Country Reports: Country Outlook: Economic - India

24 Jul 2014 IHS Economics and Country Risk

Country Risk Statement

Following a decade of near-double-digit growth, fueled by massive investment levels and impressive savings rates, India's economy has been losing its steam, mired in underinvestment, high inflation, and policy paralysis. Investment, both domestic and foreign, has been stifled by intrusive market regulation, poor infrastructure, inflexible labor-market practices, and numerous supply bottlenecks, while recurring fiscal deficits have crowded out private credit. As a result, the inflows of foreign direct investment, crucial to spurring the development of manufacturing, have dried up and remained relatively low, particularly vis-à-vis neighboring powerhouse China. Manufacturing sector growth, responsible for generating mass employment in most rapidly developing economies, has also slowed, with the sector's competitiveness in the global markets gradually eroding. The resounding victory of the Bharatiya Janata Party (BJP) in the April–May 2014 Parliamentary elections and the formation of a stable majority government (for the first time in 30 years) puts the new prime minister, Narendra Modi, in a strong position to transform the economic landscape and unlock the economy's full potential by virtue of far-reaching structural reforms. Given the government's strong mandate and reform orientation, the outlook for India's return to high growth rates over the medium and long term is positive, but the risks of slippage will persist. Given the complexity of India's political system, the BJP will face key challenges to its reform agenda, including from state governments ruled by opposition parties, and from the Indian parliament's upper house. More imminently, the return of inflationary pressures amid the dry monsoon season, mounting fiscal obligations, and potential worsening of the current-account dynamics following the removal of restrictions on gold imports will come as a first test of the government's effectiveness.

Short-Term Outlook

Key Points

- Improving business sentiment and stable reform-oriented government should help jump-start India's economic recovery, but no sharp rebound is expected.
- Controlling inflation remains the main focus for the central bank, as it carefully calibrates its monetary policy course.
- A sudden reversal of positive post-election market sentiment and returning balance-of-payments pressures remain key risks for the rupee in the near term.

Analysis

Improving business sentiment and stable reform-oriented government should help jump-start India's economic recovery, but no sharp rebound is expected. The landslide victory of the Bharatiya Janata Party (BJP) in the May 2014 general elections and the formation of a stable majority government have improved prospects for India's economic recovery. If sustained, post-election market optimism will translate into the revival of corporate investment, crucial to accelerate India's growth. With market expectations running high, though, it is critical for the new government to focus on addressing policy paralysis and accelerating much-needed reforms. Restoring momentum in the manufacturing sector and infrastructure investment will be essential. On the assumption of a faster decision-making process on reforms, we anticipate a gradual acceleration in capital spending from fiscal year (FY) 2014 onward. Easing political uncertainty, clearance of existing investment projects, and a more stable macroeconomic environment should boost confidence and revive investment. Concurrently, the manufacturing sector will benefit from the government's extended tax benefits and improving domestic and external demand. Still, the recovery will be only gradual, considering the inherently weak momentum in manufacturing and services activity as well as the likely underperformance of the agricultural sector following the dry monsoon season, which will also constrain rural demand. Meanwhile, space for monetary and fiscal policy stimuli will remain limited. With the Reserve Bank of India (RBI) determined to bring consumer price inflation down to 8% by January 2015 and 6% by January 2016, sustained monetary policy easing is unlikely in the near term. Government spending will be also constrained by the need to meet fiscal targets. As a result, we expect real GDP to accelerate to 5.4% in FY 2014 and to 6.2% in FY 2015, with more robust recovery anticipated in FY 2016.

Controlling inflation remains the main focus for the central bank, as it carefully calibrates its monetary policy course. Despite a less-hawkish tone in its June monetary policy statement, the RBI remains firmly focused on inflation, particularly in light of rising inflation risks emanating from below-average monsoon rains that threaten to disrupt summer crops, as well as rising oil prices due to unfolding instability in the Middle East. Given this backdrop, the RBI's balanced inflation outlook rests on assumptions of stronger government action on food supply and better fiscal consolidation, which would help contain inflationary pressures, bringing consumer price index inflation down to a desired rate of 8% by January 2015 and 6% by January 2016. Consistent with this outlook, IHS believes that the rising food and fuel price pressures should be balanced by the lagging impact of previous rate hikes, high base effects, and still-weak domestic demand, keeping the overall price pressures contained without the need to raise interest rates in the near term. Concurrently, with inflation risks remaining significant, previously considered interest-rate cuts should also not be expected in the coming months.

A sudden reversal of positive post-election market sentiment and returning balance-of-payments pressures remain key risks for the rupee in the near term. The overwhelmingly positive market reaction to the May 2014 election outcome sent the Indian rupee exchange rate below INR58.50/USD1.00 in the third week of May—levels last seen in July 2013. However, the rupee lost some of its gains in the following weeks, and its likely near term path will be sideways. While positive post-election sentiment is expected to support the currency in upcoming months, market expectations will be highly sensitive to the government's policy announcements and its ability to stay on the path of structural reforms. More fundamentally, capital inflows into India are likely to gradually

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resume, but the trade and current-account dynamics are expected to become less positive; imports will start to recover on improving domestic demand and easing restrictions on gold imports, while the oil import bill may also rise, given building instability in the Middle East. On balance, we believe the Indian rupee could lose some of its recent gains over the near term but remain stronger than at the end of 2013, appreciating around 4.1% vis-à-vis the US dollar by end-2014 and remaining stable throughout 2015.

Assumptions

- The Bharatiya Janata Party's (BJP) strong political mandate will enable it to push forward significant reforms, with privatization, deregulation, and infrastructure spending helping the growth recovery and improving business and consumer sentiment. With the first BJP budget seen as a preliminary indicator of policy intent, the reforms will likely be gradual and measured, rather than immediate and fast paced.
- The Reserve Bank of India will maintain a tightening near-term bias amid persistent inflation concerns. Further easing of price pressures toward the end of 2014, if at all, could open a short window of opportunity to ease policy rates, but the cut would be largely symbolic with rates likely to remain on hold through 2015.
- Dry monsoon rains may disrupt agricultural output and result in inadequate food supplies, putting upward pressure on inflation and slowing down growth recovery.
- The global economic recovery over the medium term remains fragile, given that underlying global imbalances are still in place. The lagging deleveraging process among households in many developed countries will continue to weigh on their ability to resume pre-crisis consumption levels and support Indian exports.
- While remaining timid in the near term amid an uncertain domestic economic and political landscape, foreign direct investment and other capital inflows will return and increase in the medium and longer terms, as India remains an attractive investment destination.

Changes Since Last Forecast

July interim forecast versus June interim forecast		
GDP	**STABLE**	In June, we marginally upgraded our near-term growth outlook for India to 5.4% in FY 2014 and 6.2% in FY 2015. We have left the outlook unchanged in July, reaffirming our previous assumptions of gradual recovery driven by improvements in manufacturing, trade, and investment.
CPI inflation	**UP**	Despite a weaker-than-anticipated June CPI reading, we have raised India's CPI inflation forecast to 8.0% in 2014, from 7.8% previously, to reflect greater risks to food and energy price inflation.
Industrial production	**UP**	With recent industrial production data pointing to tentative signs of manufacturing and investment recovery, we have upgraded the outlook for India's industrial production growth to 3.0% in 2014 and 5.7% in 2015, from 2.7% and 5.6%, previously.

