India Economics

Eye On The Tiger

August 2012

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- Our long-held view that the Indian economy's 'new normal' is 7% growth and 7% inflation on average is now the conventional wisdom and largely priced in. The key question for investors is whether macro-fundamentals will deteriorate yet further.
- For now, the economy is wrestling with GDP growth at a 9-year low of close to 5% and inflation close to 10%. This year's deficient monsoon will keep the growth:inflation trade-off under pressure for the next few quarters. Our FY2013 GDP forecast is cut to 5.7% (previously 6.3%).
- Loss of fiscal discipline has been the prime force behind the worse macro-outcomes of recent years. Rapid increases in spending, particularly subsidies, have pushed down national saving, crowded out private investment, weakened the balance of payments and exacerbated inflationary pressure.
- RBI is not entirely blameless: it was slow normalising policy in 2010 and its asymmetric management of capital flows has amplified the INR's volatility. But tight money is not the root cause of India's economic travails. Nor is easier money the solution. Elevated private sector inflation expectations leave RBI with little room to ease policy. We expect just a 25bp rate cut in FY2013.
- If 'Delhi deadlock' continues and the euro-area debt crisis reignites, expect severe stress in the balance of payments. Our base case of tentative policy reform in New Delhi and gradual, though not linear, improvement in Europe should help the economy back to its 7/7 'new normality' in FY2014.
- Further macro-economic improvement will require a sustained reform effort that looks impossible in the current political climate. A recasting of Indian macro-fundamentals awaits a recasting of political fundamentals. This is unlikely until after the 2014 general election at the earliest.

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■ **Our long-held view that the Indian economy's 'new normal' is 7% growth and 7% inflation on average is now the conventional wisdom and largely priced in. The key question for investors is whether macro-fundamentals will deteriorate yet further.**

■ **For now, the economy is wrestling with GDP growth at a 9-year low of close to 5% and (CPI) inflation of close to 10%. The negative supply shock of this year's deficient monsoon will keep the growth:inflation trade-off under pressure for the next few quarters. Our FY2013 GDP forecast is cut to 5.7% (previously 6.3%).**

■ **Loss of fiscal discipline since the global financial crisis has been the prime force behind the worse macro-outcomes of recent years. Rapid increases in current spending, particularly on subsidies, have pushed down national saving, crowded out private sector investment, weakened the balance of payments and exacerbated inflationary pressure.**

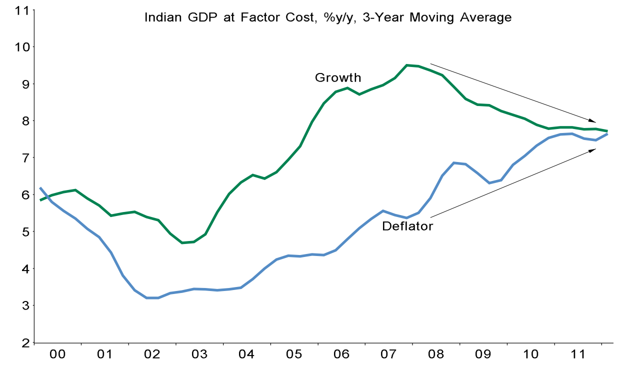
■ **RBI is not entirely blameless: it was too slow in normalising policy in 2010 and its asymmetric management of capital flows has amplified the INR's volatility. But tight money is not the root cause of India's economic travails. Nor is easier money the solution. Elevated private sector inflation expectations leave RBI with little room to ease policy.**

■ **If 'Delhi deadlock' continues and the euro-area debt crisis reignites, a balance of payments crisis cannot be ruled out. Our base case, however, of tentative policy reform in New Delhi and gradual, though not linear, resolution of the European crisis is sufficient to see the economy return to its 7/7 'new normality' in FY2014.**

■ **But further macro-economic improvement will require a sustained reform effort that looks impossible at present given the fractured and fissiparous political climate. A recasting of Indian macro-fundamentals awaits a recasting of political fundamentals. This is unlikely until after the 2014 general election at the earliest.**

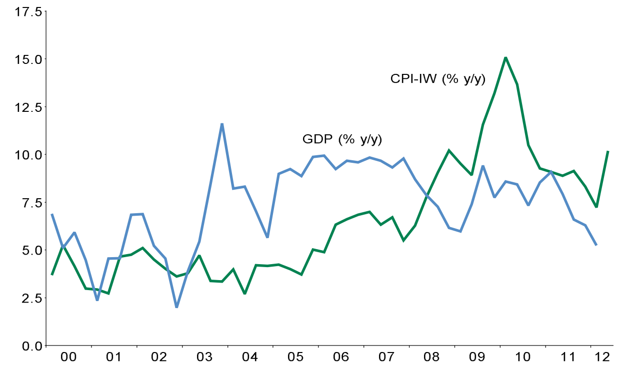
India's macro-economic performance continues to go from bad to worse. Over a year ago, we admonished in a previous 'Eye on The Tiger' that India's 'new normal' was now '7/7'; average real GDP growth of 7% mirrored by similar average rates of inflation.

Chart 1: The New Normal – '7'7'



Source: Reuters EcoWin Pro, BNP Paribas

Chart 2: The New, New Normal?



Source: Reuters EcoWin Pro, BNP Paribas

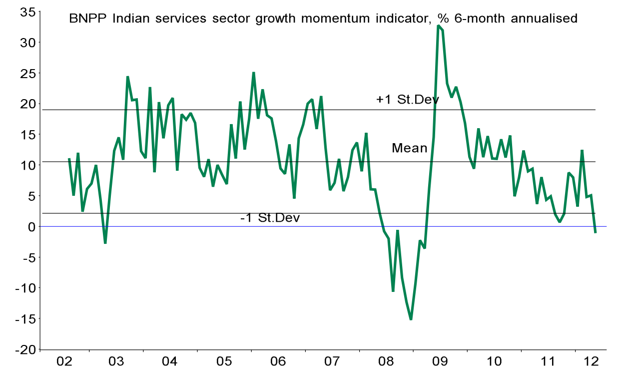
This, in turn, marked a significant worsening from the pre-crisis halcyon days of 9-10% output growth and 4-5% inflation. Top-line nominal GDP growth would still on average be c.14-15% but the blend of output growth and inflation would be much less favourable. Briefly controversial, our assessment of what seems to be an enduring deterioration in India's growth:inflation trade-off is now broadly accepted with RBI, for example, now publicly acknowledging that India's potential growth has slipped to 7-7½% per annum. Over the last three years, GDP growth has averaged 7.75% y/y with the GDP deflator – the best measure of domestic costs and prices – running at a similar 7.6% y/y average rate. But, there is an increasing threat that even the '7/7' new normal may be optimistic. There is a clear risk that India's growth:inflation trade-off could deteriorate yet further to '5/10' with just 5% output growth being accompanied by double-digit inflation. In short, a return to the so-called 'Hindu rates of growth' that characterised the economy prior to the reform drive initiated post-1991 cannot be ruled out.

If this seems unnecessarily melodramatic, '5/10' is a reasonable characterisation of India's current macro-conjuncture. GDP growth slowed to a nine-year low of 5.3% y/y in FY2012Q4 while CPI inflation gauges, both the new All-India CPI and the prior CPI-IW benchmark, show retail price inflation running close to double-digit territory (Chart 2). Nor is any short-term improvement likely. The monthly industrial production data slipped by over 1% q/q in FY2013Q1, foreshadowing another extremely weak quarter for GDP growth. Additionally, our bespoke services growth indicator which tracks a range of monthly indicators such as rail cargo, airport traffic and commercial vehicle sales, has also shown extremely weak momentum in the first half of 2012 (Chart 3). FY2013Q1 GDP, released on August 31st, is unlikely to better 2012Q4's 5.3% y/y print and could even see a '4 handle'. At the time of writing, our expectation was for a 5.0% y/y outturn. And, of course, these disappointing readings come before the looming negative supply shock of this year's still-deficient monsoon. The specific impact of the monsoon on our forecasts will be discussed in more detail below but it will clearly propel at least a further short-term deterioration in the economy's growth:inflation trade-off.

The key to any realistic prognosis is, of course, a detailed diagnosis and, in this instance, therefore, a dissection of the factors underlying India's deteriorating macro-economic performance. The answer is relatively straightforward: the dramatic loss of fiscal discipline since the global financial crisis. Any number of statistics can be marshalled to underline the scale of the latter: we select three. First, in the four years to FY2008, the gross government deficit (the combined centre and state deficit plus off-budget items) averaged 5.7% of GDP. In the subsequent four years (FY2009 to FY2012), the gross deficit has averaged 8.4% of GDP. Similarly, in the four years to end-FY2007, net credit to the government sector averaged less than 5%; in the four years to end-2011 has averaged over 26% (Chart 4)! Lastly, and possibly most damning, is that the IMF's latest forecasts anticipate India having the highest general government deficit in the G-20 outside Japan in calendar 2012. For the record, the IMF's forecast is for the deficit to be -8.3% of GDP in 2012 (Chart 5).

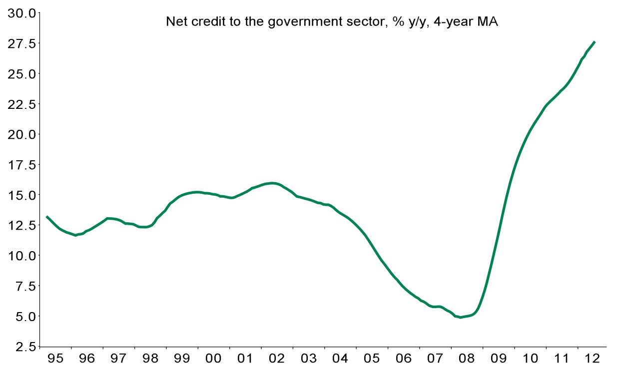
The nature of India's fiscal deterioration since the global financial crisis is also crucial. Rapid growth in government spending has been the culprit; in particular accelerating spending on government subsidies playing a dominant role. As Chart 6 details, government spending on subsidies grew at a compound growth rate of 12.5% between FY2005-FY2008 but has exploded between FY2009-FY2012, growing an average 32.1%. As a share of GDP,

Chart 3: BNPP Coincident Growth Indicator



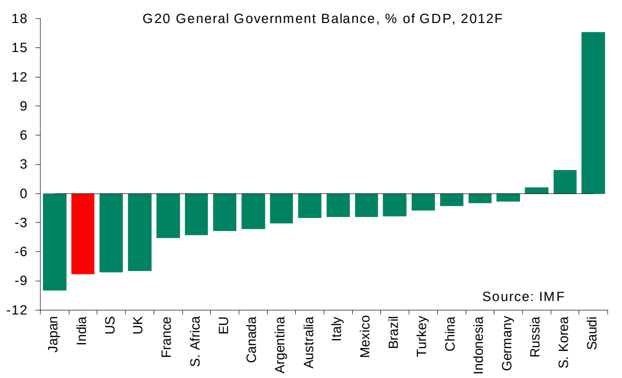
Source: Reuters EcoWin Pro, BNP Paribas

Chart 4: Loss Of Control



Source: Reuters EcoWin Pro, BNP Paribas

Chart 5: The Wrong Neighbourhood



Source: IMF, Reuters EcoWin Pro, BNP Paribas

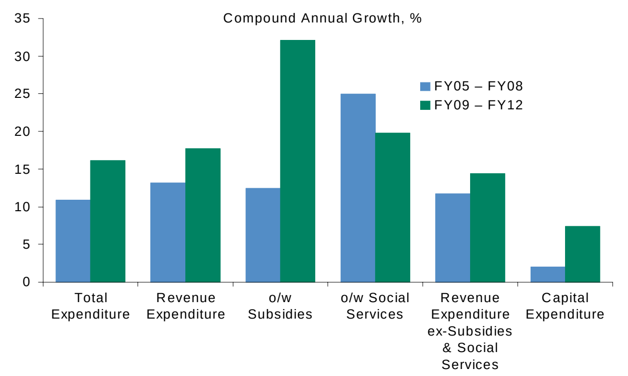
government subsidies have increased from a pre-crisis norm of c.1.4% of GDP to 2.4% of GDP in FY2012. Drilling down in more detail, rising spending on food subsidies has accounted for around 0.2% points of the increase. The lion's share of increased subsidy spending reflects greater spending on petroleum subsidies, which increased from as little as c.0.1% of GDP in FY2008 to 0.8% of GDP in FY2012 as the Indian government continues to shield domestic businesses and consumers from the full impact of what appears to be secularly higher real oil prices. Spending on social services ('plan' and 'non-plan' combined) has continued to grow rapidly over the same period (19.8% CAGR) although this represented a stepping down from the 24.5% CAGR between FY2005-FY2008. What clearly hasn't driven larger deficits is any meaningful acceleration in capital spending by the Indian government. Capital spending by the central government has averaged annual growth of just 7.3% since FY2008. While this is admittedly faster than the dismal average growth of 2.0% y/y between FY2005-FY2008, it is still disappointingly slow given the pressing needs for investment in infrastructure in particular.

That bigger budget deficits have essentially been driven by faster government consumption rather than investment spending is formalised by looking at RBI's latest Flow of Funds analysis which tracks the economy's saving and investment flows and which are now available up to FY2011. The sharp deterioration in public sector cashflow (saving less investment) has been driven by lower government saving (current spending less revenues) rather than a decline in the investment share. The former fell by 5% of GDP between FY2008 and FY2011 while the latter was broadly unchanged. The Flow of Funds also clearly show the deleterious consequences of big government deficits on the broader macro-economy and their role in worsening the growth inflation trade-off. By definition, the current account deficit is the difference between domestic saving and investment. The deterioration in the public sector accounts is the counterpart to the widening in India's current account deficit, which hit a record 4.2% of GDP in FY2012.

Fiscal laxity has therefore generated a textbook 'twin deficit' problem which has left the INR the Asian currency most reliant on hot money flows to finance its balance of payments and in turn the most exposed to swings in global risk appetite. The analogue to the euro-zone dysfunctional mini-cycles of crisis, policy response, temporary stabilisation, complacency followed by renewed crisis has been accompanied by spurts of INR depreciation interspersed with periods of stabilisation. Without a decisive policy shift in New Delhi that recasts India's macro-economic trajectory, the INR is likely to remain structurally under pressure and uncomfortably beholden to swings in global risk appetite. The other counterpart to India's loss of fiscal discipline has been a squeeze on private sector investment as increased government borrowing has pushed up borrowing costs, sapped liquidity from the banking system, working to 'crowd out' business spending. RBI's Flow of Funds data show gross investment by private corporations sliding from a peak of 17.3% of GDP in FY2008 to 12.1% in FY2011 (the latest year for which data is currently available). In turn, less dynamic investment spending has inhibited the economy's supply-side performance, thus exacerbating inflation pressures and gradually locking in lower rates of potential output growth. Faster inflation allied to the emergence of a structural current account deficit has in turn worked to weaken the INR which has then added a further negative feedback loop to India's worsening inflationary dynamics.

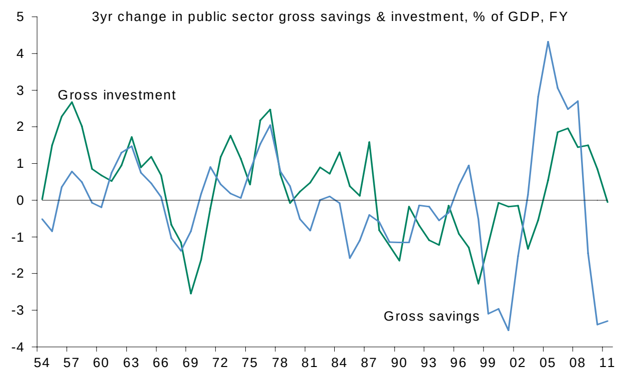
Of particular concern is that India's poor growth performance over the last 12-18 months has had little impact in pulling inflation down to more comfortable

Chart 6: Spending Growth Decomposed



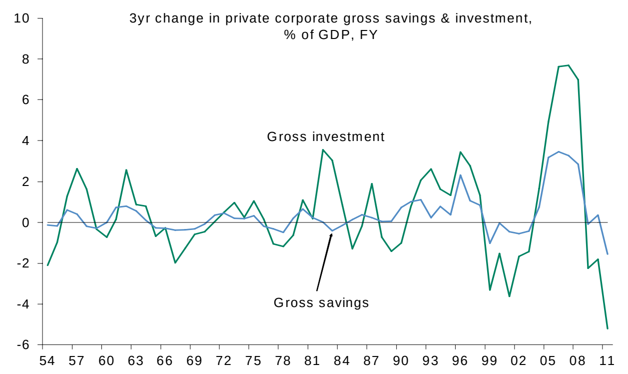
Source: Reuters EcoWin Pro, BNP Paribas

Chart 7: Public Sector Dis-saving…



Source: RBI, BNP Paribas

Chart 8: …Crowds Out Private Investment



Source: RBI, BNP Paribas

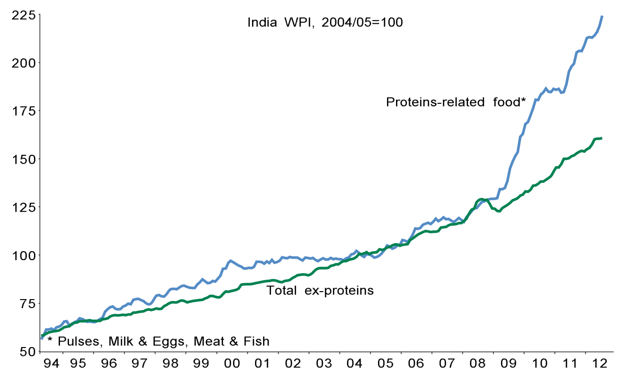
levels. Annualised GDP growth of a mere 4% in (calendar) 2011H2 probably matches most economists' definition of a 'hard landing' for the Indian economy but inflation has nonetheless remain highly recalcitrant on both a headline and even to some extent on a core basis. As this report's *Inflation Trends* section covers in some detail, Indian's structural inflation problem is essentially a food inflation problem which in turn has two strands. The first and most important is the well-documented trend-acceleration in the inflation rates of protein sources as rising incomes produce dietary shifts, boosting demand for items such as pulses, dairy and meat that supply is unable to keep up with in the short-to-medium term (Chart 9).

The timing of the structural break in protein-source inflation signals that accelerated spending on social programmes, such as NREGA, that boost rural incomes appears to have played an important role in quickening these trends and so adding to inflationary pressures. The stylised fact is that since FY2005, prices of protein sources in the WPI have increased by 113%; everything else in the WPI basket by 59%. After a pull back last year, protein source inflation has again markedly quickened, running at 13.3% y/y in July. Note too that increased demand for protein sources is increasingly being met by extra imports, adding, at least at the margin, to the pressure on India's goods trade balance

But there is a second, less heralded, aspect to India's structural food inflation problem: increasingly rapid and volatile price increases of fresh fruit and vegetables. Over the last twelve months or so, potato prices in particular have seen extreme volatility but other stables of the Indian diet such as onions and tomatoes have also seen unusually violent boom-bust cycles in recent years. The bottom line is that fresh fruit and vegetable inflation has significantly accelerated over the last 4 years, averaging 10.6% y/y between FY2009-FY2012 vs. 7.6% between FY2005-2008 (Chart 10). With a weight of 26.5% in primary WPI food prices and 3.8% in total WPI, a three-percentage point acceleration in this component is non-negligible.

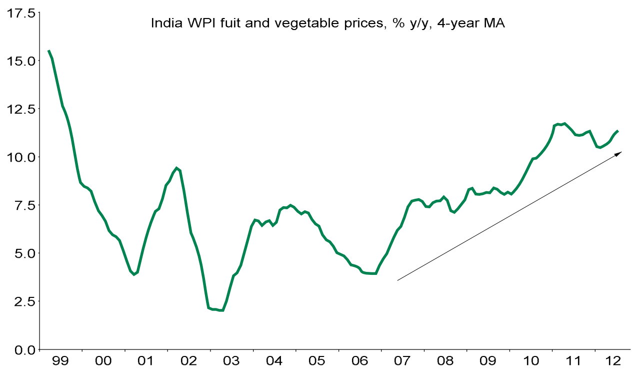
Volatility has also increased markedly (Chart 11) suggesting that the well-documented inefficiencies in India's supply, storage and distribution networks in the agricultural sector are getting worse, not better. Supply and demand shocks seem to be increasingly amplified, rather than more damped. Falling investment (as a share of GDP) is the likely culprit and so the behaviour of fruit and vegetable inflation can be thought of as a micro-example of slower capex worsening the economy's growth:inflation trade-off.

Chart 9: Protein Problem



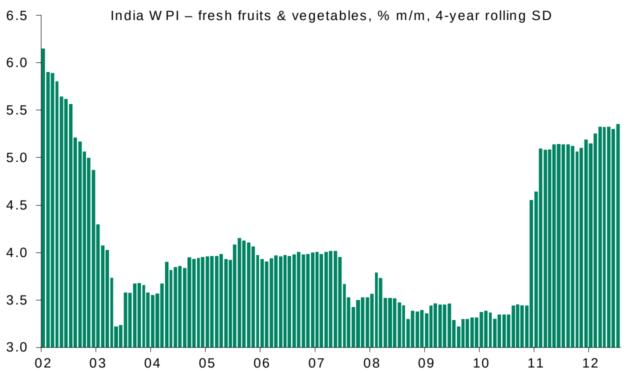
Source: Reuters EcoWin Pro, BNP Paribas

Chart 10: Fruit & Vegetable Acceleration…



Source: Reuters EcoWin Pro, BNP Paribas

Chart 11: …& Increased Volatility



Source: Reuters EcoWin Pro, BNP Paribas

The high weight of food prices in Indian inflation 'baskets' – both WPI and the various CPI gauges – means that 'core' inflation is a less valid concept for India that for many economies. As RBI Governor, Dr. Subbarao, emphasised in a recent speech[1], 'core' inflation matters to the extent that it provides an accurate guide to underlying inflation and more

[1] 'Statistics and Statistical Analysis in RBI's Work'
Address by. Dr. D. Subbaro at the Sixth Annual Statistics Day Conference, RBI, Mumbai, July 17th 2012
http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=706

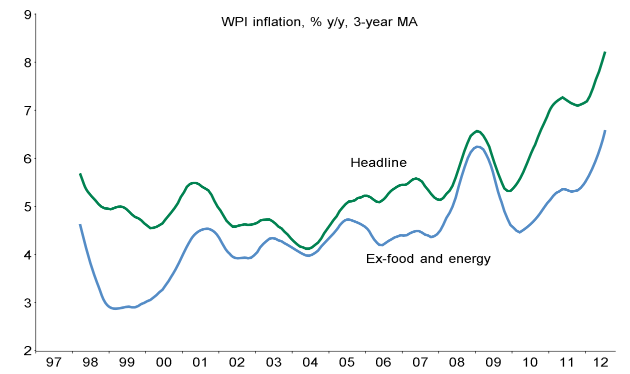
importantly is useful predictor of headline inflation. In other words, that shocks or innovations in food and energy prices are not persistent. However, as highlighted above and as Dr. Subbarao stressed in his speech, inflation for protein items in the WPI and CPI baskets clearly *is* persistent, devaluing the importance of core inflation as a guide to policy for RBI. Indeed, rather than temporary swings in headline inflation 'mean reverting' to the underlying trend core rate, accelerating headline inflation is gradually pulling core inflation up via the increasingly unglued inflation expectations of both household and corporations (Chart 12).

Rising inflation expectations are now perhaps the most alarming element of India's worrisome inflation dynamics and, if unchecked, could drive a further deterioration in the growth:inflation trade-off. Certainly, the uncomfortably high level of inflation expectations now embedded in the economy helps explain why the sub-standard growth rates have not pushed down core inflation down more forcefully over the last year. There have been three recent pieces of evidence suggesting that inflation expectations are becoming further unmoored. First, RBI's latest survey of professional forecasters showed both 5-year and 10-year ahead inflation expectations rising to record highs of 7.3% and 6.8% respectively. Second, output pricing intentions as recorded in both the PMI manufacturing and non-manufacturing surveys have markedly decoupled from output trends, signalling that slowing or even falling output is no deterrent to price increases for some producers. Lastly, RBI's latest survey of household inflation expectations showed consumer inflation expectations, which fell in the first three months of the year, rising once again and flirting with the record highs seen in late-2011 with the one-year ahead expectation running at 12.8% (Chart 13).

While RBI has palpably failed to meet what former Governor Dr. I. G. Patel labelled the 'supreme test of monetary policy' and ensuring that 'the growth in prices is checked without retarding the growth in production', it would be harsh to lay too much of the blame for India's current dire economic straits at its door. As stressed above, fiscal, not monetary, policy is clearly the prime culprit and RBI has continually highlighted its relative impotence to recast macro-fundamentals, making clear that too loose fiscal policy is the key problem (and barrier to lower rates). RBI has also justifiably highlighted, there is little evidence that too tight money has been a significant factor in retarding economic activity[2]. RBI has calculated that average real lending rates of commercial banks – whether measured based on the WPI or GDP deflator – have been comfortably below those prevailing during India' s 'go-go years' of 2003-2008 (see Chart 14). As the behaviour of inflation expectations shows, monetary policy has, if anything, been too slack on average in recent years.

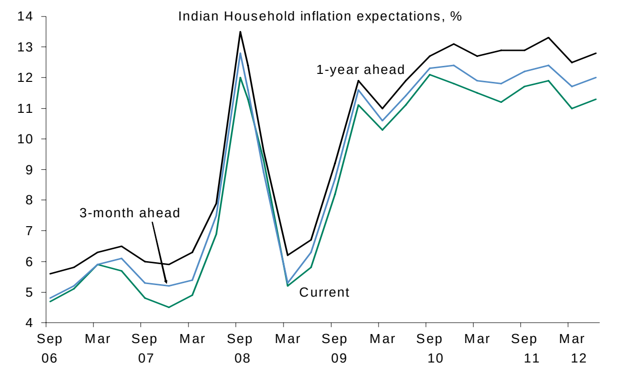
One valid criticism that can be levelled at the central bank is that it was too tardy in late 2009 and early 2010 (as *Eye on The Tiger* warned at the time) in clawing back the massive monetary policy stimulus pumped in during the global financial crisis. The effective policy rate for example was still just 3.75%

Chart 12: Who's Leading Who?



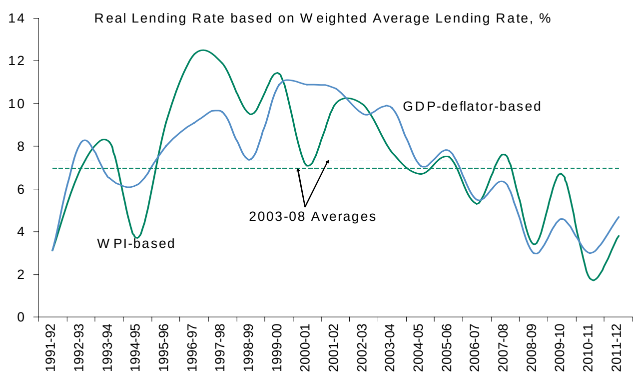
Source: Reuters EcoWin Pro, BNP Paribas

Chart 13: Unglued Inflation Expectations



Source: RBI, BNP Paribas

Chart 14: Don't Blame RBI…



Source: RBI, BNP Paribas estimates

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2 See RBI Working Paper, 'Measures of Nominal and Real Effective Lending Rates of Banks in India. 18th May 2012. http://www.rbi.org.in/scripts/PublicationsView.aspx?id=14236

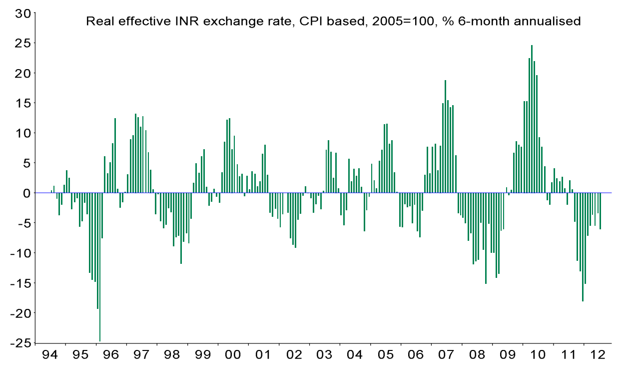
by mid-2010 when the emergency and hence the need for super-low interest rates had clearly passed. Equally, during this period, RBI adopted an unusually laissez-faire approach to the INR which, on a real trade-weighted basis, appreciated at a record 25% annualised in the six months to April 2010 as the prospect of rising rates and ample global liquidity saw powerful hot money flows into India (Chart 15). RBI's failure to more pro-actively manage these real appreciation pressures saw the INR move into overvalued territory. Real overvaluation both dented external competitiveness, so exacerbating the industrial slowdown of the last 18 months but also left the INR with further to fall when hot money flows inevitably subsequently dried up.

Ironically, the depreciation pressure on the INR in recent months has forced RBI to abandon its more 'laissez-faire approach and intervene both in spot and particularly in forward markets to support the currency. RBI has also taken a number of steps to open the capital account, primarily by encouraging more debt flows. Key measures taken have included lifting the proscribed limits on foreign holdings of domestic government and corporate bonds and increasing deposit rates for NRI (Non-resident Indians). Given a solid body of research that shows debt flows are the most footloose capital flows, these measures actually risk further entrenching the INR's position as the region's most volatile and risky currency.

As economies such as South Korea have discovered, subsequently reversing such measures during the inevitable times of buoyant capital flows only further fuels foreign investors' risk perceptions of the currency. Helped by a period of relative calm in Europe during July and August, FII (foreign institutional inflows) flows have been surprisingly buoyant over the last three months (see *Financial Trends* section) but this has still barely been sufficient to staunch the bleeding of RBI's FX reserves. While lower oil and gold prices should ensure some modest pullback in the yawning current account deficit to closer to 3¼% of GDP in FY2013, India's current account will remain a regional outlier (although Indonesia could push it close next year). With another bout of extreme financial stress in Europe a racing certainty, further strain on India's balance of payments and of course the far from 'cheap' INR looks likely.

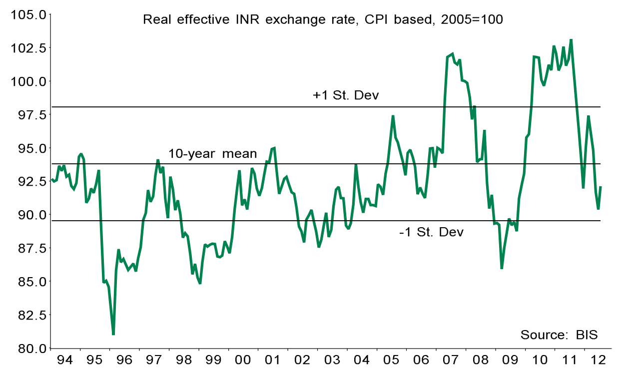
The only genuine solution to India's balance of payments woes and ultimately reversing the deterioration in growth:inflation trade off is, of course, a credible, and sizeable, fiscal consolidation. Higher government savings are needed to push gross national savings rates back up towards the rates of c.35% seen in FY2007/FY2008 from FY2011's lowly

Chart 15: ...Too Much



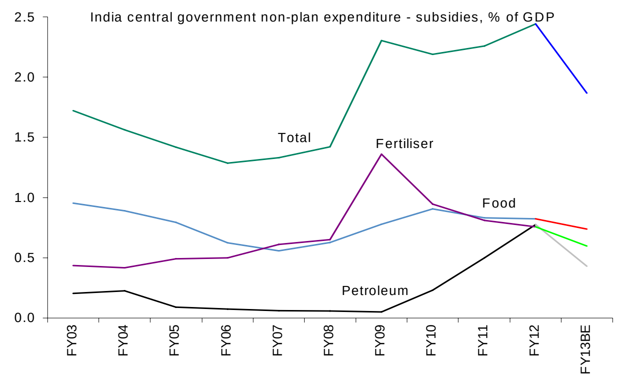
Source: BIS, Reuters EcoWin Pro, BNP Paribas

Chart 16: Not That Cheap



Source: BIS, Reuters EcoWin Pro, BNP Paribas

Chart 17: Great Expectations



Source: Reuters EcoWin Pro, BNP Paribas

32% rate, which would eventually crowd back in private investment, allowing gross investment to move back up to, even above, 37%, from its current rate of 35%. The required fiscal reforms are well-known. First, and foremost, is action on subsidies, especially fuel subsidies. This year's Union Budget arithmetic was crucially based upon presumed (and largely implausible) control of subsidies; spending on which was assumed to drop by 0.6% of GDP (Chart 17). Even with prompt action on fuel subsidies, the central government budget deficit looks likely to exceed FY2012's 5.9% of GDP as non-tax receipts disappoint optimistic assumptions and slower economic growth dull tax revenues more generally. Diesel and kerosene are the most expensive (and most unpopular) subsidies requiring action. Tax reform, particularly renewed progress of the integrated GST (goods and services tariff), which has already been delayed three years, is needed. By replacing the disparate and Byzantine state-level taxation systems, the GST should both broaden the tax base, boosting revenues and also encourage increased cross-state trade. Ballooning spending on social services also needs to be better tailored and directed. Inefficiencies and corruption mean that much of the money from the central government's well-intentioned employment and education programmes fails to reach the intended and deserving recipients. Rural spending could also be usefully redirected towards infrastructure.

With the appointment of new Finance Minister, P. Chidambaram, hopes have inevitably improved of more decisive action on the public finances given his impressive track record of fiscal consolidation during his previous stints as Finance Minister, particularly between 2004 and 2008. The fear remains however that decisive, bold actions will continue to be shirked and that the 'Delhi deadlock' will continue to prevail. For India's dysfunctional public finances ultimately reflect its dysfunctional politics. Rightly seen as key strength for the country over the long-term, India's democracy is contriving to hamstring the economy in the short-term. Politics are highly fragmented and the Congress Party does not have an absolute majority to successfully pass legislation on its own. Fractious, and frequently bad-tempered coalition politics, are therefore frequently adduced as the main reason for the policy drift of recent years. Certainly it is the Congress Party's favourite excuse for its failure to enact other crucial, but contentious, legislation such as liberalising the economy's FDI regime.

This report has previously highlighted how a more liberal FDI regime, particularly for multi-brand retail, would constitute a 'triple win' for India. It would signal to foreign investors the renewed reform aspirations of the government; it would boost FDI inflows reducing reliance on hot money flows and increase investment in supply, distribution and storage networks; it would also help damp fresh fruit and vegetable inflation. At time of writing, Finance Minister Chidambaram is apparently moving ahead with long-frozen proposals to lift the FDI ceiling in the insurance sector to 49% (from current 26%). Increased FDI in the key sectors of multi-brand and civil aviation still looks off the agenda given the continued opposition of coalition partner, Trinamool Congress.

While the constraints of coalition politics in recent years have undoubtedly been important in derailing India's reform programme and undermining fiscal discipline, they are not a sufficient explanation. India has been governed by coalitions before which have successfully introduced and passed controversial legislation. A BJP-led alliance, for example, passed the Fiscal Responsibility and Budget Management Act in 2003 which helped lay the foundation for subsequent fiscal discipline between FY2004-2008 Pratap Mehta has compellingly argued that India's current political dysfunction and in turn economic malaise is also a product of more deep-seated changes to the political system3.

