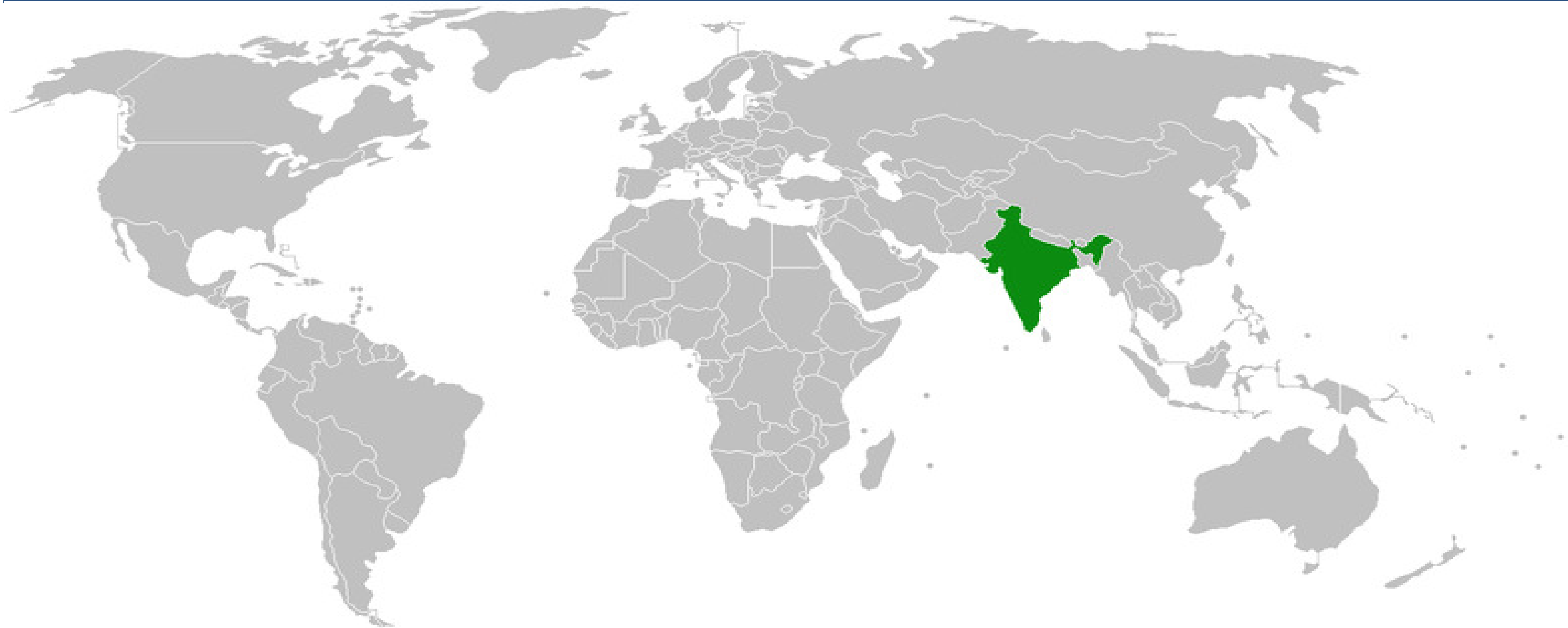
India: Coping with tardy growth of the Economy; Analyzing Concern Areas and Longer Term Opportunities

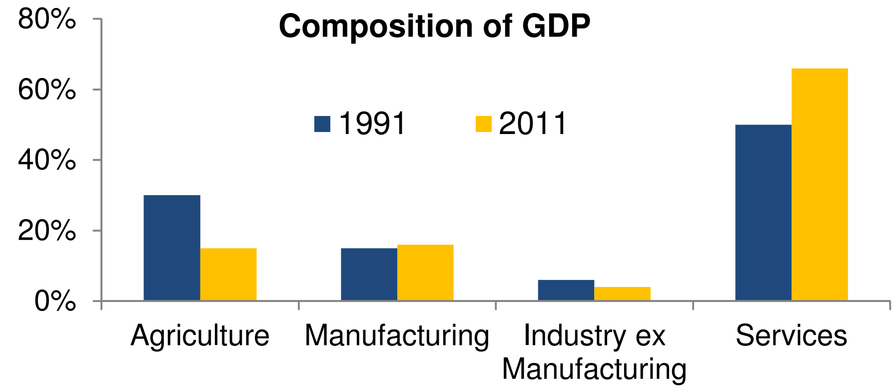


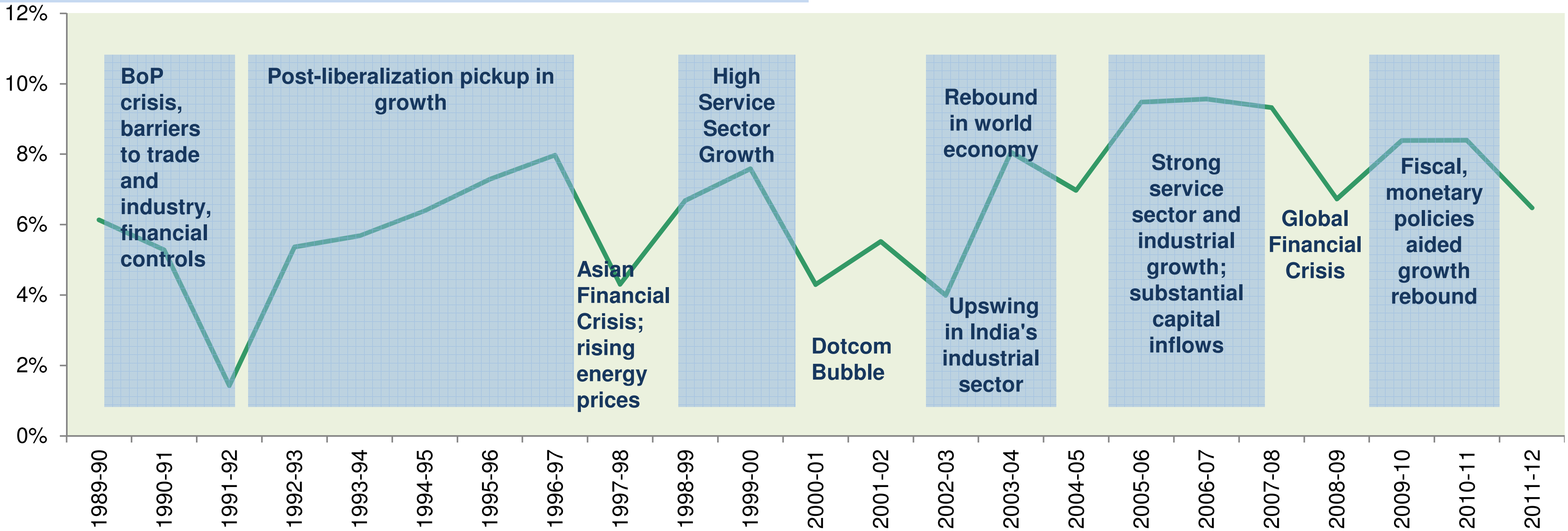
A Presentation by
Karthik Srinivasan, Co-Head Financial Sector Ratings
ICRA Limited, An Associate of Moody's Investors Service

Presentation Outline

Transformation of Indian Economy Post-Liberalization

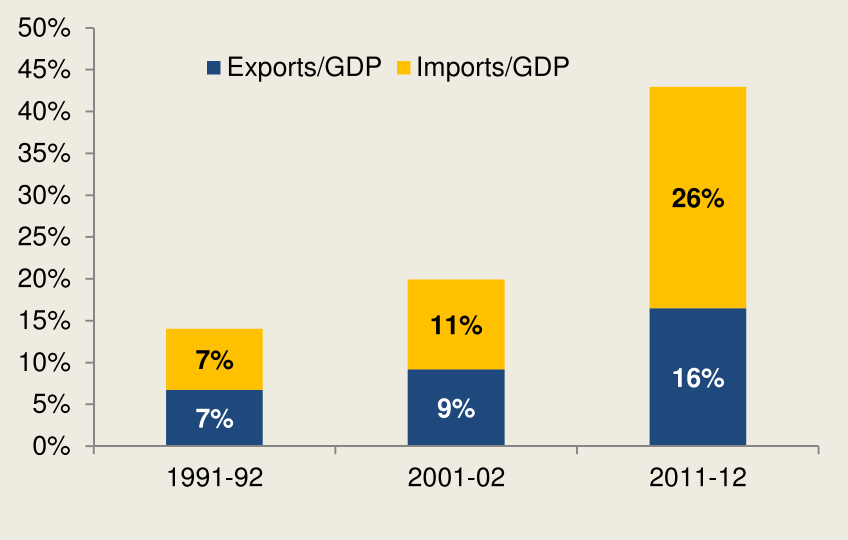
- GDP growth rose to 8.4% in 2003-11 from 5.5% in 1991-03.
- Structure of GDP transformed; share of agriculture halved, offset by an increase in the services sector.
- Per capita income improved to ~USD 3,620 in PPP terms in 2011 from ~USD 880 in 1991.
- Poverty declined to 30% in FY10 from 36% in FY94.