Alternative Scenarios

- The opposition from state governments and the parliament's upper house, where the Bharatiya Janata Party does not have a majority, will stall the reform momentum, which would translate into weaker investment recovery, lower foreign capital inflows, higher inflation, and slower growth recovery.
- Any sharp retrenchment in US and/or European growth could hit India's economy. Were external demand to experience a prolonged downturn, India's exports would be hit quickly and capital inflows would falter. A hard landing or any significant slowing in China would dampen India's economic prospects, even though the impact on India would be less than on the rest of Asia.
- Oil prices rising to USD130 per barrel or higher and remaining at elevated levels for three or more months, as a result of supply disruptions from one or more major oil-exporting countries and other factors, would adversely affect India's inflation, economic growth, and the current account.
- A worsening of the global economic and geopolitical backdrops and/or escalation of military confrontation in Kashmir with neighboring Pakistan. Even if outright conflict is averted, fresh tensions would deter foreign investment inflows and affect currency and equity markets.
- Unforeseen volatility emerges in Indian agricultural prices and output, with the lack of monsoon rains affecting the agricultural output beyond our baseline scenario.

Data

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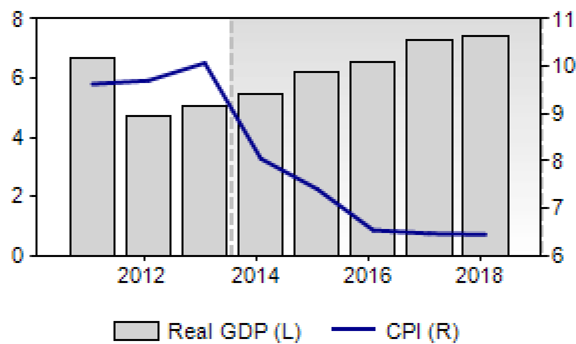

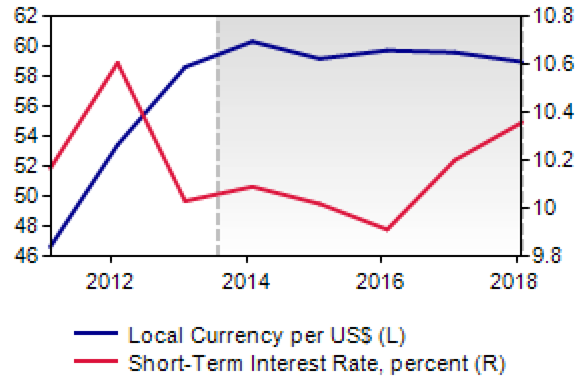

Key Macro-Economic Indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% change)	10.3	6.6	4.7	5.0	5.4	6.2	6.5	7.3	7.4
Nominal GDP (US$ bil.)	1,702.3	1,930.9	1,892.8	1,938.0	2,118.1	2,444.2	2,747.4	3,144.8	3,630.7
Nominal GDP Per Capita (US$)	1,412	1,581	1,531	1,548	1,671	1,906	2,118	2,398	2,739
Consumer Price Index (% change)	12.0	9.6	9.7	10.1	8.0	7.4	6.5	6.5	6.4
Policy Interest Rate (%)	6.25	8.50	8.00	7.75	8.00	8.00	7.25	6.75	7.00
Fiscal Balance (% of GDP)	-4.7	-5.7	-4.8	-4.9	-4.6	-4.4	-4.2	-4.0	-3.8
Population (mil.)	1,205.62	1,221.16	1,236.69	1,252.14	1,267.40	1,282.39	1,297.07	1,311.48	1,325.62
Unemployment Rate (%)	8.6	9.5	8.9	9.3	9.4	9.2	8.8	8.5	8.1
Current Account Balance (% of GDP)	-3.2	-3.2	-4.8	-1.9	-2.3	-2.3	-2.6	-2.4	-2.6
BOP Exports of Goods US$bn	231.0	307.8	298.3	315.1	336.6	373.3	428.1	493.6	566.3
BOP Imports of Goods US$bn	324.3	428.0	450.2	428.5	435.5	486.6	545.0	621.3	715.7
Exchange Rate (LCU/US$, end of period)	44.81	53.27	54.78	61.90	59.33	59.35	60.04	59.61	58.94

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated on the 15th of each month from monthly forecast update bank (GIIF). Written analysis may include references to data made available after the release of the GIIF bank.

Medium- and Long-Term Outlook

Key Points

- Formation of a stable reform-oriented government improves India's medium- and long-term growth prospects.
- Structural reforms in the private sector will continue outpacing those in the public sector, boosting trend GDP growth and slowly reducing poverty levels.
- India's underutilization of resources, implying the economy is not fully utilizing its growth potential, translates into economic advantage in the long term.
- India's democratic political system is more stable and institutionalized than those of other developing countries.
- The government's optimistic economic growth target of upwards of 10% a year, however, remains out of reach.

Analysis

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Formation of a stable reform-oriented government improves India's medium- and long-term growth prospects. Following a moderation in the near term, India's economy should regain momentum over the medium and long term, although this remains conditional on the successful implementation of structural reforms. The country's rapid economic expansion over the late 1990s/early 2000s was made possible mainly by significant efficiency gains with little increase in investment rates, allowing the economy to expand at over 6% on average annually, substantially higher than the earlier average of about 3% per year in the prior two decades. In order to move the economy forward at comparable rates, the country needs to boost its capital and labor productivity. This would require substantial investment, possible only through the acceleration of reforms. The landslide victory of the Bharatiya Janata Party (BJP) in April–May 2014 general elections and a subsequent formation of a stable majority government with a strong reform mandate improve India's chances to return to its previous rapid growth path. Nevertheless, even as the new government is well positioned to jumpstart economic momentum and address the structural issues that circumscribe India's long-term growth potential, it will require decisive and consistent policymaking and skillful collaboration of the centre with the local governments that overwhelmingly control the decision making on the ground.

Structural reforms in the private sector will continue outpacing those in the public sector, boosting trend GDP growth and slowly reducing poverty levels. With public investment being stalled by numerous bureaucratic hurdles, development is increasingly generated by the private sector, which is both saving and investing a larger share of GDP. The number of industries barred from the private sector has been gradually reduced from 47 to a mere handful. Most consumer goods are now produced in highly competitive markets. Industrial liberalization, along with a moderate cut in external trade barriers, has created more competitive Indian firms, especially in sectors such as pharmaceuticals, software, and other services. The greatest success has been in information technology. The industry has grown over 60% annually, and exports exceeded USD76 billion in fiscal year (FY) 2013. Software exports comprise around 16% of India's total exports and account for 4% of the country's GDP. India's further transformation towards a progressively greater outward orientation will raise the contribution to GDP from net exports, although the pace of change will be gradual.

India's underutilization of resources, implying the economy is not fully utilizing its growth potential, translates into economic advantage in the long term. Plentiful, undeveloped natural resources offer untapped potential. The highly skilled, educated labor force boosts prospects for both the private and public sectors. The dynamic, successful overseas Indian community also sparks domestic entrepreneurial activity, both directly and indirectly. Rapid urbanization rates will also act as an important force of change in the long term.

