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Fixed Income Research

2015 Economic outlook

India: A Goldilocks year

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

November 2014

Summary: We remain positive

- **Entering a Goldilocks era**: 2014 was an inflection year for India due to a strong political mandate, growth bottoming out, and RBI's increased credibility. Macro policies are now prudent and we believe will usher in a Goldilocks period of higher growth and lower inflation in 2015. Lower commodity prices are a positive externality.

- **A multi-year growth recovery:** We see India at the cusp of a multi-year uptrend, with real GDP growth rising from 5.2% y-o-y in 2014 (4.5% in 2013) to 6.4% in 2015. Currently, the green shoots are driven by higher consumer discretionary demand, transportation, and infrastructure sectors. We expect investment de-bottlenecking to drive a gradual pickup in capex in 2015-16.

- **Inflation set to slide**: We expect the lagged impact of past growth slowdown, lower nominal rural wages, subdued minimum support prices and higher real interest rates to moderate CPI inflation to ~5.5% in 2015, undershooting the RBI's Jan 2016 target of 6% .

- **Rate cuts…but limited**: We expect the RBI to move to a flexible inflation targeting regime in 2015 with a medium term CPI target of ~4 +/- 2%. This move towards policy orthodoxy/medium-term stability implies the RBI's policy stance will remain neutral-to-tight. We pencil in 25bp rate cut each in Q2 and Q3 2015 with 7.50% as the neutral equilibrium nominal policy rate. Nomura's rates strategist expects 10yr bond yields to fall from 8.1% in 2014 to 7.5% in 2015.

- **Piecemeal reforms to continue:** Instead of big-bang announcements, we expect a steady flow of micro-level reforms focused on governance, ease of doing business, changes in land acquisition, GST implementation, fiscal (expenditure) management, etc

- **Balance of payment surplus to continue**: As domestic growth outpaces global growth (amid lower oil prices), we expect a marginal widening of India's current account deficit (CAD) to 1.5% of GDP in 2015 from 1.3% in 2014. FDI inflows should finance more than 90% of the CAD. Nomura's FX strategists expect USD/INR at 61.0 by end-2014 and 60.8 by end-2015.

- **Key risks:** Risks are more global than local. Global: growth slowdown and capital outflows. Local: expectations, pace of recovery and aggressive rate cuts.

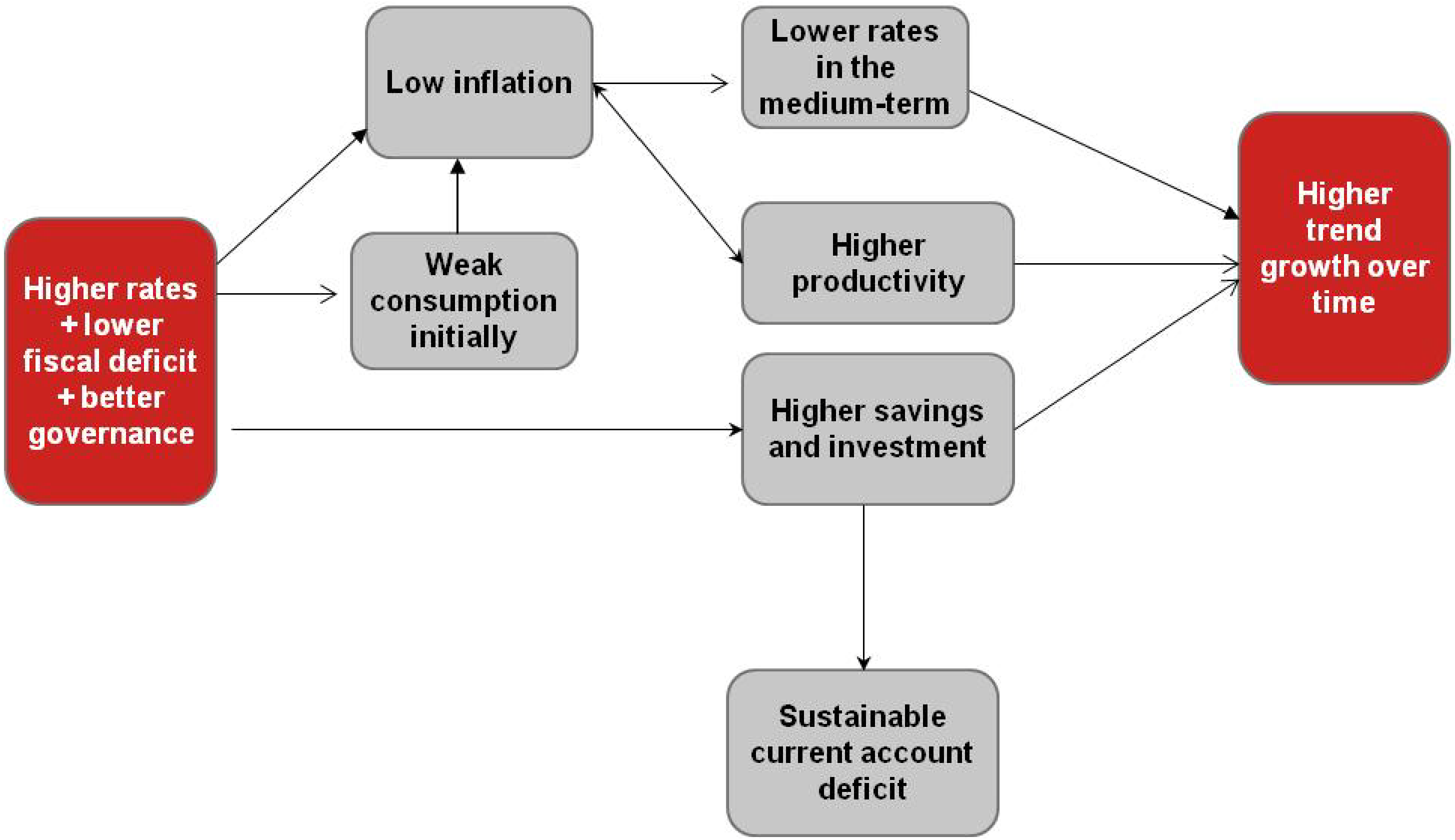
India outlook at a glance

%y-o-y growth unless otherwise state	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	2014	2015	2016
Real GDP	**4.6**	**5.7**	5.4	5.1	5.8	6.1	6.7	7.0	5.2	6.4	6.8
Agriculture	**6.3**	**3.8**	0.5	0.0	3.0	2.5	5.0	5.5	2.6	4.0	2.6
Industry	**-0.5**	**4.0**	1.1	2.0	3.1	3.7	4.1	4.9	1.6	4.0	5.1
Services (incld Construction)	**5.8**	**6.6**	7.3	7.2	7.0	7.4	7.7	7.9	6.7	7.5	8.0
Private consumption	**8.2**	**5.6**	4.0	3.0	5.5	5.0	5.5	6.0	5.2	5.5	6.1
Government consumption	**-0.4**	**8.8**	7.5	3.0	3.5	5.0	5.0	5.0	4.6	4.6	5.8
Fixed investment	**-0.9**	**7.0**	2.5	7.0	8.0	8.2	8.4	8.8	3.8	8.4	9.5
Exports (goods & services)	**10.5**	**11.5**	11.2	6.5	7.0	6.5	6.5	6.5	9.9	6.6	5.1
Imports (goods & services)	**-3.7**	**-0.4**	7.5	5.5	6.0	7.0	7.2	7.5	2.1	6.9	8.0
Wholesale price index	**5.4**	**5.9**	**3.8**	2.8	3.0	1.6	0.8	1.3	4.4	1.7	2.1
Consumer price index	**8.3**	**8.0**	**7.4**	5.3	5.9	5.4	5.3	5.3	7.2	5.5	5.7
Current account balance (% GDP)	**-0.3**	**-1.7**	-1.8	-1.4	-0.9	-1.3	-1.9	-1.8	-1.3	-1.5	-1.9
Fiscal balance (% GDP)									-4.1	-3.6	-3.1
Repo rate (%)	**8.00**	**8.00**	**8.00**	8.00	8.00	7.75	7.50	7.50	8.00	7.50	7.50
Reverse repo rate (%)	**7.00**	**7.00**	**7.00**	7.00	7.00	6.75	6.50	6.50	7.00	6.50	6.50
Cash reserve ratio (%)	**4.00**	**4.00**	**4.00**	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
10-year bond yield (%)	**8.80**	**8.75**	**8.51**	8.10	8.00	7.70	7.50	7.50	8.10	7.50	7.50
Exchange rate (INR/USD)	**60.1**	**59.7**	**60.9**	61.3	61.6	62.7	62.7	61.0	61.3	61.0	59.8

Source: CEIC and Nomura Global Economics estimates.

Growth with macro stability

Medium-term India view



We believe India is heading into a period of growth with macroeconomic stability. Tighter fiscal and monetary policies and a correct growth mix (pro-investment and less entitlement-based consumption) should gradually correct India's imbalances. Growth recovery is likely to be gradual (no-Vs), but this environment will result in a steady and more sustainable growth uptick, which would be a medium-term positive.

Source: Nomura Global Economics.

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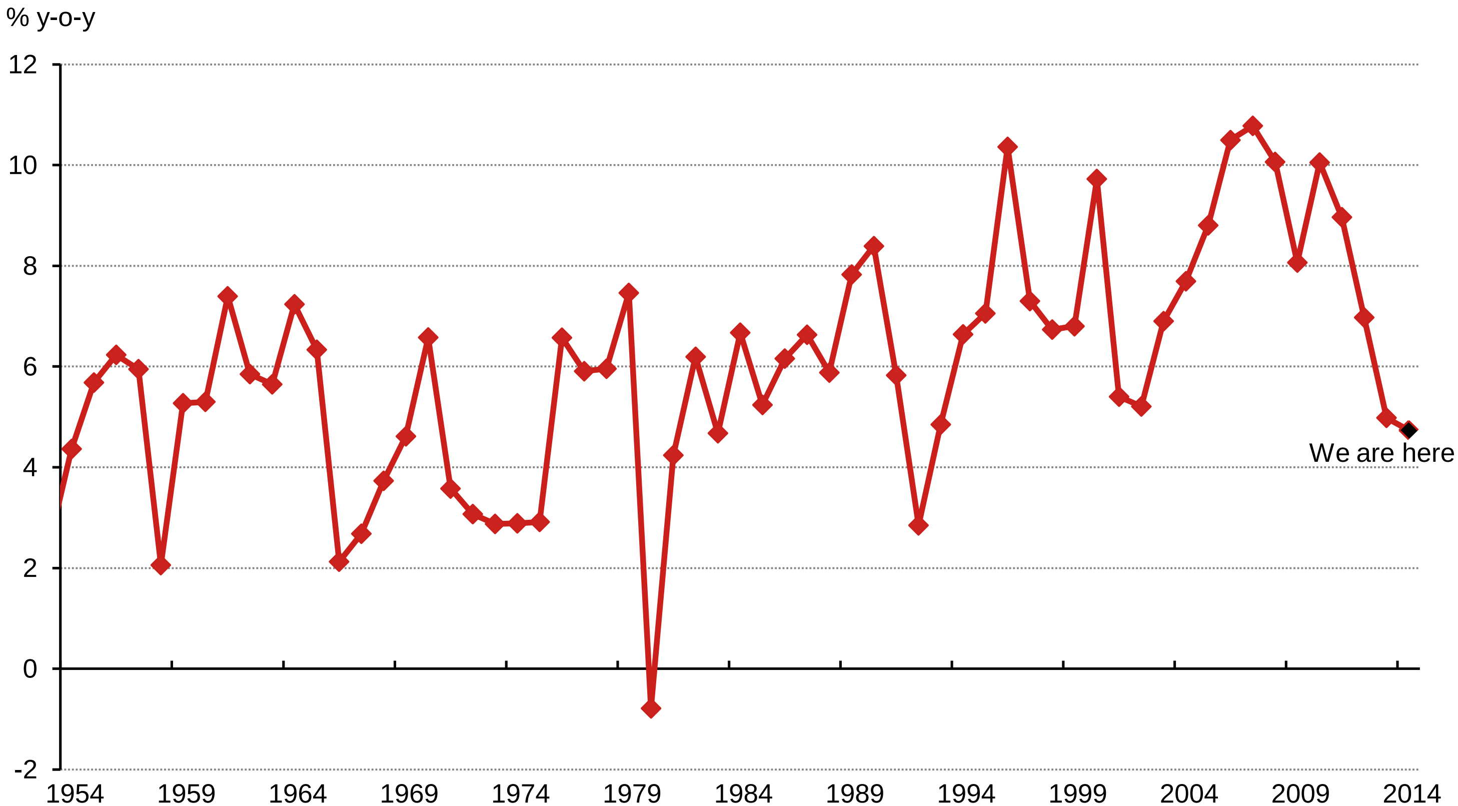
This time is (never) different

India real GDP (ex-agri) growth cycles

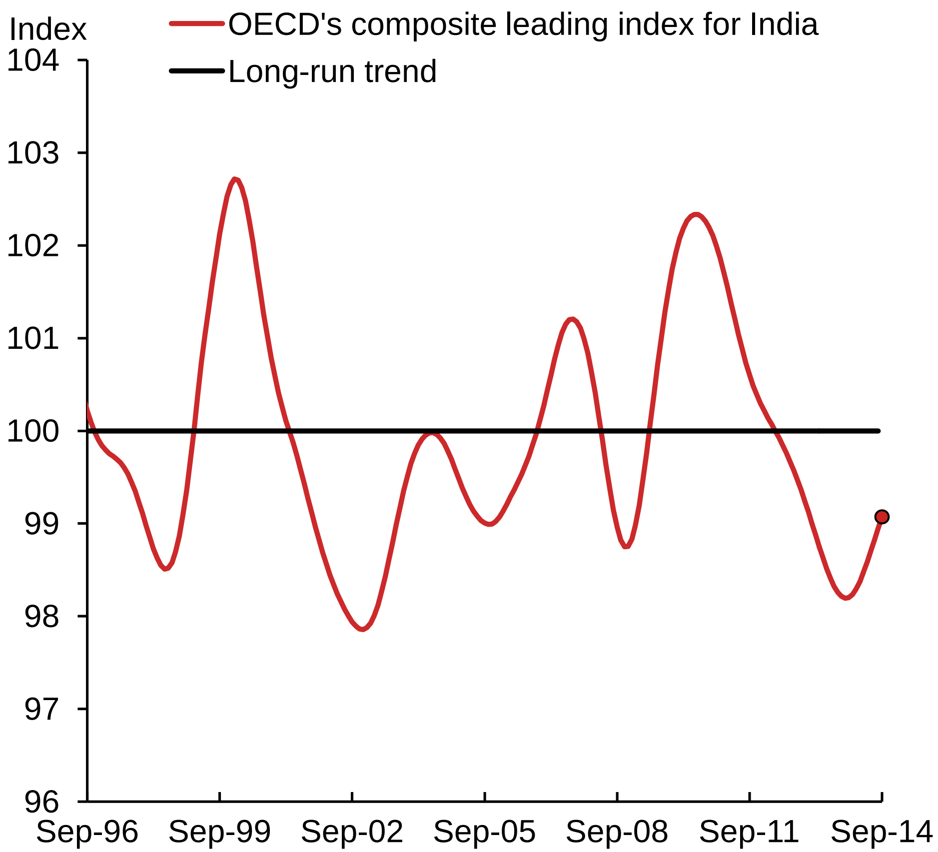


Every cycle (up or down) comes to an end. India's growth recovery will be gradual, but we expect a pickup in the coming years.

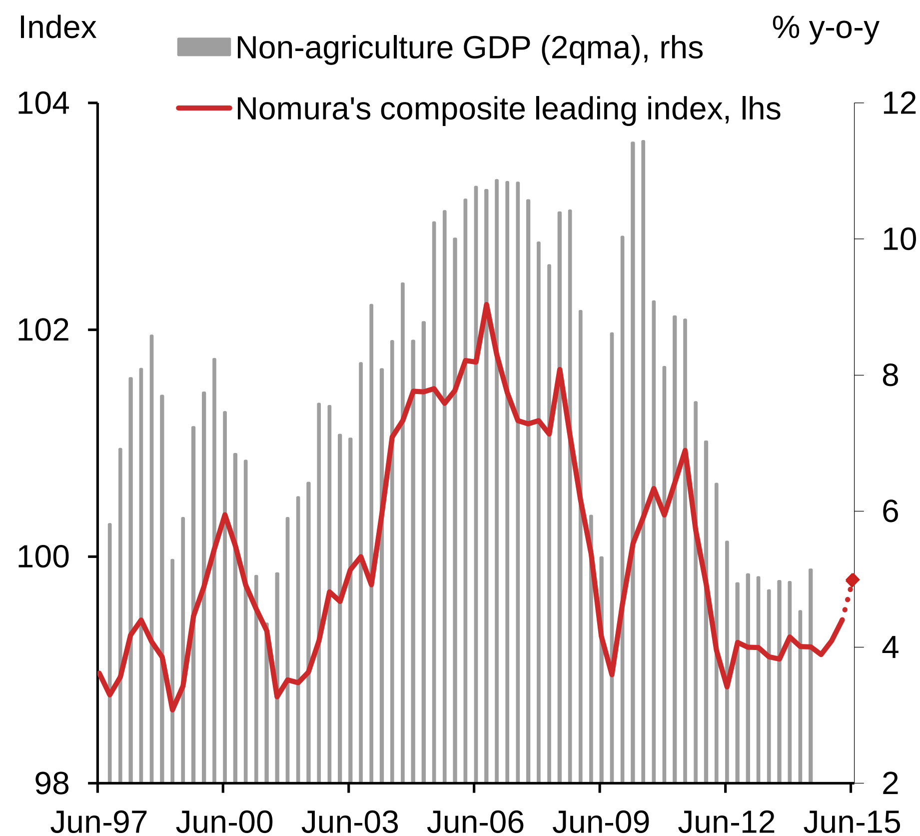
Source: CEIC and Nomura Global Economics.

Leading indicators are pointing up

OECD's composite leading index for India



Nomura's composite leading index for India



Even as IP data have been volatile, leading indicators suggest that growth momentum will continue to pick up.

Note: The constituents of our CLI are real M2 money supply, non-oil imports, equity returns, the repo rate, real bank credit, industrial output and visitor arrivals. Data for Q2 2015 are provisional estimates.

Source: CEIC and Nomura Global Economics.

Green shoots have continued into 2H 2014

% y-o-y, 3mma	2013				2014					
	Q1	Q2	Q3	Q4	Q1	Q2	Jul	Aug	Sep	Oct
Railway traffic: Net tonne km	-1.2	1.7	3.7	0.1	1.3	2.6	4.0	6.4	6.3	7.3
Aviation: Passenger traffic	-0.5	0.7	14.0	6.2	2.0	5.2	7.9	9.3	14.3	
Capital Goods	5.4	-3.5	2.5	0.1	-11.0	3.5	7.9	3.2	-0.7	
Steel	7.6	13.4	9.7	3.5	4.5	2.8	-0.4	3.3	3.2	
Cement	7.2	3.4	5.7	2.1	1.3	5.9	12.9	13.4	10.0	
Electricity generation	2.1	3.2	8.4	5.0	7.8	9.7	11.4	13.4	9.5	10.0
Passenger cars	-13.7	-12.5	13.7	-7.7	-7.2	-2.8	4.8	2.6	1.7	-2.4
MHCVs	-39.7	-8.2	-32.1	-33.6	-6.8	-8.2	5.3	13.5	23.3	25.1
2 wheelers	1.0	-3.6	7.1	13.9	12.0	15.7	16.4	16.1	20.2	12.9
Visitor arrivals	4.1	5.4	7.9	7.1	3.9	7.0	7.6	13.0	13.0	11.9
Exports	4.4	0.0	12.9	7.2	-2.0	2.3	8.9	5.9	3.8	-0.4
Imports (ex-oil, gold)	3.9	-3.6	-4.7	-6.9	-10.4	-4.4	2.6	4.6	10.4	14.1
Deposits	13.5	13.8	13.0	13.3	12.5	11.7	10.3	10.1	10.8	9.2
Diesel consumption	2.7	0.7	-2.6	-1.1	-1.5	-1.0	3.6	3.7	2.5	-0.6
Bank Credit	15.5	14.4	16.3	14.8	14.1	13.5	12.7	12.0	11.0	11.7

Green shoots are currently visible in the following categories:

1. **Consumer discretionary** demand – car and two-wheeler sales
2. **Construction sector:** cement
3. **Transportation** sector - MHCV sales, railway freight traffic and aviation passenger traffic
4. **Upstream infrastructure** sector – electricity and cement
5. Visitor arrivals on a rise indicting greater interest in India

Source: CEIC and Nomura Global Economics. Heat map based on 3-month moving average.

