



Summary

India is showing very robust economic growth, even though it is easing this year compared to last year. The economy is estimated to expand by 7.9% in 2011. Weighing on economic growth is the monetary tightening cycle by the central bank, which is necessary to combat persistently high inflation. The largest country risks are found in the political and social situation. While the political situation is stable, it is marred by frequent conflicts. Prominent political scandals have highlighted that corruption is deeply embedded. The social situation remains precarious, as mass protests frequently take place regarding a wide range of issues, but the possibility of an "Arab spring" uprising in India is very unlikely. The fiscal position is improving as consolidation efforts have been successful, but seem ambitious for the coming year. The external position remains very healthy.

Things to watch:

- Political conflicts hampering progress in the reform agenda
- Continued mass protests
- Fiscal consolidation efforts
- Persistently high inflation

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India			
National facts		Social and governance indicators	
Type of government	Federal republic	Human Development Index (rank)	rank / total 119 / 169
Capital	New Delhi	Ease of doing business (rank)	134 / 183
Surface area (thousand sq km)	3,288	Economic freedom index (rank)	124 / 179
Population (millions)	1,130.0	Corruption perceptions index (rank)	87 / 178
Main languages	Hindi (30%)	Press freedom index (rank)	122 / 178
Main religions	English	Gini index (income distribution)	36.8
	Hindu (80.5%)	Population below \$1.25 per day (PPP)	42%
	Muslim (13.4%)		
	Christian (2.3%)		
Head of State (president)	Mrs. Pratibha Patil	Foreign trade	
Head of Government (prime-minister)	Dr. Manmohan Singh	2010	
Monetary unit	Indian rupee (INR)	Main export partners (%)	Main import partners (%)
		US	China
		UAE	US
		China	UAE
		Hong Kong	Saudi Arabia
Economy		2010	
Economic size		Main export products (%)	
Nominal GDP	bn USD	% world total	Engineering goods
1729		2.77	Petroleum products
Nominal GDP at PPP	4197	5.65	Textiles & textile products
Export value of goods and services	349	1.88	Gems & jewellery
IMF quatum (in mln SDR)	4158	1.91	
Economic structure		Main import products (%)	
	2010	5-year av.	Petroleum products
Real GDP growth	8.8	8.5	Electronic goods
Agriculture (% of GDP)	19	18	Gold & silver
Industry (% of GDP)	26	28	Machinery
Services (% of GDP)	55	54	
Standards of living		Openness of the economy	
	USD	% world av.	Export value of G&S (% of GDP)
Nominal GDP per head	1460	15	Import value of G&S (% of GDP)
Nominal GDP per head at PPP	3545	30	Inward FDI (% of GDP)
Real GDP per head	1058	13	

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Country risk update

In this country risk update, we comment on the slowdown in economic growth in India. We reduce our GDP growth forecast of 9% for 2011, made in the country risk report of May 2011, to 7.9% as rising interest rates and the global economic uncertainty weigh on India's economic expansion. Moreover, in this update we analyze increased social unrest, as mass protests have become more frequent in the past year, which even resulted in rumours of an Arab Spring uprising in India.

Arab Spring uprising in India?

Over the past year, social unrest in the form of mass street protests has markedly increased all over India. Anti-government protests have been more frequent and massive recently, with demonstrators voicing their concerns over a wide range of issues, for example the reduction of fuel subsidies and the carving out of a separate Telengala state. Protests regarding high food prices and ethnic tensions have long been the norm.

But the recent protests have also addressed government corruption. The intensity of public anger over corruption in India is easy to understand. Corruption is endemic in the country, ranging from the small-scale "facilitation" payments often required for public services to industrial scale kickbacks for the award of major tenders. India ranks a poor 87th out of 178 countries on the Corruption Perceptions Index of Transparency International for 2010.

Still, corruption is no new problem in India, then why is the social unrest regarding the issue increasing now?

We distinguish three major reasons. Firstly, a series of high-profile scandals have raised public anger to a new level. The ruling United Progressive Alliance (UPA), enjoyed a relatively sound reputation, especially due to PM Singh, who was viewed as an unusually honest politician. However, the anti-corruption reputation was tarnished with the run-up to the 2010 Commonwealth Games in Delhi, where sloppy construction and huge delays were widely blamed on corrupt procurement practices. After this incident, a series of corruption cases was exposed, the most prominent one being the fraud of India's telecommunication minister, who resigned after it was revealed improper allocations of telecommunications licenses had taken place and had cost the government over USD 40bn.

