

India Business Forecast Report Q2 2014

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Abstracts

Core Views

While there is still a high degree of uncertainty over the end results, we are leaning towards a victory for the opposition (and more marketfriendly) Bharatiya Janata Party (BJP). After the disappointment of the ruling United Progressive Alliance (UPA)'s second term in office, this scenario would be looked upon kindly by investors. To this end, the BJP has made significant ground in state elections held in December (including Delhi), meaning that the party will head into the 2014 campaign very much on the front foot.

India's painful process of external rebalancing is almost complete, and this will set the stage for an economic growth revival in FY2014/15 (April-March). The pace of recovery will depend on the timing of monetary easing, as well as a decisive and business-friendly outcome to the 2014 general elections. We are optimistic on both these fronts and expect investment activity to pick up materially over the course of the year. Our constructive outlook is reflected in our real GDP growth forecast of 5.6%, which sits above consensus expectations of 5.4%.

Despite sluggish economic activity and tighter monetary conditions, headline inflation remains a key concern in India. Acute food price pressures lie at the heart of the problem, which we believe is, to a large extent, a function of expansionary government policy. Absent a major reduction in subsidies and minimum support prices for agricultural goods, both of which are unlikely with general elections nearing, there is a risk that the Reserve Bank of India (RBI) may be forced to keep interest rates tight for longer in 2014, which would in turn stifle economic recovery prospects in the coming 12 months.

The Indian rupee is one of our favourite currencies in the region as we head into the

New Year. We expect the unit to average INR58.00/ US\$ in 2014, roughly 6.3% above current spot of INR 61.90/US\$, as external risks recede and investors turn their attention to the significant value on offer. Bolstering our case is India's increasingly constructive macroeconomic outlook, which should see the economy embark on a growth recovery in the second half of the calendar year.

Major Forecast Changes

We have pushed back our interest rate expectations for India. We now expect the central bank to remain on hold for the rest of FY2013/14, before delivering monetary easing worth 50bps in the following fiscal year.

Key Risks To Outlook

Downside Risks To Growth: The manner in which the government responds to looming electoral pressures in the run-up to the 2014 general elections could see the Indian economy swing either way.

In the bearish case, the government could opt for a more populist approach, which then leads to a further exacerbation of the country's twin deficits. Such a scenario could provoke a sovereign ratings downgrade to junk status, undermining any hopes of a recovery in economic growth.

Upside Risks To Fiscal Deficit: Even more so than in FY2012/13, this fiscal year will see growing risk of fiscal slippage owing to increasing political pressure to ramp up spending prior to the 2014 general elections.

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Election Scenarios: The Good, The Bad, And The Ugly

In terms of India's investment appeal, there is a lot riding on the upcoming general elections scheduled for April-May 2014. However, with nationwide polling only a matter of months away, the outcome remains difficult to predict with much conviction. In this note, we flesh out three potential elections scenarios, each with the potency to shape India's medium-term macroeconomic fortunes for the better and for the worse. Due to the prevailing tide of uncertainty, we have also downgraded India's political risk profile in our proprietary ratings systems.

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While India's 60-year-old democracy has withstood the test of poverty, the coming decade will show whether it can withstand the test of rising prosperity. Against a backdrop of economic growth, India's government will need to work even harder to combat poverty and inequality; invest in education and infrastructure; and clamp down on corruption in order to satisfy an increasingly cognisant electorate. Meanwhile, icy relations with neighbouring Pakistan and growing competition with China will continue to dominate India's international agenda. Failure to address these shortcomings could see social disharmony and pockets of fundamentalism continue to ferment at the grassroots level.

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India's painful process of external rebalancing is almost complete, and this will set the stage for an economic growth revival in FY2014/15 (April-March). The pace of recovery will depend on the timing of monetary easing, as well as a decisive and business-friendly outcome to the 2014 general elections.

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