Economic Update India

11 March 2013

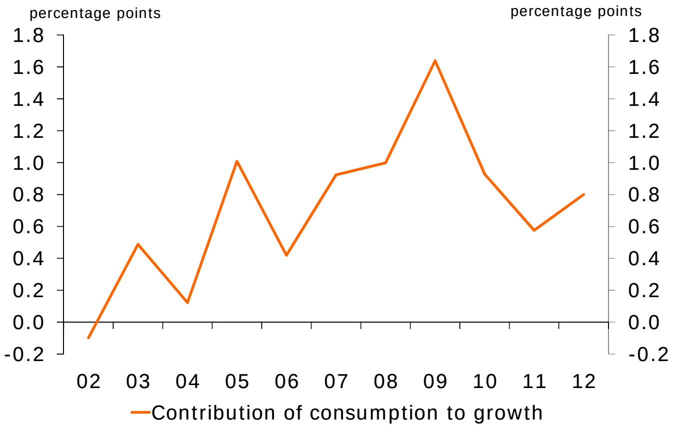
Slowly? Yes, but surely….

Year-on-year change (%)	'11	'12	'13
Gross Domestic Product	6.9	5.2	6.1
Private consumption	5.5	4.1	5.5
Government consumption	5	5.0	7.0
Investment	5.6	4.4	6.0
Exports	15.4	6.6	14.6
Imports	18.4	5.0	10.2
Inflation	8.9	9.3	8.8
Unemployment (%)	9.8	9.9	9.9
Government budget (%GDP)	-5.8	-5.4	-5.0
Government debt (%GDP)	50.5	49.9	49.7

Source: EIU, Rabobank

Not so long ago, the world was anticipating the victory of democracy over state-run economies, at least in Asian sense, with India growing faster than China. However, unfortunately for India, the fat lady has not yet sung. Worse still, India's Central Statistical Office government is now expecting growth in Financial Year 2012/13 (running to March 31st) to come in at only 5% yoy. The latest available data had already shown that growth had been declining at a rapid pace since the second half of 2011. Hampering contemporary as well as potential growth are uncertain consumers, investors and an uncertain government.

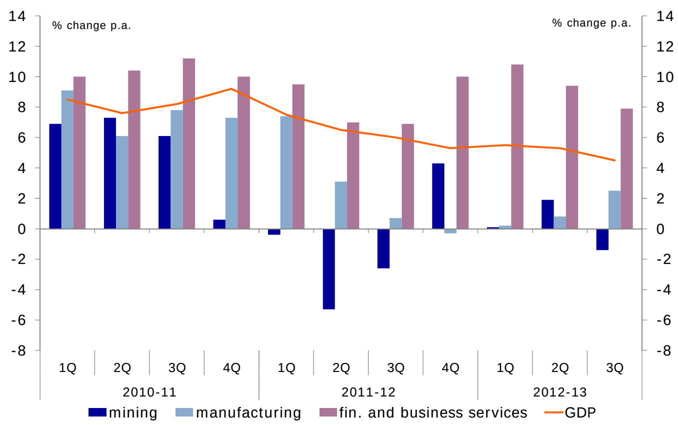
Consumers no longer willing to buy



Source: EIU

The Indian consumer has been hit by a triple whammy. Inflation has remained stubbornly high since the outbreak of the global economic crisis in 2008. For years, inflation had been kept in the range of 3-5%, but that proved no longer tenable. Currently, reducing inflation to below 8% would be a victory for the central bank. Second, monetary conditions, in tune with the higher inflation, have been tightened, providing little relief for an already underbanked society. Third, the monsoon rains have been late in the past year, leading to lower production in the agricultural sector, and thus higher food prices. Another dampening effect on the Indians' spending power.

Investors are growing weary



Source: MOSPI

Gross fixed investment is usually another anchor for India's GDP growth, next to consumer spending. However, the investors seems to have grown weary in the past years. Inflation is one item on their agenda. Next, India is famous for its red tape, and last year, the mining sector, among others was hit by the suspension of licenses after the coal scandal came to light. Moreover, high interest rates in the country are changing the risk-reward weightings of investors. Although the performance on the producers' side has been weak across the board, especially the manufacturing sector and the mining sector have performed weakly. Overall therefore, the contribution of investment to growth has also been dipping.