Recovery likely to be led by industrial sector

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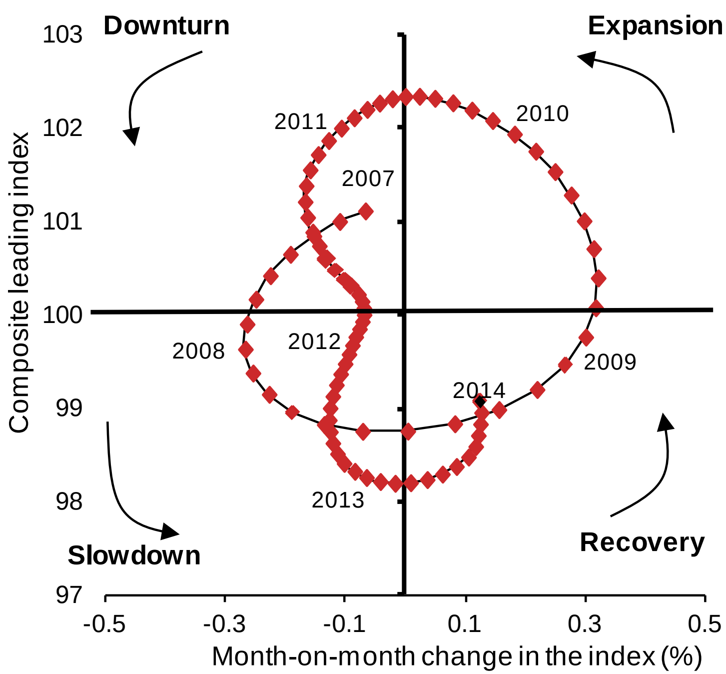
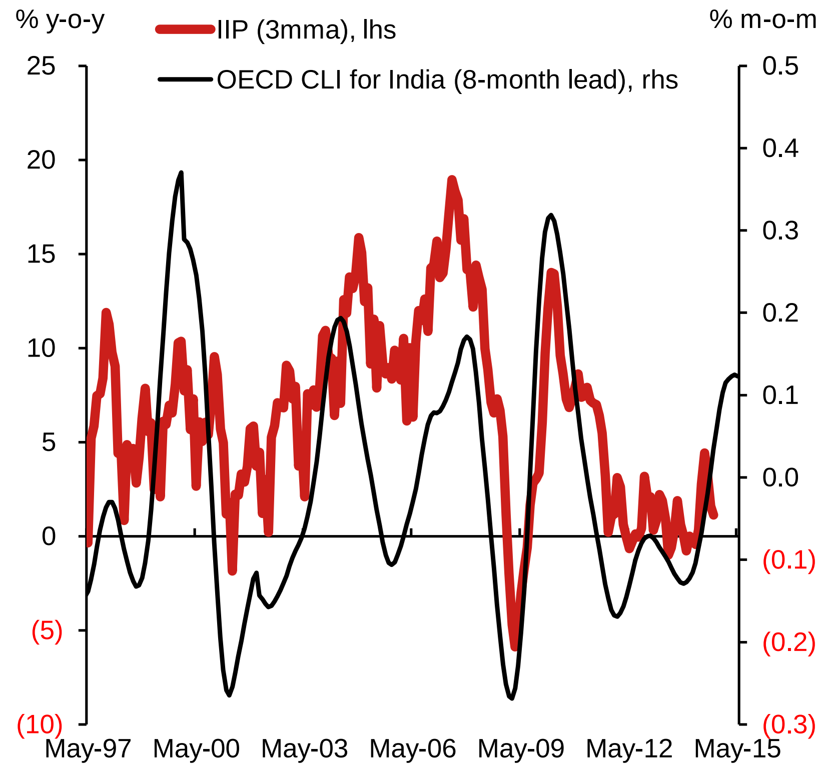
Growth getting into the recovery phase



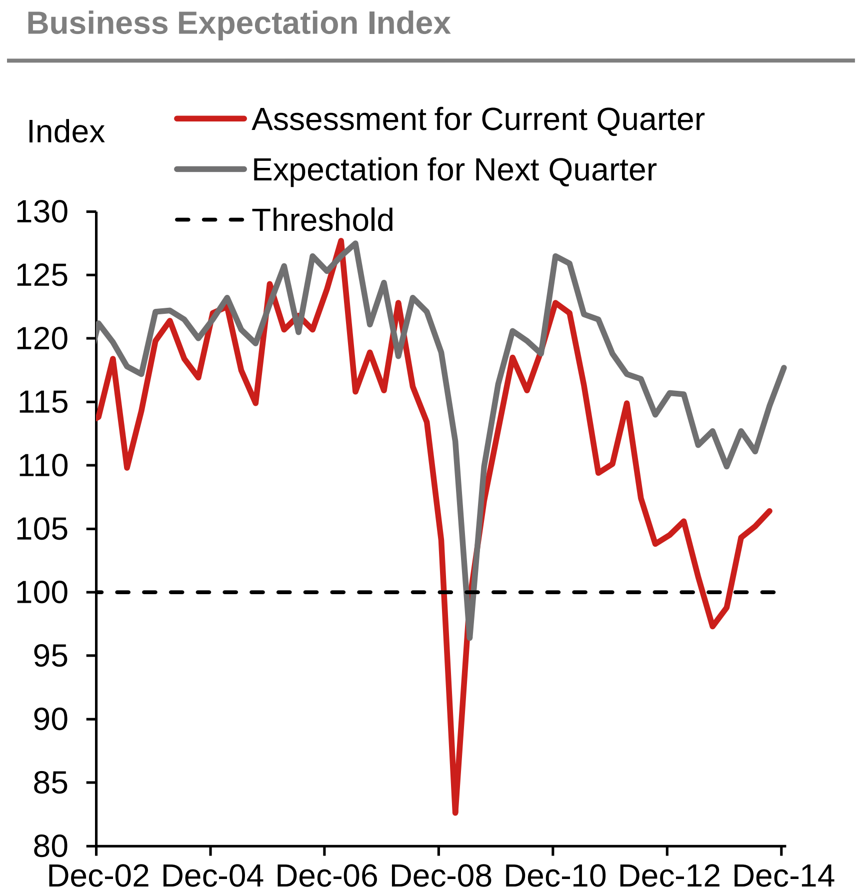
OECD's CLI for India and IP growth

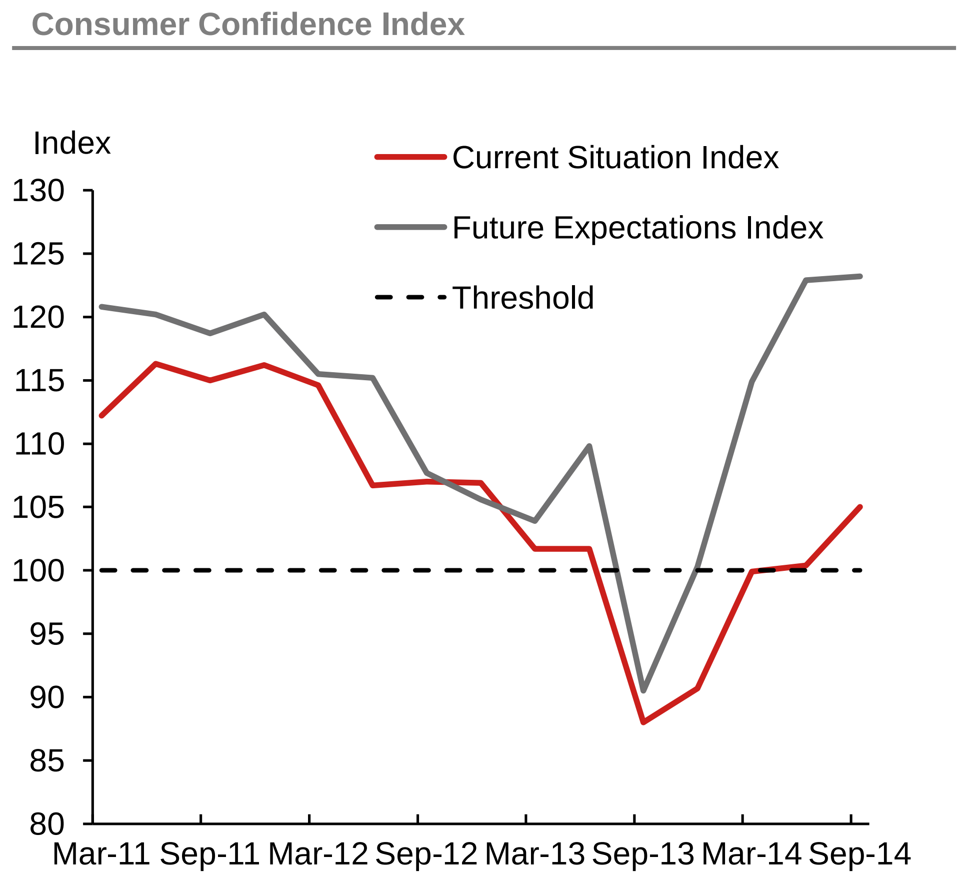


India's growth cycle has moved from slowdown to a recovery mode – last seen in 2009. As in all cycles, we expect the industrial sector to drive the cyclical turnaround.

Source: OECD, CEIC and Nomura Global Economics.

Sentiment – consumer and business – has risen



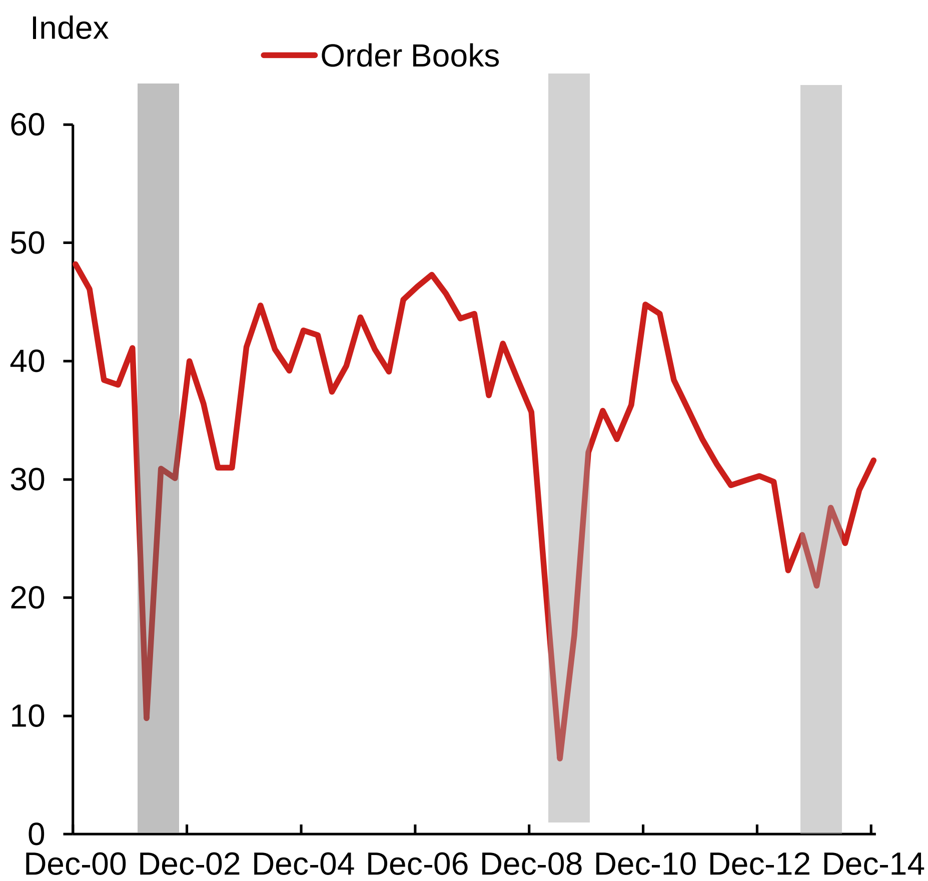


Both consumer and business confidence have picked up.

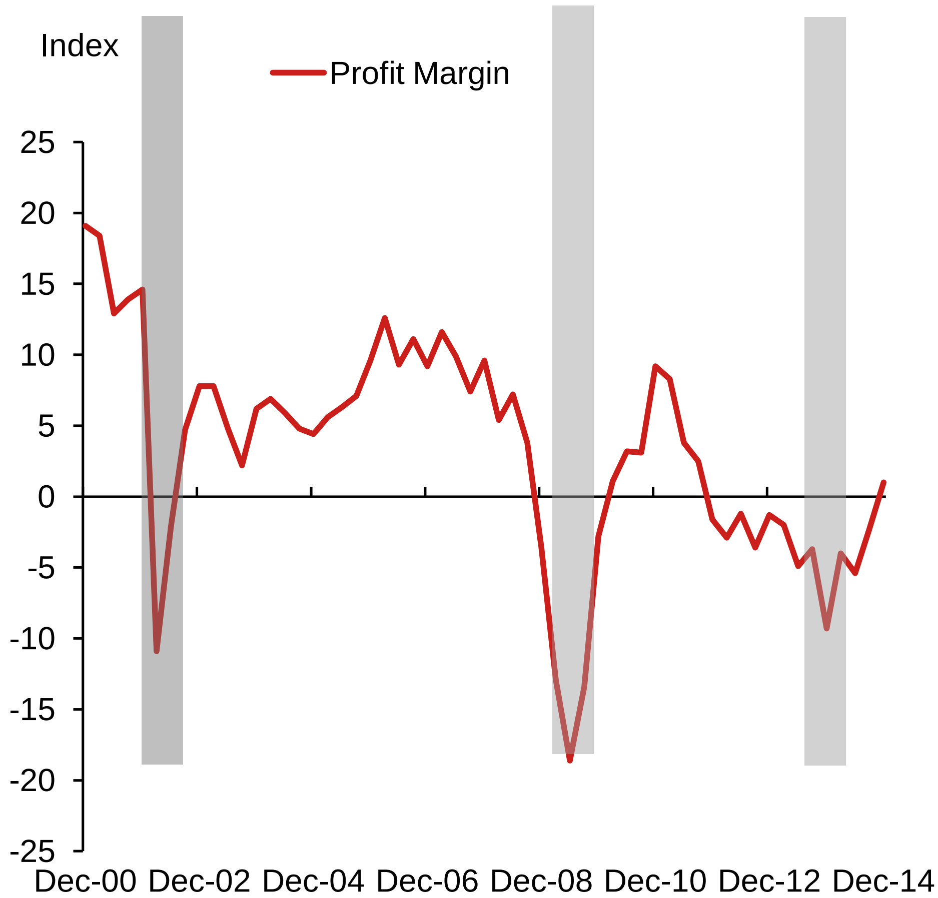
Source: RBI, CEIC and Nomura Global Economics.

Order book and profit margins expected to rise

Order book



Profit margins



Demand and profits are gradually rising – an early indicator of a growth turnaround.

Source: CEIC and Nomura Global Economics.

Other incipient signs of recovery

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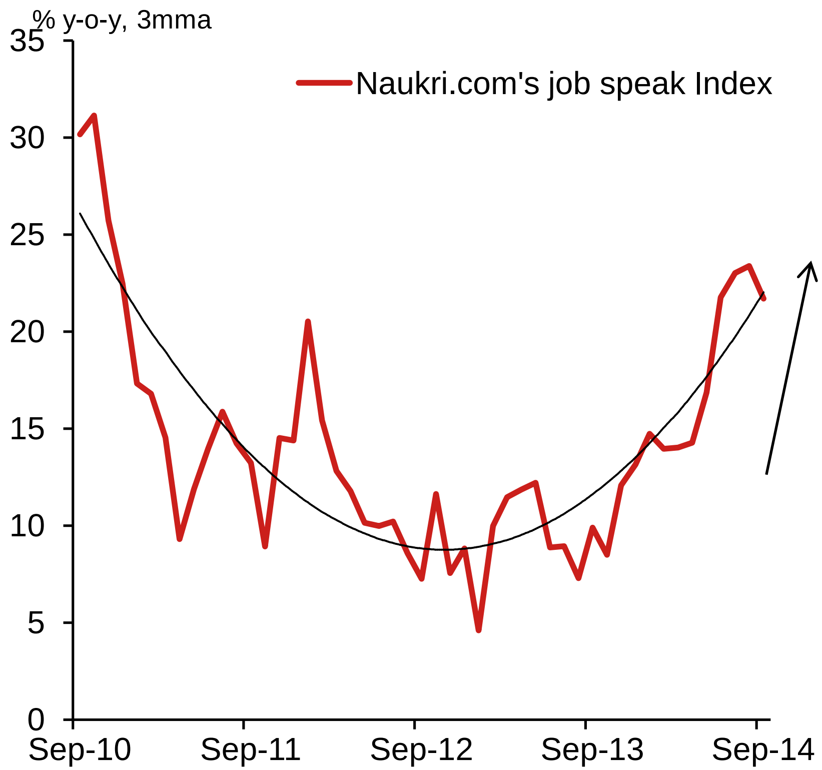
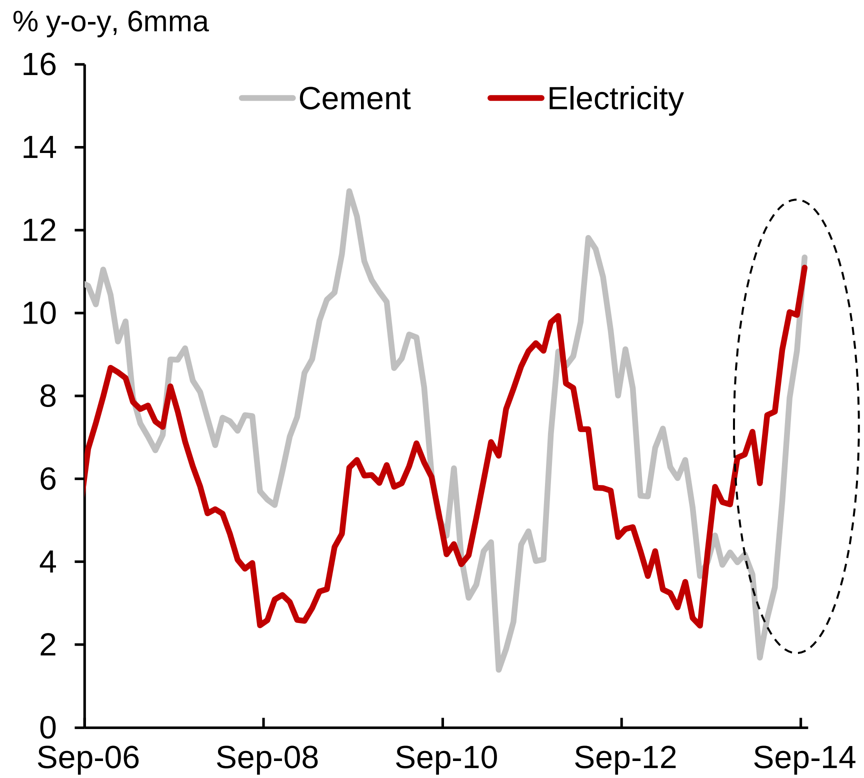
Urban job growth on the rise



Core sectors of the economy



Better job prospects will make the recovery in consumer discretionary demand more sustainable. Higher infrastructure sector output will enable higher capacity utilization.

Source: Infoedge, CEIC and Nomura Global Economics.