India's democratic political system is more stable and institutionalized than those of other developing countries. With more linguistic and religious diversity than other nations, the compulsions of governance force major parties to act pragmatically and to avoid sharp changes in policy. This ensures policy continuity and institutional stability even as governments change. On the downside, the need to accommodate multiple interests often disables rapid and effective policy implementation, resulting in a factitious and ad-hoc approach to the national policy-making.

The government's optimistic economic growth target of upwards of 10% a year, however, still remains out of reach. Such rapid growth would require a substantial increase in public and private investment. The household saving rate, which stands at around 25% of GDP, is fairly high, compared with other developing economies at similar income levels, but the share of financial savings available for corporate- and public-sector investment is less than 17% of GDP and is declining. To boost domestic savings, the government needs to make a greater effort to incentivize household financial savings and mobilize public savings, while exploring the scope for expenditure control at all levels. In addition, it needs to make India a favored destination for foreign investment, to fill the remaining resource gap from external resources. Prospects will depend critically on efforts made by the government to deregulate a broad swath of the economy and rid it of burdensome regulations stemming from the "license raj." The ability to control the country's nettlesome fiscal deficit will be key in reducing the high cost of capital for the country's private sector. Politically difficult decisions might be required to reduce expenditure, including serious downsizing of bureaucracies and cuts in subsidies. Privatization needs to stand atop the government's reform agenda, while more efficient revenue collection is essential.

Growth

GDP

Key Points

- The turnaround in manufacturing and infrastructure will drive India's near-term growth recovery, but poor agricultural output and tight monetary and fiscal policies will keep the recovery gradual.
- Boosting investment remains critical for India's growth recovery.
- The economy should regain momentum in the medium term, but the growth rates achieved in the last decade might still be out of reach.

Analysis

The turnaround in manufacturing and infrastructure will drive India's near-term growth recovery, but poor agricultural output and tight monetary and fiscal policies will keep the recovery gradual. Although still tentative, the first signs of an economic recovery in India are emerging, with recent data pointing to improving business sentiment as well as a pickup in industrial-sector activity and domestic demand. The industry sector is showing visible improvement from last year's contraction, having expanded 4.1% year on year (y/y) during April–May—the first two months of fiscal year (FY) 2014. The improvement also appears to be broad based, with both manufacturing and consumer goods output finally turning positive in May. Easing political uncertainty following the formation of a stable government in May 2014, the ongoing clearance of stalled investment projects, and a more stable macroeconomic environment should further boost business confidence. The government's tax measures announced in the FY 2014 budget should provide additional stimulus to the industry sector. Meanwhile, the ongoing improvement in global growth should support India's investment cycle and accelerate exports. On the downside, agricultural performance is likely to suffer from monsoon rains, circumscribing farm-sector output and rural demand. Likely food supply shortages will also

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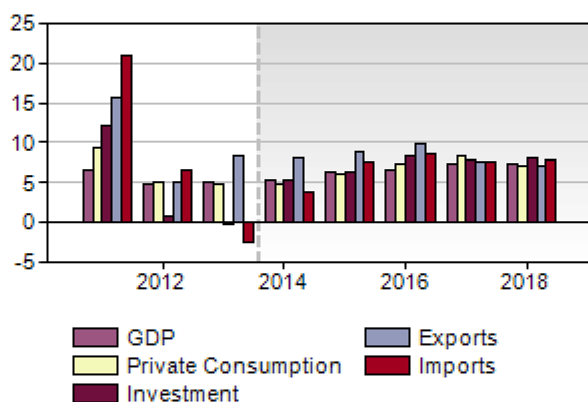
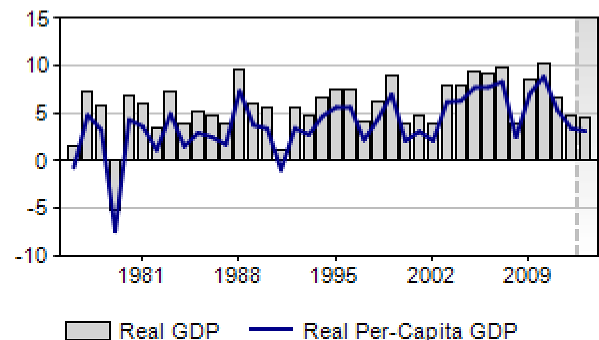
cause higher inflationary pressures, ensuring that the Reserve Bank of India's monetary policy remains tight, which would restrain the growth recovery. The government's ability to stimulate growth will remain limited given its ambitious fiscal consolidation plans. As a result, we expect the recovery to proceed slowly, with real GDP growth accelerating to 5.4% in FY 2014 and 6.2% in FY 2015.

Boosting investment remains critical for India's growth recovery. The downward spiral of India's growth has been largely caused by the structural factors that dried up investment activity. Falling productivity, lack of financing, and numerous regulatory issues have dampened investment, bringing manufacturing sector growth to naught. Real fixed investment declined 0.9% y/y during the January–March 2014 quarter, bringing the full FY 2013 average to -0.1%, which marked the first year of investment contraction in more than a decade. The new government is well positioned to resolve India's policy paralysis through a faster decision-making process and firmer stance on structural reforms; thus, we anticipate a gradual acceleration in capital spending from FY 2014 onward. The revival of capital markets should help India's businesses to deleverage their balance sheets, providing capital for new investments, while improving business sentiment will drive new investment decisions. However, as the public and private sectors go through the round of consolidation, deployment of fresh capital will likely come with a lag. As a result, we expect India's investment recovery to take time, with the real fixed investment growth gradually accelerating to 5.8% in FY 2014 and 6.8% in FY 2015.

The economy should regain momentum in the medium term, but the growth rates achieved in the last decade might still be out of reach. The formation of a new stable pro-reform government following the general elections in May 2014 brings back the prospects of India's economic revival, although the implementation of structural policy reforms remains a key to the future growth. Even including three years of well-below-trend growth, the economy has the potential to keep advancing at rates above 7% over the medium-to-long term, thanks to favorable demographics and abundant labor, strong exports potential, and greater contributions from the service and construction sectors. However, in order to bring the economy back on track and fully realize this potential, India will have to speed up investment, liberalize its stiff labor market, eliminate wasteful subsidies, and diversify from IT-enabled services into value-added manufacturing and financial services.

Data





Economic Growth Indicators

	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% change)	6.6	4.7	5.0	5.4	6.2	6.5	7.3	7.4
Real Consumer Spending (% change)	9.3	5.0	4.8	4.9	6.0	7.3	8.4	7.0
Real Government Consumption (% change)	6.9	6.2	3.8	5.0	5.1	5.3	4.4	5.1
Real Fixed Capital Formation (% change)	12.3	0.8	-0.1	5.4	6.4	8.3	8.0	8.1
Real Exports of Goods and Services (% change)	15.6	5.0	8.4	8.0	8.9	9.8	7.5	7.1
Real Imports of Goods and Services (% change)	21.1	6.6	-2.5	3.9	7.7	8.7	7.6	7.7
Nominal GDP (US$ bil.)	1,930.9	1,892.8	1,938.0	2,118.1	2,444.2	2,747.4	3,144.8	3,630.7
Nominal GDP Per Capita (US$)	1,581	1,531	1,548	1,671	1,906	2,118	2,398	2,739

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Consumer Demand

Key Points

- The first signs of recovery in consumer spending are emerging, but the dry monsoon season threatens to reverse recent gains.
- The medium-term trends still look favorable, despite the immediate weakness.

