# INDIA ECONOMY OUTLOOK 2016

## Capital Market Dynamics

Foreign Exchange ► The Indian rupee (INR) will continue to experience a gradual depreciating bias against the US dollar(USD) amid monetary tightening in the US and global financial market uncertainties. Given relatively large foreign holdings of Indian equities, shifts in global investor sentiment and portfolio rebalancing moves will continue to impact the INR. We expect USDINR to close 2016 at 68.0, implying a 2.7% depreciation over the course of the year.

Sovereign Debt & Credit Ratings ► India's sovereign credit rating profile points to a potential upgrade, subject to ongoing improvement in government finances; Moody's holds a "positive" outlook on India's "Baa3" rating. Standard & Poor's and Fitch rate India in the "BBB-" category, with a "stable" outlook. According to Fitch, the country's creditworthiness is bolstered by improvements in policymaking that have raised economic and fiscal prospects; however, India's low per capita income and weak public finances remain the country's key vulnerabilities. India's gross public debt will likely average 64% of GDP in 201517,according to the International Monetary Fund (IMF).

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## Economic Outlook

Growth ► The Indian economy is gaining momentum gradually, with the country continuing to be the world's fastest growing major economy in 2016-17, outperforming China. Real GDP expanded by 7.4% y/y in the July-September period, following a 7.0% gain in the prior quarter; in 2015 as a whole, output growth likely averaged 7.3%. India's industrial sector, led bymanufacturing, is improving and production increases averaged 6⅔% y/y in the three months to October — the fastest pace of expansion since mid-2011.

Meanwhile, private spending is showing increasing signs of strength as low international oil prices, rising wages, and accommodative monetary conditions continue to support the Indian consumer. India is relatively insulated from the ongoing concerns regarding China's economic growth deceleration as less than 5% of its exports are purchased by China compared with a regional average of over 20%. India's top two export destinations are the US and the euro area. Accordingly, we expect that stronger domestic demand and external sector performance will drive the country's output gains to 7.6% y/y in 2016-17.

## Inflation & Monetary

Context ► While India's inflation environment remains generally favourable, consumer price gains have accelerated somewhat in recent months and reached 5.4% y/y in November, driven by higher food prices. We expect a further but modest pick-up over the course of 2016 before inflation stabilizes around 6% y/y by the end of the year. The Reserve Bank of India (RBI) and the central government have agreed on a long-term consumer price inflation target of 4% ±2 percentage points, which will be effective from fiscal year 2016/17 onwards. The target will enhance policy credibility and help anchor inflation expectations, resulting in a more attractive environment for investment. Monetary conditions will remain accommodative for the foreseeable future; at the end of September, the RBI cut the benchmark interest rate by 50 basis points to 6.75%. Pressure by the government may prompt the central bank to lower the policy rate further to 6.50% over the coming months.


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Fiscal & Current Account Balance ► The budget for fiscal year 2015/16 prioritizes economic revival and therefore slightly pushes back fiscal consolidation. The budget aims to narrow the central government deficit to 3.9% of GDP in FY2015/16 from 4.1% in 2014/15, though the target may be missed slightly. The shortfall remains larger at the general government level, averaging 7% of GDP through 2017, according to the IMF. India benefits from low oil prices as it is a large net energy importer and meets around three quarters of its petroleum needs through imports. Furthermore, low oil prices help the country's authorities proceed with their fuel subsidy rationalization plan, addressing a material area of fiscal weakness. India's current account deficit will likely continue to hover around 1½% of GDP in 2015-17.

## Institutional Framework & Political Environment

Governance ► Prime Minister Narendra Modi of the Bharatiya Janata Party (BJP) has been in power since the general election in May 2014. The BJP holds a majority in the lower house; however, its minority position in the upper house slows policy execution and reform implementation. The government will focus on improving the ease of doing business; in November 2015, it relaxed foreign direct investment rules in 15 major sectors. The Goods and Services Tax bill — an important tax reform proposal — has yet to be passed in parliament.

Financial Sector ► The asset quality and profitability of Indian banks will likely remain strained in the near term on the back of increased stressed assets, muted credit growth, and weak non-interest income. The non-performing loans ratio has steadily risen in recent quarters and reached 4.8% in September 2015, according to the IMF; meanwhile, the banking sector's Tier 1 Capital ratio was 10.5% in the third quarter, up from 9.8% a year before. According to the central bank's Financial Stability Report, the country's financial system is stable, yet risks to the banking sector have increased recently.


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