Explaining India's growth gap: low hanging fruit

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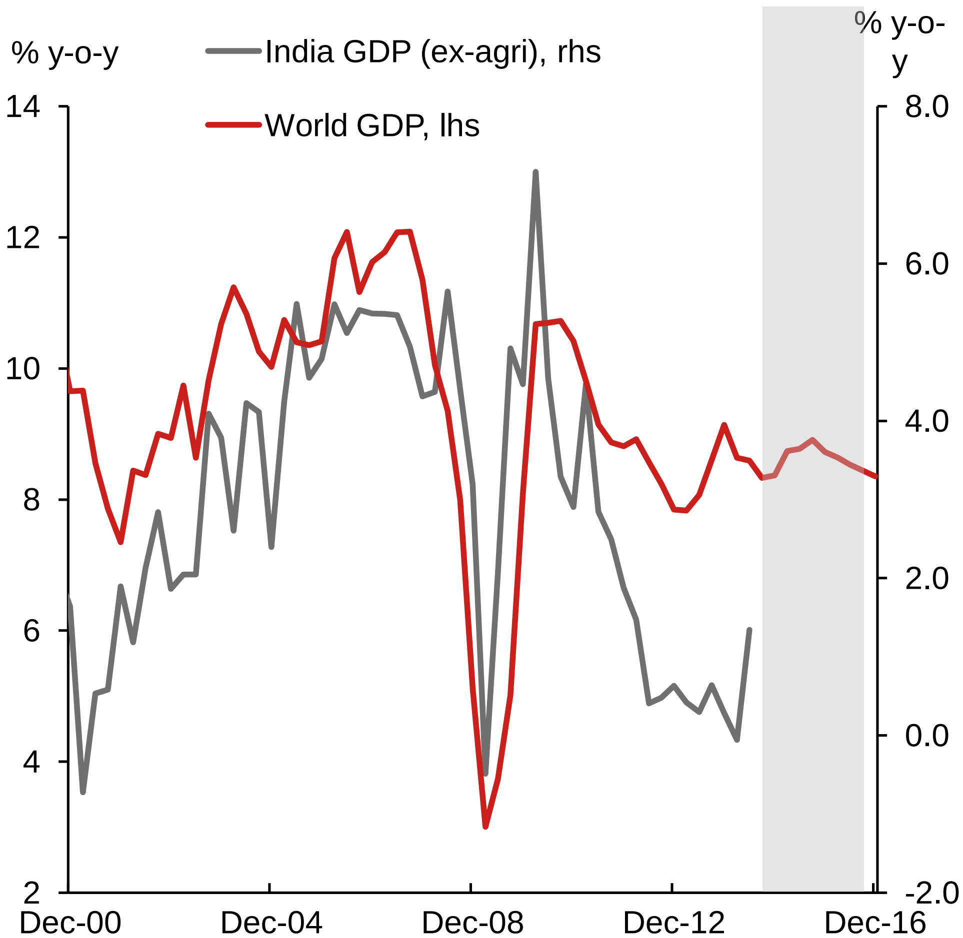
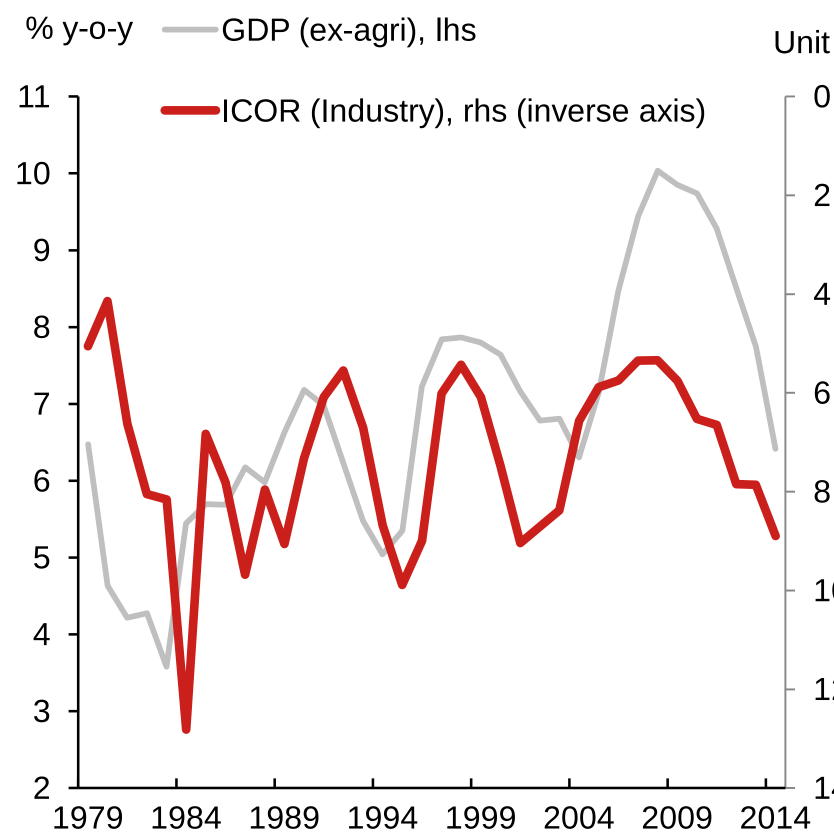
World GDP and India's GDP (ex-agri)



Capital productivity vs. GDP growth



Weak world demand can explain only part of India's growth slowdown; other factors (policy uncertainty, speed of decision making) were responsible and these are being fixed.

Source: IMF, CEIC and Nomura Global Economics.

Government efforts to drive investments

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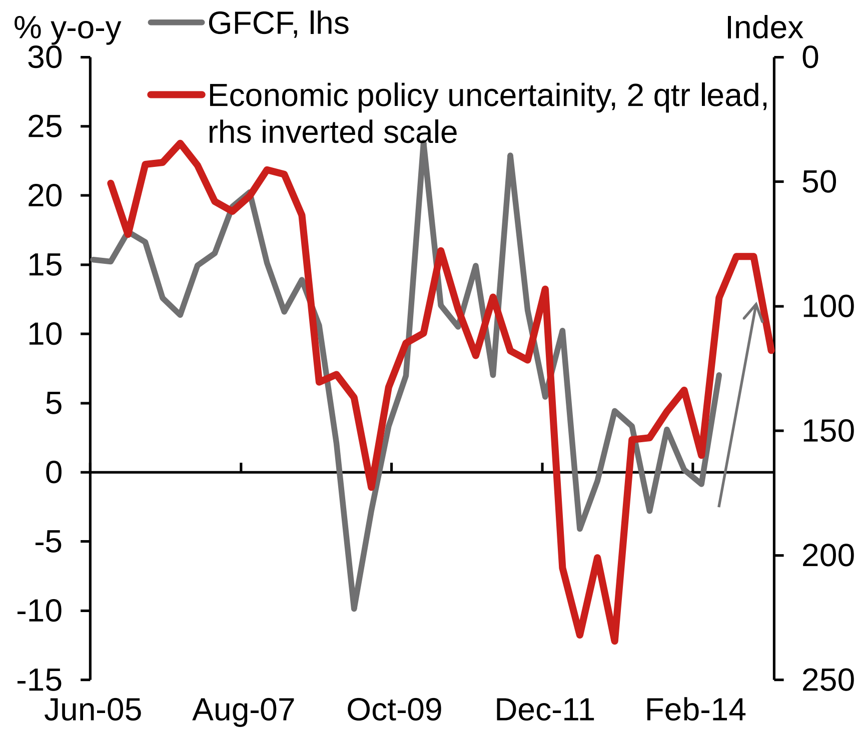
Debottlenecking of stuck projects

	UPA-II (16 months)	NDA-II (5 months)
Fertilizers	0	1
Power	**86**	55
Petroleum	**7**	**26**
Commerce	**1**	**18**
Coal	**19**	**26**
Civil aviation	2	0
Shipping	3	11
Mines	1	3
Railways	4	10
Chemicals	1	0
Road	4	19
Steel	3	22
Total	**131**	**191**

Reduced policy uncertainty to further help



De-bottlenecking of existing investment projects could drive the initial leg of the growth rebound as a number of projects are currently stuck, owing to policy hurdles. With lower policy uncertainty fresh investment activity should also rise.

Source: Cabinet Secretariat, www.policyuncertainity.com, CEIC and Nomura Global Economics.

New investments need to start from 2015-16

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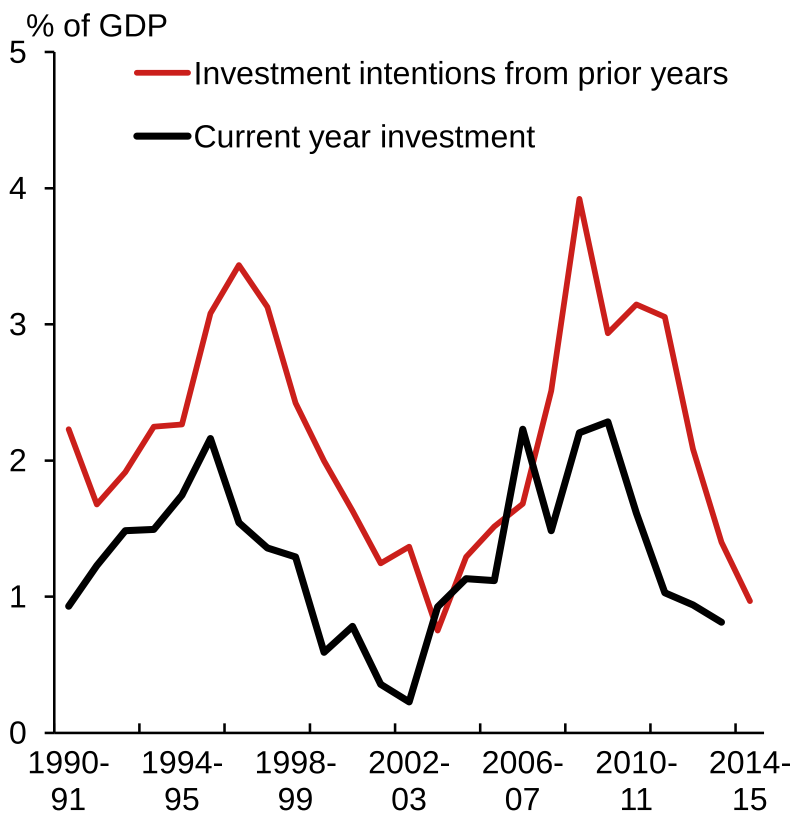
Past versus new investment pipeline



Distribution of investment projects

	FY04	FY08	FY11	FY14
Infrastructure	**33.3**	**39.4**	**53.7**	**37.9**
i) Power	13.2	29.4	46.2	33.4
ii) Telecom	16.9	1.6	5.7	-
iii) Ports & Airports	1.7	0.9	0.7	0.7
iv) Storage & Water Management	1.6	2.1	0	1.1
v) SEZ, Industrial, Biotech and IT Park	-	5.4	1.1	1.4
vi) Roads & Bridges	-	-	-	1.2
Food Products	1.9	0.7	0.7	1.7
Sugar	0.8	1.3	0.8	0.8
Textiles	**7.9**	**4.5**	**2.9**	**11.3**
Petroleum Products	0	7.5	2.6	0.5
Chemicals & Pesticides	1.9	1	1.3	1
Glass & Pottery	1.2	0.4	0.4	0.3
Cement	**3.9**	**5.9**	**2.4**	**6.8**
Metal & Metal Products	29.1	15.6	21.1	16.1
Electrical Equipment	1.1	0.9	2	2.2
Transport	1.4	3.5	0.8	1.1
Equipment & Parts Construction	0.3	3.9	3.3	2.6
Hotel & Restaurants	2.4	3.9	3.5	2.6
Transport Services	2.7	1.4	0.6	0.5
Hospitals	0.9	1.3	0.6	0.7
Entertainment	**0.9**	**0.5**	**0.8**	**4.8**
Others*	**10.3**	**8.3**	**2.5**	**9.2**

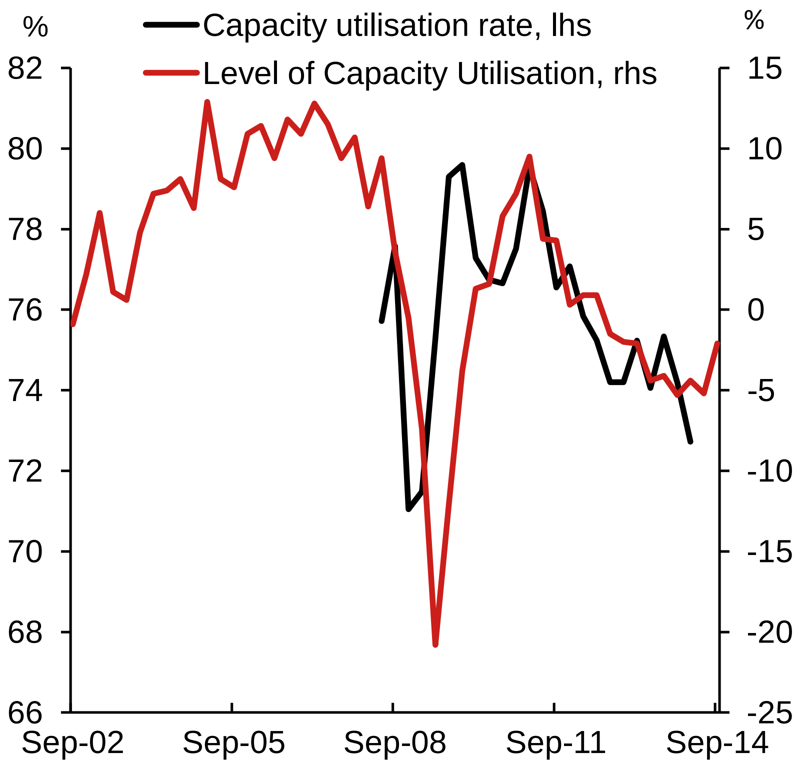
*Pharmaceuticals & Drugs, Agricultural, Mining, Paper, Printing, Rubber, IT Software, Communication, and Trading etc.

A pipeline of new investments is essential to sustain capex, as the past pipeline is shrinking.

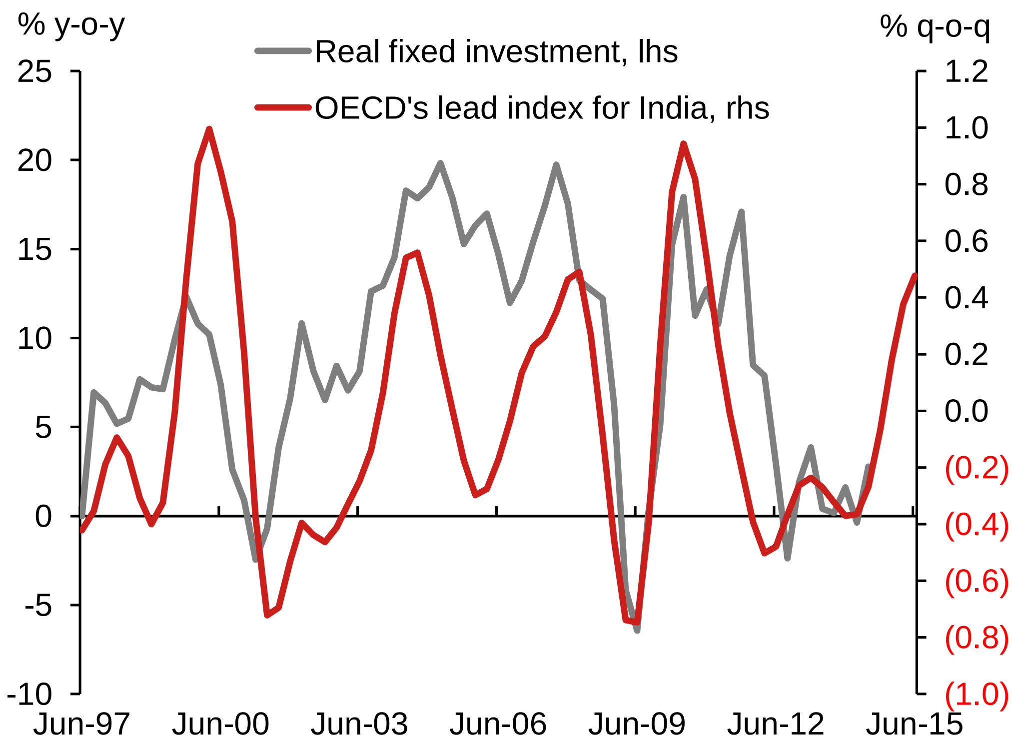
Source: RBI and Nomura Global Economics.

Investments to gradually revive in 2015

Capacity utilisation



Real investment growth to revive in 2015



Debottlenecking will drive the first phase of the capex cycle. But as demand picks up, capacity utilization will improve, increasing the prospects of new capex in the second phase.

Source: CEIC and Nomura Global Economics.

Deleveraging is already under way

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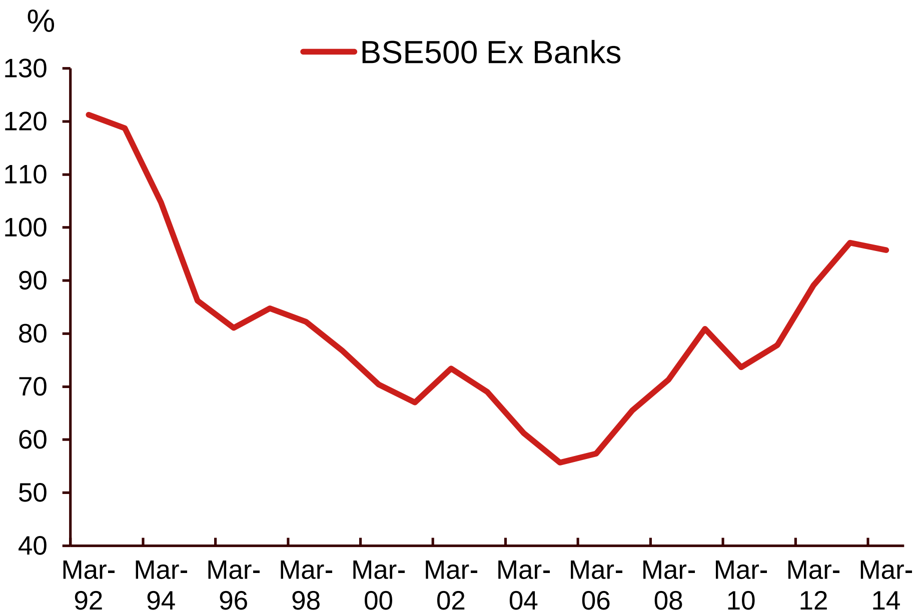
Debt-equity ratio



Sectoral debt-equity ratio

Debt to Equity Ratio (%)	Mar-91	Mar-06	Mar-10	Mar-14
Automobile	125.8	75.3	110.9	82.2
Capital Goods - Elec Equipment	111.0	42.3	60.5	59.8
Cement	91.9	64.3	43.0	70.4
Chemicals	122.9	55.7	46.7	56.6
Construction	148.8	123.8	191.2	272.8
FMCG	91.3	41.5	55.2	75.5
Metals/Steel & Mining	107.4	48.8	76.6	97.2
Power Generation & Distribution	87.0	62.2	89.4	154.0
Realty	153.4	283.5	57.8	66.3
Refineries	73.3	48.6	56.7	70.7
Telecomm-Service	198.7	57.9	53.2	136.1
Textiles	142.5	104.4	119.3	100.1
BSE500 Ex Banks	110.0	57.3	73.6	95.7