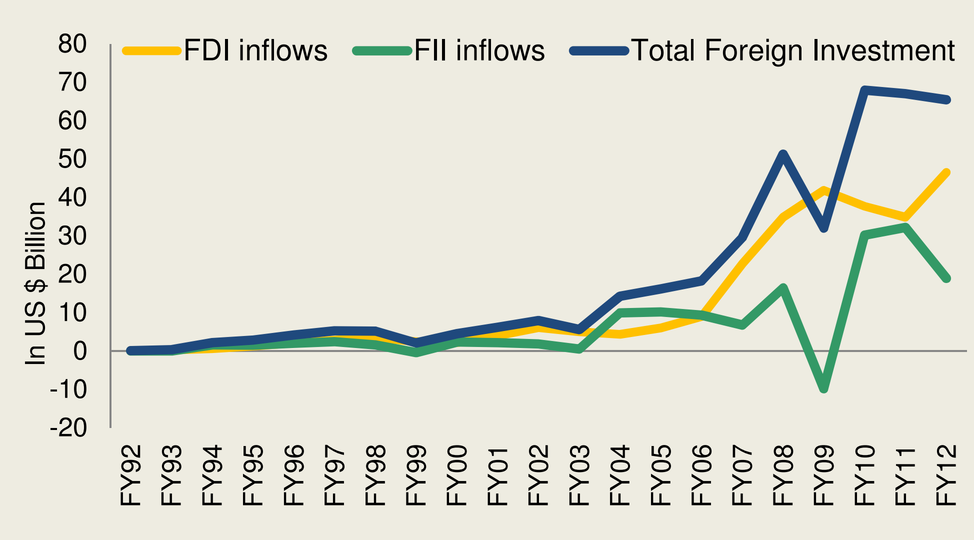


Source: Central Statistics Office (CSO)

Sharp Rise in Trade and Financial Flows



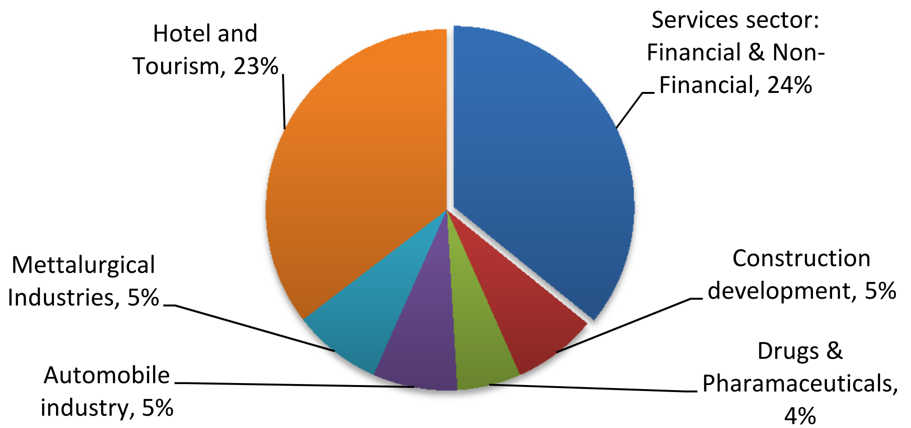
Source: CSO& RBI



Source: SEBI & RBI

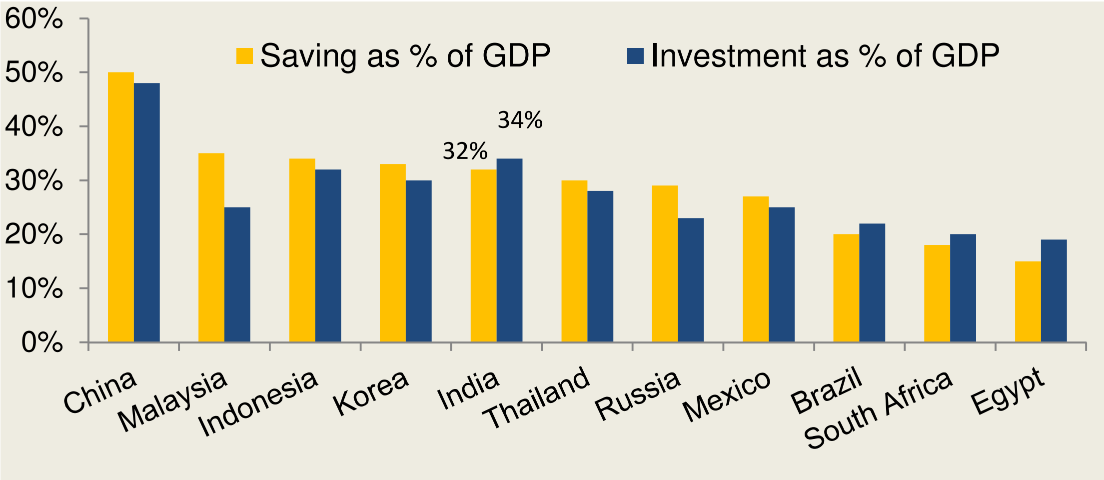
- Liberalization of FDI regime during the course of 1990's and particularly in 2000's propelled growth in several sectors.
- FDI net inflows have grown at a rate of over 30% compounded annually over the last decade.
- FII inflows dipped in 2011-12 after recording record highs in in 2009-10 and 2010-11; vulnerability to global liquidity and risk sentiments.

