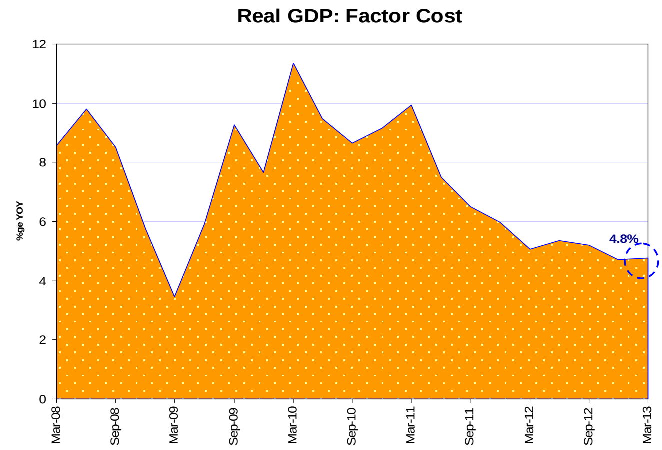
India Update - GDP

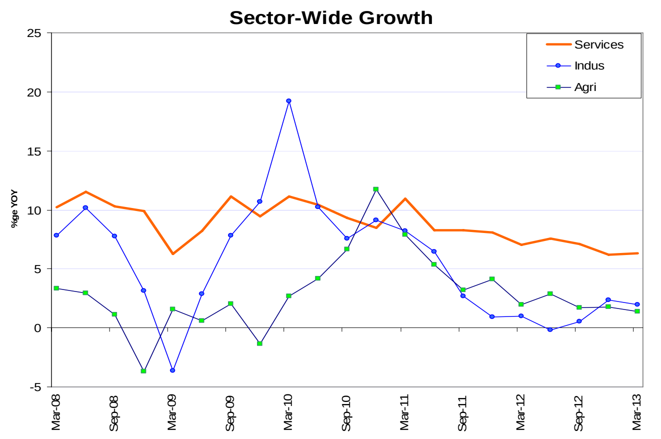
National Australia Bank

- **The Indian economy (Production, at factor cost) expanded by 4.8% in the March 2013 quarter. Annual growth over the 2012-13 fiscal was 5%, the lowest in a decade.**
- **The services sector recorded the fastest growth, while the industry sector, particularly mining, was disappointing.**
- **Partial indicators such as industrial production also reveal generally soft conditions. Moreover, leading indicators such as the RBI's Industrial Outlook Survey do not point to any rapid turnaround in growth.**
- **The Central Government's Gross Fiscal Deficit came in at 4.9% for the 2012-13 FY, an improvement on the 5.2% projection.**
- **The Current Account Deficit remains very high, driven by oil and gold imports. The Government has hiked duties and have imposed restrictions on gold imports by banks and trading houses.**
- **The RBI has also launched Inflation indexed bonds, in a bid to dissuade investors from investing in gold, and better channel savers' funds for more productive investments.**
- **Inflationary pressures are contained, which has provided space to the RBI to cut the benchmark Repo rate.**
- **Foreign exchange reserves remain sufficient to cushion against external liquidity shocks, although short term borrowing by the private sector needs to be monitored for exchange and interest rate risk.**
- **Group Economics is forecasting a growth rate of 5½% during 2013, rising to 6¼% in 2014.**
- **Critical factors include a continuation of the reform process commenced in September 2012, an easing of structural and policy bottlenecks, including more expedited project clearances, as well as a favourable monsoon season.**