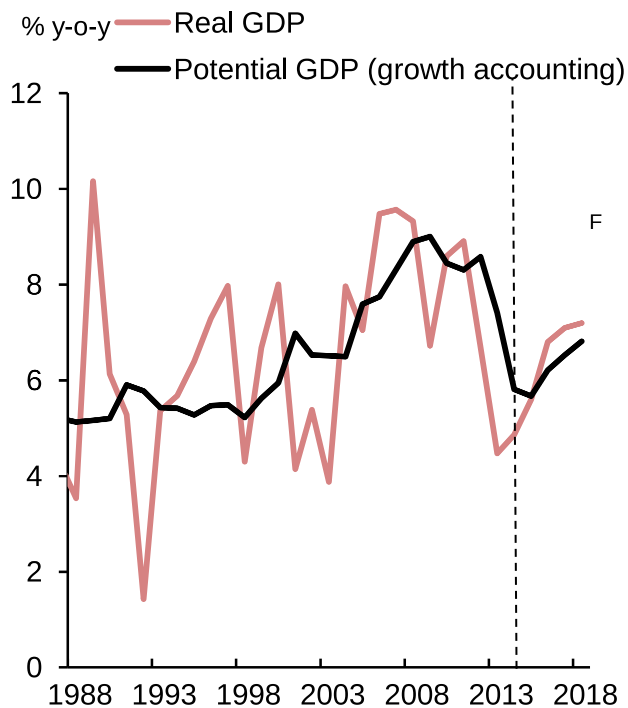
Apr-13	IVRCL announced the sale of three road BOT projects to TRIL (a Tata company)
Aug-13	Jaypee Group plans to cut about INR10bn of debt through a sale of the group’s real estate assets
Sep-13	IVRCL Ltd is selling its Chennai seawater desalination plant and Jalandhar-Amritsar road project
Sep-13	Tata Communications Ltd to sell its stake in South African fixed-line telephone operator Neotel to Vodafone
Dec-13	GMR puts Emco energy (600MW coal fired project) up for sale to reduce debt
Feb-14	GMR Infrastructure is planning to sell its two coal mines based in Indonesia, which it had bought in 2008 and 2011 for about $600 million
Jun-14	GVK looking to raise equity at Airport Holding Co. to retire the debt and exploring bringing equity investors into Hancock Infrastructure
Sep-14	Lanco Infratech to sell power projects generating 3000MW to raise INR50bn and pay down its debts
Sep-14	KKR extends USD175mn financing to GMR holdings

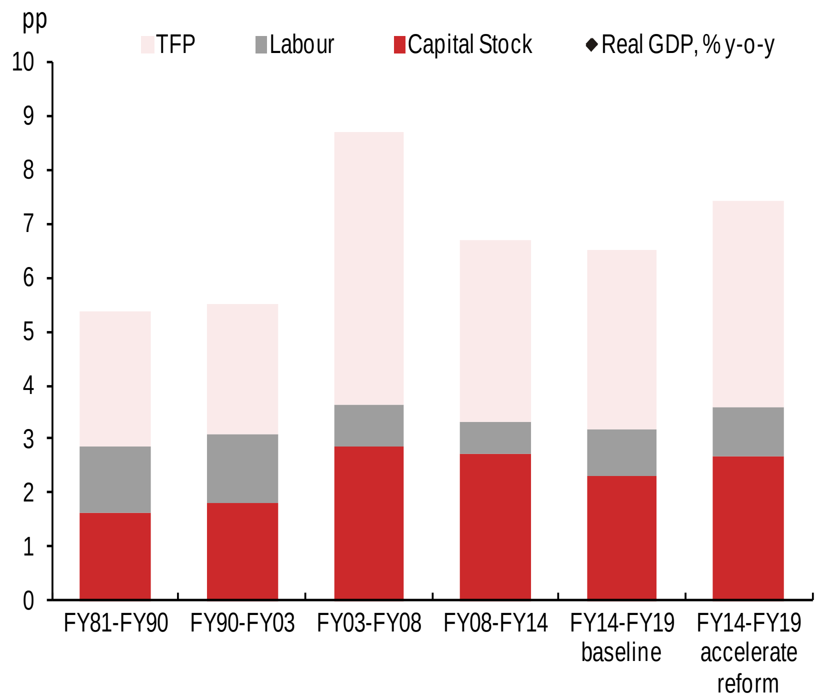
Leverage has been building since the financial crisis. Infrastructure developers, power generation, steel and telecoms have experienced a significant debt buildup. However, deleveraging is already under way, with firms selling off their assets. Rising equity markets will further aid improvement in stressed balance sheets.

Source: Media reports, CapitalLine and Nomura Global Economics.

Potential growth likely to rise

Estimates of potential growth





Real investment (% CAGR)	Potential growth (% CAGR)
0%	4.8
3%	5.3
5%	5.6
10%	6.5
15%	7.4
20%	8.5

In our base case, we expect reforms to revitalise real investment growth to 10% per annum, pushing potential output growth to 6.5% in the next five years. If reforms are fast-tracked, real investment growth could hit 15% pa, in our view, thus lifting potential growth to above 8%.

Source: CEIC and Nomura Global Economics.

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CPI inflation and its composition

Component	Wt in overall CPI basket (%)	Key items
Food, beverages and tobacco	**49.7**	
Cereals and derivatives	14.6	Rice and wheat
Pulses	2.7	Arhar (tur), gram and moong
Milk	7.7	
Oils and Fat	3.9	Groundnut oil and other edible oils
Meat fish egg	2.9	
Vegetables	5.4	Potato, onion and tomato
Fruits	1.9	Apple, banana and mango
Sugar	1.9	
Condiments & Spices	1.7	
Non-alcholic Bev	2.0	
Prepared Meals etc	2.8	
Pan,Tobacco & Intoxicants	2.1	
Clothing, bedding and footwear	**4.7**	Ready made garments, sari, footwear
Housing	**9.8**	Rentals and HRA of government employees
Fuel and Light	**9.5**	Electricity & LPG
Miscellaneous	**26.4**	
Education	3.4	School and private coaching fees
Medical care	5.7	Medicines and to partly doctor's consultation fees
Recreation and amusement	1.4	Cable TV charges
Transport & Communication	7.6	Petrol, public transport fare
Personal care	2.9	Personal care products
Household requsite	4.3	Wages of domestic help, white goods, jewelery
Others	1.1	Barber, washerman, tailor

Source: Nomura Global Economics.

‘Underlying’ inflation lower at about 6%

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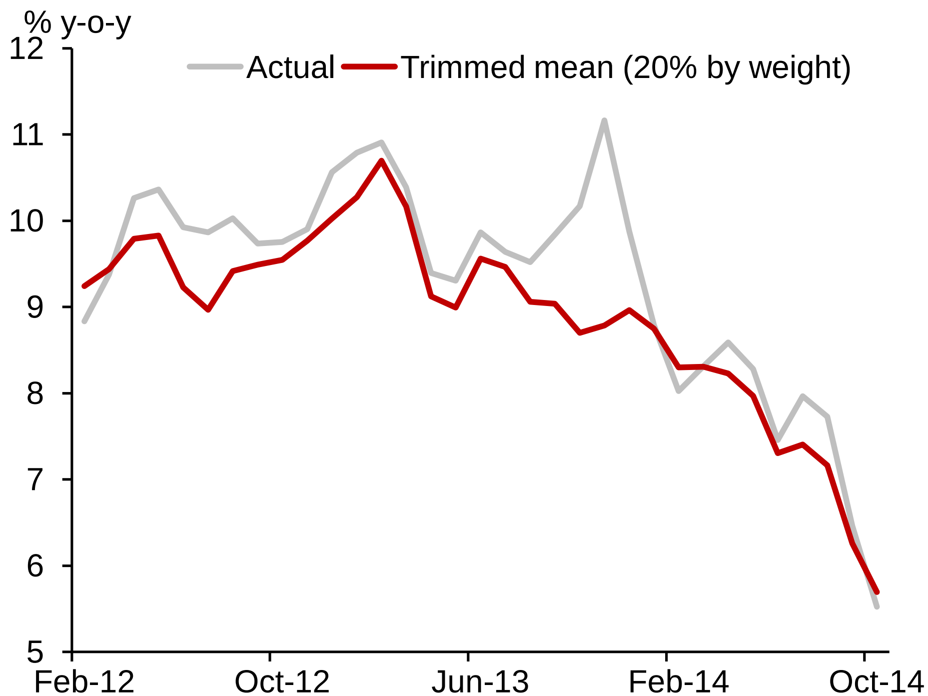
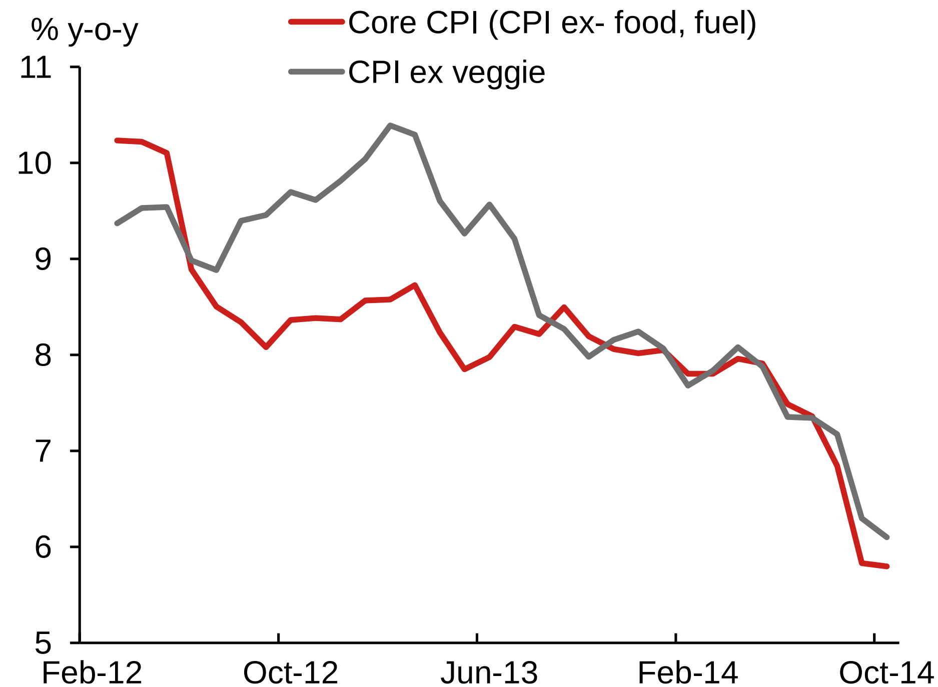
CPI inflation: 20% trimmed mean and actual



Core CPI inflation and CPI ex-vegetables



Most measures suggest that the underlying trend of disinflation has continued. Our estimate of trimmed mean CPI inflation has fallen from 9-10% last year to 5.7% currently.

Source: CEIC and Nomura Global Economics

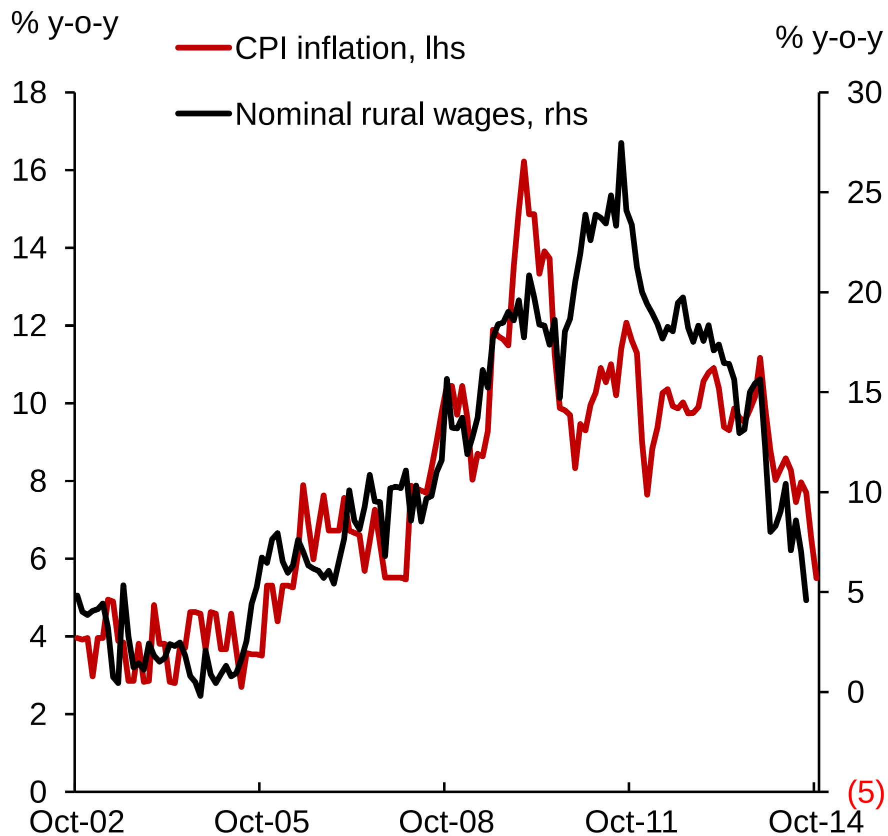
CPI more sensitive to wages than growth

Sensitivity of CPI inflation to output gap, rainfall and rates is low, but very high to rural wages

Correlation between macro variables and CPI inflation components

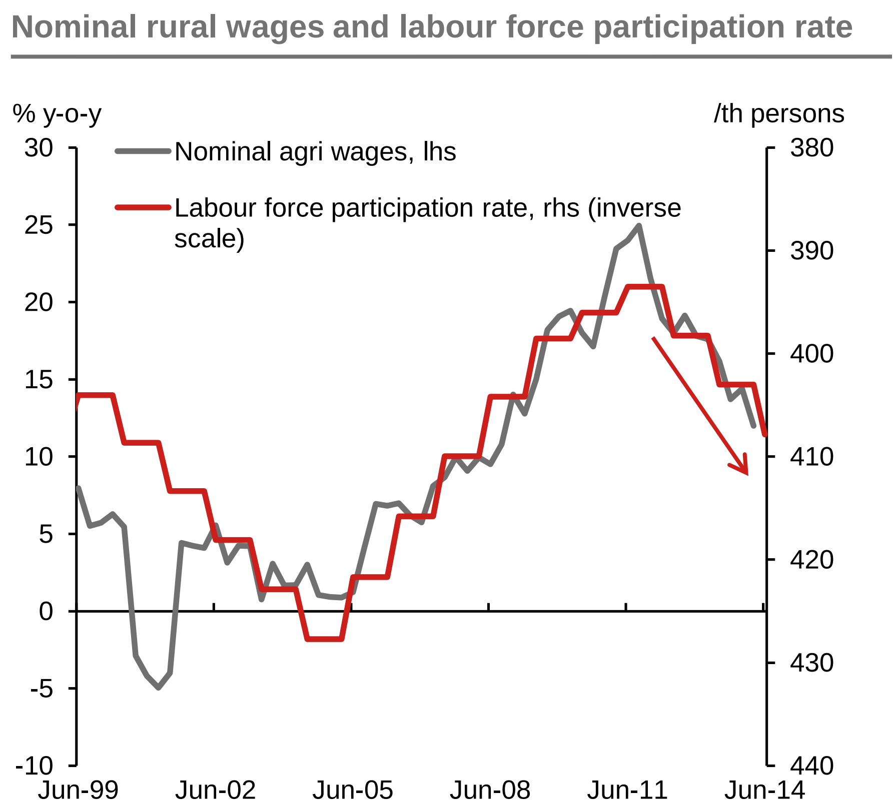
Expected sign	Positive	Positive	Positive	Positive	Negative	Negative
	Inflation Expectations	MSP	Nominal wages	Output Gap	Rainfall	Repo rate
CPI	**0.6**	**0.5**	**0.9**	**0.3**	**0.1**	**(0.2)**
CPI food	0.1	0.5	0.8	0.1	0.1	(0.3)
CPI Core	0.8	0.4	0.8	0.4	0.1	(0.2)

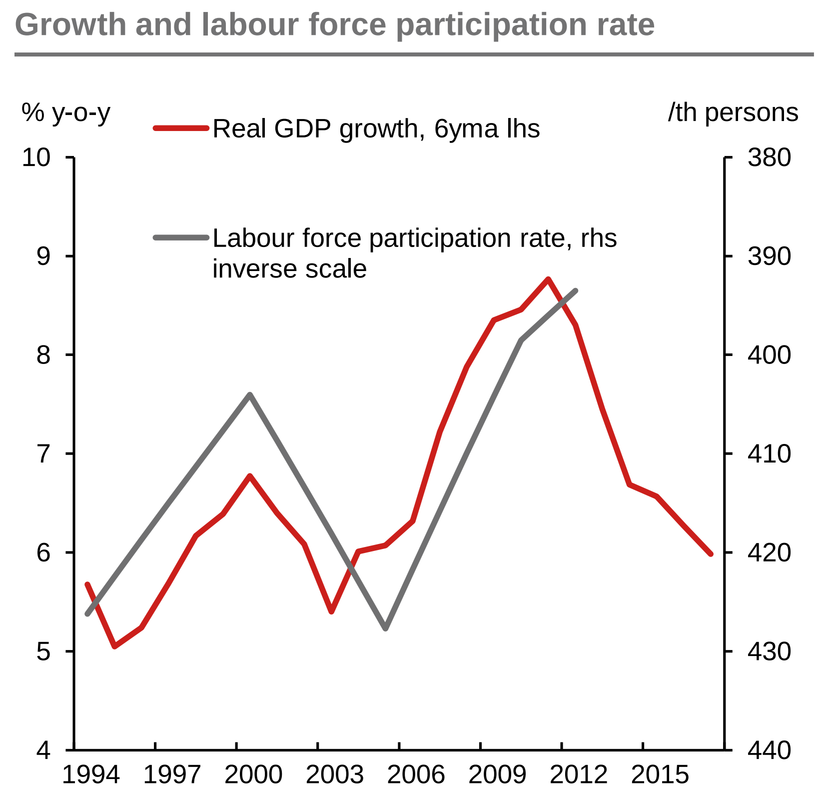
Inflation nominal rural wages



Source: CEIC and Nomura Global Economics

Labour force participation rate is rising





Labour force participation rate should pick up due to the lagged impact of growth slowdown, keeping rural wages in check.