Top Sectors attracting FDI in H1FY13

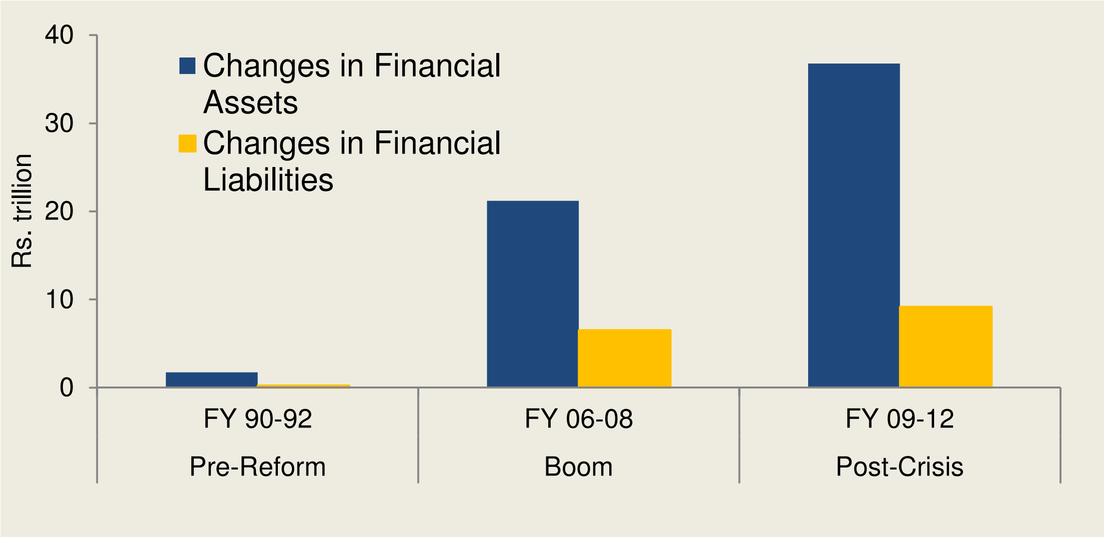


Source: Department of Industrial Policy & Promotion

Substantial Domestic Savings; Under-leveraged Households



Source: Department of Economic Affairs, GOI



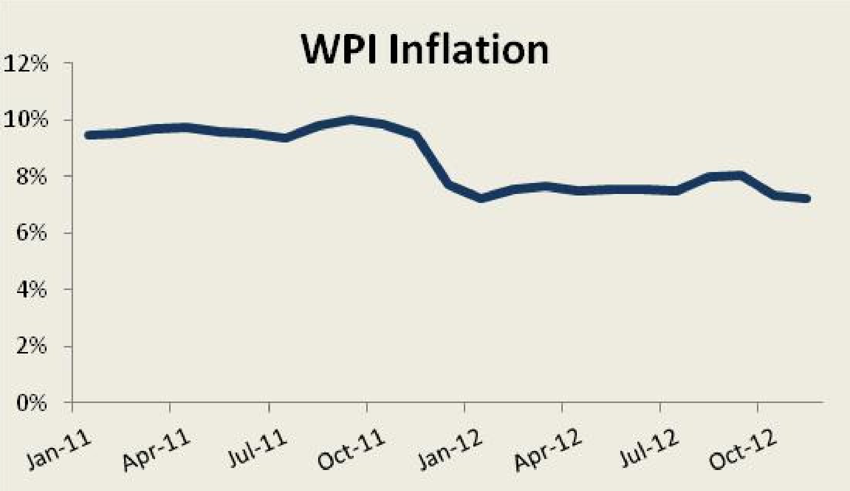
Source: RBI

- Substantial savings of the household sector provide domestic pool of capital for economic activity.
- Faster growth of household financial assets (primarily bank deposits) relative to household borrowings since 2004; relatively under-leveraged nature of Indian households to aid an improvement in penetration levels for various products.
- Concentration of household savings in physical assets and gold persists; financial instruments required to channelize savings into infrastructure and other sectors.

Domestic, External Factors Cloud Macroeconomic Scenario

- **Economic growth** likely to ease to 5.4% in FY13 from 6.5% in FY12, while outpacing most other countries.
  - *Smaller, less-developed States may grow faster than the Indian average.*
- **Inflation** expected to remain above the Central Bank's comfort zone.
- **Monetary Policy** likely to ease in near term, while remaining significantly tighter than Advanced Economies**.**
- **Current account deficit** likely to remain high at above 4.0% of GDP in FY13.
- **Refinancing risks** for short term external debt; vulnerability to global liquidity conditions and risk sentiments.

Source: CSO



Source: Office of the Economic Advisor, GoI

Recent Moderation in Economic Growth

- Growth eased to 6.5% in 2011-12, lower than the 6.7% growth recorded in 2008-09 after the onset of the global economic crisis.
- Further moderation in growth to 5.4% in H1FY13; sub-6% growth for three consecutive quarters.

Growth of GDP & Components (in %, constant 2004-05 prices, y-o-y

	Q1FY13	Q2FY13	FY12	H1FY13
Agriculture & Allied	2.9%	1.2%	2.8%	2.1%
Industry	3.6%	2.8%	3.4%	3.2%
- Manufacturing	*0.2%*	0.8%	*2.5%*	*0.5%*
Services	6.9%	7.2%	8.9%	7.0%
GDP at factor cost	**5.5%**	**5.3%**	**6.5%**	**5.4%**
Private Final Consumption	4.0%	3.7%	5.5%	3.8%
Government Final Consumption	9.0%	8.7%	5.1%	8.8%
Gross Fixed Capital Formation	0.7%	4.1%	5.5%	2.3%
GDP at market prices	**3.9%**	**2.8%**	**6.9%**	**3.4%**

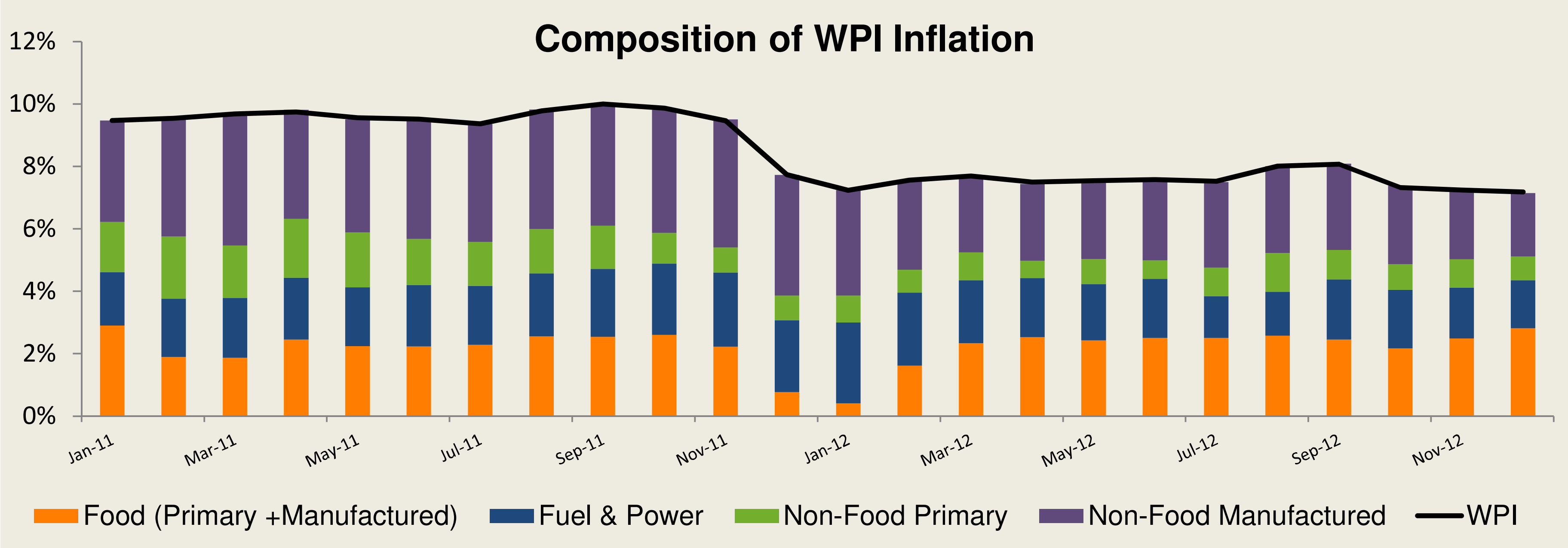
Consumption Growth Moderates further

- Private consumption growth moderated to 3.7% in Q2FY13.
- Consumption sentiments are yet to witness a substantial and sustainable improvement:
  - Sluggish growth of basic, intermediate goods: muted demand for finished goods.
  - Inventory build-up to meet festive season demand boosted the growth of consumer durables to 9.3% in October-November 2012.
  - The pickup in the pace of growth of consumer non-durables reflects a modest improvement in rural consumption demand with *kharif* production likely to be somewhat better than what was previously expected.

	Q1FY13	Q2FY13	Oct-Nov 2012
IIP	-0.3%	0.4%	4.0%
Basic Goods	3.3%	2.2%	2.9%
Capital Goods	-20.1%	-7.9%	-0.6%
Intermediate Goods	0.8%	1.5%	4.0%
Consumer Durables	8.0%	0.0%	9.3%
Consumer Non-Durables	0.6%	2.7%	5.1%

