

## India Outlook

### Modi's victory in UP sets the tone

**D**espite last November's demonetisation, the ruling BJP did well in state elections in March, notably winning in Uttar Pradesh (UP, India's largest and one of its poorest states). That will help shift the balance of power at the national level, where PM Narendra Modi's reform programme has been frustrated by opponents in the upper house. The March results also underscore the decline of Congress—the major opposition party—and suggests that Mr Modi should win a second five-year term in 2019. It may also contribute to firmer national growth by bringing better government to UP. Yogi Adityanath, UP's new Chief Minister, should improve administration in what has been one of India's worst governed states. Better state administrations, in which Mr Modi played a part when he was Chief Minister of Gujarat, is critical to lifting India's growth.

All attention is now focused on the introduction of a Goods & Services Tax (GST), which is scheduled for July 1, although there are growing calls for a delay due to the complexity of four rates (from 5 per cent to 28 per cent) and the absence of information about which rate will apply to specific goods and services. Under current

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legislation, the GST introduction can take place at any time before September. A delay beyond that would require a series of votes in parliament, which Mr Modi should manage if need be, as the GST has opposition support. Since last November, our operating risk rating for India has been Moderate with a Negative outlook because of short term risks associated with poor GST implementation.

Last November, we picked vehicle sales as the best guide to the impact of demonetisation. Total vehicle sales (including 2 and 3-wheeler) fell 4 per cent yoy in Q4'16 and 0.8 per cent yoy in Q1'17, after growth of 13.8 per cent ytd for Q1-Q3 2016 – so a sharp slowdown.

Note that the first three quarters of 2016 saw a strong recovery from a drought-affected 2015 (just 1.8 per cent growth). The passenger vehicle segment (cars and light vehicles) was least affected, with growth of 8.9 per cent ytd by Q3'16 slowing to 1.8 per cent yoy for Q4'16 and rebounding to 11.1 per cent yoy growth in Q1'17. A big public sector pay hike (done once every 10 years) helped. 3-wheeler sales (for tuk-tuks, a classic small cash-only business) were hardest hit. After growth of 15.7 per cent ytd by Q3'16, they fell 18.3 per cent yoy in Q4'16 with a bigger 24.4 per cent yoy fall in Q1'17. Reports of continued cash shortages at bank ATMs also suggest that India's cash-only economy remained constricted in Q1'17. Two-wheeler sales, a guide to low-income households, fell 4.6 per cent yoy in Q4'16 and another 2.3 per cent yoy in Q1'17, after growth of 14.6 per cent ytd by Q3'16. By contrast, commercial vehicle sales suggest that most businesses weathered demonetisation, with a sales fall of 1.1 per cent yoy in Q4'16, roughly in line with a 2 per cent ytd fall by Q3'16, followed by a rebound to 5.7 per cent yoy growth in Q1'17.

Oddly, India's new GDP series says that demonetisation triggered an acceleration in real growth for consumer spending to 10.1 per cent yoy in Q4'16 from 7.7 per cent ytd for the first three quarters. Our own clients split into three groups on what happened. Those dealing with B2B mostly report stable or improving business through demonetisation. Those serving the urban middle class saw a slight dip. Those serving rural India report major falls but a quick recovery.

Official figures for Oct-Dec 2016 put GDP growth at 7.0 per cent. This is probably an over-estimate as it does not include the performance of the informal and small scale sectors whose data is typically reported many months later. Moreover, there was a downward revision in the base of comparison (growth in Oct-Dec 2015). ■

Fiscal year starting 1 April	2013-14	2014-15	2015-16	2016-17	2017-18
GDP mp (2011-12 base year), real growth, %	6.6	7.2	7.9	6.8	7.0
Inflation - CPI, yr avg, %	9.0	6.0	4.9	4.5	5.0
RBI lending (repo) rate, year end, %	8.0	7.5	6.75	6.25	6.00
Rupee to US\$1, RBI Ref Rate, yr end	60.1	62.5	66.2	65.0	67.0

Sources: 2013-2015 data from the government (NCI, RBI) and CEIC.