The three related factors are, first, a sharp increase in horizontal accountability of politicians and government as institutions such as the Supreme Court of India and the Office of the Comptroller exert more influence, partly in response to the leadership vacuum at the centre. Second, the Right to Information Act has sharply increased vertical accountability. Passed back in 2005, the Act gives citizens the right to request information from any public authority, which is required to responds within 30 days. Responsible for a dramatic increase in transparency, the ability of individual citizens and pressure groups to challenge the government has likely contributed to policy paralysis. Lastly, power is slowly but steadily being devolved from the centre to the states or even to the village council level in some instances such as the administration of NREGA. As Mehta notes, 'India is undergoing a broad reformation of its political culture that any party would struggle to manage'. India's democracy is maturing and deepening; a trend that paradoxically is weakening India's politics in the short-to-medium term. Neither of the two main parties, Congress and the BJP, which both must face complicated succession issues in the next few years appear to be grappling successfully with these underlying shifts. The clear risk therefore is that the fissiparous dynamic in Indian politics continues to build and that the general election of 2014 will leave national politics even more splintered and divided.

While the jury necessarily remains out for the time being, the clear risk is that the return of Mr. Chidambaram to the Finance Ministry will change little and that the decisive policy thrust on subsidies, tax reform and FDI liberalisation that is required to recast India's macro-economic fundamentals and restore foreign confidence will remain lacking. If so, the spectre of continued deterioration in the growth:inflation trade-off as raised at the beginning of

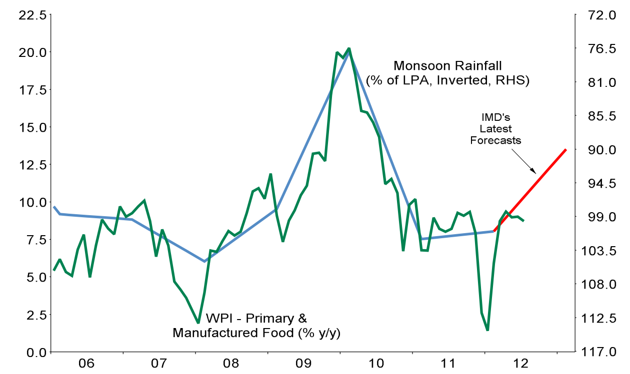
[3] Pratap Bhanu Mehta, 'How India Stumbled', Foreign Affairs, July/August 2102 http://www.foreignaffairs.com/articles/137719/pratap-bhanu-mehta/how-india-stumbled

this essay cannot be ruled out. In the near term, 2012's disappointing monsoon (see *Monsoon Trends* section for more detail) represents a fresh unwelcome negative supply shock that will push inflation up and growth down, further cramping RBI's already strictly limited policy space. Assuming the IMD's latest forecast for the monsoon to be around 10% deficient relative to the 'long-period average', food inflation risks re-accelerating back to towards 15%+ from its current 10% by calendar-year end with prices of pulses and grains likely to see the faster increases (Chart 18). Given the aforementioned high weights of food in price baskets, these high visibility price increases will risk a further ratchet effect on already too high inflation expectations that RBI will want to monitor closely. And with headline rates of inflation likely to re-accelerate up towards 9% for WPI (vs.6.9% in July) and back into double-digit territory for CPI inflation, it is difficult to see how RBI can deliver anything more than a token 25bp reduction in the policy rate for the foreseeable future. The high level of suppressed inflation still in the system from yet-to-be tackled fuel subsidies and the continued pressing need for electricity prices to be hiked adds to the upside risks to our inflation forecasts. Accordingly, we target just 25bp of policy ease by RBI before end-FY2013. The OIS market which continues to price in close to 100bp of policy ease over the next year continues to attribute too much policy pace to the central bank (Chart 19).

This year's deficient monsoon will also inevitably depress agricultural output which is still worth some 14% of GDP. The experience of previous truant monsoons suggests that agricultural output will be flat to slightly down in y/y terms in the second half of this financial year. Allied to the continued disappointing readings on industrial production and slowing world trade growth, our FY2013 forecast is pushed down further to 5.7% vs. 6.3% previously. And helpful base effects from 2011H2 (when we estimate GDP growth slowed to an annualised 4%) are crucial in preventing an even more pessimistic growth assumption for FY2013. The extent to which the economy improves in FY2104 or the dismal macro-outturns of FY2013 begin to be locked in will largely be determined by the symbiotic relation between fiscal discipline and the balance of payments and also the extent of external stress in the global economy. Further sharp falls in the INR triggered by balance of payment strains would likely be required to entrench inflation around double-digit territory and further enflame household and corporate inflation expectations.

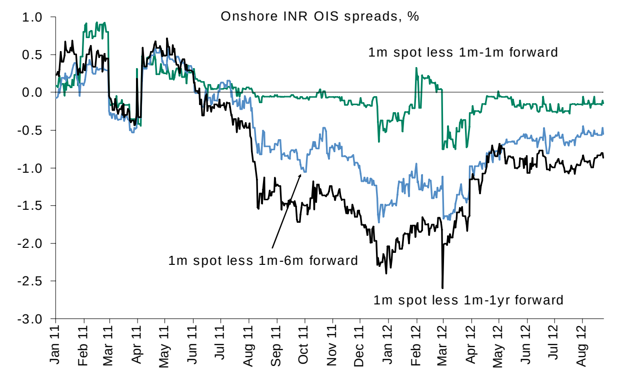
Our base case is that some gradual policy progress in New Delhi (some action on subsidies and FDI liberalisation by year end) combined with faster global growth next year and gradual (though not

Chart 18: Monsoon Inflation Risk



Source: IMD, Reuters Ecowin Pro, BNP Paribas

Chart 19: Too Much Priced In

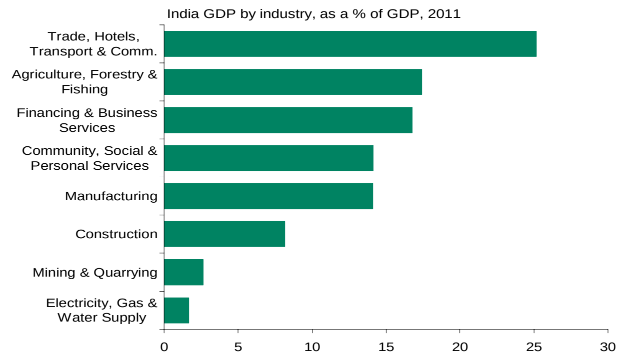


Source: Bloomberg, BNP Paribas estimates

steady) progress in resolving the euro-zone debt crisis ensures that significant further balance-of-payments stress is largely avoided and that India will at least return to 7/7 'new normality' in FY2014. Our central FY2014 forecasts are for a partial recovery in GDP growth to 7.3% and WPI inflation to retreat back to c.7% as the inflationary spike of this year's monsoon fades. But the balance of risks should be clear and the avoidance of considerably worse macro outcomes for the Indian economy over the next 18 months will require both political courage and vision to break the 'Delhi deadlock' and also considerable luck in the shape of external events, particularly Europe. And any sustained improvement in India's 7/7 new normal will require an even more concerted policy thrust that pushes national saving rates back to 35% or above which looks unfeasible given the current political climate. A genuine recasting of India's macro-fundamentals likely requires a recasting of its political fundamentals which look unlikely until after the 2014 general election at the earliest.

Economic Basics – I

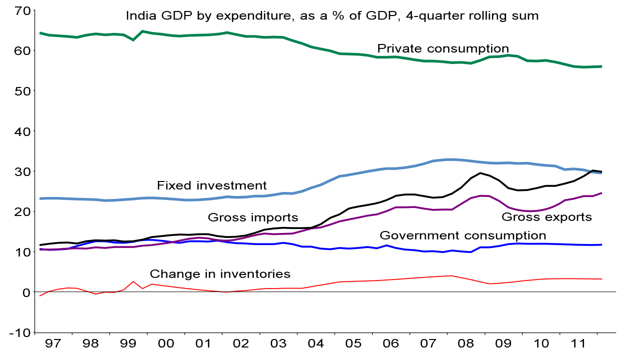
GDP By Industry



Source: BNP Paribas, Reuters EcoWin Pro

Services are the dominant pillar of the Indian economy, worth 56% of GDP in 2011. Agriculture and allied activities, at 20.0%, are almost as large as industry's 24% (construction, 8.1%; electricity, 1.7%; and manufacturing, 14.1%).

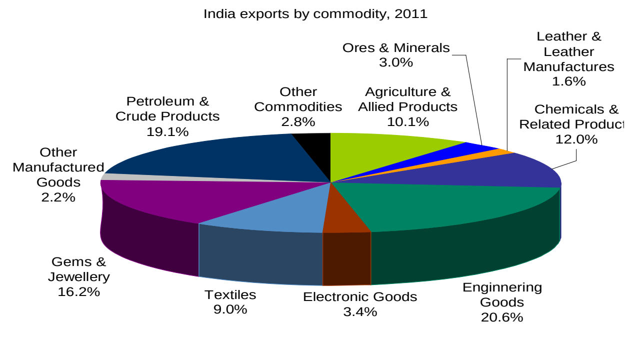
GDP By Expenditure



Source: BNP Paribas, Reuters EcoWin Pro

Viewed by expenditure, private consumption, at 56% of GDP, dominates the economy. At c.25% of GDP, gross exports are low by Asian standards. The fixed investment share has been gradually sliding from a peak of c.33% to c.29½%.

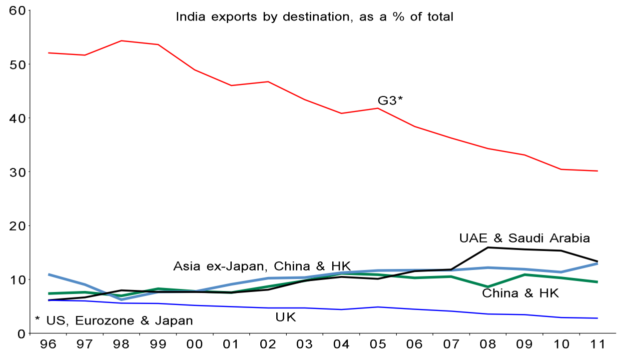
Goods Exports By Commodity



Source: BNP Paribas, RBI, Reuters EcoWin Pro

Viewed by commodity, India's export sector is well diversified. Engineering goods are the dominant category, followed by refined petroleum products. Textiles, gems, jewellery, chemical and agricultural products all account for significant portions.

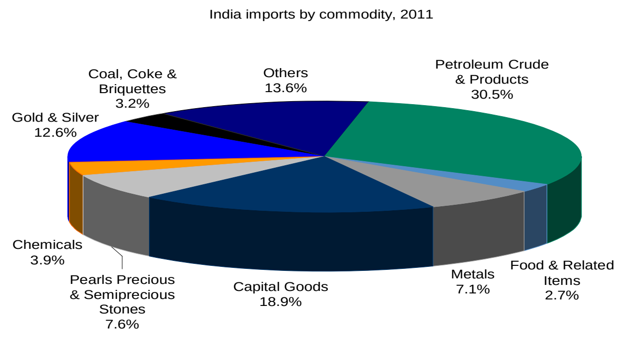
Goods Exports By Destination



Source: BNP Paribas, Reuters EcoWin Pro

The vast majority of Indian exports, of almost one-third, go to the G3. China and Hong Kong combined absorb a lowly 9.5% of Indian goods. The rest of Asia ex-Japan accounts for c.13% of Indian exports, close to Middle East's c.13½ % share.

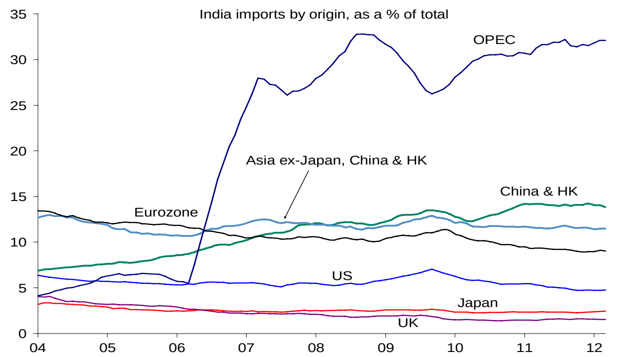
Goods Imports By Commodity



Source: BNP Paribas, Reuters EcoWin Pro

As with most Asian economies, India is a significant net importer of commodities. Crude and petroleum products account for almost one-third of India's import bill, meaning trade trends are frequently driven by oil price shocks.

Imports By Origin

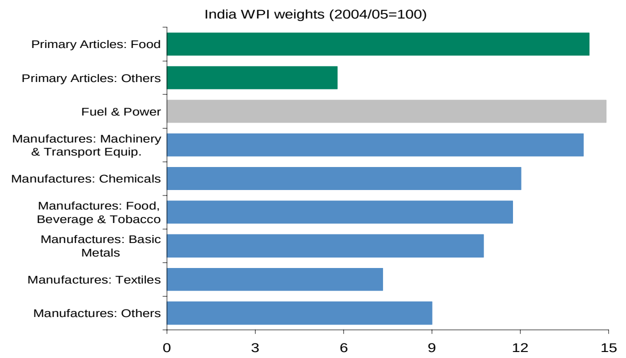


Source: BNP Paribas, Reuters EcoWin Pro

A geographical breakdown of India's imports paints a similar picture, with OPEC absorbing close to 32% of Indian demand. Oil demand aside, Asia ex-Japan (25½%) is the most important supplier of Indian imports, followed closely by the G3 (16¼%).

Economic Basics – II

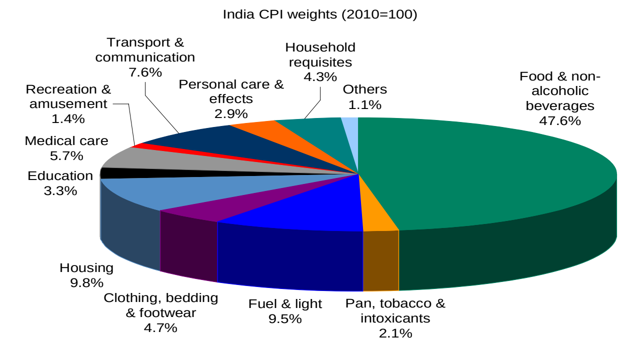
WPI Weights (2004/05=100)



Source: BNP Paribas, Reuters EcoWin Pro

Food (primary and manufactured) effectively makes up over 24% of the Indian WPI while energy-related items are worth some 15% of the representative basket. Excluding food, manufactured goods account for around 53% of the WPI.

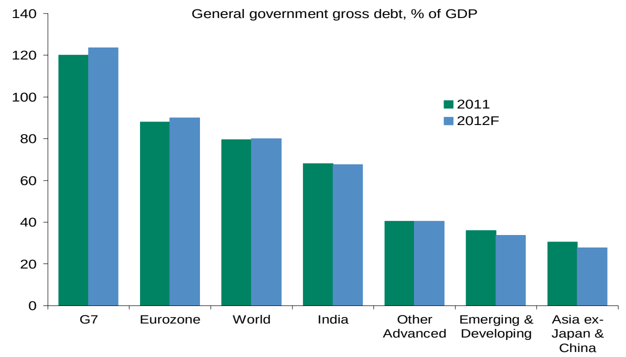
CPI Weights (2010=100)



Source: BNP Paribas, Reuters EcoWin Pro

At 47.6%, the newly revised CPI has a much higher weighting of food. Housing has a weight of 9.8%, close to fuel and light's share of 9.5%. Transport and communication, medical care, clothing and household requisites all have significant weights.

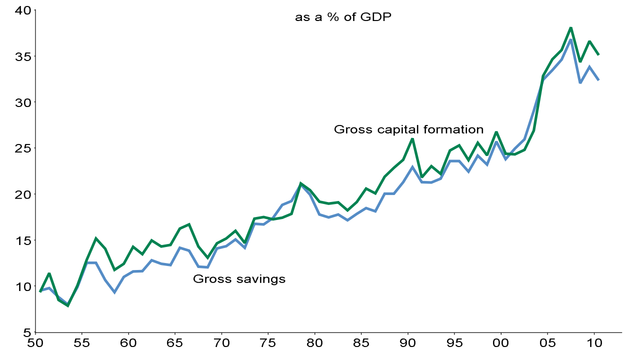
General Government Debt



Source: BNP Paribas, IMF

By Asian or EM standards, India's public debt is high at almost 70% of GDP. However, its debt levels remain favourable vis-à-vis debt levels in the 'developed' world. India's fast nominal GDP growth also greatly improves its debt sustainability arithmetic.

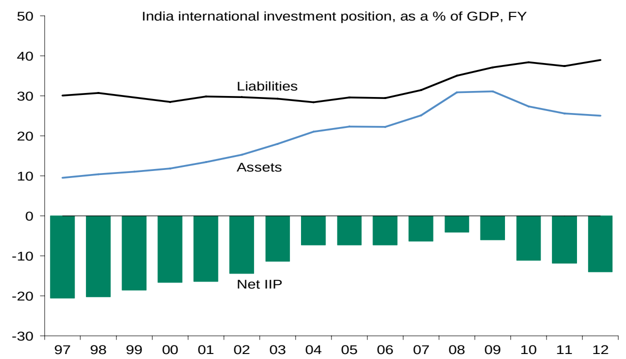
Investment vs. Savings



Source: BNP Paribas, Reuters EcoWin Pro

Gross saving and investment have moved sharply higher over the last decade with both averaging close to 35% of GDP in FY2011. Consistent with India's current account deficit, investment spending outpaces the flow of gross savings.

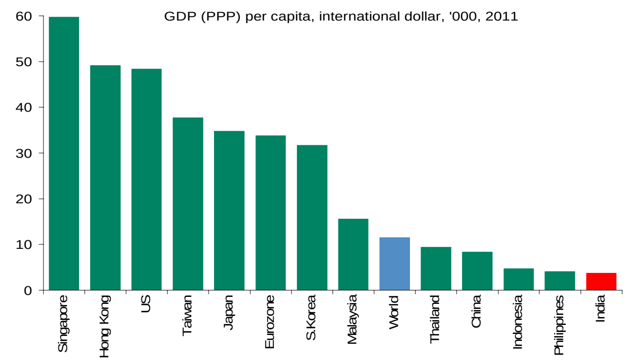
International Investment Position



Source: BNP Paribas, Reuters EcoWin Pro

Similarly, consistent with India's persistent current account deficit, India is a net, albeit small, international debtor. At the end of FY2012, India's net international investment position (NIIP) was in the red by USD245bn or 14% of GDP.

GDP (PPP) Per Capita

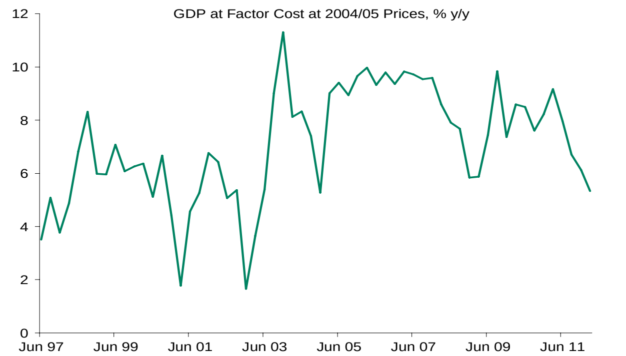


Source: BNP Paribas, IMF, Reuters EcoWin Pro

With cost-of-living adjusted GDP per capita of just below USD3.7k in 2011 according to the IMF's estimates, India remains an extremely poor economy. Per capita incomes in China are more than 2x higher at c.USD8.4k.

GDP Developments – I

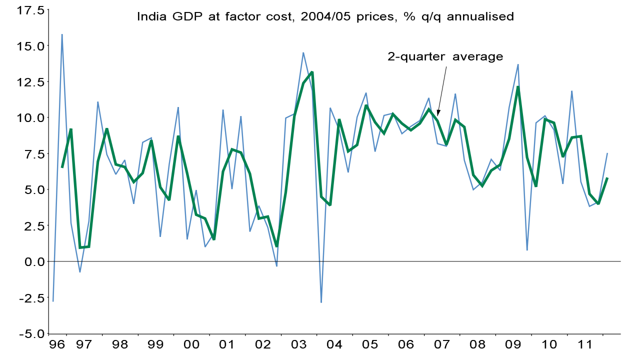
GDP Growth



Source: BNP Paribas, Reuters EcoWin Pro

India's annual GDP growth slowed for a fourth consecutive quarter to a nine-year low of 5.3% y/y in the three months to March 2012 (Q4 FY2012).

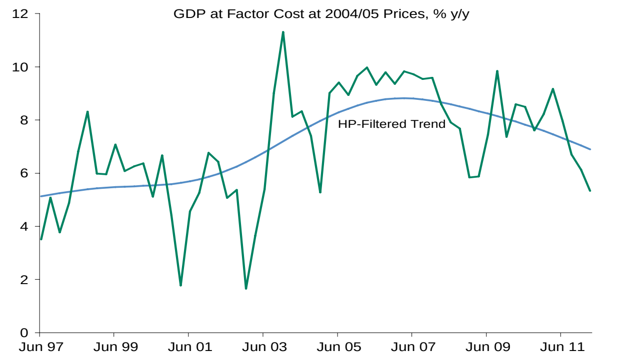
GDP Growth Momentum



Source: BNP Paribas, Reuters EcoWin Pro

On a sequential q/q annualised basis, Indian GDP growth averaged just 4% in 2011H2; close to a 'hard landing'. Momentum picked back up to c.7½% annualised in the three months to March 2012, however.

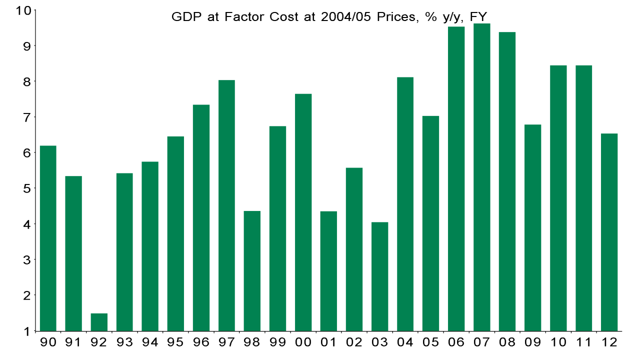
GDP Growth – Actual vs. Trend



Source: BNP Paribas, Reuters EcoWin Pro

Simple statistical filters suggest 'trend' GDP growth of c.7% post-crisis; a view now echoed by the RBI.

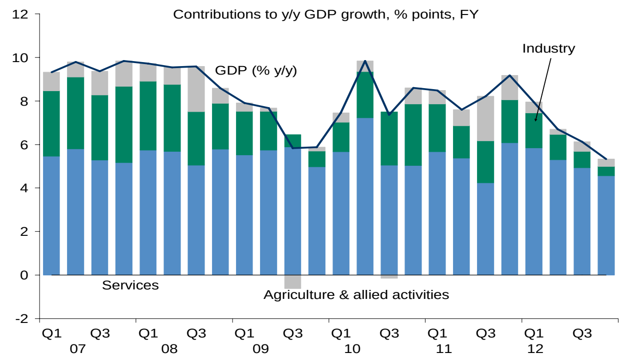
GDP Growth – FY Basis



Source: BNP Paribas, Reuters EcoWin Pro

FY2012 GDP growth, at 6.5%, is both sub-trend and below FY2009's global-financial-crisis-induced 6.7% growth.

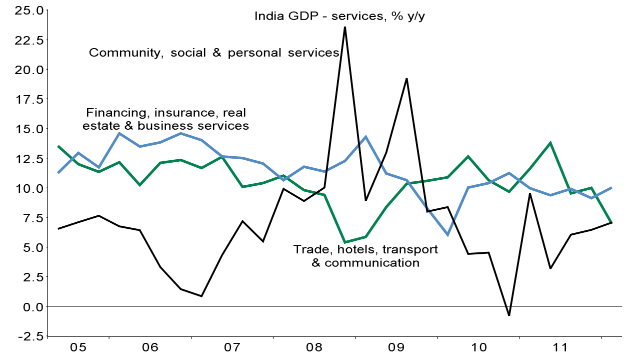
Contributions to GDP By Output



Source: BNP Paribas, Reuters EcoWin Pro

Non-agricultural sectors were key to the slowdown in annual GDP growth over the past year. Industry slid to 1.7% y/y in Q4 FY12 and services to 7.9%. They combined contributed almost 80% of the slowing in headline GDP from 9.2% y/y in Q4 FY11.

GDP – Services

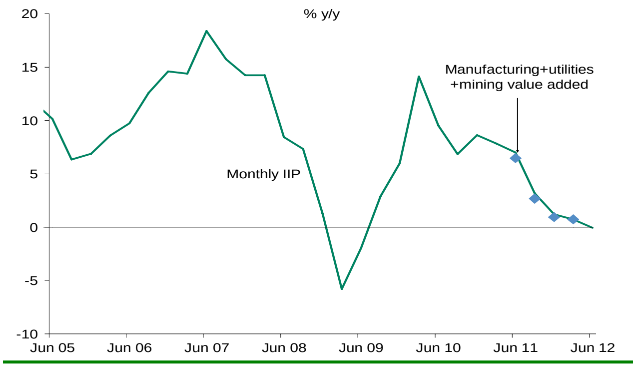


Source: BNP Paribas, Reuters EcoWin Pro

The bulk of the moderation in services in recent quarters comes from "trade, hotel, transport and communication". Community social and personal services have actually picked up while FIRE and business services have been holding up relatively well.

GDP Developments – II

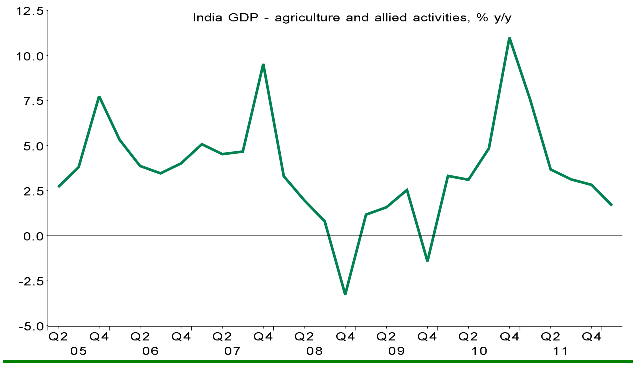
GDP – Industrial Value Added



Source: BNP Paribas, Reuters EcoWin Pro

The revised GDP data are estimated using the new index of industrial production (IIP). With the IIP dropping in 2 of the past 3 months, growth in industrial (utilities, manufacturing and mining) value added will likely have weakened further in Q1 FY2013.

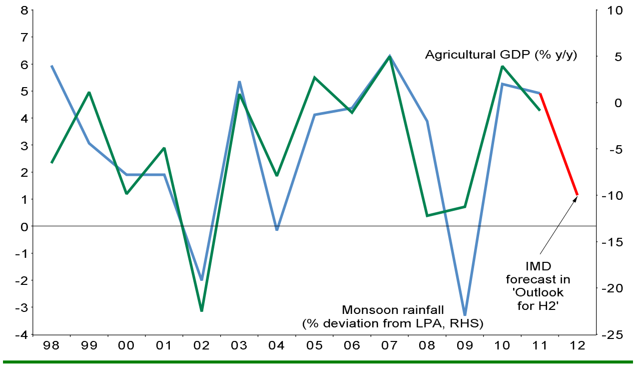
GDP – Agriculture – I



Source: BNP Paribas, Reuters EcoWin Pro

Agricultural GDP growth continued to slow after a 11% y/y gain seen in Q3 FY11 and reached 1.7% y/y in Q4 FY12. The slowdown in part reflects the strong snapback last year when the sector recovered from the drought seen through much of 2009.

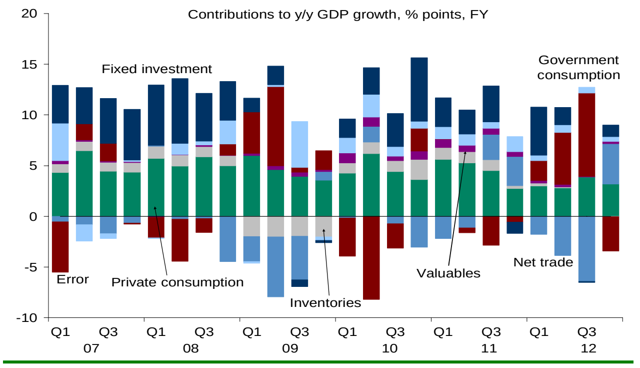
GDP – Agriculture – II



Source: BNP Paribas, Reuters EcoWin Pro

Agricultural output remains strongly influenced by swings in rainfall. With cumulative rainfall forecast at more than 10% below the LPA in 2012, the sector looks to slow to c.1-2% y/y in 2012. Recent rainfall data, however, suggest risks are to the downside.

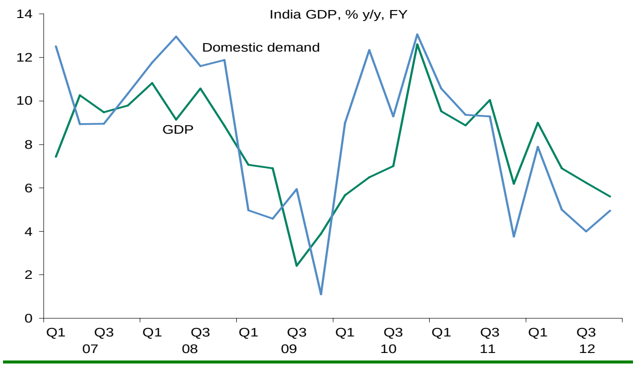
Contributions to GDP By Demand



Source: BNP Paribas, Reuters EcoWin Pro

Viewed by expenditure, the slowdown in Q4 FY12 GDP growth was domestically driven as net trade swung from a drag to a strong boost to growth. The estimates, however, are undermined by the presence of large statistical errors.

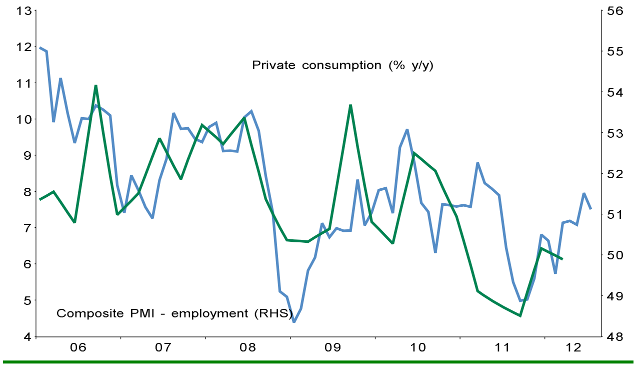
Domestic Demand



Source: BNP Paribas, Reuters EcoWin Pro

The fact that net trade was a strong contributor to Q4 FY2012 GDP growth means Indian domestic demand growth, estimated at 5.0% y/y, undershot overall GDP (at market prices) growth, of 5.6% y/y.

Private Consumption vs. Employment

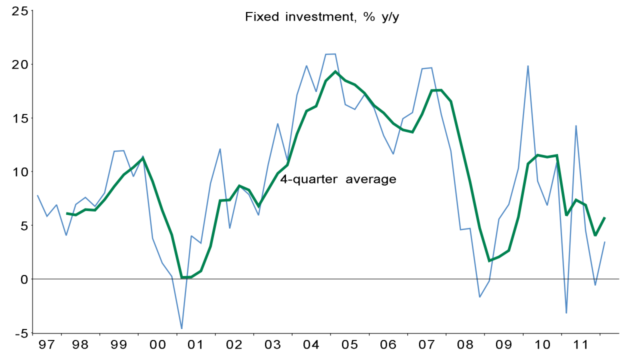


Source: BNP Paribas, Reuters EcoWin Pro

Measures of labour market trends are thin on the ground in India. However, the evolution of the composite PMI employment index points to some scope for private consumption growth to pick up from here.

GDP Developments – III

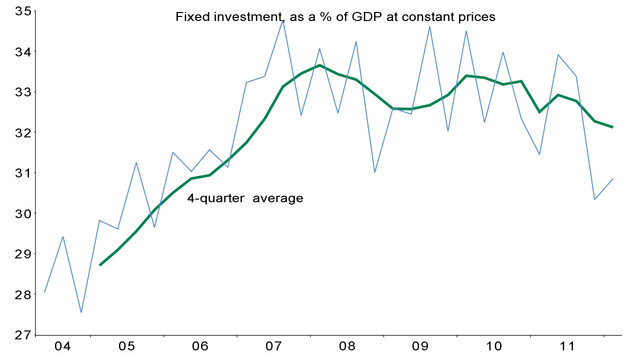
Fixed Investment Growth



Source: BNP Paribas, Reuters EcoWin Pro

Quarterly data are inevitably volatile but smoothing through volatility, fixed investment growth slowed to 5.2% y/y in FY2012; the slowest annual pace on a fiscal year basis in a decade outside of the global financial crisis.

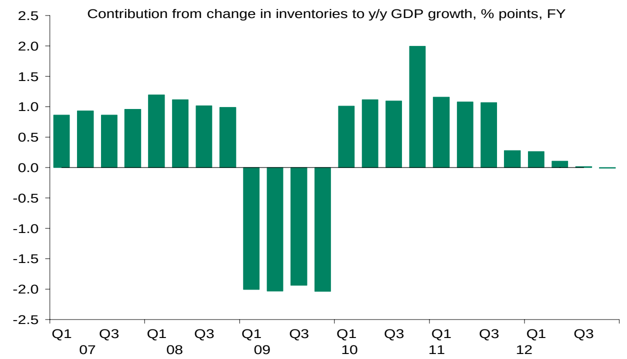
Fixed Investment Share



Source: BNP Paribas, Reuters EcoWin Pro

Sluggish investment inevitably means that investment as a share of GDP has pulled back, threatening to lock in slower growth.

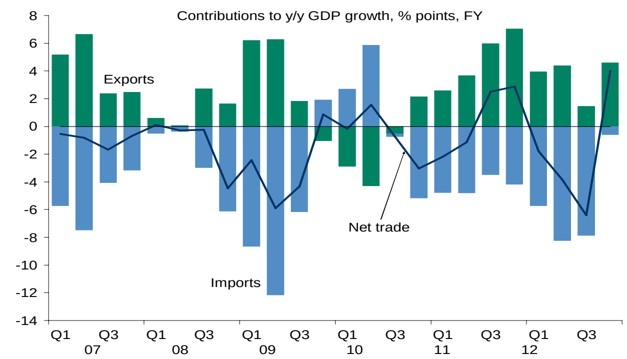
Inventories Contribution



Source: BNP Paribas, Reuters EcoWin Pro

With the pace of business stocking-building broadly stable since the recovery from the global financial crisis, the contribution from the y/y change in the change in inventories, which is what matters for annual GDP growth, remains limited.