Analysis

The first signs of recovery in consumer spending are emerging, but the dry monsoon season threatens to reverse recent gains. India's consumer spending is slowly, tentatively recovering. Industrial output data for May showed consumer goods output growth turning positive for the first time in more than a year, with consumer durable goods growing 3.2% year on year (y/y). Vehicle sales are also rebounding, up 15% y/y in June, following a contraction throughout most of FY 2013. Going forward, the improving political landscape following the general elections should help consumer sentiment pick up further, while recent moderation in price pressures and lower inflation expectations should boost consumer spending. In the automotive sector, the impetus to growth will come from the reduction in the excise duty on passenger vehicles and two-wheelers, which was introduced in February 2014 and extended by the new government until the end of the year. On the downside, the expected poor agricultural output on the back of a dry monsoon season threatens to circumscribe household incomes, particularly in rural India, while also exerting higher inflation pressures on food. IHS expects India's consumer demand growth to recover only marginally to 4.9% in FY 2014, up from 4.8% in FY 2013 (ended 31 March 2014). Growth will accelerate in FY 2015 to 6.0%.

The medium-term trends still look favorable, despite the immediate weakness. Rising rural incomes and improving access to credit will gradually revive consumer spending in the medium term. The import demand should also recover, supported by the gradual phasing out of the administrative import restrictions put in place during the summer of 2013, as well as by a recovery in the rupee exchange rate. In addition, vehicle sales (a proxy for retail sales) are expected to finally start growing again in FY 2014 and rebound even more in the coming years. Over the medium to long term, consumer demand should regain its healthy growth, bolstered by continued strength in the agricultural, service, and manufacturing sectors.

Capital Investment

Key Points

- Capital spending remains inherently weak, but a gradual pickup in investment is expected in the coming months.
- Over the medium term, investment sentiment needs to be improved if India's growth is to reaccelerate.

Analysis

Capital spending remains inherently weak, but a gradual pickup in investment is expected in the coming months. The pre-election political uncertainty, high borrowing costs, and the slowing economic momentum have dried up India's corporate investment. The latest data on investment proposals showed new investment announcements in the January–March 2014 quarter dropping by almost 50% from the average of the previous four quarters, with 191 new investment projects worth INR541 billion announced. Completion of existing industrial projects has also declined during the quarter, with 252 projects commissioned, 56% down from a year earlier. All the major sectors including metals, textiles, chemicals, automobiles, power, and transport services witnessed a steep decline in commissioning of new capacities during the quarter, with only road services infrastructure showing expansion. Going forward, the overwhelmingly positive market reaction to the outcome of the April–May general elections is expected to improve business sentiment while the government's efforts to address policy paralysis—including the fast-track mechanism for project approvals—should revive corporate and public investment. We expect real fixed investment growth to rebound to 5.4% in FY 2014, from a 0.1% contraction in FY 2013 (ended 31 March 2014).

Over the medium term, investment sentiment needs to be improved if India's growth is to reaccelerate. Despite the existing setbacks, the efficiency of investment in the economy will continue to increase, as private investors have been allowed to invest in more sectors of the economy, and public investment projects have become more selective and better managed. Nevertheless, lifting the rate of investment growth substantially—and thus maintaining the upward trend in the overall GDP growth rate—will require a much stronger effort to accelerate policy reforms and improve public spending budgeting, as the economy faces a few interrelated challenges in the next few years. In addition to increased capital, a structural transformation of the economy, together with a less distorted investment environment, is essential to stimulate productivity increases by shifting resources from the less to the more efficient sectors. Meanwhile, improvements in physical infrastructure to sustain high industrial growth will also be crucial.

Inflation

Key Points

- A dry monsoon season and instability in the Middle East increase near-term inflation risks, but high base effects may still help keep inflation in check in 2014.

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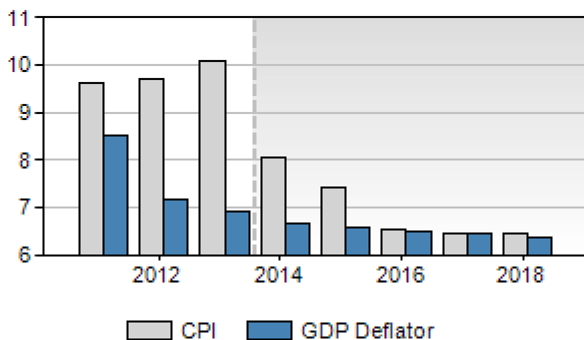
- Structural supply- and demand-side imbalances remain, particularly in agricultural products, suggesting inflation cannot be dismissed as a temporary phenomenon.

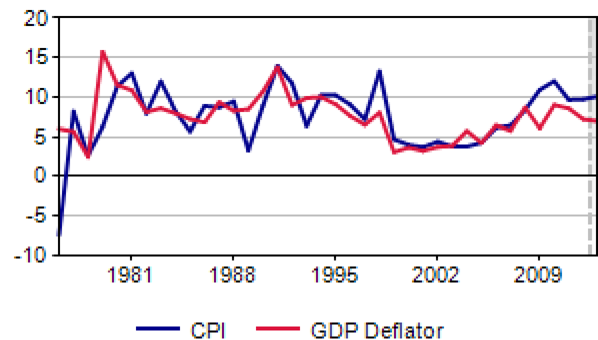
Analysis

A dry monsoon season and instability in the Middle East increase near-term inflation risks, but high base effects may still help keep inflation in check in 2014. Moderation in June inflation was stronger than anticipated, with both wholesale price index (WPI) and consumer price index (CPI) inflation easing to multiyear lows. The government's timely efforts to curb farm exports earlier in the month have kept vegetable prices in check for now, but it will become increasingly difficult to address food price pressures going forward. With the current monsoon rains proving to be below normal levels, 2014 summer crops are unlikely to provide sufficient supply, with abnormal spikes in vegetable prices—typical in India during droughts—particularly risky for the overall inflation outlook. Meanwhile, fuel prices, relatively stable in the past months, may also accelerate, given the unfolding unrest in the Middle East. While acknowledging these downside risks, IHS still believes that the previous interest rate hikes, high base effects, and only a gradual improvement in domestic demand may push the headline annual inflation slightly down in the second half of 2014. This would bring the full-year average CPI to a projected 8.0% and WPI to 5.5% in 2014, allowing the RBI to refrain from additional interest rate hikes in 2014. However, price pressures are likely to intensify in early 2015, reflecting the improving domestic demand and the potential effect of subsidy cuts should the new government accelerate its fiscal consolidation path. With the RBI determined to bring the CPI inflation down to 6.0% by January 2016, we expect the monetary stance to remain tight throughout 2015.

Structural supply- and demand-side imbalances remain, particularly in agricultural products, suggesting inflation cannot be dismissed as a temporary phenomenon. Food inflation remains high even as it is off its peaks, and we expect elevated food inflation to exert upward pressure on headline inflation in the near term. Historically, food inflation has played a big role in overall inflation, given the large weight of food prices in the overall consumer price basket (around 49%). Food prices are being driven by structural factors, such as demand for protein, not necessarily only by seasonal monsoon and farm output trends. Addressing these factors requires significant supply-side policy reforms directed at improving agricultural sector productivity and eliminating inefficiencies within distribution channels.