Source: NSSO,CEIC and Nomura Global Economics

Rural wages to stabilise ~5%

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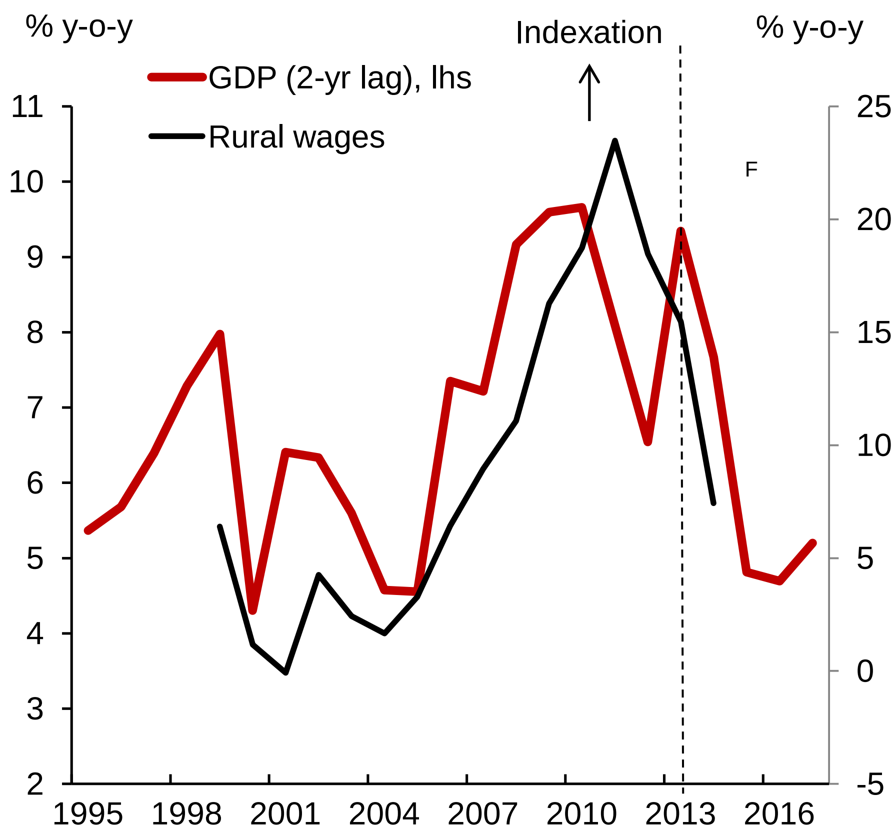
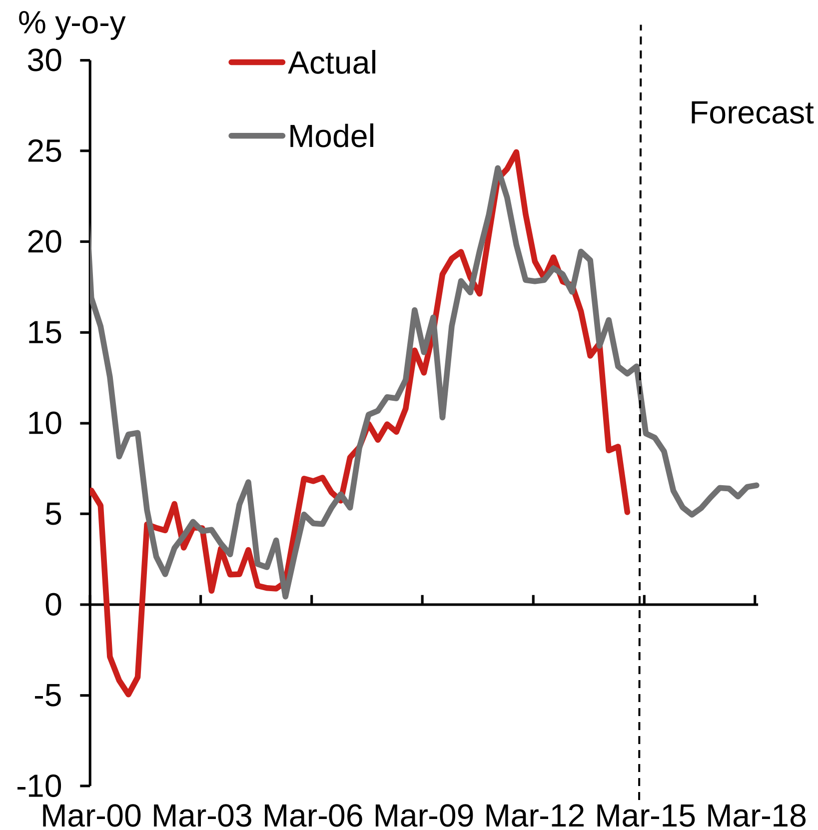
Nominal rural wages and GDP growth



Rural wages: Actual vs. model forecast

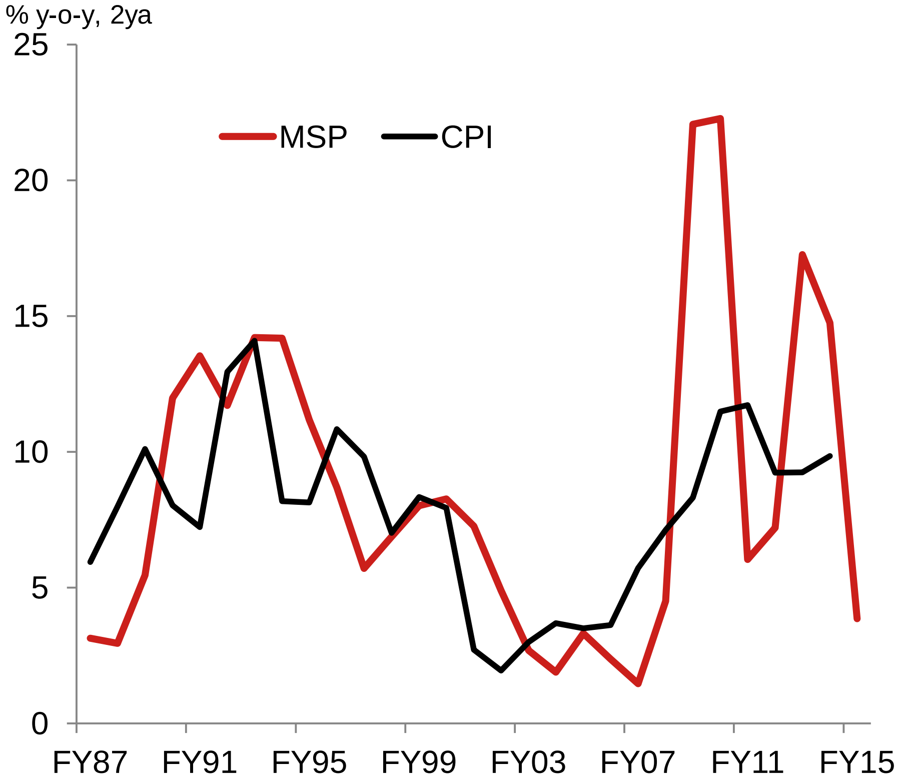


Past growth slowdown to keep rural wages contained in 2015.

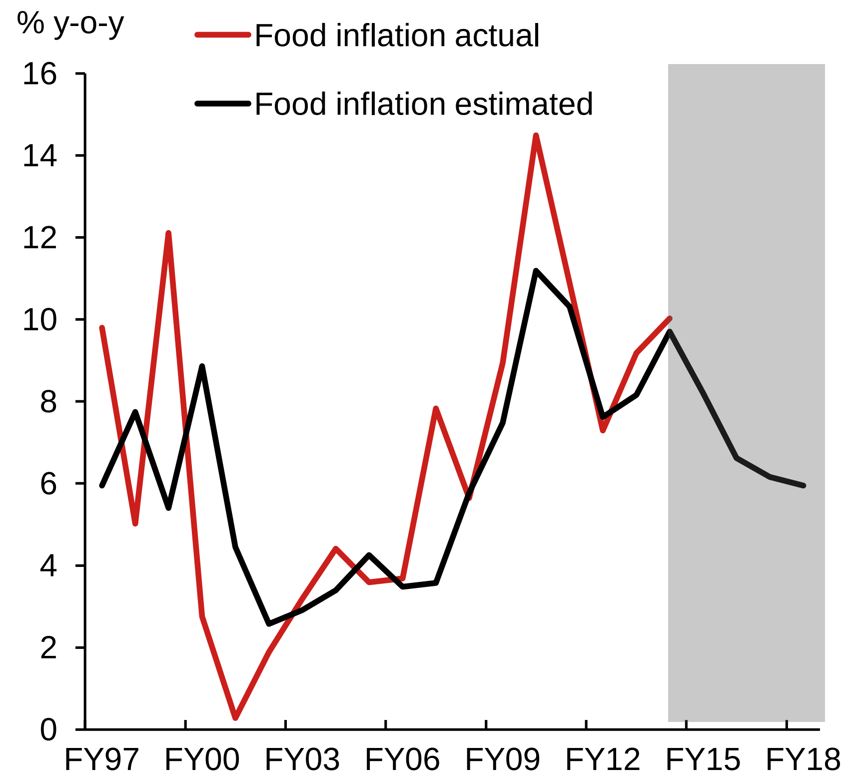
Source: CEIC and Nomura Global Economics. Rural wages are estimated as a function of output gap, MSP and lagged CPI.

Low MSPs bode well for the CPI outlook

MSPs are important in the long run



Estimated food price inflation if MSP rise @ 4% p.a.

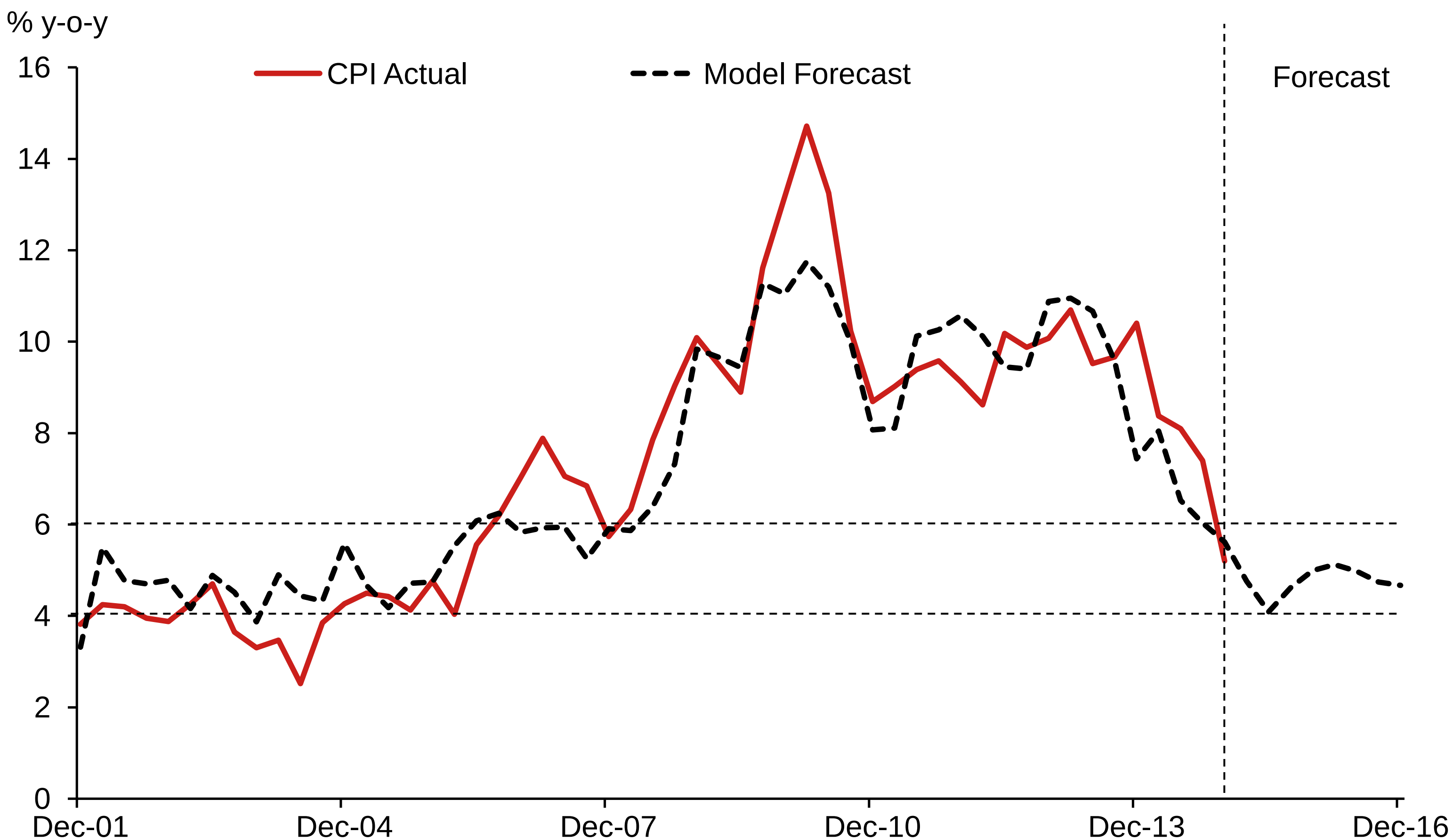


If the MSP increase is kept at 4% p.a. over the next three years (and there are no adverse supply shocks), then the MSP-food-wage spiral could be gradually circumvented.

Note: Food inflation estimated as a function of MSP(-1) and rural wage.
Source: CEIC and Nomura Global Economics

Victory against inflation…finally

CPI inflation: Actual versus fitted



Note: The CPI model uses nominal rural wage, minimum support prices , output gap, repo rate and rainfall as explanatory variables.
Source: CEIC and Nomura Global Economics.

Sensitivity to explanatory variables

Variable	Sensitivity		Comments
	Nomura	RBI	
Crude oil prices	USD10/bbl fall in crude oil prices lowers CPI inflation by 15-20bp	USD10/bbl fall in crude oil prices lowers CPI inflation by 20bp	Recent fall in crude oil prices should ↓ CPI inflation by 15-20bp
Minimum Support Prices	5% decrease in MSP prices lowers CPI inflation by 60bp	Lower MSP and normal monsoon will lower CPI inflation by ~ 80bp	Fall in MSP increases from 22% to 5% should help lower CPI inflation by around 2pp over the two year period.
Output gap	100bp narrower output gap increases CPI inflation by 30-40bp	100bp narrower output gap increases CPI inflation by 20bp	As growth picks up in the coming quarters, it will reduce the pace of fall in CPI inflation
Supply side measures by govt	NA	Lower CPI inflation by 90bp	Measures to boost supply of fresh food can have considerable impact on CPI inflation in the near term
Other commodity prices	NA	NA	Marginal direct impact. Limited second round impact on lower input cost for manufactured goods

Source: CEIC and Nomura Global Economics

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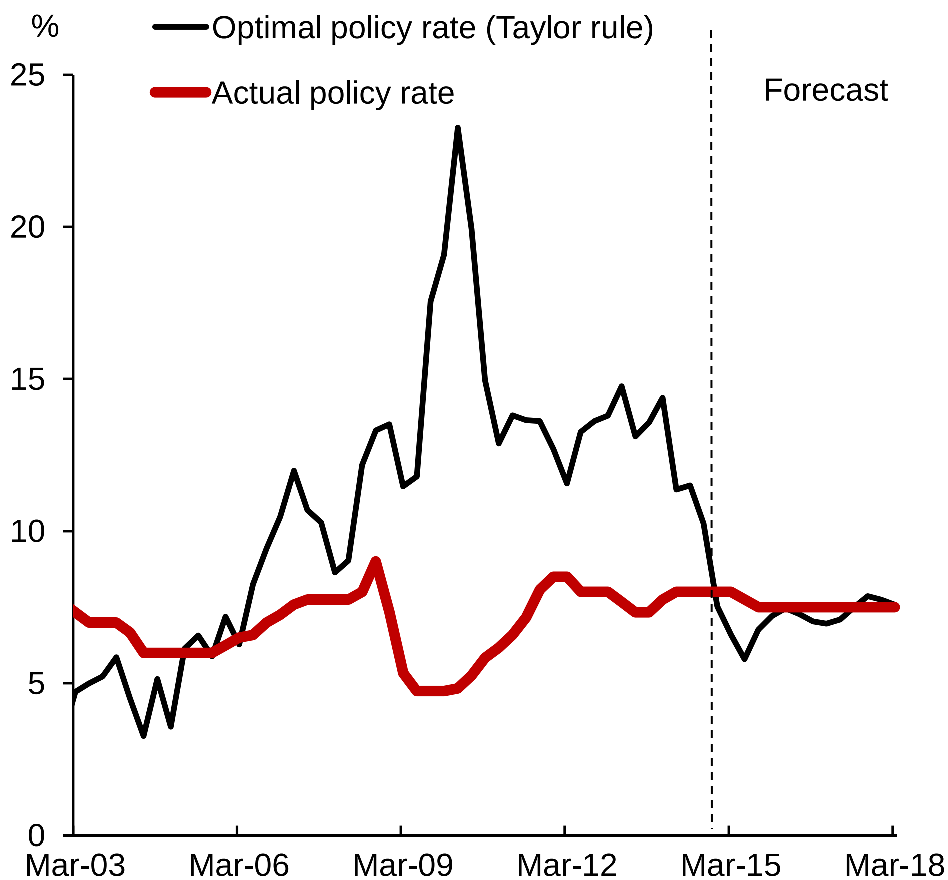
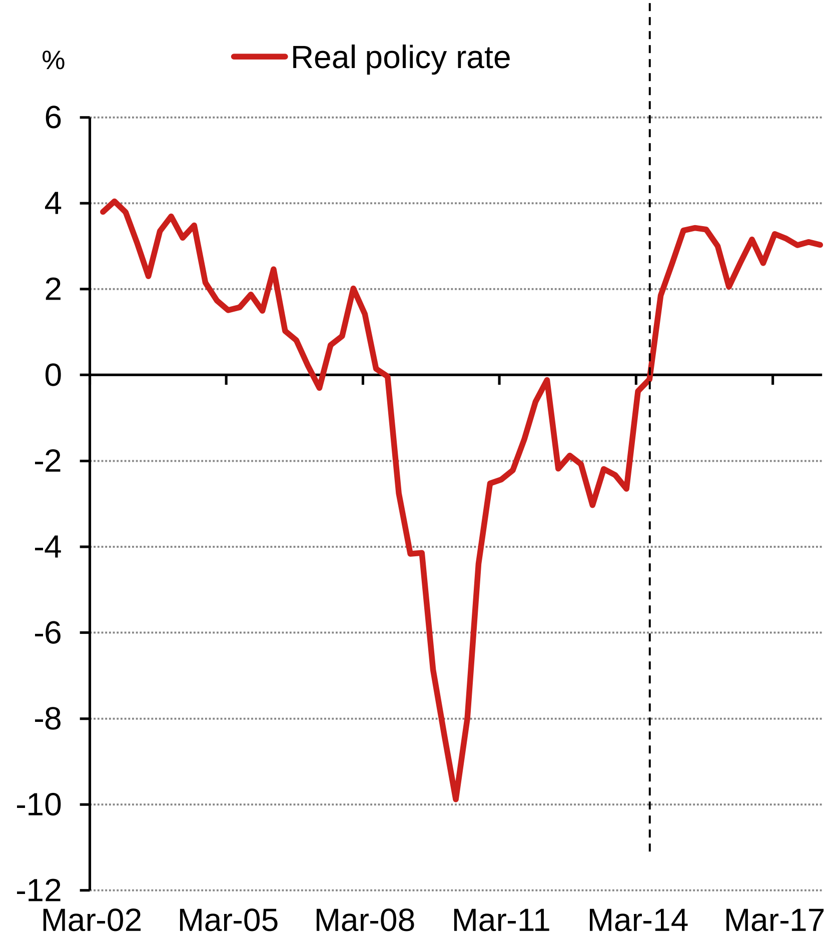
New monetary policy framework = Limited rate cuts

We estimate equilibrium nominal rate at ~7.5% i.e. policy stance has to be neutral-to-tight to meet CPI goals

Optimal versus actual policy rate



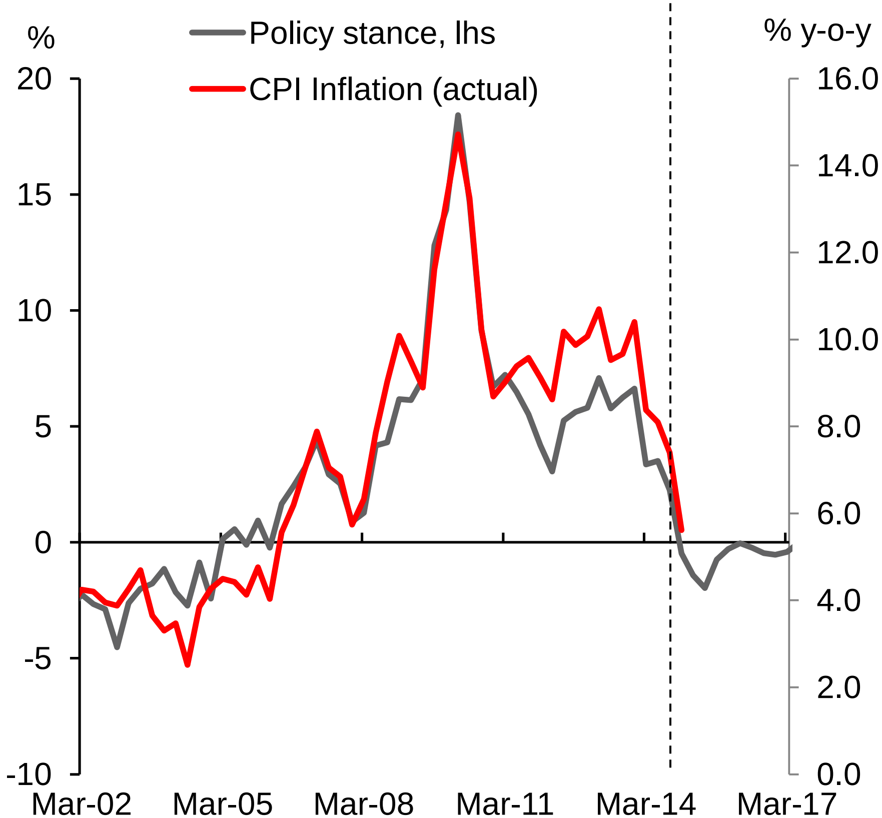
Real policy rate



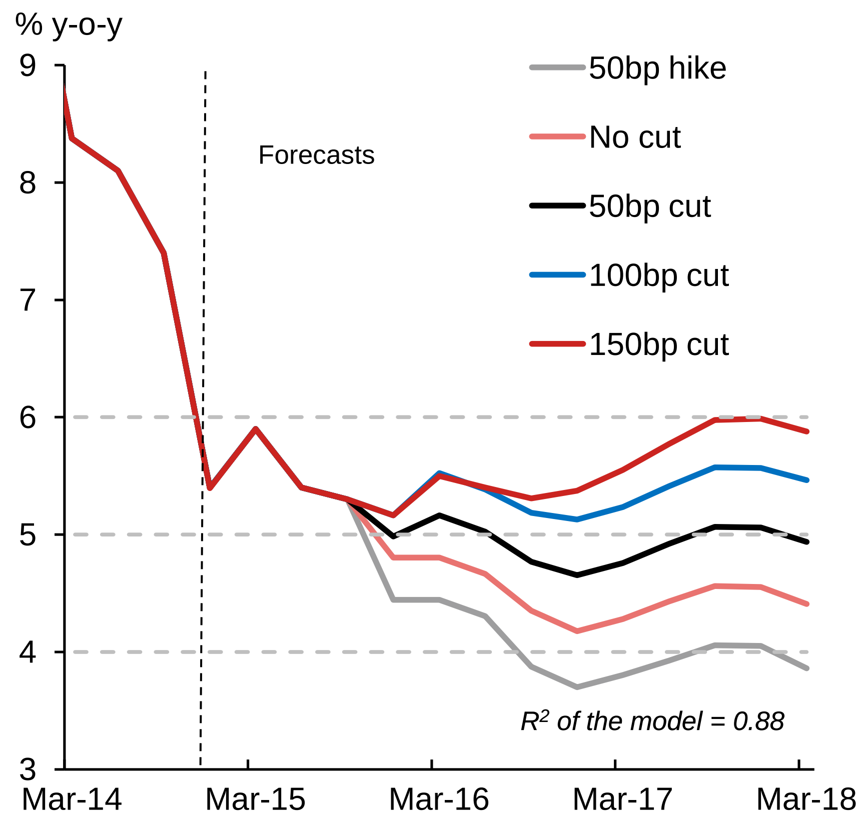
Note: Optimal rate = Neutral real rate + α (Inflation gap) + β*(Output gap), where neutral real rate is assumed as 2% and the inflation and growth co-efficients are taken as 0.5.*
Source: CEIC and Nomura Global Economics.