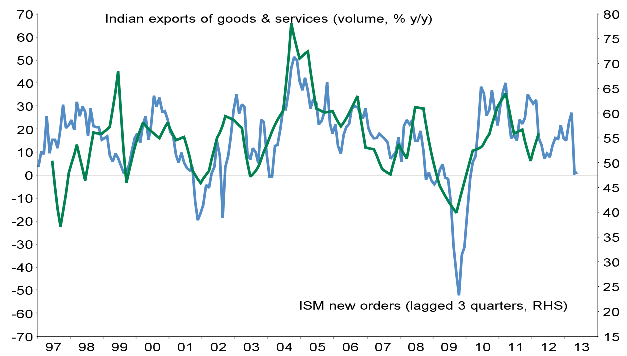
Export & Import Contributions



Source: BNP Paribas, Reuters EcoWin Pro

Export growth rebounded to 18.1% y/y in Q4 FY2012. Combined with import growth collapsing to 2.0% y/y from 27.0%, this meant net trade was a strong boost to GDP, adding an unusually large c.4.0pp to overall y/y growth on our estimates.

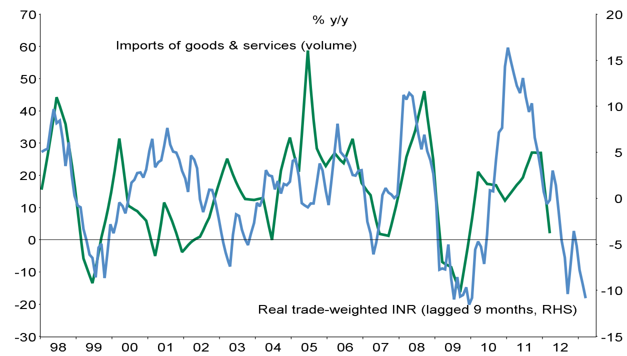
Exports vs. ISM New Orders



Source: BNP Paribas, Reuters EcoWin Pro

The US ISM manufacturing new orders balance has been a reasonable guide to Indian export dynamics. On balance, the ISM survey is consistent with damped Indian export growth into FY2013.

Imports vs. INR REER

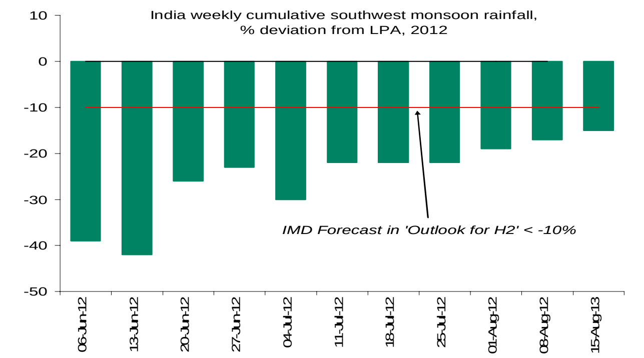


Source: BNP Paribas, Reuters EcoWin Pro

The historic correspondence of swings in the effective real INR exchange rate and import demand has weakened since the crisis. However, the weakness of the INR in real terms is consistent with slower import growth in the quarters ahead.

Monsoon Trends – I

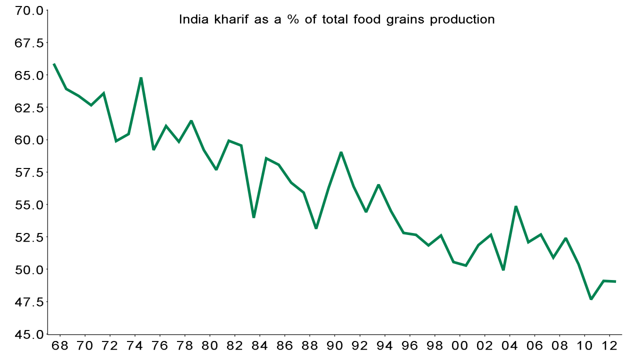
Monsoon Rainfall



Source: BNP Paribas, India Meteorological Department

The cumulative rainfall for the monsoon season this year so far has been 15% below the LPA. In its latest Outlook for H2 published on August 2nd, the IMD acknowledged that the rainfall for the entire season is likely to be over 10% below the LPA.

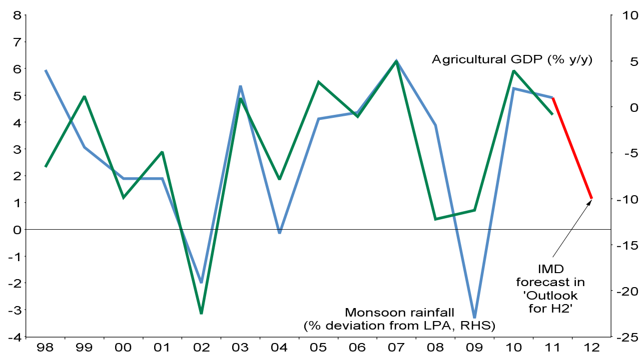
Kharif Foodgrains Production



Source: BNP Paribas, CEIC

The monsoon is the main source of water for Kharif (summer) food grains output, which, in turn, still accounts for around 50% of total Indian food-grains production.

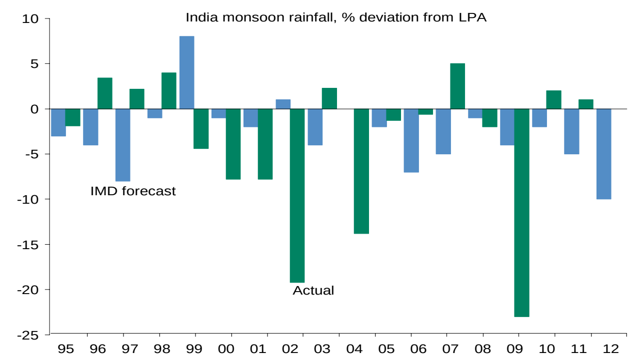
Agricultural GDP vs. Monsoon Rainfall



Source: BNP Paribas, CEIC

Historical relationships show overall agricultural value-added, which contributes almost 15% of Indian GDP, fluctuates with the monsoon. The IMD's forecasts suggest the sector looks likely to expand by only c.1% y/y in the year to December 2012.

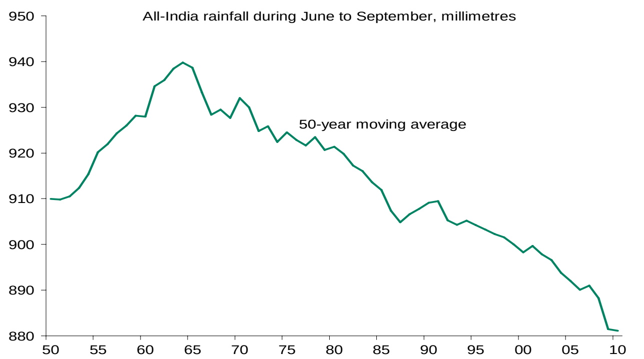
Monsoon Rainfall – IMD Forecasts vs. Actual



Source: BNP Paribas, India Meteorological Department

Forecast errors over the monsoon are large. In 2011, for example, actual rainfall was 1% above the LPA against the IMD's -4%. In 2009, the actual outturn was 23% below the LPA, falling far short of IMD's forecast of -4%.

LPA Trends



Source: BNP Paribas, Indian Institute of Tropical Meteorology

As noted by RBI, there has been a secular decline in the LPA rainfall during June-September over the years. This reflects deterioration in climatic conditions that, in turn, may also have long-run detrimental consequences for agricultural output in India.

Regional Monsoon Precipitation

Cumulative Monsoon Precipitation in Different Regions*

	Actual (mm)	Normal (mm)	% Deviation from LPA
Country as a Whole	498.6	588.6	-15.3
Northwest India	301.8	404.0	-25.3
Central India	582.8	648.7	-10.2
South Peninsula	387.3	470.5	-17.7
East & Northeast India	837.3	963.5	-13.1

*Source: India Meteorological Department. * As on 15th August 2012*

Cumulative rainfall in the monsoon season thus far has been in deficit across the four main regions of the country, with the highest deficiency observed in Northwest India, followed by South Peninsula.

Monsoon Trends – II

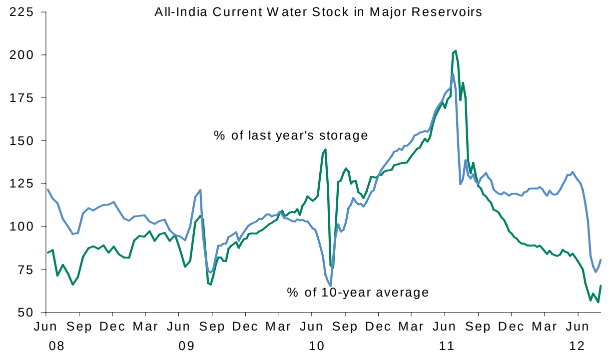
Kharif Sowing

Kharif Sowing, Million Hectares*					
	Normal Area as on Date	Area Sown		% Variation	
		2012	2011	Over 2011	Over Normal as on Date
Rice	29.1	30.8	31.9	-3.6	5.9
Coarse Cereals	18.8	15.8	18.2	-13.0	-16.0
Pulses	9.7	8.5	9.7	-12.4	-12.1
Oilseeds	16.0	16.1	16.7	-4.0	0.3
Sugarcane	4.7	5.3	5.1	4.5	13.2
Cotton	10.5	11.0	11.7	-5.6	4.9
Jute	0.8	0.9	0.9	-1.8	4.5
All Crops	89.6	88.4	94.2	-6.2	-1.4

*Source: BNP Paribas, Ministry of Agriculture. * As on 17th August 2012*

The unsatisfactory performance of the monsoon so far in terms of both quantum and distribution has impacted the progress in sowing of kharif crops. Area sown, especially for coarse cereals and pulses, has declined sharply.

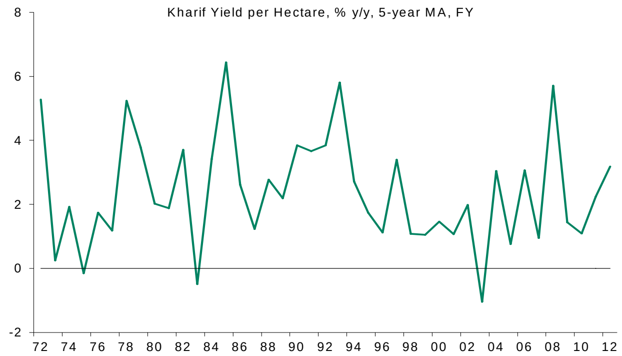
Reservoir Status



Source: BNP Paribas, Ministry of Agriculture

Deficit rainfall has also affected the level of water in India's 84 key reservoirs. The current storage is c.30% of the live capacity at full reservoir level, over 30% lower than in the same period last year and almost 20% below the last 10 year's average.

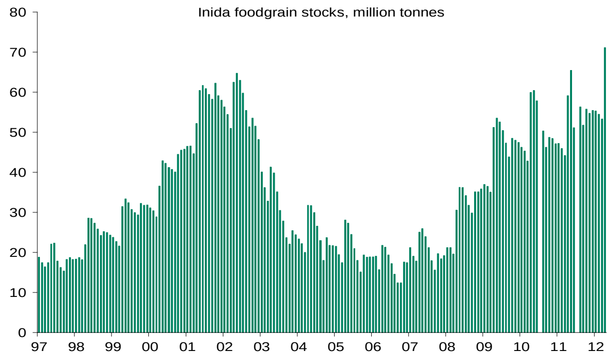
Yield of Kharif Foodgrains



Source: BNP Paribas, Ministry of Agriculture

Healthy growth in yield of food grains per hectare, averaging c.3½% over the past five years, is likely to help offset part of the impact on agricultural output if the monsoon continues to affect Kharif sowing.

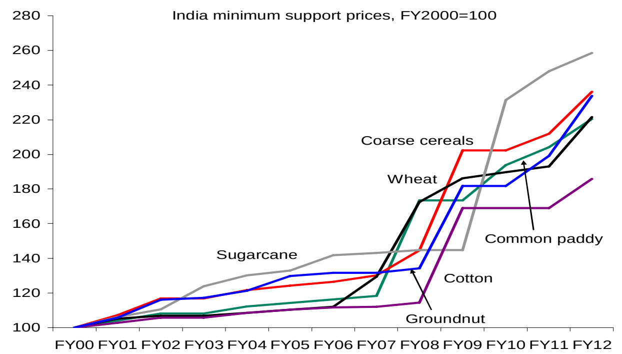
Foodgrains Stock



Source: BNP Paribas, Ministry of Finance

The current food stock, at c.70 million tonnes, appears sufficient to meet the off-take required for various welfare schemes. However, the lack of storage and cold chain and transport infrastructure inefficiencies mean that 'true' stock may be lower.

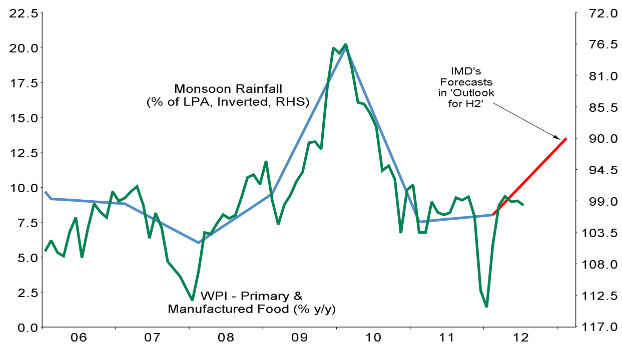
Minimum Support Prices



Source: BNP Paribas, CEIC

Minimum support prices (MSPs) for key crops, which have grown strongly in recent years, appear another factor supporting rural incomes even as agricultural output disappoints.

Food Price Inflation vs. Monsoon Rainfall

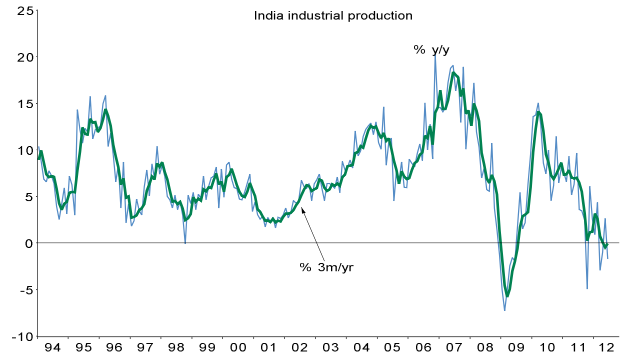


Source: BNP Paribas, India Meteorological Department

Indian food price inflation has picked since the turn of the year. Uncertainty over monsoon and high MSPs, which tend to translate into increases in market prices for most commodities, look set to boost food price inflation further.

Industrial Trends – I

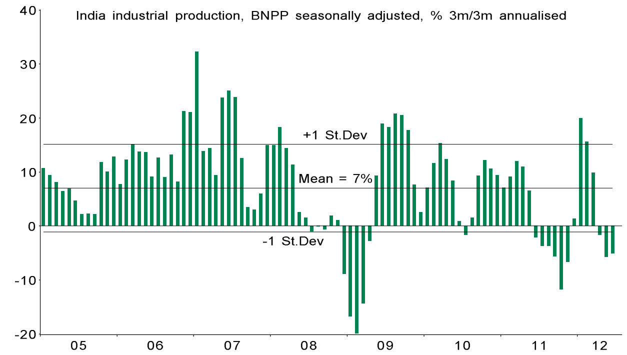
Industrial Production Growth – I



Source: BNP Paribas, Reuters EcoWin Pro

Industrial production remains volatile month-to-month, but, smoothing through the volatility, output growth has been flat to down over the last year; a dismal start to FY2013.

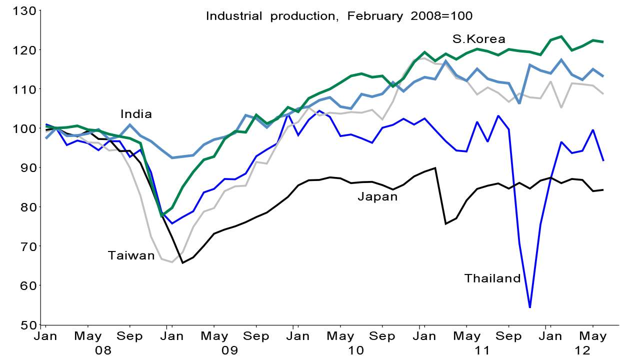
Industrial Production Growth – II



Source: BNP Paribas, Reuters EcoWin Pro

The data, once seasonally adjusted, indicate that momentum for production growth has once again faded in recent months, with the 3m/3m annualised running at c.-5% in June as the strong start to 2012 rapidly fades

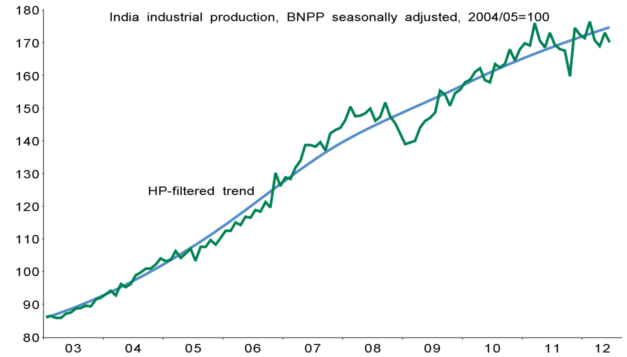
Asian Industrial Production



Source: BNP Paribas, Reuters EcoWin Pro

Most Asian economies, including Japan, have seen their industrial production run flat-to-down in recent months. This suggests the slowdown of industrial growth is not confined to India but is a global phenomenon.

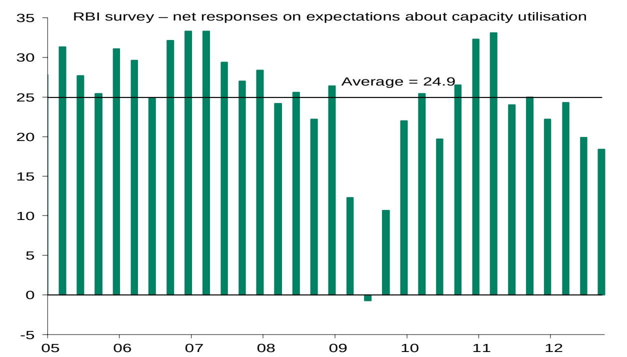
Industrial Production – Level vs. Trend



Source: BNP Paribas, Reuters EcoWin Pro

In level terms, Indian industrial production is now mildly below trend, which itself, however, is estimated to have become lower since the global financial crisis.

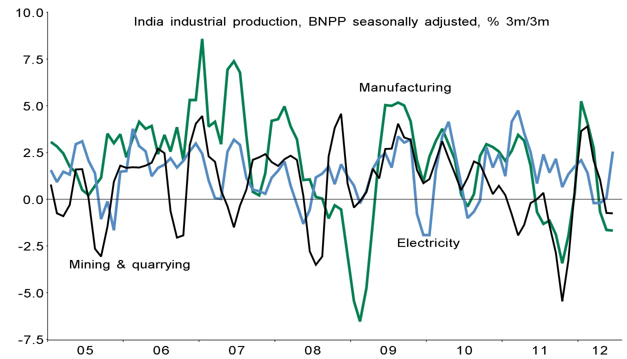
Capacity Utilisation



Source: BNP Paribas, RBI

Consistent with industrial production running below trend, the RBI's quarterly industrial outlook survey on capacity utilisation signals spare capacity has opened up over the last year.

Industrial Production By Sector

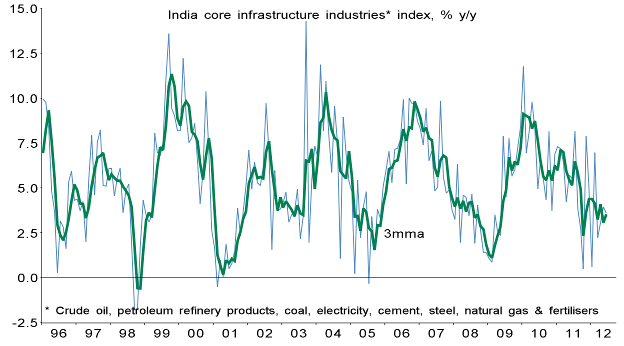


Source: BNP Paribas, Reuters EcoWin Pro

The loss of momentum has been skewed to the manufacturing sector and also the mining segment. Electricity generation has so far performed better but is expected to have weakened in July given the power blackouts in the final days of the month.

Industrial Trends – II

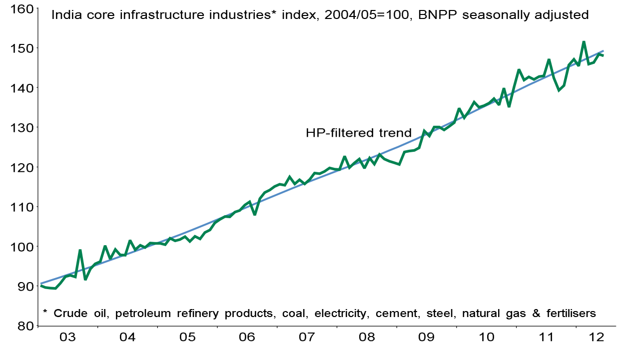
Infrastructure Industries Production – I



Source: BNP Paribas, Reuters EcoWin Pro

The 'core' Infrastructure industries, which account for c.38% of Indian industrial production, have seen y/y growth slow steadily since early 2010. But, with growth averaging c.3½% y/y in the past 3 months, they have outperformed overall production.

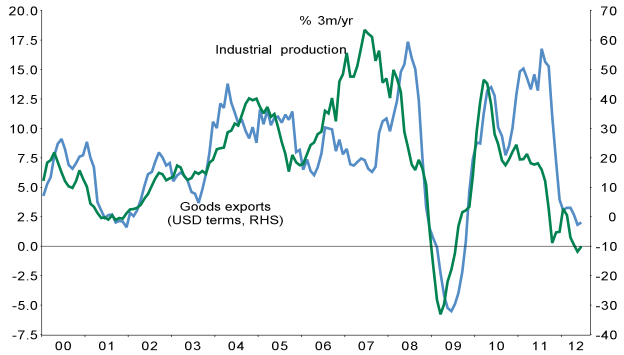
Infrastructure Industries Production – II



Source: BNP Paribas, Reuters EcoWin Pro

In seasonally-adjusted level terms, output of the 'core' infrastructure industries remains around trend, which, unlike overall industrial production's, has exhibited no obvious structural break in its time path as a result of the global financial crisis.

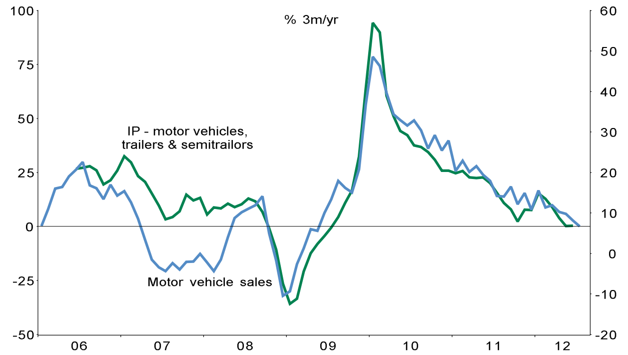
Industrial Production vs. Exports



Source: BNP Paribas, Reuters EcoWin Pro

Industrial production growth has undershot export trends since the final months of 2010, suggesting slower domestic demand, rather than external demand, has been the key impulse behind the industrial slowdown in the current cycle.

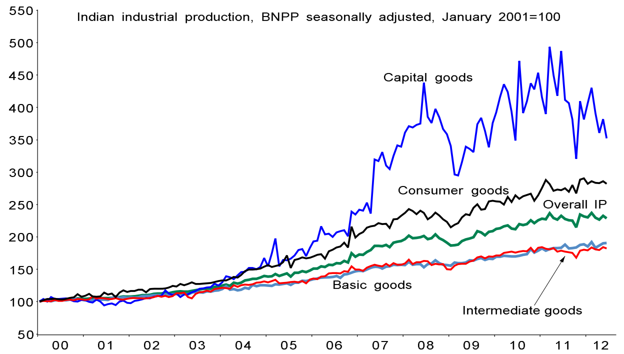
Motor Vehicles – Production vs. Sales



Source: BNP Paribas, Reuters EcoWin Pro

The secular slowdown in motor vehicle production growth that began in early 2010 has coincided with the weakness in domestic demand for autos, although foreign sales have also faltered since late 2011.

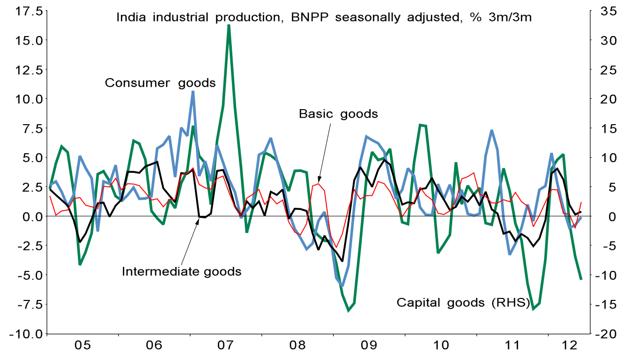
Industrial Production By Use-based Group – I



Source: BNP Paribas, Reuters EcoWin Pro

Only accounting for a lowly 8.8% of overall Indian industrial production, extreme volatility in the capital goods output data often exaggerates swings of the industrial cycle, undermining the integrity of the data.

Industrial Production By Use-based Group – II

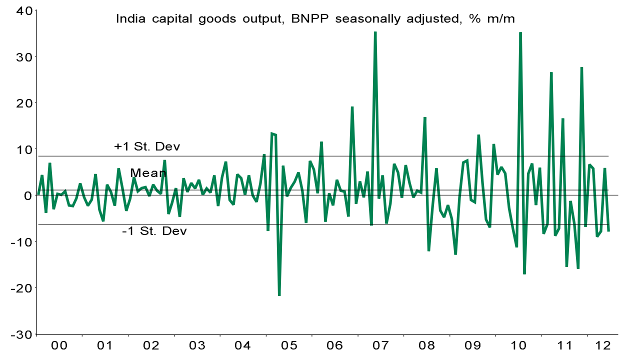


Source: BNP Paribas, Reuters EcoWin Pro

Viewed from a use-based perspective, the wild swings in production growth momentum have largely been a function of the volatility in capital goods output. There are signs production growth in other sectors has bottomed out.

Industrial Trends – III

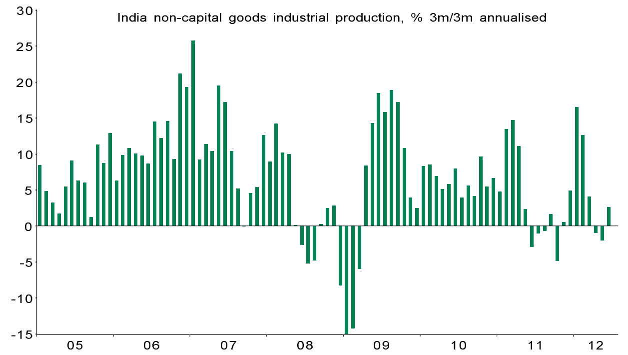
Capital Goods Production



Source: BNP Paribas, Reuters EcoWin Pro

Month-on-month changes in capital goods output even on a seasonally adjusted basis have been volatile, with swings increasing following the global financial crisis.

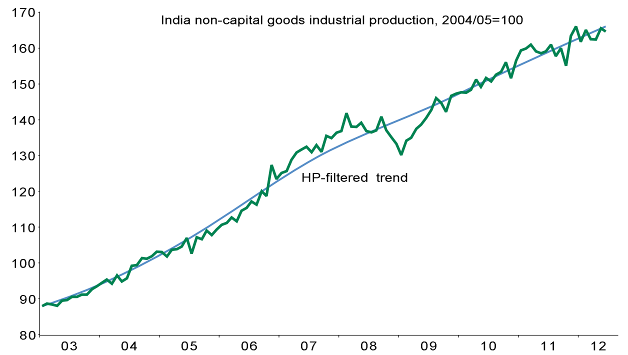
Non-Capital Goods Production Growth



Source: BNP Paribas, Reuters EcoWin Pro

Stripping out the volatile capital goods element, the remaining 90% or so of industrial output has seen 'underlying' growth regain some momentum of late, with the 3m/3m rate at 2.9% annualised in June.

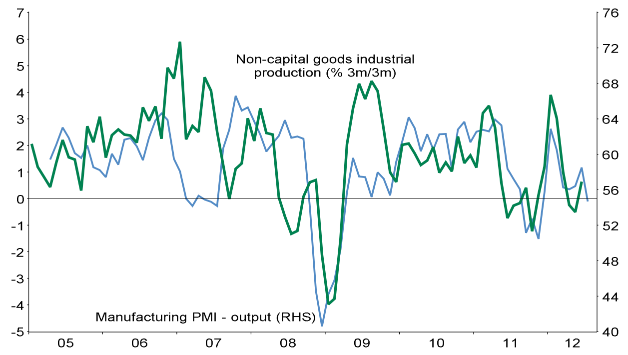
Non-Capital Goods Production



Source: BNP Paribas, Reuters EcoWin Pro

Non-capital goods industrial production, in level terms, is now broadly around its post-crisis trend, confirming that the slowdown in industrial demand has been skewed more towards the capital goods sector, consistent with weak investment demand.

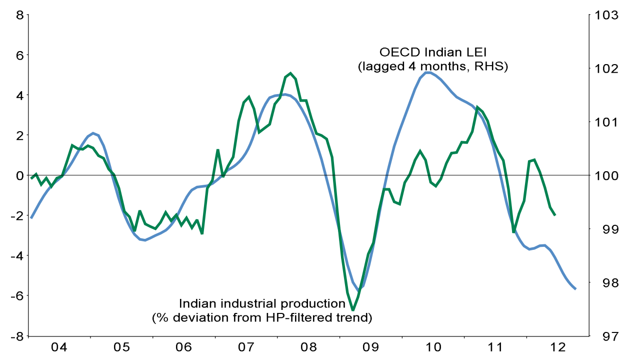
Non-Capital Goods Production vs. PMI – Output



Source: BNP Paribas, Reuters EcoWin Pro

The output index in the latest manufacturing PMI survey for Junly 2012 fell back, indicative of slower 'underlying' industrial production growth in the near term. The power 'blackouts' of late July suggest more downside for production.

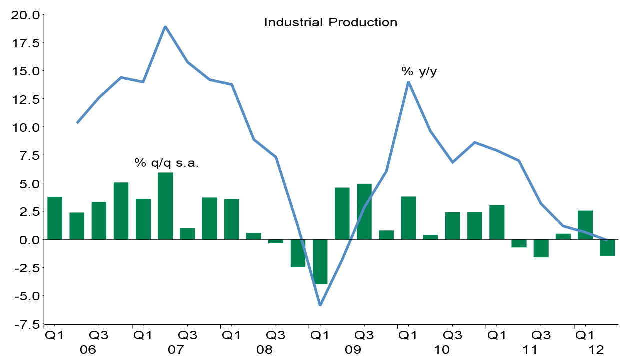
Industrial Production vs. OECD LEI



Source: BNP Paribas, Reuters EcoWin Pro

The OECD's leading indicator for India, which traditionally correlates reasonably well with de-trended Indian industrial production, has continued to weaken, suggesting sluggish output trends will persist.

Industrial Production – Quarterly



Source: BNP Paribas, Reuters EcoWin Pro

With production down in 2 of the 3 months of the quarter, FY2013 has started poorly. Industrial output fell by 1.3% q/q in FY2013Q1, dragging the y/y rate down from +0.6% to -0.1%; the weakest it has been since the global financial crisis.

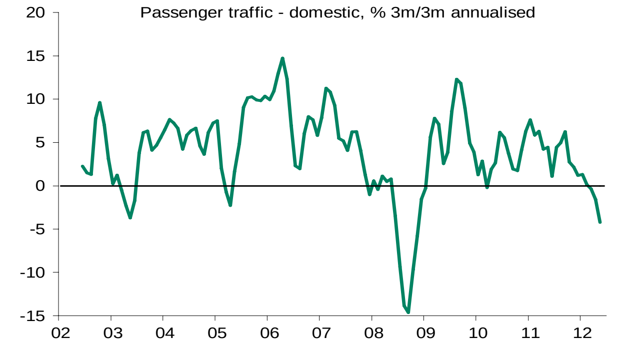
Services Sector Indicators

Railway Goods Traffic

Source: BNP Paribas, Reuters EcoWin Pro

Railway goods traffic has appeared a key drag on the transport sector of late. Growth in 3m/3m terms, having run close to 7% annualised in January, has since slid to close to zero currently, pointing to a significant loss of momentum.

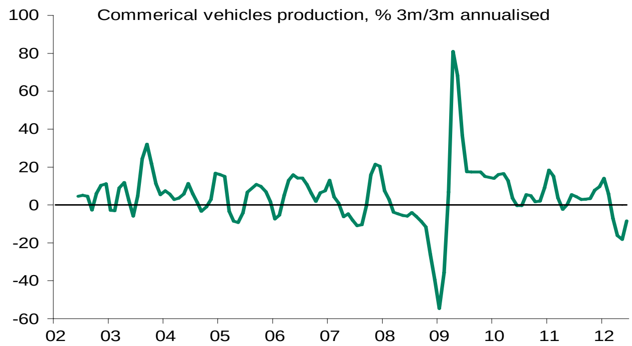
Domestic Passenger Traffic



Source: BNP Paribas, Reuters EcoWin Pro

The softness in the transport sector has also been evident in domestic passenger traffic and air cargo handled at international terminals, whose growth rates have both slid to c.-5% on a 3m/3m annualised basis in May.

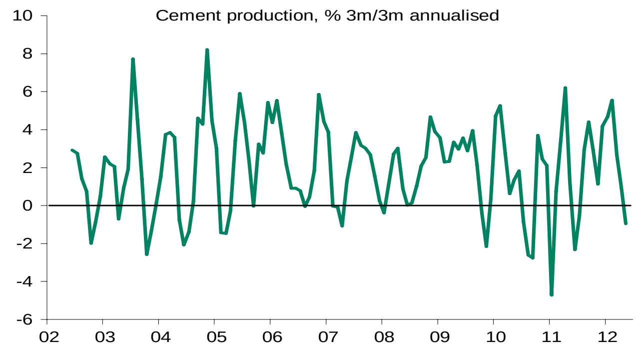
Commercial Vehicles Production



Source: BNP Paribas, Reuters EcoWin Pro

Growth in commercial vehicles production in 3m/3m annualised terms have also weakened notably since the turn of the year to c.-8½% on our estimates, further signalling great corporate caution.

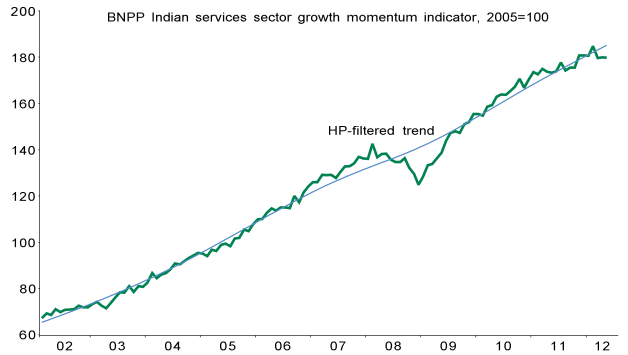
Cement Production



Source: BNP Paribas, Reuters EcoWin Pro

Leading indicators of construction activity, meanwhile, have been mixed. On a 3m/3m basis, finished steel production growth has picked up. Cement production, however, contracted for the first time since mid-2011.