Data





Inflation Indicators

	2011	2012	2013	2014	2015	2016	2017	2018
Consumer Price Index (% change)	9.6	9.7	10.1	8.0	7.4	6.5	6.5	6.4
Wholesale-Producer Price Index (% change)	9.5	7.5	6.3	5.5	6.1	6.2	5.7	5.7

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated on the 15th of each month from monthly forecast update bank (GIIF). Written analysis may include references to data made available after the release of the GIIF bank.

Exchange Rates

Key Points

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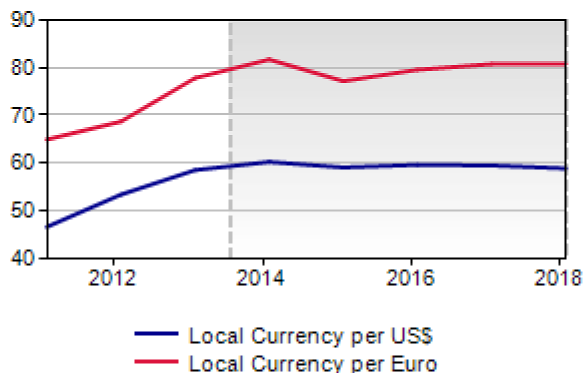
- A sudden reversal of positive post-election market sentiment and returning balance-of-payments pressures remain key risks for the rupee in the near term.
- Renewed investment prospects suggest a slightly stronger path for the rupee over the medium term.

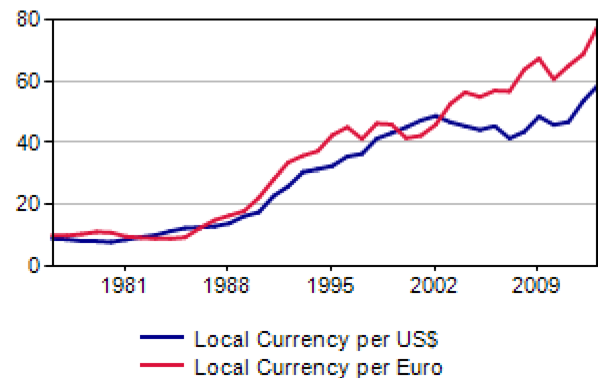
Analysis

A sudden reversal of positive post-election market sentiment and returning balance-of-payments pressures remain key risks for the rupee in the near term. The overwhelmingly positive market reaction to the May 2014 election outcome sent the Indian rupee exchange rate below INR58.50/USD1.00 in the third week of May—a level last seen in July 2013. However, the rupee lost some of its gains in the following weeks, and its likely near-term path will be sideways. While positive post-election sentiment is expected to support the currency in the upcoming months, market expectations will be highly sensitive to the government's policy announcements and its ability to stay on the path of structural reforms. More fundamentally, capital inflows into India are likely to gradually resume, but the trade and current-account dynamics are expected to become less positive ; imports will start to recover on improving domestic demand and easing restrictions on gold imports, while the oil import bill may also rise, given building instability in the Middle East. On balance, we believe the Indian rupee could lose some of its recent gains over the near term but remain stronger than at the end of 2013, appreciating around 4.1% vis-à-vis the US dollar by end-2014 and remaining stable throughout 2015.

Renewed investment prospects suggest a slightly stronger path for the rupee over the medium term. With India's new government well positioned to restart the reform momentum and improve potential growth, foreign investment into India is likely to accelerate, creating a stronger path for the rupee than previously expected. Nonetheless, much will depend on the actual reform outcomes and the speed of their implementation. Meanwhile, with developed markets expected to continue gradually withdrawing monetary support, the global financial markets will remain volatile, weighing on the Indian rupee exchange rate.

Data





Exchange Rate Indicators

	2011	2012	2013	2014	2015	2016	2017	2018
Exchange Rate (LCU/US$, end of period)	53.27	54.78	61.90	59.33	59.35	60.04	59.61	58.94
Exchange Rate (LCU/US$, period avg)	46.66	53.43	58.59	60.28	59.15	59.70	59.56	58.94
Exchange Rate (LCU/Euro, end of period)	68.92	72.28	85.36	77.72	78.34	80.70	81.31	81.10
Exchange Rate (LCU/Euro, period avg)	64.88	68.65	77.79	81.67	77.13	79.52	80.72	80.74

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated on the 15th of each month from monthly forecast update bank (GIIF). Written analysis may include references to data made available after the release of the GIIF bank.

Policy

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Key Points

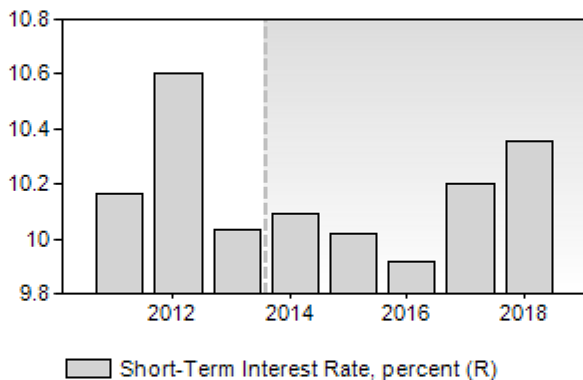
- Rising price pressures will keep the central bank firmly focused on controlling inflation in the near term.
- As macroeconomic imbalances are gradually corrected over the medium term, the policy stance may become more supportive of growth.

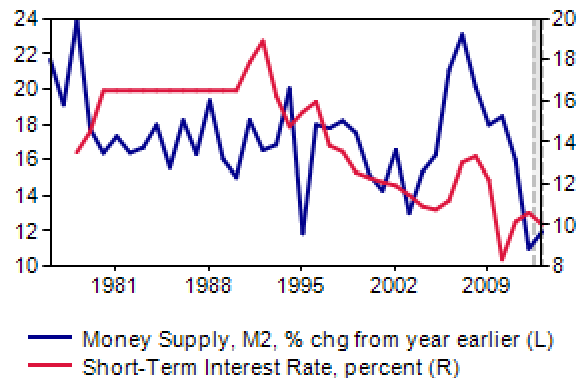
Analysis

Rising price pressures will keep the central bank firmly focused on controlling inflation in the near term. Since Reserve Bank of India (RBI) governor Raghuram Rajan took office in September 2013, India's policy repurchase rate has been raised three times by a cumulative 75 basis points to 8.00%, signaling the RBI's strong commitment to bring inflation down, even at a cost of weaker growth. Despite a less-hawkish tone in its June monetary policy statement, the RBI remains firmly focused on inflation, particularly in light of rising inflation risks emanating from below-average monsoon rains that threaten to disrupt summer crops, as well as rising oil prices because of unfolding instability in the Middle East. The RBI's balanced inflation outlook rests on assumptions of stronger government action on food supply and better fiscal consolidation, which would help contain inflationary pressures, bringing consumer price index inflation down to a desired rate of 8% by January 2015 and 6% by January 2016. Consistent with this outlook, IHS believes that the rising food and fuel price pressures should be balanced by the lagging impact of previous rate hikes, high base effects, and still-weak domestic demand, allowing the overall price pressures to remain contained without the need to raise interest rates in the near term. Concurrently, with the monetary space remaining narrow, previously considered interest-rate cuts are also not expected in the coming months.