A second reason is that the protesters had found a leader in Mr. Hazare, a Gandhian activist, who has described his struggle against the government as a second revolution. Although public discontent had been rising for months, Mr. Hazare's high-profile hunger strikes while spouting anti-government rhetoric, enjoyed massive media coverage and gathered the masses. By mid-August, protestors were regularly amassing in symbolic locations in the capital, and demonstrations had spread to major cities across the country.

Thirdly, the government's response has been very lacklustre and sometimes even counter-productive. PM Singh's handling of the telecommunications scandal drew criticism from appearing to shield political allies, and two subsequent cabinet reshuffles have not resulted in boosting public confidence that the government is taking a hard-line stance on corruption. Voters have vented their anger at the polls, as an important ally of the UPA, the Dravidra Munnetra Kazhagam party was swept from power in the Tamil Nadu state.

Moreover, the response to the hunger strikes and protests further damaged its already battered reputation. A "fast to the death" by popular guru Baba Ramdev to protest against official corruption, was countered by the government by breaking up protests of his followers with batons and tear gas. Mr. Hazare's protest campaign was also handled badly, since he was arrested as his protest methods were "subverting" democracy. As the reasons for his arrest seem dubious, the government response has only handed ammunition to its critics.

Going forward, the formation of an anti-corruption movement in India poses a huge challenge for the government. Even assuming a willingness to root out endemic corruption, the task is daunting and even impossible in the short term. It also poses a dilemma for the UPA. On the one hand, a thorough anti-corruption campaign could well uncover further scandals involving government officials of UPA allies. On the other hand, failure to show willingness and concrete results to address the protester's grievances will result in a significant loss of credibility and popularity of the UPA.

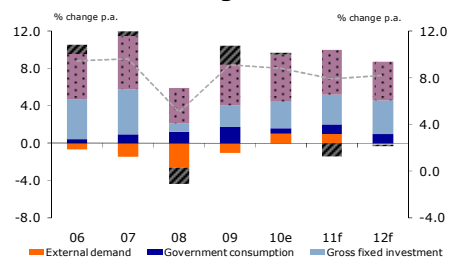
In any case, we expect the government is unlikely to make any rapid progress and as such we foresee more large-scale demonstrations occurring. However, we do not believe in an Arab Spring uprising in India for two main reasons. The first one is that the government is already, even though belatedly, addressing the protesters' concerns, which might weaken the rationale for mass demonstrations. PM Singh has discussed the possibility of the anti-corruption bill proposed by Mr. Hazare and called for a parliamentary committee meeting to consider this. PM Singh himself has also released an open letter committing to pass an anti-corruption bill that addresses the concerns of the civil society. Secondly, while the protests have been massive, the protesters mostly consist of middle class citizens and students. The much larger rural population, which is the UPA's core constituency, has not been vocal in these protests. As they are India's most important voting bloc, the political clout of the anti-government protesters does not match the fury in their voices. As such, we do not anticipate an Arab Spring uprising. However, the situation is no Indian Summer either.

Economic growth slowing?

Some of the recent data on India’s economic activity is actually quite positive. The country’s leading infrastructure index showed a jump in July, as this sector grew 7.8% yoy, up from 5.2% in June. Six out of eight core infrastructure industries showed significant expansion, which has resulted in the highest expansion of infrastructural output in the past 15 months.

India has also seen a steady rise in export volumes in recent months, mainly attributed to increased government support to exporters to tap into new markets in Latin America and Africa. Diversification into new export commodities also helped the boost export performance, offsetting softening demand from India’s largest export markets, China, the UAE and the US. Exports grew 0.4% month-on-month (mom) in July.

Chart 1: Economic growth



Source: EIU

Chart 2: Industrial production



Source: Bloomberg

However, the risks to economic growth are increasingly to the downside. It seems that the strength in the infrastructure sector has only provided temporary support to overall industrial production, which fell to 3.3% yoy in July, down from 8.8% in June. A significant risk is the rising borrowing costs, a result of the central bank’s monetary policy to hike interest rates in order to rein in inflation. This might hamper further investment and dampen domestic consumer demand. Another risk is the uncertain global economic environment, which will hurt Indian exports, especially if the US economy would stagnate and China experiences a hard landing in economic growth.