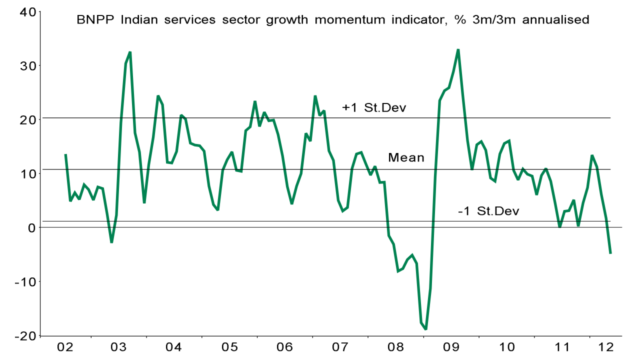
BNPP Growth Momentum Indicator – I



Source: BNP Paribas, Reuters EcoWin Pro

Our in-house growth momentum indicator for the services sector, constructed using the Conference Board methodology, is now a touch below trend. This suggests activity in the services sector has slowed at the start of the fiscal year to March 2013.

BNPP Growth Momentum Indicator – II

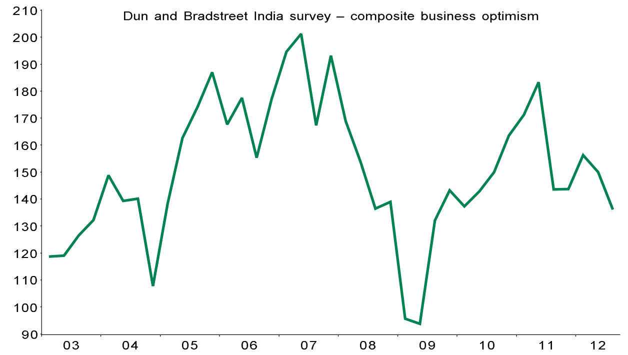


Source: BNP Paribas, Reuters EcoWin Pro

In terms of growth rates, our growth momentum indicator on a 3m/3m annualised basis, having run close to c.13% in January, has dropped close to just above -5% in May; the weakest it has been outside of the global financial crisis.

Survey Evidence

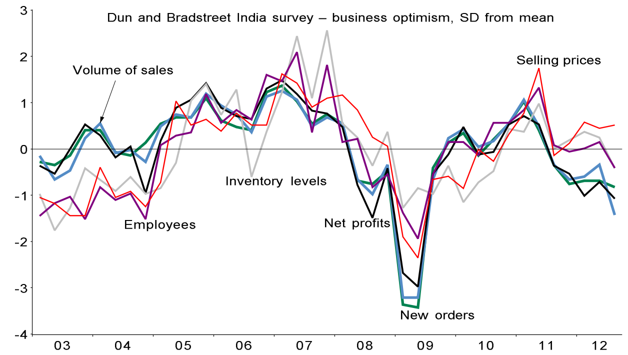
DBI Survey – Business Optimism – I



Source: BNP Paribas, Reuters EcoWin Pro

The DBI survey reveals that business confidence in India has been on a downtrend since early 2011. At 136, the index remains some way above the GFC-induced trough but is now below the historical average.

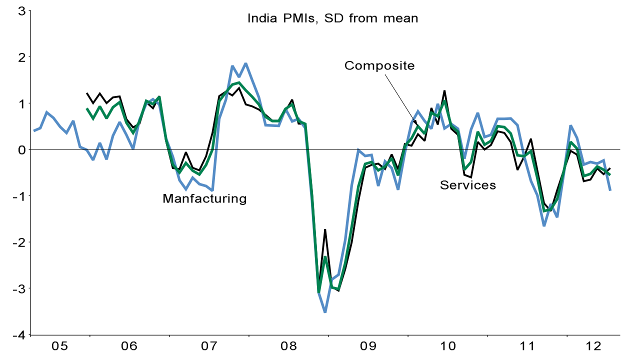
DBI Survey – Business Optimism – II



Source: BNP Paribas, Reuters EcoWin Pro

The weakness in business confidence seen of late appears more pronounced in the new orders, volume of sales and net profits sub-components. Inventory levels and employees have also weakened of late while selling prices remain around average.

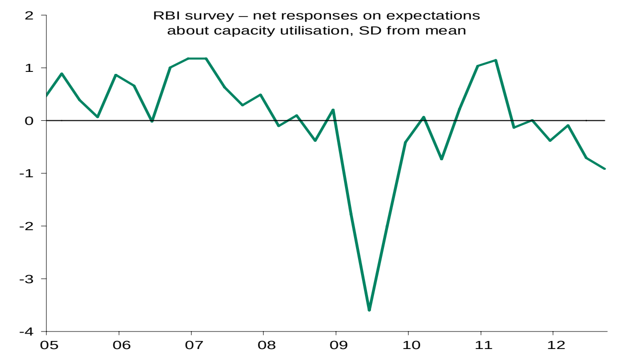
Purchasing Managers' Indices



Source: BNP Paribas, Reuters EcoWin Pro

India's purchasing managers' index (PMI) surveys tumbled in mid-2011 but bounced back strongly in late 2011 and early 2012. They have, however, since weakened again and are now more than half a standard deviation below their average levels.

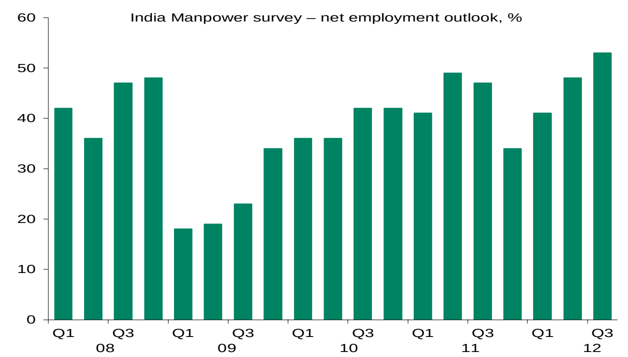
RBI IO Survey – Capacity Utilisation



Source: RBI Industrial Outlook Survey

The RBI's latest Industrial Outlook Survey shows the majority of respondents expect a moderation in capacity utilisation level. The index, once normalised, is now below average, consistent with an economy probably running below trend.

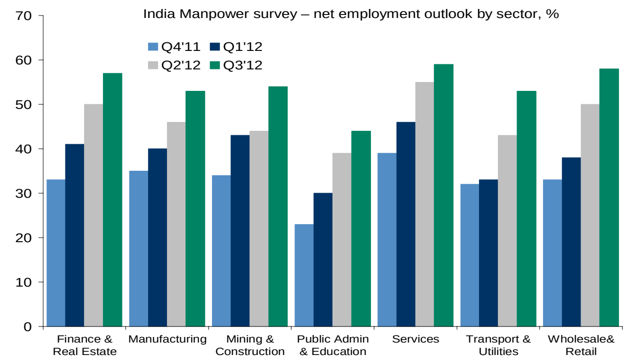
Employment Outlook – I



Source: Manpower Employment Outlook

The Manpower employment survey for Q3 2012, however, showed Indian labour demand improved for a third quarter in a row. The net outlook has risen 19 points from its Q4 2011 trough to reach a record 54% since the survey began in Q3 2005.

Employment Outlook – II

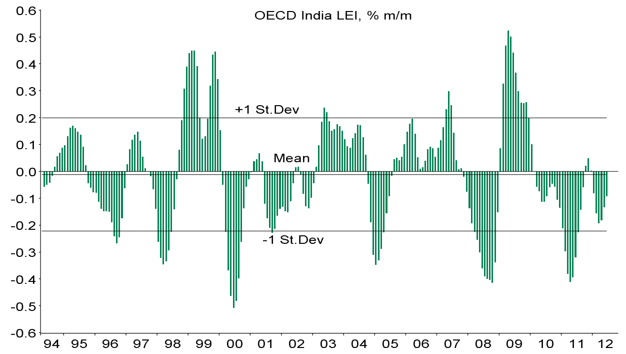


Source: Manpower Employment Outlook

The improvement in the survey was broad-based, with all seven industries expected to scale up hiring during Q3. The rise in the outlook for the public sector was less pronounced, likely reflecting the countercyclical nature of public sector employment.

OECD Leading Economic Indicator (LEI)

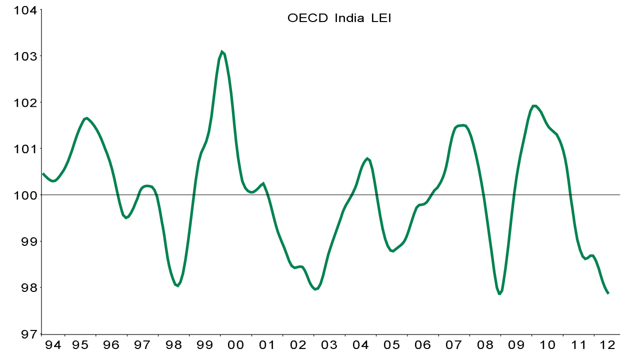
OECD India LEI – I



Source: BNP Paribas, Reuters EcoWin Pro, OECD

The Indian OECD LEI has seen a sustained period of weakness beginning in early 2010, having fallen m/m in twenty-five of the past twenty-eight months.

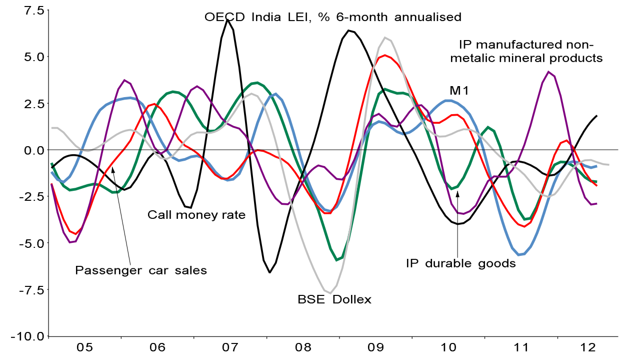
OECD India LEI – II



Source: BNP Paribas, Reuters EcoWin Pro, OECD

The string of monthly declines has left the indicator down close to 4% from its January 2010 cyclical peak, eclipsing the peak-to-trough decline seen during the crisis. In level terms, the index is now on a par with the extremes seen in late 2008.

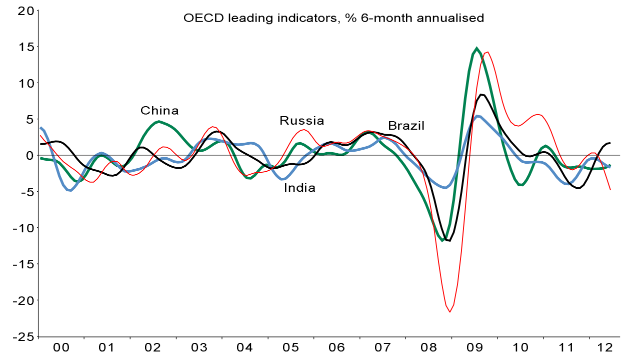
OECD India LEI Components



Source: BNP Paribas, Reuters EcoWin Pro, OECD

The weakness in the OECD LEI for India has been broad-based and more evident in the non-metallic mineral manufactures sub-component. The call money rate stands out as the only sub-component contributing positively over the past six months.

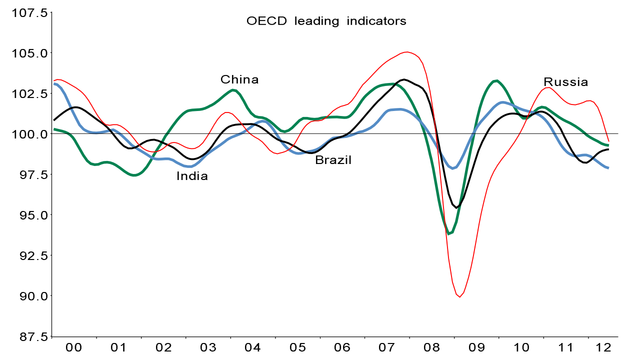
OECD LEIs – BRICs – I



Source: BNP Paribas, Reuters EcoWin Pro, OECD

India is not alone among its BRICs peers in seeing the OECD leading indicator falter of late. The indicators for China and especially Russia have similarly weakened over the past six months while the Brazilian indicator has strengthened.

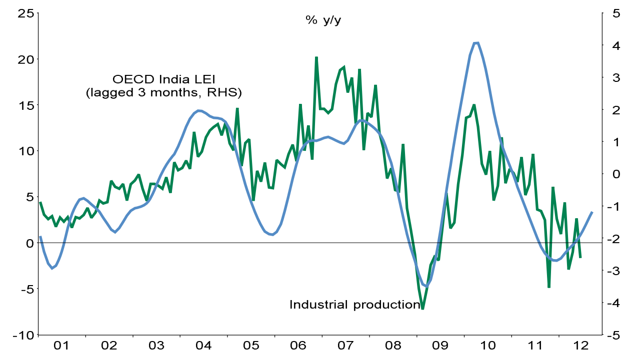
OECD LEIs – BRICs – II



Source: BNP Paribas, Reuters EcoWin Pro, OECD

In level terms, however, India's OECD LEI is well below 100, pointing to activity in the economy likely running way below trend. The Chinese, Brazilian and increasingly Russian economies look to be mildly sub trend.

OECD India LEI vs. Industrial Production

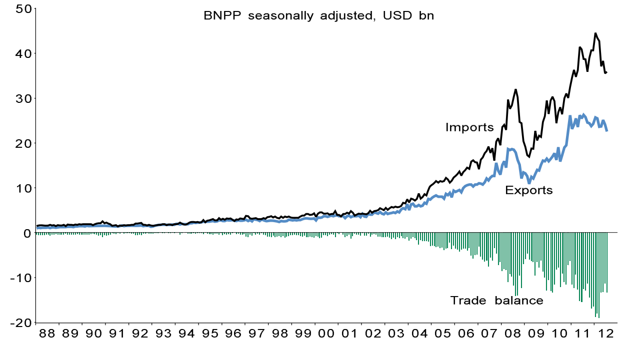


Source: BNP Paribas, Reuters EcoWin Pro, OECD

The OECD leading indicator, which correlates reasonably well with swings of India's industrial production, points to output growth in y/y terms likely on the cusp of bottoming, albeit at historic low levels.

Trade Trends – I

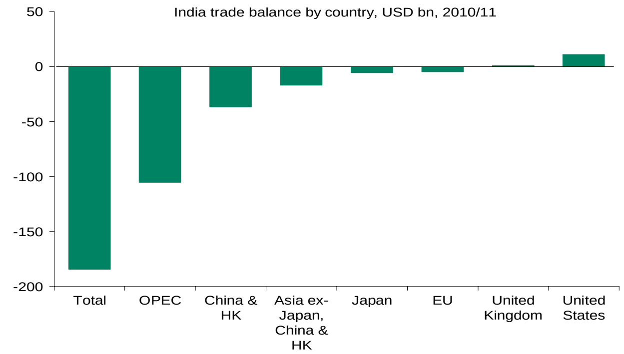
Trade Balance



Source: BNP Paribas, Reuters EcoWin Pro

India saw its merchandise trade deficit widen to a record in FY2012, as imports surged while export growth slowed. Latest data, however, suggest imports have fallen back sharply, producing some narrowing in the deficit.

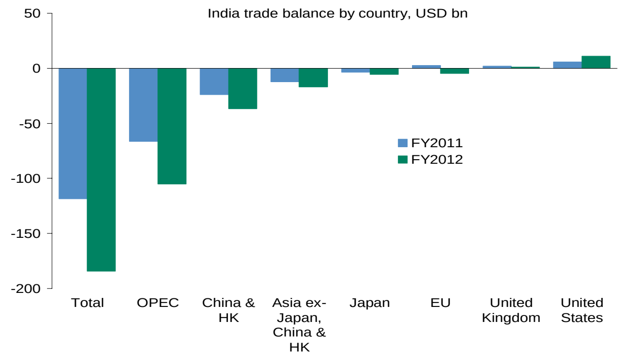
Trade Balance By Country – I



Source: BNP Paribas, Reuters EcoWin Pro

India has consistently run a goods trade deficit. In FY2012, it reached USD 184bn, with the OPEC nations the major contributor, followed by China and Asia. The UK and particularly the US were among the few net importers of Indian goods.

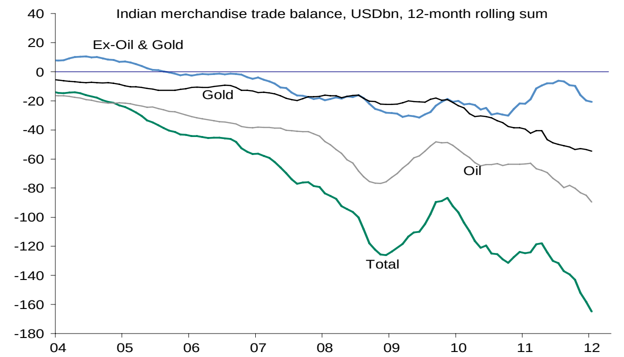
Trade Balance By Country – II



Source: BNP Paribas, Reuters EcoWin Pro

Relative to FY2011, India's merchandise trade deficit widened by almost USD 66bn in FY2012. The majority of that came from the OPEC, which contributed USD 39bn, or c.59%, of the widening in the overall deficit. Asia ex-Japan accounted for another 26%.

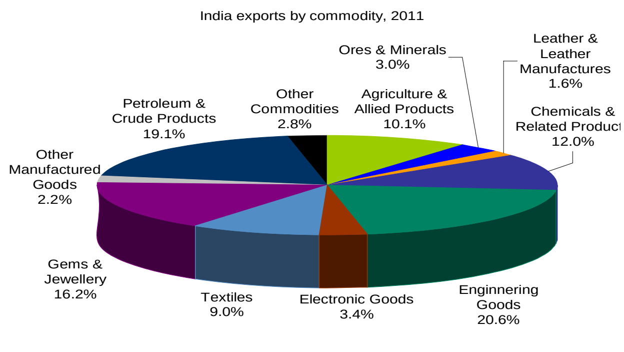
Trade Balance By Commodity



Source: BNP Paribas, CEIC

Viewed by commodity, oil and gold combined contributed over 100% of the deterioration in India's goods trade position over the past year. Excluding the two commodities, Indian merchandise trade actually registered a narrower, albeit slightly, deficit.

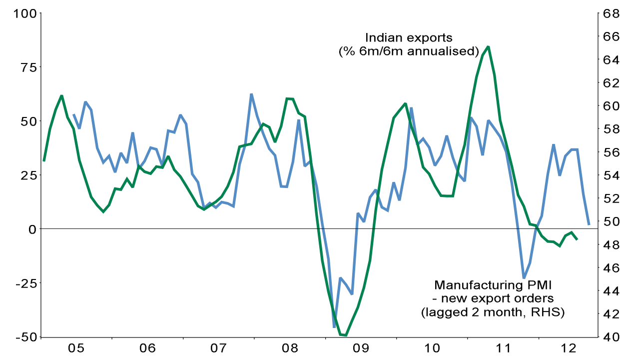
Exports By Commodity



Source: BNP Paribas, Reuters EcoWin Pro

Manufactured goods, worth close to 70% of total Indian exports, have been the dominant pillar of India's export sector and remained so in 2011, followed by petroleum and crude and primary products.

Export Growth vs. PMI New Export Orders

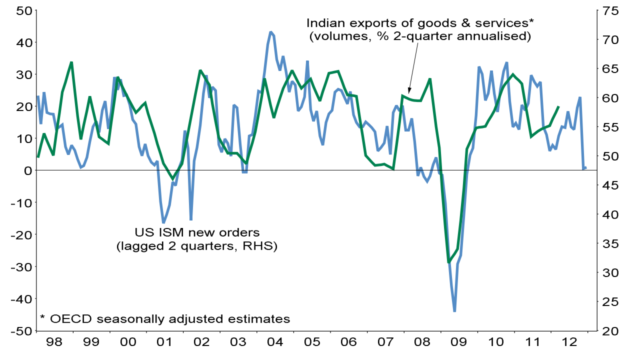


Source: BNP Paribas, Reuters EcoWin Pro

Rather than picking up as suggested by the new export orders balance of the manufacturing PMI survey, Indian goods export growth has broadly stalled since the turn of the year. Latest surveys show new export orders have come off sharply.

Trade Trends – II

Export Growth vs. ISM New Orders



Source: BNP Paribas, Reuters EcoWin Pro

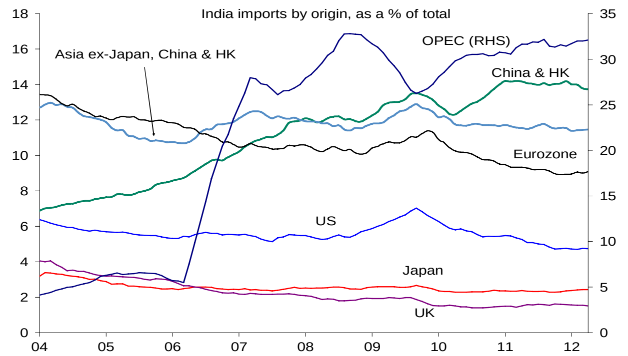
The US ISM new orders balance, a key proxy for external demand for Indian goods, has weakened notably of late, suggesting momentum for Indian export growth is fading quickly heading into FY2013.

Exports / GDP Ratios – India vs. China

Source: BNP Paribas, Reuters EcoWin Pro

Indian exports' share of GDP, at below 25%, is comparatively low by Asian standards. However, India's degree of orientation appears on course to follow a similar trajectory to that of China's since its liberalisation with a c.12-13 year lag.

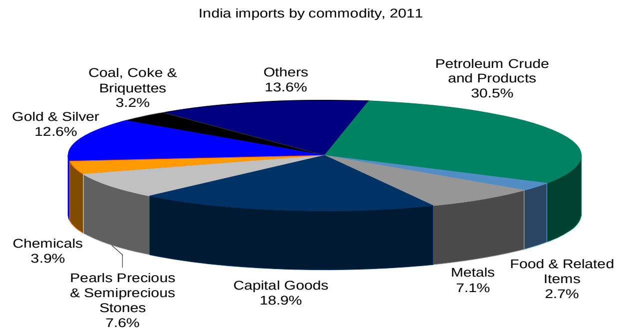
Imports By Origin



Source: BNP Paribas, Reuters EcoWin Pro

OPEC accounted for over 30% of India's imports in FY2012. However, India's source of imports is skewed increasingly towards Asia, and particularly China and Hong Kong, which combined have become India's largest supplier since late 2007.

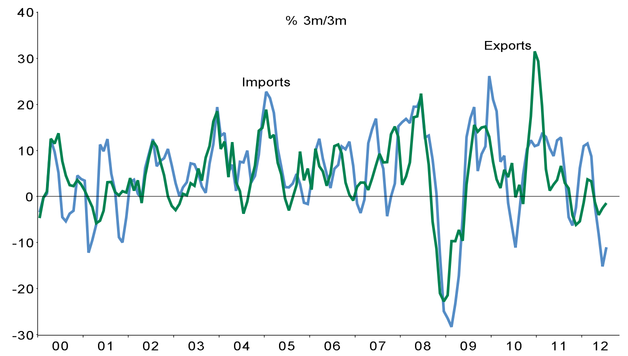
Imports By Commodity



Source: BNP Paribas, Reuters EcoWin Pro

The OPEC countries' significance as a source of Indian imports reflects India's position as a large net oil-importer. In 2011, imports of this category accounted for close to one-third of India's total import bill, followed by capital goods and gold and silver.

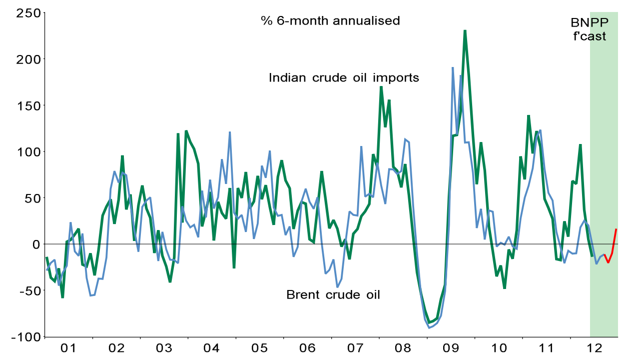
Export & Import Growth



Source: BNP Paribas, Reuters EcoWin Pro

In USD terms, Indian merchandise imports have weakened sharply of late after surging in late 2011 and early 2012. On a 3m/3m basis, import values have fallen by over 10%, underperforming exports by a large margin.

Oil Imports vs. Brent Crude Spot

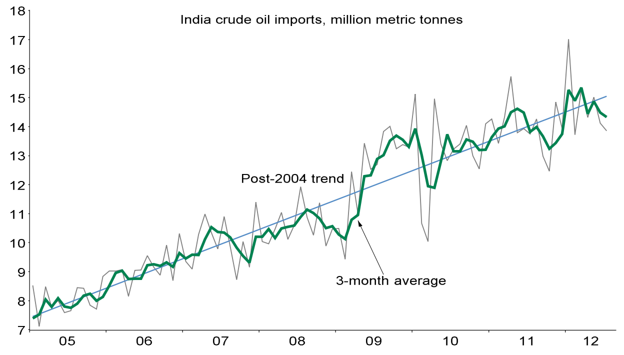


Source: BNP Paribas, Reuters EcoWin Pro

Indian import growth has slowed as the pace of oil import growth has lost some momentum in line with global oil price trends. Our Brent crude spot assumptions imply annual oil import growth, running at c.-4% y/y, should remain subdued in the near term.

Trade Trends – III

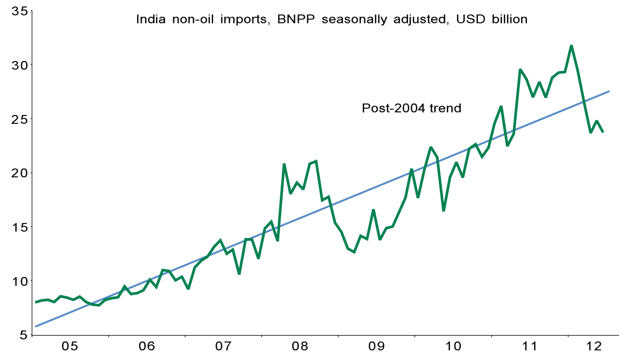
Oil Import Volumes



Source: BNP Paribas, Reuters EcoWin Pro

The decline in India's oil import bill reflects not only lower prices but also falling quantities with oil import volumes slipping since the turn of the year. Smoothing through volatility, they are some way below trend.

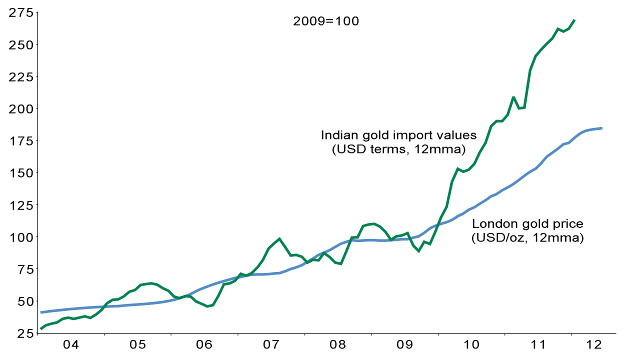
Non-oil Imports



Source: BNP Paribas, Reuters EcoWin Pro

The recent weakness of imports looks more pronounced in non-oil components. Adding to the sense that the economy has once again lost some momentum at the start of FY2013, ex-oil imports have fallen over 25% from its January peak.

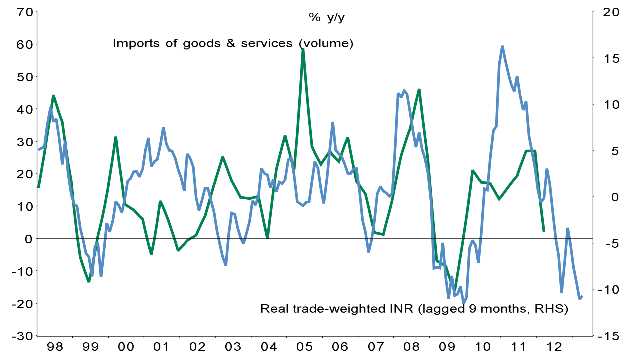
Gold Imports & London Gold Price



Source: BNP Paribas, Reuters EcoWin Pro

Imports of gold surged to a record USD 55bn in the year to January 2012, for which latest monthly data are available. The trend acceleration in Indian gold import values seen since end-FY2009 is driven by both prices and 'real' demand i.e. volumes.

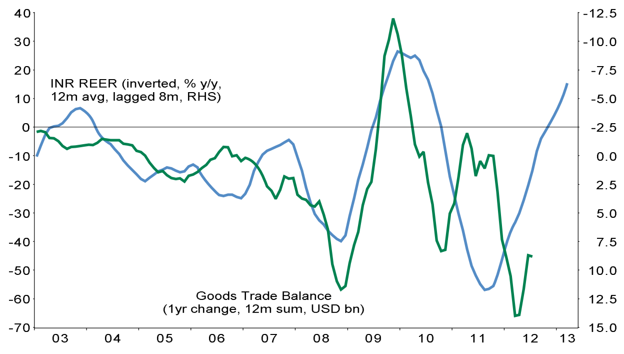
Import Growth vs. INR REER



Source: BNP Paribas, Reuters EcoWin Pro

However, despite still-high inflation, the nominal weakness of the INR has left its real effective exchange rate notably weaker over the past year, which appears among factors that should limit overall 'real' Indian import demand in the coming quarters.

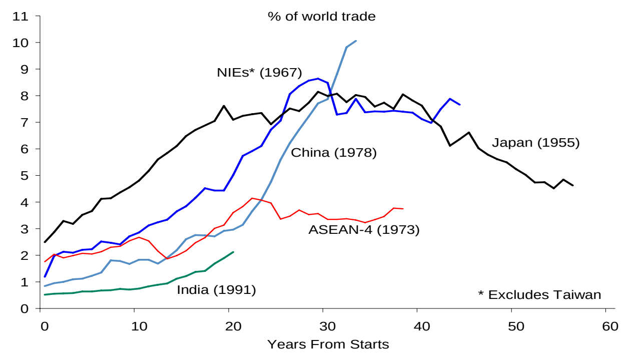
Goods Trade Balance & INR REER



Source: BNP Paribas, Reuters EcoWin Pro

The gains in external competitiveness as the INR's annual real deprecation has averaged c.5% over the past year signal an improvement in India's goods trade balance in the fiscal year to March 2013 after FY2012's record deficit.

World Trade Shares

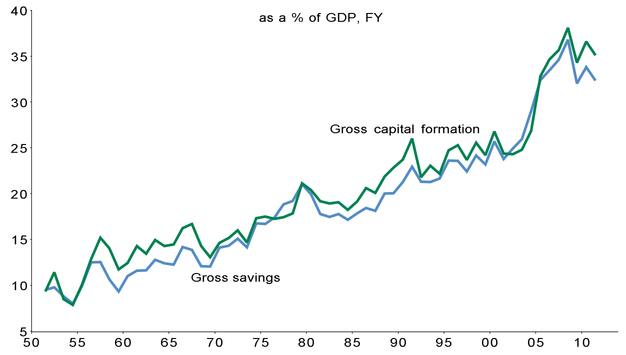


Source: BNP Paribas, Reuters EcoWin Pro

The prospective rise in India's export share as industrialisation/ urbanisation accelerates should see its world trade share, while, at just above 2% at present, lagging its regional peers, pick up strongly, following the path of other Asians.

Current and Capital Accounts – I

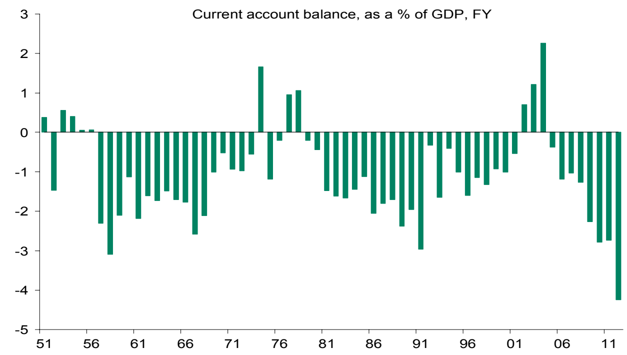
Savings & Investment – I



Source: BNP Paribas, Reuters EcoWin Pro

India's savings increased sharply during the 2000s, rising from one-quarter of GDP to over one-third by 2008. This surge, however, has been more than matched by a surge in the investment share.

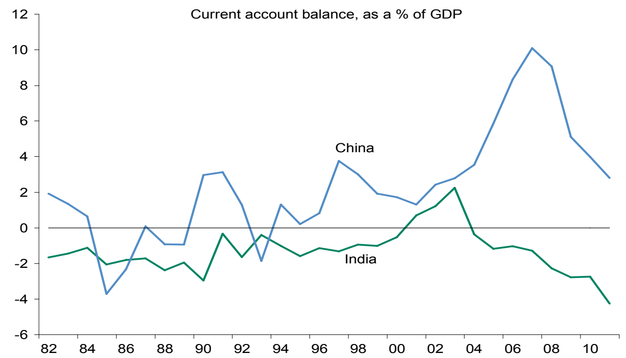
Savings & Investment – II



Source: BNP Paribas, Reuters EcoWin Pro

As the difference between saving and investment, the more rapid rise in the investment share has seen the current account deficit widen. It hit a record 4.2% of GDP in FY2012.

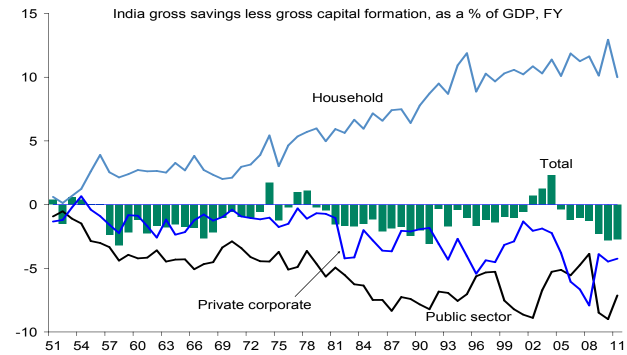
Savings & Investment – III



Source: BNP Paribas, Reuters EcoWin Pro, World Bank

There is a stark contrast with China, which has seen gross savings increase in excess of its gross investment since 1993, leading to persistently large, albeit now dwindling, current account surpluses.

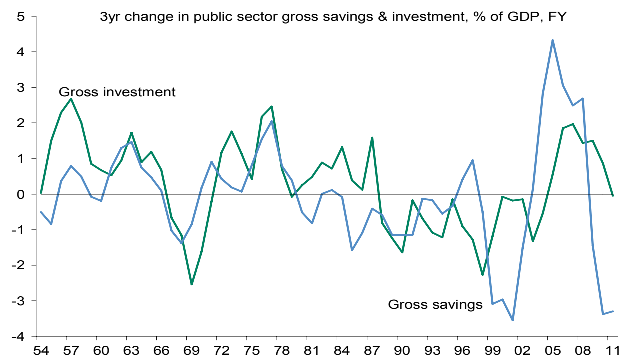
Savings & Investment – IV



Source: BNP Paribas, Reuters EcoWin Pro

The majority of the shortfall of savings relative to investment comes from the public sector, followed by private corporates. This is in contrast to the household sector, whose financial surplus stands close to 10% of GDP.

