

India Business Forecast Report Q4 2014

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Abstracts

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Core Views

The strength of the electoral win by the opposition Bharatiya Janata Party (BJP) at the lower house (Lok Sabha) elections in India surprised many – the party swept 282 seats of the 543-seat parliament, 10 more seats than it needs for a majority. Prime Minister Narendra Modi led his party to victory with a presidential-style campaign never seen before and overcame questions about his Hindu nationalist background. While we, like many others, hold high expectations for Modi's team to deliver on its promises to clear the road blocks obstructing infrastructure projects, we hold a more downbeat outlook on the prospects for the quick liberalisation of sectors such as mining, oil and gas, and insurance.

We maintain our above consensus outlook for India's real GDP growth, expecting the return of investor and business confidence to support an economic growth revival in FY2014/15 (April-March). While the pace of recovery will also depend on the timing of monetary easing, we have seen optimistic signs from June manufacturing and services purchasing managers' index readings, indicating that both sectors are in expansion. Our upbeat outlook is reflected in our real GDP growth forecast of 5.6%, which sits above consensus expectations of 5.4%.

Although headline inflation has eased somewhat in India, they remain at elevated levels, amongst the highest in the region. Acute food price pressures, as supplies often constrained by logistical inefficiencies and prices, further boosted by minimum support levels dictated by the government, lie at the heart of the problem. Expansionary government policy further exacerbates these pressures. Absent a major reduction in subsidies and minimum support prices for agricultural goods, and together with weaker-

than-usual monsoon rains, there is a risk that the Reserve Bank of India may be forced to keep interest rates higher for longer in FY2014/15.

The Indian rupee remains one of our favourite currencies in the region although we believe that much of the upside for the currency has been priced in since the unit rallied on the back of the BJP's return to power. We expect the unit to average INR58.00/USD in 2014 as external risks continue to recede and investors turn their attention to the significant value and brighter prospects on offer.

Major Forecast Changes

We have dialled back our expectations for fiscal consolidation in India. We now expect the overall government deficit to remain broadly on par in FY2014/15 compared to the previous year at 7.0% of GDP. In addition to the ramp up in non-planned spending by the previous government in the first two months of the fiscal year, we expect policy slippage and obstructions to subsidy rollbacks to restrain the ability of the new government to deliver quick repairs to the fiscal accounts.

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Improving Political Outlook After Historic Win

On the back of the landmark win by India's Bharatiya Janata Party (BJP), which gave the party a majority in the lower house, we have upgraded our Short and Long-Term Political Risk Ratings, given the significant improvements that will likely aid the new administration to form and enact growth-friendly policies.

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Foreign Policy

The Global Implications Of Modi's Victory

India under Narendra Modi will be considerably more assertive on the Asian geopolitical stage. In particular, a more robust Indian foreign policy stance will counterbalance China and benefit Japan and the US.

Gradual Reform To Prevail Over The Coming Decade

India's new government has the strongest mandate in 30 years to transform the economic and political landscape, and make the country more prosperous and business-friendly.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Positive Policy Changes Bode Well For Growth

Despite the Indian economy posting a subdued growth print of 4.7% in FY2013/14 (April-March), we believe the recent positive policy changes and weak base effect should see growth reaccelerate in the coming year.

However, the delay in fiscal consolidation could pose downside risks to growth via higher inflationary pressures and interest rate hikes.

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Higher Fiscal Expenditure Poses Inflation Risks

India's budget deficit in FY2014/15 is forecast to remain at 6.1% of GDP as we expect the new Bharatiya Janata Party-led government to increase spending to revive economic growth.

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RBI To Further Banking Reforms

The Reserve Bank of India has maintained its efforts to reform the banking sector with its most recent move in June to cut the statutory liquidity ratio, even as it holds its key interest rate at 8.00%. We believe that these reforms will improve the effectiveness of monetary policy, although we note that the government could delay the materialisation of these reforms and their relative improvements should it fail to rein in spending.

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The Indian rupee is likely to retest and break eight-month trendline resistance in the coming months, on the back of the new government announcing its fiscal plans, which we expect to broadly reflect some level of fiscal consolidation.

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Improving demographics, structural reforms and trade liberalisation in India during the 1990s set the stage for an explosion in the country's domestic savings rate, which, in turn, ignited economic growth in the 2000s. Going forward, favourable demographics and trade integration should remain strong tailwinds. However, should India's reform momentum continue to disappoint, the country could struggle to generate sufficient savings growth to finance its investment needs, with

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Political and bureaucratic hurdles will remain key obstacles to progress in India's business environment, preventing the newly elected Bharatiya Janata Party-led government from implementing any drastic shifts to liberalise the market in the first few years of its term.

That said, we believe the government will continue to take small steps in the right direction, especially in attempt to dampen inflation, clarify regulation and expedite infrastructure projects.

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