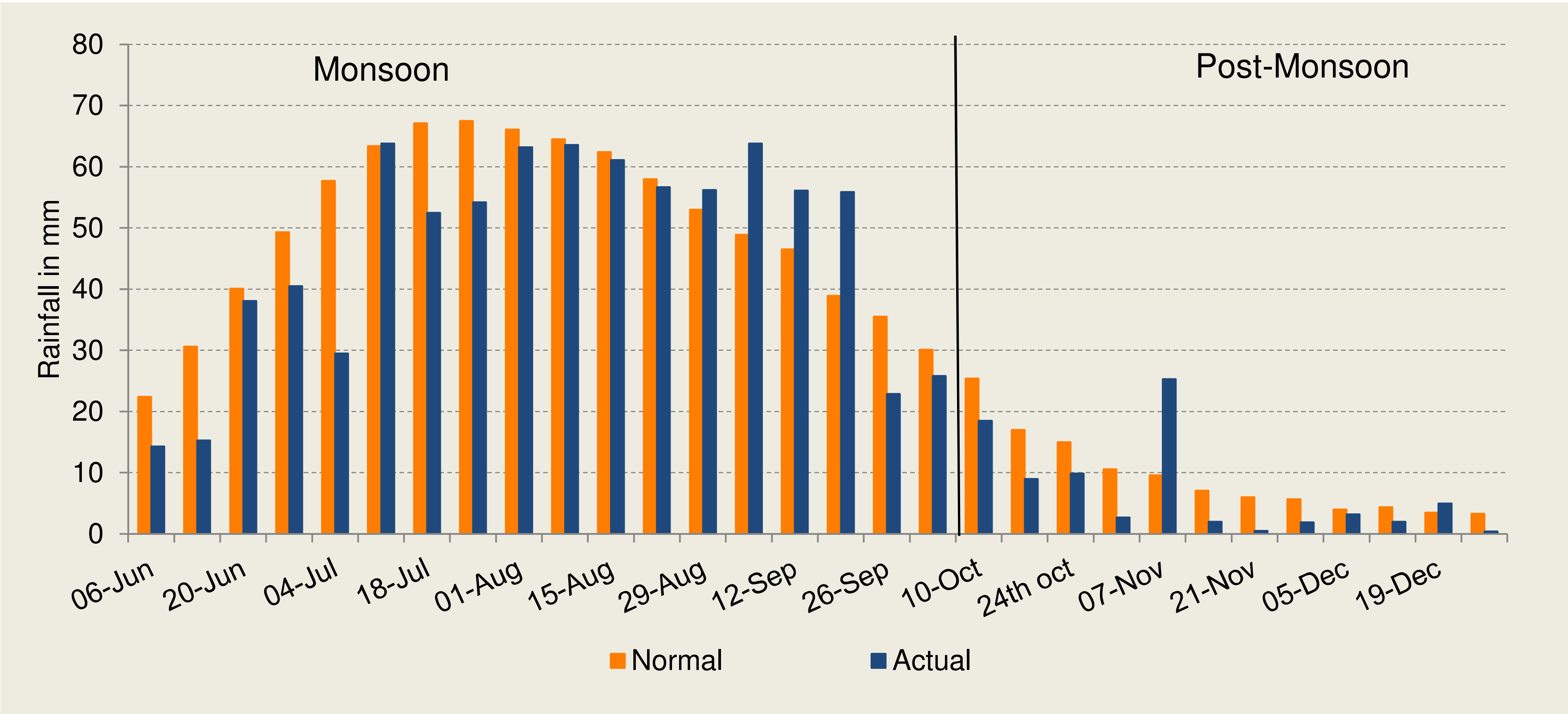
Wholesale Inflation eases while Retail Inflation firms up

- WPI inflation has eased since August 2012; core inflation moderated to 4.2% indicating some weakening of pricing power.
- Retail inflation (new CPI Index) rose above 10% in December 2012; double-digit food inflation likely to keep inflationary expectations elevated.



Sticky Food inflation to keep Indian Inflation High

- Deficit in monsoon rainfall and shortfall in *kharif* sowing to impact food inflation in FY13.
- Annual trend of increase in minimum support prices exerts pressure on food prices.
- Changing preferences for protein-rich foods with rising incomes.

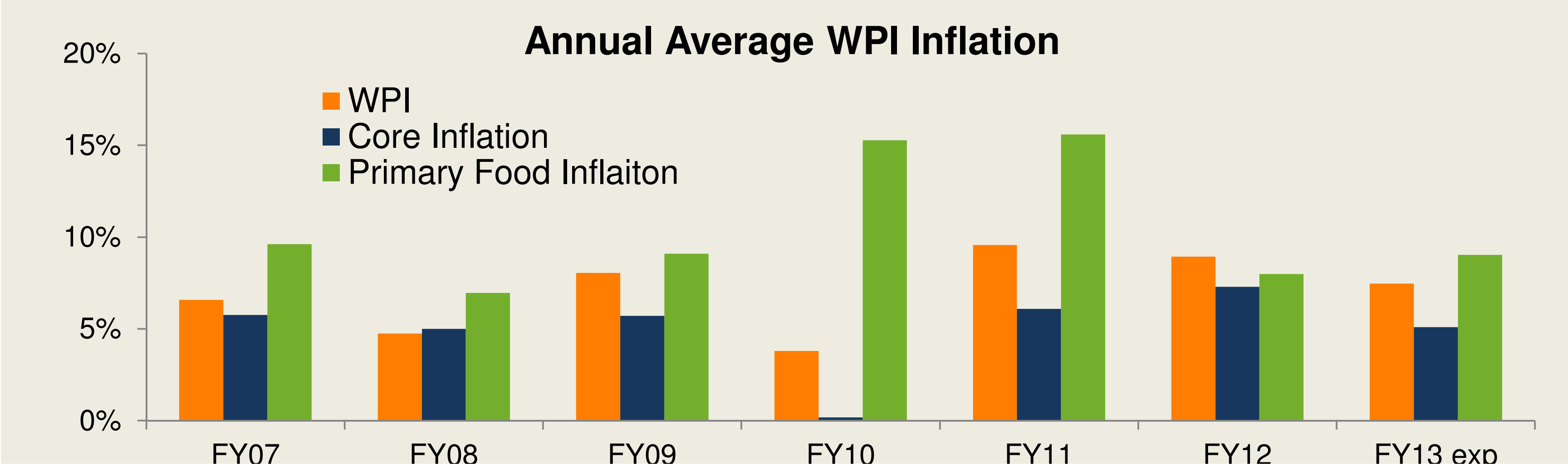


Core Inflation Likely to remain Firm

- Commodity prices and exchange rate movements will critically influence price trends.
- Generalisation of inflationary pressures related to high food prices and rising wages in excess of productivity increases exerting cost-push pressures to prices of various products over the near-to-medium term.

Baseline Projections for Medium Term:

- Food inflation : 6-9%
- Core inflation: 5-6%
- WPI inflation: 6-8%



Fiscal Concerns persist

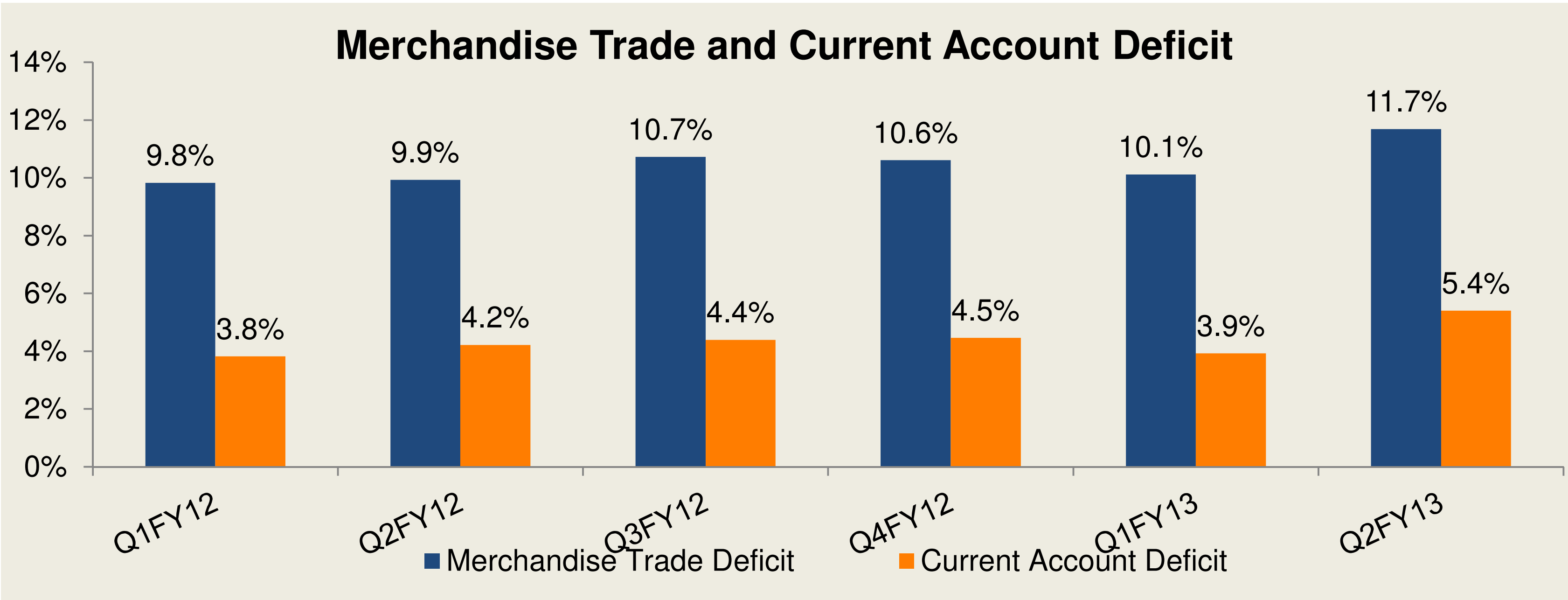
- While growth has slowed, cyclical and structural factors keeping deficits large, reducing flexibility to address shocks through fiscal policies.
- Reflecting the moderate income level, the ratio of revenues to GDP is smaller than similarly-rated countries, highlighting the need for reforms to widen the tax base.
- Interest payments appropriate a considerable share of Government revenues.
- Revenue expenditure rigidity (high subsidies, committed expenditure) limits space for stimulating growth through higher capex, contributes to crowding out of private sector.
- Continued economic growth (in nominal terms) would result in a moderation in debt/GDP.