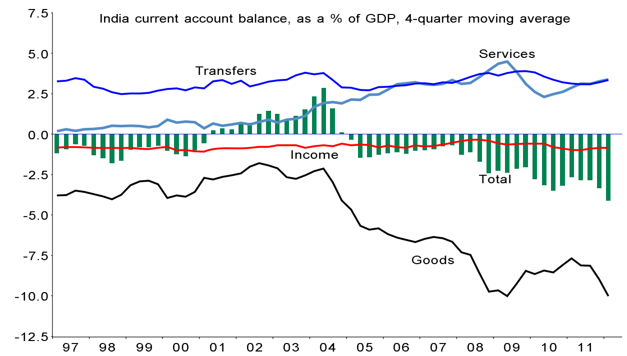
Public Sector Gross Saving & Investment



Source: BNP Paribas, Reuters EcoWin Pro

The deterioration in the public sector's net saving since the global financial crisis, in turn, was driven by a c.3⅓% of GDP slump in the gross saving share as the gross investment share was broadly flat.

Decomposing The Current Account

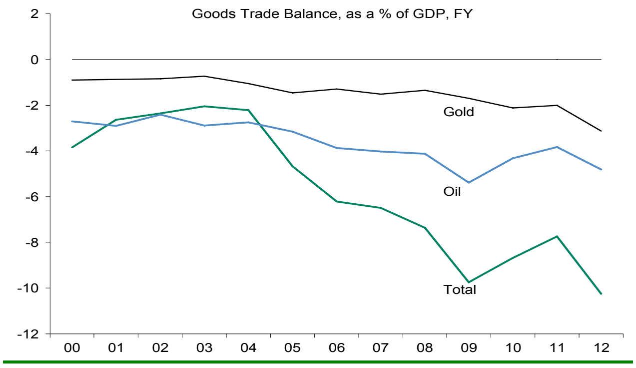


Source: BNP Paribas, Reuters EcoWin Pro

A breakdown of India's current account highlights the interplay between continued surpluses on services and current transfers but also a large goods trade deficit. The goods deficit widened to a record 10.3% of GDP in FY12 on a fiscal year basis.

Current and Capital Accounts – II

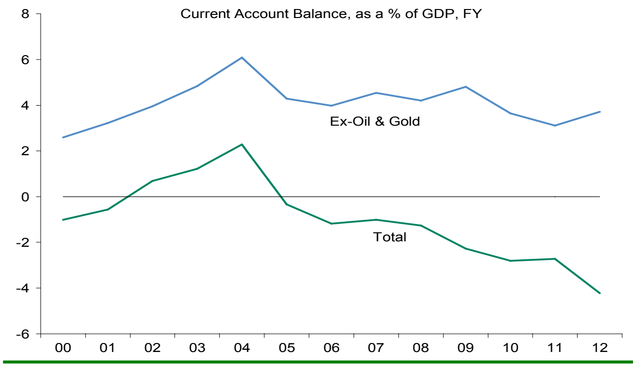
Goods Trade Balance – Total, Oil & Gold



Source: BNP Paribas, CEIC

India's goods deficit flows from its position as a substantial net oil and gold importer. Its oil trade deficit widened to 4.8% of GDP in FY2012 while its gold imports exploded to a record 3.1% of GDP.

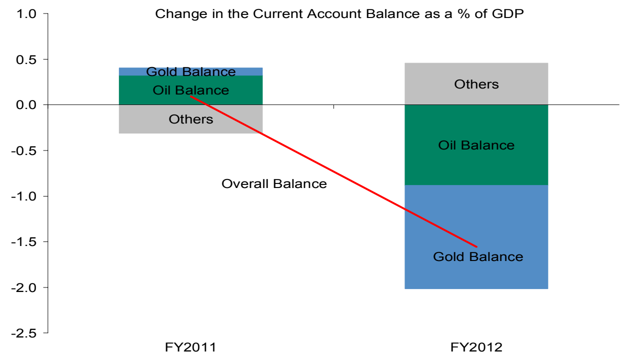
Ex-Oil & Gold Current Account Balance



Source: BNP Paribas, Reuters EcoWin Pro

Excluding oil and gold components, we estimate that India's current account balance would have been consistently in surplus since at least the early 1990s, running at 3.7% of GDP in FY2012.

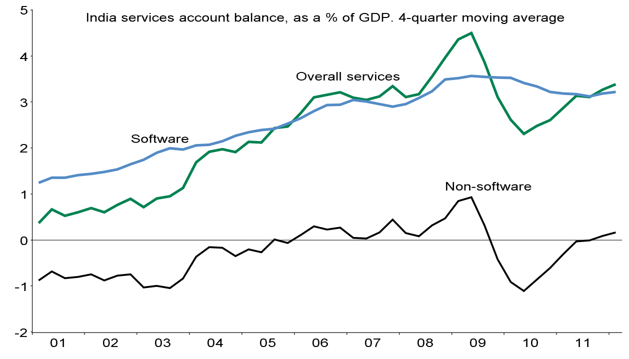
Current Account Dynamics



Source: BNP Paribas, Reuters EcoWin Pro

The oil and gold trade deficits combined, in turn, were the culprits behind the deterioration in the current account deficit to a record 4.2% of GDP in FY2012. Other components of the current account actually improved.

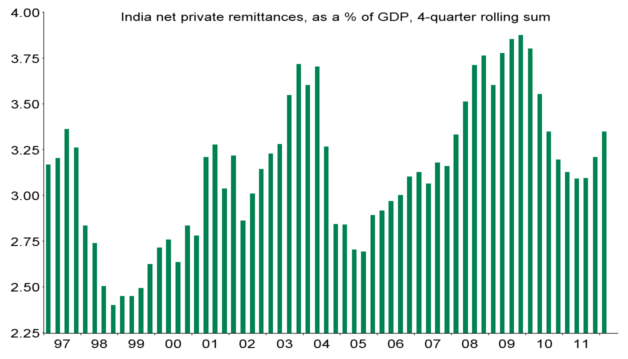
Services Account Balance



Source: BNP Paribas, Reuters EcoWin Pro

Software services, at 3.2% of GDP in FY2012, remained the largest contributor to the services trade surplus. However, the non-software balance, back into surplus of 0.2% of GDP in FY2012, was the key driver of the widening in the overall surplus.

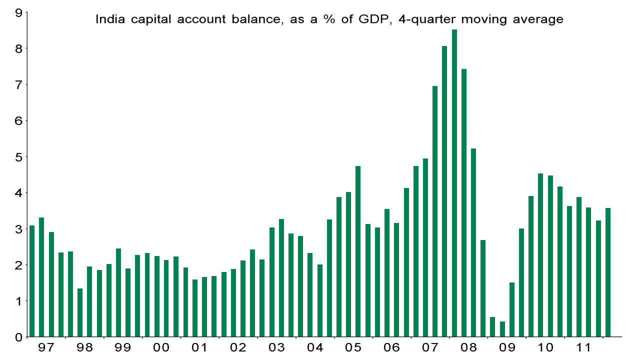
Transfer – Private Remittances



Source: BNP Paribas, Reuters EcoWin Pro

Net private remittances, while still short of the levels of almost 4% of GDP seen during the global financial crisis, picked back up to 3.3% of GDP in FY2012 and were above pre-crisis levels.

Capital Account Balance – I

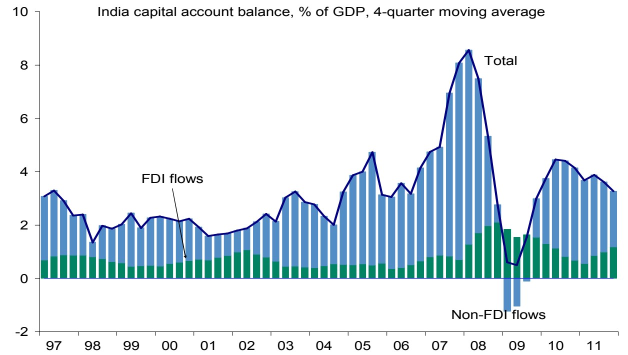


Source: BNP Paribas, Reuters EcoWin Pro

India, by definition, must attract net financing i.e. a surplus on its capital account to cover its current account deficit. In FY2012, it registered a surplus of USD 68bn or c.3.6% of GDP, which, however, fell short of the year's external borrowing requirements.

Current and Capital Accounts – III

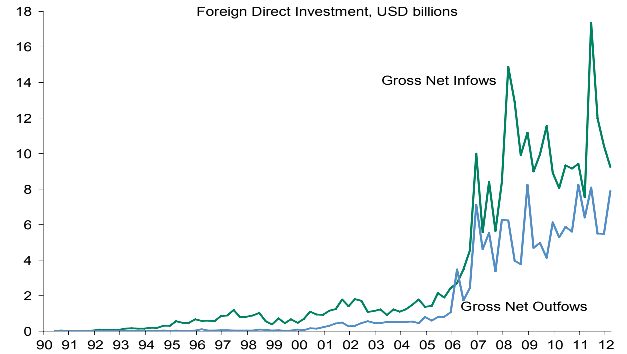
Capital Account Balance – II



Source: BNP Paribas, Reuters EcoWin Pro

Underlying the smaller capital account surplus in FY12 than was a drop in net non-FDI, and particularly portfolio and loan inflows. Net FDI inflows edged higher to 1.2% of GDP but were still some way below the peak of over 2% of GDP seen in late 2008.

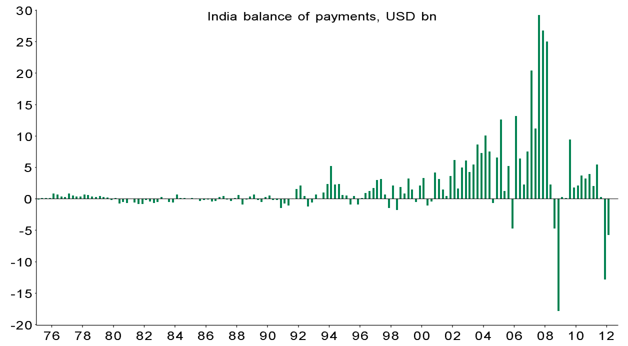
Foreign Direct Investment



Source: BNP Paribas, Reuters EcoWin Pro

The improvement in the annual foreign direct investment (FDI) figures on a fiscal year basis disguises the fact that gross FDI inflows into India actually came down sharply after a strong start to FY2012.

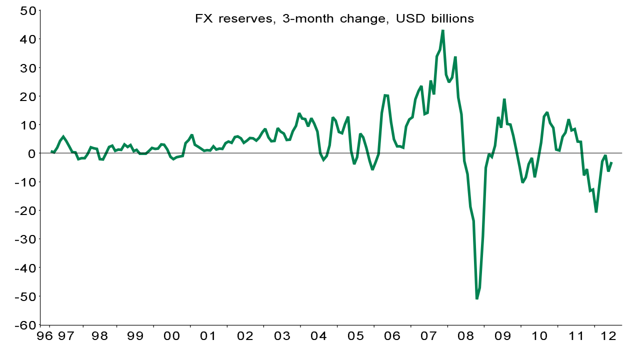
Balance Of Payments



Source: BNP Paribas, Reuters EcoWin Pro

India's overall balance of payments was in "deficit", at close 0.7% of GDP, in FY2012, with the weakness concentrated in H2. This means that it was by definition depleting its reserve assets, consistent with the INR's weakness over the past year.

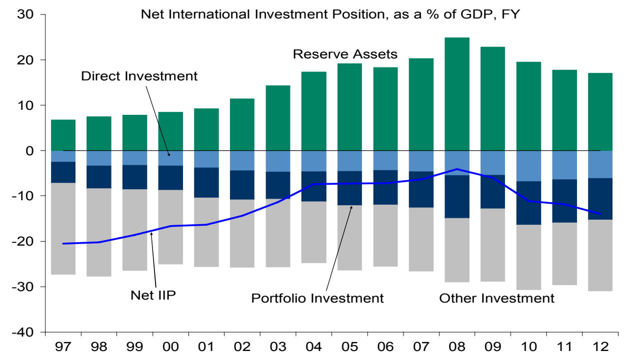
Change in FX Reserves



Source: BNP Paribas, Reuters EcoWin Pro

More recent data, nonetheless, suggest a depletion of India's foreign exchange reserves continued in the three months to June 2012, indicative of net capital flows into India running short of its borrowing requirements during the quarter.

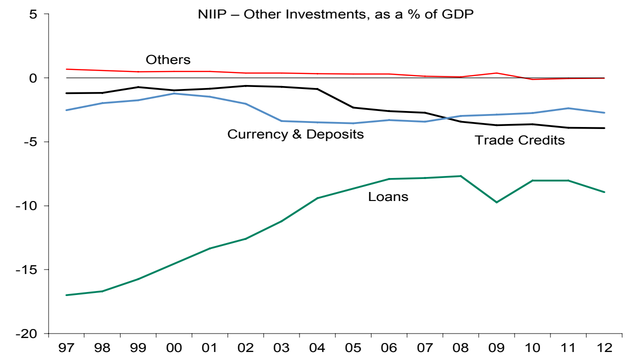
Net International Investment Position (NIIP)



Source: BNP Paribas, Reuters EcoWin Pro

India is traditionally a net borrower from the world, with its NIIP consistently negative since at least FY1997 and reaching -14% of GDP in FY2012, despite its large reserve assets accounting for over ⅔ of total gross international assets.

NIIP – Other Investments

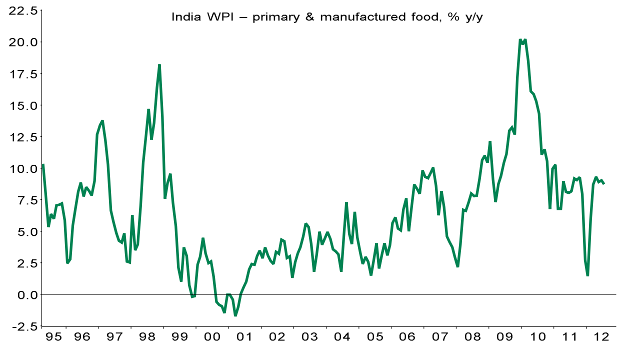


Source: BNP Paribas, Reuters EcoWin Pro

Within the 'other investments' category of the Indian net international investment position, the bulk of the net liabilities is accounted for by the net external liabilities of the general government, reported in "loans".

Inflation – I

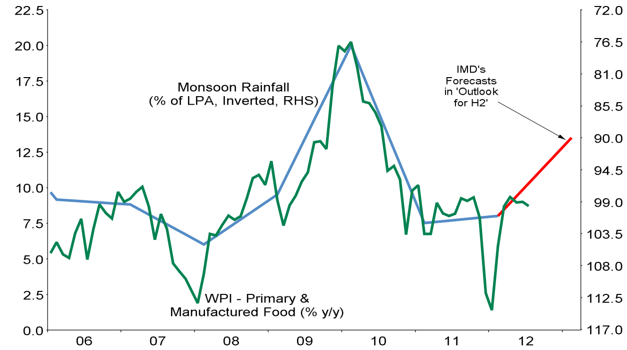
WPI Food Price Inflation – I



Source: BNP Paribas, Reuters EcoWin Pro

Food price inflation, worth c.24% of the WPI when primary and manufactured food prices are taken together, has reaccelerated back close to double-digit territory after a temporary lull around the turn of the year.

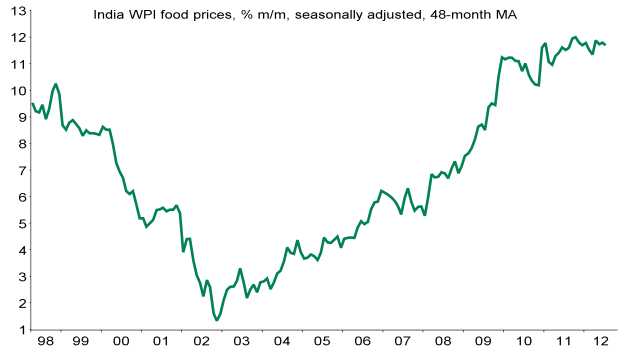
WPI Food Price Inflation – II



Source: BNP Paribas, Reuters EcoWin Pro

WPI food price inflation has come off its highs seen in late 2009 and early 2010, suggesting the presence of cyclical sensitivity to monsoons. The IMD's latest monsoon rainfall forecast of over 10% below the LPA signals upside risks to food inflation.

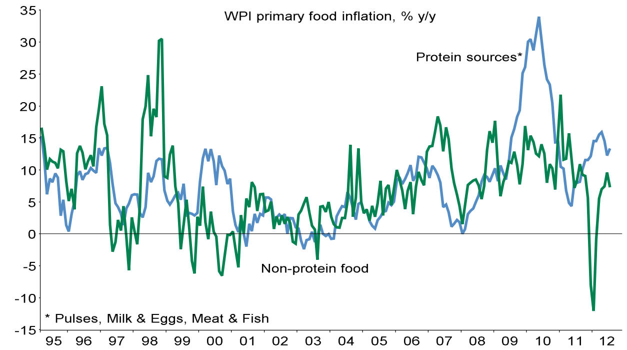
WPI Food Price Inflation – III



Source: BNP Paribas, Reuters EcoWin Pro

The WPI data, once seasonally adjusted, reveal a clear upward trend in the rate of food price inflation since 2003. Food inflation has averaged over 10% over the last 5-6 years

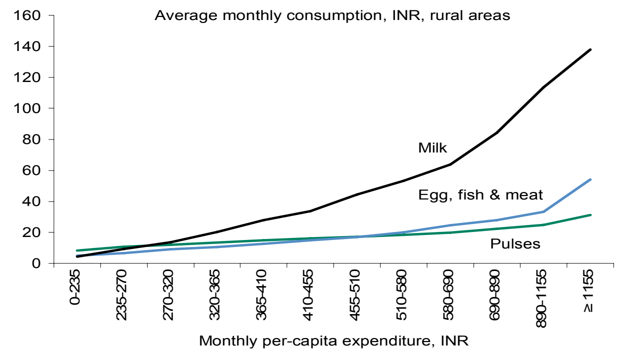
WPI – Primary Food Articles Inflation



Source: BNP Paribas, Reuters EcoWin Pro

There are two strands to India's structural food inflation problem. The first is the trend acceleration in inflation of protein sources as rising incomes produce dietary shifts with which supply is unable to keep pace in the short-to-medium term.

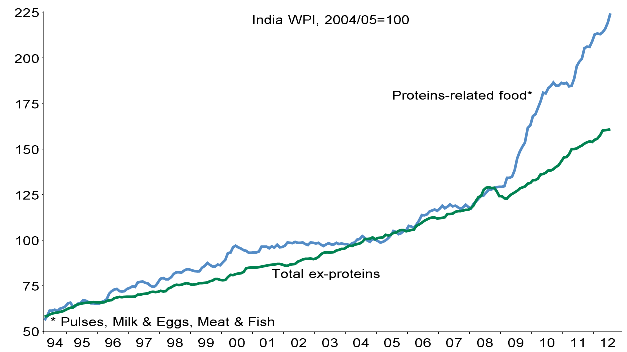
Higher Incomes, More Protein



Source: BNP Paribas, Reuters EcoWin Pro

The RBI estimates that, with per-capita income rising by c.39% during FY05-FY10, some 220mn people would have reached the threshold income level at which diets seem to shift decisively towards higher consumption of proteins.

WPI – Protein vs. Ex-Protein Sources – I

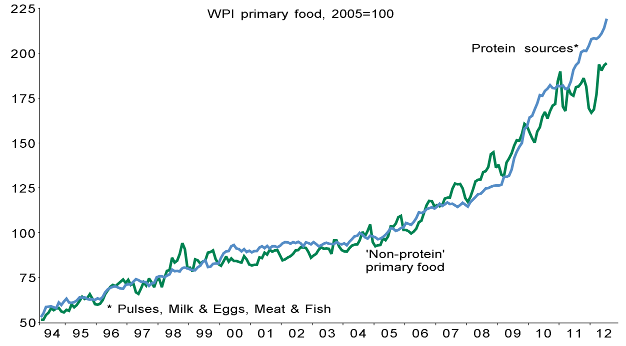


Source: BNP Paribas, Reuters EcoWin Pro

After a brief pull back in 2011H1, protein source inflation has since re-accelerated, running at 13.4% in July. Since end-FY2008, protein source prices have risen a cumulative 85%; the rest of the WPI basket just above 32%.

Inflation – II

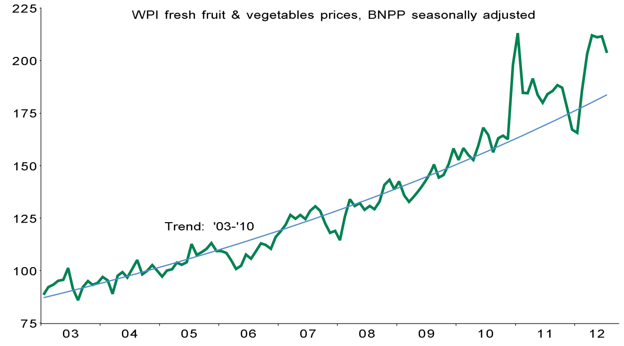
WPI – Protein vs. Ex-Protein Sources – II



Source: BNP Paribas, Reuters EcoWin Pro

However, India's structural food inflation problem is not just a "protein" story. Ex-protein source food prices also appear to have seen a trend-acceleration from around FY2007/FY2008.

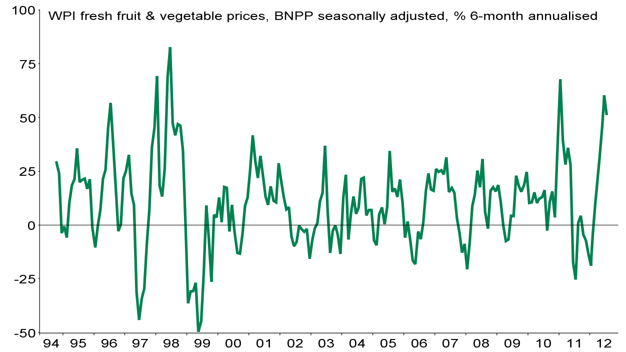
WPI – Fruit & Vegetable Prices – I



Source: BNP Paribas, Reuters EcoWin Pro

Increasingly rapid (and volatile) inflation in fresh fruit and vegetable prices look to be the key driver and hence the second strand to India's intensifying structural inflation issue. They account for 3.8% of the WPI and c.27% of primary food prices.

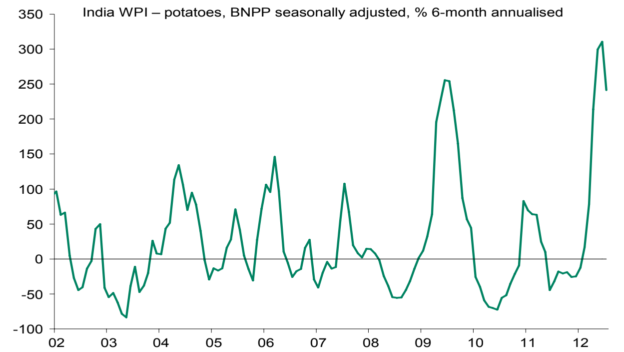
WPI – Fruit & Vegetable Prices – II



Source: BNP Paribas, Reuters EcoWin Pro

In the past 6 months, fresh fruit and vegetable prices have spiked at a remarkable 51% annualised rate. This follows annualised deflation of 19% as recently as in the 6 months to January and an even bigger spike around late 2010 and early 2011.

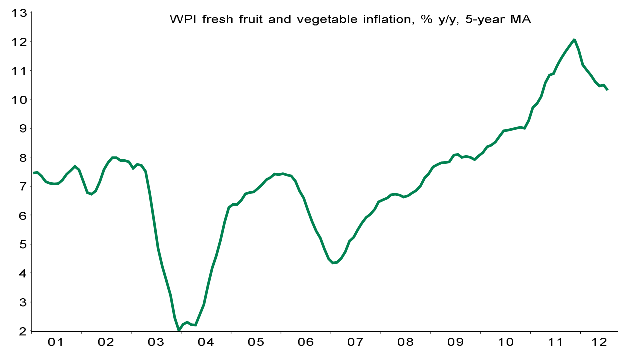
WPI – Fruit & Vegetable Prices – III



Source: BNP Paribas, Reuters EcoWin Pro

Much of the recent volatility comes from potato prices, which in some ways represent a microcosm for the problems and volatility of the overall agricultural sector. Potato prices, having crashed in late 2011, have jumped 240% annualised in the past 6 months.

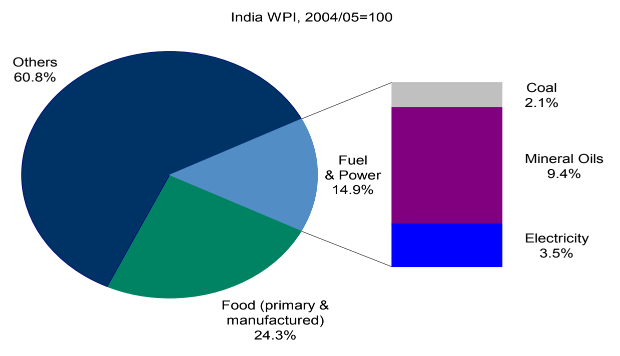
WPI – Fruit & Vegetable Prices – IV



Source: BNP Paribas, Reuters EcoWin Pro

Similar, although not as extreme, trends can be seen in onion and also tomato prices. Inefficiencies in supply, distribution and storage networks appear to be getting worse, not better, meaning supply disruptions are increasingly amplified, not damped.

WPI – Energy By Category

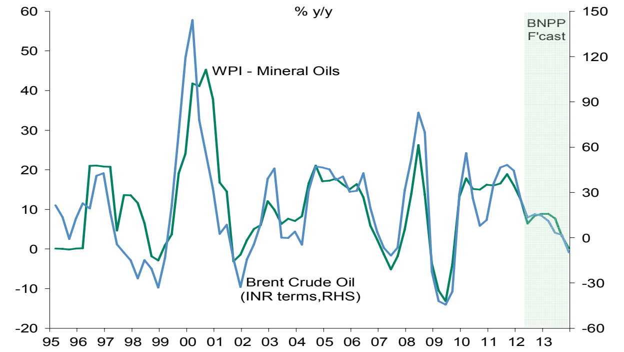


Source: BNP Paribas, Reuters EcoWin Pro

With a c.15% weight in the WPI, energy prices will also continue to produce upward pressure on headline inflation, courtesy of continued coal shortages and still-suppressed electricity tariffs and subsidised oil prices.

Inflation – III

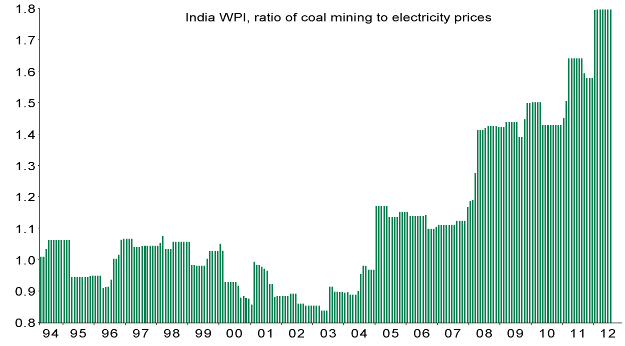
WPI Mineral Oils vs. Brent Crude Spot



Source: BNP Paribas, Reuters EcoWin Pro

While largely set by the government, domestic fuel prices have been tracking global oil prices closely. Our Brent and INR assumptions imply that Indian WPI 'mineral oils' inflation will remain steady at c.8-9% before falling into 2013H2.

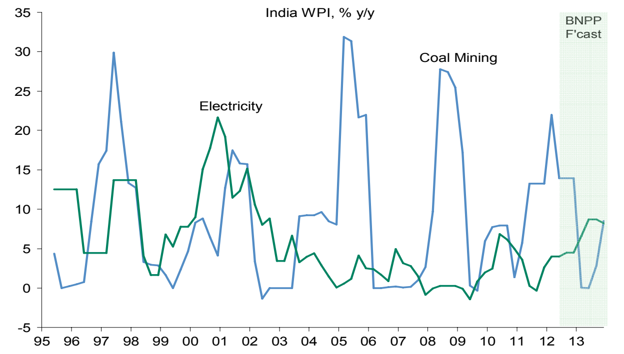
WPI – Coal Mining vs. Electricity Prices – I



Source: BNP Paribas, Reuters EcoWin Pro

State electricity boards remain under acute financial pressure as tariffs have failed to keep up with coal price rises. The ratio of coal mining to electricity prices within the WPI, which is now running at an all-time high, reinforces this point.

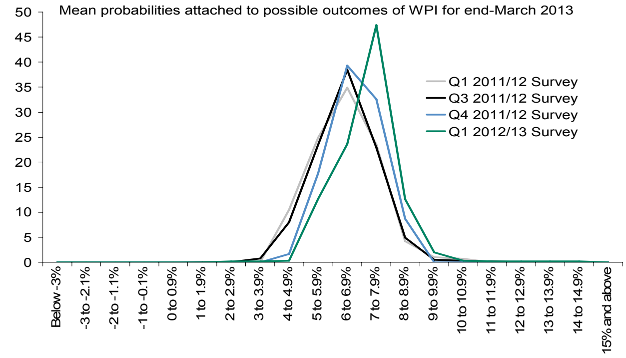
WPI – Coal Mining vs. Electricity Prices – II



Source: BNP Paribas, Reuters EcoWin Pro

Electricity price inflation has already picked up to 4.0% y/y from c.-1.3%. The combination of persistent coal shortages and financial pressures means electricity tariffs will likely be hiked in many states, probably pushing electricity inflation towards 10%.

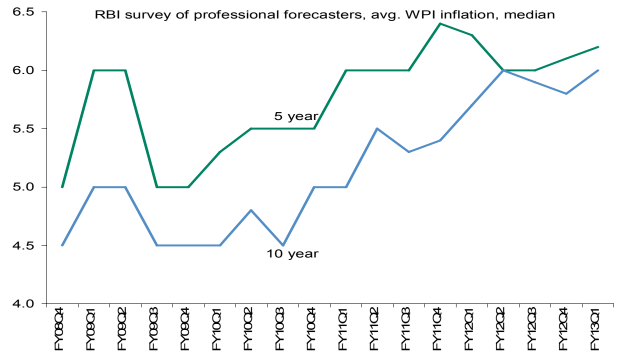
End-March 2013 WPI Forecast Distribution



Source: BNP Paribas, Reuters EcoWin Pro

The rebound of food price inflation since the turn of the year has inevitably led to increased numbers of professional forecasters projecting headline WPI inflation to remain sticky at around 7-8% by the end of the fiscal year to March 2013.

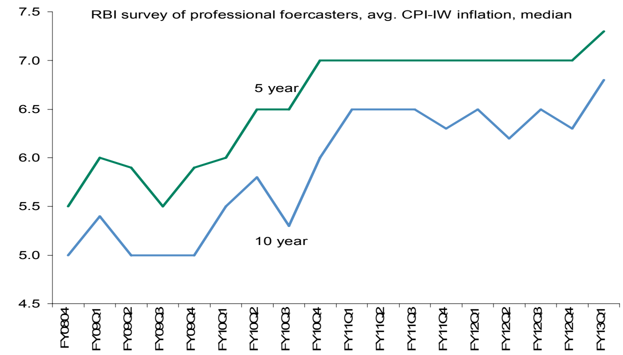
WPI Inflation Expectations – Median



Source: RBI Survey of Professional Forecasters

The RBI's latest round of survey of professional forecasters indicated 5-year-ahead median WPI expectations pushed back above 6%. 10-year-ahead expectations also rebounded to their 6% peak level.

CPI-IW Inflation Expectations – Median

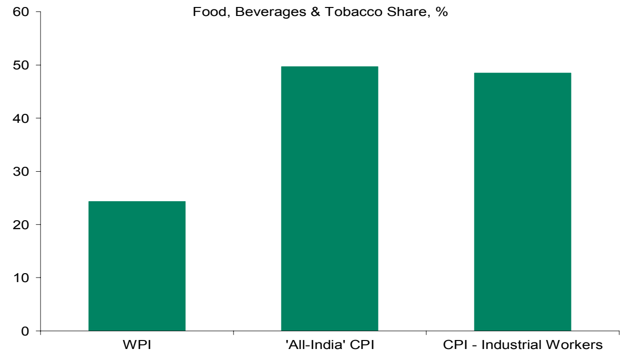


Source: RBI Survey of Professional Forecasters

5-year-ahead median consumer price expectations, having been stable at 7.0% for 10 quarters in a row, jumped to a record 7.3%. 10-year-ahead median inflation expectations also reached a record high of 6.8% in the latest survey.

Inflation – IV

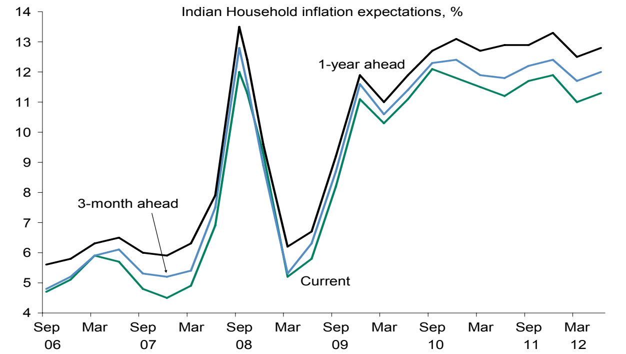
Food Share – 'All-India' CPI, CPI-IW & WPI



Source: BNP Paribas, Reuters EcoWin Pro

Food prices not only account for higher shares of the CPI (c.49%) than of the WPI (c.24%) but given the frequent, 'repeat' nature of food purchases, food inflation will inevitably have an outsized impact on consumer inflation expectations.

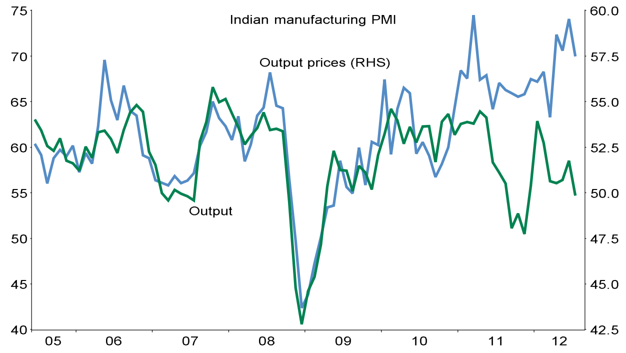
RBI Inflation Expectations Survey of Households



Source: RBI Inflation Expectations Survey of Households

The rapid food price inflation of the last 3-4 years has fed into higher inflation expectations that threaten a ratchet effect on inflation dynamics. The sharp cyclical slowdown in the economy has failed to pull inflation expectations back down.