Indian GDP Growth



GDP (P): By Sector

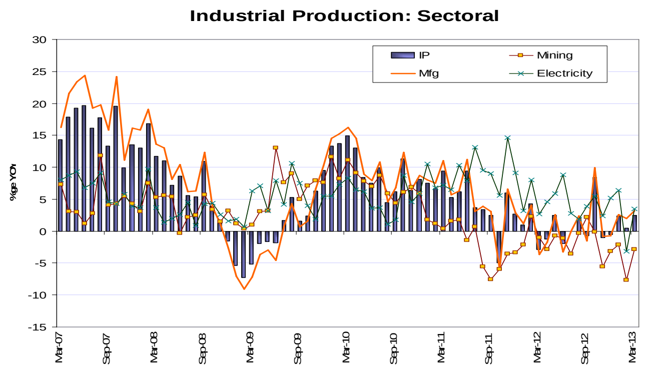


GDP Production and Partials

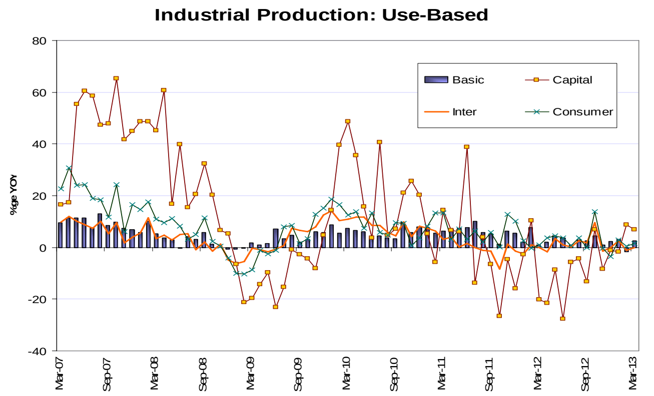
In the final quarter of 2012-13, the Indian economy grew by 4.8%. This was broadly similar to the upwardly revised third quarter estimate of 4.7%. Somewhat softer growth in the last 2 quarters of the current fiscal year has pushed overall growth in 2012/2013 to 5%, the lowest in a decade.

In terms of the various sectors, the *Agriculture* sector expanded by 1.4%; the *Industry* sector grew by 2% and the *Services* sector, the mainstay of the economy, recorded a 6.3% increase. According to advance estimates from the Ministry of Agriculture, there was a slight contraction in the production of rice, wheat and cereal during the 2012-13 fiscal year. The performance of the industry sector has been particularly disappointing, although it has improved since contracting in June 2012. Mining (-3.1%) has been the worst performer, impacted by delays relating to environmental clearances and other regulatory barriers. Manufacturing (2.6%) and electricity production (2.8%) have also seen tepid growth. Finance, property and business services (9.1%) and trade, hotels and transport (6.2%) were the principal drivers of services sector growth. Construction and Community services were somewhat subdued.

Industrial Production - Sectoral



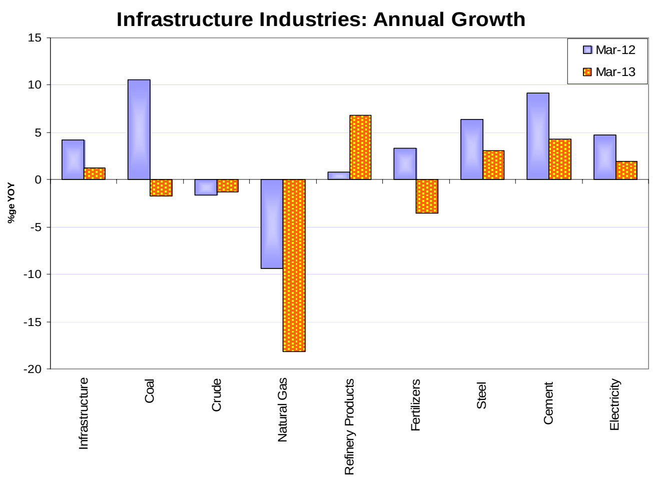
Industrial Production – Use Based



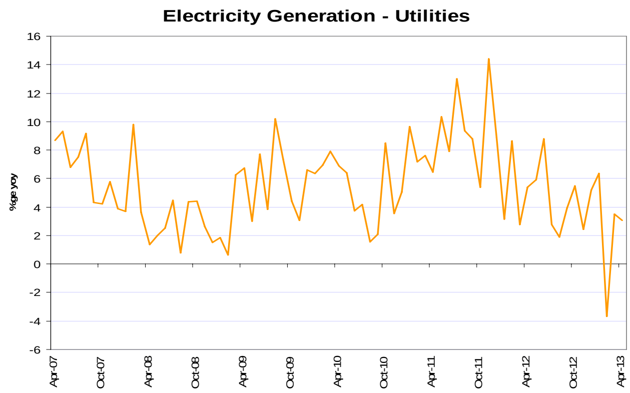
Partial indicators also confirm the weakness, particularly in the industry sector. Over the year to March 2013, industrial production remained muted, growing by 2.5%. This is still somewhat of an improvement from parts of 2012; however, it remains considerably weaker than outcomes during 2010, as well as before the GFC. Mining was by far the weakest, recording a contraction; electricity, manufacturing recorded modest increases.