RBI's policy stance to stay neutral-to-tight

RBI's policy stance vs. realised CPI inflation



CPI inflation: Scenario analysis



We expect the RBI to take real policy rates into positive territory in the coming years, contributing to macroeconomic stability.

Source: CEIC and Nomura Global Economics

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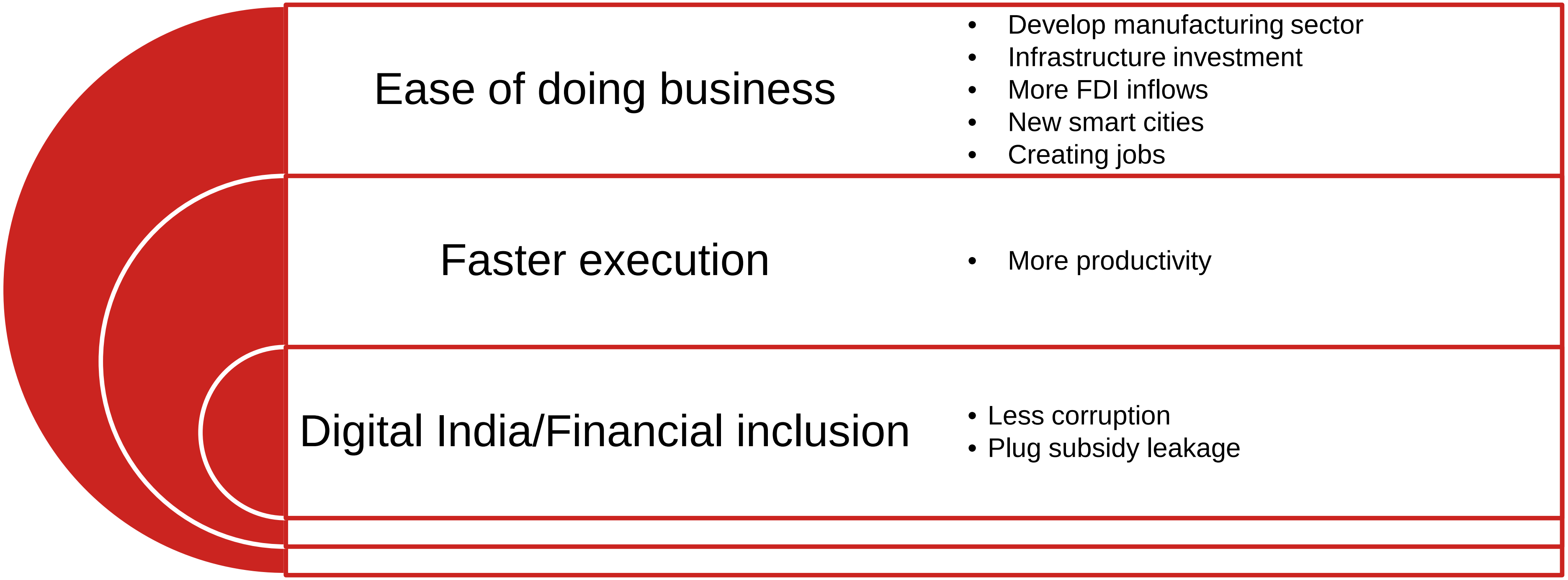
Reforms so far: Execution vs. strategic

Execution	Ease of doing business	Infrastructure	Food inflation	Fiscal	FDI
Reduced size of cabinet	**Skill devt**: amendment to Apprentice Act	To set up InvIT (Infrastructure Investment Trust); incentivise REITs	Potatoes and onions under Essential Commodities Act	Domestic natural gas prices reviewed	Defense to 49% (from 26%)
Abolished all EGoMs, Groups of Ministers (GoMs)	**Less regulation**: Scrap obsolete laws such as Boiler (Inspection) Act & move to self-certification	Roads Ministry empowered to amend the Model Concession Agreement	Minimum support prices raised by around 2.5% vs.15% (6-yr CAGR)	Diesel price deregulated	Rail infrastructure to 100%
Better inter-ministerial co-ordination	Validity of Industrial License extended from two years to three years	Banks to issue long-term infra bonds with no statutory pre-emption	To restructure Food Corporation of India	10% blanket cut in discretionary spending announced.	Insurance to 49%, but referred to select committee in Rajya Sabha (26%)
Focus on deliverables	Self-certification by citizens instead of affidavits	Sagarmala project	States urged to remove vegetables, fruits from APMC Act	Expenditure management commission constituted	
Monthly meetings & targets	**Online clearances**: Environmental & forest clearance online; 16 states also online	Bullet train	To make hoarding non-bailable offence	Goods and Services Tax on the anvil	
	Labour laws: Considering amendments in the Child Labour Act, Factories Act, Minimum Wages Act	National fibre-optic grid	Set up first of many food parks under the PPP model in Karnataka		
	To allow women to work on night shifts in a factory; raise overtime hours limit	100 smart cities	Imposed restrictions on states to announce additional mark-up over MSP.		
	Single web portal for online registration of units, reporting of inspections	E-auction of coal mines; commercial coal mining	Proposed restricting NREGA to tribal areas and thus make wages more market determined.		

Source: Nomura Global Economics.

There's method in the madness



A 100-day report card

- No big bang reforms; govt using political capital judiciously, so reforms to be incremental
- Reforms are micro, not macro
- Focus on ease of doing business to help attain target of developing manufacturing sector
- Faster execution implies productivity/efficiency will rise
- Digital and financial inclusion campaigns can reduce corruption and plus subsidy leakages
- Focus on indigenous production (lower imports)

Long term projects in focus

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Financial Inclusion

- Under Jan Dhan Yojana, target to open bank account for all households by 2016. To provide overdraft facility, RuPay debit card with inbuilt accident insurance and RuPay Kisan card
- To help increase households financial savings (target unbanked population) and later directly transfer government subsidies to the same account (reduce leakage)

Make in India

- Develop India as a global manufacturing hub. Sub-sectors covered include machine tools, textile machinery, construction and mining machinery and process plant machinery, semiconductors, electronics, textile, agro industries, among others.
- Sagarmala project to lead to port-led development and become a major link for "Make in India"
- Create jobs and reduce import dependence

Digital India

- To digitally empower the country by 2018 including availability of all government services online
- Connect all villages through a fibre-optic network to provide high-speed Internet in Gram Panchayats
- Target net zero electronic imports

Source: Nomura Global Economics.

Reform agenda and timeline

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Focus area	Measure	Timeline
Fiscal	Expenditure Reforms	Q1 2015
	LPG subsidy cap	Q1 2015
	GST Bill	Nov/Dec 2014
Infrastructure	Land acquisition law	H1 2015
	E-auction of coal blocks	Q1 2015
Financial markets	Insurance Amendment Bill	Q4 2014-H1 2015
Ease of doing business	Repeal 72 archaic laws	H1 2015
	Amend labour laws	H1 2015
Economic vision	New Planning Commission	H1 2015
Monetary Policy	New monetary policy framework	Q1 2015
Agriculture/	Restructure Food Corporation of India	H2 2015
	Reduce MGNREGA coverage	Q1 2015
Banking	On-tap/differentiated bank licenses	H1 2015
	Lower govt. stake in public sector banks	H1 2015

Seven themes

- Better governance and higher productivity,
- An improvement in the ease of doing business,
- Infrastructure development,
- Indigenous production (Make in India),
- Digital India
- Financial inclusion
- Fiscal consolidation reforms are micro, not macro

Source: Nomura Global Economics.

Focus on foreign policy

Japan

- Promised **USD35bn** investments over the next five years
- Increased cooperation in the areas of **energy** (**clean/non-renewable** sources), **infrastructure** (**railways and urban transport**)
- Key agreement on the commercial contract between Indian Rare Earths Limited and Toyota Tsusho Corporation for the production of **rare earths** signed
- Japan to be actively involved in developing India's **agricultural** sector
- Collaboration in **defense equipment** manufacturing and military cooperation

China

- **USD20bn** investments in **industrial parks** and **infrastructure** over the next five years
- Investment proposals to be signed between various companies and agencies on both sides.
- MoU establishing '**Sister Province**' relations between Guangdong and Guajarat for co-operation.
- MoU between **Ahmedabad and Guangzhou** for economic and cultural exchange between the two cities
- MoU between Industrial Extension Bureau (iNDEXTb), the nodal agency of Government of Gujarat for investment promotion, and China Development Bank, under which iNDEXTb will **assist Chinese investors in obtaining required clearances** and creating infrastructure facilities in the industrial parks.
- Enhanced cooperation in the **Railway** sector in following areas: (i)speed-raising, (ii) studying feasibility of cooperation in High-Speed Railways, (iii) Redevelopment of Railway stations
- Setting up of an industrial park in Maharashtra

Source: Nomura Global Economics.

State governments set to play a bigger role

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- **Why?**

Shift in electoral dynamics: Outcome of the last general elections and the recent state elections clearly indicates a shift in electoral dynamics in India towards development centered issues. Political parties across the country are increasingly realizing that they need to deliver on growth and development to retain power.

- **How?**

Rising clout of BJP in the states: Today BJP governed states account for more than 50% of the national economy. Greater ideological coherence and coordination between the central and state government should further improve the policy environment and lead to higher growth in the country. Most importantly it wil help government push legislative reforms such as GST and land acquisition. Further, more than 90% of Delhi Mumbai Industrial Corridor, the mega manufacturing corridor project now lies in BJP states.

Increasing competition: The pressure to deliver on growth, jobs and development promised during the elections is pushing state governments to push their own reform agendas. For example: Rajasthan, Madhya Pradesh and Gujarat each hold their own investor outreach programs to attract investments in the state.

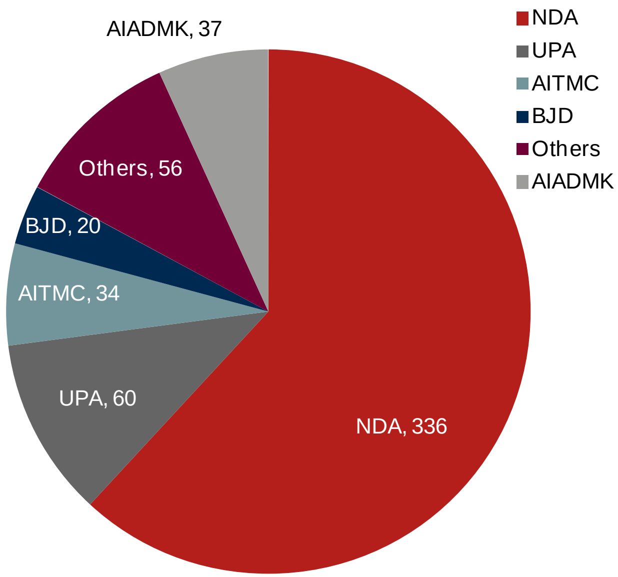
States hold the key to ease of doing business: The onus of improving the ease of doing business lies as much on the stats as on the central government. Most of the last mile issues such as land, water, power and labour are either state matters or come under the concurrent list.

Modi likely to devolve involve states much more actively: The new PM has often indicated that he would make the states a partner in the overall development of the country. Any effort to devolve power to states would allow progressive states to pursue reforms and with demonstration effect they can spread over rest of the country.

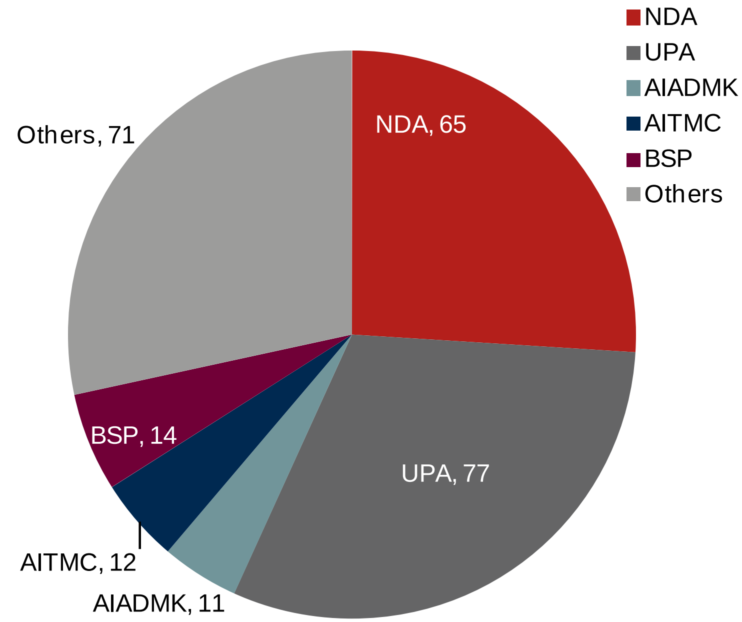
Source: Nomura Global Economics.

Political strategy: consolidate in Rajya Sabha

Lok Sabha (lower house); total seats: 543



Rajya Sabha (upper house); total seats: 245

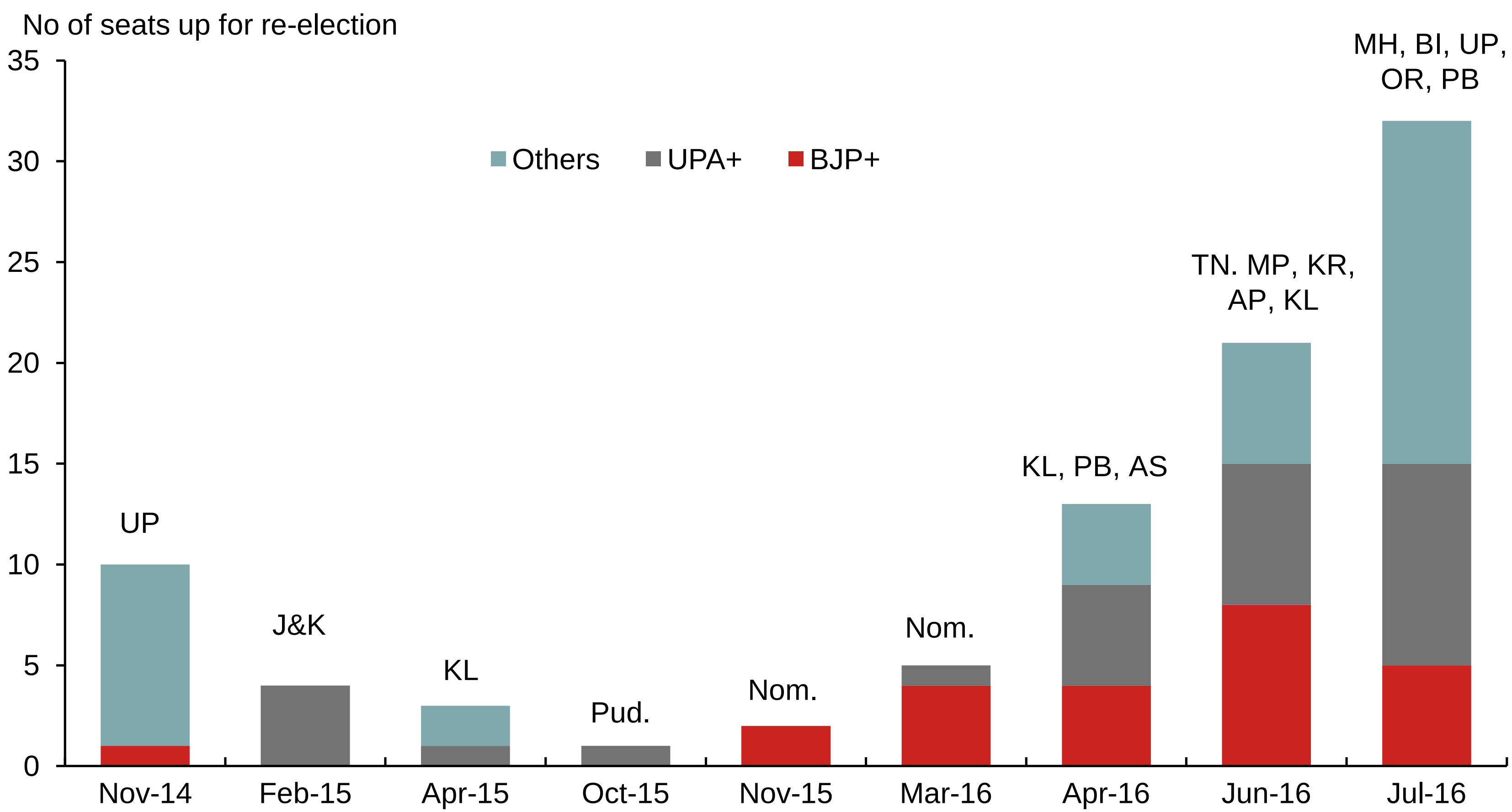


BJP's strong performance in the recently concluded state elections in Haryana and Maharashtra should incrementally help the government increase its strength in the next round of elections in the Rajya Sabha.

Source: ECI and Nomura Global Economics.

Re-election schedule in Rajya Sabha

Most Rajya Sabha seats are up for re-election in 2016



Source: ECI and Nomura Global Economics.