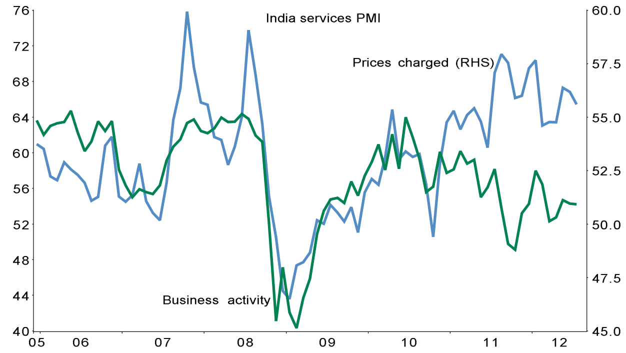
Manufacturing PMI – Output vs. Output Prices



Source: Markit Economics, BNP Paribas

The output price balance from the manufacturing PMI survey has shown signs of decoupling from output developments, further suggesting that a higher level of inflation expectations is inducing a ratchet effect.

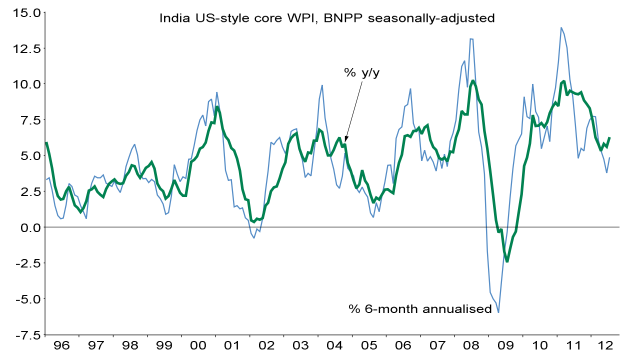
Services PMI – Activity vs. Prices Charged



Source: Markit Economics, BNP Paribas

A decoupling of prices from activity is also evident in the services sector, which is not included in the WPI. The resilience of prices charged in services relative to the weakness in business activity tallies with the strength of 'All-India' CPI – miscellaneous prices.

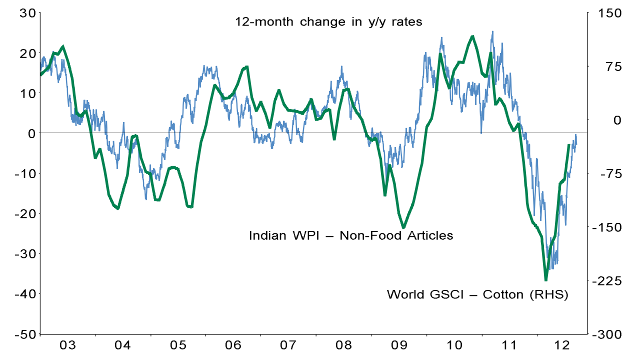
WPI – US-style 'Core'



Source: BNP Paribas, Reuters EcoWin Pro

'Core' WPI inflation pressures, however, have receded since the turn of the year, with the 6-month annualised rate in our US-style core gauge down to c.4.9%. At 6.3% at present, the y/y rate has edged higher of late but remains close to its two year lows.

WPI – Non-food Primary Articles

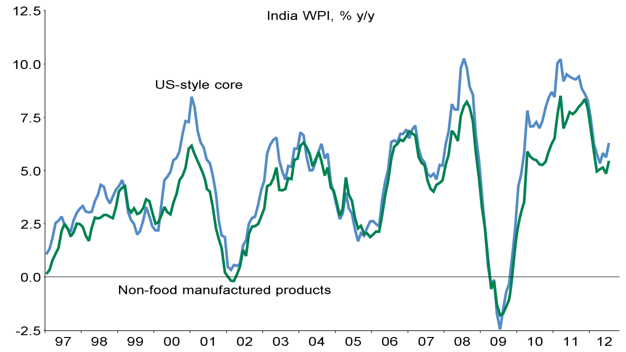


Source: BNP Paribas, Reuters EcoWin Pro

After bottoming in February, inflation in WPI non-food primary articles has since rebounded quickly. It largely reflects raw cotton prices, which, in turn, tracks global trends closely. The GSCI signals inflation for non-food articles pushing higher ahead.

Inflation – V

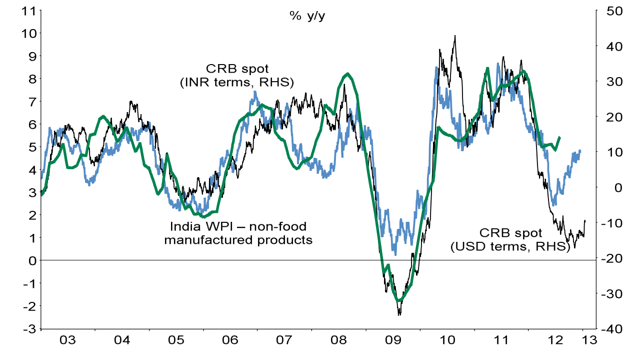
WPI – US-style 'Core' vs. Non-food Manufactures



Source: BNP Paribas, Reuters EcoWin Pro

Our 'US-style' core measure, however, inevitably tracks more closely swings in inflation in the non-food manufacturing segment of WPI which the RBI tracks, although the y/y rate of the latter is lower currently given its exclusion of non-food primary articles.

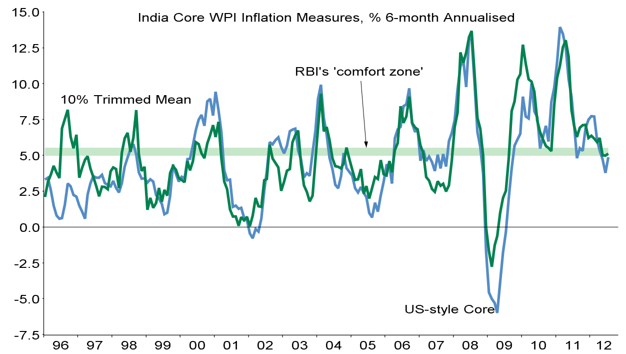
WPI – Non-food Manufactures vs. CRB Index



Source: BNP Paribas, Reuters EcoWin Pro

India's non-food manufactured WPI – the RBI's preferred 'core' inflation gauge – moves in line with trends in global commodity prices, which have slumped over the past year. The weakness of the INR has limited the pass-through, however.

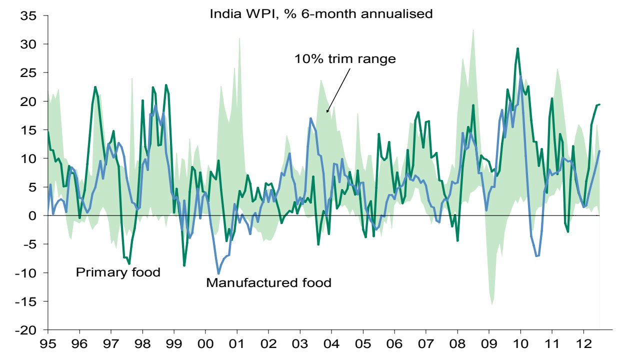
WPI – Trimmed Mean vs. US-style 'Core'



Source: BNP Paribas

Our 10% trimmed mean WPI, an alternative measure of 'core' inflation trends, similarly shows core pressures currently contained on a 6-month annualised basis but also shows signs of bottoming out.

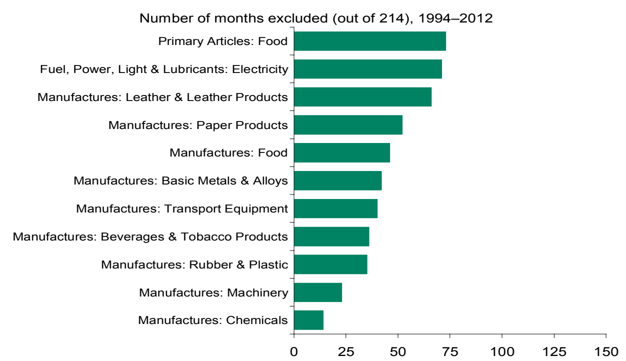
Food Price Inflation vs. Trim Points



Source: BNP Paribas

Food components, both primary and manufactured, of the WPI are excluded from our 10% symmetric trimmed mean less frequently than one might expect.

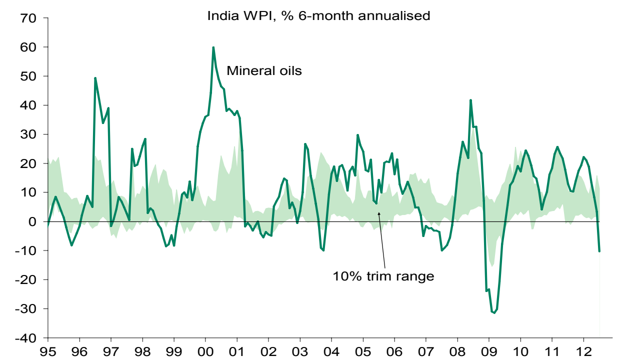
Making The Cut



Source: BNP Paribas

Food items actually occupy two of the eleven least-often-excluded components in our 6-month annualised 10% trimmed mean measure. Key manufactured goods – chemicals and machinery – are the two least frequently trimmed elements.

Mineral Oil Price Inflation vs. Trim Points

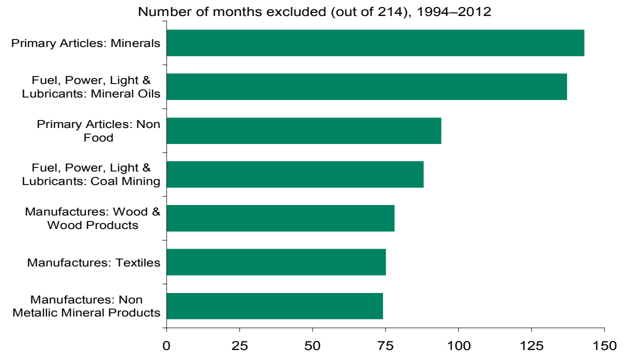


Source: BNP Paribas

The monthly inflation rate for the energy-related components 'mineral oils' on a 6-month annualised basis appears more volatile, frequently rising (falling) by more than the higher (lower) trim points and hence getting 'trimmed' away.

Inflation – VI

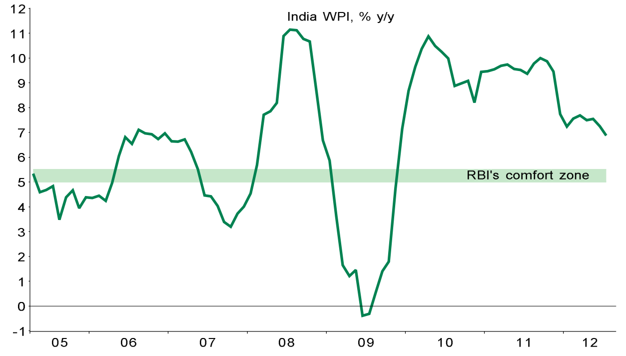
Missing The Cut



Source: BNP Paribas

The mineral oils component of the WPI, together with primary articles (both minerals and non-food), tops the list of the components most often excluded from our 10% trimmed mean WPI inflation measure (on a 6-month annualised basis).

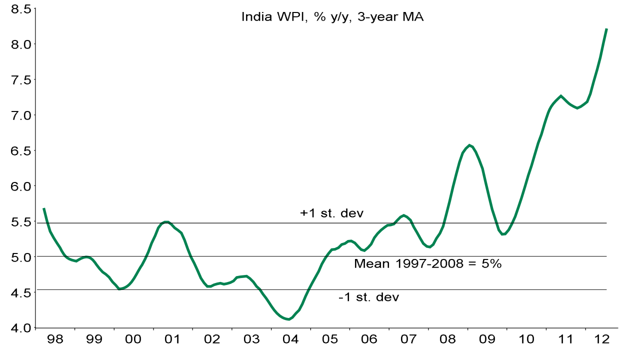
WPI – Headline – I



Source: BNP Paribas, Reuters EcoWin Pro

WPI inflation, the benchmark price pressure metric the Indian authorities primarily monitor, has run stubbornly above the RBI's 'comfort zone' of c.5-5.0% and its medium-term objective of 3%. The latest data reported WPI inflation of 6.9% in July.

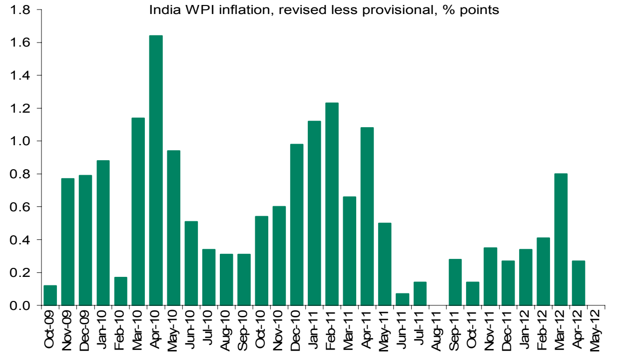
WPI – Headline – II



Source: BNP Paribas, Reuters EcoWin Pro

Over the past 3 years, India's headline WPI inflation has averaged over 8%, well above the RBI's so-called 5% 'comfort level', which it did on average attain in the decade prior to the global financial crisis.

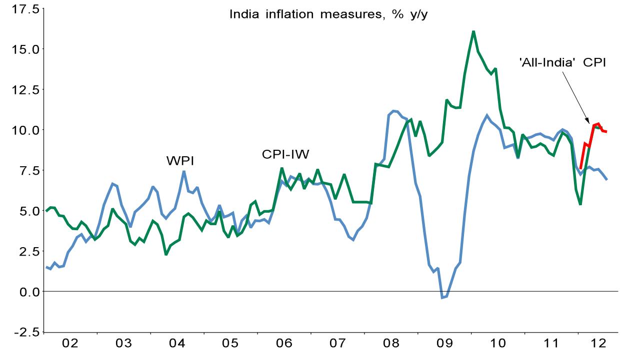
Revisions to Back Data



Source: BNP Paribas, Reuters EcoWin Pro

We have long highlighted that the revisions to the WPI back data are strongly pro-cyclical. Consistent with activity having lost some momentum once again at the start of the fiscal year, the scale of upward revisions has shown some signs of tapering off.

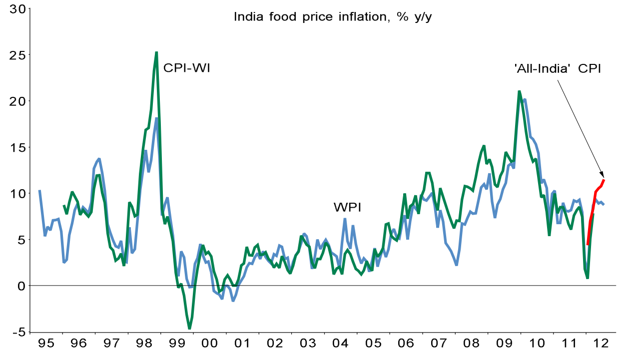
'All-India' CPI, CPI-IW & WPI



Source: BNP Paribas, Reuters EcoWin Pro

The new, 'All-India' CPI, which over time is expected to establish itself as the premier inflation benchmark given its broader coverage and more recent weights, showed inflation at just below 10% y/y in July, well above the current rate of WPI inflation.

Food Inflation – 'All-India' CPI, CPI-IW & WPI

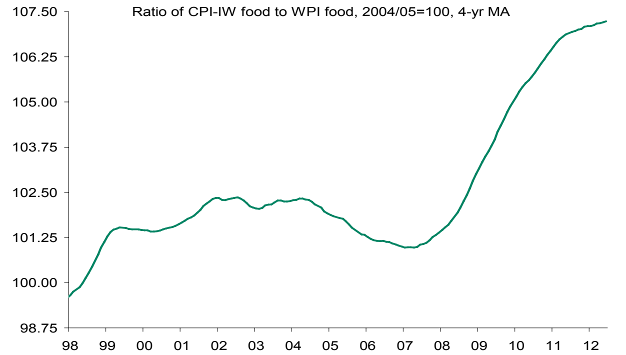


Source: BNP Paribas, Reuters EcoWin Pro

The wedge between the headline CPI and WPI rates in part reflects their different food shares. But, at 11.5% y/y based on the 'All-India' CPI, food inflation is higher at the CPI level than at the WPI level, as has generally been the case in recent years.

Inflation – VII

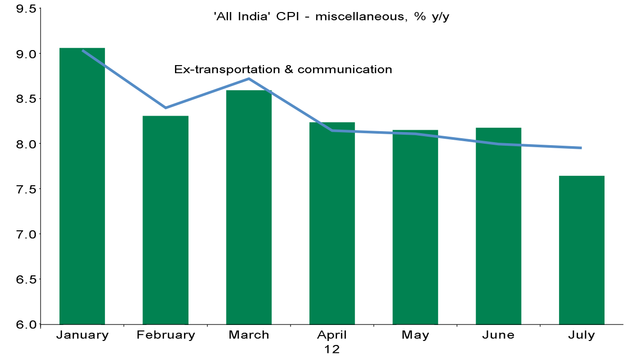
Ratio of CPI-IW Food to WPI Food



Source: BNP Paribas, Reuters EcoWin Pro

The upshot of the faster rates of food price inflation at the CPI level than at the WPI level seen in recent years is a rapid expansion of retail food margins.

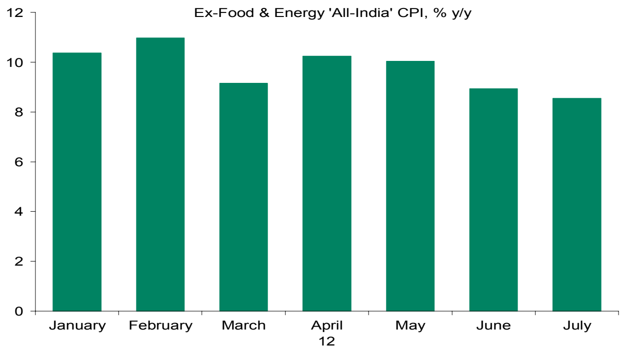
'All-India' CPI – Services



Source: BNP Paribas, Reuters EcoWin Pro

Services, which are not included in the WPI, are now captured by 'miscellaneous' components in the 'All-India' CPI. At 7.6% y/y, still-rapid inflation in services suggests more generalised price pressures not just confined to food.

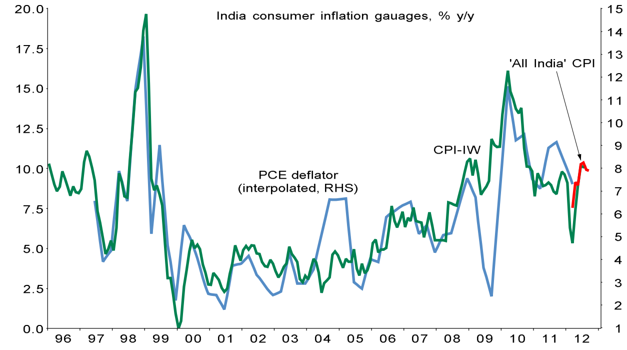
'All-India' CPI – Ex-Food & Energy



Source: BNP Paribas, Reuters EcoWin Pro

The breakdown of the 'All-India' CPI allows us to compute a so-called US-style core CPI, which edged lower to 8.5% in July. Admittedly, with the 'core' index worth less than 45% of the CPI, it is hardly a 'good' guide to underlying and future inflation trends.

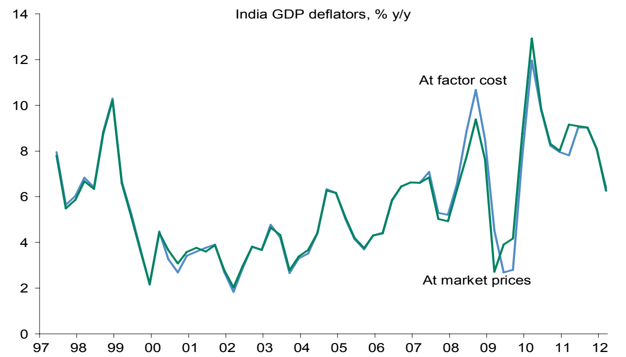
CPI-IW vs. PCE Deflator



Source: BNP Paribas, Reuters EcoWin Pro

CPIs have historically been a reasonably good guide to trends in the PCE deflator. CPI inflation has trended higher since the turn of the year, pointing to the PCE deflator likely to remain sticky at c.8% in the near term.

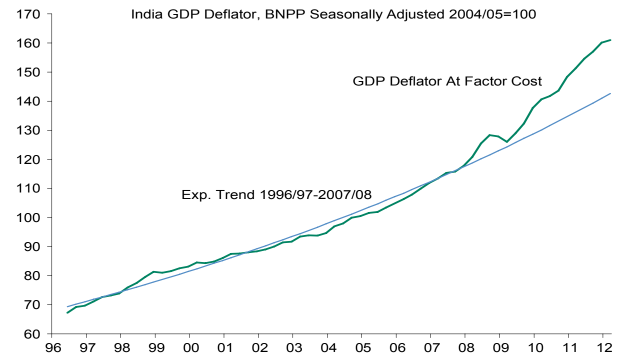
GDP Deflator – I



Source: BNP Paribas, Reuters EcoWin Pro

The GDP deflator, the best guide to overall domestic cost and price pressures, has come off the highs of c.13% y/y reached in early 2010. At 6½% y/y in FY2012 Q4, however, it remains close to the high end of its historical range seen since 2000.

GDP Deflator – II

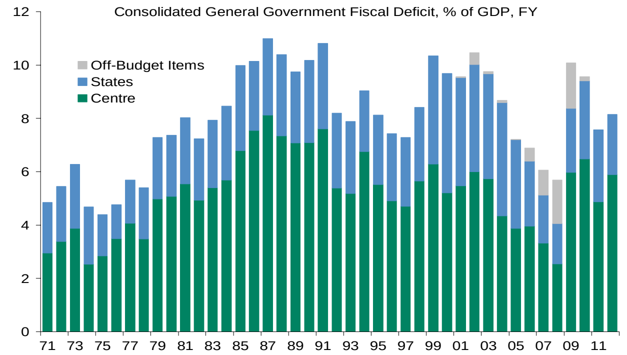


Source: BNP Paribas, Reuters EcoWin Pro

In level terms, the GDP deflator has similarly seen a clear trend-acceleration since end-FY2008. The indicator is estimated to have run almost 13% above its pre-crisis trend.

Public Finances – I

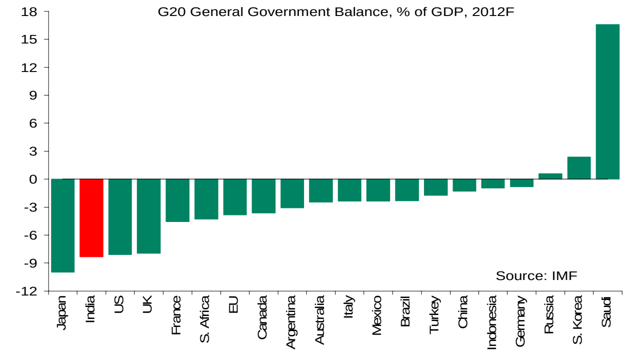
General Government Deficit



Source: BNP Paribas, Ministry of Finance

The Indian government has seen its fiscal position deteriorate since the outbreak of the GFC. Having dropped to an almost 30-year low of 5.7% of GDP in FY08, the combined deficit has since been running close to 8-10% of GDP.

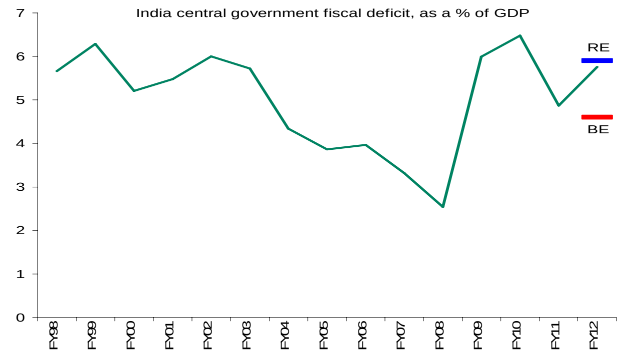
G20 General Government Balances



Source: IMF

According to the IMF, on a calendar year basis India's general government deficit is among the highest in the G20. Forecast at 8.3% of GDP in 2012, the Indian shortfall will be the second highest, only after Japan's 10% of GDP deficit.

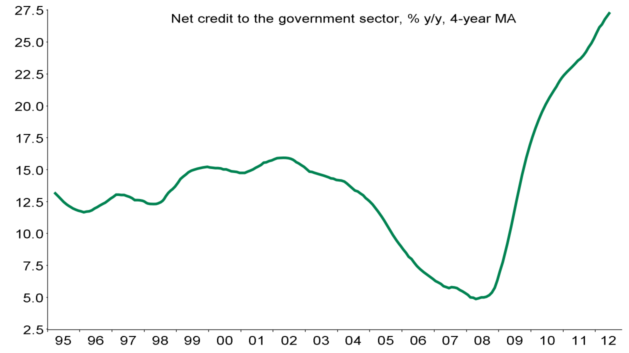
Central Government Deficit



Source: BNP Paribas, Ministry of Finance

Having dropped to 4.9% of GDP in FY11, the central government deficit ratio rebounded to 5.8% in FY12, a touch below the revised estimate of 5.9% made back in March but well above the 4.6% deficit initially forecast in the Union Budget for FY12.

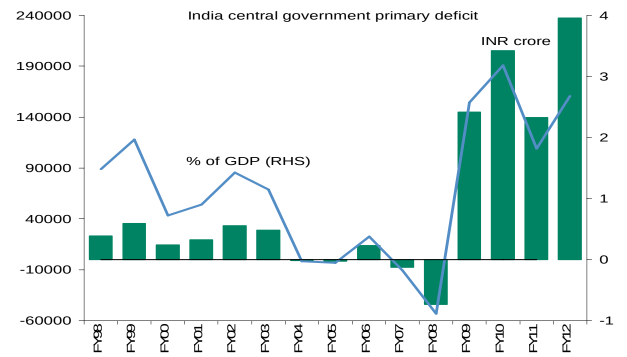
Net Bank Credit To Government



Source: BNP Paribas, Reuters EcoWin Pro

The loss of the government's fiscal discipline since the GFC is evident in net bank credit to the government sector, which has seen annual growth average over 27% over the past four years, compared with below 5% seen in the 4 years to FY2008.

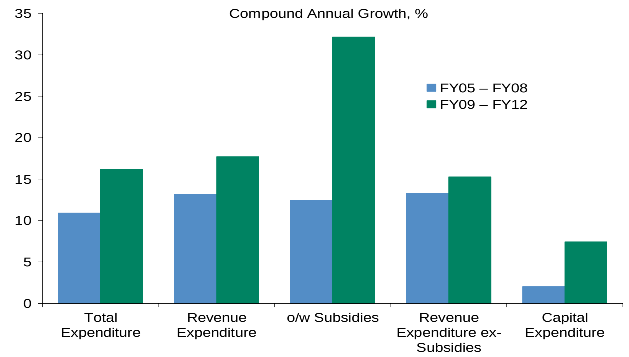
Central Government Primary Deficit



Source: BNP Paribas, Ministry of Finance

Initially entering the crisis with a primary surplus of 0.9% of GDP in FY2008, India has since seen its primary balance swing sharply into deficit. At 2.7% of GDP in FY2012, the shortfall was close to the record 3.2% seen in FY2010.

Compounded Annual Expenditure Growth

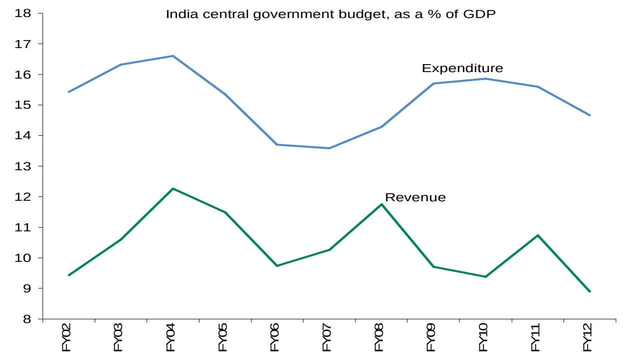


Source: BNP Paribas, Ministry of Finance

Spending on subsidies, which saw compound growth of c.32% over the past 4 years vs. c.12½% during FY05-FY08, has been the main culprit behind India's loss of fiscal discipline. The rise in capital expenditure growth, meanwhile, was far more limited.

Public Finances – II

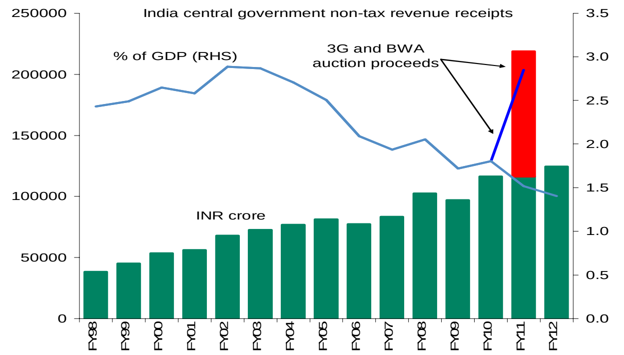
Central Government Revenues & Expenditure



Source: BNP Paribas, Ministry of Finance

The rise in the deficit ratio in FY12 was a result of a weak revenue outturn, with the share down from 10.7% of GDP to 8.8%, the weakest since at least FY02. The expenditure share, meanwhile, was down from 15.6% of GDP to 14.6%.

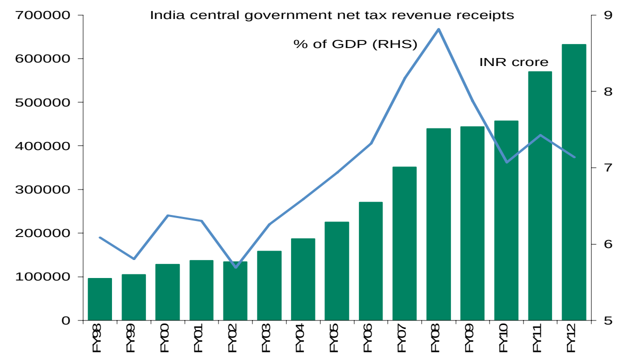
Central Government Non-Tax Revenue Receipts



Source: BNP Paribas, Ministry of Finance

FY2012's decline in the non-tax revenue share to 1.4% of GDP was in line with the budget estimates. It also more than reflected the absence of the 1.3% of GDP one-off 3G and BWA auction proceeds in FY2011.

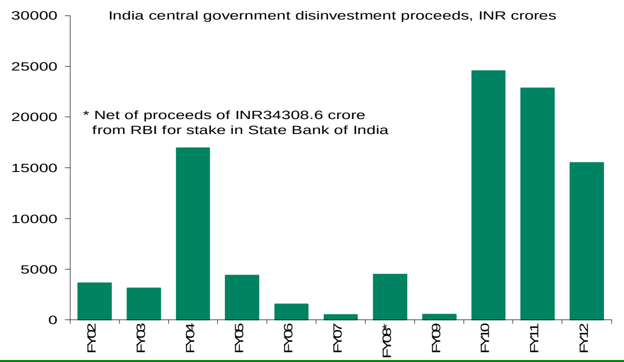
Central Government Net Tax Revenue Receipts



Source: BNP Paribas, Ministry of Finance

Net tax revenue receipts ticked down to 7.1% of GDP in FY2012 from 7.4%. They also fell short of the budget estimate of 7.4% of GDP and remain some way below their pre-crisis peak of 8.8% of GDP seen in FY2008.

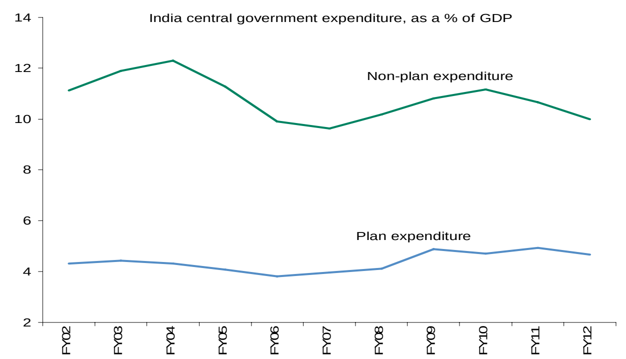
Central Government Disinvestment Proceeds



Source: BNP Paribas, Ministry of Finance

The final component of revenues is capital receipts from disinvestment. At c.INR15500 crore, or 0.2% of GDP, in FY2012, disinvestment proceeds fell short of the government's projection of INR40000 crore, or 0.4% of GDP, back in its FY2012 budget.

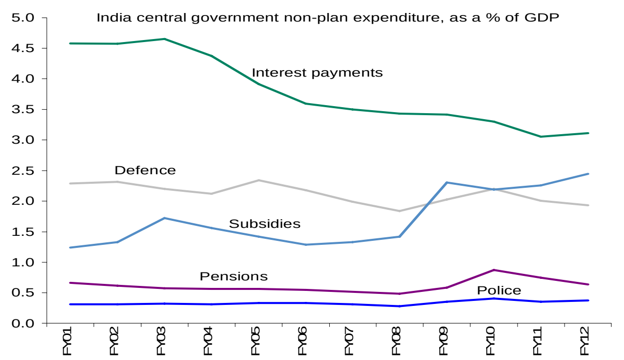
Central Government Expenditure



Source: BNP Paribas, Ministry of Finance

The decline in the overall expenditure share in FY2012 was more evident in non-plan expenditure, which was down by 0.7% of GDP. The plan expenditure share also moderated, albeit by a lesser extent, by 0.3% of GDP.

Central Government Non-Plan Expenditure

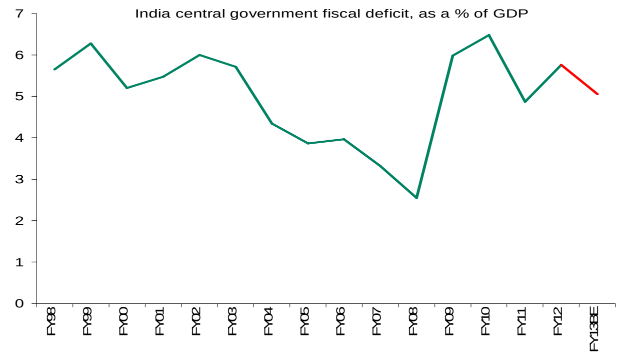


Source: BNP Paribas, Ministry of Finance

The decline in the non-plan expenditure share in FY2012 masked the fact that spending on subsidies actually pick up by almost 25% y/y to 2.4% of GDP from 2.3% in FY2011, instead of a 12.5% y/y (0.5% of GDP) decline as budgeted.

Public Finances – III

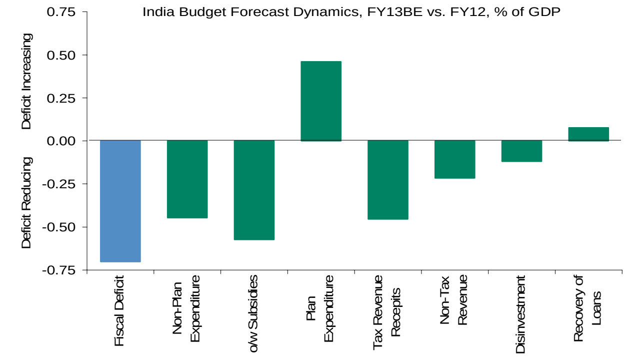
Central Government Deficit – FY2013BE



Source: BNP Paribas, Ministry of Finance

For FY2013, the central government fiscal deficit ratio is budgeted to fall back to 5.1% from 5.8%. The cash deficit, however, is targeted to widen to a record, although, at just below 1.0% y/y, the growth rate is much slower than seen in FY2012.