As macroeconomic imbalances are gradually corrected over the medium term, the policy stance may become more supportive of growth. With the recent RBI shift towards consumer prices as India's main inflation barometer (which tends to run higher than wholesale price inflation), achieving a sustained moderate level of inflation may require keeping policy interest rates high, particularly as inflation risks accelerate. In the meantime, the new government's commitment to bring structural inflation down through comprehensive reforms will create a dual mandate on inflation, which would help bring structural inflation down over the medium term. As macroeconomic imbalances gradually correct, the RBI may begin relaxing monetary policy from 2016 onwards.

Data





Monetary Policy Indicators

	2011	2012	2013	2014	2015	2016	2017	2018
Policy Interest Rate (%, end of period)	8.50	8.00	7.75	8.00	8.00	7.25	6.75	7.00
Short-term Interest Rate (%, end of period)	10.17	10.60	10.03	10.09	10.02	9.91	10.20	10.36
Long-term Interest Rate (%, end of period)	8.38	8.30	8.15	8.61	8.12	8.17	8.61	8.78

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated on the 15th of each month from monthly forecast update bank (GIIF). Written analysis may include references to data made available after the release of the GIIF bank.

Fiscal Policy

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Key Points

- The new fiscal year (FY) 2014 budget remains focused on fiscal consolidation, despite difficult targets.
- Recurring fiscal deficits remain a key constraint to growth.

Analysis

The new fiscal year (FY) 2014 budget remains focused on fiscal consolidation, despite difficult targets. The first budget of the new Bharatiya Janata Party–led government, delivered in July 2014, reaffirms the government's commitment to continued fiscal consolidation and greater openness to domestic and foreign businesses. As anticipated, the new taxation measures focus on promoting investment in manufacturing and infrastructure, reducing tax-related litigation, and creating a more favorable tax environment for foreign investors. Tax revenue collection is set to increase 17% from FY 2013, while the budget also targets raising INR634 billion (USD10.6 billion) from privatization of state enterprises—two-and-a-half times the amount raised last year. On the expenditure side, total spending is set to rise 12.9% from FY 2013, with no cuts on subsidy spending provisioned in the budget. The overall deficit target is set at 4.1% of GDP in FY 2014, unchanged from the interim budget released by the previous United Progressive Alliance government in February 2014. If achieved, this would bring the government finances closer to the medium-term goal of shrinking the budget deficit to 3% of GDP within the next three years. While this target is commendable, the feasibility of meeting it is questionable. Fresh finance ministry data showed India's budget deficit for April–May (the first two months of the current fiscal year) reaching 45.6% of the annual target. Besides, the reduction in fiscal deficit in the previous year was largely achieved by postponing disbursements of subsidies into the current fiscal year, leaving the new government a legacy of more than INR1 trillion (USD16.6 billion) in unpaid subsidies.

Recurring fiscal deficits remain a key constraint to growth. The combined central- and state-government deficit stands in excess of 10% of GDP, while domestic debt exceeds 85% of GDP. Political resistance, both from within and outside the ruling coalition, impedes meaningful cutbacks in subsidies of food, fertilizer, and electricity, whereas privatization has progressed slowly. The deficits divert resources from critical development spending. Rising debt-service payments reduce fiscal capacity to invest in physical and human capital. Meanwhile, high public debt fuels liquidity in the financial system, sparking inflation. Concurrently, large household savings deposited in the banking system are tied up because of required levels of investment in government securities, instead of extending loans to the dynamic private sector. This environment reduces the flexibility of macroeconomic policy, and places onus on monetary policy for counter-cyclical measures.

Data

External Sector

Key Points

- The latest uptick in exports growth points to tentative trade recovery.
- The current-account deficit has narrowed, but India remains vulnerable to volatility in foreign capital flows.

Analysis

The latest uptick in exports growth points to tentative trade recovery. Following a sharp narrowing from the second half of 2013 through the first half of 2014, India's trade deficit is likely to reverse this trend going forward—although a sharp deterioration, as seen in 2012 and early 2013, is not expected. The near-term outlook for India's exports remains favorable, partially owing to an ongoing recovery in external demand in India's traditional markets, the United States and Europe and partially to an expected improvement in India's domestic manufacturing sector growth. Meanwhile, merchandise imports growth rebounded to 8.3% year on year in June after 11 months of contraction and is likely to accelerate further, reflecting improving domestic demand and easing restrictions on gold imports. The ban on gold imports, imposed in summer 2013 to avert India's currency crisis, was partially removed in June 2014, and gold imports are likely to rise sharply again once the ban is fully lifted. Strong base effects from last year and rising global oil prices will also ensure that India's imports bill remains well above exports receipts. As a result, the trade and current account are set to deteriorate, with the current-account deficit projected at 2.3% of GDP in both 2014 and 2015, up from 1.9% in 2013.

The current-account deficit has narrowed, but India remains vulnerable to volatility in foreign capital flows. The large current-account deficit recorded in FY 2012/13, which amounted to 4.8% of GDP, was a key cause of the Indian rupee weakness during 2013. The current-account position improved markedly thereafter, and while the slight deterioration expected in FY 2014/15 will again raise the deficit financing requirement, it should not spark the same negative reaction in currency markets as was seen in 2013. Improving economic and business sentiment following the election of a stable, pro-reform government is likely to boost capital inflows into India, reducing the need for debt financing of the current-account deficit and/or erosion in the foreign-exchange reserve position.

Data

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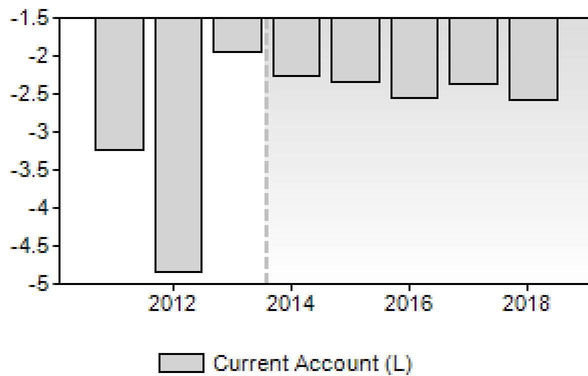
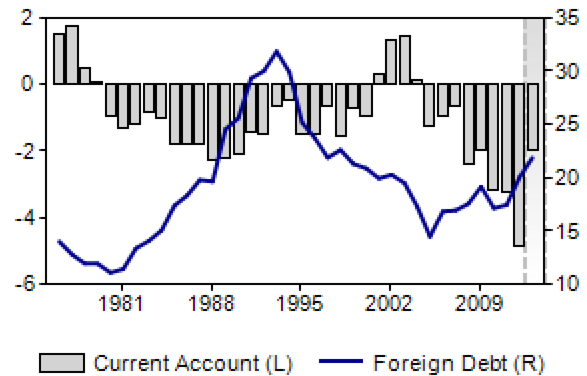
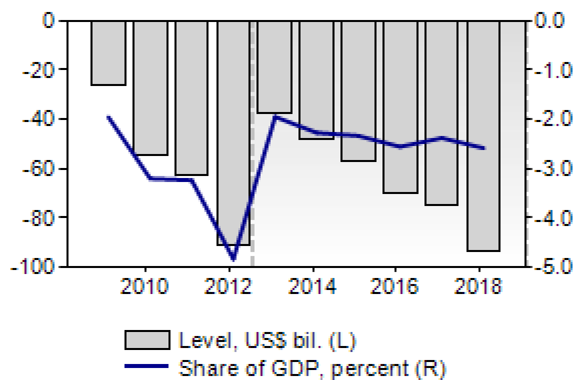
Trade and Ext. Accts: Medium Term Outlook
(Percent of GDP)