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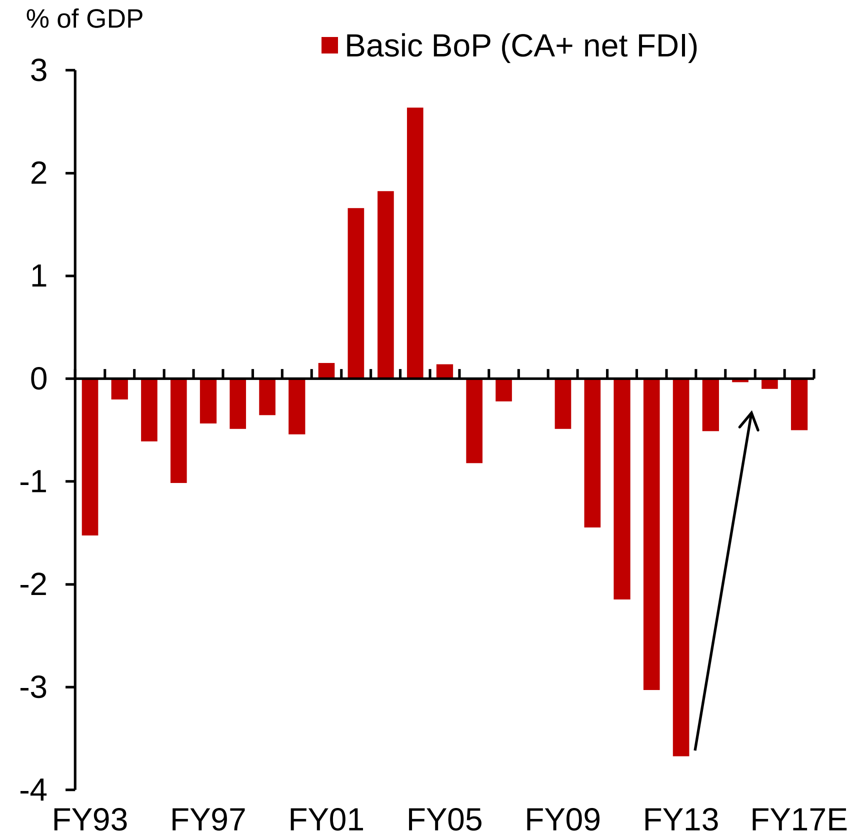
A problem of plenty on the external sector

BoP forecasts currently tracking a USD40bn surplus

	USD bn	FY12	FY13	FY14	FY15F	FY16F
A	**Current Account**	**(78.2)**	**(88.2)**	**(32.4)**	**(29.1)**	**(36.8)**
1	**Merchandise**	**(189.8)**	**(195.7)**	**(147.6)**	**(145.8)**	**(158.2)**
	Exports	309.8	306.6	318.6	336.4	349.9
	Imports	499.5	502.2	466.2	482.2	508.1
	Oil	155.0	169.4	165.2	160.0	**155.0**
	Gold	56.5	53.8	28.1	30.1	**31.8**
	Non-oil/non-gold	288.1	279.1	273.0	292.1	321.3
2	**Invisibles**	**111.6**	**107.5**	**115.2**	**116.7**	**121.4**
	Services	64.1	64.9	73.0	78.1	84.0
	Transfers	63.5	64.0	65.3	65.0	66.0
	Income	(16.0)	(21.5)	(23.0)	(26.5)	(28.6)
B	**Capital Account**	**67.8**	**89.3**	**48.7**	**68.9**	**83.9**
3	Foreign Direct Investment (net)	22.1	19.8	21.6	30.0	35.0
4	Portfolio Investment	17.2	26.9	4.8	38.0	25.0
5	Loans	19.3	31.1	7.8	16.0	24.0
	External Assistance	2.3	1.0	1.0	2.0	2.0
	Commercial Borrowings	10.3	8.5	11.8	9.0	12.0
	Short Term Credit to India	6.7	21.7	(5.0)	5.0	10.0
6	Banking Capital	16.2	16.6	25.4	(5.0)	8.0
7	Rupee Debt Service	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
8	Other Capital	(6.9)	(5.0)	(10.8)	(10.0)	(8.0)
C	**Overall Balance**	**(12.8)**	**3.8**	**15.5**	**39.8**	**47.1**
	Current account (% of GDP)	**(4.2)**	**(4.7)**	**(1.7)**	**(1.4)**	**(1.6)**

Improved basic BoP suggests less vulnerability



We expect the current account deficit to remain at sustainable levels (<2% of GDP) and an overall balance of payments surplus of around USD45bn; basic BoP has improved sharply.

Source: CEIC and Nomura Global Economics estimates.

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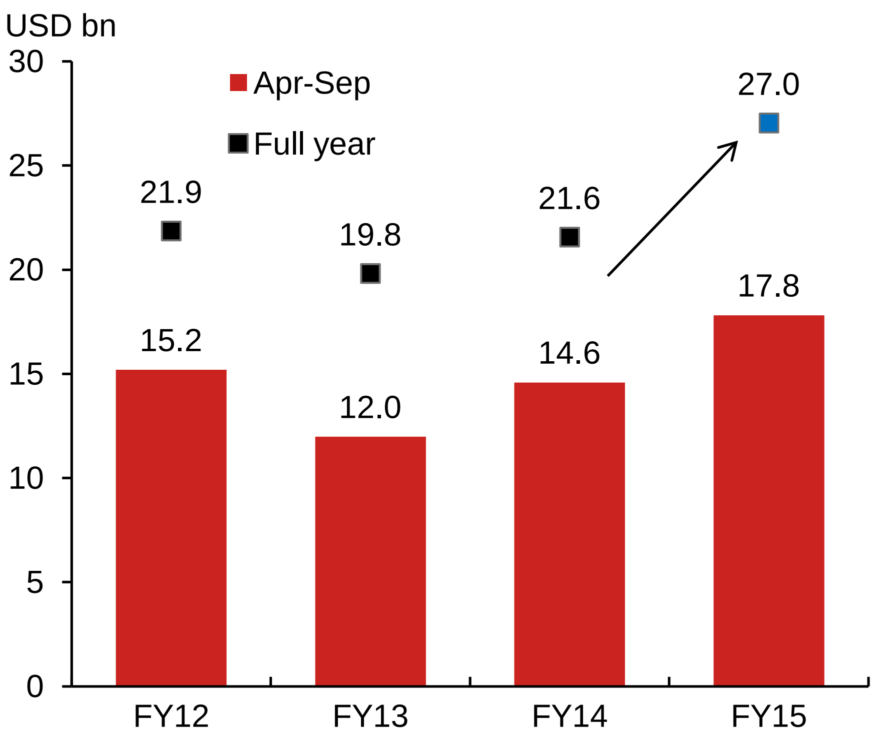
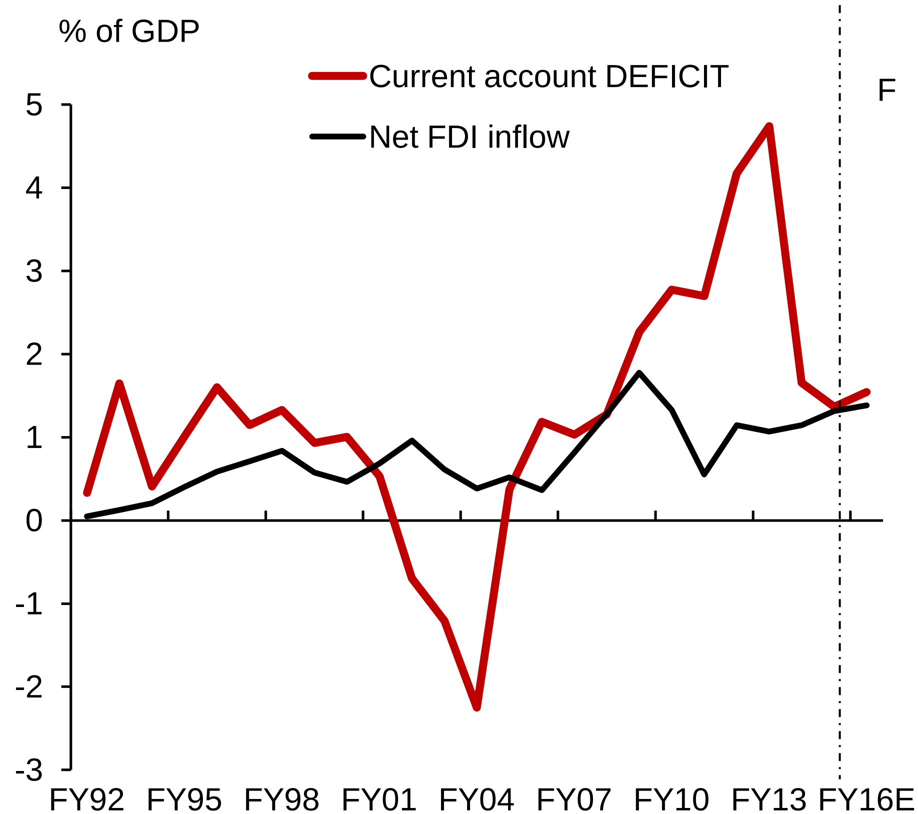
FDI inflows to surge sharply this year

Net FDI inflows tracking USD30bn in FY15



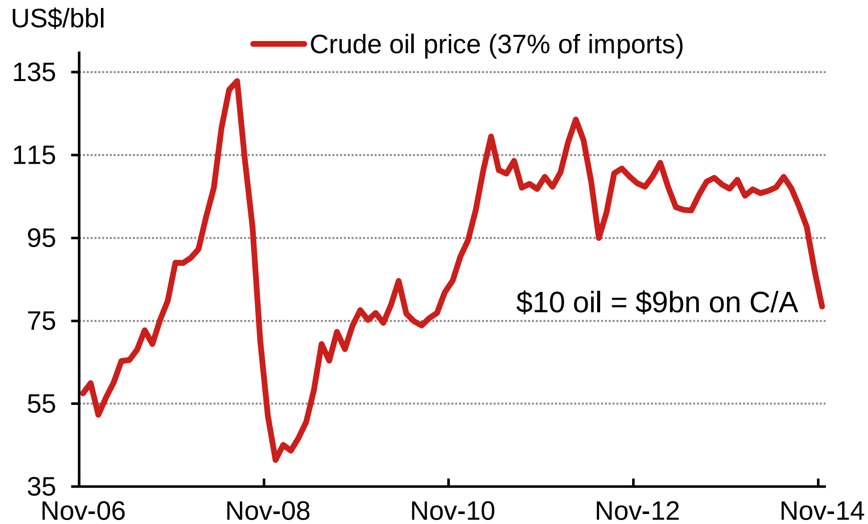
Basic balance (Current account + net FDI)

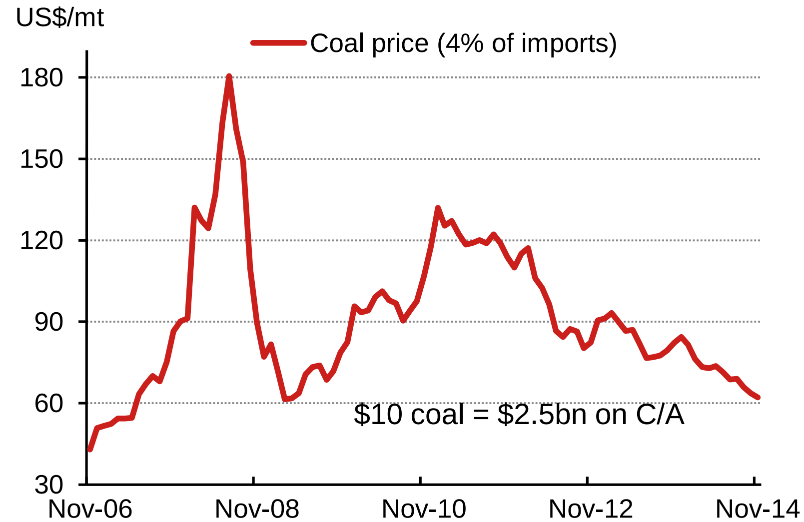


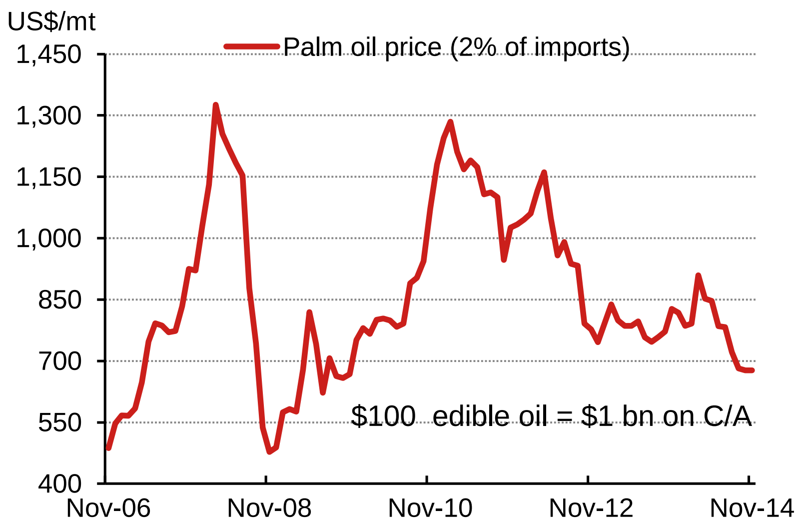
A substantial portion of the current account deficit is being financed through the more stable net FDI inflows. Most of the volatile (non-FDI) flows have reversed in the last 12 months, reducing the risk of a large outflow.

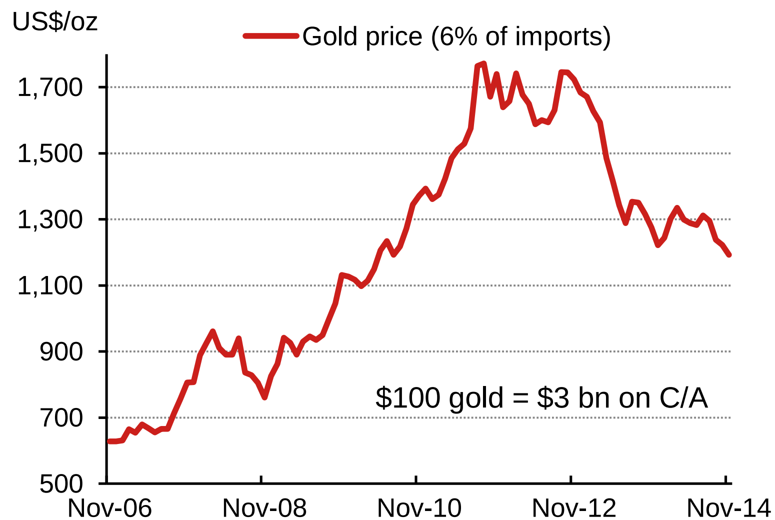
Source: CEIC and Nomura Global Economics estimates.

Lower commodity price to offset higher volumes









India is undergoing a positive terms of trade shock. Lower commodity prices should partly offset the impact of higher import volumes.

Source: Bloomberg and Nomura Global Economics.

When gold restrictions go: Not a worry

	Gold import volume	Gold price	Gold import value
	mt	$/oz	USD bn
FY04	612	378	7
FY05	878	414	10
FY06	826	477	11
FY07	818	628	14
FY08	797	766	16
FY09	880	868	21
FY10	982	1024	29
FY11	1106	1295	41
FY12	1219	1647	56
FY13	1141	1654	54
FY14	731	1328	28
Without restrictions	**970**	**1300**	**36**

mt	Total gold demand	Consumption demand	Investment demand
2007	802.9	579.5	223.4
2008	672.6	476.2	196.4
2009	445.0	372.1	72.9
2010	1006.3	657.4	348.9
2011	962.9	596.9	366.0
2012	869.7	565.7	304.0
2013	933.4	602.9	330.5

Removal of gold restrictions will NOT result in a substantially higher gold import bill due to lower gold prices and lower investment demand (lower inflation, lower returns, and lesser scope for corruption).

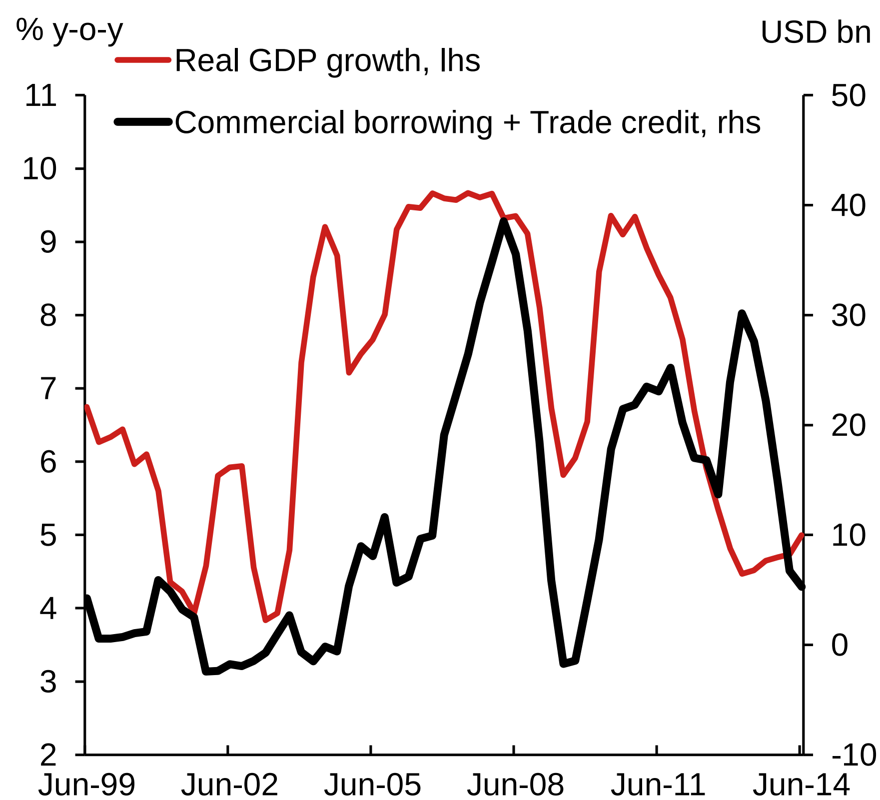
Source: WGC, CEIC and Nomura Global Economics.

Capital flows are more growth sensitive

Correlation between growth and capital inflows (t)

	Net FDI	FII-equity	FII-debt	ECB	Short-term trade credit	Banking capital	Other capital
t	-0.02	0.17	0.26	0.41	0.35	-0.16	0.08
t+1	0.05	0.08	0.30	0.51	0.36	-0.16	0.10
t+2	0.13	0.01	0.33	0.60	0.35	-0.16	0.11
t+3	0.22	-0.03	0.32	0.66	0.33	-0.16	0.13
t+4	0.32	-0.04	0.32	0.68	0.34	-0.12	0.12
t+5	0.43	-0.01	0.31	0.63	0.36	-0.06	0.07
t+6	0.52	0.04	0.31	0.56	0.39	-0.05	0.02

Higher growth attracts not just equity, but also debt inflows



As growth recovers, equity inflows rise: portfolio equity inflows pick up quickly, while FDI follows with a lag. Additionally, debt flows – external commercial borrowing and short-term trade credit – are also positively correlated to growth.

Source: CEIC and Nomura Global Economics estimates.