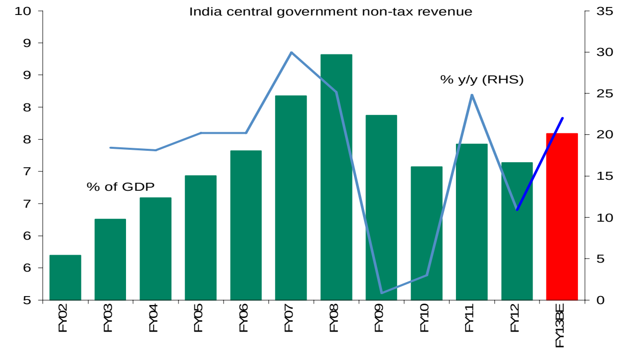
Budget Forecast Dynamics



Source: BNP Paribas, Ministry of Finance

A more detailed breakdown of the budget shows that the bulk of the forecast deficit reduction in FY2013 relative to FY2012 focuses on non-plan expenditure, particularly on subsidies, and tax revenue receipts.

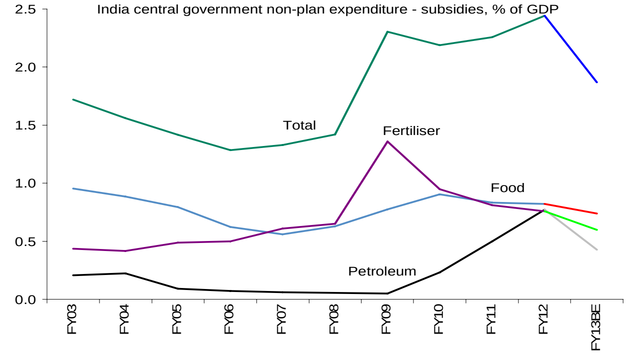
Net Tax Revenue – FY2013BE



Source: BNP Paribas, Ministry of Finance

The net tax revenue share is budgeted to jump to a four-year high of 7.6% of GDP in FY2013. But, with the economy struggling to see growth pick up in both real and nominal terms in FY2013, the assumed 22% y/y rise in net tax revenue looks

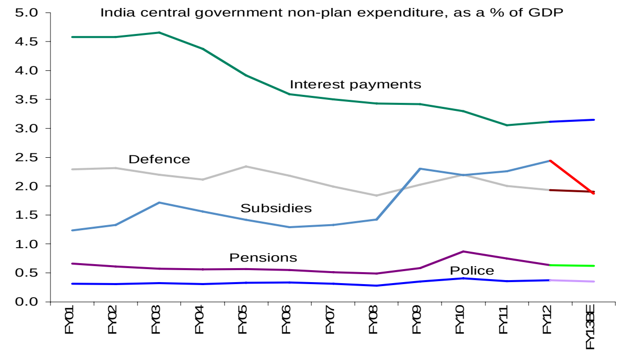
Expenditure On Subsidies – FY2013BE



Source: BNP Paribas, Ministry of Finance

The budgeted stable expenditure share for the fiscal year merely reflects a drop in the share of non-plan expenditure as spending on subsidies is once again deemed to fall by a record 12.2%, or 0.6% of GDP, in FY2013.

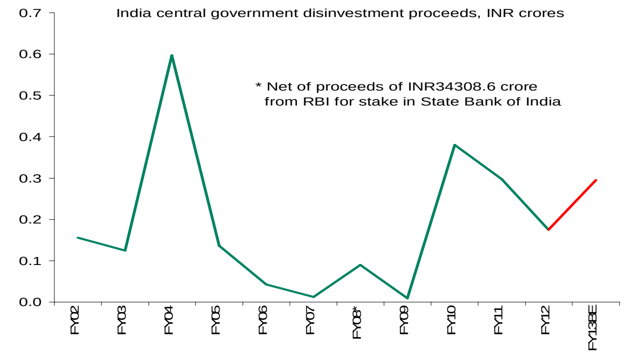
Non-Plan Expenditure – FY2013BE



Source: BNP Paribas, Ministry of Finance

Growth of the rest of non-plan expenditure in cash terms is generally assumed to pick up to above the average rates seen in the preceding few years. In relation to GDP, however, they are budgeted to be broadly flat to down.

Disinvestment Proceeds – FY2012BE

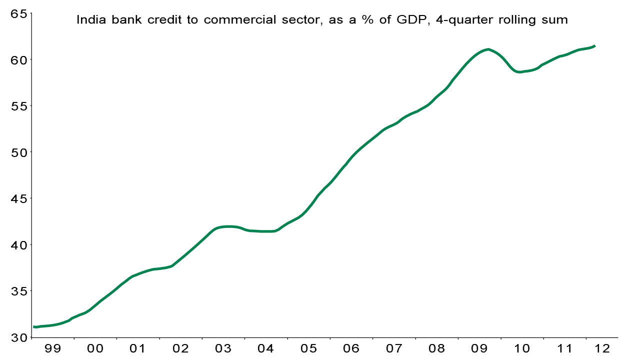


Source: BNP Paribas, Ministry of Finance

Disinvestment proceeds are once again budgeted at close to a record INR30000 crore, or 0.4% of GDP, in FY2012. However, at INR15500 crore in FY2012, they fell short of the government's projection of INR40000 crore in its FY2012 budget.

Money, Credit and Liquidity – I

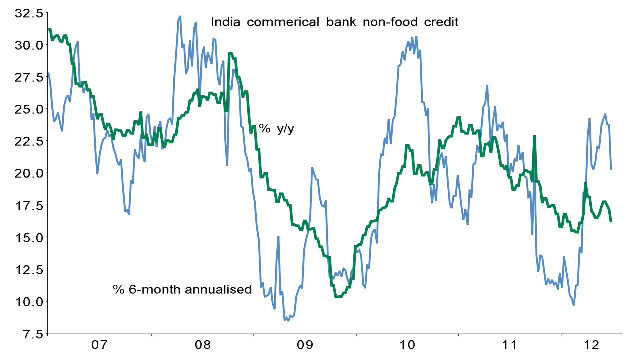
Bank Credit To Commercial Sector / GDP



Source: BNP Paribas, Reuters EcoWin Pro

Indian bank credit to the commercial sector fell to c.58% of GDP in mid-2010 following the global financial crisis. However, it has since crept higher, reaching a record c.61½% of GDP.

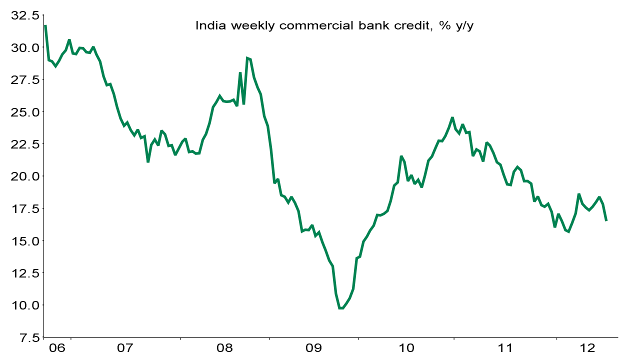
Commercial Bank Credit – Non-food



Source: BNP Paribas, Reuters EcoWin Pro

Non-food credit growth has regained some momentum since the turn of the year, with the 6-month annualised rate now running close to 20%.

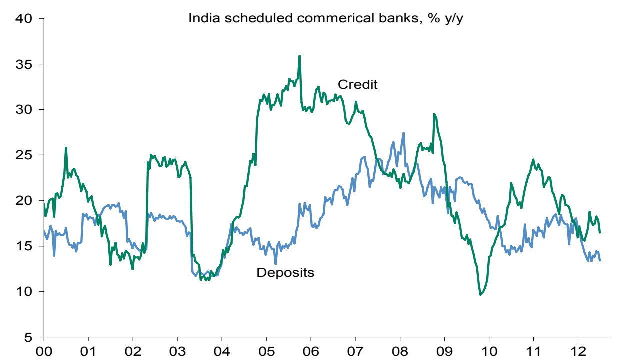
Commercial Bank Credit



Source: BNP Paribas, Reuters EcoWin Pro

Bank credit growth in y/y terms appears to have bottomed out in early 2012, currently running at c.16½%. The strength in the non-food segment on a 6-month basis means overall credit growth will likely pick up from here.

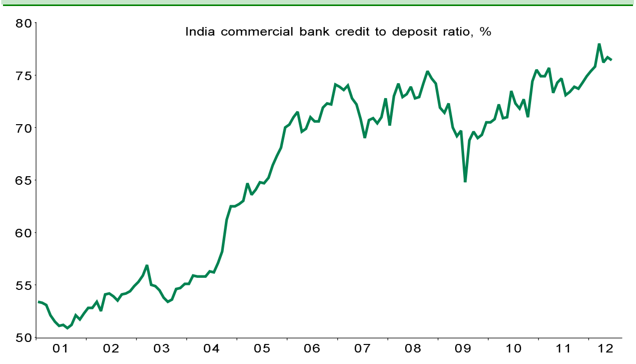
Credit Growth vs. Deposit Growth



Source: BNP Paribas, Reuters EcoWin Pro

Growth in commercial bank deposits, having picked up more into line with credit growth, has once again slowed. At just below 13½% y/y, it is still lagging behind bank credit's 16½% rate.

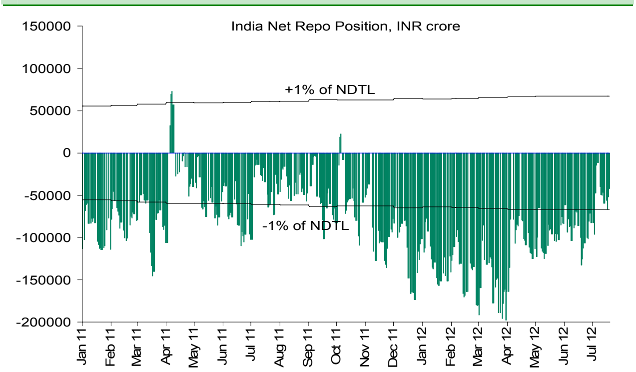
Credit To Deposit Ratio



Source: BNP Paribas, Reuters EcoWin Pro

The commercial bank sector's credit-deposit ratio hit a record 78.1% in March before edging higher of recent months. This suggests any genuine interest rate cuts risk intensifying the loan/deposit imbalance.

Net Repo Balance

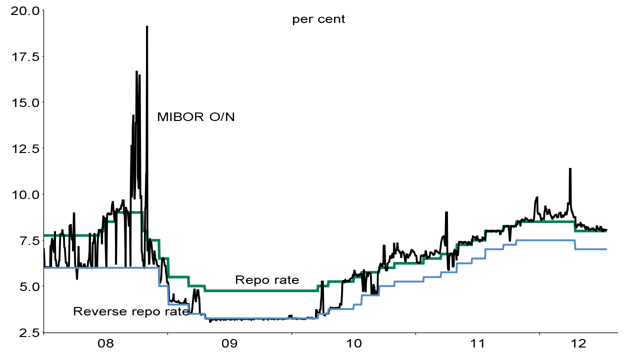


Source: BNP Paribas, CEIC

Helped in part by the release of oil subsidies, inter-bank liquidity in the banking system has improved somewhat in recent weeks, with the net repo balance now back within the RBI's 'comfort zone' of ±1% of net demand time liabilities (NDTL).

Money, Credit and Liquidity – II

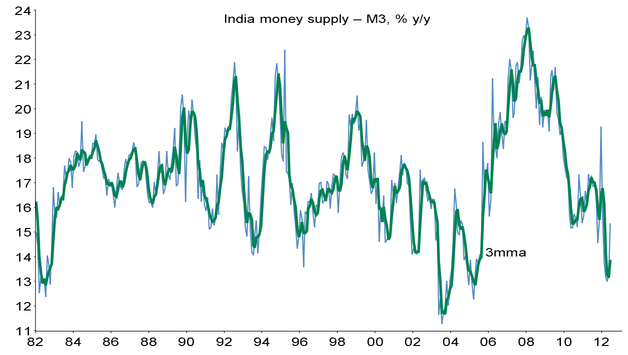
Liquidity Adjustment Facility (LAF) Corridor



Source: BNP Paribas, Reuters EcoWin Pro

Consistent with still tight domestic liquidity conditions, the inter-bank overnight rate has constantly been hovering around the upped band of the liquidity adjustment facility corridor, i.e. the repo rate.

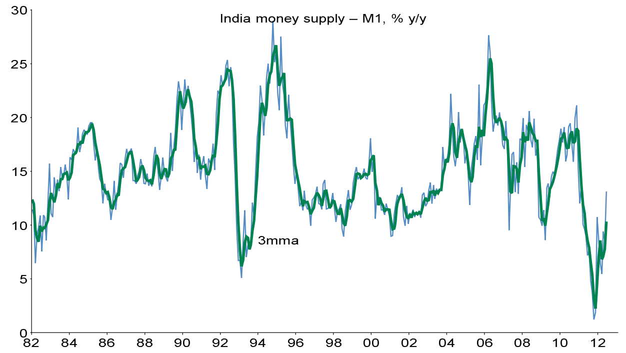
Money Supply M3



Source: BNP Paribas, Reuters EcoWin Pro

Growth of broad money supply (M3) in y/y terms has, on average, dropped to below the RBI's indicative trajectory of 15.5% in the past three months.

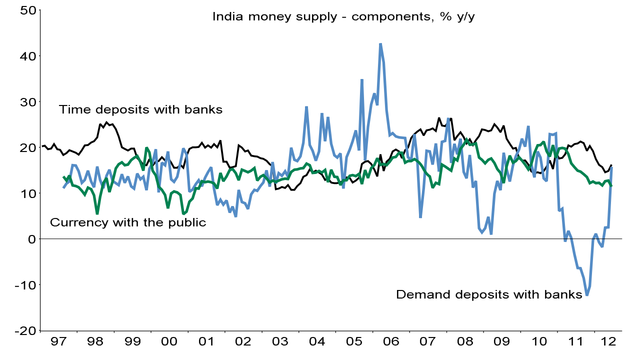
Money Supply M1



Source: BNP Paribas, Reuters EcoWin Pro

M1 narrow liquidity growth, meanwhile, having slid to just c.2%, the weakest in 30 years, in the final months of 2011, has since picked up. Averaging c.10⅓% in the past three months, however, it remains depressed by Indian standards.

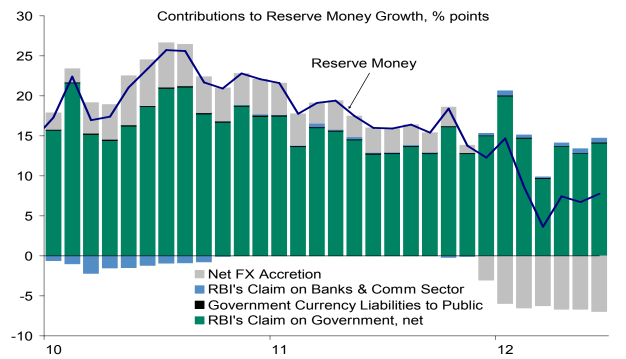
Money Supply By Component



Source: BNP Paribas, Reuters EcoWin Pro

The rebound in M1 growth mainly reflects a recovery in demand deposits from last year when private sector agents moved to lock in higher interest rates by switching from demand deposits to less liquid, longer-duration time deposits.

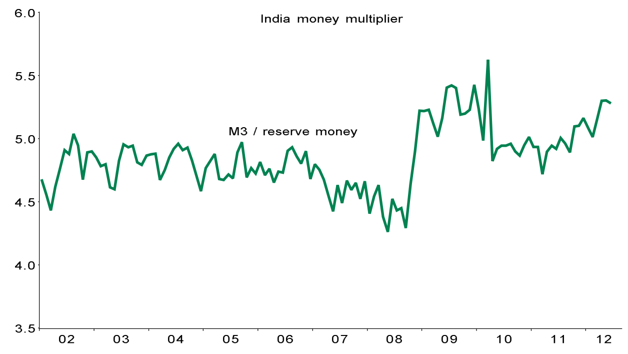
Reserve Money



Source: BNP Paribas, Reuters EcoWin Pro

FX outflows over the past year coupled with a cumulative 125bp cut in the CRR since January have seen reserve money growth fall to the lowest since the global financial crisis.

Money Multiplier

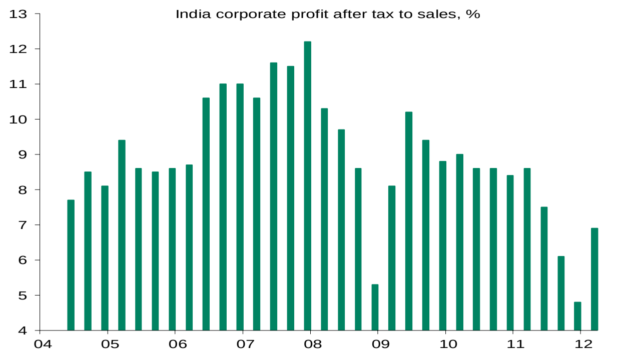


Source: BNP Paribas, Reuters EcoWin Pro

The fact that M3 broad money supply has also decelerated but by a lesser extent means the money multiplier, the ratio of M3 to reserve money, has crept higher.

Financial Market Developments – I

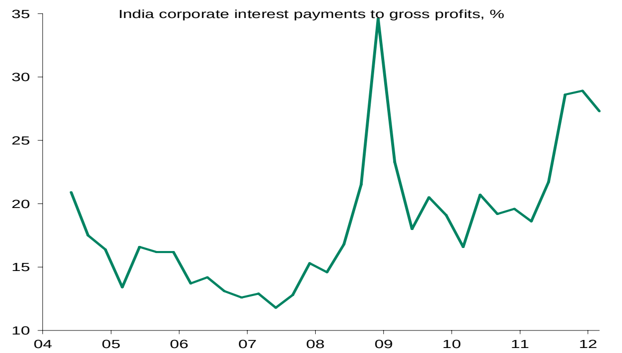
Net Corporate Profit Margin



Source: BNP Paribas, CEIC

Indian corporate profits relative to sales picked back up in the final quarter of FY2012 after falling to just 4.8%; the lowest since at least 2004. At 6.9% of sales, the profit share, nonetheless, remains well below average levels.

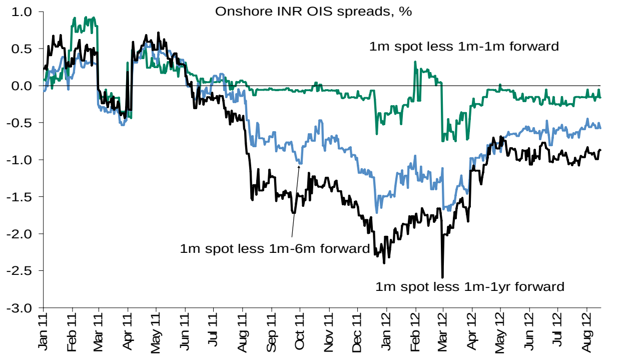
Interest Payments To Gross Profit Ratio



Source: BNP Paribas, CEIC

At 27.3% of gross profits in the three months to March 2012, interest expenses stayed close to the highest since the global financial crisis, alongside a cumulative 375bp of repo rate hike by the RBI from March 2010 to October 2011.

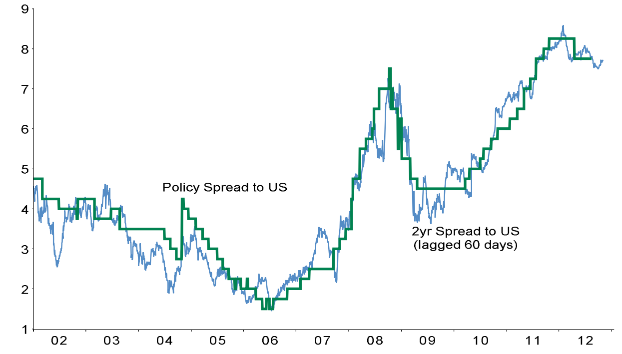
Onshore INR OIS



Source: BNP Paribas, Bloomberg

The OIS market continues to price in further policy ease following the RBI's 50bp rate cut at the April meeting. The market is now pricing in almost 90bp of rate cuts over the 1-year horizon; too optimistic relative to our forecasts.

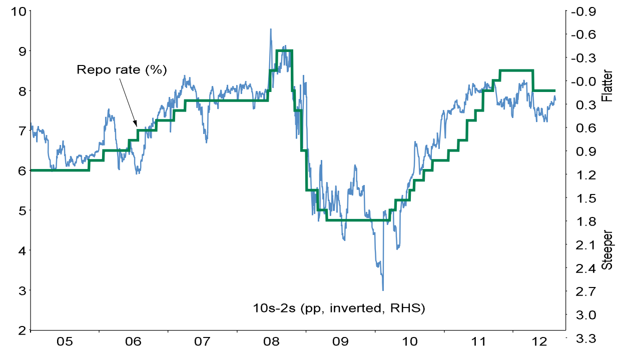
Policy & 2-Year Bond Spreads to the US



Source: BNP Paribas, Reuters EcoWin Pro

The 2-year benchmark Indian government bond spread to the US 2-year leads the policy spread. At present, it points to a broadly stable repo rate in the next couple of months.

10-2s & Policy



Source: BNP Paribas, Reuters EcoWin Pro

The relationship between the slope of the yield curve and the repo rate was tight until mid-2011 but has loosened somewhat over the last year. The slope of the yield curve, nonetheless, is currently consistent with only limited easing by the RBI.

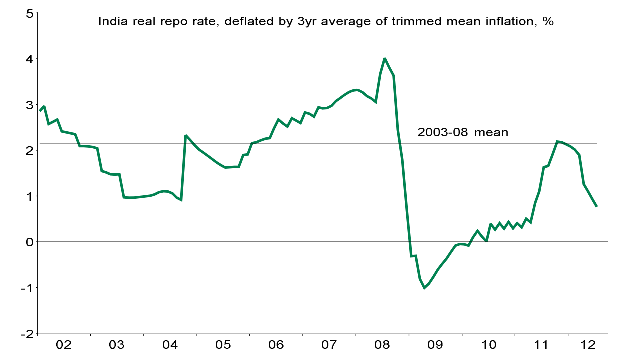
Repo Rate vs. 2-year Government Bond Yields

Source: BNP Paribas, Reuters EcoWin Pro

The pick-up in 2-year government bond yields since mid-July to now below close to the repo rate, similarly, is indicative of bond markets moving to price out any aggressive policy easing by the central bank.

Financial Market Developments – II

Policy Rates vs. Trimmed Mean Inflation



Source: BNP Paribas, Reuters EcoWin Pro

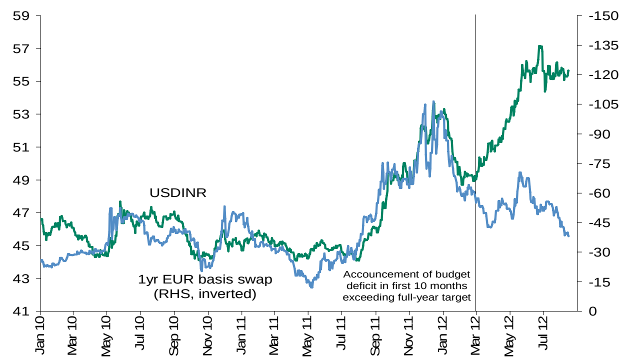
Real policy rates have fallen back and are well below the levels seen during the strong growth period of 2003-2008. This dovetails with the RBI's finding that real effective lending rates are not unusually high.

INR vs. USD – I

Source: BNP Paribas, Reuters EcoWin Pro

The INR has weakened markedly vs. the USD since July 2011. The Indian authorities have recently unveiled a series of measures to liberalise the capital account in an effort to boost debt and equity inflows to support the currency.

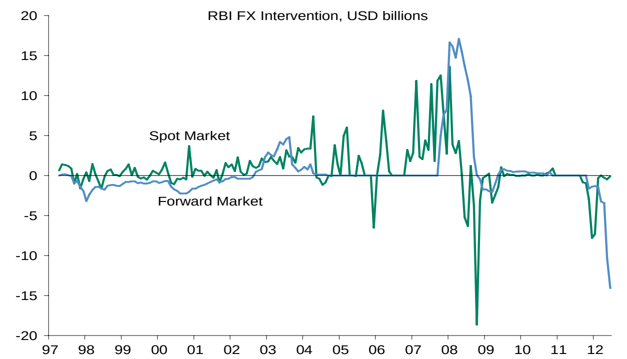
INR vs. USD – II



Source: BNP Paribas, Bloomberg

The most recent leg of selling pressure looks to have been triggered by the announcement in late February that the government's FY2012 budget target had been exceeded within the first 10 months of the fiscal year.

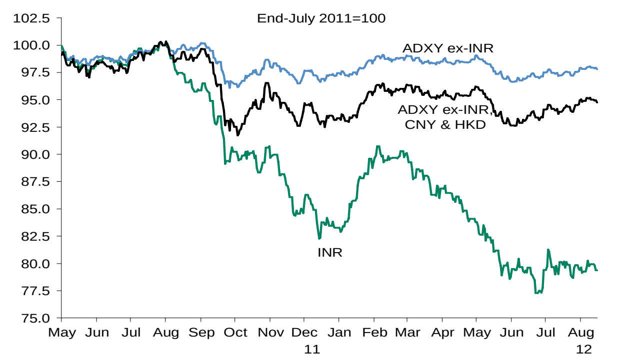
FX Intervention



Source: BNP Paribas, Reuters EcoWin Pro

The INR weakness amid persistent liquidity deficit in the banking system as suggested by the RBI's net repo balance has prompted the central bank to intervene heavily in the forward market in addition to the spot market.

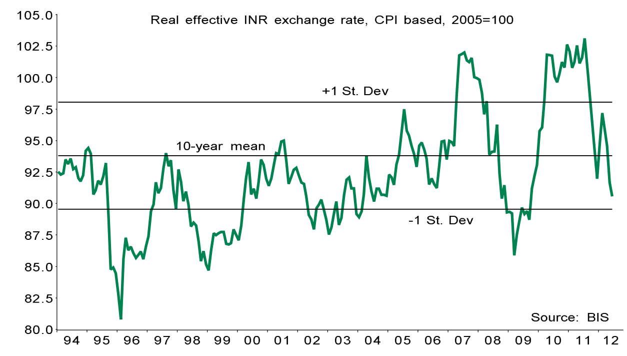
ADXY vs. USD



Source: BNP Paribas, Reuters EcoWin Pro

Consistent with its balance of payments position with least support from its 'basic balance' in Asia ex-Japan, India has seen its currency under-perform its regional peers' with a c.19% decline over the past year.

Effective INR Exchange Rate

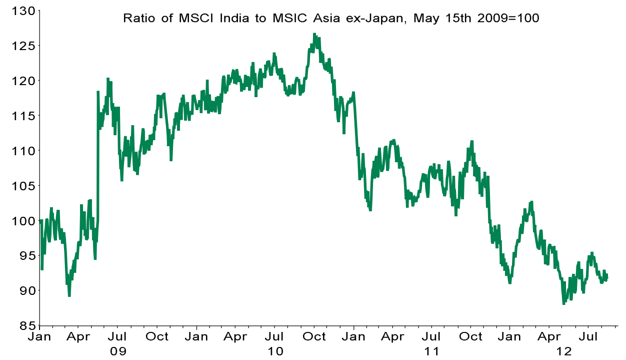


Source: BNP Paribas, Reuters EcoWin Pro

In real, trade-weighted basis, the INR now appears on the weak side historically, having been 'over-valued' for much of 2010 and 2011. Currently, it is running almost a full standard deviation below its long-run average, according to BIS data.

Financial Market Developments – III

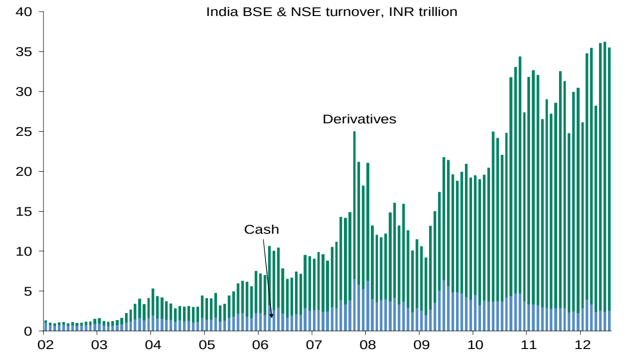
MSCI – India vs. Asia ex-Japan



Source: BNP Paribas, Reuters EcoWin Pro

Indian equities have steadily underperformed regional peers since late September 2010 as the May 2009 election 'reform premium' has slowly evaporated.

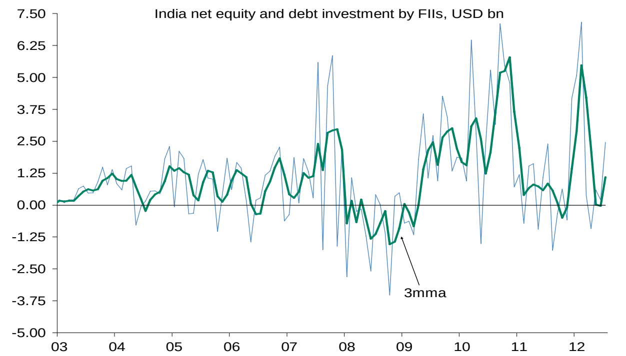
Stock Market Turnover



Source: BNP Paribas, CEIC

Indian equities' lacklustre performance since the final months of 2010 has coincided with steady increases in the activity in the derivatives segment, which now accounts for almost 93% of overall turnover values.

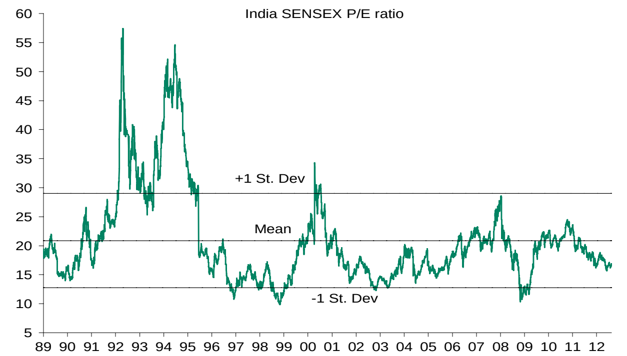
Net Equity & Debt Investment By FIIs



Source: BNP Paribas, Reuters EcoWin Pro

Consistent with equity prices and the INR showing some signs of stabilising of late, foreign institutional investors (FIIs) have once again become net buyers of Indian debt and equities in the three months to July 2012.

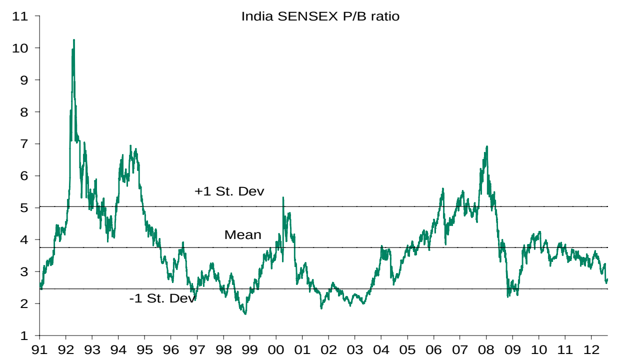
SENSEX Price To Earnings Ratio



Source: BNP Paribas, Reuters EcoWin Pro

The pull-back of Indian equity prices since the final months of 2010 has left SENSEX's price-to-earnings ratio some half of a standard deviation below its long-run average levels to stand at 16.7x currently, having risen to over 24x in October 2010.

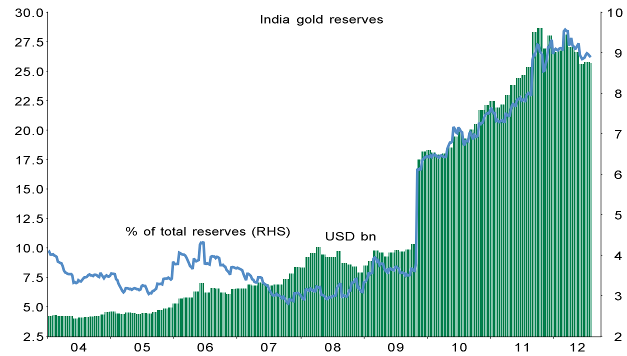
SENSEX Price To Book Value Ratio



Source: BNP Paribas, Reuters EcoWin Pro

The SENSEX's price-to-book value ratio, meanwhile, is running just below 2.8x at present, almost a full standard deviation below its long-run average levels of close to 3¾x.

Gold Reserves

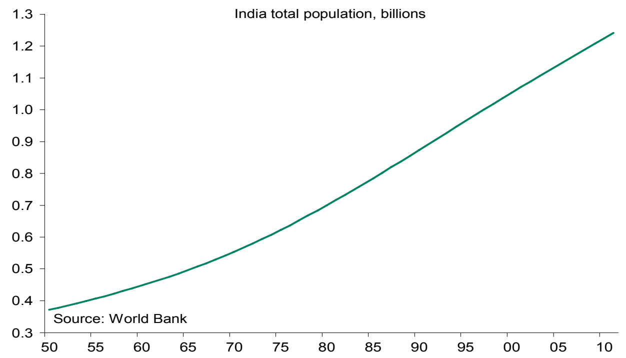


Source: BNP Paribas, Reuters EcoWin Pro

The RBI in early November 2009 bought 200 metric tonnes of gold from the IMF for USD 6.7bn and has since continued to accumulate its gold reserves to now reach almost 9.0% of total reserves holdings.

Population and Demographics – I

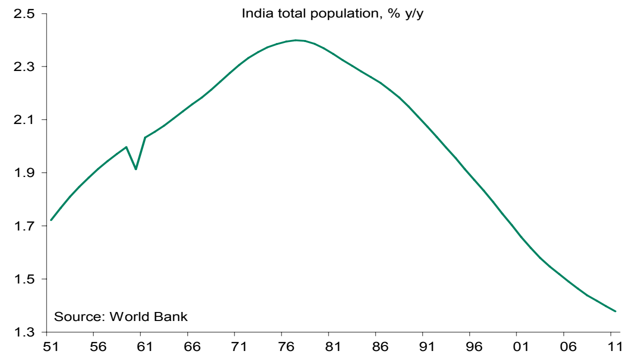
Population – I



Source: BNP Paribas, Reuters EcoWin Pro

According to the World Bank, India's population reached 1.24 billion in 2011, up from 1.07 billion in 2001, 892 million in 1991 and 716 million in 1981. Back in 1951, India's population was a little below 380 million.

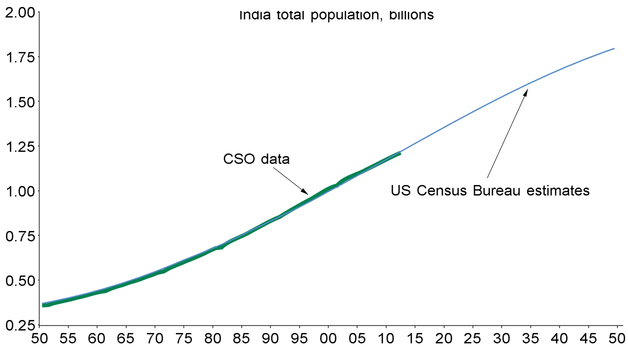
Population – II



Source: BNP Paribas, Reuters EcoWin Pro

India's population growth has clearly slowed. Averaging around 2¼% through the 1960s and 1970s, population growth eased to below 2% in the 1990s, dwindling further this decade. 2011 saw record low growth of just below 1.5%.