Country	Rating assigned by Moody's	GDP				General Government Fiscal Indicators			
		USD billion	Per capita (PPP)	Real GDP Growth		Fiscal Deficit/ GDP	Revenue/ GDP	Debt/ GDP	Interest/ Revenue
		2011	*2011*	*2010*	*2011*	*2011*	*2011*	*2011*	*2011*
India	***Baa3***	***1,860***	***3,620***	***8.4%***	***6.5%***	***-9.0%***	***18.7%***	***74%***	***27%***
Indonesia	Baa3	847	4,530	6.2%	6.5%	-1.1%	16.1%	24%	8%
Spain	Baa3	1,492	31,660	-0.1%	0.7%	-8.9%	35.1%	69%	7%
Brazil	Baa2	2,477	11,500	7.5%	2.7%	-3.5%	36.1%	54%	19%
Russia	Baa1	1,850	19,940	4.3%	4.3%	1.6%	38.4%	12%	1%
South Africa	A3	408	10,790	2.9%	3.1%	-4.5%	33.9%	38%	7%
China	Aa3	7,204	8,450	10.3%	9.2%	-1.3%	22.6%	31%	4%

Source: Moody's *www.moodys.com*; *World Bank for Per Capita GDP*

Record high Current Account Deficit Causing Concern

- Merchandise trade deficit to remain high despite weak Rupee.
- Service exports may improve in Q3FY13, given software companies' results.
- Current Account Deficit expected to exceed 4% of GDP in 2012-13.
- Extent of capital inflows remains critical.



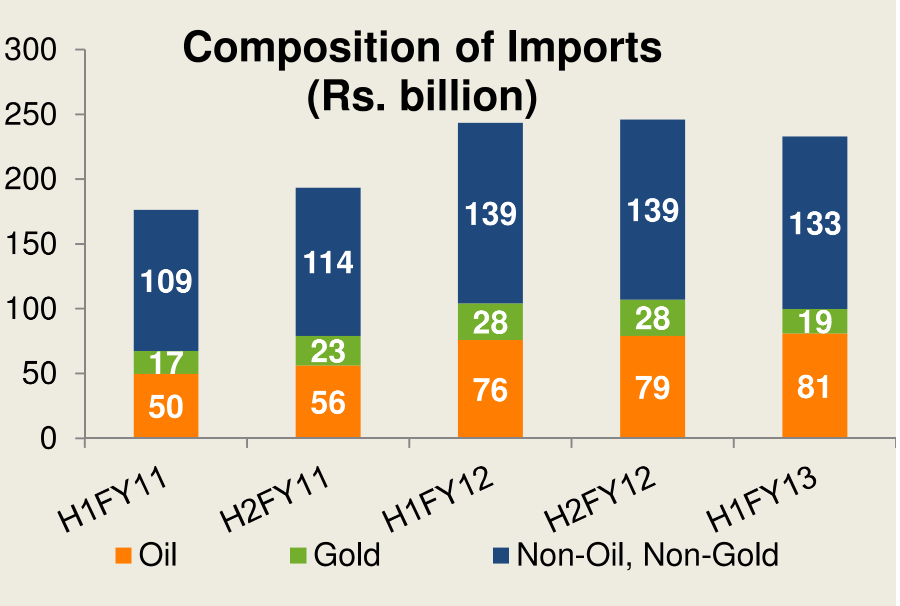
Merchandise trade deficit to remain high despite weak Rupee

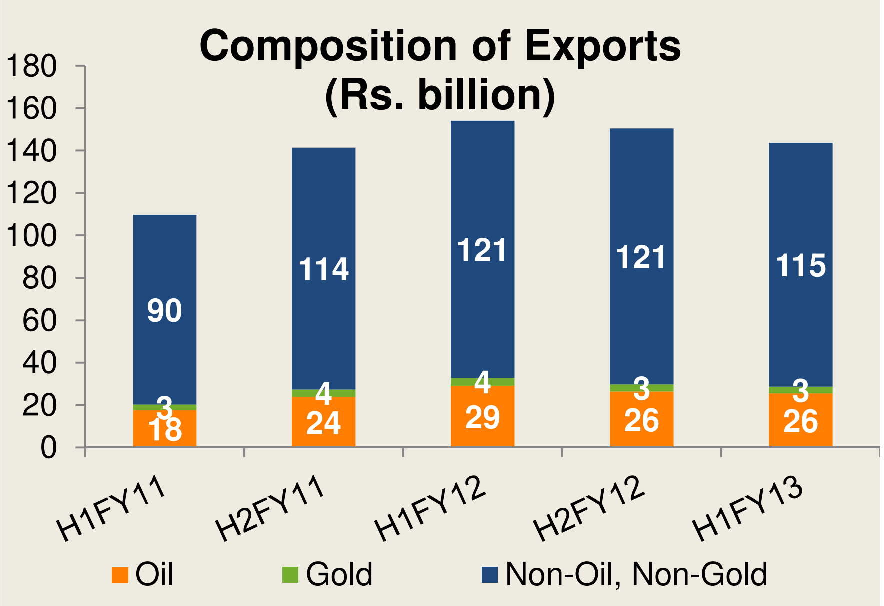
Imports to expand despite weak Rupee:

- Crude oil imports relatively inelastic.
- Despite duty hike, gold imports to remain substantial: jewellery, inflation-hedging.
- Higher imports of, natural gas, iron ore.

Exports to be weak despite impact of Rupee on competitiveness:

- Impaired availability of reasonably priced power adding to costs.
- Bleak global economic conditions.



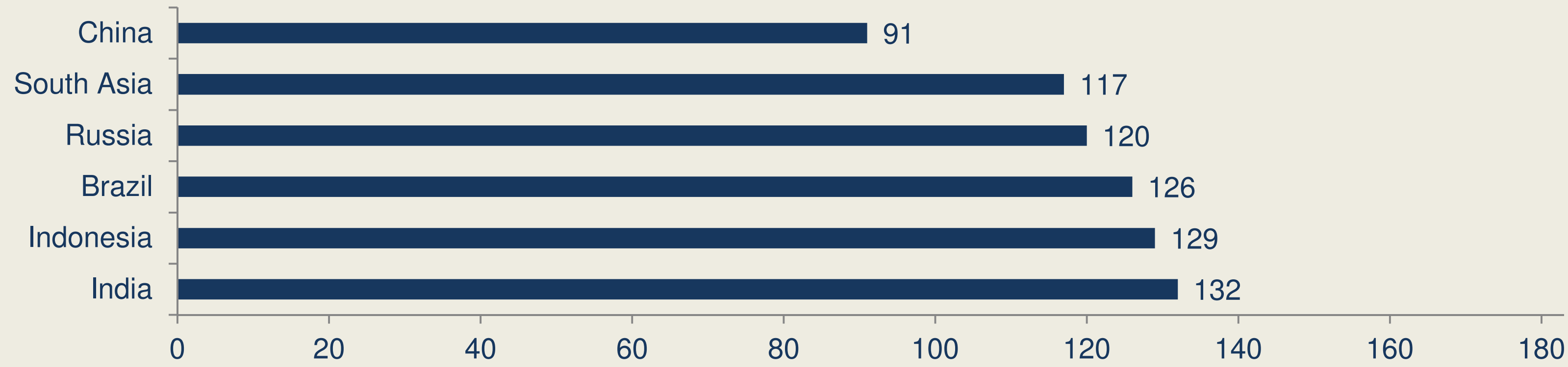


Structural Challenges: Issues related to Political Uncertainties and Governance

- Challenging political scenario, coalition politics may prevent a quick response to external shocks.
- Significant interface for infrastructure and large projects with various levels of Government.
- Delivery systems and effective implementation of plans rests closely on governance.
- Policies regarding allocation of natural resources are evolving.
- Notwithstanding negative headlines and political uncertainties, various regulatory issues are being addressed which will provide a good foundation for future growth.
- With Right to Information Act and greater awareness, civil society is demanding increased transparency.

Structural Challenges: Low Ease of Doing Business

- India falls largely in third quartile of rank league in all parameters with exception of development of credit information and investor protection.
- India ranks in the lowest quartile especially in areas like starting a business (in terms of cost and time required to start up) and getting construction permits.
- Nevertheless, India's ranking has improved from 139 in 2011 to 132 in 2012, and is not substantially inferior to many BRICS peers.



