India Outlook

Two crucial state elections have just been completed, and all eyes will now be on the February Union Budget

The BJP won two important state elections in December – Gujarat and Himachal Pradesh – retaining power albeit with a lower majority in the first and unseating the Congress with a thumping majority in the second. The opposition claimed a moral victory in Gujarat on account of its improved scores but the fact remains that it was the BJP's sixth consecutive victory in the state extending an unbroken stint of 22 years. Only one other Indian state has ever given a longer mandate to an incumbent (West Bengal, from 1978 to 2011). That said, Mr Modi's last minute campaigning was a major reason for the win implying that his personal popularity remains the pillar on which the BJP's success continues to ride. This will remain a critical factor in the 2019 national election as well as the 13 state assembly elections scheduled prior to it.

The Finance Budget will be tabled on February 1 next year and analysts will be looking for measures to reform the direct tax code and alleviate GST-related challenges. But perhaps more important is progress on clearing the state-owned banks of bad loans, and forcing the first batch of 40 bad borrowers – mostly industrial companies – through the new bankruptcy system. Whether that process will work should be apparent by March. This balance-sheet recession is a central issue behind a slowdown in growth. If the new system works, India could see a major reallocation of industrial assets in 2018 and a recovery emerge. While there is reason to be optimistic, experience in the West is that full recovery from such balance sheet recessions usually takes 2-3 years. As part of the plan, the government is injecting Rs 1.35 trillion (USD 21 billion) into state-owned banks and they are raising another Rs 580 billion (USD 9 billion) by themselves.

Signs of a demand recovery are evident, but inflation is also on the up

India's national digitalisation strategy is back on track after the Supreme Court upheld the linking of Aadhaar with the income tax permanent account number (PAN). Some 140 items, ranging from mobile phone numbers to insurance policies, social welfare payments and post office accounts, are to be linked to a unique identification number by March 31. The Court will consider various privacy challenges to Aadhaar linking in January.

2017 closes with hints of improved momentum after three quarters of sub-7 per cent growth. Q2 FY18 growth was 6.3 per centyoy while restocking by industry after a run-down in the June quarter as the GST approached, saw manufacturing GDP up by 7 per cent yoy growth from 1.2 per cent yoy in the previous quarter. Given the low base of Q3 FY17, the year-on-year measure for real growth in Q3 this year may well touch 7-7.5 per cent. However, full year growth is likely to be closer to 6.5 per cent yoy.

Growth in consumer demand in 2017 was affected by demonetisation and the GST. However, signs of a rebound are evident – November sales for 2-wheelers were up 24 per centyoy from 6.2 per cent ytd for the first 10 months and 3-wheelers were up 66 per cent yoy from 5.5 per cent ytd. Non-oil imports, a proxy for domestic demand were up 24 per cent yoy during April-October against -9 per cent yoy last year – all of which suggests consumer demand should return to 8 per cent + real growth in 2018. This should help GDP growth exceed 7 per cent in FY19.

With domestic demand recovering, inflation jumped to 4.9 per cent yoy in November from 3 per cent ytd for the first 10 months. This would suggest that the RBI is unlikely to cut interest rates in the short term, which should provide continuing support for the Rupee. The currency has generally remained strong through 2017 but is likely to face some depreciation pressures in 2018 as the US unwinding picks up speed. This should help India's exports whose recovery has been somewhat slow. They were up 9 per cent yoy in April-October 2017 and although that is an improvement over the 0.1 per cent yoy growth in the same period last year, in absolute terms they are still lower than levels achieved in FY13 and FY14. ■

Fiscal year starting 1 April	2013-14	2014-15	2015-16	2016-17	2017-18
GDP mp (FY12 series), real growth, %	7.2	7.9	7.1	6.5	7.0
Inflation - CPI, yr avg (FY12 series), %	6.0	4.9	4.5	3.5	4.5
RBI lending (repo) rate, year end, %	7.5	6.75	6.25	5.75	5.50
Rupee to US$1, RBI Ref Rate, yr end	62.5	66.2	64.8	65.5	68.0

Sources: 2013-2016 data from the government (NCI, RBI) and CEIC. 2017-2018 forecasts.