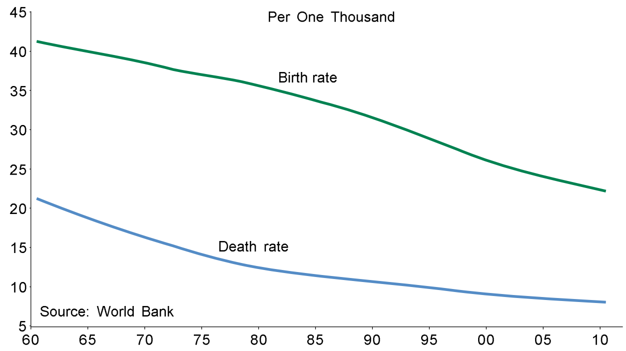
Population Projections



Source: BNP Paribas, Reuters EcoWin Pro

Despite much more sluggish growth, India's population should nonetheless continue to climb. The US Census Bureau projects that India's population should reach almost 1.45 billion by 2025 and over 1.80 billion by 2050.

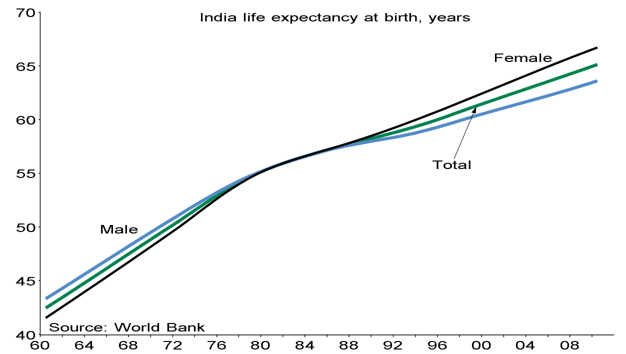
Birth & Death Rates



Source: BNP Paribas, Reuters EcoWin Pro

The key driver of India's slower rate of population growth has been a steady decline in the birth rate, from just over 30 births per 1000 in 1990 to around 22¼ by 2010. The death rate has flattened out at around 8 per 1000.

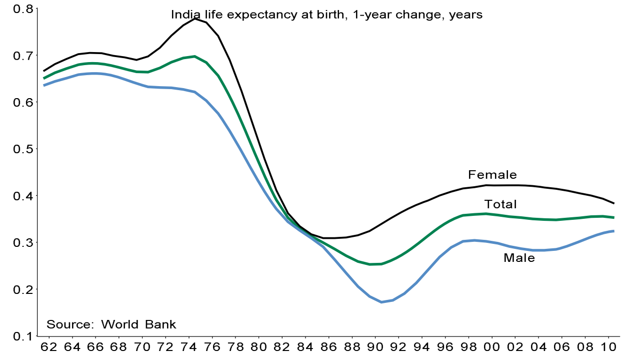
Life Expectancy – I



Source: BNP Paribas, Reuters EcoWin Pro

Life expectancy climbed steadily in the past two decades, rising from around 57½ years in 1987 to just above 65 by 2010. Notably female life expectancy, which until the mid-1980s ran below that of males, exceeds male life expectancy by 3 years.

Life Expectancy – II

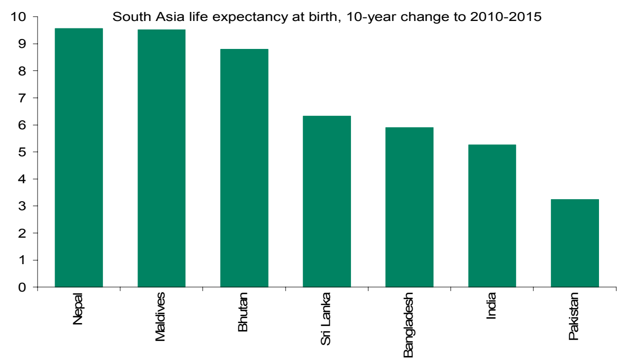


Source: BNP Paribas, Reuters EcoWin Pro

The increase in Indian life expectancy appears to have been structurally lower since the late 1980s. The pace of improvement in female life expectancy has flattened out at just 0.4 year per year but it continues to outperform that in male life expectancy.

Population and Demographics – II

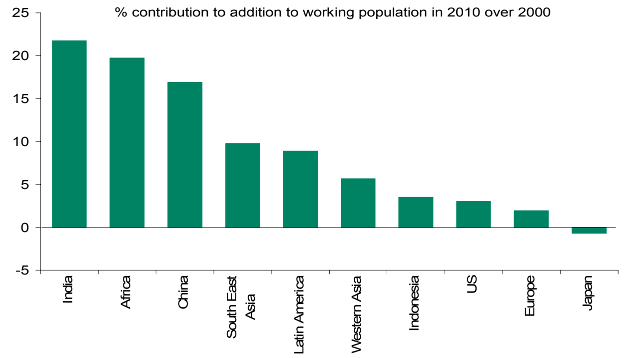
Change In Lift Expectancy By Country



Source: BNP Paribas, United Nations

The improvement in Indian life expectancy over the past decade has been relatively limited, however. Up by around 5⅓ years, it is somewhat below the average increase of over 7 years seen among the rest of its regional peers in South Asia.

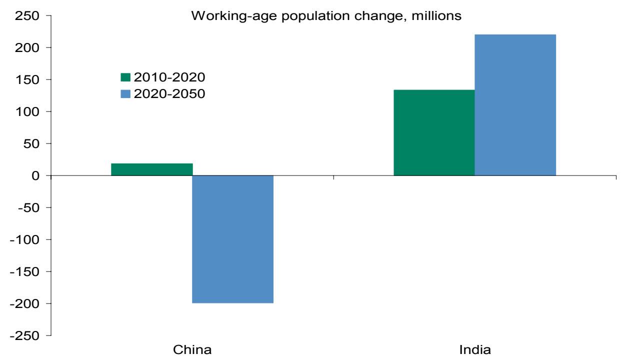
Global Working-Age Population, 2010 over 2000



Source: BNP Paribas, United Nations

With its working age population rising by 23% to close to 790mn in the 10 years to 2010, India has been the main contributor to the world's total working-age population in the past decade.

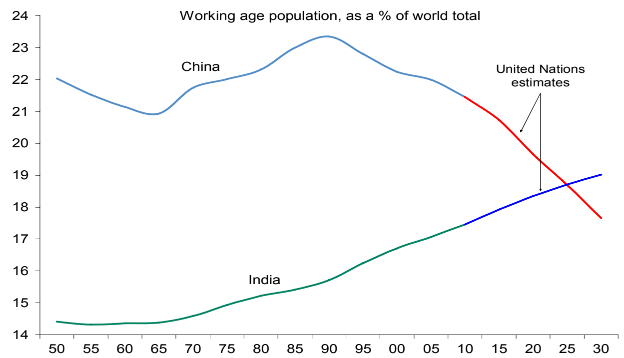
Working-Age Population Change



Source: BNP Paribas, United Nations

By 2050, China's working age population is expected to be lower than current levels. The United Nations projects the decline will set in from 2020. India's, however, is expected to rise by over 350mn, or c.45%, in the coming 40 years.

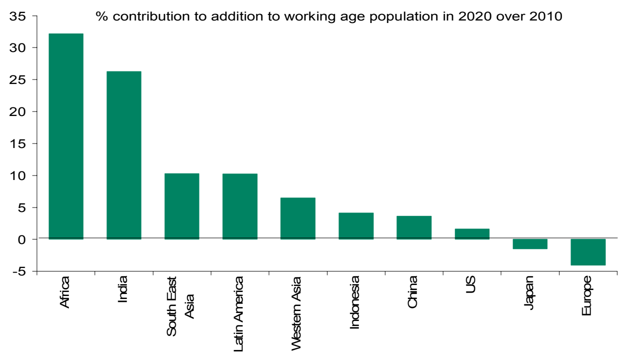
Global Working-Age Population



Source: BNP Paribas, United Nations

China is the world's largest supplier of labour, but India will overtake it by c.2025, according to the United Nations. By 2050, India's working-age population is projected to be 350mn, or c.45% larger than China's.

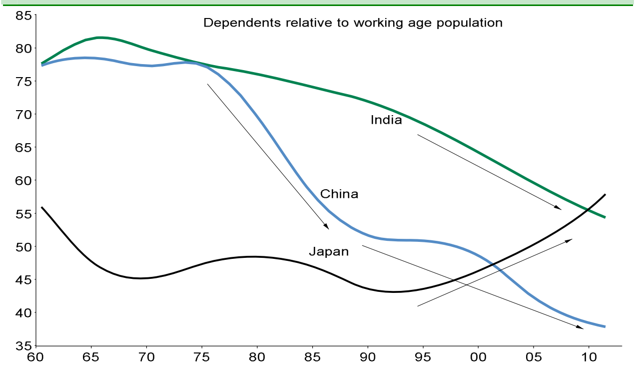
Global Working-Age Population, 2020 over 2010



Source: BNP Paribas, United Nations

In turn, India will remain one of the key marginal suppliers of labour in the global economy. The United Nations projects that India will account for over 1/4 of the 507 million increase in global working-age population over the next 10 years.

Dependency Ratios – I

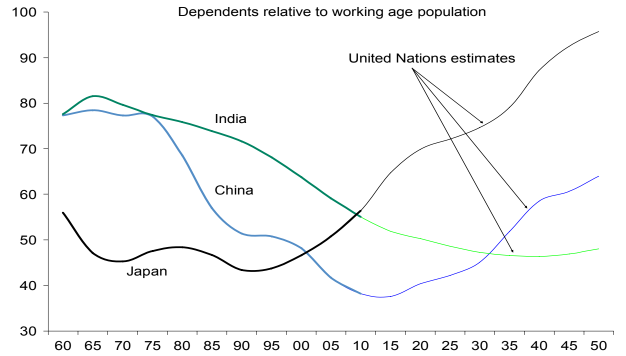


Source: BNP Paribas, United Nations

In the 1960s and much of the 1970s, China and India had similar demographics with dependency ratios, i.e. ratios of elderly and children to working age population, at c.80%. China's ratio began to plummet much faster than India from late 1970s onwards.

Population and Demographics – III

Dependency Ratios – II



Source: BNP Paribas, United Nations

India's demographic position is highly favourable with the secular decline in the dependency ratio set to accelerate in the coming years. By contrast, China is rapidly approaching its demographic inflexion point where the total dependency ratio begins to climb.

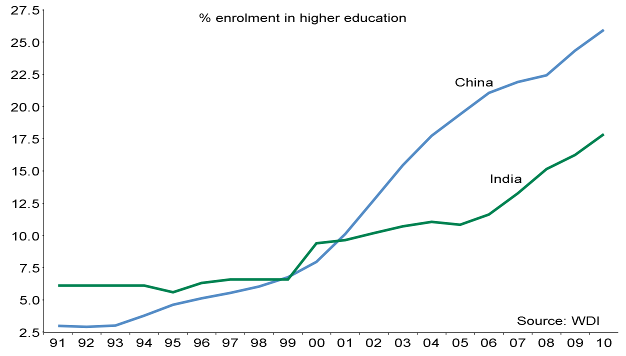
Median Age Of Population

	2005	2010	2015E	2020E
India	23.9	25.1	26.6	28.1
Indonesia	26.0	27.8	29.6	31.4
Brazil	27.1	29.1	31.3	33.4
China	32.2	34.5	36.2	38.1
USA	36.2	36.9	37.3	37.9
Russia	37.3	37.9	38.7	39.8
UK	38.8	39.8	40.3	40.4
Western Europe	40.4	42.1	43.7	44.6
Japan	43.1	44.7	46.4	48.2

Source: BNP Paribas, United Nations

The increasingly divergent trends in 'Chindia's' dependency ratio will inevitably be reflected in the average ages of population. According to United Nations' projections, China's median age will tick up to 38.1 by 2020, compared to India's 28.1.

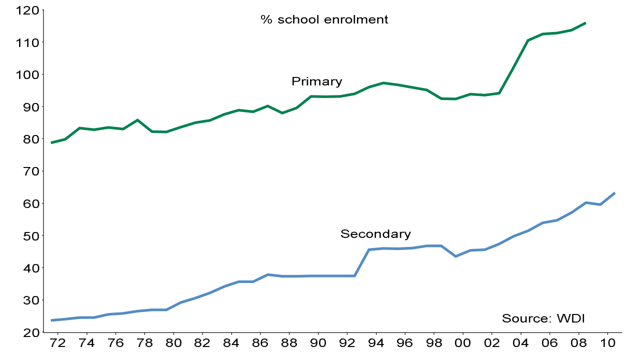
Tertiary Education Enrolment



Source: BNP Paribas, World Bank

While still lagging those in China, trends in education in India have improved and been catching up over the past few years, which clearly help create the platform of productive employment for the rapidly rising working-age population.

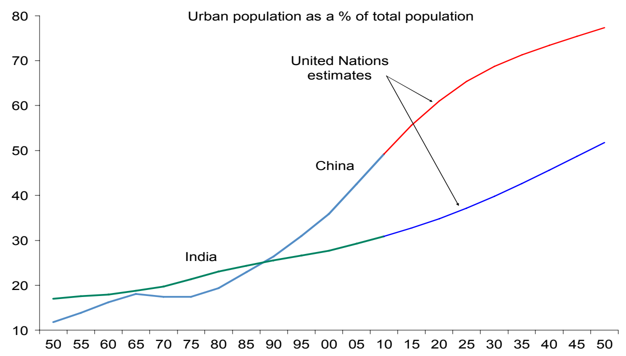
Primary & Secondary Education Enrolments



Source: BNP Paribas, Reuters EcoWin Pro

Trends in primary and secondary education, the completions of which are a minimum condition of tertiary education admission, have also continued to improve, with the enrolment ratios now at record highs.

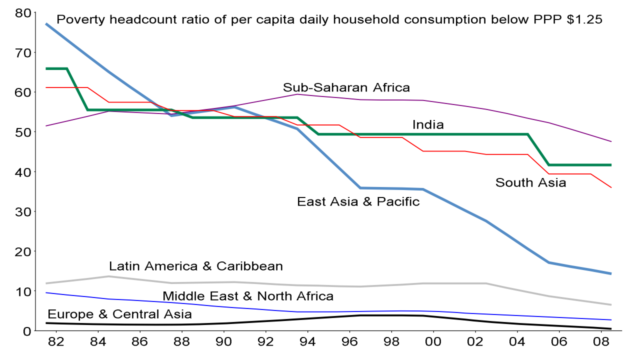
Urban Population



Source: BNP Paribas, United Nations, World Bank

China's much faster pace of urbanisation relative to India's reflects its lead in terms of growth so far although the United Nations' estimates that India will gradually narrow the gap with China in terms of the share of urban population.

Poverty Reduction



Source: BNP Paribas, Reuters EcoWin Pro, World Bank

India has seen one of the slowest rates of poverty reduction in Asia. According to the World Bank, the share of the population living below PPP USD 1.25 per day, while having fallen by over 24% since the early 1980s, remain high at above 40%.

Appendix

Economic and Financial Forecasts

	Fiscal Year					2011				2012				2013			
	'10	'11	'12	'13 (1)	'14 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP	8.3	8.4	6.5	5.7	7.3	9.2	8.0	6.7	6.1	5.3	5.0	6.2	5.3	6.2	6.8	7.4	7.6
Agriculture & Allied Activities	2.0	6.8	2.3	1.2	5.1	6.6	3.1	1.7	2.2	2.0	3.2	2.9	-1.0	0.6	2.1	3.6	7.0
- Agriculture & Forestry & Fishing	1.3	7.0	2.8	1.2	4.9	7.5	3.7	3.1	2.8	1.7	3.9	2.9	-1.5	0.7	1.4	3.0	7.2
- Mining & Quarrying	7.2	5.0	-0.9	1.1	6.3	0.6	-0.2	-5.4	-2.8	4.3	-1.1	2.7	3.1	-0.2	6.5	7.1	5.8
Industry	8.6	7.4	3.8	4.1	7.1	7.6	6.1	4.5	3.0	1.7	2.5	3.5	4.7	5.8	6.7	8.0	6.9
- Manufacturing	9.8	7.6	2.5	2.5	7.1	7.3	7.3	2.9	0.6	-0.3	-1.0	1.5	4.2	5.1	6.6	8.5	6.5
- Electricity, Gas & Water Supply	5.9	3.0	7.9	5.5	5.8	5.1	7.9	9.8	9.0	4.9	6.4	4.9	4.3	6.5	4.6	5.9	6.6
- Construction	7.0	8.0	5.3	7.0	7.6	8.9	3.5	6.3	6.6	4.8	8.4	7.0	5.7	7.0	7.3	7.7	7.7
Services	10.2	9.3	8.9	7.5	8.0	10.6	10.2	8.8	8.9	7.9	6.6	8.0	7.7	7.8	8.0	8.0	8.1
- Trade, Hotel, Transport & Comm.	10.1	11.1	9.9	7.1	8.1	11.6	13.8	9.5	10.0	7.0	4.2	8.2	7.4	8.6	8.1	8.1	8.1
- FIRE & Business Service	8.9	10.4	9.6	8.7	8.5	10.0	9.4	9.9	9.1	10.0	9.4	8.3	8.6	8.5	8.5	8.5	8.5
- Community, Social & Personal Ser.	11.9	4.5	5.8	6.9	7.1	9.5	3.2	6.1	6.4	7.1	8.3	7.2	7.0	5.6	7.0	7.0	7.5
Industrial Production	9.1	6.8	2.6	2.6	6.8	6.3	6.5	2.7	0.9	0.7	-0.3	2.0	4.1	4.6	6.4	8.1	6.4
Private Consumption	7.7	7.5	5.5	5.4	7.0	5.2	6.2	3.1	6.4	6.1	4.6	6.7	4.5	5.7	6.2	6.5	7.6
Public Consumption	12.1	9.7	5.1	5.4	8.0	13.6	4.9	7.2	4.7	4.1	3.6	3.6	6.3	7.3	8.5	7.9	8.2
Fixed Investment	11.0	5.4	5.5	5.3	8.0	-3.2	14.7	5.0	-0.3	3.6	-4.0	4.9	7.9	11.9	7.7	7.9	8.1
Exports	-5.3	24.3	15.3	8.3	15.4	35.4	18.0	19.7	6.1	18.1	13.9	9.9	11.8	0.4	14.2	14.7	15.9
Imports	-1.9	15.5	18.5	8.2	16.3	15.8	19.3	27.0	27.0	2.0	7.9	3.2	3.1	20.2	14.1	15.6	17.0
Memo:																	
Non-Agriculture GDP	9.6	8.6	7.1	6.4	7.7	9.4	8.7	7.2	6.8	5.9	5.2	6.6	6.7	7.0	7.6	8.0	7.7
Nominal GDP (2)	16.4	18.1	15.4	13.3	14.9	15.9	18.9	16.6	14.8	12.2	11.8	12.5	14.0	14.7	14.6	15.2	15.1
Nominal GDP (INR tn) (2)	65.0	76.7	88.6	100.4	115.3	21.8	20.4	20.5	23.1	24.5	22.8	23.1	26.4	28.1	26.1	26.6	30.4

	Calendar Year					2011				2012				2013			
	'09	'10	'11	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
GDP	7.6	8.2	7.5	5.4	7.0	9.2	8.0	6.7	6.1	5.3	5.0	6.2	5.3	6.2	6.8	7.4	7.6
Memo:																	
Non-Agriculture GDP	8.9	8.6	8.0	6.1	7.6	9.4	8.7	7.2	6.8	5.9	5.2	6.6	6.7	7.0	7.6	8.0	7.7

	Calendar Year					2011				2012				2013			
	'09	'10	'11	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation																	
WPI	2.4	9.6	9.5	7.6	7.8	9.6	9.6	9.7	9.0	7.5	7.4	7.2	8.5	8.6	7.7	7.7	7.1
WPI (Food)	12.1	13.9	7.9	8.8	9.9	8.0	8.4	8.8	6.6	5.3	9.1	8.6	12.0	13.4	9.6	9.2	7.7
WPI (ex. Food & Energy)	0.2	7.0	9.2	6.3	7.1	9.7	9.4	9.3	8.6	6.6	5.6	6.4	6.8	6.9	7.0	7.2	7.3
CPI - Industrial Workers	10.9	12.0	8.9	9.0	8.6	9.0	8.9	9.2	8.4	7.2	10.1	8.9	9.8	10.5	8.4	8.1	7.3

	Fiscal Year					2011				2012				2013			
	'10	'11	'12	'13 (1)	'14 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
External Trade																	
Trade Balance (USD bn)	-118.4	-130.5	-189.8	-179.6	-205.7	-	-	-	-	-	-	-	-	-	-	-	-
Current Account (USD bn)	-38.4	-45.3	-78.2	-60.3	-55.5	-	-	-	-	-	-	-	-	-	-	-	-
Current Account (% of GDP)	-2.8	-2.7	-4.2	-3.3	-2.4	-	-	-	-	-	-	-	-	-	-	-	-

	Fiscal Year					2011				2012				2013			
	'10	'11	'12	'13 (1)	'14 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Cen. Gov. Budget (INR tn)	-4.2	-3.7	-5.2	-6.1	-6.1	-	-	-	-	-	-	-	-	-	-	-	-
Cen. Gov. Budget (% of GDP)	-6.5	-4.9	-5.9	-6.1	-5.3	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% of GDP)	-3.2	-1.8	-2.8	-3.1	-2.2	-	-	-	-	-	-	-	-	-	-	-	-
Gross Cen. Gov. Debt (% GDP) (3)	49.4	46.4	46.1	46.8	46.0	-	-	-	-	-	-	-	-	-	-	-	-

	Calendar Year					2011				2012				2013			
	'09	'10	'11	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest and FX Rates (3)																	
Repo Rate (%)	4.75	6.25	8.50	7.75	7.75	6.75	7.50	8.25	8.50	8.50	8.00	8.00	7.75	7.75	7.75	7.75	7.75
3-Month Rate (%)	4.18	8.59	9.55	8.50	8.25	9.85	9.15	9.23	9.55	10.71	9.21	8.90	8.50	9.00	8.50	8.25	8.25
USD/INR	46.53	44.70	53.07	54.00	50.00	44.72	45.00	48.97	53.07	50.00	55.80	55.00	54.00	53.00	52.00	51.00	50.00

Footnotes: (1) Forecast (2) At market prices (3) End period.
Figures are year on year percentage changes unless otherwise indicated
Source: BNP Paribas

The Balance of Payments (USD bn)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Gross international reserves	42.9	54.7	76.1	113.0	141.5	151.6	199.2	309.7	252.0	279.1	304.8	294.4
% of GDP	9.3	11.5	15.0	18.7	19.5	18.2	20.9	24.8	20.9	20.2	18.0	16.0
Change in international reserves	4.2	11.8	21.4	36.9	28.6	10.1	47.6	110.5	-57.7	27.1	25.8	-10.4
1 Current account balance	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.2	-45.9	-78.2
% of GDP	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.7	-4.2
Merchandise trade balance	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.2	-130.6	-189.8
% of GDP	-2.7	-2.4	-2.1	-2.3	-4.7	-6.2	-6.5	-7.3	-9.9	-8.5	-7.7	-10.3
2 Capital account balance	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	7.4	51.6	62.0	67.8
FDI, net	3.3	4.7	3.2	2.4	3.7	3.0	7.7	15.9	22.4	18.0	9.4	22.1
Portfolio flows, net	2.6	2.0	0.9	11.4	9.3	12.5	7.1	27.4	-14.0	32.4	30.3	17.2
3 Errors and omissions, net	-0.3	-0.2	-0.2	0.6	0.6	-0.5	1.0	1.3	0.4	0.0	-3.0	-2.4
4 Valuation change	-1.7	0.1	4.4	5.4	2.4	-4.9	11.0	18.4	-37.7	13.6	12.7	2.4
Memo:												
Non-FDI capital account balance (including errors and omissions)	5.3	3.6	7.4	15.0	24.9	21.9	38.5	92.0	-14.5	33.7	49.6	43.3
GDP At Current Market Prices	459.3	477.3	508.9	603.6	724.4	835.0	955.3	1248.9	1205.8	1382.7	1689.7	1842.7

Footnotes: The non-FDI capital account balance is the capital account balance minus net FDI plus net errors and omissions

Source: BNP Paribas, CEIC

Capital Account – Gross Inflows

	Total		FDI	Portfolio	Loans	Other
	USD bn	% of GDP	% of Total			
1996/97	36.2	9.3	7.9	13.7	49.0	29.4
1997/98	39.3	9.6	9.4	14.2	44.0	32.4
1998/99	34.2	8.2	7.8	9.4	43.2	39.5
1999/00	40.5	9.0	5.6	24.6	32.2	37.6
2000/01	54.1	11.8	7.6	25.2	44.0	23.3
2001/02	43.3	9.1	14.4	21.4	26.8	37.4
2002/03	46.4	9.1	11.1	19.0	24.9	44.9
2003/04	75.9	12.6	5.9	37.2	25.9	31.0
2004/05	98.5	13.6	6.2	41.5	30.7	21.6
2005/06	144.4	17.3	6.4	47.2	27.3	19.1
2006/07	233.3	24.5	10.1	47.0	23.4	19.5
2007/08	438.4	35.2	8.5	53.3	18.8	19.4
2008/09	315.8	25.9	13.6	40.7	19.7	25.9
2009/10	345.8	25.1	11.1	46.3	21.4	21.1
2010/11	499.4	29.6	7.1	50.9	21.6	20.5
2011/12	478.8	25.9	10.2	38.8	29.4	21.6

Source: BNP Paribas, CEIC

Capital Account – Gross Outflows

	Total		FDI	Portfolio	Loans	Other
	USD bn	% of GDP	% of Total			
1996/97	24.2	6.2	0.8	6.8	53.4	39.0
1997/98	29.4	7.2	0.5	12.7	42.5	44.4
1998/99	25.7	6.2	1.0	12.8	40.2	46.0
1999/00	30.1	6.7	0.6	23.0	38.1	38.2
2000/01	45.3	9.9	1.8	24.4	40.9	32.9
2001/02	34.7	7.3	4.3	21.1	37.1	37.6
2002/03	35.5	7.0	5.5	22.2	43.4	28.9
2003/04	59.1	9.9	3.5	28.5	40.6	27.4
2004/05	70.5	9.7	3.4	44.8	27.5	24.4
2005/06	118.9	14.2	5.2	46.8	26.6	21.5
2006/07	188.1	19.7	8.5	54.5	16.0	21.0
2007/08	331.8	26.7	6.5	62.2	12.5	18.8
2008/09	308.4	25.3	6.7	46.3	17.5	29.6
2009/10	294.1	21.4	7.0	43.4	21.0	28.6
2010/11	437.4	25.9	6.0	51.1	18.1	24.8
2011/12	411.1	22.2	6.6	41.0	29.6	22.9

Source: BNP Paribas, CEIC

Monetary Aggregates (12-month change, INR bn)

	2011						2012					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
M3 (1+2+3 = 4+5+6+7-8)	9735	9985	9803	9045	9435	9920	9213	8872	8551	8760	8939	10281
Components												
1 Currency with the Public	1213	1200	1160	1121	1061	1088	1080	1101	1147	1193	1224	1097
2 Aggregate Deposits with Banks	8552	8797	8661	7952	8398	8846	8240	7796	7413	7584	7731	9184
2.1 Demand Deposits with Banks	-484	-385	-504	-834	-738	-15	75	-29	-180	153	171	995
2.2 Time Deposits with Banks	9037	9182	9165	8786	9135	8861	8165	7825	7592	7432	7560	8189
3 'Other' Deposits with Banks	-31	-12	-17	-29	-24	-14	-107	-25	-8	-17	-16	0
Sources												
4 Net Bank Credit to Government	3892	3938	3875	4011	4026	4406	4655	4563	3857	4563	4243	4554
4.1 RBI's Net Credit to Government	1495	1605	1499	1891	1574	1861	2491	1882	1392	1841	1744	1915
4.1.1 RBI's Net Credit to the Centre	1495	1605	1495	1907	1575	1861	2498	1893	1404	1832	1751	1916
4.2 Others Banks' Credit to Government	2397	2333	2376	2120	2452	2545	2164	2682	2465	2722	2499	2639
5 Bank Credit to Commercial Sector	6835	7436	7205	7285	6769	6504	6662	6495	7228	7462	7339	8009
6 NFEA of Bank Sector	843	1372	1904	2560	2101	2469	1059	869	1504	1615	2037	2632
6.1 NFA of the RBI	848	1376	2077	2733	2274	2426	1017	826	1436	1547	1969	2330
7 Government's Currency Liabilities to the Public	14	14	13	15	15	15	15	15	16	16	16	15
8 Net Non-Monetary Liabilities of the Banking Sector	1701	2775	3194	4825	3476	3474	3178	3070	4053	4896	4695	4928
Memo:												
M3 (% y/y)	16.7	17.1	16.6	14.9	15.5	15.9	14.7	13.9	13.1	13.2	13.4	15.4

Source: BNP Paribas, CEIC

Union Budget Highlights (INR crore)

	2009/10 Actuals	2010/11 Actuals	2011/12 Actuals	2012/13 Budget Estimates	2012/13 BE over 20011/12 (%)
1 Revenue Receipts	572811	788471	756193	935685.0	23.7
2 Tax Revenue (net to Centre)	456536	569869	631886	771071.0	22.0
3 Non-tax Revenue	116275	218602	124307	164614.0	32.4
4 Capital Receipts (5+6+7)	451676	408857	542251	555240	2.4
5 Recoveries of Loans	8613	12420	16898	11650.0	-31.1
6 Other Receipts	24581	22846	15622	30000.0	92.0
7 Borrowings and other Liabilities	418482	373591	509731	513590.0	0.8
8 Total Receipts (1+4)	1024487	1197328	1298444	1490925	14.8
9 Non-plan Expenditure	721096	818299	884931	969900.0	9.6
10 On Revenue Account of which,	657925	726491	806820	865596.0	7.3
11 Interest Payments	213093	234022	272455	319759.0	17.4
12 On Capital Account	63171	91808	78111	104304.0	33.5
13 Plan Expenditure	303391	379029	413513	521025.0	26.0
14 On Revenue Account	253884	314232	334095	420513.0	25.9
15 On Capital Account	49507	64797	79418	100512.0	26.6
16 Total Expenditure (9+13)	1024487	1197328	1298444	1490925	14.8
17 Revenue Expenditure (10+14)	911809	1040723	1140915	1286109	12.7
18 of which, Grants for Creation of Capital Assets	112678	156605	157529	204816	30.0
19 Capital Expenditure (12+15)	338998	252252	384722	350424	-8.9
20 Revenue Deficit (17-1)	5.2	3.3	4.3	3.4	-0.9
(% of GDP)	418482	373591	509731	513590	0.8
21 Fiscal Deficit {16-(1+5+6)}	6.5	4.9	5.8	5.1	-0.7
(% of GDP)	205389	139569	237276	193831	-18.3
22 Primary Deficit (21-11)	3.2	1.8	2.7	1.9	-0.8
(% of GDP)					
Memo:					
GDP At Current Market Prices	6457352	7674148	8855797	10159884	14.7

Source: Ministry of Finance

Balance Sheet of Indian Scheduled Commercial Banks – Business in India (INR bn)

	2011						2012					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Liabilities (1+2+3+4+5)	60957	61431	63649	63008	63011	64860	64320	64674	66200	67417	67983	69409
1 Liabilities with Banking System	1053	1054	1079	1068	1009	1190	1176	1177	1223	1283	1140	1192
2 Deposits	54854	55135	57130	56430	56622	58325	57720	58199	59091	60531	60860	62292
3 Borrowings, other than RBI, IDBI, NABARD, IEB	1523	1624	1830	1930	1789	1576	1834	1813	2065	2070	2205	2034
4 Other Demand and Time Liabilities	3504	3602	3570	3543	3532	3709	3498	3431	3734	3455	3709	3820
5 Borrowings from Reserve Bank	24	17	40	38	58	59	93	55	88	78	70	71
Assets (6+7+8+9+10)	62323	62941	65216	64099	64716	66388	66249	66773	68870	69785	70143	71787
6 Cash in Hand	354	355	370	406	381	379	371	367	361	391	388	409
7 Balance with Reserve Bank	3598	3624	4025	3509	3714	3506	3684	3117	3233	3234	3150	3254
8 Assets with Banking System	1425	1464	1730	1547	1454	1887	1753	1741	1779	1948	1827	1889
9 Investment	16832	17022	16858	17064	17107	16948	16914	17457	17378	18101	18150	18626
9.1 Government Securities	16788	16981	16819	17024	17067	16915	16883	17428	17350	18071	18123	18600
9.2 Other Securities	44	40	39	40	39	33	31	29	28	30	28	27
10 Bank Credits	40114	40476	42233	41575	42061	43669	43527	44091	46119	46112	46628	47608
10.1 Food Credits	705	736	693	727	785	846	831	832	813	895	1080	1075
10.2 Non Food Credits	39409	39741	41540	40848	41276	42823	42696	43259	45306	45217	45548	46533

Source: BNP Paribas, CEIC

India: Upcoming Key Economic Release Dates

Date	Country	Event	Reference Period
August 2012			
31	India	GDP	FY2013 Q1
September 2012			
03	India	Manufacturing PMI	August 2012
03	India	Merchandise Trade	July 2012
05	India	Services PMI	August 2012
09-12	India	Local Car Sales	August 2012
11	India	Manpower Survey	2012 Q4
12	India	Industrial Production	July 2012
14	India	WPI	August 2012
17	India	RBI Monetary Policy Review	–
18	India	CPI	August 2012
28	India	Current Account Balance	FY2013 Q1
October 2012			
01	India	Merchandise Trade	August 2012
01-02	India	Manufacturing PMI	September 2012
04-05	India	Services PMI	September 2012
09-12	India	Local Car Sales	September 2012
12	India	Industrial Production	August 2012
12	India	WPI	September 2012
18	India	CPI	September 2012
30	India	RBI Monetary Policy Review	–
November 2012			
01	India	Merchandise Trade	September 2012
01-02	India	Manufacturing PMI	October 2012
05-06	India	Services PMI	October 2012
09-12	India	Local Car Sales	October 2012
12	India	Industrial Production	September 2012
14	India	WPI	October 2012
19	India	CPI	October 2012
30	India	GDP	FY2013 Q2
December 2012			
03	India	Merchandise Trade	October 2012
03-04	India	Manufacturing PMI	November 2012
05-06	India	Services PMI	November 2012
09-12	India	Local Car Sales	November 2012
11	India	Manpower Survey	2013 Q1
12	India	Industrial Production	October 2012
14	India	WPI	November 2012
18	India	CPI	November 2012
31	India	Current Account Balance	FY2013 Q2

Source: Bloomberg. Releases dates as of 23 August 2012

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