By use, the silver lining was the increase in capital goods production (+6.9%), although this is a very volatile component. Basic goods, and more particularly consumer goods, remained restrained. However, intermediate goods – a lead indicator for downstream demand – recorded a -0.2% annual contraction in March, indicating further near-term softness.

Infrastructure Industries: Growth



Electricity generation: Utilities



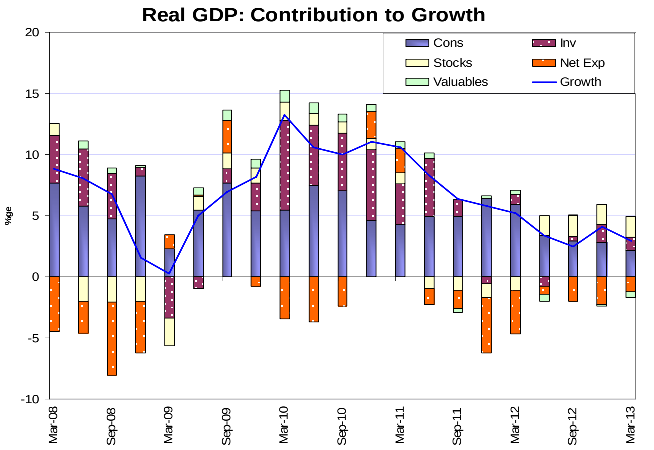
The 8 infrastructure industries remain weak when compared with year ago levels. In the March quarter of 2013, the infrastructure sector expanded by 1.3%, compared with 4.2% a year ago. Refinery products was the only segment to have improved compared with year ago levels. There were dramatic declines in natural gas and fertilizer production. Coal and crude also contracted. Steel, cement and electricity increased at a manifestly slower pace than a year ago.

Electricity production continues to remain weak, and remains an impediment to growth. Key industrial zones such as Gurgaon and Noida, on the outskirts of New Delhi, continue to be plagued by power cuts during the summer months, when there is a surge in electricity demand. This is also visible in the trend for electricity generation by utilities. Since November 2011, electricity generation has shown a visible deceleration. Problems in procuring coal, lack of generating capacity and limitations in hydroelectricity generation due to a distorted monsoon season have impacted on production. The power minister, Jyotiraditya Scindia, has promised to improve generating capacity and has worked towards improving the co-ordination among the various aspects of his ministry to improve efficiencies. Such developments are welcome, but need to be sustained to enhance India's power supply.

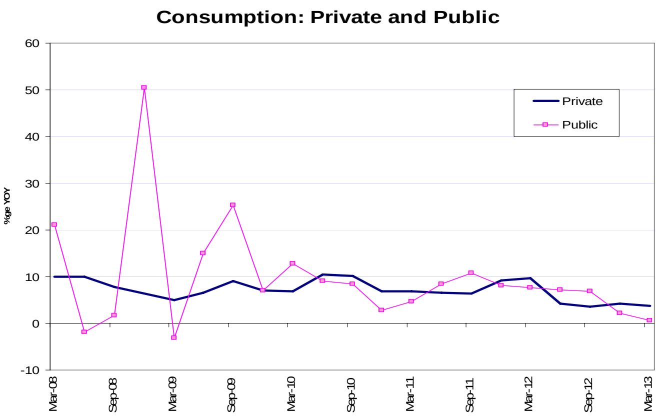
GDP by Expenditure

By expenditure, GDP at market prices increased by 3% over the year to March 2013. There were declines in the contributions of consumption (2.1%) and investment (1.1%) compared with the previous quarter, although both these components remained positive. The contribution of stocks was broadly in line with the previous quarter. Valuables (-0.5%) detracted from growth, and more so than in the previous quarter. The main positive is the lower (negative) contribution from net exports; which has resulted from the weak domestic demand. (Note that the overall GDP reading in the chart below differs from the component-wise breakdown, as the latter excludes the discrepancy term). The sharp decline in the contribution of investment spending, when compared with the March 2010-June 2011 period is striking, and reflects structural bottlenecks, weak business sentiment, high interest rates and challenges in the global economic environment.