India							
Selection of economic indicators	2006	2007	2008	2009	2010e	2011f	2012f
<i>Key country risk indicators</i>							
GDP (% real change pa)	9.4	9.6	5.1	9.1	8.8	7.9	8.2
Consumer prices (average % change pa)	6.2	6.4	8.4	10.9	12.0	6.8	5.6
Current account balance (% of GDP)	-1.0	-0.7	-2.5	-1.9	-3.0	-3.2	-2.5
Total foreign exchange reserves (mln USD)	170738	266988	247419	265182	275277	331780	379110
<i>Economic growth</i>							
GDP (% real change pa)	9.4	9.6	5.1	9.1	8.8	7.9	8.2
Gross fixed investment (% real change pa)	14.3	15.3	2.7	7.0	9.0	9.9	11.0
Private consumption (real % change pa)	8.2	9.8	6.6	7.5	8.6	8.2	7.1
Government consumption (% real change pa)	3.6	9.0	11.7	16.0	4.8	8.8	8.5
Exports of G&S (% real change pa)	22.3	5.2	15.2	-7.1	17.6	13.7	12.2
Imports of G&S (% real change pa)	22.0	10.0	22.5	-2.1	9.2	7.3	10.8
<i>Economic policy</i>							
Budget balance (% of GDP)	-3.3	-2.6	-6.0	-6.1	-5.0	-4.7	-4.8
Public debt (% of GDP)	59	57	56	53	51	52	51
Money market interest rate (%)	7.3	7.8	6.5	4.8	6.3	7.6	8.1
M2 growth (% change pa)	22	22	20	18	18	15	17
Consumer prices (average % change pa)	6.2	6.4	8.4	10.9	12.0	6.8	5.6
Exchange rate LCU to USD (average)	45.3	41.3	43.5	48.4	45.7	44.6	44.1
Recorded unemployment (%)	9.4	8.9	9.4	9.7	10.0	9.8	9.8
<i>Balance of payments (mln USD)</i>							
Current account balance	-9299	-8077	-30972	-25922	-51718	-62960	-56900
Trade balance	-61176	-77846	-125319	-106982	-132204	-152760	-163570
Export value of goods	123768	153784	198599	168218	225647	298240	347430
Import value of goods	184944	231629	323051	274566	357746	451000	511000
Services balance	29406	39142	50959	39304	41618	47870	57740
Income balance	-6245	-6136	-3542	-6851	-13141	-17100	-19050
Transfer balance	28716	37143	48751	49293	52157	59040	67990
Net direct investment flows	5992	8202	24150	19669	9967	14080	13000
Net portfolio investment flows	4162	23403	-16784	19290	39579	6300	29740
Net debt flows	38795	43355	21627	11179	13077	12420	10920
Other capital flows (negative is flight)	429	30871	-17856	-3573	1477	88890	51570
Change in international reserves	40079	97754	-19835	20644	12383	58730	48320
<i>External position (mln USD)</i>							
Total foreign debt	158493	202793	224712	237691	251852	267080	277870
Short-term debt	25097	36093	43821	42950	57333	65130	68060
Total debt service due, incl. short-term debt	23675	64462	67029	59971	79533	93510	102630
Total foreign exchange reserves	170738	266988	247419	265182	275277	331780	379110
International investment position	-59682	-74766	-85880	-122901	n.a.	n.a.	n.a.
Total assets	231642	335780	332167	380924	n.a.	n.a.	n.a.
Total liabilities	291324	410546	418047	503825	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	-6.4	-6.6	-9.9	-7.8	-7.6	-7.8	-7.3
Current account balance (% of GDP)	-1.0	-0.7	-2.5	-1.9	-3.0	-3.2	-2.5
Inward FDI (% of GDP)	2.1	2.1	3.4	2.6	1.4	1.9	1.5
Foreign debt (% of GDP)	17	17	18	17	15	14	12
Foreign debt (% of XGSIT)	68	69	61	73	61	51	46
International investment position (% of GDP)	-6.2	-6.3	-6.8	-9.0	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	10	22	18	18	19	18	17
Interest service ratio incl. arrears (% of XGSIT)	2	2	2	2	2	1	1
FX-reserves import cover (months)	9.1	11.5	7.8	9.7	7.5	7.2	7.3
FX-reserves debt service cover (%)	721	414	369	442	346	355	369
Liquidity ratio	155	157	134	145	128	127	130

Source: EIU

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