23	3.25
Mexico	12.8	12.6	12.5	12.4	12.4	12.4	17.5	17.4	17.4	17.4	17.3	17.3

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

Appendix A-1

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