Source: World Bank 2012

Structural Challenges: Issues related to Land Acquisition

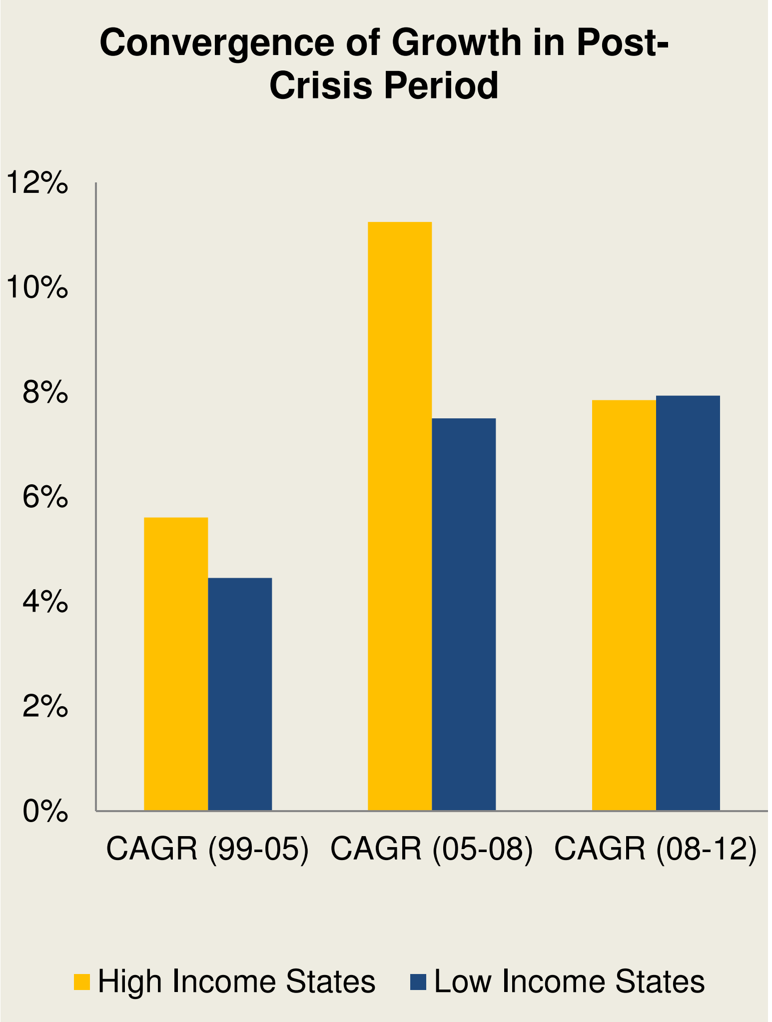
- Availability of contiguous tracts of land at a viable cost and ease of acquisition are critical for reducing bottlenecks in infrastructure and boosting manufacturing growth.
- Several government, industrial and private public partnership (PPP) projects are stalled awaiting regulatory clarity.
- Right to Fair Compensation, Resettlement, Rehabilitation and Transparency in Land Acquisition Bill currently being considered by Government.
- Land acquisition may be relatively easier to complete in States with less fertile land and relatively lower density of population.
- Ease of land acquisition likely to significantly impact pace of growth of various Indian States.
- Other key factors impacting upon investment decisions include availability of water, electricity, distance to ports as well as other infrastructure.

Structural Challenges: Infrastructure Deficit

- India lags behind several similarly rated countries in terms of infrastructure availability.
- Demand for infrastructure will continue to increase with economic growth; rising urbanization is likely to exert pressure on existing public services.
- While infrastructure provides a huge growth opportunity, curtailing bureaucratic delays, incentivizing private sector participation and resolving financing hurdles is needed.
- The required investment in infrastructure is estimated at US$ 1 trillion in 2012-17; nearly 50% of this is expected from private sector participation.
  - Upgrading rail infrastructure (new rail lines, double/multiple lines, high-speed rail): $300 billion by 2020.
  - Highways sector: $123 billion in next five years.
  - Major and non-major ports: $55 billion by 2020.
  - Airports: $13 billion in next five years; private sector to contribute $10 billion.

Latent Demand in Low-Income States makes Growth Resilient

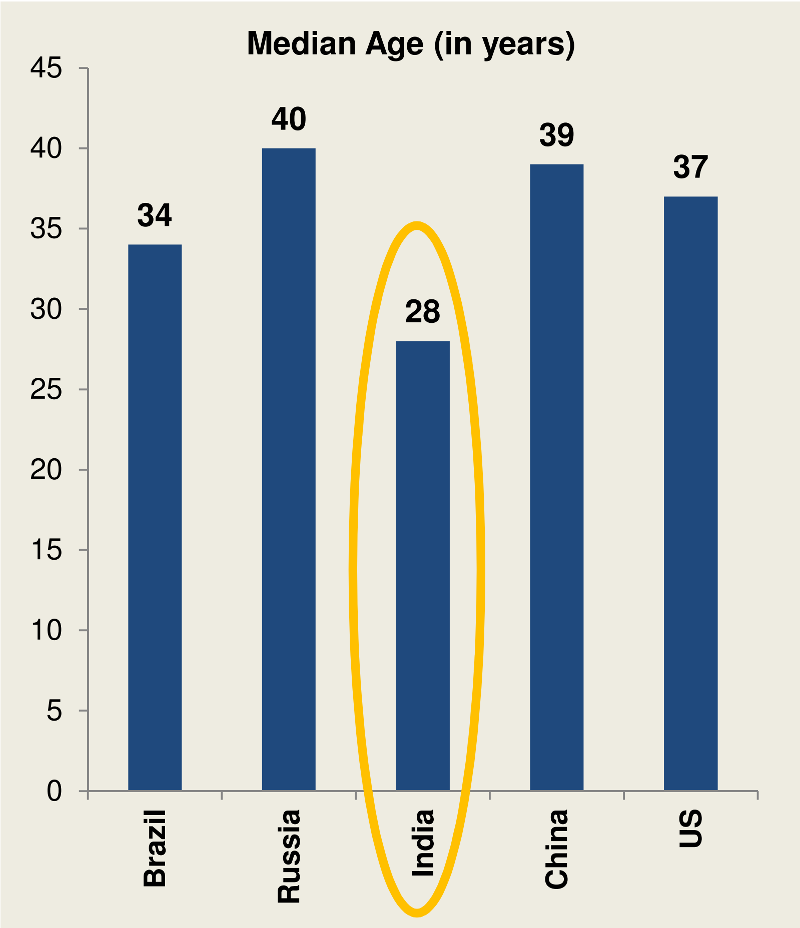
- The pace of growth of high income States (40% of India's population) doubled in 2005-08, before decelerating considerably in the post-crisis period.
- This trend is partly explained by greater trade links of high income States with the world economy.
- The pace of growth of low income States (53% of India's population) improved moderately in 2005-08; however, this higher growth has been sustained in the post-crisis period.
  - Improvement in law & order, stable political situation emerged as a catalyst for growth in some of these States.
  - Latent demand for sectors such as construction, physical infrastructure, education, healthcare, pushing economic growth.
  - Continued stability likely to attract manufacturing as well.