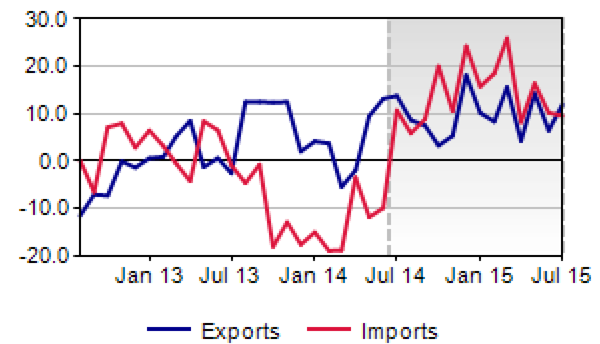
Trade and Ext. Accts: Historical Trends
(Percent of GDP)



Current Account Balance



Merchandise Trade
(Percent change from a year ago)



Trade and External Accounts Indicators

	2011	2012	2013	2014	2015	2016	2017	2018
Exports of Goods (US$ bil.)	307.8	298.3	315.1	336.6	373.3	428.1	493.6	566.3
Imports of Goods (US$ bil.)	428.0	450.2	428.5	435.5	486.6	545.0	621.3	715.7
Trade Balance (US$ bil.)	-120.2	-151.9	-113.4	-98.9	-113.3	-116.9	-127.7	-149.4
Trade Balance (% of GDP)	-6.2	-8.0	-5.9	-4.7	-4.6	-4.3	-4.1	-4.1
Current Account Balance (US$ bil.)	-62.5	-91.5	-37.8	-48.1	-57.1	-70.2	-74.8	-93.8
Current Account Balance (% of GDP)	-3.2	-4.8	-1.9	-2.3	-2.3	-2.6	-2.4	-2.6

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated on the 15th of each month from monthly forecast update bank (GIIF). Written analysis may include references to data made available after the release of the GIIF bank.

Key Indicators and Forecasts

Data (Forecasts)

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Detailed Macro-Economic Indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% change)	10.3	6.6	4.7	5.0	5.4	6.2	6.5	7.3	7.4
Nominal GDP (US$ bil.)	1,702.3	1,930.9	1,892.8	1,938.0	2,118.1	2,444.2	2,747.4	3,144.8	3,630.7
Nominal GDP Per Capita (US$)	1,412	1,581	1,531	1,548	1,671	1,906	2,118	2,398	2,739
Nominal GDP Per Capita (PPP$)	4,549	4,883	5,138	5,410	5,718	6,109	6,544	7,067	7,642
Real Consumer Spending (% change)	8.7	9.3	5.0	4.8	4.9	6.0	7.3	8.4	7.0
Real Fixed Capital Formation (% change)	11.0	12.3	0.8	-0.1	5.4	6.4	8.3	8.0	8.1
Real Government Consumption (% change)	5.8	6.9	6.2	3.8	5.0	5.1	5.3	4.4	5.1
Real Imports of Goods and Services (% change)	15.6	21.1	6.6	-2.5	3.9	7.7	8.7	7.6	7.7
Real Exports of Goods and Services (% change)	19.6	15.6	5.0	8.4	8.0	8.9	9.8	7.5	7.1
Industrial Production Index (% change)	9.7	4.8	0.7	0.6	3.0	5.7	6.2	6.8	8.5
Consumer Price Index (% change)	12.0	9.6	9.7	10.1	8.0	7.4	6.5	6.5	6.4
Wholesale-Producer Price Index (% change)	9.6	9.5	7.5	6.3	5.5	6.1	6.2	5.7	5.7
Policy Interest Rate (%)	6.25	8.50	8.00	7.75	8.00	8.00	7.25	6.75	7.00
Short-term Interest Rate (%)	8.33	10.17	10.60	10.03	10.09	10.02	9.91	10.20	10.36
Long-term Interest Rate (%)	7.83	8.38	8.30	8.15	8.61	8.12	8.17	8.61	8.78
Fiscal Balance (% of GDP)	-4.7	-5.7	-4.8	-4.9	-4.6	-4.4	-4.2	-4.0	-3.8
Population (mil.)	1,205.62	1,221.16	1,236.69	1,252.14	1,267.40	1,282.39	1,297.07	1,311.48	1,325.62
Population (% change)	1.3	1.3	1.3	1.2	1.2	1.2	1.1	1.1	1.1
Unemployment Rate (%)	8.6	9.5	8.9	9.3	9.4	9.2	8.8	8.5	8.1
Current Account Balance (US$ bil.)	-54.5	-62.5	-91.5	-37.8	-48.1	-57.1	-70.2	-74.8	-93.8
Current Account Balance (% of GDP)	-3.2	-3.2	-4.8	-1.9	-2.3	-2.3	-2.6	-2.4	-2.6
Trade Balance (US$ bil.)	-93.4	-120.2	-151.9	-113.4	-98.9	-113.3	-116.9	-127.7	-149.4
Trade Balance (% of GDP)	-5.5	-6.2	-8.0	-5.9	-4.7	-4.6	-4.3	-4.1	-4.1
BOP Exports of Goods US$bn	231.0	307.8	298.3	315.1	336.6	373.3	428.1	493.6	566.3
BOP Imports of Goods US$bn	324.3	428.0	450.2	428.5	435.5	486.6	545.0	621.3	715.7
Exchange Rate (LCU/US$, end of period)	44.81	53.27	54.78	61.90	59.33	59.35	60.04	59.61	58.94
Exchange Rate (LCU/Yen, end of period)	0.55	0.69	0.63	0.59	0.58	0.57	0.57	0.56	0.55
Exchange Rate (LCU/Euro, end of period)	59.87	68.92	72.28	85.36	77.72	78.34	80.70	81.31	81.10

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated on the 15th of each month from monthly forecast update bank (GIIF). Written analysis may include references to data made available after the release of the GIIF bank.