GDP Contribution by Expenditure



Private and Public Consumption



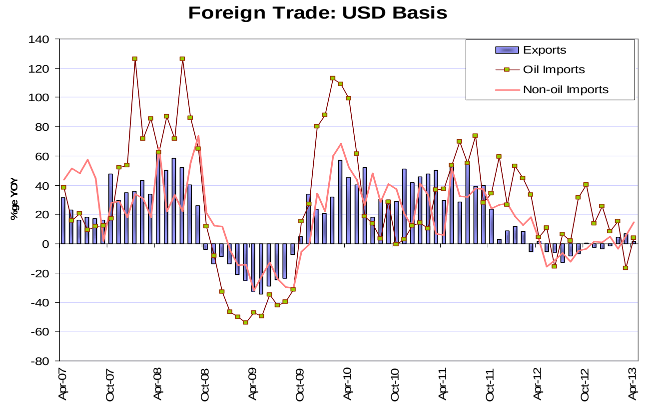
Besides investment, the other critical component of domestic demand, consumption, remains muted. This is more visible in public consumption, as the government restrains its spending to shore up its fiscal position.

Looking at the patter of foreign trade, we can clearly see imports outpacing export growth. For the greater part of 2011 and 2012, oil imports, and to a lesser extent, non-oil imports have outpaced the growth in exports. This has lead to the consistently negative contribution of net exports to overall growth, and a worsening in India's external balance. Oil and gold are the 2 largest categories of imports, and combined account for over 40% of total imports. This is an important issue, given the downward pressure on the Indian Rupee. India's gold imports, in USD, fell by -4.8% over the year to March 2013; however, they increased by 8.2% over the same period, when measured in Indian Rupees.

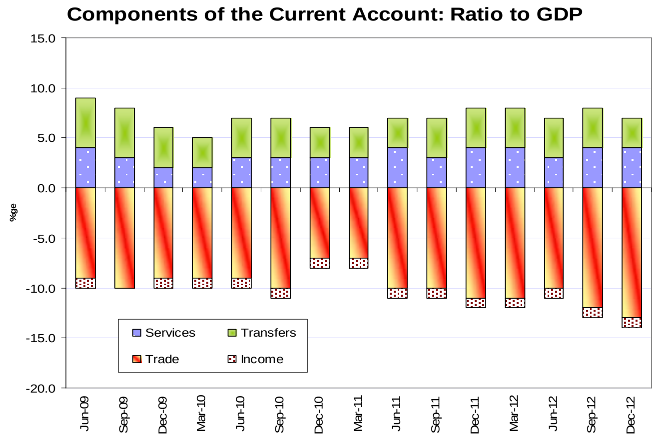
Latest data released from the Ministry of Finance revealed that India purchased 152 Tonnes of gold in May. The Government is considering further curbs on gold imports in addition to heightened import duties as well as limitations on lending by banks and non-banks against gold coins and restrictions on gold imports by banks as well as trading houses, unless the gold is to be used for jewellery exports. Group Economics is forecasting the price of gold to fall to USD1,380 per ounce by March 2014, which should ease some pressures on the trade balance.

The Indian Finance Minister, P Chidambaram, has bemoaned the appetite for gold among Indians, and how this has contributed to a dramatic worsening in the Current Account Deficit, which hit a high of -6.7% in December 2012. This was due to a sharply higher deficit in the merchandise trade balance. Positive balances in the services and transfers (including remittances) categories were insufficient to offset the weakness in the trade balance. The Reserve Bank has also launched Inflation Indexed Bonds, benchmarked to the WPI, which will come into effect from the 4th of June. The principal on these bonds will be adjusted to incorporate inflationary effects. The Government hopes that investors would channel their savings into these instruments as opposed to assets such as gold, which serve as a 'store of value'.