Source: CSO

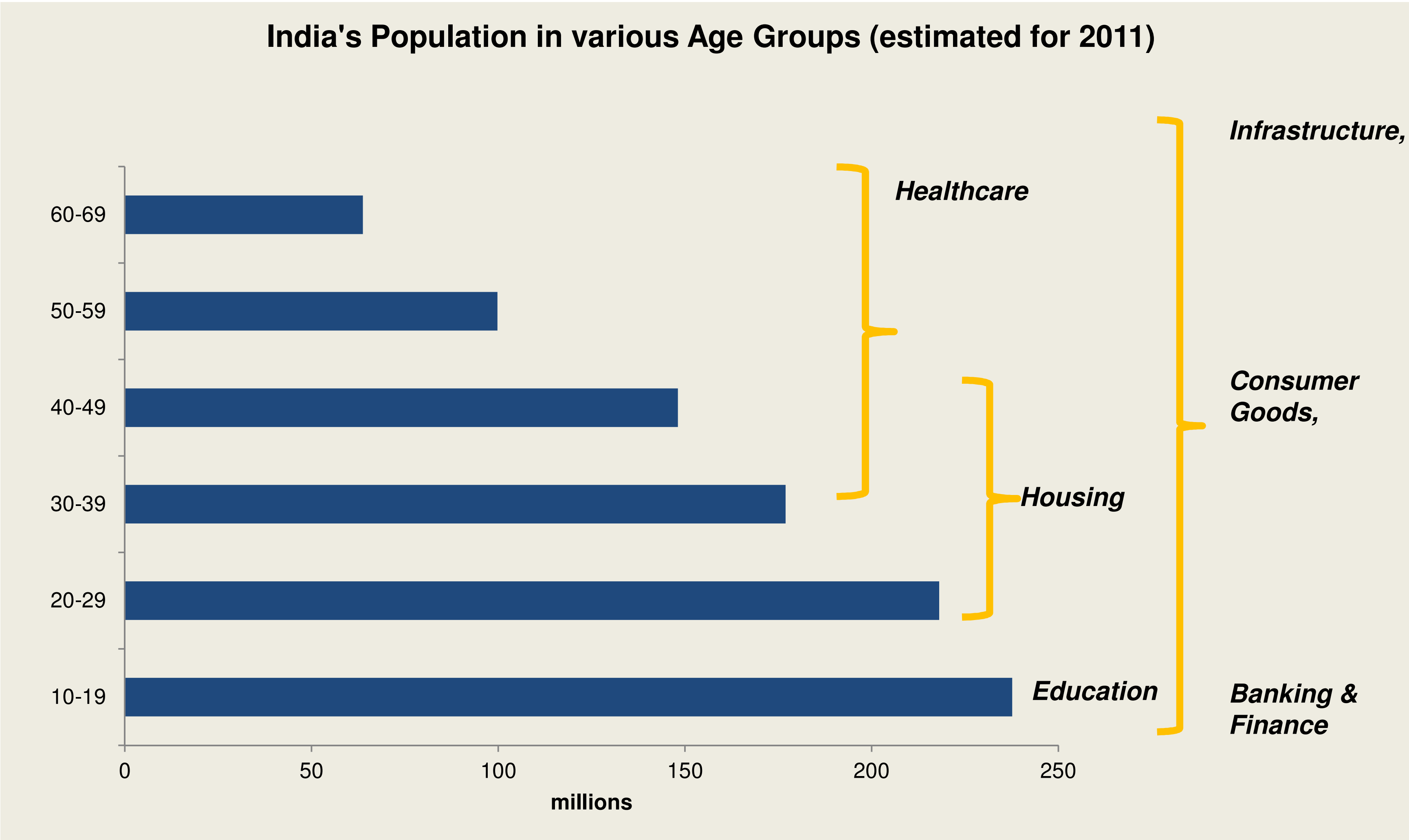
Demographic Dividend: Rise in Population, Prosperity to Boost Demand

- India's population is appreciably younger than several large countries.
  - India is estimated to account for 25% of the global workforce by 2025.
- In addition, an expanding Middle Class and rising per capita income are likely to
  - Keep domestic consumption demand strong.
  - Catalyze change in the nature of consumer spending, graduating from necessities to discretionary spending.
- Demographic transformations likely to create vast opportunities for healthcare, education, infrastructure, housing, consumer goods, banking & finance.
- With around 215 million Indians estimated to be in the 20-30 age bracket in 2011, the demand for housing is likely to increase exponentially.



Source: World Population Prospects; United Nations

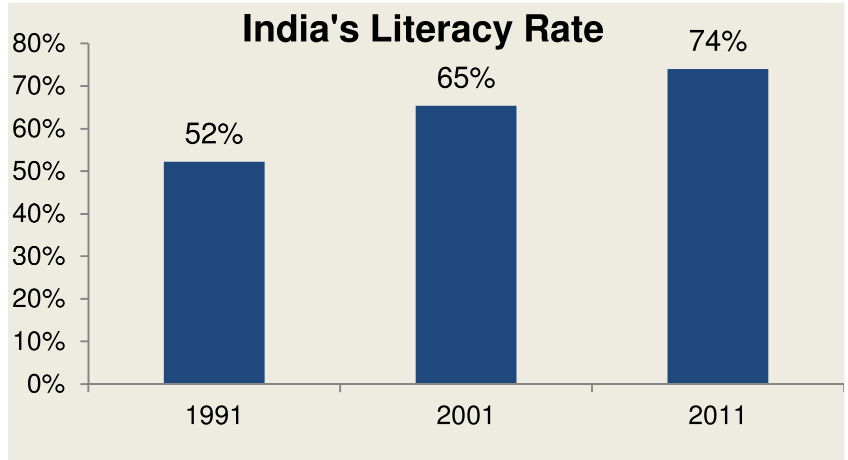
Demographic Dividend: Rise in Population, Prosperity to Boost Demand



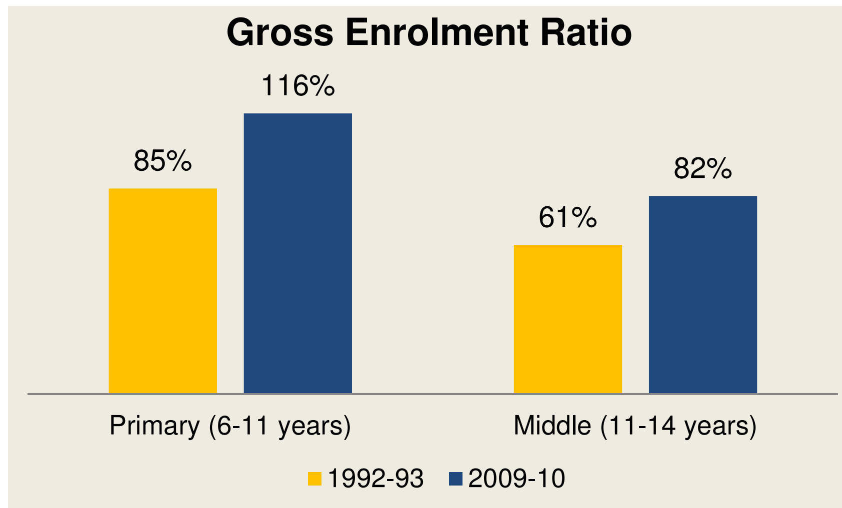
Source: Census of India; ICRA

Literacy Levels have Improved Substantially …

- Literacy levels have improved substantially in last 20 years.
- Government focus on primary and secondary education has boosted gross enrolment ratios;
- Additionally, other schemes like mid-day meals for school children are helping to arrest dropout rates.
- However, a greater focus is required on skill development, employability and job creation, to ensure that India benefits from the demographic dividend.



Source: Census of India



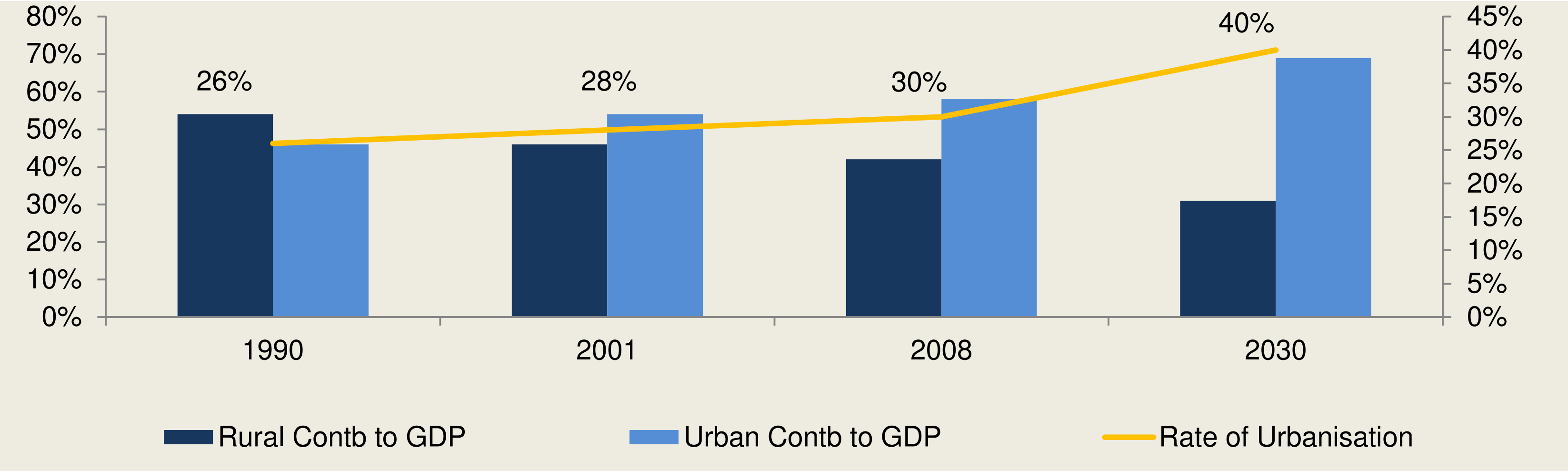
Source: Planning Commission

… but Skill Development Required for Employability

- As compared to the industry requirement of around 13 million new entrants to the workforce per year, the present education and vocational training system creates only 3-4 million workers.
- Demographic trends suggest that around 240 million people would be entering the workforce in the next decade, who have to be effectively skilled.
- Additionally, it is estimated that 250 million workers who are presently ‘untrained and underemployed’ need to be formally trained, for India to grow at 9% per year.
- Skill development and vocational training present a substantial business opportunity, through tie-ups with existing industrial training institutes, or through the creation of new institutions.