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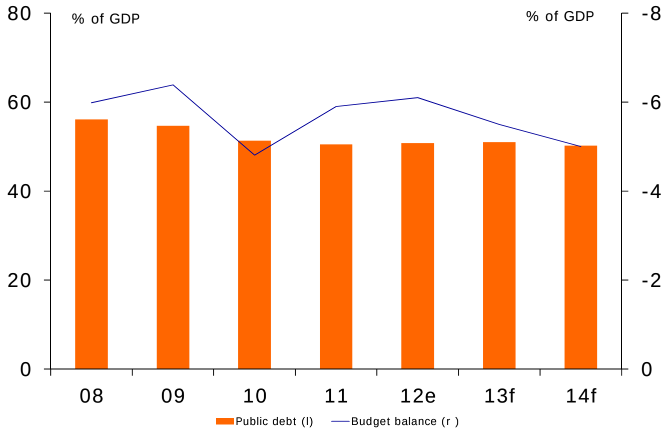
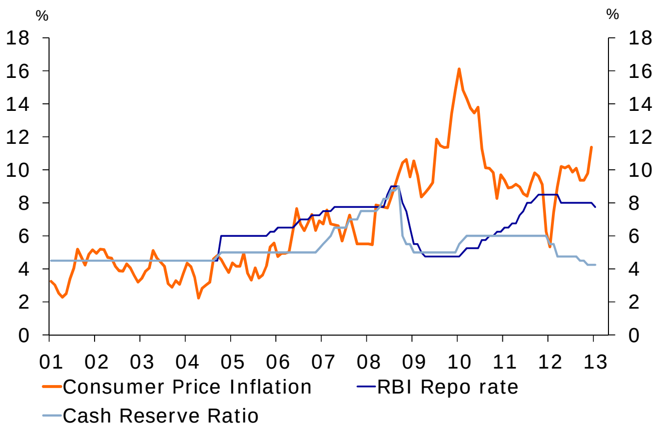
What about the government?



Source: EIU

The government has not been forthcoming with stimulus efforts. This is because the government hardly has any room to manoevre. These days, the government cannot get the fiscal deficit below 5% of GDP, a figure that does not even include the 2-3% of GDP deficit that the state budgets run. The main culprit (in financial terms) is the vast amount of subsidies, primarily in energy and food. The government wants to invest heavily in infrastructure projects to boost potential GDP by 2-3 percentage points, indicating at least some growth impetus from the government. However, rating agencies have put the government on watch for a downgrade to junk, limiting their room to manoevre even further.

Central Bank stepping to the plate... slowly



Source: Reuters EcoWin

In February, the Reserve Bank of India (RBI) cut its policy rate and the cash reserve ratio by 25bps to 7.75% and 4.0%, respectively. The RBI cited receding inflationary pressures, weaker economic growth and tight liquidity conditions as reasons. Although the pass-through mechanisms are far from perfect in India, with many consumers without access to finance, the RBI action could actually have an effect. Even though inflation remains high (at 10.8% for consumers and 6.6% for producers in January), firms may be enticed to invest by the lower interest gap. Nevertheless, the RBI will still be mindfull of the 2009 inflation rate, even though that was also boosted by high commodity prices.

Light in the middle of the tunnel

Source: Reuters EcoWin

The Central Bank in combination with some green shoots (again) across the globe may have had something to do with the upbeat sentiment in India at the moment. The Indian Service Business Activity Index of HSBC posted 57.5 in January. This was above the vital 50-point threshold, up from December (55.6). However, the manufacturing sector performed slightly weaker. The HSBC Purchasing Managers' Index (PMI) was 53.2 in January, down from 54.7 in December. Taking everything into consideration, we expect nothing spectacular from India this year, although a small growth rebound is likely to happen. India is likely on a course to post 6-6.5% growth in 2013.

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