Growth in trade



Current Account Deficit

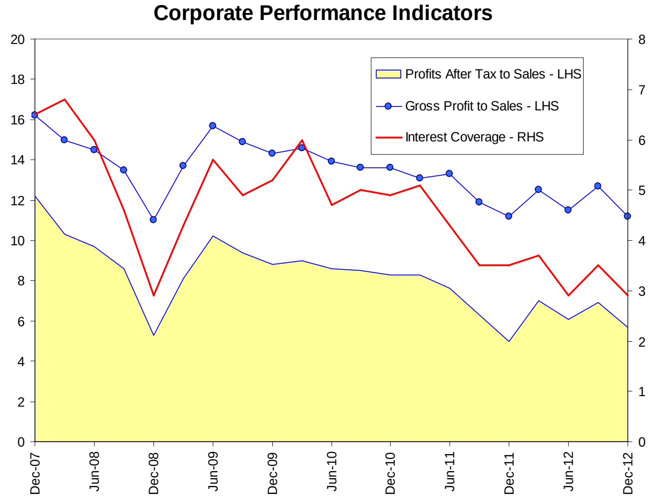


Corporate performance & Industrial Outlook

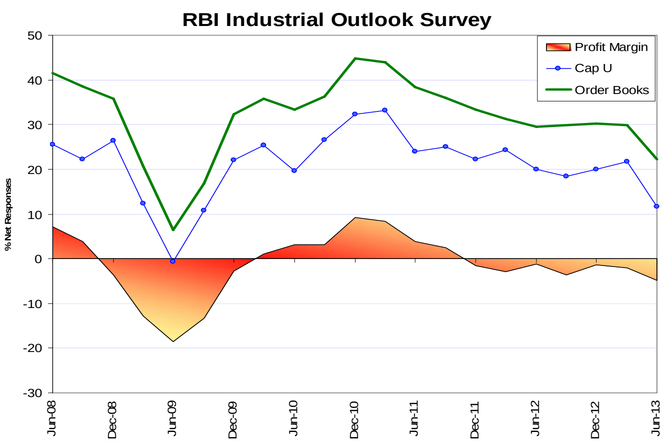
Indicators of corporate performance have weakened. Gross profit to sales has been on a steady downtrend from June 2009. The most recent reading for December 2012, revealed this ratio at 11.2%. This is also reflected in trends for overall profitability, with the ratio of profits after tax to sales declining by a broadly similar amount. One metric that has worsened considerably is the interest coverage ratio. It has fallen from 6 in March 2010 to 2.9 by December 2012. This reflects a combination of higher debt/interest payments and a weakening in sales growth.

Recent cuts to interest rates might spur growth and lower interest costs, helping to reverse this unfavourable trend.

Corporate Performance



Industrial Outlook



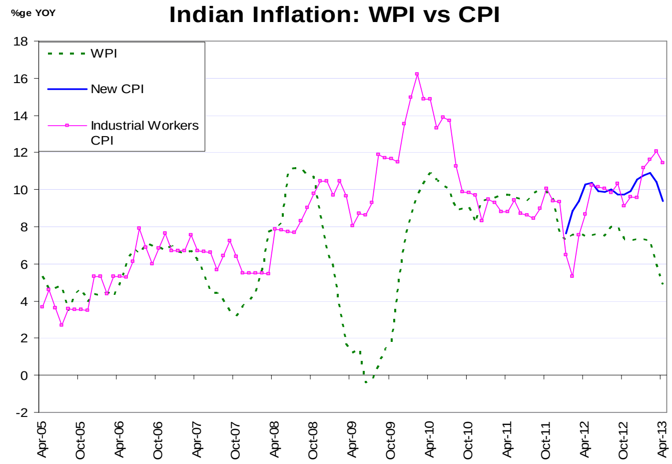
The RBI's Industrial Outlook Survey for the manufacturing sector for June 2013 revealed that businesses were less optimistic with regard to capacity utilisation and the level of order books. The one major downside was the outlook for profit margins, which was negative, implying a worsening in the profit outlook for the June quarter. This negative outlook for profits was most prevalent in basic metals, transport equipment and electrical machinery. By contrast, the profit outlook was more buoyant in pharmaceuticals and basic chemicals. To summarise, forward looking surveys do not indicate any immediate turnaround in the Indian economy.

Inflationary pressures

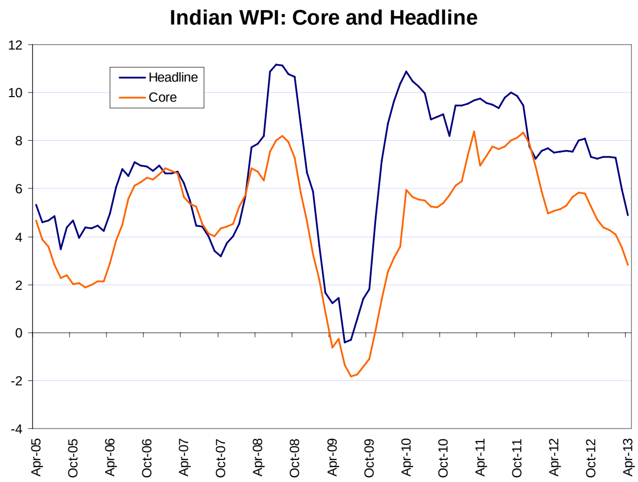
Over the year to April 2013, inflationary pressures have abated, with the Wholesale price index rising by 4.9%. Core inflation, as measured by non-food manufactured inflation remains well contained, at below 3%. This has afforded the RBI the space to cut the benchmark repo rate. The most recent being the 25bps cut in May, which brought the repo rate to 7.25%.