Debt Indicators

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Foreign Exchange Earnings (US$ bil.)	309.4	401.1	506.6	509.8	535.7	571.6	635.7	712.5	817.2	934.0

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Portfolio Investment, Net (US$ bil.)	-0.2	-1.1	0.0	-0.8	-0.9	-1.0	-1.1	-1.2	-1.4	-1.6
Portfolio Investment, Net (% of GDP)	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Direct Investment, Net (US$ bil.)	19.5	11.4	23.9	15.4	19.3	22.6	25.4	28.3	32.3	37.5
Foreign Direct Investment, Net (% of GDP)	1.5	0.7	1.2	0.8	1.0	1.1	1.1	1.0	1.0	1.0
Foreign Exchange Reserves, Excl. Gold (US$ bil.)	265.2	275.3	271.3	270.6	276.5	289.3	309.4	345.9	389.4	443.2
Import Cover (Months)	9.7	7.5	5.9	5.6	6.0	5.8	5.5	5.5	5.5	5.4
Total External Debt (US$ bil.)	256.3	291.7	336.8	379.1	421.2	477.6	548.0	645.8	751.8	882.8
Total External Debt (% of GDP)	19.2	17.1	17.4	20.0	21.9	22.8	23.0	23.9	24.3	24.7
Total External Debt (% of forex earnings)	82.8	72.7	66.5	74.4	78.6	83.5	86.2	90.6	92.0	94.5
Short Term External Debt (US$ bil.)	46.6	56.4	78.1	93.3	108.9	127.2	129.9	136.2	141.1	147.5
Short Term External Debt (% of total external debt)	18.2	19.4	23.2	24.6	25.9	26.6	23.7	21.1	18.8	16.7
Short Term External Debt (% of international reserves)	17.6	20.5	28.8	34.5	39.4	44.0	42.0	39.4	36.2	33.3
Total External Debt Service (US$ bil.)	16.5	24.4	29.3	30.7	45.3	44.6	47.2	58.0	68.3	80.7
Interest Payment Arrears (US$ bil.)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External Liquidity Gap (% of forex earnings)	24.0	30.7	31.4	40.5	33.1	36.4	35.0	35.3	33.3	33.2

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated live from quarterly Sovereign Risk forecast bank (SRS).

Data (No Forecasts)

Detailed Macro-Economic Indicators

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP (% change)	9.3	9.8	3.9	8.5	10.3	6.6	4.7	5.0	5.4
Nominal GDP (US$ bil.)	947.9	1,206.1	1,294.1	1,338.2	1,702.3	1,930.9	1,892.8	1,938.0	2,118.1
Nominal GDP Per Capita (US$)	829	1,041	1,102	1,124	1,412	1,581	1,531	1,548	1,671
Nominal GDP Per Capita (PPP$)	3,294	3,662	3,827	4,129	4,549	4,883	5,138	5,410	5,718
Real Consumer Spending (% change)	8.5	9.4	7.2	7.4	8.7	9.3	5.0	4.8	4.9
Real Fixed Capital Formation (% change)	13.8	16.2	3.5	7.7	11.0	12.3	0.8	-0.1	5.4
Real Government Consumption (% change)	3.8	9.6	10.4	13.9	5.8	6.9	6.2	3.8	5.0
Real Imports of Goods and Services (% change)	21.5	10.2	22.7	-2.1	15.6	21.1	6.6	-2.5	3.9
Real Exports of Goods and Services (% change)	20.4	5.9	14.6	-4.7	19.6	15.6	5.0	8.4	8.0
Industrial Production Index (% change)	12.0	15.6	7.7	0.2	9.7	4.8	0.7	0.6	3.0
Consumer Price Index (% change)	6.1	6.4	8.3	10.9	12.0	9.6	9.7	10.1	8.0
Wholesale-Producer Price Index (% change)	6.0	4.9	8.7	2.4	9.6	9.5	7.5	6.3	5.5
Policy Interest Rate (%)	7.25	7.75	6.50	4.75	6.25	8.50	8.00	7.75	8.00
Short-term Interest Rate (%)	11.19	13.02	13.31	12.19	8.33	10.17	10.60	10.03	10.09
Long-term Interest Rate (%)	7.66	7.95	7.86	7.02	7.83	8.38	8.30	8.15	8.61

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Fiscal Balance (% of GDP)	-3.3	-2.6	-5.9	-6.4	-4.7	-5.7	-4.8	-4.9	-4.6
Population (mil.)	1,143.29	1,159.10	1,174.66	1,190.14	1,205.62	1,221.16	1,236.69	1,252.14	1,267.40
Population (% change)	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.2	1.2
Unemployment Rate (%)	9.9	9.2	9.6	9.5	8.6	9.5	8.9	9.3	9.4
Current Account Balance (US$ bil.)	-9.3	-8.1	-31.0	-26.2	-54.5	-62.5	-91.5	-37.8	-48.1
Current Account Balance (% of GDP)	-1.0	-0.7	-2.4	-2.0	-3.2	-3.2	-4.8	-1.9	-2.3
Trade Balance (US$ bil.)	-42.7	-55.1	-92.7	-80.0	-93.4	-120.2	-151.9	-113.4	-98.9
Trade Balance (% of GDP)	-4.5	-4.6	-7.2	-6.0	-5.5	-6.2	-8.0	-5.9	-4.7
BOP Exports of Goods US$bn	123.9	153.5	199.1	168.0	231.0	307.8	298.3	315.1	336.6
BOP Imports of Goods US$bn	166.6	208.6	291.7	247.9	324.3	428.0	450.2	428.5	435.5
Exchange Rate (LCU/US$, end of period)	44.24	39.42	48.46	46.68	44.81	53.27	54.78	61.90	59.33
Exchange Rate (LCU/Yen, end of period)	0.37	0.35	0.53	0.51	0.55	0.69	0.63	0.59	0.58
Exchange Rate (LCU/Euro, end of period)	58.27	58.02	67.44	67.24	59.87	68.92	72.28	85.36	77.72

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight. Table updated on the 15th of each month from monthly forecast update bank (GIIF). Written analysis may include references to data made available after the release of the GIIF bank.

Debt Indicators

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Foreign Exchange Earnings (US$ bil.)	221.3	276.9	354.3	309.4	401.1	506.6	509.8	535.7	571.6
Portfolio Investment, Net (US$ bil.)	0.0	0.2	-0.1	-0.2	-1.1	0.0	-0.8	-0.9	-1.0
Portfolio Investment, Net (% of GDP)	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Foreign Direct Investment, Net (US$ bil.)	6.0	8.2	24.1	19.5	11.4	23.9	15.4	19.3	22.6
Foreign Direct Investment, Net (% of GDP)	0.6	0.7	1.9	1.5	0.7	1.2	0.8	1.0	1.1
Foreign Exchange Reserves, Excl. Gold (US$ bil.)	170.7	267.0	247.4	265.2	275.3	271.3	270.6	276.5	289.3
Import Cover (Months)	9.1	11.5	7.8	9.7	7.5	5.9	5.6	6.0	5.8
Total External Debt (US$ bil.)	159.5	204.1	227.1	256.3	291.7	336.8	379.1	421.2	477.6
Total External Debt (% of GDP)	16.8	16.9	17.5	19.2	17.1	17.4	20.0	21.9	22.8
Total External Debt (% of forex earnings)	72.1	73.7	64.1	82.8	72.7	66.5	74.4	78.6	83.5
Short Term External Debt (US$ bil.)	25.1	36.1	43.8	46.6	56.4	78.1	93.3	108.9	127.2
Short Term External Debt (% of total external debt)	15.7	17.7	19.3	18.2	19.4	23.2	24.6	25.9	26.6
Short Term External Debt (% of international reserves)	14.7	13.5	17.7	17.6	20.5	28.8	34.5	39.4	44.0
Total External Debt Service (US$ bil.)	17.4	39.4	31.0	16.5	24.4	29.3	30.7	45.3	44.6
Interest Payment Arrears (US$ bil.)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External Liquidity Gap (% of forex earnings)	10.7	24.2	25.7	24.0	30.7	31.4	40.5	33.1	36.4

Source: Historical data from selected national and international data sources. All forecasts provided by IHS Global Insight.

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