Key risk: Debt capital outflows

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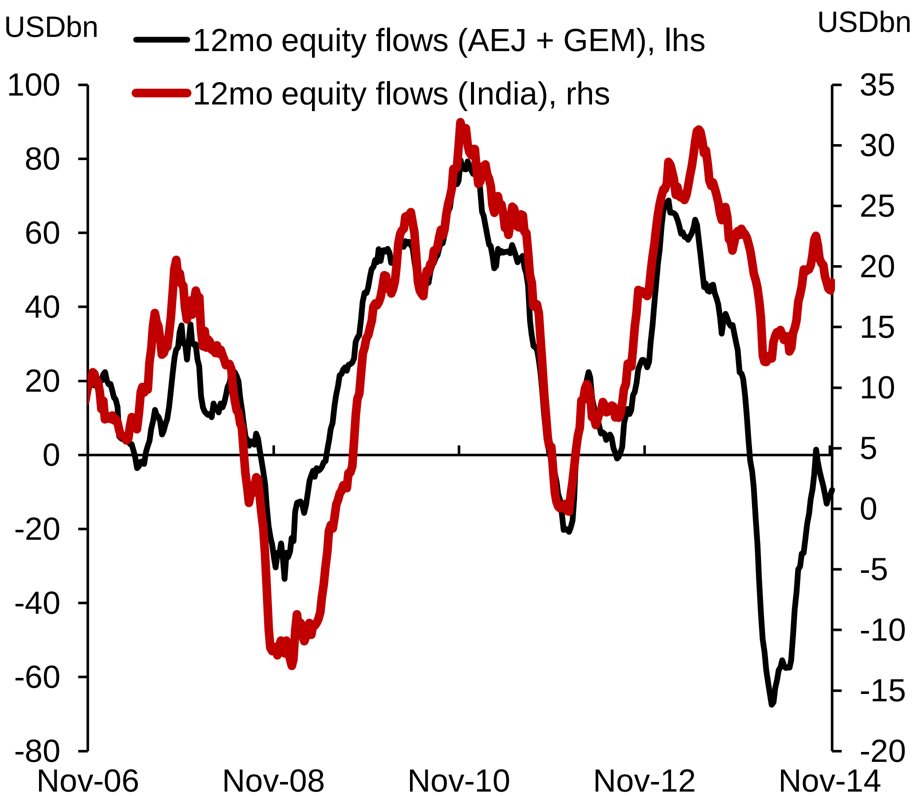
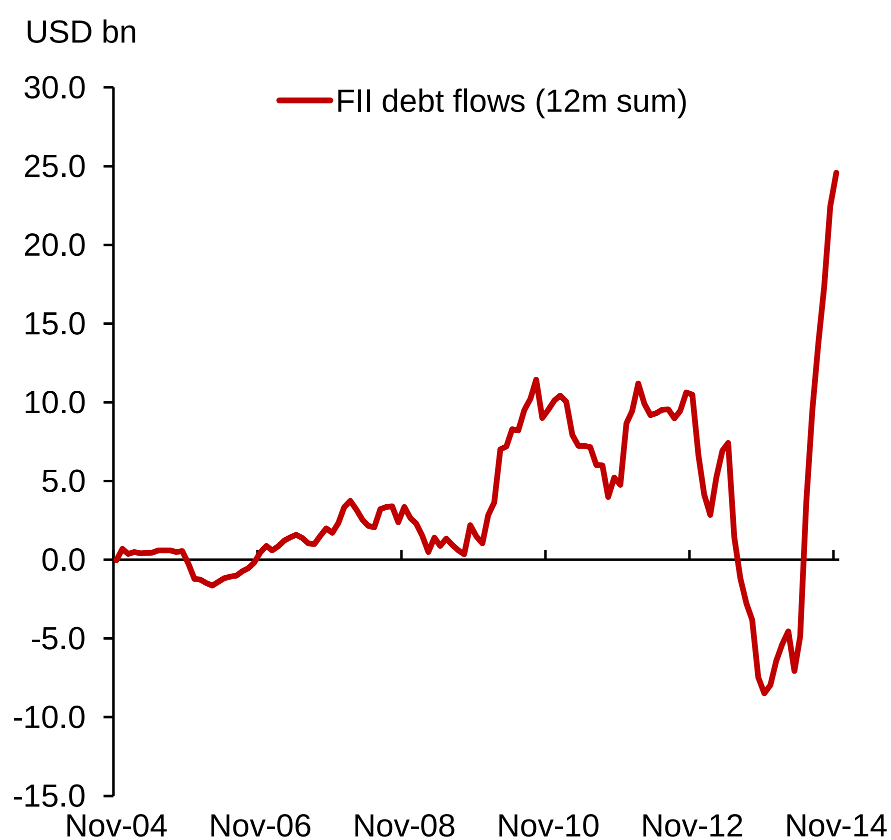
Equity inflows: EM vs. India



Debt inflows: India



Source: EPFR, CEIC and Nomura Global Economics.

Significant scope for equity catch-up

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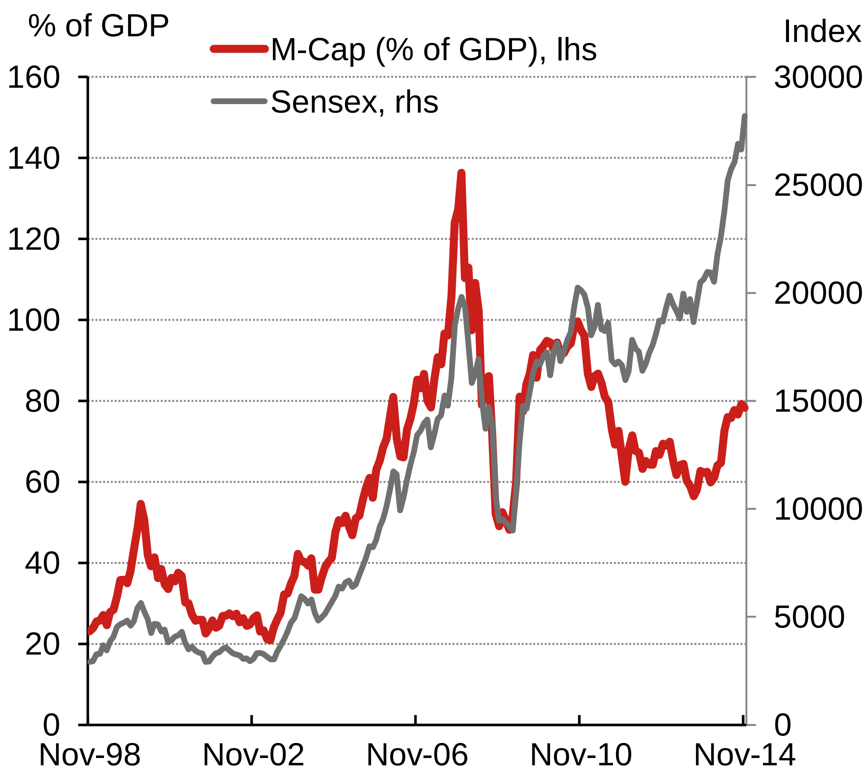
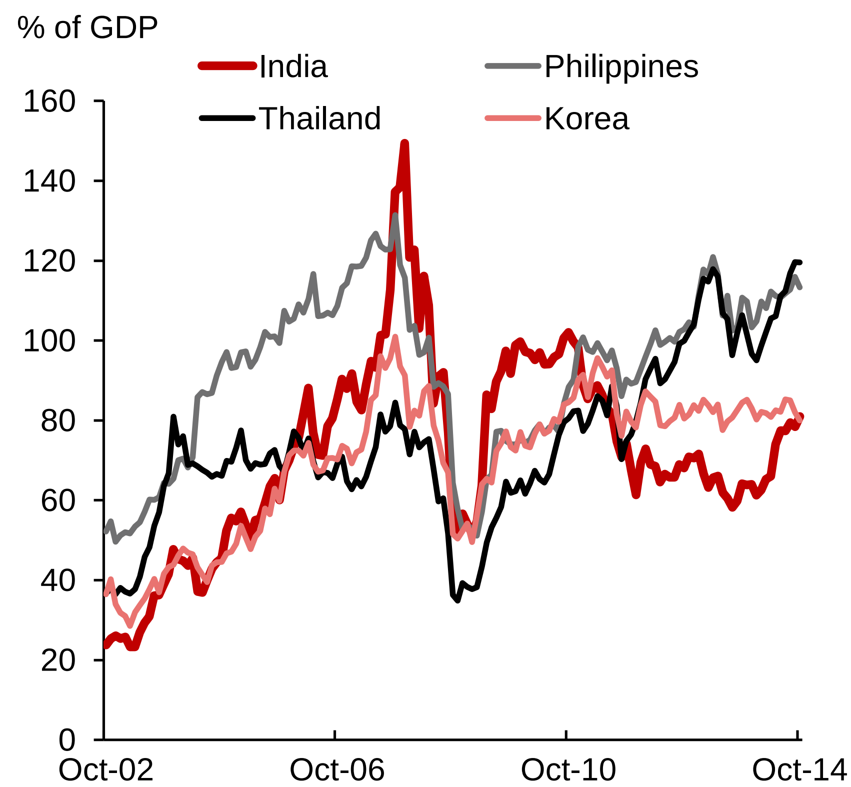
Equity index versus market cap



Cross-country market-cap comparison



India's equity market capitalisation remains well below both its own historical average and below most of its Asian peers, indicating significant upside potential.

Source: CEIC and Nomura Global Economics.

External vulnerability has reduced

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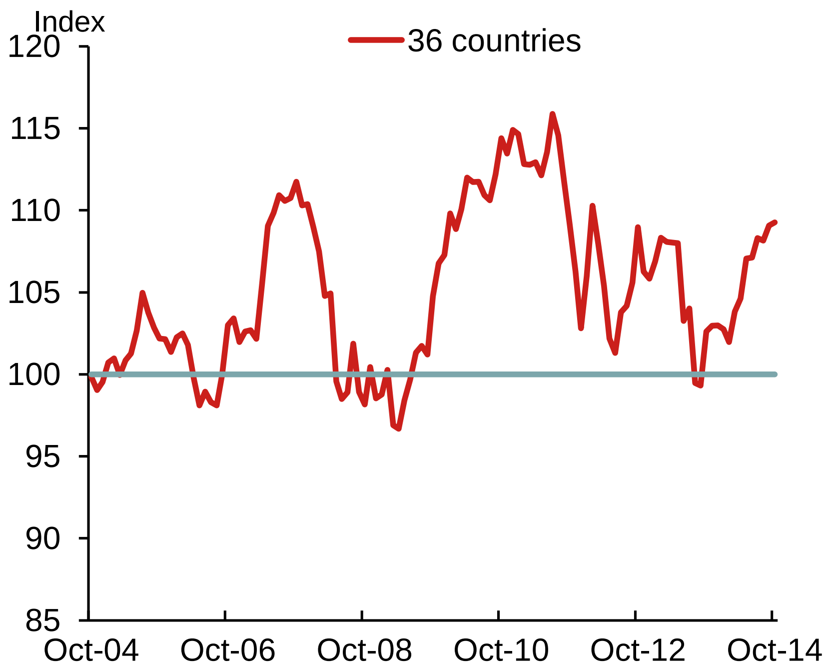
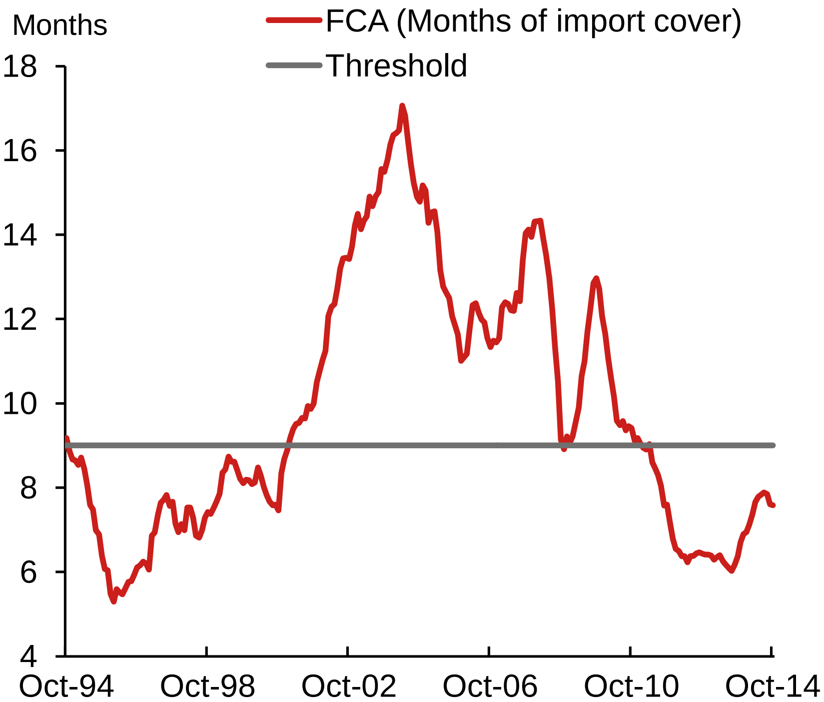
Real Effective Exchange Rate (CPI based)



Import cover



Higher FX reserves, domestic macro stability and a fairly valued currency lower external risk.

Source: CEIC and Nomura Global Economics.

No longer as fragile

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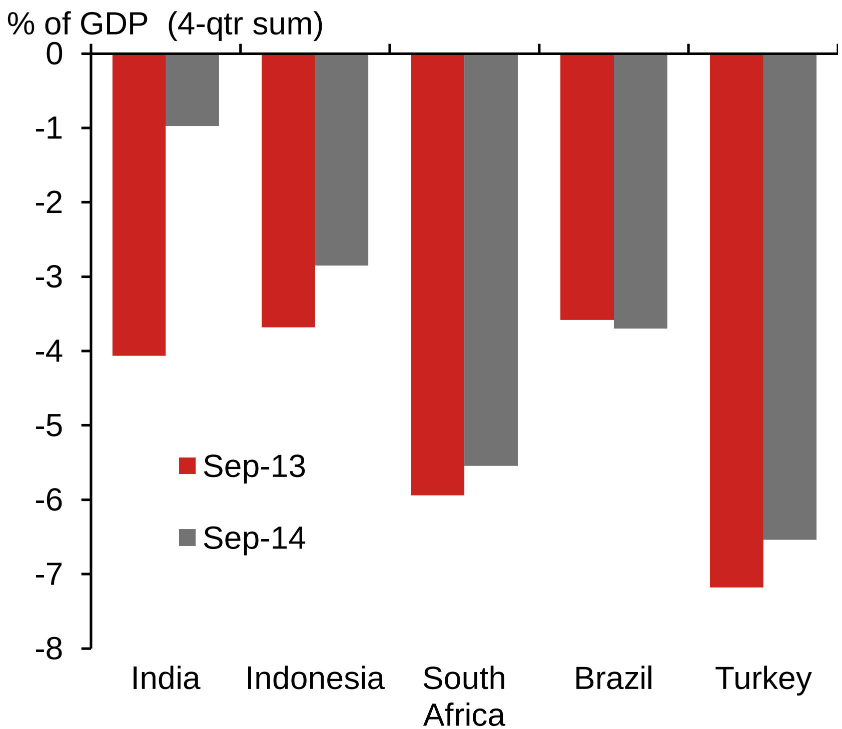
Current account balance



FX change

	Currency low against USD in Sept 2013	Oct-14	Currency Appreciation (+) against USD
India	68.8	61.4	10.8
Indonesia	12261	12085	1.4
South Africa	11.3	11.0	2.5
Brazil	2.45	2.48	-1.0
Turkey	2.34	2.22	4.9

India has had the most significant adjustment in the current account balance, reflecting its relative outperformance.

Note: CA data for India and Turkey are for Q2 2014. Source: Bloomberg, CEIC and Nomura Global Economics.

Appendix

Disinvestment pipeline

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	Market cap (INR bn)	Stake sale (%)	Potential amount raised (INR bn)	Timeline
Disinvestments cleared by cabinet			**427**	
Coal India	2180	10.0	218	Dec-Feb
NHPC	226	11.4	26	
SAIL	350	5.0	17	
ONGC	3315	5.0	166	Dec-Feb
Other candidates			**310**	
BHEL	604	5.0	30	
PFC	391	5.0	20	
REC	333	5.0	17	
NMDC	580	5.0	29	
MMTC	65	5.0	3	
NALCO	154	5.0	8	
HZL	690	29.5	204	

Disinvestment target in FY15: INR434bn

Source: Bloomberg, media reports and Nomura Global Economics.

Focus on fiscal consolidation to strengthen

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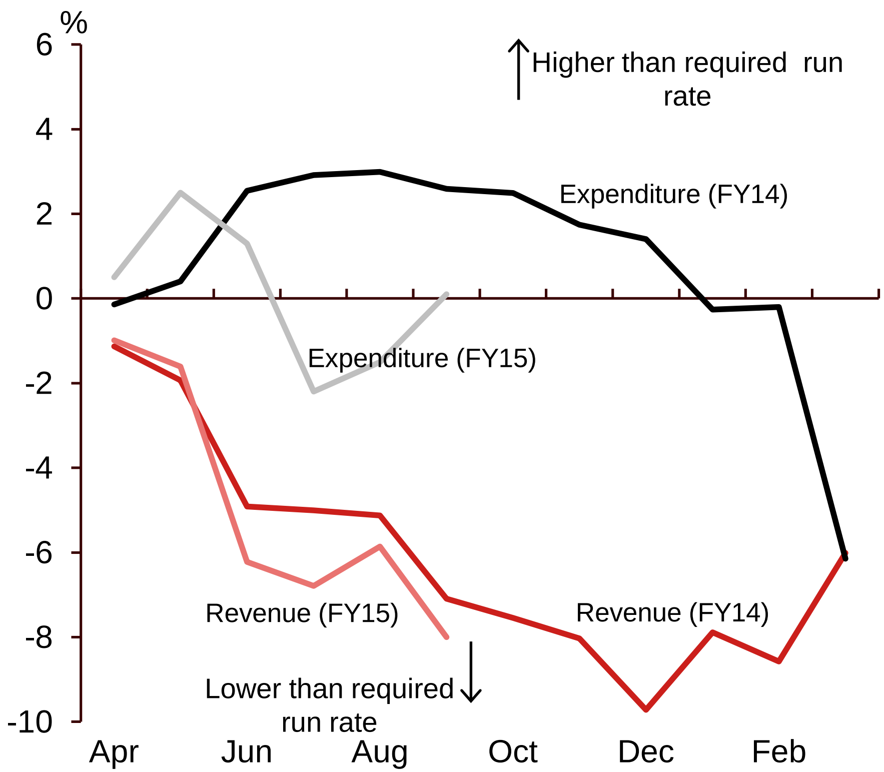
Unlike last two years the reduction in spending is likely to be more spread out



Lower fiscal deficit next year to keep net borrowings largely unchanged

INR bn	FY14 Actual	FY15 BE	FY15 Nomura	FY16 Nomura
Total receipts/expenditure	**15635**	**17949**	**16745**	**18517**
Net tax revenues	**8160**	**9773**	**8866**	**10681**
Corporation tax (% yy)	10.8	14.3	6.0	18.6
Income tax (% yy)	21.1	16.5	15.0	20.0
Customs (% yy)	4.1	17.2	4.0	26.6
Union Excise Duties (% yy)	-4.0	22.2	8.0	20.0
Service Tax (% yy)	16.6	39.7	12.0	20.0
Non-tax revenue	1992	2125	2073	2212
Disinvestment	276	634	484	500
Plan expenditure	**4531**	**5750**	**5175**	**6000**
Non-plan expenditure	**11104**	**12199**	**11570**	**12518**
Food subsidy	927	1150	1046	1098
Fertiliser subsidy	680	730	739	751
Oil subsidy	855	634	534	333
Interest payments	3775	4270	4270	4687
Fiscal deficit	5081	5312	5216	5004
Fiscal deficit (% of GDP)	**4.5**	**4.1**	**4.1**	**3.4**
Revenue Deficit (% of GDP)	3.2	2.9	2.9	2.1
Primary Deficit (% of GDP)	1.2	0.8	0.7	0.2
Net market borrowing	**4689**	**4612**	**4612**	**4477**
Gross market borrowing	**5639**	**6000**	**6000**	**6295**
Redemption	950	1388	1388	1818
Fiscal deficit financed through dated securities	92	87	88	89

Source: CEIC and Nomura Global Economics.

Priorities of the Modi government

Short term	
Boost investments	Introduce single window clearance, time bound environmental clearance; clear 5-10 big investment projects Empanel state chief ministers in Cabinet Committee on Investments
Fiscal	Fiscal audit to ascertain the outstanding payments, phase-out fuel subsidy Effective implementation of the 'right' schemes by linking to asset creation Turn around PSUs without going down the privatisation route Groundwork on implementing the Goods and Services Tax
Center state relation	Autonomy to states on expenditure and developmental plans
FDI	Increase FDI limits in sectors such as defense, railways, construction, infrastructure and online retail
Medium term	
Agriculture	Restructure Food Corporation of India and the Public Distribution System and push states to reform the APMC Act Invest in irrigation; river-linking projects; cold storage; introduce a special rail network
Infrastructure	Railways (incl. high-speed trains), ports, highways, national fibre-optic grid; renewable energy sources, freight corridor. commercial mining
Housing	Substantial low-cost affordable housing program
Governance	Use e-auction route to transfer natural resources
Urbanisation	Create 100 smart cities focusing on concept of twin cities and satellite towns; upgrade existing urban infra
Job creation	Focus on housing, tourism and other labour-intensive industries to generate jobs; focus on MSMEs

Source: Nomura Global Economics.

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