The easing in inflationary pressures has also been reflected in the All-India CPI falling below 10%. The CPI is generally higher than the WPI, as it places a greater weight on food. In terms of various components, food price inflation is somewhat elevated in cereals, pulses and protein. Power prices are also recording double-digit growth, and will face upward pressures as the Government permits an increase in electricity prices by power companies such as Tata Power and Adani Power due to higher prices for imported coal.

Wholesale and Retail Prices



Core and Headline Inflation

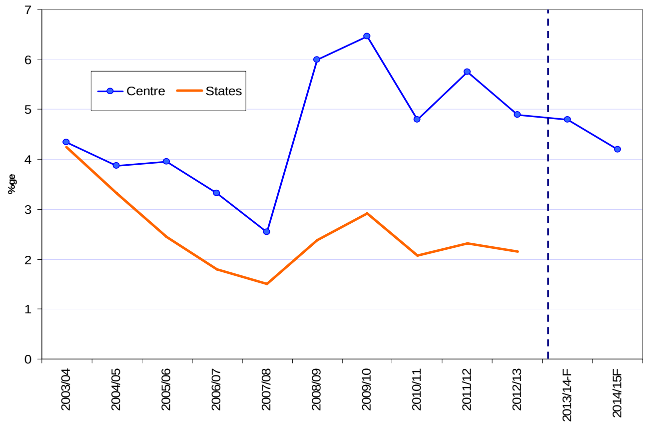


Fiscal Situation

The Central Government's Gross Fiscal Deficit for the 2012/13 came in at 4.9% of GDP, an improvement from the 5.2% projected in the Union budget. This was driven by an increase in revenue receipts as well as non-tax revenues. The improvement will help bolster confidence in India's ability to manage its fiscal position. Going forward, it is critical that the Government undertakes measures to curb the fiscal deficit in line with budgetary projects. Equally important is a need to stick to commitments to reduce the deficit by cutting down on subsidies, particularly for fuel and fertilisers. This will help 'crowd in' private investment, and free up government revenue on growth-enhancing capital expenditure.

Budgetary Balance

Gross Fiscal Deficit: Centre and States



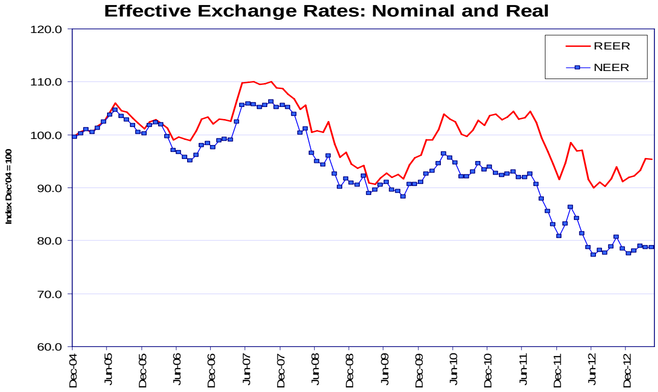
External Situation

Indian Rupee to USD

INR/USD

Effective Exchange Rates

Effective Exchange Rates: Nominal and Real

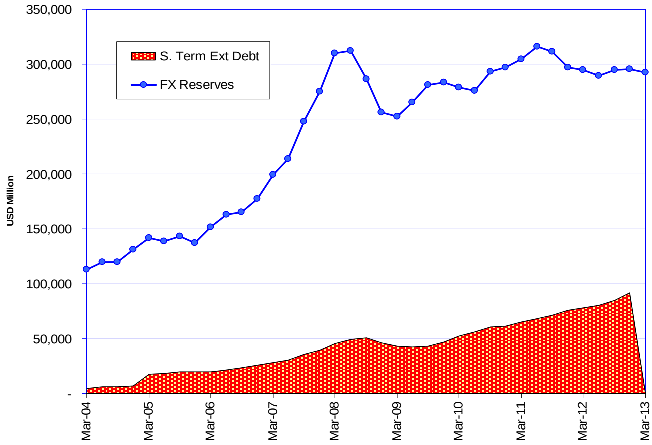


The Indian Rupee has come under pressure due to the widening Current Account deficit, among other factors. Over the period October 2012 to May 2013, the INR has depreciated by 9% against the USD. The depreciation is more acute when we extend the time horizon further back to 2011. From a recent high of INR 44.75 in August 2011, the rupee has depreciated by 28.2%.