Increase in Urbanization to Boost Consumption

- Increasing urbanization is expected to bring about a structural transformation in the economic landscape and promote a trickle-down of growth.
  - Transition out of agriculture to release workers for other sectors.
- Similar to demographic dividend, increasing urbanization is expected to boost domestic consumption demand.



Source: Census of India, McKinsey Global Institute Analysis

New Manufacturing Policy

- Target to make manufacturing contribute 25% of GDP and create 100 million additional jobs by 2022.
- National Manufacturing Zone (NIMZ) and investment regions to be set up, which will act as self governing townships, in partnership with private sector.
    - Nine NIMZs notified so far.
- Delhi-Mumbai Industrial corridor will be thrust area in the first phase.
- Single window clearance/ liberal exit policy/ exemption from capital gain/ incentives for green manufacturing & technology acquisitions envisioned under this policy.

Focus	Sectors
Employment	Textile, Garments, Leather Footwear, Jewelry, Food Processing
Capital Goods	Telecom, Power, Mining, Electronic, Heavy Machine & Tools
Strategic	Aerospace, Shipping, IT, Renewable & Defense Equipment
Competitive Advantage	Auto & Pharmaceuticals

India fares moderately on Global Competitiveness

India was ranked 51 out of 139 countries by the World Economic Forum's Global Competeiveness Index 2010-11

Areas where India received Upper Quartile Ranking	Rank
Domestic Market Size Index	4
Foreign Market Size Index	4
Local Supplier Quantity	7
National Savings Rate	9
Financing Through Local Equity Market	10
Regulation of Securities Exchanges	15
Availability of Scientists & Engineers	15
Legal Rights Index	20
Quality of Railroad Infrastructure	23
Quality of Management Schools	23
Soundness of Banks	25
Extent of Market Dominance	26
FDI & Technology Transfers	28
Effectiveness of Anti-Monopoly Policy	29
Strength of Investor Protection	33

Recent Revival of Reforms to Re-Invigorate Economy

FDI

- 51% FDI in Multi Brand Retail.
- 100% FDI in Single Brand Retail.
- 49% FDI in Aviation.
- 74% FDI in Broadcasting.
- 49% FDI in insurance firms and pension funds approved.

Infrastructure

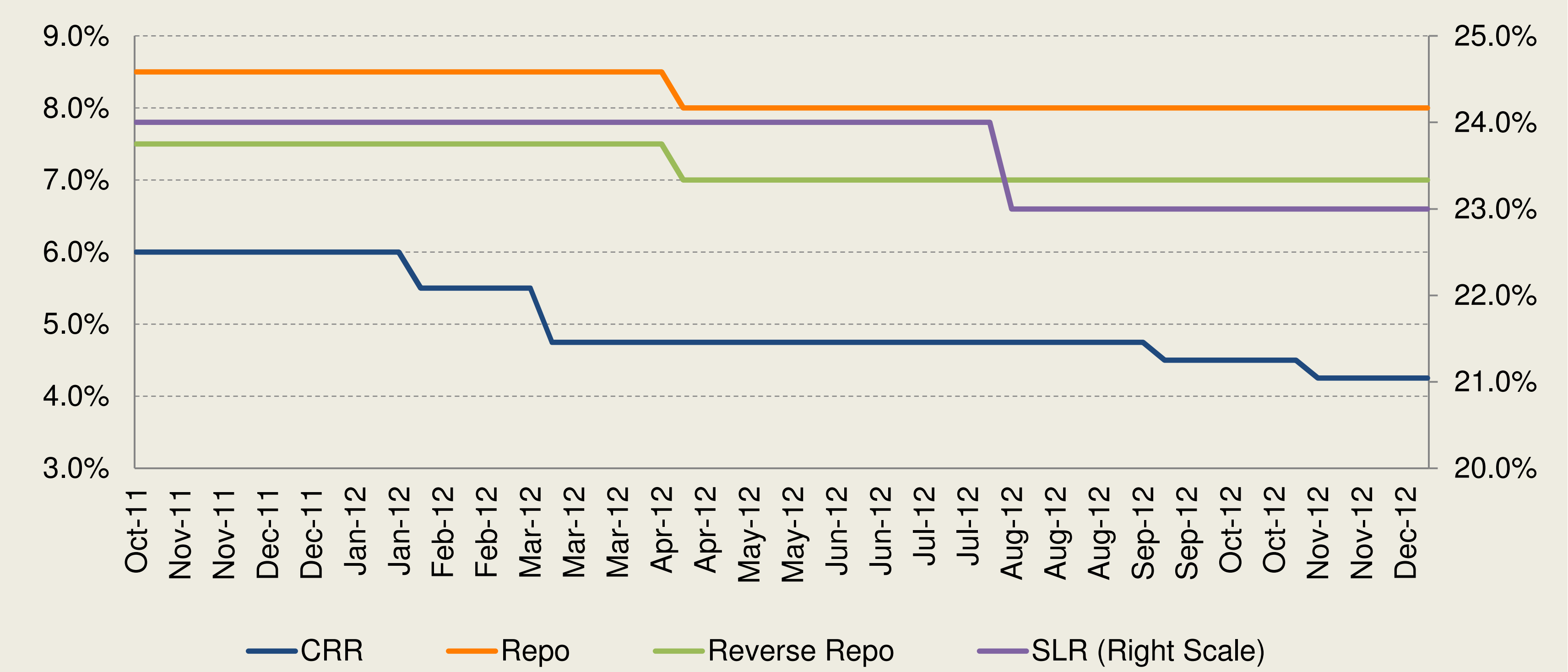
- Model Tripartite Agreement for Infrastructure Debt Funds approved by the Cabinet Committee on Infrastructure (CCI).
- National Investment Board to monitor and speed up clearances for projects with a size > Rs.1,000 crore being contemplated.

Energy Sector Reforms

- Financial Restructuring Package announced for Power Distribution Entities.
- GoI's directive for Coal India Ltd to sign Fuel Supply Agreements to supply domestic coal for power projects (which are commissioned after April 1, 2009 and will be commissioned till March 2015)
- Tariff revision & implementation of FPPCA framework and other initiatives
- Review of competitive bidding framework for power procurement

Growth-Inflation Dynamics to determine timing and extent of Monetary Easing

- Repo rate expected to be cut by a further 50 bps in FY13, 50 bps in H1FY14.
- The likelihood of CRR being cut below 4% is low, in the absence of a sizable external shock.
- Reduction in base rates of Banks expected to follow Repo cuts, with limited easing seen after last two rounds of CRR cuts.



Policy and Political Uncertainties may result in below-trend Growth

	H1FY13	FY13 (Forecast)	FY14 (Forecast)	FY15 (Forecast)
GDP	**5.4%**	**5.4%**	***6.5%***	***6.5-7.0%***
Agriculture & Allied	***2.1%***	***1.0%***	***3.0%***	***1.5%***
Industry	***3.2%***	***4.2%***	***5.5%***	***6.0-6.5%***
Mining & Quarrying	0.9%	3.8%	5.0%	5.0-6.0%
Manufacturing	0.5%	3.0%	5.5%	6.0-7.0%
Electricity Gas & Water Supply	4.8%	5.1%	5.0%	5.0-6.0%
Construction	8.8%	6.7%	6.0%	6.0%
Services	***7.0%***	***7.1%***	***7.5%***	***7.5-8.5%***

- Normal monsoon may provide demand-side boost to manufacturing, construction in FY14.
- Resolution of issues related to natural gas, improved production of coal may boost mining, electricity and manufacturing growth in FY15.
- Challenging political scenario, coalition politics may prevent quick response to external shocks.
- Uncertainty may rise post Parliamentary elections in 2014.
- Policies regarding allocation of natural resources are evolving; notwithstanding negative headlines and political uncertainties, various regulatory issues are being addressed, which will provide a good foundation for future growth.

Thank You