Examining these trends in terms of effective exchange rates, one can clearly see the decline in India's Nominal (NEER) and Real Effective (REER) exchange rates. That said, the decline in the NERR has been more pronounced relative to that of the REER. The latter has been impacted somewhat by India's higher inflation rate relative to its trading partners, notwithstanding the recent slowing in the inflation rate.

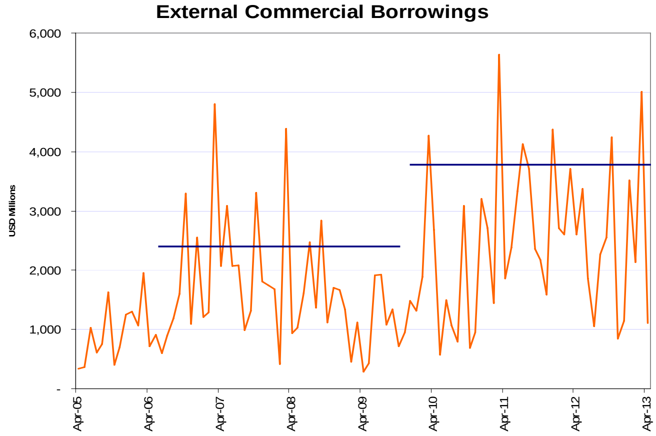
FX Reserves and Short Term External Debt

Short Term Ext. Debt & FX Reserves



External Commercial Borrowings

External Commercial Borrowings



India's stock of foreign exchange reserves currently stands at USD 292 billion, sufficient to cover 7 months' worth of merchandise imports. As such, India does not face any immediate external liquidity problems: the stock of short-term foreign debt is around 30% of total FX reserves. Moreover, Government short-term external debt is even less of a concern, with the share of public short-term external debt 20% of the total. That said, recent relaxation of FIIs (Foreign Institutional Investors) restrictions in Government of India T-Bills may witness some increase in the share of Government short term external debt. However, the principal element is trade related credit, which has shown a sharp increase.

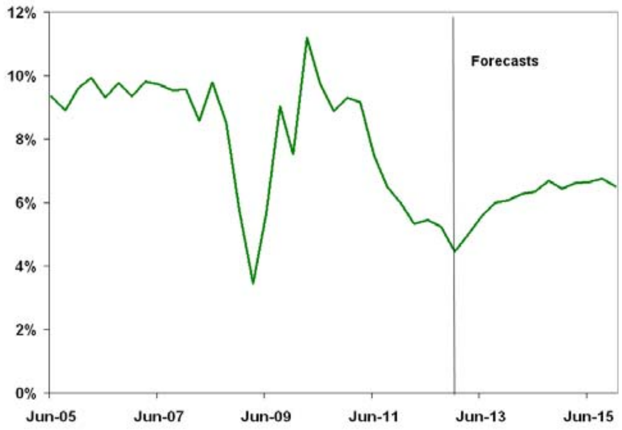
The increase in corporate borrowings can also be seen in the stepped-up increase in external commercial borrowings: there has been a marked increase in 2011-13 compared with the 2005-08 period. Indian companies aim to avail of the cheaper funding costs overseas. They however, expose themselves to potential adverse movements in the exchange rate; hence appropriate hedging strategies assume increases significance. Furthermore, with plans to moderate the pace of quantitative easing in the United States, there could be a rise in Treasury yields - negating some of the advantage in borrowing overseas.

Outlook

Group Economics is forecasting Real GDP of 5½% over calendar year 2013. We are forecasting the pace of growth to accelerate to

6¼% in 2014, as interest rate cuts gain traction and the global economy improves. Critical factors include a continuation of the reform process commenced in September 2012, an easing of structural and policy bottlenecks, including more expedited project clearances, as well as a favourable monsoon season.

FX Reserves and Short Term External Debt



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Important Notices